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FCC Issues Detailed Order Modifying Universal Service and Intercarrier Compensation Systems

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On Friday, Nov. 18, 2011, the FCC issued its order implementing major reforms in the universal service and intercarrier compensation regimes that have, for decades, governed the telecommunications industry. The FCC had formally approved these reforms at a meeting held on Oct. 27, 2011. We provided an earlier advisory describing the FCC's key actions, based on an "Executive Summary" of the Order released at the time of the vote. Today's advisory highlights details of the FCC's actions that were not available earlier. We encourage readers to review the earlier advisory for a summary of the FCC's actions.

Although many decisions in the Order will be implemented over time, some (for example, new compensation rules for the exchange of VoIP traffic) are set to become effective as soon as the Order is published in the Federal Register. That process normally takes several weeks, and at times much longer. We will provide an advisory when the Order actually takes effect.

The Order contains a Further Notice of Proposed Rulemaking (Further Notice) that seeks public comment on many issues surrounding the details of how to implement some of the specific decisions made in the Order. The Further Notice also seeks comment on issues related more generally to integrating the FCC's new approach to universal service and intercarrier compensation into the overall regulatory scheme applicable to providers of telecommunications and broadband Internet services. We note here certain issues where the FCC is seeking additional public comment. We will, however, issue an advisory in the near future discussing the Further Notice in more detail.

Overview

Universal Service: The FCC is refocusing the system of "universal service" subsidies away from the universal availability of basic landline voice telephone service, and towards the universal availability of broadband Internet service and mobile wireless service. Under intense pressure to reduce the size of the universal service fund, the FCC capped the total subsidies available for building out networks. Because these subsidies are funded by the communications industry directly (and ultimately by consumers) the cap aims to avoid distorting the marketplace and placing excessive burdens on consumers and industry by working toward a system that targets subsidies to areas that will not be served by unsubsidized firms.

There is a separate portion of the universal service system devoted to ensuring the availability of basic voice service for low income consumers (the Lifeline program). The FCC's current order does not address that issue. The FCC is currently considering a draft order dealing with this aspect of the universal service program, and is expected to act on that matter in the near future.

Intercarrier Compensation: The FCC is asserting regulatory authority over all aspects of intercarrier compensation—the payments carriers make to each other when they exchange traffic—and moving towards a bill-and-keep system where carriers have to fund the costs of terminating traffic inbound from other carriers by means of charges on their own end users. In order to mitigate the impact of the reductions in intercarrier payments on incumbent local exchange carriers (ILECs), the FCC is establishing rules to permit affected ILECs to increase rates to their end user customers in order to make up some of the shortfall. In addition, some payments from the universal service fund will be available for that purpose as well. The amount of shortfall that may be recovered in this way is phased down, but not entirely eliminated, over time.

IP-to-IP Interconnection: As part of its policy to encourage migration to "all-IP" communications networks, the FCC states that it "expects" carriers to negotiate in good faith for IP-to-IP interconnection

arrangements for the exchange of voice traffic.

Further Notice of Proposed Rulemaking: The FCC seeks additional comment on a wide range of questions regarding the future implementation of its universal service and intercarrier compensation reforms, as well as its IP-to-IP interconnection requirement.

Universal Service Fund Reforms

Connect America Fund (CAF): The CAF is the new umbrella program that will govern the disbursement of federal universal service funding aimed at increasing access to voice and broadband services in rural and remote areas. The CAF replaces the current High Cost program. It will (a) provide support to areas that are not served by an unsubsidized competitor, (b) require funding recipients to build broadband-capable networks, and (c) eliminate the rule that funds competitive providers at the same per-line rate that the ILEC in an area receives (the “identical support” rule). Total CAF funding will be capped at $4.5 billion annually. Of this, $500 million will be dedicated to the new Mobility Fund (discussed below). The remaining $4 billion will fund wireline voice and broadband services. The overall $4.5 billion cap is intended to be permanent (although of course the FCC may modify it in the future). Individual carriers may petition for relief from the cap. [MORE]

Mobility Fund: We first reported in 2010 that the Commission was considering a new fund to distribute support for wireless infrastructure in under-served and unserved areas. The Commission now has adopted what it calls the “Mobility Fund Phase I,” which will use a reverse auction to distribute $300 million for 3G or better mobile broadband to areas where such services are completely unavailable. The Mobility Fund Phase I will work like this:

1. The FCC will establish a list of unserved areas eligible for infrastructure support.
2. The FCC will oversee a sealed-bid, single round reverse auction to allocate areas to different bidders.
3. ***Only*** designated wireless ETCs will be allowed to bid on unserved areas.
4. USAC will distribute funds incrementally, ***after*** build-out and coverage targets are met by successful bidders.

