

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
A National Broadband Plan for Our Future	)	GN Docket No. 09-51
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Developing an Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link-Up	)	WC Docket No. 03-109

**NOTICE OF PROPOSED RULEMAKING AND FURTHER NOTICE OF PROPOSED  
RULEMAKING**

**Adopted: February 8, 2011**

**Released: February 9, 2011**

**Comment Date on Section XV: [30 days after date of publication in the Federal Register] ☐**  
**Reply Comment Date on Section XV: [45 days after date of publication in the Federal Register] ☐**  
**Comment Date on the Remaining Sections: [45 days after date of publication in the Federal Register] ☐**  
**Comment Date of State Members of the Federal-State Joint Board on Universal Service: [59 days  
after date of publication in the Federal Register] ☐**  
**Reply Comment Date on Remaining Sections: [80 days after date of publication in the Federal  
Register] ☐**

By the Commission: Chairman Genachowski and Commissioners Copps, McDowell, Clyburn and Baker  
issuing separate statements.

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## I. INTRODUCTION

1. Bringing robust, affordable broadband to all Americans is the great infrastructure challenge of our time. The private sector is taking the lead in meeting this challenge, but in areas of the country where it is not economically viable to deploy and/or operate broadband networks, including many rural areas, public support is needed to spur private investment. Today, as the National Broadband Plan recommends, we propose to fundamentally modernize the Commission's Universal Service Fund (USF or Fund) and inter-carrier compensation (ICC) system. We propose to do so by eliminating waste and inefficiency and reorienting USF and ICC to meet the nation's broadband availability challenge, transforming a 20th century program into an integrated program tailored for 21st century needs and opportunities.

2. The principle that all Americans should have access to communications services, a concept referred to as universal service, has been at the core of the Commission's mandate since its founding. Congress created this Commission in 1934 for the purpose of making "available . . . to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."<sup>1</sup> In the decades since, federal and state policymakers developed a complex system of public-private partnerships that supports deployment and adoption of telephone service in costly-to-serve areas. A combination of payments from long distance to local phone companies (ICC) and explicit support from USF has helped local phone

<sup>1</sup> 47 U.S.C. § 151.

companies serve nearly all Americans. But networks that provide only voice service are no longer adequate for the country's communication needs.

3. Ubiquitous broadband infrastructure has become crucial to our nation's economic development and civic life.<sup>2</sup> Businesses need broadband to start and grow; adults need broadband to find jobs; children need broadband to learn. Broadband enables people with disabilities to participate more fully in society and provides opportunity to Americans of all income levels. Broadband also helps lower the costs and improve the quality of health care. As important as these benefits are in America's cities—where more than two-thirds of residents have come to rely on broadband<sup>3</sup>—the distance-conquering benefits of broadband can be even more important in America's more remote small towns, rural and insular areas, and Tribal lands.<sup>4</sup> Furthermore, the benefits of broadband grow when all areas of the country are connected. More users online means more information flowing, larger markets for goods and services, and more rapid innovation. Congress recognized as much in 1996 when it directed the Commission to examine regularly whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely manner,<sup>5</sup> and more recently in February 2009 when it tasked the Commission with developing a National Broadband Plan “to ensure that all people of the United States have access to broadband capability,” and a “strategy for achieving affordability of such service and maximum utilization of broadband infrastructure.”<sup>6</sup>

4. In the 21st century, Americans will use fixed and mobile networks to experience the benefits of broadband. Businesses, anchor institutions, and individuals rely on the high-speed capabilities of fixed broadband networks for services such as high-definition remote medical consultations, “telepresence” videoconferencing, and video-based distance learning. Meanwhile, as desktop PCs give way to laptops, netbooks, smart phones, and tablets, more people are taking their broadband devices on the road and using mobile broadband connectivity in their jobs, education, and health care. The benefits of mobility may be particularly important to rural consumers and schoolchildren who typically travel farther distances to reach work and school, and are vital for public safety: Approximately half of all 911 calls today are made from mobile phones. At the same time, fixed networks remain essential for mobile services, which typically depend on fixed backhaul to connect cell towers and enable mobile communications to other networks.

5. Today, while most Americans have access to broadband,<sup>7</sup> as many as 24 million Americans—one in thirteen of us—live in areas where there is no access to any broadband network, fixed (e.g., DSL or cable Internet service) or mobile.<sup>8</sup> The unserved include the family in Alachua County,

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<sup>2</sup> See generally Federal Communications Commission, *Connecting America: The National Broadband Plan* (rel. Mar. 16, 2010), at xi (National Broadband Plan).

<sup>3</sup> See Industry Analysis and Technology Division, Wireline Competition Bureau *Internet Access Services: Status as of December 31, 2009*, at chart 19 (Dec. 2010) (Dec. 2010 Internet Access Services Report).

<sup>4</sup> Throughout this document, except in reference to the current interim cap on high-cost support for competitive ETCs, “Tribal lands” include any federally recognized Indian tribe's reservation, pueblo or colony, including former reservations in Oklahoma, Alaska Native regions established pursuant to the Alaska Native Claims Settlements Act (85 Stat. 688), and Indian Allotments, see 47 C.F.R. § 54.400(e), as well as Hawaiian Home Lands—areas held in trust for native Hawaiians by the state of Hawaii, pursuant to the Hawaiian Homes Commission Act, 1920, Act July 9, 1921, 42 Stat. 108, et seq., as amended.

<sup>5</sup> 47 U.S.C. § 1302(a).

<sup>6</sup> American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 6001(k)(2)(D), 123 Stat. 115, 516 (Recovery Act).

<sup>7</sup> National Broadband Plan at 20.

<sup>8</sup> *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the* (continued....)

Florida whose daughter routinely drives to a vacant public library parking lot at night to use the WiFi connection to download her high school homework, because her family cannot get broadband at home. They include the family in Montgomery County, Ohio who is frustrated that they cannot get broadband from their local telephone company, even though broadband is available two miles away in the town of Brookville. They include the Native Alaskan community of Kotzebue, which cannot retain teachers due to the lack of basic amenities including Internet connectivity. There are unserved areas in every state of the nation and its territories, and in many of these areas there is little reason to believe that Congress's desire "to ensure that all people of the United States have access to broadband capability" will be met any time soon if current policies are not reformed.

6. Our USF and ICC programs currently are directed at telephone service, not broadband. The component of the Fund that supports telecommunications service in high-cost areas has grown from \$2.6 billion in 2001 to \$4.3 billion in 2010,<sup>9</sup> but it still primarily supports voice, including, in some instances, broadband-capable infrastructure that delivers voice. While the Fund's support has enabled some rural telephone companies to deploy broadband-capable lines, many rural areas receive insufficient support for broadband, creating a "rural-rural divide." The ICC regime, too, was designed for a world of voice minutes and separate long-distance and local telephone companies. It has had the effect of rewarding carriers for maintaining outdated infrastructure rather than migrating to Internet protocol (IP)-based networks. Thus, current rules actually *disincentivize* something necessary for our global competitiveness: the transition from analog circuit-switched networks to IP networks.

7. In addition, fundamental inefficiencies riddle both USF and ICC. In many areas of the country, USF provides more support than necessary to achieve our goals, subsidizes a competitor to a voice and broadband provider that is offering service without government assistance, or supports several voice networks in a single area. Similarly inefficient ICC rules create incentives for wasteful arbitrage. In particular, because rates that local carriers receive to deliver a call vary widely depending on where the call originated and the classification and type of service providers involved, the carriers paying such charges may mask the origination of voice traffic to reduce or avoid payments, creating "phantom traffic." In addition, regulations allowing some carriers to assess above-cost rates for delivering traffic to their subscribers create incentives for local carriers to artificially inflate their traffic volumes, thereby increasing the payments they receive, a practice referred to as "access stimulation" or "traffic pumping." Practices like these and the disputes surrounding them cost hundreds of millions of dollars annually that could be used for investment and more productive endeavors—costs that are ultimately borne by consumers.

8. We face these problems because our universal service rules and our ICC system, designed for 20th century networks and market dynamics, have not been comprehensively reassessed in more than a decade, even though the communications landscape has changed dramatically. Mobile services are vastly more prominent than even a few years ago—more than 27 percent of adults live in households with only wireless phones.<sup>10</sup> Broadband Internet access revenues have grown from \$13.1

(Continued from previous page) \_\_\_\_\_

*Telecommunications Act of 1996, Amended by the Broadband Data Improvement Act*, GN Docket Nos. 09-137, 09-51, Report, 25 FCC Rcd 9556 (2010) (*Sixth Broadband Deployment Report*).

<sup>9</sup> Federal and State Staff for the Federal-State Joint Board on Universal Service in CC Docket No. 96-45, *Universal Service Monitoring Report*, CC Docket No. 98-202, at Table 3-1 (Dec. 2010) (2010 Universal Service Monitoring Report); staff analysis of 2010 High-Cost Disbursement Data, <http://www.fcc.gov/wcb/iatd/miscdata> (forthcoming) (2010 Disbursement Analysis); USAC High-Cost Disbursement Data, <http://www.usac.org/hc/tools/disbursements/default.aspx> (USAC High-Cost Disbursement Tool). Numbers shown reflect nominal growth. Adjusting for inflation over the same time period, high-cost support has increased from \$2.6 billion to \$3.5 billion in 2001 dollars.

<sup>10</sup> Stephen J. Blumberg and Julian V. Luke, *Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, January - June 2010*, National Center for Health Statistics, Centers for Disease Control (Dec. 21, 2010), available at <http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201012.pdf>.

billion in 2003 to \$36.7 billion in 2009, while traditional wireline telephone (switched access) minutes plummeted from 567 billion in 2000 to 316 billion in 2008.<sup>11</sup> From 2008 to 2009, interconnected Voice over Internet Protocol (VoIP) subscriptions increased by 22 percent, while switched access lines decreased by 10 percent.<sup>12</sup> Incumbent telephone companies that operate in rural areas increasingly face competition from other providers, including cable and wireless companies in portions of their service area, but remain the carrier of last resort (COLR) outside of towns, where there are typically too few customers to support a sustainable business.<sup>13</sup>

9. As Representative Lee Terry and Rick Boucher, former Chairman of the House Subcommittee on Communications, Technology and the Internet, said last year, “the Universal Service Fund is broken.”<sup>14</sup> And because of the interrelationship between USF and ICC, and the importance of both to the nation’s broadband goals, reform of the two programs must be tackled together. As the Commission said in its Joint Statement on Broadband, released when the National Broadband Plan was delivered to Congress last March, “[USF] and [ICC] should be comprehensively reformed to increase accountability and efficiency, encourage targeted investment in broadband infrastructure, and emphasize the importance of broadband to the future of these programs.”<sup>15</sup>

10. Consistent with the Joint Statement and the Broadband Plan, the Commission plans to be guided by the following four principles, rooted in section 254, as we proceed with USF and ICC reform:

- *Modernize USF and ICC for Broadband.* Modernize and refocus USF and ICC to make affordable broadband available to all Americans and accelerate the transition from circuit-switched to IP networks, with voice ultimately one of many applications running over fixed and mobile broadband networks. Unserved communities across the nation cannot continue to be left behind.
- *Fiscal Responsibility.* Control the size of USF as it transitions to support broadband, including by reducing waste and inefficiency. We recognize that American consumers and businesses ultimately pay for USF, and that this contribution burden may undermine the benefits of the program by discouraging adoption.
- *Accountability.* Require accountability from companies receiving support, to ensure that public investments are used wisely to deliver intended results. Government must also be accountable for the administration of USF, including through clear goals and performance metrics for the program.

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<sup>11</sup> Industry Analysis and Technology Division, Wireline Competition Bureau, *Trends in Telephone Service*, at 10-1 (Sept. 2010) (Sept. 2010 Trends in Telephone Service); Telecommunications Industry Association, *2010 ICT Market Review and Forecast*, Table 1-1.5 (Voice, Video and Data Services Revenues).

<sup>12</sup> Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition Report: Status as of December 2009*, at 6 (Jan. 2011) (Jan. 2011 Local Competition Report).

<sup>13</sup> National Telecommunications Cooperative Association, *NTCA 2010 Broadband/Internet Availability Survey Report*, at 3, 8 (Jan. 2011) (“Ninety-eight percent of survey respondents indicated that they face competition in the provision of advanced services from at least one other service provider [such as cable companies and wireless Internet service providers] in some portion of their service area,” but forty-four percent of those respondents indicate that “competitors were serving only the cities and towns in their service areas.”).

<sup>14</sup> See Boucher, Terry Introduce Universal Service Reform Act of 2010, Press Release, 111th Congress (rel. July 22, 2010).

<sup>15</sup> *Joint Statement on Broadband*, GN Docket No. 10-66, Joint Statement on Broadband, 25 FCC Rcd 3420, 3421 (2010).

- *Market-Driven Policies.* Transition to market-driven and incentive-based policies that encourage technologies and services that maximize the value of scarce program resources and the benefits to all consumers.<sup>16</sup>

11. We seek comment on these principles for reform. Section 254 of the Act lays out principles for Commission policies to preserve and advance universal service.<sup>17</sup> Section 254(c)(1) defines universal service as evolving; thus, we are seeking to modernize it.<sup>18</sup> Section 254(b)(5) requires that support be “sufficient, predictable and sufficient,” which courts have interpreted as requiring support that is sufficient but not excessive, consistent with our commitment to fiscal responsibility and market-driven, incentive-based policies.<sup>19</sup> Finally, accountability is essential to ensure that our programs are in fact preserving and advancing universal service by providing the “[a]ccess to advanced telecommunications and information services . . . in all regions of the Nation” that Congress envisioned in section 254(b)(2).<sup>20</sup>

12. As we proceed with USF and ICC reform, we intend to avoid sudden changes or “flash cuts” in our policies, acknowledging the benefits of measured transitions that enable stakeholders to adapt to changing circumstances and minimize disruption. We note that if additional funding were available for USF and ICC reform, it could accelerate and ease the necessary transitions.

13. We recognize that USF and ICC are both hybrid state-federal systems, and that reform will work best with the Commission and state regulators cooperating to achieve shared goals. We also acknowledge that crucial work has already been done to advance broadband deployment in hard-to-serve areas—including by the National Telecommunications and Information Administration (NTIA) and the Rural Utilities Service (RUS) through American Recovery and Reinvestment Act grants and loans as well as ongoing RUS programs, and by states through their own efforts to extend broadband. We seek to incorporate the lessons learned from those programs. We seek input from our federal and state partners and Tribal governments on how best to coordinate efforts to ensure that all Americans have access to modern communications networks so that we can continue to work together to build on the past success of universal service.

## II. EXECUTIVE SUMMARY

14. This section summarizes our proposed framework for reform. Our proposals are designed to achieve the four core principles above—modernizing and refocusing USF and ICC to ensure all Americans have access to robust, affordable broadband and to accelerate the transition to IP networks; fiscal responsibility; accountability; and use of market-driven and incentive-based policies—and we seek to ensure that the future of USF and ICC are consistent with those principles. We recognize, however, that there are a number of potential paths to that future state. We also recognize the difficulty of precisely forecasting the consequences of changes to a system as complex and interdependent as USF and ICC, as well as the benefits of piloting innovative policies—such as competitive bidding to support build out and ongoing operation of fixed and mobile broadband networks—before broader implementation. We therefore propose several specific, near-term steps that will accelerate broadband investment in unserved areas and set USF and ICC on a path that is consistent with the principles we have proposed; we then describe alternatives for completing the reform process over the longer term. We intend to monitor the progress of the near-term reforms and adjust course as necessary as we complete the reform process from among the longer-term options.

<sup>16</sup> We recognize that in some geographic areas there may be no private sector business case for offering voice and broadband services. This is not in tension with our commitment to use market-driven regulation.

<sup>17</sup> 47 U.S.C. § 254.

<sup>18</sup> 47 U.S.C. § 254(c)(1).

<sup>19</sup> 47 U.S.C. § 254(b)(5). *See infra* para. 412.

<sup>20</sup> 47 U.S.C. § 254(b)(2).

15. We believe the USF and ICC regimes will benefit from simplification and unification: The Connect America Fund (CAF) we propose to create would ultimately replace all other explicit support provided by the current high-cost fund as well as implicit subsidies from the ICC system. To be clear, we are not proposing to eliminate universal service support for communications services in high-cost areas of the country; rather, we are proposing to improve the efficiency and effectiveness of that support.

16. Our reforms must balance a number of other important and possibly competing priorities. These priorities include advancing broadband service to all Americans; sustaining high-quality, reliable voice service for all Americans; sustaining and expanding mobile voice and mobile broadband coverage throughout the country; increasing adoption of advanced communications services; and minimizing the burden on consumers and businesses, who pay for universal service. We seek comment on the relative importance of these objectives and look forward to developing a full record on the appropriate balance among them.

17. Reform will require all major stakeholders in the USF and ICC system to grapple with the practical consequences of change. We do not propose any “flash cuts,” but rather suggest transitions and glide paths that we believe will facilitate adaptation to reforms. Change to USF and ICC policies need not and should not be sudden or overly disruptive, but change must begin so that our country can reach its broadband goals in an efficient and accountable way.

#### **A. Universal Service Fund**

18. Building on the recommendations of the National Broadband Plan and the record from the *USF Reform NOI/NPRM*,<sup>21</sup> we propose to transform the existing high-cost program—the component of USF directed toward high-cost, rural, and insular areas (which we often refer to as “USF” in this document)—into a new, more efficient, broadband-focused Connect America Fund. As shown in Figure 1 below, we propose to undertake this comprehensive reform in two stages: a set of immediate reforms including, among other near-term goals, the establishment of the CAF, followed by the final selection of the long-term CAF funding mechanism, based on monitoring and evaluation of experiences with the near-term reforms.

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<sup>21</sup> *Comment Sought on the Role of the Universal Service Fund and Intercarrier Compensation in the National Broadband Plan*, GN Docket Nos. 09-51, 09-47, 09-137, Public Notice, 24 FCC Rcd 13757 (2009) (NBP PN #19); *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *High-Cost Universal Service Support*, WC Docket No. 05-337, Notice of Inquiry and Notice of Proposed Rulemaking, 25 FCC Rcd 6657 (2010) (*USF Reform NOI/NPRM*).

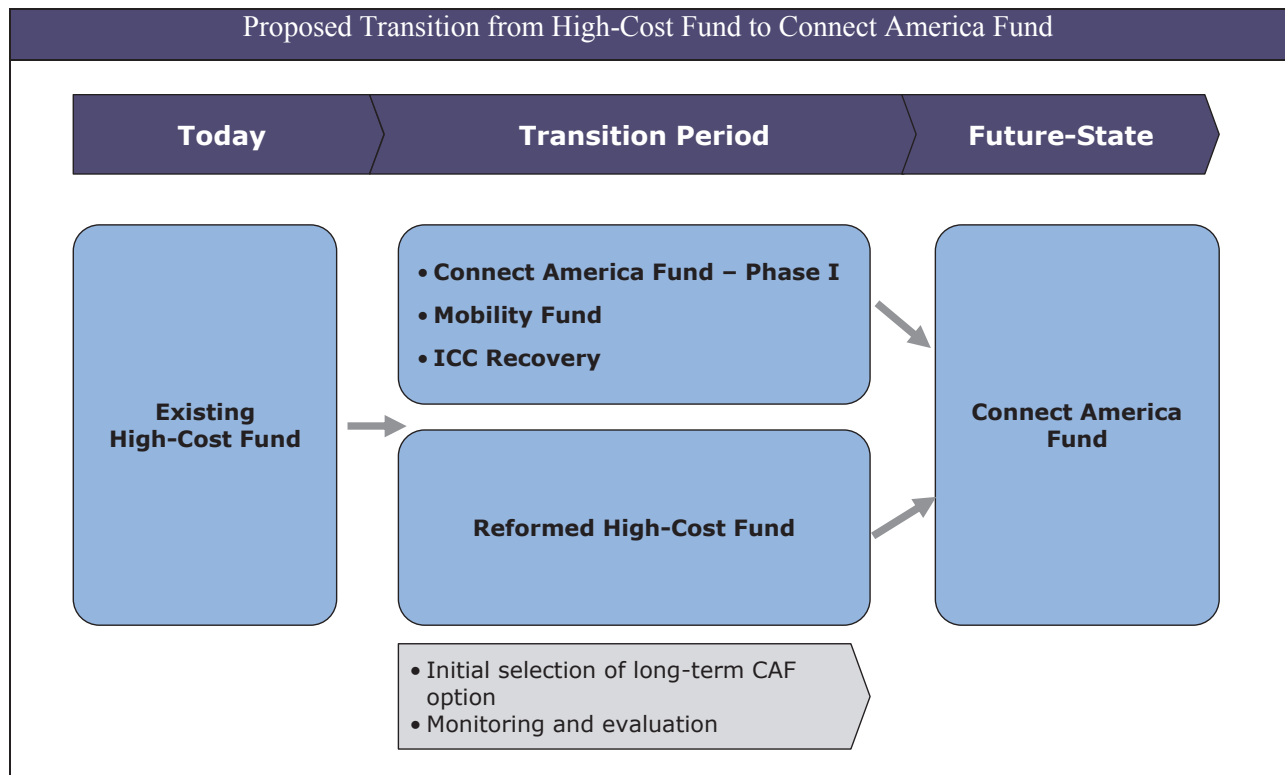


Figure 1

### 1. Immediate Reforms

19. In October 2010, we issued the *Mobility Fund NPRM*, which proposed a Mobility Fund intended to spur build out of advanced mobile wireless networks in areas not served by current-generation mobile networks. We now continue our reform efforts in this proceeding by proposing steps to spur broadband build out, whether fixed or mobile, in unserved areas, which exist in every state as well as the territories. We propose to do this by transitioning funds from less efficient uses to more efficient uses, include through the creation of the CAF. We also seek comment on other measures to reduce inefficiencies, extend broadband, and increase the accountability of companies receiving support.

20. In 2010, the high-cost fund disbursed \$4.3 billion through five separate mechanisms designed to support different kinds of costs and different types of carriers, as shown in Figure 2, below:

Existing High-Cost Fund (2010 Actual) (\$ amounts in millions)						
	High-Cost Model Support	Interstate Access Support (capped)	High-Cost Loop Support (capped)	Local Switching Support	Interstate Common Line Support	Total
<b>Total Support</b>	\$310	\$545	\$1,379	\$359	\$1,675	\$4,268
<b>Incumbent Support</b>	\$157	\$458	\$1,024	\$276	\$1,141	\$3,055
<b>Competitive ETC Support (capped)</b>	\$153	\$88	\$355	\$83	\$533	\$1,213
<b>Who receives</b>	Large “non-rural” incumbents (Bell operating companies and mid-size telcos) and competitive ETCs operating in their territories	Large incumbents (price cap companies) and competitive ETCs operating in their territories	Small incumbents (mostly rate of return but some mid-size companies), and competitive ETCs operating in their territories	Small incumbents (mostly rate of return, but some price cap companies) and competitive ETCs operating in their territories	Small “rural” incumbents (rate of return companies and recent mid-size price cap converts) and competitive ETCs operating in their territories	
<b>What it supports</b>	Subsidizes intrastate loop, switching, and interoffice transport costs based on forward looking cost model	Interstate access revenue replacement targeted to UNE zones where carrier cannot recoup revenues through SLCs	Subsidizes intrastate loop costs based on embedded (actual) costs of the carrier	Helps cover fixed intrastate switching costs for operating companies with less than 50,000 lines	Interstate revenue recovery when SLC cap does not permit full recovery of common line revenues	

Source: USAC actual disbursements January – December 2010. Amounts shown reflect disbursements made on an accrual basis for all study areas for which USAC had line count information as of November 2011. Disbursements may include true-ups for earlier years, and disbursements for calendar year 2010 are subject to additional true-ups during future periods.

Note: Competitive ETC support is capped at approximately \$1.366 billion per year.<sup>22</sup>

Figure 2

21. In this proceeding, we propose the following reforms to be implemented beginning in 2012:

- Three components of the high-cost program primarily support smaller carriers regulated under “rate-of-return” rules:<sup>23</sup> high-cost loop support (HCLS), which provided \$1 billion for incumbents

<sup>22</sup> See Letter from Sharon Gillett, Chief, Wireline Competition Bureau, to Karen Majcher, USAC, WC Docket No. 05-337, DA 11-243 (dated Feb. 8, 2011) (Interim Cap Adjustment Letter). These estimates include amounts disbursed to Sprint and Verizon Wireless, which agreed in 2008 to phase out their competitive ETC support over five years as a condition of the approval of certain transactions. Last year, the Commission provided instructions for implementing the commitments of both Verizon Wireless and Sprint to surrender their high-cost universal service support, resulting in recapture of amounts previously disbursed in 2009. See *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service, Request for Review of Decision of Universal Service Administrator by Corr Wireless Communications, LLC*, WC Docket No. 05-337, CC Docket No. 96-45, Order and Notice of Proposed Rulemaking, 25 FCC Rcd 12854 (2010) (*Corr Wireless Order*). Net of the support provided to Sprint and Verizon, the amount of competitive ETC support shown in the table would have been \$921 million.

<sup>23</sup> Rate-of-return regulation is a form of rate regulation in which a carrier’s rates are set at levels to give the carrier an opportunity to recover its operating costs plus an authorized rate of return on the regulated rate base (plant in service minus accumulated depreciation).

in 2010; local switching support (LSS), which provided \$276 million for incumbents in 2010; and interstate common line support (ICLS), which provided \$1.1 billion for incumbents in 2010.<sup>24</sup> As currently structured, these funding mechanisms provide poor incentives for rate-of-return carriers to operate and invest efficiently. While individual carriers may act in the best interests of their own customers and communities, excessive spending by any one community limits opportunities for consumers in other communities and may not be in the best interests of the nation as a whole. HCLS, for example, creates incentives for companies to outspend their peers in order to receive more funding under the current capped formula. For all three programs, there are few, if any, benchmarks for determining whether network investment is justified or appropriate, allowing a company to spend millions of dollars to build a state-of-the art network that may serve only a few customers. LSS was originally created to help small telephone companies that lack economies of scale to afford large switches, but since then the industry has moved to software-based routers and switches which can be more easily scaled to a company's size and even shared among companies. LSS now provides perverse incentives for companies *not* to realize efficiencies by combining service areas. We seek comment on a suite of reforms to these components, which will increase accountability and start rate-of-return carriers on the path towards market-driven, incentive-based regulation. Specifically, we seek comment on:

- Reducing the reimbursement rates for the current high-cost loop program, in order to distribute funding—which has been capped since the 1990s—in a more equitable manner among rural carriers. Today, high-cost loop support largely goes to companies that have accelerated network upgrades throughout their territory, leaving nothing available for other smaller companies that choose to upgrade their networks more incrementally.
- Phasing out Local Switching Support or, alternatively, combining LSS and HCLS into a single, more efficient mechanism to support network costs. Larger holding companies are able to exploit the current LSS rules to gain additional support for switching costs, increasing the burden on American consumers who support the Fund.
- Setting reasonable guidelines for reimbursements for capital and operating expenses based on benchmarks developed from investments made by comparable companies. Today, there are few controls on such reimbursements, leaving companies with broad discretion to control how much public money they get and how they use it.
- Limiting the total support per line any one carrier in the continental United States can receive, absent exceptional circumstances. While we recognize that USF provides support to the hardest-to-serve areas, which may be very costly to serve, it is not clear that all of the amounts provided today are necessary to provide reliable service. We propose a process in which companies operating in the continental United States receiving in excess of \$250 per month per line would have to justify higher amounts of support.
- Streamlining the study area waiver process to eliminate barriers to consolidation and rationalization of service territories.
- Modifying rules that limit support when acquiring lines from another provider in situations where the acquired lines are substantially unserved by broadband (the “parent trap rule”), in order to provide greater incentives to upgrade those facilities.
- We propose to phase out Interstate Access Support (IAS) over a period of a few years. In 2010, IAS totaled \$545 million. Originally created in 2000 as an interim part of a five-year transitional reform plan, IAS has long outlived its intended lifespan. The comments received in response to the *USF Reform NOI/NPRM* suggest that this fund is not critical to ensuring rural voice service,

<sup>24</sup> Some of the larger, price cap carriers, however, do receive some HCLS, LSS, and ICLS. For instance, mid-size companies that recently converted from rate-of-return to price cap regulation receive ICLS that is frozen on a per-line basis.

and we believe the funds could be more productively used to support the deployment of broadband to unserved areas.

- In addition, we propose to eliminate the “identical support” rule and to rationalize funding for competitive Eligible Telecommunications Carriers (ETCs) over a several-year period. In 2010, non-IAS competitive ETC funding totaled \$1.1 billion. Under the Commission’s identical support rule, competitive ETCs (mostly wireless carriers) receive this support, subject to an interim cap, regardless of actual costs or needs, as a per-line, dollar-for-dollar match with the incumbent wireline carrier support per line in the same area. As a result, the funding is poorly targeted—in some areas, as many as four or more providers are receiving redundant ETC funding, while other areas lack even a single provider of broadband or mobile voice. Two of the largest ETCs have voluntarily agreed to relinquish their ETC support in the context of transactions, and the *USF Reform NOI/NPRM* record supports the conclusion that current levels of competitive ETC support are unnecessary to ensure fixed or mobile voice service in many areas of the country that receive support today.

At the same time, we recognize the importance of mobile voice and mobile broadband coverage in all areas of the country and seek comment on how to balance the desire for universal mobile coverage with other USF priorities. Our proposal in the Mobility Fund proceeding was intended to provide a one-time infusion to expand mobile coverage.<sup>25</sup> We seek comment here on how best to factor the need for mobility into the reforms proposed in this proceeding to achieve our universal service objectives.

22. Taken together, the proposed changes to the high-cost program will enable significant funds to be used to support fixed and mobile broadband, as discussed below, and potentially a recovery mechanism associated with ICC reform, where necessary, as summarized below.

23. We seek comment on the appropriate size of these programs. We propose that, together with remaining high-cost support, total disbursements remain no greater than the high-cost program would be under current rules. We seek comment, however, on whether total disbursements should be lower in the future to minimize the burden on consumers. In light of the high costs that would be required to ensure ubiquitous mobile coverage and very-high-speed broadband for every American and the length of the transition to the proposed Connect America Fund, we also seek comment on whether additional investments in universal service may be needed to accelerate network deployment.

24. To spur immediate new broadband investment through the CAF, we propose to conduct a competitive bidding process (also known as a reverse auction or a procurement auction) in which providers seeking a one-time infusion of support to build out and operate broadband networks in unserved areas across the country compete against one another by bidding for the lowest amount of support they would require to provide service to unserved housing units. Specifically, using the forthcoming National Broadband Map to identify areas that currently lack broadband, we propose to award a significant amount of funding, such as \$500 million to more than \$1 billion, through a technology-neutral reverse auction in 2012, with additional auctions potentially to follow. Recipients – which could be either fixed (wireline or wireless) or mobile wireless providers – will be subject to enforceable requirements to deploy broadband to the unserved areas (defined as census blocks or aggregations of census blocks) identified in their bid within a specified time period, such as three years, and provide service for a defined period of years after deployment is complete. They will be permitted to subcontract with other providers, including satellite broadband providers, to fulfill their service obligations in particularly difficult to reach portions of their proposed service areas. We seek comment on whether the broadband service obligation should be defined as a minimum of 4 megabits per second (Mbps) downstream and 1 Mbps upstream, or whether we should use other metrics.

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<sup>25</sup> See *Universal Service Reform, Mobility Fund*, WT Docket No. 10-208, Notice of Proposed Rulemaking, 25 FCC Rcd 14716 (2010) (*Mobility Fund NPRM*).

25. If the auction winner is not the existing incumbent recipient of USF in the area during this interim transition period, that incumbent carrier of last resort would continue to receive its existing support, subject to the other reforms proposed in this Notice. If the auction winner is the existing provider, the new funding would supplement its existing support, subject to the other reforms proposed in this Notice. This use of a market-driven process to award support will spur high-impact broadband deployment and give the Commission and the private sector experience with a mechanism for providing consumers access to high-quality network infrastructure in an efficient manner.

26. To further promote deployment of broadband, we also seek comment on what broadband service obligations, based on section 254 of the Act, should apply to recipients of CAF support under the competitive bidding process described above, as well as whether any such obligations should apply to recipients of the reformed high-cost fund. We seek comment on how to ensure that service in rural areas is available at rates that are reasonably comparable to rates in urban areas. In addition, we propose to clarify that voice service can be provided by any technology, including VoIP, so that USF can be used directly to support modern IP-based networks.

27. Finally, we propose a variety of measures to increase accountability and better track performance of the Fund as a whole. Specifically:

- We propose to adopt performance goals and measures for the Fund as a tool to monitor how it is advancing the statutory goals set forth in section 254.
- We propose to adjust reporting requirements for Fund recipients, including requiring submission of certain financial information regarding operations, to enable the Commission to ensure that funds are being used efficiently and effectively. We seek comment on obtaining pricing data to ensure that services in rural areas are available at rates that are affordable and reasonably comparable to urban areas.
- We propose to revise our certification and audit processes to reflect updated public interest obligations for all Fund recipients, such as the requirement to deploy broadband networks.

28. In addition to substantially increasing Americans' access to broadband and eliminating wasteful or inefficient spending, our proposed reforms will move USF and the companies that rely on it along the road to the future state of reform. They will also provide the Commission and industry valuable experience with market-based mechanisms for allocating support, while improving the Commission's data on the functioning of USF. Finally, these reforms will introduce elements of incentive-based regulation to rate-of-return carriers.

29. To reduce uncertainty and help companies reliant on USF and ICC plan and invest for the future, we also propose several options for long-term CAF funding mechanisms, as described below. We seek comment on these options and may select the path for long-term reform at the same time we adopt the immediate reforms just described. But we propose to monitor the outcomes that result from these immediate reforms on an ongoing basis and evaluate them comprehensively beginning no later than three years after adoption of an order implementing initial reforms, to determine what course corrections may be needed at that time along the path to long-term reform.

## **2. Long-Term Vision**

30. In the second stage of our comprehensive universal service reform, we propose to transition all remaining high-cost programs to the CAF. The CAF would provide ongoing support to maintain and advance broadband across the country in areas that are uneconomic to serve absent such support, with voice service ultimately provided as an application over broadband networks.

31. We seek comment on longer-term options for providing sufficient, but not excessive support for service to be provided in rural areas at rates that are affordable and reasonably comparable to rates in urban areas. Under one option, the Commission would award all ongoing support through a competitive, technology-neutral bidding mechanism (including using technology-neutral geographic areas). Under a second option, in each part of the country requiring ongoing universal service support,

the Commission would offer the current voice carrier of last resort (likely an incumbent telephone company) a right of first refusal to serve the area as the broadband provider of last resort for an ongoing amount of annual support based on a cost model. If the provider refuses this offer, the Commission would hold a competitive, technology-neutral process to select a provider to serve the area and take on all service obligations, a process in which the current voice carrier of last resort could participate. Under either approach, we propose that all ongoing support for carriers operating in high-cost areas would come from the CAF. This funding would replace all other explicit support as well as all implicit subsidies from ICC, as described in the next section.

32. In the alternative, we seek comment on limiting right-of-first refusal or auction-based support to a subset of geographic areas, such as those served by price cap companies, while continuing to provide ongoing support based on reasonable actual investment to smaller, rate-of-return companies. Should we take this approach to the CAF, we seek comment on possible changes to the current rate-of-return system beyond those discussed in the previous section, including capping and shifting interstate common line support to an incentive regulation framework that would establish support amounts periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue, implementing a more rigorous process to examine whether investment is used and useful, and re-examining the current 11.25 percent interstate rate of return.

33. Building on the interim reforms laid out in the previous section, we believe each of these proposals for long-term reform provides a possible path to complete the transformation of the existing high-cost fund into an accountable, fiscally responsible, market-driven and incentive-based system focused on the nation's broadband challenge.

#### **B. Intercarrier Compensation**

34. We propose to take action in the near term to reduce inefficiency and waste in the intercarrier compensation system while providing a framework for long-term reform. This long-term reform would gradually phase out the current per-minute ICC system and implement a recovery mechanism (based on costs and/or revenues), which could enable some carriers to receive additional explicit support from the CAF. Figure 3 below illustrates the proposed transition.

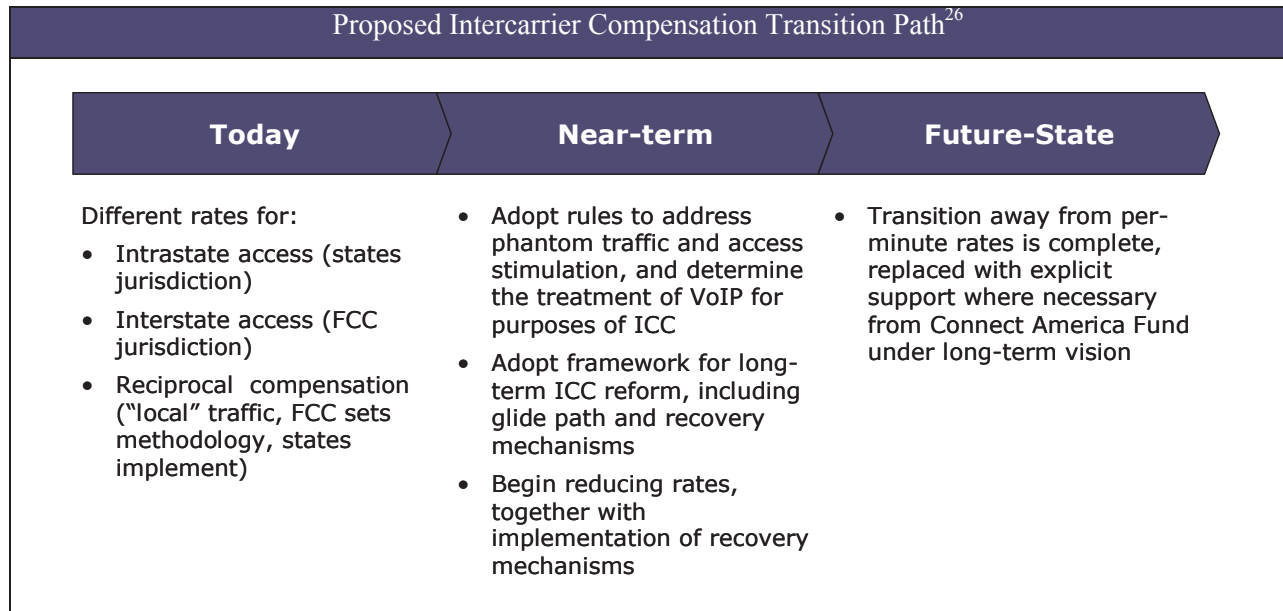


Figure 3

### 1. Immediate Reforms

35. In the near term, we propose several reforms to reduce wasteful arbitrage and increase certainty in ICC payments during the transition away from the per-minute system. The record indicates that arbitrage schemes cost hundreds of millions of dollars each year and that regulatory uncertainty about whether or what ICC payments are required for VoIP traffic is hindering investment in IP-based products and services.

36. We propose to amend our interstate access rules to address access stimulation—arrangements in which carriers, often competitive carriers, profit from revenue-sharing agreements by operating in an area where the incumbent carrier has a relatively high per-minute interstate access rate. Under our existing rules, the competitive carrier benchmarks its rate to that of the incumbent rural carrier, but the revenue-sharing arrangement results in a volume of traffic that is more consistent with a larger carrier. A competitive carrier could, for example, generate millions of dollars in revenues each month from other carriers simply by entering into a revenue sharing arrangement with a company that operates a chat line. A rate-of-return carrier can likewise use our rules to take advantage of revenue sharing by setting a rate based, for example, on historical demand and then entering into an arrangement that inflates demand without adjusting its tariff to reflect a rate appropriate for such demand. We propose that carriers that have entered a revenue-sharing arrangement be required to refile their interstate switched access tariffs to reflect a low rate consistent with their volume of traffic. For rate-of-return incumbent local exchange carriers (LECs), the rate would be adjusted to account for new demand. For competitive carriers, that rate would be benchmarked to that of a large incumbent local exchange carrier (LEC) in the

<sup>26</sup> Today, there are three major forms of intercarrier compensation: interstate access charges, intrastate access charges, and reciprocal compensation. Access charges apply to long distance calls. The Commission regulates rates for interstate calls and states regulate rates for intrastate calls. Reciprocal compensation today primarily governs "local" calls, and rates are either negotiated by carriers or set by states using the Commission's pricing methodology. Intrastate access rates are generally higher than interstate rates, and both are generally higher than reciprocal compensation rates, although large variations exist within each category.

state, rather than to that of the local rate-of-return carrier. We also seek comment on alternative approaches.

37. We propose to amend our call signaling rules to address “phantom traffic” by ensuring that calls received by the terminating provider include sufficient signaling information for that provider to identify and bill the appropriate provider. Phantom traffic today causes carriers to devote substantial resources to resolving billing disputes that could be used to invest or innovate. One provider, for example, estimates that 5-8 percent of all traffic terminating on its network is “phantom” or disguised traffic. Rules requiring the inclusion of appropriate signaling information would apply to all voice traffic, including interconnected VoIP, but the rules would be flexible enough to adapt to a variety of technical standards and accommodate their evolution. We also make clear that applying the signaling rules to interconnected VoIP does not prejudice the determination of any intercarrier payment obligation for interconnected VoIP calls.

38. We propose to determine the obligations for interconnected VoIP traffic under the ICC framework, and we seek comment on the appropriate intercarrier compensation regime. We seek comment on payment obligations for VoIP ranging from adopting a bill-and-keep methodology for VoIP, to applying a VoIP-specific ICC rate, to requiring VoIP calls to pay all existing ICC charges. We also seek comment on the implications for existing commercial arrangements that may address compensation for VoIP traffic.

39. By reducing inefficient use of resources and expenditures on disputes and litigation, we believe these proposals will allow companies to begin directing increased capital resources toward investment and innovation that ultimately benefits consumers.

## 2. Comprehensive Reform

40. At the same time, we propose to adopt a sustainable long-term framework to gradually reduce all per-minute charges. Per-minute charges are inconsistent with peering and transport arrangements for IP networks, where traffic is not measured in minutes. The record suggests that the current ICC system is impeding the transition to all-IP networks and distorting carriers’ incentives to invest in new, efficient IP equipment. Moreover, although the short-term measures we propose will address the most common forms of arbitrage today, wasteful attempts to game the system will likely persist as long as ICC rates remain disparate and well above carriers’ incremental costs of terminating a call.

41. Because the ICC system has not been reformed to reflect fundamental shifts in technology and competition in the last two decades, the current system results in considerable instability for carriers as revenues are declining at often unpredictable rates. Declining minutes for incumbent carriers have led to a concurrent decline in revenues, particularly for price cap carriers. By providing a more certain glide path for the transition to an all-IP future, intercarrier compensation reform will bring much needed predictability to the industry and investors, which will ultimately benefit consumers.

42. We seek comment on several aspects of our proposed reduction of ICC rates. In particular:

- *Federal/State Role:* We seek comment on two possible overall approaches for working with states to reform intercarrier compensation. The first approach relies on the Commission and states to act within their existing roles in regulating intercarrier compensation, such that states would remain responsible for reforming intrastate access charges. Under a possible variation, states would remain responsible for reforming wireline intrastate charges, but we also seek comment on whether we should set a glide path to reform wireless termination charges, possibly including intrastate access charges paid by or to wireless providers. The second approach relies on the Commission using the tools provided by sections 251 and 252 in the 1996 Act to unify all intercarrier rates, including those for intrastate calls, under the reciprocal compensation framework. Under this framework, the Commission would establish a methodology, which states would then work with the Commission to implement.

- *Sequencing*: We seek comment on the sequencing of ICC rate reductions and how the sequencing options relate to the roles of the states and the Commission. Interstate and intrastate access charges could change concurrently, particularly if the Commission and the states each act within their existing roles; alternatively, reforms could proceed sequentially, for example beginning with reductions in intrastate access charges to interstate levels, followed by a reduction of all ICC rates. We seek comment on these possibilities as well as the timing to reduce reciprocal compensation rates and wireless termination charges.
- *Timing*: We also seek comment on the appropriate timing of the overall transition and propose to complete the transition away from per-minute rates consistent with the implementation of long-term CAF support, so that all subsidies necessary to serve an area are explicit as part of whichever long-term CAF funding mechanism is adopted. We seek comment on the glide path to this end point.

43. As ICC rates decrease, we propose to adopt a mechanism for recovery, where necessary, which may include explicit universal service support and reasonable end-user charges. In so doing, we recognize that ICC revenues today remain an implicit subsidy for certain carriers, and we seek comment on how to structure the recovery mechanism to provide certainty and predictability during the transition. We also seek comment on how to structure this mechanism consistent with limiting burdens on consumers and constraining the size of the CAF.

44. By modernizing our policies for a broadband world and reducing the underlying incentives for wasteful arbitrage, we believe these reforms will promote investment in IP facilities and free up valuable resources, provide certainty and ultimately encourage new broadband investment and innovation.

### III. ROLE OF INTERCARRIER COMPENSATION AND UNIVERSAL SERVICE PROGRAMS

45. Intercarrier compensation and universal service have long been intertwined. Historically, both universal service policies and intercarrier compensation policies worked in tandem to enable companies to provide affordable local phone service to residential consumers – which in some areas of the country requires recovery of network costs from sources other than those residential end-user customers.

46. *Pre-AT&T Divestiture*. A primary policy objective of regulators during the 20th century was to promote universal service through affordable local telephone rates for residential customers. To accomplish this objective, regulators created a patchwork of implicit subsidies. Thus, for example, regulators permitted higher rates to business customers so that residential rates could be lower, and they frequently required similar rates for urban and rural customers, even though the cost of serving rural customers was higher.<sup>27</sup> Similarly, AT&T<sup>28</sup> was permitted to charge artificially high long-distance toll rates, and then shared a portion of these interstate revenues with independent telephone companies and AT&T's Bell Operating Companies (BOCs).<sup>29</sup> These high long-distance rates enabled regulators to promote universal service through lower residential rates for the BOCs and independent local telephone companies.

<sup>27</sup> See, e.g., Jonathan E. Nuechterlein & Philip J. Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* 10–15 (2007) (Digital Crossroads).

<sup>28</sup> See AT&T, *A Brief History: Origins*, <http://www.corp.att.com/history/history1.html> (last visited Feb. 9, 2011).

<sup>29</sup> The sharing of revenues was known as the “settlements” process and was a major source of support for small rural companies, in some cases representing as much as 85% of certain costs allocated to the interstate jurisdiction. See Gerald W. Brock, *The Second Information Revolution* 188 (2003).

47. *Access Charges and Universal Service.* Following the divestiture of AT&T,<sup>30</sup> the Commission created access charges to provide intercarrier payments from long distance companies to local companies.<sup>31</sup> In conjunction with access charges, the Commission introduced flat-rated, per-line monthly charges for end users, known as the subscriber line charge or SLC, to enable carriers to recover some of the costs of their network.<sup>32</sup>

48. Access charges require a long distance carrier to pay both the originating local carrier and the terminating local carrier a per-minute rate to originate and terminate the call (e.g., when a consumer in Philadelphia places a call to Miami, the consumer's long distance carrier pays access charges to both the originating carrier in Philadelphia and the terminating carrier in Miami).<sup>33</sup> The access charge rules enabled local carriers to recover their historical costs, including common network costs and overhead,<sup>34</sup> from long distance carriers. These intercarrier payments were one means by which local telephone companies were able to keep residential rates low by recovering some of their network costs from other carriers rather than the telephone companies' own customers.<sup>35</sup>

49. Also in the 1980s, the Commission created what was then known as the Universal Service Fund, or high-cost assistance fund, using its Title I authority to promote and preserve universal service.<sup>36</sup> Historically, through the separations process, incumbent telephone companies have been required to separate their costs and revenues between the intrastate and interstate jurisdictions.<sup>37</sup> The Universal Service Fund effectively shifted cost recovery for a portion of loop costs from the intrastate jurisdiction to the interstate jurisdiction. In addition, the Commission provided support for switching costs for smaller carriers, enabling those companies to assign a greater portion of local switching costs from the intrastate jurisdiction to the interstate jurisdiction. And, in the early 1990s, the Commission began moving away from traditional rate-of-return regulation of the interstate switched and special access rates—of the Bell Operating Companies and GTE, moving to a form of incentive regulation, known as

<sup>30</sup> In 1974, the Department of Justice filed an antitrust lawsuit against AT&T, which ultimately led to AT&T's divestiture under the Modification of Final Judgment (MFJ). See *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The 1982 consent decree, as entered by the court, was called the Modification of Final Judgment because it modified a 1956 Final Judgment against AT&T stemming from a 1949 antitrust lawsuit.

<sup>31</sup> *MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 683, para. 2 (1983).

<sup>32</sup> The Commission initially limited the SLC to \$1.00. See *1983 Access Charge Order*, 93 FCC 2d at 253, para. 35; see also *id.* at 243, para. 4. The Commission also permitted the remaining interstate loop costs to be recovered through a per-minute charge, known as the carrier common line charge, imposed on long distance carriers. See *Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24. Under the current Commission rules, SLCs are subject to caps based on whether the line is: (a) a primary residential or single-line business line; (b) a non-primary residential line; or (c) a multi-line business or Centrex line. For price cap and rate-of-return carriers, the current SLC cap for residential and single-line business lines is \$6.50, 47 C.F.R. §§ 69.104(n)(1)(ii)(C): 69.152(d)(1)(ii)(D0, and the current SLC cap for multi-line business and Centrex lines is \$9.20, 47 C.F.R. §§ 69.104(o)(1)(i): 69.152(k)(1)(i). Price cap carriers currently also have a SLC cap of \$7.00 for non-primary residential lines, 47 C.F.R. § 69.152(e)(1)(i).

<sup>33</sup> The Commission regulates the rates for interstate access charges (paid on long distance calls that cross state lines), and states regulate the rates for intrastate access charges (paid on long distance calls within a state).

<sup>34</sup> See 47 C.F.R. §§ 69.301–502; see also *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6787, para. 1 (1990) (*LEC Price Cap Order*). The rate-of-return regulations are set forth in Part 69 of our rules. See generally 47 C.F.R. §§ 69.1–701.

<sup>35</sup> See, e.g., *Digital Crossroads* 10–15.

<sup>36</sup> 47 U.S.C. §§ 151, 152(a), 154(i).

<sup>37</sup> See, e.g., 47 C.F.R. Part 36. In the 1980's, the Commission adopted a rule allocating a fixed amount—25%—of loop cost to the interstate jurisdiction. See 47 C.F.R. § 36.154(c).

price caps, that was designed to replicate some of the efficiency incentives found in competitive markets.<sup>38</sup>

50. *Telecommunications Act of 1996-Today.* In the Telecommunications Act of 1996, Congress enacted section 254, which provides that consumers in all regions of the nation, including rural, insular, and high-cost areas, should have access to telecommunications and information services at rates that are “reasonably comparable” to those services and charges provided in urban areas.<sup>39</sup> This codified the Commission’s long-standing universal service policy and led to changes in the high-cost fund that existed at the time. In particular, section 254(b) directs, among other things, that there should be “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service,” and access to advanced telecommunications and information services should be provided in all regions of the nation.<sup>40</sup>

51. The Commission initially implemented the provisions of section 254 in 1997, and preserved the universal service programs that pre-dated the 1996 Act, while concluding that the level of universal service support should be determined based on forward-looking economic costs. The Commission subsequently developed a forward-looking cost model to determine support amounts for the provision of voice service by the largest incumbent telephone companies, primarily the Bell Operating Companies. These carriers continue to receive support determined by this model today.

52. Smaller incumbent carriers operating under rate-of-return regulation at the federal level continued to receive universal service support based on their historical costs, rather than the forward-looking cost model. In 2001, the Commission adopted a five-year plan to maintain the existing high-cost loop support program, with some modifications, for the more than 1,000 smaller carriers that operate in rural areas.<sup>41</sup> In that order, the Commission also adopted what has become known as the “no barriers to advanced services” policy, which permits rate-of-return carriers to upgrade their facilities to modern networks, and continue to receive support based on their historical investment (actual or an average derived from other small companies).<sup>42</sup> This no-barriers policy, coupled with the decision to retain support based on historical costs, has allowed smaller companies to largely finance network upgrades to provide high speed Internet access and, increasingly, video services, in many communities.

53. With respect to intercarrier compensation, the 1996 Act did not displace the existing access charge system,<sup>43</sup> but did introduce another mechanism, known as “reciprocal compensation,” through which local carriers compensate each other for the exchange of traffic. In particular, section 251(b)(5) of the 1996 Act imposed on all LECs a “duty to establish reciprocal compensation

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<sup>38</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20, paras. 257-79 (1990).

<sup>39</sup> 47 U.S.C. § 254(b)(3).

<sup>40</sup> 47 U.S.C. § 251(b)(5).

<sup>41</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, 16 FCC Rcd 11244 (2001) (*Rural Task Force Order*). Although the Commission originally intended that the rules adopted in the *Rural Task Force Order* would remain in place for five years, in 2006 the Commission extended those rules until such time that it “adopts new high-cost support rules for rural carriers.” *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *High-Cost Universal Service Support*, WC Docket No. 05-337, Order, 21 FCC Rcd 5514, 5515, para. 2 (2006).

<sup>42</sup> *Rural Task Force Order*, 16 FCC Rcd at 11322, para. 199 (“[O]ur universal service policies should not inadvertently create barriers to the provision of access to advanced services.”).

<sup>43</sup> 47 U.S.C. § 251(g).

arrangements for the transport and termination of telecommunications.”<sup>44</sup> For example, reciprocal compensation would apply to calls that begin and end within the same local calling area, such as when a customer of one local telephone company makes a call to a customer of a different local telephone company in the same calling area. As a result, a provider delivering a call to a local carrier pays a different per-minute rate based on whether the call originated across state lines (interstate access, regulated by the Commission), within the state (intrastate access, governed by state law and typically higher than interstate rates), or within the local calling area (reciprocal compensation, rates which are either negotiated by the parties, or set by states using a Commission methodology).

54. Since 1996, the Commission has made incremental efforts to modify the intercarrier compensation regime to reflect technological and marketplace changes in the telecommunications network, but the last intercarrier compensation reform occurred a decade ago in the 2000 *CALLS Order* and 2001 *MAG Order*, when the Commission reduced certain interstate access charges for the larger, price cap carriers and rate-of-return carriers respectively. Both orders permitted local carriers to offset the interstate access rate reductions through an increase in SLCs and also created two new offsetting funding vehicles within the universal service fund: Interstate Access Support for price cap carriers,<sup>45</sup> and Interstate Common Line Support for rate-of-return carriers.<sup>46</sup> Although the high-cost program increased in size as a result of the creation of these programs, consumers also typically saw reductions in their long distance phone bills during this time period.<sup>47</sup> Similarly, a handful of states have taken steps to reduce intrastate access rates and realign local residential rates with costs,<sup>48</sup> but the majority of states have not comprehensively reformed intrastate access charges, and continue to maintain intrastate access charges

<sup>44</sup> 47 U.S.C. § 251(b)(5).

<sup>45</sup> See *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long-Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962, 13046–49, paras. 201–05 (2000) (*CALLS Order*) (establishing a “\$650 million interstate access universal service support mechanism”), *aff’d in part, rev’d in part, and remanded in part, Texas Office of Public Util. Counsel et al. v. FCC*, 265 F.3d 313 (5th Cir. 2001) (subsequent history omitted) (*TOPUC*). The price cap companies included the Bell Operating Companies, as well as some of the operating companies of the mid-size incumbent telephone companies.

<sup>46</sup> *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Federal-State Joint Board on Universal Service, Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket Nos. 96-45, 98-77, 98-166, 00-256, Second Report and Order and Further Notice of Proposed Rulemaking Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613, at 19617, para. 3 (2001) (*MAG Order*). The rate-of-return carriers included many smaller companies and cooperatives that typically have fewer than 10,000 access lines in a study area.

<sup>47</sup> See Industry Analysis and Technology Division, Wireline Competition Bureau, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, at Chart 2 (Consumer Price Indices for Toll Service Since 1984) (2008) (2008 Reference Book of Rates).

<sup>48</sup> See, e.g., *BA-WV’s Intrastate Access Charges*, Case No. 00-0318-T-GI, Commission Order, 2001 WL 935643 (West Virginia PSC June 1, 2001) (ordering that “the traffic-sensitive intrastate access charges of Verizon-WV shall be modified to mirror the interstate rate structure and rate elements”); *Tariff Filing of BellSouth Telecommunications, Inc to Mirror Interstate Rates*, Case No. 98-065, Order (Kentucky PSC Mar. 31, 1999) (requiring BellSouth “to eliminate the state-specific Non-Traffic Sensitive Revenue Requirement . . . , thus moving its aggregate intrastate switched access rate to the FCC’s ‘CALLS’ interstate rate”); *Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Order, 2007 WL 3023991 (Ohio PUC Oct. 17, 2007) (“[T]his Commission requires ILECs to mirror their interstate switched access rate on the intrastate side . . .”). See also Letter from Brian J. Benison, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket No. 05-337; GN Docket No. 09-51, Attachs. 1 & 2 (filed Oct. 25, 2010) (AT&T Oct. 25, 2010 *Ex Parte* Letter) (describing access reforms in various states).

that far exceed interstate charges, with some intrastate access charges in excess of 13 cents per minute.<sup>49</sup> These high intrastate intercarrier rates have enabled local residential rates to remain artificially low in some areas, such as \$8 or less.<sup>50</sup>

#### IV. LEGAL AUTHORITY TO SUPPORT BROADBAND

55. In this section, we propose to adopt a new principle for universal service policies, recently recommended by the Federal-State Joint Board on Universal Service (Joint Board), “that universal service support should be directed where possible to networks that provide advanced services, as well as voice services.”<sup>51</sup> We then discuss a threshold legal issue: the Commission’s authority to provide universal service support for broadband under both the current high-cost program and the CAF. We believe we have the necessary authority, and we seek comment on this analysis.

56. Section 254 of the Act governs administration of universal service programs. Section 254(b) requires the Commission to “base policies for the preservation and advancement of universal service” on six enumerated principles.<sup>52</sup> Two key principles provide that “[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation,”<sup>53</sup> and that “[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high-cost areas, should have access to telecommunications and information services, including . . . advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas.”<sup>54</sup> In section 706 of the Telecommunications Act of 1996,<sup>55</sup> Congress likewise directed the Commission to “encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans.”<sup>56</sup> Section 254(b) further provides that “[q]uality services should be available at just, reasonable, and affordable rates,”<sup>57</sup> and that universal service

<sup>49</sup> See, e.g., Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 80-286, Attach. (filed Dec. 29, 2010) (NECA Dec. 29, 2010 *Ex Parte* Letter);

<sup>50</sup> See, e.g., AT&T Oct. 25, 2010 *Ex Parte* Letter, Attach. 3 (showing the range of incumbent LEC residential local rates); Comments of The Oregon Telecommunications Association and The Washington Independent Telecommunications Association, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51 (filed July 12, 2010), Table 5 (showing local rates for independent telephone companies in the states of Washington and Oregon that are both above and below the nationwide average local rate of \$15.62).

<sup>51</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, Recommended Decision, 25 FCC Rcd 15598, 15625, para. 75 (Joint Board 2010) (*Joint Board 2010 Recommended Decision*).

<sup>52</sup> 47 U.S.C. § 254(b)(1)-(6).

<sup>53</sup> *Id.* § 254(b)(2).

<sup>54</sup> *Id.* § 254(b)(3).

<sup>55</sup> Pub. L. No. 104-104, 110 Stat. 56, § 706, *codified at* 47 U.S.C. § 1302.

<sup>56</sup> 47 U.S.C. § 1302(a). Section 706 defines “advanced telecommunications capability” as “high-speed, switched, broadband telecommunications capability.” *Id.* § 1302(d)(1); see also *National Broadband Plan for our Future*, Notice of Inquiry, 24 FCC Rcd 4342, 4309, App. para. 13 (2009) (“advanced telecommunications capability” includes broadband Internet access); *Inquiry Concerning the Deployment of Advanced Telecomms. Capability to All Americans in a Reasonable and Timely Fashion*, CC Docket No. 98-146, Report, 14 FCC Rcd 2398, 2400, para. 1 (1999) (Section 706 addresses “the deployment of broadband capability”), 2406, para. 20 (same). Although the Communications Act does not define “advanced telecommunications and information services,” the Commission has observed that the phrase is similar to the term “advanced telecommunications capability” in Section 706. See *Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111, 11113 n.9 (2006).

<sup>57</sup> 47 U.S.C. § 254(b)(1).

mechanisms “should be specific [and] predictable.”<sup>58</sup> Section 254(b) is not merely aspirational—it directs that universal service “shall” be based on these principles. “This language indicates a mandatory duty on the FCC,”<sup>59</sup> and reflects “congressional intent to delegate difficult policy choices to the Commission’s discretion.”<sup>60</sup> We may balance these principles to achieve statutory objectives, but may not depart from them altogether to achieve some other goal.<sup>61</sup>

57. Section 254(c) defines “universal service” as “an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services.”<sup>62</sup> The Joint Board may “recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms,”<sup>63</sup> and has recommended that broadband “should be eligible for support under Section 254.”<sup>64</sup> Section 254(e) provides that “only an eligible telecommunications carrier designated under section 214(e) of this title shall be eligible to receive specific Federal universal service support,”<sup>65</sup> and also states that universal service support “should be explicit and sufficient.”<sup>66</sup> Section 254 provides no particular methodology for determining the amount of universal service support or for distributing support.

#### A. Additional Section 254(b) Principle

58. In November 2010, the Joint Board recommended adoption of a principle “that universal service support should be directed where possible to networks that provide advanced services, as well as voice services.”<sup>67</sup> The Joint Board found that “[s]uch a principle is consistent with section 254(b)(3) of the Communications Act” and would serve the public interest.

59. We believe this principle strikes a reasonable balance between the goal of preserving and advancing universal service as currently supported and the goal of increasing access to advanced telecommunications and information services, and that it provides a beneficial clarification of federal universal service objectives. We propose to adopt this principle pursuant to section 254(b)(7), and seek comment on that proposal. If we adopt the proposed principle, how should we apply it with respect to the other criteria in section 254?

<sup>58</sup> *Id.* § 254(b)(5).

<sup>59</sup> *Qwest Corp. v. FCC*, 258 F.3d 1191, 1200 (10<sup>th</sup> Cir. 2001) (*Qwest I*).

<sup>60</sup> *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 615 (5<sup>th</sup> Cir. 2000) (*Alenco*).

<sup>61</sup> *Rural Cellular Ass’n v. FCC*, 588 F.3d 1095, 1102-03 (D.C. Cir. 2009) (*Rural Cellular*); *Qwest I*, 258 F.3d at 1199-1200.

<sup>62</sup> 47 U.S.C. § 254(c)(1).

<sup>63</sup> *Id.* § 254(c)(2).

<sup>64</sup> *High-Cost Universal Service*, WC Docket No. 05-337, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477, 20492, para. 62 (Joint Board 2007) (*Joint Board 2007 Recommended Decision*).

<sup>65</sup> 47 U.S.C. § 254(e); *see also id.* § 214(e)(1) (“a common carrier designated as an eligible telecommunications carrier . . . shall be eligible to receive universal service support in accordance with section 254”). Section 214(e) governs designation of ETCs. *Id.* § 214(e)(2)-(3), (6).

<sup>66</sup> *Id.* § 254(e).

<sup>67</sup> *Joint Board 2010 Recommended Decision*, 25 FCC Rcd at 15625, para. 75.

## B. Commission Authority to Support Broadband

60. We have express statutory authority to extend universal service support to broadband services that providers offer as telecommunications services.<sup>68</sup> For the reasons set forth below, we believe we also have authority to extend universal service support to broadband services offered as information services under section 254, section 706 and/or our ancillary authority.<sup>69</sup> In any event, we believe we have clear authority to condition awards of universal service support on a recipient's commitment to offer broadband service. We seek comment on these issues, as well as any other approaches that would buttress our legal authority, including use of our section 10 forbearance authority.

### 1. Section 254

61. Some have suggested that section 254 is ambiguous regarding the Commission's authority to support broadband service, but that read as a whole, it may reasonably be interpreted to authorize such support.<sup>70</sup> Section 254(b) requires the Commission to promote access to "advanced telecommunications and *information services*," which requires supporting broadband networks.<sup>71</sup> Although section 254(c)(1) defines "universal service" as "an evolving level of *telecommunications services*," Congress expressly contemplated that the definition will evolve over time based on "advances in telecommunications and information technologies and services."<sup>72</sup> Section 254(c)(2), which authorizes the Joint Board to "recommend to the Commission modifications in the definition of the *services* that are supported,"<sup>73</sup> does not explicitly limit the Joint Board to telecommunications services. The Joint Board in 2007 recommended that broadband be eligible for support, and in 2010 recommended that we adopt a new principle that universal service support be "directed where possible to networks that provide advanced services as well as voice services."<sup>74</sup>

<sup>68</sup> *Id.* § 254(c) (defining universal service as an evolving level of telecommunications services); *see also Wireline Broadband Order*, 20 FCC Rcd at 14899-903, paras. 86-95. More than 800 incumbent local telephone companies offer broadband transmission as a telecommunications service. *See* Comments of Organization for the Promotion and Advancement of Small Telecommunications Companies, GN Docket No. 09-51, at 30-31 (June 8, 2009).

<sup>69</sup> *See Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT Docket No. 07-53, Declaratory Ruling, 22 FCC Rcd 5901 (2007); *Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, CC Docket Nos. 02-33, 01-337, 95-20, 98-10, WC Docket Nos. 04-242, 05-271, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) (*Wireline Broadband Order*), *aff'd sub nom. Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007); *Inquiry Concerning High-Speed Access to the Internet Over Cable & Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798 (2002), *aff'd sub nom. Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 978 (2005). An "information service" is "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service." 47 U.S.C. § 153(24).

<sup>70</sup> *See* Letter from Gary L. Phillips, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket Nos. 09-51, 09-47, 09-137, WC Docket Nos. 05-337, 03-109, attachment at 1-5 (Jan. 29, 2010) (*AT&T USF White Paper*); Letter from Gary L. Phillips, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket Nos. 09-51, 09-137, WC Docket Nos. 05-337, 03-109, at 3 (April 12, 2010) (*AT&T USF/Comcast Letter*).

<sup>71</sup> *AT&T USF White Paper* at 3.

<sup>72</sup> *Id.*; 47 U.S.C. § 254(c)(1) (emphasis added).

<sup>73</sup> *Id.* § 254(c)(2) (emphasis added).

<sup>74</sup> *Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20492, para. 62; *Joint Board 2010 Recommended Decision*, 25 FCC Rcd at 15625, para. 75; *AT&T USF White Paper* at 3-4; *see also supra* note 64 and accompanying text.

62. We seek comment on this analysis. Could we provide support to information service providers consistent with section 254(e), which states that “only an eligible telecommunications carrier designated under section 214(e) shall be eligible to receive specific Federal universal service support,”<sup>75</sup> and 214(e), which sets forth the framework for designating “telecommunications carrier[s] . . . eligible to receive universal service support”?<sup>76</sup> If not, under what mechanism could we designate and offer support to information service providers? What role would the states play in designating eligible information service providers? Would disbursement of support to information service providers comport with federal appropriations laws?<sup>77</sup> We seek comment on these and other pertinent issues.

63. In the event we interpret section 254 to authorize support of broadband, we also seek comment on adding broadband to the supported services list. Before modifying the list of supported services, the Commission must “consider the extent to which such telecommunications services—(1) are essential to education, public health, or public safety; (2) have, through the operation of market choices by customers, been subscribed to by a substantial majority of residential customers; (3) are being deployed in public telecommunications networks by telecommunications carriers; and (4) are consistent with the public interest, convenience, and necessity.”<sup>78</sup>

64. In 2007, the Joint Board also recommended that the Commission revise the definition of supported services to include mobility.<sup>79</sup> The Joint Board concluded that both broadband and mobility satisfied the four part criteria and should be eligible for federal universal service support.<sup>80</sup> We note that the Joint Board also recommended that the Commission create separate designations for voice, broadband, and mobility.<sup>81</sup> In 2008, the Commission declined to act on the Joint Board’s recommendation.<sup>82</sup>

65. The Commission currently requires ETCs to provide all of the supported services. If we were to add broadband and/or mobility to the list of supported services, should we create separate designations for each supported service (voice, broadband, and mobility) so that a provider does not need to offer all of the supported services to be eligible for support, as the Joint Board recommended in 2007?

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<sup>75</sup> 47 U.S.C. § 254(e).

<sup>76</sup> *Id.* § 214(e).

<sup>77</sup> *See, e.g.*, U.S. CONST. art. I, § 9, cl. 7 (“[n]o money shall be drawn from the Treasury, but in consequence of Appropriations made by law”); 31 U.S.C. § 1301 (“[a]ppropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law”); 31 U.S.C. § 1341(a)(1) (prohibiting an officer or employee of the federal government from making or authorizing “an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation,” or involving the government in an “obligation for the payment of money before an appropriation is made unless authorized by law”); 31 U.S.C. § 3302(b) (“an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim”).

<sup>78</sup> *Id.*

<sup>79</sup> *See Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20491-94, paras. 55-68

<sup>80</sup> *See id.*

<sup>81</sup> *See Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20494, para. 69.

<sup>82</sup> *See High-Cost Universal Service Support*, WC Docket No. 05-337, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, *Universal Service Contribution Methodology*, WC Docket No. 06-122, *Numbering Resource Optimization*, CC Docket No. 99-200, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, *IP-Enabled Services*, WC Docket No. 04-36, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6475, 6495, para. 37 (2008) (2008 Order and ICC/USF FNPRM), *aff’d Core Communications, Inc. v. FCC*, 592 F.3d 139 (D.C. Cir. 2010); *cert denied*, 131 S. Ct. 597, 626 (2010).

We seek comment on this proposal.<sup>83</sup> We also ask what would be the impact of such an approach on Lifeline providers, who today also are required to offer all supported services.<sup>84</sup>

## 2. Section 706

66. As noted, section 706(a) of the 1996 Act directs the Commission “to encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . by utilizing . . . methods that remove barriers to infrastructure investment.”<sup>85</sup> Section 706(b) directs the Commission to undertake annual inquiries concerning the availability of advanced telecommunications capability to all Americans and requires that, if the Commission finds that such capability is not being deployed in a reasonable and timely fashion, it “*shall take immediate action* to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market.”<sup>86</sup> In July 2010, a majority of the Commission concluded that “broadband deployment to *all* Americans is not reasonable and timely” and noted that “[a]s a consequence of that conclusion” section 706(b) was triggered.<sup>87</sup>

67. We seek comment on whether sections 706(a) and (b), alone or in concert with sections 254 and 214(e), grant us authority to provide universal service support for broadband information services. The D.C. Circuit has concluded that “[t]he general and generous phrasing of § 706 means that the FCC possesses significant, albeit not unfettered, authority and discretion to settle on the best regulatory or deregulatory approach to broadband.”<sup>88</sup> We believe that providing universal service support for broadband would “remove barriers to infrastructure investment” by supplying financial incentives to invest in areas where it may otherwise be uneconomic to do so. We seek comment on this issue. Would providing support for broadband information services under section 706 be inconsistent with the definition of universal service in section 254(c) or the limitation of support to ETCs in section 254(e)? If we act pursuant to section 706 alone, would we have authority to collect universal service contributions and disburse them to eligible recipients under the current universal service mechanisms, or should we develop a separate mechanism under our section 706 authority? Would the collection and disbursement of funds comport with federal appropriations laws?<sup>89</sup> What criteria should we use to determine who is eligible to receive support? What role should states play? We seek comment on these and other relevant issues.

## 3. Title I Ancillary Authority

68. Section 1 of the Communications Act states that Congress created the Commission “[f]or the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to

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<sup>83</sup> We note that, as discussed in the *Mobility Fund NPRM*, we have proposed to provide support for the expansion of advanced mobile wireless networks capable of providing broadband without adding broadband and/or mobility to the list of support services.

<sup>84</sup> The Lifeline and Link Up programs reimburse telephone companies for discounts provided to eligible low-income customers on initial service installation (Link Up) and their monthly bill for local telephone service (Lifeline). Together, the Lifeline and Link Up programs help consumers who might not otherwise be able to afford phone service. We will address reform of the Lifeline and Link Up programs in a separate proceeding.

<sup>85</sup> 47 U.S.C. § 1302(a). See also *Preserving the Open Internet*, GN Docket No. 09-191, *Broadband Industry Practices*, WC Docket No. 07-52, Report and Order, FCC 10-201, at para. 119 (rel. Dec. 23, 2010) (*Preserving the Open Internet Order*).

<sup>86</sup> 47 U.S.C. § 1302(b) (emphasis added).

<sup>87</sup> *Sixth Broadband Deployment Report*, 25 FCC Rcd at 9558, paras. 2-3.

<sup>88</sup> *Ad Hoc Telecom. Users Comm. v. FCC*, 572 F.3d 903, 906-07 (D.C. Cir. 2009).

<sup>89</sup> See *supra* note 77 (discussing federal appropriations law).

make available, so far as possible, to all the people of the United States, . . . Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.”<sup>90</sup> Section 2 grants the Commission jurisdiction over “all interstate and foreign communication by wire or radio,”<sup>91</sup> and section 4(i) authorizes the Commission to “perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions.”<sup>92</sup> When the Commission created the high-cost universal service program in 1984,<sup>93</sup> it relied upon these provisions in Title I, and its decision was affirmed by the D.C. Circuit.<sup>94</sup> More recently, however, in *Comcast Corp. v. FCC*, the D.C. Circuit concluded that its prior decision rested not on Title I alone, but *sub silentio* “on the fact that creation of the [pre-1996 Act] Universal Service Fund was ancillary to the Commission’s Title II responsibility to set reasonable interstate rates.”<sup>95</sup>

69. We seek comment on whether the Commission could rely on its ancillary authority to support broadband information services. Would providing support for broadband be reasonably ancillary to the Commission’s statutory responsibilities under section 254(b), which imposes “a mandatory duty on the FCC”<sup>96</sup> to base universal service policies on promotion of access to advanced telecommunications and information services throughout the nation?<sup>97</sup> Similarly, would supporting broadband be reasonably ancillary to section 706 as a “specific delegation of legislative authority”<sup>98</sup> to encourage deployment of advanced telecommunications capability to all Americans?<sup>99</sup> We seek comment on whether these provisions or others provide a sufficient statutory basis for exercising ancillary authority. As with other theories described above, we also seek comment on what criteria should be used to designate eligible recipients, and on who should perform the designations. We also seek comment on whether adopting the competitive bidding process in the first phase of the CAF and permanent CAF programs pursuant to our ancillary authority would be consistent with federal appropriations laws.<sup>100</sup> We invite comment on these and any other relevant issues.

#### 4. Conditional Support

70. We believe the Commission also has authority to direct high-cost or CAF support toward broadband-capable networks by conditioning awards of universal service support on a recipient’s commitment to offer broadband service alongside supported voice services. Under the “no barriers” policy, the Commission has long authorized rural carriers receiving high-cost loop support “to invest in infrastructure capable of providing access to advanced services” as well as supported voice services.<sup>101</sup> “[R]ecogniz[ing] that the network is an integrated facility that may be used to provide both supported and

<sup>90</sup> 47 U.S.C. § 151.

<sup>91</sup> *Id.* § 152(a).

<sup>92</sup> *Id.* § 154(i).

<sup>93</sup> *Amendment of Part 67 of the Commission’s Rules and Establishment of a Joint Board, Decision and Order*, CC Docket No. 80-286, Decision and Order, 96 FCC 2d 781, 795 (1984).

<sup>94</sup> *Rural Tel. Coalition v. FCC*, 838 F.2d 1307, 1315 (D.C. Cir. 1988).

<sup>95</sup> *Comcast Corp. v. FCC*, 600 F.3d 642, 656 (D.C. Cir. 2010).

<sup>96</sup> *Qwest I*, 258 F.3d at 1200.

<sup>97</sup> 47 U.S.C. § 254(b)(2), (3). *See also AT&T USF White Paper* at 5-13; *AT&T USF/Comcast Letter* at 1-3.

<sup>98</sup> *Preserving the Open Internet Order*, FCC 10-201, at para. 122.

<sup>99</sup> 47 U.S.C. § 706(a), (b).

<sup>100</sup> *See supra* note 77 (discussing federal appropriations law).

<sup>101</sup> *Rural Task Force Order*, 16 FCC Rcd at 11322, para. 200 (2001).

non-supported services,” we have concluded that the no barriers policy furthers “the Congressional goal of ensuring access to advanced telecommunications and information services throughout the nation.”<sup>102</sup>

71. We believe requiring carriers receiving high-cost or CAF support to invest in modern broadband-capable networks would be a logical extension of this policy. Nothing in section 254 prohibits the Commission from conditioning the receipt of support, and the Commission has imposed conditions in the past.<sup>103</sup> Similarly, both the states and the Commission may impose eligibility conditions as part of the ETC designation process under section 214(e).<sup>104</sup> Today, we require telecommunications carriers seeking ETC designation from the Commission to demonstrate not only compliance with the requirements of section 214(e)(1), but also, among other things, that they have the ability to remain functional in emergency situations and that they will satisfy consumer protection and service quality standards.<sup>105</sup> Requiring recipients of support to offer broadband service would be fully consistent with and promote Congress’s overall objectives as stated in sections 254(b) and 706.<sup>106</sup> We see no reason why conditioning the receipt of support on offering broadband is not permissible under the Commission’s general authority to promulgate general rules related to universal service. We invite comment on this approach.

## 5. Other Approaches

72. *Forbearance.* Section 10 of the Communications Act provides that the Commission “shall forbear from applying any regulation or provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services,” if enforcement of the provision is not necessary to protect consumers or to ensure that telecommunications carriers’ charges and practices are just and reasonable, and forbearance is in the public interest.<sup>107</sup> We seek comment on whether we should exercise our forbearance authority, alone or in combination with any of the theories described above, to facilitate use of funding to support broadband information services. For example, could we forbear from applying section 254(c)(1), which defines universal service as an evolving level of telecommunications services? Could we likewise forbear from applying sections 254(e) and 214(e), which restrict universal service support to ETCs? Are the statutory criteria for forbearance from these provisions met? Are there any other provisions from which we should forbear? If we grant forbearance, may we adopt rules that are broader than the statutory provisions? We seek comment on these issues.

<sup>102</sup> *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order and Order on Reconsideration, 18 FCC Rcd 15090, 15095-15096, para. 13 (2003).

<sup>103</sup> For example, the Commission requires ETCs to certify that universal service support will be used only for the facilities and services for which the support is intended as a condition of receiving support. 47 C.F.R. §§ 54.313(a)-(b), 54.314(a)-(b) (federal high-cost support “shall only be provided to the extent” the requisite certification is provided). Also, the Commission previously considered imposing service quality and technical conditions on the receipt of high cost support, but concluded that the conditions were not warranted at that time. See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8831, para. 98 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

<sup>104</sup> See *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 417-18 (5th Cir. 1999) (*TOPUC*) (states may impose additional eligibility requirements on a carrier seeking support); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-46, Report and Order, 20 FCC Rcd 6371 (2005) (*ETC Designation Report and Order*); see also *Federal-State Joint Board on Universal Service, Virginia Cellular LLC*, CC Docket No. 96-45, Memorandum Opinion and Order, 19 FCC Rcd 1563, 1584 n.141 (2004) (“nothing in section 214(e)(6) prohibits the Commission from imposing additional conditions on ETCs when such designations fall under our jurisdiction”).

<sup>105</sup> *ETC Designation Report and Order*, 20 FCC Rcd at 6372, para. 2

<sup>106</sup> 47 U.S.C. §§ 254(b)(2)-(3), 1302(a).

<sup>107</sup> 47 U.S.C. § 160(a). In making its public interest determination, the Commission must also consider whether forbearance from enforcing a provision will promote competitive market conditions. *Id.* § 160(b).

73. *Classifying Interconnected VoIP.* We also invite comment on whether we should consider classifying interconnected voice over Internet protocol as a telecommunications service or an information service. If the Commission were to classify interconnected VoIP as a telecommunications service, this would enable the Commission to support networks used to provide interconnected VoIP, including broadband networks. To date, the Commission has not classified interconnected VoIP service as either an information service or a telecommunications service. The Commission has, however, extended certain obligations to providers of such service, including local number portability,<sup>108</sup> 911 emergency calling capability,<sup>109</sup> universal service contribution,<sup>110</sup> CPNI protection,<sup>111</sup> disability access and TRS contribution requirements,<sup>112</sup> and section 214 discontinuance obligations.<sup>113</sup> We seek comment on this issue. Does interconnected VoIP have characteristics that warrant classifying it as a telecommunications service or an information service?<sup>114</sup> If the Commission classified interconnected VoIP as a telecommunications service, should we forbear from applying any provisions in Title II to the service? We request comment.

74. We invite parties to comment on these and any other legal theories that they believe will provide a sound legal basis for providing universal service support for broadband.

## V. SETTING AMERICA ON A PATH OF REFORM

75. As a critical first step for reform, we propose strategic priorities for the program. In light of changes in technology and the marketplace, we also propose to re-examine the requirements for eligible telecommunications carriers and to update and modernize the public interest obligations of fund recipients.

<sup>108</sup> *Telephone Number Requirements for IP-Enabled Service Providers*, WC Docket Nos. 07-243 & 244, Report and Order, Declaratory Ruling, Order on Remand, and NPRM, 22 FCC Rcd 19531 (2007).

<sup>109</sup> *IP-Enabled Services*, WC Docket Nos. 04-36 & 05-196, First Report and Order and NPRM, 20 FCC Rcd 10245 (2005), *aff'd sub nom. Nuvio Corp. v. FCC*, 473 F.3d 302 (D.C. Cir. 2007).

<sup>110</sup> *Universal Service Contribution Methodology*, WC Docket No. 06-122, Report and Order and NPRM, 21 FCC Rcd 7518 (2006), *pet. for review granted in part and denied in part sub nom. Vonage Holdings Corp. v. FCC*, 489 F.3d 1232 (D.C. Cir. 2007).

<sup>111</sup> *Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information*, CC Docket No. 96-115, WC Docket No. 04-36, Report and Order and FNPRM, 22 FCC Rcd 6927 (2007), *aff'd sub nom. Nat'l Cable & Telecomms. Ass'n v. FCC*, 555 F.3d 996 (D.C. Cir. 2009).

<sup>112</sup> *IP-Enabled Services, Implementation of Sections 255 and 251(a)(2) of the Communications Act of 1934, as enacted by the Telecommunications Act of 1996*, WC Docket No. 04-36, Report and Order, 22 FCC Rcd 11275 (2007).

<sup>113</sup> *IP-Enabled Services*, WC Docket No. 04-36, Report and Order, 24 FCC Rcd 6039 (2009).

<sup>114</sup> See, e.g., NARUC 2008 ICC/USF FNPRM Comments at 13-16 (arguing for a "telecommunications service" classification); NECA 2008 ICC/USF FNPRM Comments at 29-37 (same); CTIA 2008 ICC/USF FNPRM Comments at 23-24 (arguing for an "information service" classification); Global Crossing 2008 ICC/USF FNPRM Comments at 6-8 (same); USTelecom 2008 ICC/USF FNPRM Comments at 8 (same). See also *IP Enabled Services*, WC Docket No. 04-36, Notice of Proposed Rulemaking, 19 FCC Rcd 4863, 4886, para. 35 (2004) (seeking comment on what regulatory scheme the Commission should apply to IP-enabled services). A "telecommunications service" is "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(53). An "information service" is "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service." *Id.* § 153(24).

### A. National Goals and Priorities for Universal Service

76. As we embark on a path to modernize USF, we seek comment on national goals and priorities for the high-cost program, consistent with our key statutory obligations and recommendations of the Joint Board.

77. We are guided in the first instance by the Act. As described in the legal authority discussion above, section 254(b) of the Act sets forth principles that the Commission must follow in creating policies to preserve and advance universal service. The principles that are directly relevant to the operation and size of the high-cost program are found in section 254(b)(1)-(3) and (b)(5).<sup>115</sup> Section 254(b)(1) specifies that services “be available at just, reasonable, and affordable rates.”<sup>116</sup> Section 254(b)(2) specifies that “[a]ccess to advanced telecommunications services and information services should be provided in all regions of the Nation.” Section 254(b)(3) specifies that “[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, that are reasonably comparable to those services provided in urban areas” and “at rates that are reasonably comparable to rates charged for similar services in urban areas.”<sup>117</sup> And section 254(b)(5) specifies that federal and state mechanisms “should be specific, predictable and sufficient . . . to preserve and advance universal service.”<sup>118</sup>

78. We recognize that service providers commonly pass through universal service contribution costs to their customers, and that providing support for broadband may therefore implicate the principle in section 254(b)(1) that services should be affordable.<sup>119</sup> We note that federal courts have held that the Commission has broad discretion in balancing the principles in section 254(b),<sup>120</sup> and have specifically upheld prior Commission decisions adopting cost control mechanisms.<sup>121</sup> We propose below various cost control mechanisms that are designed to minimize the burden on consumers. We seek comment on whether our proposals strike the right balance between the imperatives to promote access to broadband services in all areas and to maintain affordable rates for services.

<sup>115</sup> As we discussed in the *Qwest II Remand Order*, the Commission has never “attempt[ed] to fully address each universal service principle in section 254(b) through each support mechanism. Nor is there any indication that Congress intended each principle to be fully addressed by each separate support mechanism. The Commission believes that any determination about whether the Commission has adequately implemented section 254 must look at the cumulative effect of the four support programs, acting together.” *High-Cost Universal Service Support Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, *Joint Petition of the Wyoming Public Service Commission and the Wyoming Office of Consumer Advocate for Supplemental Federal Universal Service Funds for Customers of Wyoming’s Non-Rural Incumbent Local Exchange Carrier*, CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072, 4086, para. 26 (2010) (*Qwest II Remand Order*).

<sup>116</sup> 47 U.S.C. § 254(b)(1).

<sup>117</sup> 47 U.S.C. § 254(b)(3).

<sup>118</sup> 47 U.S.C. § 254(b)(5).

<sup>119</sup> See *Qwest Communications Int’l Inc. v. FCC*, 398 F.3d 1222, 1234 (10<sup>th</sup> Cir. 2005) (*Qwest II*) (“excessive subsidization arguably may affect the affordability of telecommunications services”); *Alenco*, 201 F.3d at 620 (“excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market”).

<sup>120</sup> See *Rural Cellular*, 588 F.3d at 1103 (“The Commission enjoys broad discretion when conducting exactly this type of balancing.”); *TOPUC*, 183 F.3d at 434 (noting the Commission’s “considerable amount of discretion” in balancing “the competing concerns set forth in § 254(b)”).

<sup>121</sup> See *Rural Cellular*, 588 F.3d at 1108; *Alenco*, 201 F.3d at 620-21.

79. As noted above, the Joint Board has proposed that USF support broadband and mobile services.<sup>122</sup> In 2007, the Joint Board recommended that the Commission add broadband and mobility to the list of services supported by federal universal service, and recommended that the Commission create both a broadband fund and a mobility fund. At that time and more recently, however, the Joint Board also has expressed concern about the size of the Fund.<sup>123</sup> Other commenters have suggested that we cap or reduce the size of the Fund.<sup>124</sup>

80. Consistent with the statute and the Joint Board recommendations, we propose four specific priorities for the federal universal service high-cost program. *First*, the program must preserve and advance voice service. Even as we refocus USF to support broadband, we are committed to ensuring that Americans have access to voice service, while recognizing that over time, such voice service could be provided over broadband networks, both fixed and mobile. *Second*, we seek to ensure universal deployment of modern networks capable of supporting necessary broadband applications as well as voice service. This priority is directly tied to high-level goals for universal service reform—to ensure that all Americans in all parts of the nation, including those in rural, insular, and high-cost areas, have access to modern communications networks capable of supporting the necessary applications that empower them to learn, work, prosper and innovate. These modern networks could employ both fixed and mobile technologies. With respect to improving mobile coverage, we recognize the important role that mobility can play in improving everyday lives of Americans as well as contributing to our public safety, national economy and competitiveness. *Third*, the program must ensure that rates for broadband service are reasonably comparable in all regions of the nation, and rates for voice service are reasonably comparable in all regions of the nation. Availability of broadband and voice service by itself is not a sufficient goal. We must also make sure that rates are reasonably comparable so that consumers have meaningful access to these services. *Fourth*, we seek to limit the contribution burden on households. As we have recognized in the past, “if the universal service fund grows too large, it will jeopardize other statutory mandates, such as ensuring affordable rates in all parts of the country, and ensuring that contributions from carriers are fair and equitable.”<sup>125</sup>

81. We ask that commenters consider the reform proposals that follow in light of these priorities. Are there additional or alternative priorities that we should consider? Should advancing the deployment of mobile networks be its own independent priority? To the extent these four priorities, or any others the Commission may adopt, may be in tension with each other, commenters should suggest how we should prioritize them. We note that if additional funding were to be made available for

<sup>122</sup> See *Joint 2010 Board Recommended Decision*, 25 FCC Rcd at 15625, para. 75 (stating that the Joint Board believes it is appropriate for the USF to support networks that provide broadband service, in addition to voice service); *Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20482, para. 12, 20483, para. 16 (proposing funds to support broadband and mobile wireless services).

<sup>123</sup> *Joint Board 2010 Recommended Decision*, 25 FCC Rcd at 15628, at paras. 84-85; *Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20484-85, paras. 24-26 (recommending an overall cap of \$4.5 billion on high cost funding).

<sup>124</sup> See, e.g., Comments of American Cable Assoc., WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 3 (filed July 12, 2010); Comments of Comcast Corp., WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 3-4 (filed July 12, 2010); Comments of the Five MACRUC States of the Mid-Atlantic Conference of Regulatory Utility Commissioners, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 3-4 (filed July 12, 2010); Comments of National Cable & Telecommunications Assoc. (NCTA), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 7-8 (filed July 12, 2010); NBP Comments at 6; Comments of the Public Utilities Commission of Ohio (Ohio PUC), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 24 (filed July 14, 2010); Comments of Verizon and Verizon Wireless (Verizon), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 3, 10-11 (filed July 12, 2010); Comments of Vonage Holding Corp. (Vonage), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 3 (filed July 12, 2010); Comments of Windstream Communications, Inc. (Windstream), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 24 (July 12, 2010) (all supporting capping the high-cost fund).

<sup>125</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4087, para. 28.

advanced networks in rural America, that could accelerate reform and help ease potential tension among these priorities.

82. We also request comment on how we should weigh other section 254(b) principles, including the principle that universal service support should be competitively neutral,<sup>126</sup> which the Commission adopted pursuant to section 254(b)(7).<sup>127</sup> We believe our proposal to support broadband is competitively neutral because it will not unfairly advantage one provider over another or one technology over another.<sup>128</sup> We invite comment on whether our proposals are technology neutral. We also seek comment on whether our proposed reforms are consistent with the directive in section 254(b)(5) that support “should be specific, predictable, and sufficient.”<sup>129</sup>

83. We propose to periodically review whether we are making progress in addressing these goals by measuring specific outcomes, as discussed in the Performance Goals section, below.<sup>130</sup> If we are not, the Commission would consider corrective actions in future rulemakings so that we better achieve our intended purposes.

## **B. Encouraging State Action To Advance Universal Service**

84. As we undertake reform, we are mindful of the longstanding federal-state partnership for universal service. We seek comment generally on the role of the states in preserving and advancing universal service as we transition from the current programs to the Connect America Fund, and we seek comment more specifically in the sections that follow on the role of states in advancing universal service consistent with a national framework. We welcome the input of the state members of the Joint Board on these and other important questions.

85. In section 254(f), Congress expressly permitted states to take action to preserve and advance universal service, so long as not inconsistent with the Commission’s universal service rules.<sup>131</sup> Federal law recognizes that individual states and territories play an important role in accomplishing universal service goals.<sup>132</sup> Federal law charges states with the designation of carriers as ETCs,<sup>133</sup> and it authorizes states to maintain their own universal service funds.<sup>134</sup> Additionally, section 706 of the 1996 Act directs “[t]he Commission and each State commission with regulatory jurisdiction over telecommunications services” to “encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans.”<sup>135</sup> The Commission has understood section

<sup>126</sup> *Universal Service First Report and Order*, 12 FCC Rcd at 8801, para. 47.

<sup>127</sup> Section 254(b)(7) requires the Commission to base universal service on “[s]uch other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.” 47 U.S.C. § 254(b)(7).

<sup>128</sup> *See Universal Service First Report and Order*, 12 FCC Rcd at 8801, para. 47; *see also Rural Cellular*, 588 F.3d at 1104 (competitive neutrality principle “only prohibits the Commission from treating competitors differently in ‘unfair’ ways”).

<sup>129</sup> 47 U.S.C. § 254(b)(5); *see also id.* § 254 (e) (“support should be explicit and sufficient to achieve the purposes of this section”).

<sup>130</sup> *See infra* Section IX (proposing to establish performance goals and measures for USF).

<sup>131</sup> 47 U.S.C. § 254(k)

<sup>132</sup> *See* 47 U.S.C. § 1301(4) (“The Federal Government should also recognize and encourage complementary State efforts to improve the quality and usefulness of broadband data and should encourage and support the partnership of the public and private sectors in the continued growth of broadband services and information technology for the residents and businesses of the Nation.”).

<sup>133</sup> *See* 47 U.S.C. § 214(e).

<sup>134</sup> *See* 47 U.S.C. § 254(f).

<sup>135</sup> 47 U.S.C. § 1302.

706(a) to authorize the Commission and state commissions to take actions, within their subject matter jurisdiction and not inconsistent with other provisions of law, that encourage the deployment of advanced telecommunications capability by any of the means listed in the provision.<sup>136</sup> The Commission also has recognized the important role of the states.<sup>137</sup> Courts have also previously said that the Act “plainly contemplates a partnership between the federal and state governments to support universal service,”<sup>138</sup> and that “it is appropriate—even necessary—for the FCC to rely on state action.”<sup>139</sup>

86. In its 2007 Recommended Decision, the Federal-State Joint Board on Universal Service highlighted the roles and responsibilities of states. The Joint Board, among other things, recommended that “the Commission adopt policies that encourage states to provide matching funds” for a proposed Broadband Fund and Mobility Fund.<sup>140</sup> We seek comment on what level of financial commitment should be expected from the states and territories to advance broadband. How should we address states that are disproportionately rural and generally lack a sizeable population to support service in rural areas? How should we address the various efforts of states and territories to contribute to preserving and advancing universal service—both in deployment and adoption?

87. Many states have state universal service funds to support voice service,<sup>141</sup> while some states, such as California and New York, have established broadband grant programs.<sup>142</sup> More than 40

<sup>136</sup> 47 U.S.C. § 1302(a); *Deployment of Wireline Servs. Offering Advanced Telecomms. Capability et al.*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 24012, 24046, para. 74 (1998) (*Advanced Services Order*); *Preserving the Open Internet Order*, FCC 10-201, paras. 117-123. We note that our mandate under section 706(a) must be read consistently with sections 1 and 2 of the Act, which define the Commission’s subject matter jurisdiction over “interstate and foreign commerce in communication by wire and radio.” 47 U.S.C. §§ 151, 152. The Commission historically has recognized that services carrying Internet traffic are jurisdictionally mixed, but generally subject to federal regulation. *See, e.g., Nat’l Ass’n of Regulatory Util. Comm’rs Petition for Clarification or Declaratory Ruling that No FCC Order or Rule Limits State Authority to Collect Broadband Data*, Memorandum Opinion and Order, 25 FCC Rcd 5051, 5054, paras. 8–9 & n.24 (2010). Where, as here, “it is not possible to separate the interstate and intrastate aspects of the service,” the Commission may preempt state regulation where “federal regulation is necessary to further a valid federal regulatory objective, i.e., state regulation would conflict with federal regulatory policies.” *Minn. Pub. Utils. Comm’n v. FCC*, 483 F.3d 570, 578 (8th Cir. 2007); *see also La. Pub. Serv. Comm’n v. FCC*, 476 U.S. 355, 375 n.4 (1986). Except to the extent a state requirement conflicts on its face with a Commission decision herein, the Commission will evaluate preemption in light of the fact-specific nature of the relevant inquiry, on a case-by-case basis. We recognize, for example, that states play a vital role in protecting end users from fraud, enforcing fair business practices, and responding to consumer inquiries and complaints. *See, e.g., Vonage Order*, 19 FCC Rcd at 22404–05, para. 1. We have no intention of impairing states’ or local governments’ ability to carry out these duties unless we find that specific measures conflict with federal law or policy. In determining whether state or local regulations frustrate federal policies, we will, among other things, be guided by the overarching congressional policies described in section 230 of the Act and section 706 of the 1996 Act. 47 U.S.C. §§ 230, 1302.

<sup>137</sup> *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, 22568 para. 17 (2003) (“The Act makes clear that preserving and advancing universal service is a shared federal and state responsibility.”).

<sup>138</sup> *Qwest I*, 258 F.3d at 1203; *Qwest II*, 398 F.3d at 1232.

<sup>139</sup> *Qwest I*, at 1203.

<sup>140</sup> *Joint Board 2007 Recommended Decision*, 22 FCC Rcd at 20489, paras. 50-52.

<sup>141</sup> *See* Peter Bluhm, et al., *State High Cost Funds: Purposes, Design, and Evaluation* (Nat’l Regulatory Res. Inst. (NRRRI), Working Paper No. 10-04 (2010), available at [http://www.nrrri.org/pubs/telecommunications/NRRRI\\_state\\_high\\_cost\\_funds\\_jan10-04.pdf](http://www.nrrri.org/pubs/telecommunications/NRRRI_state_high_cost_funds_jan10-04.pdf). According to the NRRRI, as of 2010, the following 21 states have state high-cost funds: Alaska, Arizona, Arkansas, California, Colorado, Idaho, Illinois, Indiana, Kansas, Maine, Nebraska, Nevada, New Mexico, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Wisconsin, and Wyoming.

states have established their own low-income universal service support programs to help eligible low-income customers afford voice service.<sup>143</sup> Others support statewide health care networks, such as Nebraska, or more general statewide networks, such as Kansas.<sup>144</sup> Many states have reformed intrastate access charges and rebalanced local rates, and many have adopted a state universal service fund to offset reduced revenues due to access charge reform.<sup>145</sup> We seek comment on how to encourage or require additional commitments to support universal service by states in partnership with the federal government.<sup>146</sup>

### C. Eligible Telecommunications Carrier Requirements

88. Section 254(e) of the Act limits high-cost universal service support to telecommunications carriers that have been designated as ETCs.<sup>147</sup> Under section 214 of the Act, states have the responsibility for designating ETCs within their states, except in those cases where they lack jurisdiction.<sup>148</sup> In instances where a state lacks jurisdiction to designate an ETC, the Commission determines whether to designate an ETC.<sup>149</sup> When designating an ETC, the state (or the Commission) defines the ETC's service area.<sup>150</sup> The statute also provides that if no common carrier will provide the supported services to any unserved community or any portion thereof, the Commission, with respect to interstate services and areas served by carriers over which the state lacks jurisdiction, shall determine

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<sup>142</sup> On December 20, 2007, the California Public Utilities Commission created funding to encourage deployment of broadband facilities for use in provisioning advanced telecommunications service in unserved and underserved areas of California. *Order Instituting Rulemaking into the Review of the California High Cost Fund B Program, Interim Opinion Implementing California Advanced Services Fund*, Rulemaking 06-06-028 (CA PUC rel. Dec. 20, 2007).

On December 20, 2007, the New York State Office of the Chief Information Officer and Office of Technology adopted a comprehensive approach to providing affordable universal broadband access to its residents and businesses. *Universal Broadband Access Grant Program*, 2007-08 Request for Proposals, RFP CIO/OFT 001-2007 (CIO/OFT rel. December 20, 2007).

<sup>143</sup> See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link Up*, WC Docket No. 03-109, Order, 25 FCC Rcd 5079, 5080, para. 3 (2010).

<sup>144</sup> The Nebraska Public Service Commission, through the Nebraska Universal Service Fund, provides annual support for the Nebraska Statewide Telehealth Network. See Nebraska PSC Press Release (March 20, 2008), available at [http://www.psc.state.ne.us/home/NPSC/news\\_releases/news\\_releases.htm](http://www.psc.state.ne.us/home/NPSC/news_releases/news_releases.htm). Another example is Kansas KanEd, a middle-mile network connecting community anchor institutions with support from Kansas' state universal service fund. See Kan-ed, <http://www.kan-ed.org/> (last visited Feb. 9, 2011).

<sup>145</sup> AT&T Oct. 24, 2010 *Ex Parte* Letter, at 1, Attach. 2 (providing information on access reform in the states and noting that while many states had some access reform in the last six years and several others have open proceedings, only a few states have moved to complete parity between intrastate and interstate switched access rates and structures); see also *infra* para. 543 (describing states that have undertaken intrastate access charge reform measures).

<sup>146</sup> See *infra* para. 296 (seeking comment on whether and how the Commission could use the first phase of CAF support to create incentives for states to take action that will advance our mutual goals).

<sup>147</sup> 47 U.S.C. § 254(e). Section 214(e) further requires that ETCs be common carriers. *Id.* at § 214(e).

<sup>148</sup> 47 U.S.C. § 214(e)(2).

<sup>149</sup> 47 U.S.C. § 214(e)(6). In the *ETC Designation Replot and Order*, the Commission adopted additional requirements for federally designated ETCs. *ETC Designation Report and Order*, 20 FCC Rcd at 6380, para. 20. The Commission requires that applicants seeking ETC designation demonstrate the following: (1) a commitment and ability to provide services, including providing service to all customers within its proposed service area; (2) that the applicant will remain functional in emergency situations; (3) that it will satisfy consumer protection and service quality standards; (4) that it offers local usage comparable to that offered by the incumbent LEC; and (5) the applicant's acknowledgement that it may be required to provide equal access if all other ETCs in the designated service area relinquish their designations pursuant to section 214(e)(4). *Id.*; 47 U.S.C. § 214(e)(4).

<sup>150</sup> 47 U.S.C. § 214(e)(5).

which common carrier or carriers are best able to provide service to the requesting unserved community and shall order such carrier or carriers to provide such service.<sup>151</sup> Once designated, ETCs are required to offer and advertise supported services “throughout the service area for which the designation is received.”<sup>152</sup> Those obligations apply regardless of whether support is actually provided to ETCs operating within the designated service area.

89. We seek comment on how the Commission can best interpret these existing requirements to achieve our goals for reform. We also seek comment on whether (and if so how) we should modify the ETC requirements as we proceed with reforms. How would we provide incentives for state commissions to apply any Commission-adopted requirements to ETCs designated by the states? Alternatively, we seek comment on whether the Commission could or should forbear from requiring that recipients of universal service support be designated as ETCs at all.<sup>153</sup> Commenters asserting that the Commission has the authority to forbear from imposing this requirement should address the scope of the Commission’s authority under section 10 and in particular should address whether the Commission could forbear from applying section 254(e) to entities that are not telecommunications carriers to allow their receipt of universal service support to serve rural, insular and high-cost areas under the Act.<sup>154</sup> If we do forbear from this requirement, what if any requirements should replace it? How should we transition from existing to any new requirements? How should existing ETCs be treated during such a transition? We also seek comment on additional, more discrete ETC-related issues raised by our proposals in the sections that follow.

#### **D. Public Interest Obligations of Fund Recipients**

90. Universal service support is a public-private partnership that is made to preserve and advance access to modern communications networks. Providers that benefit from public investment in their networks should be subject to clearly defined obligations associated with the use of such funding. This ensures that providers know how they are expected to use the funding and that the public will receive specific benefits from its investment.

91. Current high-cost funding recipients are subject to certain statutory public interest obligations because they are ETCs.<sup>155</sup> In addition, states and the Commission have authority to impose (and have imposed) additional obligations on the ETCs they designate.<sup>156</sup> Incumbent carrier ETCs also typically are required to comply with state-mandated carrier of last resort obligations, which may include a duty to serve all customers in the geographic region, to extend lines upon request, to provide service until the state grants permission to exit the market, and other obligations.<sup>157</sup>

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<sup>151</sup> 47 U.S.C. § 214(e)(3). As a practical matter, the Commission has not had the occasion to interpret this provision to date, because at the time of the 1996 Act, virtually all communities were served by voice telephony.

<sup>152</sup> 47 U.S.C. § 214(e)(1). “Service area” is defined in 47 U.S.C. § 214(e)(5). *See also* 47 C.F.R. § 54.207.

<sup>153</sup> *See* 47 U.S.C. § 160(a).

<sup>154</sup> 47 U.S.C. §§ 10, 254(e).

<sup>155</sup> Specifically, ETCs are required to provide supported services throughout the service area and advertise the availability of such services. 47 U.S.C. § 214(e)(1).

<sup>156</sup> 47 U.S.C. § 214(e)(6).

<sup>157</sup> Carrier of last resort obligations for incumbent LECs are a matter of state law and vary from state to state. State COLR obligations derive from state statutes, state regulations, certificates of public convenience and necessity, and administrative practice. *See generally* Peter Bluhm and Phyllis Bernt, *Carriers of Last Resort: Updating a Traditional Doctrine*, at 9 (NRRI July 2009), *available at* [http://www.nrri.org/pubs/telecommunications/COLR\\_july09-10.pdf](http://www.nrri.org/pubs/telecommunications/COLR_july09-10.pdf).

92. We seek comment on what public interest obligations should apply to ETCs going forward, as we reform and modernize the existing high-cost program to advance broadband.<sup>158</sup> First, we seek comment on the characteristics of voice service and associated voice obligations. Then, we seek comment on the characteristics of broadband service and associated broadband obligations. In responding to these questions, we ask commenters to address whether the public interest obligations for recipients should vary, depending on whether broadband is a supported service, or alternatively, if support is provided to voice recipients conditioned on their deployment of broadband-capable facilities.

93. As a general matter, we propose that all recipients be required to meet public interest obligations tied to the provision of voice and/or broadband services. These obligations would apply to all funding recipients going forward, whether already designated as ETCs by states or the Commission or designated in the future, as a condition of receiving support from the existing high-cost program or the Connect America Fund. The public interest obligations that we propose are intended to be technology-neutral, where possible. With respect to the provision of voice service, we propose that recipients continue to be subject to any existing state or federal requirements for providers of voice service. With regard to the provision of broadband, we propose that recipients be subject to broadband deployment, infrastructure build out, pricing, and other requirements described below. We seek comment on this proposal generally, as well as on the specific components identified below.

94. Although we propose that public interest obligations apply generally to all funding recipients, to what extent, if any, should the obligations proposed in this section vary for recipients under the current high-cost funding programs, recipients of funding in the first phase of the CAF, and CAF recipients over the longer term?<sup>159</sup> We ask commenters to consider and explain whether (and if so how) each of the obligations discussed below should apply under what circumstances, recognizing that it may be appropriate to tailor obligations to avoid creating unfunded mandates. We also ask commenters to address specifically whether the duties and responsibilities of ETCs should differ depending on whether they are also the state-mandated carrier of last resort in a particular area. Finally, we recognize that there may be costs and burden for the Commission and recipients associated with the monitoring of, enforcement of, and compliance with the proposed public interest obligations. We acknowledge the risk of discouraging participation in these programs or reducing the impact of USF support because of the costs associated with public interest obligations. We seek comment on how best to balance these costs

<sup>158</sup> Commenters generally supported imposing obligations on recipients of universal service funding. *See, e.g.*, Five MACRUC States Comments at 9 (recommending a broadband, voice, and wireless provider-of-last resort obligation as a condition of competitive bidding); Joint Comments of the National Exchange Carrier Assoc., Inc., National Telecommunications Cooperative Assoc., Organization for the Promotion and Advancement of Small Telecommunications Companies, Western Telecommunications Alliance, and the Rural Alliance (NECA, *et al.*), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 32 (filed July 12, 2010) (“[U]niversal service requires the presence of a clearly identified carrier in each service area that is ready, willing and able to serve the most expensive, least profitable or otherwise less desirable customers therein.”); NCTA Comments at 11 (recipients should include state COLR costs when demonstrating the minimum necessary support for area); Comments of Qwest Communications International Inc., WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 12-13 (filed July 12, 2010) (the Commission should require “the company that has chosen to receive support [to] provide supported broadband and voice services throughout the supported geographic territory”); Reply Comments of AT&T, Inc. (AT&T), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 6 (filed Aug. 11, 2010); Comments of Cox Communications, Inc., GN Docket Nos. 09-51, 09-47, 09-137, in re NBP PN #19, at 10 (filed Dec. 7, 2009) (“[M]onopoly providers subject to COLR obligations should be required to meet service quality standards and reporting and oversight obligations to guarantee that they provide reasonable service in areas where customers have no competitive choice.”); Comments of the National Assoc. of State Utility Consumer Advocates (NASUCA), GN Docket Nos. 09-51, 09-47, 09-137, in re NBP PN #19, at 22 (filed Dec. 7, 2009).

<sup>159</sup> Below, we propose to conduct a reverse auction to distribute a non-recurring amount of support to extend broadband in unserved areas, during the first phase of the CAF. We propose public interest obligations specific to recipients of funding during this first phase of the CAF. *See infra* para. 309 *et seq.*

with our proposed principles of fiscal responsibility and accountability and our goal of rapidly increasing broadband deployment in unserved areas.

## 1. Characteristics of Voice Service

95. Section 214(e) of the Act requires an ETC to offer and advertise the services that are supported by federal universal service support using its own facilities or a combination of its own facilities and resale of another carrier's services throughout its designated service area.<sup>160</sup> In 1997, the Commission defined the services to be supported in functional terms as: voice grade access to the public switched network; local usage; dual tone multi-frequency (DTMF) signaling or its functional equivalent; single-party service or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation to qualifying low-income consumers.<sup>161</sup> The Commission chose to define the supported services in functional terms, rather than as tariffed services, in order to promote competitive neutrality and provide greater flexibility.

96. We now propose to simplify how we describe these core functionalities into one term: "voice telephony service."<sup>162</sup> The existing rules, as formulated, suggest that ETCs must advertise specific components of voice service (e.g., operator services, DTMF), even though such terminology may not be familiar to the average American consumer. In practice, carriers likely advertise the supported services using much more generic language. We seek comment on this proposal to simplify how we define supported "voice telephony service."<sup>163</sup>

97. With respect to the performance characteristics for "voice telephony service," we note that "voice grade access" to the public switched network is defined in section 54.101 of the Commission's rules as "a functionality that enables a user of telecommunications services to transmit voice communications, including signaling the network that the caller wishes to place a call, and to receive voice communications, including receiving a signal indicating there is an incoming call. For the purposes of this part, bandwidth for voice grade access should be, at a minimum, 300 to 3,000 Hertz."<sup>164</sup> Should we preserve this definition, modify this definition, or adopt a new definition? Is DTMF still relevant in today's networks? Is the 300 to 3,000 Hertz bandwidth requirement appropriate for mobile or satellite voice technologies? Should providers still be required to provide access to operator services and directory assistance? Parties that support a different definition should provide analysis and data supporting such a definition. Parties also should explain whether such a definition would be technology-neutral and if not, the basis for adopting a definition that is not technology-neutral.

## 2. Voice Obligations

98. We propose that recipients must provide "voice telephony service" throughout their designated service areas.<sup>165</sup> We propose that recipients be permitted to partner with another voice provider, in part, to provide voice capability that meets the definition of "voice telephony service."<sup>166</sup> For example, a recipient could partner with a satellite voice provider to provide "voice telephony service" in

<sup>160</sup> 47 U.S.C. § 214(e).

<sup>161</sup> 47 C.F.R. § 54.101(a)(1)-(9); *see also Federal-State Joint Board on Universal Service*, 12 FCC Rcd at 8810, para. 61 (defining supported services).

<sup>162</sup> Letter from Henry Hultquist, AT&T, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 10-90, 05-337, CC Docket Nos. 01-91, 80-286 (filed Dec. 6, 2010) (AT&T Dec. 6, 2010 *Ex Parte* Letter).

<sup>163</sup> Because we are merely proposing to consolidate all currently supported services for high cost under one new term, "voice telephony service," we need not consider whether these consolidated services should be part of the definition of supported services. 47 U.S.C. § 254(c)(1)(A)-(D).

<sup>164</sup> 47 C.F.R. § 54.101(a)(1).

<sup>165</sup> *See supra* para. 95 *et seq.* (Characteristics of Voice Service).

<sup>166</sup> *See id.*

areas where the recipient has not yet built out its network. We propose that the voice telephony service provided by a recipient (or its partner if we allow such an arrangement) may be provided via any technology (wireline, terrestrial wireless, satellite or VoIP) that meets or exceeds the universal service definition of “voice telephony service.” We seek comment on whether the “partnering” is sufficient to satisfy the facilities requirement of section 214(e)(1)(A).<sup>167</sup> We propose that recipients be responsible for ensuring compliance with these requirements, regardless of whether they are themselves or their partner is providing the service. We seek comment on these proposals.

99. We further propose that recipients be required to offer voice telephony service as a standalone service. We seek comment on this proposal, including whether we should adopt the requirement that such a standalone voice service be offered at an affordable rate.<sup>168</sup> If we adopt such a requirement, what should be deemed an affordable rate for voice service? Alternatively, if the recipient provides broadband, is it sufficient that a customer could subscribe to an over-the-top VoIP service for voice service?

100. In addition, we propose that recipients continue to be subject to any applicable baseline state or federal requirements for the provision of voice service by ETCs. We seek comment on these proposals. To the extent that such requirements overlap with the requirements we are proposing herein, we seek comment on how to harmonize the requirements or transition to new requirements. Are there existing requirements that are duplicative of requirements we are proposing herein?

101. How can we create incentives for states to re-evaluate and harmonize the requirements they impose on the ETCs that they designate to be consistent with any new federal requirements? We also seek comment on whether the Commission could or should adopt any measures to provide incentives to states to eliminate state COLR obligations for any company that relinquishes its ETC designation or no longer receives universal service support.<sup>169</sup> Should there be any additional obligations imposed on recipients serving areas in which the telephone penetration rate historically has been substantially lower than the national average (e.g., on Tribal lands and in Native communities)?

102. For the near term, we envision that the existing state-federal roles with respect to existing ETCs would remain the same, but over the longer term, that could change as carriers migrate to all-IP networks, and voice is available as an application on such networks. Given that we envision a transition to an integrated voice-broadband network in the future, how should voice universal service public interest obligations change over time? In the future, will there be a need for separate voice and broadband public interest obligations?

### 3. Characteristics of Broadband Service

103. For purposes of universal service funding, we propose to adopt metrics for broadband using specific performance characteristics.<sup>170</sup> These metrics would apply to the CAF and also to the

<sup>167</sup> 47 U.S.C. § 214(e)(1)(A).

<sup>168</sup> See *infra* para. 137 (proposing that recipients must offer voice and broadband (individually and together) in rural areas at rates that are affordable and reasonably comparable to rates in urban areas).

<sup>169</sup> See, e.g., Comments of AT&T, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 17-18 (filed July 12, 2010); Comments of CenturyLink, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 14 (filed July 12, 2010); Comments of the Pennsylvania Public Utility Commission, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 36 (filed July 12, 2010) (explaining that “the traditional concepts for the duties and/or responsibilities of COLRs need to be jointly re-examined in a coordinated fashion by both the FCC and the state utility regulatory commissions”); Comments of the United States Telecom Assoc. (USTA), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 7 (filed July 12, 2010) (“If a provider is serving an area in which it is not the supported entity, it should be relieved of ETC, [COLR] and dominant carrier obligations for voice and broadband in the supported area.”); Windstream July 12, 2010 Comments at 16.

<sup>170</sup> For purposes of its *Fourteenth Mobile Wireless Competition Report*, the Commission used “mobile broadband” to refer to mobile Internet access and other data services provided using Third Generation (3G) and Fourth (continued....)

existing high-cost program, until it is transitioned into the CAF.<sup>171</sup> We reserve the right to specify different metrics for other purposes, including other universal service programs.<sup>172</sup> We also propose to re-evaluate the specified metrics on a regular basis to ensure that these metrics remain useful and up-to-date as broadband networks and the applications running over them evolve.

104. First, we propose to characterize broadband without reference to any particular technology, so that current high-cost and future CAF recipients would be permitted to use any technology platform, or combination of technology platforms, that satisfies the specified metrics. We envision that recipients will choose a range of technologies, including wireline technologies, fixed and mobile terrestrial wireless technologies, and fixed and mobile satellite technologies in any combination. Although this proposal would not require that recipients employ any particular type of technology, we seek comment on whether there are reasons to adopt technology-specific minimum standards that would depend on the technology deployed, given that there are trade-offs among the different types of technologies. For instance, should specific but not identical standards be adopted for wireline versus wireless, fixed versus mobile, or terrestrial versus satellite technologies, given the attributes and challenges of these different networks?

105. We seek comment on the key attributes of broadband that will be supported as we reform the current high-cost program and create the CAF. In particular, we seek comment on whether we should characterize broadband by its speed, functional attributes, or in some other way. We note that speed is only one measure of broadband performance. Commenters should discuss additional ways of measuring the broadband services provided to consumers, such as throughput, latency, jitter, or packet loss, for purposes of establishing performance requirements for recipients of universal service funding.<sup>173</sup> Some applications, like e-mail or text-based Web surfing, may be less sensitive to these other measures of network performance, but for other applications, such as videoconferencing, these other, non-speed-related measures may be important.<sup>174</sup>

106. Based on results of a Pew Research Center broadband user survey and additional analysis by the Commission, the National Broadband Plan categorized U.S. consumers into four distinct broadband-use profiles, based on usage characteristics and speed demands:<sup>175</sup> (1) Advanced: consumers who use large amounts of data and tend to use the highest quality voice, video, and other cutting-edge applications; (2) Full media: consumers who are moderately heavy users of broadband and mobile

(Continued from previous page)

Generation (4G) mobile network technologies, CDMA EV-DO, WCDMA/HSPA, and WiMAX, even though these do not necessarily meet the 4/1 Mbps speed threshold as discussed herein. *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*, WT Docket No. 09-66, Fourteenth Report, 25 FCC Rcd 11407, 11413 n.7 (2010) (*Fourteenth Mobile Wireless Competition Report*).

<sup>171</sup> As the existing high-cost program is currently administered, if broadband is a supported service, recipients are statutorily required to provide broadband as defined by the Commission. 47 U.S.C. § 214(e)(1)(A). Alternatively, if funding is conditioned on the provision of broadband, then recipients still must provide broadband as defined by the Commission.

<sup>172</sup> See Letter from Daniel Mitchell, Vice President, NTCA, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 96-45, 01-92, CC Docket No. 96-45 (filed May 20, 2010) (enclosing *Providing World-Class Broadband: The Future of Wireless and Wireline Broadband Technologies*, Rural Telecom Educational Series, at 3). In particular, we expressly reserve the right to choose a different speed for any future expansion of the Low-Income universal service support mechanism to include support of broadband.

