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FCC Proposes Major USF, Intercarrier Compensation Reforms: Broadband Expansion the Goal

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On Feb. 9, 2011, the FCC released a nearly 300-page Notice of Proposed Rulemaking (NPRM) proposing a thorough overhaul of the federal High-Cost Universal Service program and the current system of "intercarrier compensation" (ICC). The NPRM was adopted at the FCC's Feb. 8 meeting. (See our prior summary of the FCC's discussion of the NPRM at its meeting here.) The existing federal Universal Service Fund (USF) funds the High-Cost program which subsidizes telephone companies whose costs are significantly above national averages. ICC refers to the hodge-podge of different rates that carriers charge each other when they exchange traffic, which depend on the particular regulatory category of the traffic at issue.

High-Cost and ICC are similar in that both ICC rates and payments from the High-Cost fund often end up higher than is necessary to accomplish the purported goal, which is to help defray the actual cost of network operations and to ensure lower retail rates. In its NPRM, the FCC seeks simultaneously to control the costs of these programs to industry and consumers, rationalize and make more explicit the subsidies involved, and shift the type of services being supported from traditional, "narrowband" telephone services to advanced broadband communications. We summarize the key features of this complex proposal below with links at the end to our more detailed analysis on the proposed USF and ICC reforms.

The unifying feature of the FCC's proposal is the recognition that the nation's communications infrastructure has changed from a single-purpose telephone network, optimized for low-bandwidth voice communications, into a multi-provider broadband infrastructure that relies on various technologies (wireless, fiber, copper, hybrid fiber-coax), within which low-bandwidth voice communications is almost an afterthought. The USF, and ICC system reflect decades of slow regulatory accretion and tinkering that have created Byzantine—if not outright arbitrary—rules, customs, practices, and requirements. Some companies are able to exploit the current USF and ICC systems to their financial advantage. Others find themselves subject to unexpected liabilities and deprived of revenues they expected to receive. As the FCC acknowledges, both the USF and the ICC system are "broken."

The FCC's proposed long-term solution is to replace both the current High-Cost and ICC systems with a new "Connect America Fund" (CAF) that will focus on subsidizing broadband infrastructure (whether wired or wireless) in those locations where normal market forces have not provided it—typically the same remote, rural areas the High-Cost program now supports. With adequate broadband connectivity, the FCC believes, voice service will become an application offered via broadband; voice services will no longer require specific support. The FCC proposes to eventually replace the High-Cost program entirely with the CAF. The current ICC system, based on per-minute-of-use payments, will also be eliminated, and any continued support to reimburse carriers for the exchange of traffic would also be provided from the CAF.

Many of the details of these long-term proposals are unclear due to the complexity of the various interrelated policies, and the FCC seeks comment on a wide range of alternatives to best achieve the ultimate goal of ubiquitous broadband.

While the FCC clearly wants to move towards its long-term goals, it recognizes that a "flash-cut" to the new CAF-based system is not feasible. For decades, the existing communications industry has co-evolved with the current USF and ICC systems, and industry participants have adjusted their prices, operations, and business plans to reflect them. To permit the transition to the new CAF-based system to occur in a workable manner, the FCC proposes specific interim steps for both systems:

- *Universal Service:* (1) Establish the CAF; (2) establish a separate "Mobility Fund" (which was proposed in a separate proceeding); (3) modify the existing High-Cost fund; and (4) create a mechanism by which small carriers significantly affected by these reforms may continue to recover their costs of service for an interim period.
- *Intercarrier Compensation:* (1) Determine the proper ICC rate for VoIP traffic; (2) adopt rules to deal with "phantom traffic" (traffic received without sufficient data to determine which carrier to bill, or which rate applies); (3) adopt rules to deal with "access stimulation" (arrangements that encourage end users to make calls that allow the carrier receiving them to charge high per-minute rates to the carriers serving the calling end users); (4) reduce current ICC rates, while implementing non-per-minute-based payments to carriers most dependent on the current system; and (5) determine a "glide path" to eliminating per-minute ICC rates and replacing them with the CAF.

The FCC recognizes that the implementation of its interim proposals may provide information that will be useful in determining how to achieve its longer-term goals. Thus its current proposals are subject to course corrections.

Notably, the FCC has not proposed to reform the contribution mechanisms used to fund the USF (including High-Cost), and has not suggested any reforms to the three other disbursement programs supported through the USF (Low Income, E-rate and Rural Healthcare). It is expected that the FCC will consider such contribution reform in a later proceeding. Further, although the High-Cost program receives approximately 60% of all USF funds, any reforms or expansion of the three other distribution programs will affect the overall size of the fund and the resulting contribution needs.

We discuss the High-Cost/USF and ICC reforms proposed in the FCC's Feb. 9 NPRM in more detail in the advisories found at the links below.

Proposed universal service reforms

In its Feb. 9 Notice of Proposed Rulemaking (NPRM), the FCC announced a variety of proposals to reform the High-Cost disbursement program, which is funded through the federal universal service fund (USF) and is the largest of the four disbursement programs drawing from the USF. These reforms would take place in two stages, with the ultimate goal of transitioning all remaining High-Cost funding, e.g., high-cost loop support, interstate common line support, and high-cost model support, to the Connect America Fund (CAF). [MORE]

Proposed intercarrier compensation reforms

In its Feb. 9 Notice of Proposed Rulemaking (NPRM), the FCC announced a variety of proposals to reform the existing system of intercarrier compensation (ICC). ICC includes both interstate and intrastate access charges (which are fees typically imposed by local exchange carriers (LECs) on interexchange carriers (IXCs) for originating and terminating long distance calls) as well as reciprocal compensation, which is the system under which LECs pay and receive compensation for terminating (but not originating) local traffic, ISP-bound traffic, and other traffic not subject to pre-1996-Act access charges or other specific payment arrangements. [MORE]