Parties interested in participating in the Mobility Fund Phase I auction should be aware of several significant FCC requirements and expectations, including QOS standards and penalties. [MORE]

Other Issues: In conjunction with its decision to refocus the universal service system on broadband services, the Order also modifies obligations of existing ETCs. First, it establishes a revised, technology-neutral definition of the voice services eligible for support, mainly in order to ensure that VoIP services count as supported voice services. Second, it requires ETCs currently receiving support under the High Cost program to offer broadband service in “their supported area” consistent with basic performance requirements, and to report on their performance measures. The basic performance requirements are 4 Mbps downstream / 1 Mbps upstream, latency suitable for VoIP, and reasonable usage limitations (presumptively no less than 10 GB per month).

It does not appear that competitive ETCs whose support will be phased down under the new system will be subject, during the phase-down, to the broadband performance requirements, unless those ETCs win bids for providing broadband through the CAF or Mobility Fund. [MORE]

Intercarrier Compensation Reforms

As detailed in our earlier advisory, the Order makes a number of reforms in intercarrier compensation. The two most significant changes are the phase-down of termination charges to zero and the integration of VoIP traffic into the intercarrier compensation system.

Phase-Down of Termination Charges. The Order contains a detailed chart (accessible via the link below) that lays out the timeline for the phase-down of termination charges. The phase-down for large carriers subject to price cap regulation begins on July 1, 2012 and is complete on July 1, 2018. For smaller

carriers subject to rate of return regulation, the phase-down also begins on July 1, 2012, but is not complete until July 1, 2020. Consult the chart for details, but for large incumbent carriers and competing firms that operate in their areas, the key dates are:

DATE	EVENT
Effective Date of the rules	All intercarrier switched access rates ***capped***.
July 1, 2012	Most intrastate terminating rates brought half-way to interstate rates.
July 1, 2013	Most intrastate terminating rates reduced to interstate level.
July 1, 2014	Terminating end office and reciprocal compensation rates reduced one-third of the way to $0.0007.
July 1, 2015	Terminating end office and reciprocal compensation rates reduced the second one-third of the way to $0.0007.
July 1, 2016	Terminating end office and reciprocal compensation rates reduced to $0.0007.
July 1, 2017	Terminating end office and reciprocal compensation rates reduced to zero; terminating transport generally reduced to $0.0007.
July 1, 2018	Terminating transport generally reduced to zero.

The process for smaller, rate-of-return regulated carriers is longer, as shown in the FCC's chart. [MORE]

Integration of VoIP Calling. The intercarrier compensation status of calls to and from VoIP services has been controversial. The Order sets new rules that apply prospectively to govern intercarrier compensation for such calls. Non-toll VoIP calls will be subject to reciprocal compensation under Section 251(b)(5). VoIP calls that would normally be considered toll calls (that is, typically, where the calling and called party are in different calling areas) will be subject to ***interstate*** access charges as of the effective date of the rules. This new rate level applies even to VoIP toll calls that are ***intrastate*** in nature (such as calls from Los Angeles to San Francisco, or Houston to Dallas). So, from that date until July 1, 2013 (when inter- and intrastate access charges become identical), intrastate ***VoIP*** toll traffic will be subject to different access rates than intrastate ***non-VoIP*** toll traffic (that is, traditional toll calls). The permitted compensation rates for VoIP may be set in carrier-to-carrier agreements or, for VoIP toll traffic, in FCC and state access tariffs. In addition, the permitted compensation for VoIP traffic must be paid to the LEC that terminates the calls, even if some termination functions are provided by the LEC's VoIP-provider customer, including affiliates of the LEC. [MORE]

ILEC Recovery Mechanisms. To partially compensate ILECs for the reduced revenues they will collect under the new system, the Order permits ILECs to impose a monthly "Access Recovery Charge" (ARC) on wireline telephone service end users. If the ARC does not recover all eligible revenues, the ILEC may also seek support from the CAF. This mechanism permits ILECs to recover much, but not all, of their lost intercarrier compensation revenues. It justifies the partial recovery on the ground that ILECs might be subject to significant revenue shortfalls as demand for traditional landline telephone service declines, which could interfere with their efforts to modernize their networks. The Order refers to the recovery mechanism as "transitional," but—while it will decline—it will not be phased out entirely unless the FCC takes additional action in response to the Further Notice.