<sup>173</sup> See *id.*

<sup>174</sup> See Omnibus Broadband Initiative, *Broadband Performance: OBI Technical Paper No. 4*, at 8, Ex. 10 (OBI, Broadband Performance).

<sup>175</sup> See *id.* at 7; see also John B. Horrigan, Pew Internet & American Life Project, “The Mobile Difference” (2009), available at [http://www.pewinternet.org/~media/Files/Reports/2009/The\\_Mobile\\_Difference.pdf](http://www.pewinternet.org/~media/Files/Reports/2009/The_Mobile_Difference.pdf).

applications, seeking to access high-quality voice, data, graphics, and video communications but, typically not in the most cutting-edge forms; (3) Emerging multimedia: consumers who utilize some video and graphical content but still see the Internet primarily as a way to communicate and access news and entertainment in a richer format than found in offline content; and (4) Utility: consumers who are largely content to access the Internet for basic news, communication, and basic entertainment. Each use profile has a “basket of applications” that reflect typical uses of the Internet for that set of users.<sup>176</sup>

107. The basic utility user requires actual download speeds of approximately 500 kbps, while emerging multimedia and full media users require actual download speeds of 1–4 Mbps, depending on the quality demands of particular applications they might use. Data indicate that 80% of broadband users today fall into these first three use cases.<sup>177</sup> Advanced users accessing applications such as enhanced two-way videoconferencing and high-definition video streaming could require actual symmetric (i.e., upload and download) speeds of 5 Mbps or more and significant quality of service performance (e.g., low latency) from the network.<sup>178</sup> Users’ speed and performance demands may change over time as applications become more data-intensive and the “common basket” of applications in each use profile evolves.<sup>179</sup>

108. Recently, the Commission relied on reported 3 megabits per second (Mbps) downstream and 768 kilobytes per second (kbps) upstream speeds for purposes of its annual inquiry into whether broadband is being deployed to all Americans in a reasonable and timely fashion pursuant to section 706 of the Telecommunications Act of 1996, as amended.<sup>180</sup> For purposes of that inquiry, the Commission benchmarked broadband as “a transmission service that actually enables an end user to download content from the Internet at 4 Mbps and to upload such content at 1 Mbps over the broadband provider’s network.”<sup>181</sup> However, broadband providers already report the number of their subscribers at several levels of speed, including at the 3 Mbps/768 kbps level.<sup>182</sup> We note that the Commission’s most recent *Internet Access Services Report* found that, as of December 2009, only about 32% of reportable Internet access service subscriptions would meet the broadband availability benchmark adopted in the *Sixth Broadband Deployment Report*.<sup>183</sup>

109. The National Broadband Plan recommended that the Commission set an initial target of 4 Mbps actual download/1 Mbps actual upload for universal service.<sup>184</sup> We seek comment on that recommendation. If we adopt a specific threshold speed requirement as a proxy for the capabilities that consumers should be able to access with broadband, what would be the impact on the universal service

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<sup>176</sup> The “basket of applications” approach builds on numerous comments filed in response to National Broadband Plan Public Notice #1. *Comment Sought on Defining “Broadband”*, Public Notice, 24 FCC Rcd 10897 (2009) (NBP PN #1); see, e.g., Comments of Sprint Nextel Corp. in re *NBP PN #1*, at 2 (filed Aug. 31, 2009); Comments of AT&T in re *NBP PN #1*, at 4-5 (filed Aug. 31, 2009); Comments of Kodiak Kenai Cable Company, LLC in re *NBP PN #1*, at 4 (filed Aug. 31, 2009).

<sup>177</sup> See OBI Broadband Performance at 10.

<sup>178</sup> See *id.*, Ex. 11.

<sup>179</sup> See *infra* para. 119 (seeking comment on how often we should re-evaluate requirements for broadband).

<sup>180</sup> *Sixth Broadband Deployment Report*, 25 FCC Rcd at 9568-69, para. 20; see also 47 U.S.C. § 1302(b).

<sup>181</sup> *Sixth Broadband Deployment Report*, 25 FCC Rcd at 9568-69, para. 20.

<sup>182</sup> See Form 477 Resources for Filers, <http://www.fcc.gov/form477/> (last visited Feb. 9, 2011). At present, the Commission categorizes connections reported through its FCC Form 477 at 72 speed tiers defined by eight ranges of downstream speed and nine ranges of upstream speed.

<sup>183</sup> Industry Analysis and Technology Division, Wireline Competition Bureau, *Internet Access Services: Status as of December 31, 2009*, at 6 (Dec. 2010) (Internet Access Services Report); *Sixth Broadband Deployment Report*, 25 FCC Rcd at 9574, para. 28 (citing 47 U.S.C. § 1302(b)).

<sup>184</sup> National Broadband Plan at 135.

funding levels of choosing a different threshold for download and upload speeds than 4 Mbps/1 Mbps? Should any speed ultimately adopted be the minimum that a funding recipient is required to provide, while recognizing that recipients can and will provide higher speeds as the marketplace and technology evolves?

110. What would be the impact, for instance, of setting the initial threshold for broadband to be networks capable of delivering at least 3 Mbps of actual download speed and 768 kbps of actual upload speed? Several commenters support a 768 kbps upload speed threshold, which current technologies could deliver with significantly lower deployment costs.<sup>185</sup> Would adopting a slightly lower threshold than proposed in the National Broadband Plan lessen the financial impact on USF? In the near term, given our current Form 477 reporting requirements, would it be administratively simpler for the Commission to verify that fund recipients are offering their subscribers 3 Mbps/768 kbps?

111. On the other hand, we note that other commenters assert that the speed threshold proposed in the National Broadband Plan is too low.<sup>186</sup> These commenters argue that a 4 Mbps down/1 Mbps upstream definition would create a permanent rural/urban digital divide, would be obsolete by the time funding is disbursed, and would halt the deployment of fiber optic facilities and other long-term broadband solutions.<sup>187</sup> We seek comment on how we should balance such considerations, taking into account the competing national priorities for the use of universal service funding and our proposed goal of controlling the size of the universal service fund.<sup>188</sup>

112. We invite commenters that support a different speed requirement to provide specific analysis and evidence addressing the following questions: What additional features or applications could be provided at, or above, such a threshold? What percentage of consumers today use such features or applications? What would be the estimated additional cost to fund higher speeds?

113. We propose that the speed be “actual” speed rather than the “advertised” or “up to” speed, which may be different from the actual speed an end-user experiences. We seek comment on these proposals including how to define “actual” speed.

114. Are there other metrics we should consider that are unrelated to speed or service quality, such as mobility? As we are considering broadband performance characteristics, how should we think

<sup>185</sup> See CenturyLink July 12, 2010 Comments at 19, n.54 (arguing that current technologies may not be able to deliver 1 Mbps upload speeds without significant effect on download speeds and/or increased deployment costs); Qwest Comments at 11 (arguing that 1 Mbps upload speed requirement would eliminate DSL-based technologies that could help accomplish universal broadband at lower costs in many rural areas); Windstream July 12, 2010 Comments at 10 (arguing the incremental benefit of a ubiquitous 1 Mbps upload speed threshold outweighs the incremental additional deployment cost incurred when exceeding a more universally accepted upload speed of 768 Kbps); AT&T Dec. 6, 2010 *Ex Parte* Letter at 1 (arguing that changing the upload target to 768 Kbps could materially reduce the amount of funding needed).

<sup>186</sup> Dec. 2010 Internet Access Services Report, at 6.

<sup>187</sup> See, e.g., Comments of Blooston Rural Carriers, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 8 (filed July 12, 2010) (expressing concern that target speed is too low and will create a digital divide between rural and urban areas); Comments of Home Telephone Company, Inc., WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 4-5 (filed July 12, 2010); Comments of the Texas and Oklahoma Small Company Group, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 11-12 (filed July 12, 2010) (arguing that services will require bandwidth far in excess of the 4 Mbps); Comments of Nebraska Rural Independent Companies, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 52-55 (filed July 12, 2010) (arguing that 4/1 Mbps is likely to be outmoded by the end of 2010); Comments of Nebraska Telecommunications Association, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 1 (filed July 12, 2010) (cautioning that subjecting rural customers to speeds lower than those generally available to many urban customers “could relegate much of the nation’s rural consumers to substandard broadband if never improved upon”); NECA *et al.* July 12, 2010 Comments at 15-18.

<sup>188</sup> See *supra* Section V.A (National Goals and Priorities for Universal Service).

about the migration of networks to Internet Protocol version 6 (IPv6)? Should we adopt more stringent performance metrics, even if it means excluding specific technologies that are unable to meet that standard? How would a requirement that excludes certain technologies comport with the technology neutral principle proposed above? Or, should we adopt more inclusive performance metrics, even if most technologies are capable of better performance?

115. *Measuring the Attributes of Broadband.* We note that the Commission is in the process of working in partnership with a third-party measurement company, SamKnows, to test actual consumer broadband speeds, in order to inform the Commission and other government consumer disclosure initiatives, and to make data publicly available for better understanding of broadband speed and performance.<sup>189</sup> The SamKnows process is providing the Commission with more detailed data on the actual performance characteristics of the nation's broadband networks, including recommendations on definitions of actual speed, key performance metrics and measurement points associated with those metrics. In addition, in March 2010, the Commission released a mobile data consumer test application for iPhone and Android devices which collects and reports data rates, latency, and user location when initiated on the mobile device.<sup>190</sup> The Commission is also considering a mobile broadband measurement partnership with a third-party company.<sup>191</sup> We look forward to the data that results from these tests, and seek comment on whether it should be incorporated, as it becomes available in a reliable and uniform manner, into the metrics we ultimately adopt for defining broadband for purposes of universal service funding.

116. We propose that recipients test their broadband networks for compliance with whatever metrics ultimately are adopted and report the results to the Universal Service Administrative Company (USAC) on a quarterly basis,<sup>192</sup> and that these results be subject to audit. We seek comment on whether the benefits of such a requirement would outweigh the burdens. Are there alternatives that could ease burdens on recipients? Alternatively, should we instead require that recipients provide a specific speed (e.g., 4/1 Mbps) at a "reasonable service quality," and rely on customer complaints regarding the quality of their broadband as a means of enforcing service quality?

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<sup>189</sup> *Comment Sought on Residential Fixed Broadband Services Testing and Measurement Solution*, CG Docket No. 09-158, CC Docket No. 98-170, WC Docket No. 04-36, Public Notice, 25 FCC Rcd 3836 (2010).

<sup>190</sup> The mobile application is available for download for the iPhone App Store or Android Market. As of December 2010, about 100,000 unique users have installed the Commission's mobile application, collectively taking over 1 million tests. The Commission also released a fixed consumer broadband test which collects street address and broadband performance data, which has been accessed about 1 million times. The fixed application is accessible at [www.broadband.gov/qualitytest](http://www.broadband.gov/qualitytest) (last visited Feb. 9, 2011).

<sup>191</sup> *See Comment Sought on Measurement of Mobile Broadband Network Performance and Coverage*, CG Docket No. 09-158, CC Docket No. 98-170, WC Docket No. 04-36, Public Notice, 25 FCC Rcd 7069 (2010).

<sup>192</sup> The Universal Service Administrative Company (USAC), a subsidiary of the National Exchange Carrier Association (NECA), is the private not-for-profit corporation created to serve as the Administrator of the Fund under the Commission's direction. *See Changes to the Board of Directors of the National Exchange Carrier Association, Third Report and Order* in CC Docket No. 97-21, *Fourth Order on Reconsideration* in CC Docket No. 97-21 and *Eighth Order on Reconsideration* in CC Docket No. 96-45, 13 FCC Rcd 25,058, 25,063-66, paras. 10-14 (1998); 47 C.F.R. § 54.701(a). The Commission appointed USAC the permanent Administrator of all of the federal universal service support mechanisms. *See* 47 C.F.R. §§ 54.702(b)-(m), 54.711, 54.715. USAC administers the Fund in accordance with the Commission's rules and orders. The Commission provides USAC with oral and written guidance, as well as regulation through its rulemaking process. USAC plays a critical role as day-to-day Administrator in collecting necessary information that enables the Commission to oversee the entire universal service fund. *See, e.g., Memorandum of Understanding Between the Federal Communications Commission and the Universal Service Administrative Company* (Sept. 9, 2008) (*2008 FCC-USAC MOU*), available at <http://www.fcc.gov/omd/usac-mou.pdf>.

117. To the extent the Commission measures broadband by specific attributes such as speed, we seek comment on where in the network these attributes should be measured – whether it should be just the access network or the end-to-end speed – and how they should be measured. We propose that the attributes be measured on each broadband provider's access network from the end-user interface to the nearest (logical) Internet access point.<sup>193</sup> In Figures 4 and 5 below, the two end-points would be the Internet gateway (2), the closest peering point between the broadband provider and the public Internet for a given consumer connection, and the modem (for a wireline network and some wireless networks) or the consumer mobile device (for some wireless networks) (5), the customer premise equipment typically managed by a broadband provider as the last connection point to the managed network. We seek comment on this proposed approach, and any alternatives that commenters believe would be more accurate. Specifically, we seek comment about how to measure speeds for networks that provide mobile services, where capacity per user changes over time as the number of users in a given sector increases and decreases.

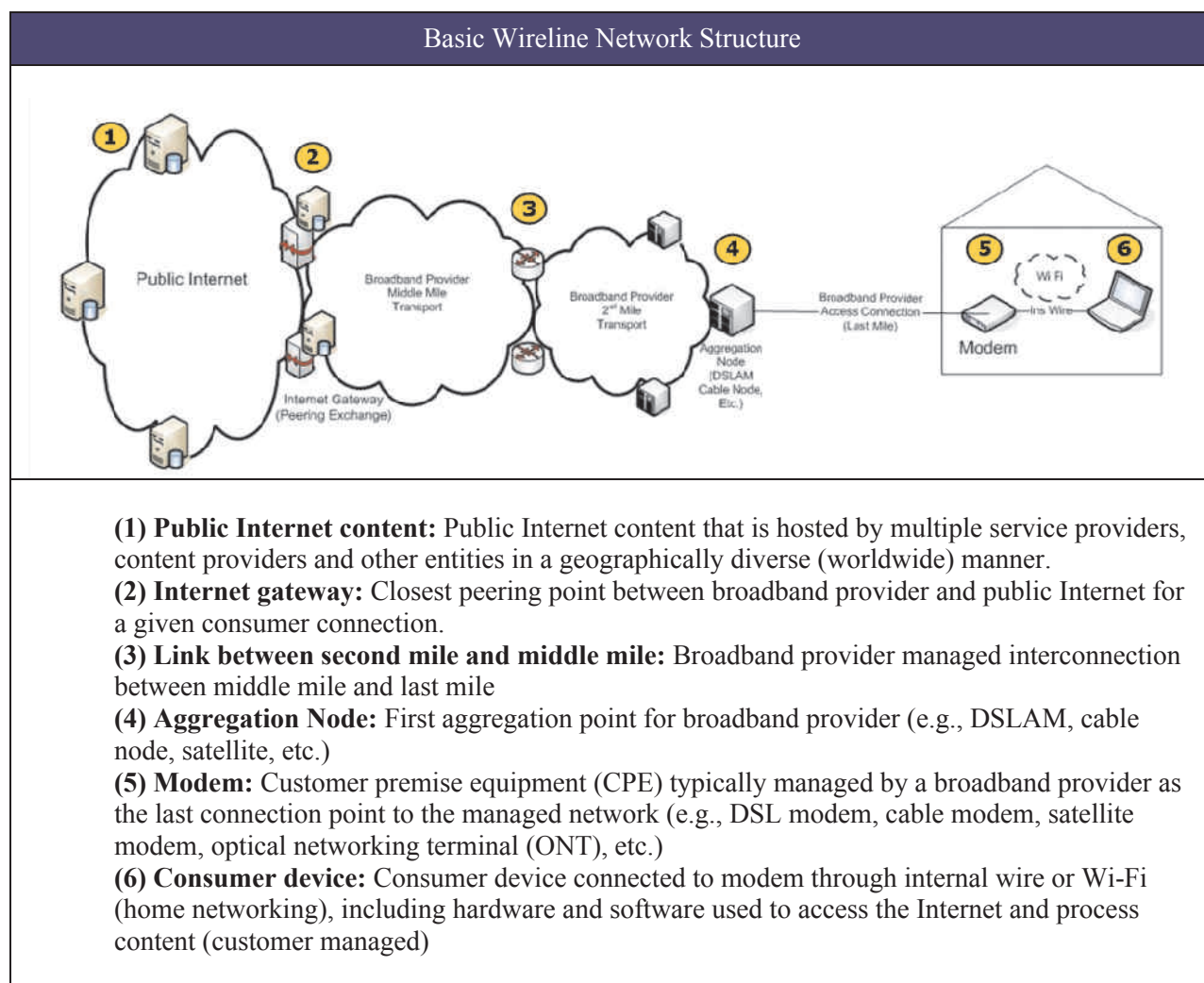


Figure 4

<sup>193</sup> The SamKnows tests will use these parameters.

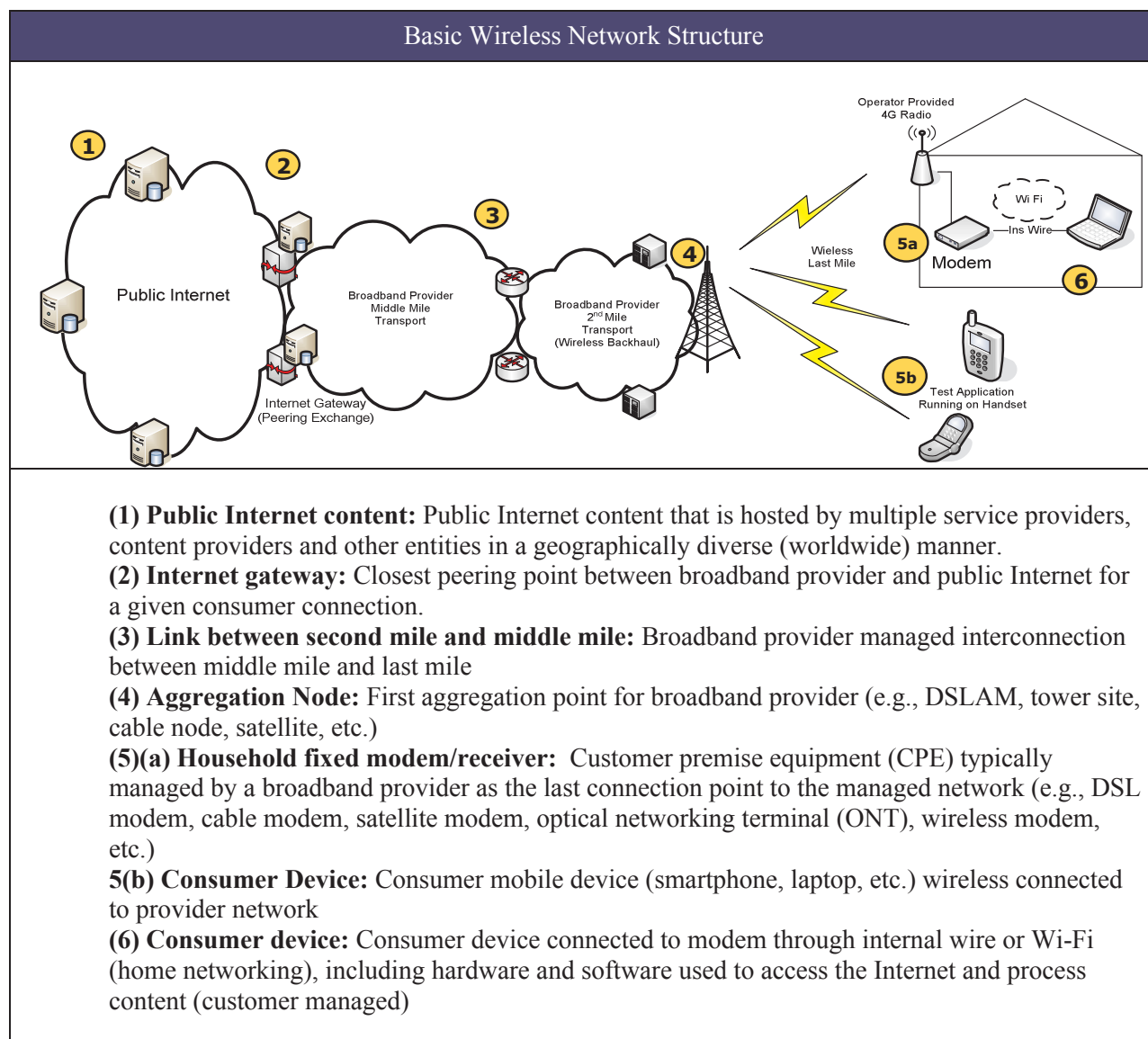


Figure 5

118. One alternative would be to measure end-to-end speeds with the idea that these speeds would be more representative of the end-user experience. This is the approach taken implicitly by many software-based speed tests. However, this approach has several drawbacks. First, where the “other end” (the end away from the end user) is located could have a significant impact on measurements. Those who take measurements at a local server will get far different results from those who take measurements from a server located across the country or around the world. Second, many potential choke points on the network are outside of the broadband provider’s control—meaning that such measurements would not highlight either the cause of any problems or present any solutions. These choke points include everything from customer equipment (including computers and routers at the end-user premises) to server-side congestion and traffic on the Internet itself. We do not believe that end-to-end measurement is

an ideal tool to measure speed or other network performance metrics for the purpose of measuring compliance with a broadband performance metric requirement.<sup>194</sup>

119. *Evolution.* We acknowledge that broadband performance is constantly evolving, and propose that the broadband metrics we adopt for purposes of universal service funding should evolve as well. We seek comment on how often we should re-evaluate our requirements for broadband capability for universal service purposes. Historical speed growth indicates a doubling of speed roughly every four years for broadband technologies.<sup>195</sup> Therefore, should we re-evaluate the definition every four years? Should we re-evaluate more frequently; for example, every year? Every time the median speed subscribed to in the U.S. increases by more than a certain percentage (e.g., 20 percent)?

120. We also seek comment on what procedural vehicle would be appropriate for re-evaluating broadband metrics. Under section 706 of the Telecommunications Act of 1996, as amended, the Commission must conduct an annual inquiry into whether broadband is being deployed to all Americans in a reasonable and timely fashion.<sup>196</sup> Could the broadband deployment and inquiry proceeding be used to re-evaluate the broadband speed goal in those years that we have determined to re-evaluate the metrics of broadband? Alternatively, should the Commission conduct a separate inquiry for purposes of defining minimum attributes of broadband performance for purposes of universal service funding?

#### 4. Broadband Obligations

121. As noted above, some incumbent telephone companies are using existing high-cost support to extend modern networks capable of delivering both high-speed Internet access and voice. We propose that all existing high-cost funding recipients going forward and all future CAF recipients must offer broadband service that meets or exceeds the minimum metrics prescribed by the Commission, assuming they receive funding for that purpose.<sup>197</sup> Below, we propose specific obligations that recipients must meet in providing broadband service in the areas for which they receive support. We ask parties to explain their reasoning to the extent they believe that different requirements should apply in different circumstances. We ask parties to comment on how best to balance the costs associated with public interest obligations so that we do not discourage participation in any programs we may adopt to advance broadband deployment, such as reverse auctions, or reduce the impact of CAF support, while balancing our proposed principles of fiscal responsibility and accountability and our goal of rapidly increasing broadband deployment in unserved areas. We recognize that, should recipients be required to provide broadband service, they may need a transition period to comply with the broadband obligations proposed below, and thus, we propose a process for seeking waivers during the transition period.<sup>198</sup>

122. We propose that all recipients should be subject to an annual certification regarding compliance with any obligations that we ultimately adopt for the provision of USF-supported broadband services. Should recipients file certifications with state regulators or with USAC? How should compliance with the metrics and the certifications be monitored and enforced?

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<sup>194</sup> While one could argue that speed and other performance characteristics on the Internet are at least partially in control of the broadband provider through commercial agreements, end-user equipment is not something the broadband provider can control, so the problems of identifying the root cause of performance problems remain.

<sup>195</sup> OBI Broadband Performance at 11.

<sup>196</sup> 47 U.S.C. § 1301 et seq.

<sup>197</sup> See *supra* para. 103 et seq. (Characteristics of Broadband Service).

<sup>198</sup> See *infra* para. 154 (Waiver Process).

123. We also seek comment on whether there are lessons learned or best practices we should consider from other federal and state broadband programs and, if so, whether and how to incorporate those here.<sup>199</sup>

**a. Service, Coverage, and Deployment**

124. We seek to ensure that customers have meaningful access to broadband. To this end, we seek comment on whether to impose a service requirement on recipients, or a service requirement *and* a coverage requirement on recipients. A service requirement, at a high level, would specify that a recipient must provide service upon request within a reasonable period of time. To satisfy a service requirement, a recipient would need to have built facilities close enough to potential subscribers so that it is able to serve them upon request. Relative to a coverage requirement (e.g., recipients must cover 99 percent of all housing units in an area), a service requirement could result in lower costs to the Fund, because a recipient would not necessarily need to extend its facilities as far. On the other hand, addition of a coverage requirement would help guarantee timely access to broadband by ensuring that facilities are present whether or not consumers in the area have previously requested service. Below we seek comment on these two types of requirements.

125. *Service Requirement.* We note that an applicant seeking ETC designation from the Commission currently must commit to provide service throughout the proposed designated service area to all customers making a reasonable request for service, and must certify that it will: (1) provide service on a timely basis to requesting customers within the applicant's service area where the applicant's network already passes the potential customer's premises; and (2) provide service within a reasonable period of time, if the potential customer is within the applicant's licensed service area but outside its existing network coverage, if service can be provided at reasonable cost.<sup>200</sup> We seek comment on whether states that designate ETCs impose similar requirements. We also seek comment on whether Commission and state requirements have been effective in ensuring that requesting customers receive service in a timely basis. If these requirements have not been effective, should we adopt more specific requirements about what we consider a "reasonable period of time" or "reasonable cost"?

126. In instances where customers are not connected to existing plant, at what "standard distance" may a recipient charge the requesting customer to recoup some, or all, of its cost for extending facilities that can deliver broadband as well as voice?<sup>201</sup> For these line extensions, how should a "just and reasonable" charge be calculated? Or should providers be required to fund a specified dollar amount or percentage of the cost of build-out to customers that are not connected to existing plant, and recover the rest from the requesting customer? Should a wireless terrestrial provider be able to charge a customer for the cost of extending its service area to serve that customer? If it would be less costly to use a different technology to reach that customer, such as satellite broadband, should the line extension charge to the customer be capped at the amount it would cost to use that other, cheaper technology?<sup>202</sup> We also seek comment on whether there should be different standards for business and residential consumers.

<sup>199</sup> See, e.g., American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 6001(k)(2)(D), 123 Stat. 115, 516.

<sup>200</sup> 47 C.F.R. § 54.202(a).

<sup>201</sup> See Bluhm & Bernt at 9 (noting that, in New Jersey, no contribution can be required from customer where line extension would be profitable without contribution).

<sup>202</sup> To clarify, in this situation, the customer is responsible for paying the provider to extend service; no federal USF money would pay for the cost of extending service, just as federal USF does not pay to extend, upon customer request, a voice line today. We note that in the *Non-Rural Insular NPRM*, we sought comment on "whether we should provide additional Link-Up support to help offset special construction charges incurred by [eligible consumers in Puerto Rico] when facilities must be built to provide them with access to voice telephone service." *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service; Lifeline and Link-Up*, WC Docket Nos. 05-337, 03-109, CC Docket No. 96-45, Order and Notice of Proposed Rulemaking, 25 FCC Rcd 4136, (continued....)

127. Historically, state commissions have imposed requirements regarding the termination of service for non-payment. We seek comment on whether we should adopt similar requirements in the broadband context. What should be recipients' obligations to serve a customer that is a high credit risk? Is a security deposit requirement a reasonable way for a recipient to ensure the creditworthiness of a customer? Is it sufficient? Are there other types of "reasonable requirements" that should be used to ensure creditworthiness?

128. We also seek comment on whether, separate and apart from the process of relinquishing ETC designation, there is a need to adopt rules relating to exit from the marketplace to ensure that there is a provider willing and able to serve customers in that area.<sup>203</sup> We seek comment on whether to require recipients to comply with Commission rules regarding appropriate notice and approval before discontinuing service.<sup>204</sup> How should the federal obligations deal with any market exit on the part of the recipient?<sup>205</sup> If there is only one supported provider in an area, what happens if the recipient discontinues operations in the supported area? What provider would assume the public interest obligations? Should that determination be made by state regulators or the Commission? Under what statutory authority would a state determine who must assume federal obligations? Additionally, if a recipient subsequently declares bankruptcy, what effect will the declaration of bankruptcy have on its public interest obligations and the subsidy that it receives? Should the public interest obligations the Commission adopts continue to apply to a recipient in bankruptcy proceedings, or should the obligations be transferred to another provider to serve the area? Who should make that determination—the Commission or a state regulator? Do we need to adopt new rules to address this issue?

129. *Coverage Requirement.* We seek comment on whether to adopt a coverage requirement in addition to a service requirement. In the event we choose to adopt a coverage requirement, we seek comment on how we would create the measurement for such a requirement.<sup>206</sup> Should there be a uniform national requirement that recipients must serve a specified percentage of housing units within a given geographic territory with broadband service, such as 99%? We propose to define "housing unit" per the U.S. Census Bureau: "A housing unit is a house, an apartment, a mobile home, a group of rooms, or a single room that is occupied (or if vacant, is intended for occupancy) as separate living quarters. Separate living quarters are those in which the occupants live and eat separately from any other persons in the building and which have direct access from the outside of the building or through a common hall."<sup>207</sup>

130. Alternatively, the Commission could determine the number of housing units in each area that meet selected criteria, such as being located in an area with population density above a specified threshold, or deemed serviceable for less than a particular cost estimated by a model. Should the

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4138, para. 3 (2010). Some commenters argued the proposal would be insufficient given the high cost of special construction charges in Puerto Rico. *See, e.g.,* Comments of Puerto Rico Telephone Company, WC Docket Nos. 05-337, 03-109, CC Docket No. 96-45, at 6 (filed June 7, 2010).

<sup>203</sup> We note that section 214(e)(4) of the Act addresses relinquishment of ETC designation. 47 U.S.C. § 214(e)(4).

<sup>204</sup> 47 C.F.R. § 63.71.

<sup>205</sup> *See* Bluhm & Bernt at 43-45.

<sup>206</sup> Because the specific objective of the first phase of the CAF program is to provide non-recurring support for deployment of networks to provide broadband and voice services in areas unserved by broadband, we seek comment elsewhere on similar alternative coverage requirements to which only recipients of funding in the first phase of the CAF would be subject. *See infra* para. 310.

<sup>207</sup> *See* U.S. Census Bureau, State and County QuickFacts, Housing Units, [http://quickfacts.census.gov/qfd/meta/long\\_HSG010209.htm](http://quickfacts.census.gov/qfd/meta/long_HSG010209.htm) (last visited Feb. 9, 2011).

Commission adopt, in consultation with Tribal governments, tailored coverage requirements for Tribal lands?<sup>208</sup>

131. Are there scenarios where it would be preferable for recipients themselves to establish the coverage requirement they must meet? For example, in scenarios where parties bid for support, should we require potential recipients to specify the number of housing units that they would pass or cover with broadband infrastructure in the designated area should they win the bidding?<sup>209</sup> Winning bidders would then be required to pass or cover their specified number of housing units.

132. Above, in the context of providing voice telephony service, we proposed that recipients be permitted to partner with another voice provider, such as a satellite or wireless voice provider, to provide “voice telephony service” in areas where the recipient has not yet built out its network.<sup>210</sup> Similarly, we propose that recipients be permitted to partner with another broadband provider, such as a satellite or wireless broadband provider, to provide broadband service in areas where the recipient has not yet built out its network. In such arrangements where a recipient partners with another provider to provide broadband service to a portion of its service area, should customers’ voice service be provided by the current voice COLR, or also by the partner?<sup>211</sup> We propose that the primary recipients of funding be responsible for ensuring compliance by themselves and their partner with any broadband obligations ultimately adopted by the Commission, regardless of whether they or their partner physically provides the service.

133. Satellite service is ideally suited for serving housing units that are the most expensive to reach via terrestrial technologies, because there is little marginal cost to add a subscriber, assuming capacity is available.<sup>212</sup> Thus, serving the most expensive locations with satellite would reduce the overall support levels needed, and we would expect recipients to want to partner with satellite providers in the most expensive unserved areas. In order to most efficiently leverage the capacity of satellite throughout the unserved high-cost areas across the nation, should we limit the number of housing units in a given service area that can be served by a partnering arrangement with a satellite provider?<sup>213</sup>

134. Alternatively, we seek comment on whether support recipients should be allowed to carve out from the coverage requirement a small percentage of housing units that may be served by high-speed Internet access service—such as satellite service—that may not meet the minimum performance metrics adopted by the Commission.<sup>214</sup> If we pick a specific percentage (e.g., no more than two to five percent of housing units in a given area), we acknowledge that in some areas, because of terrain or density, recipients may have a higher percentage of housing units that can only be served by broadband with different performance metrics, while in other areas, a recipient may be able to serve all housing units with broadband that meets the Commission-adopted metrics. We seek comment on these issues.

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<sup>208</sup> We note that the Commission has recognized that Tribes are inherently sovereign governments that enjoy a unique relationship with the federal government, and we have reaffirmed our policy to promote a government-to-government relationship between the Commission and federally recognized Indian tribes. *Statement of Policy on Establishing a Government-to-Government Relationship with Indian Tribes*, 16 FCC Rcd 4078, 4079-80 (2000) (*Tribal Policy Statement*).

<sup>209</sup> Although we propose measuring coverage in terms of housing units passed, CAF recipients must serve requesting business customers, too.

<sup>210</sup> See *supra* para. 95.

<sup>211</sup> See Windstream July 12, 2010 Comments at 14 n.27 (suggesting the Commission support a satellite provider of last resort for broadband and a terrestrial provider of last resort for telephone service).

<sup>212</sup> See *infra* note 433 (discussing debate over satellite capacity).

<sup>213</sup> See *infra* para. 272.

<sup>214</sup> See CenturyLink July 12, 2010 Comments at 15 n.43 (suggesting an exception for hardest-to-reach customers to be served by satellite-delivered broadband services).

135. If we adopt a coverage requirement, we seek comment on whether recipients should be required to complete deployment within a specific timeframe, such as three years.<sup>215</sup> We seek comment on alternative timeframes. We note that, currently, Commission-designated ETCs are not required to be able to serve their entire service area at the time of designation, but must commit only to offering service throughout the service area.<sup>216</sup> However, we propose adopting a specific timeframe so that we can ensure public funds are being used effectively. We seek comment on how recipients should demonstrate compliance with a coverage requirement, and their progress towards meeting it. For example, the Commission proposed requiring Mobility Fund recipients to conduct “drive tests” in order to verify the coverage of their networks built with Mobility Fund support.<sup>217</sup> Given that CAF will be available to both fixed and mobile broadband providers, what sort of verification requirement would be appropriate? Should recipients of support under the existing programs be required to demonstrate the extent broadband coverage is improved through receipt of existing funding, and if so, how would they do so? We propose that recipients be subject to an annual certification regarding compliance with the coverage and deployment requirement. How should compliance with these requirements be monitored and enforced?

136. We seek comment on this proposal, including specific milestones for deployment. What milestone is appropriate for the end of the first year, for instance, recognizing that capital investment projects typically require significant planning, engineering analyses, and issuance of requests for proposal, which can be time consuming? Are there critical factors that should be taken into account in establishing timetables for deployment in different areas? Should there be different timetables on Tribal lands or in insular areas? What additional interim deployment requirements should be imposed on CAF recipients serving Tribal lands, if additional time is required to complete deployment in areas in which population demographics are significantly below national averages, where infrastructure does not currently exist, or where Tribal land use access permitting is required? In the alternative, under what circumstances might deployment schedules on Tribal lands be shortened? Should there be different timetables for carriers that meet the definition of a small entity?<sup>218</sup> We note that recipients deploying new infrastructure also would have to comply with the National Environmental Policy Act and other relevant federal environmental statutes,<sup>219</sup> as well as all local requirements for construction. Are there areas where the projected time needed to comply with those environmental requirements would make it appropriate to adopt alternative deployment schedules, such as weather or construction seasons?

#### **b. Affordable and Reasonably Comparable Rates**

137. We propose that recipients must offer voice and broadband (individually and together) in rural areas at rates that are affordable and reasonably comparable to rates in urban areas. As noted above, section 254(b) directs that universal service policies be designed to make services available at “just, reasonable, and affordable” rates,<sup>220</sup> and to make services in rural areas available at rates that are “reasonably comparable” to rates in urban areas.<sup>221</sup> Additionally, the National Broadband Plan recommended that “subsidized providers should be subject to specific service quality and reporting

<sup>215</sup> Recipients of Recovery Act funding were given three years to complete their projects. 74 Fed. Reg. 33104, 33110 (2009).

<sup>216</sup> See *ETC Designation Report and Order*, 20 FCC Rcd at 6380-82, paras. 21-24. ETCs must file a five-year network improvement plan, and then an annual report thereafter, covering build-out progress, outages, service requests, and complaints. 47 C.F.R. § 54.209.

<sup>217</sup> See *Mobility Fund NPRM*, 25 FCC Rcd at 14729-31, paras. 40-44.

<sup>218</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6685, App. A (Initial Regulatory Flexibility Analysis, defining small entities).

<sup>219</sup> 47 C.F.R. Ch. 1, Subpart I.

<sup>220</sup> 47 U.S.C. § 254(b)(1).

<sup>221</sup> 47 U.S.C. § 254(b)(3).

requirements, including obligations to report on service availability and pricing. Recipients of funding should offer service at rates reasonably comparable to urban rates.”<sup>222</sup>

138. If the Commission ultimately makes broadband a supported service, then it is critical the Commission have sufficient information to ensure compliance with the statutory directives. Even if broadband is not designated a supported service, however, we seek comment on whether providers should be required to offer broadband at affordable and reasonably comparable rates as a condition of receiving support. We emphasize that, if such an approach were followed, our intent in these proposals is not to price regulate broadband service; rather, we seek to ensure that we are not using public funding to subsidize recipients more than necessary, taking into account the rates that consumers generally pay when receiving broadband service from unsubsidized providers.

139. We seek comment on how the Commission should obtain data on voice and broadband pricing to develop possible rate benchmarks for supported voice and/or broadband service, in order to satisfy Congress’s requirement that universal service ensure that services are available to all regions, “including rural, insular, and high cost areas,” at rates that are “affordable” and “reasonably comparable” to those in urban areas.<sup>223</sup> Should the Commission collect pricing data from providers, or are there adequate third-party reports or other means by which to ensure these statutory obligations are met?

140. *Affordable.* Section 254(b) directs that universal service policies be designed to make services available at “affordable” rates.<sup>224</sup> We seek comment on how to assess whether rates for broadband and voice are affordable. With respect to supported voice service, we have explained in the past that affordability should be assessed based on the totality of the Commission’s universal service programs, and we have viewed the telephone subscribership penetration rate as strong evidence that our universal service programs as a whole provide sufficient support to ensure that rates are affordable.<sup>225</sup> We have also pointed to data showing that average consumer expenditures on telephone service as a percentage of household expenditures have been relatively stable over time—approximately 2 percent—even while the amount of telephone service consumers are purchasing has increased.<sup>226</sup>

<sup>222</sup> The National Broadband Plan at 145-46; *see also, e.g.*, AT&T Comments in re NBP PN #19, App. A at 19 (filed Dec. 7, 2009) (arguing that recipients should provide supported services at rates, terms and conditions reasonably comparable to those offered in urban areas); Qwest Comments in re NBP PN #19, at 4 (filed Dec. 7, 2009) (arguing that winning bidders of subsidies to deploy broadband to unserved areas should be limited to charging no more than 125% of the state-wide average for comparable broadband service); OPASTCO Comments in re NBP PN #19, at 21 (filed Dec. 7, 2009) (arguing that ETCs should be required to serve all customers at minimum broadband speeds and maximum rates).

<sup>223</sup> 47 U.S.C. §§ 254(b)(1), (3). One possible approach would be for providers to report the total revenue associated with all delivered products (including voice, video and broadband Internet access services), and identify the attributes associated with that revenue, such as the types of services provide (*e.g.*, voice, video, and broadband) and key descriptors of those services (*e.g.*, basic video, extended video, very high speed Internet access). The Commission could then determine the average effective price for each attribute in a given area by performing statistical analysis on aggregate revenue and attribute data across areas large enough to generate a significant number of measurements. *Modernizing the FCC Form 477 Data Program*, WC Docket No. 11-10, *Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans*, *Improvement of Wireless Broadband Subscribership Data*, and *Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, *Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering*, WC Docket No. 08-190, *Review of Wireline Competition Bureau Data Practices*, WC Docket No. 10-132, Notice of Proposed Rulemaking, FCC 11-14, at paras. 66-76 (rel. Feb. 8, 2011) (*Broadband Data NPRM*) (seeking comment on whether and how the Commission should collect price data).

<sup>224</sup> *See supra* Section V.A (National Goals and Priorities for Universal Service).

<sup>225</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4080-81, para. 18, 4101-11, para. 54.

<sup>226</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4081, para. 19; *see also* Sept. 2010 Trends in Telephone Service, 3-1; 3-3, Table 3-1 (“About 2% of all consumer expenditures are devoted to telephone service. This percentage has (continued....)”).

141. Applying a similar approach to broadband may be more difficult, however. Many variables other than affordability affect penetration, including lack of necessary equipment such as a computer, a lack of digital literacy and a belief that broadband is not relevant.<sup>227</sup> Moreover, some of the metrics that we have used in the past for voice service—such as the relative stability of expenses over time—may not be readily available. We thus seek comment on appropriate ways to measure affordability of broadband service in the absence of longitudinal data regarding the pricing of such service.<sup>228</sup>

142. When the Commission initially implemented the 1996 Act, it noted that a variety of factors may affect affordability, including non-rate factors such as income levels, cost of living, population density, and the size of the customer's local calling area.<sup>229</sup> We seek comment on what factors are relevant in today's environment for determining affordability of broadband. To what extent should we take into account income levels in determining affordability,<sup>230</sup> how would that interplay with the statutory requirement that rates be reasonably comparable,<sup>231</sup> and what would be the implications of doing so for reforming our current programs to support broadband? Would it be feasible to implement a system where support is available only to subsidize the cost of serving customers under a specified income level? Should we establish a national benchmark for affordability?

143. We also seek comment on whether to adopt specific requirements to ensure that voice and broadband services supported by universal service are affordable.<sup>232</sup> Should we require recipients to offer a basic tier of broadband service at an affordable rate? If so, would we need to specify what an "affordable rate" is, or specify an upper bound for such a rate using a dollar figure, a percentage of the national average, or some other measure such as two standard deviations above the national average? Should there be different broadband performance requirements for such a tier? What role should our low-income programs play in ensuring the affordability of broadband services? Is affordability an issue best addressed outside the high-cost program?

144. *Reasonably Comparable.* Section 254(b) directs that universal service policies be designed to make services in rural areas available at rates that are "reasonably comparable" to rates in urban areas.<sup>233</sup> We seek comment on how to measure whether rates are reasonably comparable, and whether, for this purpose, we should look at rates for voice and broadband individually, or combined. For the purposes of high-cost support for non-rural carriers, the Commission has defined "reasonably

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remained virtually unchanged over the past twenty years, despite major changes in the telephone industry and in telephone usage.").

<sup>227</sup> See National Broadband Plan at 168; Omnibus Broadband Initiative, *Broadband Adoption & Use in America; OBI Working Paper Series No. 1*, p. 24-33 (February 2010) (OBI, Broadband Adoption) (describing non-adopters and barriers to adoption).

<sup>228</sup> See *infra* para. 137 (proposing that recipients must offer voice and broadband (individually and together) in rural areas at rates that are affordable and reasonably comparable to rates in urban areas).

<sup>229</sup> *Universal Service First Report & Order*, 12 FCC Rcd at 8840-42, paras. 114-117. The Commission concluded that states, by virtue of their local ratemaking authority, should exercise primary responsibility for determining affordability of rates.

<sup>230</sup> We note that in its most recent recommended decision, the Joint Board highlighted several issues related to extending Lifeline universal service support to include broadband. *Joint Board 2010 Recommended Decision*, 24 FCC Rcd at 15625-26, para. 77.

<sup>231</sup> 47 U.S.C. § 254(b)(1).

<sup>232</sup> See *infra* para. 573 (proposing to adopt a rate benchmark that moves from a voice benchmark to a voice and broadband rate benchmark).

<sup>233</sup> See *supra* Section V.A (National Goals and Priorities for Universal Service).

comparable” in terms of a national rate benchmark.<sup>234</sup> The national rate benchmark for voice service is currently set at two standard deviations above the average urban rate as reported in the most recent annual rate survey published by the Wireline Competition Bureau.<sup>235</sup> Rates in rural areas that fall within the national rate benchmark are presumed to be reasonably comparable to rates in urban areas.<sup>236</sup> In practice, voice rates are often the same across a state to comply with state requirements.<sup>237</sup> Where there are differences, however, rural rates within most states tend to be *lower* than urban rates in those same states.<sup>238</sup>

145. We seek comment on whether to adopt a similar definition of “reasonably comparable” for voice and broadband rates, such that rural rates for voice and broadband together are deemed reasonably comparable if within two standard deviations of a national rate benchmark for voice and broadband. If we adopt the definition used for the provision of high-cost support to non-rural carriers for voice service, should we modify it so that we do not provide support to carriers whose combined voice and broadband rates in rural areas are *below* the average urban rate to ensure that we do not subsidize networks where the retail price of the service offering is significantly below a national benchmark? We also seek comment on how to compare voice and broadband offerings across regions that may include many pricing and service-quality variations.

146. Alternatively, should we adopt a different upper bound on the rates for broadband and voice services supported by our existing high-cost program or the CAF? For those carriers that receive support in only a portion of their service area, should we require that those recipients charge no more for broadband or voice in subsidized areas than they do in non-subsidized areas?<sup>239</sup> If so, how would we deal with recipients that are subsidized in all areas? Should we require that, in order to receive funding, rates for broadband in subsidized areas be no more than a certain percentage of the average urban rate?<sup>240</sup>

147. We also seek comment on whether the Commission should require recipients to file with the Commission rates that it will charge customers for a set period after receiving funding.<sup>241</sup>

### c. Additional Considerations

148. *Joint Infrastructure Use.* Some commenters have suggested that we consider policies to encourage sharing of infrastructure, including by residential and anchor institution users.<sup>242</sup> We seek

<sup>234</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4076, para. 8; *see* 47 C.F.R. §54.316(b); *Order on Remand*, 18 FCC Rcd at 22582-89, 22607-10, paras. 38-48, 80-82.

<sup>235</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4076, para. 8; *see* 47 C.F.R. §54.316(b); 2008 Reference Book of Rates.

<sup>236</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4076, para. 8.

<sup>237</sup> Such requirements typically apply to voice but not broadband as state commissions typically do not regulate broadband services.

<sup>238</sup> *Qwest II Remand Order*, 25 FCC Rcd at 4095-96, para. 43.

<sup>239</sup> Comments of the Regulatory Studies Program of the Mercatus Center at George Mason University (Mercatus Center), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 12 (filed July 9, 2010).

<sup>240</sup> *See supra* para. 458 *et seq.* (proposing all recipients must report on deployment, adoption, and pricing data for voice and broadband).

<sup>241</sup> Mercatus Center July 9, 2010 Comments, at 10 (“It is difficult to see how the FCC could legally subsidize broadband without having the provider make some type of commitment on the price it will charge as a quid pro quo for universal service subsidies.”).

<sup>242</sup> *See, e.g.,* Comments of COMPTTEL, GC Docket No 09-51, at 9-10 (filed June 8, 2009) (“Any strategy for achieving maximum utilization of broadband infrastructure must include a requirement that incumbent LECs provide nondiscriminatory access to their broadband networks at wholesale rates to competing broadband service providers, competing Internet service providers and competing information service providers.”); Reply Comments of Consumer Federation of America, Consumers Union, Free Press, Media Access Project, National Alliance for (continued....)

comment on the costs and benefits of such applying such policies in the universal service context. On the one hand, facilities-sharing arrangements could result in more efficient use of supported infrastructure.<sup>243</sup> Some parties, including PCIA – The Wireless Infrastructure Association, have suggested that providers share services or facilities with other providers.<sup>244</sup> Indeed, some, including AT&T and CTIA, have provided examples of successful sharing arrangements.<sup>245</sup> On the other hand, we recognize that mandating such policies could discourage participation in universal service programs or increase the costs to the Fund. We seek comment on the appropriate role of such policies in the USF context, if any, including how we might promote voluntary sharing arrangements.

149. We also seek comment on how USF can best achieve synergies with the connectivity objectives articulated for schools, libraries, and rural health care facilities in section 254.<sup>246</sup> Where build out is required to connect these particular types of community anchor institutions—for example, through the construction of lateral connections to regional fiber networks—should this construction be supported through the CAF, E-Rate, or Rural Health Care programs, individually or in combination? Would such a requirement complement or overlap any goals or requirements of those programs?<sup>247</sup> Should USF recipients have any obligations to serve anchor institutions, such as health care facilities or community centers, in the communities in which they serve residential customers?<sup>248</sup> On the one hand, we recognize (Continued from previous page) \_\_\_\_\_

Media Arts + Culture, New America Foundation’s Open Technology Initiative, and Public Knowledge in re NBP Public Notice #30, GN Docket No. 09-51, at 4 (filed Jan. 27, 2010) (supporting “the reintroduction of some form of infrastructure sharing policies if competition does not emerge under current market trends.”). *See Reply Comments Sought in Support of National Broadband Plan*, GN Docket Nos. 09-47, 09-51, 09-137, Public Notice, 25 FCC Rcd 241 (2010) (NBP PN #30).

<sup>243</sup> Health Network Group Organized by Internet2 Comments in re NBP PN #17, GN Docket No. 09-51, at 4-5 (filed Dec. 2, 2009). *See Comment Sought on Health Care Delivery Elements of National Broadband Plan*, GN Docket Nos. 09-47, 09-51, 09-137, WC Docket No. 02-60, 24 FCC Rcd 13728 (2009) (NBP PN #17)

<sup>244</sup> For example, in response to the *Mobility Fund NPRM*, PCIA recommended that the Commission encourage collocation of wireless antennas on existing infrastructure and require collocation opportunities on new structures constructed with Mobility Fund support “where feasible for the given deployment” to spur competitive entry in unserved markets. Comments of PCIA—The Wireless Infrastructure Association, WT Docket No. 10-208, at 4 (filed Dec. 16, 2010). Also in response to the *Mobility Fund NPRM*, MetroPCS Communications Inc. argued that Mobility Fund “recipients should be required to agree to provide data roaming over their Mobility Fund-enabled networks on just, reasonable and nondiscriminatory terms” and to “permit resale of their services on fair and reasonable prices.” Comments of MetroPCS Communications Inc., WT Docket No. 10-208, at 14-15 (filed Dec. 16, 2010). *See also* Comments of Rural Internet and Broadband Policy Group, GN Docket No. 09-51, at 16 (filed June 8, 2009) (asserting that access, nondiscrimination, and infrastructure sharing “are especially important to boost competition in rural areas.”).

<sup>245</sup> Comments of AT&T, GN Docket No. 09-51, at 45-46 (filed Nov. 4, 2009) (noting that “[t]here are many instances of competing or neighboring broadband service providers working together in consortia to lower their backhaul costs” and that “in many states ILECs have banded together in statewide consortia to construct and operate shared fiber rings”); Letter from Christopher Guttman-McCabe, Vice President, Regulatory Affairs, CTIA – The Wireless Association®, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, at 18 (filed April 29, 2010) (“noting a strong trend of collocations involving multiple carriers sharing the same towers.”); Comments of Sprint Nextel Corp., GN Docket Nos. 09-51, 157, at 43 (filed Sept. 30, 2009) (describing its own sharing arrangement and observing that “[s]haring the costly expenses associated with carrier-grade monitoring, diagnostic, and repair services reduces operating costs in rural, remote and underserved areas.”).

<sup>246</sup> *See* 47 U.S.C. § 254(h); 47 C.F.R. §§ 54.501, 54.601.

<sup>247</sup> *See infra* para. 416 (seeking comment on whether to take into account the cumulative effect of the four USF disbursement programs).

<sup>248</sup> Community anchor institutions are large potential customers of broadband that could reduce broadband-related costs in unserved areas by aggregating demand, and could include institutions such as K-12 schools, community colleges, colleges and universities, town halls, federal and corporate research laboratories, libraries, museums, hospitals, and clinics. National Broadband Plan at 153-154. The American Telemedicine Association argues (continued....)

the critical importance of ensuring adequate access to broadband infrastructure for community anchor institutions and recognize the value of specialized programs tailored to the unique needs of particular anchor institutions. On the other hand, splitting infrastructure and/or service funding among different programs that serve discrete types of institutions may forego potential efficiencies from aggregating funding for multi-use broadband networks.<sup>249</sup>

150. *Other Public Interest Obligations.* We seek comment on whether any additional public interest obligations should apply to USF recipients. To the extent broadband is not a supported service, should we nonetheless require recipients to market their broadband service, and if so, should we specify minimum requirements? Should recipients be required to provide customers with the option to subscribe to a basic broadband service on a stand-alone basis, without having to subscribe to voice or pay television services? Should the recipient be prohibited from requiring a term commitment or imposing an early termination penalty?<sup>250</sup>

151. We also seek comment on public interest requirements that should apply to carriers providing service on Tribal lands.<sup>251</sup> Should recipients be required to engage with Tribal governments to provide broadband to Tribal and Native community institutions? If so, should the requirements mirror those adopted in the general context? Should the Commission adopt tailored rules relating to broadband public interest obligations on Tribal lands, in consultation with Tribal governments, to ensure that broadband becomes widely available in ways that voice service has not? Are there additional requirements that should apply on Tribal lands?

152. *Evolution.* Above, we seek comment on periodically re-evaluating the broadband performance metrics. Here, we propose that we periodically re-evaluate the broadband public interest

(Continued from previous page)

against using rural health care funds for broadband network construction because a “community’s needs are best met through a common infrastructure.” See ATA RHC NPRM Comments at 3-5; see also Health Network Group Organized by Internet2 Comments in re NBP PN #17, filed Dec. 2, 2009, at 4-5 (suggesting that “the creation of independent special purpose networks . . . does not encourage the aggregation of services” and “does not consider the community needs such as economic development”); Letter from John Windhausen, Jr., Telepoly, to Marlene H. Dortch, FCC, GN Docket Nos. 09-191, 10-127, WC Docket No. 07-52 (filed July 27, 2010) (supporting anchor institutions having at least a 1 gigabit per second connection); National Broadband Plan at 10.

<sup>249</sup> Several parties have recommended that CAF recipients connect to community anchors institutions and to the national Research and Education networks. See Comments of Communications Workers of America (CWA), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 4 (filed July 12, 2010); Comments of Internet2, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 1-2 (filed July 12, 2010); Comments of National LambdaRail, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 4 (July 12, 2010) (all recommending that); Health Network Group Organized by Internet2 Comments in re NBP PN #17, GN Docket No. 09-51, at 4-5 (filed Dec. 2, 2009). See *Comment Sought on Health Care Delivery Elements of National Broadband Plan*, GN Docket Nos. 09-47, 09-51, 09-137, WC Docket No. 02-60, 24 FCC Rcd 13728 (2009) (NBP PN #17). See also *supra* Section V.C. We also note that section 254(h)(1)(A)-(B) requires telecommunications carriers to provide service to qualifying rural health care providers and schools and libraries for qualifying purposes at rates reasonably comparable to urban rates (in the case of health care providers) and at a discounted amount that is “appropriate and necessary to ensure affordable access to and use of such services by such entities” (in the case of schools and libraries). 47 U.S.C. § 254(h)(1)(A)-(B).

<sup>250</sup> ETCs would continue to be subject to other Commission rules, as applicable. See, e.g., 47 C.F.R. §§ 1.20000, *et seq.* (Communications Assistance for Law Enforcement Act (CALEA)), 47 C.F.R. §§ 8.1, *et seq.* (Preserving the Open Internet), 47 C.F.R. §§ 64.601 *et seq.* (Telecommunications Relay Services), and 47 C.F.R. §§ 64.3000, *et seq.* (E-911). We note that some commenters have suggested that compliance with the Commission’s open Internet rules should be spelled out as a public interest obligation for USF recipients, and seek comment on this suggestion. See, e.g., Letter from Matthew F. Wood, Associate Director, Media Access Project, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 10-90, 05-337, 03-109, and WT Docket No. 10-208 (filed Feb. 1, 2011).

<sup>251</sup> See *supra* note 208.

obligations. Should public interest obligations be re-evaluated at the same time the Commission re-evaluates its definition of broadband, or less frequently? We seek comment on the effect that changing the obligations would have on program administration and on funding recipients. In light of changing technological developments and marketplace conditions, how can the Commission best ensure that public interest obligations remain useful and up to date, with minimal disruption to recipients' deployment plans? We acknowledge that the evolution of obligations will affect the support levels necessary to meet these obligations. We therefore propose the Commission re-examine funding levels each time it re-evaluates the public interest obligations. Are there other ways that the Commission could ensure that its public interest obligations provide meaningful standards on an ongoing basis?

153. *Remedies for Non-Compliance.* We seek comment on remedies for failure to meet any public interest obligations, including but not limited to loss of universal service funding and repayment of funds already disbursed. Pursuant to Commission rules and directives, USAC already has the authority to recover funds through its established processes in instances where an audit or investigation finds that a recipient failed to comply with high-cost program rules and requirements. We propose that USAC also recover funds through its normal processes in instances where an audit or investigation finds that a recipient has failed to comply with certain CAF program rules and requirements.<sup>252</sup> We seek comment on this proposal. Should states or the Commission establish additional penalties to be imposed on a recipient that fails to fulfill its public interest obligations in a geographic area?

154. *Waiver Process.* We note that some recipients may require more time to come into compliance with the obligations proposed here, whether because their unserved customers exhibit certain costs characteristics or because support amounts are not sufficient to deploy broadband-capable facilities as widely within their service areas. We propose to allow those carriers that are unable to meet a deployment schedule that we may adopt in the future to seek a waiver of the requirement from the Commission. We seek comment on this proposal and ask what the criteria should be for such a waiver.

155. *Role of States and Tribal Governments.* We seek comment on the role of states and Tribal governments in enforcing compliance with these federally defined public interest obligations. Should states be responsible for enforcement? If so, in states where the public utility commission does not have jurisdiction over broadband providers, should a different state agency be responsible for enforcement? Where will funding for any additional administration and enforcement come from? Because Tribal governments are not political subdivisions of states but are, instead, sovereign nations that share a trust relationship with the federal government, should they be required to coordinate enforcement actions with the federal government? If a state or Tribal government declines to enforce these obligations, or lacks the legal authority to do so, should the Commission itself be responsible for enforcing the obligations?

156. We also seek comment on whether states or Tribal governments may impose additional obligations on funded providers. If so, should the state or Tribe bear the costs associated with those obligations? Does the Commission have the authority to direct states or Tribal governments to impose and enforce additional obligations under existing precedent?<sup>253</sup> As providers transition to all-IP networks, with voice as an application on such networks, what will be the role of state commissions generally in

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<sup>252</sup> See Letter from Dana R. Shaffer, FCC, to Scott Barash, USAC (Oct. 13, 2010), *available at* <http://www.fcc.gov/omd/usac-letters/2010/101310CPA-USAC.pdf> (re independent CPA firm and USAC's procedures for follow-up on audit findings and recommendations in USF program engagements) (Oct. 13, 2010 USAC Letter); Letter from Steven Van Roekel, FCC, to Scott Barash, USAC (Feb. 12, 2010), *available at* <http://www.fcc.gov/omd/usac-letters/2010/021210-ipia.pdf> (re implementation of the Improper Payments Information Act of 2002 (IPIA) assessment program and companion audit program) (Feb. 12, 2010 USAC Letter).

<sup>253</sup> See *United States Telecom Assoc. v. FCC*, 359 F.3d 554, 565 (D.C. Cir. 2004) (finding the Commission may not delegate decision-making authority to outside entities, as opposed to subordinates, absent affirmative evidence of authority to do so).

such matters as determining and enforcing COLR obligations for voice carriers, designating ETCs and monitoring their compliance with ETC voice obligations?

## VI. NEAR-TERM REFORMS

157. Over time, we propose to transform the existing high-cost fund into the Connect America Fund. In the near term, we seek comment on a set of proposals to eliminate waste and inefficiency, improve incentives for rational investment and operation by companies operating in rural areas, and set rate-of-return companies on the path to incentive-based regulation. These reforms will also help ensure that the size of USF is controlled as it transitions from supporting telephone service to broadband.

158. As discussed in detail below, we seek comment on: (a) modifying high-cost loop support reimbursement percentages and eliminating loop support known as “safety net”; (b) eliminating local switching support as a separate funding mechanism; (c) eliminating the reimbursement of corporate operations expenses; (d) imposing reasonable caps on reimbursable capital and operating costs; and (e) capping total high-cost support at \$3,000 per line per year. These reforms would commence in 2012, although they could be phased in over a period of time. These proposals are intended to ensure incentives for rate-of-return carriers to invest in and operate modern networks capable of delivering broadband as well as voice services, while eliminating excessive spending that may ultimately limit funding available to enable the provision of affordable services to consumers in other rural communities that remain unserved.

159. We also seek to encourage small companies to explore opportunities for joint management and operation so that they can continue to serve their communities and offer innovative services to meet consumer demand. We seek comment on measures to remove barriers to achieving efficiencies, specifically to streamline the study area waiver process and revise the “parent trap” rule which limits support upon acquiring lines of another company so as to provide additional support when a company acquires lines in areas that are unserved. We propose to implement both of these reforms in 2012.

160. In addition, beginning in 2012, we propose to eliminate IAS over a few years and rationalize competitive ETC support over five years, eliminating the identical support rule no later than 2016. We propose to re-direct this funding in two ways. In 2012 and potentially again in 2014, we propose to disburse a specific amount of money from the Connect America Fund that will bring broadband to unserved Americans. Through this first phase of the CAF program, we will test an approach that will provide a fixed amount of funding through a competitive process to companies that commit to deploying broadband in the area within three years. During this period, existing ETCs will continue to receive ongoing funding under the existing high-cost programs, subject to any rule changes we may make, as proposed below. As discussed in more detail below, we also propose to use some of the reclaimed IAS and competitive ETC support as part of revenue or cost recovery to help offset reductions in intercarrier compensation rates, particularly interstate access charges, if necessary.<sup>254</sup> We seek comment on these proposals, including on ways to implement these immediate reforms in a technology-neutral manner.

161. We conclude this discussion of near term reforms by seeking comment on measures to encourage state action and how to target funding to areas of greatest need.

### A. Rationalizing Loop Support, Local Switching Support, and Interstate Common Line Support

162. In this section we seek comment on a number of proposals to rationalize the universal service mechanisms for rural and rate-of-return carriers. These mechanisms – HCLS, LSS, and ICLS – often do not provide incentives for controlling capital and operating costs. Moreover, support is not

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<sup>254</sup> See *infra* Section XIV.

distributed among high-cost carriers in a way that maximizes overall consumer benefits across communities. In some areas, more support is provided than a carrier needs to achieve the goal of reasonably comparable services at rates that are affordable and reasonably comparable to those in urban areas, while in other areas carriers cannot afford to deploy modern networks. The intent of the proposals below is to provide us with additional tools to target funding more effectively to support universal service in areas served by the smaller telephone companies, while we consider longer term proposals to provide appropriate amounts of ongoing support for areas that are uneconomic to serve through the Connect America Fund. Considering such reforms is desirable even without the national imperative to advance broadband. Many of these rules have not been comprehensively examined in more than a decade, and prioritize funding in ways that may no longer make sense in today's marketplace.

163. We invite commenters to offer additional or alternative solutions or proposals to reform universal service support for rural and rate-of-return carriers, and request that any comments include detailed supporting analysis and data. We seek comment on the intersection of these proposals, both with each other, and the proposals for intercarrier compensation reform, below.<sup>255</sup> We recognize that some of the proposed rule changes could impact firms that receive public funding from other governmental agencies, such as RUS. To the extent these proposals in the aggregate would impact company cash flow to repay outstanding loans, how should we take that into account, while balancing our commitment to fiscal responsibility?

### 1. Background

164. *Regulatory Framework.* The current high-cost program consists of five separate primary funding mechanisms: (1) HCLS (with additional support available under safety net additive and safety valve), (2) high-cost model support (HCMS), (3) LSS, (4) ICLS, and (5) IAS. Companies receive support depending on whether they are classified as either “rural” or “non-rural” under the Commission’s rules (rural companies receive high-cost loop support, while non-rural companies receive high-cost model support), how they are regulated at the interstate level (rate-of-return carriers receive ICLS, while price cap carriers receive IAS), and the size of the company’s study area LSS.<sup>256</sup> In this section, we focus primarily on the three existing programs – HCLS, LSS and ICLS – that predominantly support rate-of-return carriers, but also price cap carriers to the extent that they receive HCLS or LSS.<sup>257</sup>

165. Rural carriers have fewer than 100,000 lines and serve predominantly rural areas.<sup>258</sup> Most, though not all, rural LECs are subject to rate-of-return regulation under Commission regulations. Our rules in practice provide a stable 11.25 percent return on certain expenditures by rate-of-return companies, regardless of their marketplace performance.<sup>259</sup> Rate-of-return carriers are, by total support, the largest category of high-cost universal service support recipients. In 2010, high-cost support was distributed to 1,150 rate-of-return study areas (owned by 754 holding companies) that received high-cost

<sup>255</sup> See *infra* Sections X-XIV.

<sup>256</sup> A small number of carriers that converted to price cap regulation relatively recently receive ICLS on a frozen, per-line basis, not IAS. See, e.g., *Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order 23 FCC Rcd 5294, 5302-04, paras. 19-22 (2008) (*Windstream Price Cap Conversion Order*). The reforms proposed in this section apply to price cap carriers, including these recent price cap converts, only to the extent that they receive HCLS or LSS. For a discussion of proposed reforms to IAS and frozen ICLS for price cap carriers, see *infra* Sections VI.C and VI.D.

<sup>257</sup> See *supra* note 24. A small number of rural carriers that are price cap companies receive support through Interstate Access Support.

<sup>258</sup> 47 C.F.R. § 51.5 (adopting the 1996 Act’s definition of “rural telephone company” for universal service purposes). Many rural areas are served by non-rural carriers – so classified because they serve too many lines to meet the definition of “rural carrier” – which often are also subject to price-cap regulation in the federal jurisdiction.

<sup>259</sup> In particular, rate-of-return companies have the opportunity to earn a rate of return of 11.25 percent on their regulated common line investment.

disbursements of approximately \$2.0 billion for serving approximately 5.8 million lines.<sup>260</sup> As shown in Figure 6 below, on average, rate-of-return carriers received \$348 in support per line annually, which is \$29 in support per line per month.

Existing High-Cost Fund by Type of Regulation (2010 Actual Disbursements)					
Regulation Type	Study Areas	Support (in millions)	Eligible Lines	Annual \$/Line	Monthly \$/Line
Rate-of-Return	1,150	\$2,016	5,783,801	\$348.48	\$29.04
Price-Cap Converts	105	387	4,536,242	\$85.26	\$7.11
Price-Cap	187	653	106,005,816	\$6.16	\$0.51
<b>Total ILEC</b>	<b>1,442</b>	<b>\$3,055</b>	<b>116,325,859</b>	<b>\$26.26</b>	<b>\$2.19</b>
Price-Cap + Price-Cap Converts	292	\$1,040	110,542,058	\$9.40	\$0.78

Source: USAC actual disbursements January – December 2010. Amounts shown reflect disbursements made on an accrual basis for all study areas for which USAC had line count information as of November 2011. Disbursements may include true-ups for earlier years, and disbursements for calendar year 2010 are subject to additional true-ups during future periods.  
 Note: “Price-Cap Converts” include several ILECs – primarily mid-size carriers – that chose to convert from rate-of-return regulation to price-cap regulation during the 2008 – 2010 time period.

Figure 6

166. Over time, aggregate high-cost support for rate-of-return carriers has increased, while such support for carriers that have chosen to move to price cap regulation has declined, as shown in the Figure 7 below.

<sup>260</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool. This figure includes ICLS, HCLS, and LSS received by carriers that are subject to rate-of-return regulation. It does not include ICLS received by recent converts to price cap regulation or HCLS received by non-rural price cap carriers. A small number of rural LECs, and most larger carriers that do not meet the definition of a “rural telephone company,” operate under price-cap regulation rather than rate-of return regulation. The price cap carriers (including several mid-size companies that recently converted from rate-of-return regulation) received approximately \$1 billion for serving over 111 million eligible lines, or \$0.78 per line per month. This includes \$144 million in high-cost loop support received by rural price cap carriers.

Growth in High-Cost Fund by Type of Regulation 2006 – 2010 Actual (\$ in millions)							
Regulation Type	2006	2007	2008	2009	2010	Growth '06-'10	CAGR '06-'10
Rate-of-Return	\$1,790	\$1,834	\$1,867	\$1,931	\$2,016	\$226	
Growth		2.5%	1.8%	3.4%	4.4%	12.6%	3.0%
Price-Cap Converts	\$489	\$493	\$414	\$411	\$387	(\$102)	
Growth		0.7%	-16.1%	-0.6%	-5.9%	-20.9%	-5.7%
Price-Cap	\$864	\$785	\$727	\$676	\$653	(\$212)	
Growth		-9.2%	-7.4%	-7.0%	-3.4%	-24.5%	-6.8%
Total ILEC	\$3,143	\$3,112	\$3,008	\$3,018	\$3,055	(\$88)	
Growth		-1.0%	-3.4%	0.3%	1.2%	-2.8%	-0.7%

Note: “Price-Cap Converts” include several ILECs – primarily mid-size carriers – that recently converted from rate-of-return regulation to price-cap regulation during the 2008 – 2010 time period.  
Source: 2006 – 2009 disbursements based on Universal Service Monitoring Report 2010. 2010 disbursement data based on USAC actual disbursements January – December 2010. Amounts shown may include true-ups for earlier years. Disbursements for calendar year 2010 are subject to additional true-ups during future periods.

Figure 7

167. HCLS helps offset the non-usage based costs associated with the local loop in areas where the cost to provide voice service exceeds 115% of the national average cost per line.<sup>261</sup> In effect, HCLS serves to shift some loop cost recovery from the intrastate jurisdiction, in which loop costs are recovered through local rates and intrastate access charges, to the interstate jurisdiction, to the federal universal service fund which provides explicit support for such costs.<sup>262</sup>

168. LSS allows incumbent LECs serving 50,000 access lines or fewer to allocate a higher portion of their switching costs to the interstate jurisdiction and recover those costs through the federal universal service fund.<sup>263</sup> Historically, the rationale for LSS was that mechanical switches were relatively expensive for the smallest of carriers because such switches were not easily scaled to the size of the

<sup>261</sup> “Loop costs” are the costs associated with providing the facilities between the carrier’s switch, or central office, and the end user’s premises. This includes not only the investment in copper loop or fiber cable, but the associated labor and maintenance costs and a share of overhead costs. Through the Commission’s cost accounting rules, carriers assign costs to regulated and non-regulated activities, and the regulated costs are further assigned to functional categories, such as loop or switching. The regulated costs are further allocated between the intrastate and interstate jurisdictions. See *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Order, 25 FCC Rcd 6046, 6046-48, paras. 2-4 (2010). The terms “loop” and “common line” are often used interchangeably, but common line costs, as defined by Part 69 of the Commission’s rules include other, non-loop costs such as general support facilities. See, e.g., 47 C.F.R. § 69.307. As described in more detail below, see *infra* para. 176, carriers receive up to 75 percent of their loop costs above a certain cost threshold from HCLS. The remainder is recovered through the interstate jurisdiction and, specifically, ICLS to the extent their interstate common line revenue requirement exceeds their SLC revenues.

<sup>262</sup> See 47 C.F.R. § 36.601(a).

<sup>263</sup> 47 C.F.R. § 36.125(f), (j). The precise amount of the extra allocation depends on a weighting factor determined by the number of access lines served by the incumbent LEC, with key thresholds established at 10,000, 20,000, and 50,000 lines. See 47 C.F.R. § 36.125(f).

carrier, and therefore required additional support from the federal jurisdiction. Smaller carriers continue to receive LSS even though modern switching technology is cheaper and more efficiently scaled to smaller service areas.<sup>264</sup> Qualification for LSS is solely based on the size of the incumbent LEC study area. For that reason, a large incumbent LEC holding company, such as CenturyLink, Frontier, Windstream, or Verizon, may receive LSS for a small study area.<sup>265</sup> Incumbent LECs do not have to meet a high-cost threshold to qualify for LSS.

169. ICLS helps rate-of return carriers, whether classified as “rural” or “non-rural,” recover their interstate common line revenue requirements. The common line revenue requirements for carriers subject to rate-of-return regulation in the federal jurisdiction are equal to their regulated interstate-allocated expenses plus an 11.25 percent rate of return on investment. Carriers satisfy a portion of their common line revenue requirements by assessing customers a flat monthly fee called a SLC.<sup>266</sup> Because SLCs are capped, however, few if any rate-of-return carriers can recover sufficient revenues through SLCs alone. For this reason, rate-of-return carriers receive ICLS to recover any shortfall between their revenue requirement and their SLC revenues. Because ICLS is uncapped, increases in common line costs associated with upgrading and maintaining or operating modern networks, and declines in SLC revenues caused by line loss, both have the effect of increasing federal high-cost universal service support.

170. *Implications of our Regulatory Framework.* Rate-of-return carriers, on the whole, have made significant progress in extending high speed Internet access service in their territories, in part due to the operation of the Commission’s “no barriers to advanced services” policy.<sup>267</sup> As shown in Figure 8 below, according to its 2010 survey, 75 percent of NTCA’s predominantly rural member carriers reported offering Internet access service at speeds of 1.5 to 3.0 Mbps, up from 30 percent in 2005.<sup>268</sup>

<sup>264</sup> See, e.g., 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6610-12, 6613-14 App. A, paras. 254-57, 260-61.

<sup>265</sup> See 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool.

<sup>266</sup> Monthly SLCs are capped at the lesser of the average common line revenue requirement per line per month in a study area or \$6.50 for residential and single line business customers (or \$9.20 for multiline business customers).

<sup>267</sup> In the *Rural Task Force Order*, the Commission emphasized that modern telecommunications networks are not single-use networks and the Commission’s universal service policies should not create barriers to the deployment of modern technology capable of providing access to advanced services. *Rural Task Force Order*, 16 FCC Rcd at 13211-12, paras. 199-200. As a result, carriers are permitted to recover high-cost universal service support for facilities capable of providing broadband data and video services when they are used to provide supported voice services. *Id.*

<sup>268</sup> NTCA 2010 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (Jan. 2011); NTCA 2009 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (November 2009); NTCA 2008 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (October 2008); NTCA 2007 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (September 2007); NTCA 2006 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (August 2006); NTCA 2005 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (September 2005) (NTCA broadband surveys available at [http://www.ntca.org/index.php?option=com\\_content&view=article&id=3757&Itemid=240](http://www.ntca.org/index.php?option=com_content&view=article&id=3757&Itemid=240)). We note that the NTCA survey refers only to service provided by NTCA members and does not reflect deployment of high speed Internet access by other providers serving the same areas as NTCA members. NTCA 2010 Broadband/Internet Availability Survey Report, National Telecommunications Cooperative Association (Jan. 2011).

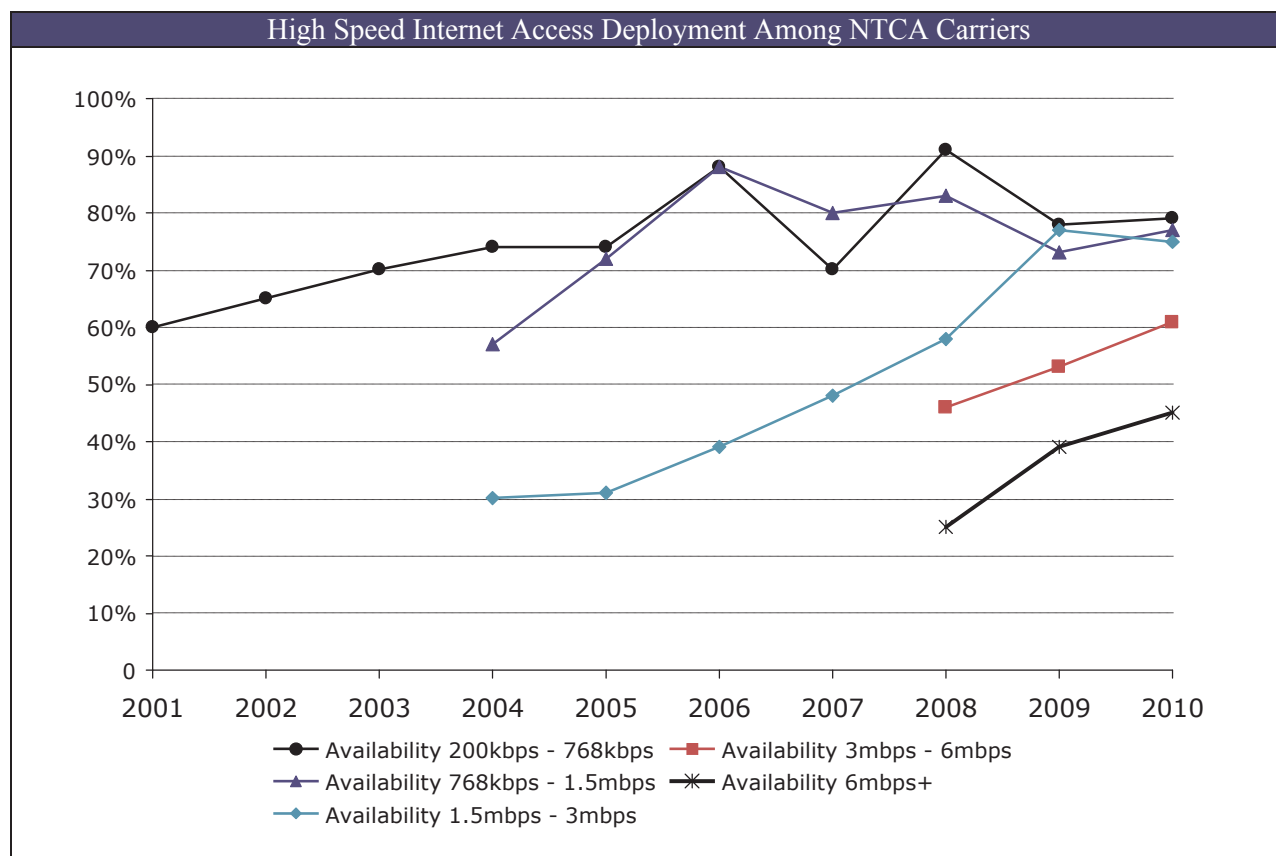


Figure 8

171. At the same time, our current high-cost universal service rules – combined with potential lack of clarity regarding what costs should be reimbursable for universal service purposes – may have the unintended effect of providing some carriers more support than is necessary to ensure reasonably comparable local voice service at reasonably comparable rates.<sup>269</sup> Moreover, our current “no barriers to advanced services” policy imposes no practical limits on the type or extent of network upgrades, so long as such networks continue to provide access to voice service. As such, incumbent companies are free to use high-cost support to deploy broadband networks to areas where there is an unsubsidized competitor, such as a cable company, as well as to areas where satellite service would be a significantly less expensive option. Companies also are free to accelerate network upgrades even where a more measured approach to capital investment might be appropriate, given the demographics of the customer base and rate of consumer adoption for new services. Absent any limits, the rate-of-return regulatory framework provides universal service support to both a well-run company operating as efficiently as possible given the geography and demography of its service area, and a company with high costs due to or exacerbated by imprudent investment decisions, bloated corporate overhead, or an inefficient operating structure.

172. In addition, our high-cost universal service rules may subsidize excessively low rates for consumers served by rural and rate-of-return carriers. One commenter notes that roughly 20 percent of the residential lines of small rate-of-return companies have monthly rates of \$12 or less and another 22 percent have local rates between \$12 and \$15 per month, while the nationwide average urban rate is

<sup>269</sup> We discuss measures to strengthen oversight, including reporting requirements and internal controls, *infra* Section VIII.

\$15.47 according to the most recent reference book of rates published by the FCC.<sup>270</sup> While individual consumers in those areas may benefit from such low rates, when a carrier uses universal service support to subsidize local rates well below those required by the Act, the carrier is spending universal service funds that could potentially be better deployed to the benefit of consumers elsewhere.

173. Although the costs of universal service are spread approximately equally among consumers across the nation, our current rules may not create the right incentives for individual companies. Given our current regulatory framework, those stakeholders who stand to benefit the most may, without realizing it, unfairly increase costs for other consumers. Though those carriers are often acting in the best interests of their customers and communities – and in a manner consistent with or even encouraged by our current rules – excessive spending in any one community may have the unintended consequence of limiting opportunities for consumers in other communities and therefore not be in the best interests of the country as a whole.

174. Below we propose several measures to control the total amount of support, including, among other things, eliminating or capping local switching support and capping total high-cost support on a per-line basis. We believe we have authority to impose such limits. Courts have consistently upheld Commission measures taken to control universal service costs, including caps on support.<sup>271</sup> Our “broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service.”<sup>272</sup> We also have broad authority to adopt transitional rules as we move high-cost support to the CAF.<sup>273</sup> It is particularly appropriate for the Commission to craft a transition plan in this context, where we are acting to reconcile the “implicit tension between” the Act’s goals of “moving toward cost-based rates and protecting universal service.”<sup>274</sup> We seek comment on this issue.

## 2. Modification of High-Cost Loop Support

175. We propose to reduce the reimbursement percentages for high-cost loop support to promote more equitable distribution of limited HCLS funds. We also propose to eliminate the safety net additive component of high-cost loop support. We seek comment on these proposals.

176. As shown in Figure 9 below, HCLS is calculated, in part, based on a formula that allows carriers to recover a higher percentage of their costs from the interstate jurisdiction as their total (interstate and intrastate) study area cost per loop (SACPL) increases relative to the national average cost per loop (NACPL).<sup>275</sup>

<sup>270</sup> Letter from Brian J. Benison, AT&T, to Marlene H. Dortch, FCC, dated Feb. 23, 2010, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51, at Attachment; 2008 Reference Book of Rates, at Table 1.1 (showing urban rates as of Oct. 15, 2007). In 2006, Verizon submitted rate data in the Qwest II Remand proceeding to support the argument that rural carriers charge, on average, 90 percent of the average urban rate and that many rural carriers charge less than that. Comments of Verizon, CC Docket No. 96-45, WC Docket No. 05-337, Declaration at 5 & Attachment B (filed Mar. 27, 2006).

<sup>271</sup> See *Rural Cellular*, 588 F.3d at 1108 (“the Commission acted reasonably by adopting a prophylactic tool it has used numerous times before to control USF growth”); *Alenco*, 201 F.3d at 620 (cap on high cost growth “reflects a reasonable balance between the Commission’s mandate to ensure sufficient support for universal service and the need to combat wasteful spending”).

<sup>272</sup> *Rural Cellular*, 588 F.3d at 1103 (quoting *Alenco*, 201 F.3d at 620-21).

<sup>273</sup> See *supra* Section IV.

<sup>274</sup> *Southwestern Bell Tel Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

<sup>275</sup> For example, most rural carriers receive support equal to 65 percent of costs in excess of 115 percent of the NACPL. If the NACPL is \$100 and a carrier’s costs are \$120, it receives \$3.25 in support:  $(\$120 - (\$100 * 115\%)) * 65\%$ . Those carriers receive support equal to 75 percent of their total costs in excess of the next threshold, (continued....)

High-Cost Loop Fund Formulas		
Study Area Size	Cost Range as % of National Average	% Expense Adjustment Within Range
< 200,000 loops	0 – 115%	0%
	115 – 150%	65%
	150% and above	75%
>200,000 loops	0 – 115%	0%
	115% - 160%	10%
	160% - 200%	30%
	200% - 250%	60%
	250% and above	75%

Figure 9

177. Total HCLS for incumbent LECs is subject to a cap, which is indexed to inflation plus line growth (or minus line loss, which has been the case in recent years). For 2008, 2009, 2010, and 2011, the indexed cap on high-cost loop support was \$1.03 billion, \$1.01 billion, \$962 million, and \$906 million, respectively. The cap operates by adjusting the NACPL used in calculating HCLS upward until the formula yields a total support amount for all incumbent rural carriers equal to the cap amount. As a result, even though the 2009 actual NACPL calculated based on data filed by all incumbent LECs is \$423.15, an NACPL of \$458.36 is used to calculate HCLS for 2011 because that is the level necessary to constrain HCLS within the cap.<sup>276</sup> This “ratcheting up” of the NACPL has the effect of concentrating HCLS among the carriers with the highest costs per loop, at the expense of carriers with high loop costs that nonetheless are relatively lower when compared to these highest cost carriers.

178. As discussed above, the current structure may provide inadequate incentive for high-cost loop support recipients, especially those operating 200,000 or fewer loops, to operate as efficiently as possible.<sup>277</sup> For example, as illustrated in Figure 10 below, data compiled by NECA shows that for most companies, total net plant has declined with access line loss. However, the investment trends for companies that in 2009 had a study area cost per loop (SACPL) greater than 150% of the NACPL were different from what may be expected.<sup>278</sup> Even as these companies experienced increasing rates of access line loss, their investment in net plant continued to increase. This may suggest that these companies continue to invest and upgrade their networks more than otherwise would be considered prudent for a company that is losing customers.

(Continued from previous page) \_\_\_\_\_

150 percent of the NACPL. HCLS is calculated based on the size and cost characteristics of an incumbent LEC’s study area, not at the holding or operating company level. See 47 C.F.R. §§ 36.621, 631; *infra* para. 218.

<sup>276</sup> See National Exchange Carrier Assoc., Inc., NECA’s Overview of Universal Service Fund, Submission of 2009 Study Results USF Filing Overview at 6 (filed Sep. 30, 2010) (NECA 2010 USF Overview Filing), available at <http://www.fcc.gov/wcb/iatd/neca.html>. Actual costs incurred during 2009 are used to calculate 2011 HCLS payments. In addition, the *Rural Task Force Order* “froze” the NACPL (notwithstanding the operation of the cap) at \$240 per loop. See *Rural Task Force Order*, 16 FCC Rcd at 11268, para. 55. Due to the operation of the cap, however, the \$240 frozen NACPL has never been used to actually calculate support.

<sup>277</sup> See *supra* paras. 171 and 176.

<sup>278</sup> See National Exchange Carrier Assoc., Inc., Universal Service Fund Data: NECA Study Results, 1999 Report through 2008 Report, <http://www.fcc.gov/wcb/iatd/neca.html>. Staff analysis based on trends in Net Plant and Total Loops using NECA Universal Service Fund Data Reports from 1999-2008. Analysis is limited to cost company study areas in existence throughout the entire 10 year period, excluding study areas owned by Regional Bell Operating Companies, and does not fully account for changes in study areas due to mergers and acquisitions. Study areas are grouped based on their SACPL relative to the NACPL as reported in the 2008 Report.

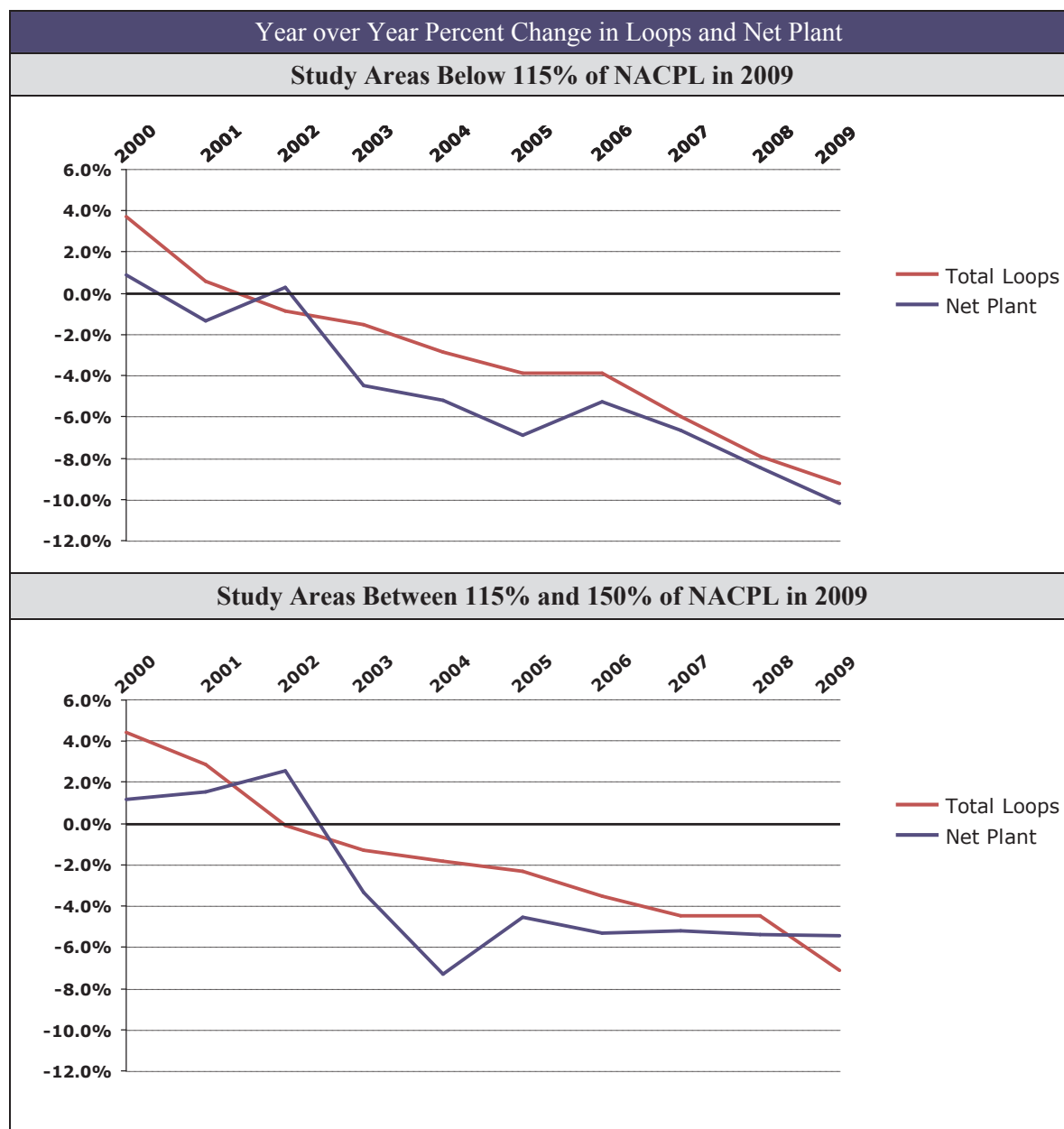


Figure 10

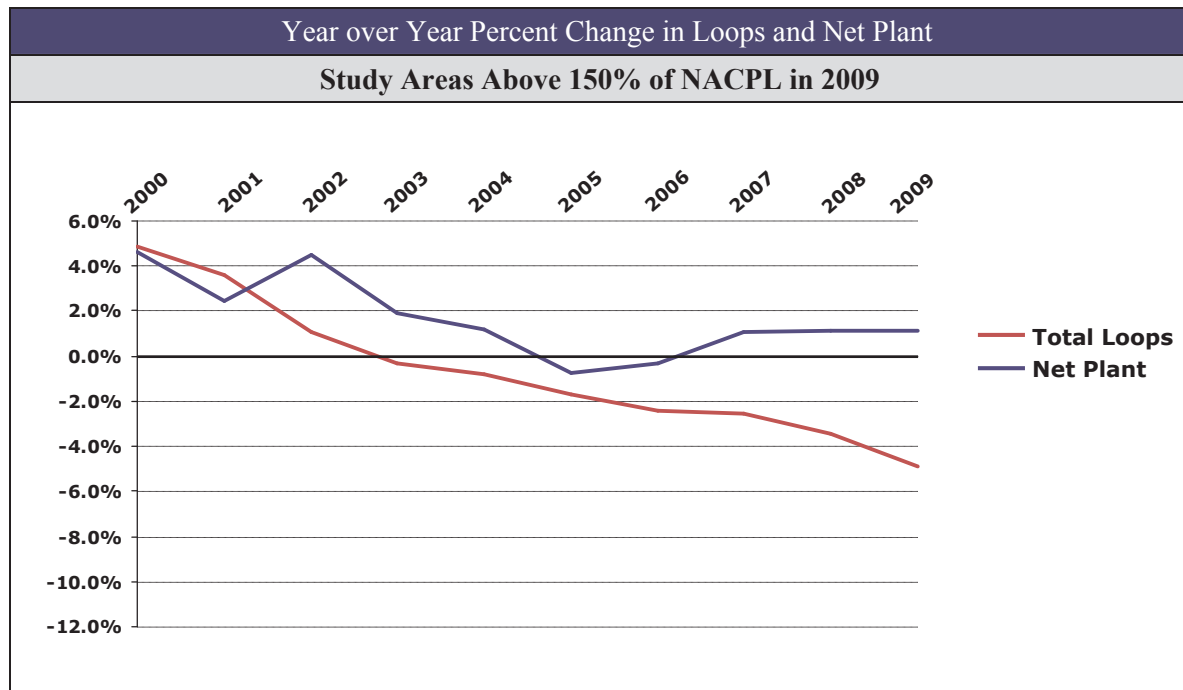


Figure 10 (cont.)

179. As noted above, because of the operation of an indexed cap on HCLS, total available HCLS support has decreased in recent years due to the decline in access lines.<sup>279</sup> As a result, each year, lesser total support must be spread among the qualifying carriers. The existing cap on HCLS and rules for determining support has been sometimes referred to as a “race to the top,” i.e., giving some carriers an incentive to outspend their neighbors to maintain high-cost support. The net result of our existing HCLS rules is to concentrate support among a subset of rural carriers with very high costs and to reduce support to other rural carriers whose costs may be only modestly lower. For instance, in 2007, the cap-adjusted NACPL was \$344 and 1,115 rate-of-return companies qualified for HCLS, with 725 companies having costs in excess of the 150 percent benchmark.<sup>280</sup> By 2010, the NACPL had grown to \$424 and only 1,066 rate-of-return companies qualified for HCLS, with 581 companies having costs in excess of the 150 percent benchmark.<sup>281</sup> Moreover, in 2007, 50 percent of HCLS was claimed by the 340 incumbent LECs with the highest costs per loop, but for 2010, 50 percent of HCLS is concentrated among only 288 incumbent LECs with the highest costs per loop.<sup>282</sup> Figure 11 below depicts how HCLS has been

<sup>279</sup> Total rural high-cost loop support each year is limited to the previous year’s support increased by the sum of Gross Domestic Product-Chained Price Index plus the percentage change in the total number of rural incumbent local exchange carrier working loops during the previous calendar year. See 47 C.F.R. §§ 36.603(a), 36.604. See NECA 2010 USF Overview Filing; NECA 2009 USF-Overview; NECA 2008 USF Overview.

<sup>280</sup> See National Exchange Carrier Assoc., Inc., Universal Service Fund Data: NECA Study Results, 2009 Report (filed Sept. 30, 2010) (NECA 2010 USF Data Filing), <http://www.fcc.gov/wcb/iatd/neca.html>. 2011 support is based on 2009 cost data, filed on October 1, 2010. This submission includes data for the current year plus the previous four years.

<sup>281</sup> See NECA 2010 USF Data Filing.

<sup>282</sup> See *id.*

concentrated among fewer incumbent LECs from 2007 to 2010 and that because of the escalating NACPL, a smaller number of carriers have costs per loop in excess of 150% of the NACPL.<sup>283</sup>

Concentration of Declining High-Cost Loop Support Among Fewer Incumbent Carriers, 2007 to 2010				
Payment Year	HCLS Cap (in millions)	No. of LECs receiving HCLS	No. of LECs with highest costs receiving half of available HCLS support	No. of LECs with costs per loop greater than 150% of NACPL
2007	\$1,050	1,115	340	725
2008	\$1,034	1,112	324	701
2009	\$1,007	1,106	308	614
2010	\$962	1,066	288	581

Figure 11

180. To facilitate more equitable distribution of limited HCLS funds among rural carriers and to increase incentives for carriers to operate efficiently, we propose to decrease the current 65% and 75% support percentages, for incumbent LECs operating 200,000 or fewer loops, to 55% and 65%, respectively. Such incumbent LECs would be eligible for 55% reimbursement at 115% of the NACPL and support would increase to 65% when the average cost per loop is 150% or higher than the NACPL. Because rural LECs also recover 25% of their loop costs from the federal jurisdiction (through SLCs and ICLS), rural LECs would still receive between 80% and 90% reimbursement of costs in excess of 115% of the NACPL from the federal jurisdiction with this modification to high-cost loop support.<sup>284</sup> A reduction in the reimbursement percentages, even a modest reduction as proposed, may encourage incumbent LECs to invest and expend funds more efficiently and effectively, without jeopardizing universal service. We seek comment on this proposal.

181. For those rural carriers that have more than 200,000 working loops, the current reimbursement percentages are 10% when the carrier's cost per loop exceeds 115% of the NACPL, 30% at 160%, 60% at 200%, and 75% at 250%.<sup>285</sup> We note, however, that no rural incumbent LEC with more than 200,000 working loops currently qualifies to receive HCLS based on actual costs.<sup>286</sup> We also propose that the Commission's rule for providing HCLS to carriers with more than 200,000 working loops be eliminated because there are only five rural incumbent LECs with more than 200,000 working loops and all five incumbent LECs have costs per loop that are well below the NACPL.<sup>287</sup> We seek comment on this proposal. We also seek comment on whether the 200,000 threshold for providing support to rural incumbent study areas should be lower and, if so, what the appropriate threshold should be.

<sup>283</sup> Staff analysis of NECA 2010 USF Data Filing. This analysis includes both cost-based and average schedule incumbent LECs.

<sup>284</sup> Carriers would receive between 80% and 90% reimbursement of costs by the combination of recovering 55% or 65% from HCLS and the 25% assignment of loop costs to the federal jurisdiction by jurisdictional separation process. See 47 C.F.R. § 36.154(c).

<sup>285</sup> 47 C.F.R. § 36.631(d).

<sup>286</sup> Windstream Communications, a rural incumbent LEC that operates in Texas, receives frozen per-line HCLS support pursuant to section 54.305 of the Commission's rules due to a purchase of former GTE lines in Texas. See NECA 2010 USF Data Filing.

<sup>287</sup> See NECA 2010 USF Data Filing.

182. Finally, we note that these proposals would not affect the relative balance of cost recovery from the interstate and intrastate jurisdictions at an aggregate level as we expect the effect to spread federal support from a smaller number of carriers to a larger number of carriers. However, to the extent federal support would be lower for some carriers in particular instances, that could create the need for increased state support or higher intrastate rates. Any increased intrastate rates may have to be addressed in connection with our intercarrier compensation reforms discussed later in this Notice.<sup>288</sup> We invite parties to comment on the extent of this potential shift, the effect it will have on the evaluation of the transition and revenue recovery mechanisms identified in connection with intercarrier compensation reform, and any measures that might be available to mitigate those effects.

183. In 2001, as part of the Rural Task Force proceeding, the Commission adopted a rule known as the “safety net additive” with the intent of providing additional support to rural incumbent LECs who make additional significant investments in years where high-cost loop support is capped.<sup>289</sup> The safety net additive provides additional loop support if the incumbent LEC realizes growth in year-end telecommunications plant in service (TPIS) (as prescribed in section 32.2001 of the Commission’s rules) on a per-line basis of at least 14 percent more than the study area’s TPIS per-line investment at the end of the prior period.<sup>290</sup> Essentially, the safety net additive was designed for an incumbent LEC to receive support above its capped support amount for incremental additional investment.<sup>291</sup> Once an incumbent LEC qualifies for such support, it receives such support for the qualifying year plus the four subsequent years.<sup>292</sup>

184. From 2003 to 2010, the safety net additive has increased significantly from \$9.1 million to \$78.9 million.<sup>293</sup> It is projected to be \$90.1 million for 2011, an increase of almost ten-fold in nine years.<sup>294</sup> Aggregate safety net additive support is not capped. We are concerned that this rule may provide inadequate incentives for rural incumbent LECs to operate efficiently and that the rule’s design leads to additional support in situations where no additional investment is occurring. Specifically, some incumbent LECs that qualify for the safety net additive are not qualifying as a result of significant increases in investment. To qualify for the safety net additive, an incumbent LECs year-over-year TPIS, *on a per-line basis*, must increase by a minimum of 14 percent. If an incumbent LEC loses a significant number of lines, however, its per-line TPIS may meet the 14 percent threshold because of the loss of lines

<sup>288</sup> See *infra* para. 490.

<sup>289</sup> 47 C.F.R. § 36.605. The safety net additive was adopted based on the recommendation of the Rural Task Force. See *Rural Task Force Order*, 16 FCC Rcd at 11276-81, paras. 77-90.

<sup>290</sup> See 47 C.F.R. §§ 36.605(c) and 32.2001.

<sup>291</sup> Specifically, the safety net additive is equal to the amount of capped high-cost loop support in the qualifying year minus the amount of support in the year prior to qualifying for support subtracted from the difference between the uncapped expense adjustment for the study area in the qualifying year minus the uncapped expense adjustment in the year prior to qualifying for support as shown in the by the following equation: Safety net additive support = (Uncapped support in the qualifying year–Uncapped support in the base year)–(Capped support in the qualifying year–Amount of support received in the base year). 47 C.F.R. § 36.605(b).

<sup>292</sup> For the four subsequent years, the safety net additive is the lesser of the sum of capped support and the safety net additive support received in the qualifying year or the rural telephone company’s uncapped support. See 47 C.F.R. § 36.605(c)(3)(ii).

<sup>293</sup> See 2010 Universal Service Monitoring Report at Table 3.7.

<sup>294</sup> See Universal Service Administrative Company, Quarterly Administrative Filings for 2011, Second Quarter (2Q), Appendices at HC01 (filed Jan. 31, 2011) (USAC 2Q 2011 Filing), <http://www.usac.org/about/governance/fcc-filings/2011/>.

and not because of significant increases in investment, contrary to the original intent of the rule to provide additional funding only for new investment.<sup>295</sup>

185. For these reasons, we propose to eliminate the safety net additive. We seek comment on this proposal. Should we eliminate the safety net additive immediately, or implement a phase-down over a period of years, such as three years?

### 3. Local Switching Support

186. We propose to eliminate local switching support,<sup>296</sup> or in the alternative, to combine this program with high-cost loop support.

187. Historically, the rationale for LSS was that traditional circuit switches, which were based on specialized hardware, were relatively expensive for the smallest of carriers because such switches were not easily scaled to the size of the carrier, and therefore required additional support from the federal jurisdiction. LSS was created to ensure that small companies would be able to buy large, expensive hardware-based switches. In recent years, however, telecommunications technology has been evolving from circuit-switched to an IP-based environment and many smaller rate-of-return carriers are purchasing soft switches.<sup>297</sup> Soft switches and routers tend to be cheaper and more efficiently scaled to smaller operating sizes than the specialized hardware-based switches that predominated when LSS was created.<sup>298</sup> For that reason, the size-based eligibility for LSS may be inappropriate in an IP-based environment where switching platforms may be shared among non-contiguous properties.

188. LSS provides funding for study areas with 50,000 or fewer access lines, but in some instances, the incumbent LECs that receive LSS serve multiple study areas and much more than 50,000 access lines in total. There are 94 telephone holding companies today that receive local switching support for more than one study area in a given state.<sup>299</sup> For example, in Wisconsin, one carrier provides telephone service to approximately 137,000 lines in 21 separate study areas. The line counts for those 21 study areas range from a low of 1,073 to a high of 30,430 and received disbursements totaling \$2.6 million in LSS for 2010.<sup>300</sup> Similarly, another carrier in Wisconsin serves 17 study areas, 14 of which have less than 50,000 lines each, with approximately 174,000 of its lines in those 14 separate study areas. The line counts for those 14 study areas range from a low of 1,042 to a high of 45,374 and received disbursements totaling \$2.8 million in LSS for 2010.<sup>301</sup> In each instance, because the company chooses to

<sup>295</sup> For example, we are aware of an incumbent LEC that will receive approximately \$6.4 million in safety net additive during 2011 (the highest among any incumbent LEC), even though its total annual year-end TPIS has increased only in the range of between 5% and 9% over the past five years. That carrier, however, has lost approximately 8% of its lines in each of the past two years and 18% of its lines over the past five years. Additionally, its cost per loop is well below the HCLS qualifying threshold and therefore does not qualify for HCLS. See USAC 2Q 2011 filing, Appendices at HC01; NECA 2010 USF Data Filing.

<sup>296</sup> See 47 C.F.R. § 54.301.

<sup>297</sup> See, e.g., 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6610-12, 6613-14 App. A, paras. 254-57, 260-61.

<sup>298</sup> *Id.* A soft switch connects calls by means of software running on a computer system. In such configurations the “switching” is virtual because the actual path through the electronics is based on signaling and database information rather than a physical pair of wires. Soft switches are economically desirable because they offer significant savings in procurement, development, and maintenance. Such devices feature vastly improved economies of scale compared to switches based on specialized hardware. *Id.*; see also *infra* para. 506 (noting that the current intercarrier compensation regime creates the perverse incentive to maintain and invest in legacy, circuit-switched-based networks).

<sup>299</sup> Staff analysis of Universal Service Administrative Company, Quarterly Administrative Filings for 2011, First Quarter (1Q) (filed Nov. 2, 2010) (USAC 1Q 2011 Filing), Appendices at HC08; NECA 2010 USF Data Filing.

<sup>300</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool.

<sup>301</sup> *Id.*

operate through multiple study areas in the state, it is eligible for LSS; if it were required to report its costs at the holding company level in a given state, it would not be eligible for LSS at all.

189. The LSS rule provides support without any high-cost qualifying threshold, i.e., the only qualification is that incumbent LEC study areas have less than 50,000 lines, even when those companies are using scalable switching technology and/or are part of a much bigger holding company. As a result, in 2010, four of the largest carriers in the country received millions (and in some cases tens of millions) of dollars in local switching support because they have some small study areas. These four carriers received \$16.2 million (7.3 million lines), \$14 million (6.6 million lines), \$12.6 million (557,847 lines), and \$9.4 million (2.9 million lines) each in local switching support during 2010.<sup>302</sup>

190. LSS in its current form may not appropriately target funding to high-cost areas, nor does it target funding to areas that are unserved with broadband. For these reasons, we propose to eliminate LSS and utilize those savings to direct support through the CAF to areas that are unserved. We seek comment on this proposal. Should we eliminate LSS immediately, in one year, or implement a transition over a period of years, such as three years? Should we eliminate LSS more quickly, i.e., immediately in 2012, for companies that have more than a specified number of lines, such as 50,000, at the holding company level? What impact would this proposal have on interstate access charges (if we make no changes to our access charge rules) or local rates? If we were to eliminate LSS, do we need to allow existing recipients an opportunity to recover sunk costs associated with their past investment in switches? In this regard, we request that current local switching support recipients provide information on the types of switching equipment currently employed, including dates placed in service, and information on the remaining depreciable life of such equipment.

191. Alternatively, we propose to combine LSS and HCLS into one high-cost mechanism that recognizes support should flow to areas with above-average costs. Merging these two support mechanisms into one may be more appropriate as telecommunications network architecture evolves toward an all-IP environment; indeed, the distinction between certain switching and loop equipment has blurred over the years due to the evolution of telecommunications technology. Combining these two high-cost mechanisms could reduce the incentives for carriers to design network architecture or to classify equipment in a particular way merely to maximize high-cost support.<sup>303</sup> This distinction is important because a remote switch is eligible for support under the LSS rules, while a remote terminal of a concentrator is eligible for support under the HCLS rules.<sup>304</sup>

192. Finally, merging of LSS and HCLS into one program may also remove the incentive for carriers not to merge study areas within the same state. The current LSS rules reward incumbent LECs for maintaining small study areas in a state, even in situations where they have other operations in the state, by allowing additional recovery of costs from the interstate jurisdiction. Combining LSS with HCLS may encourage carriers to gain the efficiencies of scale by merging operations with other small

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<sup>302</sup> Sept. 2010 Trends in Telephone Service, at Table 7.3.

<sup>303</sup> In 1992, the Bureau issued a Responsible Accounting Officer Letter 21 (RAO 21) to define how to differentiate between remote switching equipment and remote terminals of a concentrator. *See Responsible Accounting Officer Letter 21*, Classification of Remote Central Office Equipment for Accounting Purposes, 7 FCC Rcd 6075 (1992) (RAO 21); *see also* Letter from Albert M. Lewis, Chief, Pricing Policy Division, Wireline Competition Bureau to John T. Nakahata, Counsel for Aztek Network, 24 FCC Rcd 2945 (2009) (clarifying that “the installation of emergency standalone routing capability at a terminal classified as a remote concentrator prior to installation of such capability shall not alter the classification of that terminal or location as a remote terminal of a concentrator, provided that the router does not routinely perform the interconnection function locally.”).

<sup>304</sup> The Bureau issued RAO 21 in part to address a concern that some carriers were improperly classifying remote switches as loop circuit equipment rather than as switching equipment, which would result in greater amounts of HCLS. *See RAO 21* at 1.

rural study areas, because there no longer would be an advantage to keeping the two study areas separate to maximize LSS receipts.<sup>305</sup>

193. Under this alternative proposal to revise the Commission's rules to combine local switching costs with loop costs into one high-cost loop and switching support mechanism known as local high-cost support (LHCS), LHCS would be calculated in a similar manner to HCLS, where incumbent LECs would qualify if their LHCS cost per loop exceeds the national average cost per loop by 115%. HCLS is currently capped, while LSS is not capped. We propose to establish a cap for the new LHCS as the sum of the current cap on HCLS in the year of implementation of the proposed rule change, plus total LSS support paid during the calendar year prior to the implementation of LHCS. In the alternative, should the new LHCS cap be the sum of the current cap on HCLS in the year of implementation of the proposed rule change and the amount of LSS received in the prior year by companies with 50,000 or fewer lines at the holding company level, with the remaining funds, not incorporated into LHCS, folded into the CAF? This reformed support mechanism would be subject to whatever other rule changes we adopt as proposed in this Notice, such as the proposal to impose benchmarks on allowable expenses, the proposal to reduce the reimbursement percentages, and the overall limitation on total support per line. We propose to index the LHCS cap using the rural growth factor as is currently used for HCLS.<sup>306</sup> We seek comment on these proposals. What impact, if any, would these proposals have on rates for local service or interstate access charges?<sup>307</sup>

#### 4. Corporate Operations Expenses

194. We propose to reduce or eliminate universal service support for corporate overhead expenses.

195. Corporate operations expenses are general and administrative expenses, sometimes referred to as overhead expense.<sup>308</sup> More specifically, corporate operations expense includes expenses for overall administration and management, accounting and financial services, legal services, and public relations.

196. Corporate operations expenses are currently eligible for recovery through HCLS, LSS, and ICLS,<sup>309</sup> although for many years the Commission has limited the amount of recovery for these expenses through HCLS (but not through LSS and ICLS).<sup>310</sup> We estimate that approximately \$117 million or 13% of HCLS support during 2011 is for corporate operations expenses.<sup>311</sup>

197. In the *Universal Service First Report and Order*, the Commission agreed with commenters that these expenses do not appear to result from costs inherent in providing telecommunications services, but rather may result from managerial priorities and discretionary spending.<sup>312</sup> As a result, the Commission limited the amount of corporate operations expense that could be recovered from HCLS to help ensure that carriers use such support only to offer better service to their customers through prudent facility investment and maintenance consistent with their obligations under section 254(k).<sup>313</sup> Section 36.621(a)(4) of the Commission's current rules specifies the limits on the

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<sup>305</sup> See *supra* para. 189.

<sup>306</sup> 47 C.F.R. § 36.604.

<sup>307</sup> See *infra* para. 557 (seeking comment on the need to cap interstate access rates).

<sup>308</sup> 47 C.F.R. § 32.6720.

<sup>309</sup> 47 C.F.R. §§ 36.611(e), 54.301, and 54.901.

<sup>310</sup> 47 C.F.R. § 36.611(e).

<sup>311</sup> Staff analysis of NECA 2010 USF Data Filing.

<sup>312</sup> See *Universal Service First Report and Order*, 12 FCC Rcd at 8930, para. 283.

<sup>313</sup> See *id.* at 12 FCC Rcd at 8930, para. 283.

amount of corporate operations expense that may be recovered from HCLS.<sup>314</sup> Holding companies with multiple operating companies in different study areas allocate their overhead costs among their study areas. This creates incentives for such holding companies to arbitrarily allocate overhead to avoid the corporate operations expense limitations for HCLS.

198. To focus finite universal service funds more directly on investments in network build-out, maintenance, and upgrades, we propose to eliminate the eligibility for recovery of corporate operations expenses through HCLS, LSS, and ICLS. We seek comment on this proposal. We also seek comment on alternatives to outright elimination of corporate operations expense as eligible for recovery, such as limiting the amount of corporate operations expenses eligible for recovery at the holding company level, rather than at the study area level. Such a proposal could eliminate potential gamesmanship in the allocation of such expenses among commonly-owned study areas. We also seek comment on whether there is any basis to permit recovery of such expenses for one program as opposed to another.

199. Through operation of the indexed cap on HCLS, the overall amount of HCLS available to carriers has decreased in recent years from \$1.01 billion in 2009 to \$906 million for 2011 due to the decline in access lines.<sup>315</sup> As a result, each year, fewer dollars must be spread among qualifying carriers. Reduction or elimination of corporate operations expense as an eligible expense for purposes of high-cost loop support would enable more targeted and efficient use of these limited funds. First, it would reduce the overall pressure for high-cost loop funds at the indexed cap. Second, it would result in more funds being made available under the cap for direct support of investment and maintenance of facilities, without changing the overall amount of HCLS.<sup>316</sup>

200. With respect to LSS, we seek comment on the effect of reducing or eliminating corporate operations expense as an eligible expense and whether that would have a material effect on current recipients. Regarding ICLS, we seek comment on the effect on interstate rates or carriers' opportunity to earn the authorized interstate rate-of-return if corporate operations expense is reduced or eliminated as an eligible expense for ICLS. Finally, should we reduce or eliminate the recovery of corporate operations expense in one year, or implement a transition over a period of years, such as three years?

## **5. Limits on Reimbursable Operating and Capital Costs**

201. We propose to establish benchmarks for reimbursable operating and capital costs for rate-of-return companies. Our proposal is based significantly on analysis submitted by the Nebraska Rural Independent Companies.<sup>317</sup>

202. Currently, rural rate-of-return carriers with high loop costs may have up to 100 percent of their marginal loop costs above a certain threshold reimbursed from the federal universal service fund. This produces two interrelated effects. First, carriers with high costs may further increase their loop costs

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<sup>314</sup> The Commission's rules limit corporate operations expense to a monthly per-line amount developed from a statistical study of data submitted by NECA in its annual filing. 47 C.F.R. § 36.621(a)(4). Incumbent LECs with less than 6,000 lines are allowed monthly corporate operations expense as much as \$50,000 divided by the number of access lines. 47 C.F.R. § 36.621(a)(4)(ii)(A). For example, for 2009 operating results, one incumbent telephone company with only 19 access lines, will be claiming \$587 in corporate operations expense per-line per month for purposes of calculating 2011 high-cost loop support. *See* NECA 2010 USF Data Filing. In other words, USF is subsidizing the majority of the nearly \$600 dollars in overhead per customer every month.

<sup>315</sup> *See* Universal Service Fund, 2008 Submission of 2007 Data Collection Study Results by the National Exchange Carrier Association, Inc. (Sep. 30, 2008); NECA 2010 USF Data Filing.

<sup>316</sup> Even though our proposal eliminates the eligibility of corporate operations expense for high-cost loop support, it is unlikely that, due to the operation of the indexed cap, total high-cost loop support would decrease.

<sup>317</sup> *See* Letter from Thomas Moorman, Counsel to Nebraska Rural Independent Companies, to Marlene H. Dortch, FCC, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, Attachment (dated Jan. 7, 2011) (Nebraska Rural Independent Companies Study).

and recover the marginal amount entirely from USF, rather than from their customers. Second, carriers that take measures to cut their costs to operate more efficiently may actually lose support to carriers that increase their costs. These two effects may lessen incentives for some carriers to control costs and invest rationally. It also shifts the responsibility of supporting these high-cost carriers to the federal jurisdiction, and ultimately to consumers across the country.

203. We propose to address these shortcomings in our current rules by capping the amount of operating expenses (opex) and capital expenses (capex) that are reimbursable for universal service purposes at specified levels that will allow ongoing, reasonable investment consistent with section 254. Opex and capex amounts above the cap would be ineligible for reimbursement through universal service. Because opex and capex have different drivers of cost, caps on each would need to be based on separate analyses.<sup>318</sup> Specifically, we propose to use regression analyses to estimate appropriate levels of opex and capex for each incumbent study area. Drivers of capex likely include factors such as density (area density, e.g., homes per square mile; or linear density, e.g., homes per linear road mile), topography, and soil type.<sup>319</sup> Drivers of opex could include such line items as staff salaries, rent, and power costs. From a modeling perspective, we could parameterize these costs in terms of quantities more easily modeled or captured in data, such as plant investment (more plant investment being indicative of, for example, more employees to operate and maintain operations) or the number of subscribers (e.g., as an indicator of billing and customer care costs). In each case, the actual variables used and their weights would be determined by standard statistical techniques. Given sufficient source data, we could potentially create different regressions for operators of different size to capture scale effects.<sup>320</sup>

204. Under this proposal, a carrier would only be eligible for reimbursement from the HCLS and ICLS mechanisms for capex and opex at or below a specified threshold. This proposal would establish clear standards that could be evaluated in the context of compliance audits and other ongoing Commission oversight.<sup>321</sup> We seek comment on this proposal. It would also provide regulatory clarity regarding appropriate expenses and investment, and enable companies to plan ahead for longer-term investment. We note that under such a proposal, the Commission would retain the authority to conclude

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<sup>318</sup> See Omnibus Broadband Initiative, The Broadband Availability Gap: OBI Technical Paper No. 1, at 96 (April 2010) (OBI, Broadband Availability Gap); OBI, Broadband Assessment Model, Documentation, at 22-34; *both available at* <http://www.broadband.gov/plan/broadband-working-reports-technical-papers.html>; *see also* Nebraska Rural Independent Companies Study.

<sup>319</sup> See Nebraska Rural Independent Companies Study. We note that Nebraska has successfully implemented a state universal service fund that relies significantly on household density to determine support. See Nebraska Rural Independent Companies July 12, 2010 Comments, at Attachment B.

<sup>320</sup> Indeed, many rate-of-return carriers already effectively receive support based on a similar regression analysis under the Commission's average schedule rules, although we do not propose to use that methodology here. The National Exchange Carrier Association (NECA) is an association that allows rate-of-return carriers to pool costs and revenues for the purpose of filing common tariffs. Pursuant to sections 36.611, 36.612, and 36.613 of the Commission's rules, NECA also has responsibility for collecting loop cost data from all LECs and calculating HCLS. 47 C.F.R. §§ 36.611-613. Some carriers, called average schedule carriers, do not routinely file their cost data for either tariff settlement or universal service purposes. Instead, NECA annually proposes formulas to determine settlements and HCLS. These formulas are derived from a regression analysis performed on cost data filed by non-average schedule companies and a sample of average schedule companies. See *National Exchange Carrier Association, Inc. and Universal Service Administrative Company; 2010 Modification of Average Schedule Universal Service Support Formulas; High-Cost Universal Service Support*, WC Docket No. 05-337, Order, DA 10-2350 (rel. Dec. 20, 2010); 2011 National Exchange Carrier Inc.'s Association Modification of the Average Schedule Universal Service High-Cost Loop Support Formula, Docket No. 05-337 (filed August 24, 2010); National Exchange Carrier Association Inc.'s 2010 Modification of Average Schedule Formulas, WC Docket No. 09-221 (filed December 23, 2009).

<sup>321</sup> For a discussion of proposals related to oversight of high-cost universal service, *see infra* Section VIII.

investment in a particular instance is not appropriate, even though within the benchmark. We seek comment on this proposal.

205. To follow such an approach, the Commission would need access to a source data set for each analysis that is both reasonably representative of the carriers to whom we would apply its results, and indicative of reasonable levels of costs. We seek comment on sources of availability of such data to the Commission. In particular, we seek comment on the potential use of cost data from rate-of-return carriers and/or the Rural Utilities Service for such an analysis, and whether such data would be sufficiently representative. In addition, because we anticipate benefits from public input to any such data collection and related analysis, we seek comment on ways to solicit and incorporate input from the public in a way that is consistent with the timeline laid out for these reforms.

206. We seek comment regarding the implementation details of such caps. What cost data should be used in the regression analysis, and how often should it be updated? What cost drivers should be considered for inclusion in the regression analysis? Are there benefits to a simpler formula, with fewer variables (perhaps even one relying solely on density) over a more complex formula using more variables? Would a cap of 110 percent of the estimated cost and investment provide a reasonable buffer for carriers that have higher costs for reasons not captured in the formulas? Should the allowable percentage above the benchmark be set higher or lower? We also seek comment regarding whether a process should be created to permit carriers with higher costs to receive a greater amount of support notwithstanding the cap based on a showing that their costs are justified for reasons not captured in the formula. We also seek comment regarding whether additional allowances should be made for carriers that have existing loans or other commitments that would make immediate implementation of the caps unduly burdensome. Alternatively, we seek comment regarding whether some alternative means of cost recovery should be permitted when a carrier's expenses exceed the relevant benchmarks and how this proposal would impact rates. We also seek comment on whether this proposal should be applied only to a limited subset of expenses, such as corporate operations expenses, as opposed to all accounts.

207. Finally, we seek comment on whether this proposal would be an effective method for limiting the growth of ICLS and better distributing HCLS among rural carriers. We recognize that this proposal to cap reimbursable expenses, in its application to ICLS, may affect some carriers' opportunities to recover the amounts that they currently do through interstate rates. Would such a change result in a carrier receiving an amount from interstate access charges that would produce an inadequate return on its interstate net investment? We seek comment on whether this proposal could be implemented solely by modifying the Commission's universal service rules, or whether the rate-of-return rules should be amended as well to implement this proposal.

## **6. Limits on Total per Line High-cost Support**

208. We propose to adopt a cap on total support per line for all companies operating in the continental United States.

209. Although the current HCLS mechanism is capped in the aggregate, there is no cap on the amount of high-cost loop support an individual incumbent LEC may receive. Further, there is no limit on support either in the aggregate or for an individual incumbent LEC for ICLS and LSS. As shown in Figure 12 below, for calendar year 2010, out of a total of approximately 1,442 incumbent LECs receiving support, less than 20 incumbent LECs received more than \$3,000 per line annually (i.e., more than \$250 monthly) in high-cost universal service support.<sup>322</sup>

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<sup>322</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool.

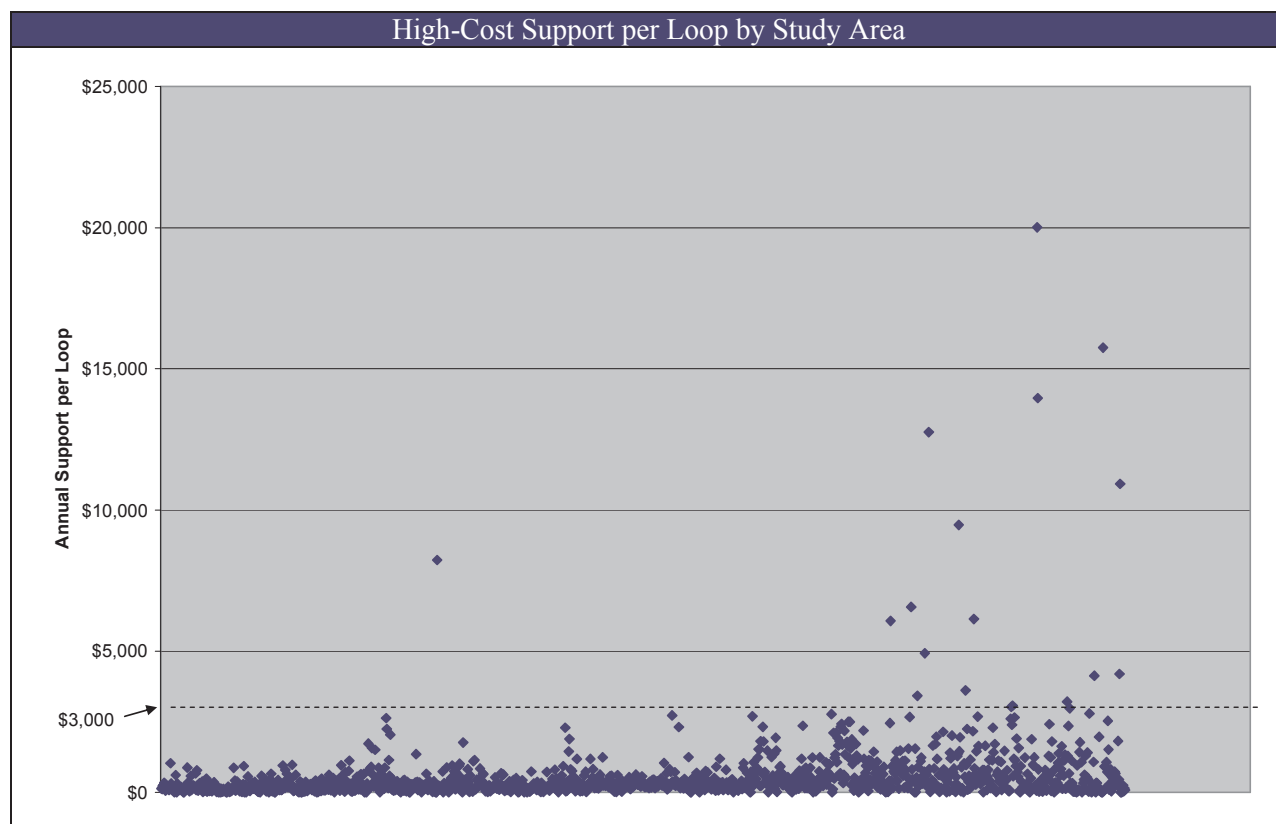


Figure 12

210. We recognize that the cost of providing terrestrial phone service in some rural areas is significant, and we reaffirm that universal service must truly be universal. But some companies with fewer than 500 lines have received USF support for line, switching, and other costs in the last several years ranging between \$8,000 to over \$23,000 per year per line, which translates into subsidies for local phone service ranging from roughly \$700 to nearly \$2,000 per line per month.<sup>323</sup> We recognize that there may be unique circumstances in very high-cost areas justifying higher levels of support, and that not all areas may be reachable by satellite offerings because of geographic or topographic limitations. But we seek comment on whether requiring American consumers and small businesses, whose contributions support universal service, to pay more than \$3,000 annually or more than \$250 per month for a single home phone line is consistent with fiscally responsible universal service reform.

211. As we move forward to transform the existing high-cost fund into the Connect America Fund, it may be prudent to adopt as an interim step a cap on total annual support per line. When universal service support for a carrier exceeds the cap, there would be a rebuttable presumption that the costs associated with the support above the cap are ineligible for recovery through universal service. We seek comment on this proposal and the level of the total per line cap amount (e.g., \$3,000 per line annually). In setting the level of the cap in total support per line, should we take into account the equivalent cost of satellite voice and/or broadband service? We also seek comment on what would be a reasonable transition period from the current unlimited per-line support to the limited per-line support. For instance, should we implement this proposal in one year, or implement a transition over a period of years, such as three years? Should there be an exception for carriers serving Tribal lands in addition to carriers operating outside of the continental United States?

<sup>323</sup> *Id.* On average, incumbent LECs operating less than 500 lines receive approximately \$1,148 per-line in high-cost support annually.

212. We also seek comment on the application of a total per-line cap to each universal service mechanism. For example, if the per-line cap is \$3,000 and an incumbent LEC would have received, prior to the application of a cap, \$2,400, \$1,000, and \$600 (\$4,000 total) in HCLS, LSS (or combined LHCS), and ICLS, respectively, how would the reduction in support be applied to each high-cost support mechanism? Should each mechanism be reduced by its relative percentage to the total pre-cap high-cost support?<sup>324</sup> Alternatively, should an order of precedence for reducing support be established, e.g., first HCLS would be reduced, then LSS, and then ICLS until the necessary reduction is attained?

213. We also seek comment on whether we should develop separate per-line caps for each universal service mechanism. Because 25 percent of total common line costs are allocated to the interstate jurisdiction and recovered through SLCs and ICLS, while carriers with costs per loop exceeding 150 percent of the NACPL qualify for the 75 percent recovery rate under the HCLS formula, the federal fund bears most of the burden to ensure these carriers satisfy their revenue requirements.<sup>325</sup> We are concerned that, absent some limit in federal support, carriers lack adequate incentives to curb costs. Should we impose per-line caps on LSS and HCLS to limit the amount of costs that can be shifted to the interstate jurisdiction through these mechanisms? If we were to take such action, how would companies recover such costs?

214. We seek comment on whether an incumbent LEC whose current per-line support is above the cap should be able to make a showing that additional support is in the public interest. Specifically we seek comment on what criteria should be applied when considering the request and whether the availability of less costly satellite voice service (or voice and broadband service) is a sufficient criterion to establish that additional support is not in the public interest. We also seek comment on whether such a showing should include the following additional information about that carrier:

- Density characteristics of the study area including total square miles, subscribers per square mile, route miles, subscribers per route mile, or any other characteristics that contribute to the study area's high costs. We propose to include this information because physical attributes of a study area are likely a primary driver of costs per line.<sup>326</sup>
- How unused or spare equipment or facilities is accounted for by providing the Part 32 account and Part 36 separations category this equipment is assigned to. We propose to include this information because plant held for future use is not eligible for support.<sup>327</sup>
- Specific details on the make-up of corporate operations expenses such as corporate salaries, the number of employees, the nature of any overhead expenses allocated from affiliated or parent companies, or other expenses. We propose to include this information because corporate operations expense is highly discretionary.<sup>328</sup>
- All local rate plans including local, long distance, Internet, video, and wireless package plans. We propose to include this information because rural rates should be comparable and not significantly less than urban rates if the incumbent LEC is eligible for support.
- A list of services other than traditional telephone services provided by the universal service supported plant, e.g., video, Internet, and the percentage of the study area's telephone

<sup>324</sup> Using this methodology, HCLS, LSS and ICLS would each absorb 60%, 25% and 15%, respectively, of the \$1,000 in excess of the per-line cap of \$3,000.

<sup>325</sup> When costs per loop exceed 150% of the NACPL, carriers currently receive 100% recovery of incremental costs from the combination of jurisdictional separations (25% of costs) and high-cost loop support (75% of costs). 47 C.F.R. §§ 36.154(c) and 36.631(c)(2).

<sup>326</sup> See *supra* para. 203 (discussing cost drivers).

<sup>327</sup> 47 C.F.R. § 36.611.

<sup>328</sup> See *supra* para. 197.

subscribers that take these additional services. We propose to include this information to determine the extent of cross-subsidization to competitive services, if any.

- Procedures for allocating shared or common costs between incumbent LEC regulated operations and competitive operations. We propose to include this information to verify that competitive operations are allocated a fair share of shared or common costs.
- Audited financial statements and notes to the financial statements, if available, and otherwise unaudited financial statements for the most recent three fiscal years. Specifically, the cash flow statement, income statement and balance sheets. We propose to include this information to verify that rates of return, cash flow and net income are sufficient to service any outstanding debt.

215. We also seek comment on the effect on interstate rates or the incumbent LEC's ability to earn the authorized interstate rate-of-return should ICLS support be reduced because of an application of a cap on total support. Should we re-examine the 11.25 percent rate-of-return for any company over that cap to determine whether the imposition of such a cap would prevent it from earning its authorized rate-of-return? Should we lower the authorized rate of return for any such carrier?

## **B. Reducing Barriers to Operating Efficiencies**

216. We propose specific changes to our current processes and rules to remove obstacles to increasing the operational efficiencies of incumbent LECs. Specifically, we propose to streamline the study area waiver process to facilitate the transfer and acquisition of exchanges and consider in our public interest inquiry whether granting such a waiver would result in beneficial consolidation. We also propose to revise section 54.305 to strike a better balance between discouraging carriers from acquiring exchanges solely to increase universal service support and encouraging carriers to invest in modern communications networks. We seek comment on these proposals.

217. Our current universal service rules may have the unintended consequence of discouraging beneficial consolidation of small carriers by subsidizing inefficient operating structures and limiting the ability of small companies to acquire and upgrade lines from other providers that have little interest in serving rural markets. As noted above, in 2010, there were 1,150 incumbent rate-of-return operating companies (owned by 754 incumbent telephone holding companies), the vast majority of which are also rural carriers eligible to receive HCLS.<sup>329</sup> Although we recognize the benefits of local firms serving local markets, it may not serve the public interest for consumers across the country to subsidize the cost of operations for so many very small companies, when those companies could realize cost savings through implementation of efficiencies of scale in corporate operations that would have little impact on the customer experience.

### **1. Study Area Waiver Process**

218. A study area is the geographic territory of an incumbent LEC's telephone operations. The Commission froze all study area boundaries effective November 15, 1984.<sup>330</sup> The Commission took this action to prevent incumbent LECs from establishing separate study areas made up only of high-cost exchanges to maximize their receipt of high-cost universal service support. A carrier must therefore apply to the Commission for a waiver of the study area boundary freeze if it wishes to transfer or acquire additional exchanges.<sup>331</sup>

<sup>329</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool.

<sup>330</sup> See *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72, 80-286, Decision and Order, 50 Fed. Reg. 939 (1985) (*Part 67 Order*). See also 47 C.F.R. Part 36, App.

<sup>331</sup> *Part 67 Order* at para. 1.

219. The Commission's current procedures for addressing petitions for study area waiver require the Wireline Competition Bureau to issue an order either granting or denying the request. Most petitions for study area waiver are routine in nature and are granted as filed without modification. Nevertheless, the current rules require the issuance of an order granting the request. To more efficiently and effectively process petitions for waiver of the study area freeze, we propose to streamline the process. We propose a process similar to the Bureau's processing of routine section 214 transfers of control applications.<sup>332</sup> The section 214 process deems the application granted, absent any further action by the Bureau, on the 31st day after the date of the public notice listing the application as accepted for filing as a streamlined application.<sup>333</sup>

220. We propose that upon receipt of a petition for study area waiver, a public notice shall be issued seeking comment on the petition. As is our normal practice, comments and reply comments would be due 30 and 45 days, respectively, after release of the public notice. Under this streamlined proposal, rather than the requirement for the issuance of an order granting the petition for waiver, the waiver would be deemed granted 60 days after the reply comment due date absent any further action by the Bureau. Additionally, any study area waiver related waiver requests that petitioners routinely include in petitions for study area waiver, which we routinely grant, would also be deemed granted after the 60 day period.<sup>334</sup> Should the Bureau have concerns with any aspect of the petition for study area waiver, however, the Bureau would issue a subsequent public notice stating that the petition will not be deemed granted 60 days after the reply comment due date and is subject to further analysis and review. We seek comment on this proposal.

221. In evaluating petitions seeking a waiver of the rule freezing study area boundaries, the Commission currently applies a three-prong standard: (1) the change in study area boundaries must not adversely affect the universal service fund; (2) the state commission having regulatory authority over the transferred exchanges does not object to the transfer; and (3) the transfer must be in the public interest.<sup>335</sup> In evaluating whether a study area boundary change will have an adverse impact on the universal service fund, the Commission historically has analyzed whether a study area waiver would result in an annual aggregate shift in an amount equal to or greater than one percent of high-cost support in the most recent calendar year.<sup>336</sup> The Commission began applying the one-percent guideline in 1995 to limit the potential adverse impact of exchange sales on the overall fund, and partially in response to the concern that, because high-cost loop support was capped, an increase in the draw of any fund recipient necessarily

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<sup>332</sup> 47 C.F.R. §§ 63.03-04.

<sup>333</sup> 47 C.F.R. § 63.03.

<sup>334</sup> Typically, petitions for study area waivers also include a request for waiver of section 69.3(e)(11) of the Commission's rules to include any acquired lines in the NECA pool or a request to remain an average schedule company after an acquisition of exchanges. 47 C.F.R. §§ 69.3(e)(11) and 69.605(c). Requests for waiver of section 54.305 are not routinely granted because such requests require a high degree of analysis. *See United Telephone Company of Kansas, United Telephone of Eastern Kansas, and Twin Valley Telephone, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36 of the Commission's Rules; Petition for Waiver of Section 69.3(e)(11) of the Commission's Rules, Petition for Clarification or Waiver of Section 54.305 of the Commission's Rules*, CC Docket No. 96-45, Order, 21 FCC Rcd 10111, 10117, n. 45 (Wireline Comp. Bur. 2006) (*United-Twin Valley Order*).

<sup>335</sup> *See, e.g., US WEST Communications, Inc., and Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules*, AAD 94-27, Memorandum Opinion and Order, 10 FCC Rcd 1771, 1772, para. 5 (1995) (*PTI/Eagle Order*).

<sup>336</sup> *See id.* at 1774, paras. 14-17; *see also US WEST Communications, Inc., and Eagle Telecommunications, Inc., Joint Petition for Waiver of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules, and Petition for Waiver of Section 61.41(c) of the Commission's Rules*, AAD 94-27, Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd 4644 (1997).

would reduce the amounts that other LECs receive from that support fund.<sup>337</sup> After the Commission adopted its current “parent trap” rule limiting companies that acquire lines from another company from realizing additional high-cost support, section 54.305, it continued to apply the one-percent guideline to determine the impact on the universal service fund in light of the adoption of safety valve support and ICLS.<sup>338</sup>

222. At the time the one-percent guideline was implemented in 1995, the Universal Service Fund consisted of high-cost loop support for incumbent LECs.<sup>339</sup> The annual aggregate high-cost loop support at the time of the establishment of the one-percent guideline was approximately \$745 million.<sup>340</sup> The threshold for determining an adverse impact at that time, therefore, was approximately \$7.45 million. Subsequently, the Telecommunications Act of 1996 directed the Commission to make universal service support explicit, rather than implicitly included in interstate access rates.<sup>341</sup> As a result, over the next few years the Commission created universal service high-cost support mechanisms for local switching, interstate common line access, and interstate access.<sup>342</sup>

223. The expansion of universal service high-cost support to include additional mechanisms, pursuant to the 1996 Act, significantly increased the base from which the one-percent guideline is applied with respect to determining whether a study area waiver would result in an adverse effect on the fund. Currently, annual aggregate high-cost support for all mechanisms is approximately \$4.3 billion.<sup>343</sup> One-percent of \$4.3 billion is \$43 million. The study area waiver with the greatest estimated impact on universal service support in the past several years was the *United-Twin Valley Order* where the estimated increase in support was \$800,000 or only approximately 2% of the current \$43 million one-percent threshold.<sup>344</sup>

224. Continuing to apply the one-percent guideline in this manner is unlikely to shed any insight on whether a study area waiver should be granted. It is implausible that any study area waiver could exceed the one-percent of aggregate universal service support.<sup>345</sup> Moreover, the cumulative impact

<sup>337</sup> See *PTI/Eagle Order*, 10 FCC Rcd at 1773, para. 13.

<sup>338</sup> See *infra* note 346.

<sup>339</sup> See *PTI/Eagle Order*, 10 FCC Rcd at 1773, para. 17; 47 C.F.R. § 36.601-631. Although dial equipment minute (DEM) weighting and other implicit support flows were present in the Commission’s rules at the time, only high-cost loop support was considered for the purposes of the one-percent rule.

<sup>340</sup> See Universal Service Fund 1997 Submission of 1996 Study Results by the National Exchange Carrier Association, Tab 11, page 225 (October 1, 1997). This filing included five years of historical data. High-cost loop payments for 1995 were based on 1993 cost and loop data.

<sup>341</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (the 1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151, *et seq.* 47 U.S.C. § 254(e) (“Any such [universal service] support should be explicit and sufficient to achieve the purposes of this section.”).

<sup>342</sup> 47 C.F.R. §§ 54.301, 54.901-904, and 54.800-809. Forward-looking high-cost model support was also implemented to provide support to non-rural incumbent LECs, however, but not as a result of the statute’s requirement that all support be explicit. 47 C.F.R. § 54.309.

<sup>343</sup> See USAC 2Q 2011 Filing at Appendices at HC01.

<sup>344</sup> See *United Telephone Company of Kansas, United Telephone of Eastern Kansas, and Twin Valley Telephone, Inc., Joint Petition for Waiver of the Definition of “Study Area” Contained in Part 36 of the Commission’s Rules; Petition for Waiver of Section 69.3(e)(11) of the Commission’s Rules, Petition for Clarification or Waiver of Section 54.305 of the Commission’s Rules*, CC Docket No. 96-45, Order, 21 FCC Rcd 10111 (Wireline Comp. Bur. 2006) (*United-Twin Valley Order*).

<sup>345</sup> Historically, rural incumbent LECs have been the buyers of telephone exchanges from non-rural incumbent LECs in most study area waiver transactions. Currently, the greatest amount of support any one rural incumbent LEC receives is \$39 million. See Universal Service Administrative Company, Federal Universal Service Support (continued....)

on the Fund of granting a series of waivers that each individually had slightly less than a one percent impact could be significant. We therefore propose to eliminate the one-percent guideline as a measure of evaluating whether a study area waiver will have an adverse impact on the universal service fund. Instead, we propose to focus our evaluation on the public interest benefits of the proposed study area waiver including: (1) the number of lines at issue; (2) the projected universal service fund cost per line; and, (3) whether such a grant would result in consolidation of study areas that facilitates reductions in cost by taking advantage of the economies of scale, i.e., reduction in cost per line due to the increased number of lines. We seek comment on this proposal.

## 2. Revising the “Parent Trap” Rule, Section 54.305

225. Section 54.305(b) of the Commission’s rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of high-cost universal service support for which the acquired exchanges were eligible prior to their transfer.<sup>346</sup> The Commission adopted section 54.305 to discourage a carrier from placing unreasonable reliance upon potential universal service support in deciding whether to purchase exchanges or merely to increase its share of high-cost universal service support.<sup>347</sup>

226. To encourage carriers subject to the requirements of section 54.305 of the Commission’s rules to invest in modern communications networks in unserved areas, we propose to eliminate immediately the applicability of section 54.305 in those instances when the study area waiver order was adopted five or more years ago and when a certain minimum percentage of the acquired lines, e.g., 30%, are unserved by 768 kbps broadband, as indicated on NTIA’s broadband map and/or our Form 477 data collection. For those carriers subject to the requirements of section 54.305 where the implementing order

(Continued from previous page)

Mechanism, Fund Size Projection for the First Quarter 2011, Table HC01 (Nov. 2, 2010). It is highly improbable that any study area waiver transaction could cause an increase in universal service support approaching the current \$43 million threshold given that the rural incumbent LEC receiving the greatest amount of annual support receives less than \$43 million. Further, section 54.305 of the Commission’s rules currently limits high-cost loop support and local switching support for the acquired exchanges to the same per-line support levels for which the exchanges were eligible prior to their transfer. See 47 C.F.R. § 54.305.

<sup>346</sup> 47 C.F.R. § 54.305(b). This rule applies to high-cost loop support and local switching support. A carrier’s acquired exchanges, however, may receive additional support pursuant to the Commission’s “safety valve” mechanism for additional significant investments. See 47 C.F.R. § 54.305(d)-(f). Since 2005, safety valve support has ranged from an annual low of \$700,000 to a projected high of \$6.2 million for 2011. See 2010 Universal Service Monitoring Report at Table 3.8; USAC 2Q 2011 Filing, Appendices at HC01. A carrier acquiring exchanges also may be eligible to receive ICLS, which is not subject to the limitations set forth in section 54.305(b). See 47 C.F.R. § 54.902.

<sup>347</sup> See *Universal Service First Report and Order*, 12 FCC Rcd at 8942-43. Prior to the adoption of section 54.305 of the Commission’s rules, the Common Carrier Bureau had approved several study area waivers relying on purported minimal increases in universal service support, and later the acquiring carriers subsequently received significant increases in universal service support. For example, in 1990 the Bureau approved a study area waiver in order to permit Delta Telephone Company (Delta) to change its study area boundaries in conjunction with its acquisition of Sherwood Telephone Company (Sherwood). Delta stated in its petition for waiver that it did not currently receive universal service support while Sherwood only received \$468 for 1989, and Delta stated that the acquisition would not skew high cost support in Delta’s favor. The Bureau concluded that the merging of the two carriers could not have a substantial impact on the high cost support program. After completion of the merger, Delta’s support grew from \$83,000 in 1991 to \$397,000 in 1993. See *Delta Telephone Company, Waiver of the Definition of “Study Area” contained in Part 36, Appendix-Glossary, of the Commission’s Rules*, AAD 90-20, Memorandum Opinion and Order, 5 FCC Rcd 7100 (Com. Car. Bur. 1990). In another example, in the US West and Gila River Telecommunications, Inc. (Gila River) study area waiver proceeding, Gila River’s high-cost support escalated from \$169,000 to \$492,000 from 1992 to 1993. See *US West Communications and Gila River Telecommunications, Inc., Joint Petition for Waiver of the Definition of “Study Area” contained in Part 36, Appendix-Glossary, of the Commission’s Rules*, AAD 91-2, Memorandum Opinion and Order, 7 FCC Rcd 2161 (Com. Car. Bur. 1992).

was adopted less than five years ago, we propose to eliminate the applicability of section 54.305 five years after the adoption of the implementing order, if a specified minimum percentage of housing units in the service area are unserved by broadband. What would be the appropriate trigger for elimination of the parent trap rule in this instance? For study area waivers granted subsequent to this order, we propose that the requirements of section 54.305 expire five years after the adoption of the related study area waiver order and if the area has the minimum designated percentage of unserved housing units by broadband. We propose that safety valve support will continue to be available while the requirements of section 54.305 are in force.<sup>348</sup> However, if the applicability of section 54.305 is eliminated for any carrier, that carrier would no longer eligible for safety valve support.

227. We seek comment on this proposal, including an appropriate minimum percentage of unserved households. We recognize that these proposals essentially trade the opportunity for some incumbent LECs to increase their universal service support in exchange for the potential efficiency benefits of consolidation, i.e., some carriers, by increasing efficiencies due to consolidation may reduce total company costs and increase net income, while reducing the need for universal service support.<sup>349</sup> We specifically seek comment regarding whether these efficiency benefits are likely to be sufficient to outweigh the potential loss in universal service support. Finally, we note that some rural incumbent LECs receive support pursuant to section 54.305 that would otherwise not receive any support or would receive lesser support based upon their own costs.<sup>350</sup> We seek comment on modifying section 54.305 to eliminate this unintended consequence. Specifically, seek comment on revising section 54.305 so that rural incumbent LECs, subject to section 54.305 of the Commission's rules, would receive either the lesser of the support pursuant to section 54.305 or the support based on their own actual costs.

### C. Transitioning IAS to CAF

228. We seek comment on transitioning amounts from Interstate Access Support for price cap carriers to the CAF beginning in 2012, over a period of a few years.<sup>351</sup> We also seek comment on transitioning amounts from IAS for competitive ETCs to the CAF on the same schedule as proposed for price cap carriers.<sup>352</sup>

#### 1. Background

229. IAS is a high-cost program that historically has supported a portion of the local loop, the facility to the end user that delivers both interstate and intrastate services. It acts to reduce the amount of revenues that price cap carriers need to recover from end users and other carriers to meet their allowable interstate revenues.<sup>353</sup> It was expressly designed to keep regulated voice rates affordable.

<sup>348</sup> See *supra* note 346.

<sup>349</sup> The existing cap on total high-cost loop support for rural carriers would continue to apply.

<sup>350</sup> Staff analysis of NECA 2010 USF Data Filing and USAC 2Q 2011 Filing. See *supra* para. 286.

<sup>351</sup> See Appendix A, section 54.807.

<sup>352</sup> See *id.*

<sup>353</sup> Price cap regulation focuses primarily on rates incumbent LECs may charge and the revenues they may generate from interstate access services. See *LEC Price Cap Order*, 5 FCC Rcd at 6787, para. 2. The price cap system was intended to create incentives for LECs to reduce costs and improve productivity while maintaining affordable rates for consumers through caps on prices. *Id.* Although initial price cap rates were set equal to the rates LECs were charging under rate-of-return regulation, the rates of price cap LECs have been limited ever since by price indices that have been adjusted annually pursuant to formulas set forth in the Commission's Part 61 rules. See *Access Charge Reform, Price Cap Performance Review, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, Order on Remand, 18 FCC Rcd 14976, 14978, para. 4 (2003) (*CALLS Remand Order*).

230. The Commission created IAS as part of the May 2000 *CALLS Order*, a five-year transitional interstate access and universal service reform plan for price cap carriers.<sup>354</sup> The *CALLS Order* lowered interstate common line access rates and replaced the reduced revenues with increased subscriber line charges and IAS.<sup>355</sup> The Commission initially sized IAS in 2000 at \$650 million annually, to offset the reductions in the interstate access charges of price cap carriers.<sup>356</sup> In 2003, the Commission, on remand, further explained why \$650 million was the appropriate size of the mechanism.<sup>357</sup> The Commission specifically noted that it could adjust the amount of IAS upward or downward, as warranted, at the end of the five-year transition period adopted in the *CALLS Order*.<sup>358</sup> At the end of the five-year period, however, the Commission did not take further action to re-examine whether this was an appropriate level of IAS.

231. In the 2008 *Interim Cap Order*, the Commission capped IAS for incumbent LECs at the amount incumbent LECs were eligible to receive in March 2008, indexed to line growth or loss by incumbent LECs, and separately capped IAS for competitive ETCs at the amount they were eligible to receive in March 2008.<sup>359</sup> In 2010, incumbent price cap carriers received IAS disbursements totaling \$458 million for serving 187 study areas, while competitive ETCs received IAS disbursements totaling \$88 million.<sup>360</sup> The three largest recipients of IAS for incumbents at the holding company level received a total of \$307 million.<sup>361</sup> The average amount of IAS disbursed to incumbent carriers in 2010 was \$0.44 per eligible line per month.<sup>362</sup>

232. In the *USF Reform NOI and NPRM*, the Commission sought comment on the National Broadband Plan recommendation to eliminate IAS, and the timeline for doing so.<sup>363</sup> Although many commenters supported the elimination of the IAS mechanism,<sup>364</sup> several argued that IAS should not be eliminated without a reasoned basis and adequate replacement of revenues.<sup>365</sup> No commenter, however,

<sup>354</sup> *CALLS Order*, 15 FCC Rcd. at 12964, para. 1.

<sup>355</sup> *Id.* at 12974-75, para. 30.

<sup>356</sup> *Id.* at 13046, para. 202; *see TOPUC*, 265 F.3d at 327-28. The Commission found \$650 million to be a reasonable amount that would provide sufficient, but not excessive, support. *CALLS Order*, 15 FCC Rcd at 13046, para. 202. It observed that a range of funding levels might be deemed “sufficient” for the purposes of the 1996 Act, and that “identifying an amount of implicit support in our interstate access charge system is an imprecise exercise.” *Id.* at 13046, para. 201 (“The various implicit support flows (e.g., business to residential, high-volume to low-volume, and geographic rate averaging) are not easily severable and quantifiable. Moreover, the competitive pricing pressures present during this transitional period between monopoly and competition present additional complexities in identifying a specific amount of implicit support.”).

<sup>357</sup> *CALLS Remand Order*, 18 FCC Rcd at 14983-96, paras. 13-33.

<sup>358</sup> *Id.* at 14995, para. 31.

<sup>359</sup> *High -Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (2008) (*Interim Cap Order*).

<sup>360</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool. This amount does not include any IAS amounts going to competitive ETCs that are affiliated with wireline incumbent carriers. It also does not include any frozen Interstate Common Line support received by carriers serving 105 study areas that have converted to price cap regulation since the adoption of the *CALLS Order*.

<sup>361</sup> *See id.* These numbers do not include support received by competitive ETC affiliates of price cap carriers.

<sup>362</sup> *See id.* We note that the Commission’s IAS formula does not provide support to all eligible lines.

<sup>363</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6680-81, paras. 57-58.

<sup>364</sup> Comments of Missouri Public Service Commission, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 7 (filed July 9, 2010); NCTA July 12, 2010 Comments at 13.

<sup>365</sup> *See, e.g.*, AT&T July 12, 2010 Comments 22-23; USTA July 12, 2010 Comments at 16-17; Windstream July 12, 2010 Comments at 38-40.

including those commenters arguing against IAS's elimination, provided data or analysis demonstrating that IAS continues to be necessary to address its original intended purpose of maintaining affordable voice service, or that IAS is an efficient, effective, or accountable mechanism for advancing broadband in high-cost areas of America.<sup>366</sup>

## 2. Discussion

233. As noted above, IAS was a component of the transitional CALLS Plan, which has lasted long past its intended five-year lifespan. Although several commenters argue generally that the Commission should designate successor funding sources,<sup>367</sup> they have not established in the record that such support is needed to ensure the provision of voice service at reasonable rates. Commenters have failed to provide specific information identifying particular geographic areas in which people would no longer have access to voice capability at affordable and reasonably comparable rates as a result of this proposed rule change and/or quantifying the extent of potential rate impact on consumers if IAS were eliminated. Moreover, in its current form, IAS is not focused on broadband, recipients are not required to use the funding to deploy broadband, and there is no mechanism to ensure that funds in fact are used to build broadband in unserved areas. IAS was designed to be a complement to price cap carriers' interstate end-user rates and other access charges, and provides a source of revenues for price cap carriers serving voice customers, but not broadband-only customers. As a result, IAS does not appear necessary to provide voice service at affordable and reasonably comparable rates and does not appear to be effectively structured to promote broadband deployment. We therefore propose to transition IAS to the CAF, where funding can be better targeted to areas requiring additional investment to support modern communications networks that provide voice and broadband service. We note that current IAS recipients would be eligible to compete for CAF support pursuant to the rules proposed below.<sup>368</sup> Alternatively, should such funding be used to reduce the size of the Fund? If so, how would that impact our near-term and long-term goals for reform?

234. *Incumbent ETCs.* Building on the record developed in the *USF Reform NOI/NPRM*, we now propose to transition IAS to the CAF over a period of a few years, beginning in 2012. Specifically, we seek comment on whether the IAS funding level for incumbent carriers adopted in the *Interim Cap Order* should be capped in 2012 at 50 percent of the 2011 IAS cap amount and then eliminated in 2013, or whether it should be transitioned to the CAF more gradually to help further minimize disruption to service providers. Alternatively, we seek comment on whether the transition should be accomplished more slowly for certain types of recipients (e.g., mid-sized carriers). We also note that below we seek comment on potential intercarrier compensation revenue recovery from the federal universal service fund, subject to meeting certain standards.<sup>369</sup>

235. We seek comment on the specific timeframe for implementing the elimination of the IAS rules and any associated changes to the Commission's pricing rules. What is a reasonable transition for price cap carriers to operationalize any changes necessary to address the IAS reduction? Would the appropriate transition period differ in the event that price cap carriers replace the IAS revenue, in whole or in part, with revenues from other sources, such as SLCs or other access rates? Should the Commission consider transitioning IAS more rapidly, for instance in a single year? If so, what would the consequences be of doing so and would the benefits of freeing additional funding in the near term for the CAF outweigh any potential negative consequences? We also seek comment on whether additional rule

<sup>366</sup> See AT&T July 12, 2010 Comments 22-23; USTA July 12, 2010 Comments at 16-17; Windstream July 12, 2010 Comments at 38-40.

<sup>367</sup> See AT&T July 12, 2010 Comments 22-23; USTA July 12, 2010 Comments at 16-17; Windstream July 12, 2010 Comments at 38-40.

<sup>368</sup> See *infra* Section VII.

<sup>369</sup> See *infra* Section XIV.

changes must be made to implement this proposal, and ask that commenters identify the specific changes that should be made. For example, a price cap carrier typically would be permitted to make an exogenous adjustment to its price cap indices (which are used to set access rates including SLCs) when a regulatory change materially affects its ability to recover its permitted revenues. We seek comment regarding whether there is any basis under the Commission's price cap rules for concluding that an exogenous adjustment should not be permitted due to the transitional reduction in IAS. Are there any showings, in addition to the loss of IAS, that a price cap carrier should be required to make in order to be permitted an exogenous adjustment? For example, should a price cap carrier be required to show that it has not realized productivity gains since the introduction of the CALLS plan sufficient to offset any corresponding loss of IAS in the future?

236. To the extent an exogenous adjustment to price cap indices is permitted, we seek comment on the ramifications under our existing rules and in light of our proposals for intercarrier compensation reform set forth more fully below.<sup>370</sup> We also seek comment on whether the Commission should adopt a productivity factor or other adjustment to the X-factor that could be targeted to partially or wholly offset exogenous adjustments associated with the transition of IAS.<sup>371</sup> We note that price cap regulation schemes typically provide some mechanism for sharing the benefits of productivity gains with ratepayers.<sup>372</sup> Prior to the *CALLS Order*, the Commission included a productivity adjustment to the price cap indices to ensure that such savings would be shared.<sup>373</sup> The *CALLS Order* did not include a productivity-related adjustment, providing instead a transitional X-factor designed simply to targeted lower rates.<sup>374</sup> Although not a productivity adjustment, this transitional X-factor provided some consumer benefit to the extent it achieved lower targeted rates. After the targeted rates were achieved, however, the X-factor was set equal to inflation and provided no additional consumer benefit, productivity-related or otherwise.<sup>375</sup> As with the IAS mechanism, the X-factor adopted in the *CALLS Order* was a transitional part of the five-year CALLS plan. We seek comment regarding whether a productivity factor or similar

<sup>370</sup> To the extent that a price cap carrier could not recover its allowable revenues through SLCs and IAS, the *CALLS Order* permitted price cap carriers to recover the remainder of its allowable revenues through two charges paid by interexchange carriers: the multiline business presubscribed interexchange carrier charge (MLB PICC)—a flat per-line charge assessed on the interexchange carrier to whom the customer is presubscribed, and the carrier common line (CCL) charge—a per-minute charge assessed on interstate interexchange traffic. The Commission capped the MLB PICC at \$4.31 per line per month and permitted recovery of the CCL charge only to the extent that a price cap carrier could not recover its allowable revenues through SLCs, IAS, and MLB PICCs.

<sup>371</sup> We note that past price cap performance reviews have, in addition to raising the productivity factor, reduced the price cap index to reflect that productivity increases had been higher than the productivity factor in the previous period. See *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9053-54, para. 209 (1995); *Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16645, para. 1 (1997).

<sup>372</sup> David E.M. Sappington, *Price Regulation*, in *Handbook of Telecommunications Economics*, Vol. I 225, 231, 248-53 (Martin E. Cave et al. eds., 2002).

<sup>373</sup> See *CALLS Remand Order*, 18 FCC Rcd at 14997-98, para. 35.

<sup>374</sup> *CALLS Order*, 15 FCC Rcd at 13028-29, paras. 160-63.

<sup>375</sup> See *id.*, 15 FCC Rcd at 13028-29, paras. 160-63. Because price cap carriers reached their target rates at different times, the inflation-only X-factor took effect at different times for different price cap carriers. In the *CALLS Remand Order*, the Commission concluded that price cap carriers serving 36 percent of total nationwide price cap access lines had achieved their target rates by their 2000 annual access filing. *CALLS Remand Order*, 18 FCC Rcd at 15002, para. 43, 15010-13, App. B. By the 2001 annual accessing filings the number grew to carriers serving 75 percent of total access lines, and by the 2002 annual access filings, carriers serving 96 percent of total access lines had achieved their target rates. *Id.* As a result, price cap carriers serving nearly all price cap access lines have had no reductions to their price cap indices, productivity-related or otherwise, since 2002, and some price cap carriers have had no reductions in ten years.

adjustment is an appropriate part of the post-CALLS plan access rate structure. If so, how should the productivity factor be determined? We request that commenters provide detailed analysis supported with specific data, if available to them, or identify data that would be necessary to support the analysis, if the data is not available to them. We also invite commenters to submit alternative proposals or analyses regarding the consequences of IAS phase out.

237. *Competitive ETCs.* We propose to transition IAS for competitive ETCs on the same schedule adopted for incumbent price cap carriers.<sup>376</sup> We note that the Commission's IAS rules were designed initially to provide incumbents and competitive ETCs with the same per-line level of support.<sup>377</sup> Although the Commission's actions in the *Interim Cap Order* – subjecting IAS to separate caps for incumbent price cap carriers and competitive ETCs and capping high-cost universal service support for competitive ETCs generally – to some extent disrupted the identical support relationship, it is difficult to justify continuing to provide this type of support to competitive ETCs when it no longer exists for incumbent carriers. In addition, the calculation of IAS for competitive ETCs depends significantly on data filed by incumbent recipients of IAS.<sup>378</sup> As a practical matter, it is likely to be administratively difficult to continue to provide IAS to competitive ETCs without the continuing participation of incumbent price cap carriers. We seek comment on this proposal.

238. *Redirecting IAS to Broadband.* Carriers receiving IAS today are not required to use such funding to deploy broadband-capable networks; however, in some instances it may be a significant source of revenue for carriers that have ongoing broadband deployment plans. Moreover, we recognize that in some states, a significant portion of high-cost support is IAS. We seek comment on designing the CAF in a way that enables support associated with the IAS phase down for incumbent carriers to be reserved for the same state in the CAF mechanism. In other words, under this alternative, any state whose carriers receive IAS now would receive at least the same amount of CAF support in the future. The CAF support would otherwise be subject to all other rules and obligations associated with the CAF, and there would be no guarantee that the same carrier that received IAS would receive CAF. We seek comment on this proposal.

239. *Legal Authority.* We believe the Commission has authority to transition IAS for both incumbents and competitive ETCs as part of the broader transition of moving all support to the CAF. The Commission generally has authority to establish a transition plan in a manner that will minimize market disruptions.<sup>379</sup> Federal courts have consistently “deferred to the Commission’s decisions to enact interim rules based on its predictive judgment that such rules were necessary to preserve universal service,”<sup>380</sup> and have specifically deferred “to the agency’s reasonable judgment about what will constitute ‘sufficient’ support during the transition period from one universal service system to another.”<sup>381</sup> We seek comment on this issue.

240. We do not believe that transitioning these forms of support would implicate the Fifth Amendment’s Takings Clause. When Congress creates a benefit program, it is free to alter or eliminate

<sup>376</sup> Below, we also seek comment on transitioning all competitive ETC support received pursuant to the identical support rule to the CAF. *See infra* Section VI.D.

<sup>377</sup> *See* 47 C.F.R. §54.807.

<sup>378</sup> *See generally* 47 C.F.R. §§ 54.800-807.

<sup>379</sup> *See, e.g., Rural Cellular*, 588 F.3d at 1105-06; *Competitive Telecommunications Ass’n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002); *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 410 (D.C. Cir. 2002); *Alenco*, 201 F.3d at 616; *TOPUC*, 183 F.3d at 437; *Competitive Telecommunications Ass’n v. FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997); *MCI Telecommunications Corp. v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984).

<sup>380</sup> *Rural Cellular*, 588 F.3d at 1106; *see also Competitive Telecommunications Ass’n*, 309 F.3d at 14-15; *Alenco*, 201 F.3d at 616, 620-22; *Southwestern Bell Tel Co. v. FCC*, 153 F.3d 523, 537-39, 549-50 (8th Cir. 1998).

<sup>381</sup> *TOPUC*, 183 F.3d at 437.

that program without running afoul of the Takings Clause.<sup>382</sup> “The Fifth Amendment protects against takings; it does not confer a constitutional right to government-subsidized profits.”<sup>383</sup> Section 254 does not expressly or impliedly provide that particular companies are entitled to ongoing USF support.<sup>384</sup> Carriers designated as ETCs pursuant to section 214(e) are “eligible” for support, not entitled to it, and we are not aware of any other law that would give particular companies a reasonable investment-backed expectation of entitlement to ongoing support.<sup>385</sup> The purpose of universal service is to benefit the consumer, not the carrier.<sup>386</sup> For these reasons, we do not believe the Commission would have a constitutional obligation to compensate carriers that lose support as a result of our proposed reforms. We invite comment on this issue.

#### **D. Rationalizing Competitive ETC Support Through Elimination of the Identical Support Rule**

241. Mobile voice and mobile broadband services are playing an increasingly prominent role in modern telecommunications. Given the important benefits of and the strong consumer demand for mobile services, ubiquitous mobile coverage must be a national priority. Yet there remain many areas of the country where people live, work, and travel that lack mobile voice coverage, and still larger geographic areas that lack current generation mobile broadband coverage. For this reason, funding for mobile networks must be more efficiently deployed than it is today. At the same time, we recognize that funding mobile coverage in unserved areas through universal service programs must be balanced with other priorities, including controlling the size of the universal service fund and the resulting burden on American consumers and businesses, and the need for high-bandwidth fixed broadband networks that both provide unique capabilities in themselves and may provide necessary infrastructure for mobile networks.

242. In this section, we seek comment on two high-level approaches to rationalizing funding for competitive ETCs (which are mainly mobile providers). Both approaches involve eliminating the existing identical support rule, which we believe fails to efficiently promote deployment of mobile voice services, much less fixed or mobile broadband. First, we seek comment on redirecting all available competitive ETC funding, over five years, to CAF for redistribution through new market-driven funding mechanisms to provide support for mobile and fixed broadband.<sup>387</sup> Second, we seek comment on generally redirecting available competitive ETC support to CAF to be distributed through such new mechanisms over five years, but allowing individual mobile providers to demonstrate that some level of continuing support under the current high-cost program is necessary, on a transitional basis, to achieve universal service goals in areas that would otherwise be unserved by mobile voice and/or broadband.

<sup>382</sup> See, e.g., *Bowen v. Gilliard*, 483 U.S. 587, 604 (1987) (“Congress is not, by virtue of having instituted a social welfare program, bound to continue it at all, much less at the same benefit level.”); *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986); *United States Railroad Retirement Board v. Fritz*, 449 U.S. 166, 174 (1980) (reducing retirement benefits did not violate the Takings Clause, “since railroad benefits, like social security benefits, are not contractual and may be altered or even eliminated at any time”).

<sup>383</sup> *Alenco*, 201 F.3d at 624.

<sup>384</sup> See *id.* at 620 (“The Act does *not* guarantee all local telephone service providers a sufficient return on investment; quite the contrary, it is intended to introduce competition into the market.”).

<sup>385</sup> See *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972) (to have a property interest in a benefit provided by the government, “a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.”).

<sup>386</sup> *Rural Cellular*, 588 F.3d at 1103; *Alenco*, 201 F.3d at 621.

<sup>387</sup> As described in the *Mobility Fund NPRM*, the Commission has proposed using a portion of competitive ETC funding already relinquished by Verizon Wireless and Sprint for the Mobility Fund. See *Mobility Fund NPRM*, 25 FCC Rcd 14716.

Under either approach, we also seek comment on a variety of implementation issues and other possible exceptions, such as for Tribal lands and Alaska Native regions.

### 1. Background

243. Section 54.307 of the Commission's rules, also known as the "identical support rule," provides competitive ETCs the same per-line amount of high-cost universal service support as the incumbent local exchange carrier serving the same area.<sup>388</sup> In the 2008 *Interim Cap Order*, the Commission concluded that rapid growth in support to competitive ETCs as a result of the identical support rule threatened the sustainability of the universal service fund.<sup>389</sup> Further, it found that providing the same per-line support amount to competitive ETCs had the consequence of encouraging wireless competitive ETCs to supplement or duplicate existing services while offering little incentive to maintain, or expand, investment in unserved or underserved areas.<sup>390</sup> As a consequence, the Commission adopted an interim state-by-state cap on high-cost support for competitive ETCs, pending comprehensive high-cost universal service reform.<sup>391</sup>

244. The interim cap for competitive ETCs is \$1.36 billion.<sup>392</sup> In 2010, 446 competitive ETCs, owned by 212 holding companies, received funding under the identical support rule.<sup>393</sup> Aside from Verizon Wireless, which previously agreed to give up competitive ETC high-cost support through merger commitments (as did Sprint), the largest competitive ETC recipient by holding company in 2010 was AT&T, which received \$289 million.<sup>394</sup> On average, competitive ETCs received approximately \$2.65 per supported line per month, compared to an average of \$3.35 per supported line per month for incumbents.<sup>395</sup>

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<sup>388</sup> 47 C.F.R. § 54.307. In adopting the identical support rule, the Commission assumed that competitive ETCs would be competitive LECs (*i.e.*, wireline telephone providers) competing directly with incumbent LECs for particular customers. See *Universal Service First Report and Order*, 12 FCC Rcd at 8932, para. 286. Based on this assumption, the Commission concluded that high-cost support should be portable – *i.e.*, that support would follow the customer to the new LEC when the customer switched service providers. *Id.* at 8932-33, paras. 287-88. The Commission planned that eventually all support would be provided based on forward-looking economic cost estimates and not based on the incumbents' embedded costs. *Id.* at 8932, paras. 287. The Commission did not contemplate the growing role that mobile service would play as a supplement to landline telephony.

<sup>389</sup> *Interim Cap Order*, 23 FCC Rcd at 8837-40, paras. 6-11. As the Commission noted, from 2001 through 2007, support for competitive ETCs grew from under \$17 million to \$1.18 billion. *Id.* at 8837-38, para. 6.

<sup>390</sup> *Id.* at 8843-44, paras. 20-21.

<sup>391</sup> *Id.* at 8837, para. 5. Specifically, the Commission capped support for competitive ETCs in each state at the total amount of support for which all competitive ETCs serving the state were eligible to receive in March 2008, annualized. *Id.* at 8846, paras. 26-28. The *Interim Cap Order* included exceptions for competitive ETCs serving lands and for competitive ETCs submitting cost studies demonstrating their own high costs of providing service. *Id.* at 8848-49, paras. 31-33.

<sup>392</sup> See *Interim Cap Adjustment Letter*.

<sup>393</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool. These amounts include disbursements to Verizon Wireless and Sprint that USAC now is in the process of reclaiming pursuant to the *Corr Wireless Order*. *Corr Wireless Order*, 25 FCC Rcd at 12859-63, paras. 14-22. We note that actual competitive ETC disbursements may vary from the interim cap amount for two reasons. First, true-ups and other out-of-period adjustments sometimes result in disbursements in a year other than the one against the payments apply for interim cap purposes. Second, some states have seen a reduction in demand for competitive ETC support since the cap was established and, as a result, total support is less than the interim cap amount.

<sup>394</sup> 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool. Competitive ETCs affiliated with another large wireless carrier, T-Mobile, received \$30.3 million in 2010. *Id.*

<sup>395</sup> *Id.* This per-line amount includes competitive ETC support received by Sprint and Verizon Wireless. Excluding Sprint and Verizon Wireless, competitive ETCs received \$4.65 per supported line per month. *Id.*

245. In the *USF Reform NOI/NPRM*, the Commission sought comment on the National Broadband Plan recommendation to eliminate high-cost support for competitive ETCs over a five-year period.<sup>396</sup> Many commenters supported the proposal,<sup>397</sup> while others indicated that it would be difficult to address the issue without more information regarding the Commission's proposal for the CAF.<sup>398</sup> Still others argued that competitive ETC support should not be eliminated, in some instances arguing that they use such support to extend mobile coverage in areas that they otherwise would not serve.<sup>399</sup> These commenters, however, did not provide specific data or analysis sufficient for the Commission to draw any particular conclusion regarding the role of competitive ETC support in advancing universal service.<sup>400</sup>

## 2. Discussion

246. As noted above, in 2008, the Commission concluded that the identical support rule offers limited and only indirect incentive to invest in unserved and underserved areas.<sup>401</sup> A significant amount of high-cost support is provided, for example, to competitive ETCs providing duplicative services. State processes to hold competitive ETCs accountable for productive use of funding vary from state to state.<sup>402</sup> We estimate that for nearly nine percent of the country's population, universal service is subsidizing two or more competitors (not including Verizon Wireless or Sprint) in a given geographic area, in addition to an incumbent.<sup>403</sup> In 2010, portions of 46 incumbent study areas (out of 1442 incumbent study areas nationwide) received service from three or four competitive ETCs (not including Verizon Wireless or Sprint) and portions of 237 incumbent study areas received service from 2 or more competitive ETCs.<sup>404</sup> Many of these incumbent study areas were additionally served by other competitive carriers that received no high-cost support.<sup>405</sup> In addition, because high-cost support is not based on competitive ETCs' costs,

<sup>396</sup> *USF Reform NOI and NPRM*, 25 FCC Rcd at 6681-82, paras. 60-61.

<sup>397</sup> Comments of Alexicon Telecommunications Consulting, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 6-7 (filed July 12, 2010); CWA July 12, 2010 Comments at 4; Comments of Indiana Utility Regulatory Commission WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 4 (filed July 12, 2010); Missouri PSC July 9, 2010 Comments at 8; NASUCA July 12, 2010 Comments at 15-18; USTA July 12, 2010 Comments at 14-16; Windstream July 12, 2010 Comments at 26-33.

<sup>398</sup> AT&T July 12, 2010 Comments at 23; CTIA July 12, 2010 Comments at 6-9.

<sup>399</sup> Comments of Rural Telecommunications Group, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 15-16 (filed July 12, 2010); Comments of Rural Independent Competition Alliance (RICA), WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 11-13 (filed July 12, 2010).

<sup>400</sup> See, e.g., Rural Telecommunications Group July 12, 2010 Comments at 15-16; RICA July 12, 2010 Comments at 11-13.

<sup>401</sup> *Interim Cap Order*, 23 FCC Rcd at 8843-44, paras. 20-21.

<sup>402</sup> See Jing Liu & Edwin Rosenberg, *State Universal Service Funding Mechanisms: Results of the NRRI's 2005-2006 Survey* at 43 & tbl. 26 (NRRI, Working Paper No. 06-09, 2006), available at <http://nrri.org/pubs/telecommunications/06-09.pdf>. For instance, in Maine, applicants seeking competitive ETC designation must file a plan describing with specificity, for the first two years, proposed improvements or upgrades to the applicant's network throughout the designated service area, projected start and completion date for each improvement, estimated amount of investment for each project that is funded by high cost support, specific geographic areas where improvements will be made, and the estimated population that will be served as a result of the improvements; only competitive ETCs are required to report annually on investments made with high cost support. Standards for Designating and Certifying Eligible Telecommunications Carriers Qualified to Receive Federal Universal Service Funding, 65-407-206 Me. Code R. § 3, § 6, available at <http://www.maine.gov/sos/cec/rules/65/407/407c206.doc>.

<sup>403</sup> The staff analysis utilizes American Roamer data, TeleAtlas wire center boundaries, and USAC disbursement data.

<sup>404</sup> Staff analysis of American Roamer data, Oct. 2010.

<sup>405</sup> *Id.*

even in unserved areas, competitive ETCs may receive high per-line support amounts even though they potentially could provide affordable service with much less or even no support.<sup>406</sup> In other instances, a competitive ETC is affiliated with an incumbent carrier that receives relatively higher amounts of support per line due to recent broadband network investment, which enables the holding company owning both to obtain higher support amounts for its wireless affiliate as well. Finally, we note that competitive ETCs may have incentives to seek designation in study areas that exhibit higher amounts of support on average than other areas.

247. To address these problems, we propose to eliminate the identical support rule, which we believe no longer adequately furthers the universal service principles in section 254(b).<sup>407</sup> To replace it, we seek comment on two approaches to rationalizing funding for mobile networks.

248. *Redirect Available Competitive ETC Funding to CAF:* First, we seek comment on transitioning competitive ETC support to the CAF by reducing the interim cap on competitive ETCs support adopted in the *Interim Cap Order* in five equal installments, with the initial 20 percent reduction to occur in 2012.<sup>408</sup> To the extent we do not transition such support over five years, we seek comment on whether some other timeframe better serve the Commission's universal service goals? Are there any other transition plans that the Commission should consider? Should the Commission adopt a faster timeframe for competitive ETCs that are nationwide wireless carriers and have not already committed to phase-down their high-cost support pursuant to merger conditions? If so, how would the Commission define a nationwide wireless carrier for this purpose?<sup>409</sup>

249. Under this approach, we propose that available funding from the phase down of the interim cap be redirected to the CAF for redistribution through new competitive mechanisms for providing support to both mobile and fixed broadband, as discussed in detail in section VII., below. We seek comment on whether these mechanisms would support mobile networks, especially mobile broadband networks, in a manner more consistent with our proposed overarching goals for universal service reform: modernizing for broadband; fiscal responsibility; accountability; and the use of market-

<sup>406</sup> For example, a competitive ETC serving a service area within the territory of one of the very highest cost incumbent carriers may receive in excess of \$1,000 per line per month even though that amount is unlikely to be appropriate or related to the competitive ETC's costs of providing service. We also note that, in one instance, where support is not targeted to high-cost areas in a study area, competitive ETCs currently receive \$4.60 per line per month to serve an urban area with a highly competitive wireless market. *See Universal Service Administrative Company, Federal Universal Service Support Mechanisms Fund Size Projections for Second Quarter 2011*, filed Jan. 31, 2011, at App. HC10; *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*, WT Docket No. 09-66, Fourteenth Report, 25 FCC Rcd 11407, App. D (*Fourteenth CMRS Competition Report*). For discussion of proposals to further target high-cost support, *see infra* Section VI.F.

<sup>407</sup> *See* App. A, section 54.305 (draft rule eliminating identical support). More than two years ago, four commissioners observed that there was a growing consensus that the identical support rule "should be eliminated." *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6903 (Joint Statement of Commissioners Copps, Adelstein, McDowell, and Tate).

<sup>408</sup> Each year, the total cap for each state would be reduced by 20 percent of the cap during the base period. The base period would be the interim cap amount as established by the *Interim Cap Order* and adjusted pursuant to the *Corr Wireless II Order*. *See Corr Wireless Order*, 25 FCC Rcd at 12854; *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service, Request for Review of Decision of Universal Service Administrator by Corr Wireless Communications, LLC*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 25 FCC Rcd 18146 (2010) (*Corr Wireless II Order*). We do not propose to amend our rules to reflect this process because the interim cap itself is not codified in our rules.

<sup>409</sup> The Fourteenth Mobile Wireless Competition Report observed that "[a]s of year-end 2008, there were four facilities-based mobile wireless service providers in the United States that industry observers typically describe as 'nationwide': AT&T, Sprint Nextel, T-Mobile, and Verizon Wireless." *Fourteenth CMRS Competition Report*, 25 FCC Rcd at 11438, para. 27.

driven, incentive-based policies. We also seek comment on whether this approach would appropriately balance support for mobile services with other potentially competing universal service goals. Alternatively, should we use such funding to reduce the size of the Fund? If so, how would that impact our near-term and long-term goals for reform? We note that we have proposed that a portion of the funds already relinquished by Verizon Wireless and Sprint, apart from a more general transition of competitive ETC support, be used to support the deployment of mobile networks capable of providing broadband through the Mobility Fund.<sup>410</sup>

250. *Presumptively Redirect Available Competitive ETC Funding to CAF:* In the alternative, we seek comment on presumptively reducing the interim cap, as described above, but allowing for waivers or exceptions to address those instances in which the availability of affordable mobile service in an area would be jeopardized by the transition of support to the CAF. This alternative could also include waivers for competitive ETCs that could demonstrate that continued ETC support would be required for them to build out coverage in areas presently unserved by mobile voice and/or mobile broadband.

251. To the extent commenters contend that this approach is preferable to a uniform phase down of competitive ETC support, we invite submission of detailed data and analysis to support such contentions. Specifically, we request any information that would permit the Commission to identify any areas in which consumers would not have access to mobile service as a result of a uniform transition of competitive ETC funding to the CAF and/or to quantify the extent of any rate increases that could result from a loss of competitive ETC support.

252. In addition, we seek comment regarding how to identify circumstances in which the availability of affordable mobile service would be jeopardized. The waiver option would require an affirmative showing by a competitive ETC that its costs and revenues would not permit provision of service to a particular service territory, absent continued competitive ETC support, and that no other wireless carrier served that territory. We seek comment on the specific showing that a competitive ETC would need to make under this approach. For instance, we could require that competitive ETCs file cost and revenue data, including an audited financial statement with accompanying notes, to demonstrate that they would be cash flow negative without competitive ETC support, or other documentation indicating that, without the waiver, customers in the service area would be without mobile service. We seek comment on what specific data would be necessary to support any such showing and whether this process would be administratively feasible.

253. An alternative option would be to create an exception within our rules for competitive ETCs meeting specified criteria. A carrier meeting such criteria would receive support under the exception by certifying that it met all of the criteria. We seek comment on this process. We also seek comment on what qualifications a carrier should meet for the exception to apply. For example, we might permit an exception only when a competitive ETC is not a nationwide carrier or it receives more than \$1 per line per month on the assumption that such carriers are more likely to be dependent on universal service support to maintain their operations. Similarly, exceptions might be available only in those areas in which there is only a single wireless carrier, because in other areas consumers have an alternative if a competitive ETC ceases its service. We seek comment on these proposals.

254. We also seek comment regarding how support would be calculated if a waiver is granted or an exception is applicable. One option would be to continue applying the identical support rule, on an uncapped basis, much as the interim cap exception for Tribal lands and Alaska Native regions has been implemented. Another option would be to freeze per line support as of a specific date. With regard to the date of the per-line support freeze, we note that certain proposals in this Notice, such as the proposal to target high-cost support, to phase down IAS, or to reform the support mechanisms for rate-of-return and rural carriers, would have an impact on the per-line amount. For either option, we would propose capping

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<sup>410</sup> See *Mobility Fund NPRM*, 25 FCC Rcd at 14722, para. 13.

support on a carrier-specific basis, after implementation of the other reforms. We seek comment on these options.

255. Finally, we propose that any waiver or exception to the interim cap phase down would be eliminated when the long-term vision for CAF is implemented.<sup>411</sup> We seek comment regarding whether that should occur over one year or a multi-year period. We seek comment regarding whether any other events would trigger the elimination of the waiver or exception.

256. *Implementation Issues:* Under either approach, we seek comment on implementation and transitional issues related to transitioning some or all competitive ETC support. How should the transition be implemented in conjunction with the proposal above to phase out IAS for competitive ETCs over a shorter period?<sup>412</sup>

257. The National Broadband Plan suggested that the Commission could accelerate the phase down of competitive ETC support by immediately treating a wireless family plan as a single line for purposes of support calculations.<sup>413</sup> One commenter estimated that this could save up to \$463 million annually.<sup>414</sup> We seek comment on this proposal and specifically invite comment on how we should define a family plan if we were to adopt such a rule, and what measures would minimize efforts to evade such a rule. For instance, should we treat all residential lines with the same account holder at a single billing address as a family plan for purposes of such a rule?

258. Are there any other transitional issues that we should take into consideration? For instance, we note that, if existing competitive ETCs relinquish their ETC designations, such relinquishments could impact existing Lifeline subscribers served by such carriers. Should there be any required notification to such customers so that they have an opportunity to switch to another carrier that is an ETC? Should we mandate or permit Lifeline only-ETCs in specific circumstances?

259. *Exception to the Transition to the CAF for Tribal Lands and Alaska Native Regions.* We seek comment on GCI's proposal that, as with the interim cap, any reduction in competitive ETC support should include an exception for carriers serving Tribal lands or Alaska Native regions.<sup>415</sup> Under this proposal, all competitive ETCs on Tribal lands or in Alaska Native regions would not be subject to the interim cap phase down.<sup>416</sup> Should any exception include Hawaiian Home Lands? If commenters believe that unique circumstances on Tribal lands and in Alaska Native regions and Hawaiian Home Lands require a different approach, are there changes we should consider to the proposals for the long-term CAF and/or first phase of the CAF that would better address those unique circumstances than would creating an exception to the proposed phase out of competitive ETC support? If unique circumstances justify providing an exception, are there any additional limitations or conditions that that should apply to the exception? Should support be maintained for competitive ETCs owned, operated, or engaged in joint ventures with Tribal governments? What conditions should be imposed under such an approach, to ensure that the goals of universal service are met in areas with such low telephone penetration rates?

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<sup>411</sup> See *infra* Section VII (seeking comment on long term role for mobile service providers under the CAF).

<sup>412</sup> See *supra* Section VI.C.

<sup>413</sup> National Broadband Plan at 148.

<sup>414</sup> See Letter from Melissa Newman, Vice Pres., Fed. Relations, Qwest Communications International, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45 (Feb. 4, 2010) (proposing that universal service support be limited to one handset per wireless family plan and suggesting that could yield savings of up to \$463 million annually). In comments filed in response to the *USF Reform NOI/NPRM*, CTIA opposed limiting support based on family plans. CTIA July 12, 2010 Comments, at 12.

<sup>415</sup> Comments of General Communications Inc., WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, at 24 (filed July 12, 2010).

<sup>416</sup> See *supra* note 4.

How should support be calculated pursuant to the exception? For instance, should support amounts per line be frozen? Commenters should provide detailed data and analysis to support their contentions.

260. *Legal Authority.* We seek comment on our legal authority to transition, to the CAF, competitive ETC support provided pursuant to the identical support rule. In section IV., above, we outline and seek comment on our legal authority to transition IAS for price cap carriers to the CAF. We believe the same analysis is applicable with respect to support provided to competitive ETCs pursuant to the identical support rule. We ask commenters also to provide comment on that analysis in this context of eliminating the identical support rule.

## **E. The First Phase of the Connect America Fund**

261. The National Broadband Plan recommended that the Commission “create a fast-track program in CAF for providers to receive targeted funding for new broadband construction in unserved areas.”<sup>417</sup> In the *USF Reform NOI/NPRM*, we sought comment on the use of a competitive process to promote investment in rural America unserved by broadband networks. We specifically invited commenters to address the potential use of an auction proposed by a group of economists to award one-time subsidies to stimulate the deployment of broadband in discrete areas.<sup>418</sup> Building on the record developed in that proceeding, we now propose rules for awarding, through auctions, targeted non-recurring funding to support the deployment of robust fixed or mobile broadband in areas of the country that lack even basic broadband today, as determined by the forthcoming National Broadband Map and/or our Form 477 data collection (i.e., areas without broadband advertised as providing download speeds of at least 768 kbps). This first phase of implementation of the CAF will provide targeted funding that would supplement, not replace, other support provided through the high-cost program in its current form or as modified as part of the reforms proposed above. We envision conducting such an auction in 2012 and potentially again in 2014. We seek comment on the proposals presented below.

### **1. Legal Authority to Establish a Competitive Process for CAF**

262. We believe the Commission has authority to adopt a competitive process for awarding support. In the *Universal Service First Report and Order*, the Commission agreed “with the Joint Board that competitive bidding is consistent with section 254, and comports with the intent of the 1996 Act to rely on market forces and to minimize regulation.”<sup>419</sup> We seek comment on our authority to establish a program under which non-recurring support would be provided, based on a competitive bidding system, to a single entity to deploy and provide broadband service.<sup>420</sup>

263. In 1997, the Commission recognized two advantages of using competitive bidding to determine high-cost universal service support. First, “a compelling reason to use competitive bidding is its potential as a market-based approach to determining universal service support, if any, for any given area.”<sup>421</sup> Second, “by encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured competitive bidding system would be its ability to reduce the

<sup>417</sup> National Broadband Plan at 144.

<sup>418</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6674, 6678 para. 43-48.

<sup>419</sup> *Universal Service First Report and Order*, 12 FCC Rcd at 8951, para. 325.

<sup>420</sup> The proposed program is designed to accelerate the deployment of broadband to areas that are unserved. Accordingly, while we propose to require these recipients to deploy and provide broadband, we assume the area already has voice telephony service (as we propose to define it herein) through the operation of our existing high cost programs. We therefore do not propose to require these recipients to provide such voice service in a given area. If, however, we ultimately do not create a broadband-only ETC designation for these recipients, or if we condition voice support on the provision of broadband, these recipients may be required to provide voice telephony service as well as broadband.

<sup>421</sup> *Id.* at 8948, para. 320.

amount of support needed for universal service.”<sup>422</sup> Despite these advantages, the Commission determined that the record at the time was insufficient to support adoption of a competitive bidding mechanism, in part because there likely would have been no competition in a significant number of rural, insular, or high-cost areas.<sup>423</sup> Much has changed since then, including the advent of cable and wireless Internet, and we therefore seek comment on whether it would be appropriate at this time to test the use of a competitive process for awarding support.

264. We also believe we have authority to limit CAF support to only one provider per unserved area. Although state commissions and the Commission may designate more than one ETC per service area pursuant to section 214(e),<sup>424</sup> that designation merely makes a provider eligible to receive support; it does not guarantee support. The term “eligible” is generally defined to mean “qualified to participate or be chosen.”<sup>425</sup> Other provisions in section 254 demonstrate that Congress understood the difference between eligibility and entitlement.<sup>426</sup>

265. Finally, we believe we have broad authority to take measured steps to trial this approach during this first phase of the CAF.<sup>427</sup> We recognize that if the Commission ultimately makes broadband a supported service, all ETCs would be required to offer broadband. It is not our intention, however, to create an unfunded mandate for new obligations. To the extent firms that bid for support do not receive funding to build out unserved areas, we recognize the need for a flexible approach in developing timelines for the deployment of broadband.

## 2. Overall Design of Phase I CAF

266. The proposed objectives for the first phase of the CAF are to make available non-recurring support<sup>428</sup> for broadband in unserved areas and test the use of reverse auctions more generally as a longer-term means of disbursing ongoing CAF support. We seek comment on whether these are appropriate objectives.

267. We propose to design the first phase of the CAF to use funds efficiently to expand broadband to as many unserved housing units—that would be unlikely to be served soon or at all without public investment—as possible. We note that because of our commitment to control the overall size of the high-cost fund and our proposals to modify rather than immediately transition existing support mechanisms, funding available in the first phase of the CAF is likely to be insufficient to fund broadband deployment in all areas that currently lack even basic high speed Internet access—which, for these purposes, we propose to be 768 kbps download speed. We further note that differences in the cost to deploy broadband vary significantly among these unserved areas, and our proposed reverse auction will identify and target funding to those unserved areas that could be served at the lowest cost (i.e., the lowest

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<sup>422</sup> *Id.*

<sup>423</sup> *Id.* at 8949-50, paras. 322-24.

<sup>424</sup> 47 U.S.C. § 214(e)(2), (6).

<sup>425</sup> See Merriam-Webster, <http://www.merriam-webster.com/dictionary/eligible> (defining “eligible” as “qualified to participate or be chosen”) (last visited Feb. 9, 2011).

<sup>426</sup> See, e.g., 47 U.S.C. §§ 254(h)(1)(A) (carriers offering services to rural health care providers “shall be entitled” to have the difference between the rates to health care providers and other customers in comparable rural areas treated as a service obligation), 254(h)(1)(B)(ii) (carriers providing services to schools and libraries “shall . . . receive reimbursement” from the universal service fund).

<sup>427</sup> We note that the Commission previously implemented a pilot program to support the construction of broadband networks designed to promote access to innovative telehealth and telemedicine services in areas where the need for those services was most acute. *Rural Health Care Support Mechanism*, 21 FCC Rcd at 11111, para. 1.

<sup>428</sup> Although we propose to award non-recurring support, we do not propose to require recipients of support to specify or certify that they will use the money only for capex rather than opex.

level of public support). In other words, the competition in our proposed auction would primarily be among providers seeking to serve different geographic areas rather than among providers seeking to serve the same geographic area.

268. As discussed more fully below, to maximize the reach of available funds, support would be available to, at most, one provider in any given unserved area. We propose to use a competitive process to compare all offers to provide service across the unserved areas eligible for participation in the first phase of the CAF, which should give providers incentives to seek the least support needed and enable identification of the providers that will achieve the greatest additional coverage with the limited funding available.<sup>429</sup> We also seek comment on alternative methods for distributing support.

269. We propose to specify unserved areas eligible for support on a census block basis, using data compiled by NTIA pursuant to the Broadband Data Improvement Act of 2008<sup>430</sup> or data from our proposed revised Form 477,<sup>431</sup> and to distribute support based on bidders' aggregations of census blocks.

270. We seek comment on whether we should limit eligibility for CAF support in this first phase to states that have engaged in access charge reform and/or prioritize support to states that have established high-cost universal service or other broadband support mechanisms.<sup>432</sup> Alternatively, we could decline to impose such limits and instead distribute support to any of the identified unserved census blocks nationwide.

271. We propose that providers eligible to compete for support be allowed to deploy terrestrial wireline or wireless (including using unlicensed spectrum) technologies, and to allow such firms to partner with satellite broadband providers to fill in gaps in coverage. We seek comment on requiring deployment to be complete within three years of receipt of funding and propose that the provider's obligations to serve the community would last for a defined period of time, such as five years, upon completion of the deployment.

272. We note that the unique features of satellite broadband make it difficult to treat it the same as other technologies. Generally speaking, once a satellite is launched, the incremental cost to reach a new subscriber (to the extent coverage and capacity are available) is the same whether that subscriber lives in an area that would be expensive for a terrestrial technology to serve or not. Consequently, satellites are well suited to serve housing units that are the most expensive to reach for terrestrial technologies. Planned upcoming satellite launches could provide broadband access to a significant number of currently unserved housing units. However, while satellite broadband can serve (almost) any particular unserved housing unit in an area, it does not appear that existing and expected satellite capacity will be sufficient to serve all unserved housing units in the United States over the next few years at projected usage levels.<sup>433</sup> Because, from a universal service perspective, limited satellite capacity would be better used to provide access to the areas most expensive for terrestrial technologies to reach, we propose to allow satellite broadband providers to partner with terrestrial broadband providers that bid for

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<sup>429</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6704, App. B, Paul Milgrom, Gregory Rosston, Andrzej Skrzypacz & Scott Wallsten, "Comments of 71 Concerned Economists: Using Procurement Auctions to Allocate Broadband Stimulus Grants," (April 13, 2009) (submitted to NTIA and Rural Utilities Service) (71 Economists' Proposal).

<sup>430</sup> Pub. L. No. 110-385, 122 Stat. 4096 (codified at 47 U.S.C. §§ 1301-04).

<sup>431</sup> See *Broadband Data NPRM*, FCC 11-14, at paras. 49-65 (seeking comment on whether and how the Commission should collect deployment data).

<sup>432</sup> See *infra* paras. 297-298.

<sup>433</sup> Debate exists about current and future satellite capacity. See, e.g., Letter from John P. Janka, Counsel for ViaSat, Inc. and WildBlue Communications, Inc., to Marlene Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 05-337, 10-90, attachment at 2 (filed Nov. 2, 2010). Nevertheless, the capacity of publicly announced future launches could only serve all unserved areas at a much lower rate of data usage per subscriber than even current usage patterns suggests. See OBI, Broadband Availability Gap, at 90-92.

support, subject to certain limits, but not to allow satellite broadband providers to bid on their own.<sup>434</sup> We seek comment on this proposal.

273. We propose to direct USAC to administer the CAF in accordance with the terms of its current appointment as Administrator and all existing Commission rules and orders applicable to the Administrator. We seek comment on whether there are any specific rules or orders currently applicable to USAC's administration of the Fund that should not apply to the CAF, and whether there are new or different requirements we should apply to USAC's administration of CAF support.

### 3. Size of Phase I CAF

274. We propose to dedicate a defined amount of money to fund the first phase of the CAF. As noted above, this new program would be a new support mechanism that would co-exist with our other, existing support mechanisms, and funds provided to an area through the CAF would not reduce existing support mechanisms in the same area. We seek comment on this proposal.

275. As we undertake reform, we remain committed to controlling the size of USF, and we expect the reforms we propose today will result in more efficient use of federal support. We seek comment on whether the Commission should set an overall budget for the CAF such that the sum of any annual commitments for the CAF and any existing high-cost programs (as modified) in 2012 would be no greater than projections for the current high-cost program, absent any rule changes. In the alternative, the budget for the CAF could be set at a smaller amount, allowing program savings to go to reducing the overall size of the Fund and contribution obligations on consumers. We seek comment on the appropriate size of the CAF. In light of the high costs that would be required to ensure ubiquitous mobile coverage and very-high-speed broadband for every American and the length of the transition to the proposed Connect America Fund, we also seek comment on whether additional investments in universal service may be needed to accelerate network deployment.

276. We propose to fund the CAF with savings that we expect to realize from our existing high-cost support programs. We are currently reclaiming high-cost support that Verizon Wireless and Sprint agreed to phase out consistent with earlier merger orders.<sup>435</sup> We have proposed above to rationalize high-cost support provided to remaining competitive ETCs, as well as IAS support, beginning in 2012, with certain possible exceptions.<sup>436</sup> In addition, we have proposed reforms to the other high-cost support mechanisms to promote efficiency and accountability, including the elimination of local switching support and a total limit on total support per line.<sup>437</sup> Together, these reforms could generate close to a billion dollars in savings over the next few years, which could be made available to support broadband deployment through the CAF program without increasing the overall size of the high-cost portion of USF. We seek comment on whether directing such a defined amount of funding to the CAF more effectively serves our universal service goals than continuing to provide IAS and competitive ETC support under current program rules.

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<sup>434</sup> See *supra* para. 98; *infra* paras. 282, 424.

<sup>435</sup> See *Corr Wireless Order*, 25 FCC Rcd at 12854; *Corr Wireless II Order*, 25 FCC Rcd at 18146.

<sup>436</sup> See *supra* Sections VI.C, VI.D. The National Broadband Plan recommended that these funding streams be retargeted to broadband deployment. National Broadband Plan at 147-48. In the *USF Reform NOI/NPRM*, we proposed to transition CETC and IAS funding toward broadband. 25 FCC Rcd at 6680-82, paras. 57-58, 60-61. More recently, in the *Corr Wireless Order*, the Commission directed USAC to hold reclaimed funds from Verizon Wireless and Sprint in reserve for eighteen months to allow time for this Commission to complete rulemakings to implement various recommendations in the National Broadband Plan. *Corr Wireless Order*, 25 FCC Rcd 12682-83, paras. 20, 22. In October 2010, the Commission proposed to use a portion of those reclaimed funds to create a Mobility Fund. See *Mobility Fund NPRM*, 25 FCC Rcd at 14722, para. 13.

<sup>437</sup> See *supra* Section VI.A.

277. If we transition high-cost support for IAS and competitive ETCs more rapidly, additional funding could be dedicated to the CAF program in 2012. Conversely, if we create exceptions for phasing down competitive ETC support, less funding would be available for the CAF. We seek comment on these alternatives in light of our national goals for universal service funding.

278. As discussed more fully below, we envision that we will hold an initial auction in 2012, and possibly a second auction in a subsequent year (e.g., in 2014), as more funding is reclaimed through our reforms. We seek comment on these proposals. If we only use a portion of the funding reclaimed for the CAF, we also could use some of the remaining funds to help offset proposed reductions in access charges and/or for other potential support mechanisms. We seek comment on how much, and under what conditions, such funds might be used for these alternative purposes or to reduce the USF contribution burden on consumers and businesses.<sup>438</sup>

279. In our initial auction in 2012, we could award funds that, by the time the auction closes and support is obligated, will have already been reclaimed as a result of the reforms identified above. Alternatively, we could auction off support based on the existing funds set aside combined with projected savings from these reforms that have not yet been realized (i.e., we would include amounts projected to be saved in 2013 and 2014 as well), with a specified amount obligated and paid out initially and the remainder obligated and paid out in subsequent years.<sup>439</sup> We seek comment on these alternatives and on other ways we could size the CAF.

280. In addition, we seek comment on the appropriate size of the CAF in light of our intention to award support through an auction mechanism. To ensure the most efficient use of funds, we envision a support mechanism in which bidders compete for limited funds such that not all bids would be successful. How should we strike the balance in sizing the CAF to encourage a sufficient number of bidders to participate while achieving our other objectives?

#### **4. One CAF Provider Per Unserved Area**

281. Given our objective of extending broadband to unserved housing units in as efficient a manner as possible, we propose that only one entity in any given geographic area receive support in the first phase of the CAF. We seek comment on this proposal. In some instances, the current incumbent ETC may also be the winning bidder for CAF support. In others, another entity could win CAF support for deploying broadband in the unserved area, but the current incumbent would continue to receive support for its entire study area under existing support mechanisms as modified. What would be the impact on the incumbent ETC if another entity receives funding to overbuild a portion of the study area?

282. We propose that only one provider per area would receive CAF support during this initial phase of the CAF, but we also propose to allow the subsidized provider to partner with others to satisfy the public interest obligations associated with the CAF. For example, a wireline incumbent carrier in an area might partner with a satellite provider to leverage the wireline provider's existing network and to fill in the highest-cost areas with service provided by satellite. We seek comment on the benefits and risks of allowing such arrangements, and whether our proposal is consistent with the requirement of section 214(e)(1)(A) of the Act that an ETC provide supported services using its own facilities or a combination of its own facilities and resold facilities.<sup>440</sup> We also seek comment on whether to impose limits on the percentage of housing units that could be served by such arrangements.

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<sup>438</sup> See *infra* Section XIV.

<sup>439</sup> See *infra* paras. 361-362.

<sup>440</sup> See 47 U.S.C. § 214(e)(1)(A). While we propose to require support recipients to be designated as ETCs, we seek comment on whether we should forbear from imposing such a requirement. See *infra* para. 318.

283. We acknowledge that wireless providers have expressed competitive concerns about the possibility of limiting support to one provider per area.<sup>441</sup> That is, because different service providers may use incompatible technologies, only certain carriers—those using a compatible technology—would have the capability of permitting their own customers to roam onto the supported network (which would be the only network) in that area. In the *Mobility Fund NPRM*, we sought comment on whether we should impose terms and conditions of support in light of this concern.<sup>442</sup> Should we consider similar terms and conditions for the first phase of the CAF program?<sup>443</sup> Are there similar terms and conditions that we should consider for other types of providers? In light of the advance of technology, is such a concern likely to still be an issue by the time facilities funded through this program are deployed?

## 5. Auction to Determine Awards of Support

284. We propose to use auctions to determine the entities that will receive support and the amount of support they will receive. Specifically, we propose to award a fixed amount of support, paid out in installments, based on the lowest bid amounts submitted in a reverse auction, as we discuss in more detail below. Such a mechanism should allow the market to identify the lowest level of public support needed to deploy broadband in areas unserved by broadband today.<sup>444</sup> It will also allow us to select providers without regard to the type of technology used by such providers, consistent with our goal of being technology-neutral.

285. In this proposed reverse auction, bidders would evaluate the amount of support they need to provide the specified services. In general, bidders would not want to overstate the support they require because they would be competing against other providers for limited support funds and a higher bid would reduce their chances of winning. At the same time, they would not want to understate the support they require because, if they win the auction, they will be required to meet their public interest obligations with only that level of support.<sup>445</sup> As a result, the submitted bids should represent a good estimate of the support needed to offer service to the areas covered by the bid. We seek comment generally on the use of a competitive process to determine recipients of support and support amounts, and on the auction format. We also seek comment on how we might structure the design of CAF to minimize barriers to participation for entities that may wish to prequalify for loans, either from governmental agencies or private sources, to complete a proposed buildout.

286. We propose to determine winning bidders to maximize the extension of broadband deployment in areas lacking service that provides a download speed of 768 kbps or better. If no bids cover the same geographic area, selecting winning bids would be straightforward. All bids, across all areas, would be compared against all other bids, and would be ordered from lowest-price-per-unit bid to

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<sup>441</sup> See Comments of U.S. Cellular, WC Docket No. 10-90, GN Docket No. 09-51, at 12-18 (filed July 12, 2010); Comments of Rural Cellular Association, WC Docket No. 10-90, GN Docket No. 09-51, at 16-17 (filed July 12, 2010); Comments of USA Coalition, WC Docket No. 10-90, GN Docket No. 09-51, at 34-40 (filed July 12, 2010); Comments of Sprint Nextel, WC Docket No. 10-90, GN Docket No. 09-51, at 5-11 (filed July 12, 2010); Reply Comments of SouthernLINC, WC Docket No. 10-90, GN Docket No. 09-51, at 22-24 (filed Aug. 11, 2010).

<sup>442</sup> *Mobility Fund NPRM*, 25 FCC Rcd at 14723–24, paras. 15–19.

<sup>443</sup> Cf. *supra* para. 148.

<sup>444</sup> As noted above in the Legal Authority section, we could potentially allow ETCs not to provide all supported services, and therefore allow ETCs to provide only broadband service. On the other hand, if we were to condition receipt of support for the provision of voice service on the deployment of broadband, a participant in the CAF would have to provide voice as well as broadband service.

<sup>445</sup> Bidders would have significant incentives to fulfill their obligations. We propose that recipients of funding be required to obtain a letter of credit that would be forfeited if they fail to meet their obligations, and we propose to verify, through field testing, that they have actually done so. See *infra* paras. 356-360, 370.

highest.<sup>446</sup> If, as discussed in more detail below, we decide to adjust bids to account for bidders' commitments to exceed our minimum performance requirements (e.g., bidders offering greater bandwidth, or lower latency), we would adjust the per-unit bid by a pre-defined amount before ranking them. Support would be allocated first to the bidder making the lowest (adjusted) per-unit bid, and then to bidders with the next lowest per-unit bids in turn, until the running sum of support funds for the winning bidders exhausted the money available in the CAF.

287. On the other hand, if more than one bid covers the same unserved geographic area, the method for selecting winning bids may be more complex, given our proposed objective of maximizing the deployment of broadband to housing units given the available funds. We seek comment below on possible auction approaches that might be used to achieve this objective. We also seek comment on our proposal to allocate support by comparing all bids across all areas, rather than just comparing those within certain subsets of otherwise eligible geographic areas.

288. Although we propose to use a reverse auction approach to awarding support in the first phase of the CAF, we note that some commenters have suggested, as an alternative, that we use a competitive application approach in which we solicit confidential proposals which we (or another entity, such as USAC) would evaluate using a number of weighted criteria.<sup>447</sup> For example, the Commission could use a process similar to those used for the Broadband Technology Opportunities Program and the Broadband Initiatives Program established pursuant to the American Recovery and Reinvestment Act of 2009.<sup>448</sup> We seek comment on using such an approach as an alternative to the reverse auction design described herein.

## 6. Identifying Unserved Areas Eligible for Support

289. We propose to identify unserved areas on a census block basis and to offer support for deployment of broadband to bidder-defined service areas, which could be individual census blocks or aggregations of census blocks. We seek comment on alternative ways to distribute support to these unserved areas.

290. *Identifying Unserved Areas by Census Block.* As a first step in identifying those areas for which applicants can bid for support, we propose to determine the deployment of broadband service at the census block level. Census blocks are the smallest geographic unit for which the Census Bureau collects and tabulates decennial census data, so determining coverage by census block should provide a detailed picture of the deployment of broadband service. We propose to use either official census data and/or a widely used commercial data source, such as the Geolytics Block Estimates and Block Estimates Professional databases, to identify census block boundaries and for demographic data, depending on whether data are publicly available that will meet our needs. We seek comment on this proposal.

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<sup>446</sup> If we choose to weight bids to account for various additional factors, such as promised speeds or latency, we would compare weighted bids. *See infra* paras. 338-341.

<sup>447</sup> *See* Comments of AT&T, WC Docket No. 10-90, GN Docket No. 09-51, at 5-12 (filed July 12, 2010) (proposing that the Commission use a competitive application process to award support in several iterations as funds become available); Comments of Verizon and Verizon Wireless, WC Docket No. 10-90, GN Docket No. 09-51, at 33 (filed July 12, 2010) (encouraging the Commission to use a grant-based program to distribute funds). *But see* Reply Comments of National Association of State Utility Consumer Advocates, WC Docket No. 10-90, GN Docket No. 09-51, at 33-34 (filed Aug. 11, 2010) (claiming that AT&T's proposal would not do enough to spur competition).

<sup>448</sup> The Rural Utilities Service, Department of Agriculture, established the Broadband Initiatives Program and the National Telecommunications and Information Administration, Department of Commerce, established the Broadband Technology Opportunities Program pursuant to the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115. *See* Department of Agriculture, Rural Utilities Service, Broadband Initiatives Program; Department of Commerce, National Telecommunications and Information Administration, Notice of Funds Availability (NOFA) and Solicitation of Applications, 75 Fed. Reg. 3792 (Jan. 22, 2010).

291. The use of census blocks should also facilitate the use of NTIA's nationwide broadband map to identify areas eligible for funding.<sup>449</sup> We propose to define unserved areas based on the data collection initiated by the Broadband Data Improvement Act and funded through the State Broadband Data and Development Grant Program (SBDD); the first data from that effort are due to be made public by February 17, 2011.<sup>450</sup> We seek comment on how we should define served and unserved areas using that data; we ask commenters to examine the National Broadband Map once it becomes available and to provide comment on how we can best use the data available, consistent with our goals. What criteria should we use to determine whether an area should be considered "unserved" for purposes of the first phase of the CAF? Should it be the same as any criteria used in the NTIA map? How should we account for potential limitations in the data? We recognize that, while data are first due to be made available in February 2011, NTIA's data collection is ongoing and so we propose using the most recent data available at the time of our auction. In the alternative, should we rely on Commission data obtained from an updated Form 477? How should we define served and unserved census blocks using these alternative data? We seek comment on these possible methods of identifying unserved census blocks and whether any workable alternatives would be more appropriate in connection with the first phase of the CAF.

292. We note that NTIA data, on which we propose to rely, may not be completely accurate because NTIA does not require broadband providers to report their coverage as part of the SBDD program. We seek comment on whether there is something more that the Commission should do to encourage states, territories, and Tribal governments to verify that areas for which there is no reported broadband service are, in fact, unserved. Are there other ways we could ensure that an area reported as unserved is actually unserved? We also seek comment on whether the value of such verification outweighs its cost, given that providers will have an incentive to report their coverage if the failure to report means that a potential competitor could receive a federal subsidy to deploy broadband to that same area. Does this incentive mean we should be more concerned about overstatement of coverage rather than understatement of coverage? If so, how should we address such concerns?

293. *Offering Support by Census Blocks.* We propose that the geographic areas for auction should be based on small common building blocks such as census blocks, which bidders could aggregate together as part of a package bid to cover larger areas. Although we propose to identify unserved areas at the census block level using the method described above, we propose to allow bidders to bid on multiple census blocks at auction. Winning bidders would then be awarded support in one or more census blocks.

294. We seek comment on whether census blocks are the most appropriate basic geographic unit (which would be subject to aggregation by bidders) for awarding support to expand coverage, or whether there are other basic geographic units that might better balance the need to identify discrete unserved areas for which we propose to require coverage with business plan requirements of the different types of providers that may seek to participate in the first phase of the CAF.<sup>451</sup> Are census blocks the most appropriate basic geographic unit for us to use in relation to support for deployment on Tribal lands, or would some other basic geographic unit better serve our purposes?

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<sup>449</sup> Comments of National Cable & Telecommunications Association, WC Docket No. 10-90, GN Docket No. 09-51, at 18 (filed July 12, 2010).

<sup>450</sup> See Department of Commerce, National Telecommunications and Information Administration, State Broadband Data and Development Grant Program, Docket No. 0660-ZA29, Notice of Funds Availability, 74 Fed. Reg. 32545, 32547 (July 8, 2009) (*NTIA State Mapping NOFA*). NTIA defines "broadband" for the purposes of the National Broadband Map to be two-way data transmission to and from the Internet with advertised speeds of at least 768 kbps downstream and 200 kbps upstream. *Id.* at 32548.

<sup>451</sup> We recognize that, as with any networked service, the benefits of expanding the availability of service accrue not only to the additional population reached by the expansion but also to the population already covered. Because there may be both commercial and public interest benefits in expanding service into areas in which the resident covered population is relatively low, we are not proposing to set an absolute minimum resident population for an area to receive support.

295. *Establishing Unserved Units.* We propose to use unserved housing units, identified as described above, to establish a baseline number of unserved units in each census block identified as unserved. We also seek comment on whether we should further consider unserved businesses or community anchor institutions such as schools, libraries, other government buildings, health care facilities, job centers, or recreation sites in determining the number of unserved units in each census block to be used for assigning support. Would using such additional factors in determining the unserved units in each area better represent the public benefits of providing new access to broadband service? Are there additional or different types of anchor institutions in Tribal lands that should be considered in such an analysis? We ask that commenters address how we should measure the factors we propose as well as any other factors they advocate, and how coverage for one type of unit, such as a work site, should compare with coverage for other units, such as housing units. We also seek comment on how we would obtain the necessary data to be able to determine with a sufficient level of accuracy the number of businesses and other institutions in a given area.

296. *Leveraging Support through Cooperation with States.*<sup>452</sup> We seek comment on whether and how the Commission could use CAF support to create incentives for states to take action that will advance our mutual goals.

297. The intercarrier compensation section below seeks comment on how to provide states with incentives to reform intrastate switched access rates.<sup>453</sup> We could, for example, limit support in the first phase of the CAF program to states that have taken or are taking measures to reduce intrastate switched access rates. Would limiting the program to states that have undertaken access charge reform provide sufficient incentive for them to do so? We seek comment below on the appropriate criteria for determining whether a state has taken sufficient action to reform intrastate intercarrier compensation rates so as to be eligible to participate in the program, if we were to adopt such a limitation. Alternatively, rather than limiting support only to those states that have undertaken such reforms, should we consider providing a bidding credit to bidders who propose to deploy in states that have taken action? We also seek comment on whether Tribal lands should be eligible for support irrespective of the actions of the states in which they are located to reform access charges.

298. We note that a number of states have assumed a role in preserving and advancing universal service by creating high-cost programs similar to the federal high-cost program,<sup>454</sup> and some states have undertaken efforts to promote broadband.<sup>455</sup> We seek comment on whether and how to prioritize support in the first phase of the CAF to states that have created such programs or that complete such actions by a predefined date (such as the date bids are due).<sup>456</sup> To the extent we create such a

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<sup>452</sup> The Act defines the term “State” to include territories and possessions. 47 U.S.C. § 153 (47).

<sup>453</sup> See *infra* paras. 544-549.

<sup>454</sup> See Peter Bluhm, Phyllis Bernt & Jing Liu, *State High Cost Funds: Purposes, Design, and Evaluation*, 2-3 (NRRRI January 2010) (Bluhm Paper). According to the Bluhm Paper, the following states have high cost funds: Alaska, Arizona, Arkansas, California, Colorado, Idaho, Illinois, Indiana, Kansas, Maine, Nebraska, Nevada, New Mexico, Oklahoma, Oregon, Pennsylvania, South Carolina, Texas, Utah, Wisconsin and Wyoming.

<sup>455</sup> Not all of these programs are administered by the state public utility commission. See Bluhm Paper at 32. Examples of funding programs to support the build-out of advanced networks in unserved and underserved areas include the California Advanced Services Fund, ConnectME Authority, Illinois Technology Revolving Loan Program, Idaho Rural Broadband Investment Program (IRBIP), Louisiana Delta Development Initiative, and Massachusetts Broadband Initiative. See Alliance for Pub. Tech. & Commc’ns Workers of Am., *State Broadband Initiatives 3*, 47-49 (2009), available at [http://www.thebroadbandresourcecenter.org/apt/publications/reports-studies/state\\_broadband\\_initiatives.pdf](http://www.thebroadbandresourcecenter.org/apt/publications/reports-studies/state_broadband_initiatives.pdf).

<sup>456</sup> See, e.g., Joint Comments of Nebraska Public Service Commission and North Dakota Public Service Commission, WC Docket No. 10-90, GN Docket No. 09-51, at 15 (filed July 12, 2010) (advocating that the Commission create explicit support incentives to encourage states to take action to support universal service).

preference or priority, we propose that states that have created broadband deployment support mechanisms using state funds would be eligible, regardless of whether they have created high-cost funds.<sup>457</sup> We seek comment on whether all states and territories with broadband support programs should receive priority, or whether only states and territories that provide a certain amount of support through their programs should be included. If we provide some form of preference for support to only states that have programs meeting a certain threshold, how should we determine what that threshold should be? Should it be a defined dollar amount, an amount per housing unit (or person), or an amount of support per housing unit unserved by broadband (or per person residing in an unserved housing unit)? What should the amount be? Also, how should we take account of the significant variation in the design of such programs across the country?<sup>458</sup> Should Tribal lands, as federal enclaves, be eligible for support irrespective of the actions of the states in which they are located?

299. We also note that many municipalities have taken an active role in supporting the deployment of broadband. If we establish a priority or preference for funding for states that have taken a more active role in supporting broadband or have established a high-cost program, should our rules also take into account these municipalities' efforts? Should our rules take into account whether states have restricted municipalities from funding or deploying broadband networks? If our rules should take these considerations into account, how should they do so? We seek comment on these issues.

300. Alternatively, we could treat equally all areas in the country, including territories, that we determine to be unserved. We seek comment on this alternative proposal.

301. We invite comment on all of the above alternatives—distributing support among unserved areas nationwide and prioritizing support to a subset of unserved areas. Under either approach, are there other measures the Commission should take to ensure an equitable distribution of support, and if so, what would constitute an equitable distribution? Are there others ways to prioritize support to a subset of unserved areas that we should consider? We seek comment on the relative merits and drawbacks of these alternative approaches.

302. *Tribal Areas.* We seek comment on whether we should reserve a defined amount of funds in the first phase of the CAF to award to bidders that will deploy broadband on Tribal lands that are unserved.<sup>459</sup> In the *USF Reform NOI/NPRM*, we sought comment generally on whether unique circumstances on Tribal lands warrant a different approach to high-cost support for broadband service.<sup>460</sup> Several commenters asserted that a different approach was appropriate for Tribal lands.<sup>461</sup>

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<sup>457</sup> This would include, for instance, state broadband programs financed by state bonds or special authorities.

<sup>458</sup> For instance, some states have created high cost funds to replace revenues lost as a result of intrastate access charge reductions, while others have created funds to address changes in regulatory rules. Some states limit the amount of support provided by establishing benchmark rates for local service. There is variation among the states in whether support is determined based on forward-looking costs or embedded costs. In some states, carriers provide explicit bill credits for customers who otherwise would pay retail rates above a specified benchmark, with the fund reimbursing carriers for such bill credits. *See generally* Bluhm Paper.

<sup>459</sup> *See supra* note 4.

<sup>460</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6677, para. 50.

<sup>461</sup> *See, e.g.*, Comments of Cheyenne River Sioux Tribe Telephone Authority, WC Docket No. 10-90, GN Docket No. 09-51, at 4-7 (filed July 12, 2010); Comments of Navajo Nation Telecommunications Regulatory Commission, WC Docket No. 10-90, GN Docket No. 09-51, at 3-6 (filed July 12, 2010); Joint Comments of Native Public Media and the National Congress of American Indians, WC Docket No. 10-90, GN Docket No. 09-51, at 3-6 (filed July 12, 2010).

303. We recognize that communities on Tribal lands have historically had less access to telecommunications services than any other segment of the population.<sup>462</sup> While recent and reliable data are lacking, in the past the Commission has estimated that less than ten percent of residents on Tribal lands have access to broadband.<sup>463</sup> Also, Tribal lands are often located in rural, high-cost areas, and present distinct connectivity challenges. Indeed, the National Broadband Plan observed that many Tribal communities face significant obstacles to the deployment of broadband infrastructure, including high build-out costs, limited financial resources that deter investment by commercial providers and a shortage of technically trained members who can undertake deployment and adoption planning.<sup>464</sup> As a result, the National Broadband Plan noted that Tribes need substantially greater financial support than is presently available to them, and accelerating Tribal broadband will require increased funding.<sup>465</sup> Setting aside a portion of the CAF support for use in Tribal lands may be one way to address these unique challenges and to ensure affordable access to broadband. We seek comment on whether we should reserve funds for these purposes, and, if so, how large a reserve we should set aside. We also seek comment on whether we should adopt any additional measures to ensure any funds reserved in this manner are used efficiently, in the event that few bidders compete for such funding. We further seek comment on whether any funds reserved for Tribal lands that remain unawarded should be treated any differently from unreserved funds that remain unawarded after the auction.<sup>466</sup>

304. As an alternative to, or possibly in addition to, setting aside funds to support broadband deployment on Tribal lands, we seek comment on whether we should provide bidding credits to bidders, including Tribally owned carriers, that propose to deploy to Tribal lands.

305. We have recognized that Tribes are inherently sovereign governments that enjoy a unique relationship with the federal government.<sup>467</sup> And we have reaffirmed our policy to promote a government-to-government relationship between the Commission and federally recognized Indian Tribes.<sup>468</sup> This relationship warrants a tailored approach that takes into consideration the unique characteristics of Tribal lands.<sup>469</sup> We note that bidders (and ultimately, recipients) seeking to serve Tribal lands and Native communities will be required to comply with certain federal and Tribal land lease and access permitting processes. They will likely face challenges to deployment planning resulting from demographic conditions that lead to the very low broadband coverage rates on Tribal lands. Because bidders will need to engage directly with Tribal governments to address these requirements and to partner with Tribal anchor institutions, we seek comment on how the design of the program may properly include Tribal governments to ensure the efficient operation of the CAF on Tribal lands. We seek comment on how to

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<sup>462</sup> See National Broadband Plan at 152 (citing *Extending Wireless Telecommunications Services to Tribal Lands*, WT Docket No. 99-266, Report and Order and Further Notice of Proposed Rule Making, 15 FCC Rcd 11974, 11978 (2000)).

<sup>463</sup> See National Broadband Plan at 152.

<sup>464</sup> *Id.*

<sup>465</sup> *Id.*

<sup>466</sup> See *infra* para. 346.

<sup>467</sup> *Tribal Policy Statement*, 16 FCC Rcd 4078; see also National Broadband Plan at 146. The United States currently recognizes more than 565 American Indian Tribes and Alaska Native Villages. See *The Federally Recognized Indian Tribe List Act of 1994*, Pub. L. 103-454, 108 Stat. 4791 (1994) (Secretary of the Interior is required to publish in the Federal Register an annual list of all Indian Tribes which the Secretary recognizes to be eligible for the special programs and services provided by the United States to Indians because of their status as Indians).

<sup>468</sup> *Tribal Policy Statement*, 16 FCC Rcd at 4079-80.

<sup>469</sup> National Broadband Plan at 146.

design the CAF program to address these issues and to promote the deployment of broadband to Tribal lands.

306. *Insular Areas.* We seek comment on whether we should reserve a defined amount of funds in the CAF for insular areas. Section 254 of the Act, which provides for the federal universal service program, specifically references the need for “insular” areas of the United States to have access to advanced services. The Commission has, to date, not defined the term “insular” areas in the context of the universal service program.<sup>470</sup> In the *USF Reform NOI/NPRM*, however, we sought comment generally on whether unique circumstances in insular areas warrant a different approach to high-cost support for broadband service.<sup>471</sup> Several commenters contended that a different approach is needed because geographic, economic and social challenges present in insular areas serve as obstacles to deployment and adoption.<sup>472</sup> PRTC contends that the Commission should prioritize deployment in insular areas until they achieve the same level of penetration as other areas.<sup>473</sup> PR Wireless urges that any reform of universal service must include a separate mechanism for insular areas.<sup>474</sup> Setting aside funds to be specifically targeted to insular areas that trail national broadband coverage rates may be one way to help address these issues. Accordingly, we seek comment on whether we should reserve some funds in the first phase of the CAF for bidders seeking to serve insular areas, and, if so, how much. Is there sufficient evidence that such a set-aside is necessary or appropriate? In addition, we seek comment on how we should define “insular areas” in this context. We further seek comment on whether any funds reserved for insular areas that remain unawarded should be treated any differently from unreserved funds that remain unawarded after the auction.<sup>475</sup>

307. As an alternative to, or possibly in addition to, setting aside funds to support broadband deployment in insular areas, we seek comment on whether we should provide bidding credits to bidders that propose to deploy to insular areas.

## 7. Pre-existing Deployment Plans

308. The goal of the first phase of the CAF is to increase broadband deployment in unserved rural and high-cost areas, not to fund existing facilities or deployment to which a carrier has already committed to federal or state regulators. We seek comment on how to structure the program to avoid outcomes that would be inconsistent with that goal. We note, for example, that Frontier Communications, in connection with its acquisition from Verizon of almost 5 million lines in primarily rural and small-town

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<sup>470</sup> The Commission has previously proposed defining insular areas as “islands that are territories or commonwealths of the United States.” *Federal-State Joint Board on Universal Service: Promoting Deployment and Subscribership in Unserved and Underserved Areas, Including Tribal and Insular Areas*, CC Docket No. 96-45, Further Notice of Proposed Rulemaking, 14 FCC Rcd 21177, 21233, para. 137 (1999). The Commission has never formally adopted that proposed definition, although it did, in 2005, seek to refresh the record on the issues raised in the 1999 NPRM. See *Federal-State Joint Board on Universal Service, High-Cost Universal Service Support*, CC Docket No. 96-45, WC Docket No. 05-337, Notice of Proposed Rulemaking, 20 FCC Rcd 19731, 19746-47, para. 34 (2005).

<sup>471</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6677, para. 50.

<sup>472</sup> See, e.g., Reply Comments of PR Wireless, Inc., WC Docket No. 10-90, GN Docket No. 09-51, at 4 (filed Aug. 11, 2010); Comments of Puerto Rico Telephone Company, Inc. (PRTC), WC Docket No. 10-90, GN Docket No. 09-51, at 5-7 (filed July 12, 2010). PRTC attributes the lack of broadband connectivity in Puerto Rico to a number of factors, including the extensive poverty in Puerto Rico, the island’s poor overall economic health, and the unique expenses of providing service in an isolated and tropical area like Puerto Rico. *Id.* at 9.

<sup>473</sup> Reply Comments of Puerto Rico Telephone Company, Inc., WC Docket No. 10-90, GN Docket No. 09-51, at 3 (filed Aug. 11, 2010).

<sup>474</sup> PR Wireless Aug. 11, 2010 Reply Comments at 4.

<sup>475</sup> See *infra* para. 346.

areas, has committed to significantly extend broadband availability in its service areas.<sup>476</sup> Should we, in addition, explicitly limit funding in the first phase of the CAF to “new,” or incremental, capacity or deployment to which the carrier has not already committed? How would we define “new” capacity or deployment? As of what date? How would we enforce such a requirement? We note that any limits we might impose in this regard would not be intended to preclude carriers from receiving support—if otherwise available—for deploying broadband beyond any commitments they have made to state or federal regulators. We propose below to ensure that we avoid funding through the CAF the deployment of broadband in an area where deployment is funded by other sources, such as the NTIA BTOP or RUS BIP programs.<sup>477</sup>

## 8. Public Interest Obligations for Phase I CAF

309. Above, we generally propose public interest requirements for all recipients (current high-cost recipients and CAF recipients) including coverage, deployment, reporting, and other obligations. The unique circumstances and purposes of the first phase of the CAF, however, could warrant some different obligations. To what extent should we adopt the same public interest obligations for the first phase of the CAF as for the CAF more generally, and to what extent we should adopt differing requirements? In this section, we highlight a few key proposed obligations.

310. *Broadband coverage.* We seek comment on the relative merits of our proposal to employ a Commission-established coverage requirement and the alternative of using a bidder-established coverage requirement in this context. Commission-established minimum coverage requirements may result in more ubiquitous service within each supported area as service would likely be required to reach more housing units within each area than would a bidder-established requirement, but may also result in service being supported in fewer areas as each area could require more support. The alternative approach of bidder-defined coverage requirements may result in new broadband service being made available in more housing units overall than a Commission-established requirement, but may also result in less extensive coverage in each area. In order to reduce their bids and increase their likelihood of winning support, bidders may target the housing units that can be reached with the least support within any area and not attempt to reach other units in the same area which would require more support. We seek comment on the respective merits and drawbacks of our proposal and the alternative. In particular, will one approach or the other better serve the public interest given the intent to provide a non-recurring infusion of funds intended to spur investment in areas requiring the least support, recognizing that support available would not be sufficient to reach all unserved areas nationwide? We also seek comment on what coverage requirement the Commission should establish if we decide to adopt that approach.

311. *Speed.* We propose that recipients of support in the first phase of the CAF be required to deploy broadband networks of at least 4 Mbps (actual) downstream and 1 Mbps (actual) upstream.<sup>478</sup> We seek comment on this proposal and possible alternatives, such as 3 Mbps (actual) downstream and 768 kbps (actual) upstream.

312. We seek comment on whether we should require recipients of support during the first phase of the CAF to meet an evolving speed requirement, post-award, to account for changes in technology and consumer demand over time, and how that would impact willingness to participate in the auction or the bids offered. To provide sufficient clarity for bidders, should we specify that performance requirements will not be increased for a specified number of years, such as 3 years after the first receipt of

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<sup>476</sup> *Applications Filed by Frontier Communications Corporation and Verizon Communications, Inc. for Assignment or Transfer of Control*, WC Docket No. 09-95, Memorandum Opinion and Order, 25 FCC Rcd 5972, 6001 App. C (2010).

<sup>477</sup> See *infra* para. 323.

<sup>478</sup> See *supra* Section V.D.3 (discussing attributes of broadband and seeking comment on how to define and measure “actual” performance).

funding? How should our rules address the possibility that a recipient of support might not be able, because of technological limitations or other reasons, to meet new standards after the initial period? What are the cost implications of requiring recipients to meet an evolving speed standard? Should there be a process to adjust support amounts in the future, if higher speeds are required?

313. *Deployment and Duration.* We also seek comment on the appropriate duration of public interest obligations imposed on recipients. In the Public Interest Obligations section, we seek comment on requiring recipients to build out within a specified timeframe (e.g., three years) of their initial receipt of funding. Here, we propose that recipients of support during the first phase of the CAF build out within three years of their initial receipt of funding, and that obligations continue for a defined period, such as five years, following completion of the build out by the provider. We seek comment on these timeframes. We further seek comment on whether we should require that recipients meet a certain threshold of their coverage requirement, such as 50 percent within the bid area, by a milestone date, such as 18 months after the initial receipt of funding.

314. Given the ongoing nature of our reform efforts, we seek comment on whether, upon the completion of comprehensive universal service reform, recipients that ultimately receive long-term CAF support should be relieved of any obligations imposed as a result of receipt of funding in the first phase of the CAF, with those obligations being replaced by any public interest obligations imposed on long-term support recipients. Assuming a different provider begins receiving long-term support and complying with the public interest obligations for long-term support recipients, should the recipient of first-phase support be required to continue to comply with any still-applicable obligations, or should those obligations be phased out in these circumstances? We seek comment on these issues.

315. In addition, we seek comment on the role of states, territories, and Tribal governments in monitoring the public interest obligations of CAF recipients. Should states, territories, and Tribal governments be permitted to establish additional public interest obligations for CAF recipients? If so, how should those obligations be funded and enforced? We propose that if we permit such additional obligations to be imposed on those receiving support in the first phase of the CAF, we would require them to be promulgated before our deadline for submitting auction bids, so that potential bidders could take into account such requirements in formulating their bids. We seek comment on this proposal.

## 9. Support Eligibility Requirements

316. In this section, we seek comment on what minimum requirements we should impose on entities applying for support during the first phase of the CAF. We: (1) seek comment on whether we should require that an entity be designated (or have applied for designation) as an ETC pursuant to section 214(e) of the Act, by the state public utilities commission (PUC) (or the Commission, where the state PUC does not designate ETCs) in any area that it seeks to serve; (2) propose that an applicant must be a terrestrial wireline or wireless service provider and hold any necessary authority (or have applied for any necessary authority) to provide broadband in the geographic area it seeks to serve, as well as to hold any spectrum licenses necessary to provide the services proposed; and (3) propose to require that an entity certify that it has submitted all requested broadband deployment data as part of the State Broadband Data and Deployment program. We propose that, subject to these requirements, applicants be eligible to submit bids seeking support to deploy service in multiple unserved areas. Below, we seek comment on these minimum requirements, inquire whether other minimum standards are desirable, and solicit comment on other provider eligibility issues.

317. We propose a two-stage application process similar to the one we use in spectrum license auctions.<sup>479</sup> Based on the eligibility requirements for support, we would require a pre-auction “short-

<sup>479</sup> This is consistent with Qwest’s recommendation that any competitive bid process should include a prescreening process, a bidding period, a bid selection period, and a service delivery and reporting period that would include provider-of-last-resort obligations. Comments of Qwest Communications International, Inc. (Qwest), WC Docket No. 10-90, GN Docket No. 09-51, at 8-9 (filed July 12, 2010).

form” application to establish eligibility to participate in the auction, relying primarily on disclosures as to identity and ownership and applicant certifications, and perform a more extensive, post-auction review of the winning bidders’ qualifications based on required “long-form” applications. Such an approach should provide an appropriate screen to ensure participants are serious without being unduly burdensome. This would allow us to move forward quickly with the auction, which would speed the distribution of funding and ultimately the provision of broadband to currently unserved areas. We seek comment on the use of this proposal.

**a. ETC Designation and Service Areas**

318. As discussed above,<sup>480</sup> section 254(e) of the Act provides that a carrier must be designated as an ETC to receive universal service support.<sup>481</sup> Above, we sought comment on whether we could or should forbear from imposing this requirement on recipients in general;<sup>482</sup> here, we seek comment on whether we could or should forbear from imposing this requirement on recipients of support in the first phase of the CAF, even if we do not forbear in a broader context.<sup>483</sup> And if we do forbear from this requirement, what requirements should replace it?

319. Even if we do not forbear from the requirement in section 254(e) that universal service support recipients be designated as ETCs, we nevertheless may wish to permit entities to bid for support even if they have not yet been designated. We seek comment on allowing entities that have applied for designation as ETCs in the relevant area to participate in the reverse auction. Alternatively, or additionally, we could permit entities to apply for ETC designation on a contingent basis. We envision that applicants could identify areas for which they seek designation only if they win support for those areas. Applicants filing these conditional applications would thus be protected from finding themselves designated, and subject to the obligations that go along with being designated, in areas where they do not win support.<sup>484</sup> Alternatively, we could require carriers to be designated as ETCs wherever they wish to bid prior to their participation in the auction. We seek comment on these proposals as well. Commenting parties should discuss whether the potential gain by allowing a larger pool of applicants through one or both of these proposals offsets any potential abuse and delay that could result if a non-ETC were to bid and win the auction, but then be deemed ineligible for support.

**b. Authorization to Provide Required Services and Other Certifications**

320. To participate in an auction and receive support, we propose that an entity be required to hold, or otherwise have access to, any required authorization to provide the required services. As an initial matter, we propose that entities currently authorized to operate in targeted unserved areas should be deemed to meet this requirement. We also seek comment on whether entities other than currently authorized providers should be eligible to participate if they have either applied for any necessary authorization or have entered into an agreement to obtain any necessary authorization (e.g., through an assignment, transfer of control, or leasing arrangement). For example, in the case of a wireless carrier, would a binding agreement for access to necessary spectrum be sufficient for eligibility? In the case of

<sup>480</sup> See *supra* para. 88.

<sup>481</sup> 47 U.S.C. §§ 214(e), 254(e). If the relevant state commission lacks jurisdiction to designate a particular carrier an ETC, the Act gives that authority to the Commission. See 47 U.S.C. § 214(e)(6).

<sup>482</sup> See *supra* para. 89.

<sup>483</sup> See 47 U.S.C. § 160(a).

<sup>484</sup> Pursuant to 47 U.S.C. § 214(e)(1) and section 54.101(b) of the Commission’s rules, an ETC is obligated to provide all of the supported services defined in section 54.101(a) throughout the area for which it has been designated an ETC. Accordingly, if we do not permit conditional ETC applications, but instead require a carrier to be designated (or have applied for designation) as an ETC, at the time of an auction, in all areas for which it wishes to receive support, the carrier could find itself designated and obliged to provide services in areas where it does not receive any support.

Tribal lands, should entities be required to obtain authorization from Tribal governments to serve on their lands before becoming eligible for support? We seek comment on these issues.

321. Above, we seek comment on whether to limit eligibility to those states that have undertaken intrastate access charge reform.<sup>485</sup> If we impose such a limit, should we require potential bidders to provide certification or documentation that such state action has occurred where they seek support?

322. We propose to limit participation in the auction to those applicants able to certify that they have submitted all requested broadband deployment data as part of the State Broadband Data and Deployment program. We note that parties that have not been requested to provide such data would be permitted to certify that they have provided all data requested, and that, because the SBDD program is ongoing, parties that have not previously responded to requests for broadband data would have an opportunity to provide requested data as part of that program before any auction for support was conducted. We seek comment on this proposal generally, and on whether such a limitation should apply to Tribal areas.

323. We propose to require additional applicant certifications to avoid funding the deployment of broadband in an area where broadband deployment is funded by other sources (i.e., other federal or state broadband grants to the same or other carriers in a given area).<sup>486</sup> We seek comment on this proposal. Would a potential bidder have sufficient information to make a certification that no other carrier in a given area is receiving funding to extend facilities in the same geographic area? In addition, should we require applicants to demonstrate that they have the ability to meet accounting, financial, monitoring and reporting requirements?<sup>487</sup> We seek comment on these issues and whether such requirements are appropriate for a competitive process. Parties providing suggestions should be specific and explain how the eligibility requirements would serve the ultimate goals of the CAF.