The Order does not establish any recovery method for CLECs, because CLECs are already free to raise end user rates without restriction. This does not appear entirely logical, in that CLECs will be competing against ILECs with ongoing subsidies for ***their*** end user rates. Since CLECs will not normally be able to increase rates above ILEC levels, the availability of CAF funding for ILECs but not CLECs appears to continue the tilt of the competitive playing field in ILECs' favor with respect to subsidized local services. [MORE]

Wireless Compensation: The Order clarifies certain aspects of intercarrier compensation for traffic exchanged between Commercial Mobile Radio Service providers (wireless carriers) and LECs. Most significantly, the Order adopts bill-and-keep as the default compensation for intraMTA traffic exchanged between LECs and wireless carriers, as of the effective date of the Order. The FCC did not adopt any "glide path" for moving to bill-and-keep for wireless interconnection. The Order also (i) clarifies that compensation obligations under 47 C.F.R. § 20.11 are coextensive with reciprocal compensation under 47 U.S.C. § 251(b)(5); (ii) adopts an interim default rule limiting rate-of-return LEC's responsibility for transport costs for non-access wireless traffic; and (iii) reaffirms that neither interstate nor intrastate access charges apply to intraMTA traffic. While these changes will affect many existing LEC-wireless compensation arrangements over time, the FCC did not abrogate existing commercial arrangements or permit a "fresh look" with respect to existing contracts. [MORE]

IP-to-IP Interconnection: An increasingly controversial question among entities such as cable-affiliated CLECs, VoIP providers, and some wireless carriers on the one side, and traditional ILECs on the other, has been whether ILECs can be required to interconnect in IP format for the exchange of voice traffic. The FCC states its clear expectation that such interconnection should occur as a result of good-faith negotiations between the carriers. It also repudiates the notion, advanced by some ILECs, that the general obligation on carriers to interconnect is affected or eliminated based on the signaling protocol (TDM, IP, etc.) that might be used.

Access Stimulation: As noted in our earlier advisory, the FCC takes immediate action to cut down on "access stimulation." Access stimulation occurs when LECs encourage inbound long distance calls in order to collect access charge revenues while sharing those revenues with the entity providing the "lure" for the calls, such as chat lines. Under the new rules, access stimulation exists if a LEC has a revenue sharing arrangement, and if it either (a) sees a large year-over-year increase in traffic, or (b) exceeds a three-to-one ratio of terminating to originating minutes. A CLEC engaging in access stimulation will be required to reduce its access charges to those of the price cap carrier in the state in which the LEC operates with the lowest rates. ILECs will have 45 days to refile access tariffs based on realistic traffic projections (which will result in much lower rates) unless they terminate all revenue sharing arrangements before that time.

Because the rules are prospective only, they will not have binding effect on pending complaints regarding access stimulation. On a going-forward basis, carriers challenging a LEC's access bills on grounds of access stimulation may rely on the 3:1 ratio and/or the growth test as the basis for filing a complaint. The LEC whose bills are being challenged would then have to prove that it is ***not*** stimulating access traffic.

Phantom Traffic: The FCC also takes action to help deal with the problem of "phantom traffic," which arises when calls arrive for termination without call identifying information. The FCC is now requiring carriers to include the calling party's telephone number in the signaling information associated with a call and forbidding any carriers involved in handling the call from deleting or altering this information.

Further Notice

Although the Order makes a large number of significant decisions with respect to both universal service and intercarrier compensation, many open issues remain.

In the universal service area, these include questions regarding how to measure broadband speed and performance; how to determine whether broadband and voice services in rural and remote areas are "reasonably comparable" to those in urban areas; numerous details of the auction processes for wireless broadband and, where ILECs decline their right of first refusal, landline broadband; and whether and how existing ETC obligations should be modified in light of the new policies.

In the intercarrier compensation area, the open questions include the implementation of bill-and-keep (including matters such as the location of the "edge" of a receiving carrier's network), how and under what legal rationale the FCC can transition origination charges and transport charges to bill-and-keep, and how to implement any IP-to-IP interconnection requirement the FCC may choose to adopt.

Some of the issues addressed in the Further Notice are quite controversial in their own right, such as measuring the speed and performance of broadband service. For example, *see* our advisory on broadband notices and speed testing. This suggests the challenges the FCC faces in attempting to integrate its new policies regarding universal service and intercarrier compensation into its overall regulatory framework for telecommunications and broadband services.

We will provide additional analysis of the Further Notice in a subsequent advisory.

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