## 10. Competitive Award Process

324. In this section, we propose rules for and seek comment on certain elements of the auction process, including the application and bidding processes. Accordingly, as detailed in Appendix A, we propose rules that will provide some flexibility to choose among various methods of conducting the

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<sup>485</sup> See *supra* para. 297.

<sup>486</sup> See, e.g., Comments of Florida Public Service Commission, GN Docket Nos. 09-47, 09-51, 09-137, at 4 (filed Dec. 15, 2009) (carriers should not be able to double dip from different federal agencies for the same project); Comments of US Cellular, GN Docket Nos. 09-47, 09-51, 09-137, at 15 (filed Dec. 7, 2009); Comments of CenturyLink, GN Docket Nos. 09-47, 09-51, 09-137, at 27-28 (filed Dec. 7, 2009); see also American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, 119 (providing that no area in which a broadband project is being funded through the Rural Utilities Service's Broadband Initiatives program may receive funding to provide broadband service under the Broadband Technology Opportunities Program). We note that NTIA and the Rural Utilities Service, in administering their respective broadband deployment initiatives under the American Recovery and Reinvestment Act of 2009, sought to prevent a single deployment from obtaining funding from both programs. See Department of Commerce, National Telecommunications and Information Administration, Broadband Technology Opportunities Program, Notice of Funds Availability and Solicitation of Applications, 75 Fed. Reg. 3795-96 (Jan. 22, 2010) (NTIA stating that it strongly recommends that applicants eligible for Rural Utilities Service loans or grants or those applicants whose projects sought to include a last mile service area that was at least 75 percent rural to apply for BIP funding; NTIA stating thereafter it would view such applications unfavorably and would not consider them a funding priority).

<sup>487</sup> See Qwest July 12, 2010 Comments at 8.

bidding and procedures to use during the bidding.<sup>488</sup> These rules are generally modeled on the Commission rules that govern the design and conduct of our spectrum license auctions.<sup>489</sup>

325. Although the rules we propose below establish the framework for conducting an auction, they do not necessarily by themselves establish the specific detailed procedures that will govern any auction process. We envision that the Commission will develop and provide notice to potential bidders of detailed auction procedures prior to conducting an auction. Specifically, we propose that, after establishing program and auction rules, the Commission release a Public Notice announcing an auction date, identifying areas eligible for support through the auction, and seeking comment on specific detailed auction procedures to be used, consistent with those rules. We further propose that the Commission release a subsequent Public Notice specifying the auction procedures, including dates, deadlines, and other details of the application and bidding process. Consistent with our existing practice for spectrum license auctions, we propose to delegate authority to the Wireline Competition Bureau and the Wireless Telecommunications Bureau to establish as outlined here, through public notices, the necessary detailed auction procedures prior to an auction, and to take all other actions needed to conduct any such auction. We seek comment on this proposal.

**a. Short-Form Application**

326. As noted above, we propose to use a two-stage application process similar to the one we use in spectrum license auctions.<sup>490</sup> Under this proposal, we would require entities interested in participating in an auction to submit a pre-auction “short-form” application. After the auction, a more extensive review of the winning bidders’ qualifications through “long-form” applications would be conducted. We envision that both applications would be filed electronically, in a process similar to that used for spectrum license auctions. Here we seek comment on the specifics of the “short-form” application.

327. We propose that, in the short-form application, potential bidders must provide basic ownership information, including all real parties in interest and officers and directors of such parties, and certify their compliance with the eligibility requirements for obtaining support. We anticipate requiring disclosure of information consistent with our proposals in the *Broadband Data NPRM*.<sup>491</sup> For example, we anticipate requiring bidders to identify any partnerships with others to provide supported services and to state whether they will provide supported services using leased spectrum (identifying from whom it will be leased). This information will establish the identity of applicants and provide information that will aid in ensuring compliance with and enforcement of our rules. Also, a potential bidder would need to certify its qualifications to receive CAF support.<sup>492</sup> Finally, we propose that applicants be required to certify that they have and will comply with all applicable rules. We seek comment on these proposed short-form application requirements.

328. We seek comment on the extent to which we can minimize the reporting burden on applicants by allowing them to refer to ownership information already possessed by the Commission and either update the ownership information or certify that there have been no changes in the ownership information since it was last submitted to the Commission.

329. In addition, we propose that applicants be required to identify in their short-form applications the specific areas they might bid to serve. As in our spectrum license auctions, identifying an

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<sup>488</sup> See *infra* Appendix A.

<sup>489</sup> Cf., 47 C.F.R. Part 1, Subpart Q.

<sup>490</sup> See *supra* para. 317.

<sup>491</sup> See *Broadband Data NPRM*, FCC 11-14, paras. 100-104 (seeking comment whether the Commission should collect ownership and contact information).

<sup>492</sup> See *supra* Section VI.E.9.b.

area as one in which a bidder was potentially interested in serving would not commit the bidder to actually bidding for support for that area in the auction. However, the availability of this information could be helpful in ensuring compliance with our auction rules. We seek comment on this proposal and on any other information that we should require of applicants in the pre-auction stage that would help ensure a quick and reliable application process.<sup>493</sup>

330. We propose that applications to participate in an auction should be subject to review for completeness and compliance with our rules, and we envision a process similar to that used in spectrum license auctions. Specifically, after the application deadline, we would review the short-form applications. Once review is complete, we would publicly announce which short-form applications are deemed acceptable and which are deemed incomplete. Applicants whose short-form applications were deemed incomplete would be given a limited opportunity to cure defects and to resubmit corrected applications.<sup>494</sup> As with spectrum license auctions, applicants would be able to make only minor modifications to their short-form applications.<sup>495</sup> Major amendments would result in the application being dismissed.<sup>496</sup> Following review of any resubmitted applications, we would make a second public announcement designating the applicants that have qualified to participate in auction. We seek comment on this application process.

#### **b. Basic Auction Design**

331. In a reverse auction, potential providers of a defined service or other benefit compete to provide it at the lowest bid. This approach can offer a relatively quick, simple, and transparent method of selecting parties that will provide a benefit for the lowest subsidy amount and setting the support those parties should be paid. There are a number of potential auction formats. We seek comment on the best auction design to maximize the deployment of broadband to housing units where there is currently no access to broadband for a fixed total amount of support. In addition to the likelihood of maximizing broadband deployment to currently unserved housing units, design considerations should include simplicity for both bidders and the Commission, transparency, and the minimization of opportunities for gaming.

#### **c. Bidding Process**

332. In discussing the public interest obligations of parties receiving support in the first phase of the CAF, we sought comment on the minimum coverage the Commission might require providers to offer in areas for which they receive support. We noted above that establishing minimum coverage requirements may maximize the number of housing units within supported areas where new broadband service would be deployed. We also described the alternative possibility of allowing bidders to establish their own coverage requirements by specifying the number of housing units to be passed in areas on which they bid. This alternative approach of bidder-defined coverage requirements may result in new broadband service being made available to more housing units overall than a Commission-established requirement, but may also result in less extensive coverage in each area. In this section, we seek comment on aspects of the bidding process related to our proposal and the alternative method of establishing coverage requirements in areas for which support is received.

333. Under our proposal that the Commission establish the minimum coverage that must be provided in an area, multiple bids for the same area would be offers to serve the same number of housing

<sup>493</sup> We note that we propose below that the Commission have the discretion to determine how much, if any, information regarding short form applications should be made public. *See infra* para. 347.

<sup>494</sup> *Cf.* 47 C.F.R. § 1.2105(b)(2).

<sup>495</sup> *Id.* Major amendments would include, for example, changes in ownership of the applicant that would constitute an assignment or transfer of control.

<sup>496</sup> In addition, applicants who fail to correct defects in their applications in a timely manner as specified by public notice would have their applications dismissed with no opportunity for resubmission. *Cf.* 47 C.F.R. § 1.2105(b)(3).

units (at minimum), and the bids could be compared simply based on their per-required-unit-covered subsidy amount, without needing to consider additional variables. We seek comment on such an approach.

334. Alternatively, bidders might be permitted to specify the minimum coverage they will provide in an area—i.e., the number of units they will commit to pass—in their bids. This would permit bidders to propose lower bids by selecting the units that they could reach within a given area with the lowest amount of support. We seek comment on how to best design an auction process incorporating bidder-specified coverage requirements consistent with our aims. How should the extent of coverage proposed by the bid be balanced with the amount of support sought by the bid?

335. In addressing the two coverage requirements we discuss above, we ask commenters to consider the relative merits and drawbacks of the different auction mechanisms that are necessitated by the different coverage requirements in light of our goals for the CAF in particular and universal service reform generally. The auction mechanism could be simpler if the Commission establishes minimum requirements.<sup>497</sup> In contrast, allowing bidder-defined coverage would require that we take both bid amount and varying bidder-defined coverage numbers into account when determining winning bids, which would require a somewhat more complex mechanism.

336. Regardless of how the minimum coverage to be provided is established, we do not intend to discourage providers from providing coverage beyond the minimum in any area for which they receive support. Should winning bidders be able to receive additional support if they exceed their coverage requirements? If so, how should such additional support be calculated? Should the answers differ depending on which approach to coverage is adopted, and if so, how?

337. We also seek comment on whether we should use a single-round sealed bid format or a different format.

338. *Other criteria or bidding credits/penalties.* We propose to select winning bidders and award support based on bids that state a price at which the bidder would meet our minimum performance requirements for the number of housing (or other) units covered by the bid, ranking bids by price per unit covered. This approach simplifies the bidding and minimizes the administrative burden of conducting an auction.

339. As an alternative to considering units passed as alike as long as providers meet minimum performance requirements, we could permit bidders to commit to various quality adjustments—such as higher speeds, lower latency, mobility, or a better upgrade path—and take those quality adjustments into consideration when determining winning bidders. We also could take into account whether the bidder is the carrier of last resort for voice service. One way to do this is to adjust bid prices using specified weights for various criteria not related to housing units served. We seek comment on this proposal. Are there benefits to using multiple weighted criteria? If so, would such an approach be preferable to considering bids for minimum performance requirements? If commenters prefer the use of multiple criteria, they should specify the criteria and weights associated with such criteria.

340. Another approach to considering performance quality would be to use bidding credits to allow tradeoffs among coverage and certain performance requirements, such as speed, latency, mobility, or upgrade path. If so, which performance characteristics should be selected for credits? How would we determine the value of any performance characteristic? What data or other information, such as

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<sup>497</sup> A Commission-defined coverage requirement avoids the need to select among multiple bids that would provide coverage for different numbers of housing (or other) units within the same geographic area. We note that certain ways of implementing package bidding with a Commission-defined coverage requirement may create a need to select among multiple bids for packages of geographic areas that partially overlap. However, there are also ways to implement package bidding that could preclude this possibility or limit its effect. We seek comment elsewhere on the need for package bidding and alternative ways to implement it.

econometric studies on the value to consumers of speed, reduced latency, and other performance characteristics, could be used to set the size of the credit?<sup>498</sup>

341. Under either scenario—weighted criteria or bidding credits/penalties—should the rankings or bids be adjusted to reflect other differences, such as a commitment to setting the retail price below some maximum level or a usage cap above some minimum? How could we administer bidding credits or weighting criteria to provide preferences to carriers in Tribal lands, insular areas, or states that have undertaken intercarrier compensation reform? How would we monitor and enforce performance according to the criteria selected? We seek comment on these issues.

342. *Reserve prices.* We propose that the Commission reserve the discretion, prior to the auction, to establish area-specific reserve prices (on a per-unit or other basis), separate and apart from any maximum opening bids, and to elect whether or not to disclose those reserves. We seek comment on this proposal and the basis for determining such reserve prices.

343. *Aggregating service areas and package bidding.* We propose to provide that the Commission would have discretion to establish bidding procedures for any auction that would permit bidders to submit package bids on aggregations of census blocks, so that their bids may take into account scale and other essential efficiencies that block-by-block bidding may not permit.<sup>499</sup> We seek comment on the extent to which such scale efficiencies are significant in this context, and if they are important, whether there are other auction designs that would better accommodate such concerns. For example, if bidders simply specify, in dollars, the subsidy required to serve a single defined number of housing units, a bidder might make several bids in overlapping areas, each bid taking into account the effects of any economies of scale that would be realized from winning support to deploy to that combination of census blocks. Alternatively, should we permit bidders to make flexible bids, expressing an offer in terms of a fixed price necessary to serve any housing units in some broad geographic area (defined by the bidder as an aggregation of census blocks) plus a separate price for each census block served (with the bidder specifying number of housing units passed) within that area? How would such contingent bids be treated in the winner-determination process we discuss above?

344. We seek comment generally on the use of package bidding. We propose that specific procedures for package bidding be among those determined as part of the process of establishing the detailed procedures for an auction. We expect that proposals for such procedures would consider how to implement package bidding consistent with our proposal to award support to at most one provider in a geographic area, without allowing geographic overlaps among packages to disqualify desirable bids. For this purpose, proposals might include limited package bidding, including permitting only predefined non-overlapping packages, permitting bidders to submit package bids on geographically adjacent census blocks, and/or the possibility of requiring that bidders submitting package bids also submit separate bids on the component blocks. We seek comment on all of these issues. We further seek comment on whether package-bidding procedures should include provisions permitting re-packaging of census blocks under certain circumstances, and, if so, what those provisions should be.

345. *Withdrawn bids.* The Commission has discretion, in developing procedures for its spectrum license auctions, to provide bidders limited ability to withdraw provisionally winning bids before the close of an auction. We propose that the Wireline Competition Bureau and the Wireless Telecommunications Bureau be delegated authority to determine any such procedures in the pre-auction process, including establishing bid withdrawal payments, when required.

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<sup>498</sup> See, e.g., Gregory Rosston, Scott J. Savage, and Donald M. Waldman, Household Demand for Broadband Internet Service, [http://www.tprcweb.com/images/stories/2010%20papers/Rosston-Savage-Waldman\\_2010.pdf](http://www.tprcweb.com/images/stories/2010%20papers/Rosston-Savage-Waldman_2010.pdf) (last visited Feb. 9, 2011).

<sup>499</sup> If a bidder were awarded support based on a package bid, it would still be required to meet the performance requirements for each census block in the package. For example, it would have to provide access to a specified percentage of the units in each census block if the Commission were to establish such a requirement.

346. *Funds remaining unawarded after auction.* We anticipate that some funds may remain unawarded after the last bid is accepted—for there to be no remaining funds, the last bid accepted would have to be priced precisely to exhaust all remaining funds. We seek comment on ways to address the issue of unawarded funds. Should we retain such funds for future auctions, use such funds to satisfy existing high-cost demand in the upcoming quarter, or should we choose some other alternative?

**d. Information and Competition**

347. In the interests of fairness and maximizing competition in the auction process, we propose to prohibit applicants competing for support from communicating with one another regarding the substance of their bids or bidding strategies.<sup>500</sup> Information available in short-form applications or in the auction process itself might also be used to attempt to reduce competition. Accordingly, for spectrum license auctions, the Commission adopted rules providing it with discretion to limit public disclosure of auction-related information, for example by keeping non-public during the auction process certain information from applications and/or the bidding.<sup>501</sup> We propose to adopt similar rules for a CAF reverse auction and seek comment on this proposal. We recognize that some communication among potential bidders may be necessary for them to evaluate whether they wish to bid jointly. We seek comment on how to design our rules to permit communications necessary to enable joint or cooperative bids but to prohibit improper bid coordination or bid-rigging.

**e. Auction Cancellation**

348. As with the Commission's spectrum license auctions, we propose that the Commission's rules provide it with the discretion to delay, suspend, or cancel bidding before or after a reverse auction begins under a variety of circumstances, including, but not limited to, natural disasters, technical failures, administrative necessity, or any other reason that affects the fair and efficient conduct of the bidding.<sup>502</sup> We seek comment on this proposal.

**11. Post-auction Process and Administration of Phase I CAF**

**a. Post-auction Long-Form Application**

349. We propose that, after bidding has ended, the Commission identify and notify the winning bidders and declare the bidding closed. We propose that, unless otherwise specified by public notice, a winning bidder be required to submit a long-form application within 10 business days after being notified that it is a winning bidder. We seek comment on the procedures that we should apply to a winning bidder that fails to submit a long-form application by the established deadline. Imposition of some deterrent measure, in addition to dismissal of the late-filed application, could deter auction participants from submitting insincere bids and serve as an incentive for winning bidders to timely submit their long-form applications. In the event a winning bidder does not timely file a long-form application, we propose that the funds that would have been provided to the applicant be offered in a subsequent auction, or, in the alternative, that such funds be restored to the initial auction pool and awarded to bidders that, but for the failed winning bid, would have themselves won support through the auction. We seek comment on these proposals.

350. We seek comment on the specific information and showings that should be required of winning bidders on the long-form application before they can be certified to receive support and before actual disbursements can be made to them.

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<sup>500</sup> Cf. 47 C.F.R. § 1.2105(c).

<sup>501</sup> Cf. 47 C.F.R. § 1.2104(h).

<sup>502</sup> Cf. 47 C.F.R. § 1.2104(i).

351. We propose that an applicant be required to confirm the ownership information provided in its pre-auction short-form application or to update that information, as appropriate.<sup>503</sup> We seek comment on whether we should require applicants to provide any other ownership information.

352. We propose that, if we were to adopt a rule allowing an applicant to participate in the auction while its ETC designation status is pending, the applicant would be required in its long-form application to demonstrate its ETC status by, for example, providing a copy of its ETC designation order from the relevant state PUC. We seek comment on this proposal.

353. We seek comment on the information a winning bidder should be required to provide regarding the network it will deploy with that support. We propose that an applicant be required to include in its long-form application a detailed project description that describes the network, identifies the proposed technology or technologies, demonstrates that the project is technically feasible, and describes each specific development phase of the project (e.g., network design phase, construction period, deployment and maintenance period). We seek comment on this proposal.

354. *Certifications.* We seek comment on the certifications that should be required of a winning bidder. We propose that, prior to receiving support, an applicant be required to certify to the availability of funds for all project costs that exceed the amount of support to be received from the CAF and certify that it will comply with all program requirements.

355. We further seek comment on whether we should require applicants to show that they have the demonstrated financial and management resources to operate a network capable of providing the required broadband services.<sup>504</sup> Should we require applicants to provide a business plan that shows their proposed project is economically sustainable?

356. *Guarantee of Performance.* We propose that a winning bidder should be required to post financial security as a condition to receiving support in the first phase of the CAF to ensure that it has committed sufficient financial resources to meeting the program obligations associated with such support under the Commission's rules. In particular, we seek comment on whether all winning bidders should be required to obtain an irrevocable standby letter of credit (LOC) no later than the date on which the bidder's long-form application is submitted to the Commission. We also seek comment on whether, alternatively, only certain applicants that do not meet specified criteria should be subject to this requirement, and if so, what those criteria should be. For example, should we establish criteria, based on bond rating, market capitalization, or debt/equity ratios (combined with minimum levels of available capital) that, if not met, would make an LOC necessary? Would such a requirement unnecessarily preclude providers that otherwise might be able to satisfy the obligations of the CAF from seeking to participate?

357. We seek comment on how to determine the amount of the LOC necessary to ensure uninterrupted construction of a network, as well as the length of time that the LOC should remain in place. For example, the amount of the LOC could be determined on the basis of an estimated annual budget that could accompany the build-out schedule required as part of the long-form applications, or we could simply require a specific dollar figure for the LOC in an amount that would ensure that construction could proceed for a given amount of time. Should the amount of an initial LOC, or a subsequent LOC, also ensure the continuing maintenance and operation of the network? Under what circumstances should the participant be required to replenish the LOC?

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<sup>503</sup> See *supra* para. 327.

<sup>504</sup> See Qwest July 12, 2010 Comments at 8; Affidavit of Trevor R. Roycroft, Ph.D. on behalf of the National Association of State Utility Consumer Advocates, Maine Office of Public Advocate, Office of the Ohio Consumers' Counsel, Pennsylvania Office of Consumers Advocate, and the Utility Reform Network (Trevor R. Roycroft, Ph.D. July 12, 2010 Affidavit), WC Docket No. 10-90, GN Docket No. 09-51, at 44 (filed July 12, 2010).

358. We also seek comment on what events would constitute a default by the recipient of support that would allow a draw on the entire remaining amount of the LOC. Further, in the event of bankruptcy, the LOC should be insulated from claims other than the draws authorized for the construction and operation of the network. We seek comment on provisions we might adopt to provide these safeguards.<sup>505</sup>

359. We seek comment on any additional safeguards we might adopt to protect against breaches by recipients of their promise to build out their networks in a timely manner. For example, should construction delays, failure to deliver service meeting specified performance characteristics speeds, and failure to comply with other public interest obligations constitute a default that would allow a draw on the LOC?

360. As an alternative to a Letter of Credit, we seek comment on whether we should require a winning bidder to guarantee completion of construction by obtaining a performance bond covering the cost of network construction and operation. Such a requirement would be similar to that which the Commission has imposed as a condition on satellite licenses.<sup>506</sup> We also seek comment on the types of requirements that bond issuers might impose and whether such requirements would be so unduly burdensome as to restrict the number of carriers that might be able to bid for support. We also seek comment on the relative merits of performance bonds and LOCs and the extent to which performance bonds, in the event of the bankruptcy of the support recipient, might frustrate our goal of ensuring timely build-out of the network. We also seek comment on whether there are other protections that the Commission should reasonably seek to ascertain the financial viability of the winning bidder, and ensure construction of the network and its subsequent operation.

**b. Disbursing Support**

**(i) Support Payments**

361. We propose that each party receiving support would receive funds over time as performance milestones are reached. We seek comment on what funding milestones would be most appropriate. For example, we could distribute fifty percent of the support associated with a census block (or aggregation of blocks) once the application for support is granted, and then expect to distribute the remaining funds in two equal increments, the first after fifty percent of the buildout was completed and the second following full deployment. Consistent with the requirements of the Antideficiency Act<sup>507</sup> discussed below, although we would fully expect that any funds not paid immediately would be paid if certain conditions are met, we note that such payments cannot be guaranteed. The Commission's obligation to pay the remainder of the support amount would be contingent upon issuance of a notice that: (1) funds are available; and (2) the Commission has determined that the recipient has complied with all program requirements. In the example of a milestone plan given above, a party might satisfy this last condition with respect to the second increment of funding by filing a report demonstrating compliance with 50 percent of the coverage requirement and the party's continued financial viability, and then might

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<sup>505</sup> For example, we could require, as a condition of receiving support, that a winning bidder first provide the Commission with a legal opinion letter that would state, subject only to customary assumptions, limitations and qualifications, that in a bankruptcy proceeding under Title 11 of the United States Code, in which the winning bidder is the debtor, the bankruptcy court would not treat the LOC or proceeds of the LOC as property of the winning bidder's bankruptcy estate (or the bankruptcy estate of any other bidder-related entity requesting the issuance of the LOC) under 11 U.S.C. § 541.

<sup>506</sup> See, e.g., 47 C.F.R. §§ 25.137, 25.165.

<sup>507</sup> See 31 U.S.C. §§ 1341, 1517; OMB Circular No. A-11, Preparation, Submission and Execution of the Budget § 145, App. G (July 21, 2010).

obtain its third increment of funding by filing a report demonstrating that it has met 100 percent of its coverage requirement.<sup>508</sup> We seek comment on this proposal.

362. We propose to structure the CAF in a manner that would assure compliance with the Antideficiency Act, which requires the Commission to collect funds before they may be obligated.<sup>509</sup> Such compliance is currently assured under the terms of an exemption, scheduled to expire December 31, 2011,<sup>510</sup> which permits the Commission to obligate certain universal service funds before they are collected. We seek comment, however, on how to assure compliance in the event the exemption is permitted to lapse or expire.

363. Are there particular steps the Commission could take in designing the CAF to enable recipients to meet current requirements for treatment of capital investment for tax purposes, which may minimize tax liabilities in the year funds are disbursed? We note, for example, that in certain circumstances, the Internal Revenue Service treats governmental payments to private parties for the purpose of making capital investments to advance public purposes as contributions to capital under section 118 of the Internal Revenue Code. Such treatment allows recipients to reduce payments from income, but reduces depreciation deductions in future years. Both NTIA's BTOP grants and RUS's BIP grants have been treated as contributions to capital.<sup>511</sup>

364. We also seek comment on the interplay between existing high-cost support for rate-of-return carriers and CAF support for rate-of-return carriers and other providers in rate-of-return territories. With respect to rate-of-return carriers that win CAF support, consistent with section 32.2000(a)(2) of the Commission's rules, we propose that such carriers be prohibited from including such infrastructure in their revenue requirement as a way to increase support under the existing high-cost mechanisms.<sup>512</sup> We seek comment on this proposal.

## **(ii) Support Liabilities**

365. We seek comment on the extent to which parties qualifying to receive support should be liable in the event that they are unable to provide broadband service pursuant to the requirements of the CAF. As discussed above, we propose that applicants qualifying for support be able to receive initial payments in advance of providing such service to finance the deployment of facilities to serve customers in the area. Should parties receiving such support be required to repay support if they fail to provide the intended service? For example, should we use a sliding scale for reclaiming support based on failure to serve housing units passed?

366. We propose to require carriers to acknowledge and agree that support is contingent upon completion (or substantial completion) of the build out in accordance with specified performance requirements. Should they be subject to additional liabilities and/or security requirements (such as letters of credit or performance bonds) to provide them with proper incentives to perform and to protect the CAF in case they fail to perform as required? Should the Commission require affiliates, such as parent

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<sup>508</sup> Because we propose below to delegate to the Wireline Competition Bureau and the Wireless Telecommunications Bureau the authority to determine the method and procedures by which parties submit documents and information required to receive support, we do not propose here specific filing procedures for these reports.

<sup>509</sup> See 31 U.S.C. §§ 1341, 1517; OMB Circular No. A-11, Preparation, Submission and Execution of the Budget § 145, App. G (July 21, 2010).

<sup>510</sup> Universal Service Antideficiency Temporary Suspension Act, Pub. L. 108-494, 118 Stat. 3986 (2004) as most recently amended in the Continuing Appropriations and Surface Transportation Extensions Act, 2011, Pub. L. 111-322, 124 Stat. 3518, 3520 (2010).

<sup>511</sup> See Rev. Proc. 2010-34, 2010-41 I.R.B. 426.

<sup>512</sup> 47 C.F.R. § 32.2000(a)(2).

corporations or entities within the same larger enterprise, to be responsible if the recipient fails to meet its obligations? If so, how should we define the level or nature of affiliation that would create this responsibility? Is there a level of service short of the full service sought that ought to offset the supported parties' liabilities? We seek comment on these issues.

367. We note that the Commission's rules provide that the Commission will generally not act on any application, petition, or request by an entity that owes money to the Commission.<sup>513</sup> We seek comment on whether bidders that are found to have failed to meet their obligations relating to the program should similarly be ineligible for Commission action until they can demonstrate that they are in compliance or obtain a waiver.

#### **c. Audits and Compliance**

368. Consistent with the discussion below,<sup>514</sup> we intend to require all recipients of CAF funding to comply with audits and record retention requirements. We seek comment on this proposal. Are there fewer, more, or different requirements we should consider for recipients of support in the first phase of the CAF?

369. Section 254(e) requires that a carrier shall use "support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."<sup>515</sup> How should the Commission ensure that support from the CAF is used for the purposes for which it was intended as required by section 254(e)? We seek comment on requiring additional information from the recipients concerning how the funds were used and specifically what information should be submitted.<sup>516</sup>

370. We generally seek comment below on what procedures we should put in place to ensure that CAF support recipients provide the services they have committed to provide.<sup>517</sup> We similarly intend to confirm that recipients of support in the first phase of the CAF are satisfying their obligations under the program, such as by conducting inspections in the field. We seek comment on whether either state commissions or RUS could play a role in confirming deployment. For instance, hundreds of smaller telephone companies are currently RUS borrowers, and required to report to RUS on their use of funds. What information-sharing mechanisms between the Commission and RUS would facilitate our ability to confirm deployment? We seek comment on what kinds of verification procedures are appropriate in this context. Should they differ from the verification procedures we adopt for the CAF? If so, how?

#### **d. Delegation of Authority**

371. To implement the various requirements we adopt for applicants and recipients of CAF support, we propose to delegate to the Wireline Competition Bureau and the Wireless Telecommunications Bureau the authority to determine, subject to existing legal requirements such as the rules of the Office of Management and Budget, the method and procedures for applicants and recipients to submit appropriate information. This delegation of authority to the bureaus would authorize modification, as necessary, of existing FCC forms and the creation, if necessary, of new FCC forms to implement the rules we adopt in this proceeding.

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<sup>513</sup> See 47 C.F.R. § 1.1910(b)(2).

<sup>514</sup> See *infra* Section VIII.

<sup>515</sup> 47 U.S.C. § 254(e).

<sup>516</sup> See *infra* para. 475.

<sup>517</sup> See *infra* para. 477.

## F. Targeting Support

372. Today, incumbent ETCs are designated to serve an entire service area, regardless of whether there is a need for support in a particular wire center<sup>518</sup> Our current rules effectively average costs across a geographic area, to varying degrees. For high-cost loop, local switching, and interstate common line support—which are the primary programs for smaller, rate-of-return companies—there is no requirement that support be targeted to specific areas within the study area. In contrast, the two programs primarily used by price cap companies do target funding to specific areas within the study area. IAS is targeted to density zones of greatest need within a study area, and high-cost model support is targeted to particular wire centers within a study area.<sup>519</sup>

373. Averaging costs between high- and low-cost areas always has been a key element of providing universal service support to help ensure that all Americans have access to telephone service. By averaging costs across study areas, e.g., in the case of high-cost loop support, or across states, in the case of high-cost model support, low-cost lines in a given area help to support high-cost lines in the same study area or state. Some commenters have argued, however, that support should be targeted at a more granular level.<sup>520</sup>

374. Below, we seek comment on two distinct proposals to target support more directly to areas that are uneconomic to serve, which could be implemented in conjunction with the reforms proposed above. The first, disaggregating support, would shift support within study areas to those portions that are more costly to serve but would not change overall support levels for incumbents. The second, redrawing study areas, could alter which areas receive support, the size of those areas, and support levels for those areas.

### 1. Disaggregating Support

375. First, we propose to target support more directly to the areas of greatest need by requiring rural carriers to disaggregate support within existing study areas beginning in 2012. Section 54.315 of the Commission's rules today allow incumbents to disaggregate support, but such disaggregation is optional.<sup>521</sup> We recognize that disaggregation of support would not alter the total amount of support that an incumbent LEC would receive in a given study area. Mandatory disaggregation of support while we develop and implement measures to transition more fully to the CAF should, however, facilitate our ability to identify those areas most in need of ongoing support in the future. Pending the phase-down of competitive ETC support as proposed above, disaggregation could also reduce existing competitive ETC support by better identifying only those areas that do require support to provide services.

376. In 2001, in the *Rural Task Force Order*, the Commission adopted three paths for the geographic disaggregation and targeting of rural high-cost loop support at or below the study area level.<sup>522</sup> When the Commission established the ICLS mechanism in the 2001 *MAG Order*, it determined that rate-of-return carriers should have the option of choosing one of the same three paths to disaggregate ICLS as

<sup>518</sup> A service area may encompass many wire centers. A “service area” generally means a geographic area established by a State commission or the Commission “for the purposes of determining universal service obligations and support mechanisms. In the case of an area served by a rural telephone company, ‘service area’ means such company’s ‘study area’ unless and until the Commission and States . . . establish a different definition of service area for such company.” 47 U.S.C. § 214(e)(5).

<sup>519</sup> Under the rules for high-cost model support, which is generally provided to the larger, price-cap companies, eligibility for support is determined by comparing the statewide average cost per line (calculated through a forward looking cost model) to a national average cost per line, but then such support is targeted to particular wire centers in an eligible state that have forward-looking costs in excess of the benchmark.

<sup>520</sup> See, e.g., USTA July 12, 2010 Comments at 12-13; Windstream July 12, 2010 Comments at 31.

<sup>521</sup> 47 C.F.R. § 54.315.

<sup>522</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11302-09, paras. 144-64.

well, and amended its rules accordingly.<sup>523</sup> The Commission explained that the disaggregation and targeting of portable ICLS would ensure that support is used for its intended purpose, consistent with section 254(e) of the Act.<sup>524</sup> Disaggregation would allow incumbent carriers to target explicit support to regions within a study area that cost relatively more to serve, ensuring that a competitive entrant receives the targeted support only if it also serves the high-cost region.<sup>525</sup> At the same time, it would prevent the competitive entrant from receiving greater support than needed to serve relatively low-cost regions, which, if permitted, would give the competitive carrier a potential price advantage over the incumbent.<sup>526</sup>

377. In the *MAG Order*, the Commission also required rate-of-return carriers to select identical disaggregation zones for all forms of high-cost support based on embedded costs.<sup>527</sup> In addition, carriers were required to allocate the same ratio of high-cost loop support and ICLS to each disaggregation zone and base their disaggregation plans on cost.<sup>528</sup> Because the high-cost loop and ICLS mechanisms “each support loop costs and therefore share similar cost structures,” the Commission could “see no reason why such support should be allocated differently in different disaggregation zones.”<sup>529</sup>

378. Few incumbent carriers took advantage of these disaggregation options. We now seek comment on applying the Commission’s rules for the geographic disaggregation and targeting of portable high-cost universal service support below the study area level adopted in the *Rural Task Force Order*, and subsequently extended to ICLS in the *MAG Order*, to all current high-cost support mechanisms.<sup>530</sup> Specifically, we propose to require rural carriers that receive high-cost loop support to disaggregate such support under one of two approaches, as explained below.<sup>531</sup> In addition, consistent with our existing disaggregation rules and policies, we also propose to require carriers to disaggregate their ICLS.

379. Specifically, consistent with section 54.315 of the Commission’s rules, we propose two options for disaggregation: A carrier may disaggregate either in accordance with a plan approved by the appropriate regulatory authority,<sup>532</sup> or by self-certifying to the appropriate regulatory authority a disaggregation plan of up to two cost zones per wire center that are reasonably related to the cost of providing service within each zone.<sup>533</sup> Consistent with the *Rural Task Force Order* and the *MAG Order*,

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<sup>523</sup> See *MAG Order*, 16 FCC Rcd at 19674-78, 19748-49, paras. 143-150, App. A; 47 C.F.R. § 54.315(a).

<sup>524</sup> See *MAG Order*, 16 FCC Rcd at 19674, para. 143; 47 U.S.C. § 254(e); see also *Rural Task Force Order*, 16 FCC Rcd at 11302, para. 145.

<sup>525</sup> See *MAG Order*, 16 FCC Rcd at 19674, para. 144.

<sup>526</sup> See *id.*

<sup>527</sup> See *id.* at 19675, para. 146 & n.401. Forward-looking high-cost model support received by non-rural rate-of-return carriers is not subject to disaggregation under section 54.315, but such support is (and hold-harmless support was) targeted to wire centers under sections 54.309 and 54.311. See 47 C.F.R. §§ 54.309, 54.311, 54.315(a).

<sup>528</sup> See *MAG Order*, 16 FCC Rcd at 19676, para. 147.

<sup>529</sup> See *id.* Carriers are permitted to use a different allocation ratio for local switching support. See *id.*

<sup>530</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11302-09, paras. 144-64; *MAG Order*, 16 FCC Rcd at 19674-78, paras. 143-150; 47 C.F.R. § 54.315.

<sup>531</sup> Under the *MAG Order*’s Path One, carriers could choose not to disaggregate support. See 47 C.F.R. § 54.315(b). Path One was intended to address those instances where a carrier concluded that, given the demographics, cost characteristics, and location of its study area, and the lack of a realistic prospect of competitive entry, disaggregation is not economically rational. See *MAG Order*, 16 FCC Rcd at 19675, para. 145.

<sup>532</sup> This is Path Two under our current rules. See *MAG Order*, 16 FCC Rcd at 19675, para. 145; 47 C.F.R. § 54.315(c).

<sup>533</sup> Under Path Three, a carrier could also self-certify a disaggregation plan that complies with a prior regulatory determination. See *MAG Order*, 16 FCC Rcd at 19675, para. 145; 47 C.F.R. § 54.315(d).

carriers' disaggregation plans would be subject to the general requirements governing all disaggregation plans.<sup>534</sup>

380. By providing carriers with the option of self-certifying a disaggregation plan, our proposal here differs from our previous disaggregation rules in one notable respect. For study areas where a competitive ETC had been designated prior to the effective date of the disaggregation rules, an incumbent carrier could elect to self-certify a disaggregation plan only to the extent that it was self-certifying a plan that had already been approved by the state.<sup>535</sup> The Commission was concerned at the time that permitting the incumbent to self-certify to a disaggregation plan in such circumstances might result in the anti-competitive targeting of support.<sup>536</sup> Based on our experience since this rule was adopted, we believe that the safeguards and procedural remedies in our current rules, along with the additional safeguards we propose here, will adequately protect against anti-competitive targeting.

381. The Commission designed the self-certification requirements adopted in the *MAG Order* to help ensure that the disaggregation plans would not be anti-competitive. When submitting information in support of self-certification, an incumbent carrier was required to provide USAC with publicly available information that allows competitors to verify and reproduce the algorithm used to determine zone support levels, and also demonstrate that the underlying rationale was reasonably related to the cost of providing service in each cost zone.<sup>537</sup> Carriers also were required to submit to USAC maps in which the boundaries of the designated disaggregation zones of support are clearly specified, which USAC makes available for public inspection.<sup>538</sup> In addition, the Commission found that limiting self-certifying carriers to a maximum of two zones below the wire center level minimizes the incentives to disaggregate in a manner that does not accurately reflect cost differences.<sup>539</sup> Finally, a self-certified plan was subject to challenge by interested parties before the appropriate regulatory authority on the grounds that it is anti-competitive and does not comply with the self-certification requirements.<sup>540</sup>

382. We propose to retain these safeguards under a mandatory disaggregation requirement and seek comment on this proposal. We propose that carriers must submit data in a geographic information systems (GIS)-standard format, such as, for example, an ESRI file geodatabase.<sup>541</sup> We also seek comment on whether carriers that have already chosen to disaggregate should be required to refile their disaggregation maps with USAC.

383. In addition to complying with the safeguards in the Commission's current rules, we propose carriers be required to serve the competitive ETCs in its area at the time it files with USAC its self-certification and supporting material, including the maps. Competitive ETCs are required to file disaggregated line count data, so timely service of this information would facilitate implementation of disaggregated support.<sup>542</sup> Nevertheless, some time lag between the filing of a disaggregation plan by an incumbent and the distribution of disaggregated support amounts by USAC to both incumbents and

<sup>534</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11307, paras. 159-160; *MAG Order*, 16 FCC Rcd at 19677, para. 149.

<sup>535</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11305-06, para. 155; 47 C.F.R. § 54.315(a).

<sup>536</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11305, para. 155. When the Commission adopted this restriction, competitive ETCs had been designated in rural study areas only "in a few limited instances." *Id.*

<sup>537</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11308, para. 161; 47 C.F.R. § 54.315(d)(2).

<sup>538</sup> See 47 C.F.R. § 54.315(f)(4). Carriers disaggregating under Path Two also are required to file maps with USAC.

<sup>539</sup> See *Rural Task Force Order*, 16 FCC Rcd at 11306, para. 157.

<sup>540</sup> See *id.* at 11305, para. 152. We are not aware of any disaggregation plan that has been challenged as anti-competitive.

<sup>541</sup> See Esri, <http://www.esri.com/> (last visited Feb. 9, 2011).

<sup>542</sup> See 47 C.F.R. § 54.307(b).

competitive ETCs is necessary to provide sufficient time for competitive ETCs to also disaggregate their lines. Accordingly, we propose that disaggregated line count data filed pursuant to sections 36.611, 36.612, and 54.307 of the Commission's rules would not be used to determine per line support amounts until the second filing deadline after the effective date of this proposed rule.<sup>543</sup> This period of time would also provide competitive ETCs the opportunity to assess the competitive impact of a carrier's disaggregation plan and, if warranted, file a petition seeking modifications to the plan with the state regulatory commission.<sup>544</sup> We invite comment on the above proposal.

## 2. Redrawing Study Areas

384. Second, we seek comment on whether we should begin a process in the near term to establish new service areas that would be eligible for ongoing support under the CAF in stage two of our comprehensive reform. Although we do not expect to disburse ongoing support under the CAF for a number of years, states would need time to complete proceedings to redraw study area boundaries. We seek comment on whether we should take steps to encourage states to redraw existing study area boundaries to create more narrowly targeted service areas for purposes of the CAF by a specified date, and what actions we may take if states decline to do so. Should the Commission require such proceedings as a precondition of carriers receiving CAF support in a particular state? Would such a requirement unfairly burden states that lack resources to undertake such proceedings? To what extent can we impose a deadline on states to complete such proceedings? In addition, should the Commission specify minimum federal criteria for new CAF support areas, such as requiring that new CAF support areas meet minimum size or population specifications?

385. What are the advantages and disadvantages of creating new geographic areas to be supported through the CAF? For example, would there be a benefit to carving out of study areas the portions that states determine do not need support (e.g., due to the presence of unsubsidized competition)?<sup>545</sup> Would there be a benefit to re-sizing study areas—either to split up large study areas to target support at a more granular level or to consolidate smaller study areas under common ownership within a given state? For example, CTIA has proposed that we “require ILECs with multiple study areas in a given state to combine those study areas at the parent company level within each state before support is calculated.”<sup>546</sup>

386. If there is a process to redraw study areas, should we also require all current ETCs to reapply for ETC designation by a specified date for purposes of receiving funding in the future? We seek comment on how such a process could be integrated with the provision of ongoing support, whether through currently existing or subsequently reformed mechanisms. In view of technological and marketplace changes, and given the reforms we propose in this Notice, it could provide ETCs a timely opportunity to reassess where they wish to continue serving as an ETC. If so, what should that date be?

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<sup>543</sup> See 47 C.F.R. §§ 36.611, 36.612, 54.307(c).

<sup>544</sup> See 47 C.F.R. § 54.315(d)(5).

<sup>545</sup> *C.f.* National Cable & Telecommunications Association, Reducing Universal Service Support in Geographic Areas that are Experiencing Unsupported Facilities-Based Competition, Petition for Rulemaking, GN Docket No. 09-51 and WC Docket No. 05-337, at i (filed Nov. 5, 2009) (NCTA Petition for Rulemaking) (proposing that “the Commission establish procedures to reduce the amount of universal service support provided to carriers in those areas of the country where there is extensive, unsubsidized facilities-based voice competition and where government subsidies no longer are needed to ensure that service will be made available to consumers.”); Universal Service Reform Act of 2010, H.R. 5828, 111th Cong. (2010).

<sup>546</sup> Comments of CTIA – The Wireless Association®, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 19 (filed July 12, 2010).

Alternatively, we note that carriers are permitted to relinquish ETC designations in any areas served by more than one ETC.<sup>547</sup> Should the Commission adopt rules to streamline the relinquishment process?

387. We also seek comment on issues related to the geographic scope of ETC obligations and ETC designations. Current ETC obligations apply throughout a designated service area regardless of whether support is actually provided to an ETC operating within the designated service area.<sup>548</sup> To what extent could we limit ETC obligations to the targeted geographic areas for which an ETC receives support, under both the existing high-cost programs as well as the proposed CAF, consistent with section 214(e)?<sup>549</sup> Alternatively, should ETCs be allowed to modify their ETC designation to cover only a portion of the geographic area they currently serve today, in order to better target support to the areas that need it most? If carriers become ETCs for purposes of CAF support in only portions of a state, what are the implications for the low income program, and should we establish a separate Low-Income only ETC designation for that program to ensure continued access to Lifeline for households living in urban areas?<sup>550</sup>

388. We recognize that by determining the need for support in smaller areas, total support levels in some areas may increase because there would be little or no cross-subsidy from lower cost areas within the carrier's service area. The more we disaggregate areas for support, the higher per-unit costs will be in some areas. On the other hand, disaggregating areas for support should reduce inefficiencies in some areas and better align universal service funding with need. As we discuss the proposals for long-term reform below, we acknowledge the tradeoffs between averaging over larger areas, which may result in supporting areas that do not need support, and targeting support to small pockets of high need, which may result in support levels that exceed any anticipated budget.

#### **G. Pending Proceedings and Other Issues**

389. The Commission previously has recognized the need for universal service reform, and has sought comment on various proposals for comprehensive reform of the high-cost support mechanisms.<sup>551</sup> Although these pending proceedings were initiated prior to the National Broadband Plan, for a number of years, many commenters have identified problems with the current high-cost support programs, and some submitted proposals that would redirect high-cost support toward supporting broadband.<sup>552</sup> During the development of the National Broadband Plan, interested parties continued to refine and submit proposals for comprehensive high-cost reform directed to broadband deployment.<sup>553</sup>

<sup>547</sup> 47 U.S.C. § 214(e)(4).

<sup>548</sup> See *supra* para. 88 (describing ETC obligations).

<sup>549</sup> AT&T Dec. 6, 2010 *Ex Parte* Letter, at 1; see also 47 U.S.C. § 214(e).

<sup>550</sup> See AT&T July 12, 2010 Comments at 18.

<sup>551</sup> See, e.g., *Comprehensive Reform FNPRM*, 24 FCC Rcd 6475; *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support Rule NPRM*); *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions Notice*); *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1531 (2008) (*Joint Board Comprehensive Reform NPRM*).

<sup>552</sup> See, e.g., Comments of AT&T, Inc., WC Docket No. 05-337, CC Docket No. 96-45 (filed April 17, 2008).

<sup>553</sup> See, e.g., Comments of CenturyLink, Consolidated Communications, Frontier Communications Corp., Iowa Telecommunications Services, Inc., and Windstream Communications, Inc., Comments in re NBP PN #19, at 1-2 (filed Dec. 7, 2009) (Broadband Now Plan); Letter from Stuart Polikoff, OPASTCO to Marlene Dortch, FCC, in re NBP PN #19, GN Docket No. 09-51, WC Docket Nos. 05-337, 06-122, 03-109, CC Docket Nos. 96-45, 01-91 (filed Dec. 8, 2009) (OPASTCO Plan); Comment Sought on the National Cable & Telecommunications Association Petition for Rulemaking to Reduce Universal Service High-Cost Support Provided to Carriers in Areas Where There (continued....)

We seek comment on these and other relevant proposals in the record as we consider the near-term reforms we propose above and the long-term vision for the Connect America Fund we outline below, and invite parties to update their proposals as appropriate.

390. *Broadband Now Plan.* In 2009, a group of mid-sized carriers submitted the Broadband Now Plan, which proposed, among other things, to provide “targeted, incremental support that would be dedicated to deployment of broadband facilities in high-cost areas that are currently unserved or have access only to service at speeds slower than 6 Mbps”; condition receipt of such support on “making private investment equal to at least \$800 per household without access to broadband (and \$50 per household with access to broadband, but at less than 6 Mbps throughput); and “[i]ncrease the efficiency of universal service by calculating support on a more granular wire center level and awarding that wire center support in a competitively neutral manner that would permit a provider that required less targeted support to step forward and receive support in place of the incumbent (while then assuming carrier of last resort obligations for that wire center).”<sup>554</sup> We seek comment on whether and how these recommendations could be operationalized in the context of the reforms proposed herein.

391. *NCTA Petition for Rulemaking.* Also in 2009, NCTA filed a petition for rulemaking proposing that “the Commission establish procedures to reduce the amount of universal service support provided to carriers in those areas of the country where there is extensive, unsubsidized facilities-based voice competition and where government subsidies no longer are needed to ensure that service will be made available to consumers.”<sup>555</sup> Consistent with that proposal, we seek comment above, in the discussion on redrawing study areas, on “whether there would be a benefit to carving out of study areas the portions that states determine do not need support (e.g., due to the presence of unsubsidized competition).”<sup>556</sup> Here we seek more focused comment on how the presence of unsubsidized competition should be factored into our proposals generally. For instance, should we eliminate universal service in any study area where there is 100% coverage by an unsubsidized voice provider? Should we create a rebuttable presumption that universal service support is unnecessary in those study areas where at least 95% of the households can get service from an unsubsidized competitor?<sup>557</sup> How would such a process impact an incumbent that may have outstanding loan obligations and/or be subject to state-mandated carrier of last resort obligations? If federal universal service for the incumbent in that situation were eliminated, should that carrier also be relieved of carrier of last resort obligations? What mechanisms should be in place to make sure that consumers throughout the area continue to have service? For instance, should the unsubsidized competitor be required to serve the entire area? Should support levels be modified for the incumbent that continues to serve those lines where there is no unsubsidized competitor? We also seek comment on whether and how to rationalize funding in circumstances in which a single company operates two or more networks in the same area (e.g., telecommunications and cable plant, or wireline and wireless networks).

392. *Non-regulated Revenues.* Several parties have suggested that when calculating universal service support levels, the Commission should take into account unregulated as well as regulated

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is Extensive Unsubsidized Facilities-Based Voice Competition. GN Docket No. 09-51, WC Docket No. 05-337, RM-11584, Public Notice, 24 FCC Rcd 14394 (Wireline Comp. Bur. 2009).

<sup>554</sup> See Broadband Now Plan at 1.

<sup>555</sup> NCTA Petition for Rulemaking at i. See also Universal Service Reform Act of 2010, H.R. 5828, 111<sup>th</sup> Cong. (2010).

<sup>556</sup> See *supra* para. 385.

<sup>557</sup> The NCTA petition estimated that, based on then available information, recipients of funding in areas where there was 95% or greater coverage by an unsubsidized voice provider collectively received \$109 million in high-cost support.

revenues.<sup>558</sup> In its comments in response to the *USF Reform NOI/NPRM*, NASUCA argued that “[c]urrent [universal service] funding levels continue to reflect erroneous assumptions that voice services alone are provided over the supported carrier’s network.”<sup>559</sup> Likewise, NCTA has argued that when considering need for ongoing support, the FCC should consider whether incumbent carrier costs, including costs attributable to provider of last resort obligations imposed under state law, cannot be recovered through the regulated and unregulated services provided over the network.<sup>560</sup> We seek comment on how to ensure that universal service is not inappropriately subsidizing non-regulated services or excessively subsidizing carriers that have the ability to recover additional non-regulated revenues as a result of their deployment of subsidized local loops. We seek comment on the proposal to include all revenues (including broadband revenues) when evaluating the rate of return revenue requirement.

393. *Interstate Common Line Support for Price Cap Converts.* We also note that several carriers that converted to price cap regulation since the adoption of the *CALLS Order* do not receive IAS in certain study areas, but instead receive another form of support for interstate costs, known as ICLS, on a frozen per-line basis.<sup>561</sup> In 2010, these carriers received frozen ICLS disbursements of approximately \$239 million, or an average of \$4.85 per line eligible for ICLS per month.<sup>562</sup> In granting the waivers necessary for these carriers to convert to price cap regulation, the Commission acknowledged that the waivers would be subject to any future reform of price cap regulation, intercarrier compensation, or universal service.<sup>563</sup> Verizon has suggested that frozen ICLS for those price cap companies should be phased down on the same schedule as IAS, while Windstream has argued that doing so would be contrary to good policy.<sup>564</sup> We do not propose to transition frozen ICLS to the CAF at this time, but we seek comment on Verizon’s suggestion.

394. *Freezing ICLS for Rate-of-Return Companies.* In the April 2010 *USF Reform NOI/NPRM*, the Commission sought comment on capping ICLS on a per line basis.<sup>565</sup> We seek more focused comment here on whether, in order to restrain the growth of ICLS in the near term while we undertake more comprehensive universal service reform, we should cap ICLS either per line or per study area for rate-of-return companies on an interim basis (e.g., for two years), to take effect in 2012. Such a temporary cap could enable us to move more efficiently to transition all funding to the Connect America Fund over the longer term.

<sup>558</sup> See, e.g., Comcast Comments in re NBP PN #19, filed Dec. 7, 2009, at 3–4; New Jersey Division of Rate Counsel Comments in re NBP PN #19, filed Dec. 7, 2009, at 7–8; Letter from Ben Scott, Free Press to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51 (Jan. 19, 2010) (need for high cost should be based on forward-looking infrastructure and total revenue earning potential); *Discussion Draft of the Universal Service Reform Act of 2009: Hearing Before the Subcomm. on Communications, Technology and the Internet of the H. Comm. on Energy and Commerce*, 111th Cong. (2009) (statement of The Hon. Ray Baum, Comm’r, Oregon Public Utility Commission), available at <http://go.usa.gov/Yec>.

<sup>559</sup> See Comments of NASUCA, et. al. on NOI, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337 at ii, 6 (Filed July 12, 2010).

<sup>560</sup> See NCTA Petition for Rulemaking; see also Sprint Comments in re *National Cable and Telecommunications Association Petition for Rulemaking To Reduce Universal Service High-Cost Support Provided To Carriers In Areas Where There Is Extensive Unsubsidized Facilities-based Voice Competition*, WC Docket No. 05-337, GN Docket No. 09-51, RM-11584, filed Jan. 7, 2010, at 7 (FCC must recognize that USF recipients derive revenues from broadband and video services delivered over common network).

<sup>561</sup> See, e.g., *Windstream Price Cap Conversion Order*, 23 FCC Rcd at 5302-04, paras. 19-22.

<sup>562</sup> See 2010 Disbursement Analysis (forthcoming); USAC High-Cost Disbursement Tool.

<sup>563</sup> See, e.g., *Windstream Price Cap Conversion Order*, 23 FCC Rcd at 5299, para. 10.

<sup>564</sup> Verizon July 12, 2010 Comments at 17; Reply Comments of Windstream Communications, Inc, WC Docket Nos. 10-90 and 05-337, GN Docket No. 09-51, at 37-40 (filed Aug. 11, 2010)

<sup>565</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6679-80, paras. 55-56.

395. *Middle Mile Costs.* A number of parties have suggested that middle mile costs are a significant component of the costs of serving customers in rural areas.<sup>566</sup> The National Broadband Plan observed that “[i]t is not clear whether the high costs of middle-mile connectivity in rural areas are due solely to long distances and long population density, or also reflect excessively high special access prices as some parties have alleged.”<sup>567</sup> We seek comment on whether to modify our universal service rules to provide additional support for middle mile costs. If we were to do so, how could we ensure that support is provided for middle mile circuits that are offered on rates, terms, and conditions that are just and reasonable? Further, we observe that in the absence of universal service support for middle mile costs, some small carriers have cooperatively developed regional networks to provide lower cost, higher capacity backhaul capability. What effect would middle mile support have on incentives for small carriers to continue to seek such efficiencies?

396. *Separations.* As also noted below, in a separate proceeding the Federal-State Joint Board on Separations is evaluating reform of the jurisdictional separations process.<sup>568</sup> We seek comment on how our proposed reforms may affect or be affected by the existing separations process and any future separations reform. We also note that one party has “urged the Commission to make clear that as it transforms its universal service objectives from plain old telephone service to broadband, it will treat loops used to provide broadband as exclusively interstate.”<sup>569</sup> We seek comment on this suggestion.

397. *Accelerated Transition for Rate-of-Return Territories.* Below we seek comment on an alternate path for rate-of-return territories over the longer term that would provide ongoing support based on actual investment, while moving to an incentive regulation framework.<sup>570</sup> This could include capping and shifting interstate common line support to an incentive regulation framework that would establish support amounts periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue, implementing a more rigorous process to examine whether investment is used and useful, and re-examining the current 11.25 percent interstate rate of return.<sup>571</sup> Under what circumstances would it be appropriate to accelerate the transition, and adopt such measures impacting rate-of-return companies in the near term? We also seek comment on whether to allow carriers to opt-in to any of the reforms on an accelerated timeframe. We generally emphasize that we intend to monitor progress in extending broadband under the near-term reforms discussed above, and we reserve the right to move more quickly to the long-term reforms set forth below.

<sup>566</sup> Per-megabit costs can vary significantly for small rural providers. During development of the National Broadband Plan, the National Exchange Carrier Association reported that the price its members pay for a 45 Mbps DS3 connection ranges from \$50–\$375 per month. National Exchange Carrier Association Comments in re NBP PN# 11, filed Nov. 4, 2009, at 4. *See also* National Telecommunications Cooperative Association Comments in re NBP PN #11, filed Nov. 20, 2009, at 5-13 (asserting that total middle-mile cost will rise as Internet demand increases, and small rural providers have per Mbps middle-mile costs higher than the larger providers).

<sup>567</sup> National Broadband Plan at 143 (citations omitted).

<sup>568</sup> *See infra* para. 563; *see Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 24 FCC Rcd 6162, 6167–69, paras. 15–20 (2009) (2009 *Jurisdictional Separations Referral Order*). *See also Federal-State Joint Board on Separations Seeks Comment on Proposal for Interim Adjustments to Jurisdictional Separations Allocation Factors and Category Relationships Pending Comprehensive Reform and Seeks Comment on Comprehensive Reform*, CC Docket No. 80-286, Public Notice, 25 FCC Rcd 3336 (2010) (2010 *Jurisdictional Separations Public Notice*).

<sup>569</sup> *See* AT&T Dec. 6, 2010 *Ex Parte* Letter.

<sup>570</sup> *See infra* Section VII.C.3.

<sup>571</sup> *See id.*

## VII. LONG-TERM VISION FOR THE CONNECT AMERICA FUND

398. In the second stage of our comprehensive reform package, we propose to provide all funding through the Connect America Fund, which will provide ongoing support to enable Americans to access robust, affordable IP-based networks that are capable of providing both high-quality voice service and broadband Internet access service. The goal is to transition 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.

399. In this section, we first seek comment on how many providers the CAF should support per high-cost geographic area and how to address situations where no firm is willing to provide service in a particular area. Similarly, we ask whether any funding is appropriate in an area if high-quality voice service and broadband Internet access services are provided today by a provider without universal service support. Next, we discuss how to size the CAF and how the CAF interrelates with our other universal service programs, which work together to ensure universal service. We then conclude with a discussion of alternative approaches for determining appropriate amounts of ongoing CAF support that would replace all existing high-cost funding.

400. Under one option, in each part of the country requiring ongoing universal service support, the Commission would hold a competitive, technology-neutral bidding mechanism to select the firm to receive support for serving the area and take on all broadband and voice service obligations. Under another option, the Commission would offer the current voice carrier of last resort (likely an incumbent telephone company) a right of first refusal to serve the area as the broadband and voice provider of last resort for an ongoing amount of annual support based on a cost model. If the provider refuses this offer, the Commission would award ongoing support through a competitive, technology-neutral bidding mechanism, in which the current voice carrier of last resort could participate. Under either approach, all support for carriers operating in high-cost areas would come from the CAF. This funding would replace all other explicit support as well as all implicit subsidies from intercarrier compensation rates, as described in the next section.

401. In the alternative, we seek comment on limiting the full transition to the CAF to a subset of geographic areas, such as those served by price cap companies, while continuing to provide ongoing support based on reasonable actual investment to smaller, rate-of-return companies. Should we take this approach, we seek comment on possible changes to the current rate-of-return system beyond those discussed in the previous section, including capping and shifting interstate common line support to an incentive regulation framework that would establish support amounts periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue, implementing a more rigorous process to examine whether investment is used and useful, and re-examining the current 11.25 percent interstate rate of return.

### A. Supported Providers

402. The National Broadband Plan recommended that there should be at most one – whether fixed or mobile – subsidized provider of broadband service per geographic area, noting that subsidizing duplicate, competing networks would impose significant burdens on consumers.<sup>572</sup> We seek comment on that recommendation.

403. By providing support to at most one provider in a given high-cost area, we should be able to maximize the reach of available funds to extend broadband service. We are committed to controlling the size of the universal service fund. At the same time, some commenters have suggested that our long-term goal should be to ensure comparable service for both fixed and mobile services. For example, the Rural Cellular Association argues that “[n]ew universal service mechanisms must take into account the

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<sup>572</sup> See National Broadband Plan at 145.

fact that wireless is now the dominant mode of voice communications.”<sup>573</sup> AT&T proposed that the Commission “shift legacy competitive ETC support to an Advanced Mobility Fund, where it would remain until there were no more areas unserved by mobile wireless broadband and voice service.”<sup>574</sup> In addition, several associations representing small rural carriers support funding one fixed and one mobile provider in each geographic area.<sup>575</sup> We seek comment on proposals to support both fixed and mobile networks under the CAF, rather than funding only one provider in any given area.

404. To the extent we provide separate, ongoing support for mobility within the CAF, we seek comment on possible changes to the way support is determined for competitive ETCs, including an alternative to the current identical support rule. Specifically, we seek comment on designing an alternative mechanism – tailored to the business models and cost structures of mobile wireless providers to provide sufficient but not excessive support – that would promote the deployment of mobile services in areas for which service would not otherwise be practical.

405. We seek comment on two potential funding options. First, we seek comment on the use of a model to determine high-cost support for wireless carriers. Specifically, should we develop a model to estimate the appropriate levels of support associated with provision of mobile service in specific geographic areas and provide support based on those estimates? If we were to adopt such an approach, we propose a simplified model, which could rely solely on density as an input, or could incorporate a small number of other inputs such as topography or distance from a population center. We seek comment on this approach. We seek comment regarding how to limit model-based support to a single competitive ETC for each geographic area, or how to limit support to the extent multiple competitive ETCs are designated in a particular area.

406. Second, we seek comment on using reverse auctions to determine support for competitive ETCs only. We note that the Commission has previously sought comment on the use of reverse auctions to distribute high-cost universal service support.<sup>576</sup> In that proceeding, several commenters proposed that reverse auctions should be used to determine support for competitive ETCs only.<sup>577</sup> We ask commenters to refresh the record in that proceeding with specific emphasis on using reverse auctions only for mobile wireless competitive ETCs.

407. To the extent we create long-term alternatives within the CAF for mobile carriers, we propose to limit support under such a mechanism to one wireless competitive ETC per geographic area. We seek comment on this proposal, and specifically how it could be implemented and whether support should be provided to some other number of mobile wireless carriers. To the extent we were to fund only one mobile wireless provider in a given geographic area, should we require that provider to share infrastructure, such as cell towers, with other non-supported wireless providers?

408. To the extent we decide to support a single provider through the CAF, we seek comment on whether (and if so, how) that would impact the operation or effectiveness of the Commission’s E-rate,

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<sup>573</sup> Comments of Rural Cellular Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 20 (filed July 12, 2010) (citing Morgan Stanley research indicating that the total number of mobile Internet users will surpass the total number of desktop Internet users by 2014).

<sup>574</sup> AT&T July 12, 2010 Comments, at 23.

<sup>575</sup> See Letter from Glenn Brown, Rural Associations, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, 99-68, 80-286, WC Docket Nos. 06-122, 05-337, 04-36, Attach. (filed Nov. 15, 2010). The Rural Associations include NECA, NTCA, OPASTCO, and WTA.

<sup>576</sup> *Reverse Auctions Notice*, 23 FCC Rcd 1495.

<sup>577</sup> See, e.g., Comments of Embarq, WC Docket No. 05-337, CC Docket No. 96-45, at 14-19 (filed April 17, 2008); Comments of the Oklahoma Corporation Commission, WC Docket No. 05-337, CC Docket No. 96-45, at 13-17 (filed April 17, 2008); Comments of the United States Telecom Association, WC Docket No. 05-337, CC Docket No. 96-45, at 19-26 (filed April 17, 2008).

Rural Health Care, and low-income programs. For instance, would funding only one CAF provider per geographic area, at most, reduce the number of carriers that bid to provide services to schools, libraries, and health care providers eligible for funding from the E-rate or Rural Health Care programs? Should we designate “Lifeline Only” ETCs to ensure that all low-income consumers have access to the low-income program?<sup>578</sup>

409. We also seek comment on whether any funding is appropriate in an area if high-quality voice service and broadband Internet access services are provided today by an operator without universal service support. If long-term funding is based on census blocks, how should we establish that an area is served today by an unsubsidized provider? Is the existence of unsubsidized competition today a reliable indicator that future funding will not be necessary? How can we ensure that the unsubsidized provider will continue to provide an evolving level of voice and broadband services? We seek comment on whether model-based support or a reverse auction approach would sufficiently avoid providing support to areas in which no funding is necessary due to existing unsubsidized service.

410. We also seek comment on how to address situations where no entity wishes to serve an area. Section 214(e)(3) provides that “[i]f no common carrier will provide the services that are supported by Federal universal service support mechanisms under section 254(c) . . . to an unserved community,” the Commission or a state commission, as appropriate, “shall determine which common carrier or carriers are best able to provide such service to the requesting unserved community . . . and shall order such carrier or carriers to provide such service.”<sup>579</sup> If the Commission makes broadband a supported service, should the Commission or a state commission require a particular provider (wireline or wireless) to provide broadband service in all areas? What factors should be applied in determining which provider is “best able to provide” supported broadband service? What relative roles should the Commission and the states play in determining which carriers are best able to provide the supported services in unserved areas? We seek comment on whether a consistent, national approach is necessary to further the universal service goals of the Act or to provide certainty to eligible entities regarding the possible application of this important provision.

411. To the extent we ultimately provide ongoing support to only one provider in each geographic area where support is available, we seek comment on whether there should be exceptions to the rule that only one provider should receive ongoing CAF support. For example, we seek comment above on whether any reduction in competitive ETC support should include an exception for carriers serving Tribal lands.<sup>580</sup> We seek comment on whether there are unique circumstances in Tribal lands and Alaska Native Regions that would require ongoing funding of more than one provider, after the CAF is fully implemented. If commenters believe that unique circumstances require ongoing funding for multiple providers in those areas, they should provide detailed explanation, data and analysis to support their contentions.

## **B. Sizing the Federal Commitment to Universal Service**

412. The Commission has had a long-standing commitment to providing support that is sufficient but not excessive.<sup>581</sup> As the United States Court of Appeals for the Fifth Circuit held in *Alenco*, “[t]he agency’s broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service.”<sup>582</sup> The

<sup>578</sup> See AT&T Dec. 6, 2010 *Ex Parte* Letter.

<sup>579</sup> *Id.* § 214(e)(3).

<sup>580</sup> See *supra* note 4.

<sup>581</sup> See 2010 *Order on Remand*, 25 FCC Rcd at 4088, para. 29 (concluding that a determining the sufficiency of support must also take into account the Commission’s generally applicable responsibility to be a prudent guardian of the public’s resources).

<sup>582</sup> *Alenco*, 201 F.3d at 620-21.

*Alenco* court also found that “excessive funding may itself violate the sufficiency requirements,”<sup>583</sup> while the United States Court of Appeals for the Tenth Circuit has stated that “excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in [section] 254(b)(1).”<sup>584</sup> As we undertake reform, we remain committed to controlling the size of the federal universal service fund, and expect the reforms we propose today will result in more efficient use of federal support.

413. The National Broadband Plan recommended that the Commission take steps to manage the fund so that its total size remains close to its current level (in 2010 dollars) to minimize the burden of increasing universal service contributions on consumers.<sup>585</sup> In the *USF Reform NOI/NPRM*, we sought comment on capping high-cost support provided to incumbent telephone companies at 2010 levels.<sup>586</sup> Some commenters supported this proposal,<sup>587</sup> while other commenters argued that the benefits of broadband envisioned in the National Broadband Plan will not be realized without increasing the size of the fund.<sup>588</sup>

414. In 2010, the current high-cost program disbursed roughly \$4.3 billion and was projected to disburse roughly the same amount in 2011.<sup>589</sup> We seek comment on a proposal to set an overall budget for the CAF such that the sum of the CAF and any existing high-cost programs (however modified in the future) in a given year are equal to the size of the current high-cost program in 2010. Alternatively, if the Commission were to set an overall budget, should it use a different year as the relevant baseline, and under what circumstances (if any) should the Commission adjust the baseline? For instance, should the baseline be adjusted for inflation? In the alternative, is a smaller amount of total funding appropriate to ensure support is sufficient, but not excessive, and the contribution obligation of consumers is minimized? On the other hand, in light of the high costs required to deploy ubiquitous mobile coverage

<sup>583</sup> *Alenco*, 201 F.3d at 620.

<sup>584</sup> *Qwest II*, 398 F.3d at 1234.

<sup>585</sup> National Broadband Plan at 149-50; see also *Joint Board 2007 Recommended Decision*, at 20484, paras. 26-27 (recommending overall cap on the high-cost fund and a transition in which existing funding mechanisms would be reduced, and all, or a significant share of savings transferred to proposed new funds for broadband and mobility); New Jersey Division of Rate Counsel Comments in re NBP PN #19 at 5,7 (filed Dec. 7, 2009) (arguing the FCC should cap the high-cost fund and transition to a Mobility Fund, a Broadband Fund, and a Provider of Last Resort Fund, such that combined total of the three stays within the cap).

<sup>586</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6677-78, paras. 51-52.

<sup>587</sup> See, e.g., Comments of Verizon and Verizon Wireless, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 10 (filed July 12, 2010); Comments of the American Cable Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3 (filed July 12, 2010); Comments of Comcast Corporation, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3-4 (filed July 12, 2010); Comments of the Public Service Commission of the State of Missouri, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 6 (filed July 12, 2010).

<sup>588</sup> See, e.g., Joint Comments of the National Exchange Carrier Association, Inc., National Telecommunications Cooperative Association, Organization for the Promotion and Advancement of Small Telecommunications Companies, Western Telecommunications Alliance, and the Rural Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 10 (filed July 12, 2010) (cautioning that “the benefits envisioned by the Plan will not be fully realized, and the Plan itself is at risk of failure, because of the Commission’s perplexing insistence that nationwide broadband deployment can be accomplished without the size of the USF growing in real terms”); Comments of the Nebraska Telecommunications Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3 (filed July 12, 2010).

<sup>589</sup> This estimate is based on annualizing USAC estimated demand for the first quarter of 2011. See *Federal Universal Service Support Mechanisms Fund Size Projections for First Quarter 2011*, Universal Service Administrative Company, Appendix HC01 (Nov. 2, 2010), <http://www.usac.org/about/governance/fcc-filings/2011/quarter-1.aspx> (projecting first quarter 2011 demand of approximately \$1.1 billion).

and very-high-speed broadband to every American and the length of the transition to the proposed Connect America Fund, we also seek comment on whether additional investments in universal service may be needed to accelerate network deployment.

415. What factors should the Commission consider in sizing the CAF? We note that there are many levers that could impact the level of financial commitment required from the federal universal service fund to achieve our goals, including: how we define affordability; the extent of broadband coverage; our benchmark for broadband capability; whether we fund more than one network per area; the level of financial co-investment from carriers and, potentially, states and localities; the existence of unsubsidized competition; the technologies used to deliver service; the respective roles of satellite and terrestrial technologies; prioritization for certain unserved areas (such as Tribal lands); and the timeframe for extending facilities to unserved areas.

416. We also note that the Commission's high-cost universal service support is only one of the four federal universal service support programs designed to advance the statutory goals of universal service. The Commission developed four universal service disbursement mechanisms – high-cost, low income, schools and libraries, and rural health care – to implement all of the statutory requirements set forth in section 254 of the Act.<sup>590</sup> We seek comment on whether, in determining the size and role of the CAF, we should take into account the cumulative effect of the four support programs, acting together, to achieve the goals of universal service. Should the Commission be focused on sizing the CAF to ensure that the total universal service program, not just the high-cost program, remains at its current size?

### **C. Alternative Approaches for Targeting and Distribution of CAF funds**

417. The National Broadband Plan recommended that by 2020, the existing high-cost programs would be eliminated, and all funding for supported services would be provided through the Connect America Fund.<sup>591</sup> We seek comment below on alternative approaches for determining ongoing CAF support that ultimately would replace all remaining high-cost funding in stage two. In addition, we seek comment on whether these proposals would be effective on Tribal lands, given the low telephone and broadband penetration rate and the associated demographic challenges.

#### **1. Competitive Bidding Everywhere**

418. We seek comment on using a competitive bidding mechanism to award funding to one provider per geographic area in all areas designated to receive CAF support. This competitive bidding mechanism would be designed to maximize the number of households passed by broadband networks while ensuring that Americans retain access to voice service, without exceeding any defined budget for the CAF. We could use a competitive bidding mechanism that would simultaneously select the providers of both broadband and voice or, if necessary to avoid growing the size of the CAF, in some areas voice-only providers that would receive ongoing CAF support. Providers could submit bids for the “complete package,” which includes broadband and voice, bids for voice only, or bids for both options.<sup>592</sup> Any carrier that plans to use technology that can meet or exceed the proposed performance requirements and accepts the associated public interest obligations would be eligible for support. Ultimately, the carrier would decide what technology or combination of technologies is most appropriate to serve its own territory. In addition, the process could be designed in a way that allows a carrier to use technologies that

<sup>590</sup> 47 U.S.C. § 254(b); *2010 Order on Remand*, 25 FCC Rcd at 4086-87, paras. 26-27. (describing interrelation of four universal service disbursement programs in advancing the statutory goals of universal service).

<sup>591</sup> See National Broadband Plan at 150 (Recommendation 8.13).

<sup>592</sup> We note that although a single-round auction is the simplest to run, it could deprive bidders of potentially useful information compared to a multiple round format.

may not meet the minimum performance requirements in place at that time, such as satellite technologies, for the most costly housing units to serve, in order to manage the overall size of the Fund.<sup>593</sup>

419. Bids for the “complete package” in any area would be selected to maximize the number of households and businesses passed. When none of the bids overlap (cover the same geographic area), bids would be ranked by dollars per households passed from lowest to highest, starting with the lowest. This approach would identify the providers that propose to achieve the greatest broadband coverage with the limited funding available.<sup>594</sup> Because bidders would be in direct competition with bidders in every area in the nation where support is offered, they should have incentives to limit the amount of support they seek. Participation could be open to all types of providers, provided that they are ETCs (or become ETCs) that meet the public policy parameters for broadband (e.g., speed, coverage, latency) and voice (e.g., outages, E911, COLR obligations) in the areas where they will be providing service.

420. Bids for “voice only” would compete only against other bids for serving the same area (except for satellite bids that are independent of geography), because voice service must be provided in every area. Participation could be open to all types of providers, provided that they are ETCs (or become ETCs) that can meet voice COLR obligations in the areas where they would be providing service. Using satellite voice service as a backstop effectively would set a maximum bid price for voice service because satellite voice service would be available everywhere but at a high bid price. Bids for satellite providers could be in the form of a “per household” price of voice-only service independent of geography.

421. We seek comment on whether we should use bidding credits for bids to provide service exceeding the minimum requirements for features such as higher speed, latency, mobility, or upgrade potential, or to provide preferences to carriers serving Tribal lands or insular areas. We seek comment on how competitive bidding processes may properly involve Tribal governments and what impact these processes will have on the provision of CAF-supported services on Tribal lands.

422. We also seek comment on alternative competitive bidding mechanisms to maximize the number of households passed by broadband networks while ensuring that voice service remains available everywhere without exceeding any defined budget for the CAF. Is there some sequential approach that would first determine the least cost method for ensuring that voice service remains available everywhere and then maximizes broadband coverage subject to a budget constraint by substituting bids for the “complete package” of broadband and voice service for voice only bids?

423. *Geographic Areas for Auction.* We seek comment on defining areas for bidding that are aggregations of census blocks. The Commission could use the same Commission-defined geographic areas for complete package and voice only bids to ensure that continued access to voice service everywhere. In contrast to the right of first refusal alternative discussed below, the Commission-defined areas would not have to account for study area boundaries that intersect census block boundaries.<sup>595</sup>

424. *Role of Satellite.* As discussed above, satellites are ideally suited to serve housing units that are the most expensive to reach via terrestrial technologies (assuming available coverage and capacity), because there is little marginal cost to add a subscriber, assuming capacity is available.<sup>596</sup> Thus, serving the most expensive locations with satellite would reduce the overall support levels needed. For example, using the assumptions made in developing the National Broadband Plan, Commission staff estimated that the \$24 billion broadband availability gap could be reduced by more than half if the

<sup>593</sup> We seek comment above on alternative methods of establishing coverage requirements that CAF recipients must achieve. See *supra* at paras. 129-136, 135.

<sup>594</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd 6657, at Appendix B (71 Economists’ Proposal).

<sup>595</sup> See *infra* Section VII.C.2.

<sup>596</sup> See *supra* paras. 133, 272.

250,000 most expensive housing units were served by satellite.<sup>597</sup> Because satellite capacity is limited, the number of broadband subscribers that satellite can support depends on the evolution of residential users' demand for bandwidth, and the number and capabilities of the satellites themselves. Regardless, there could be benefits in terms of the size and efficiency of the CAF if our rules were designed to support the use of satellite for the housing units that are most expensive to reach via terrestrial technologies.<sup>598</sup> The most costly-to-reach housing units in any given area, however, may not be among the most expensive nationally; in another area, a large fraction of the housing units could be among the most expensive. One possible approach to aligning the use of satellite capacity with the areas of greatest cost would be to limit support for any line with cost over a specified threshold (e.g., five times the national average cost per line) to the amount of support needed to serve the housing unit with satellite. An alternative would be to allow providers to use satellite to serve the most expensive homes. We seek comment on these and other methods for effectively using funding for satellite.

425. A judicious use of support for satellite service could reduce costs associated with building out networks. There are several approaches for how best to capture these potential savings in a competitive bidding process. One approach would be to allow satellite providers to bid on areas against other providers. For larger geographies, however, this approach could become problematic, because any given area is likely to contain a mix of high- and low-cost lines. In addition, as the number of housing units in the area increases, the aggregate demand could outstrip a single spot-beam's capacity. Satellite companies could respond by deploying narrower spot beams in that area, but that would require designing the satellite for that specific purpose.

426. A second approach could be for satellite providers to bid in the form of a per-housing-unit price of the "complete package" for a maximum number of housing units within geographic areas corresponding to the approximate coverage of their spot beams. This would allow satellite providers to bid in a simple way that accounts for possible capacity constraints within a given area. The auction mechanism would optimally allocate these bids to geographic areas in which competing bids are higher than the satellite bid.<sup>599</sup>

427. A third approach would be to exclude satellite operators from bidding, but allow winning bidders complete freedom in their choice of technology. Where satellite is the most cost-effective solution, the winning bidders would have economic incentives to subcontract with satellite providers. This would allow the market to find the lowest cost solutions for many geographies, but could lead to sub-optimal use of satellite capacity – for example, a large national carrier could lock-in more capacity for its most expensive-to-serve housing units leaving no capacity for a rural carrier with homes that are more costly to serve than the larger carrier's most expensive-to-serve housing units. We seek comment on which of these approaches, or any others, might be best suited to making the best use of satellite capacity with competitive bidding.

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<sup>597</sup> See National Broadband Plan at 138; OBI, Broadband Availability Gap at 5, 89. The \$24 billion broadband availability gap represents the difference between the incremental costs of deploying and operating broadband networks in unserved areas and the incremental revenues generated by those networks. See National Broadband Plan at 136-37.

<sup>598</sup> Serving an area with satellite may provide only limited savings, however, if there is ongoing support for the existing twisted-pair infrastructure.

<sup>599</sup> More specifically, in all geographic areas in which the minimum bid by a non-satellite bidder is less than or equal to the satellite bid, these bids would be accepted. If the total number of households in the remaining geographic areas is less than the maximum number of households specified in the satellite bid, then each of these would be served by satellite. If the number of remaining households is greater than the satellite maximum, then the geographic areas with the highest non-satellite bid would be served up to the satellite maximum, and the remaining geographic areas would be served by non-satellite bidders, but at a bid greater than the satellite bid.

428. Although we recognize that currently unserved areas may be more economically served by satellite, we do not believe that consumers currently served by terrestrial broadband or voice services should lose access to their terrestrial service. How do we structure our support to ensure this result?

429. Some satellite providers have argued that the ETC designation process imposes burdens on carriers that are interested in providing supported services in multiple states.<sup>600</sup> Commenters have suggested that, to address this concern, the Commission should designate ETCs on a nationwide basis.<sup>601</sup> Although we recognize that the Act assigns, in the first instance, each state the authority to designate as ETCs those carriers that seek to provide service within that state,<sup>602</sup> we seek comment on whether the Commission nevertheless possesses authority to act on applications for designation that cover service areas in multiple states. If so, what is the legal basis for that authority? We also seek comment on how the Commission should evaluate such applications if the Commission were to find that it had authority to grant them. Moreover, to the extent a provider seeks to become an ETC to provide only broadband services, would the Commission have exclusive jurisdiction to rule on such applications?

430. *Price-Cap Areas First.* We seek comment on whether we should implement a competitive bidding process for ongoing CAF support on a phased basis, beginning with price cap service areas. If we were to follow such a staged approach, we presumably would need to determine how to divide the CAF between the price cap territories and the rate-of-return territories, so that we could maintain our overall budget for the CAF. How would we do so? Would it make sense to differentiate between Bell Operating Companies and mid-size price cap carriers if we were adopt a staged approach? Commenters should address whether this would limit the pool of eligible bidders in a way that undermines the benefits of allowing the market to drive support levels down. We also seek comment on how a staged approach would impact the timeline for comprehensive reform and transition to the CAF. If we were to adopt such an approach, rate-of-return service areas would continue to receive support under the current high-cost programs, subject to any modification described above,<sup>603</sup> while this approach is implemented first in areas served by price-cap companies.

## **2. Right of First Refusal Everywhere, Followed by Competitive Bidding Where Necessary**

431. *Right of First Refusal.* In the alternative, we seek comment on an approach under which, in each service area designated to receive CAF support, the Commission would offer the current COLR for voice services (i.e., most likely a wireline incumbent LEC) support through a “right of first refusal” (ROFR) to provide both voice and broadband to customers in the area for a specific amount of ongoing support.<sup>604</sup> If the current COLR accepts the ROFR, that carrier would commit to deploying a network capable of delivering both broadband and voice services throughout its service area, consistent with the coverage requirements and other public interest obligations of CAF fund recipients discussed above.<sup>605</sup> An incumbent LEC with the broadband public interest and voice COLR obligations could deploy any technology (e.g., terrestrial wireless) to build out in unserved areas, and would not be required to extend

<sup>600</sup> See Letter from John P. Janka, Counsel for ViaSat, Inc. and WildBlue Communications, Inc., to Marlene Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 05-337, 10-90, Attach. at 2 (filed Nov. 2, 2010).

<sup>601</sup> See *id.*; see also Letter from L. Charles Keller, Wilkinson Barker Knauer, LLP, Counsel for DISH Network and EchoStar Satellite Services, to Marlene Dortch, Secretary, FCC, WC Docket Nos. 10-90, 05-337, Attach. at 7 (filed Nov. 11, 2010).

<sup>602</sup> 47 U.S.C. § 214(e)(2).

<sup>603</sup> See *supra* Section VI.

<sup>604</sup> As noted above, that amount of support would not be guaranteed in future years, but rather would be obligated only after a Commission determination that the recipient has complied with all program requirements. See *supra* para. 362.

<sup>605</sup> See *supra* Section V.D.

its wireline network. As discussed above, for the most expensive areas to serve, the carrier may have the option of using technologies that may not meet the minimum performance requirements in place at that time for broadband service, such as satellite technologies.<sup>606</sup> We also seek comment on alternative ways to conduct the ROFR. For example, instead of the Commission making an all-or-nothing offer to the current COLR, should the Commission request that the current COLR make an offer of the support level it believes it needs, which the Commission will either accept or reject?

432. *Use of a Cost Model.* The Commission would determine the amount of CAF support to be offered to the current COLR using a cost model developed in an open, deliberative, and transparent process with ample opportunity for interested parties to participate and verify model results. The amount of support offered would be determined by comparing the cost of serving the COLR's service area compared to a national cost benchmark. Support would be provided for costs above the benchmark. Total CAF support (assuming all COLRs accepted the ROFR) could be estimated by adjusting the benchmark.

433. In the *USF Reform NOI/NPRM*, the Commission sought comment on whether we should develop a nationwide broadband model to estimate support levels for the provision of broadband and voice services in areas that are currently served by broadband with the aid of existing high-cost support, as well as areas that are unserved.<sup>607</sup> Among other things, the Commission asked whether it should develop a forward-looking economic cost model that estimates the costs of all technologies currently being (or soon to be) deployed that are capable of providing voice service and broadband service that meets whatever standard the Commission ultimately adopts for broadband.<sup>608</sup> We seek comment on using a model that would estimate the forward-looking economic costs of providing broadband and voice service. The model could estimate costs of providing service over a wireline network; alternatively, the model could estimate costs of providing service using the lowest-cost (or lowest-net-cost, if revenues are taken into account) technology capable of providing the required minimum level of voice and broadband service for each area, which may be wireless in some areas and wireline in others. Under the second alternative, if the model determined that service could be provided to an area more cost effectively using wireless technology, the wireline incumbent might choose to accept the offer of support and find a wireless company to partner with for at least some of its service area, or it might prepare to offer wireless service itself in some or all of its service area, provided it could obtain access to the necessary inputs, including spectrum.<sup>609</sup> The duration of the transition period to new funding levels and new broadband service obligations may be a key factor in determining the feasibility of this latter approach for wireline incumbents. We seek comment on the relative merits of these two alternatives. Below, we seek comment on specific proposals regarding how a model based on a wireline network could be developed. However, we do not intend to suggest that the amount of support offered under the ROFR would necessarily be

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<sup>606</sup> We seek comment above on alternative methods of establishing coverage requirements that CAF recipients must achieve. See *supra* paras. 129-136.

<sup>607</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6665, para. 17. Although some parties provided useful comments about the use of a model in response to the *USF Reform NOI/NPRM*, there was some confusion about the relationship of the National Broadband Plan model to any model the Commission might ultimately adopt in conjunction with a distribution mechanism for CAF support. For example, some commenters claimed that they could not provide detailed comments on using a model, because they did not have access to the proprietary data used in the National Broadband Plan model. See, e.g., AT&T July 12, 2010 Comments at 14. The intent of the NOI was to solicit comment on certain threshold design issues, and we clarify here that we do not intend to use the National Broadband Model to determine ongoing support amounts under the CAF.

<sup>608</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6668, para. 25.

<sup>609</sup> We note that Verizon Wireless recently announced an "LTE in Rural America" initiative that would make spectrum and LTE equipment available to companies seeking to offer 4G (LTE) wireless service in rural America beyond the reach of Verizon's 4G (LTE) network. See Verizon Wireless, LTE in Rural America, *available at* <http://aboutus.vzw.com/rural/Overview.html>.

based on the specific model described below. If the Commission were to use a model to determine the amount of support offered under a ROFR, we seek comment on how such support should be adjusted if the Commission adopts a coverage requirement that is less than 100 percent of the ROFR area, or permits carriers to provide some form of high speed Internet access service that may not meet the broadband performance metrics adopted by the Commission.<sup>610</sup>

434. If we were to use a wireline-only model, we seek comment on how we should define the forward-looking economic costs of a wireline broadband network and what types of costs we should include in the model, if we were to take such an approach. In the *USF Reform NOI/NPRM*, we sought comment on whether the Commission should consider any existing plant.<sup>611</sup> We noted that the Commission's hybrid cost proxy model (HCPM) adopted a "scorched node" approach, which, while not a total-green field approach, assumes as given only incumbent LEC central office (switch) locations.<sup>612</sup> We also sought comment on whether the Commission should use a cost model that estimates the total costs of broadband-capable networks, rather than the incremental costs of upgrading or extending existing networks to provide broadband in unserved areas.<sup>613</sup>

435. In considering what types of costs to include in a broadband cost model, there are two basic approaches. One approach is to assume that only no, or very limited, network facilities exist currently; this green-field approach includes the costs of building, maintaining and operating a network.<sup>614</sup> The second approach is to assume that some form of network currently exists; this brown-field approach includes the cost of upgrading, maintaining and operating a network to offer the required level of service.<sup>615</sup> Each of these approaches has some advantages.

436. The green-field approach, because it includes the cost of the entire initial build-out, would include the cost of connecting each home. This would eliminate concerns expressed by commenters about the size and quality of copper gauge in existing network deployments.<sup>616</sup> Over the lifetime of a network, the cost of a fiber-to-the-premises (FTTP) and short-loop (12,000-foot) DSL network may be basically equal,<sup>617</sup> meaning that green-field costs are equivalent to those for an FTTP deployment. The potential downside to using a model based on the green-field approach is that it would

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<sup>610</sup> See *supra* paras. 129-134.

<sup>611</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6668-69, para. 27.

<sup>612</sup> See *id.*

<sup>613</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6670-71 paras. 33-34. We explained that the National Broadband Plan model estimates the incremental costs and revenues associated with new broadband deployment, but does not take into account any current universal service support in either served or unserved areas. In contrast, HCPM estimates the total local exchange network costs of providing telephone service to all households and businesses within a geographic area. *Id.*

<sup>614</sup> One common approach is a "scorched node" approach where the location of incumbent central offices is taken as fixed; another approach is a "scorched earth" approach where no facilities are taken as fixed.

<sup>615</sup> The National Broadband Plan model took a particular brown-field approach where the costs of maintaining and operating the existing network were allocated to existing products. This approach makes sense when evaluating a new-product launch – allocating existing operating costs to a not-yet-launched product would worsen its viability and likelihood of being launched – and calculating the value such a new product would bring to a company. We are not proposing to follow such an approach here for ongoing support under the CAF.

<sup>616</sup> See, e.g., AT&T July 12, 2010 Comments, at 16.

<sup>617</sup> Commission staff analyzed data from the model used to create the NBP, comparing the cost of a FTTP build to every housing unit with the cost of a green-field 12,000-foot-loop DSL build to every home; we note that the latter calculation was not part of the analysis done for the NBP. The analysis showed that the costs associated with FTTP were higher up-front, but those costs are offset by savings over the lifetime of the network. This is consistent with the description of FTTP economics in OBI Tech Paper #1. See OBI, Broadband Availability Gap, at 96.

provide support to a carrier to build a completely new network, regardless of whether the carrier actually deployed a new network or merely upgraded portions of the existing network.

437. The brown-field approach assumes the existence of a last-mile copper network.<sup>618</sup> Upgrading an existing network to support broadband involves pushing fiber deeper into the network, and adding electronics capable of supporting broadband. The costs associated with upgrading the network include the cost to build, maintain, and operate the new components of the network. In addition, one can include the cost to maintain and operate the un-upgraded, last-mile portion of the network.<sup>619</sup> This brown-field approach ensures that the value of (sunk) private investment is captured in the cost calculation, and thereby limits the support required. However, this approach likely underestimates costs in some areas (where the last-mile network is not capable of delivering broadband service); and would likely overestimate costs in other areas because it would fail to take account of areas where carriers have already upgraded networks.

438. Despite certain drawbacks, if we adopt this alternative, we propose to use a green-field, “scorched node,” approach in developing a broadband cost model. A number of commenters suggest that any model used to estimate ongoing CAF support, which would replace current high-cost support, should estimate the total forward-looking economic costs of deploying networks capable of providing broadband and voice services.<sup>620</sup> We therefore seek more focused comment on developing a total cost model.

439. In the *USF Reform NOI/NPRM*, the Commission also sought comment on whether the Commission should consider revenues, as well as costs, in determining CAF support.<sup>621</sup> Despite the advantages of including demand-side metrics in the determination of which areas are truly uneconomic to serve, we recognize that there could be difficulties in accurately estimating and modeling revenues. We seek comment on these issues.

440. The Commission is committed to a robust public comment process, and commenters have asserted that developing an engineering cost model, such as the Commission’s existing HCPM, through a full comment process is a difficult, time-consuming effort.<sup>622</sup> We seek comment on whether there are other approaches to modeling that would be both data-based and rigorous on the one hand, and provide a means to move forward more quickly and easily on the other.

441. As discussed above, to set reasonable limits on existing high-cost support for rate-of-return carriers, we propose to use regression analysis to develop formulas that estimate the operating costs and investment requirements associated with serving specific geographic areas.<sup>623</sup> We seek comment on whether we should use this approach for purposes of determining ongoing support under the CAF for all companies, calculating cost as a function of density and other variables that are shown to have predictive value. Such a model could calculate the costs for a small geographic area, e.g., census blocks, which

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<sup>618</sup> One could, in theory, capture actual network deployments and therefore calculate the costs required for this upgrade at a local level. However, this approach is administratively complex and is likely impractical; the focus here is on modeling what networks currently exist and what would have to be upgraded.

<sup>619</sup> We note that the National Broadband Plan model did not include these costs, allocating them instead to existing products.

<sup>620</sup> See, e.g., Comments of Windstream Communications, Inc., WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 11 (filed July 12, 2010); Comments of the Independent Telephone & Telecommunications Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 16-18 (filed July 12, 2010).

<sup>621</sup> See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6671-40, paras. 35-40.

<sup>622</sup> See, e.g., Comments of the Independent Telephone & Telecommunications Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 6, 10 (filed July 12, 2010); Comments of the National Cable & Telecommunications Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 18-20 (filed July 12, 2010).

<sup>623</sup> See *supra* para. 203.

could then be aggregated to larger, relevant geographies, e.g., COLR service areas for the ROFR. Of course any regression-based model will include some level of error – some amount of variation that is not explained by the regression. Averaged over any large number of measurements, this error should disappear, as over- and under-estimates cancel one another out.<sup>624</sup> We seek comment on this approach and on whether such a model would be sufficiently reliable to use for determining the amount of CAF support offered under a ROFR. In particular, we seek comment from those who may have experience with using this approach to calculate support. In addition, as noted above, such an approach would require an appropriate source data set in order to be effective. The Commission would need to calculate support for both large carriers and small carriers operating in rural areas in a wide variety of terrains. We seek comment on what data, from what network operators, could be used as an appropriate data set; and on any difficulties the Commission could face in compiling such a source data set.

442. Alternatively, the Commission could develop a cost model more similar to HCPM or the model created for the NBP. In such a model, the costs of each area would be calculated from the local conditions – including whatever information is available about the location of homes and roads, soil type, presence of aerial plant, etc. This approach, more similar to traditional engineering-cost models, is likely more time-consuming to develop, and given that there are more model inputs and more model code, would likely require more input from the public. However, such a model would avoid the issues noted above about statistically driven errors (noting that any model will have some level of errors driven by, at the very least, imperfect input data). We seek comment on the trade-offs between a larger investment, both in time and in effort, of an engineering cost model approach relative to a regression-based model.

443. Creating a model, regardless of the method chosen, does not specify support levels. Choices about the level of geographic aggregation or the type(s) of network technology supported, among many others, are large drivers of calculated support.<sup>625</sup> Ensuring that all Americans have access to a modern telecommunications network while still controlling the size of the fund is challenging. There are, however, a handful of such choices that could increase the number of those with broadband access for a given level of funding. One such choice concerns the role of satellite, discussed above, in serving the most expensive-to-serve housing units.<sup>626</sup> Another is the level of geographic aggregation used in calculating an area's cost. As noted above, at the simplest level, averaging over larger geographies lowers the average cost of the most expensive areas within that geography (in effect, requiring geographic cross-subsidies within a carrier's footprint). However, reducing the calculated cost by averaging means that there may be areas unserved by broadband that will not receive support. Using smaller geographies, for example by moving from study-area to wire center cost averaging, de-averages the costs of the most expensive areas to some extent. Because there is some co-linearity between the unserved and the most expensive areas, this would provide more support to unserved areas. The potential drawback is that it means fewer areas would be supported, because of the higher average cost per home in these areas. Another approach, which targets support to those areas that need it most, would be to de-average both served and unserved geographies, funding any area (regardless of whether served or unserved) that exceeds a cost threshold. Other factors, like the role of revenue in the model and the choice of network deployment are discussed above.<sup>627</sup> We seek comment on the advantages and disadvantages of each of the choices mentioned and ask how that would impact our ability to maximize access to broadband for a given level of CAF funding. We also seek comment on how each of these choices would impact the provision of services on Tribal lands.

444. *Competitive Bidding if ROFR Refused.* If we were to adopt such an approach, we would also need to have a process in place to address situations where the current voice COLR refuses to accept

<sup>624</sup> See OBI, Broadband Availability Gap, at 24.

<sup>625</sup> See OBI, Broadband Availability Gap, at chapter 3.

<sup>626</sup> See *supra* paras. 424-428.

<sup>627</sup> See *supra* para. 439.

the amount of ongoing support calculated by the cost model. If the COLR refuses the ROFR, a competitive bidding mechanism could be used to provide ongoing CAF support to at most one provider in any given area. Such a competitive bidding mechanism would simultaneously select the providers of both broadband and voice, or if necessary, voice-only providers that would receive CAF support, and, as with the auction approach above, would seek to maximize the number of households passed by broadband networks while ensuring that consumers retain access to voice service. As above, we also seek comment on using alternative competitive bidding mechanisms and specifically ask whether there is a sequential approach that would first determine the least-cost method for ensuring that voice service remains available everywhere and then maximizes broadband coverage subject to a budget constraint by substituting bids for the “complete package” of broadband and voice service for voice only bids. Consistent with the proposals above,<sup>628</sup> that amount of support would not be guaranteed in future years, but rather would be obligated only after a Commission determination that the recipient has complied with all program requirements.

445. *Geographic Areas for Auction.* The geographic areas where the right of first refusal is offered would necessarily be defined by the COLRs’ service areas. Despite this constraint, the areas for auction should be defined in as technology neutral a way as possible. Bidder-defined geography not exactly the same as entire study areas could increase the likely number of bidders. For example, the Commission could define areas for bidding that are aggregations of census blocks. The same Commission-defined geographic areas could be used for complete-package and voice-only bids. This way, if there is no complete package bid for an area there would be a voice-only bid for *exactly* the same area. It could avoid the problem of having to fill in an area with no complete-package bids with multiple voice-only bids that overlap with complete-package bids in adjacent areas. We seek comment on what factors the Commission should consider when defining the geographic areas for the auction, if it were to use such an approach.

446. *Transition.* We seek comment on how support under the existing programs would be transitioned to the Connect America Fund under each of the possible scenarios for the outcome of the ROFR option. We seek comment on whether a transition is necessary or appropriate in all circumstances. For example, if a COLR currently receiving support accepts a ROFR, we could presume that the amount offered is sufficient and that no transition is necessary. Similarly, if a COLR currently receiving support refuses the ROFR and subsequently wins the auction, we could presume that the bid reflects sufficient support and that no transition is necessary. If a COLR currently receiving support refuses the ROFR and subsequently does not win the auction, a transition may be appropriate because there may be a period of time before the new provider is able to build-out and serve the area. How quickly should we phase down the current COLR’s support immediately if a new provider wins the auction? How long should the current recipient be required to comply with public interest obligations, as proposed above, if it is not the ultimate recipient of ongoing support?

447. *Price-Cap Areas First.* We seek comment on whether we should implement a ROFR followed by competitive bidding on a phased basis, beginning with price cap service areas. If we were to follow such a staged approach, we presumably would need to determine how to divide the CAF between the price cap territories and the rate-of-return territories, so that we could maintain our overall budget for the CAF. How would we do so? Would it make sense to differentiate between Bell Operating Companies and mid-size price cap carriers if we were to adopt a staged approach? Would limiting the number of study areas that participate in the ROFR potentially limit the efficacy of any potential auction for companies that refuse the ROFR, due to too few bidders? We also seek comment on how a staged approach would impact the timeline for comprehensive reform and transition to the CAF. If we were to follow such an approach, pending completion of the transition to the CAF for the price cap carriers, rate-of-return companies would continue to receive support under the current high-cost programs, subject to

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<sup>628</sup> See *supra* para. 362.

any modification described above,<sup>629</sup> while this approach is implemented first in areas served by price-cap companies.

### 3. Continued Rate-of-Return Reform for Certain Areas

448. We sought comment above on a package of proposals intended to improve the incentives for rational investment and operation by small companies operating in rural areas.<sup>630</sup> Assuming that we adopt some or all of these reforms, we could evaluate their success in meeting these objectives before we implement stage two of our comprehensive reform package. If the Commission finds that the reforms have adequately improved the incentives for investment and operation by small, rural companies, it could determine that support for these carriers should remain based on reasonable actual investment, rather than a cost model or auction. On the other hand, the Commission previously determined that if support is based on cost, it should be based on forward-looking economic cost, not embedded costs,<sup>631</sup> and that “there may be significant problems inherent in indefinitely maintaining separate mechanisms based on different economic principles.”<sup>632</sup>

449. In the event that the Commission determines that it should take different approaches to implementing the Connect America Fund in different geographic areas, it could, for example, determine that only price cap territories would receive support awarded either through a ROFR, followed by competitive bidding, or through competitive bidding without a ROFR, depending on which option the Commission adopts for determining CAF support. The Commission could follow an alternative path for rate-of-return territories that would provide ongoing support based on reasonable actual investment. Should we take this approach, we seek comment on the need for possible changes to the current rate-of-return system beyond those discussed in the previous section, including capping and shifting interstate common line support to an incentive regulation framework that would establish support amounts periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue, implementing a more rigorous process to examine whether investment is used and useful, and re-examining the current 11.25 percent authorized rate of return.

450. *Capping Interstate Common Line Support and Shifting Into a New Incentive-Based Mechanism.* In April 2010, in the *USF Reform NOI/NPRM*, the Commission sought comment on shifting rate-of-return carriers to incentive regulation generally, including comment on capping ICLS.<sup>633</sup> Specifically, we sought comment on whether we should convert ICLS to a frozen amount per line, which would have the effect of limiting growth in the existing high-cost program.<sup>634</sup> We seek comment on whether capping ICLS on either a per-line, study area, or any other basis would be consistent with rate-of-return regulation or whether we would need to adopt some form of incentive regulation to accomplish the objective of limiting the size of the Fund.

<sup>629</sup> See *supra* Section VI.

<sup>630</sup> See *supra* Section VI.A.

<sup>631</sup> See, e.g., *Universal Service First Report and Order*, 12 FCC Rcd at 8899, paras. 224-25, *Rural Task Force Order*, 16 FCC Rcd at 11311-12, para. 174; *USF Reform NOI/NPRM*, 25 FCC Rcd at 6667-68, para. 23.

<sup>632</sup> *Rural Task Force Order*, 16 FCC Rcd at 11311, para. 173. Although the Commission adopted a separate mechanism for rural carriers in the *Rural Task Force Order*, it rejected arguments that only an embedded cost mechanism would provide sufficient support for rural carriers and did not find the the Rural Task Force’s analysis justified a reversal of the Commission’s position with respect to the use of forward-looking cost as a general matter. *Id.* at 11311-12, para. 174.

<sup>633</sup> *USF Reform NOI/NPRM*, 25 FCC Rcd at 6679-80, paras. 55-56.

<sup>634</sup> *Id.* at 6680, para. 56.

451. As discussed in greater detail below,<sup>635</sup> this Notice seeks comment on an incentive regulation framework for any intercarrier compensation replacement funding that would be distributed through the CAF to carriers that currently set their access charges based on a rate-of-return framework. ICLS, however, would continue to be computed based on a rate-of-return framework, unless otherwise modified. We seek comment on whether the same incentive regulation framework described below in the intercarrier compensation context could also be used to replace the ICLS mechanism.<sup>636</sup>

452. Under an incentive regulation framework, once intercarrier compensation reform is completed, universal service distributions could be determined as part of the same CAF distribution process applicable to all carriers. Alternatively, if rate-of-return carriers are treated differently within the CAF, funding levels could be set periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue.<sup>637</sup> Would that be an appropriate way for the Commission to shift from ICLS into that incentive-based universal service mechanism?

453. In addition, we also seek comment on the manner in which such funding might transition. For example, should any shifting of support from ICLS to a new recovery mechanism be accomplished in a lump-sum manner—e.g., by simply adding the then-existing level of ICLS funding, either in aggregate or on a per-carrier basis, to the revenues to be recovered through the new mechanism? Or should any shifting of support occur be phased-in over time, and if so, how would that be accomplished?

454. *Used and Useful.* Historically, the Commission's rate-of-return ratemaking policies have reflected the equitable principle that ratepayers should not be forced to pay a return except on investments that can be shown to benefit them.<sup>638</sup> As a result, the Commission has allowed recovery through regulated rates for property only when it is "used and useful" in the provision of regulated services—i.e., only if it is "necessary to the efficient conduct of a utility's business, presently or within a reasonable future period."<sup>639</sup> As described above, the Commission's universal service policies for rate-of-return carriers have evolved to enable them to recover through universal service support certain costs that they cannot recover from end users because of rules that cap their rates below the level that would be permitted by a rate-of-return calculation. Thus, inclusion of excess costs in a carrier's rate base—such as costs that are not "used and useful"—can increase the demands on the universal service fund, as well. We seek comment on whether more detailed, industry-wide clarifications regarding what should be deemed "used and useful" would be helpful to ensure that excess costs are not recovered through universal service (or carriers' rates). If so, what clarification would be appropriate?

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<sup>635</sup> See *infra* Section XIV.D-E.

<sup>636</sup> For example, the Commission could adopt the incentive-based universal service distribution mechanism both for any funding to replace intercarrier compensation revenues and to replace ICLS. Alternatively, even if it were not adopted in the intercarrier compensation reform context, this mechanism theoretically still could be used to replace ICLS.

<sup>637</sup> Although this mechanism would not guarantee a particular carrier a defined rate of return, it could include certain "safety valves." See *infra* Section XIV.D-E.

<sup>638</sup> "Equally central to the used and useful concept, however, is the equitable principle that the ratepayers may not fairly be forced to pay a return except on investment which can be shown directly to benefit them. Thus, imprudent or excess investment, for example, is the responsibility and coincident burden of the investor, not the ratepayer." *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 112 (1977) (*AT&T Phase II Order*). The benefit, however, does not have to be immediate and can include, for example, a portion of equipment that is serving as a reserve for future use. See, e.g., *Investigation of Special Access Tariffs of Local Exchange Carriers*, FCC 86-52, 1986 WL 291617, para. 41 (1985) (*Phase I Special Access Tariffs Investigation Order*), remanded on other grounds, *MCI Telecom. Corp. v. FCC*, 842 F.2d 1296 (D.C. Cir. 1988).

<sup>639</sup> *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 111 (1977) (*AT&T Phase II Order*).

455. *Authorized Rate of Return.* Rate-of-return carriers currently are permitted to charge interstate rates that will allow them the opportunity to recover their expenses, plus an 11.25 percent rate of return on their net common line investment. The Commission last adjusted the authorized rate of return in 1990.<sup>640</sup> In 1998, the Commission initiated a proceeding to represcribe the authorized rate of return for rate-of-return carriers.<sup>641</sup> In the *MAG Order*, the Commission terminated the prescription proceeding in CC Docket No. 98-166.<sup>642</sup> The Commission also stayed the effectiveness of section 65.101 of the Commission's rules, which otherwise would have required the Commission to initiate a unitary rate of return prescription proceeding immediately as a result of termination of the CC Docket No. 98-166 proceeding.

456. We seek comment on whether the Commission should initiate a proceeding to represcribe the authorized rate of return for rate-of-return carriers if it determines that such carriers should continue to receive high-cost support under a modified rate-of-return system. We seek comment on whether these changes, or any other potential changes to rate-of-return regulation, would adversely affect the ability of rate-of-return carriers to provide voice and broadband services.

## **VIII. INCREASING ACCOUNTABILITY AND MEASURING PROGRESS TO ENSURE INVESTMENTS DELIVER INTENDED RESULTS**

### **A. Increasing Transparency, Oversight and Accountability**

457. Universal service represents an investment overseen by the Commission on behalf of the public as a whole. As such, the Commission has an obligation to the public to ensure that the funds are spent appropriately and efficiently. To ensure that universal service funds are spent in a fiscally responsible manner, the Commission, and USAC, must have sufficient insight into the operations and financial condition of fund recipients. To meet this obligation, we propose that the Commission require increased disclosures about the operating performance and financial condition of companies that receive universal service support.

#### **1. Reporting Requirements**

458. To improve performance management and strengthen oversight of the high-cost program – as well as to lay a solid foundation for the CAF – we propose annual data collections from current recipients of high-cost USF as well as from any future recipients of the CAF. We envision these data collections as a primary means to evaluate whether these universal service programs are meeting the performance goals proposed below. We also expect that these collections will help assess recipients' compliance with program rules and cost-effective use of program funds.<sup>643</sup>

459. First, beginning within six months of the effective date of an order, we propose to require all high-cost funding recipients – and ultimately CAF recipients – to report to USAC on deployment, adoption, and pricing for both their voice and broadband offerings. We note that we seek comment on related issues in the *Broadband Data NPRM*.<sup>644</sup> We propose that the first reporting submission show operating results as of the end of the calendar year prior to the adoption of an order and then submitted

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<sup>640</sup> *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990).

<sup>641</sup> *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998).

<sup>642</sup> See *MAG Order*, 16 FCC Rcd at 19701, para. 208.

<sup>643</sup> See *infra* para. 479 (explaining that performance goals and measures should improve program accountability).

<sup>644</sup> See *Broadband Data NPRM*, FCC 11-14, at paras. 47-76 (seeking comment on whether and how the Commission should collect deployment and price data).

annually thereafter.<sup>645</sup> We seek comment on whether this information would be sufficient to enable us to determine whether our proposed performance goals are being met,<sup>646</sup> or if additional reporting requirements are needed to oversee the Universal Service Fund. To the extent that some high-cost recipients already report some of that information, such as competitive ETCs designated by the Commission,<sup>647</sup> we seek comment on how to transition from the current reporting requirements to more competitively neutral reporting requirements that would apply to all high-cost and CAF recipients.

460. We acknowledge the statutory mandate that rates for supported services in rural areas should be reasonably comparable to rates in urban areas. We note, however, that there is evidence in the record that local rates for a number of smaller carriers that operate in rural areas may actually be lower than the national average rates of \$15.62 (excluding additional charges) and \$25.62 (including additional charges).<sup>648</sup> Although local rates, to the extent they are regulated, are governed by state regulators, it is imperative that we gather essential information so that we can better determine the degree of federal commitment that may be required to support universal service, particularly as we transition to a world where consumers are purchasing broadband-voice packages. We also seek comment on whether the approach for collecting essential information as set forth in the *Broadband Data NPRM* is sufficient or whether a reporting requirement unique to high-cost and CAF recipients is necessary.<sup>649</sup>

461. Second, we propose to require recipient carriers to file with the Commission within 120 days of the end of each of their fiscal years a full and complete annual report of their financial condition and operations, in form and substance satisfactory to the Commission, which is audited and certified by an independent certified public accountant satisfactory to the Commission, and accompanied by a report of such audit in form and substance satisfactory to the Commission.<sup>650</sup> The report shall include, at a minimum, balance sheets, income statements, statements of cash flow, and notes to the financial statements, if available.

462. Consistent with policies and regulations governing public equity and debt capital markets, we also seek comment on making the information included in these disclosures available to the public to promote increased transparency and efficiency.<sup>651</sup> Increased disclosure of this information may lead to more competition or the acquisition of less efficient carriers without disrupting service to consumers in areas served by those carriers. We seek comment on the confidentiality issues that public disclosure may raise.

463. We recognize the potential benefits of increased reporting and disclosure are not without cost. To minimize the cost and reporting burden on carriers, we propose to allow those carriers that are required to file financial reports with the Securities and Exchange Commission or the Rural Utilities

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<sup>645</sup> See *id.*, at para. 46 (seeking comment on frequency of filing FCC Form 477).

<sup>646</sup> See *infra* para 489 (establishing performance goals).

<sup>647</sup> 47 C.F.R. § 54.209; see *supra* para. 100.

<sup>648</sup> The average local rate of \$15.62 for flat-rate service excludes Federal and State Subscriber Line Charges, taxes, 911, and other charges. With the inclusion of these additional charges, the average monthly cost for local flat-rate service is \$25.62. See 2008 Reference Book of Rates, at Table 1.1. See also Comments of The Oregon Telecommunications Association and The Washington Independent Telecommunications Association, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51 (filed July 12, 2010), Table 5 (showing local rates for independent telephone companies in the states of Washington and Oregon that are both above and below the nationwide average local rate of \$15.62).

<sup>649</sup> See generally *Broadband Data NPRM*, FCC 11-14, at paras. 49-65.

<sup>650</sup> See Comments of John Staurulakis, Inc., GN Docket Nos. 10-90, 09-51, WC Docket No. 05-337 (filed July 12, 2010), at 10 (stating that most state commissions require the filing of financial, demand, and service-level standards on a regular basis).

<sup>651</sup> See The Securities Exchange Act of 1934, 48 Stat. 881 (1934), 15 U.S.C. § 78 et seq.

Service to satisfy our requirement by providing electronic copies of the annual reports filed with those agencies to the Commission so long as the reports meet the minimum information requirements imposed by the Commission's rules and are filed with the Commission by the deadline imposed in accordance with this requirement.<sup>652</sup>

464. For SEC registrants and RUS borrowers the submission of the same data and information required by the SEC or RUS would not require any additional burden since such documents are already being prepared to satisfy other reporting requirements. For companies that are neither an SEC registrant nor an RUS borrower, such a requirement should not be a significant additional burden because such financial accounting statements are normally prepared in the usual course of business.

465. Third, we propose that all recipients report intercarrier compensation revenues and expenses as described in detail below.

466. We seek comment on these proposals. We also seek comment on reducing or suspending universal support payments for non-compliance with reporting requirements. For example, should universal service support be suspended immediately if a recipient fails to submit the required information and not restored until such information is submitted?

467. We also seek comment on codifying additional reporting requirements applicable to USAC to further assist the Commission in fulfilling its oversight responsibilities of the universal service support mechanisms. Specifically, we propose that USAC routinely provide to the Commission the data that it collects from both incumbent LECs and competitive ETCs for calculating high-cost payments, specifically, high-cost loop support, interstate common line support, local switching support, safety net, and safety valve support payments, pending any elimination of any of those programs.<sup>653</sup> For example, section 54.901 of the Commission's rules requires USAC to calculate ICLS support as the difference between the common line revenue requirement and the sum of end-user common line charges and certain other revenues.<sup>654</sup> Similarly, section 54.301 of the Commission's rules requires USAC to collect local switching revenue requirement and weighting factor data for calculating LSS.<sup>655</sup> We propose that USAC provide to the Commission, in an electronic spreadsheet format, all data it collects from carriers with respect to HCLS, ICLS, LSS, safety net, and safety valve support mechanisms, to the extent those mechanisms continue to exist.<sup>656</sup> We seek comment on this proposal.

## 2. Internal Controls

468. We propose to improve internal control mechanisms for the current high-cost program and apply such internal control mechanisms to the CAF.

469. In 2008, the GAO recommended that the FCC identify areas of risk in its internal control environment and implement mechanisms that will help ensure compliance with program rules and produce cost-effective use of program funds.<sup>657</sup> The GAO highlighted three areas of internal controls: (1)

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<sup>652</sup> See *id.*

<sup>653</sup> The National Exchange Carrier Association (NECA) is already required to submit incumbent LEC HCLS data to the Commission. See 47 C.F.R. § 36.613. We propose that USAC also report HCLS data for competitive ETCs, pending any phase-out of such support is phased-out.

<sup>654</sup> See 47 C.F.R. § 54.901.

<sup>655</sup> See 47 C.F.R. § 54.301.

<sup>656</sup> USAC collects projected ICLS data, actual ICLS data, projected LSS data, and actual LSS data from the carriers on FCC Forms 508, 509, and the Local Switching Support Data Collection Form, respectively.

<sup>657</sup> United States Government Accountability Office, Report to Congressional Committees, Telecommunications: FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program, at 40 (June 2008) (GAO High-Cost Report).

audits; (2) annual certifications; and (3) data validation processes. In each of these three areas, the GAO found weaknesses.<sup>658</sup> We seek comment on measures to strengthen our internal controls in each of the areas identified for improvement by GAO.

470. In the 2009 Executive Order regarding Improper Payments Information Act of 2002 (IPIA), President Obama stated that when making payments to program beneficiaries, federal government agencies “must make every effort to confirm the right recipient is receiving the right payment for the right reason at the right time.”<sup>659</sup> Consistent with this directive and guidance from the Office of Management and Budget, in February 2010 the Commission directed USAC to implement both an improved IPIA assessment program and compliance audit programs of the universal service fund (the FCC IPIA Letter). For the high-cost program alone, the FCC IPIA Letter directed USAC to undertake 240 IPIA audits and 100 compliance audits.<sup>660</sup>

471. *Audits.* Audits are an essential tool for the Commission and USAC to ensure program integrity and to detect and deter waste, fraud, and abuse. Commission rules authorize USAC to conduct audits of carriers and contributors reporting data to USAC.<sup>661</sup> The 2008 FCC-USAC MOU requires USAC to conduct audits, including audits of Fund beneficiaries, in accordance with generally accepted government auditing standards, as required by section 54.702(n) of the Commission’s rules.<sup>662</sup> USAC’s audit program consists of audits by USAC’s internal audit division staff as well as audits by independent auditors under contract with USAC.<sup>663</sup>

472. In December 2010, as part of the Commission’s IPIA initiatives, USAC released its final report and statistical analysis for a sample of 285 of 390 beneficiaries audited previously.<sup>664</sup> Of this

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<sup>658</sup> GAO High-Cost Report at 31.

<sup>659</sup> President Obama further emphasized that the federal government must intensify efforts to eliminate payment error while “continuing to ensure that Federal programs serve and provide access to their intended beneficiaries.” Executive Order 13520, § at 1 (Nov. 20, 2009) (IPIA Executive Order); Feb. 12, 2010 USAC Letter; Oct. 13, 2010 USAC Letter.

<sup>660</sup> Feb. 12, 2010 USAC Letter; OMB Circular A-123. The IPIA assessment program was developed with the following objectives: (1) separately cover all four USF programs; (2) measure the accuracy of the Administrator’s payments to program applicants; (3) evaluate the eligibility of program applicants who have received payments; (4) include high-level testing of information obtained from program participants; and (5) tailor scope of procedures to ensure reasonable cost while meeting IPIA requirements for sample size and precision. The compliance audit program was developed with the following objectives: (1) cover all four programs and contributors; (2) tailor audit type and scope to program risk elements, size of disbursement, audit timing and other specific factors; (3) keep costs reasonable in relation to overall program disbursements, amount disbursed to beneficiary being audited, and USF administrative costs; (4) spread audits throughout the year; and (5) retain capacity and capability for targeted and risk-based audits. See Feb. 12, 2010 USAC Letter at 2, 4.

<sup>661</sup> 47 C.F.R. § 54.707.

<sup>662</sup> 47 C.F.R. § 54.702(n).

<sup>663</sup> In addition, the Commission’s OIG has conducted audits of USF program beneficiaries. See Office of Inspector General, Semiannual Report to Congress, October 1, 2009 through March 31, 2010, at 17-20. In a February 12, 2010, letter to USAC, OMD directed USAC to separate its two audit objectives into distinct programs – one focused on Improper Payments Information Act (“IPIA”) assessment and the second on auditing compliance with all four USF programs. Improper Payments Information Act of 2002, Pub.L.No. 107-300, 116 Stat. 2350 (2002). In addition to providing guidance on the implementation of the IPIA assessment program and compliance audit program, the letter informed USAC that OMD would assume responsibility for oversight of USAC’s implementation of both programs. Feb. 12, 2010 USAC Letter.

<sup>664</sup> See *Universal Service Administrative Company, Final Report and Statistical Analysis of the 2007-08 Federal Communications Commission Office of Inspector General High-Cost Program Beneficiary* (Dec. 15, 2010), available at <http://www.fcc.gov/omd/usf-letters2011.html> (December 2010 USAC Compliance Report).

sample, USAC determined an error rate of 2.7 percent resulting in \$54.4 million in improper payments.<sup>665</sup> According to USAC, the top issues resulting in the highest improper payments were: (1) inaccurate line counts; (2) inadequate or missing documentation; (3) accounting errors; (4) eligibility errors; and (5) subscriber list errors.<sup>666</sup> In response, USAC has developed a set of measures to reduce improper payments associated with these issues, including, outreach, oversight and management, audits, and information technology improvements.<sup>667</sup>

473. We seek comment on the December 2010 USAC Compliance Report. In particular, we seek comment on ways to improve the audit process to further reduce improper payments and assess risks. In doing so, how can audits be targeted to better understand and discover errors associated with the top issues resulting in improper payments, discussed above? Also, what other measures, than those already implemented, can be taken to mitigate risks? How can internal controls in the program be improved in response to the December 2010 Audit Report?

474. We also seek comment on whether high-cost universal service support recipients (including CAF recipients) should be subject to additional audit requirements beyond the current compliance audits and IPIA audits described above, in light of the proposals presented in this Notice. Should audits be conducted with additional or different objectives than the current plan initiated by the FCC IPIA Letter? Should more program participants be audited? Are there other or additional oversight measures, in addition to those initiated by the FCC IPIA Letter, which would be appropriate and effective in detecting and deterring waste, fraud, and abuse?

475. *Annual Certifications.* Section 254(e) requires that a carrier shall use “support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”<sup>668</sup> The Commission requires annual certifications to enforce carrier accountability for use of high-cost program support.<sup>669</sup> GAO found inconsistencies in the certification process among states and questioned whether such certifications enabled program administrators to fully assess whether carriers are appropriately using high-cost program support.<sup>670</sup> We seek comment on how to improve the certification process to make it more meaningful in light of the increased public interest responsibilities proposed above and our objective to advance the deployment of networks that are capable of providing both broadband and voice services. In particular, we seek comment on requiring additional information from recipients concerning how funds were used and specifically what information should be submitted.

476. *Data validation.* In 2008, GAO found that “data validation processes to ensure the reliability of financial data primarily focus on the completeness of the data provided by carriers, but not the accuracy of the data.”<sup>671</sup> Specifically, NECA collects cost and line count data for the high-cost loop support mechanism, and USAC collects cost and line count data for the remaining components of the high-cost program. As GAO noted, “these data are subject to several electronic data validations for completeness.”<sup>672</sup> However, GAO determined that “while these validations and reviews provide NECA and USAC with opportunities to identify input errors, they do not addresses whether or not the data provided by participants are accurate or if the money spent addresses the intended purposes of the high-

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<sup>665</sup> December 2010 USAC Compliance Report at 6.

<sup>666</sup> *Id.* at 7-8.

<sup>667</sup> *Id.* at 8.

<sup>668</sup> 47 U.S.C. § 254(e).

<sup>669</sup> 47 C.F.R. §§ 54.313, 314, 809, and 904.

<sup>670</sup> GAO High-Cost Report at 38.

<sup>671</sup> *Id.* at 37.

<sup>672</sup> *Id.*

cost program.”<sup>673</sup> We seek comment on how to improve the data validation process to correct the weakness identified by GAO. We propose above to adopt new benchmarks for cost submissions for rate-of-return carriers. Are there specific steps that we should take to ensure that funds are spent for their intended purposes? Would the certifications regarding coverage and deployment be adequate to address this issue? Should other measures be implemented in the data certification process to mitigate the risk that funds are not used to advance modern networks capable of providing broadband and voice services?

### 3. Additional Monitoring Procedures

477. We seek comment on what types of procedures we should put in place to ensure that recipients provide services they have committed to provide. We propose to affirmatively confirm, in the field, that recipients have complied with their deployment obligations. What kinds of field inspections and tests are appropriate? We seek comment on whether either state commissions or RUS could play a role in confirming deployment. For instance, hundreds of smaller telephone companies are currently RUS borrowers, and required to report to RUS on their use of funds. What information-sharing mechanisms between the Commission and RUS would facilitate our ability to confirm deployment? Should we conduct different inspections depending on whether the provider has deployed a wireline or a wireless broadband system? Should we verify that each and every recipients has fulfilled its obligations, or should we conduct random audits? What additional procedures should we put in place to ensure that the public is receiving the services it has paid for?

### 4. Record Retention Requirements

478. In the *Universal Service Fund Oversight Order*, the Commission adopted rules establishing rigorous document retention requirements for high-cost program participants.<sup>674</sup> We seek comment on whether to modify the current requirements or adopt additional requirements at this time in light of the changed responsibilities and expectations for Fund recipients proposed in this Notice. Are the current record retention requirements adequate to facilitate audits of program participants? Are any additional measures necessary to ensure that program participants retain relevant documentation and provide the relevant and complete documentation to auditors upon request?

## IX. ESTABLISHING CLEAR PERFORMANCE GOALS AND MEASURES FOR UNIVERSAL SERVICE

479. We propose several performance goals and measures to improve program accountability. Performance goals and measures should improve program accountability by measuring whether the existing federal high-cost program and any modified or new programs (i.e. the CAF) that support high-cost areas produce public benefits.<sup>675</sup> Consistent with the Government Performance and Results Act of 1993 (GPRA), clear performance goals and measures should enable the Commission to determine not just whether federal funding is used for the intended purposes, but whether that funding is accomplishing the intended purposes—including our objective of advancing broadband for all Americans.<sup>676</sup> Moreover,

<sup>673</sup> *Id.*

<sup>674</sup> *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket No. 05-195, Report and Order, 22 FCC Rcd 16372, 16385, para. 24 (2007) (*Universal Service Fund Oversight Order*); 47 C.F.R. § 54.202(e).

<sup>675</sup> See *supra* Section V.A (National Goals and Priorities for Universal Service).

<sup>676</sup> The Government Performance and Results Act (GPRA) of 1993 established statutory requirements for federal agencies to engage in strategic planning and performance measurement. Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993). GPRA is intended to improve efficiency and effectiveness of federal programs through the establishment of specific goals for program performance. GPRA has three main requirements. Federal agencies must develop strategic plans with long-term, outcome-related goals and objectives, develop annual goals linked to the long-term goals, and measure progress toward the achievement of those goals in (continued....)

performance goals and measures may assist in identifying areas where additional action by state regulators, Tribal governments, or other entities is necessary to meet the goal of universal service. Performance goals and measures should also improve participant accountability.

480. In recent years, the Office of Management and Budget (OMB) has built upon GPRA through its Program Assessment Rating Tool (PART). OMB PART guidance sets forth three types of performance measures: (1) outcome measures; (2) output measures; and (3) efficiency measures.<sup>677</sup> Outcome measures “describe the intended result from carrying out a program or activity.”<sup>678</sup> Output measures describe the level of activity, such as applications process, number of housing units repaired, or number of stakeholders served by a program. Efficiency measures capture a program’s ability to perform its function and achieve its intended results relative to the resources expended.<sup>679</sup> These performance measures should be intrinsically linked to the purpose of the program and the strategic goal to which it contributes.

481. In 2008, the Government Accountability Office recommended that, in order to strengthen management and oversight of the high-cost program, the Commission should clearly define the goals of the high-cost program and subsequently develop quantifiable performance measures.<sup>680</sup> Also in 2008, the Commission released a Notice of Inquiry, seeking comment on, among other things, how to define more clearly the goals of universal service and to identify any additional quantifiable performance measures that may be necessary or desirable.<sup>681</sup>

482. We propose that funding of recipients be tied to the specific outcomes proposed below. We propose the following four specific performance goals for the current high-cost program and CAF: (1) preserve and advance voice service; (2) increase deployment of modern networks capable of supporting necessary broadband applications as well as voice service; (3) ensure that rates for broadband service are reasonably comparable in all regions of the nation, and that rates for voice service are reasonably comparable in all regions of the nation; and (4) limit universal service contribution burden on households. We request comment on these or other goals and measures commenters believe would be appropriate. We also seek comment on how our performance measures should take into account the actions of other governmental agencies, such as state regulators, that may impact the Commission’s ability to meet its universal service goals.

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annual performance plans and report annually on their progress in program performance reports. *See also* GPRA Modernization Act of 2010, Pub. L. 111-352, 124 Stat. 3866 (2011).

<sup>677</sup> *See* Memorandum from Clay Johnson III, Deputy Director for Management, Office of Management and Budget, to Program Associate Directors, Budget Data Request No. 04-31 (Mar. 22, 2003) (*OMB PART Guidance Memorandum*); *see also* ExpectMore.gov, <http://expectmore.gov> (last visited Feb. 9, 2011). The most current PART guidance, referred to herein as “2008 PART Guidance,” is available at [http://www.whitehouse.gov/sites/default/files/omb/assets/performance\\_pdfs/part\\_guid\\_2008.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/performance_pdfs/part_guid_2008.pdf) (last visited Feb. 9, 2011).

<sup>678</sup> *See* 2008 PART Guidance at 9.

<sup>679</sup> The 2008 PART Guidance states that “[m]eaningful efficiency measures consider the benefit to the customer and serve as indicators of how well the program performs.” *Id.* at 11.

<sup>680</sup> GAO High-Cost Report) at 40.

<sup>681</sup> *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket No. 05-195, 23 FCC Rcd 13583 (2008) (*2008 Comprehensive Review NOI*). We note that, in 2007, the Commission took initial steps to improve the performance management of universal service by adopting performance measures to help ensure the program operates in an efficient, effective manner. *Universal Service Fund Oversight Order*, 22 FCC Rcd 16372. Most of these performance measures were “output measures.” At that time, the Commission declined to establish performance goals because it did not have sufficient data. The Commission did require USAC to report annually certain performance measurements related to the high-cost program on which it could base future performance goals. *Id.* at 16397-98, para. 55.

483. *Preserve and Advance Voice Service.* The first performance goal we propose is to preserve and advance voice service.<sup>682</sup> We anticipate that our proposals to rationalize investment in modern communications and to better target support will enable the program to meet this goal. As an outcome measure, historically, the Commission has measured telephone penetration as a proxy for network deployment.<sup>683</sup> We seek comment on whether we should continue to use the telephone penetration rate, which measures subscription to voice service, or whether we should adopt a deployment measure that measures access to voice service.<sup>684</sup> We note that the Commission's current telephone subscription penetration rate is based on the Census Bureau's Current Population Survey (CPS), which does not specifically break-out wireless, VoIP, or over-the-top voice options available to consumers.<sup>685</sup> Are there alternative methods the Commission should use to acquire data regarding deployment of voice-capable networks?

484. Although certain segments of the population lag behind, such as low-income and Tribal consumers—and the Commission is committed to addressing those shortfalls—we note that the national voice penetration rate is at an all-time high.<sup>686</sup> To the extent that subscription to voice services is lagging in certain areas, is that largely due to socio-economic forces such as lower household income rather than a lack of access to voice service? If so, would it be unrealistic to expect a significant increase in voice subscription even with a larger influx of high-cost funding? What role should Lifeline play in advancing the adoption of voice service? We also seek comment on an appropriate measure for whether universal service funding, from either the existing high-cost program or the CAF, is being used efficiently to achieve this performance goal.

485. *Increase Deployment of Modern Networks.* The second performance goal we propose is to increase the deployment of modern networks capable of delivering broadband and voice service, using either fixed or mobile technologies, in areas where such networks would not exist absent governmental support.<sup>687</sup> This performance goal is directly tied to our goals for universal service reform—to ensure that all Americans in all parts of the nation, including those in rural, insular, and high-cost areas, have access to modern communications networks capable of supporting the necessary applications that empower them to learn, work, prosper and innovate. We expect that our proposals to rationalize investment in modern communications networks, to better target support, and to create the CAF to expand access to broadband, will enable the program to meet this goal. To measure this goal, we propose as an outcome measure the number of new housing units which gain access to broadband service, as benchmarked above, as a result

<sup>682</sup> See 47 U.S.C. § 254(b). See also Qwest 2008 Comprehensive Review NOI Comments at 4.

<sup>683</sup> See Industry Analysis and Technology Division, Wireline Competition Bureau *Telephone Subscription in the United States* (Sept. 2010) (Sept. 2010 Subscription Report).

<sup>684</sup> The *Broadband Data NPRM* seeks comment on whether to collect voice and broadband network deployment data. See *Broadband Data NPRM*, FCC 11-14, at paras. 49-65 (seeking comment on whether and how the Commission should collect deployment data).

<sup>685</sup> Sept. 2010 Subscription Report at 1. The specific questions asked in the CPS are: “Does this house, apartment, or mobile home have telephone service from which you can both make and receive calls? Please include cell phones, regular phones, and any other type of telephone.” And, if the answer to the first question is “no,” this is followed up with, “Is there a telephone elsewhere on which people in this household can be called?” If the answer to the first question is “yes,” the household is counted as having a telephone “in unit.” If the answer to either the first or second question is “yes,” the household is counted as having a telephone “available.” *Id.* at 3.

<sup>686</sup> As of March 2010, the national telephone subscription penetration rate was 96%, the highest reported rate since the CPS began collecting data in 1983. *Id.* at Table 1.

<sup>687</sup> Comments of Mercatus Center, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, at 9-10 (filed Oct. 17, 2005); Comments of TCA, WC Docket No. 05-195, at 6-7 (filed Nov. 13, 2008) (proposing a performance measure of service availability); Comments of Qwest, WC Docket No. 05-195, at 4 (filed Nov. 13, 2008); see also Comments of NECA, WC Docket No. 05-195, at 8 (filed Nov. 13, 2008) (pending rule changes, goals and performance metrics should be consistent with existing rules).

of universal service funding, whether from the existing high-cost programs or the CAF. As an efficiency measure, we propose the change in the number of homes passed or covered by these networks per million USF dollars spent. We note that this efficiency measure could be biased toward lower-cost areas. Is there an alternative measure that would fairly capture how well the CAF funding was accomplishing the goal of increasing deployment of modern networks? How will we isolate USF funding as the cause of change in deployment, to distinguish from other sources of funding, such as BTOP/BIP? How should we take into account increased deployment resulting from other regulatory actions, such as voluntary merger commitments? We seek comment on this performance goal and measures.

486. *Reasonably Comparable Rates for Broadband and Voice Services.* The third performance goal we propose is to ensure that rates for broadband service are reasonably comparable in rural, insular, and high cost areas and urban areas, and that rates for voice service are reasonably comparable in rural, insular, and high cost areas and urban areas.<sup>688</sup> We envision that our proposals to rationalize investment in modern communications networks and to better target support will enable the program to meet this goal. As an outcome measure, we propose the ratio of the rural price to rural household disposable income should be similar to the ratio in urban areas, both for voice services and for broadband services. In other words, are rural Americans devoting a similar percentage of their disposable household income to similar services as urban Americans? Alternatively, should we instead measure the percentage of total household income devoted to these services? Or should we measure the relative actual prices of these services in rural and urban areas? For the purposes of measuring reasonable comparability, we propose to rely on the voice and broadband pricing data the Commission collects.<sup>689</sup> We also seek comment on an appropriate measure of the efficiency of the use of universal service funding in achieving this goal.

487. *Limit Universal Service Contribution Burden on Households.* In considering reform to the current high-cost program, the Commission seeks to balance the various objectives of section 254(b) of the Act to ensure that support is sufficient to meet statutory goals, while not imposing an excessive burden on American consumers who are ultimately the payors for the Fund.<sup>690</sup> We believe that our proposals to rationalize investment in modern communications networks, to better target support, and to employ market-based mechanisms will control costs and thereby control the contribution burden borne by consumers. We seek comment on whether to establish as a performance goal limiting the overall burden of universal service contribution costs on American households. For example, one means of measuring this goal could be to divide the total inflation-adjusted expenditures of the Fund each year by the number of American households and to express the measure as a monthly dollar figure. This calculation would be relatively straightforward and could rely on publicly available data; as such, the measure would be transparent and easily verifiable. By adjusting for inflation and looking at the universal service burden, we could determine whether or not the overall burden of universal service contributions costs is increasing or decreasing for the typical American household. For example, the Fund spent \$7.9 billion in

<sup>688</sup> 47 U.S.C. § 254(b)(3). See Mercatus Center Oct. 17, 2005 Comments at 9-10; TCA Nov. 13, 2008 Comments at 6-7 (proposing a performance measure of comparability of service prices between urban and rural areas); Qwest Nov. 13, 2008 Comments at 4; see also NECA Nov. 13, 2008 Comments at 8.

<sup>689</sup> See *supra* para. 137 (proposing that recipients must offer voice and broadband (individually and together) in rural areas at rates that are affordable and reasonably comparable to rates in urban areas); see also *Broadband Data NPRM*, FCC 11-14, at paras. 66-76 (seeking comment on whether and how the Commission should collect price data).

<sup>690</sup> Contributions are assessed on the basis of a contributor's projected collected interstate and international end-user telecommunications revenues, based on a percentage or "contribution factor" that is calculated every quarter. See 47 C.F.R. § 54.709. A contributor may recover the costs of universal service contributions by passing an explicit charge through to its customers. 47 CFR § 54.712(a). See *Qwest II Remand Order*, 25 FCC Rcd at 4088, para. 29 (explaining that the Commission could not be a prudent guardian of the public's resources without taking into account the costs of universal service, alongside the benefit); *Rural Cellular Ass'n*, 588 F.3d at 1102; see also, e.g., *Alenco*, 201 F.3d at 620-21 (concluding that the Commission properly considered the costs of universal service in reforming one part of the high-cost support mechanism).

2010;<sup>691</sup> the overall per-household burden of universal service in 2010 was thus approximately \$5.61 per month under the proposed measure, and \$3.03 per month for the high-cost program in particular.<sup>692</sup> In contrast, the Fund spent \$5.5 billion in 2000, adjusted for inflation, and the overall per-household burden for universal service was approximately \$4 in 2000 and \$2 per month for the high-cost program.<sup>693</sup> A contribution burden measure, when considered with other measures such as average household expenditures on telecommunications as a percentage of household personal consumption expenditures, could help the Commission and other stakeholders assess the impact of universal service policy decisions over time. We seek comment on this proposed performance measure and also seek comment on an appropriate efficiency measure.

488. *Use and Re-evaluation of Performance Measures.* These performance measures are designed to track whether the program is achieving the intended purposes, as opposed to whether program recipients are using funding for the intended purposes. Above we seek comment on reporting requirements for program recipients, to ensure that they are complying with program requirements. However, we expect that the data we will collect from program recipients, in the aggregate, will provide the foundation for tracking the success of the program using these performance measures. We invite comment on whether that data will be useful for this purpose. If not, what other data would be useful as inputs to these performance measures?

489. We also propose to review annually whether the program is meeting its goals based on the results of the performance measures. If the program is not meeting its goals we intend to consider corrective actions in future rulemakings so that we achieve the intended purposes. In addition, to the extent that these performance measures do not help us assess program performance, we would revisit them as well.

## **X. INTERCARRIER COMPENSATION FOR A BROADBAND AMERICA**

### **A. Steps Necessary to Achieve Our Objectives**

490. In this section, we seek comment on proposals to comprehensively reform intercarrier compensation to bring the benefits of broadband to all Americans. We plan to use the same section 254-derived principles to inform our intercarrier compensation reforms that we use to guide our universal service reforms.<sup>694</sup> Specifically, the changes to the intercarrier compensation rules discussed below will: (1) modernize our rules to make affordable broadband available to all Americans and reduce waste and inefficiency by taking steps to curb arbitrage; (2) promote fiscal responsibility; (3) require accountability; (4) transition to market-driven and incentive-based policies. In addition, we aim to create a framework and transition that is predictable to enable service providers and investors time to react and plan appropriately.

491. We first highlight inefficiencies, including distorted incentives and wasted resources, enabled by the current intercarrier compensation rules and why reform is necessary. Next we provide an

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<sup>691</sup> Universal Service Administrative Company, 2009 Annual Report, at 5, *available at* [http://www.usac.org/\\_res/documents/about/pdf/usac-annual-report-2009.pdf](http://www.usac.org/_res/documents/about/pdf/usac-annual-report-2009.pdf); *see also* Sept. 2010 Subscribership Report, Table 1 (rel. Aug. 2010).

<sup>692</sup> We note that this includes business contributions to USF, which households support indirectly, so the amount per month on the phone bills of individual households is lower.

<sup>693</sup> Comments of USAC, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, App. A at 19, 23 (filed Oct. 18, 2005). Adjustments for inflation were calculated using the Bureau of Labor Statistics' Consumer Price Index Inflation Calendar, [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm) (last visited Feb. 9, 2011). We note that during that intervening period, as the Commission removed explicit support from access charges and made such support explicit in the high-cost program, long distance rates decreased.

<sup>694</sup> As discussed above, section 254 of the Act lays out principles for Commission policies to preserve and advance universal service. *See supra* para. 11.

overview of the Commission's authority to pursue reform, identify certain goals of intercarrier compensation reform, and seeks comment on how possible intercarrier compensation rate methodologies would advance those goals. We also seek comment on the dimensions of the intercarrier compensation reform transition, and lay out two possible approaches for working with states to implement reform. The first approach relies on the Commission and states to act within their existing roles in regulating intercarrier compensation, such that states would remain responsible for reforming intrastate access charges. Additionally, we also seek comment on whether we should set a glide path to reform wireless termination charges, possibly including intrastate access charges paid by or to wireless providers. Under the second approach, the Commission would use the tools provided by sections 251 and 252 in the 1996 Act to unify all intercarrier rates, including those for intrastate calls, under the reciprocal compensation framework. Under this framework, the Commission would establish a methodology for intercarrier rates, which states then work with the Commission to implement. Within these approaches, we identify and develop a specific set of options for commenters to consider regarding the sequencing of reductions in specific rates. We also seek comment on the appropriate timing of the overall transition and propose to complete the transition away from per-minute rates before implementing the long-term vision for the CAF, which will ultimately make explicit all subsidies necessary to serve an area (including subsidies that are currently provided implicitly through the intercarrier compensation system).

492. Next, we seek comment on how to structure any necessary recovery mechanism for providers, including threshold questions of whether our evaluation should be based on a provider's cost of originating, transporting, and terminating a call (i.e., cost recovery) or whether we should focus recovery on replacing reduced intercarrier compensation revenues (i.e., revenue recovery) or some combination thereof. In evaluating the criteria for recovery, we seek comment on doing so through reasonable end-user charges and the CAF. If we focus on revenue recovery, we recognize that existing intercarrier compensation revenues may be a significant source of free cash flow and regulated revenues for some carriers, and we request data to help quantify the impact of intercarrier compensation reform on the industry and consumers. We also recognize that some high-cost, insular, and Tribal areas may need explicit support to maintain service because there may be no private business case to serve such areas. We seek comment on how to reform intercarrier compensation and universal service in tandem so that such areas receive any ongoing support necessary to ensure that they continue to receive quality and affordable services, and to ensure that providers serving those areas can continue to advance connectivity where it lags far behind the rest of the nation. As noted above, one of the proposed principles guiding universal service reform is controlling the size of the universal service fund and reducing waste and inefficiency. This proposed principle likewise informs our intercarrier compensation reforms, and we ask commenters how best to calibrate any intercarrier compensation recovery to be consistent with this principle.

493. Third, we seek comment on proposals to address the National Broadband Plan recommendation that the Commission adopt interim rules to reduce arbitrage and specifically seek comment on the applicability of intercarrier compensation to VoIP and measures to address phantom traffic and access stimulation. We believe that our proposals to address the treatment of VoIP traffic for purposes of intercarrier compensation and to adopt rules to address phantom traffic and access stimulation will reduce inefficient use of resources and promote investment and innovation. Service providers will benefit from increased certainty and predictability regarding future revenues and reduced billing disputes and litigation, enabling companies to direct capital resources toward broadband investment. We also seek comment on whether the actions we propose in this Notice should encourage incumbent LECs to move to IP-to-IP interconnection. Finally, we seek comment on other pending issues related to intercarrier compensation reform.

## **B. Why Intercarrier Compensation Must Be Reformed**

494. Intercarrier compensation is a system of payments between carriers to compensate each other for the origination, transport and termination of telecommunications traffic. For example, when a family in one state makes a telephone call to their grandmother in a neighboring state, the calling family's long distance provider pays the family's local phone company a per-minute charge, which may be a few

cents a minute, for originating the call. The family's long distance provider also pays their grandmother's local phone company a per-minute charge, anywhere from less than a cent to close to 5 cents a minute, for terminating the call.<sup>695</sup> In contrast, if the family then places a call to an uncle who lives in a different part of the state, a different set of rates apply. Here again, the calling family's long distance provider pays the family's local phone company a per-minute charge for originating the call and also must pay their uncle's local phone company a per-minute charge for terminating the call. But, in comparison to the first example, payments for calls within a state, known as intrastate access charges, are often higher than those that apply to calls across states, or interstate access charges. A long distance provider may have to pay an average rate of 13.5 cents a minute or more to the local phone company to deliver a call within a state.<sup>696</sup> Thus, under the present system, the amounts service providers charge each other for completing such a call can vary considerably depending not on the service provided but on whether a call starts and finishes in the same state, or whether it crosses state lines.<sup>697</sup> To complicate matters further, these charges also can vary based on what technology (e.g., wireline, wireless) is used to make a call. Industry wide, these charges add up to a significant amount of money. An estimate from 2008 indicated that all forms of intercarrier compensation result in up to \$8 billion in transfers between carriers every year.<sup>698</sup>

495. These examples highlight four fundamental problems with the current system, each of which is discussed further below: (1) the system is based on outdated concepts and a per-minute rate structure from the 1980s that no longer matches industry realities; (2) rates vary based on the type of provider and where the call originated, even though the function of originating or terminating a call does not change; (3) because most intercarrier compensation rates are set above incremental cost, they create incentives to retain old voice technologies and engage in regulatory arbitrage for profit; and (4) technological advances, including the rise of new modes of communications such as texting, e-mail, and wireless substitution have caused local exchange carriers' compensable minutes to decline, resulting in additional pressures on the system and uncertainty for carriers. Our proposals for reform would address each of these issues and create a framework for a stable, predictable transition to a new system.

496. The current intercarrier compensation framework arose primarily out of a series of regulatory choices made to implement the 1984 AT&T divestiture and the passage of the Telecommunications Act of 1996.<sup>699</sup> As a result, the country has an intercarrier compensation system with a variety of distinct compensation rules and mechanisms: originating and terminating access charges at the state and the federal levels; reciprocal compensation; and distinct rules applicable to wireless

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<sup>695</sup> See, e.g., Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 80-286, Attach. (filed Dec. 29, 2010) (NECA Dec. 29, 2010 *Ex Parte* Letter) (providing a report showing average interstate access rates per state for NECA common line 2010 pool members as high as 6 cents per minute); Letter from Brian J. Benison, Director – Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 07-135, 05-337, 99-68, CC Docket Nos. 01-92, 96-45 Attach. at 2 (filed Jan. 6, 2010) (AT&T Jan. 6, 2010 *Ex Parte* Letter); Letter from Michael B. Hazzard, Counsel to Pac-West Telecomm, Inc., WC Docket Nos. 01-92, 07-135 Attach. at 7 (filed Oct. 28, 2010).

<sup>696</sup> See NECA Dec. 29, 2010 *Ex Parte* Letter, Attach. (attaching a report providing average intrastate access rates per state for NECA common line 2010 pool members); AT&T Jan. 6, 2010 *Ex Parte* Letter, Attach. at 2 (noting rates as high as 35.9 cents per minute).

<sup>697</sup> The Commission regulates the rates for interstate access charges (paid on long distance calls that cross state lines), and states regulate the rates for intrastate access charges (paid on long distance calls within a state).

<sup>698</sup> See Letter from Ray Baum, Chairman, NARUC Communications Committee, et al., to Kevin Martin, Chairman, FCC, CC Docket Nos. 80-286, 01-92, 08-152, WC Docket Nos. 04-36, 06-122, WT Docket No. 05-194, at 1 n.1 (filed Oct. 21, 2008). We note that this estimate is from 2008 and seek data to quantify the current scope of intercarrier compensation to help formulate a recovery mechanism. See *infra* para. 572.

<sup>699</sup> *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); Telecommunications Act of 1996. Pub. L. No. 104-104, 110 Stat. 56 (1996).

traffic,<sup>700</sup> ISP-bound traffic<sup>701</sup> and traffic on competitive networks. The wildly varying and disparate rates within the intercarrier compensation system create arbitrage opportunities and introduce layers of regulatory complexity and associated costs, which hinder deployment of IP networks.

497. The history of the current intercarrier compensation system is well-documented in this proceeding, and is only summarized here.<sup>702</sup> For much of the twentieth century, telephone service was viewed as a natural monopoly. Prior to AT&T's divestiture, most telephone subscribers obtained their local services from independent telephone companies or AT&T's Bell Operating Companies (BOCs) and their long distance services from AT&T Long Lines.<sup>703</sup> As discussed above,<sup>704</sup> under this system, regulators allowed high long-distance rates as an offset to ensure lower local rates and promote universal service. Thus, AT&T was allowed to charge above-cost long distance toll rates, and its interstate toll revenues were placed into an interstate settlements pool.<sup>705</sup> AT&T then shared a portion of these interstate revenues with independent telephone companies and AT&T's BOCs.<sup>706</sup>

<sup>700</sup> The Commission's existing rules include a number of provisions affecting intercarrier compensation for traffic exchanged with CMRS providers. Prior to the 1996 Act, the Commission established rules governing LEC interconnection with CMRS providers. *See Implementation of Sections 3(n) and 332 of the Communications Act and regulatory Treatment of Mobile Services*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd 1411 (1994) (*CMRS Second Report and Order*) (subsequent history omitted). Pursuant to its authority under section 201(a) of the Act, the Commission adopted rules requiring mutual and reasonable compensation for the exchange of traffic between LECs and CMRS providers. *See* 47 C.F.R. § 20.11. Further, the Commission decided to forbear from requiring or permitting the filing of tariffs for interstate access services offered by CMRS providers. *See CMRS Second Report and Order*, 9 FCC Rcd at 1480, para. 179; *see also* 47 C.F.R. § 20.15(c). Thus, a CMRS provider is currently entitled to collect access charges from an IXC "only to the extent that a contract imposes a payment obligation" with that IXC. *See Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13198, para 12 (2002), *petitions for review dismissed*, *AT&T Corp. v. FCC*, 349 F.3d 692 (D.C. Cir. 2003). Following the 1996 Act, the Commission stated that "traffic to or from a CMRS network that originates and terminates within the same Major Trading Area is subject to [reciprocal compensation obligations] under section 251(b)(5), rather than interstate and intrastate access charges." *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd 15499, 16016 para. 1036 (1996) (subsequent history omitted); *see also* 47 C.F.R. § 51.701 *et seq.*

<sup>701</sup> *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) (*ISP Remand Order*); *remanded but not vacated by WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002); *see also 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd 6475.

<sup>702</sup> *See, e.g., 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd 6475, 6565-65680, App. A, paras. 159-185 & 6763-6778, App. C, paras. 154-180.

<sup>703</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, 4688, para. 6 (2005) (*Intercarrier Compensation FNPRM*).

<sup>704</sup> *See supra* Section III.

<sup>705</sup> *See Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Information, Jurisdictional Separations and Rate Structures*, Docket No. 20003, First Report, 61 FCC 2d 766, 796-97, paras. 81-82 (1976); *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6567, App. A, para. 162; *id.* at 6765-66, App. C, para. 157.

<sup>706</sup> *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6567 App. A para. 162, *id.* at 6765-66 App. C para. 157. This regime and its assumption that long-distance telecommunications was a natural monopoly, became unsettled with the introduction of competition from Microwave Communications, Inc. (MCI) in the 1970s. In 1974, the Department of Justice filed an antitrust lawsuit against AT&T, which ultimately led to AT&T's divestiture of the BOCs under the Modification of Final Judgment (MFJ). *See 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6567-6568 App. A, para. 163-64, *id.* at 6766 App. C, para. 158-59; *see also United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The 1982 consent decree, as entered by the court, was called the Modification of Final Judgment because it modified a 1956 Final Judgment (continued....)

498. Following the AT&T divestiture, the BOCs were allowed to maintain monopoly franchises in their local markets, but AT&T's long-distance business was split off, thereby removing the incentive for the BOCs to favor AT&T's long-distance business over that of competitors.<sup>707</sup> In 1983, the Commission eliminated the "existing potpourri of [compensation] mechanisms," and replaced it "with a single uniform mechanism . . . through which local carriers [could] recover the cost of providing access services needed to complete interstate and foreign telecommunications."<sup>708</sup> This formal system of access charge rules provides for the recovery of LECs' costs assigned to the interstate jurisdiction. The rules effectively replaced AT&T's pre-divestiture settlements system and provided the framework for the current interstate and intrastate access charges that exist today.

499. With the 1996 Act, Congress sought to promote and facilitate competition in telecommunications markets.<sup>709</sup> The 1996 Act did not displace the existing access charge rules,<sup>710</sup> but did introduce yet another mechanism through which carriers compensate each other for the exchange of traffic. In particular, section 251(b)(5) of the 1996 Act imposed on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."<sup>711</sup> Although section 251(b)(5) does not discuss the jurisdiction of calls subject to the reciprocal compensation framework, the Commission initially interpreted this statutory provision to apply to calls that begin and end within the same local calling area such as when a customer of one company makes a call to a customer of a company in the same local calling area.<sup>712</sup>

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against AT&T stemming from a 1949 antitrust lawsuit. MCI introduced competition, but was still dependent on the BOCs to complete long-distance calls to end users and there were disputes over access charges (the fees that an IXC like MCI would pay to the BOCs to originate and terminate long distance calls) arose. *See Access Charge Reform Order*, 12 FCC Rcd at 15991, paras. 19-20.

<sup>707</sup> *See Access Charge Reform Order*, 12 FCC Rcd at 15991, para. 20.

<sup>708</sup> *MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 683, para. 2 (1983).

<sup>709</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996); *see also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15505, para. 3 (1996) (*Local Competition First Report and Order*) (subsequent history omitted).

<sup>710</sup> *See* 47 U.S.C. § 251(g).

<sup>711</sup> 47 U.S.C. § 251(b)(5). In the *Local Competition First Report and Order*, the Commission concluded that section 251(b)(5) applied only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge." *See Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033. In the *ISP Remand Order*, the Commission reversed course on the scope of 251(b)(5), finding that it was not limited to local traffic, noting that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)." *Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9167, para. 34 (2001) (*ISP Remand Order*), *remanded*, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002) (*WorldCom*), *cert denied*, 538 U.S. 1012 (2003), *mandamus granted*, 531 F.3d 849 (D.C. Cir. 2008). In 2008, the Commission affirmed this interpretation, finding "that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2)." *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6482-83, para. 15.

<sup>712</sup> In the *Local Competition First Report and Order*, the Commission defined the local calling area for calls to or from a CMRS network for purposes of applying reciprocal compensation obligations under section 251(b)(5). Accordingly, it determined that traffic to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges. *See Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; *see also* 47 C.F.R. § 24.202(a) (defining the term "Major Trading Area").

500. The 1996 Act and the Commission's rules prohibit long distance carriers from charging customers in one state a rate different from that in another state.<sup>713</sup> To implement this requirement, long distance carriers charge averaged long-distance rates. Thus, long-distance carriers lack the ability to directly pass on higher access rates to the particular customer making calls to or from areas with higher access rates. Averaged long-distance rates do not provide customers with any incentive to choose a LEC with low switched access charges, since the customer only pays the long-distance charge, but does not pay the access charges directly.

501. Intercarrier compensation has not been reformed to reflect fundamental, ongoing shifts in technology, consumer behavior and competition. The Commission has made incremental efforts to modify interstate access charges to reflect technological changes in the telecommunications network and the advent of competition, but the last intercarrier compensation reform occurred a decade ago in the 2000 *CALLS Order* and the 2001 *MAG Order*. As discussed above,<sup>714</sup> in those orders, the Commission removed certain implicit subsidies from interstate charges and replaced them with explicit cost recovery from customers through increased SLCs<sup>715</sup> and through a new universal service mechanism – IAS for price cap LECs,<sup>716</sup> and ICLS for rate-of-return incumbent LECs.<sup>717</sup> Although the Commission has sought comment on a variety of proposals over the last decade to comprehensively reform intercarrier compensation,<sup>718</sup> such efforts stalled, leaving the current antiquated rules in place.

<sup>713</sup> See 47 U.S.C. § 254(g); 47 C.F.R. § 64.1801 (providing that “[a] provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each U.S. state at rates no higher than the rates charged to its subscribers in any other state”).

<sup>714</sup> See *supra* Section III.

<sup>715</sup> See *supra* Section III.

<sup>716</sup> See *CALLS Order*, 15 FCC Rcd at 13046-49, paras. 201-05 (establishing a “\$650 million interstate access universal service support mechanism”). Earlier in this Notice, we propose cutting IAS support over two years, and using those funds to expand broadband coverage through the the first phase of the CAF. See *supra* Section VI.

<sup>717</sup> See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613 (2001) (*MAG Order*), *recon. in part, Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon., Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003); see also *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service*, CC Docket Nos. 00-256, 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004).

<sup>718</sup> In 2001, the Commission sought comment on possible alternatives to existing intercarrier compensation regimes with the intent of moving toward a more unified system, such as bill-and-keep. In the 2001 Notice, the Commission recognized the need for fundamental reform, observing that, “[i]nterconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation regulations . . . [that] treat different types of carriers and different types of services disparately, even though there may be no significant differences in the costs among carriers or services.” *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*). In 2005, the Commission sought comment on the various industry proposals, including the Intercarrier Compensation Forum (ICF), the Expanded Portland Group (EPG), and the Alliance for Rational Intercarrier Compensation (ARIC) – Fair (continued....)

502. As a result of this long history, today, there are two primary types of intercarrier compensation regulation: (1) access charges; and (2) reciprocal compensation. However, the rates that apply to traffic under these systems continue to depend on a number of factors including: (1) where the call begins and ends (interstate, intrastate, or “local”); (2) what types of carriers are involved (incumbent LECs, competitive LECs, interexchange carriers (IXCs), wireless); and (3) the type of traffic (wireline voice, wireless voice, ISP-bound, data). The resulting patchwork of rates and regulations is inefficient, wasteful and slowing the evolution to IP networks.

503. Competition and technological advancements have also put additional pressures on the intercarrier compensation system. Originating and terminating minutes on incumbent LEC networks have plummeted in the last decade, as shown in Figure 13:

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Affordable Comprehensive Telecommunications Solution (FACTS) plans, among others, which attempted to reform intercarrier compensation. *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (2005). In 2006, another coalition submitted an alternative comprehensive intercarrier compensation reform proposal, known as the Missoula Plan. *Comment Sought on Missoula Intercarrier Compensation Reform Plan*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 8524 (2006). Subsequently, the Missoula Plan supporters filed additional details concerning specific aspects of the plan, on which the Commission continued to seek comment. *See Comment Sought on Missoula Plan Phantom Traffic Interim Process and Call Detail Records Proposal*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 13179 (2006); *Comment Sought on Amendments to the Missoula Plan Intercarrier Compensation Proposal to Incorporate a Federal Benchmark Mechanism*, CC Docket No. 01-92, Public Notice, 22 FCC Rcd 3362 (2007). In 2008, the Commission sought comment again on specific proposals to reform intercarrier compensation by bringing all traffic under the reciprocal compensation framework and creating a new methodology for states to set rates. *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6497-6654, App. A; *id.* at 6697-6853, App. C.

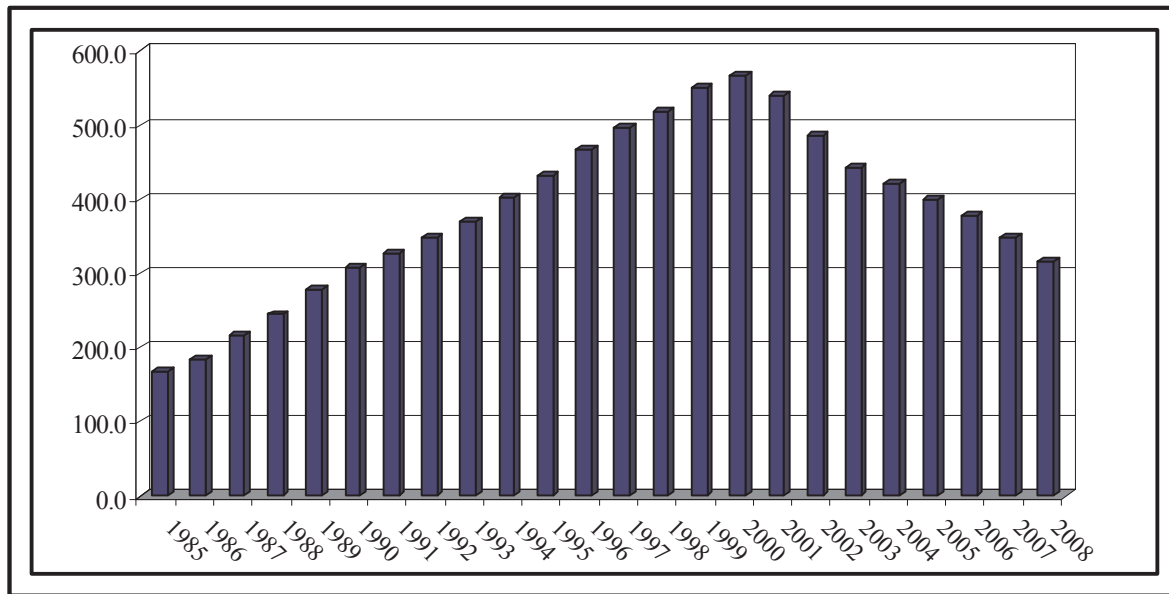
**Switched Access Minutes for Incumbent LECs (In Billions)**<sup>719</sup>

Figure 13

Such decline is due in part to competition and technological advances and the proliferation of alternate means of communicating, such as text messaging and emailing. Broadband also enables consumers to drop switched access lines from incumbent carriers, and the emergence of VoIP provides another alternative to traditional wireline phone service. In addition, wireless minutes of use have increased steadily,<sup>720</sup> as consumers use their wireless service, rather than their wireline phone, to both make and receive long-distance calls.<sup>721</sup>

504. Declining minutes of use affect rate-of-return and price cap carriers in different ways, both of which demonstrate the pressing need for reform. Under rate-of-return regulation, a carrier's interstate access rates are designed to give the carrier an opportunity to earn its authorized 11.25 percent rate of return.<sup>722</sup> Rates are calculated by dividing the company's relevant revenue requirement by the

<sup>719</sup> See Sept. 2010 Trends in Telephone Service, at 7-1, 10-1 (indicating that both access lines and interstate switched access minutes have been declining due to a number of reasons, including substitution of services). Specifically, incumbent LEC interstate switched access minutes decreased from 566.9 billion in 2000 to 315.7 billion in 2008. *Id.* at Table 10.1. Similarly, incumbent LEC access lines declined from 187.6 million in 2000 to 121.7 million in 2009. *Id.* at Table 7.1. See also OPASTCO Comments in re NBP #19 at 22 (filed Dec. 7, 2010) (stating that intercarrier compensation revenue has become an unreliable source of revenue "due to several factors, including: (1) the arbitrage of disparate access rates, (2) various forms of access avoidance (e.g., unidentifiable and unbillable 'phantom traffic,' the refusal of many interconnected VoIP service providers to pay access charges), and (3) the proliferation of broadband connections, which has caused a drop in the number of traditional access lines as well as a related decline in minutes that originate and terminate on the PSTN").

<sup>720</sup> See Sept. 2010 Trends in Telephone Service, at Table 11.3 (showing an increase of average wireless minutes of use per month increase from 255 minutes a month in 2000 to 708 minutes a month in 2008).

<sup>721</sup> See *id.* at Tables 11.3, 11.4. See also Section 272(f)(1) *Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440, 16452 at n.73 (2007) (describing consumers' options for making a long distance telephone call, such as wireless, wireline, broadband and VoIP technologies).

<sup>722</sup> Specifically, the rules are designed to provide the revenue required to cover costs and to achieve a prescribed rate-of-return on net investment used in the provision of regulated switched access service. *MAG Order*, 16 FCC Rcd at 19623-24, para. 19.

projected or historical minutes of use,<sup>723</sup> which means that as demand increases, prices fall but as demand falls, prices increase. Thus, declining minutes-of-use results in increased interstate access rates to reflect these reductions in demand. Recent filings indicate that rate-of-return carriers' interstate switched access rates increased 9.4 percent in 2010,<sup>724</sup> which follows similar increases during the last few years.<sup>725</sup> Higher rates put further pressure on the system and create new opportunities for arbitrage. Price cap LECs' access rates, on the other hand, are limited by a price cap index (PCI), a form of rate ceiling, that is not affected by the level of investment or changes in demand. Thus, as minutes-of-use decline and demand falls, price cap LECs have no means of offsetting these losses through rate changes.<sup>726</sup> As a result, for price cap carriers, declining interstate access minutes lead to unpredictably declining access revenues, making it more difficult for such carriers to make investment decisions with any level of certainty. Reform will bring greater certainty to the industry, which will ultimately benefit consumers.

505. Consistent with our vision to reform universal service and intercarrier compensation, it is important that intercarrier compensation rules create the proper incentives for carriers to invest in new broadband technologies so that consumers have the opportunity to take full advantage of the new capabilities of this broadband world. Unfortunately, however, the "current [intercarrier compensation] system is not sustainable in an all-broadband Internet Protocol (IP) world where payments for the exchange of IP traffic are not based on per-minute charges, but instead are typically based on charges for the amount of bandwidth consumed per month."<sup>727</sup> We therefore seek to reform intercarrier compensation to ensure that it does not stand as a barrier to the broadband future.

506. Evidence indicates that the current system is hindering progress to all IP networks. For example, the current regime creates the perverse incentive to maintain and invest in legacy, circuit-switched-based, time-division multiplexing (TDM) networks to collect intercarrier compensation revenue, hindering "the transformation of America's networks to broadband."<sup>728</sup> The record suggests that intercarrier compensation reform will encourage carriers to "more rapidly deploy broadband facilities and the IP based services,"<sup>729</sup> and that the current system "motivates some carriers to refrain from

<sup>723</sup> See *Access Charge Reform Order*, 12 FCC Rcd at 15993, para. 25 & n. 4. Rate-of-return companies currently have separate revenue requirements for switched access, special access and common line. The discussion here focuses on switched access.

<sup>724</sup> See NECA Transmittal No. 1278, Vol. 1, Description and Justification, at Table 3.

<sup>725</sup> See NECA Transmittal No. 1245, Vol. 1, Description and Justification, at Table 3 (showing a 5.8 percent increase in switched access rates in 2009), NECA Transmittal No. 1214, Vol. 1, Description and Justification, at Table 3 (4.6 percent increase in switched access rates in 2008), NECA Transmittal No. 1172, Vol. 1, Description and Justification, at Table 3 (16.8 percent increase in switched access rates in 2007), NECA Transmittal No. 1129, Vol. 1, Description and Justification, at Table 3 (5.8 percent increase in switched access rates in 2006).

<sup>726</sup> See National Broadband Plan at 142. The only means of addressing this revenue decline is to lower costs or reduce investment. See 47 C.F.R. § 61.45(b).

<sup>727</sup> National Broadband Plan at 142.

<sup>728</sup> *Id.*

<sup>729</sup> See Sprint Nextel Comments in re NBP PN #25 at 7-10 (filed Dec. 22, 2009) ("The current intercarrier compensation ("ICC") system provides the wrong incentives to carriers, encourages foot dragging in regard to TDM/IP transition, and results in significant economic waste and inefficiency. ... Sprint believes that if ICC were reformed and were to be provided on either a bill-and-keep basis or at rates using the Faulhaber methodology previously outlined by the Commission, that ILECs would more rapidly deploy broadband facilities and the IP based services that are facilitated by this technology."); see also Cablevision Comments in re NBP PN #25 at 2 (filed Dec. 22, 2009) ("[E]ven as incumbent local exchange carriers ("ILECs") upgrade their legacy networks to IP, they refuse to provide IP interconnection to their competitors on reasonable terms or at all. As a result, each IP voice call initiated on a competing carriers' network must be reduced to TDM, transmitted over an electrical DS-0 or similar connection, and routed to an ILEC customer over the legacy hierarchical circuit-switched network, with all of its associated costs, inefficiencies, and limitations").

transitioning networks to IP architecture [which] has the compounding effect of forcing interconnecting carriers to also retain legacy TDM network architecture to accommodate the exchange of traffic.”<sup>730</sup> The record also suggests that IP interconnection can be more efficient. In particular, the transition to IP can result in cost savings, including reductions in circuit costs, switch costs, space needs, and utility costs, as well as the elimination of other signaling overhead.<sup>731</sup>

507. At the same time, pressure continues to mount to address increasing regulatory arbitrage, particularly from phantom traffic where carriers seek to avoid paying intercarrier charges, and access stimulation where carriers seek to inflate intercarrier revenues. The record indicates that the impact of these arbitrage opportunities is significant and may cost the industry hundreds of millions of dollars each year.<sup>732</sup> For example, Verizon estimates that it will be billed between \$66 and \$88 million by access stimulators for approximately two billion wireline and wireless long distance minutes in 2010.<sup>733</sup> One of the many benefits of intercarrier compensation reform would be to allow the industry to devote resources currently committed to arbitrage-related disputes and litigation to capital investment and other more productive uses. Moreover, regulatory uncertainty about whether or what intercarrier compensation payments are required for VoIP traffic is hindering investment in and the introduction of new IP-based products and services.<sup>734</sup> Evidence indicates that some providers are taking advantage of this uncertainty and creating new ways to game the system. One provider, for example, relying on the regulatory uncertainty surrounding VoIP traffic, touts that it can provide service at low prices because it collects access charges but does not pay them.<sup>735</sup>

508. The intercarrier compensation system is broken and needs to be fixed. We seek comment below on ways to comprehensively reform the current system to realign incentives and promote investment and innovation in IP networks.

## **XI. LEGAL AUTHORITY TO ACCOMPLISH COMPREHENSIVE REFORM**

509. In this Notice, we seek comment on our legal authority to reform intercarrier compensation, and specifically propose two different transition paths for consideration. For the reasons set forth below, we believe we have the authority to adopt either of these transition paths, and implement a transition away from per-minute intercarrier compensation. We seek comment on these issues.

510. As discussed above, there are many different forms of intercarrier compensation, subject to varying regulatory regimes, even though carriers in each case are performing largely the same call origination or termination functions. For example, some regulations vary based on whether the calls are interstate long distance calls (subject to Commission-regulated access charges); intrastate long distance

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<sup>730</sup> See PAETEC Comments in re NBP PN # 25 at 3 (filed Dec. 22, 2009).

<sup>731</sup> See Letter from Russell M. Blau, Counsel to Neutral Tandem, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, GN Docket No. 09-51 at 1-2, Attach. at 4, 6 (filed Oct. 22, 2010).

<sup>732</sup> See *infra* para. 637.

<sup>733</sup> Letter from Donna Epps, Vice President-Federal Regulatory, Verizon, to Ms. Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 (filed Oct. 12, 2010) (Verizon Oct. 11, 2010 *Ex Parte* Letter). The record indicates that there are disputes over payment for these charges. See, e.g., Letter from Ross A. Buntrock, Counsel for Northern Valley Communications, LLC, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 (filed Oct. 14, 2010) (Northern Valley Oct. 14, 2010 *Ex Parte* Letter) (describing disputes over failure to pay tariffed switched access charges).

<sup>734</sup> National Broadband Plan at 142. See also T. RANDOLPH BEARD & GEORGE S. FORD, DO HIGH CALL TERMINATION RATES DETER BROADBAND DEPLOYMENT? (Phoenix Center Policy Bulletin No. 22, Oct. 2008), available at <http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf>.

<sup>735</sup> See Sarah Reedy, MagicJack Attacks, CONNECTED PLANET (May 2, 2008), <http://connectedplanetonline.com/voip/news/magicjack-attacks-0502/> (“As a VoIP Company, we don’t have to pay for access charges . . . . Telephone companies do have to pay access charges to terminate calls to our customers.”).

calls (subject to state-regulated access charges); or calls, such as local calls or calls to dial-up ISPs, that are subject to reciprocal compensation (and regulated in part by both the Commission and the states). Regulations also can vary depending upon whether the called party's carrier (terminating carrier) is a rate-of-return carrier, price-cap carrier, competitive carrier, or mobile wireless provider. We conclude that reducing interstate access charges falls well within our general authority to regulate interstate access under sections 201 and 251(g).<sup>736</sup> Further, as discussed below, we believe that we have authority, as appropriate, to reform other categories of intercarrier compensation charges.

511. *Wireless Termination Charges.* We first address whether we could take action to reduce intercarrier compensation charges paid by or to CMRS or wireless providers, including intrastate and interstate access charges (which we refer to collectively as “wireless termination charges”). We believe that we plainly have authority under sections 201 and 332 to regulate charges with respect to interstate traffic involving a wireless provider, as well as charges imposed by wireless providers regarding intrastate traffic. In addition, there is support for the proposition that section 332 of the Act also gives the Commission authority to regulate the intercarrier compensation rates paid by wireless carriers for intrastate traffic—including charges that otherwise would be subject to intrastate access charges. In a 1996 decision, the Eighth Circuit construed the Act to authorize the Commission to issue “rules of special concern to the CMRS providers,” including reciprocal compensation rules that encompass intrastate charges imposed by wireline providers on wireless providers.<sup>737</sup> In reaching that decision, the court relied on: (a) section 332(c)(1)(B), which obligates LECs to interconnect with wireless providers “pursuant to the provisions of section 201;” (b) section 2(b), which provides that the Act should not be construed to apply or to give the Commission jurisdiction with respect to charges in connection with intrastate communication service by radio “[e]xcept as provided in . . . section 332;” and (c) the preemptive language in section 332(c)(3)(A), which prohibits states from regulating the entry of or the rates charged by CMRS providers.<sup>738</sup> In addition, in the 2005 *T-Mobile Order*, the Commission relied upon its authority under sections 201 and 332 of the Act to adopt a rule prohibiting LECs from imposing compensation obligations for non-access traffic pursuant to tariff.<sup>739</sup> We seek comment on whether the Commission has authority under sections 201 and 332 to take measures to reduce wireless termination charges for both intrastate and interstate traffic.

512. *Reciprocal Compensation and Intrastate Access Charges.* As discussed below, the Commission has jurisdiction to determine a methodology for establishing the rates applicable to the exchange of reciprocal compensation traffic. We also believe that the Commission could apply section 251(b)(5) to all telecommunications traffic exchanged with LECs, including intrastate and interstate access traffic. Thus, the Commission could bring all telecommunications traffic (intrastate, interstate, reciprocal compensation, and wireless) within the reciprocal compensation framework of section 251(b)(5), and determine a methodology for such traffic. Or, the Commission could maintain the separate regimes of access charges and reciprocal compensation, and set a different methodology for traffic subject to reciprocal compensation.

<sup>736</sup> See 47 U.S.C. §§ 201, 251(g).

<sup>737</sup> See *Iowa Util. Bd. v. FCC*, 120 F.3d 753, n.21 (1997), *vacated and remanded in part on other grounds*, *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999). For example the court concluded that rule 51.703, which *inter alia* prohibits a LEC from “assess[ing] charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC’s network,” was validly grounded in section 332 of the Act. *Id.*

<sup>738</sup> *Id.*

<sup>739</sup> *Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855, 4863, para. 14 (2005) (*T-Mobile Order*) (“We take this action pursuant to our plenary authority under sections 201 and 332 of the Act. . . .”), *petitions for review pending*, *Ronan Tel. Co. et al. v. FCC*, No. 05-71995 (9<sup>th</sup> Cir. filed Apr. 8, 2005).

513. Section 251(b)(5) imposes on all LECs the “duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.”<sup>740</sup> The Act broadly defines “telecommunications” as “the transmission, between or among points specified by the user, of information of the user’s choosing, without change in the form or content of the information as sent and received.”<sup>741</sup> The reference to “telecommunications” in section 251(b)(5) is not limited in geographic scope (e.g., “local,” “intrastate,” or “interstate”) or confined to particular services (e.g., “telephone exchange service,”<sup>742</sup> “telephone toll service,”<sup>743</sup> or “exchange access”<sup>744</sup>). Had Congress intended to exclude certain types of telecommunications traffic from the reciprocal compensation framework, it could have easily done so by using more restrictive terms to define the traffic subject to section 251(b)(5). In the *2008 Order and ICC/USF FNPRM*, the Commission concluded that “[b]ecause Congress used the term ‘telecommunications,’ the broadest of the statute’s defined terms, ... section 251(b)(5) is not limited only to the transport and termination of certain types of telecommunications traffic, such as local traffic.”<sup>745</sup> The Commission also concluded that section 251(b)(5) is not limited to traffic exchanged between LECs; it applies to all traffic exchanged between a LEC and another carrier.<sup>746</sup> Consistent with those findings, we could apply the duty to provide reciprocal compensation under section 251(b)(5) to all telecommunications traffic exchanged with LECs. We seek comment on this issue.

514. We believe that section 251(g) provides further support that we have authority to apply section 251(b)(5) to all telecommunications, including access traffic. Section 251(g) singles out access traffic for special treatment and temporarily grandfathered the pre-1996 rules applicable to such traffic, including rules governing “receipt of compensation.”<sup>747</sup> Presumably, Congress would not have needed to preserve those compensation rules against the effects of section 251 if section 251(b)(5) did not in fact address the “receipt of compensation” for the access traffic covered by section 251(g).<sup>748</sup> We believe that section 251(g) should be read to encompass not just interstate access, but also intrastate access. Section 251(g) preserves all pre-existing “equal access and nondiscriminatory interconnection ... obligations (including receipt of compensation) ... under any court order, consent decree, or regulation, order, or policy of the Commission, until such ... obligations are explicitly superseded by regulations prescribed by the Commission.”<sup>749</sup> The intrastate access charge regime, like its interstate counterpart, was established by the 1982 AT&T consent decree.<sup>750</sup> Given that fact, section 251(g) appears to cover intrastate as well

<sup>740</sup> 47 U.S.C. § 251(b)(5).

<sup>741</sup> *Id.* § 153(43).

<sup>742</sup> *Id.* § 153(47).

<sup>743</sup> *Id.* § 153(48).

<sup>744</sup> *Id.* § 153(16).

<sup>745</sup> *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6480, para. 8.

<sup>746</sup> *Id.* at 6480-81, para. 10.

<sup>747</sup> 47 U.S.C. § 251(g).

<sup>748</sup> Applying basic principles of statutory construction, courts have repeatedly rejected statutory interpretations that would render a statutory provision meaningless. *See, e.g., Halverson v. Slater*, 129 F.3d 180, 185 (D.C. Cir. 1997) (“Congress cannot be presumed to do a futile thing”); *RCA Global Commc’ns, Inc. v. FCC*, 758 F.2d 722, 733 (D.C. Cir. 1985) (a proposed statutory construction that “would deprive” a statutory exemption “of all substantive effect” would produce “a result self evidently contrary to Congress’ intent”).

<sup>749</sup> 47 U.S.C. § 251(g).

<sup>750</sup> *See United States v. AT&T Co.*, 552 F. Supp. 131, 227, 232-34 (D.D.C. 1982); *MTS and WATS Market Structure*, 93 F.C.C.2d 241, 246, para. 11 (1983). The court order accompanying the AT&T consent decree made clear that the decree required access charges to be used in both the interstate and intrastate jurisdictions: “Under the proposed decree, state regulators will set access charges for intrastate interexchange service and the FCC will set access charges for interstate interexchange service.” *AT&T*, 552 F. Supp. at 169 n.161. Because both the interstate and (continued....)

as interstate access obligations. The D.C. Circuit has read section 251(g) “to provide simply for the ‘continued enforcement’” of certain restrictions and obligations that predated the 1996 Act, “including the ones contained in the consent decree that broke up the Bell System, until they are explicitly [superseded] by Commission action implementing the Act.”<sup>751</sup> Under that reading of the statute, the Commission has authority to supersede all access charge obligations preserved by section 251(g), including intrastate access requirements, by adopting rules to implement the reciprocal compensation requirements of section 251(b)(5). We seek comment on these issues.

515. Because section 251(b)(5) applies to all traffic exchanged between a LEC and another carrier, we believe that we have authority to regulate reciprocal compensation arrangements involving intrastate as well as interstate traffic. Section 201(b) of the Communications Act empowers the Commission to “prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.”<sup>752</sup> In upholding the Commission’s authority to promulgate pricing rules to implement section 252(d)(1), the Supreme Court declared that “the grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the ‘provisions of this Act.’”<sup>753</sup> The Court there held that insofar as provisions of the Communications Act (including those added by the 1996 Act) governed intrastate telecommunications services, the Commission has authority under section 201(b) to adopt rules covering intrastate services.<sup>754</sup> Proceeding from the premise that the broad term “telecommunications” in section 251(b)(5) encompasses both intrastate and interstate services, we believe that section 201(b) authorizes the Commission to adopt reciprocal compensation rules governing all telecommunications traffic (whether interstate or intrastate). We seek comment on this issue.

516. We also believe that the Commission has authority to adopt a methodology for traffic that is within the scope of section 251(b)(5). Section 252(d)(2) prescribes standards for setting charges for the transport and termination of traffic under section 251(b)(5),<sup>755</sup> and section 252(d)(2)(B)(i) expressly authorizes all regulatory “arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements).”<sup>756</sup> Although section 252(c)(2) directs the states to establish rates in accordance with the standards set forth in section 252(d),<sup>757</sup> the Supreme Court made clear in *Iowa Utilities Board* that “the Commission has jurisdiction to design a pricing methodology” under section 252(d).<sup>758</sup> As a result, in place of the current patchwork of compensation rules governing different types of services, we propose to transition to a new methodology. We seek comment below on the appropriate methodology. We ask whether we should move to a bill-and-keep methodology but also seek comment on alternative methodologies that are consistent with the goals of moving away from per-minute charges.

517. Although section 251(b)(5) refers only to transport and termination of telecommunications, not to origination, we do not think that the statute precludes us from moving originating access charges to a new methodology. We believe that pursuant to section 251(g), the “regulations prescribed by the Commission” to replace the current access charge system may permit the

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intrastate access charge systems were created by the same consent decree, it is reasonable to conclude that both systems were preserved by section 251(g).

<sup>751</sup> *WorldCom*, 288 F.3d at 432.

<sup>752</sup> 47 U.S.C. § 201(b).

<sup>753</sup> *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 at 378 (1999).

<sup>754</sup> *Id.* at 377-85.

<sup>755</sup> 47 U.S.C. § 252(d)(2).

<sup>756</sup> *Id.* at § 252(d)(2)(B)(i).

<sup>757</sup> 47 U.S.C. § 252(c)(2).

<sup>758</sup> *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

reduction of originating access charges or adoption of a bill-and-keep methodology or some other methodology for all rates.

518. We also could adopt a new methodology that would reduce reciprocal compensation charges but could leave the categories of telecommunications traffic that are currently subject to the reciprocal compensation obligation under section 251(b)(5) unchanged.<sup>759</sup> Doing so would leave intrastate and interstate access charges under their current regulatory structures and could permit separate glide paths for all three types of traffic. We seek comment on the policy merits of doing so.

519. If the Commission moves all traffic within the section 251(b)(5) reciprocal compensation framework, we seek comment on the impact of section 251(f)(2), which permits states to suspend or modify the reciprocal compensation obligations for carriers with less than two percent of the nation's subscriber lines.<sup>760</sup> In particular, a state may suspend or modify any of the requirements of section 251(b) and (c) if the state finds that doing so is consistent with the public interest and "is necessary: (i) to avoid a significant adverse economic impact to the users of telecommunications services generally; (ii) to avoid imposing a requirement that is unduly economically burdensome; or (iii) to avoid imposing a requirement that is technically infeasible."<sup>761</sup> The suspension or modification provision in section 251(f)(2) could permit a state to suspend or modify the intercarrier compensation reform obligations for smaller carriers. Doing so could undermine the reforms we propose today, particularly if the Commission moves all traffic within the reciprocal compensation framework.

520. We note that the Commission has not interpreted the section 251(f)(2) statutory language for determining whether a suspension or modification is appropriate. In the *Local Competition First Report and Order*, the Commission "decline[d] . . . to adopt national rules or guidelines" regarding the specific implementation of section 251(f), but explained that the Commission "may offer guidance on these issues at a later date, if we believe it is necessary and appropriate."<sup>762</sup> Should the Commission interpret section 251(f)(2) to require that any suspension or modification be for a limited "duration"<sup>763</sup> and not indefinite?<sup>764</sup> Should the Commission offer guidance regarding the substantive standards that state commissions must apply when evaluating requests pursuant to section 251(f)(2) for a suspension or modification of section 251(b) or (c)?<sup>765</sup> In light of possible ambiguities in section 251(f)(2), should the Commission adopt rules specifically addressing certain of the implications of a suspension or modification of intercarrier compensation rules?<sup>766</sup> We seek comment on these issues.

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<sup>759</sup> See *infra* Section XIII.A.

<sup>760</sup> 47 U.S.C. § 251(f)(2).

<sup>761</sup> 47 U.S.C. § 251(f)(2)(A). Specifically, section 251(f)(2) of the Act permits a "local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide" to "petition a State commission for a suspension or modification of the application of a requirement or requirements of [section 251] (b) or (c)." 47 U.S.C. § 251(f)(2).

<sup>762</sup> *Local Competition First Report and Order*, 11 FCC Rcd at 16118, para. 1263; 47 U.S.C. § 251(f)(2). In 2008, the Commission sought comment on possible guidelines regarding the application of section 251(f)(2). 2008 ICC/USF FNPRM, 24 FCC Rcd at 6623-26, App. A, paras. 282-90; *id.* at 6822-25, App. C, paras. 277-85. Only a few parties provided comment in opposition to the proposed guidelines, claiming that they were contrary to the plain language of the statute and would improperly limit state authority. See, e.g., SDTA 2008 ICC/USF FNPRM Comments at 7.

<sup>763</sup> 47 U.S.C. § 251(f)(2) (indicating that the state commission shall "grant such petition to the extent that, and for such duration as, the [s]tate commission determines").

<sup>764</sup> 2008 ICC/USF FNPRM, 24 FCC Rcd at 6624 App. A para. 283; *id.* at 6822-23 App. C para. 278.

<sup>765</sup> 2008 ICC/USF FNPRM, 24 FCC Rcd at 6624-26 App. A paras. 284-87; *id.* at 6823-24 App. C paras. 279-282.

<sup>766</sup> 2008 ICC/USF FNPRM, 24 FCC Rcd at 6626 App. A paras. 288-90; *id.* at 6824-25 App. C paras. 283-285.

521. *Authority to Set a Transition Plan.* In addition to our authority to reform interstate access charges, wireless termination charges, and reciprocal compensation to eliminate per-minute rates, we also believe we have authority to establish a transition plan for moving toward that ultimate objective in a manner that will minimize market disruptions.<sup>767</sup> As the D.C. Circuit has recognized, avoiding “market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule.”<sup>768</sup> In our judgment, it would be prudent to adopt interim, temporary rules that provide for a gradual, phased implementation of our proposed reforms. We believe that interim rules are needed to mitigate market disruption that might occur during the transition away from per-minute intercarrier compensation rates. It is particularly appropriate for the Commission to exercise its authority to craft a transition plan in this context, where the Commission is acting, as it has in prior orders, to reconcile the “implicit tension between” the Act’s goals of “moving toward cost-based rates and protecting universal service.”<sup>769</sup> We seek comment on our authority to implement a plan for easing the transition to comprehensive intercarrier compensation reform.

522. Section 251(g) supports our view that the Commission has authority to adopt a transitional scheme with regard to access charges. We agree with the D.C. Circuit that section 251(g) created a “transitional enforcement mechanism,”<sup>770</sup> that preserves the access charge regimes that predated the 1996 Act “until [they] are explicitly superseded by regulations *prescribed by the Commission*.”<sup>771</sup> Because section 251(g) contemplates that the Commission may take action to end the grandfathered access charge regimes, we think it reasonable to conclude that the Commission may also take steps to smooth the transition to a new regulatory scheme. We seek comment on this interpretation of section 251(g).

## XII. CONCEPTS TO GUIDE INTERCARRIER COMPENSATION REFORM

523. We seek comment below on the ultimate end-point once the transition away from per-minute intercarrier compensation rates is completed. We begin by identifying key concepts to inform our evaluation and then seek comment on alternative end-points for comprehensive intercarrier compensation reform that could further these goals.

### A. Concepts to Guide Sustainable Reform

524. *Addressing Arbitrage and Marketplace Distortions.* A number of problems arise from intercarrier compensation rates set above incremental cost and predicated on the recovery of average costs on a traffic sensitive, per-minute basis. Under average cost pricing, a network can invest in facilities to attract subscribers and recover some of those costs from subscribers of other, potentially competing, networks. As competition has increased, the ability to shift the recovery of costs to competitors through intercarrier charges increasingly distorts the competitive process.<sup>772</sup> This also creates arbitrage opportunities and other marketplace distortions.<sup>773</sup> These problems arise from a combination of

<sup>767</sup> See National Broadband Plan at 148.

<sup>768</sup> *Rural Cellular Ass’n v. FCC*, 588 F.3d 1095, 1106 (D.C. Cir. 2009) (quoting *Competitive Telecommc’ns Ass’n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002)); see also *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 410 (D.C. Cir. 2002); *Competitive Telecommc’ns Ass’n v. FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997); *MCI Telecommc’ns Corp. v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984).

<sup>769</sup> *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

<sup>770</sup> *WorldCom*, 288 F.3d at 433

<sup>771</sup> 47 U.S.C. § 251(g) (emphasis added).

<sup>772</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4694, para. 16.

<sup>773</sup> For example, some incumbent LECs may receive approximately one-third of their regulated revenues from access charges, while mobile wireless carriers generally must recover all costs from their end users. See, e.g., *Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, Memorandum Opinion and Order, 25 FCC Rcd 8622, 8681- (continued....)

intercarrier compensation rates set above incremental cost and the terminating access monopoly that exists today, which allows LECs to recover revenues through charges that cannot be disciplined by competition.<sup>774</sup> For example, the ability of companies to design business plans driven almost entirely by the profits from access charges<sup>775</sup> or reciprocal compensation<sup>776</sup> suggest just how far above incremental cost those rates can be. In addition, the varying regulatory regimes that apply to different providers, and different types of traffic, can lead to efforts to evade compliance with the existing system.<sup>777</sup> The long-term endpoint for reform should address the flaws in the current system of intercarrier compensation.

525. *Cost Causation.* Underlying historical pricing policies for termination of traffic was the assumption that the calling party was the sole beneficiary and sole cost-causer of a call.<sup>778</sup> More recent analyses, however, have recognized that both parties generally benefit from participating in a call, and therefore, that both parties should share the cost of the call.<sup>779</sup>

526. *Providing Appropriate Pricing Signals.* Many of the problems that have arisen in the current intercarrier compensation system would have been far less likely to occur if the party that chooses the service provider received appropriate pricing signals about the costs associated with their provider. For example, the Commission has recognized that customers have little incentive to choose a carrier with (Continued from previous page)

82, para. 116 n.339 (2010) (*Qwest Phoenix Forbearance Order*). Cf. Body of European Regulators for Electronic Communications, BEREC Common Statement on Next Generation Networks Future Charging Mechanisms / Long Term Termination Issues, at 39 (June 2010) (describing how certain intercarrier compensation reforms in European markets would eliminate the advantage that mobile operators currently have over fixed operators because mobile termination rates currently are higher than fixed termination rates) (BEREC Common Statement). Further, some have contended that above-cost access charges could create competitive advantages for IXC's that are affiliated with LECs. Cf. *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9617-18, para. 15.

<sup>774</sup> For a more detailed discussion of the problems arising under the current regulatory regime from the terminating access monopoly, see, e.g., *Qwest Phoenix Forbearance Order*, 25 FCC Rcd at 8664, 8678-79, paras. 79, 112; *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 9935-38, paras. 31-40 (2001) (*CLEC Access Charge Reform Order*); *Inter-carrier Compensation NPRM*, 16 FCC Rcd 9610, at 9616-17, paras. 13-14; Patrick DeGraba, *Bill and Keep at the Central Office as the Efficient Interconnection Regime*, OPP Working Paper Series No. 33 at 7-8, (Dec. 2000), available at [http://www.fcc.gov/Bureaus/OPP/working\\_papers/oppwp33.pdf](http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp33.pdf) (DeGraba).

<sup>775</sup> See *supra* para. 507; *infra* Section XV.C

<sup>776</sup> Indeed, the Commission found it necessary to adopt a regime providing a cap of \$0.0007 for reciprocal compensation rates for dial-up traffic bound for ISPs to address arbitrage in that context. *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6477, para. 3. And carriers now are expressing concerns about other possible reciprocal compensation arbitrage problems. See *infra* Section XV.C.2.b.

<sup>777</sup> See *infra* Section XV.B.

<sup>778</sup> See, e.g., *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9626, para. 42 (citing *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, 11 FCC Rcd 15499, 16028-29, paras. 1063-64 (1996) (*Local Competition Order*)); DeGraba at 15.

<sup>779</sup> See, e.g., BEREC Common Statement at 2 n.6, 27-30; DeGraba at 15-17. See also Stephen C. Littlechild, *Mobile Termination Charges: Calling Party Pays versus Receiving Party Pays*, in TELECOMMUNICATIONS POLICY, Vol. 30, 242 – 277 (2006); J. Scott Marcus, *Interconnection in an NGN Environment*, ITU/02, (Apr. 2006) available at <http://www.itu.int/osg/spu/ngn/documents/Papers/Marcus-060323-Fin-v2.1.pdf>; David Harbord & Marco Pagnozzi (2008), *On-net / Off-net Price Discrimination and “Bill-and-Keep” vs. “Cost-Based” Regulation of Mobile Termination Rates* (Jan. 2008) available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1374851](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1374851); J. Scott Marcus and Dieter Elixmann, WIK-Consult, *The Future of IP Interconnection: Technical, Economic, and Public Policy Aspects*, Final Report, Study for the European Commission (Jan. 2008) available at [http://ec.europa.eu/information\\_society/policy/ecom/doc/library/ext\\_studies/future\\_ip\\_intercon/ip\\_intercon\\_study\\_final.pdf](http://ec.europa.eu/information_society/policy/ecom/doc/library/ext_studies/future_ip_intercon/ip_intercon_study_final.pdf).

lower access charges because the market does not provide them accurate pricing signals.<sup>780</sup> Indeed, in some cases carriers actually have subsidized customers to entice them to obtain service from them, rather than another, possibly lower-cost provider.<sup>781</sup>

527. *Consistent with All-IP Broadband Networks.* Most fundamentally, the long-term approach to intercarrier compensation reform also must be consistent with the exchange of traffic on an IP-to-IP basis. A methodology that is consistent with IP networks is important because the record suggests that the current intercarrier compensation system may be disrupting a market-driven transition to more efficient forms of interconnection, such as IP-to-IP interconnection.<sup>782</sup> Voice traffic exchanged on an IP-to-IP basis can simply involve the exchange of packets, and does not require occupying an entire circuit for the duration of the call as in a circuit-switched network. Current policies, however, have resulted in per-minute intercarrier compensation charges, which make little sense for IP traffic. Specifically, certain carriers may require an interconnecting carrier to convert IP traffic to time-division-multiplexed traffic even if IP-to-IP interconnection would be more efficient, to ensure continued collection of intercarrier compensation.<sup>783</sup> The National Broadband Plan encouraged the Commission, as part of intercarrier compensation reform, “to determine what actions it could take to encourage transitions to IP-to-IP interconnection where that is the most efficient approach.”<sup>784</sup>

528. *Other Concepts.* We also seek comment on any additional concepts that should guide the Commission’s evaluation of the appropriate end-point for comprehensive intercarrier compensation reform. Parties proposing such concepts should describe how they advance, or are consistent with, the transition to all-IP networks, as well as the other reforms discussed in this Notice.

## **B. Intercarrier Compensation Methodologies for All-IP Networks**

529. We seek comment below on possible intercarrier compensation methodologies that the Commission might adopt as an end-point for comprehensive reform. We also encourage commenters to submit alternative methodologies that are consistent with the concepts identified above.

<sup>780</sup> See, e.g., *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, 9935-36, para. 31 (2001) (*CLEC Access Reform Order*).

<sup>781</sup> See, e.g., Level 3 Petition for Declaratory Ruling Regarding Access Charges by Certain Inserted CLECs for CMRS-Originated Toll-Free Calls, CC Docket No. 01-92 at 2, 12-15 (filed May 12, 2009) (Level 3 Declaratory Ruling Petition).

<sup>782</sup> See National Broadband Plan at 142 (observing that “the current system creates disincentives to migrate to all IP-based networks”). See also, e.g., PAETEC Comments in re PN #25 at 3 (filed Dec. 22, 2009) (arguing that “[c]ompensating carriers at different rates for use of their network based on the type of traffic motivates some carriers to refrain from transitioning networks to IP architecture. This has the compounding effect of forcing interconnecting carriers to also retain legacy TDM network architecture to accommodate the exchange of traffic”); Sprint Nextel Comments in re NBP PN #25 at 7-10 (filed Dec. 22, 2009) (maintaining that “[t]he current intercarrier compensation (“ICC”) system provides the wrong incentives to carriers, encourages foot dragging in regard to TDM/IP transition, and results in significant economic waste and inefficiency”).

<sup>783</sup> See National Broadband Plan at 142. See also Cablevision Comments in re NBP PN # 25 at 2 (filed Dec. 22, 2009) (stating that an “IP voice call initiated on a competing carriers’ network must be reduced to TDM, transmitted over an electrical DS-0 or similar connection, and routed to an ILEC customer over the legacy hierarchical circuit-switched network, with all of its associated costs, inefficiencies, and limitations”); Global Crossing Comments in re NBP PN #19 at 9-10 & n.13 (filed Dec. 7, 2009) (describing how Global Crossing has to convert its IP traffic back to TDM in order to hand it off to its access vendors); Sprint Nextel Comments in re NBP PN #25 at 5 (filed Dec. 22, 2009) (observing that incumbent LECs are slow to deploy IP or do so inefficiently in order to hold on to access revenues).

<sup>784</sup> National Broadband Plan at 49. See also Letter from Russell M. Blau, Counsel for Neutral Tandem, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, GN Docket No. 09-51 at 1-2 (filed Oct. 22, 2010) (describing the costs and benefits of IP interconnection among voice providers).

530. *Bill-and-Keep Methodology.* The Commission previously has sought comment on forms of bill-and-keep methodologies.<sup>785</sup> At a high level, under a bill-and-keep methodology, carriers would not impose charges on other service providers to recover the costs of transporting telephone calls from a specified point in the network or for originating or terminating those calls.<sup>786</sup> Instead, they would recover such costs from their own end users, possibly in conjunction with CAF support. This is roughly akin to the manner in which wireless providers already operate today.<sup>787</sup> We seek comment on the merits of a bill-and-keep methodology. We also seek comment on the scope of functions provided by a carrier that should be encompassed by the bill-and-keep framework.<sup>788</sup> For example, under some circumstances, certain special access services may be viewed as substitutes for certain switched access services today, and we seek comment on whether, and how, to address such circumstances if the Commission were to adopt a bill-and-keep approach.<sup>789</sup> We also seek comment on how any bill-and-keep methodology could be crafted in a way that is sufficiently flexible to accommodate evolving network architectures. In this regard, we note that there are a number of technical issues associated with developing a particular bill-and-keep methodology, and we seek more detailed comment on those issues below.<sup>790</sup> We also seek

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<sup>785</sup> See generally *Intercarrier Compensation NPRM*, 16 FCC Rcd 9610; see also, e.g., *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4703-04, 4705-07, 4711-12, 4714-15, paras. 37-38, 40-44, 54-55, 59.

<sup>786</sup> The carrier handing off traffic for termination would be responsible for transporting the traffic to that specified point in the network, which could include payment for the use of other carriers' networks for that transmission. We seek comment below on how to define the specified point in the network where traffic would need to be delivered before "bill-and-keep" would apply. See *infra* Section XVI.

<sup>787</sup> Wireless providers are prohibited from filing interstate access tariffs, see 47 C.F.R. § 20.15(c), and may collect access charges from an IXC only if both parties agree to do so pursuant to contract. See *Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13198, para. 12 (2002) (*Sprint/AT&T Declaratory Ruling*), petitions for review dismissed, *AT&T Corp. v. FCC*, 349 F.3d 692 (D.C. Cir. 2003). Practically speaking, this means that CMRS providers generally do not collect access charges for calls that originate or terminate on their networks. CMRS providers are, however, able to receive reciprocal compensation for eligible traffic that terminates on their networks, although the record indicates that many of those arrangements are bill-and-keep. See, e.g., Letter from Tamara Preiss, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 6, 10 (filed June 28, 2010); Letter from Norina Moy, Dir., Gov't. Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 04-36, at 1 (filed Sept. 19, 2008).

<sup>788</sup> See, e.g., COMPTTEL 2008 ICC/USF FNPRM Comments at 23 (arguing that as a result of the conversion to IP-based networks the proposed default "edge" rules may not even be relevant at the end of the transition period); NCTA 2008 ICC/USF FNPRM Comments at 19-21 (arguing that the 2008 Edge interconnection proposal would not work for IP-based networks).

<sup>789</sup> For example, at sufficient traffic volumes a carrier that previously interconnected and delivered traffic via a tandem switch, paying switched transport charges, might instead purchase a special access connection to deliver traffic directly to the relevant central office. See, e.g., Cincinnati Bell 2008 ICC/USF FNPRM Comments at 17-18. We note that questions regarding the appropriate regulation of price cap carriers' special access services more generally remains the subject of a pending proceeding. See *Special Access Rates for Price Cap Local Exchange Carriers*, *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005); *Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking*, WC Docket No. 05-25, RM-10593, Public Notice, 22 FCC Rcd 13352 (2007); *Parties Asked to Resolve Analytical Framework Necessary to Resolve Issues in Special Access NPRM*, WC Docket No. 05-25, RM-10593, Public Notice, 24 FCC Rcd 13638 (2009); *Data Requested in Special Access NPRM*, WC Docket No. 05-25, RM-10593, Public Notice DA 10-2073 (rel. Oct. 28, 2010); *Clarification of Data Requested in Special Access NPRM*, WC Docket No. 05-25, RM-10593, Public Notice, DA 10-2413 (rel. Dec. 23, 2010).

<sup>790</sup> See *infra* Section XVI.

comment on our legal authority to adopt a bill-and-keep methodology either for particular traffic, or for all traffic generally.<sup>791</sup>

531. *Flat-Rated Inter-carrier Charges.* The Commission also previously has sought comment on proposals that involved converting per-minute interstate access charges into flat-rated inter-carrier charges imposed on long distance, interexchange carriers.<sup>792</sup> We note, however, that the marketplace has evolved significantly since the time of those proposals, with end-user customers increasingly shifting from stand-alone long distance service to bundled packages including local and long distance voice service, frequently at flat rates.<sup>793</sup> At least one proposal discussed in the 2005 *Inter-carrier Compensation FNPRM* did suggest the use of flat inter-carrier compensation charges for all traffic, however.<sup>794</sup> Would any such flat inter-carrier charge proposals make policy sense, and be administrable, in the present context as customers transition to broadband? Would such changes facilitate, or hinder, the transition from circuit-switched to IP networks? We also seek comment on our legal authority to implement a particular flat charge proposal.

532. *Other Alternative Methodologies and Transition Proposals.* We seek comment on alternative methodologies consistent with the guiding concepts for long-term reform, and which would provide us with authority to adopt the transition proposals set forth below. Various alternative approaches to reform have been proposed in the record, which would retain some form of per-minute inter-carrier compensation charges.<sup>795</sup> We seek comment on these and other proposed approaches to inter-carrier

<sup>791</sup> As discussed above, the Commission could bring all traffic within the section 251(b)(5) reciprocal compensation framework and adopt a new pricing methodology. *See supra* Section XI. Section 252(d)(2) prescribes standards for setting charges for the transport and termination of traffic under section 251(b)(5), and section 252(d)(2)(B)(i) expressly authorizes all regulatory “arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements).” 47 U.S.C. § 252(d)(2)(B)(i). Citing this provision, the D.C. Circuit has declared that “there is plainly a non-trivial likelihood that the Commission has authority to elect” a bill-and-keep system. *WorldCom* 288 F.3d at 434. Although section 252(c)(2) directs the states to establish rates in accordance with the standards set forth in section 252(d), the Supreme Court made clear in *Iowa Utilities Board* that “the Commission has jurisdiction to design a pricing methodology” under section 252(d). *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385; *see also id.* at 384. We thus believe that the adoption of a federal bill-and-keep mandate would fall comfortably within our jurisdiction to develop a pricing methodology for transport and termination charges. *See supra* Section XI.

<sup>792</sup> *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 98-63, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, at 14328-30, paras. 211-16 (1999) (*Pricing Flexibility Order and NPRM*) (seeking comment on converting from per-minute rates to capacity-based charges); *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4707-08, paras. 45-47 (discussing the Expanded Portland Group (EPG) proposal, which would transition to flat charges for access traffic and retain per-minute charges for local and extended area service traffic).

<sup>793</sup> *See, e.g., Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission’s Dominant Carrier Rules As They Apply After Section 272 Sunsets*, Memorandum Opinion and Order, 22 FCC Rcd 5207, 5217-19, paras. 15-19 (2007) (noting that long distance service purchased on a stand-alone basis is becoming a fringe market).

<sup>794</sup> *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4710-11, paras. 52-53 (discussing the Home Telephone Company and PBT Telecom (Home/PBT) proposal that carriers tariff flat capacity-based interconnection charges to be paid by any interconnecting carrier).

<sup>795</sup> *See, e.g.,* Letter from Tiki Gaugler, Senior Manager & Counsel, XO Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135, Attach. at 2 (filed Sept. 10, 2010) (XO Sept. 10, 2010 *Ex Parte* Letter); Letter from Tamar E. Finn, Counsel, PAETEC to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 (filed Sept. 24, 2010). Some suggest that such reforms include reconsideration of the Commission’s interpretation of section 254(g) to, among other things, allow carriers to send price signals to their customers about the costs of delivering calls for termination. *See, e.g.,* Letter from Tamar E. Finn, counsel for PAETEC, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, Attach. at 5 (filed Jan. 14, 2010).

compensation reforms. To what extent would these proposals that retain per-minute rates make policy sense, given the National Broadband Plan recommendations concerning the elimination of per-minute charges and the Commission's goal of accelerating the transition to all-IP networks? To what extent would particular plans be administrable? We seek comment on our legal authority to adopt these and other proposals in the record, and also ask interested parties to provide alternative transition proposals.<sup>796</sup>

### **XIII. SELECTING THE PATH TO MODERNIZE EXISTING RULES AND ADVANCE IP NETWORKS**

533. In this section, we seek comment on how to begin the transition away from the current per-minute intercarrier compensation rates to facilitate carriers' movement to IP networks consistent with the guiding concepts identified above. There are multiple dimensions of any transition plan, each of which can be calibrated in a variety of ways. For one, there are a range of roles that could be played by state and federal policy makers. We also believe it is important for any transition to be gradual enough to enable the private sector to react and plan appropriately.<sup>797</sup> In significant part, this can be accommodated by the sequencing and timing of rate reductions. We seek comment on how each of these dimensions should be addressed as part of the intercarrier compensation reform transition.

534. In particular, we propose to work in partnership with the states to reform intercarrier compensation, and we seek comment below on two general options for addressing the various elements of the transition. Under the first option, the transition would be implemented through reliance on the existing roles played by the states and the Commission with respect to regulation of rates. The Commission would reduce interstate access charges, and adopt a methodology that states would implement to reduce reciprocal compensation rates; but the categories of traffic under the reciprocal compensation framework would remain unchanged. We also seek comment on whether we should determine a rate for wireless termination charges (including intrastate access charges paid by wireless carriers). States would otherwise continue to be responsible for reforming intrastate access charges. We seek comment on including incentives for states to complete reform of intrastate access charges. We also propose a backstop mechanism through which, after a specified period of time such as four years, the Commission would take action if states have not done so. Under the second option, the Commission would use the tools provided by sections 251 and 252 in the 1996 Act to unify all intercarrier rates, including those for intrastate calls, under the framework of reciprocal compensation. In this framework, the Commission establishes a methodology for intercarrier rates, which states then work with the Commission to implement.

535. We seek comment on the benefits and disadvantages of each approach and the potential rule changes necessary to implement each alternative. In discussing or proposing particular alternatives, we ask commenters to discuss how particular approaches balance several potentially competing considerations: (a) harmonizing rates and otherwise reducing arbitrage opportunities; (b) minimizing disruption to service providers, including litigation and revenue uncertainty; and (c) minimizing the impact on consumers and on the Commission's ability to control the size of the universal service fund.

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<sup>796</sup> See Letter from James S. Blaszk, Attorney for Ad Hoc Telecommunications Users Committee to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51 at 1-2 (filed Sept. 29, 2010) (Ad Hoc Telecommunications Users Committee (Ad Hoc) suggests that the Commission implement intercarrier compensation reform in two phases. Specifically, Ad Hoc suggests that in the first phase the Commission "apply [intercarrier compensation reform] to the major local exchange carriers" and "[n]ot until the second phase would the Commission impose [intercarrier compensation reform] on small rural local exchange carriers.").

<sup>797</sup> This is consistent with the National Broadband Plan, which observed that "[s]udden changes in USF and ICC could have unintended consequences that slow progress" and that "[s]uccess will come from a clear road map for reform, including guidance about the timing and pace of changes to existing regulations, so that the private sector can react and plan appropriately." National Broadband Plan at 141. See also *id.* at 135-36, 143.

536. Finally, we emphasize that the Commission intends to use a data-driven process to analyze the proposed reforms. As a result, commenters should submit data to explain and substantiate their position or concerns.

**A. Reform Based on the Existing Jurisdictional Framework**

537. Under this approach, both the Commission and states would be responsible for taking steps, consistent with their existing jurisdictional roles, to reform intercarrier compensation charges as described below. By focusing on areas that the courts have made clear are within the Commission's jurisdiction, this option could minimize the risk of litigation and disputes, providing greater stability regarding the reform. On the other hand, although we discuss a possible Commission backstop below, intrastate rates will continue to be different as states grapple with different ways to reform intrastate access, which could result in different transitions and varying rates, potentially allowing continued arbitrage based on the disparity in rates for different jurisdictions. We thus seek comment on the overall strengths and weaknesses of such an approach, as well as the implementation considerations discussed below.

**1. Reforms Undertaken by the Commission**

538. Under this option, the Commission would exercise its broad authority to determine the transition, stages, and future state for reforming the current interstate access charge rules to eliminate per-minute rates, including any necessary cost or revenue recovery that might be provided through the CAF. Likewise, the Commission would create a new methodology for reciprocal compensation, although the scope of traffic encompassed by the reciprocal compensation framework would not change. We recognize that these reductions could be sequenced and staged in different ways, and we seek comment on the strengths and weaknesses of particular approaches. For example, reducing interstate access charges at the outset has the advantage that arbitrage related to interstate access charges would be addressed and eliminated earlier in the transition,<sup>798</sup> thereby realizing the benefits of reform earlier in the transition. An initial focus primarily on interstate access reductions also could be more consistent with a limited CAF, depending upon how the details of recovery are resolved.<sup>799</sup> Reductions in reciprocal compensation rates potentially could occur from the start of the transition, as well. Depending upon the reciprocal compensation methodology chosen, however, this could increase the complexity of issues that need to be addressed earlier in the transition process, as compared to an approach that deferred reciprocal compensation rate reforms until later in the process.<sup>800</sup> Under any approach, as to staging, reductions could occur through equal increments, an equal annual percentage, or other mechanisms.

539. In addition to interstate access and reciprocal compensation, there is support for the proposition that section 332 of the Act gives the Commission authority to regulate wireless termination charges—that is, intercarrier compensation charges paid to wireless carriers, or paid by wireless carriers—including charges that otherwise would be subject to intrastate access charges.<sup>801</sup> We seek comment on whether the Commission should address all wireless termination charges or whether we must or should leave wireless intrastate access charges within the states' jurisdiction. We also seek comment on whether wireless termination charges—whether arising under section 20.11 of the Commission's rules,

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<sup>798</sup> As discussed below, we also propose rules to further minimize access stimulation while the broader reforms are occurring. *See infra* Section XV.C.

<sup>799</sup> *See infra* Section XIV.B.

<sup>800</sup> For example, in the Interconnection and Related Issues section below, we seek comment on whether new rules regarding physical points of interconnection or the network edge would be required for particular reform proposals. *See infra* Section XVI. We also seek comment on the effect, if any, a glide path applicable to reciprocal compensation traffic should have on current interconnection and other traffic exchange agreements between parties. *Id.*

<sup>801</sup> *See supra* Section XI.

the access charge regimes, or reciprocal compensation—should be separately dealt with in the transition process.<sup>802</sup> We note that, today, there is some dispute regarding certain wireless termination charges.<sup>803</sup> If wireless termination charges are subject to their own transition, would it still be necessary or appropriate to clarify those issues?

540. The overall timing for the Commission to reduce those rates subject to its jurisdiction could be structured in various ways, as well.<sup>804</sup> We propose completing the transition away from the current per-minute framework before the Commission implements its long-term vision for CAF reform.<sup>805</sup> We believe doing so is in the public interest because it will remove implicit subsidies from the current intercarrier compensation system consistent with the transition to explicit support provided under the CAF mechanisms proposed in this Notice.

541. We seek comment on whether the transition for wireless termination charges, if reduced separately, should be subject to distinct transition timing. For example, should we adopt an alternative or more accelerated transition for wireless termination charges?<sup>806</sup> We note, for example, that we propose to rationalize CETC support over five years. Since reducing wireless termination charges could result in cost savings to wireless providers, should the Commission seek to reduce such charges so that those cost savings are realized in parallel with the elimination of CETC support?

<sup>802</sup> See 47 C.F.R. § 20.11(b) (requiring “reasonable compensation” for traffic exchanged between LECs and CMRS carriers).

<sup>803</sup> These include debates about the relationship between sections 20.11 and 51.701 of the Commission’s rules, 47 C.F.R. §§ 20.11, 51.701, and what constitutes a “reasonable” rate under section 20.11. See Letter from Tamara Preiss, Vice President—Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 1, 7 (filed June 28, 2010) (asking the Commission to adopt CMRS-CLEC compensation rules either on an interim basis or in the context of more comprehensive intercarrier compensation reform); Letter from L. Charles Keller, Counsel to CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135, Attach. at 3 (filed Aug. 26, 2010) (describing the need for clarification concerning section 20.11). See also *infra* Section XV.C.2.b. In addition, there are pending petitions for clarification or reconsideration of the Commission’s 2005 *T-Mobile Order*. *Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855 (2005) *petitions for review pending*, *Ronan Tel. Co. et al. v. FCC*, No. 05-71995 (9<sup>th</sup> Cir. filed Apr. 8, 2005); American Association of Paging Carriers Petition for Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005); MetroPCS Petition for Limited Clarification or for Partial Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005); MSTCG Petition for Reconsideration, CC Docket No. 01-92 (filed Mar. 25, 2005); RCA Petition for Clarification, or in the Alternative, Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005); T-Mobile Petition for Clarification, or in the Alternative Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005).

<sup>804</sup> We note that the National Broadband Plan proposed a 10-year transition to eliminate per-minute charges. See National Broadband Plan at 148. Specifically, it suggests that in 2010-2011 the Commission “adopt a framework for long-term intercarrier compensation (ICC) reform that creates a glide path to eliminate per-minute charges while providing carriers the opportunity for adequate cost recovery, and establish interim solutions to address arbitrage.” *Id.* The National Broadband Plan recommends that in 2012-2016 the Commission “begin a staged transition of reducing per-minute rates for intercarrier compensation.” *Id.* at 149. From 2017-2020 the National Broadband Plan recommends that the Commission “continue reducing ICC rates by phasing out per-minute rates for the origination and termination of telecommunications traffic.” *Id.* at 150.

<sup>805</sup> See *supra* Section VII.

<sup>806</sup> For example, some industry members believe that a 10-year transition, as proposed in the National Broadband Plan, is too long. See, e.g., Letter from Norina Moy, Director, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 07-135, 05-25, CC Docket No. 0-192, GN Docket No. 09-51 at 1 (filed Sept. 28, 2010). See also Letter from Tiki Gaugler, Federal Regulatory Counsel, XO Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 3 (filed Nov. 23, 2010) (proposing a five-year transition for comprehensive intercarrier compensation reform).

542. The timing of the transition also could vary by the type of terminating carrier, given that some carriers' rates are higher at the outset. For example, distinct transition timing could be adopted for price cap versus rate-of-return carriers.<sup>807</sup> Although price cap carriers' rates are limited by a price cap index,<sup>808</sup> a form of rate ceiling, rate-of-return carriers' interstate rates have been increasing the last few years as demand has declined.<sup>809</sup> Rate-of-return carriers' interstate access rates are higher than price cap carriers' interstate access rates, and continue to increase every year. Should the Commission consider giving rate-of-return carriers additional time? If so, what should the glide path be and why?<sup>810</sup> Or, are there countervailing policy considerations that counsel in favor of reducing all rates along a similar glide path?

## 2. Reforms Undertaken by the States

543. States that have undertaken intrastate access charge reform measures have pursued a variety of approaches, underscoring states' ability to account for the unique characteristics of their state and the impact on local consumers in setting a glide path for reform. Nebraska, for example, reduced intrastate rates and established a state universal service fund initially designed to help carriers replace required intrastate rate reductions.<sup>811</sup> To be eligible to receive support under the state Universal Service Fund, Nebraska adopted residential and business rate benchmarks and established separate transition periods for rural and non-rural carriers to reduce their access charges.<sup>812</sup> Following a transition period, the Nebraska Universal Service Fund was then directed to target support to high-cost areas of the state.<sup>813</sup> Indiana has adopted a policy by which small incumbent LECs "mirror the rates and rate structure applicable to their interstate access services for their intrastate access services."<sup>814</sup> The state also developed a universal service program to assist rural LECs with revenue recovery.<sup>815</sup> Under that program, recovery of intrastate revenue shortfalls is available to eligible rural LECs that undergo rate

<sup>807</sup> See *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4737, para. 118.

<sup>808</sup> See *supra* para. 504.

<sup>809</sup> See *supra* para. 504 & notes 726-27.

<sup>810</sup> See Letter from Kathleen O'Brien Ham, Vice President, Federal Regulatory Affairs, T-Mobile USA, Inc. and Charles W. McKee, Vice President, Government Affairs, Federal and State Regulatory, Sprint Nextel Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at 4 (filed Jan. 21, 2011) (T-Mobile/Sprint Nextel Jan. 21, 2010 *Ex Parte* Letter) (suggesting that BOCs and "service providers that operate in any of the [ ]BOCs' service areas" should be given four years to transition, while rural and other LECs should have ten years).

<sup>811</sup> See Nebraska PSC 2008 ICC/USF FNPRM Comments at 8; *Investigation into Intrastate Access Charge Reform*, Application No. C-1628, Findings and Conclusions, 1999 WL 135116, \*7 (Neb. Pub. Serv. Comm'n 1999) (*Nebraska Access Charge Reform Order*).

<sup>812</sup> *Nebraska Access Charge Reform Order*, 1999 WL 135116 at \*7.

<sup>813</sup> Nebraska Comm'n 2008 ICC/USF FNPRM Comments at 8; *Nebraska Public Service Commission on Its Own Motion, Seeking to Establish a Long-Term Universal Service Funding Mechanism*, Applications No. NUSF-26, Findings and Conclusions (Neb. Pub. Serv. Comm'n 2004) available at <http://www.psc.state.ne.us/home/NPSC/usf/Orders/NUSF26.2004.11.03.Findings%20and%20Conclusions.doc>. Specifically, non-rural carriers were required to eliminate their Carrier Common Line (CCL) charge immediately and phase out the Transport Interconnection Charge (TIC) over a three-year period. Rural carriers were required to reduce their CCL and phase it out over four years, and phase out the TIC to other transport elements. See Letter from Cheryl L. Parrino, Counsel to Nebraska Rural Independent Companies, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, Attach. at 1 (filed Nov. 12, 2010) (NE Rural Nov. 12, 2010 *Ex Parte* Letter).

<sup>814</sup> *Universal Service Reform*, Cause No. 42144, 2004 WL 1170315, \*3 (Ind. Util. Reg. Comm'n 2004) (subsequent history omitted).

<sup>815</sup> *Id.*

rebalancing.<sup>816</sup> Further, in Iowa, intrastate access rates for local exchange companies were reduced in the context of a tariff proceeding.<sup>817</sup> Notably, no recovery mechanism was established in the proceeding because affected LECs did not provide cost data to substantiate the need for recovery.<sup>818</sup> We seek comment on the status of intrastate access reform, as well as different approaches and best practices of states that have undertaken intrastate access reform.<sup>819</sup>

544. *Incentives for States to Act.* Considering the variety of approaches that states have undertaken to achieve reform, we seek comment on what steps the Commission should take to encourage states to reduce intrastate intercarrier compensation rates and how we could do so without penalizing states that have already begun the difficult process of reforming intrastate rates or rewarding states that have not yet engaged in reform. We seek comment above on ways the Commission could structure the first phase of the CAF to reward states that take action to advance our broadband goals, and here we likewise seek comment on how the first phase of the CAF preferences might create incentives for states to reduce intrastate access charges. Would a preference for receipt of the first phase of the CAF funds be an appropriate and sufficient incentive to encourage states or carriers to act to reduce intrastate intercarrier compensation rates?<sup>820</sup> If so, how should the Commission determine if a state has undertaken intrastate access reform? Would states need an order or similar regulation setting forth a transition to reduce intrastate rates, or should the Commission require a more specific schedule of reductions? Or, for example, should the Commission require that a certain percentage of providers in the state have reduced

<sup>816</sup> *Id.* at \*3-\*5. Similarly, in furtherance of a statutory requirement for intrastate access rates to mirror interstate rates, Maine provides state universal service funding to assist rural LECs with revenue recovery. ME. REV. STAT. ANN. tit. 35, § 7101-B. Under this mechanism, a rate proceeding is required for eligible carriers seeking support. 65-407 ME CODE R. Ch. 288, § 3(C).

<sup>817</sup> *Iowa Telecommunications Association*, Docket Nos. TF-07-125, TF 07-139, Final Order, 2008 WL 4489065 (Iowa Utils. Bd. 2008) (*Iowa 2008 Final Order*), Order Denying Requests for Reconsideration and Denying Motion to Vacate Stay, 2009 WL 2141213 (Iowa Utils. Bd. 2009) (*Iowa 2009 Order*).

<sup>818</sup> *Iowa 2008 Final Order*, 2008 WL 4489065 at \*6 (“[T]he Board cannot determine, based on the record provided, if a reduced revenue level resulting from reduced intrastate access services rates would fail to adequately recover the costs of providing service. In the absence of that evidence, the Board cannot take any steps to consider replacement of those revenues.”); *Iowa 2009 Order*, 2009 WL 2141213 at \*6 (“[Iowa Telecommunications Association (ITA)] claims that it would be arbitrary and capricious for the Board to reduce its members’ access rates without an opportunity for the affected companies to provide cost information that would show that the reduced access rates would not cover their costs and consequently ask for a gradual phase in of the reductions. The Board finds that this case presented an adequate opportunity for ITA to produce cost data. ... ITA had the opportunity throughout this proceeding to produce cost data to support its tariffed rates and chose not to do so.”).

<sup>819</sup> See, e.g., Letter from Brian J. Benison, Director – Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51, Attach. 1, 2 (filed Oct. 25, 2010) (AT&T Oct. 25, 2010 *Ex Parte* Letter) (providing information on access reform in the states and noting that few states have moved to complete parity between intrastate and interstate switched access rates and structures). AT&T asserts that Alabama, Alaska, Georgia, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Massachusetts, Michigan, Mississippi, Missouri, New Jersey, New Mexico, Nevada, North Carolina, Ohio, Oklahoma, Oregon, Tennessee, Texas, Virginia, Wisconsin, and West Virginia have taken varied approaches to embrace intrastate/interstate parity or lower intrastate access rates. *Id.* See also Wyoming Comm’n and WTA Comments Responding to AT&T *Ex Parte*, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51 (filed Dec. 7, 2010) (describing access charge reform efforts); Early Adopter State Commission Comments on the Missoula Plan at 6, 10 (describing certain state efforts to reform intrastate access charge). The Commission requests accurate information concerning the status of intrastate access state reform activity to determine which states would be eligible to participate in the first phase of the CAF should the Commission adopt CAF preferences as an incentive for state action. See *supra* Section VI.F.

<sup>820</sup> Regardless of prior state action or the glide path established for intrastate access charges (or other rates), carriers in states that do not regulate, or have deregulated, intrastate access charges may be free to eliminate per-minute intercarrier charges more quickly.

rates to satisfy the requirement for state action? Should we require intrastate rates be reduced to a certain level, such as mirroring interstate rates? What other alternative determinations or criteria should the Commission consider?<sup>821</sup>

545. What other incentives for intrastate intercarrier compensation reform might be appropriate and effective for the Commission to adopt? For example, should we explore matching some CAF dollars to a state universal service fund for states that are using such a fund to reform intrastate access charges? If so, how could such a match be structured, particularly given our commitment to control the size of the CAF? We note, for instance, that NECA submitted data from a survey of its members (rate-of-return companies) estimating that if the NECA companies reduced their current intrastate access charges to the level of their current interstate access rates, they would, in the aggregate, lose approximately \$361 million in annual intercarrier compensation revenues.<sup>822</sup> We seek comment below on possible recovery of reduced intercarrier compensation through a variety of mechanisms, including through end-user charges such as modifications to the interstate SLC cap.<sup>823</sup> If the SLC cap is modified, should we permit recovery via the federal SLC to offset intrastate revenues reduced through access reform? If so, how could this incentive be structured, and should it decrease over time? We seek alternative proposals on what actions we can take to provide effective incentives to states to lower intrastate access rates.

546. We also seek comment on whether the Commission should provide guidance to states as they reform intrastate rates. Should we, for example, provide guidance on the timing of the transition or encourage states to set up a state universal service fund and/or rebalance local rates? For example, we seek comment on adopting a rate benchmark as part of a recovery mechanism in Section XIV below. If the Commission adopts a rate benchmark, should that be used as a guide for states that undertake rate rebalancing? Are there other guidelines the Commission should adopt? We seek comment on these issues.

547. We also seek comment on how the Commission can work in partnership with state public utility commissions that lack jurisdiction over intrastate access rates. Should carriers in these states be responsible for reducing charges or should there be a process for states or carriers to petition the Commission to set a glide path? Should the Commission act on its own to set a glide path when it is clear the state will not act to reduce intrastate access rates? How would we make the determination to act?

548. *Timeframe for State Action.* Although we would strive to work in collaboration with states, we are mindful that some state commissions may decline to act—possibly because they lack jurisdiction over intrastate rates—and such lack of action could frustrate our national goals associated with intercarrier compensation reform. We seek comment on whether, after initially relying on states to act pursuant to their historical role, the Commission should bring traffic within the reciprocal compensation framework if states fail to act within a specified period of time, such as four years. We seek comment on the merits of adopting such a “backstop” under this alternative, and how we could minimize its effects on those states that had acted to reform intrastate access. How could the Commission set a glide path that would constrain only those states that had not undertaken reform, while allowing states that had already adopted transitions to continue on the glide path determined by each state? For example, the Commission could set a glide path as a “floor” for reform and enable states that have already begun reform to adopt alternative approaches. We also seek comment on how much time would be sufficient for states to initiate proceedings and begin reform before adopting such a “backstop.” Is four years sufficient time? Should we wait until after the first phase of the CAF auctions are complete? We seek comment on these questions and invite any alternate proposals.

<sup>821</sup> As discussed above, we seek comment on requiring the provision of certifications or documentations that state action has occurred for participation in the first phase of the CAF. See Section VI.E.3.b.

<sup>822</sup> See NECA Dec. 29, 2010 *Ex Parte* Letter, Attach.

<sup>823</sup> See *infra* Section XIV.

549. How could the Commission structure any incentives for state action to ensure that states are encouraged to undertake appropriate reforms within the allotted time rather than simply waiting for the Commission to intervene in the future? For example, should the Commission decline to provide any revenue recovery for intrastate rate reductions for states that have not begun intrastate access reform by a specified date?<sup>824</sup> Should the Commission continue to limit access to the CAF only to states that have undertaken intrastate access reforms? Or should (or could) the Commission phase out federal high-cost funding in states that have not implemented reform?

#### **B. Reform Based on the 1996 Act Framework**

550. As an alternative, the Commission could use the mechanism established by section 251 of the 1996 Act to work with the states on intercarrier compensation reform. As discussed above, although section 251(g) of the Act preserved the historical intercarrier compensation rules that existed prior to 1996 on an interim basis, section 251(b)(5) established an intercarrier compensation framework broad enough to ultimately encompass the various forms of intercarrier compensation that are regulated separately today.<sup>825</sup> Under this alternative, the Commission would bring all traffic within the reciprocal compensation framework of section 251(b)(5) at the initiation of the transition, and set a glide path to gradually reduce all intercarrier compensation rates to eliminate per-minute charges (including any necessary cost or revenue recovery that might be provided through the CAF). The Commission would adopt a pricing methodology to govern these charges, which ultimately would be implemented by the states. We seek comment on the relative advantages and disadvantages of this alternative, as well as any implementation considerations.

551. In contrast to the first option—where the state and federal roles would vary based on the intercarrier compensation charge at issue—under this approach, both the state and federal roles would be the same for all types of traffic. In seeking comment on this type of approach in the past, the Commission considered whether it retained authority to regulate rates subject to its jurisdiction, such as for interstate traffic and CMRS traffic, notwithstanding the decision to bring all traffic within the section 251(b)(5) framework.<sup>826</sup> We seek further comment on that interpretation, and on the circumstances, if any, when it might be appropriate for the Commission to exercise such authority.

552. The options for sequencing and staging rate reductions under this approach are largely the same as those under the prior approach, except that the Commission would have the ability to determine the glide path for all traffic, including traffic currently subject to intrastate access charge regimes. In the alternative, the Commission could set the methodology and defer to each state to determine the transition. In addition to the alternatives discussed above, we seek comment on how the Commission should address the sequencing of intrastate rate reductions under this approach. For example, we seek comment on reducing intrastate access rates to interstate levels (leaving all other rates unchanged),<sup>827</sup> and then reducing all intercarrier rates until per-minute rates are eliminated. There is

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<sup>824</sup> See *Legislative Hearing on a Discussion Draft of the “Universal Service Reform Act of 2009” Before the Subcomm. On Communications, Technology, and the Internet of the H. Comm. on Energy and Commerce*, 111<sup>th</sup> Cong. 12-13 (2009) (statement of Ray Baum, Commissioner, Oregon Public Utility Commission on behalf of the National Association of Regulatory Utility Commissioners) (suggesting that the Commission encourage states to reform intrastate access charges by “condition[ing] receipt of federal high-cost support on the State reducing in stages intrastate access charges to mirror Federal rates”).

<sup>825</sup> See *supra* Section XI.

<sup>826</sup> See *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6592, App. A, para. 215; *id.* at 6790-91, App. C, para. 210.

<sup>827</sup> See, e.g., *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6582, App. A, para. 192; *id.* at 6780-81, App. C, para. 187. See also National Broadband Plan at 148 (recommending that intercarrier compensation reform begin by reducing intrastate rates to interstate levels).

general industry sentiment that intrastate rates should be reduced first because they are the highest,<sup>828</sup> and because eliminating the discrepancy between intrastate and interstate access charges could reduce arbitrage, such as phantom traffic. On the other hand, if interstate access rates remain unchanged during the initial stage of the transition, arbitrage such as access stimulation that is based on absolute rate levels (rather than on jurisdictional differences) would be more likely to continue. And addressing the possible need for cost or revenue recovery associated with reduced intrastate access revenues could be a significant undertaking.<sup>829</sup> We note, however, that the Commission has not previously used the federal universal service fund to offset reforms to intrastate access charges; rather, states have addressed intrastate recovery on a case-by-case basis.<sup>830</sup> We question whether the Commission has any legal obligation to offset reductions to intrastate revenues, particularly given our commitment to control the size of USF. Even so, we seek comment on whether we should offset such reductions as a policy matter.

553. Alternatively, all categories of intercarrier compensation rates could be reduced from the beginning of the transition period. In principle, depending upon the pace at which particular rates are reduced,<sup>831</sup> this potentially could both reduce the existing disparities among different intercarrier compensation rates and also help address arbitrage arising from existing intercarrier compensation rate levels. However, reducing all rates concurrently may increase any recovery from the CAF needed early in the transition, as well as the complexity of issues that need to be addressed earlier in the transition process, as compared to an approach that deferred certain types of rate reductions until later in the process. As an alternative, we seek comment on the advantages and disadvantages of reducing intrastate and interstate access rates at the same time, as well as other variations that commenters might propose.<sup>832</sup>

554. We also seek comment on how rate reductions should be structured and implemented if all traffic is brought under the reciprocal compensation framework. For example, because all of the traffic would be section 251(b)(5) traffic, would the reductions be negotiated by the carriers and reflected in interconnection agreements? Are individual negotiations preferable to a uniform glide path set by the Commission? Alternatively, should the Commission propose a default glide path for reductions, such as a percentage per year for a certain number of years, but leave carriers free to negotiate alternate arrangements? If we adopt a default glide path for rate reductions, what impact, if any, would that glide path have on existing agreements between carriers? We also seek comment on alternative approaches to structuring a glide path to eliminate per-minute intercarrier compensation rates under this approach. We

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<sup>828</sup> See Letter from Malena F. Barzilai, Regulatory Counsel & Director, Federal Regulatory Affairs, Windstream to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at 1 (filed Aug. 24, 2010) (Windstream Aug. 24, 2010 *Ex Parte* Letter); Letter from Joe A. Douglas, VP, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51 (filed Sept. 2, 2010) (Rural Alliance Sept. 2, 2010 *Ex Parte* Letter); Verizon and Verizon Wireless Comments in re NBP PN #19 at 19-20 (filed Dec. 7, 2009).

<sup>829</sup> See *supra* para. 545 (citing estimates from a NECA survey).

<sup>830</sup> The Commission has sought comment on whether and how intrastate access revenues could be replaced using some sort of federal mechanisms, but has not adopted those mechanisms. See, e.g., 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6628-34, App. A, paras. 294-310; *id.* at 6827-32, App. C, paras. 289-305; *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4735-36, paras. 114-15.

<sup>831</sup> For example, both interstate and intrastate access charges could be reduced at the same pace—such as equal annual increments or percentage reductions—over a staged transition. Alternatively, if intrastate access rates currently are higher than interstate access rates, intrastate access rates could be reduced more quickly until they are at the same level as interstate rates. Of course, given the magnitude of intrastate access charges, accelerated intrastate access rate reductions may have a larger financial impact for certain carriers.

<sup>832</sup> Indeed, even with respect to access charge reductions, the Commission potentially might distinguish among the different *components* of access charges. For example, rate reductions might focus initially on terminating access, with originating access rates addressed later in the transition.

also seek comment on whether there are any technical issues that we would need to address at the beginning of the transition in order to begin reforming reciprocal compensation rates at that time.<sup>833</sup>

555. Finally, one industry proposal recommends that the Commission establish a glide path to reduce intrastate rates to interstate levels and then reassess the status of intercarrier compensation before finalizing the transition. Specifically, they suggest that the Commission “decline to set further rate reductions (beyond the interstate level) until after it can assess financial conditions in the wake of the first stage of reforms.”<sup>834</sup> We seek comment on this suggestion, as well as our legal authority to do so.

### C. Other Transition Issues

556. As a general matter, we seek comment on how our interstate access rules applicable to rate-of-return and price cap carriers would need to be revised as part of the interstate access rate reduction process. We request that commenters identify specific rule sections that would need to be revised and explain what revisions would, in their view, be required. We invite parties to submit proposed rule changes with their comments and identify the timing of the proposed transition and the methodology used to reduce rates during the glide path. We also invite comment on whether any changes to intrastate access rules—such as rules governing intrastate access rate structures—would be needed under particular alternatives.

557. More specifically, we also seek comment on the need to cap interstate access rates. If, during the transition period over which the glide path operates, interstate minutes of use continue to decline, rate-of-return carriers’ interstate access rates would continue to increase.<sup>835</sup> Therefore, if intercarrier compensation reform begins by reducing intrastate access rates, we seek comment on whether the Commission should cap rate-of-return carriers’ interstate access rates at existing levels during stage one of the transition.<sup>836</sup> We seek comment on any other issues we should consider in conjunction with such a cap, and ask whether changes to our rate-of-return rules would be necessary to effectuate such a freeze and, if so, what rule changes would be necessary or appropriate under those circumstances.<sup>837</sup>

558. If commenters do not believe a cap is the best way to prevent an increase in intercarrier compensation rates prior to rates being put on a declining glide path, what alternative measures are available to ensure that carriers do not increase intercarrier compensation rates prior to the start of the transition? Do commenters see any other possible arbitrage opportunities created by the transitions proposed above? In Section VI.A above, we seek comment on eliminating local switching support, or combining LSS with HCLS.<sup>838</sup> What impact would such a proposal have on interstate access rates? Does such a proposal impact commenters’ opinions on whether or not we should cap interstate access rates?

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<sup>833</sup> We seek comment below on technical issues associated with intercarrier compensation reform. *See infra* Section XVI.

<sup>834</sup> Windstream Aug. 24, 2010 *Ex Parte* Letter at 2; *see also* Letter from CenturyLink, Consolidated Communications, Frontier Communications Corporation, Iowa Telecommunications Services, Inc. and Windstream Communications, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 3-4 (Dec. 7, 2009) (Broadband Now Plan).

<sup>835</sup> *See supra* Section I.

<sup>836</sup> *See* Rural Alliance Sept. 2, 2010 *Ex Parte* Letter (suggesting one of the near-term steps to intercarrier compensation reform the Commission could take is capping interstate access rates at their existing levels). In response to the 2008 *Order and ICC/USF FNPRM*, NTCA suggested allowing state commissions to voluntarily lower intrastate access rates and “[f]reezing interstate tariffed access rates . . . in order to keep cost-based rates from increasing as a result of demand decreases.” NTCA 2008 ICC/USF FNPRM Comments at 8.

<sup>837</sup> *See supra* Section XIV.

<sup>838</sup> *See infra* Section VI.

#### XIV. DEVELOPING A RECOVERY MECHANISM

559. In this section, we seek comment on how to structure a recovery mechanism as part of comprehensive reform, including threshold questions of how to evaluate the need for recovery of reduced intercarrier compensation (whether focusing on costs, revenues, or both), and how to structure such recovery with the appropriate incentives to accelerate the migration to all IP networks, including IP interconnection. We discuss proposals for recovery first from end users, such as through a rate benchmark as a means of accounting for existing revenue streams, and the appropriate role, if any, of interstate SLCs. At the same time, we also recognize that some high-cost, rural, insular, and Tribal areas may lack a private sector business case to provide service at affordable rates and seek comment on whether providers may need additional support from the CAF and, if so, the criteria that should be met to receive such support. In commenting on the proposals below, we reiterate our commitment to controlling the size of the universal service fund. In section VI.E.3 above, we seek comment on rationalizing CETC support over five years, cutting IAS support over two years, and using those funds to expand broadband coverage through the CAF. During the transition period to long-term CAF reform, any universal service support associated with intercarrier compensation reform would also derive from the same sources – savings realized from reductions to existing support mechanisms. We ask commenters how best to structure any CAF support for recovery of reduced intercarrier compensation, and, in particular, how best to balance the goals of expanding broadband coverage, ensuring adequate recovery for providers, and controlling the size of the CAF.

##### A. Threshold Considerations

560. Various possible mechanisms for recovery may be appropriate either as intercarrier compensation reform is ongoing, or once reform is complete. As an initial matter, however, we consider certain threshold issues that will inform our analysis of specific recovery alternatives.

561. In contrast to interstate access charge reform a decade ago, today we are faced with a telecommunications industry transitioning to all-IP networks. And the universal service reforms proposed above seek to reinforce, and facilitate, this trend. In this environment, non-regulated services are an increasingly important source of revenues derived from multi-purpose networks. Consequently, our analysis of recovery needs should not be limited to the voice-centric approach that has tended to characterize prior reform efforts. We seek comment below regarding the development of a recovery framework to accompany intercarrier compensation and universal service reform that reflects the ongoing marketplace evolution, including the data necessary to meaningfully develop and analyze such recovery mechanisms.

562. As an initial matter, we seek comment on the objectives for any recovery mechanism and, relatedly, any Commission obligations with regard to recovery from both a legal and policy perspective. Specifically, what are the Commission's legal obligations with regard to recovery? Would these obligations vary depending on the reform approach ultimately adopted? Certainly, one primary consideration is the need to maintain affordable end-user rates.<sup>839</sup> In addition, should our objectives for recovery be focused on providing incentives to transition to broadband, ensuring the ability of carriers to continue to provide voice service, securing investment and developing advanced services, or some

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<sup>839</sup> In prior intercarrier compensation reforms, for example, the Commission sought to balance the role of cost-causation principles in setting economically rational rates with concerns about the impact on subscribership from increased end-user charges. See, e.g., *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982, 15992-93, 16004-07, paras. 24, 54-66 (1997) (*Access Charge Reform Order*) (subsequent history omitted); *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Memorandum Opinion and Order, 97 FCC 2d 682, 688-89, para. 10 (1983) (*First Reconsideration of 1983 Access Charge Order*) (subsequent history omitted); *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241, 253, para. 35 (1983) (*1983 Access Charge Order*).

combination thereof? What other objectives should the Commission consider and what are the relevant priorities of these objectives?

563. Moreover, in a separate proceeding, the Commission is evaluating reform of the jurisdictional separations process.<sup>840</sup> For the recovery mechanisms discussed below, we seek comment on how each approach may affect and be affected by the existing separations process and any future separations reform. Specifically, we seek comment on whether the recovery mechanisms under consideration here would affect the costs currently allocated to intrastate categories. Parties should address these and any other issues relevant to the relationship between a recovery approach and the separations process.

## **B. Determining the Type and Amount of Recovery**

564. *Cost Recovery.* In adopting a recovery mechanism we ask, as a threshold matter, whether we should be evaluating carrier costs, carrier revenues, or some combination thereof. The National Broadband Plan references an opportunity for “adequate cost recovery.”<sup>841</sup> Is this the right standard? Should we evaluate a carrier’s costs associated with switching and transport in determining the need for recovery? If so, should we evaluate such costs as intercarrier charges are reduced during the transition or should we evaluate intercarrier revenues at some baseline to determine the need, if any, for alternative recovery during this period?

565. What cost standard or cost components should be considered when determining what recovery should be allowed? Parties supporting a cost-based approach to recovery should address these issues and provide specific data to assist the Commission in determining whether this is the right approach. In particular, parties should focus on the local switching and transport cost characteristics in evaluating the efficiencies that could be achieved as networks transform to all IP, noting particularly any cost differences that may exist in rural networks serving high-cost, insular or Tribal areas. Parties should also consider the extent to which today’s usage of the interoffice transport networks could shift over time to special access or some dedicated transmission alternative.

566. Further, would a cost-based approach provide incentives to make prudent and efficient investment decisions or would carriers be inclined to exaggerate or maximize costs to secure additional recovery? What, if any, are the Commission’s legal obligations concerning recovery of a carrier’s costs and would such obligations change depending on the reform approach adopted? In 2005 and 2008, the Commission sought comment on moving intercarrier compensation rates within the reciprocal compensation framework of section 251(b)(5).<sup>842</sup> In so doing, the Commission sought comment on interpreting section 252(d)(2)’s statutory language regarding the “additional costs”<sup>843</sup> associated with terminating reciprocal compensation calls as an incremental, rather than average, cost standard.<sup>844</sup> If the Commission focuses on costs, is this the right approach to determining a provider’s costs of originating, transporting and terminating traffic? Although much of the remainder of this section discusses revenue recovery rather than cost recovery, we ask parties supporting a cost recovery approach to address any

<sup>840</sup> See *2009 Jurisdictional Separations Referral Order*, 24 FCC Rcd at 6167–69, paras. 15–20 (2009). See also *2010 Jurisdictional Separations Public Notice*, 25 FCC Rcd 3336 (2010).

<sup>841</sup> National Broadband Plan at 148.

<sup>842</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4721-23, paras. 78-82; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6588-99, App. A, paras. 207-29; *id.* at 6786-98, App. C, paras. 202-24.

<sup>843</sup> Section 252(d)(2) of the Act sets an “additional cost” standard for reciprocal compensation rates under section 251(b)(5). 47 U.S.C. § 252(d)(2)(A). Thus, we seek comment on the relationship, if any, between these (or other) statutory obligations and the recommendation to provide an opportunity for adequate cost recovery.

<sup>844</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4719, paras. 71-73; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6610-18, App. A, paras. 253-267; *id.* at 6806-16, App. C, paras. 248-63.

additional issues raised in this section from a cost recovery rather than, or in addition to, a revenue recovery perspective.

567. *Revenue Recovery.* Existing intercarrier compensation revenues may represent 10-30 percent of some carriers' regulated revenues.<sup>845</sup> Such revenues may exceed the costs, however defined, of providing origination, transport, and termination functions. As a result, should the Commission focus on recovery of reduced intercarrier compensation revenues instead of or in addition to costs? If we consider intercarrier compensation revenues as the basis for recovery, how should we evaluate or define revenues? For example, should "revenues" include a company's gross intercarrier revenue or should it be based on net intercarrier compensation, which we define as being a company's total intercarrier compensation revenue (including but not limited to interstate access, intrastate access and reciprocal compensation) less its intercarrier compensation expense (including access expenses paid by affiliated long distance and wireless companies, reciprocal compensation payments, as well as pass through access charges via wholesale long distance arrangements)? Should we evaluate only regulated revenues or include non-regulated revenues? We seek comment on these issues, and request data below on intercarrier compensation revenues and expenses to help us evaluate the potential size of any revenue recovery mechanism.

568. As we evaluate revenue recovery, we do not believe that recovery needs to be revenue neutral given that carriers have a variety of regulated (e.g., not only switched but also special access) and non-regulated revenues.<sup>846</sup> Indeed, some parties question whether and to what extent it is necessary to establish any recovery mechanism specifically to address the effects of intercarrier compensation reform.<sup>847</sup> We ask whether an adequate opportunity for recovery already exists given the variety of

<sup>845</sup> See, e.g., NECA Comments in re NBP PN #19, filed Dec. 7, 2009, at 27 (representing that, in 2005, an average 29 percent of its incumbent carriers' revenues came from intercarrier compensation, and some carriers received up to 49 percent of revenues from intercarrier compensation); ITTA Comments in re NBP PN #19, filed Dec. 7, 2009, at 6 ("A survey of ITTA members revealed that approximately 12 percent of member carrier revenues are obtained via ICC.").

<sup>846</sup> See, e.g., Ad Hoc 2008 ICC/USF FNPRM Comments at 7-8 (stating that revenue neutrality is neither required nor justified); CTIA 2008 ICC/USF FNPRM Comments at 35-37 (urging the Commission to reject calls for revenue neutrality and to take all revenue opportunities into account when targeting support); NCTA 2008 ICC/USF FNPRM Comments at 5 (observing that "[c]arriers generally have numerous retail revenue streams – both regulated and unregulated – from which to recover the costs of operating their networks and that dollar-for-dollar replacement of 'lost' access revenues is unnecessary"); Letter from David C. Bergmann, Assistant Consumers' Counsel, Chair – NASUCA Telecommunications Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 05-337, 07-135, 10-90, GN Docket No. 09-51, at 2 (filed Oct. 15, 2010) (maintaining that "[t]here should be no guaranteed recovery of lost revenues" and that any consideration of lost revenues must "take into account sources of increased revenues (such as from broadband), and intracompany revenues transfers"); Letter from Michael R. Peevey, President, California Public Utilities Commission, *et al.*, to Hon. Kevin Martin, Chairman, FCC, *et al.*, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 04-36, at 5 (filed Oct. 28, 2008) (stating that "California does not support the 'revenue neutrality' concept" and "that recovery of lost revenue should be a net recovery that takes into account such factors as the natural decline in revenue due to competition from other communications technologies such as wireless, VOIP, and CLECs"); Letter from Joseph K. Witmer, Assistant Counsel, Pennsylvania Public Utility Commission *et al.*, to Marlene Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 05-337, 06-122, at 7 (filed Oct. 27, 2008) (arguing that "[t]he premise that ICC reform must equate to revenue neutrality for affected carriers is flawed and should be rejected"). But see, e.g., Windstream 2008 ICC/USF FNPRM Comments at 41-42 (stating that "[a] reasonable recovery mechanism must be part of any significant intercarrier compensation reform" and that "[t]he mechanism need not guarantee 'absolute revenue neutrality' for mid-sized carriers, but it should be sufficient to ensure that these carriers are able to continue providing affordable, quality services in rural areas as required by Section 254 of the Act"); Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket Nos. 05-337, 04-36, Attach. at 5 (filed Sept. 19, 2008) (maintaining that "[r]evenue neutrality and long term revenue stability should be foundational reform goals in order to ensure long term network investment").

<sup>847</sup> See, e.g., Letter from Ben Scott, Policy Director, Free Press to Marlene H. Dortch, Secretary, FCC, WC Docket (continued....)

regulated and non-regulated services provided over multi-purpose networks. If so, how would the Commission evaluate whether a provider has sufficient revenues so that it does not need any additional recovery? The Commission could, for example, evaluate a price cap company's total switched and special access revenues to determine if recovery from intercarrier compensation reform generally or access to the CAF was warranted. If special access revenues are increasing, the Commission could evaluate whether such increases offset the decline in switched access revenues. But what if special access revenues were declining? Similarly, for a rate-of-return carrier, the Commission could evaluate whether a carrier has the opportunity to earn its authorized rate of return across its switched and special access revenue requirements rather than just switched access.

569. Alternatively, or in addition, the Commission could evaluate total company regulated and non-regulated revenues. Under our "no barriers" policy, a significant portion of rate-of-return carriers' costs, including costs of upgrading the network with fiber for broadband, is allocated to regulated services, even though non-regulated services increasingly have been provided using that same network, and have accounted for an increasing percentage of revenue.<sup>848</sup> As a policy matter, when evaluating recovery in the context of intercarrier compensation reform, it is unclear why the Commission would simply ignore all revenues earned from such services. If so, what information would the Commission need to collect for privately-held companies to evaluate a provider's total revenues? Should carriers seeking recovery be required to file such data with the Commission or USAC? We seek comment on these and related issues concerning the appropriate role of regulated and non-regulated revenues in any revenue recovery proposal.<sup>849</sup>

570. If the Commission uses a revenue approach for recovery, what should the baseline criteria be for determining whether a carrier qualifies for revenue recovery?<sup>850</sup> Commission data and the record show that carriers are losing lines and experiencing a decrease in minutes-of-use.<sup>851</sup> Should these patterns be considered as part of any projection and, if so, how should such trends be reflected in a calculation of needed revenue recovery? Alternatively, should we consider intercarrier compensation revenues that are actually billed or received as of a particular point in time? Is it appropriate to consider disputed intercarrier compensation revenues in any calculation of revenues to be recovered? Is there a way to define the revenues subject to recovery in a way to encourage carriers to retain customers and hence, end-user revenues?

571. We also seek comment on whether reductions in intercarrier compensation rates would impact all carriers in a similar manner. Should the recovery approach adopted (i.e., cost-based versus revenue-based) be different depending on the type of carrier or type of regulation? For example, because

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Nos. 05-337, 06-122, CC Docket Nos. 01-92, 96-45 at 8 (filed Oct. 24, 2008); Letter from David C. Bergmann, Assistant Consumer's Counsel, Chair -- NASUCA Telecommunications Committee, to Kevin Martin, Chairman et al., FCC, WC Dockets Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Dockets Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286 at 4-6 (filed Sept. 30, 2008); Letter from James S. Blaszk, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 05-337, 99-68, 07-135, Attach. at 7-8 (filed Oct. 14, 2008).

<sup>848</sup> See *supra* para. 52.

<sup>849</sup> For instance, we seek comment on whether revenues from non-regulated services should be considered as part of any benchmark proposal. See *infra* Section XIV.C.I.

<sup>850</sup> We note that the proposal to eliminate LSS may impact any baseline we establish in determining whether cost or revenue recovery is necessary. See *supra* Section VI.A.3.

<sup>851</sup> See, e.g., *Sept. 2010 Trends in Telephone Service*, at Table 7.1, Chart 10.1; 2010 Universal Service Monitoring Report at Table 8.1; Letter from Donna Epps, Vice President – Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 1 (filed Oct. 28, 2010); Letter from Mary L. Henze, Assistant Vice President – Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51 Attach. at 3-4 (filed Nov. 24, 2009).

of competition, long distance providers experiencing reduced switched access charges will experience cost reductions that may be passed on to purchasers of long distance services—whether wholesale or retail customers. Is it appropriate for the Commission to consider the degree to which cost savings are or should be passed through when determining the necessary amount of revenue recovery? We note that there appear to be significant complexities associated with determining the magnitude of cost savings passed on to consumers.<sup>852</sup> We seek comment on these issues.

572. To support our consideration of a revenue recovery mechanism, the Commission requests data to analyze existing revenues, assess the magnitude of the revenue reductions resulting from the proposed reforms, and determine the appropriate size and scope of a recovery mechanism. In requesting these data, we seek to minimize the burden on commenters while requesting sufficient information to enable the Commission to develop and size a recovery mechanism. In particular, we request information regarding switched access revenue, expense, and minutes of use (MOU), on a by-provider, by-state basis for intrastate access, interstate access, and reciprocal compensation. For NECA pool carriers, this would include both billable and settlement revenue. Additionally, we request total regulated revenue and total revenue to understand the significance of intercarrier compensation revenue as a percent of total regulated revenue and total revenue. We also request information concerning residential rates. All such requests are made for annual data from 2008 to 2010, pro-forma for all mergers, acquisitions and divestitures.<sup>853</sup> We recognize the commercially sensitive nature of this information, and have established a protective order in this docket to permit the data to be provided subject to confidentiality protections.<sup>854</sup>

## C. Evaluating Reasonable Recovery from End-Users

### 1. Residential Benchmark

573. Consistent with our goal of reforming universal service to support voice and broadband, we seek comment on how to structure a benchmark to recognize ongoing consumer migration from voice only to voice plus broadband services, and the evolution of circuit-switched networks to IP networks. We seek comment on tools, such as rate benchmarks and imputation of benchmark revenues, that might be used as part of revenue recovery both today, and as the marketplace fully transitions to broadband networks.<sup>855</sup> In particular, we seek comment on using a rate benchmark based on local rates for voice service at the outset and transitioning to a rate benchmark for voice and broadband at the end of the transition.<sup>856</sup>

574. With respect to state revenue sources, commenters previously have proposed various “local rate benchmarks” to address the considerable variation among states today in their regulation of residential rates. In particular, we note that some states already have reduced intrastate access charges

<sup>852</sup> See DEBRA J. ARON, *ET AL.*, AN EMPIRICAL ANALYSIS OF REGULATOR MANDATES ON THE PASS THROUGH OF SWITCHED ACCESS FEES FOR IN-STATE LONG-DISTANCE TELECOMMUNICATIONS IN THE U.S. at 6-11, 30-31 (Oct. 14, 2010), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1674082](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674082).

<sup>853</sup> If providers choose to use it, a sample data template will be available on the Commission’s website at <http://www.fcc.gov/wcb/ppd/iccdatatemplate.xls>. We urge that providers file such information with their opening comments.

<sup>854</sup> See *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Protective Order, 25 FCC Rcd 13160 (WCB 2010).

<sup>855</sup> Under a benchmark approach, the benchmarked rate is imputed to the carrier for purposes of determining support, but carriers typically are not required to raise their rates to the benchmark level.

<sup>856</sup> We seek comment in para. 149 and note 223, *supra*, about developing a rate benchmark for voice and broadband services to satisfy Congress’s requirement that universal service ensure that services are available to all regions, “including rural, insular, and high cost areas,” at rates that are “affordable” and “reasonably comparable” to those in urban areas. 47 U.S.C. §§ 254(b)(1), (3). If the Commission adopts a rate benchmark in this context, should the Commission use this benchmark for purposes of an intercarrier compensation recovery mechanism as well?

significantly, often accompanied by the opportunity to increase end-user charges, receive funds from a state universal service mechanism, or some combination.<sup>857</sup> A benchmark potentially could help achieve greater equality in the treatment of states that have already undertaken significant intercarrier compensation and universal service reform and those that have not yet done so. In particular, under various proposals, a certain amount of intrastate revenue would be imputed to the carriers in a state that has not reduced intrastate rates, rather than being eligible for recovery through a federal revenue recovery mechanism.<sup>858</sup> In principle, such a benchmark should encourage states that had not yet undertaken such reforms to begin doing so.<sup>859</sup> If the Commission adopts a rate benchmark, we propose, consistent with the National Broadband Plan, that benchmark revenues be imputed to carriers, before becoming eligible for additional revenue recovery. Doing so rewards states that have already rebalanced rates and should encourage other states to increase previously subsidized (i.e., artificially low) residential rates.<sup>860</sup> We seek comment on this proposal and whether imputation adequately rewards states that have rebalanced rates and encourages other states to do the same.

575. We seek comment on how the Commission should select a rate benchmark. The Commission has previously sought comment on the use of a revenue benchmark or threshold in the context of comprehensive intercarrier compensation reform,<sup>861</sup> which was supported by several parties,<sup>862</sup> and we invite parties to refresh the record on their views of the appropriate rate benchmark. Although most of the proposals in the record date back to 2008,<sup>863</sup> we note that the Nebraska Rural Independent

<sup>857</sup> See, e.g., AT&T Oct. 25, 2010 *Ex Parte* Letter, Attach. 1, 2; Early Adopter State Commission Comments on the Missoula Plan at 6, 10 (describing efforts to reduce intrastate access charges and establish state universal service funds). See also, e.g., In the Matter of the Commission's Investigation into Intrastate Carrier Access Reform Pursuant to Sub. S.B. 162, Case No. 10-2387-TP-COI, Entry, App. A (Ohio Commission Nov. 3, 2010) (providing details of the state Access Restructuring Plan, including a state recovery mechanism); In re Iowa Telecommunications Association, Docket Nos. TF-07-125, TF-07-139, Order Denying Requests for Reconsideration and Denying Motion to Vacate Stay, at 12-16 (Iowa Commission Jan. 8, 2009) (rejecting a request by Iowa Telecommunications Association for a phased-in reduction of access charges).

<sup>858</sup> See, e.g., National Broadband Plan at 148 (citing proposals to "impute local rates that meet an established benchmark"); see also Letter from Joe A. Douglas, Vice President – Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, Attach. at 7 (filed Jan. 27, 2011) (proposing an urban benchmark to make "rural rates and services reasonably comparable to urban").

<sup>859</sup> See, e.g., *id.* at 148 (describing the possible state incentives arising from the adoption of a benchmark).

<sup>860</sup> See generally AT&T Oct. 25, 2010 *Ex Parte* Letter, Attach. at 3 (indicating residential rates of less than \$8).

<sup>861</sup> See 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6632-33, App. A, paras. 306-07; *id.* at 6831-32, App. C, paras. 301-02.

<sup>862</sup> See, e.g., Nebraska Public Service Commission 2008 ICC/USF FNPRM Comments at 8; Windstream 2008 ICC/USF FNPRM Comments at 6, 8; AT&T 2008 ICC/USF FNPRM Reply at 9 n. 19; Minnesota Independent Coalition 2008 ICC/USF FNPRM Reply at 16; North Carolina Telephone Cooperative Coalition 2008 ICC/USF FNPRM Reply at 2; Windstream 2008 ICC/USF FNPRM Reply at 15-16; Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 05-337, 06-122, at 7 (filed Oct. 14, 2008).

<sup>863</sup> See, e.g., Minnesota Independent Coalition 2008 ICC/USF FNPRM Comments at 11 (supporting a benchmark using either a state-by-state average local rate calculation or adopting the 2008 national average benchmark of \$20.76); NTCA 2008 ICC/USF FNPRM Comments at 3, 10-11 (suggesting a federal benchmark of \$20); TCA 2008 ICC/USF FNPRM Comments at 9 (supporting a benchmark based on the 2008 national urban local exchange rate of \$20.76); USTA 2008 ICC/USF FNPRM Comments at 7-8 (discussing the Missoula Plan's national benchmark of \$25 with a \$20 lower end adjustment); Fred Williamson and Associates 2008 ICC/USF FNPRM Reply at 10 (proposing a \$20 benchmark rate); Windstream 2008 ICC/USF FNPRM Reply at 15-16 (suggesting a benchmark based on the 2008 national urban local exchange rate of approximately \$20.76). See also Letter from Jeffrey S. Lanning, Director – Federal Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, GN Docket No. 09-51, Attach. at 2 (filed Nov. 4, 2010) (noting that the benchmark "must be no higher (continued....)

Companies recently encouraged the Commission to set the rate benchmark at \$19.50 for residential service, which, after SLCs and other fees, is close to \$30, noting “[i]t is important that customers in early-adopter states such as Nebraska that have rebalanced rates are not treated unequally by adoption of a benchmark that is too low.”<sup>864</sup> We seek comment on this proposal. Commenters advocating a lower benchmark should explain how doing so does not penalize states that have already undertaken intercarrier compensation reform and rebalanced rates.

576. We seek comment on what elements should be included in a rate benchmark and whether we should distinguish between discretionary end-user charges, charges mandated by state or federal regulators, and/or pass-through fees paid by the carrier. Prior benchmark proposals in the record have included various combinations of discretionary and mandatory charges. The proposed elements have included the local residential rate, federal subscriber line charges, SLC-like charges (e.g., interconnection charges or network access fees), mandatory Extended Area Service (EAS) charges, per-line state universal service fund end-user collections, and Telecommunications Relay Service (TRS) charges.<sup>865</sup> We seek comment on these proposals and on what elements should be included in any rate benchmark. We also seek comment on the timing of the revenue benchmark, and whether it should be implemented and imputed in the first year or whether it should be phased in, as some of the mid-size carriers recommend.<sup>866</sup>

577. As consumers move from voice to broadband, we propose adopting a rate benchmark that gradually increases over time from a benchmark for voice services to a benchmark for voice and

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than competitive levels” and should not exceed \$25); Letter from Jeffrey S. Lanning, Director – Federal Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. to Broadband Now Plan at 3 (filed Jan. 6, 2010) (attaching Letter from CenturyLink, Consolidated Communications, Frontier Communications Corp., Iowa Telecommunications Services, Inc., and Windstream Communications, Inc. to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-47, 09-51, 09-137, CC Docket No. 96-45, 99-200, 96-98, 01-92, 99-68, WC Docket No. 03-109, 06-122, 04-36 ((dated Dec. 7, 2009) (setting the residential benchmark at \$23.50 for mid-sized price cap carriers under the Broadband Now Plan) (Broadband Now Plan).

<sup>864</sup> NE Rural Nov. 12, 2010 *Ex Parte* Letter, at 2 (the local benchmark was originally set at \$17.50 monthly for residential service and \$27.50 monthly for business service, however the residential benchmark for rural areas was increased in 2006 to \$19.95). The benchmarks do not include the federal SLC or the state USF surcharge. *Id.*

<sup>865</sup> The following parties included at a minimum, the basic service rate, SLC, and mandatory EAS charges in their benchmark. *See, e.g.*, NTCA 2008 ICC/USF FNPRM Comments at 3, 10-11 (also including a per-line contribution to state USF collections and specifying that state and federal SLC are to be included in benchmark); OPASTCO and WTA 2008 ICC/USF FNPRM Comments, Attach. 2 at A-8 (listing similar benchmark components to NTCA above); Rural ETCs in Arkansas 2008 ICC/USF FNPRM Comments at 3-4 (favoring inclusion of 911, universal service and other required state and federal regulatory surcharges into the benchmark); TCA 2008 ICC/USF FNPRM Comments at 9 (contending that the benchmark should also include a per-line contribution to state high-cost fund); USTA 2008 ICC/USF FNPRM Comments at 7-8 (including USF fees dedicated to access reduction as well as state and local SLCs); Fred Williamson and Associates 2008 ICC/USF FNPRM Reply at 10 (specifying that the benchmark should include state and federal SLCs and per line state USF collections); Letter from Melissa Newman, Vice President – Federal Relations, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 07-135, 04-36, GN Docket No. 09-51, Attach. at 7 (filed Aug. 30, 2010) (Qwest Aug. 30, 2010 *Ex Parte* Letter) (proposing the same basic benchmark elements as the others parties listed above: basic local exchange rate, mandatory EAS and a SLC). *See also* Broadband Now Plan at 3 (proposing a benchmark including the basic service rate, subscriber line charges, and mandatory EAS charges); Letter from Susanne A. Guyer, Senior Vice President – Federal Regulatory Affairs, Verizon, to Chairman Kevin J. Martin *et al.*, FCC, CC Docket Nos. 96-45, 01-92, Attach. at 7 (filed Sept. 12, 2008) (Verizon Sept. 12, 2008 *Ex Parte* Letter) (specifying that federal and any state SLCs would be included in its proposed benchmark).

<sup>866</sup> *See* Broadband Now Plan at 4.

broadband services.<sup>867</sup> We note that carriers have advocated the Commission include broadband revenues in a rate benchmark,<sup>868</sup> and seek comment on whether the non-regulated revenues should be limited to broadband or include other non-regulated revenues. How would the benchmark level of non-regulated revenues be established? As the marketplace increasingly transitions to broadband networks and services, how should the benchmark change over time to reflect this evolution? For example, could a benchmark increase by \$1.00 or \$2.00 each year to phase in a transition from a benchmark reflecting retail voice service rates to one reflecting retail broadband service rates? What impact would such a rate benchmark approach have on Tribal lands, which are historically economically disadvantaged areas with telephone penetration rates below the national average? At the same time, we note that not all consumers do or will subscribe to broadband. If this approach is adopted, how should we account for consumers that subscribe to voice-only services?

578. Finally, we note that Nebraska has adopted separate benchmarks for residential and business rates.<sup>869</sup> We seek comment on this approach and whether it would be useful to incorporate a business rate benchmark into any framework we adopt. Parties supporting adoption of a business rate benchmark should address how to select a business revenue benchmark, what services and elements should be included, and how it should be implemented.

## 2. Interstate Subscriber Line Charges

579. The Commission's prior reforms of interstate access charges often allowed carriers to recover at least part of their costs through an increased interstate subscriber line charge or SLC, which is a flat-rated charge that recovers some or all of the interstate portion of the local loop from an end user. We seek comment on the role that interstate SLCs should play in intercarrier compensation reform and the ongoing relevance of the SLC as the marketplace moves to IP networks.

580. Currently, SLCs charged by incumbent LECs are subject to an absolute cap that varies based upon whether the line is: (a) a primary residential or single-line business (\$6.50); (b) a non-primary residential line (\$7.00 for price cap LECs); or (c) a multi-line business or Centrex line (\$9.20).<sup>870</sup> We seek comment on whether there are ways to modify the operation of SLCs to enable additional end-user recovery before increasing the SLC cap. For example, should the Commission consider allowing (or requiring) carriers to set each SLC at its respective cap before allowing additional recovery through other

<sup>867</sup> In the past, certain providers recommended that a benchmark be used to consider certain non-regulated revenues. See, e.g., CTIA 2008 ICC/USF FNPRM Comments at 36; Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 7.

<sup>868</sup> See, e.g., Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 6-7 (urging the adoption of a \$22-26 benchmark for average urban flat-rate residential local service, or a benchmark that incorporates the LEC's average revenue per local exchange line from all sources including vertical features and broadband services).

<sup>869</sup> See NE Rural Nov. 12, 2010 *Ex Parte* Letter, Attach. at 2.

<sup>870</sup> See *supra* paras. 47. The current SLC ceilings, \$6.50 for residential and single-line business customers and \$9.20 for multi-line business and Centrex customers, were adopted as part of the 2000 *CALLS Order* and 2001 *MAG Order*. See *CALLS Order*, 15 FCC Rcd at 12991, 13004, paras. 76, 105-06; *MAG Order*, 16 FCC Rcd at 19634, 19638, paras. 42, 51.

The actual SLC cap may be lower than the absolute cap, however. For LECs subject price cap regulation, the actual cap is equal to "the Average Price Cap CMT Revenue per Line month as defined in § 61.3(d)" if it is lower than the absolute cap. See generally 47 C.F.R. § 69.152 (d), (e), and (k). Average Price Cap CMT Revenue per Line month is calculated using the maximum total revenue a filing entity would be permitted to receive from End User Common Line charges under § 69.152, Presubscribed Interexchange Carrier charges (PICCs) under § 69.153, Carrier Common Line charges under § 69.154, and Marketing under § 69.156, as of July 1, 2000, using Base Period lines. This amount excludes Universal Service Contributions assessed to local exchange carriers pursuant to § 54.702 and may be adjusted for exogenous cost changes. See 47 C.F.R. §§ 69.3(c), (cc).

For rate-of-return LECs, the actual cap is equal to the projected monthly revenue requirement for an end user common line" if that amount is less than the absolute cap. See generally 47 C.F.R. § 69.104(n) and (o).

sources, such as federal universal service funds?<sup>871</sup> We also seek comment on whether there are benefits associated with further disaggregating the categories of SLCs or making other changes to the structure of the SLC. For example, should the Commission establish separate residential and single-line business SLCs?<sup>872</sup> Should the Commission establish a non-primary residential line SLC for rate-of-return carriers?

581. We invite comment on whether the Commission should permit carriers to assess SLCs that, instead of being a flat charge for all customers, could vary depending on a customer's usage of the network. Adopting a range of SLCs could reduce the SLC rate for certain consumers that are light users of the network today. For example, should the Commission adopt rules permitting carriers to assess differing SLC levels depending on a customer's local switching and transport network usage? Parties supporting this approach are invited to comment on how many SLC rate levels would be appropriate, and why, and how the rates for each level should be developed. For example, if the Commission were to maintain a residential rate category with three rate levels, should residential customers be classified in equal groups reflecting low, medium, and high usage? How would those usage levels be determined? Or, is there a usage level that should be associated with each rate level? We also ask parties to suggest alternate approaches for implementing variable SLC increases.

582. Many parties have urged the Commission to increase SLC caps as a means of recovery. Most commenters supported the 2008 *Order and ICC/USF FNPRM* proposal to increase the residential SLC by \$1.50 and a multiline business increase of \$2.30,<sup>873</sup> and some parties have urged a residential SLC increase of up to \$4.00 depending in part on the operation of a benchmark mechanism.<sup>874</sup> We seek comment on those proposals. If the Commission were to modify the SLC caps, how much should particular SLC caps change, and how would those changes be implemented? For instance, should any SLC increases be phased in over time and should the timing be different for discrete SLC caps?

583. We note that the National Broadband Plan suggested that the Commission consider whether to deregulate SLC caps in areas where states have deregulated local service rates.<sup>875</sup> We seek comment on that suggestion. We also recognize that many states have already undertaken reform to reduce intrastate access rates, and several states have reduced intrastate access rates to interstate rate levels.<sup>876</sup> Should the Commission limit SLC increases in the initial stages to states that have not

<sup>871</sup> 2008 *ICC/USF FNPRM*, 24 FCC Rcd at 6639 App. A para. 320; *id.* at 6838, App. C, para. 316.

<sup>872</sup> *Qwest Phoenix Forbearance Order*, 25 FCC Rcd at 8655, para. 60 n.185.

<sup>873</sup> See 2008 *Order and ICC/USF FNPRM*, 24 FCC Rcd at 6630, App. A, para 298; *id.* at 6828-29, App. C, para. 293 (describing a \$1.50 increase to the residential SLC, a \$1.50 increase to the non-primary residential SLC and a \$2.30 increase to the multiline business SLC). A number of parties supported these increases. See, e.g., Embarq 2008 *ICC/USF FNPRM* Comments at 7; Frontier 2008 *ICC/USF FNPRM* Comments at 6; ITTA 2008 *ICC/USF FNPRM* Comments at 9; USTA 2008 *ICC/USF FNPRM* Comments at 7. More recently, the mid-size carriers proposed a SLC increase of \$1.50. See *Broadband Now Plan* at 3-4. Specifically, a carrier would be permitted to increase its total retail rate, including the SLC, by no more than \$1.50 each year until it reached a final benchmark rate of \$23.50 and the carrier would be imputed revenue equal to that amount regardless of whether it actually increased its rates for purposes of determining whether it would receive any additional USF support. *Id.*

<sup>874</sup> See, e.g., Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 6 (proposing SLC increases of up to \$4.00 or more depending on whether the benchmark amount is reached); Letter from Brian J. Benison, Director, Federal Regulatory Affairs, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket Nos., 05-337, 06-122, 07-135, Attach. (filed Oct. 24, 2008) (describing reform model scenarios whereby SLCs would be increased by \$1.50 (residential) and \$2.30 (multiline business)).

<sup>875</sup> See National Broadband Plan at 148 (suggesting that “[t]o offset the impact of decreasing ICC revenues, the FCC should permit gradual increases in the subscriber line charges (SLC) and consider deregulating the SLC in areas where states have deregulated local rates”).

<sup>876</sup> See AT&T Oct. 25, 2010 *Ex Parte* Letter, Attach. at 1-2; Letter from Shana Knutson, Legal Counsel, Nebraska Public Service Commission, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, WT Docket No. 10-208 at 1 (filed Oct. 18, 2010).

undertaken intercarrier compensation reform? Or, should we increase the federal SLC as a means of offsetting reduced intrastate revenues? If so, how would such SLCs be structured, what should the increase be, and should we do so as an incentive to encourage states to reform?

584. We also seek comment on how any changes to incumbent LEC SLCs might impact competitive carrier charges and on how changes to the SLC might affect subscribership. In particular, how might such changes impact subscribership in areas in which the telephone penetration rate lags below the national average and where significant low-income populations exist (e.g., on Tribal lands or insular areas)? For instance, would increases to the SLC caps lead to lower take rates among certain populations? Further, we invite comment on any other questions, issues or concerns surrounding the role of SLCs in any revenue recovery mechanism.

#### **D. Criteria for Recovery from the Connect America Fund**

585. We seek comment above on comprehensive reform of our high-cost universal service programs to create the CAF. As we reform intercarrier compensation, we seek comment on how to ensure that any intercarrier compensation revenue recovery from the federal universal service fund fulfills our objectives of ensuring that Americans in all parts of the Nation, especially those in rural, insular and high-cost areas,<sup>877</sup> have access to modern communications networks capable of delivering the services that support necessary applications that empower them to learn, work, prosper, and innovate.

586. We recognize that, as part of some prior intercarrier compensation reform efforts, the Commission created new high-cost universal service mechanisms – specifically, IAS and ICLS – to move implicit intercarrier compensation support from interstate access charges to explicit federal subsidies.<sup>878</sup> We seek comment on the relationship between any universal service support received as part of the CAF and any support that might be provided as a result of intercarrier compensation reform.

587. Consistent with the proposed principles of increased accountability and transparency and to avoid waste, fraud, and abuse in the future, we believe there is benefit in creating a more objective, auditable standard to determine whether a provider qualifies for access to explicit universal service support for intercarrier compensation cost or revenue recovery. On the one hand, access to explicit support may be necessary for carriers in areas where costs exceed potential revenues. On the other hand, we want to create incentives for companies to move away from relying on intercarrier revenues as the market shifts from telephone service to broadband. Is there an objective and auditable metric that balances the policy goal of a gradual migration away from the current intercarrier compensation system while not putting undue pressure on a provider's ability to repay debt and make investment in IP facilities that were made in reliance on these revenue flows? To minimize such concerns, we seek comment on whether we should apply any criteria at the outset, before reform begins, to determine which providers are eligible to receive recovery from the CAF and which providers are not. We seek comment on whether any such criteria could be based on objective metrics, e.g., generally accepted accounting principles (GAAP) as established by the Financial Accounting Standards Board (FASB). If so, what should such criteria be and how could they be structured to encourage carriers to move away from relying on intercarrier revenues?

588. If a carrier is eligible for CAF support as part of a recovery mechanism, the baseline criteria we seek comment on above for recovery would help determine the amount of CAF support. We also propose that a provider first seek recovery through reasonable end-user charges, if adopted, before receiving support under the CAF. Thus, if the Commission adopts a residential benchmark that increases over time from a voice to a broadband benchmark, the amount of support a carrier receives from the CAF would likewise decrease each year. We seek comment on this issue.

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<sup>877</sup> 47 U.S.C. § 254(b).

<sup>878</sup> See *MAG Order*, 16 FCC Rcd at 19621-2, para. 15; *CALLS Order*, 15 FCC Rcd at 12964 para. 3.

589. We note that such an approach is consistent with some states' reforms. For example, Nebraska established a state universal service fund as part of intrastate access reform that was initially designed to help carriers replace required reductions in intrastate access charges,<sup>879</sup> but after a transition period,<sup>880</sup> the Nebraska Universal Service Fund was then directed to target support to high-cost areas.<sup>881</sup> Should the Commission adopt a similar approach? Commenters should also explain whether any federal universal service funding for reduced intrastate revenues should be ongoing or only for a limited number of years as a transitional matter. What would be the appropriate number of years if adopted as a temporary measure?

590. Finally, we seek comment on what obligations should apply to any universal service funding a carrier receives as part of intercarrier compensation reform. To the extent such funding is provided outside of the CAF, should there be specific public interest conditions and/or reporting tied to receipt of such universal service funds, such as broadband build-out requirements, and if so, what conditions would further the Commission's goals? Should those conditions be the same or different than those public interest obligations proposed above for the CAF?<sup>882</sup> Should the oversight and accountability provisions discussed in section VIII above apply equally to funding that is designed to provide revenue recovery associated with intercarrier compensation reform? What other obligations or conditions should apply to receipt of any universal service funding as part of any intercarrier compensation recovery mechanism?

591. *Long-Term Reform.* In section VII, we seek comment on alternative proposals to determine ongoing support for the CAF, including competitive bidding, a right of first refusal followed by competitive bidding, if necessary, and alternative approaches specific to particular classes of carriers, among others.<sup>883</sup> We ask parties that advocate for federal universal service support as part of any recovery proposal to comment on the relationship between those universal service reform proposals and the intercarrier compensation reform proposals described herein and how to harmonize such reforms.

592. We propose completing the transition away from current per-minute charges consistent with the implementation of long-term CAF reform. Under competitive bidding, as discussed in section VII.C.1, we seek comment on whether the competitive bid should encompass all explicit universal service support necessary to provide affordable service in a particular geographic area to avoid the need for separate universal service funding mechanisms to address recovery for intercarrier compensation reform (i.e., that all bids account for any necessary explicit support in the absence of per-minute intercarrier compensation rates) and to ensure that bids could be evaluated and compared on equal terms. Similarly, under a right of first refusal, should funding include all explicit universal service support necessary to provide affordable service in a particular geographic area?

593. If the glide path away from per-minute charges is not complete before we commence long-term CAF reforms, how does this impact the competitive bidding and right of first refusal reforms? For example, if a provider had not reduced all of its intercarrier compensation rates at the time of the competitive bidding or right of first refusal, should carriers be required to reduce all rates as a condition of receiving new CAF support? Or, should some funding equal to then-existing intercarrier compensation

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<sup>879</sup> See Nebraska Comm'n 2008 ICC/USF FNPRM Comments at 8; *Nebraska Access Charge Reform Order*, 1999 WL 135116, \*7.

<sup>880</sup> The Nebraska access reform required carriers to conform to rate benchmarks and provided separate transition periods for rural and non-rural carriers to reduce their access charges. *Nebraska Access Charge Reform Order*, 1999 WL 135116 at \*7 (non-rural carriers had a three-year transition period and rural carriers had a four year transition period).

<sup>881</sup> Nebraska Comm'n 2008 ICC/USF FNPRM Comments at 8.

<sup>882</sup> See *supra* Section V.C.

<sup>883</sup> See *supra* Section VII.C.

revenues or some other metric be withheld until such time that the provider reaches the end-point of intercarrier compensation reform to prevent double recovery? We also seek comment on alternative proposals and means of harmonizing intercarrier compensation and universal service reform.

594. Finally, we invite additional comment on any other questions, issues or proposals related to recovery.<sup>884</sup> For example, parties should address whether any recovery mechanisms adopted as part of intercarrier compensation reform should serve as a transitional mechanism and if so, how the Commission should determine when such recovery is no longer necessary. Similarly, we seek comment on whether the Commission should commit to re-examining any recovery mechanism within a specified timeframe. If so, what would be the appropriate timeframe?

#### **E. Specific Recovery Considerations for Rate-of-Return Carriers**

595. We also seek comment on whether any cost or revenue recovery mechanism could provide rate-of-return carriers greater incentives for efficient operation. As discussed above, a number of variables can affect the manner and level of revenue recovery under a reformed intercarrier compensation system for carriers generally. In the specific context of rate-of-return carriers, however, there are additional issues on which we seek comment.<sup>885</sup> In particular, under the transition proposed as part of comprehensive intercarrier compensation reform, intercarrier compensation rates would be defined by the terms of the glide path, rather than a rate-of-return calculation. The issue for rate-of-return carriers, then, is not whether intercarrier compensation *rates* should be set under a rate-of-return methodology—under the proposal, they would not be. Rather, the question is what framework should be used in determining *cost or revenue recovery* with respect to reduced intercarrier compensation revenues, particularly through CAF funding, if such recovery is found to be appropriate. Thus, with respect to rate-of-return carriers, we seek comment on whether the Commission’s policy determinations regarding the cost or revenue recovery variables discussed above should be implemented through a rate-of-return framework, or if they instead should be implemented through an approach based on incentive regulation.

596. For much of the twentieth century, the Commission sought to ensure that incumbent LECs’ rates remained “just and reasonable” as required by the Communications Act through the use of rate-of-return rate regulation. Under rate-of-return regulation, “rate levels are directly linked to a carrier’s embedded or accounting costs” and the associated rates “are designed to provide the revenue required to cover costs and to achieve a prescribed return on investment.”<sup>886</sup> Beginning in the late 1980s, the Commission began considering alternative forms of rate regulation in light of concerns about certain shortcomings of rate-of-return regulation and perceived benefits of incentive regulation.<sup>887</sup> Other regulators as well, have trended away from rate-of-return regulation.<sup>888</sup>

<sup>884</sup> See, e.g., Qwest Aug. 30, 2010 *Ex Parte* Letter, Attach. at 6-8 (stating that carriers should have adequate recovery of reduced intercarrier compensation revenues and setting forth proposals for SLC increases, benchmarks, and access replacement funding).

<sup>885</sup> We note that in April, 2010 the Commission sought comment generally on shifting rate-of-return carriers to incentive regulation in the context of universal service reform. See *USF Reform NOI/NPRM*, 25 FCC Rcd 6657, 6679-80, paras. 54-55. The issues discussed below focus specifically on interstate switched access service, and not regulation of other services, such as special access. The proposals discussed in the CAF section above seek comment on alternative ways to reform rate of return rather than shifting such carriers to incentive regulation.

<sup>886</sup> *MAG Order*, 16 FCC Rcd at 19623-24, para. 19.

<sup>887</sup> See, e.g., *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987); Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 3 FCC Rcd 3195 (1988); Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873 (1989); Supplemental Notice of Proposed Rulemaking, CC Docket No. 87-313, 5 FCC Rcd at 2176 (1990).

<sup>888</sup> See, e.g., *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873, 2892, para. 35 (continued....)

597. Although widespread in its use historically by telecommunications regulators,<sup>889</sup> rate-of-return regulation has, over time, been subject to a number of criticisms. For example, because both decreases and increases in company costs are passed on to consumers, a rate-of-return regulated carrier has little incentive to manage inputs efficiently.<sup>890</sup> Further, if the authorized rate-of-return exceeds the carrier's actual cost of capital, it may have an incentive to expand its rate base uneconomically.<sup>891</sup> As discussed above, these problems can be exacerbated by the current operation of certain universal service funding mechanisms.<sup>892</sup> In addition, absent sufficient oversight, the accounting requirements needed to implement rate-of-return regulation can enable excessive earning by a regulated carrier. For example, where regulated prices reflect reported costs, a carrier may have an incentive to exaggerate costs to secure higher prices.<sup>893</sup> And rate-of-return regulation on a subset of a carrier's services can entail arbitrary cost allocation,<sup>894</sup> and enable carriers to shift some of the costs of their non-regulated, competitive services to the captive customers of their rate-of-return regulated services.<sup>895</sup> Nonetheless, rate-of-return regulation does provide certain benefits to the regulated carrier, for example by providing revenue certainty, stability, and predictable support.<sup>896</sup> Such certainty, stability, and predictability arises both through the operation of rate-of-return regulation itself, as well as through additional risk sharing mechanisms for

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(1989) (*AT&T Price Cap Order*) (“Regulators in the United Kingdom have administered price cap regulation successfully since 1984.”); *see also, e.g.,* Lilia Pérez-Chavolla, *State Retail Rate Regulation of Local Exchange Providers as of December 2006*, NATIONAL REGULATORY RESEARCH INSTITUTE Report #07-04, <http://nrri.org/pubs/telecommunications/07-04.pdf> (2007) (discussing state approaches to telecommunications rate regulation); CHUNRONG AI, SALVADOR MARTINEZ & DAVID E. M. SAPPINGTON, *Incentive Regulation And Telecommunications Service Quality*, JOURNAL OF REGULATORY ECON., 26(3), 263–285 (2004) (same); DAVID E. M. SAPPINGTON, *Price Regulation*, in THE HANDBOOK OF TELECOMMUNICATIONS ECONOMICS VOLUME I: STRUCTURE, REGULATION, AND COMPETITION at 225-293 (M. Cave, S. Majumdar, & I. Vogelsan, Eds. 2002) (same); HANK INTVEN & MCCARTHY TÉTRAULT, *Price Regulation (Module 4)* at 4-24, in TELECOMMUNICATIONS REGULATION HANDBOOK, available at <http://www.infodev.org/en/Publication.22.html> (2000) (discussing foreign regulators' approaches to telecommunications rate regulation).

<sup>889</sup> *See, e.g.,* DAVID E. M. SAPPINGTON & DENNIS L. WEISMAN, DESIGNING INCENTIVE REGULATION FOR THE TELECOMMUNICATIONS INDUSTRY, 1 (1996) (SAPPINGTON & WEISMAN).

<sup>890</sup> *See* MICHAEL A. EINHORN, *Introduction*, in PRICE CAPS AND INCENTIVE REGULATION IN TELECOMMUNICATIONS at 2-3 (Michael A. Einhorn, ed., 1991) (Einhorn, Price Caps); *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6789, para. 22 (1990) (*LEC Price Cap Order*) (stating that rate-of-return regulation lacks incentives for carriers to become more productive); *AT&T Price Cap Order*, 4 FCC Rcd at 2889-90, para. 30 (illustrating the “distorted incentives” created by rate-of-return regulation); *Price Cap Further Notice*, 3 FCC Rcd at 3218-19, 3222, paras. 38, 43 (describing how the incentive to operate efficiently is “sacrificed” under rate-of-return regulation).

<sup>891</sup> *See, e.g.,* *Price Cap Further Notice*, 3 FCC Rcd at 3219-20, paras. 39-40; *AT&T Price Cap Order*, 4 FCC Rcd at 2889-90, para. 30; Einhorn, Price Caps at 3.

<sup>892</sup> *See supra* Section VI.A.1.

<sup>893</sup> *See, e.g.,* *LEC Price Cap Order*, 5 FCC Rcd at 6790, paras. 29-30; *AT&T Price Cap Order*, 4 FCC Rcd at 2889-90, paras. 30-31.

<sup>894</sup> *See, e.g.,* *AT&T Price Cap Order*, 4 FCC Rcd at 2890-91, para. 32.

<sup>895</sup> *See, e.g.,* *Price Cap Further Notice*, 3 FCC Rcd at 3223-24, para. 48; Einhorn, Price Caps at 3.

<sup>896</sup> *See, e.g.,* *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, First Order on Reconsideration, CC Docket No. 00-256, Twenty-Fourth Order on Reconsideration, CC Docket No. 96-45, Report and Order, 17 FCC Rcd 5635, 5636, para. 2 (2002).

rate-of-return carriers such as NECA pooling.<sup>897</sup> Rate-of-return carriers also cite this form of regulation as underlying their “success in . . . deployment and provision of broadband services to rural areas.”<sup>898</sup>

598. At the same time, there are a number of benefits with incentive regulation. As the Commission has recognized, “[t]he attractiveness of incentive regulation lies in its ability to replicate more accurately than rate-of-return the dynamic, consumer-oriented process that characterizes a competitive market.”<sup>899</sup> An incentive regulation system can better encourage efficient operation, because “[c]arriers that can substantially increase their productivity can earn and retain profits at reasonable levels above those [allowed] for rate-of-return carriers”<sup>900</sup> although under some forms of incentive regulation “earnings above a certain level are shared or returned.”<sup>901</sup> Incentive regulation also can reduce the necessary reliance on accounting regulation, mitigating regulatory concerns about the enforcement of those requirements.<sup>902</sup> On the other hand, concerns sometimes are expressed that forms of incentive regulation can lead carriers to reduce costs by reducing investment.<sup>903</sup>

599. In light of the relative strengths and weaknesses of rate-of-return regulation and incentive regulation, and given the direction of proposed universal service reforms, we believe that it may be possible to adopt a recovery framework that provides incentives for carriers to operate efficiently, while still providing reasonable certainty and stability. We therefore seek comment below on an alternative framework for determining such recovery, as well as any alternative proposals that commenters would recommend. Specifically, we seek comment on a possible revenue recovery framework for rate-of-return carriers that departs from traditional rate-of-return principles. As set out in greater detail in Appendix D, this framework could be used to offset some reduced interstate intercarrier compensation revenues, some reduced intrastate intercarrier compensation revenues, or both, based on the policy determinations made by the Commission with respect to the recovery issues raised in this section. The framework would, for one, establish a formula to determine the magnitude of reduced intercarrier compensation revenues a carrier might recover through new universal service funding. In implementing this framework, the magnitude of revenues at issue could be calibrated in several ways, consistent with the revenue recovery considerations discussed above,<sup>904</sup> to reflect, for example, an offsetting of actual or imputed end-user revenues, or by incorporating measures to encourage carriers to retain customers.<sup>905</sup> And any support from a CAF mechanism under this framework during the intercarrier compensation reform transition—if determined to be appropriate under the considerations discussed above—would not guarantee carriers a specified rate-of-return.

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<sup>897</sup> *Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation*, CC Docket No. 92–135, Report and Order, 8 FCC Rcd 4545, 4546, para. 9 (1993). “In a pooling environment, rates are based upon the total costs and total demand of all participating companies. Each company receives its actual costs, plus its share of the pool’s earnings. The major reason companies want to participate in pools is to share risks, by providing a high degree of assurance that the company will recover its costs.” *Id.* at 4546, para. 8.

<sup>898</sup> NECA *et al.* USF Reform NOI/NPRM Comments at 46.

<sup>899</sup> *AT&T Price Cap Order*, 4 FCC Rcd at 2893, para. 36.

<sup>900</sup> *LEC Price Cap Order*, 5 FCC Rcd at 6789, para. 22.

<sup>901</sup> *See id.*; *see also Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order, 23 FCC Rcd 5294, 5298, para. 8 (2008) (*Windstream Order*); *AT&T Price Cap Order*, 4 FCC Rcd at 2893, para. 36; Einhorn, Price Caps at 8.

<sup>902</sup> *See, e.g., LEC Price Cap Order*, 5 FCC Rcd at 6791, para. 34; *AT&T Price Cap Order*, 4 FCC Rcd at 2893, para. 37; Einhorn, Price Caps at 8.

<sup>903</sup> *See, e.g., MAG Order*, 16 FCC Rcd at 19705, para. 220.

<sup>904</sup> *See supra* Section XIV.B.

<sup>905</sup> *See* Appendix D.

600. Given the Commission's long-term vision for the CAF, we anticipate that intercarrier compensation replacement funding would not exist as a distinct CAF component. Rather, as discussed above, such funding could be subsumed within the support provided to serve a particular geographic area under either a right of first refusal or competitive bidding approach.<sup>906</sup> If the Commission were to adopt a different long-term approach to the CAF, however, a way to determine ongoing intercarrier compensation replacement CAF support could be needed. We seek comment on alternatives in that regard. For example, once intercarrier compensation reform was complete, could ongoing intercarrier compensation replacement CAF support be set periodically (such as every five years) to generate an appropriate return for an efficient carrier (unrelated to that currently prescribed for rate-of-return regulation)? If so, how would the appropriate return be established and calculated? Would it be appropriate under such an approach to adopt policies or procedures to enable changes within the review periods,<sup>907</sup> and if so, how should those be defined?

601. We seek comment on the merits of this possible framework generally, and on specific implementation considerations.<sup>908</sup> For example, we note that some carriers, in addition to experiencing lost intercarrier compensation *revenues*, also could experience reductions in intercarrier compensation *expenses*. Should those cost reductions be reflected in this framework, and if so, how? Could this be implemented in a way that would avoid competitive distortions arising from the variation in cost savings among different carriers? Additionally, the formulas in Appendix III explicitly address only interstate and intrastate switched access. Should the framework also address reciprocal compensation, and if so, how?

602. We also seek comment on ways that the forgoing framework might be modified and on other proposed frameworks for revenue recovery that do not rely on traditional rate-of-return methodologies. For each alternative, we ask commenters to explain why it is preferable to the alternative discussed above, how the magnitude of revenues at issue could be calibrated, and how, administratively, it would be implemented. Further, unless otherwise reformed, interstate common line support (ICLS) would continue to operate based on a rate-of-return framework. Would it instead make sense to shift recovery from ICLS to any new, incentive-based CAF mechanism the Commission might create in this context? If so, should that occur at some point in the reform transition, or after the other reforms have been completed? We also note that this Notice raises issues of revenue recovery for price cap carriers, and we seek comment on whether some form of the framework discussed above, or an alternative proposal, might be appropriate for these carriers, as well.

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<sup>906</sup> See *supra* Section XIV.D.

<sup>907</sup> For example, if the annual rate of economy-wide inflation exceeds a specified threshold, these CAF payments might be adjusted automatically on an annual basis between the periodic reviews to account for inflation. The Commission might also allow carriers to request a defined number of low-end earnings adjustments during the period between reviews of such CAF payments. If warranted, such a low-end earnings adjustment could modify a carrier's CAF payment to ensure that the carrier earns a return on relevant investment that is not too far below the prevailing appropriate return most recently specified by the Commission. A carrier's request for a modification of its CAF payment might be entertained only if its return on relevant investment has been sufficiently low for a sufficiently long period of time (e.g., more than three percentage points below the appropriate return most recently specified by the Commission for at least one year).

<sup>908</sup> In addition, as noted, implementation of such a framework will be impacted by decisions regarding issues discussed above, which bear on the magnitude of reduced intercarrier compensation revenues to be recovered in particular ways, such as through SLC increases or from state sources; how particular benchmarks might be established and change over time; the extent to which non-regulated revenues are considered; the relationship of CAF recovery to offset reduced intercarrier compensation revenues to broader universal service reform; etc. See *supra* Section XIV. We also recognize that certain data would be necessary both in evaluating this possible framework and in implementing it, and as part of the consideration of broader data collection issues below we seek comment on how best to obtain those data. See *supra* para. 572.

## **XV. REDUCING INEFFICIENCIES AND WASTE BY CURBING ARBITRAGE OPPORTUNITIES**

603. The comprehensive intercarrier compensation reforms on which we seek comment in this Notice would, if adopted, significantly reduce and eventually eliminate opportunities and incentives for arbitrage. We believe, nevertheless, consistent with the recommendations in the National Broadband Plan, that we should take action to address arbitrage until such reform is fully implemented.<sup>909</sup> In this section, we therefore seek comment on rules intended to curb arbitrage opportunities and thereby reduce inefficiencies and wasteful use of resources enabled by the current intercarrier compensation system.

604. First, the Commission has never addressed whether interconnected VoIP is subject to intercarrier compensation rules and, if so, the applicable rate for such traffic. This uncertainty has led to numerous billing disputes and litigation and may be deterring innovation and the introduction of new services.<sup>910</sup> Thus, we seek comment on the appropriate intercarrier compensation framework for voice over Internet protocol (VoIP) traffic.

605. Second, significantly different rates for terminating traffic create the incentive for service providers to disguise the nature, or conceal the source, of the traffic being sent to avoid or reduce payments to other service providers. This type of arbitrage is referred to as “phantom traffic.”<sup>911</sup> We seek comment below on revisions to the Commission’s call signaling rules to reduce phantom traffic.

606. Third, intercarrier rates above incremental cost are an incentive to increase revenues through arrangements such as “access stimulation,” in which carriers seek to inflate the amount of traffic they receive subject to intercarrier compensation payments. For example, a LEC with high switched access rates will agree to share its access revenues with a company that expects to receive large numbers of incoming calls, such as a company providing an adult chat line. Because these incentives exist, investment is directed to arbitrage activities, such as “free” conference calling services, the cost of which are ultimately spread among all customers whether they use any of these offerings or not. As USTelecom noted, “[s]ignificant levels of regulatory arbitrage are an indictment of a poorly constructed or enforced regulatory regime and an unproductive use of financial and intellectual capital. It results in a great deal of resources of both communications providers and state regulators and courts being devoted to brokering and litigating disputes stemming from this archaic system.”<sup>912</sup> We therefore seek comment on a proposal to amend the Commission’s access charge rules to address access stimulation and help ensure that rates remain just and reasonable as required by section 201(b) of the Act.

607. In addition to these proposals, we also invite comment on other arbitrage issues that we should consider. In particular, parties should provide information about other arbitrage schemes present in the market or that might arise in the future.

### **A. Intercarrier Compensation Obligations for VoIP Traffic**

608. In this section, we seek comment on the appropriate intercarrier compensation framework for voice over Internet protocol (VoIP) traffic. The Commission has never addressed whether interconnected VoIP is subject to intercarrier compensation rules and, if so, the applicable rate for such

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<sup>909</sup> The National Broadband Plan recommends that as a part of comprehensive intercarrier compensation reform, the Commission should adopt interim rules to reduce arbitrage in the intercarrier compensation regime, including prohibiting carriers from eliminating information necessary for a terminating carrier to bill an originating carrier for a call. National Broadband Plan at 148.

<sup>910</sup> See *infra* para. 608.

<sup>911</sup> See *supra* para. 620.

<sup>912</sup> US Telecom Comments re NBP PN #19 at 7 (filed Dec. 7, 2009).

traffic. There is mounting evidence that this lack of clarity has not only led to billing disputes and litigation,<sup>913</sup> but may also be deterring innovation and introduction of new IP services to consumers.<sup>914</sup>

609. Consistent with the National Broadband Plan recommendation to specify the treatment of VoIP for purposes of intercarrier compensation, we seek comment on the appropriate treatment of interconnected VoIP traffic for purposes of intercarrier compensation. In particular, as we are undertaking intercarrier compensation and universal service reform and as the market is evolving toward broadband, all-IP networks, we need a framework for VoIP traffic that is consistent with those overarching changes. We therefore seek comment below on a range of approaches, including how to define the precise nature and timing of particular intercarrier compensation payment obligations.

### 1. Background

610. Since 2001, the Commission has sought comment in various proceedings on the appropriate intercarrier compensation obligations associated with telecommunications traffic that originate or terminate on IP networks.<sup>915</sup> Even so, the Commission has declined to explicitly address the intercarrier compensation obligations associated with VoIP traffic.<sup>916</sup> Given this lack of clear resolution,

<sup>913</sup> See, e.g., Letter from Stephen Brown, Counsel for 3 Rivers Telephone Cooperative, Inc., et al., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket Nos. 01-92, 99-68 at 1 (filed June 24, 2009) (citing *Three Rivers Tel. Coop., Inc. v. Commpartners, LLC*, Case No. 08-68-M-DWM (D. Mont.) (filed May 21, 2008); Letter from Hank Hultquist, Vice President, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 99-68, 07-135, 04-36, GN Docket No. 09-51 Attachment at 7 (filed Mar. 15, 2010) (describing a “litigation bonanza”); Letter from Colin Sandy, Counsel, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92 Attach. at 9-10 (filed Aug. 12, 2009) (describing pending cases). See also, e.g., CenturyLink, Inc., Form 10-Q (filed Nov. 5, 2010) (“subsidiaries of CenturyLink filed two lawsuits against subsidiaries of Sprint Nextel to recover terminating access charges for VoIP traffic owed under various interconnection agreements and tariffs which presently approximate \$32 million”); *Pleading Cycle Established for Comments on Global NAPS Petition for Declaratory Ruling and for Preemption of The Pennsylvania, New Hampshire and Maryland State Commissions*, WC Docket No. 10-60, Public Notice, 25 FCC Rcd 2692 (2010) (seeking comment on request for declaratory rulings regarding “controversies between Global and several local exchange carriers (‘LECs’) regarding the tariff treatment of Voice over Internet Protocol (‘VoIP’) traffic”).

<sup>914</sup> National Broadband Plan at 142. “Because providers’ rates are above cost, the current system creates disincentives to migrate to all IP-based networks. For example, to retain ICC revenues, carriers may require an interconnecting carrier to convert [VoIP] calls to time-division multiplexing in order to collect intercarrier compensation revenue. While this may be in the short-term interest of a carrier seeking to retain ICC revenues, it actually hinders the transformation of America’s networks to broadband.” *Id.* See also AT&T Comments in re NBP PN #25 at 12 (filed Dec. 22, 2009) (maintaining legacy regulatory structures diverts resources from the investments necessary to achieve broadband deployment); Global Crossing Comments in re NBP PN#19 at 5 (filed Dec. 7, 2009) (outdated regulations undermine incentives for carriers to transition to IP-based networks); 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6581-82, para. 189 (because carriers receive significant revenues from terminating telecommunications traffic they have reduced incentives to upgrade their networks or to negotiate to accept IP traffic because both will reduce their intercarrier compensation revenues); Qwest Aug. 30, 2010 *Ex Parte* Letter, Attach. at 3 (“Current ICC system crippled by inefficiencies and arbitrage. Current ICC system never designed to promote broadband deployment.”); Verizon Comments in re NBP PN #19 at 18 (filed Dec. 7, 2009) (it no longer makes sense to maintain a system that allows the application of different rates to different traffic types based on antiquated reasons).

<sup>915</sup> See, e.g., *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9629, para. 52; *IP-Enabled Services*, WC Docket No. 04-36, Notice of Proposed Rulemaking, 19 FCC Rcd 4863, 4903-05, paras. 61-62; *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4722, para. 80; 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6618-20, paras. 269-75.

<sup>916</sup> See, e.g., *Feature Group IP Petition for Forbearance From Section 251(g) of the Communications Act and Sections 51.701(b)(1) and 69.5(b) of the Commission’s Rules*, WC Docket No. 07-256, Memorandum Opinion and Order, 24 FCC Rcd 1571 at 1575-76, paras. 7-10 (2009) *pet. for review denied*, 25 FCC Rcd 8867 (2010), *pet. for review pending*, *Feature Group IP et al., v. FCC*, No. 10-1257 (D.C. Cir. filed Aug. 23, 2010) (Order denying forbearance because the request would cause a regulatory void in contradiction of the plain language of the Communications Act since the Commission has not yet taken affirmative action to address intercarrier compensation (continued....))

particularly as consumer demand for VoIP services continues to increase,<sup>917</sup> disputes increasingly have arisen among carriers and VoIP providers regarding intercarrier compensation for VoIP traffic. As AT&T observes, for example, various parties have taken “extreme all-or-nothing positions” regarding the compensation obligations associated with VoIP traffic.<sup>918</sup> Thus, although some LECs contend that this traffic is subject to the same intercarrier compensation obligations as any other voice traffic, other carriers contend no compensation is required.<sup>919</sup> In addition, there is some evidence of asymmetrical revenue flows for traffic exchanged between a traditional wireline LEC and a VoIP provider, with the VoIP provider (or its LEC partner) collecting access charges, for example, but refusing to pay them.<sup>920</sup>

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regulation for VoIP traffic). *Time Warner Cable Request for Declaratory Ruling that Competitive Local Exchange Carriers May Obtain Interconnection Under Section 251 of the Communications Act of 1934, as Amended, to Provide Wholesale Telecommunications Services to VoIP Providers*, WC Docket No. 06-55, Memorandum Opinion and Order, 22 FCC Rcd 3513 at 3520-21, para. 15 (2007) (Order in which the Commission refused to classify VoIP service, finding that doing so was unnecessary to decide an interconnection dispute involving completing VoIP traffic). We note that the Commission has addressed the classification, and thus the intercarrier compensation obligations, associated with certain traffic that uses IP transport. See, e.g., *Petition for Declaratory Ruling that AT&T’s Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 at 7457-58, para. 1 (2004) (Order finding that calls dialed on a 1+ basis, using IP technology in the middle and that meet three criteria are telecommunications service, not information service).

<sup>917</sup> See, e.g., Sept. 2010 Trends in Telephone Service at Table 8.3.

<sup>918</sup> Letter from Henry Hultquist, Vice President-Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92, WC Docket Nos. 04-36, 05-337, 07-135 at 2 (filed July 17, 2008) (AT&T July 17, 2008 *Ex Parte* Letter). See also *id.*, Attach. 1 at 4, 8-9. See also NECA Comments in re NBP PN #19, at 28-30 (filed Dec. 7, 2009) (noting that many billing disputes arise from a refusal to pay when a carrier claims that traffic is “enhanced” because of the use of IP-based technology and the Commission has not decided the appropriate compensation for such traffic).

<sup>919</sup> See, e.g., Letter from Joseph A. Douglas, Vice President-Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36, Attach. at 2 (filed May 23, 2008); Letter from Kristopher E. Twomey, Regulatory Counsel, CommPartners, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Dec. 12, 2007); Letter from Joseph A. Douglas, Vice President-Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36, Attach. at 6 (filed May 2, 2007); Letter from Gregory J. Vogt, counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 96-98, 99-68, WC Docket No. 05-337 at 4-5 (filed Oct. 20, 2008); Windstream Comments, CC Docket Nos. 94-68, 96-45, 96-98, 99-68, WC Docket Nos. 04-36, 05-337, 06-122, 07-135, 08-152 at 14-15 (filed Aug. 21, 2008); Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 05-337, Attach. at 3 (filed Oct. 16, 2008); AT&T July 17, 2008 *Ex Parte* Letter, Attach. 1 at 11; Letter from Melissa E. Newman, Vice President-Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, WC Docket Nos. 05-337, 06-122, 07-135 at 9-10 (filed Oct. 23, 2008); Letter from Colin Sandy, Counsel, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92 at 1 (filed Sept. 23, 2009); Letter from Tom Karalis, Fred Williamson & Associates, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket Nos. 09-47, 09-51, 09-137, 10-66, CC Docket Nos. 09-45, 01-92 Attach. at 11 (filed Apr. 7, 2010).

<sup>920</sup> See, e.g., AT&T July 17, 2008 *Ex Parte* Letter, Attach. 2 at 7-8, 18-19; Letter from James C. Smith, SBC, to Chairman Powell, FCC, WC Docket No. 03-266, Attach. at 16 (The possibility that access charges “may flow from PSTN carriers to VoIP providers and their CLEC partners but never in the opposite direction . . . could lead to the same type of economically irrational arbitrage opportunity the Commission thought it had stamped out when it reduced reciprocal compensation rates for dial-up ISP-bound traffic, for which compensation flows were similarly unidirectional. Where an opportunity for arbitrage exists, moreover, the industry tends not to tarry long before it finds a means to exploit it. The result, again, would be discriminatory, inimical to the interests of consumers, and at war with the public interest.”) cited in AT&T July 17, 2008 *Ex Parte* Letter, Attach. 2 at 8 n.20; Connected Planet, MagicJack Attacks, May 2, 2008, <http://connectedplanetonline.com/voip/news/magicjack-attacks-0502/> (“As a VoIP company, we don’t have to pay for access charges. . . . Telephone companies do have to pay access charges to terminate calls to our customers.”). See also Letter from Samuel L. Feder, counsel for Cox *et al.*, to Marlene H. (continued....)

611. There is also evidence that the uncertainty may be affecting IP innovation and investment, in particular. For example, some commenters observe that “[b]oth new entrants and established incumbents seeking to offer VoIP products and services are hampered by continued regulatory uncertainty. As the VoIP industry has shown over the past few years, the impact of regulation affects whether consumers will have access to innovative features and functionalities offered by VoIP providers at the edge or if they will have access only to very limited VoIP products that merely mimic the circuit-switched offerings of the past.”<sup>921</sup> Likewise, Verizon notes “that the uncertainty and complexity endemic to the existing intercarrier compensation system may well deter providers from rolling out advanced services.”<sup>922</sup>

## 2. Discussion

612. *Scope of VoIP Traffic.* In addressing these compensation issues, we propose to focus specifically on the intercarrier compensation rules governing interconnected VoIP traffic. Interconnected VoIP services, among other things, allow customers to make real-time voice calls to, and receive calls from, the public switched telephone network (PSTN),<sup>923</sup> and increasingly appear to be viewed by consumers as substitutes for traditional voice telephone services.<sup>924</sup> We seek comment on whether the proposed focus on interconnected VoIP is too narrow or whether the Commission should consider intercarrier compensation obligations associated with other forms of VoIP traffic, as well. We also seek comment on whether the Commission should distinguish between facilities-based “fixed” and “nomadic” interconnected VoIP.<sup>925</sup>

613. *Defining the Appropriate Intercarrier Compensation Regime.* There is considerable dispute about whether, and to what extent, interconnected VoIP traffic is subject to existing intercarrier compensation rules. These disputes have been costly and resulted in uncertain or unexpectedly reduced revenue streams for some carriers that may rely on those revenues for network investments. We also note that the Commission has recognized the need to move away from today’s intercarrier compensation system. Balancing these concerns suggests a spectrum of possible outcomes. The alternative approaches (Continued from previous page)

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Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 (filed Feb. 1, 2011) (expressing concern about nonpayment of access charges for traffic exchanged in TDM where the traffic is alleged to be “IP-originated or IP-terminated,” including on the part of companies with competing local exchange carrier operations).

<sup>921</sup> High Tech Associations 2008 ICC/USF FNPRM Comments at 9-10.

<sup>922</sup> Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 04-36, 05-337 CC Docket Nos. 96-45, 01-92 at 1 (filed Dec. 11, 2009).

<sup>923</sup> Interconnected VoIP service “(1) [e]nables real-time, two-way voice communications; (2) [r]equires a broadband connection from the user’s location; (3) [r]equires IP-compatible customer premises equipment (CPE); and (4) [p]ermits users generally to receive calls that originate on the public switched telephone network and to terminate calls to the public switched telephone network.” 47 C.F.R. § 9.3.

<sup>924</sup> See *IP-Enabled Services*, WC Docket No. 04-36, Report and Order, 24 FCC Rcd 6039 at 6045-46 n.36 (2009) (citing a House of Representatives survey that in 2007 over nine million consumers used VoIP service as a substitute for traditional telephone service); see also *Local Telephone Competition: Status as of December 31, 2009*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, at 3 (Jan. 2011) (“Between December 2008 and December 2009 – the first full year of mandatory interconnected VoIP reporting – interconnected VoIP subscriptions increased by 22% (from 21 million to 26 million) and retail switched access lines decreased by 10% (from 141 million to 127 million). The combined effect was an annual decrease of 6% in wireline retail local telephone service connections (from 162 million to 153 million).”).

<sup>925</sup> See, e.g., *Petition of Qwest Corporation For Forbearance Pursuant To 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, Memorandum Opinion and Order, 25 FCC Rcd 8622, 8650, para. 54 & n.163 (2010) (*Qwest Phoenix Order*) (distinguishing between, on the one hand, “facilities-based” VoIP services, such as those provided by cable operators, and, on the other hand, “over-the-top” or “nomadic” VoIP services).

discussed below vary along two main dimensions: (1) the appropriate timing for specifying the intercarrier compensation obligations applicable to interconnected VoIP traffic; and (2) the appropriate magnitude of intercarrier compensation charges that should apply to interconnected VoIP traffic. As noted in our discussions of each alternative below, we also seek comment on any aspects of existing law that would need to be addressed to define an appropriate intercarrier compensation regime for interconnected VoIP traffic. In addition, we seek comment on how the various options below would be administered. For example, could terminating carriers identify interconnected VoIP traffic – as distinct from other traffic – for purposes of intercarrier compensation? Are there technical issues that would need to be resolved to enable a terminating carrier to identify whether traffic originated as VoIP? We seek comment on these issues.

614. We recognize the need for the Commission to move forward expeditiously with reform and understand that disputes regarding compensation for interconnected VoIP traffic have increased during the time these issues have been pending. We recognize that such disputes could impede the industry's ability to make an orderly transition to a reformed intercarrier compensation system. Accordingly, nothing in the instant Notice should be read to encourage, during the pendency of this proceeding, unilateral action to disrupt existing commercial arrangements regarding compensation for interconnected VoIP traffic. Such actions could create additional uncertainty for investments in broadband-capable networks and fuel further disputes, which is counter to our goal of developing a predictable framework for reform, and we strongly discourage such actions. Given that some parties have negotiated different rates to resolve the treatment of VoIP traffic, we seek comment on how the different options we seek comment on here may impact these existing commercial arrangements. We also seek comment on whether particular reform options would have retroactive effect, and whether such retroactivity would be counterproductive.

615. *Immediate Adoption of Bill-and-Keep for VoIP.* Under one alternative, the Commission could adopt bill-and-keep for interconnected VoIP traffic. We note that section 251(b)(5) requires LECs “to establish reciprocal compensation arrangements for the transport and termination of telecommunications,”<sup>926</sup> and that interconnected VoIP traffic is “telecommunications” traffic, regardless of whether interconnected VoIP service were to be classified as a telecommunications service or information service.<sup>927</sup> Moreover, the Commission can specify that VoIP traffic is within the section 251(b)(5) framework even if one of the parties is not a LEC.<sup>928</sup> Could and should the Commission bring interconnected VoIP traffic within the section 251(b)(5) framework and immediately apply the bill-and-keep methodology? Is there other legal authority by which to adopt such an approach? What factual and policy basis would justify this approach for interconnected VoIP traffic? How would such a regime be administered? Are there technical issues associated with a bill-and-keep methodology that would need to be resolved to implement such an approach?

616. *Immediate Obligation to Pay VoIP-Specific Intercarrier Compensation Rates.* Alternatively, the Commission could determine that interconnected VoIP traffic is subject to intercarrier compensation charges under a regime unique to interconnected VoIP traffic.<sup>929</sup> For example, should all

<sup>926</sup> 47 U.S.C. § 251(b)(5). Although section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing “receipt of compensation,” 47 U.S.C. 251(g), section 251(g) “is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act.” *WorldCom*, 288 F.3d 429, 430.

<sup>927</sup> See, e.g., *Universal Service Contribution Methodology*, WC Docket Nos. 06-122, 04-36, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, 7538-40, paras. 39-41 (2006).

<sup>928</sup> See, e.g., *Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023 (bringing LEC-CMRS traffic exchange within the section 251 framework as it relates to intraMTA (including interstate intraMTA) traffic).

<sup>929</sup> We understand that some commercial arrangements apply a specific rate for VoIP traffic. See Joan Engebretson, *Verizon, Bandwidth.com Interconnection Deal Could Be Precedent Setting*, ConnectedPlanet.com (Jan. 20, 2011), (continued....)

interconnected VoIP traffic be subject to intercarrier compensation rates equal to interstate access charges; reciprocal compensation rates; or some other defined rate, such as \$0.0007 per minute? If rates equal to interstate access charges are applied to VoIP traffic, would that create an incentive to originate all voice traffic as VoIP—or simply declare it to be originated as VoIP—such that little traffic ultimately would be billed at the higher rates?<sup>930</sup> What impact would a VoIP-specific intercarrier compensation rate have on investment in and deployment of broadband facilities? How should those interconnected VoIP-specific rates decline as intercarrier compensation rates decline more generally as part of comprehensive reform? Could the Commission rely on section 251(b)(5) for its legal authority in this context, given questions about the extent to which the Commission can set particular rates rather than a methodology under that legal framework?<sup>931</sup> We recognize that, even for traffic subject to section 251(b)(5), the Commission retains its authority to set rates for certain forms of traffic.<sup>932</sup> Are there other sources of legal authority to adopt such an approach for all interconnected VoIP traffic, consistent with relevant precedent? Alternatively, is there legal authority for the Commission to adopt such an approach for a subset of interconnected VoIP traffic? What factual and policy basis would justify any such approach specifically for interconnected VoIP traffic, and how would such a regime be administered?

617. *Obligation to Pay Intercarrier Compensation As Part of Future Glide Path.* The Commission could determine that interconnected VoIP traffic is subject to intercarrier compensation—whether standard rates<sup>933</sup> or VoIP-specific rates—but only as of some future date. In particular, we note that, as discussed above, this Notice proposes a gradual transition away from the current intercarrier compensation system to help ensure predictability for providers and investors.<sup>934</sup> What flexibility, if any, does the Commission have to adopt the intercarrier compensation obligations for interconnected VoIP traffic specific to some future point in that glide path? What legal authority would enable the Commission to adopt this alternative?

618. *Immediate Obligation to Pay Existing Intercarrier Compensation Rates.* The Commission could determine that interconnected VoIP traffic is subject to the same intercarrier compensation charges—intrastate access, interstate access, and reciprocal compensation—as other voice telephone service traffic both today, and during any intercarrier compensation reform transition. Although this outcome potentially could result if interconnected VoIP services were classified as telecommunications services, we recognize that the Commission thus far has not addressed the classification of interconnected VoIP services.<sup>935</sup> Given that, we seek comment on whether the

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<http://connectedplanetonline.com/independent/news/verizon-bandwidthcom-interconnection-could-set-precedent-0120/#>.

<sup>930</sup> We note that some carriers have expressed concern about other providers making overstated claims about the portion of their traffic that is VoIP. See, e.g., D&E Communications 2008 ICC/USF FNPRM Comments at 4-6; USTelecom 2008 ICC/USF FNPRM Comments at 8 n.11.

<sup>931</sup> See *Iowa Utilities Board v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. I*), *rev'd in part and remanded on other grounds*, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (rejecting proxy rates established by the Commission for use until states completed pricing proceedings because “the Act clearly grants the states the authority to set the rates for interconnection, unbundled access, resale, and transport and termination of traffic,” and thus “the FCC has no valid pricing authority over these areas of new localized competition”).

<sup>932</sup> See *Core Communications Inc. v. FCC*, 592 F.3d 139, 143-45 (D.C. Cir. 2010); *Iowa Utils. I*, 120 F.3d at 800 n.21.

<sup>933</sup> See *infra* para. 618.

<sup>934</sup> See *supra* Section XIII.

<sup>935</sup> The Commission has only addressed the statutory classification of two forms of VoIP, neither of which are interconnected VoIP. For one, the Commission classified as an “information service” Pulver.com’s free service that did not provide transmission and offers a number of computing capabilities. *Petition for Declaratory Ruling that Pulver.com’s Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, WC Docket No. 03-45, Memorandum Order and Opinion, 19 FCC Rcd 3307 (2004) (*Pulver.com Order*). The Commission also (continued....)

Commission could achieve this outcome without classifying interconnected VoIP. For example, would this alternative result if the Commission held that the “ESP exemption”<sup>936</sup> did not encompass interconnected VoIP traffic? Could the Commission rely on section 251(b)(5), or some other legal authority, to adopt such an approach? Depending upon the approach used by the Commission, would it need to clarify jurisdictional issues associated with interconnected VoIP traffic?<sup>937</sup>

619. *Alternative Approaches.* We also seek comment on other approaches that have been proposed for addressing the intercarrier compensation obligations associated with VoIP traffic. For example, AT&T has proposed that, in the absence of comprehensive intercarrier compensation reform, the Commission should adopt a regime under which terminating LECs charge interstate access and reciprocal compensation for VoIP traffic, as well as intrastate access for such traffic if those charges are at or below the level of the carrier’s interstate access rates.<sup>938</sup> By comparison, PAETEC has proposed that, if a carrier adopts a unified intercarrier compensation rate, it should have the clear right to charge that rate for all traffic it terminates, including IP-originated traffic.<sup>939</sup> XO has proposed that all carriers be required to transition to IP-based interconnection within five years, with a unified default compensation rate for all

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has found that certain “IP-in-the-middle” services are “telecommunications services” where they: (1) use ordinary customer premises equipment (CPE) with no enhanced functionality; (2) originate and terminate on the public switched telephone network (PSTN); and (3) undergo no net protocol conversion and provides no enhanced functionality to end users due to the provider’s use of IP technology. *Petition for Declaratory Ruling that AT&T’s Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 (2004) (*IP-in-the-Middle Order*); *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290, 7297, para. 18 (2006) (*Prepaid Calling Card Order*). Even though the Commission has not addressed the classification of VoIP traffic, we note that some states have made their own determinations regarding the statutory classification of VoIP. See, e.g., *Investigation into Whether Providers of Time Warner ‘Digital Phone’ Service and Comcast ‘Digital Voice’ Service Must Obtain Certificate of Public Convenience and Necessity to Offer Telephone Service*, Docket No. 2008-421, Order (ME PUC rel. Oct. 27, 2010).

<sup>936</sup> In developing the access charge regime, the Commission recognized that certain companies, such as enhanced service providers (ESPs), had “been paying the generally much lower business service rates” and “would experience severe rate impacts were we immediately to assess carrier access charges up on them.” *First Reconsideration of 1983 Access Charge Reform Order*, 97 FCC 2d 682, 715, para. 83. Thus, the Commission established the so-called “ESP exemption,” which permits enhanced service providers to purchase local business access lines from intrastate tariffs as end-users, or to purchase special access connections, and thus avoid paying carrier-to-carrier access charges. See, e.g., *Amendments of Part 69 of the Commission’s Rules Relating to Enhanced Service Providers*, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2632-33, para. 13 (1988) (*ESP Exemption Order*); *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982, 16133, para. 345 (1997) (*Access Charge Reform Order*).

<sup>937</sup> *Universal Service Contribution Methodology; Petition of Nebraska Public Service Commission and Kansas Corporation Commission for Declaratory Ruling or, in the Alternative, Adoption of Rule Declaring that State Universal Service Funds May Assess Nomadic VoIP Intrastate Revenues*, WC Docket No. 06-122, Declaratory Ruling, FCC 10-185, paras. 5-10, 12-16, 22 (rel. Nov. 5, 2010).

<sup>938</sup> See generally *Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers Regarding Access Charges and the “ESP Exemption,”* WC Docket No. 08-152 (filed July 17, 2008) (AT&T VoIP Petition) (see also Letter from Henry Hultquist, Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. 2 (filed July 17, 2008) (attaching Petition for inclusion in open dockets)). AT&T proposed that revenues lost from reductions in intrastate access charges be recovered through increases in the interstate SLC or interstate originating access charges. AT&T VoIP Petition at 8-10.

<sup>939</sup> See Letter from Tamar E. Finn, Counsel to PAETEC, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, WC Docket 07-135 at 1 (filed Mar. 26, 2010).

carriers and all traffic.<sup>940</sup> We seek comment on these and other alternatives for addressing intercarrier compensation for interconnected VoIP traffic.

## **B. Rules To Address Phantom Traffic**

620. The current disparity of intercarrier compensation rates gives service providers an incentive to misidentify or otherwise conceal the source of traffic to avoid or reduce payments to the terminating service provider.<sup>941</sup> In this section, we propose amending the Commission's rules to help ensure that service providers receive sufficient information associated with each call terminated on their networks to identify the originating provider for the call. Our proposal, including the specific rules contained in Appendix B, balances a desire to facilitate resolution of billing disputes with a reluctance to regulate in areas where industry resolution has, in many cases, proven effective. The requirements proposed here are intended to facilitate the transfer of information to terminating service providers, and to improve their ability to identify providers from whom they receive traffic, without imposing unduly burdensome costs. Our proposal is similar, in many respects, to the proposal on which comment was sought in November 2008, which had support from many stakeholders.<sup>942</sup> The industry, however, has changed dramatically even in the last two years. Indeed, interconnected VoIP subscriptions increased by 22 percent from 2008 to 2009.<sup>943</sup> Yet, the proposal we sought comment on in 2008 did not explicitly contemplate applying rules to Internet Protocol signaling for VoIP traffic. As a result, we believe it is necessary to seek comment on the proposed rules, which build upon the 2008 proposal but also apply to Internet Protocol signaling.<sup>944</sup> This will best ensure that our rules will be an effective, technologically neutral, and forward-looking solution to the problem and will not introduce unintended consequences.

### **1. Background**

621. A service provider needs certain information to bill and receive intercarrier payments for traffic that terminates on its network. In particular, a terminating service provider must be able to identify the appropriate upstream service provider, and the geographic location of the caller (or a proxy for the caller's location), which is necessary to determine the appropriate charge under existing intercarrier compensation rules to bill the appropriate upstream provider for the call.<sup>945</sup> Service providers get this

<sup>940</sup> See XO Sept. 10, 2010 *Ex Parte* Letter, Attach. at 4-8.

<sup>941</sup> We use the term "service providers" in this section to refer both to traditional telecommunications carriers, as well as providers of interconnected VoIP service (for which the Commission has not yet clarified the statutory classification).

<sup>942</sup> 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6641-49, App. A, paras. 326-342; *id.* at 6841-48, App. C, paras. 322-338; see also, e.g. Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 9 ("the Joint Commenters endorse the rule modifications intended to end the so-called "Phantom Traffic" problem outlined in the Chairman's Draft Proposal."); Verizon 2008 ICC/USF FNPRM Comments at 63 ("The draft orders represent a reasonable approach to addressing phantom traffic that could be adopted as part of a broader order or on a standalone basis"); Windstream 2008 ICC/USF FNPRM Comments at 24 ("Windstream largely supports the phantom traffic reform measures proposed by the Commission."); but see AT&T 2008 ICC/USF FNPRM Comments at 35-39 (suggesting modifications to the proposal); ITTA 2008 ICC/USF FNPRM Comments at 14 n.27 (urging that terminating providers should not be allowed to charge their highest rate where traffic lacks required information); RNK 2008 ICC/USF FNPRM Reply at 12-19 (suggesting that carriers should be allowed to block phantom traffic in limited circumstances).

<sup>943</sup> See Jan. 2011 Local Competition Report at 6 (showing interconnected VoIP subscriptions from 2008 to 2009).

<sup>944</sup> Though our proposed rule revisions would apply to service providers originating or transmitting interconnected VoIP traffic, they do not specify what, if any, intercarrier compensation obligations apply to any interconnected VoIP call. We seek comment in this Notice about the appropriate intercarrier compensation obligations for interconnected VoIP traffic. See *supra* section XV.A.

<sup>945</sup> Although this Notice seeks comment on the elimination of per-minute intercarrier compensation charges, it anticipates a multi-year transition, during which these issues remain relevant.

information from one of several sources: signaling used to set up calls, industry standard billing records sent by tandem switch operators to terminating service providers, and session initiation protocol (SIP) messages for VoIP calls.<sup>946</sup> A pathway across the PSTN is typically set up for PSTN calls using the Signaling System 7 (SS7) call signaling system, which is a separate, or “out of band,” network that runs parallel to the PSTN. The SS7 system performs the function of identifying a path across the PSTN a dialed call can take after the caller dials the called party’s telephone number. Once the SS7 system identifies a path across the PSTN, it signals the originating caller’s network to notify it that a call path is available, and the call is established over the path.<sup>947</sup> Technical content and format of SS7 signaling is governed by industry standards rather than by Commission rules, although Commission rules require carriers using SS7 to transmit the calling party number (CPN) to subsequent carriers on interstate calls where it is technically feasible to do so.<sup>948</sup> SS7 was designed to facilitate call routing and was not designed to provide billing information to terminating service providers.<sup>949</sup> Industry standard billing records are the other common source of information that terminating service providers not directly connected to originating service providers receive about calls sent to their networks for termination.

622. Billing records are typically created by a tandem switch that receives a call for delivery to a terminating network.<sup>950</sup> Service providers delivering billing records typically use the Exchange Message Interface (EMI) format created and maintained by the Alliance for Telecommunications Industry Solutions Ordering and Billing Forum (ATIS/OBF), an industry standards-setting group.<sup>951</sup> Billing records are also transmitted to terminating service providers for traffic delivered using IP protocols.<sup>952</sup> When the originating and terminating networks are not directly connected, as is the case when calls are delivered via tandem transit service, complications with transmitting and receiving billing information

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<sup>946</sup> See RFC 3261, SIP: Session Initiation Protocol (2002) at [www.ietf.org/rfc/rfc3261.txt](http://www.ietf.org/rfc/rfc3261.txt).

<sup>947</sup> The following steps typically occur when SS7 sets up a call path for a wireline LEC to wireline LEC call originating and terminating on the PSTN. When a wireline LEC customer dials a call destined for an end user served by a different wireline LEC, the calling party’s LEC determines, based on the dialed digits, that it cannot terminate the call. The SS7 call signaling system then begins the process of identifying a path that the call will take to reach the called party’s network. SS7 identifies each service provider in the call path and provides each with the called party’s telephone number and other information related to the call, including message type and nature of connection indicators, forward call indicators, calling party’s category, and user service information if that information was correctly populated and not altered during the signaling process.

<sup>948</sup> 47 C.F.R. § 64.1601.

<sup>949</sup> See Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Sept. 13, 2005) (Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter).

<sup>950</sup> Tandem switches transmitting traffic in TDM format create billing records by combining CPN or Charge Number (CN) information from the SS7 signaling stream with information identifying the originating service provider to provide terminating service providers with information necessary for billing. See Verizon, *Verizon’s Proposed Regulatory Action to Address Phantom Traffic* at 5–7 (Verizon Phantom Traffic White Paper), attached to Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 20, 2005). The tandem switch creating the billing record identifies service providers from whom it receives traffic using the trunk group number (TGN) of the trunk on which a call arrives. Cf. Verizon Phantom Traffic White Paper at 4. The tandem switch translates the TGN into one of two codes identifying the originating service provider: Carrier Identification Code (CIC) if the originating service provider is an IXC, or Operating Company Number (OCN) for non-IXC calls. The appropriate CIC or OCN is then added, by the tandem switch if it is equipped to record such information, to the billing record for the call, which is then forwarded to the terminating service provider. See Verizon Phantom Traffic White Paper at 4; see also Verizon *ICC FNPRM* Reply at 16.

<sup>951</sup> See ATIS Exchange Message Interface 22 Revision 2, ATIS Document number 0406000-02200 (July 2005).

<sup>952</sup> See RFC 3398, Integrated Services Digital Network (ISDN) User Part (ISUP) to Session Initiation Protocol (SIP) Mapping (2002) at <http://www.rfc-editor.org/rfc/rfc3398.txt>.

related to a call can arise.<sup>953</sup> In some instances, the operation of these systems can—intentionally or unintentionally—result in traffic arriving for termination with insufficient identification information, which makes it difficult or impossible for the terminating provider to identify and bill the originating provider.

623. Numerous parties have described receiving traffic with insufficient information to ensure proper billing.<sup>954</sup> A cross section of the communications industry has called for Commission action to address this problem of unidentifiable traffic<sup>955</sup> and the National Broadband Plan recommended that the Commission adopt rules to address these concerns.<sup>956</sup> One significant source of billing problems is traffic routed through an intermediate provider that does not include calling party number or other information identifying the calling party.<sup>957</sup> In addition, commenters describe several examples of other situations where traffic arrives for termination with insufficient information to identify the originating service provider.<sup>958</sup> Several commenters also allege that they receive traffic in which the billing information intentionally has been altered or stripped before the call reaches the terminating service provider.<sup>959</sup> One

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<sup>953</sup> See, e.g., Letter from Patrick J. Donovan, Counsel for PacWest Telecomm, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3–4 (filed Oct. 14, 2005).

<sup>954</sup> See, e.g., Letter from Glenn T. Reynolds, Vice President, Policy, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 12, 2008) (USTA Feb. 12, 2008 *Ex Parte* Letter). See also *Developing a Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, NECA Petition for Interim Order (filed Jan. 22, 2008) (NECA Petition); Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 6 (“the current disparity in inter-carrier compensation rates creates both an opportunity and an incentive to misidentify or conceal the source of traffic in order to avoid or reduce payments to other service providers”); NCTA 2008 ICC/USF FNPRM Comments at 5 (“additional requirements . . . needed are signaling rules to facilitate the ability of a terminating carrier to determine who is responsible for paying any termination charges”); Verizon 2008 ICC/USF FNPRM Comments at 64 (“some carriers . . . engage in deliberate misconduct to disguise jurisdictional information in an attempt to pay a lower rate or to get paid a higher rate than properly applies to the traffic”); Windstream 2008 ICC/USF FNPRM Comments at 25 (“reforms would help ensure the proper labeling of traffic so carriers can appropriately bill for carrying it”).

<sup>955</sup> See, e.g., Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 10-90, 05-337, 01-92 at 1 (filed Sept. 30, 2010); AT&T 2008 ICC/USF FNPRM Reply at 35; Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 2, 6-9; ITTA 2008 ICC/USF FNPRM Reply at 13-14; NCTA 2008 ICC/USF FNPRM Comments at 5; OhioComm’n 2008 ICC/USF FNPRM Comments at 55-57; USTelecom 2008 ICC/USF FNPRM Comments at 9-10; Verizon 2008 ICC/USF FNPRM Comments at 63-67.

<sup>956</sup> See National Broadband Plan at 145.

<sup>957</sup> The Commission recognized that the ability of service providers to identify the provider to bill appropriate inter-carrier compensation payments depends, in part, on billing records generated by intermediate service providers. Thus, the Commission sought comment on whether current rules and industry standards create billing records that are sufficiently detailed to permit determinations of the appropriate compensation due. See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4743, para. 133.

<sup>958</sup> For example, when a call bound for a number that has been ported to a different service provider is delivered without the responsible service provider performing a local number portability (LNP) query, the call may be delivered to the wrong end office and then may be re-routed to a tandem switch for delivery to the correct end office. See Verizon Phantom Traffic White Paper at 18–19. According to Verizon, neither the end office that re-routes the call nor the tandem switch receiving the rerouted call are able to route the call over an access trunk; the call must be sent over a local interconnection trunk. See *id.* In this scenario, the terminating service provider may have difficulty billing the appropriate charges to the service provider responsible for payment.

<sup>959</sup> See, e.g., Balhoff and Rowe 2008 ICC/USF FNPRM Reply at 10; California Small LECs 2008 ICC/USF FNPRM Comments at 9; Montana Independent Telecommunications Systems (MITS) *et al.* 2008 ICC/USF FNPRM Comments at 14, 20; NECA 2008 ICC/USF FNPRM Comments at 16; Rural Alliance 2008 ICC/USF FNPRM Comments at 108; SureWest 2008 ICC/USF FNPRM Comments at 7; TDS 2008 ICC/USF FNPRM Comments at 10.

provider recently estimated that five to eight percent of the traffic terminating on its network is “phantom” or disguised traffic.<sup>960</sup> Some commenters also contend that there is a particular need to encompass VoIP traffic in any call information rules, although others argue that such rules should be tailored to reflect unique aspects of VoIP services.<sup>961</sup>

624. For the reasons detailed below, we agree that traffic lacking sufficient information to enable proper billing of intercarrier compensation charges is not consistent with the public interest, and rules are needed to address this problem. In 2008, the Commission sought comment on possible steps to help ensure proper billing of all traffic.<sup>962</sup> The record in that proceeding demonstrated more widespread support for certain signaling rules than for other measures described in the *2008 ICC/USF FNPRM*.<sup>963</sup> Consequently, our proposal below focuses specifically on rules governing signaling. But, given the increased number of interconnected VoIP lines and minutes,<sup>964</sup> our rules need to be forward-looking and avoid inadvertently creating another arbitrage opportunity by limiting applicability to signaling for circuit-switched calls. We also seek comment on whether our proposed rules will be flexible enough to address current and future network technologies, and on whether additional measures are necessary to help ensure proper functioning of the intercarrier compensation system during a transition to all-IP networks.

## 2. Discussion

625. We propose to amend the Commission’s rules as described below to facilitate the transfer of necessary information to terminating service providers, particularly in cases where traffic is delivered through indirect interconnection arrangements. If adopted, these rules would assist in determining the appropriate service provider to bill for any call. We intend for these proposed rules to reflect standard industry practice and for them to remain applicable as providers migrate toward IP networks, and we seek comment on whether they do so.

626. We propose modifying the Commission’s rules to require that the calling party’s telephone number be provided by the originating service provider and to prohibit stripping or altering call signaling information.<sup>965</sup> The proposed rules reflect the recommendations of commenters that the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call is to require all providers involved in transmitting a call from the originating to the

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<sup>960</sup> See Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier Communications, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 07-135, 05-337, 04-36, CC Docket Nos. 01-92, 99-68, at 1 (filed Dec. 21, 2010).

<sup>961</sup> See NTCA Comments in re NBP PN #25 at 9 (filed Dec. 21, 2009); Voice on the Net Coalition Comments in re NBP PN #25 at 7 (filed Dec. 22, 2009).

<sup>962</sup> *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6641-49 App. A paras. 326-342; *id.* at 6841-48 App. C paras. 322-338.

<sup>963</sup> See, e.g., AT&T 2008 ICC/USF FNPRM Comments at 35 (“By requiring the transmission of specified signaling information to the terminating carrier, the *Draft Order* takes a number of the steps needed to fix the problem”); Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 7-9; Embarq 2008 ICC/USF FNPRM Reply at 40 (offering support for signaling rules); NRIC 2008 ICC/USF FNPRM Reply at 22 (“The Nebraska Companies agree that incorporating . . . [signaling] rules will facilitate resolution of billing disputes and provide incentive for service providers to ensure that traffic traversing their networks is properly labeled and identified”).

<sup>964</sup> See, e.g., *Local Telephone Competition: Status as of June 30, 2009*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, at 3 (Sept. 2010) (noting that VoIP subscriptions increased by 10 percent and switched access lines decreased by 5 percent during the first six months of 2009).

<sup>965</sup> Call signaling information subject to our proposed rule includes, but is not limited to SS7 signaling information, MF signaling, such as ANI, and IP signaling such as signaling within SIP sessions.

terminating provider to transmit the calling parties' telephone number to the next provider in the call path. This transmission will vary with the technology used by providers.

627. For example, to comply with this provision, providers transmitting traffic using Internet protocols would be subject to the rule amendments we propose, and would likely transmit the required information in the Internet protocol signaling messages that set up and terminate calls.<sup>966</sup> We seek comment on whether our proposed rules will ensure complete and accurate passing of call signaling information as voice traffic migrates increasingly to interconnected VoIP.<sup>967</sup> We take a cautious approach in considering any new or revised signaling requirements. IP transmission standards and practices are evolving rapidly as service providers migrate to IP networks. Accordingly, although we make clear that our proposed rules apply to traffic originated or transferred using IP protocols, we do not specify how, technologically, providers using IP protocols must comply. In particular we seek comment on ways to ensure that our proposed rules are forward rather than backward-looking, and will remain relevant as technology evolves.

628. For service providers using SS7 to pass information about traffic, the proposed rules require originating providers to populate the SS7 calling party number (CPN) field. When CPN is populated in the SS7 stream for a call by an originating service provider and passed, unaltered, along a call path potentially involving numerous service providers to a terminating service provider, the terminating provider can use the CPN information to help determine the applicable intercarrier compensation. We do not, however, propose making any changes to the designation of particular SS7 fields as mandatory or optional, nor do we otherwise propose changes to industry standards that govern population of the SS7 signaling stream. With regard to SS7 signaling, we note that SS7 was designed to facilitate call setup and routing, and proposals we make in this Notice are not in any way intended to interfere with the ability of calls to reach their intended recipient.<sup>968</sup>

629. Although our existing rules impose obligations to pass CPN,<sup>969</sup> they currently apply only to service providers using SS7 and only to interstate traffic. Commenters contend that expanding the application of those rules would help to address problems associated with unidentified traffic.<sup>970</sup> We therefore propose extending these requirements to all traffic originating or terminating on the PSTN, including, but not limited to jurisdictionally intrastate traffic and traffic transmitted using Internet protocols. We seek comment on our authority to apply our proposed rules to all forms of traffic originating or terminating traffic on the PSTN. Specifically, we seek comment on whether our proposed rule revision is sufficient to require service providers originating or transferring traffic using Internet

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<sup>966</sup> These signaling messages would include the SIP From header (RFC 3261), and possibly the P-Asserted-Identity (RFC 3325) and Authenticated Identity Management (RFC 4474) headers.

<sup>967</sup> *Local Telephone Competition: Status as of June 30, 2009*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, at 3 (Sept. 2010) (noting that VoIP subscriptions increased by 10 percent and switched access lines decreased by 5 percent during the first six months of 2009).

<sup>968</sup> As Verizon Wireless explains, certain SS7 fields are considered mandatory, while others (including CPN, CN, and JIP) are considered optional. See Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2. The distinction is significant because a call will not be completed if a mandatory field has not been populated. See Letter from Thomas Goode, Associate General Counsel, ATIS, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. (filed Feb. 10, 2006).

<sup>969</sup> See 47 C.F.R. § 64.1601. Although CPN is considered optional in the industry standard, the Commission's rules require service providers to pass CPN in specified circumstances, and our proposal would not alter this requirement. *Id.*

<sup>970</sup> See Verizon and Verizon Wireless 2008 ICC/USF FNPRM Comments at 64-65; see also Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 7-8; Missoula Plan for Intercarrier Compensation Reform at 56 (Missoula Plan), attached to Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, NARUC Task Force, and Larry Landis, Commissioner and Vice-Chair, NARUC Task Force, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 24, 2006).

protocols to include or transmit information identifying the originating service provider. We seek comment on whether intrastate calls fall within the Commission's jurisdiction for these purposes.<sup>971</sup> Similarly, we seek comment on USTelecom's assertion that the Commission has jurisdiction under Title I of the Act "to apply fundamental obligations to non-carriers that deliver traffic to the PSTN."<sup>972</sup>

630. We also recognize that some service providers do not use SS7 signaling, and instead rely on MF signaling. To the extent that we propose expanding our rules beyond SS7, we likewise propose amending our rules to require service providers using MF signaling to pass CPN information, or the charge number (CN) if it differs from the CPN, in the Multi Frequency Automatic Number Identification (MF ANI) field. This proposal is intended to ensure that information identifying the calling party is included in call signaling information for all calls. We seek comment on whether this proposal is a necessary and effective measure to address a problem requiring resolution.

631. In addition to CPN, our proposed call signaling rules also address CN, as recommended by a number of commenters.<sup>973</sup> As Verizon has explained, in accordance with industry practice, the CN parameter is not populated in the SS7 stream when it is the same as CPN.<sup>974</sup> But when the CN parameter is populated, CN is included in billing records in place of CPN. The proposed rules would clarify, consistent with industry practice, that populating the SS7 CN field with information other than the charge number to be billed for a call is prohibited. In addition, the proposed rules would prohibit altering or stripping signaling information in the CN as well as CPN field.

632. The proposed call signaling rules are intended to help ensure that signaling information is passed completely and accurately to terminating service providers. These proposed rules are not intended to affect existing agreements between service providers regarding how to "jurisdictionalize" traffic in the event that traditional call identifying parameters are missing, as long as such agreements are consistent with Commission rules or other legal requirements. We seek comment on whether the proposed rules will achieve our goal of helping to ensure complete and accurate passing of call signaling information while not inappropriately disrupting industry practices or existing carrier agreements. Finally, we seek comment on whether we should consider adopting any specific enforcement mechanism to ensure compliance with our proposed rules.

633. The proposed rules contain a few very limited exceptions to accommodate situations, identified in the record, where industry standards permit, or even require, some alteration in signaling information by an intermediate service provider.<sup>975</sup> As noted above, our proposal is not intended to change industry practice with respect to the content of the signaling stream. Service providers that follow

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<sup>971</sup> We note, for example, that the Commission found intrastate call signaling to be within its jurisdiction on the Caller ID context. In particular, when it first adopted rules governing caller ID, the Commission's primary objective was to remove uncertainties impeding the development of valuable interstate services related to caller ID. *See Rules and Policies Regarding Calling Number Identification Service – Caller ID*, CC Docket No. 91-281, Memorandum Opinion and Order on Reconsideration, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 11700, 11728, para. 79 (1995) (*Caller ID Order*). The Commission found that certain state regulations related to end-user blocking of call signaling information would impede attainment of that objective by creating separate federal and state call signaling policies that would be unfeasible to maintain. *See id.* at 11729-30, paras. 84-85. The Commission preempted these state regulations. *See id.* at 11703, para. 5.

<sup>972</sup> *See* USTelecom Feb. 12, 2008 *Ex Parte* Letter, Attach. at 7.

<sup>973</sup> *See, e.g.,* NECA Petition; Letter from Cheryl A. Tritt, Counsel for T-Mobile USA, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 6 (filed Feb. 2, 2006); Verizon Phantom Traffic White Paper at 8-10.

<sup>974</sup> *See* Verizon Phantom Traffic White Paper at 21.

<sup>975</sup> For example, Verizon states that on a call to a party that has forwarded its number, the called party's service provider will replace the caller's CN with the called party's CN before sending the call to the forward location. *See* Verizon Phantom Traffic White Paper at 9-10.

industry practice in this way would not, under the proposed rules, be in violation of the prohibition on altering signaling information. We also note that the exemptions from the existing call signaling requirements described in section 64.1601(d) remain necessary for their limited purposes, and will continue to apply.<sup>976</sup> We seek comment on whether the limited exceptions in the proposed rules are necessary and appropriate. And, we seek comment on any other changes the Commission should make to update our rules concerning the delivery of CPN and association information.<sup>977</sup>

634. Although the proposed rules focus on call signaling, USTelecom's proposal also seeks Commission action related to routing traffic, local number portability queries, and providing incumbent LECs with certain rights with regard to the section 251 and 252 negotiation and arbitration processes as additional measures to address phantom traffic.<sup>978</sup> We invite comment on these proposals to add to or update existing information in the record on these issues.<sup>979</sup> Specifically, we invite comment on any other actions that the Commission should take or proposals in the record related to unbillable traffic and signaling requirements.<sup>980</sup>

### C. Rules to Reduce Access Stimulation

635. In this section, we seek comment on specific revisions to our interstate access rules to address access stimulation, a form of arbitrage that, by some estimates, is impacting hundreds of millions of dollars in intercarrier compensation.<sup>981</sup> The ability to engage in this arbitrage arises from the current access charge regulatory structure as it applies to LEC origination and termination of interstate and intrastate calls.<sup>982</sup> The Commission has addressed similar arbitrage in the past—including access

<sup>976</sup> 47 C.F.R. § 64.1601(d).

<sup>977</sup> In addition to the exceptions described in this section, section 64.1601(b) contains rules regarding the *Privacy* of CPN, section 64.1601(c) contains rules prohibiting *Charges* for providing CPN blocking or delivering CPN to connecting carriers, and section 64.1601(e) contains signaling rules for *Telemarketing*. We ask whether any of these sections should be revised to conform to the changes proposed above to section 64.1601(a).

<sup>978</sup> See USTA Feb. 12, 2008 *Ex Parte* Letter, Attach. at 10-12.

<sup>979</sup> See, e.g., Broadview, *et al.*, 2008 ICC/USF FNPRM Comments at 8; Windstream 2008 ICC/USF FNPRM Comments at 25; Letter from Henry T. Kelly, Counsel to Peerless Networks to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92 *et al.* (filed Sept. 16, 2008); Letter from Charles W. McKee, Director—Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 16, 2008); Letter from Thomas Cohen and Edward A. Yorkgitis, Jr., Counsel to NuVox Communications, *et al.*, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2-3 (filed Mar. 8, 2008); Letter from Daniel L. Brenner, Senior Vice President, Law and Regulatory Policy, NCTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 29, 2008); Letter from Paul Garnett, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 25, 2008).

<sup>980</sup> See, e.g., North Carolina Telephone Cooperative Coalition 2008 ICC/USF FNPRM Reply at 5 (“[T]he Commission should grant State Commission’s the authority to settle [phantom traffic payment] disputes between carriers.”); RNK 2008 ICC/USF FNPRM Reply at 12-19 (proposing that carriers be allowed to block phantom traffic under certain circumstances); Letter from W. Scott McCollough, General Counsel, Feature Group IP, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 & Attach. (filed Mar. 28, 2007) (proposing a Universal Tele-traffic Exchange specification as “a much better way to answer the demand for information about the identity of the party initiating a call session involving the PSTN at one or more endpoints”).

<sup>981</sup> See *infra* para. 637.

<sup>982</sup> We also note that there have been allegations of traffic stimulation associated with intra-MTA CMRS telecommunications traffic. See *infra* para. 672. We seek comment below on the nature of these allegations and whether the Commission should take action to reduce such concerns. In the *Local Competition First Report and Order*, the Commission stated that traffic to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges. See *Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; see also 47 C.F.R. § 24.202(a) (defining the term “Major Trading Area”).

stimulation by certain incumbent LECs in some circumstances—and these actions inform our proposals here. To provide context for our proposed rules, we begin by describing the Commission’s regulatory structure as it applies to LEC origination and termination of interstate telecommunications traffic. We then review prior Commission actions to address arbitrage related to intercarrier compensation rates. We seek comment on each aspect of our proposed rules, and finally, we seek comment on other proposals to address access stimulation.

636. In broad terms, access stimulation is an arbitrage scheme employed to take advantage of intercarrier compensation rates by generating elevated traffic volumes to maximize revenues.<sup>983</sup> Access stimulation occurs when, for example, a LEC enters into an arrangement with a provider of high call volume operations such as chat lines, adult entertainment calls, and “free” conference calls.<sup>984</sup> The arrangement inflates or stimulates the amount of access minutes terminated to the LEC, and the LEC then shares a portion of the increased access revenues resulting from the increased demand with the “free” service provider.<sup>985</sup> Although the conferencing or adult chat lines may appear as “free” to a consumer of these services, the significant costs of these arbitrage arrangements are in fact borne by the entire system as long distance carriers that are required to pay these access charges must recover these funds from their customers.

637. Access stimulation imposes undue costs on consumers, inefficiently diverting the flow of capital away from more productive uses such as broadband deployment, and harms competition. Although long distance carriers are billed for and pay for minutes associated with access stimulation schemes, all customers of these long distance providers bear these costs and, in essence, ultimately support businesses designed to take advantage of today’s above-cost intercarrier compensation system. Projections indicate that the annual impact to the industry from access stimulators is significant. TEOCO estimates that the total cost of access stimulation to the industry has been over \$2.3 billion over the past five years.<sup>986</sup> Verizon estimates the industry impact to be between \$330 and \$440 million per year and as noted above, states that it will be billed between \$66 and \$88 million by access stimulators for approximately two billion wireline and wireless long distance minutes in 2010.<sup>987</sup> Although these

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<sup>983</sup> See *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 17989, 17995-96, paras. 14-15 (2007) (*Access Stimulation NPRM*).

<sup>984</sup> *Id.* at 17994-95, para. 12. Among other things, it is this active involvement of the LEC in driving high volumes of traffic to particular LEC switches that is not reflected in the underlying rate calculation that differentiates access stimulation from the more normal situation in which the LEC prices its service offerings based on historical trends and expected changes in traffic patterns.

<sup>985</sup> See, e.g., FuturePhone.com Access Stimulation Comments at 16-18. Some conference providers, in addition to their “free services,” also offer services through the use of an 800 number for which they charge fees and bill customers, as is done in traditional conferencing arrangements. See, e.g., Global Conference Partners Access Stimulation Comments at 5. See also Letter from David Frankel, CEO, ZipDX, LLC, to Ms. Marlene Dortch, Secretary, FCC, WC Docket No. 07-135, at 2 (filed April 8, 2009) (ZipDX April 8, 2009 *Ex Parte* Letter). In one instance involving a rural incumbent LEC entering into an agreement with a “free” conference call company, Qwest reported that the minutes of interstate access traffic it delivered to that incumbent LEC increased from about 49,000 in June 2005 to over 10 million minutes a month at its peak. The effective interstate rate for this particular incumbent LEC was approximately 5.1 cents per minute. In another instance involving a rural ILEC that entered into an agreement with a “free” chat line provider, Qwest stated that the minutes of interstate access traffic it delivered increased from 27,000 in June 2006 to over 6.4 million minutes in November 2006. In this case, the incumbent LEC’s effective interstate rate was approximately 13 cents per minute. Qwest Access Stimulation Comments at 4.

<sup>986</sup> See TEOCO, ACCESS STIMULATION BLEEDS CSPS OF BILLIONS, at 5 (TEOCO Study), attached to Letter from Glenn Reynolds, Vice President – Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 (filed Oct. 18, 2010).

<sup>987</sup> See Letter from Donna Epps, Vice President-Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 (filed Oct. 12, 2010) (Verizon Oct. 11, 2010 *Ex Parte* Letter).

projections are subject to debate in this proceeding,<sup>988</sup> and there may be litigation surrounding payment of some of these charges,<sup>989</sup> the record also suggests that the amount of capital that access stimulation diverts from broadband deployment and other investments that would benefit consumers is substantial.<sup>990</sup>

638. Moreover, access stimulation harms competition by giving companies that offer a “free” service a competitive advantage over companies that charge their customers for the service. As a result, “free” conferencing providers that leverage arbitrage opportunities can put other companies that charge consumers for services at a distinct competitive disadvantage.<sup>991</sup> For example, ZipDX, a conference calling provider, indicates that, although it has not engaged in the access stimulation model to date, it is at a competitive disadvantage vis à vis those providers engaged in access stimulation.<sup>992</sup>

## 1. Background

639. As discussed below, access stimulation occurs against the backdrop of a legal framework governing access charges that has facilitated such activity in several ways. We must account for those regulatory frameworks when identifying appropriate measures to respond to access stimulation. Moreover, prior Commission efforts to address arbitrage, including its initial actions to reign in access stimulation, can help inform proposals to address access stimulation more broadly.

### a. Access Rate Regulation

640. The methods different types of carriers can use to establish access charges vary. In this section, we provide a high-level background of the framework for access rate regulation and tariffing that applies to incumbent LECs, both price cap and rate-of-return, competitive LECs, and CMRS providers. This discussion will identify the differences in how access regulations apply to each type of carrier, and how these differences, in combination with Commission policies regarding tariffs, call-blocking, and rate integration, set the stage for access stimulation and similar arbitrage opportunities.

641. LEC access charges apply to much of the traffic originating or terminating on their networks. The Commission regulates the rates, terms and conditions of LECs’ interstate access charges, which are rates that IXCs pay a LEC to originate and terminate interstate telecommunications traffic.

<sup>988</sup> See Northern Valley Oct. 14, 2010 *Ex Parte* Letter at 2 n.4 (questioning the data and analyses underlying the TEOCO Report and Verizon estimates). See also Letter from Ross A. Buntrock, Counsel for Bluegrass Telephone Company, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 n.1 (filed Sept. 16, 2010) (arguing that a study by Connectiv Solutions, which claims that access stimulation costs the wireless industry approximately \$190 million a year, is flawed); see CONNECTIV SOLUTIONS, THE IMPACT OF TRAFFIC PUMPING, 2010, <http://www.connectiv-solutions.com/traffic-pumping.html>.

<sup>989</sup> See, generally Northern Valley Oct. 14, 2010 *Ex Parte* Letter (highlighting litigation regarding payment of access charges).

<sup>990</sup> See Verizon Oct. 11, 2010 *Ex Parte* Letter at 3; see also Letter from L. Charles Keller, Counsel for CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. at 6 (filed Aug. 26, 2010) (CTIA Aug. 26, 2010 *Ex Parte* Letter). These claims are consistent with the National Broadband Plan recommendation that the Commission adopt solutions to address access stimulation, noting that “investment is directed to free conference calling and similar schemes for adult entertainment that ultimately cost consumers money, rather than to other, more productive endeavors.” National Broadband Plan at 142. Specifically, the National Broadband Plan recommended that the Commission “adopt rules to reduce access stimulation and to curtail business models that make a profit by artificially inflating the number of terminating minutes.” *Id.* at 148.

<sup>991</sup> See, e.g., Letter from Glenn Reynolds, Vice President – Policy, US Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 (filed Nov. 12, 2010); Letter from David Frankel, CEO, ZipDX LLC, to Marlene Dortch, Secretary, FCC, WC Docket No. 07-135 at 2-5 (filed Sept. 21, 2009) (ZipDX Sept. 21, 2009 *Ex Parte* Letter); Letter from Michael B. Fingerhut, Director, Government Affairs, Sprint Nextel to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 2 (filed Apr. 29, 2009).

<sup>992</sup> Letter from David Frankel, CEO, ZipDX, to Marlene Dortch, Secretary, FCC, WC Docket No. 07-135, at 1, 3 (filed Nov. 26, 2010).

Currently, LECs use different methodologies to calculate their interstate access rates depending on whether the LEC is a price cap carrier, a rate-of-return carrier, or a competitive LEC. As a result of the different methodologies, a LEC's access rates may or may not reflect its actual costs.

642. *Price Cap Carriers.* Interstate access rates for price cap incumbent LECs are capped based on the individual carriers' price cap indexes after the Commission reduced interstate access charges for price cap carriers in the 2000 *CALLS Order*.<sup>993</sup> Under certain conditions, these rates are adjusted annually pursuant to the Commission's price cap rules.<sup>994</sup> As the Commission observed in the *Access Stimulation NPRM*, as a general matter, complaints regarding access stimulation activities have not directly involved price cap carriers.<sup>995</sup> The absence of access stimulation complaints against price cap incumbent LECs is not surprising given the low level of price cap LEC interstate access rates relative to other carrier types.

643. *Rate-of-Return Carriers.* Interstate access rates for rate-of-return incumbent LECs are not capped, but rather are designed to provide those carriers the opportunity to earn a rate-of-return by calibrating their interstate access charges to the level of demand for those services.<sup>996</sup> This linkage, for rate-setting purposes, between rates and demand has the effect of increasing rates as demand (i.e., the number of minutes) declines, or as costs increase. As discussed in greater detail below, many complaints regarding access stimulation activities have involved rate-of-return LECs. In 2007, the Commission took action to address initial concerns regarding access stimulation activity involving rate-of-return LECs.<sup>997</sup>

644. Rate-of-return LECs establish their interstate access rates by filing tariffs with the Commission. Commission rules provide rate-of-return LECs three alternative means for filing interstate access tariffs: (1) participation in the National Exchange Carrier Association (NECA) Tariff No. 5, which sets forth interstate access charges for participating LECs;<sup>998</sup> (2) filing a tariff pursuant to section 61.38 of the Commission's rules, which would be based on projected costs and demand; or (3) for carriers with 50,000 or fewer lines, filing a tariff pursuant to section 61.39 of the Commission's rules, which would be based on historical costs and demand.

645. Most rate-of-return LECs participate in a traffic-sensitive pool managed by NECA and participate in the traffic-sensitive tariff filed annually by NECA on behalf of participating members.<sup>999</sup> Interstate access rates in the traffic-sensitive tariff are set based on the projected aggregate costs (or average schedule settlements) and demand of all pool members and are targeted to achieve an 11.25 percent return.<sup>1000</sup> Each participating carrier receives a settlement from the pool based on either its costs plus a pro rata share of profits, receives a settlement pursuant to the average schedule formulas. Carriers may enter or leave the NECA pool on July 1 of any year by providing notice to NECA by the preceding March 1.<sup>1001</sup>

<sup>993</sup> See *CALLS Order*, 15 FCC Rcd at 12962.

<sup>994</sup> See 47 C.F.R. §§ 61.41-49.

<sup>995</sup> See *Access Stimulation NPRM*, 22 FCC Rcd at 18033, para. 33.

<sup>996</sup> See generally *id.* at 17992-93, paras. 6-8.

<sup>997</sup> See *infra* para. 657.

<sup>998</sup> See 47 C.F.R. § 69.601 *et seq.*

<sup>999</sup> See NECA, Inc., Tariff FCC No. 5, Title Pages 1-68.

<sup>1000</sup> In lieu of cost studies, average schedule carriers are compensated by formulas that establish settlements for average schedule carriers that are comparable to the settlements received by comparable cost companies. 47 C.F.R. § 69.606(a). The average schedule settlements are added to the costs of the cost companies to form the revenue requirement for the pool.

<sup>1001</sup> See 47 C.F.R. § 69.3(e)(6).

646. As an alternative to participating in the NECA tariff, a rate-of-return carrier may file its own access tariff(s) pursuant to the provisions of section 61.38 of the Commission's rules (section 61.38 carrier). Under section 61.38, a carrier is required to file access tariffs in even numbered years to be effective for a two-year period.<sup>1002</sup> A section 61.38 carrier files tariffed rates based on its projected costs and demand and targets its rates to earn an 11.25 percent return on its regulated rate base. If a section 61.38 carrier's demand increases above the level projected by the carrier in its tariff filing during the tariff period, it does not share the increased revenues with any other carrier. Accordingly, a section 61.38 carrier retains the increased revenues to the extent they exceed any increase in costs if the rates are "deemed lawful" as discussed below.

647. Finally, a rate-of-return carrier that has 50,000 or fewer access lines in a study area may elect to file its access tariffs in accordance with section 61.39 of the Commission's rules (section 61.39 carrier), which was adopted in the *Small Carrier Tariff Order* to simplify the procedures and reduce the cost of filing tariffs for small LECs.<sup>1003</sup> A carrier choosing to proceed under this rule is required to file access tariffs in odd numbered years to be effective for a two-year period.<sup>1004</sup> The initial rates of section 61.39 carriers are set based on historical costs (or average schedule settlements) and associated demand for the preceding year, which the Commission believed to reasonably reflect the costs of these carriers for the next two years.<sup>1005</sup> Section 61.39 carriers, therefore, do not have to project future test period costs and demand. These carriers do not pool their costs and revenues with any other carrier. Thus, if demand increases for the section 61.39 carrier, the carrier retains the revenues resulting from the increased demand to the extent they exceed any cost increase if the rates are "deemed lawful" as discussed below.

648. The ability of carriers filing interstate access tariffs under sections 61.38 and 61.39 to retain revenues generated from higher than projected (for 61.38) or historical (for 61.39) traffic volumes without adjusting their rates for the two-year period during which their tariffs are effective provides an incentive to engage in access stimulation activity. In particular, some rate-of-return LECs filing tariffs under section 61.39 could leave the NECA pool and establish rates based on historical demand when their demand was low, thus resulting in a high rate for the two-year effective period of the tariff. Once access charges are set at these levels, the LECs could enter into access stimulation arrangements, leading to and resulting in vastly higher traffic volumes than were used to set the rates and earnings far in excess of the authorized rate-of-return.<sup>1006</sup> Then, at the end of that two-year period, the LEC would reenter the NECA

<sup>1002</sup> See 47 C.F.R. § 69.3(f)(1).

<sup>1003</sup> See *Regulation of Small Telephone Companies*, CC Docket No. 86-467, Report and Order, 2 FCC Rcd 3811 (1987) (*Small Carrier Tariff Order*).

<sup>1004</sup> See 47 C.F.R. § 69.3(f)(2). These carriers have the option of filing tariffs pursuant to either section 61.38 or section 61.39. See 47 C.F.R. §§ 61.38 and 69.3(f)(1).

<sup>1005</sup> See 47 C.F.R. § 61.39(b); see also *Small Carrier Tariff Order*, 2 FCC Rcd at 3812, para. 7 (noting that this process "should not permit or provide incentives for small companies to file access tariffs producing excessive returns"). For subsequent tariff filings, cost carriers establish rates based on a cost of service study for Traffic Sensitive elements for the total period since the local exchange carriers' last annual filing, with related demand for the same period, while average schedule carriers establish rates based on an amount calculated to reflect the Traffic Sensitive average schedule pool settlement the carrier would have received if the carrier had continued to participate in the NECA pool, based upon the most recent average schedule formulas approved by the Commission. See 47 C.F.R. § 61.39(b)(2)(ii). Thus, because a section 61.39 carrier does not have to reflect future events affecting its cost or demand levels in the ratemaking process, high access rates are established based on low levels of demand, which, when the tariffed rates are deemed lawful, creates the arbitrage opportunity presented by access stimulation.

<sup>1006</sup> See, e.g., *Qwest Communications Corp. v. Farmers and Merchants Mut. Tel. Co.*, EB-07-MD-001, Memorandum Opinion and Order, 22 FCC Rcd 17973, 17980-83, paras. 21-25 (2007) (finding that Farmers' revenues increased many fold during the period at issue, without a concomitant increase in costs, and Farmers vastly exceeded the prescribed rate-of-return), *recon. in part on other grounds*, 23 FCC Rcd 1615 (2008), *further recon. on other grounds*, 24 FCC Rcd 14801 (2009).

traffic-sensitive pool to avoid basing its individual rates for the next two years on the high demand realized as a result of access stimulation.<sup>1007</sup>

649. *Competitive Local Exchange Carriers.* Unlike rate-of-return LECs, whose interstate access rate levels are linked to their own projected or historical demand and costs, competitive LECs do not tariff interstate access rates based on their own costs. Instead, competitive LECs generally are permitted to tariff interstate access charges at a level no higher than the tariffed rate for such services offered by the incumbent LEC serving the same geographic area (the benchmarking rule).<sup>1008</sup> The Commission adopted this “benchmarking” policy in response to the practice of some competitive LECs that were tariffing access rates for terminating traffic that were higher than the rates being charged by the incumbent LECs serving the same area. By “benchmarking” competitive LEC access rates to the access rates of the incumbent LEC serving the same area, the rule uses incumbent LEC access rates as a basis to establish a rate level that could be presumed to be just and reasonable. This regulatory framework was adopted to mimic the results of competition by capping rates at the level of the competing incumbent LEC, without the need to subject competitive LECs to detailed accounting and other regulatory requirements traditionally imposed in the context of incumbent LECs’ rates.

650. The Commission established an exemption for rural competitive LECs offering service in the same areas as non-rural incumbent LECs. This exemption permits rural competitive LECs to “benchmark” to the access rates prescribed in the NECA access tariff, assuming the highest rate band for local switching. This exemption was designed to recognize that a rural competitive LEC’s costs would be higher than those of a non-rural price cap LEC that was required to geographically average its access rates across its entire study area. The NECA rate was selected “because it is tariffed on a regular basis and is routinely updated to reflect factors relevant to pricing rural carriers’ access service.”<sup>1009</sup> Access stimulation, however, undermines this framework, because if a rate-of-return incumbent LEC that the competitive LEC is being benchmarked to were to experience the level of demand increase commensurate with access stimulating competitive LECs, they would be required to lower their access rates, likely quite significantly. Thus, access stimulation activities conducted by competitive LECs using the rural exemption, whose interstate access rates are benchmarked to the NECA tariff rates, exploit the lack of connection between the rates charged by the competitive LEC for providing switched access services (which are not affected by changes in demand) and the rates that would be charged by a rural incumbent LEC for providing such services (which are determined on the basis of a projected demand level).

651. *CMRS Providers.* CMRS providers are prohibited from filing interstate access tariffs.<sup>1010</sup> Accordingly, CMRS providers are entitled to collect access charges from a long distance carrier only pursuant to contract.<sup>1011</sup> Thus, as a practical matter, CMRS providers generally do not collect access charges for calls that originate or terminate on their networks. Accordingly, because CMRS providers are typically unable to collect access charges for traffic terminated on their networks, the potential incentives to engage in access stimulation are absent.

<sup>1007</sup> See July 2007 Annual Access Charge Tariff Filings, Petition of Verizon to Suspend and Investigate Tariff Filings, WCB/Pricing 07-10, at 10 (filed June 19, 2007) (identifying several carriers that have a history of exiting the NECA traffic-sensitive pool and having their access minutes increase significantly and then reentering the pool, after which minutes of use return to pre-exiting levels). See also Verizon Access Stimulation Comments at 7-8, 11.

<sup>1008</sup> See 47 C.F.R. § 61.26; see also *CLEC Access Reform Order*, 16 FCC Rcd 9923, 9925, para. 3.

<sup>1009</sup> *CLEC Access Reform Order*, 16 FCC Rcd at 9956, para 81.

<sup>1010</sup> See 47 C.F.R. § 20.15(c).

<sup>1011</sup> See *Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13198, para. 12 (2002) (*Sprint/AT&T Declaratory Ruling*), petitions for review dismissed, *AT&T Corp. v. FCC*, 349 F.3d 692 (D.C. Cir. 2003).

### b. Interstate Access Tariffs and Interexchange Carriers

652. The preceding discussion explained how, under the Commission's rules, incumbent LECs and competitive LECs establish interstate access rates. This section provides additional detail about the Commission's tariffing, call blocking and rate integration policies and how these policies affect access stimulation.

653. *Deemed Lawful Status.* Interstate access tariffs provide notice regarding the rates, terms and conditions applicable to interstate access service and provide the Commission and the public the opportunity to review the tariff filings to help ensure that they comply with governing rate regulations. In the 1996 Act, Congress enacted section 204(a)(3), which provides that LEC tariffs filed on seven days notice (when rates are reduced) or 15 days notice (for any other change) are "deemed lawful" following the notice period unless rejected or suspended and investigated by the Commission. In the *Streamlined Tariff Order*, the Commission concluded that a tariff filed pursuant to section 204(a)(3) (a "streamlined" tariff) that takes effect, without prior suspension and investigation, is conclusively presumed to be reasonable under section 201 and is thus protected from retrospective refund liability in a formal complaint proceeding, even if the carrier is ultimately found to have overearned.<sup>1012</sup>

654. *Call Blocking and Geographic Rate Averaging.* The Commission's prohibition of call blocking and the geographic rate averaging requirement in the Act are part of the background from which access stimulation arose. Commission precedent prohibits an IXC from unreasonably blocking calls to a customer of a LEC, even if that LEC is engaged in access stimulation, because the ubiquity and reliability of the nation's telecommunications network is of paramount importance to the goals of the Act.<sup>1013</sup> Meanwhile, geographic rate averaging, which precludes IXCs from charging customers in one state a rate different from that in another state, limits the IXCs' ability to directly pass the generally higher and typically "deemed lawful" tariffed interstate access charges of some mostly rural LECs on to the particular end-users placing calls to a stimulating entity in the LEC's service area.<sup>1014</sup> Customers initiating calls to access stimulating entities are generally unaware that their calls are part of an access stimulation arrangement and that very high access charges are being assessed on the IXC. IXCs who believe that a LEC's access charges are excessive may invoke the complaint processes to seek relief.<sup>1015</sup>

<sup>1012</sup> See *Implementation of Section 401(b)(1)(A) of the Telecommunications Act of 1996*, CC Docket No. 96-187, Report and Order, 12 FCC Rcd 2170 (1997) (*Streamlined Tariff Order*).

<sup>1013</sup> *Establishing Just and Reasonable Rates for Local Exchange Carriers; Call Blocking by Carriers*, WC Docket No. 07-135, Declaratory Ruling and Order, 22 FCC Rcd 11629 (2007).

<sup>1014</sup> See 47 U.S.C. § 254(g); 47 C.F.R. § 64.1801(b) (providing that "[a] provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each U.S. state at rates no higher than the rates charged to its subscribers in any other state."). Geographic rate averaging thus prohibits an IXC from charging customers a surcharge for the higher access charges often associated with access stimulation. The end-user customers therefore have no incentive to choose a LEC that charges low switched access charges, since he or she does not pay the charges directly. See *CLEC Access Reform Order*, 16 FCC Rcd at 9935–36, para. 31.

<sup>1015</sup> Section 203(c) provides two relevant requirements governing the tariffing of charges for telecommunication services. Section 203(c)(1) provides that no carrier shall "charge, demand, collect, or receive a greater or less or different compensation for such communication...than the charges specified in the schedule then in effect." 47 U.S.C. § 203(c)(1). This requirement is generally known as the filed rate doctrine. See, e.g., *AT&T Co. v. Central Office Tel., Inc.*, 524 U.S. 214 (1998) for a general description of the filed rate doctrine. As a corollary to subparagraph (1), section 203(c)(2) provides that no carrier shall "refund or remit by any means or device any portion of the charges so specified." 47 U.S.C. § 203(c)(2). A LEC that has not been paid its tariffed charges may proceed in federal court to recover the tariffed charges. See, e.g., *Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, Order, 19 FCC Rcd 7457, 7472 n.93 (2004) (long-standing Commission precedent holds that "under sections 206-209 of the Act, the Commission does not act as a collection agent for carriers with respect to unpaid tariffed charges, and that such claims should be filed in the appropriate state or federal courts").

But, where such activities are underway, the IXC must complete the calls and may not charge a higher rate to the caller. Because most interstate access rates today are “deemed lawful,” long distance carriers are not entitled to refunds for tariffed services even if the tariffed rates later are found to be unjust or unreasonable.

**c. Prior Commission Action**

655. The Commission has previously taken steps to curb arbitrage incentives created by above-cost intercarrier compensation rates. These measures primarily involved dial-up ISP-bound traffic and business schemes designed to generate profits from reciprocal compensation rates that were substantially higher than the carrier’s incremental cost of terminating a call.<sup>1016</sup> Although these schemes used reciprocal compensation rates, as opposed to access charges, they were, nevertheless, a form of arbitrage designed to stimulate traffic to generate intercarrier revenues.

656. Initial concerns about interstate access stimulation involved rate-of-return LECs, and the Commission took action to address these concerns in 2007. Specifically, the Wireline Competition Bureau suspended and designated for investigation the access tariffs of certain carriers allegedly involved in access stimulation.<sup>1017</sup> The 2007 *Designation Order* identified two safe harbor provisions that would allow the affected carriers to avoid the investigation if the carrier either: (1) elected to return to the NECA pool; or (2) added language to its tariff that would commit to the filing of a revised tariff if the filing carrier experienced a 100 percent increase in monthly demand over the same month in the prior year. Ultimately, the Wireline Competition Bureau terminated the tariff investigation because all carriers whose tariffs were subject to investigation elected to modify their tariffs consistent with one of the safe harbors.<sup>1018</sup>

657. In 2007, the Commission also initiated a rulemaking proceeding to seek comment on interstate access stimulation and tentatively concluded that rule modifications were necessary to ensure that interstate access charges remained just and reasonable.<sup>1019</sup> Since 2007, the record indicates that access stimulation activity by rate-of-return LECs has decreased, but that competitive LECs now conduct a significant amount of access stimulation, either by benchmarking to a particular rate-of-return LEC or relying on the rural exemption to benchmark to NECA rates.<sup>1020</sup>

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<sup>1016</sup> See *Inter-carrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) (*ISP Remand Order*); *remanded but not vacated by WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002); see also *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd 6475. The Commission also found “convincing evidence in the record” that carriers had “targeted ISPs as customers merely to take advantage of . . . intercarrier payments” (including offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud). See *ISP Remand Order*, 16 FCC Rcd at 9153, para. 2. It adopted an ISP payment regime to “limit, if not end, the opportunity for regulatory arbitrage.” See *id.* at 9187, para. 77.

<sup>1017</sup> See *July 1, 2007 Annual Access Tariff Filings*, WCB/Pricing No. 07-10, Order, 22 FCC Rcd 11619 (2007) (*Designation Order*).

<sup>1018</sup> See *Investigation of Certain 2007 Annual Access Tariffs*, WC Docket No. 07-184, WCB/Pricing File No. 07-10, Order, 22 FCC Rcd 21261 (2007) (*Termination Order*).

<sup>1019</sup> See *Access Stimulation NPRM*, 22 FCC Rcd 17989. The *Access Stimulation NPRM* sought comment on a variety of related issues, including: (1) whether switched access rates were becoming unjust and unreasonable because of excessive earnings; (2) whether any shared revenues are properly included in a rate-of-return LEC’s revenue requirement; (3) the possible use of growth triggers and tariff language to require the refiling of tariffs upon certain events occurring; (4) the use of LEC certifications that access stimulation was not being engaged in; and (5) possible modification of the benchmarking rules for competitive LECs.

<sup>1020</sup> Parties have also alleged that some competitive LECs appear to be affiliated with rate-of-return LECs. See Letter from Brian J. Benison, Director Federal Regulatory, AT&T, to Marlene Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. at 3 (filed Jan. 12, 2010); AT&T Access Stimulation Comments at 10.

## 2. Discussion

### a. Proposed Access Stimulation Rules

658. After considering comments received in response to the 2007 *Access Stimulation NPRM*, and in light of recent filings in the Commission's access stimulation docket, we conclude that it is appropriate to revisit our access charge rules. However, we seek to strike the appropriate balance of addressing the policy concerns outlined above without imposing unnecessary burdens on LECs or inadvertently stifling non-stimulated competition in rural areas. We therefore propose revisions to our interstate access rules and seek comment on whether our proposed revisions achieve our goal of providing a targeted response to address access stimulation while minimizing additional burdens on LECs not engaged in access stimulation.<sup>1021</sup>

659. *Trigger.* To address access stimulation, we propose to adopt a trigger based on the existence of access revenue sharing arrangements. As discussed below, once a particular LEC meets the trigger, it would be subject to modified access charge rules that would vary depending upon the nature of the carrier at issue. We believe this is the appropriate approach for several reasons. First, as recognized in the *Access Stimulation NPRM*<sup>1022</sup> and the resulting record, access revenue sharing arrangements commonly are used to facilitate access stimulation activity,<sup>1023</sup> as well as other forms of arbitrage.<sup>1024</sup> Second, the sharing of significant amounts of interstate access revenues with another entity (whether a third party or an entity affiliated with the LEC), raises questions about whether the underlying access rates remain just and reasonable, particularly given the policy concerns discussed above.<sup>1025</sup> Consequently, we propose that if a rate-of-return LEC or a competitive LEC is a party to an existing access revenue sharing agreement or enters into a new access revenue sharing agreement, the revised rules outlined below for interstate switched access charges would become applicable. More specifically, we propose to focus on revenue sharing arrangements between the LEC charging the access charges at issue and another entity that result in a net payment to that other entity over the course of the agreement. For this purpose, revenue sharing includes all payments, including those characterized as marketing fees or other similarly named payments that result in a net payment to the access stimulator. How should we address a revenue sharing arrangement within the same company where an explicit revenue sharing

<sup>1021</sup> To limit burdens associated with our proposal, we decline to propose measures suggested in the record to address access stimulation that rely on certifications or additional reporting. *See, e.g.,* AT&T Access Stimulation Comments at 25-26 (proposing certification requirements); Sprint Access Stimulation Comments at 19-20 (proposing self-reporting and certification requirements); Verizon Access Stimulation Comments at 18-19 (proposing certification requirements).

<sup>1022</sup> *See, e.g., Access Stimulation NPRM*, 22 FCC Rcd at 17997, para. 20 (seeking "comment on whether the Commission should examine any such [revenue sharing] payments, and, if the commenters believe that such payments should be examined, . . . [what] actions the Commission can or should take").

<sup>1023</sup> *See, e.g.,* AT&T Access Stimulation Comments at 6-11; Qwest Access Stimulation Comments at 3-10; Sprint Access Stimulation Comments at 2-10; Verizon Access Stimulation Comments at 8-10.

<sup>1024</sup> *See, e.g.,* Sprint Access Stimulation Comments at 4-5; Level 3 Petition for Declaratory Ruling Regarding Access Charges by Certain Inserted CLECs for CMRS-Originated Toll-Free Calls, CC Docket No. 01-92 at 2, 12-15 (filed May 12, 2009) (Level 3 Declaratory Ruling Petition) (the petition asks for Commission action clarifying the operation of the CLEC benchmark rules).

<sup>1025</sup> *See, e.g., Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606, 16619-20, para. 44 (*Access Charge Reform Second Order*) (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)) (recognizing that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking").

agreement may not exist? For instance, would the prohibition on cross-subsidization in section 254(k) address this concern and, if not, how could the Commission address it?<sup>1026</sup>

660. We invite parties to comment on whether there are revenue sharing arrangements that are in the public interest and on revisions that would be necessary to the proposed rules to ensure that such arrangements are not encompassed by the rule.<sup>1027</sup> We also ask parties to comment on the enforceability of this trigger. For example, how easy would it be for parties involved in access stimulation to reconfigure arrangements with their business partners to avoid a revenue sharing agreement trigger? Are there other aspects of such a trigger that would make it difficult to enforce? Alternatively, would enforcement have even more consequences than is the case today because, under the proposed rules, failure to file new tariffs when the trigger is met, or failure to disclose that the trigger is met, would be a violation of Commission rules?

661. *Revenue Requirement Treatment.* As reflected above, we do not propose to declare all payments to third parties as part of access stimulation activity to be *per se* unjust and unreasonable under section 201 of the Act.<sup>1028</sup> Even so, we agree with the tentative conclusion in the *Access Stimulation NPRM* that payments made by a LEC pursuant to an access stimulation arrangement are not properly included as costs in the incumbent LEC's interstate switched access revenue requirement.<sup>1029</sup> Such payments have nothing to do with the provision of interstate switched access service and are thus not used and useful in the provision of such service.<sup>1030</sup> Thus, consistent with the *Access Stimulation NPRM*, we propose to clarify prospectively that "a rate-of-return carrier that shares revenue, or provides other compensation to an end-user customer, or directly provides the stimulating activity, and bundles those costs with access is engaging in an unreasonable practice that violates section 201(b) and the prudent expenditure standard."<sup>1031</sup>

662. *Participation in NECA Tariffs.* The record indicates that although access stimulation is less likely in the NECA pooling context because the increased revenues must be shared amongst the pool members, it is not necessarily precluded.<sup>1032</sup> To address the possibility of access stimulation activity by a NECA tariff participant, under the proposed rules, a carrier would lose eligibility to participate in the NECA tariffs 45 days after meeting the trigger, or 45 days after the effective date of this rule if it currently meets the trigger. Such a carrier leaving the NECA tariff would have to file its own tariff(s) for interstate switched access, pursuant to the rules set forth for carriers subject to section 61.38. We invite

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<sup>1026</sup> 47 U.S.C. § 254(k).

<sup>1027</sup> For example, a number of local telephone companies operate as cooperatives, and as such, may have agreements to share their revenues with their members (who are customers for local service).

<sup>1028</sup> Parties are free to pursue complaints or other Commission action in specific instances if they believe it is warranted, however. This Notice should not be construed to resolve any pending access stimulation complaint addressing alleged access stimulation activity prior to the effectiveness of any final order in this proceeding.

<sup>1029</sup> *Access Stimulation NPRM*, 22 FCC Rcd at 17997, paras. 18-19. For example, in the case of conferencing service, these might include the cost of the conference bridge, the expenses of operating the bridge, and the costs of promotion.

<sup>1030</sup> See Embarq Access Stimulation Comments at 8; ITTA Access Stimulation Comments at 15; Ohio Comm'n Access Stimulation Comments at 6 (recovery of such costs is an unjust and unreasonable practice in violation of section 201(b) of the Act); Qwest Access Stimulation Comments at 15-16 (recovery of such costs is an unjust and unreasonable practice in violation of section 201(b) of the Act); Sprint Access Stimulation Comments at 9 (citing *Access Stimulation NPRM* at 17997, para. 19); Western Telecommunications Alliance Access Stimulation Comments at 13 (recovery of such costs should be prohibited as an unjust and unreasonable practice in violation of section 201(b) of the Act).

<sup>1031</sup> *Access Stimulation NPRM*, 22 FCC Rcd at 17997, para. 19.

<sup>1032</sup> See NECA Access Stimulation Comments at 3; Ohio Comm'n Access Stimulation Comments at 4.

comment on the need for this requirement and the impact, if any, it might have on the operation of the NECA pools.

663. *Projected Costs and Demand: Section 61.38.* A carrier filing interstate exchange access tariffs pursuant to section 61.38 of the Commission's rules would be required to file a new tariff within 45 days of meeting the proposed trigger if the costs and demand arising from the new revenue sharing arrangement had not been reflected in its most recent tariff filing. This requirement provides the carrier with the opportunity to show, and the Commission to review, any projected increase in costs, as well as to consider the higher anticipated demand in setting revised rates. In determining a reasonable rate, the carrier would not be permitted to include projected amounts paid to the entity stimulating traffic as a recoverable cost in its revenue requirement calculation, pursuant to section 61.38(b), absent Commission approval. We invite comment on these proposals for addressing carriers subject to section 61.38 of the Commission's rules.

664. *Historical Costs and Demand: Section 61.39.* LECs filing access tariffs pursuant to section 61.39 of the Commission's rules currently base their rates on historical costs and demand.<sup>1033</sup> Once such a carrier meets the relevant trigger under the proposed rules, it would lose the eligibility to file tariffs based on historical costs under that section. Instead, it would be required to file revised interstate access tariffs using the procedures set forth for carriers subject to section 61.38 of the Commission's rules, establishing its rates based on projected costs and demand.<sup>1034</sup> This rule change would not affect the ability of an eligible carrier to operate under the provisions of section 61.39 if it has not met the defined trigger.<sup>1035</sup> We invite parties to comment on this proposed change and its effectiveness in addressing the access stimulation issue with respect to carriers seeking to use section 61.39 to establish interstate switched access rates.

665. *Competitive LEC Benchmarking.* The historical justification for the current competitive LEC access charge rules involved a balancing of the need to ensure just and reasonable rates against the burden that would be imposed on competitive LECs from implementing detailed accounting and ratemaking requirements associated with using historical or projected costs as a basis for their interstate access rates. Without abandoning the premise of the existing framework, we believe that the record demonstrates a need to revisit the benchmarking levels once competitive LECs meet the relevant trigger. In particular, we propose that when competitive LECs meet the trigger, they would be required to benchmark to the rate of the BOC in the state in which the competitive LEC operates, or the independent incumbent LEC with the largest number of access lines in the state if there is no BOC in the state, if they are not already doing so.<sup>1036</sup> This modification recognizes that competitive LECs that meet the trigger have access demand likely to be more comparable to that of the BOC in the state or of the incumbent LEC with the largest number of access lines in the state, rather than smaller carriers to which they previously could have been benchmarking. The competitive LEC would have to file a revised tariff within 45 days of meeting the relevant trigger, or within 45 days of the effective date of the rule if it currently meets the trigger. We invite parties to comment on the adequacy of this proposal to address access stimulation activities of competitive LECs. We also invite parties to comment on whether competitive LECs that

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<sup>1033</sup> 47 C.F.R. § 61.39.

<sup>1034</sup> 47 C.F.R. § 61.38. For LECs with access sharing agreements, when these rules become effective, new tariffs must be filed within 45 days.

<sup>1035</sup> The Commission's premise in adopting the historical costing approach for smaller incumbent LECs was that rates based on the previous two years' historical cost and demand data would produce just and reasonable access rates going forward and that over-earnings and under-earnings would offset each other over time. *Small Carrier Tariff Order*, 2 FCC Rcd at 3812, paras. 12-13. As discussed above, however, the record reveals that some carriers have exhibited a pattern of gaming this regulatory regime through a process of exiting and subsequently re-entered the NECA traffic-sensitive pool. See *supra* para. 648.

<sup>1036</sup> See generally 47 C.F.R. § 61.26(b), (d), and (e).

engage in revenue sharing should be required to file tariffs that would conform with the requirements of section 61.38. Parties supporting this approach should identify and address the rule changes that would be necessary to implement such an approach. Parties should propose any simplifying steps that could be made to the section 61.38 requirements to address accounting and operational differences that may exist.

666. *Section 204(a)(3) (“Deemed Lawful”) Considerations.* Section 204(a)(3) provides that filed tariffs are “deemed lawful” unless suspended by the Commission within specified time periods.<sup>1037</sup> In practice, deemed lawful status means that a carrier providing service pursuant to a “deemed lawful” tariff cannot be subject to refund liability.<sup>1038</sup> However, the D.C. Circuit has recognized that the deemed lawful provision is not an unqualified right, but may be subject to reasonable limitations.<sup>1039</sup> In this context, whether a LEC has met a proposed access stimulation trigger might not be readily apparent when the tariff is filed. As a result, the LEC could invoke the “deemed lawful” protection to avoid refund liability, and effectively evade the operation of our proposed rules at least for a period of time, such as until a new tariff is filed. We accordingly propose to require LECs that meet the trigger to file tariffs on a notice period other than the statutory seven or fifteen days that would result in deemed lawful treatment. Both competitive LECs and incumbent LECs would be required to file on not less than 16 days’ notice. We seek comment on this analysis of the deemed lawful provision of section 204(a)(3) and our proposed filing requirements. Finally, if a LEC failed to comply with the proposed tariffing requirements, we would find such a practice to be an effort to conceal its noncompliance with the substantive rules proposed above that would disqualify the tariff from deemed lawful status.<sup>1040</sup> Such incumbent LECs would be subject to refund liability for earnings over the maximum allowable rate-of-return,<sup>1041</sup> and competitive LECs would be subject to refund liability for the difference between the rates charged and the rate that would have been charged if the carrier had used the prevailing BOC rate, or the rate of the independent LEC with the largest number of access lines in the state if there is no BOC. We invite parties to comment on this proposal for addressing situations in which a carrier does not make the necessary tariff filings.

#### **b. Other Proposals**

667. The record contains other alternatives for addressing access stimulation, on which we seek comment. For these alternatives, we invite parties to address how each approach would be more or less effective in responding to the access stimulation problem than the proposal outlined above. We also invite parties to comment on whether the alternative approaches may be more easily enforced than the revenue sharing agreement trigger. Commenters should also discuss the extent of any regulatory burdens associated with each approach.

668. *Trigger-Based Proposals.* A number of commenters proposed alternative approaches that would apply modified access charge rules to LECs in the case of particular triggering events or circumstances. For example, many of these proposals relied on forms of minutes-of-use triggers. In the case of rate-of-return LECs, many of these proposals suggested a trigger based on a particular percentage

<sup>1037</sup> See 47 U.S.C. § 204(a)(3).

<sup>1038</sup> See *id.*; see also *Streamlined Tariff Order*, 12 FCC Rcd at 2202-03, paras. 67-68.

<sup>1039</sup> In 2002, the United States Court of Appeals for the D.C. Circuit, in reversing a Commission decision that had found a tariff filing did not qualify for deemed lawful treatment and was thus subject to possible refund liability, noted that it was not addressing “the case of a carrier that furtively employs improper accounting techniques in a tariff filing, thereby concealing potential rate-of-return violations.” *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 413 (D.C. Cir. 2002).

<sup>1040</sup> The carrier would also be subject to sanctions for violating the Commission’s tariffing rules.

<sup>1041</sup> 47 C.F.R. § 65.700. An exchange carrier’s interstate earnings are measured in accordance with the requirements set forth in 47 C.F.R. § 65.702.

growth in traffic—such as 25 to 100 percent—over a specified period of time.<sup>1042</sup> Once the trigger is met under these proposals, the rate-of-return LEC would need to refile its tariff with reduced interstate access rates<sup>1043</sup> or, under some proposals, the rate-of-return LEC could enter the NECA pool.<sup>1044</sup> In the case of competitive LECs, many commenters' proposals recommended a trigger based on the average number of minutes per line per month, with the proposed triggers ranging from a few hundred minutes per line per month to several thousand minutes per line per month.<sup>1045</sup> We seek comment on these alternative proposals and the factual basis for adopting a particular trigger. In the case of proposed competitive LEC triggers, how have those proposals accounted for the non-stimulated competitive growth of competitive LECs or the possibility that competitive LECs might have a different mix of customers than incumbent LECs (e.g., business vs. residential), potentially resulting in differences in the average number of minutes per line, even when terminating the same number of minutes? We are concerned that the triggers in the record may be over-inclusive and capture LECs not engaging in access stimulation. Commenters advocating for a minutes or ratio trigger should demonstrate how the proposed trigger would not unnecessarily burden LECs that are not participating in any access stimulation arrangement. How would a minutes-of-use or other trigger be structured to ensure that it adapts to future traffic volumes?

669. We note that the Iowa Utilities Board (IUB) adopted rules to address intrastate access stimulation in Iowa that relied on certain triggering events or circumstances,<sup>1046</sup> and that Qwest filed a proposal in the record here, which it describes as based on the IUB's decision.<sup>1047</sup> Qwest's proposal

<sup>1042</sup> See, e.g., Verizon Access Stimulation Comments at 13, 18 (25 percent increase in traffic compared to the same quarter of the prior year); Qwest Access Stimulation Comments at 20-22 (100 percent increase in traffic compared to average monthly historical volume figures).

<sup>1043</sup> See, e.g., Sprint Access Stimulation Comments at 13-14; Qwest Access Stimulation Comments at 20-22.

<sup>1044</sup> See, e.g., Verizon Access Stimulation Comments at 13, 15.

<sup>1045</sup> See, e.g., Verizon Access Stimulation Comments at 26-27 (350 minutes of use per line per month); Letter from Glenn T. Reynolds, Vice President for Policy, USTelecom, *et al.* to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 4 (filed Oct. 8, 2010) (tie cap to the minutes of use per line of the 99<sup>th</sup> percentile of NECA Band 8 carriers, 406 minutes of use per line per month based on 2009 data); Letter from Jennifer Bagg, Counsel for Global Conference Partners, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 at 1 (filed Oct. 7, 2009) (Global Conference Partners Oct. 7, 2009 *Ex Parte* Letter) (1500 minutes of use per line per month); see also Letter from Jeff Holoubek, Director of Legal and Finance, Free Conferencing Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 2 (filed Oct. 27, 2010) (Free Conferencing Corp. Oct. 27, 2010 *Ex Parte* Letter) ("Specifically, a High-Volume Access (HVA) rate structure, which applies instead of the highest benchmark rate when telecommunications traffic to a rural area exceeds a pre-determined volume threshold established in the LEC's tariff, appropriately balances the competing intrerests by restraining IXC costs while allowing competitive carriers to continue enjoying the benefits contemplated in the rural exemption."). The proposals also varied in the regulation that would result once the competitive LEC trigger was met. Under some proposals, for example, the competitive LEC would be required to benchmark to the BOC or largest incumbent LEC in the state. See, e.g., Letter from Brian Benison, Director-Federal Regulatory, AT&T, and Steve Kraskin, Counsel to the Rural Independent Competitive Alliance (RICA), to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. at 1-2 (filed Nov. 25, 2008) (*ATT/RICA Proposal Letter*); Sprint Access Stimulation Comments at 18. Other proposals would adopt a rate cap at some other specified level. See, e.g., Global Conference Partners Oct. 7, 2009 *Ex Parte* Letter (\$.02 per minute).

<sup>1046</sup> *High Volume Access Service*, Docket No. RMU-2009-0009, 2010 WL 2343199 (Iowa Utils. Bd. 2010) (*Iowa Order*). The *Iowa Order* adopted a number of reforms applicable to "high-volume access services" (HVAS), defined as access growth of more than 100 percent in a six month time period. Pursuant to the *Iowa Order*, new obligations may arise when a LEC is adding a new HVAS customer or otherwise reasonably anticipates a HVAS situation, including notice, tariff approval, and good faith negotiation requirements. *Id.* 2010 WL 2343199 at \*4-10.

<sup>1047</sup> Letter from Melissa E. Newman, Vice President-Federal Relations, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 (filed June 17, 2010) (referencing an April 24, 2008, *ex parte* letter initially proposing the approach).

would prohibit a LEC from assessing tariffed switched access charges on an IXC for traffic delivered to a LEC's "business partner." For purposes of this proposal, business partner would be defined as: (1) the LEC itself; (2) any affiliate of the LEC; or (3) any entity that pays the LEC no net compensation, or that receives net compensation from the LEC, in connection with the LEC's delivery of telecommunications traffic to the entity.<sup>1048</sup> We seek comment both on the IUB's rules, and on the Qwest proposal based on that approach. In particular, we seek comment on the proposed definition of "business partner." We seek comment on whether this proposed definition would include interstate switched access charges for a toll call to a business office, which we believe should not be part of any such rule. Parties favoring this approach should suggest the rule language that would be needed to implement the proposal. Parties should also explain what procedures would be necessary to address any impasses that might develop in negotiations and the extent to which the Commission should specify the costing standard that should be used. For example, should the incremental cost approach adopted by the IUB be used, or some other standard?<sup>1049</sup>

670. *Categorical Approaches.* Other commenters have suggested that the Commission adopt a more categorical approach to address access stimulation. For example, some parties propose to modify aspects of the current competitive LEC access charge rules to eliminate the possibility of competitive LECs benchmarking to the highest access rates.<sup>1050</sup> Others propose that the Commission issue a declaratory ruling holding that some or all access revenue sharing arrangements are unjust and unreasonable under section 201 of the Act.<sup>1051</sup> We seek comment on whether, and how, this provision might apply in the context of access revenue sharing, either in the context of LEC access sharing arrangements with third parties, or when a LEC, rather than contracting with a third party, engages in access stimulation activity on an integrated basis. Another party has proposed separate definitions for "traffic pumping" and "access stimulation" and further suggested that while traffic pumping should be prohibited, access stimulation should be recognized as a legitimate practice.<sup>1052</sup> We seek comment on this proposal.

671. *Reciprocal Compensation.* We note that the *Access Stimulation NPRM* sought general comment on traffic stimulation in the context of reciprocal compensation.<sup>1053</sup> Recently, parties have alleged that some LECs are also adopting traffic stimulation strategies with respect to reciprocal compensation rates.<sup>1054</sup> Parties allege that high reciprocal compensation rates, just like high access charges, provide sufficient revenue streams for revenue sharing, which enables traffic stimulation activity. Unlike the access charge situation that relies on tariffs, however, reciprocal compensation arrangements are often negotiated arrangements between carriers, though they are sometimes set pursuant to state arbitration. As noted above, the Commission has previously taken steps pursuant to our interstate jurisdiction under section 201 of the Act to curb arbitrage involving dial-up ISP-bound traffic (which is

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<sup>1048</sup> According to Qwest, in a "high volume access" situation under the IUB's rules, IXCs and LECs have the opportunity to negotiate a reasonable rate for the high volume traffic, which would result in an appropriate tariff filing. If no negotiated agreement is reached, the IUB will prescribe a rate for the traffic based on the incremental costs of the LEC in processing the high volume access traffic. *Id.* at 1.

<sup>1049</sup> See *Iowa Order*, 2010 WL 2343199 at \*6-9.

<sup>1050</sup> See, e.g., Letter from David Frankel, CEO, ZipDX, LLC, to Sharon Gillett, Chief, Wireline Competition Bureau, FCC, WC Docket No. 07-135 at 6 (filed Nov. 6, 2009).

<sup>1051</sup> See, e.g., AT&T Access Stimulation Comments at 32; Qwest Access Stimulation Comments at 15; CTIA Aug. 26, 2010 *Ex Parte* Letter, Attach. at 5.

<sup>1052</sup> See Free Conferencing Corp. Oct. 27, 2010 *Ex Parte* Letter at 1-2.

<sup>1053</sup> *Access Stimulation NPRM*, 22 FCC Rcd at 18004-05, para. 38.

<sup>1054</sup> 47 U.S.C. § 251(b)(5). See e.g., Letter from Tamara L. Preiss, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 (filed July 28, 2010); CTIA Aug. 26, 2010 *Ex Parte* Letter, Attach.

interstate traffic) and business schemes designed to generate profits from reciprocal compensation rates that were substantially higher than the carrier's incremental cost of terminating a call.<sup>1055</sup>

672. In particular, CTIA alleges that traffic stimulation involving reciprocal compensation rates between CMRS providers and competitive LECs is increasing.<sup>1056</sup> According to commenters, this can occur with intraMTA calls when the terminating carrier takes steps to stimulate traffic volumes to create a positive revenue stream from the reciprocal compensation payments.<sup>1057</sup> To address these concerns, CTIA urges the Commission to adopt rules to curtail traffic stimulation by adopting the following trigger: if a LEC's terminating to originating traffic exceeds a 3:1 ratio, it would be subject to bill-and-keep.<sup>1058</sup> We invite parties to quantify the extent of this problem today, and the steps that could be taken to address the stimulation activity, including the CTIA proposal. We also ask whether our proposals for comprehensive reform discussed above mitigate concerns about such activities in the reciprocal compensation context.

673. We seek comment on the impact, if any, of the Commission's recent *North County* decision.<sup>1059</sup> We ask commenters to explain specifically how and to what extent the decision has had any impact on traffic stimulation. We seek comment on whether, as an interim measure, the Commission should adopt any procedural or substantive rules governing competitive LEC-CMRS compensation arrangements under section 20.11 of the Commission's rules.<sup>1060</sup> For example, should the Commission establish a default rate for all such traffic, such as the .0007 rate proposed by Verizon,<sup>1061</sup> or provide a federal methodology such as the pricing methodology applicable to reciprocal compensation under Part 51 of the Commission's rules?<sup>1062</sup> Should the Commission clarify that carriers may only assess a charge under section 20.11 after an agreement has been signed?

674. We also invite parties to comment on whether our proposed rules to address access stimulation would also be appropriate in the reciprocal compensation stimulation context. Alternatively, should the Commission, as CTIA suggests, adopt a trigger or rules to identify these types of stimulation arrangements, and if so, which trigger or rules, and what remedy should be adopted for such stimulation arrangements? Does the Commission have authority to do so? If so, who would resolve disputes that a stimulation arrangement exists: the Commission, states, or courts? Elsewhere, we seek comment on whether the Commission has authority to apply a bill-and-keep methodology to traffic that is within the scope of section 251(b)(5).<sup>1063</sup> Would this authority also support a rule to impose bill-and-keep on a subset of such traffic such as in the CTIA proposal? For CMRS traffic, could we, subject to section 201

<sup>1055</sup> See *supra* para. 655. The Commission has found that reciprocal compensation rates whether "inefficiently structured or set too high, do not simply compensate the terminating network, but also appear to generate profits for each minute that is terminated." See *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9616, para 11. The Commission adopted rules to address the arbitrage, but the scope of the decision was limited to dial-up ISP traffic.

<sup>1056</sup> CTIA Aug. 26, 2010 *Ex Parte* Letter, Attach. at 5.

<sup>1057</sup> See Leap Wireless Access Stimulation Comments at 3, 5; MetroPCS Access Stimulation Comments at 5-6 (noting that, "[t]hese incentives have caused carriers to adopt one-way traffic business models purposefully designed to generate inbound-only traffic from CMRS carriers and other telecommunications carriers").

<sup>1058</sup> See CTIA Aug. 26, 2010 *Ex Parte* Letter, Attachment at 5.

<sup>1059</sup> *North County Communications Corp. v. MetroPCS California, LLC*, Memorandum Opinion and Order, 24 FCC Rcd 3807 (Enf. Bur. 2009), *pet. for recon. granted in part and denied in part*, 24 FCC Rcd 14036 (2009), *pet. for rev. pending sub nom., MetroPCS California, LLC v. FCC*, No. 10-1003 (D.C. Cir. filed Jan. 11, 2010).

<sup>1060</sup> See 47 C.F.R. § 20.11.

<sup>1061</sup> See Letter from Tamara Preiss, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 3 (filed June 28, 2010).

<sup>1062</sup> See 47 C.F.R. Part 51.

<sup>1063</sup> See *supra* Section XI.

or 332 of the Act and the rationale adopted in the *ISP Remand Order*, establish traffic stimulation triggers or rules?<sup>1064</sup> We invite parties to comment on these proposals or to suggest other approaches, explaining why such approaches might be more appropriate.

675. *Intrastate Access Stimulation.* Some states, such as Iowa, have taken action to curb access stimulation associated with intrastate access rates.<sup>1065</sup> We seek comment on the scope and magnitude of any intrastate access stimulation. We seek comment on actions other states may have taken to address intrastate access stimulation.<sup>1066</sup> We are especially interested in any lessons that we can learn from the results of those state efforts.

676. *Potential Public Interest Benefits.* Some commenters have recently asserted that access stimulation is good public policy because, for example, it generates revenues that LECs can use to fund broadband deployment, or to provide Internet service and other benefits to Tribal lands.<sup>1067</sup> Some commenters also claim that the free services, such as conference calling, made possible through revenue sharing in access stimulation arrangements are a public good.<sup>1068</sup> As a threshold matter, we note that the Commission previously indicated that the use of access charges to subsidize chat lines or similar services would not be consistent with the policies underlying its access charge rules.<sup>1069</sup> Similarly, we note that section 254(k) of the Act provides that a “telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition.”<sup>1070</sup> However, we seek comment on these assertions, and, whether we should, as a result of them, consider alternative approaches to address access stimulation from those contained in our proposed rules. In addition, we seek comment on the potential negative impact of access stimulation practices on the development of sustainable, ubiquitous networks capable of supporting Tribal economic development, education, health care, public safety, and other needs.

677. Finally, we invite parties to comment on other regulatory and policy implications of access stimulation. For example, we invite parties to comment on whether Commission actions in the context of tariff reviews or enforcement proceedings have altered any of the relationships between LECs and access stimulators. We also seek comment on whether any other specific regulatory or policy considerations should inform our rules, such as the ban on off-tariff rebates in section 203(c) of the Act.<sup>1071</sup> If a LEC is providing tariffed service to a customer and enters into an access revenue sharing

<sup>1064</sup> See *ISP Remand Order*, 16 FCC Rcd at 9187-88, para. 79 (adopting a rebuttable presumption that traffic delivered to a carrier that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic).

<sup>1065</sup> See *supra* para. 669.

<sup>1066</sup> See NARUC, Resolution Supporting Expeditious FCC Action of Traffic Pumping Schemes at 2 (2010), at <http://www.naruc.org/Resolutions/Resolution%20Supporting%20FCC%20Action%20on%20Traffic%20Pumping.pdf> (acknowledging “the need for the FCC to act immediately to address the issue of traffic pumping and not wait for the finalization of comprehensive inter-carrier compensation reform”).

<sup>1067</sup> See Hypercube & McLeodUSA Access Stimulation Comments at 8; Futurephone Access Stimulation Reply at 4; Letter from Dr. Alan Pearce, President, Information Age Economics, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. 5-6 (“Fact Report: The Economic Impact of Free Conference Calling Services”) (filed March 1, 2010); Letter from Dave Butts, Founder, Harvest Prayer Ministries, to Marlene Dortch, Secretary, FCC, WC Docket No. 07-135 (filed Oct. 12, 2010).

<sup>1068</sup> See Global Conference Partners Access Stimulation Comments at 4-7; Rural Iowa Independent Telephone Association Access Stimulation Comments at 2-3; Chase Com, *et al.* Access Stimulation Reply at 5-6; Futurephone Access Stimulation Reply at 5-8.

<sup>1069</sup> See *Access Stimulation NPRM*, 22 FCC Rcd at 17994-95, para. 12.

<sup>1070</sup> 47 U.S.C. § 254(k).

<sup>1071</sup> 47 U.S.C. § 203(c), which provides that “no carrier shall...refund or remit by any means or device any portion of the charges so specified [in the filed schedules].” The penalties applicable to carriers who provide untariffed rebates and to customers who accept them are spelled out in section 503 of the Act. 47 U.S.C. § 503.

agreement with that same customer, but not other similarly situated customers, would such an arrangement violate section 203(c) or any other provision of the Act?<sup>1072</sup> We note that the prohibition on rebates has long been an important guard against rate discrimination,<sup>1073</sup> and that the Commission has been vigilant in its review under section 203(c).<sup>1074</sup> We also note that section 203(c) claims have been asserted by carriers in the context of access stimulation disputes.<sup>1075</sup> We seek comment on whether the refund prohibition in section 203(c) of the Act has a prohibitive effect on revenue sharing arrangements between LECs and access stimulating entities, or, if there are aspects of these relationships that fall outside the scope of this statutory provision.

## XVI. INTERCONNECTION AND RELATED ISSUES

678. In this section, we seek comment on several issues related to intercarrier compensation reform, including other steps we can take to promote IP-to-IP interconnection, network edges and points of interconnection (POIs), transiting, and disputes that have arisen over other technical issues in intercarrier compensation rules and carrier practices.<sup>1076</sup> For each of these issues, we ask whether the Commission should address the issue as part of comprehensive intercarrier compensation reform, and if so, at what stage of reform it should be addressed, and what actions the Commission should take. We also seek comment on whether there are any other outstanding technical issues related to intercarrier compensation reform that the Commission should address, and, if so, when and how the Commission should address them.

679. *Additional Steps to Encourage IP-to-IP Interconnection.* As discussed above, we seek to encourage the deployment of more efficient technologies and interconnection. In addition to intercarrier compensation reforms considered above, are there other ways to address disincentives to move to IP-to-IP interconnection or any other specific actions that the Commission should take to encourage transitions to IP-to-IP interconnection? For example, we note that interconnection for circuit-switched voice traffic is governed by section 251 of the Act. At the same time, there historically have not been Commission rules governing IP interconnection for the exchange of Internet traffic. As networks evolve, however, it may make little sense for providers to maintain different interconnection arrangements for the exchange of VoIP and other forms of Internet traffic. We therefore seek comment on how IP-to-IP interconnection arrangements for the exchange of VoIP traffic fit within existing legal and technical interconnection

<sup>1072</sup> 47 U.S.C. § 203(c).

<sup>1073</sup> *AT&T Co. v. Central Office Tel., Inc.*, 524 U.S. 214, 222-223 (1998).

<sup>1074</sup> See, e.g., *Revisions to AT&T Communications Tariff F.C.C. No. 1, Hospitality Network Service*, Transmittal No. 1046, 3 FCC Rcd 975, 976, para. 10 (CCB 1988) (suspending tariff revisions pending investigation of tentative conclusion that payment plan represented an illegal rebate), *terminated as moot*, Order, 3 FCC Rcd 3961 (CCB 1988) (investigation terminated due to withdrawal of tariff transmittal).

<sup>1075</sup> See, e.g., *N. Valley Commc'ns, LLC v. Qwest Commc'ns Corp.*, 711 F. Supp. 2d 1018, 1026 (D. S.D. 2010) (rejecting motion to dismiss claim alleging that payment of marketing fees to conference calling companies may represent an illegal rebate under § 203(c)(2)), *case stayed pending referral*, No. 09-1004, slip op. at 6-7 (D. S.D. Sept. 29, 2010).

<sup>1076</sup> See, e.g., *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4737-48, paras. 120-43; *Pleading Cycle Established for Petition of Blue Casa Communications, Inc. for Declaratory Ruling Concerning Inter-carrier Compensation for ISP-Bound VNXX Traffic*, WC Docket No. 09-8, Public Notice, 24 FCC Rcd 2436 (2009) (*Blue Casa VNXX Petition Public Notice*); *Pleading Cycle Established for Petition of ASAP Paging, Inc. for Preemption of the Public Utility Commission of Texas Concerning Retail Rating of Local Calls to CMRS Carriers*, WC Docket No. 04-6, Public Notice, 19 FCC Rcd 936 (2004) (*ASAP Paging Petition Public Notice*); *Comment Sought on Sprint Petition for Declaratory Ruling Regarding the Routing and Rating of Traffic by ILECs*, CC Docket No. 01-92, Public Notice, 17 FCC Rcd 13859 (2002) (*Sprint Rating and Routing Petition Public Notice*).

frameworks.<sup>1077</sup> Does this present any challenges or otherwise have any implications for the actions the Commission should consider in the context of this proceeding?<sup>1078</sup>

680. *Points of Interconnection and Network Edges.* In past intercarrier compensation rulemaking items, the Commission sought comment on requirements and methods for establishing POIs and on proposed rules for network “edges.”<sup>1079</sup> With regard to network edges, proposals to treat traffic under a bill-and-keep methodology typically assume the existence of a network edge, beyond which terminating carriers cannot charge other carriers to transport and terminate their traffic. This approach requires that the calling party’s service provider transmit, route and otherwise perform all the network functions necessary to deliver traffic to the network edge of the called party’s service provider. Both the ICF<sup>1080</sup> and Missoula<sup>1081</sup> plans generally proposed that the edge be set at the tandem switch for incumbent LECs with hierarchical networks, and at the local switch for CMRS, competitive LEC, and rural LEC networks. In the 2008 ICC/USF FNPRM, the proposed network edge was the location of the called party’s end office, mobile switching center (MSC), point of presence, media gateway, or trunking media gateway unless that location subtended a tandem switch owned or controlled by that service provider, in which case the tandem was the network edge.<sup>1082</sup>

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<sup>1077</sup> See, e.g., Letter from Mary C. Albert, Assistant General Counsel, COMPTTEL, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket No. 10-143 at Attach. (filed Nov. 1, 2010); Letter from Kathleen Grillo, Senior Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51 at 3-4 (filed Jan. 13, 2010).

<sup>1078</sup> The National Broadband Plan recommended that the “FCC should carefully monitor compensation arrangements for IP traffic as the industry transitions away from per-minute rates, particularly in areas where there is little or no competition, to ensure that such arrangements do not harm the public interest.” National Broadband Plan at 150.

<sup>1079</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4728-29, paras. 92-94 & nn.303-05; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6493, para. 40; *id.* at 6619-20, App. A, para. 275; *id.* at 6818-19, App. C, para. 270.

<sup>1080</sup> Regulatory Reform Proposal of the Intercarrier Compensation Forum (ICF Proposal), attached to Letter from Gary M. Epstein and Richard R. Cameron, Counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, App. A, at 4-9 (filed Oct. 5, 2004).

<sup>1081</sup> Missoula Plan for Intercarrier Compensation Reform at 42-46 (Missoula Plan), attached to Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, NARUC Task Force, and Larry Landis, Commissioner and Vice-Chair, NARUC Task Force, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 24, 2006).

<sup>1082</sup> See *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6619-20, App. A, para. 275; *id.* at 6818-19, App. C, para. 270. The primary difference between the two edge interconnection proposals contained in the appendices to the *2008 Order and ICC/USF FNPRM* was consideration of a “rural transport rule” that would have limited the transport and provisioning obligations of a rural rate-of-return regulated incumbent LEC to its meet point when the non-rural terminating carrier’s point of presence is located outside of the rural rate-of-return incumbent LEC’s service area. Compare *id.* at 6619-20, App. A, para. 275 with *id.* at 6818-19, para. 270. Support for these proposed network edge rules varied greatly in the record. See, e.g., Verizon and Verizon Wireless 2008 ICC/USF FNPRM Comments at 53-58 (supporting the proposed edge rules but not the rural transport rule); CTIA 2008 ICC/USF FNPRM Comments at 29-33 (also supporting the proposed edge rules but not the rural transport rule); AT&T 2008 ICC/USF FNPRM Reply at 17-18 (defending the proposed network edge rules); Comcast 2008 ICC/USF FNPRM Reply at 7-8 (arguing that the proposed network edge rules “fail to account for the complexity of existing interconnection arrangements and ignore current network configurations designed to achieve network efficiencies”); NTCA 2008 ICC/USF FNPRM Reply at 29 (asking the Commission to dismiss the AT&T Edge proposal and seek further comment); Paetec Communications, Inc., et al. 2008 ICC/USF FNPRM Reply Comments at ii (urging the Commission to reject the proposed network edge rules).

681. Several parties maintain that the edge proposals currently in the record do not acknowledge or contemplate IP-based interconnection.<sup>1083</sup> We invite comment on whether the Commission should address POI and network edge issues as part of comprehensive intercarrier reform, and, if so, when they should be addressed and what actions the Commission should take to address them.<sup>1084</sup> If commenters believe we should address the edge as part of comprehensive reform, we seek comment on how we should define the edge for purposes of the reform proposals described herein. If we ultimately adopt bill-and-keep, we ask parties to identify the specific network facilities, functions and services that would be subject to that methodology. With regard to access charges, parties should identify what access rate elements would be subject to bill-and-keep and whether such definitions should change depending on the reform approach adopted by the Commission. We also seek comment on how an edge definition may need to be adjusted as IP technology replaces circuit-switched technology, and as networks evolve.

682. In prior proceedings, the issue of mandatory POIs has been raised,<sup>1085</sup> and certain parties, including incumbent LECs, have argued that carriers should be required to establish a minimum number of physical POIs, or at least establish a physical POI in a geographic area they intend to serve.<sup>1086</sup> Under section 251(c)(2)(B), an incumbent LEC must allow a requesting telecommunications carrier to interconnect at any technically feasible point.<sup>1087</sup> The Commission has interpreted this provision to mean that competitive LECs have the option to interconnect at a single POI per LATA.<sup>1088</sup> We seek comment

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<sup>1083</sup> See, e.g., Comcast 2008 ICC/USF FNPRM Comments at 21 (maintaining that these proposals are based on “an already outdated circuit-switched network hierarchy” and that such an approach “would likely have a significant negative effect on provider investment and deployment decisions”); COMPTel 2008 ICC/USF FNPRM Comments at 23 (noting that, given the conversion from circuit-switched to IP-based networks, the default edge rules may be irrelevant by the time they take effect); NCTA 2008 ICC/USF FNPRM Comments at 20-21 (explaining that the 2008 edge proposals do not seem to contemplate the interconnection of IP networks or the exchange of traffic in IP format).

<sup>1084</sup> The record suggests that there is disagreement as to whether the Commission must address edge and related interconnection issues concurrent with implementation of rate reform. Compare, e.g., COMPTel 2008 ICC/USF FNPRM Comments at 20 (stating that the Commission need not adopt network architecture rules to implement reform) with AT&T 2008 ICC/USF FNPRM Reply at 19 (contending that default interconnection rules are a critical component of any reform plan).

<sup>1085</sup> See *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9650-52, paras. 112-14; *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4725-30, paras. 87-97; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6619-20, App. A, para. 275; *id.* at 6818-19, App. C, para. 270. See also *infra* note 1092 (discussing competitive carrier concerns that the certain edge proposals would affect statutory interconnection rights and obligations).

<sup>1086</sup> See, e.g., Michigan Exchange Carriers Association Inter-carrier Compensation NPRM Comments at 44; SBC Inter-carrier Compensation NPRM Comments at 18-19; Letter from Daniel Mitchell, Vice President, Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Nov. 21, 2008); Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 2.

<sup>1087</sup> See 47 U.S.C. § 251(c)(2)(B). We note that rural telephone companies are exempt from 251(c) obligations by virtue of what is termed the “rural exemption.” See 47 U.S.C. § 251(f)(1)(A) (stating that “[s]ubsection (c) of this section [251] shall not apply to a rural telephone company until (i) such company has received a bona fide request for interconnection, services, or network elements, and (ii) the State commission determines (under subparagraph (B)) that such request is not unduly economically burdensome, is technically feasible, and is consistent with section 254 (other than subsections (b)(7) and (c)(1)(D) thereof”).

<sup>1088</sup> See *Application by SBC Communications Inc., Southwestern Bell Tel. Co. And Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services In Texas*, CC Docket No. 00-65, Memorandum Opinion and Order, 15 FCC Rcd 18354, 18390, para. 78 n.174 (2000).

on whether the transition from circuit-switched to IP networks may affect our rules concerning POIs.<sup>1089</sup> We also seek comment on whether information in the record concerning POIs and “edges” is still relevant or useful, or if the underlying issues have changed.<sup>1090</sup> If the issues have changed, we invite parties to provide current information to identify issues that the Commission should consider. In this regard, we note that under the existing interconnection system, situations arise where carriers are financially responsible for network design or interconnection decisions that they do not control.<sup>1091</sup> We invite parties to address the extent to which the definition of the edge or POI should align the payment responsibility with the control of the design, provisioning, and cost incurrence. Recognizing that interconnection and network architecture may change over time, we also ask parties to comment on the extent to which the location of a POI should be defined in a competitively neutral location for all networks. Parties supporting such an approach should address the appropriate definition of a “competitively neutral location.” One approach may be to locate the POI where interconnecting carriers have competitive alternatives—other than services or facilities provided by the terminating carrier—to transport traffic to the terminating carrier’s network. We seek comment on these questions.

683. *Transiting.* Transiting occurs when two carriers that are not directly interconnected exchange non-access traffic by routing the traffic through an intermediary carrier’s network. The Commission has previously sought comment on issues that arise under the intercarrier compensation rules when calls involve a transit service provider.<sup>1092</sup> Specifically, the Commission sought comment on whether there is a statutory obligation to provide transit service under the Act and if so, what rules the Commission should adopt to advance the goals of the Act.<sup>1093</sup> Numerous parties commented on transit issues in response to the 2005 FNPRM<sup>1094</sup> and 2008 ICC/USF FNPRM.<sup>1095</sup> More recently, the record in

<sup>1089</sup> For example, two parties suggest that the Commission establish default interconnection and intercarrier compensation rules applicable to packetized voice traffic. See Letter from Kathleen O’Brien Ham, Vice President, Federal Regulatory Affairs, T-Mobile USA, Inc. and Charles W. McKee, Vice President, Government Affairs, Federal and State Regulatory, Sprint Nextel Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at 2-3 (filed Jan. 21, 2011) (urging the Commission to adopt initial interconnection rules regarding the establishment of POIs for the exchange of traffic using Session Initiated Protocol (SIP), with long term interconnection rules based on recommendations from a Technical Advisory Committee, and to establish default rules establishing providers’ respective financial obligations for transporting and terminating packetized voice traffic).

<sup>1090</sup> For instance, in 2008, some competitive carriers voiced concern that the proposed edge rules would alter the statutory interconnection rights of carriers or displace voluntary interconnection arrangements. See, e.g., Broadview Networks, Inc., et al. 2008 ICC/USF FNPRM Comments at 46-47; Citynet, LLC, et al. 2008 ICC/USF FNPRM Comments at 13-14; COMPTTEL 2008 ICC/USF FNPRM Comments at 20-21; Embarq 2008 ICC/USF FNPRM Comments at 51; NCTA 2008 ICC/USF FNPRM Comments at 18-19. But see AT&T 2008 ICC/USF FNPRM Reply Comments at 17-18 (discussing these positions and refuting these claims).

<sup>1091</sup> For example, one party alleges that competitive LECs are being unnecessarily inserted into the traffic flow between CMRS carriers and incumbent LEC tandem transit providers to collect access fees from interexchange carriers. See Level 3 Declaratory Ruling Petition at 1-7.

<sup>1092</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4737-44, paras. 120-33; 2008 *Order and ICC/USF FNPRM*, 24 FCC Rcd at 6650, App. A, para. 347; *id.* at 6849, App. C para. 344.

<sup>1093</sup> See *Inter-carrier Compensation FNPRM*, 20 FCC Rcd at 4737-44, paras. 120-33.

<sup>1094</sup> See, e.g., Allied National Paging Association Comments *Inter-carrier Compensation FNPRM* Comments at 6; BellSouth *Inter-carrier Compensation FNPRM* Comments at 32-38; Cincinnati Bell *Inter-carrier Compensation FNPRM* Comments at 15-16; Coalition for Capacity-Based Access Pricing *Inter-carrier Compensation FNPRM* Comments at 28-29.

<sup>1095</sup> See, e.g., Coalition for Rational Universal Service and *Inter-carrier Reform 2008 ICC/USF FNPRM* Comments at 6 (seeking a definition of transit obligations); Comcast 2008 ICC/USF FNPRM Comments at 28-30 (asking the Commission to affirm that transit arrangements are subject to the section 251/252 negotiation and arbitration process); Embarq 2008 ICC/USF FNPRM Comments at 64-65 (arguing that transit service should be subject to negotiation); Integra Telecom 2008 ICC/USF FNPRM Comments at 4 (seeking regulation of transit rates using a (continued....))

this proceeding indicates that a competitive market for transit services exists.<sup>1096</sup> In light of these changes in the transit market, we invite parties to refresh the record with regard to the need for the Commission to regulate transiting service, and the Commission's authority to do so.<sup>1097</sup> We also ask parties to comment on whether the proposed reforms under consideration here would impact the provision of transit service and if so, how.

684. *Other Pending Issues.* Below, we seek comment on other pending items and ask whether any of these issues may be rendered moot by proposed reforms under consideration here. If pending issues need resolution, parties should explain how such proposals may be implicated by the reforms proposed today, and parties may refresh the record in this proceeding regarding: (1) interpretation of the intraMTA rule;<sup>1098</sup> (2) disputes regarding rating and routing of traffic;<sup>1099</sup> and (3) the appropriate intercarrier compensation regime applicable to virtual central office code calls to distant ISPs.<sup>1100</sup> We also invite comment on any other outstanding technical or policy issues related to intercarrier compensation reform that the Commission should address.<sup>1101</sup> Parties commenting on other outstanding

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forward-looking methodology); T-Mobile 2008 ICC/USF FNPRM Comments at 3, 14-15 (stating that incumbent LECs should be required to provide tandem transit services upon request and that rates should be reduced to cost-based levels); AT&T 2008 ICC/USF FNPRM Reply at 20-22 (urging the Commission to refrain from regulating transit service or rates); TW Telecom, Inc., et al. 2008 ICC/USF FNPRM Reply at 14 (seeking regulation of tandem transit rates).

<sup>1096</sup> See, e.g., Letter from Russell M. Blau, Counsel for Neutral Tandem, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135, Attach. A at 3 (filed Sept. 23, 2010); AT&T 2008 ICC/USF FNPRM Reply Comments at 21-22 (stating that transit has become a competitive service).

<sup>1097</sup> In 2008, we sought comment on a proposal related to call signaling information that would have, among other things, obligated transit service providers, in certain circumstances, to take financial responsibility for traffic they receive for delivery via transit service. See *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6647-48, App. A, para. 337; *id.* at 6846-47, App. C, para. 333.

<sup>1098</sup> 47 C.F.R. 51.701(b)(2). In the *Local Competition First Report and Order*, the Commission stated that traffic to or from a CMRS network that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges. See *Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; see also 47 C.F.R. § 24.202(a) (defining the term "Major Trading Area").

<sup>1099</sup> Under the current system, wireline carriers often determine whether a phone call is local or toll by comparing the rating points associated with the originating and terminating NXX codes. To give wireless customers the same inbound local calling area that these customers have with their wireline phones, CMRS providers obtain NXX codes that are rated in the customer's wireline rate center. In some cases, however, the routing point for the wireless number, which indicates the geographic point to which calls to the wireless number should be routed, is located outside of the customer's rate center. Specifically, because CMRS providers will generally connect with small LECs indirectly through a BOC's tandem, the routing point specified for these NXXs often is a BOC tandem. In these situations, CMRS providers obtain NXX codes with different rating and routing points. See, e.g., Sprint Petition for Declaratory Ruling, CC Docket No. 01-92 (filed May 9, 2002) (Sprint Petition).

<sup>1100</sup> Virtual central office codes, sometimes referred to as virtual NXX codes, are central office codes that correspond to a particular geographic area, but are assigned to a customer physically located in a different geographic area. See *Inter-carrier Compensation NPRM*, 16 FCC Rcd 9610, 9652 n.188. Competitive LECs typically assign virtual NXX codes to business customers that receive significant amounts of traffic, including Internet service providers. When a virtual NXX number is assigned, the NPA/NXX is no longer associated with the specific geographic location, i.e., rate center, in which the customer is located. As a result, a call from one rate center or local calling area to another may appear to be within the same rate center or local calling area based on a simple comparison of the NPA/NXX codes. Previously, the Commission sought comment on whether the LEC using the virtual NXX code should be required to provide transport from the central offices associated with those NXX codes. See *Inter-carrier Compensation NPRM*, 16 FCC Rcd at 9652, para. 115.

technical issues should also identify what action the Commission should take, and when during the comprehensive reform process the action should be taken.

685. With regard to the intraMTA rule, the Commission previously sought comment on a number of issues related to this rule, including whether it should be eliminated, particularly in light of intercarrier compensation reform proposals that would eliminate distinctions between wireline and CMRS traffic.<sup>1102</sup> We invite comment on whether the Commission should prioritize addressing this issue as it addresses comprehensive reform that would remove the underlying distinctions that contribute to disputes arising from this rule. If so, when and how should the Commission address this issue?

686. In addition, there are pending disputes regarding the assignment of telephone numbers with separate, and geographically distant, rating and routing points.<sup>1103</sup> The Commission has sought comment on these disputes and related issues over the course of this proceeding.<sup>1104</sup> We invite parties to refresh the record on these issues, and, in particular seek comment on whether the issues raised in the Sprint, ASAP and @ Communications petitions still require resolution through Commission action, and if so, what actions the Commission should take and when.

687. We also seek comment on whether Commission attention is still required to resolve issues regarding intercarrier charges applicable to calls to Internet service providers located outside of the originating caller's local calling area. Specifically, carriers do not agree on the appropriate intercarrier compensation regime applicable to ISP traffic delivered to an ISP located in a distant exchange outside the originating local calling area.<sup>1105</sup> We ask parties to comment on whether the Commission's 2008 order addressing the intercarrier compensation rate for ISP-bound traffic has any impact on, or moots any of the underlying issues.<sup>1106</sup> Furthermore, we seek comment on whether market developments, including the decline in dial-up Internet service usage and commercial agreements regarding compensation, have changed the need for Commission action.

688. *Effect of Intercarrier Compensation Reform on Existing Agreements.* Finally, we seek comment on the effect of our intercarrier compensation reforms on certain types of existing agreements. With respect to interconnection agreements, we do not intend for our proposed reform to disturb the processes established by section 252 of the Act.<sup>1107</sup> We seek comment on whether the reforms we propose would constitute a change in law, recognizing that interconnection agreements may contain

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<sup>1101</sup> For example, Arizona Dialtone and IDT filed petitions for reconsideration of the Commission's 2006 *Prepaid Calling Card Order*. Arizona Dialtone, Inc., Petition for Reconsideration, WC Docket No. 05-68 (filed Aug. 31, 2006); IDT Corp., Petition for Reconsideration, WC Docket No. 05-68 (filed Aug. 31, 2006). See *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290 (2006), *vacated in part sub nom. Qwest Services Corp. v. FCC*, 509 F.3d 531 (D.C. Cir. 2007). See also, e.g., Letter from Tamar E. Finn, counsel for IDT *et al.*, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket No. 05-68; GN Docket No. 09-51 (filed Jan. 14, 2011) (asking the Commission to clarify that the 2006 *Prepaid Calling Card Order* does not require the application of access charges to prepaid calling card calls placed using a locally-dialed number).

<sup>1102</sup> See *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4744-46, paras. 134-38.

<sup>1103</sup> See generally Sprint Petition; ASAP Paging, Inc., Petition for Preemption of Public Utility Commission of Texas Concerning Retail Rating of Local Calls to CMRS Carriers, WC Docket No. 04-6 (filed Dec. 22, 2003).

<sup>1104</sup> See *Sprint Rating and Routing Petition Public Notice*, 17 FCC Rcd at 13859 (2002); *Pleading Cycle Established for Comments on @Communications Petition for Declaratory Ruling*, CC Docket No. 02-4, Public Notice, 17 FCC Rcd 1010 (2002); *ASAP Paging Petition Public Notice*, 19 FCC Rcd at 936; *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4747-48, paras. 141-43.

<sup>1105</sup> See, e.g., *Blue Casa VNXX Petition Public Notice*, 24 FCC Rcd 2436 (2009).

<sup>1106</sup> 2008 Order and ICC/USF FNPRM, 24 FCC Rcd at 6478-89 paras. 6-29.

<sup>1107</sup> See 47 U.S.C. § 252.

change of law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.<sup>1108</sup> We also seek comment regarding the impact our proposed reforms may have on contracts in “evergreen” status, which Verizon describes as “contracts that have reached the end of their terms but remain in effect pending entry into new contracts.”<sup>1109</sup>

689. As discussed above, the intercarrier compensation reforms we propose may require carriers to make certain changes to their tariffs relating to carrier-to-carrier charges, and potentially also SLCs. We seek comment on whether these proposed reforms should abrogate existing contracts or otherwise allow for a “fresh look” with regard to existing commercial agreements.<sup>1110</sup> As the Commission has recognized, for example, early termination provisions can be mutually beneficial by giving providers greater assurance of revenue recovery, and giving customers (whether wholesale or end-users) discounted and stable prices over the relevant term.<sup>1111</sup> Indeed, allowing for a fresh look could result in a windfall for customers that entered long-term arrangements, in exchange for lower prices, as compared to other customers that avoided early termination fees by electing shorter contract periods at higher prices.<sup>1112</sup> We seek comment on whether such issues should be left to any change of law provisions in these commercial arrangements, or to commercial negotiations among the parties, or, alternatively, if we should provide an opportunity for re-negotiation of affected commercial agreements in light of comprehensive intercarrier compensation reform.<sup>1113</sup>

<sup>1108</sup> See *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 at 17403-04, para. 700 (2003) (*Triennial Review Order*). Although section 252(a)(1) and section 252(b)(1) refer to requests that are made to incumbent LECs, we have interpreted that in the interconnection agreement context to mean that either the incumbent or the competitive LEC may make such a request, consistent with the parties’ duty to negotiate in good faith pursuant to section 251(c)(1). See *Triennial Review Order*, 18 FCC Rcd at 17405, para. 703 n.2087; see also 47 U.S.C. §§ 251(c)(1), 252(a)(1), (b)(1). We believe that this adequately addresses concerns about existing interconnection agreements that do not include express change of law provisions.

<sup>1109</sup> See, e.g., Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 5–6 (urging that any new intercarrier compensation regime displace such contracts).

<sup>1110</sup> In the past, commenters requested that the Commission give them a fresh look at existing contracts. See, e.g., Letter from Richard R. Cameron and Teresa D. Baer, Counsel for Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 08-152; CC Docket Nos. 01-92, 99-68, 96-45 at 2 (filed Sept. 18, 2008) (asking that the Commission “provide an 18-month window within which carriers can reconfigure their interconnection facilities without incurring reconfiguration charges or early termination liabilities under existing transport contracts”); Ad Hoc 2008 ICC/USF FNPRM Comments at 22–24 (arguing that customers should be allowed to opt out of existing contracts); Earthlink 2008 ICC/USF FNPRM Reply at 7 (arguing that end-users should have the opportunity to negotiate different terms and, if renegotiation is not possible, be permitted to terminate existing contracts without liability).

<sup>1111</sup> See, e.g., *Triennial Review Order*, 18 FCC Rcd at 17400, 17402–03, paras. 692, 697–99; see also, e.g., AT&T 2008 ICC/USF FNPRM Reply at 17–19 (arguing against giving end-users a fresh look at existing contracts). To the extent that there is evidence that particular termination penalties are inappropriate, the Commission can resolve such a matter through an enforcement proceeding. See *Triennial Review Order*, 18 FCC Rcd at 17403, para. 698.

<sup>1112</sup> See *Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

<sup>1113</sup> This situation is thus different than cases where the Commission found that certain contract provisions might adversely affect competition or where end-user customers would be denied the benefits of new Commission policy absent a fresh look opportunity. See, e.g., *Local Competition First Report and Order*, 11 FCC Rcd at 16044-45, para. 1094; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7350, para. 21 (1993) (allowing a fresh look at agreements in “situations where excessive termination liabilities would affect competition for a significant period of time”); *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report and (continued....)

## XVII. PROCEDURAL MATTERS

### A. Filing Requirements

690. *Ex Parte Rules.* This Notice will be treated as a “permit-but-disclose” proceeding subject to the “permit-but-disclose” requirements under section 1.1206(b) of the Commission’s rules.<sup>1114</sup> *Ex parte* presentations are permissible if disclosed in accordance with Commission rules, except during the Sunshine Agenda period when presentations, *ex parte* or otherwise, are generally prohibited. Persons making oral *ex parte* presentations are reminded that a memorandum summarizing a presentation must contain a summary of the substance of the presentation and not merely a listing of the subjects discussed. More than a one- or two-sentence description of the views and arguments presented is generally required.<sup>1115</sup> Additional rules pertaining to oral and written presentations are set forth in Section 1.1206(b).

691. *Comments and Reply Comments.* Pursuant to sections 1.415 and 1.419 of the Commission’s rules, interested parties may file comments and reply comments on or before the dates indicated on the first page of this document. All filings should refer to CC Docket No 01-92, WC Docket Nos. 10-90, 07-135, and 05-337 and GN Docket No. 09-51. Comments may be filed using: (1) the Commission’s Electronic Comment Filing System (ECFS), (2) the Federal Government’s eRulemaking Portal, or (3) by filing paper copies.<sup>1116</sup>

692. *Electronic Filers:* Comments may be filed electronically using the Internet by accessing the ECFS: <http://fjallfoss.fcc.gov/ecfs2/> or the Federal eRulemaking Portal: <http://www.regulations.gov>.

693. *Paper Filers:* Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers must submit two additional copies for each additional docket or rulemaking number.

694. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail. All filings must be addressed to the Commission’s Secretary, Office of the Secretary, Federal Communications Commission.

695. All hand-delivered or messenger-delivered paper filings for the Commission’s Secretary must be delivered to FCC Headquarters at 445 12<sup>th</sup> St., SW, Room TW-A325, Washington, DC 20554. The filing hours are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743. U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12<sup>th</sup> Street, SW, Washington DC 20554.

696. *People with Disabilities:* To request materials in accessible formats for people with disabilities (braille, large print, electronic files, audio format), send an e-mail to [fcc504@fcc.gov](mailto:fcc504@fcc.gov) or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice), 202-418-0432 (tty).

697. In addition, parties shall also serve one copy with the Commission’s copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12<sup>th</sup> Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300 or via e-mail to [fcc@bcpiweb.com](mailto:fcc@bcpiweb.com).

(Continued from previous page) \_\_\_\_\_

Order, 6 FCC Rcd 5880, 5907, para. 151 (1991) (giving customers of AT&T 90 days to terminate their contracts without penalty to let them “tak[e] advantage of 800 number portability when it arrives”).

<sup>1114</sup> See 47 C.F.R. § 1.1206(b).

<sup>1115</sup> *Id.*

<sup>1116</sup> 47 C.F.R. §§ 1.415, 1.419. See *Electronic Filing of Documents in Rulemaking Proceedings*, 63 FR 24121 (1998).

698. Further Information: For further information, contact Jennifer Prime at (202) 418-1500 or Patrick Halley at (202) 418-1500, Wireline Competition Bureau.

**B. Initial Regulatory Flexibility Analysis**

699. As required by the Regulatory Flexibility Act of 1980, as amended,<sup>1117</sup> the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) for this Notice, of the possible significant economic impact on small entities of the policies and rules addressed in this document. The IRFA is set forth as Appendix F. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice provided on or before the dates indicated on the first page of this Notice.

**C. Paperwork Reduction Act Analysis**

700. This document contains proposed modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198, *see* 44 U.S.C. 3506(c)(4), we seek specific comment on how we might further reduce the information collection burden for small business concerns with fewer than 25 employees.

**XVIII. ORDERING CLAUSES**

701. Accordingly, IT IS ORDERED that, pursuant to Sections 1, 2, 4(i), 201-206, 214, 218-220, 251, 252, 254, 256, 303(r), 332, 403 and 706 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 201-206, 214, 218-220, 251, 252, 254, 256 303(r), 332, 403 and 706 and sections 1.1 and 1.1421 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.421, this Notice and Further Notice of Proposed Rulemaking IS ADOPTED.

702. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this Notice and Further Notice of Proposed Rulemaking, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

703. IT IS FURTHER ORDERED, pursuant to sections 1.4(b)(1) and 1.103(a) of the Commission's rules, 47 C.F.R. §§ 1.4(b)(1) and 1.103(a), that this Notice and Further Notice of Proposed Rulemaking SHALL BE EFFECTIVE on the date of publication of a summary thereof in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch  
Secretary

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<sup>1117</sup> 5 U.S.C. § 603.

## APPENDIX A

## Proposed Universal Service Rules

Part 36 of Title 47 of the Code of Federal Regulations is amended as follows:

**PART 36—JURISDICTIONAL SEPARATIONS PROCEDURES; STANDARD PROCEDURES FOR SEPARATING TELECOMMUNICATIONS PROPERTY COSTS, REVENUES, EXPENSES, TAXES AND RESERVES FOR TELECOMMUNICATIONS COMPANIES**

**F—Universal Service Fund**

1. Section 36.605 is amended by revising the first sentence of paragraph (b) and by adding one sentence at the end of paragraph (b) as follows:

**§ 36.605 Calculation of safety net additive.**

\*\*\*\*\*

b) *Calculation of safety net additive support:* Until December 31, 2011, safety net additive support is equal to the amount of capped support calculated pursuant to this subpart F in the qualifying year minus the amount of support in the year prior to qualifying for support subtracted from the difference between the uncapped expense adjustment for the study area in the qualifying year minus the uncapped expense adjustment in the year prior to qualifying for support as shown in the following equation: Safety net additive support = (Uncapped support in the qualifying year - Uncapped support in the base year) - (Capped support in the qualifying year - Amount of support received in the base year). For calendar year 2012 payments, the safety net additive shall be 75% of the amount calculated pursuant to this section. For calendar year 2013 payments, the safety net additive shall be 50% of the amount calculated pursuant to this section. For calendar year 2014 payments, the safety net additive shall be 25% of the amount calculated pursuant to this section. Beginning January 1, 2015, no carrier shall receive the safety net additive.

\*\*\*\*\*

2. Section 36.621 is amended by revising the last sentence of paragraph (a)(4) and adding three additional sentences at the end of paragraph (a)(4) as follows:

**§ 36.621 Study area total unseparated loop cost.**

(a) \*\*\*

(4) \*\*\* Total Corporate Operations Expense, for purposes of calculating universal service support payments beginning July 1, 2001 and ending December 31, 2011, shall be limited to the lesser of § 36.621(a)(4)(i) or (ii). For purposes of calculating universal service support payments in calendar year 2012, total corporate operations expense shall be limited to the lesser of § 36.621(a)(4)(i) or (ii) then multiplied by 67%. For purposes of calculating universal service support payments in calendar year 2013, total corporate operations expense shall be limited to the lesser of § 36.621(a)(4)(i) or (ii) then multiplied by 33%. Beginning January 1, 2014, Corporate Operations Expense shall no longer be eligible for purposes of calculating universal service payments.

\*\*\*\*\*

3. Section 36.631 is amended by revising paragraphs (c)(1) and (c)(2) and by removing paragraph (d) as follows:

**§ 36.631 Expense adjustment.**

\*\*\*\*\*

(c) \*\*\*

(1) Until December 31, 2011, sixty-five percent of the study area average unseparated loop cost per working loop as calculated pursuant to §36.622(b) in excess of 115 percent of the national average for this cost but not greater than 150 percent of the national average for this cost as calculated pursuant to §36.622(a) multiplied by the number of working loops reported in §36.611(h) for the study area. Beginning January 1, 2012, fifty-five percent of the study area average unseparated loop cost per working loop as calculated pursuant to §36.622(b) in excess of 115 percent of the national average for this cost but not greater than 150 percent of the national average for this cost as calculated pursuant to §36.622(a) multiplied by the number of working loops reported in §36.611(h) for the study area; and

(2) Until December 31, 2011, seventy-five percent of the study area average unseparated loop cost per working loop as calculated pursuant to §36.622(b) in excess of 150 percent of the national average for this cost as calculated pursuant to §36.622(a) multiplied by the number of working loops reported in §36.611(h) for the study area. Beginning, January 1, 2012, sixty-five percent of the study area average unseparated loop cost per working loop as calculated pursuant to §36.622(b) in excess of 150 percent of the national average for this cost as calculated pursuant to §36.622(a) multiplied by the number of working loops reported in §36.611(h) for the study area.

(d) [Remove]

\*\*\*\*\*

Part 54 of Title 47 of the Code of Federal Regulations is amended as follows:

**PART 54—UNIVERSAL SERVICE**

Part 54 of Title 47 of the Code of Federal Regulations is amended as follows:

4. The authority citation for Part 54 continues to read as follows:

AUTHORITY: 47 U.S.C. 151, 154(i), 201, 205, 214, 254 unless otherwise noted.

**Subpart D—Universal Service Support for High-Cost Areas**

5. Section 54.301 is amended by adding three sentences at the end of paragraph (a) and by adding three sentences to the beginning of paragraph (c)(5) as follows:

**§ 54.301 Local switching support.**

(a) \*\*\* Subject to specified exceptions, for calendar year 2012 payments, local switching support shall be 67% of the amount calculated pursuant to this section and for calendar year 2013 payments, local

switching support shall be 33% of the amount calculated pursuant to this section. Beginning January 1, 2014, no carrier shall receive local switching support, subject to specified exceptions.

(b) \*\*\*

(c) \*\*\*

(5) For calendar year 2012, for purposes of calculating local switching support, the amount of corporate operations expense allocated by this factor shall be multiplied by 67%. For calendar year 2013, for purposes of calculating local switching support, the amount of corporate operations expense allocated by this factor shall be multiplied by 33%. Beginning January 1, 2014, corporate operations expense shall no longer be eligible for purposes of calculating local switching support. \*\*\*

\*\*\*\*\*

6. Section 54.302 is added to Subpart D as follows;

**§ 54.302 Annual per-line limit on universal service support.**

Subject to specified exceptions, beginning January 1, 2012, each study area in the continental United States shall be limited to \$3,000 per-line annually in universal service support. For purposes of this section, universal service support is defined as the sum of the amounts calculated pursuant to sections 36.605, 36.631, 54.301, 54.305, 54.309, 54.800-808, and 54.901-904 of this chapter. Line counts for purposes of this section shall be as of the most recent line counts reported pursuant to section 36.611(h) of this chapter. The fund administrator, in order to limit support to \$3,000 for affected carriers, shall reduce safety net additive support, high-cost loop support, local switching support, safety valve support, forward-looking support, interstate access support, and interstate common line support in proportion to the relative amounts of each support mechanism to total support the study area would receive absent such limitation.

7. Section 54.305 is amended by adding a sentence at the end of paragraph (a) as follows:

**§ 54.305 Sale or transfer of exchanges.**

(a) \*\*\* Five years after approval of the relevant study area waiver for the sale or transfer of exchanges, the provisions of this section are no longer applicable to acquired exchanges, if the acquired exchanges have more than 30% of housing units unserved by broadband, as indicated on the National Telecommunications and Information Administration's broadband map and/or the Commission's Form 477 data collection.

\*\*\*\*\*

8. Section 54.307(a) is revised by adding a third sentence as follows:

**§ 54.307 Support to a competitive eligible telecommunications carrier.**

(a) \* \* \* Subject to specified exceptions beginning January 1, 2016, no competitive eligible telecommunications carrier shall be eligible to receive universal service support on the basis of this section. On or after January 1, 2012, competitive eligible telecommunications carriers shall be eligible to receive universal service support pursuant to subpart L and subpart M of this Part.

9. Section 54.315 is amended by adding a sentence at the end of paragraph (a) as follows:

**§ 54.315 Disaggregation and targeting of high-cost support.**

(a) \*\*\* On or before [60 days from effective date of adoption of order], all rural incumbent local exchange carriers and rate-of-return carriers for which high-cost universal service support pursuant to §§54.301, 54.303, and/or 54.305 of this subpart, subpart K of this part, and/or part 36 subpart F is available, that previously selected the disaggregation path as described in paragraph (b) of this section, must select a disaggregation path as described in paragraphs (c) or (d) of this section.

\*\*\*\*\*

10. Section 54.807 is revised by adding text as follows:

**§ 54.807 Interstate access universal service support.**

(a) \* \* \* Subject to specified exceptions, eligible telecommunications carriers shall be eligible to receive Interstate Access Support as follows:

(1) During the 2012 calendar year, the interstate access support available to incumbent local exchange carriers and competitive eligible telecommunications carriers shall be capped at 50 percent of the amount paid in 2011, excluding amounts paid during 2011 for true-ups or revisions for years prior to 2011. Interstate access support payments shall be reduced, if necessary, by multiplying each incumbent local exchange carrier's or competitive eligible telecommunications carrier's support by the percentage factor necessary to reduce the aggregate interstate access support to the capped amounts.

(2) Interstate access support shall be eliminated beginning January 1, 2013, and no eligible telecommunications carrier shall receive interstate access support, except as for true-ups and revisions related to prior periods.

11. Section 54.901 is amended by adding paragraph (c) as follows:

**§ 54.901 Calculation of Interstate Common Line Support.**

\*\*\*\*\*

(c) For calendar year 2012, for purposes of calculating Interstate Common Line Support, corporate operations expense allocated to the Common Line Revenue Requirement, pursuant to section 69.409 of this chapter, shall be reduced by multiplying the corporate operations expense allocated by 67%. For calendar year 2013, for purposes of calculating Interstate Common Line Support, corporate operations expense allocated to the Common Line Revenue Requirement, pursuant to section 69.409 of this chapter, shall be reduced by multiplying the corporate operations expense allocated by 33%. Beginning January 1, 2014, corporate operations expense shall no longer be eligible for purposes of calculating Interstate Common Line Support.

12. New Subpart M is added to read as follows:

**Part 54 Subpart M – Competitive Bidding Program****§ 54.1001 Purpose**

This subpart sets forth procedures for competitive bidding to determine the recipients of universal service support available through the first phase of the Connect America Fund and the amount(s) of support that they may receive, subject to post-auction procedures established by the Commission.

**§ 54.1002 Areas Eligible for Support**

- (a) Support may be made available for specific unserved areas identified by the Commission.
- (b) The Commission may assign relative coverage units to each identified geographic area in connection with conducting competitive bidding and disbursing support.

**§ 54.1003 Provider Eligibility**

- (a) A party applying for support must be designated an Eligible Telecommunications Carrier, or have applied for a designation as an Eligible Telecommunications Carrier, for an area that includes unserved area(s) with respect to which it applies for support.
- (b) A party applying for support must, if specified and required by the Commission, hold any necessary authority or conditional authorization to provide voice service in the unserved area with respect to which it applies for support.

**§ 54.1004 Short-Form Applications for Participation in Competitive Bidding to Apply for Support**

- (a) *Public Notice of the Application Process.* When conducting competitive bidding pursuant to this subpart, the Commission shall by Public Notice announce the dates and procedures for submitting applications to participate in related competitive bidding.
- (b) *Application Contents.* All parties submitting applications to participate in competitive bidding pursuant to this subpart must provide the following information in their application in a form acceptable to the Commission.
  - (i) The identity of the applicant, *i.e.*, the party seeking support, including any information that the Commission may require regarding parties that have an ownership or other interest in the applicant.
  - (ii) The identities of up to three individuals designated to bid on behalf of the applicant.
  - (iii) The identities of all real parties in interest to any agreements relating to the participation of the applicant in the competitive bidding.
  - (iv) Certification that the application discloses all real parties in interest to any agreements involving the applicant's participation in the competitive bidding.

(v) Certification that the applicant, any party capable of controlling the applicant, and any related party with information regarding the applicant's planned or actual participation in the competitive bidding will not communicate any information regarding the applicant's planned or actual participation in the competitive bidding to any other party with an interest in any other applicant until after the post-auction deadline for winning bidders to submit long-form applications for support, unless the Commission by Public Notice announces a different deadline.

(vi) Certification that the applicant is in compliance with any and all statutory or regulatory requirements for receiving universal service support. The Commission may elect to accept as sufficient the applicant's demonstration in its application that the applicant will be in compliance at a point in time designated by the Commission.

(vii) Such additional information as the Commission may require, including but not limited to applicants certifying its qualifications to receive support, providing its eligible telecommunications carrier designation status and information regarding its authorization to provide service, and specifying the unserved area applicant seeks to provide service to.

(c) *Demonstration of Financial Qualification.* The Commission may require as a prerequisite to participating in competitive bidding pursuant to this subpart that applicants demonstrate their financial qualifications or commitment to provide required services by depositing funds, posting performance bonds, or any other means the Commission considers appropriate.

(d) *Application Processing.*

(i) Commission staff shall review any application submitted during the period for submission and before the deadline for submission for completeness and compliance with the Commission's rules. No applications submitted at any other time shall be reviewed or considered.

(ii) The Commission shall not permit any applicant to participate in competitive bidding pursuant to this subpart to do so if, as of the deadline for submitting applications, the application does not adequately identify the applicant or does not include required certifications.

(iii) The Commission shall not permit any applicant to participate in competitive bidding pursuant to this subpart to do so if, as of the applicable deadline, the applicant has not provided any required demonstration of financial qualifications that the Commission has required.

(iv) The Commission shall not permit applicants to make any major modifications to their applications after the deadline for submitting applications. The Commission shall not permit applicants to participate in the competitive bidding if their applications require major modifications to be made after deadline for submitting applications. Major modifications include but are not limited to any changes to the identity of the applicant or to the certifications required in the application.

(v) The Commission may permit applicants to make minor modifications to their applications after the deadline for submitting applications. The Commission may establish deadlines for making some or all permissible modifications to applications and may permit some or all permissible modifications to be made at any time. Minor modifications include correcting typographical errors in the application and supplying non-material information that was inadvertently omitted or was not available at the time the application was submitted.

(vi) After receipt and review of the applications, the Commission shall by Public Notice identify all applicants that may participate in an auction conducted pursuant to this subpart.

#### § 54.1005 Competitive Bidding Process

(a) *Public Notice of Competitive Bidding Procedures.* The Commission shall by Public Notice establish detailed competitive bidding procedures any time it conducts competitive bidding pursuant to this subpart.

(b) *Competitive Bidding Procedures.* The Commission may conduct competitive bidding pursuant to this subpart using any of the procedures described below.

(i) The Commission may establish procedures for limiting the public availability of information regarding applicants, applications, and bids during a period of time covering the competitive bidding process. The Commission may by Public Notice establish procedures for parties to report the receipt of non-public information regarding applicants, applications, and bids during any time the Commission has limited the public availability of the information during the competitive bidding process.

(ii) The Commission may sequence or group multiple items subject to bidding, such as multiple or overlapping self-defined geographic areas eligible for support, and may conduct bidding either sequentially or simultaneously.

(iii) The Commission may establish procedures for bidding on individual items and/or for combinations or packages of items.

(iv) The Commission may establish reserve prices, and/or lowest or maximum acceptable per-unit bid amounts, either for discrete items or combinations or packages of items, which may be made public or kept non-public during a period of time covering the competitive bidding process.

(v) The Commission may prescribe the form and time for submitting bids and may require that bids be submitted remotely, by telephonic or electronic transmission, or in person.

(vi) The Commission may prescribe the number of rounds during which bids may be submitted, whether one or more, and may establish procedures for determining when no more bids will be accepted.

(vii) The Commission may require a minimum level of bidding activity.

(viii) The Commission may establish acceptable bid amounts at the opening of and over the course of bidding.

(ix) The Commission may establish procedures for ranking and comparing bids and specific performance requirements, if any, and comparing and determining the winning bidders that may become recipients of universal service support and the amount(s) of support that they may receive, subject to post-auction procedures established by the Commission.

(x) The Commission may identify winning bidder(s) for any remaining amounts of support by considering bids in order of per-unit bid amount. The Commission may skip bids that would require more support than is available, or at its discretion, not identify winning bidder(s) for the remaining funds and instead offer such funds in a subsequent auction.

(xi) The Commission may permit bidders the limited opportunity to withdraw bids and, if so, establish procedures for doing so.

(xii) The Commission may delay, suspend or cancel bidding before or after bidding begins for any reason that affects the fair and efficient conduct of the bidding, including natural disasters, technical failures, administrative necessity or any other reason.

(c) *Apportioning Package Bids.* If the Commission elects to accept bids for combinations or packages of items, the Commission may provide a methodology for apportioning such bids to discrete items within the combination or package when a discrete bid on an item is required to implement any Commission rule.

(d) *Public Notice of Competitive Bidding Results.* After the conclusion of competitive bidding, the Commission shall by Public Notice identify the winning bidders that may become recipients of universal service support and the amount(s) of support that they may receive, subject to post-auction procedures established by the Commission.

#### **§ 54.1006 Communications Prohibited During the Competitive Bidding Process**

(a) *Prohibited Communications.* Each applicant, each party capable of controlling an applicant, and each party related to an applicant with information regarding an applicant's planned or actual participation in the competitive bidding is prohibited from communicating any information regarding the applicant's planned or actual participation in the competitive bidding to any other party with an interest in any other applicant to participate in the competitive bidding from the deadline for submitting applications to participate in the competitive bidding until after the post-auction deadline for winning bidders to submit long-form applications for support, unless the Commission by Public Notice announces a different deadline.

(b) *Duty to Report Potentially Prohibited Communications.* Any applicant or related party receiving communications that may be prohibited under this rule shall report the receipt of such communications to the Commission.

(c) *Procedures for Reporting Potentially Prohibited Communications.* The Commission may by Public Notice establish procedures for parties to report the receipt of communications that may be prohibited under this rule.

#### **§ 54.1007 Long-Form Application Process for Winning Bidders**

(a) *Application Deadline.* Unless otherwise provided by Public Notice, winning bidders for support must file a long-form application for support within 10 business days of the Public Notice identifying them as eligible to apply.

(b) *Application Contents.*

(i) Identification of the party seeking the support.

(ii) Information the Commission may require to demonstrate that the applicant is legally, technically and financially qualified to receive support, including but not limited to proof of its designation as an Eligible Telecommunications Carrier for an area that includes the area with respect to which support is requested.

- (iii) Disclosure of all parties with a controlling interest in the applicant and any party with a greater than ten percent ownership interest in the applicant, whether held directly or indirectly.
- (iv) A detailed project description that identifies the unserved area applicant seeks to serve, describes how the applicant will meet public interest obligations and performance requirements, describes the anticipated network, identifies the proposed technology or technologies, demonstrates that the project is technically feasible, and describes each specific development phase of the project, *e.g.*, network design phase, construction period, deployment and maintenance period.
- (v) A detailed project schedule that identifies the following project milestones: start and end date for network design; start and end date for drafting and posting requests for proposal; start and end date for selecting vendors and negotiating contracts; start date for commencing construction; end date for completing construction; and dates by which it will meet applicable requirements to receive the installments of support for which it subsequently qualifies.
- (vi) Certifications that the applicant has available funds for all project costs that exceed the amount of support to be received and that the applicant will comply with all program requirements.
- (vii) Any guarantee of performance that the Commission may require by Public Notice or other proceedings, including but not limited to, letters of credit, performance bonds, or demonstration of financial resources.

*(c) Application Processing.*

- (i) No application will be considered unless it has been submitted during the period specified by Public Notice. No applications submitted or demonstrations made at any other time shall be accepted or considered.
- (ii) The Commission shall deny any application that, as of the submission deadline, either does not adequately identify the party seeking support or does not include required certifications.
- (iii) After reviewing applications submitted, the Commission may afford an opportunity for parties to make minor modifications to amend applications or correct defects noted by the applicant, the Commission, or other parties. Minor modifications include changing the individuals authorized to bid for the applicant, correcting typographical errors in the application, and supplying non-material information that was inadvertently omitted or was not available at the time the application was submitted.
- (iv) The Commission shall deny all applications to which major modifications are made after the deadline for submitting applications. Major modifications include any changes to the identity of the applicant or to the certifications required in the application.
- (v) After receipt and review of the applications, the Commission shall release a Public Notice identifying all applications that have been granted and the parties that are eligible to receive support.

**§ 54.1008 Default**

Winning bidders that fail to substantially comply with the requirements for filing the post-auction long-form application by the applicable deadline shall be in default on their bids and subject to such measures as the Commission may provide, including but not limited to disqualification from future competitive bidding pursuant to this subpart.

**§ 54.1009 Public Interest Obligations**

(a) Applicants receiving support under this section must perform the following under their public interest obligations:

(1) *Speed.* Applicants must provide broadband speeds of 4 Mbps downstream (actual) and 1 Mbps upstream (actual), subject to specified exceptions.

(2) *Coverage requirement.* Applicants must comply with the coverage requirement established by the Commission and must comply with all reasonable requests for service from end users in its coverage area.

(3) *Deployment and duration of obligation.* Applicants must complete deployment within three years after receiving support and must fulfill provider obligations under this section for five years upon completion of deployment.

**§ 54.1010 Disbursements**

(a) Support shall be disbursed to recipients in three stages, as follows:

(i) One-half of the total possible support, if coverage were to be extended to 100 percent of the units in the portion of the geographic area deemed unserved, when a recipient's long-form application for support with respect to a specific area is deemed granted.

(ii) One-quarter of the total possible support with respect to a specific geographic area when a recipient files a report demonstrating coverage of 50 percent of the units in the portion of that area previously deemed unserved.

(iii) The remainder of the total possible support when a recipient files a report demonstrating coverage of 100 percent of the units in the portion of that area previously deemed unserved.

(b) If the Commission concludes for any reason that coverage of 100 percent of the units in the portion of a specific geographic area previously deemed unserved will not be achieved, the Commission instead may provide support based on the final total units covered in that area. In such circumstances, the final disbursement will be the difference between the total amount of support based on the final units covered in that area and any support previously received with respect to that area. Parties accepting a final disbursement for a specific geographic area based on coverage of less than 100 percent of the units in the portions of that area previously deemed uncovered waive any claim for the remainder of support for which they previously were eligible with respect to that area.

**§ 54.1011 Oversight**

(a) Parties receiving support are subject to random compliance audits and other investigations to ensure compliance with program rules and orders.

(b) Parties receiving support shall submit to the Commission annual reports for eight years after they qualify for support. The annual reports shall include:

(i) Electronic coverage maps illustrating the area reached by new services at a minimum scale of 1:240,000;

(ii) A list of relevant census blocks previously deemed unserved, with total resident population and resident population residing in areas reached by new services (based on 2010 Census Bureau data and estimates);

(iii) A report regarding the services advertised to the population in those areas;

(iv) Data received or used from speed tests analyzing network performance for new broadband services in the area for which support was received.

(c) No later than two months after providing service or two years after receiving support, parties receiving support shall submit to the Commission data from broadband speed tests for areas in which support was received demonstrating broadband performance data to and from the network meeting or exceeding the following:

(i) 4 Mbps downstream (actual) and 1 Mbps upstream (actual).

(d) Parties receiving support and their agents are required to retain any documentation prepared for or in connection with the recipient's support for a period of not less than eight years. All such documents shall be made available upon request to the Commission's Office of Managing Director, Wireless Telecommunications Bureau, Wireline Competition Bureau, Office of Inspector General, and the Universal Service Fund Administrator, and their auditors.

## APPENDIX B

## Proposed Call Signaling Rules

Part 64, Subpart P of Title 47 of the Code of Federal Regulations would be amended as follows:

**AMENDMENT TO THE CODE OF FEDERAL REGULATIONS**

1. The authority citation for Part 64 continues to read as follows:

Authority: 47 U.S.C. 154, 254(k); secs. 403(b) (2) (B),(c), Pub. L. 104–104, 110 Stat. 56.  
Interpret or apply 47 U.S.C. 201, 218, 222, 225, 226, 228, and 254 (k) unless otherwise noted.

2. Section 64.1601 is amended to read as follows:

**§ 64.1601 Delivery requirements and privacy restrictions.**

(a) *Delivery.* Except as provided in paragraphs (d) and (e) of this section:

(1) Telecommunications providers and entities providing interconnected voice over Internet protocol services who originate interstate or intrastate traffic on the public switched telephone network, or originate interstate or intrastate traffic that is destined for the public switched telephone network, are required to transmit the telephone number received from, or assigned to or otherwise associated with the calling party to the next provider in the path from the originating provider to the terminating provider, where such transmission is feasible with network technology deployed at the time a call is originated. The scope of this provision includes, but is not limited to, circuit-switched and packetized transmission, such as Internet protocol and any successor technologies. Entities subject to this provision who use Signaling System 7 are required to transmit the calling party number (CPN) associated with every interstate or intrastate call in the SS7 CPN field to interconnecting providers, and are required to transmit the calling party's charge number (CN) in the SS7 CN field to interconnecting providers for any call where CN differs from CPN. Entities subject to this provision who are not capable of using SS7 but who use multifrequency (MF) signaling are required to transmit CPN, or CN if it differs from CPN, associated with every interstate or intrastate call, in the MF signaling automatic numbering information (ANI) field.

(2) Telecommunications providers and entities providing interconnected voice over Internet protocol services who are intermediate providers in an interstate or intrastate call path must pass, unaltered, to subsequent carriers in the call path, all signaling information identifying the telephone number of the calling party, and, if different, of the financially responsible party that is received with a call, unless published industry standards permit or require altering signaling information. This requirement applies to all SS7 information including, but not limited to CPN and CN, and also applies to MF signaling information or other signaling information intermediate providers receive with a call. This requirement also applies to Internet protocol signaling messages, such as calling party identifiers contained in Session Initiation Protocol (SIP) header fields, and to equivalent identifying information as used in successor technologies.

\* \* \* \* \*

## APPENDIX C

## Proposed Access Stimulation Rules

Part 61 and Part 69 of the Code of Federal Regulations are amended as follows:

## AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

## Part 61 - TARIFFS

1. The authority citation for Part 61 continues to read as follows:

Authority: Secs. 1, 4(i), 4(j), 201-205 and 403 of the Communications Act of 1934, as amended; 47 U.S.C 151, 154(i), 154(j), 201-205 and 403, unless otherwise noted.

2. Section 61.3 is amended by adding paragraph (aaa) to read as follows:

**§ 61.3 Definitions.**

\* \* \* \* \*

(aaa) *Access revenue sharing.* Access revenue sharing occurs when a rate-of-return ILEC or a CLEC enters into an access revenue sharing agreement that will result in a net payment to the other party (including affiliates) to the access revenue sharing agreement, over the course of the agreement. A rate-of-return ILEC or a CLEC meeting this trigger is subject to revised interstate switched access charge rules.

3. Section 61.26 is amended by revising subsections (b), (d) and (e) and adding new paragraph (g) as follows:

**§ 61.26 Tariffing of competitive interstate switched exchange access services.**

\* \* \* \* \*

(b) Except as provided in paragraphs (c), (e), and (g) of this section, a CLEC shall not file a tariff for its interstate switched exchange access services that prices those services above the higher of:

(1) The rate charged for such services by the competing ILEC or

(2) The lower of:

(i) The benchmark rate described in paragraph (c) of this section or

(ii) The lowest rate that the CLEC has tariffed for its interstate exchange access services, within the six months preceding June 20, 2001.

\* \* \* \* \*

(d) Except as provided in paragraph (g) of this section, and notwithstanding paragraphs (b) and (c) of this section, in the event that, after June 20, 2001, a CLEC begins serving end users in a metropolitan statistical area (MSA) where it has not previously served end users, the CLEC shall not file a tariff for its interstate exchange access services in that MSA that prices those services above the rate charged for such services by the competing ILEC.

(e) Rural exemption. Except as provided in paragraph (g) of this section, and notwithstanding paragraphs (b) through (d) of this section, a rural CLEC competing with a non-rural ILEC shall not file a tariff for its interstate exchange access services that prices those services above the rate prescribed in the NECA access tariff, assuming the highest rate band for local switching. In addition to that NECA rate, the rural CLEC may assess a presubscribed interexchange carrier charge if, and only to the extent that, the competing ILEC assesses this charge.

\* \* \* \* \*

(g) Notwithstanding paragraphs (b)-(e) of this section, a CLEC engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this Part, shall not file a tariff for its interstate exchange access services that prices those services above the rate prescribed in the access tariff of the RBOC in the state, or, if there is no RBOC in the state, the incumbent LEC with the largest number of access lines in the state.

(1) A CLEC engaging in access revenue sharing, as that term is defined in section 61.3(aaa) of this Part, shall file revised interstate switched access tariffs within forty-five (45) days of commencing access revenue sharing as that term is defined in section 61.3(aaa) of this Part, or within forty-five (45) days of [the effective date of the Order] if the CLEC on that date is engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this Part.

(2) A CLEC shall file the revised interstate access tariffs required by subparagraph (1) of this paragraph on at least sixteen (16) days' notice.

4. Section 61.39 is amended by revising paragraph (a) and adding new paragraph (g) to read as follows:

**61.39 Optional supporting information to be submitted with letters of transmittal for Access Tariff filings effective on or after April 1, 1989, by local exchange carriers serving 50,000 or fewer access lines in a given study area that are described as subset 3 carriers in § 69.602.**

(a) Scope. Except as provided in paragraph (g) of this section, this section provides for an optional method of filing for any local exchange carrier that is described as a subset 3 carrier in § 69.602, which elects to issue its own Access Tariff for a period commencing on or after April 1, 1989, and which serves 50,000 or fewer access lines in a study area as determined under § 36.611(a)(8) of this chapter. However, the Commission may require any carrier to submit such information as may be necessary for review of a tariff filing. This section (other than the preceding sentence of this paragraph) shall not apply to tariff filings of local exchange carriers subject to price cap regulation.

\* \* \* \* \*

(g) A local exchange carrier otherwise eligible to file a tariff pursuant to this section may not do so if it is engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this Part. A carrier so engaged must file interstate access tariffs in accordance with section 61.38 of this Part and section 69.3(e)(12)(1) of this chapter.

5. Section 61.58 is amended by revising paragraph (a)(2)(i) and adding section a new paragraph (a)(2)(iv) to read as follows:

§ 61.58 Notice requirements.

(a)\* \* \*

(2)(i) Except as provided in paragraph (2)(iv) of this section, local exchange carriers may file tariffs pursuant to the streamlined tariff filing provisions of section 204(a)(3) of the Communications Act. Such a tariff may be filed on 7 days' notice if it proposes only rate decreases. Any other tariff filed pursuant to section 204(a)(3) of the Communications Act, including those that propose a rate increase or any change in terms and conditions, shall be filed on 15 days' notice. Any tariff filing made pursuant to section 204(a)(3) of the Communications Act must comply with the applicable cost support requirements specified in this part.

\* \* \* \* \*

(iv) A local exchange carrier engaging in access revenue sharing, as that term is defined in section 61.3(aaa) of this Part, that is filing pursuant to the provisions of section 69.3(e)(12)(i) of this chapter shall file revised tariffs on at least 16 days' notice.

## **PART 69 – ACCESS CHARGES**

6. The authority citation for Part 69 continues to read as follows:  
Authority: 47 U.S.C. 154, 201, 202, 203, 205, 218, 220, 254, 403.
7. Section 69.3 is amended by revising subparagraphs (e)(6) and (e)(9) and adding new subparagraph (e)(12) to read as follows:

### **§ 69.3 Filing of access tariffs.**

\* \* \* \* \*

(e) \* \* \*

(6) Except as provided in subparagraph (e)(12) of this paragraph, a telephone company or companies that elect to file such a tariff shall notify the association not later than March 1 of the year the tariff becomes effective, if such company or companies did not file such a tariff in the preceding biennial period or cross-reference association charges in such preceding period that will be cross-referenced in the new tariff. A telephone company or companies that elect to file such a tariff not in the biennial period shall file its tariff to become effective July 1 for a period of one year. Thereafter, such telephone company or companies must file its tariff pursuant to paragraphs (f)(1) or (f)(2) of this section.

\* \* \* \* \*

(9) Except as provided in subparagraph (e)(12) of this paragraph, a telephone company or group of affiliated telephone companies that elects to file its own Carrier Common Line tariff pursuant to paragraph (a) of this section shall notify the association not later than March 1 of the year the tariff becomes effective that it will no longer participate in the association tariff. A telephone company or group of affiliated telephone companies that elects to file its own Carrier Common Line tariff for one of its study areas shall file its own Carrier Common Line tariff(s) for all of its study areas.

\* \* \* \* \*

(12)(i) A local exchange carrier, or a group of affiliated carriers in which at least one carrier, is engaging in access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter, shall file its own access tariffs within forty-five (45) days of commencing access revenue sharing, as that

term is defined in section 61.3(aaa) of this chapter, or within forty-five (45) days of [the effective date of the Order] if the local exchange carrier on that date is engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter.

(ii) Notwithstanding subparagraphs (e)(6) and (e)(9) of this paragraph, a local exchange carrier, or a group of affiliated carriers in which at least one carrier, is engaging in access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter, must withdraw from all interstate access tariffs issued by the association within forty-five (45) days of commencing access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter, or within forty-five (45) days of [the effective date of the Order] if the local exchange carrier on that date is engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter.

(iii) Any such carrier(s) shall notify the association when it begins access revenue sharing, or on [the effective date of the order] if it is engaged in access revenue sharing, as that term is defined in section 61.3(aaa) of this chapter, on that date, of its intent to leave the association tariffs within forty-five (45) days.

## APPENDIX D

**Incentive Regulation: A Framework for Calculating Intercarrier Compensation Replacement Payments for Rate-of-Return Carriers**

1. This Appendix describes a possible framework for calculating payments from a CAF component that a carrier theoretically could receive to offset, as desired, lost interstate or intrastate switched access revenues in a simple setting (i.e., the maximum payment).<sup>1</sup>

2. As discussed in the text,<sup>2</sup> adjustments to this simple calculation are possible to reflect various policy decisions regarding the nature and extent of such revenue recovery. For purposes of describing the basic framework, the equations below reflect the various elements that theoretically could be a component of revenue recovery as part of intercarrier compensation reform, but does not prejudice the treatment of those issues. Rather, the details of this framework can be calibrated to reflect whatever decisions the Commission ultimately makes regarding those issues (whether to establish a revenue benchmark, whether to modify subscriber line charge caps, etc.).

3. The following notation is helpful in specifying precisely the maximum payment from the CAF component that a carrier might receive under this framework.

Notation

0	denotes the initial (pre-reform) period.
1	denotes the final (post-reform) period.
$L_t$	denotes the number of lines the carrier serves in period $t$ .
$s_0$	denotes the carrier's monthly subscriber line charge (SLC) in period 0.
$s^{max}$	denotes the maximum permissible monthly subscriber line charge (SLC) in period 1.
$A_t$	denotes the average number of minutes of interstate access the carrier supplies each month in period $t$ .
$\underline{A}_t$	denotes the average number of minutes of intrastate access the carrier supplies each month in period $t$ .
$a_t$	denotes the carrier's per-minute interstate access charge in period $t$ .
$\underline{a}_t$	denotes the carrier's per-minute intrastate access charge in period $t$ .
$C$	denotes the carrier's contribution to the maximum interstate CAF component payment.
$\underline{C}$	denotes the carrier's contribution to the maximum intrastate CAF component payment.
$r^B$	denotes a benchmark monthly per-line local service revenue in period 1.
$r_t$	denotes the carrier's monthly per-line local service revenue in period $t$ .
$r^n$	denotes the average per-line revenue that carriers derive from the sale of non-regulated services.
$f^n$	denotes a specified fraction of the average per-line revenue that carriers derive from the sale of non-regulated services.

<sup>1</sup> As discussed in the Notice, we are seeking comment on the appropriate relationship between any CAF funding designed to offset a portion of reduced intercarrier compensation revenues and the broader CAF proposals being considered. See section XIV.D.

<sup>2</sup> See section XIV.

$\alpha^n$  denotes the fraction of a carrier's non-regulated revenue contribution that is attributed to interstate operations.

The Maximum Interstate CAF Component Payment:

$$[a_0 A_0 - a_1 A_1] - [s^{max} L_1 - s_0 L_0] - C \quad (1)$$

$$\text{where } C = \alpha^n f^n r^n L_1. \quad (2)$$

The Maximum Intrastate CAF Component Payment:

$$[\underline{a}_0 \underline{A}_0 - \underline{a}_1 \underline{A}_1] - \underline{C} \quad (3)$$

$$\text{where } \underline{C} = [1 - \alpha^n] f^n r^n L_1 + \text{maximum } \{0, [r^B - r_1] L_1\}. \quad (4)$$

4. *Explaining the Maximum Interstate CAF Component Payment.* The first expression in square brackets  $[\bullet]$  in equation (1) reflects the extent to which the reform of interstate access charges reduces the carrier's revenue. The second expression in square brackets  $[\bullet]$  represents the increase in the carrier's revenue from any authorized increase in the SLC cap (if any). Together, the first two expressions in equation (1) represent the net reduction in revenue that a carrier will experience from the reform of interstate access charges if it sets the maximum authorized SLC.<sup>3</sup>

5. The carrier contribution,  $C$ , in equation (1) reflects a component of the maximum interstate CAF component payment that a carrier is expected to finance with the revenue it derives from the sale of non-regulated services (if any). So as not to diminish a carrier's incentive to generate non-regulated revenue, the carrier contribution,  $C$ , identified in equation (1) and defined in equation (2) might not reflect the non-regulated revenue actually secured by an individual carrier. Instead, it could reflect a fraction of the revenue that all carriers derive from the sale of non-regulated services, on average.<sup>4</sup>

6. The total revenue from non-regulated services that a carrier might be expected to contribute to offset any reduction in its revenue resulting from intercarrier compensation reform is divided between an interstate and an intrastate contribution. As equation (2) indicates,  $\alpha^n$  is the fraction of the total non-regulated revenue contribution ( $f^n r^n L_1$ ) that is assigned to the maximum interstate CAF component payment.  $\alpha^n$  might be set at 0.25, for example, to be roughly consistent with the prevailing standard separation of loop costs between interstate and intrastate operations.

7. *Explaining the Maximum Intrastate CAF Component Payment.* The second set of equations could be used to the extent that the Commission wishes to provide federal support from the

<sup>3</sup> A carrier may choose to set a SLC in period 1 below the maximum authorized SLC ( $s^{max}$ ). Under this framework, however, the carrier will not receive payments from the CAF component to offset the associated reduction in revenue.

If  $s^{max} L_1 - s_0 L_0 > |a_0 A_0 - a_1 A_1|$  so that the proposed maximum SLC increase would generate more revenue for a carrier than it loses from reduced access charges, the carrier would only be permitted to increase its SLC to the level that just offsets the revenue reduction from reduced access charges. (Formally, the maximum SLC the carrier can set in period 1 is the smaller of  $s^{max}$  and  $[s_0 L_0 + |a_0 A_0 - a_1 A_1|] / L_1$ ).

<sup>4</sup> If the average per-line revenue from the sale of non-regulated services differs substantially by carrier size, then different values of  $r^n$  (average per-line non-regulated revenue) can be employed for carriers of different size (e.g., small, medium, and large).

CAF component to offset reduced intrastate intercarrier compensation revenues. The expression in square brackets  $[\bullet]$  in equation (3) reflects the extent to which the reform of intrastate access charges reduces the carrier's revenue. This reduction is offset by the carrier contribution,  $\underline{C}$ . As equation (4) indicates, this contribution is the sum of two terms: (1) the portion of the carrier's total non-regulated revenue contribution that is not assigned to the maximum intrastate payment from the CAF component ( $[1 - \alpha] f^n r^n L_1$ ); and (2) any shortfall in the carrier's revenue from intrastate ("local") services relative to a benchmark level of local service revenue. To limit the extent to which scarce universal service resources are employed to compensate carriers that choose to set below-benchmark rates for local services, the maximum intrastate payment from the CAF component is reduced by the difference between the relevant benchmark local service revenue ( $r^B L_1$ ) and the carrier's actual local service revenue ( $r_1 L_1$ ), as indicated in equation (4).<sup>5</sup>

8. *Implementation Considerations.* The maximum payments from the CAF component as described in equations (1) – (4) would increase as the number of lines that a carrier serves declines. To encourage carriers to limit customer loss and to avoid discouraging carriers from engaging in service expansion,  $L_1$  in equations (1), (2), and (4) could, for example, be replaced either by  $L_0$  or by  $[1 - l] L_0$ .  $l \in (0,1)$  here can be viewed as an estimate of the fraction of its lines that a carrier is likely to lose even when it acts diligently to limit line loss.

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<sup>5</sup> As the *maximum*  $\{\bullet\}$  term in equation (4) indicates, the maximum intrastate CAF payment is not increased for carriers whose local service revenue exceeds the benchmark local service revenue. Instead, the maximum intrastate CAF payment is only reduced for carriers whose local service revenue is less than the benchmark local service revenue.

## APPENDIX E

## Initial Regulatory Flexibility Analysis

1. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),<sup>1</sup> the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on a substantial number of small entities by the policies and rules proposed in this Notice. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice. The Commission will send a copy of the Notice, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).<sup>2</sup> In addition, the Notice and IRFA (or summaries thereof) will be published in the Federal Register.<sup>3</sup>

**A. Need for, and Objectives of, the Proposed Rules**

2. The Notice and Further Notice (Notice) seeks comment on a variety of issues relating to comprehensive reform of universal service and intercarrier compensation. As discussed in the Notice, the Commission believes that such reform will eliminate waste and inefficiency while modernizing and reorienting these programs on a fiscally responsible path to extending the benefits of broadband throughout America. Bringing robust, affordable broadband to all Americans is the great infrastructure challenge of our time. To meet this challenge, the Notice proposes to fundamentally modernize the Commission's Universal Service Fund (USF) and intercarrier compensation system, eliminating waste and inefficiency.

3. Millions of Americans live in areas where there is no access to any broadband network. Meanwhile, fundamental inefficiencies and waste affect both USF and intercarrier compensation. In many areas of the country, USF provides more support than necessary to achieve our goals, subsidizes a competitor to a voice and broadband provider that is offering service without government assistance, or supports several voice networks in a single area.<sup>4</sup> Similarly, inefficient intercarrier compensation rules create incentives for wasteful arbitrage opportunities like phantom traffic and access stimulation.<sup>5</sup> We face these problems because our universal service rules and our intercarrier compensation system, designed for 20<sup>th</sup> century networks and market dynamics, have not been comprehensively reassessed in more than a decade, even though the communications landscape has changed dramatically.<sup>6</sup> Due to the interrelationship between USF and intercarrier compensation, and the importance of both to the nation's broadband goals, reform of the two programs must be tackled together.

4. In the Notice, the Commission proposes to transform the existing high-cost program—the component of USF directed toward high-cost, rural, and insular areas—into a new, more efficient, broadband-focused Connect America Fund (CAF).

5. In the first stage of reform, beginning in 2012, the Commission proposes to update the public interest obligations that pertain to current and future recipients.<sup>7</sup> The Commission also proposes to

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<sup>1</sup> See 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601–612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

<sup>2</sup> See 5 U.S.C. § 603(a).

<sup>3</sup> See *id.*

<sup>4</sup> See *supra* section I.

<sup>5</sup> See *id.*

<sup>6</sup> See *id.*

<sup>7</sup> See *supra* section V.D.

transition funds from less efficient uses to more efficient uses. Over a period of a few years, the Commission proposes to phase out Interstate Access Support (IAS) and funding for competitive eligible telecommunications carriers (ETCs), subject to possible exceptions.<sup>8</sup> In addition, the Commission seeks comment on a set of proposals to eliminate waste and inefficiency, improve incentives for rational investment and operation by companies operating in rural areas, and set rate-of-return companies on the path to incentive-based regulation. Specifically, the Commission seeks comment on: (a) establishing benchmarks for reimbursable capital and operating costs; (b) modifying high-cost loop support reimbursement percentages and eliminate loop support known as “safety net”; (c) eliminating local switching support as a separate funding mechanism; (d) eliminating the reimbursement of corporate operations expenses; and (e) capping total high-cost support at \$3,000 per line per year for carriers operating in the continental United States.<sup>9</sup>

6. The Commission also proposes to create a CAF program that would immediately make available support for broadband in unserved areas using competitive bidding.<sup>10</sup> The Commission seeks comment on this proposal, including proposed CAF eligibility requirements, the proposed framework for a CAF auction, and post-auction process, administration, and management and oversight of the CAF program.<sup>11</sup>

7. In the second stage, the Commission proposes to transition all remaining high-cost programs to the CAF, which would provide ongoing support to maintain and advance broadband across the country in areas that are uneconomic to serve absent such support, with voice service ultimately provided as an application over broadband networks.<sup>12</sup> The Commission seeks comment on options for determining support levels under the CAF, including the use of a model and/or competitive bidding. The Commission also seeks comment on an alternative that would limit the full transition to a subset of geographic areas, such as those served by price cap companies, while continuing to provide ongoing support based on reasonable actual investment to smaller, rate-of-return companies.<sup>13</sup> The Commission also seeks comment on whether USF should support mobile voice and/or mobile broadband service in all areas of the country.<sup>14</sup>

8. The Commission further proposes a variety of measures, including establishing performance goals and improving reporting requirements to increase accountability and better track performance of the Fund as a whole.<sup>15</sup>

9. The Notice also seeks comment on proposals to comprehensively reform intercarrier compensation in order to bring the benefits of broadband to all Americans. The current intercarrier compensation system’s distorted incentives and wasted resources are a roadblock to a world-leading broadband ecosystem. Reform of the current morass of regulatory distinctions and access charges will help to modernize the Commission’s rules to advance broadband, reduce waste and inefficiency, increase accountability, and lead to market-driven outcomes that promote investment.

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<sup>8</sup> See *supra* sections VI.C - VI.D.

<sup>9</sup> See *supra* section VI.A.

<sup>10</sup> See *supra* section VI.E.

<sup>11</sup> See *id.*

<sup>12</sup> See *supra* section VI.G.

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See *supra* section IX.

10. The Notice seeks comment on the Commission's authority to pursue intercarrier compensation reform, identifies certain goals of intercarrier compensation reform, and seeks comment on how possible intercarrier compensation rate methodologies would advance those goals.<sup>16</sup> The Notice also seeks comment on the appropriate transition away from the current per-minute intercarrier compensation rates, including two possible approaches.<sup>17</sup> One approach relies on the Commission and states to act within their existing roles in regulating intercarrier compensation, and the other follows the federal and state roles established for reciprocal compensation under the 1996 Act. Within these approaches, the Notice identifies a range of possible outcomes for the sequencing of reductions for specific rates and seeks comment on other implementation details, including the timing of any transition.<sup>18</sup> In addition, the Notice seeks comment on how the Commission could provide a recovery mechanism as part of any comprehensive reform and how to structure recovery with the appropriate incentives to accelerate the migration to IP broadband networks.<sup>19</sup>

11. The Notice also seeks comment on rules intended to reduce incentives for wasteful arbitrage. First, to address existing uncertainty, the Notice invites comment on the appropriate intercarrier compensation framework for VoIP traffic.<sup>20</sup> Second, the Notice seeks comment on: (1) amendments to the Commission's call signaling rules to address phantom traffic; and (2) amendments to the Commission's interstate access rules to address access stimulation and to ensure that rates remain just and reasonable.<sup>21</sup> Finally, the Notice seeks comment on other issues related to intercarrier compensation reform including network edges and points of interconnection, transiting, and disputes that have arisen over technical issues in intercarrier compensation rules and carrier practices.<sup>22</sup>

## **B. Legal Basis**

12. The legal basis for any action that may be taken pursuant to the Notice is contained in Sections 1, 2, 4(i), 201-206, 214, 218-220, 251, 252, 254, 256, 303(r), 332, 403, and 706 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154(i), 201-206, 214, 218-220, 251, 252, 254, 256 303(r), 332, 403 and 706 and sections 1.1 and 1.1421 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.1421.

## **C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply**

13. The RFA directs agencies to provide a description of, and where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted.<sup>23</sup> The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."<sup>24</sup> In addition, the term "small business" has the

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<sup>16</sup> See *supra* sections XI - XII.

<sup>17</sup> See *supra* section XIII.

<sup>18</sup> See *id.*

<sup>19</sup> See *supra* section XIV.

<sup>20</sup> See *supra* section XV.A.

<sup>21</sup> See *supra* sections XV.B - XV.C .

<sup>22</sup> See *supra* section XVI.

<sup>23</sup> See 5 U.S.C. § 603(b)(3).

<sup>24</sup> See 5 U.S.C. § 601(6).

same meaning as the term “small-business concern” under the Small Business Act.<sup>25</sup> A small-business concern” is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.<sup>26</sup>

14. **Small Businesses.** Nationwide, there are a total of approximately 27.5 million small businesses, according to the SBA.<sup>27</sup>

15. **Wired Telecommunications Carriers.** The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees.<sup>28</sup> According to Census Bureau data for 2007, there were 3,188 firms in this category, total, that operated for the entire year.<sup>29</sup> Of this total, 3144 firms had employment of 999 or fewer employees, and 44 firms had employment of 1000 employees or more.<sup>30</sup> Thus, under this size standard, the majority of firms can be considered small.

16. **Local Exchange Carriers (LECs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>31</sup> According to Commission data, 1,307 carriers reported that they were incumbent local exchange service providers.<sup>32</sup> Of these 1,307 carriers, an estimated 1,006 have 1,500 or fewer employees and 301 have more than 1,500 employees.<sup>33</sup> Consequently, the Commission estimates that most providers of local exchange service are small entities that may be affected by the rules and policies proposed in the Notice.

17. **Incumbent Local Exchange Carriers (incumbent LECs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to incumbent local exchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>34</sup> According to Commission data, 1,307 carriers reported that they were incumbent local exchange service providers.<sup>35</sup> Of these 1,307 carriers, an estimated 1,006 have 1,500 or fewer employees

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<sup>25</sup> See 5 U.S.C. § 601(3) (incorporating by reference the definition of “small-business concern” in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies “unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register.”

<sup>26</sup> See 15 U.S.C. § 632.

<sup>27</sup> See SBA, Office of Advocacy, “Frequently Asked Questions,” <http://www.sba.gov/advo/stats/sbfaq.pdf> (accessed Dec. 2010).

<sup>28</sup> 13 C.F.R. § 121.201, NAICS code 517110.

<sup>29</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, “Establishment and Firm Size: Employment Size of Firms for the United States: 2007 NAICS Code 517110” (issued Nov. 2010).

<sup>30</sup> See *id.*

<sup>31</sup> 13 C.F.R. § 121.201, NAICS code 517110.

<sup>32</sup> See *Trends in Telephone Service*, Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division at Table 5.3 (Sept. 2010) (*Trends in Telephone Service*).

<sup>33</sup> See *id.*

<sup>34</sup> See 13 C.F.R. § 121.201, NAICS code 517110.

<sup>35</sup> See *Trends in Telephone Service* at Table 5.3.

and 301 have more than 1,500 employees.<sup>36</sup> Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by rules adopted pursuant to the Notice.

18. We have included small incumbent LECs in this present RFA analysis. As noted above, a “small business” under the RFA is one that, *inter alia*, meets the pertinent small business size standard (e.g., a telephone communications business having 1,500 or fewer employees), and “is not dominant in its field of operation.”<sup>37</sup> The SBA’s Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not “national” in scope.<sup>38</sup> We have therefore included small incumbent LECs in this RFA analysis, although we emphasize that this RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

19. **Competitive Local Exchange Carriers (competitive LECs), Competitive Access Providers (CAPs), Shared-Tenant Service Providers, and Other Local Service Providers.** Neither the Commission nor the SBA has developed a small business size standard specifically for these service providers. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>39</sup> According to Commission data, 1,442 carriers reported that they were engaged in the provision of either competitive local exchange services or competitive access provider services.<sup>40</sup> Of these 1,442 carriers, an estimated 1,256 have 1,500 or fewer employees and 186 have more than 1,500 employees.<sup>41</sup> In addition, 17 carriers have reported that they are Shared-Tenant Service Providers, and all 17 are estimated to have 1,500 or fewer employees.<sup>42</sup> In addition, 72 carriers have reported that they are Other Local Service Providers.<sup>43</sup> Of the 72, seventy have 1,500 or fewer employees and two have more than 1,500 employees.<sup>44</sup> Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, Shared-Tenant Service Providers, and Other Local Service Providers are small entities that may be affected by rules adopted pursuant to the Notice.

20. **Interexchange Carriers (IXCs).** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to interexchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>45</sup> According to Commission data, 359 companies reported that their primary telecommunications service activity was the provision of

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<sup>36</sup> See *id.*

<sup>37</sup> 5 U.S.C. § 601(3).

<sup>38</sup> See Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of “small business concern,” which the RFA incorporates into its own definition of “small business.” See 15 U.S.C. § 632(a); see also 5 U.S.C. § 601(3). SBA regulations interpret “small business concern” to include the concept of dominance on a national basis. See 13 C.F.R. § 121.102(b).

<sup>39</sup> See 13 C.F.R. § 121.201, NAICS code 517110.

<sup>40</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>41</sup> See *id.*

<sup>42</sup> See *id.*

<sup>43</sup> See *id.*

<sup>44</sup> See *id.*

<sup>45</sup> See 13 C.F.R. § 121.201, NAICS code 517110.

interexchange services.<sup>46</sup> Of these 359 companies, an estimated 317 have 1,500 or fewer employees and 42 have more than 1,500 employees.<sup>47</sup> Consequently, the Commission estimates that the majority of interexchange service providers are small entities that may be affected by rules adopted pursuant to the Notice.

21. **Prepaid Calling Card Providers.** Neither the Commission nor the SBA has developed a small business size standard specifically for prepaid calling card providers. The appropriate size standard under SBA rules is for the category Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>48</sup> According to Commission data, 193 carriers have reported that they are engaged in the provision of prepaid calling cards.<sup>49</sup> Of these, an estimated all 193 have 1,500 or fewer employees and none have more than 1,500 employees.<sup>50</sup> Consequently, the Commission estimates that the majority of prepaid calling card providers are small entities that may be affected by rules adopted pursuant to the Notice.

22. **Local Resellers.** The SBA has developed a small business size standard for the category of Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>51</sup> According to Commission data, 213 carriers have reported that they are engaged in the provision of local resale services.<sup>52</sup> Of these, an estimated 211 have 1,500 or fewer employees and two have more than 1,500 employees.<sup>53</sup> Consequently, the Commission estimates that the majority of local resellers are small entities that may be affected by rules adopted pursuant to the Notice.

23. **Toll Resellers.** The SBA has developed a small business size standard for the category of Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>54</sup> According to Commission data, 881 carriers have reported that they are engaged in the provision of toll resale services.<sup>55</sup> Of these, an estimated 857 have 1,500 or fewer employees and 24 have more than 1,500 employees.<sup>56</sup> Consequently, the Commission estimates that the majority of toll resellers are small entities that may be affected by rules adopted pursuant to the Notice.

24. **Other Toll Carriers.** Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to Other Toll Carriers. This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>57</sup> According to Commission data, 284 companies reported that

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<sup>46</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>47</sup> See *id.*

<sup>48</sup> See 13 C.F.R. § 121.201, NAICS code 517911.

<sup>49</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>50</sup> See *id.*

<sup>51</sup> See 13 C.F.R. § 121.201, NAICS code 517911.

<sup>52</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>53</sup> See *id.*

<sup>54</sup> See 13 C.F.R. § 121.201, NAICS code 517911.

<sup>55</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>56</sup> See *id.*

<sup>57</sup> See 13 C.F.R. § 121.201, NAICS code 517110.

their primary telecommunications service activity was the provision of other toll carriage.<sup>58</sup> Of these, an estimated 279 have 1,500 or fewer employees and five have more than 1,500 employees.<sup>59</sup> Consequently, the Commission estimates that most Other Toll Carriers are small entities that may be affected by the rules and policies adopted pursuant to the Notice.

25. **800 and 800-Like Service Subscribers.**<sup>60</sup> Neither the Commission nor the SBA has developed a small business size standard specifically for 800 and 800-like service (toll free) subscribers. The appropriate size standard under SBA rules is for the category Telecommunications Resellers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>61</sup> The most reliable source of information regarding the number of these service subscribers appears to be data the Commission collects on the 800, 888, 877, and 866 numbers in use.<sup>62</sup> According to our data, as of September 2009, the number of 800 numbers assigned was 7,860,000; the number of 888 numbers assigned was 5,588,687; the number of 877 numbers assigned was 4,721,866; and the number of 866 numbers assigned was 7,867,736.<sup>63</sup> We do not have data specifying the number of these subscribers that are not independently owned and operated or have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of toll free subscribers that would qualify as small businesses under the SBA size standard. Consequently, we estimate that there are 7,860,000 or fewer small entity 800 subscribers; 5,588,687 or fewer small entity 888 subscribers; 4,721,866 or fewer small entity 877 subscribers; and 7,867,736 or fewer small entity 866 subscribers.

26. **Wireless Telecommunications Carriers (except Satellite).** Since 2007, the SBA has recognized wireless firms within this new, broad, economic census category.<sup>64</sup> Prior to that time, such firms were within the now-superseded categories of Paging and Cellular and Other Wireless Telecommunications.<sup>65</sup> Under the present and prior categories, the SBA has deemed a wireless business to be small if it has 1,500 or fewer employees.<sup>66</sup> For this category, census data for 2007 show that there were 1,383 firms that operated for the entire year.<sup>67</sup> Of this total, 1,368 firms had employment of 999 or fewer employees and 15 had employment of 1000 employees or more.<sup>68</sup> Similarly, according to Commission data, 413 carriers reported that they were engaged in the provision of wireless telephony, including cellular service, Personal Communications Service (PCS), and Specialized Mobile Radio

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<sup>58</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>59</sup> See *id.*

<sup>60</sup> We include all toll-free number subscribers in this category, including those for 888 numbers.

<sup>61</sup> See 13 C.F.R. § 121.201, NAICS code 517911.

<sup>62</sup> See *Trends in Telephone Service* at Tables 18.7-18.10.

<sup>63</sup> See *id.*

<sup>64</sup> See 13 C.F.R. § 121.201, NAICS code 517210.

<sup>65</sup> U.S. Census Bureau, 2002 NAICS Definitions, “517211 Paging”; <http://www.census.gov/epcd/naics02/def/NDEF517.HTM>; U.S. Census Bureau, 2002 NAICS Definitions, “517212 Cellular and Other Wireless Telecommunications”; <http://www.census.gov/epcd/naics02/def/NDEF517.HTM>.

<sup>66</sup> 13 C.F.R. § 121.201, NAICS code 517210. The now-superseded, pre-2007 C.F.R. citations were 13 C.F.R. § 121.201, NAICS codes 517211 and 517212 (referring to the 2002 NAICS).

<sup>67</sup> U.S. Census Bureau, Subject Series: Information, Table 5, “Establishment and Firm Size: Employment Size of Firms for the United States: 2007 NAICS Code 517210” (issued Nov. 2010).

<sup>68</sup> *Id.* Available census data do not provide a more precise estimate of the number of firms that have employment of 1,500 or fewer employees; the largest category provided is for firms with “100 employees or more.”

(SMR) Telephony services.<sup>69</sup> Of these, an estimated 261 have 1,500 or fewer employees and 152 have more than 1,500 employees.<sup>70</sup> Consequently, the Commission estimates that approximately half or more of these firms can be considered small. Thus, using available data, we estimate that the majority of wireless firms can be considered small.

27. **Broadband Personal Communications Service.** The broadband personal communications service (PCS) spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission defined “small entity” for Blocks C and F as an entity that has average gross revenues of \$40 million or less in the three previous calendar years.<sup>71</sup> For Block F, an additional classification for “very small business” was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.<sup>72</sup> These standards defining “small entity” in the context of broadband PCS auctions have been approved by the SBA.<sup>73</sup> No small businesses, within the SBA-approved small business size standards bid successfully for licenses in Blocks A and B. There were 90 winning bidders that qualified as small entities in the Block C auctions. A total of 93 small and very small business bidders won approximately 40 percent of the 1,479 licenses for Blocks D, E, and F.<sup>74</sup> In 1999, the Commission re-auctioned 347 C, E, and F Block licenses.<sup>75</sup> There were 48 small business winning bidders. In 2001, the Commission completed the auction of 422 C and F Broadband PCS licenses in Auction 35.<sup>76</sup> Of the 35 winning bidders in this auction, 29 qualified as “small” or “very small” businesses. Subsequent events, concerning Auction 35, including judicial and agency determinations, resulted in a total of 163 C and F Block licenses being available for grant. In 2005, the Commission completed an auction of 188 C block licenses and 21 F block licenses in Auction 58. There were 24 winning bidders for 217 licenses.<sup>77</sup> Of the 24 winning bidders, 16 claimed small business status and won 156 licenses. In 2007, the Commission completed an auction of 33 licenses in the A, C, and F Blocks in Auction 71.<sup>78</sup> Of the 14 winning bidders, six were designated entities.<sup>79</sup> In 2008, the

<sup>69</sup> See *Trends in Telephone Service* at Table 5.3.

<sup>70</sup> See *id.*

<sup>71</sup> See generally *Amendment of Parts 20 and 24 of the Commission’s Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, GN Docket No. 90-314, Report and Order, 11 FCC Rcd 7824 (1996); see also 47 C.F.R. § 24.720(b)(1).

<sup>72</sup> See generally *Amendment of Parts 20 and 24 of the Commission’s Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap*, WT Docket No. 96-59, GN Docket No. 90-314, Report and Order, 11 FCC Rcd 7824 (1996); see also 47 C.F.R. § 24.720(b)(2).

<sup>73</sup> See, e.g., *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, PP Docket No. 93-253, Fifth Report and Order, 9 FCC Rcd 5532 (1994).

<sup>74</sup> See FCC News, *Broadband PCS, D, E and F Block Auction Closes*, No. 71744 (rel. Jan. 14, 1997). See also *Amendment of the Commission’s Rules Regarding Installment Payment Financing for Personal Communications Services (PCS) Licensees*, WT Docket No. 97-82, Second Report and Order and Further Notice of Proposed Rulemaking, 12 FCC Rcd 16436 (1997).

<sup>75</sup> See “C, D, E, and F Block Broadband PCS Auction Closes,” *Public Notice*, 14 FCC Rcd 6688 (WTB 1999).

<sup>76</sup> See “C and F Block Broadband PCS Auction Closes; Winning Bidders Announced,” *Public Notice*, 16 FCC Rcd 2339 (2001).

<sup>77</sup> See “Broadband PCS Spectrum Auction Closes; Winning Bidders Announced for Auction No. 58,” *Public Notice*, 20 FCC Rcd 3703 (2005).

<sup>78</sup> See “Auction of Broadband PCS Spectrum Licenses Closes; Winning Bidders Announced for Auction No. 71,” *Public Notice*, 22 FCC Rcd 9247 (2007).

Commission completed an auction of 20 Broadband PCS licenses in the C, D, E and F block licenses in Auction 78.<sup>80</sup>

28. **Advanced Wireless Services.** In 2008, the Commission conducted the auction of Advanced Wireless Services (“AWS”) licenses.<sup>81</sup> This auction, which as designated as Auction 78, offered 35 licenses in the AWS 1710-1755 MHz and 2110-2155 MHz bands (“AWS-1”). The AWS-1 licenses were licenses for which there were no winning bids in Auction 66. That same year, the Commission completed Auction 78. A bidder with attributed average annual gross revenues that exceeded \$15 million and did not exceed \$40 million for the preceding three years (“small business”) received a 15 percent discount on its winning bid. A bidder with attributed average annual gross revenues that did not exceed \$15 million for the preceding three years (“very small business”) received a 25 percent discount on its winning bid. A bidder that had combined total assets of less than \$500 million and combined gross revenues of less than \$125 million in each of the last two years qualified for entrepreneur status.<sup>82</sup> Four winning bidders that identified themselves as very small businesses won 17 licenses.<sup>83</sup> Three of the winning bidders that identified themselves as a small business won five licenses. Additionally, one other winning bidder that qualified for entrepreneur status won 2 licenses.

29. **Narrowband Personal Communications Services.** In 1994, the Commission conducted an auction for Narrowband PCS licenses. A second auction was also conducted later in 1994. For purposes of the first two Narrowband PCS auctions, “small businesses” were entities with average gross revenues for the prior three calendar years of \$40 million or less.<sup>84</sup> Through these auctions, the Commission awarded a total of 41 licenses, 11 of which were obtained by four small businesses.<sup>85</sup> To ensure meaningful participation by small business entities in future auctions, the Commission adopted a two-tiered small business size standard in the Narrowband PCS Second Report and Order.<sup>86</sup> A “small business” is an entity that, together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than \$40 million.<sup>87</sup> A “very small business” is an entity that,

(Continued from previous page) \_\_\_\_\_

<sup>79</sup> *Id.*

<sup>80</sup> See Auction of AWS-1 and Broadband PCS Licenses Rescheduled For August 13, 3008, Notice of Filing Requirements, Minimum Opening Bids, Upfront Payments and Other Procedures For Auction 78, *Public Notice*, 23 FCC Rcd 7496 (2008) (“AWS-1 and Broadband PCS Procedures Public Notice”).

<sup>81</sup> See AWS-1 and Broadband PCS Procedures Public Notice, 23 FCC Rcd 7496. Auction 78 also included an auction of Broadband PCS licenses.

<sup>82</sup> *Id.* at 23 FCC Rcd at 7521-22.

<sup>83</sup> See “Auction of AWS-1 and Broadband PCS Licenses Closes, Winning Bidders Announced for Auction 78, Down Payments Due September 9, 2008, FCC Forms 601 and 602 Due September 9, 2008, Final Payments Due September 23, 2008, Ten-Day Petition to Deny Period”, *Public Notice*, 23 FCC Rcd 12749 (2008).

<sup>84</sup> *Implementation of Section 309(j) of the Communications Act – Competitive Bidding Narrowband PCS*, PP Docket No. 93-253, GEN Docket No. 90-314, ET Docket No. 92-100, Third Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 10 FCC Rcd 175, 196, para. 46 (1994).

<sup>85</sup> See “Announcing the High Bidders in the Auction of Ten Nationwide Narrowband PCS Licenses, Winning Bids Total \$617,006,674,” *Public Notice*, PNWL 94-004 (rel. Aug. 2, 1994); “Announcing the High Bidders in the Auction of 30 Regional Narrowband PCS Licenses; Winning Bids Total \$490,901,787,” *Public Notice*, PNWL 94-27 (rel. Nov. 9, 1994).

<sup>86</sup> *Amendment of the Commission’s Rules to Establish New Personal Communications Services*, GEN Docket No. 90-314, ET Docket No. 92-100, PP Docket No. 93-253, Narrowband PCS, Second Report and Order and Second Further Notice of Proposed Rule Making, 15 FCC Rcd 10456, 10476, para. 40 (2000) (“*Narrowband PCS Second Report and Order*”).

<sup>87</sup> *Narrowband PCS Second Report and Order*, 15 FCC Rcd at 10476, para. 40.

together with affiliates and controlling interests, has average gross revenues for the three preceding years of not more than \$15 million.<sup>88</sup> The SBA has approved these small business size standards.<sup>89</sup> A third auction was conducted in 2001. Here, five bidders won 317 (Metropolitan Trading Areas and nationwide) licenses.<sup>90</sup> Three of these claimed status as a small or very small entity and won 311 licenses.

30. **Paging (Private and Common Carrier).** In the *Paging Third Report and Order*, we developed a small business size standard for “small businesses” and “very small businesses” for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.<sup>91</sup> A “small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years. Additionally, a “very small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$3 million for the preceding three years.<sup>92</sup> The SBA has approved these small business size standards.<sup>93</sup> According to Commission data, 291 carriers have reported that they are engaged in Paging or Messaging Service.<sup>94</sup> Of these, an estimated 289 have 1,500 or fewer employees, and two have more than 1,500 employees.<sup>95</sup> Consequently, the Commission estimates that the majority of paging providers are small entities that may be affected by our action. An auction of Metropolitan Economic Area licenses commenced on February 24, 2000, and closed on March 2, 2000. Of the 985 licenses auctioned, 440 were sold. Fifty-seven companies claiming small business status won.

31. **220 MHz Radio Service – Phase I Licensees.** The 220 MHz service has both Phase I and Phase II licenses. Phase I licensing was conducted by lotteries in 1992 and 1993. There are approximately 1,515 such non-nationwide licensees and four nationwide licensees currently authorized to operate in the 220 MHz band. The Commission has not developed a small business size standard for small entities specifically applicable to such incumbent 220 MHz Phase I licensees. To estimate the number of such licensees that are small businesses, we apply the small business size standard under the SBA rules applicable to Wireless Telecommunications Carriers (except Satellite). Under this category, the SBA deems a wireless business to be small if it has 1,500 or fewer employees.<sup>96</sup> The Commission estimates that nearly all such licensees are small businesses under the SBA’s small business size standard that may be affected by rules adopted pursuant to the Notice.

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<sup>88</sup> *Id.*

<sup>89</sup> *See Alvarez Letter 1998.*

<sup>90</sup> *See* “Narrowband PCS Auction Closes,” *Public Notice*, 16 FCC Rcd 18663 (WTB 2001).

<sup>91</sup> *See Amendment of Part 90 of the Commission’s Rules to Provide for the Use of the 220-222 MHz Band by the Private Land Mobile Radio Service*, PR Docket No. 89-552, GN Docket No. 93-252, PP Docket No. 93-253, Third Report and Order and Fifth Notice of Proposed Rulemaking, 12 FCC Rcd 10943, 11068–70, paras. 291–295 (1997) (*220 MHz Third Report and Order*).

<sup>92</sup> *See* Letter to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from A. Alvarez, Administrator, SBA (Dec. 2, 1998).

<sup>93</sup> *See Revision of Part 22 and Part 90 of the Commission’s Rules to Facilitate Future Development of Paging Systems*, WT Docket No. 96-18, PR Docket No. 93-253, Memorandum Opinion and Order on Reconsideration and Third Report and Order, 14 FCC Rcd 10030, 10085–88, paras. 98–107 (1999) (*Paging Third Report and Order*).

<sup>94</sup> *See Trends in Telephone Service* at Table 5.3.

<sup>95</sup> *See id.*

<sup>96</sup> *See* 13 C.F.R. § 121.201, NAICS code 517210.

32. **220 MHz Radio Service – Phase II Licensees.** The 220 MHz service has both Phase I and Phase II licenses. The Phase II 220 MHz service is subject to spectrum auctions. In the *220 MHz Third Report and Order*, we adopted a small business size standard for “small” and “very small” businesses for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.<sup>97</sup> This small business size standard indicates that a “small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years.<sup>98</sup> A “very small business” is an entity that, together with its affiliates and controlling principals, has average gross revenues that do not exceed \$3 million for the preceding three years.<sup>99</sup> The SBA has approved these small business size standards.<sup>100</sup> Auctions of Phase II licenses commenced on September 15, 1998, and closed on October 22, 1998.<sup>101</sup> In the first auction, 908 licenses were auctioned in three different-sized geographic areas: three nationwide licenses, 30 Regional Economic Area Group (EAG) Licenses, and 875 Economic Area (EA) Licenses. Of the 908 licenses auctioned, 693 were sold. Thirty-nine small businesses won licenses in the first 220 MHz auction. The second auction included 225 licenses: 216 EA licenses and 9 EAG licenses. Fourteen companies claiming small business status won 158 licenses.<sup>102</sup>

33. **Specialized Mobile Radio.** The Commission awards small business bidding credits in auctions for Specialized Mobile Radio (“SMR”) geographic area licenses in the 800 MHz and 900 MHz bands to entities that had revenues of no more than \$15 million in each of the three previous calendar years.<sup>103</sup> The Commission awards very small business bidding credits to entities that had revenues of no more than \$3 million in each of the three previous calendar years.<sup>104</sup> The SBA has approved these small business size standards for the 800 MHz and 900 MHz SMR Services.<sup>105</sup> The Commission has held auctions for geographic area licenses in the 800 MHz and 900 MHz bands. The 900 MHz SMR auction was completed in 1996.<sup>106</sup> Sixty bidders claiming that they qualified as small businesses under the \$15 million size standard won 263 geographic area licenses in the 900 MHz SMR band.<sup>107</sup> The 800 MHz SMR auction for the upper 200 channels was conducted in 1997. Ten bidders claiming that they qualified as small businesses under the \$15 million size standard won 38 geographic area licenses for the upper 200

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<sup>97</sup> See *220 MHz Third Report and Order*, 12 FCC Rcd at 11068–70, at paras. 291–95.

<sup>98</sup> See *id.* at 11068–69, para. 291.

<sup>99</sup> See *id.* at 11068–70, paras. 291–95.

<sup>100</sup> See Letter to D. Phythyon, Chief, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Jan. 6, 1998).

<sup>101</sup> See *Phase II 220 MHz Service Auction Closes*, Public Notice, 14 FCC Rcd 605 (1998).

<sup>102</sup> See *Phase II 220 MHz Service Spectrum Auction Closes*, Public Notice, 14 FCC Rcd 11218 (1999).

<sup>103</sup> 47 C.F.R. §§ 90.810, 90.814(b), 90.912.

<sup>104</sup> 47 C.F.R. §§ 90.810, 90.814(b), 90.912.

<sup>105</sup> See *Alvarez Letter 1999*.

<sup>106</sup> “FCC Announces Winning Bidders in the Auction of 1,020 Licenses to Provide 900 MHz SMR in Major Trading Areas: Down Payments due April 22, 1996, FCC Form 600s due April 29, 1996,” *Public Notice*, 11 FCC Rcd 18599 (WTB 1996).

<sup>107</sup> *Id.*

channels in the 800 MHz SMR band.<sup>108</sup> A second auction for the 800 MHz band was conducted in 2002 and included 23 BEA licenses. One bidder claiming small business status won five licenses.<sup>109</sup>

34. The auction of the 1,053 800 MHz SMR geographic area licenses for the General Category channels was conducted in 2000. Eleven bidders won 108 geographic area licenses for the General Category channels in the 800 MHz SMR band qualified as small businesses under the \$15 million size standard.<sup>110</sup> In an auction completed in 2000, a total of 2,800 Economic Area licenses in the lower 80 channels of the 800 MHz SMR service were awarded.<sup>111</sup> Of the 22 winning bidders, 19 claimed small business status and won 129 licenses. Thus, combining all three auctions, 40 winning bidders for geographic licenses in the 800 MHz SMR band claimed status as small business.

35. In addition, there are numerous incumbent site-by-site SMR licensees and licensees with extended implementation authorizations in the 800 and 900 MHz bands. We do not know how many firms provide 800 MHz or 900 MHz geographic area SMR pursuant to extended implementation authorizations, nor how many of these providers have annual revenues of no more than \$15 million. One firm has over \$15 million in revenues. In addition, we do not know how many of these firms have 1,500 or fewer employees.<sup>112</sup> We assume, for purposes of this analysis, that all of the remaining existing extended implementation authorizations are held by small entities, as that small business size standard is approved by the SBA.

36. **Broadband Radio Service and Educational Broadband Service.** Broadband Radio Service systems, previously referred to as Multipoint Distribution Service (“MDS”) and Multichannel Multipoint Distribution Service (“MMDS”) systems, and “wireless cable,” transmit video programming to subscribers and provide two-way high speed data operations using the microwave frequencies of the Broadband Radio Service (“BRS”) and Educational Broadband Service (“EBS”) (previously referred to as the Instructional Television Fixed Service (“ITFS”)).<sup>113</sup> In connection with the 1996 BRS auction, the Commission established a small business size standard as an entity that had annual average gross revenues of no more than \$40 million in the previous three calendar years.<sup>114</sup> The BRS auctions resulted in 67 successful bidders obtaining licensing opportunities for 493 Basic Trading Areas (“BTAs”). Of the 67 auction winners, 61 met the definition of a small business. BRS also includes licensees of stations authorized prior to the auction. At this time, we estimate that of the 61 small business BRS auction winners, 48 remain small business licensees. In addition to the 48 small businesses that hold BTA

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<sup>108</sup> See “Correction to Public Notice DA 96-586 ‘FCC Announces Winning Bidders in the Auction of 1020 Licenses to Provide 900 MHz SMR in Major Trading Areas,’” *Public Notice*, 11 FCC Rcd 18,637 (WTB 1996).

<sup>109</sup> See “Multi-Radio Service Auction Closes,” *Public Notice*, 17 FCC Rcd 1446 (WTB 2002).

<sup>110</sup> See “800 MHz Specialized Mobile Radio (SMR) Service General Category (851-854 MHz) and Upper Band (861-865 MHz) Auction Closes; Winning Bidders Announced,” *Public Notice*, 15 FCC Rcd 17162 (WTB 2000).

<sup>111</sup> See, “800 MHz SMR Service Lower 80 Channels Auction Closes; Winning Bidders Announced,” *Public Notice*, 16 FCC Rcd 1736 (WTB 2000).

<sup>112</sup> See generally 13 C.F.R. § 121.201, NAICS code 517210.

<sup>113</sup> *Amendment of Parts 21 and 74 of the Commission’s Rules with Regard to Filing Procedures in the Multipoint Distribution Service and in the Instructional Television Fixed Service and Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, MM Docket No. 94-131 and PP Docket No. 93-253, Report and Order, 10 FCC Rcd 9589, 9593 para. 7 (1995).

<sup>114</sup> 47 C.F.R. § 21.961(b)(1).

authorizations, there are approximately 392 incumbent BRS licensees that are considered small entities.<sup>115</sup> After adding the number of small business auction licensees to the number of incumbent licensees not already counted, we find that there are currently approximately 440 BRS licensees that are defined as small businesses under either the SBA or the Commission's rules. The Commission has adopted three levels of bidding credits for BRS: (i) a bidder with attributed average annual gross revenues that exceed \$15 million and do not exceed \$40 million for the preceding three years (small business) is eligible to receive a 15 percent discount on its winning bid; (ii) a bidder with attributed average annual gross revenues that exceed \$3 million and do not exceed \$15 million for the preceding three years (very small business) is eligible to receive a 25 percent discount on its winning bid; and (iii) a bidder with attributed average annual gross revenues that do not exceed \$3 million for the preceding three years (entrepreneur) is eligible to receive a 35 percent discount on its winning bid.<sup>116</sup> In 2009, the Commission conducted Auction 86, which offered 78 BRS licenses.<sup>117</sup> Auction 86 concluded with ten bidders winning 61 licenses.<sup>118</sup> Of the ten, two bidders claimed small business status and won 4 licenses; one bidder claimed very small business status and won three licenses; and two bidders claimed entrepreneur status and won six licenses.

37. In addition, the SBA's Cable Television Distribution Services small business size standard is applicable to EBS. There are presently 2,032 EBS licensees. All but 100 of these licenses are held by educational institutions. Educational institutions are included in this analysis as small entities.<sup>119</sup> Thus, we estimate that at least 1,932 licensees are small businesses. Since 2007, Cable Television Distribution Services have been defined within the broad economic census category of Wired Telecommunications Carriers; that category is defined as follows: "This industry comprises establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies."<sup>120</sup> The SBA defines a small business size standard for this category as any such firms having 1,500 or fewer employees. The SBA has developed a small business size standard for this category, which is: all such firms having 1,500 or fewer employees. According to Census Bureau data for 2007, there were a total of 955 firms in this previous category that operated for the entire year.<sup>121</sup> Of this total, 939 firms had employment of 999 or fewer employees, and 16 firms had employment of

<sup>115</sup> 47 U.S.C. § 309(j). Hundreds of stations were licensed to incumbent MDS licensees prior to implementation of Section 309(j) of the Communications Act of 1934, 47 U.S.C. § 309(j). For these pre-auction licenses, the applicable standard is SBA's small business size standard.

<sup>116</sup> 47 C.F.R. § 27.1218. *See also* "Auction of Broadband Radio Service (BRS) Licenses, Scheduled for October 27, 2009, Notice and Filing Requirements, Minimum Opening Bids, Upfront Payments, and Other Procedures for Auction 86," Public Notice, 24 FCC Rcd 8277, 8296 (WTB 2009) (*Auction 86 Procedures Public Notice*).

<sup>117</sup> *Auction 86 Procedures Public Notice*, 24 FCC Rcd at 8280.

<sup>118</sup> "Auction of Broadband Radio Service Licenses Closes, Winning Bidders Announced for Auction 86, Down Payments Due November 23, 2009, Final Payments Due December 8, 2009, Ten-Day Petition to Deny Period," Public Notice, 24 FCC Rcd 13572 (WTB 2009).

<sup>119</sup> The term "small entity" within SBREFA applies to small organizations (nonprofits) and to small governmental jurisdictions (cities, counties, towns, townships, villages, school districts, and special districts with populations of less than 50,000). 5 U.S.C. §§ 601(4)-(6). We do not collect annual revenue data on EBS licensees.

<sup>120</sup> U.S. Census Bureau, 2007 NAICS Definitions, "517110 Wired Telecommunications Carriers" (partial definition); <http://www.census.gov/naics/2007/def/ND517110.HTM#N517110>.

<sup>121</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, Employment Size of Firms for the United States: 2007, NAICS code 517110 (issued Nov. 2010).

1000 employees or more.<sup>122</sup> Thus, under this size standard, the majority of firms can be considered small and may be affected by rules adopted pursuant to the Notice.

38. **700 MHz Band Licenses.** The Commission previously adopted criteria for defining three groups of small businesses for purposes of determining their eligibility for special provisions such as bidding credits.<sup>123</sup> The Commission defined a “small business” as an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$40 million for the preceding three years.<sup>124</sup> A “very small business” is defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$15 million for the preceding three years.<sup>125</sup> Additionally, the Lower 700 MHz Band had a third category of small business status for Metropolitan/Rural Service Area (“MSA/RSA”) licenses, identified as “entrepreneur” and defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$3 million for the preceding three years.<sup>126</sup> The SBA approved these small size standards.<sup>127</sup> The Commission conducted an auction in 2002 of 740 Lower 700 MHz Band licenses (one license in each of the 734 MSAs/RSAs and one license in each of the six Economic Area Groupings (EAGs)). Of the 740 licenses available for auction, 484 licenses were sold to 102 winning bidders.<sup>128</sup> Seventy-two of the winning bidders claimed small business, very small business or entrepreneur status and won a total of 329 licenses.<sup>129</sup> The Commission conducted a second Lower 700 MHz Band auction in 2003 that included 256 licenses: 5 EAG licenses and 476 Cellular Market Area licenses.<sup>130</sup> Seventeen winning bidders claimed small or very small business status and won 60 licenses, and nine winning bidders claimed entrepreneur status and won 154 licenses.<sup>131</sup> In 2005, the Commission completed an auction of 5 licenses in the Lower 700 MHz Band, designated Auction 60. There were three winning bidders for five licenses. All three winning bidders claimed small business status.<sup>132</sup>

39. In 2007, the Commission adopted the *700 MHz Second Report and Order*, which revised the band plan for the commercial (including Guard Band) and public safety spectrum, adopted services rules, including stringent build-out requirements, an open platform requirement on the C Block, and a requirement on the D Block licensee to construct and operate a nationwide, interoperable wireless broadband network for public safety users.<sup>133</sup> In 2008, the Commission conducted Auction 73 which

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<sup>122</sup> See *id.*

<sup>123</sup> See *Reallocation and Service Rules for the 698-746 MHz Spectrum Band (Television Channels 52-59)*, GN Docket No. 01-74, Report and Order, 17 FCC Rcd 1022 (2002) (*Channels 52-59 Report and Order*).

<sup>124</sup> See *Channels 52-59 Report and Order*, 17 FCC Rcd at 1087-88 para. 172.

<sup>125</sup> See *id.*

<sup>126</sup> See *id.* at 1088 para. 173.

<sup>127</sup> See Letter from Aida Alvarez, Administrator, SBA, to Thomas Sugrue, Chief, Wireless Telecommunications Bureau, FCC (Aug. 10, 1999) (*Alvarez Letter 1999*).

<sup>128</sup> See “Lower 700 MHz Band Auction Closes,” Public Notice, 17 FCC Rcd 17272 (WTB 2002).

<sup>129</sup> *Id.*

<sup>130</sup> See “Lower 700 MHz Band Auction Closes,” Public Notice, 18 FCC Rcd 11873 (WTB 2003).

<sup>131</sup> See *id.*

<sup>132</sup> “Auction of Lower 700 MHz Band Licenses Closes, Winning Bidders Announced for Auction No. 60, Down Payments due August 19, 2005, FCC Forms 601 and 602 due August 19, 2005, Final Payment due September 2, 2005, Ten-Day Petition to Deny Period,” Public Notice, 20 FCC Rcd 13424 (WTB 2005).

<sup>133</sup> *Service Rules for the 698-746, 747-762 and 777-792 MHz Band, WT Docket No. 06-150, Revision of the Commission’s Rules to Ensure Compatibility with Enhanced 911 Emergency Calling Systems, CC Docket No. 94-* (continued....)

offered all available, commercial 700 MHz Band licenses (1,099 licenses) for bidding using the Commission's standard simultaneous multiple-round ("SMR") auction format for the A, B, D, and E Block licenses and an SMR auction design with hierarchical package bidding ("HPB") for the C Block licenses. For Auction 73, a bidder with attributed average annual gross revenues that did not exceed \$15 million for the preceding three years (very small business) qualified for a 25 percent discount on its winning bids. A bidder with attributed average annual gross revenues that exceeded \$15 million, but did not exceed \$40 million for the preceding three years, qualified for a 15 percent discount on its winning bids. At the conclusion of Auction 73, 36 winning bidders identifying themselves as very small businesses won 330 of the 1,090 licenses, and 20 winning bidders identifying themselves as a small business won 49 of the 1,090 licenses.<sup>134</sup> The provisionally winning bids for the A, B, C, and E Block licenses exceeded the aggregate reserve prices for those blocks. However, the provisionally winning bid for the D Block license did not meet the applicable reserve price and thus did not become a winning bid.<sup>135</sup>

40. **700 MHz Guard Band Licensees.** In the *700 MHz Guard Band Order*, we adopted a small business size standard for "small businesses" and "very small businesses" for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.<sup>136</sup> A "small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$40 million for the preceding three years.<sup>137</sup> Additionally, a "very small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$15 million for the preceding three years.<sup>138</sup> An auction of 52 Major Economic Area (MEA) licenses commenced on September 6, 2000, and closed on September 21, 2000.<sup>139</sup> Of the 104 licenses auctioned, 96 licenses were sold to nine bidders. Five of these bidders were small businesses that won a total of 26 licenses. A second auction of 700 MHz Guard Band licenses commenced on February 13, 2001 and closed on February 21, 2001. All eight of the licenses auctioned were sold to three bidders. One of these bidders was a small business that won a total of two licenses.<sup>140</sup>

41. **Cellular Radiotelephone Service.** Auction 77 was held to resolve one group of mutually exclusive applications for Cellular Radiotelephone Service licenses for unserved areas in New

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*102, Section 68.4(a) of the Commission's Rules Governing Hearing Aid-Compatible Telephone, Biennial Regulatory Review – Amendment of Parts 1, 22, 24, 27, and 90 to Streamline and Harmonize Various Rules Affecting Wireless Radio Services, Former Nextel Communications, Inc. Upper 700 MHz Guard Band Licenses and Revisions to Part 27 of the Commission's Rules, Implementing a Nationwide, Broadband Interoperable Public Safety Network in the 700 MHz Band, Development of Operational, Technical and Spectrum Requirements for Meeting Federal, State, and Local Public Safety Communications Requirements Through the Year 2010, WT Docket Nos. 96-86, 01-309, 03-264, 06-169, PS Docket No. 06-229, Second Report and Order, 22 FCC Rcd 15289 (2007) (700 MHz Second Report and Order).*

<sup>134</sup> See "Auction of 700 MHz Band Licenses Closes, Winning Bidders Announced for Auction 73, Down Payments Due April 3, 2008, FCC Forms 601 and 602 April 3, 2008, Final Payment Due April 17, 2008, Ten-Day Petition to Deny Period," Public Notice, 23 FCC Rcd 4572, 4572-73 (WTB 2008).

<sup>135</sup> *Id.*

<sup>136</sup> See *Service Rules for the 746-764 and 776-794 MHz Bands, and Revisions to Part 27 of the Commission's Rules*, WT Docket No. 99-168, Second Report and Order, 15 FCC Rcd 5299 (2000) (*700 MHz Guard Band Order*).

<sup>137</sup> See *id.* at 5343-45 paras. 106-10.

<sup>138</sup> See *id.*

<sup>139</sup> See *700 MHz Guard Band Auction Closes*, Public Notice, 15 FCC Rcd 18026 (2000).

<sup>140</sup> See *700 MHz Guard Band Auction Closes*, Public Notice, 16 FCC Rcd 4590 (2001).

Mexico.<sup>141</sup> Bidding credits for designated entities were not available in Auction 77.<sup>142</sup> In 2008, the Commission completed the closed auction of one unserved service area in the Cellular Radiotelephone Service, designated as Auction 77. Auction 77 concluded with one provisionally winning bid for the unserved area totaling \$25,002.<sup>143</sup>

42. **Private Land Mobile Radio (“PLMR”).** PLMR systems serve an essential role in a range of industrial, business, land transportation, and public safety activities. These radios are used by companies of all sizes operating in all U.S. business categories, and are often used in support of the licensee’s primary (non-telecommunications) business operations. For the purpose of determining whether a licensee of a PLMR system is a small business as defined by the SBA, we use the broad census category, Wireless Telecommunications Carriers (except Satellite). This definition provides that a small entity is any such entity employing no more than 1,500 persons.<sup>144</sup> The Commission does not require PLMR licensees to disclose information about number of employees, so the Commission does not have information that could be used to determine how many PLMR licensees constitute small entities under this definition. We note that PLMR licensees generally use the licensed facilities in support of other business activities, and therefore, it would also be helpful to assess PLMR licensees under the standards applied to the particular industry subsector to which the licensee belongs.<sup>145</sup>

43. As of March 2010, there were 424,162 PLMR licensees operating 921,909 transmitters in the PLMR bands below 512 MHz. We note that any entity engaged in a commercial activity is eligible to hold a PLMR license, and that any revised rules in this context could therefore potentially impact small entities covering a great variety of industries.

44. **Rural Radiotelephone Service.** The Commission has not adopted a size standard for small businesses specific to the Rural Radiotelephone Service.<sup>146</sup> A significant subset of the Rural Radiotelephone Service is the Basic Exchange Telephone Radio System (“BETRS”).<sup>147</sup> In the present context, we will use the SBA’s small business size standard applicable to Wireless Telecommunications Carriers (except Satellite), *i.e.*, an entity employing no more than 1,500 persons.<sup>148</sup> There are approximately 1,000 licensees in the Rural Radiotelephone Service, and the Commission estimates that there are 1,000 or fewer small entity licensees in the Rural Radiotelephone Service that may be affected by the rules and policies proposed herein.

45. **Air-Ground Radiotelephone Service.** The Commission has not adopted a small business size standard specific to the Air-Ground Radiotelephone Service.<sup>149</sup> We will use SBA’s small business size standard applicable to Wireless Telecommunications Carriers (except Satellite), *i.e.*, an

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<sup>141</sup> See “Closed Auction of Licenses for Cellular Unserved Service Area Scheduled for June 17, 2008, Notice and Filing Requirements, Minimum Opening Bids, Upfront Payments, and Other Procedures for Auction 77,” Public Notice, 23 FCC Rcd 6670 (WTB 2008).

<sup>142</sup> *Id.* at 6685.

<sup>143</sup> See “Auction of Cellular Unserved Service Area License Closes, Winning Bidder Announced for Auction 77, Down Payment due July 2, 2008, Final Payment due July 17, 2008,” Public Notice, 23 FCC Rcd 9501 (WTB 2008).

<sup>144</sup> See 13 C.F.R. § 121.201, NAICS code 517210.

<sup>145</sup> See generally 13 C.F.R. § 121.201.

<sup>146</sup> The service is defined in 47 C.F.R. § 22.99.

<sup>147</sup> BETRS is defined in 47 C.F.R. §§ 22.757 and 22.759.

<sup>148</sup> 13 C.F.R. § 121.201, NAICS code 517210.

<sup>149</sup> See 47 C.F.R. § 22.99.

entity employing no more than 1,500 persons.<sup>150</sup> There are approximately 100 licensees in the Air-Ground Radiotelephone Service, and we estimate that almost all of them qualify as small under the SBA small business size standard and may be affected by rules adopted pursuant to the Notice.

46. **Aviation and Marine Radio Services.** Small businesses in the aviation and marine radio services use a very high frequency (VHF) marine or aircraft radio and, as appropriate, an emergency position-indicating radio beacon (and/or radar) or an emergency locator transmitter. The Commission has not developed a small business size standard specifically applicable to these small businesses. For purposes of this analysis, the Commission uses the SBA small business size standard for the category Wireless Telecommunications Carriers (except Satellite), which is 1,500 or fewer employees.<sup>151</sup> Census data for 2007, which supersede data contained in the 2002 Census, show that there were 1,383 firms that operated that year.<sup>152</sup> Of those 1,383, 1,368 had fewer than 100 employees, and 15 firms had more than 100 employees. Most applicants for recreational licenses are individuals. Approximately 581,000 ship station licensees and 131,000 aircraft station licensees operate domestically and are not subject to the radio carriage requirements of any statute or treaty. For purposes of our evaluations in this analysis, we estimate that there are up to approximately 712,000 licensees that are small businesses (or individuals) under the SBA standard. In addition, between December 3, 1998 and December 14, 1998, the Commission held an auction of 42 VHF Public Coast licenses in the 157.1875-157.4500 MHz (ship transmit) and 161.775-162.0125 MHz (coast transmit) bands. For purposes of the auction, the Commission defined a “small” business as an entity that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed \$15 million dollars.<sup>153</sup> In addition, a “very small” business is one that, together with controlling interests and affiliates, has average gross revenues for the preceding three years not to exceed \$3 million dollars.<sup>154</sup> There are approximately 10,672 licensees in the Marine Coast Service, and the Commission estimates that almost all of them qualify as “small” businesses under the above special small business size standards and may be affected by rules adopted pursuant to the Notice.

47. **Fixed Microwave Services.** Fixed microwave services include common carrier,<sup>155</sup> private operational-fixed,<sup>156</sup> and broadcast auxiliary radio services.<sup>157</sup> At present, there are approximately

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<sup>150</sup> See 13 C.F.R. § 121.201, NAICS code 517210.

<sup>151</sup> See 13 C.F.R. § 121.201, NAICS code 517210.

<sup>152</sup> U.S. Census Bureau, 2007 Economic Census, Sector 51, 2007 NAICS code 517210 (rel. Oct. 20, 2009), [http://factfinder.census.gov/servlet/IBQTable?\\_bm=y&-geo\\_id=&-fds\\_name=EC0700A1&-\\_skip=700&-ds\\_name=EC0751SSSZ5&-\\_lang=en](http://factfinder.census.gov/servlet/IBQTable?_bm=y&-geo_id=&-fds_name=EC0700A1&-_skip=700&-ds_name=EC0751SSSZ5&-_lang=en).

<sup>153</sup> See generally *Amendment of the Commission's Rules Concerning Maritime Communications*, PR Docket No. 92-257, Third Report and Order and Memorandum Opinion and Order, 13 FCC Rcd 19853, 19884–88 paras. 64–73 (1998).

<sup>154</sup> See *id.*

<sup>155</sup> See 47 C.F.R. §§ 101 *et seq.* (formerly, Part 21 of the Commission's Rules) for common carrier fixed microwave services (except Multipoint Distribution Service).

<sup>156</sup> Persons eligible under parts 80 and 90 of the Commission's Rules can use Private Operational-Fixed Microwave services. See 47 C.F.R. Parts 80 and 90. Stations in this service are called operational-fixed to distinguish them from common carrier and public fixed stations. Only the licensee may use the operational-fixed station, and only for communications related to the licensee's commercial, industrial, or safety operations.

<sup>157</sup> Auxiliary Microwave Service is governed by Part 74 of Title 47 of the Commission's Rules. See 47 C.F.R. Part 74. This service is available to licensees of broadcast stations and to broadcast and cable network entities. Broadcast auxiliary microwave stations are used for relaying broadcast television signals from the studio to the (continued....)

22,015 common carrier fixed licensees and 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. The Commission has not created a size standard for a small business specifically with respect to fixed microwave services. For purposes of this analysis, the Commission uses the SBA small business size standard for Wireless Telecommunications Carriers (except Satellite), which is 1,500 or fewer employees.<sup>158</sup> The Commission does not have data specifying the number of these licensees that have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of fixed microwave service licensees that would qualify as small business concerns under the SBA's small business size standard. Consequently, the Commission estimates that there are up to 22,015 common carrier fixed licensees and up to 61,670 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services that may be small and may be affected by the rules and policies adopted herein. We note, however, that the common carrier microwave fixed licensee category includes some large entities.

48. **Radiotelephone Service.** This service operates on several UHF television broadcast channels that are not used for television broadcasting in the coastal areas of states bordering the Gulf of Mexico.<sup>159</sup> There are presently approximately 55 licensees in this service. The Commission is unable to estimate at this time the number of licensees that would qualify as small under the SBA's small business size standard for the category of Wireless Telecommunications Carriers (except Satellite). Under that standard,<sup>160</sup> Under that SBA small business size standard, a business is small if it has 1,500 or fewer employees.<sup>161</sup> Census data for 2007, which supersede data contained in the 2002 Census, show that there were 1,383 firms that operated that year.<sup>162</sup> Of those 1,383, 1,368 had fewer than 100 employees, and 15 firms had more than 100 employees. Thus under this category and the associated small business size standard, the majority of firms can be considered small.

49. **39 GHz Service.** The Commission created a special small business size standard for 39 GHz licenses – an entity that has average gross revenues of \$40 million or less in the three previous calendar years.<sup>163</sup> An additional size standard for “very small business” is: an entity that, together with affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.<sup>164</sup> The SBA has approved these small business size standards.<sup>165</sup> The auction of the 2,173 39 GHz licenses began on April 12, 2000 and closed on May 8, 2000. The 18 bidders who claimed small business status won 849 licenses. Consequently, the Commission estimates that 18 or fewer 39 GHz licensees are small entities that may be affected by rules adopted pursuant to the Notice.

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transmitter, or between two points such as a main studio and an auxiliary studio. The service also includes mobile television pickups, which relay signals from a remote location back to the studio.

<sup>158</sup> See 13 C.F.R. § 121.201, NAICS code 517210.

<sup>159</sup> This service is governed by Subpart I of Part 22 of the Commission's Rules. See 47 C.F.R. §§ 22.1001-22.1037.

<sup>160</sup> 13 C.F.R. § 121.201, NAICS code 517210.

<sup>161</sup> *Id.*

<sup>162</sup> U.S. Census Bureau, 2007 Economic Census, Sector 51, 2007 NAICS code 517210 (rel. Oct. 20, 2009), [http://factfinder.census.gov/servlet/IBQTable?\\_bm=y&-geo\\_id=&-fds\\_name=EC0700A1&-\\_skip=700&-ds\\_name=EC0751SSSZ5&-\\_lang=en](http://factfinder.census.gov/servlet/IBQTable?_bm=y&-geo_id=&-fds_name=EC0700A1&-_skip=700&-ds_name=EC0751SSSZ5&-_lang=en).

<sup>163</sup> See *Amendment of the Commission's Rules Regarding the 37.0-38.6 GHz and 38.6-40.0 GHz Bands*, ET Docket No. 95-183, PP Docket No. 93-253, Report and Order, 12 FCC Rcd 18600, 18661-64, paras. 149-151 (1997).

<sup>164</sup> See *id.*

<sup>165</sup> See Letter to Kathleen O'Brien Ham, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Aida Alvarez, Administrator, SBA (Feb. 4, 1998).

50. **Local Multipoint Distribution Service.** Local Multipoint Distribution Service (“LMDS”) is a fixed broadband point-to-multipoint microwave service that provides for two-way video telecommunications.<sup>166</sup> The auction of the 986 LMDS licenses began and closed in 1998. The Commission established a small business size standard for LMDS licenses as an entity that has average gross revenues of less than \$40 million in the three previous calendar years.<sup>167</sup> An additional small business size standard for “very small business” was added as an entity that, together with its affiliates, has average gross revenues of not more than \$15 million for the preceding three calendar years.<sup>168</sup> The SBA has approved these small business size standards in the context of LMDS auctions.<sup>169</sup> There were 93 winning bidders that qualified as small entities in the LMDS auctions. A total of 93 small and very small business bidders won approximately 277 A Block licenses and 387 B Block licenses. In 1999, the Commission re-auctioned 161 licenses; there were 32 small and very small businesses winning that won 119 licenses.

51. **218-219 MHz Service.** The first auction of 218-219 MHz spectrum resulted in 170 entities winning licenses for 594 Metropolitan Statistical Area (MSA) licenses. Of the 594 licenses, 557 were won by entities qualifying as a small business. For that auction, the small business size standard was an entity that, together with its affiliates, has no more than a \$6 million net worth and, after federal income taxes (excluding any carry over losses), has no more than \$2 million in annual profits each year for the previous two years.<sup>170</sup> In the *218-219 MHz Report and Order and Memorandum Opinion and Order*, we established a small business size standard for a “small business” as an entity that, together with its affiliates and persons or entities that hold interests in such an entity and their affiliates, has average annual gross revenues not to exceed \$15 million for the preceding three years.<sup>171</sup> A “very small business” is defined as an entity that, together with its affiliates and persons or entities that hold interests in such an entity and its affiliates, has average annual gross revenues not to exceed \$3 million for the preceding three years.<sup>172</sup> These size standards will be used in future auctions of 218-219 MHz spectrum.

52. **2.3 GHz Wireless Communications Services.** This service can be used for fixed, mobile, radiolocation, and digital audio broadcasting satellite uses. The Commission defined “small business” for the wireless communications services (“WCS”) auction as an entity with average gross revenues of \$40 million for each of the three preceding years, and a “very small business” as an entity with average gross revenues of \$15 million for each of the three preceding years.<sup>173</sup> The SBA has

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<sup>166</sup> See *Rulemaking to Amend Parts 1, 2, 21, 25, of the Commission’s Rules to Redesignate the 27.5-29.5 GHz Frequency Band, Reallocate the 29.5-30.5 Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services*, CC Docket No. 92-297, Second Report and Order, Order on Reconsideration, and Fifth Notice of Proposed Rule Making, 12 FCC Rcd 12545, 12689-90, para. 348 (1997) (“*LMDS Second Report and Order*”).

<sup>167</sup> See *LMDS Second Report and Order*, 12 FCC Rcd at 12689-90, para. 348.

<sup>168</sup> See *id.*

<sup>169</sup> See *Alvarez to Phythyon Letter 1998*.

<sup>170</sup> See *generally Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, PP Docket No. 93-253, Fourth Report and Order, 9 FCC Rcd 2330 (1994).

<sup>171</sup> See *generally Amendment of Part 95 of the Commission’s Rules to Provide Regulatory Flexibility in the 218-219 MHz Service*, WT Docket No. 98-169, Report and Order and Memorandum Opinion and Order, 15 FCC Rcd 1497 (1999).

<sup>172</sup> See *id.*

<sup>173</sup> *Amendment of the Commission’s Rules to Establish Part 27, the Wireless Communications Service (WCS)*, GN Docket No. 96-228, Report and Order, 12 FCC Rcd 10785, 10879 para. 194 (1997).

approved these definitions.<sup>174</sup> The Commission auctioned geographic area licenses in the WCS service. In the auction, which was conducted in 1997, there were seven bidders that won 31 licenses that qualified as very small business entities, and one bidder that won one license that qualified as a small business entity.

53. **1670-1675 MHz Band.** An auction for one license in the 1670-1675 MHz band was conducted in 2003. The Commission defined a “small business” as an entity with attributable average annual gross revenues of not more than \$40 million for the preceding three years and thus would be eligible for a 15 percent discount on its winning bid for the 1670-1675 MHz band license. Further, the Commission defined a “very small business” as an entity with attributable average annual gross revenues of not more than \$15 million for the preceding three years and thus would be eligible to receive a 25 percent discount on its winning bid for the 1670-1675 MHz band license. One license was awarded. The winning bidder was not a small entity.

54. **3650–3700 MHz band.** In March 2005, the Commission released a *Report and Order and Memorandum Opinion and Order* that provides for nationwide, non-exclusive licensing of terrestrial operations, utilizing contention-based technologies, in the 3650 MHz band (*i.e.*, 3650–3700 MHz).<sup>175</sup> As of April 2010, more than 1270 licenses have been granted and more than 7433 sites have been registered. The Commission has not developed a definition of small entities applicable to 3650–3700 MHz band nationwide, non-exclusive licensees. However, we estimate that the majority of these licensees are Internet Access Service Providers (ISPs) and that most of those licensees are small businesses.

55. **24 GHz – Incumbent Licensees.** This analysis may affect incumbent licensees who were relocated to the 24 GHz band from the 18 GHz band, and applicants who wish to provide services in the 24 GHz band. For this service, the Commission uses the SBA small business size standard for the category “Wireless Telecommunications Carriers (except satellite),” which is 1,500 or fewer employees.<sup>176</sup> To gauge small business prevalence for these cable services we must, however, use the most current census data. Census data for 2007, which supersede data contained in the 2002 Census, show that there were 1,383 firms that operated that year.<sup>177</sup> Of those 1,383, 1,368 had fewer than 100 employees, and 15 firms had more than 100 employees. Thus under this category and the associated small business size standard, the majority of firms can be considered small. The Commission notes that the Census’ use of the classifications “firms” does not track the number of “licenses”. The Commission believes that there are only two licensees in the 24 GHz band that were relocated from the 18 GHz band, Teligent<sup>178</sup> and TRW, Inc. It is our understanding that Teligent and its related companies have fewer than 1,500 employees, though this may change in the future. TRW is not a small entity. Thus, only one incumbent licensee in the 24 GHz band is a small business entity.

56. **24 GHz – Future Licensees.** With respect to new applicants in the 24 GHz band, the size standard for “small business” is an entity that, together with controlling interests and affiliates, has

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<sup>174</sup> See Letter from Aida Alvarez, Administrator, SBA, to Amy Zoslov, Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC (Dec. 2, 1998) (*Alvarez Letter 1998*).

<sup>175</sup> The service is defined in section 90.1301 *et seq.* of the Commission’s Rules, 47 C.F.R. § 90.1301 *et seq.*

<sup>176</sup> 13 C.F.R. § 121.201, NAICS code 517210.

<sup>177</sup> U.S. Census Bureau, 2007 Economic Census, Sector 51, 2007 NAICS code 517210 (rel. Oct. 20, 2009), [http://factfinder.census.gov/servlet/IBQTable?\\_bm=y&-geo\\_id=&-fds\\_name=EC0700A1&-\\_skip=700&-ds\\_name=EC0751SSSZ5&-\\_lang=en](http://factfinder.census.gov/servlet/IBQTable?_bm=y&-geo_id=&-fds_name=EC0700A1&-_skip=700&-ds_name=EC0751SSSZ5&-_lang=en).

<sup>178</sup> Teligent acquired the DEMS licenses of FirstMark, the only licensee other than TRW in the 24 GHz band whose license has been modified to require relocation to the 24 GHz band.

average annual gross revenues for the three preceding years not in excess of \$15 million.<sup>179</sup> “Very small business” in the 24 GHz band is an entity that, together with controlling interests and affiliates, has average gross revenues not exceeding \$3 million for the preceding three years.<sup>180</sup> The SBA has approved these small business size standards.<sup>181</sup> These size standards will apply to a future 24 GHz license auction, if held.

57. **Satellite Telecommunications.** Since 2007, the SBA has recognized satellite firms within this revised category, with a small business size standard of \$15 million.<sup>182</sup> The most current Census Bureau data are from the economic census of 2007, and we will use those figures to gauge the prevalence of small businesses in this category. Those size standards are for the two census categories of “Satellite Telecommunications” and “Other Telecommunications.” Under the “Satellite Telecommunications” category, a business is considered small if it had \$15 million or less in average annual receipts.<sup>183</sup> Under the “Other Telecommunications” category, a business is considered small if it had \$25 million or less in average annual receipts.<sup>184</sup>

58. The first category of Satellite Telecommunications “comprises establishments primarily engaged in providing point-to-point telecommunications services to other establishments in the telecommunications and broadcasting industries by forwarding and receiving communications signals via a system of satellites or reselling satellite telecommunications.”<sup>185</sup> For this category, Census Bureau data for 2007 show that there were a total of 512 firms that operated for the entire year.<sup>186</sup> Of this total, 464 firms had annual receipts of under \$10 million, and 18 firms had receipts of \$10 million to \$24,999,999.<sup>187</sup> Consequently, we estimate that the majority of Satellite Telecommunications firms are small entities that might be affected by rules adopted pursuant to the Notice.

59. The second category of Other Telecommunications “primarily engaged in providing specialized telecommunications services, such as satellite tracking, communications telemetry, and radar station operation. This industry also includes establishments primarily engaged in providing satellite terminal stations and associated facilities connected with one or more terrestrial systems and capable of transmitting telecommunications to, and receiving telecommunications from, satellite systems. Establishments providing Internet services or voice over Internet protocol (VoIP) services via client-

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<sup>179</sup> See *Amendments to Parts 1, 2, 87 and 101 of the Commission’s Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd 16934, 16967 para. 77 (2000); see also 47 C.F.R. § 101.538(a)(2).

<sup>180</sup> See *Amendments to Parts 1, 2, 87 and 101 of the Commission’s Rules to License Fixed Services at 24 GHz*, WT Docket No. 99-327, Report and Order, 15 FCC Rcd 16934, 16967 para. 77 (2000); see also 47 C.F.R. § 101.538(a)(1).

<sup>181</sup> See Letter to Margaret W. Wiener, Deputy Chief, Auctions and Industry Analysis Division, Wireless Telecommunications Bureau, FCC, from Gary M. Jackson, Assistant Administrator, SBA (July 28, 2000).

<sup>182</sup> See 13 C.F.R. § 121.201, NAICS code 517410.

<sup>183</sup> *Id.*

<sup>184</sup> See 13 C.F.R. § 121.201, NAICS code 517919.

<sup>185</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517410 Satellite Telecommunications”.

<sup>186</sup> See [http://factfinder.census.gov/servlet/IBQTable?\\_bm=y&-geo\\_id=&-\\_skip=900&-ds\\_name=EC0751SSSZ4&-\\_lang=en](http://factfinder.census.gov/servlet/IBQTable?_bm=y&-geo_id=&-_skip=900&-ds_name=EC0751SSSZ4&-_lang=en).

<sup>187</sup> See [http://factfinder.census.gov/servlet/IBQTable?\\_bm=y&-geo\\_id=&-\\_skip=900&-ds\\_name=EC0751SSSZ4&-\\_lang=en](http://factfinder.census.gov/servlet/IBQTable?_bm=y&-geo_id=&-_skip=900&-ds_name=EC0751SSSZ4&-_lang=en)

supplied telecommunications connections are also included in this industry.”<sup>188</sup> For this category, Census Bureau data for 2007 show that there were a total of 2,383 firms that operated for the entire year.<sup>189</sup> Of this total, 2,346 firms had annual receipts of under \$25 million.<sup>190</sup> Consequently, we estimate that the majority of Other Telecommunications firms are small entities that might be affected by our action.

60. **Cable and Other Program Distribution.** Since 2007, these services have been defined within the broad economic census category of Wired Telecommunications Carriers; that category is defined as follows: “This industry comprises establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies.”<sup>191</sup> The SBA has developed a small business size standard for this category, which is: all such firms having 1,500 or fewer employees.<sup>192</sup> According to Census Bureau data for 2007, there were a total of 955 firms in this previous category that operated for the entire year.<sup>193</sup> Of this total, 939 firms had employment of 999 or fewer employees, and 16 firms had employment of 1000 employees or more.<sup>194</sup> Thus, under this size standard, the majority of firms can be considered small and may be affected by rules adopted pursuant to the Notice.

61. **Cable Companies and Systems.** The Commission has developed its own small business size standards, for the purpose of cable rate regulation. Under the Commission’s rules, a “small cable company” is one serving 400,000 or fewer subscribers, nationwide.<sup>195</sup> Industry data indicate that, of 1,076 cable operators nationwide, all but eleven are small under this size standard.<sup>196</sup> In addition, under the Commission’s rules, a “small system” is a cable system serving 15,000 or fewer subscribers.<sup>197</sup> Industry data indicate that, of 1,076 cable operators nationwide, all but eleven are small under this size standard.<sup>198</sup> In addition, under the Commission’s rules, a “small system” is a cable system serving 15,000

<sup>188</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517919 Other Telecommunications”, <http://www.census.gov/naics/2007/def/ND517919.HTM>.

<sup>189</sup> See 13 C.F.R. § 121.201, NAICS code 517919.

<sup>190</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, “Establishment and Firm Size: Employment Size of Firms for the United States: 2007 NAICS Code 517919” (issued Nov. 2010).

<sup>191</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517110 Wired Telecommunications Carriers” (partial definition), <http://www.census.gov/naics/2007/def/ND517110.HTM#N517110>.

<sup>192</sup> 13 C.F.R. § 121.201, NAICS code 517110.

<sup>193</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, Employment Size of Firms for the United States: 2007, NAICS code 5171102 (issued Nov. 2010).

<sup>194</sup> See *id.*

<sup>195</sup> See 47 C.F.R. § 76.901(e). The Commission determined that this size standard equates approximately to a size standard of \$100 million or less in annual revenues. See *Implementation of Sections of the 1992 Cable Television Consumer Protection and Competition Act: Rate Regulation*, MM Docket Nos. 92-266, 93-215, Sixth Report and Order and Eleventh Order on Reconsideration, 10 FCC Rcd 7393, 7408 para. 28 (1995).

<sup>196</sup> These data are derived from R.R. BOWKER, *BROADCASTING & CABLE YEARBOOK 2006*, “Top 25 Cable/Satellite Operators,” pages A-8 & C-2 (data current as of June 30, 2005); WARREN COMMUNICATIONS NEWS, *TELEVISION & CABLE FACTBOOK 2006*, “Ownership of Cable Systems in the United States,” pages D-1805 to D-1857.

<sup>197</sup> See 47 C.F.R. § 76.901(c).

<sup>198</sup> These data are derived from: R.R. Bowker, *Broadcasting & Cable Yearbook 2006*, “Top 25 Cable/Satellite Operators,” pages A-8 & C-2 (data current as of June 30, 2005); Warren Communications News, *Television & Cable Factbook 2006*, “Ownership of Cable Systems in the United States,” pages D-1805 to D-1857.

or fewer subscribers.<sup>199</sup> Industry data indicate that, of 6,635 systems nationwide, 5,802 systems have under 10,000 subscribers, and an additional 302 systems have 10,000-19,999 subscribers.<sup>200</sup> Thus, under this second size standard, most cable systems are small.

62. **Cable System Operators.** The Act also contains a size standard for small cable system operators, which is “a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed \$250,000,000.”<sup>201</sup> The Commission has determined that an operator serving fewer than 677,000 subscribers shall be deemed a small operator, if its annual revenues, when combined with the total annual revenues of all its affiliates, do not exceed \$250 million in the aggregate.<sup>202</sup> Industry data indicate that, of 1,076 cable operators nationwide, all but ten are small under this size standard.<sup>203</sup> We note that the Commission neither requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed \$250 million,<sup>204</sup> and therefore we are unable to estimate more accurately the number of cable system operators that would qualify as small under this size standard.

63. **Open Video Services.** The open video system (“OVS”) framework was established in 1996, and is one of four statutorily recognized options for the provision of video programming services by local exchange carriers.<sup>205</sup> The OVS framework provides opportunities for the distribution of video programming other than through cable systems. Because OVS operators provide subscription services,<sup>206</sup> OVS falls within the SBA small business size standard covering cable services, which is “Wired Telecommunications Carriers.”<sup>207</sup> The SBA has developed a small business size standard for this category, which is: all such firms having 1,500 or fewer employees. According to Census Bureau data for 2007, there were a total of 3,188 firms in this previous category that operated for the entire year.<sup>208</sup> Of this total, 3,144 firms had employment of 999 or fewer employees, and 44 firms had

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<sup>199</sup> 47 C.F.R. § 76.901(c).

<sup>200</sup> Warren Communications News, *Television & Cable Factbook 2008*, “U.S. Cable Systems by Subscriber Size,” page F-2 (data current as of Oct. 2007). The data do not include 851 systems for which classifying data were not available.

<sup>201</sup> 47 U.S.C. § 543(m)(2); *see also* 47 C.F.R. § 76.901(f) & nn.1–3.

<sup>202</sup> 47 C.F.R. § 76.901(f); *see FCC Announces New Subscriber Count for the Definition of Small Cable Operator*, Public Notice, 16 FCC Rcd 2225 (Cable Services Bureau 2001).

<sup>203</sup> These data are derived from R.R. BOWKER, *BROADCASTING & CABLE YEARBOOK 2006*, “Top 25 Cable/Satellite Operators,” pages A-8 & C-2 (data current as of June 30, 2005); WARREN COMMUNICATIONS NEWS, *TELEVISION & CABLE FACTBOOK 2006*, “Ownership of Cable Systems in the United States,” pages D-1805 to D-1857.

<sup>204</sup> The Commission does receive such information on a case-by-case basis if a cable operator appeals a local franchise authority’s finding that the operator does not qualify as a small cable operator pursuant to § 76.901(f) of the Commission’s rules.

<sup>205</sup> 47 U.S.C. § 571(a)(3)-(4). *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, MB Docket No. 06-189, Thirteenth Annual Report, 24 FCC Rcd 542, 606 para. 135 (2009) (“*Thirteenth Annual Cable Competition Report*”).

<sup>206</sup> *See* 47 U.S.C. § 573.

<sup>207</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517110 Wired Telecommunications Carriers”; <http://www.census.gov/naics/2007/def/ND517110.HTM#N517110>.

<sup>208</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, Employment Size of Firms for the United States: 2007, NAICS code 5171102 (issued Nov. 2010).

employment of 1000 employees or more.<sup>209</sup> Thus, under this second size standard, most cable systems are small and may be affected by rules adopted pursuant to the Notice. In addition, we note that the Commission has certified some OVS operators, with some now providing service.<sup>210</sup> Broadband service providers (“BSPs”) are currently the only significant holders of OVS certifications or local OVS franchises.<sup>211</sup> The Commission does not have financial or employment information regarding the entities authorized to provide OVS, some of which may not yet be operational. Thus, again, at least some of the OVS operators may qualify as small entities.

**64. Internet Service Providers.** The 2007 Economic Census places these firms, whose services might include voice over Internet protocol (VoIP), in either of two categories, depending on whether the service is provided over the provider’s own telecommunications facilities (e.g., cable and DSL ISPs), or over client-supplied telecommunications connections (e.g., dial-up ISPs). The former are within the category of Wired Telecommunications Carriers,<sup>212</sup> which has an SBA small business size standard of 1,500 or fewer employees.<sup>213</sup> These are also labeled “broadband.” The latter are within the category of All Other Telecommunications,<sup>214</sup> which has a size standard of annual receipts of \$25 million or less.<sup>215</sup> These are labeled non-broadband. The most current Economic Census data for all such firms are 2007 data, which are detailed specifically for ISPs within the categories above. For the first category, the data show that 396 firms operated for the entire year, of which 159 had nine or fewer employees.<sup>216</sup> For the second category, the data show that 1,682 firms operated for the entire year.<sup>217</sup> Of those, 1,675 had annual receipts below \$25 million per year, and an additional two had receipts of between \$25 million and \$ 49,999,999. Consequently, we estimate that the majority of ISP firms are small entities.

**65. Internet Publishing and Broadcasting and Web Search Portals.** Our action may pertain to interconnected VoIP services, which could be provided by entities that provide other services such as email, online gaming, web browsing, video conferencing, instant messaging, and other, similar IP-enabled services. The Commission has not adopted a size standard for entities that create or provide these types of services or applications. However, the Census Bureau has identified firms that “primarily engaged in 1) publishing and/or broadcasting content on the Internet exclusively or 2) operating Web sites

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<sup>209</sup> See *id.*

<sup>210</sup> A list of OVS certifications may be found at <http://www.fcc.gov/mb/ovs/csovsr.html>.

<sup>211</sup> See *Thirteenth Annual Cable Competition Report*, 24 FCC Rcd at 606-07 para. 135. BSPs are newer firms that are building state-of-the-art, facilities-based networks to provide video, voice, and data services over a single network.

<sup>212</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517110 Wired Telecommunications Carriers”; <http://www.census.gov/naics/2007/def/ND517110.HTM#N517110>.

<sup>213</sup> 13 C.F.R. § 121.201, NAICS code 517110.

<sup>214</sup> U.S. Census Bureau, 2007 NAICS Definitions, “517919 All Other Telecommunications”; <http://www.census.gov/naics/2007/def/ND517919.HTM#N517919>.

<sup>215</sup> 13 C.F.R. § 121.201, NAICS code 517919 (updated for inflation in 2008).

<sup>216</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, “Establishment and Firm Size,” NAICS code 5171103 (issued Nov. 2010) (employment size). The data show only two categories within the whole: the categories for 1-4 employees and for 5-9 employees.

<sup>217</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, “Establishment and Firm Size,” NAICS code 5179191 (issued Nov. 2010) (receipts size).

that use a search engine to generate and maintain extensive databases of Internet addresses and content in an easily searchable format (and known as Web search portals).<sup>218</sup> The SBA has developed a small business size standard for this category, which is: all such firms having 500 or fewer employees.<sup>219</sup> According to Census Bureau data for 2007, there were 2,705 firms in this category that operated for the entire year.<sup>220</sup> Of this total, 2,682 firms had employment of 499 or fewer employees, and 23 firms had employment of 500 employees or more.<sup>221</sup> Consequently, we estimate that the majority of these firms are small entities that may be affected by rules adopted pursuant to the Notice.

66. **Data Processing, Hosting, and Related Services.** Entities in this category “primarily ... provid[e] infrastructure for hosting or data processing services.”<sup>222</sup> The SBA has developed a small business size standard for this category; that size standard is \$25 million or less in average annual receipts.<sup>223</sup> According to Census Bureau data for 2007, there were 8,060 firms in this category that operated for the entire year.<sup>224</sup> Of these, 6,726 had annual receipts of under \$24,999,999.<sup>225</sup> Consequently, we estimate that the majority of these firms are small entities that may be affected by rules adopted pursuant to the Notice.

67. **All Other Information Services.** The Census Bureau defines this industry as including “establishments primarily engaged in providing other information services (except news syndicates, libraries, archives, Internet publishing and broadcasting, and Web search portals).”<sup>226</sup> Our action pertains to interconnected VoIP services, which could be provided by entities that provide other services such as email, online gaming, web browsing, video conferencing, instant messaging, and other, similar IP-enabled services. The SBA has developed a small business size standard for this category; that size standard is \$7.0 million or less in average annual receipts.<sup>227</sup> According to Census Bureau data for 2007, there were 367 firms in this category that operated for the entire year.<sup>228</sup> Of these, 334 had annual receipts of under \$5.0 million, and an additional 11 firms had receipts of between \$5 million and \$9,999,999. Consequently, we estimate that the majority of these firms are small entities that may be affected by our action.

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<sup>218</sup> U.S. Census Bureau, “2007 NAICS Definitions: 519130 Internet Publishing and Broadcasting and Web Search Portals,” <http://www.naics.com/censusfiles/ND519130.HTM>.

<sup>219</sup> See 13 C.F.R. § 121.201, NAICS code 519130.

<sup>220</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 5, “Establishment and Firm Size: Employment Size of Firms for the United States: 2007 NAICS Code 519130” (issued Nov. 2010).

<sup>221</sup> *Id.*

<sup>222</sup> U.S. Census Bureau, “2007 NAICS Definitions: 518210 Data Processing, Hosting, and Related Services,” <http://www.census.gov/naics/2007/def/NDEF518.HTM>.

<sup>223</sup> See 13 C.F.R. § 121.201, NAICS code 518210.

<sup>224</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 4, “Establishment and Firm Size: Receipts Size of Firms for the United States: 2007 NAICS Code 518210” (issued Nov. 2010).

<sup>225</sup> *Id.*

<sup>226</sup> U.S. Census Bureau, “2007 NAICS Definitions: 519190 All Other Information Services,” <http://www.census.gov/naics/2007/def/ND519190.HTM>.

<sup>227</sup> See 13 C.F.R. § 121.201, NAICS code 519190.

<sup>228</sup> U.S. Census Bureau, 2007 Economic Census, Subject Series: Information, Table 4, “Establishment and Firm Size: Receipts Size of Firms for the United States: 2007 NAICS Code 519190” (issued Nov. 2010).

**D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements for Small Entities**

68. In this Notice, the Commission seeks public comment on comprehensive universal service and intercarrier compensation reform. The transition to reformed universal service programs and new intercarrier compensation rules could affect all carriers, including small entities, and may include new administrative processes. In proposing these reforms, the Commission seeks comment on various reporting, recordkeeping, and other compliance requirements that may apply to all carriers, including small entities. We seek comment on any costs and burdens on small entities associated with the proposed ruled, including data quantifying the extent of those costs or burdens.

69. In this Notice, the Commission proposes annual data collection from high-cost and, ultimately, CAF recipients. The Commission also proposes to require all such recipients to report on deployment, adoption and pricing for their voice and broadband offerings.

70. The Commission also proposes to require recipients to file an annual report of their financial condition and operations, which is audited and certified by an independent certified public accountant, and accompanied by a report of such audit. The report shall include, at a minimum, balance sheets, income statements, statements of cash flow, and notes to the financial statements, if available. The Commission further proposes that the information included in these disclosures be made available to the public to promote increased transparency and efficiency. To minimize the cost and reporting burden on carriers, the Commission proposes to allow those carriers that are required to file financial reports with the Securities and Exchange Commission or the Rural Utilities Service to satisfy this requirement by providing electronic copies of the annual reports filed with those agencies to the Commission so long as the reports meet the minimum information requirements imposed by the Commission's rules and are filed with the Commission by the deadline imposed in accordance with this requirement. The Commission also proposes that recipients must test their broadband networks for specific metrics on a periodic basis and report the results to USAC. The results would be subject to an audit.

71. The Commission further seeks comment on any additional reporting requirements that should be required of high-cost or CAF recipients. For example, should there be additional reporting requirements for providers serving Tribal lands and Native communities? The Commission also seeks comment on how to transition from the current reporting requirements to more comprehensive reporting requirements that would apply to all high-cost and CAF recipients.

72. The Commission seeks comment on ways to target support more directly to areas that are uneconomic to serve, including by targeting support through disaggregation within study areas. We propose two options for disaggregation that may require recordkeeping or reporting: either a carrier may disaggregate in accordance with a plan approved by the appropriate regulatory authority, or by self-certifying to the appropriate regulatory authority a disaggregation plan.

73. The Commission also proposes the creation of a CAF program, which includes the establishment of performance coverage requirements and possible requirements applicable to parties receiving support to demonstrate coverage and compliance with other possible metrics. The Commission proposes that all recipients of CAF funding comply with audit and record keeping requirements. The Commission proposes that parties seeking to participate in a CAF auction and receive support to meet a variety of eligibility criteria, which may involve reporting, recordkeeping or other compliance requirements. Further, as part of a CAF auction, we propose an auction process that would require the completion of a pre-auction "short-form" application by all bidders and a post-auction "long-form application" by winning bidders. Finally, in the Notice we seek comment on other potential requirements, including requirements designed to ensure guarantee of performance for winning bidders as well as certification requirements necessary to receive CAF support.

74. Further, the Commission proposes to improve internal control mechanisms to apply to the high-cost program and, ultimately, to the CAF. We seek comment on improvements that can be made the section 254(e) certification process. We also seek comment on whether high-cost universal support recipients should be subject to additional audit requirements and data validation processes. We seek comment on whether to modify or adopt additional record retention documents as well as performance coverage requirements.

75. In the Notice, the Commission seeks comment and data on issues that must be addressed to comprehensively reform intercarrier compensation. These issues include the appropriate path or transition to modernize the existing rules, the ultimate end point for intercarrier compensation reform, if and how carriers should be allowed to recover costs or revenues that might be reduced by any intercarrier compensation reforms, and data to analyze the effects of proposed reforms and need for revenue recovery.

76. Compliance with a transition to a new intercarrier compensation system may impact some small entities and may include new or reduced administrative processes. For carriers that may be affected, obligations may include certain reporting and recordkeeping requirements to determine and establish their eligibility to receive recovery from other sources as intercarrier compensation rates are reduced. Additionally, these carriers may need to modify some administrative processes relating to the billing and collection of intercarrier compensation in order to comply with any new or revised rules the Commission adopts as a result of the Notice.

77. Proposed modifications to the rules to address arbitrage opportunities also will affect certain carriers, potentially including small entities. To the extent that the Commission addresses the intercarrier compensation framework applicable to interconnected VoIP, providers might be required to modify or adopt administrative, recordkeeping, or other processes to implement that framework. Moreover, the Notice considers possible rule modifications to require that call signaling information is passed completely and accurately to terminating service providers, which may require service providers to modify some administrative processes. Further, possible rule modifications to address access stimulation, if adopted, may affect certain carriers. For example, carriers that meet the revenue sharing trigger or other thresholds proposed in the Notice may be subject to revised tariff filing or other requirements.

#### **E. Steps Taken to Minimize the Significant Economic Impact on Small Entities, and Significant Alternatives Considered**

78. The RFA requires an agency to describe any significant, specifically small business, alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): “(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for such small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for such small entities.”<sup>229</sup>

79. The Notice seeks comment from all interested parties. The Commission is aware that some of the proposals under consideration may impact small entities. Small entities are encouraged to bring to the Commission’s attention any specific concerns they may have with the proposals outlined in the Notice.

80. The Commission expects to consider the economic impact on small entities, as identified in comments filed in response to the Notice, in reaching its final conclusions and taking action in this proceeding.

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<sup>229</sup> 5 U.S.C. § 603(c)(1)–(c)(4).

81. In the Notice, the Commission seeks comment on several issues and measures that may apply to small entities in a unique fashion. Specifically, the Commission seeks comment on whether certain public interest obligations should be different for small entities.<sup>230</sup> The Commission also seeks comment on whether there should be an exception to the proposed phase out of support for competitive ETCs, which could be based, in whole or in part, on the size of the provider.<sup>231</sup> And the Commission seeks comment on whether to provide different transition periods or different reform path for particular classes of carriers.<sup>232</sup>

82. The Commission also seeks comment on the appropriate sequence and timing of intercarrier rate reductions and alternative intercarrier compensation methodologies that might be adopted as an end-point for reform, including bill-and-keep, flat-rated intercarrier charges, or other proposals.<sup>233</sup> The Commission seeks comment on the impact to small entities of reduced intercarrier rates under intercarrier compensation reform transition options, including whether a different transition period might be appropriate for particular classes of carriers.<sup>234</sup>

83. The Notice also seeks comment on the appropriate standard for recovery and on whether reductions in intercarrier compensation rates would impact all carriers in a similar manner.<sup>235</sup> The Commission asks if the recovery approach adopted should be different depending on the type of carrier or regulation.<sup>236</sup> The Commission also invites comment on specific recovery considerations for rate-of-return carriers and whether any cost or revenue recovery mechanism could provide rate-of-return carriers with greater incentives for efficient operation.<sup>237</sup>

84. Finally, the Commission seeks comment on whether separate consideration for small entities is necessary or appropriate for each of the following issues discussed in the Notice: the potential impact of rules governing interconnected VoIP traffic;<sup>238</sup> the potential impact of rules related to call signaling;<sup>239</sup> the potential impact of rules relating to access stimulation, including revised tariff-filing requirements;<sup>240</sup> the potential impact of rules relating to interconnection and related issues.<sup>241</sup>

**F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules**

85. None.

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<sup>230</sup> See *supra* section V.D.

<sup>231</sup> See *supra* section VI.D.

<sup>232</sup> See *supra* section VI.G.

<sup>233</sup> See *supra* section XII.B..

<sup>234</sup> See *supra* section XIII.

<sup>235</sup> See *supra* section XIV.

<sup>236</sup> See *id.*

<sup>237</sup> See *supra* section XIV.E.

<sup>238</sup> See *supra* section XV.A.

<sup>239</sup> See *supra* section XV.B.

<sup>240</sup> See *supra* section XV.C.

<sup>241</sup> See *supra* section XVI.

**STATEMENT OF  
CHAIRMAN JULIUS GENACHOWSKI**

Re: *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109

“The Universal Service Fund is broken.” You don’t have to take my word for it. Those are the words of the bipartisan team of Lee Terry, Vice Chair of the House subcommittee that oversees communications, and Rick Boucher, then the Chairman of the subcommittee. The Intercarrier Compensation system is broken too. Neither program is up to the nation’s broadband challenge, and both are plagued with waste and inefficiency. So today I’m happy to join all my colleagues in putting forward a comprehensive plan with the twin goals of modernizing and streamlining these programs – of getting broadband infrastructure to rural America, promoting private investment and innovation, and cutting costs and constraining the fund’s growth. In doing so, we take a major step forward in implementing the National Broadband Plan.

Building on other recommendations of the Plan, we have already made important strides in the last year to reform aspects of USF: We’ve modernized our E-rate program so schools and libraries can get faster Internet connections and access 21st century learning tools. We’re updating our rural health care program so patients at rural clinics can benefit from broadband-enabled care like remote consultations with specialists anywhere in the country. These changes are helping deliver on the National Broadband Plan’s goal of ultra-high-speed broadband to anchor institutions in every community in the country. We’ve also proposed a Mobility Fund to spur the build out of advanced mobile wireless in areas not served by current-generation networks. On Lifeline/LinkUp, an important program for low-income Americans, we’ll be proposing reforms next month.

Today, we take on the largest part of the USF program – the part focused on supporting service for consumers in rural America – along with the intertwined Intercarrier Compensation system.

Universal service has been at the core of the FCC’s mission since the Communications Act of 1934 created the agency with the commitment to make vital communications services accessible to all Americans. Fifteen years ago today, our country recommitted to that goal with the Telecommunications Act of 1996.

Together, USF and ICC helped connect virtually every American to our 20th century communications grid, first bringing basic telephone service to places where there was no economic case for service, and then extending the benefits of mobile phone service to more and more areas across the country. But the communications landscape has fundamentally changed since then. The most recent statistics show that more than 25% of adults now live in households with only wireless phones, and voice-over-IP lines are growing rapidly as traditional phone lines decline. Broadband – high-speed Internet – now serves the role that telephone service once did. It is the indispensable infrastructure of the 21st century. Broadband has become vital for our economic future and global competitiveness, and it is a key building block for achieving common goals on education, health care, energy, and public safety.

Yet multiple studies show the U.S. lagging other countries on key broadband metrics. Roughly one-third of Americans aren’t online – that figure is under 10% in Singapore. And too many parts of the country aren’t connected at all. Up to 24 million Americans couldn’t get broadband today even if they wanted it. The infrastructure simply isn’t there.

We won't fully realize the promise of broadband and the fundamental American promise of opportunity for all if large swaths of our country are left out. Americans without broadband know this all too well: Americans like the 17-year-old girl in Alachua County, Florida who's doing her homework in the parking lot of the local library at night because her family can't get broadband at home. Or the firemen in Northern California, who missed out on a grant for public safety equipment because their dial-up connection kept kicking them off the application website.

A couple of months ago, I was in West Virginia with Chairman Rockefeller, who has long been a champion of serving the unserved. During our visit I spoke with people who can't get high-speed Internet or mobile coverage at their home or business, even though communities right next door are connected. How frustrating is that? This rural-rural digital divide is a problem in virtually every state and territory.

At the same time, USF and ICC have become riddled with inefficient, outdated rules and perverse incentives. For example, according to one study, approximately one hundred million dollars flow to phone companies each year to serve areas where competing providers, without a dollar of government support, offer voice service to all households. In many places, USF funds four or more phone companies to serve the same area. And it leaves hundreds of companies to control their own funding spigot, with guaranteed double-digit returns. Does that make sense?

On the ICC side, it can cost 10 times more to call a friend a few towns over than to call someone on the other side of the world. Because of the incentives our rules create, we have "traffic pumping" and "phantom traffic." And carriers are tangled in costly litigation about the treatment of VoIP traffic for purposes of ICC, creating real uncertainty.

Looking at these problems, some say we should eliminate the Universal Service Fund altogether. I disagree. While the world has changed, the importance of universal service has not. We simply shouldn't let millions of Americans be bypassed by the broadband revolution. Instead, we must streamline and modernize the program.

Some say the Universal Service Fund doesn't need major change, that the status quo is largely fine. I disagree with that too. The program is not getting the job done, and tinkering won't be enough. It's leaving millions on the outside looking in, wasting taxpayer dollars every year, and growing without constraint. That's unacceptable. We need to be responsible fiscal stewards, to get the most bang for our USF buck. Particularly in light of its inefficiencies, we need to control the costs of USF.

The reform proposal we are putting forward rests on four pillars:

- Modernizing USF and ICC to support broadband networks;
- Ensuring fiscal responsibility by controlling costs and constraining the size of the Fund;
- Demanding accountability from both USF recipients and the government itself;
- Enacting market-driven and incentive-based policies to maximize the impact of scarce program resources and the benefits to all consumers.

It also calls for a sensible but certain transition – one that gives participating companies sufficient runway to adapt, with no overnight flash cuts, but with clear milestones and a firm path forward.

In the first stage of this transition, we propose cutting waste and inefficiency from the current program, and shifting funding, as it becomes available, to the Connect America Fund. So we'll fund broadband for unserved areas out of savings from existing programs. Throughout the transition, we will ensure that all Americans keep robust, reliable voice service and can make calls from their homes.

Like any big transition, this one won't be easy, and it will take time. But we stand ready to work with Congress and all parties on ideas for accelerating the transition, so we can provide broadband to more unserved areas faster.

I'm very pleased to be joined by all four of my colleagues in adopting today's proposals. This NPRM builds on a history of bipartisan commitment to reform on this issue. When we released the Broadband Plan last year, we unanimously affirmed the need for USF and ICC reform, and today we take the next step to deliver on that joint commitment, with complete agreement on the need to move forward quickly. Fixing these programs is not a partisan issue. It's simply the right thing to do.

Now let me turn to what's next: We plan to move expeditiously. At the same time, as with all our efforts, we will run a fact-based, data-driven, open, and participatory process. In recognition of the federal-state partnership that undergirds USF and ICC, we are providing a special opportunity for comment for the state members of the Joint Board. And in the coming weeks, there will be ample opportunity for input from all, including through public workshops on key issues.

I call on all stakeholders to engage with us in this process, and I look forward to all input and ideas, especially on the hard issues, consistent with the pillars for reform I outlined earlier.

To those who say the Connect America Fund should fund the highest possible speeds and all bells and whistles: Bring us your specific proposals – but you must show us how much it would cost and who would pay for it, consistent with our commitment to fiscal responsibility and accountability.

To providers concerned the Connect America Fund won't help them build out wired or wireless broadband networks, but will support only their competitors or providers in other areas: Work with us to maximize the number and types of providers that can compete for support. A technology-neutral approach is key to putting scarce resources to the best possible use.

To those who receive ICC: Help us develop sensible transition paths that maximize predictability while minimizing disruption.

To those who pay ICC: Work with us to ensure that reforms ultimately benefit consumers, which will be the true measure of the success of our efforts.

I understand that change is not easy, but we all agree: Ignoring the problems with USF and ICC is no longer an option. This is not a question of *if* we should reform the system, but *how* we reform it.

If we care about the U.S. having world-class 21st century infrastructure, if we care about U.S. leadership in innovation and our global competitiveness, if we care about fiscal responsibility and market-based solutions to public policy challenges, we have to move forward with USF and ICC reform as we propose to do today.

Let me conclude by thanking the remarkable staff that worked on this item—those sitting at the table today and all the many others who have worked so hard over the past months and especially the past few weeks. What they say about the post office has been true here at the FCC: the team really did work through snow and rain and dark of night to get this done. They edited and crunched numbers around the clock straight through Martin Luther King weekend to prepare the item for circulation, and have worked tirelessly in the weeks since to incorporate input from my fellow Commissioners, helping refine and improve it.

I also want to extend my thanks to the National Broadband Plan team, whose excellent and groundbreaking work laid the foundation for the proposals we are voting on today. Thank you all.

Finally, thank you to my colleagues and their staffs for working together on this important item.

I am proud to cast my vote for this item to modernize and streamline USF and ICC.

**STATEMENT OF  
COMMISSIONER MICHAEL J. COPPS**

Re: *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109

This is our best chance yet to get from here to there with a Universal Service system that will truly serve the telecommunications needs of Twenty-first century consumers. It's very likely our last chance for a while, too, because if we can't bring this home now, with all the preparation and effort and expectation that has gone into it, we'll be left with a rickety, tottering, last-century system that did good things for plain old telephone service but hasn't got a shot at taking us where we need to go in the years ahead. By now we should all understand the importance of this. The President, the Congress and the Commission are clearly looking to broadband infrastructure as one of the great tools to build a better and more prosperous future for America. We undertake this task with nothing less than the prosperity of our local communities, our global competitiveness, and the infrastructure for our national civic dialogue all at stake. Whether the United States will continue to give rise to the ideas, inventions, and innovations that drive the global economy will in no small part depend upon the strength of our communications networks and on the ability of all Americans—urban and rural—to access them. Universal Service is the bedrock of our national communications policy—and of this Commission's enabling statute—because all of us benefit when more of us are connected.

Let's keep in mind that, for all its faults, the present system has accomplished a lot. Good things have come from the high-cost support mechanism. National telephone penetration stands at 96%—although we know, and I'm pleased that this item acknowledges, that some areas such as Indian Country remain inexcusably behind. Communications infrastructure has been deployed in many rural, insular and high cost areas—those places where there may never be a private sector business case for broadband and high-quality voice service. Good jobs have been created. And here's something that gets too seldom mentioned: because of our Universal Service mechanisms we have less industry consolidation than we would otherwise have in an already overly-consolidated sector.

But new times, new challenges and new technologies are passing the old system by. It just hasn't had the maintenance and modernization any system needs to keep functioning. Plus the action has moved to far more advanced telecommunications. So the chorus for reform has, rightly, grown loud. Yet much work remains before we are all singing off the same song sheet. Writing that song sheet is what we will be doing in the months immediately ahead. The current regime of Universal Service and Intercarrier Compensation has many moving parts and categories that can be mind-boggling in their intricacies, applications and exemptions. We must be upfront that phasing down and eliminating the inefficiencies that we all know exist in legacy mechanisms will not be easy or painless. We must face the hard truth that our current system is not designed to live up to either the public interest or the dictate of the law for today's needs—ensuring access to the services all Americans require to participate fully in the digital age. We see some money, frankly, being wasted right in sight of the need for funds in unserved areas.

The item before us commits to a stable and predictable framework for Intercarrier Compensation as we rationalize a system too often plagued with gamesmanship. We all see the symptoms of decision-making deferred: too much litigation, self-help, and market power as a substitute for the honest rules needed to minimize arbitrage, promote investment and deployment, and maximize the opportunity for new technology to flourish. The Commission must address these issues head-on – the treatment of VOIP, phantom traffic and access stimulation, to name the most obvious.

Because many providers' current business models—and ultimately the consumers they serve—rely on today's outdated system, our Commission must move quickly from the proposals teed up in today's item to a real roadmap. Industry and consumers will benefit from the certainty of mile-markers guiding us on the road to reform. We won't complete the transition right away, but we have an obligation to complete the transition plan this year.

This is why I have been talking about—and I appreciate working with my colleagues on this—a series of workshops between the FCC and all stakeholders—and no one is more a stakeholder than the public who will be living with its results. My hope is participants would come prepared to put on the table their final, best and considered thoughts on the shape of our decisions, cognizant that Commission decisions and votes were imminent and that everyone will have to sacrifice a little so the country can gain a lot. These workshops would take place as soon as possible after all stakeholders have had an opportunity to submit written comments on today's item, so that we can have open and transparent discussions on the eve of Commission votes, which I am hoping and expecting will take place this year—2011. That means a final transition plan and necessary formative Orders.

To truly reshape our Universal Service and Intercarrier Compensation policies to meet our national broadband goals *will* require a commitment to shared sacrifice and an ability to rise above the clamor for whatever piece of the status quo has been beneficial to any one private interest. I have served at the Commission through many iterations and attempts at reform. While we have resolved some discrete issues and made some adjustments, comprehensive reform is what is required to make it across the finish line, and that's going to demand more from each and every one of us.

Today's item certainly does not lack for questions, and if there are more that stakeholders think of, I hope they will tee them up and respond with their thoughts in this record. Our inquiry also needs to expand beyond the important considerations about how to distribute efficient and targeted support for broadband to include how to assess the contributions necessary to put the Universal Service Fund on solid footing for the future. Recognizing that consumers ultimately bear the burden, equity would suggest that a fund that distributes support for broadband ought to require those same services to contribute. The \$4.3 billion in annual high cost funding is obviously key to our broadband build-out, but it's unlikely to be the total bill for bringing truly high-speed telecommunications to every citizen and every corner of the land in sufficient time to keep America fully productive and globally competitive. Extending world-class communications infrastructure across the length and breadth of the country isn't something that can be done on the cheap. Universal Service will be a large part of the solution; it may not be the whole solution.

I also look forward to further, final action to implement the Mobility Fund. We have started down the road on this already, realizing that setting up and running the reverse auctions proposed in that item will provide an important test drive for the proposals—both interim and long-term—that we contemplate here for the Connect America Fund. Modernizing our low income support mechanisms to support broadband must also be a top priority. The Federal-State Joint Board has already issued recommendations and identified key issues in the Lifeline and Linkup programs – and I anticipate action soon on that agenda. And we have made impressive progress toward making sure E-Rate is able to fulfill its maximum potential going forward. A stellar performer in the past, E-Rate will deliver equally amazing results in the years ahead.

Finally, it is imperative that we work closely with our state colleagues as partners in this transition. You have heard me speak many times about this so I won't belabor it here, but I believe the Telecommunications Act of 1996 envisioned a level of federal-state cooperation in implementing the statute that has not yet been achieved. Maybe we can achieve it here; I hope so.

So I look forward to a fast pace as we set out to win this race together. I want to thank the several Bureaus who have been working so hard for so long on preparing this item. My thanks to the Chairman for putting it front-and-center with a commitment to action soon. Thanks to our Eighth Floor staffs for their many contributions to the proceeding and, of course, to all of my esteemed colleagues who share a commendable desire to get on with this job and actually finish it. Today, as I vote to approve this Notice of Proposed Rulemaking, I do so with more confidence than ever in my nearly ten years here that this is a job that can finally get done.

**STATEMENT OF  
COMMISSIONER ROBERT M. McDOWELL**

Re: *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109

Thank you Mr. Chairman. Fifteen years ago today, President Clinton signed into law the landmark Telecommunications Act of 1996. It took almost twelve years for Congress to pass that legislation, but when it did, it garnered overwhelming bipartisan support, passing 91 to 5 in the Senate, and 414 to 16 in the House. A key component of that legislation is section 254 which outlines broad powers and duties for the FCC to structure the universal service subsidy program. The Act also defined our authority to modernize our complex intercarrier compensation rules.

The universal service fund's original mission was to make traditional analog, circuit-switched, voice service available and affordable to as many Americans as possible. Congress also called upon the Commission, however, to ensure that we refine the program from time to time to ensure affordable access to "advanced services." In the fall of 2008, four commissioners, two Democrats and two Republicans (myself included), agreed in principle on many fundamental reforms of the universal service and intercarrier compensation regimes. Unfortunately, four votes were not sufficient to carry the day. Nonetheless, I remain optimistic that the five of us can rekindle that positive and constructive spirit as we take the first steps on the next segment of this long journey.

As I have said since I first arrived here at the Commission, the universal service fund's growth, from \$4.9 billion in 2000 to over \$8 billion, is troubling. Equally problematic has been the unbridled growth of the contribution factor. In its early stages in 1998, this "tax" to support the fund, which is derived ultimately from consumers, stood at 5.53 percent of interstate revenues. Today, that "tax rate" skyrocketed to an all time high of more than fifteen percent last year. As with many government programs in general, the trends on both the spending and the taxing sides of this equation are simply unsustainable. As a 21<sup>st</sup> century program, the universal service fund should evolve away from subsidizing inefficient 20<sup>th</sup> century systems and support the efficiencies of current technologies as brought about by competitive pressures.

As I have stated many times, my first priority has always been to restore fiscal responsibility to this program. Accordingly, I have long advocated for *comprehensive* reform of the entire universal service and intercarrier compensation regimes. It's like fixing a watch; it is impossible to tinker with one component of the mechanism without affecting all of its parts at the same time. Today, the Commission is choosing to take the piecemeal route again by not addressing the contribution mechanism at the same time. While not ideal, in my view, piecemeal reform is better than no reform at all. As such, I commend the Chairman for taking on this complex but important effort. I also thank him for his willingness to work with all of his colleagues to achieve consensus.

As we go forward, I will work to ensure that we contain the growth of the fund, or preferably, *reduce* the size of the fund. And, when I refer to the size of the fund, I mean the *entire* universal service fund, not just the high cost program which we address in this proposed rulemaking. It would not be fiscally responsible if the FCC found savings in one universal service program, such as the high cost fund, but then expanded other universal service programs. In the same vein, as technology offers consumers more efficiencies resulting in reduced costs, I challenge my colleagues to work toward actually *reducing* the size of the fund over time to reflect the savings brought about by competition and innovation.

Ultimately, competition supplants any ostensible need for regulation and subsidies. In that spirit, I am delighted that we are seeking comment on ways to transition to market-driven policies such as exploring reverse auctions.

Of course, to undertake serious universal service reform, the Commission must have the legal authority to do so. As such, I am pleased that this notice asks for comment on our statutory authority to support broadband with universal service funds. My opinion is that the Commission *does* have such authority through section 254. In section 254(b), Congress specified that “[t]he Joint Board and the Commission *shall* base policies for the preservation and advancement of universal service on [certain] principles.” Two of those principles are particularly instructive: First, under section 254(b)(2), Congress sets forth the principle that “[a]ccess to advanced telecommunications and *information services* should be provided in all regions of the Nation.” Second, with section 254(b)(3), Congress established the principle that “[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and *information services* . . .” If other language appears to be ambiguous, it is ambiguous in a classic *Chevron*<sup>1</sup> deference sense and the Commission’s reasonable interpretation of it would be upheld by the courts.<sup>2</sup>

I am concerned, however, that some lobbying groups are pushing for us to impose Internet network management conditions on recipients of universal service funds. Such policies are unnecessary and would be counterproductive.

In sum, all stakeholders, especially American consumers, should be on notice that the five of us are determined to go forward with honest reform as soon as possible. While today marks the beginning of the latest installment of the universal service and intercarrier compensation reform saga, we will do all that we can to write the last chapter with great haste and care. I look forward to working with my colleagues, Members of Congress and all stakeholders on these issues. Consensus can and should be found this time.

Finally, many thanks to the legions of dedicated professionals in both the Wireline and Wireless Bureaus for your seemingly endless hours of hard work on this notice. You’ve done an outstanding job.

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<sup>1</sup> *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984); see also *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) (relying on *Chevron* deference in affirming FCC authority to implement universal service provisions set forth in the Telecommunications Act of 1996).

<sup>2</sup> Some contend that the definition of universal service under section 254(c)(1) muddies the water because it does not include “information service.” Instead, that provision states that “[u]niversal service is an evolving level of *telecommunications services* . . . taking into account advances in telecommunications and information technologies and services.” But, it is also relevant that the term “telecommunications service” is qualified by the adjective “evolving.” Even if section 254 were viewed as ambiguous, pursuant to the well established principle of *Chevron* deference, the courts would likely uphold the FCC’s interpretation as a reasonable and permissible one.

**STATEMENT OF  
COMMISSIONER MIGNON L. CLYBURN**

Re: *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109

In order to fully participate and succeed in our 21<sup>st</sup> Century economy, all citizens—no matter where they live—must have access to broadband technology. Most of us in this room take for granted the presence of high-speed Internet access in our homes. But in many regions of our nation, there are consumers who are not so fortunate.

I still hear stories of the persistent digital divide in our country, and the significant disadvantages citizens face without broadband service. For example, just last week, I learned of two more stories that highlight the need for universal service reform. In the small Texas town of Von Ormy, a young woman who had been out of work for three months, missed a job opportunity because her town has no reliable high-speed Internet service, or even dependable wireless phone reception. Only by traveling 17 miles away to the closest metropolitan area of San Antonio and staying with friends, was she able to receive communications about a job for which she applied, and to complete the employer's applications requirements by accessing the Internet at a library. Still another situation involved a high school student who was forced to spend a night in his local library to complete a writing assignment due the next day and his home had no reliable high-speed Internet service. These are real stories and real people who do not question the power of broadband, but right now, they are unable to access it at home. As such, I fully agree with my fellow Commissioners that the Universal Service Fund must be reformed to bring the benefits of broadband to the millions of Americans who lack access to a high-speed network where they live.

The step we take today in adopting this Notice of Proposed Rulemaking, builds upon the work we began immediately after the release of the National Broadband Plan. Reforming the Universal Service Fund in order to provide a meaningful opportunity for every American to benefit from the broadband communications era, is an action consistent with the principles Congress set forth in Section 254 of the Communications Act to ensure that *all* Americans have access to affordable voice and advanced communications services. While the Universal Service Fund has been instrumental in providing affordable telephone service to millions of Americans, it has not been as effective in ensuring that advanced services reach all American homes. Indeed, it is apparent that the current structure of the high-cost mechanisms of the Fund has led to the support of multiple providers and networks, rather than focusing on the mission Congress gave us to ensure quality voice and advanced services at just, reasonable, and affordable rates in rural, insular, and high cost areas. Moreover, it also is apparent that we cannot be certain that our financial support of communications networks is being used prudently by providers to achieve these goals. Accordingly, it is imperative that we move expeditiously to reform the high-cost mechanisms to address the broadband needs of our country and ensure that support is used efficiently for making both voice and broadband services available and affordable in all areas of our nation.

As a Commissioner from a rural state, I know how important it is that citizens have access to the same critical communications services—both wireline and wireless—in rural areas as they do in urban areas, and that such services are comparable and affordable. Without modern communications services, the economic survivability of rural areas is in jeopardy. Large and small businesses must have access to broadband to compete in our global economy, and rural areas especially, must have broadband in order to

keep and attract employers who can help sustain and grow their economies.

I have listened closely to numerous stakeholders and understand that many companies, their employees and families, are currently relying upon USF support to provide services in their local communities. I recognize the need for a careful balance, and of providing adequate time for entities to adjust to any proposed transition, while we effectuate the necessary changes required to ensure that we realize as many benefits from the Universal Service Fund. Service providers and investors must and will have time to adjust, so that all providers can make the migration successfully. We must ensure that areas currently served by wireline or wireless providers, that would not be served but for Universal Service Fund support, continue to receive their service. At the same time, however, we must ask each company's help in identifying and eliminating inefficiencies so that the Fund can benefit more consumers.

As communications technologies evolve, so too must the entire framework that ensures that our nation is fully connected. As such, it is not sufficient to solely focus on the Universal Service Fund. We must also consider the necessary changes to the intercarrier compensation regime. The communications marketplace has changed dramatically and intercarrier compensation revenues have decreased significantly. The implicit subsidies that have been used to support networks have eroded, and we have every reason to believe that they will continue to do so as more communications move to broadband networks. Such uncertainty and instability should be addressed simultaneously with USF reform. I am sympathetic to industry's concerns that there are immediate issues in the ICC regime that should be addressed, and I want to work with my fellow Commissioners on these issues in a timely fashion. I also want to encourage industry to work with us on developing both immediate and long-term solutions, rather than start new disputes about intercarrier compensation based on the Notice's proposals. Such disputes detract from the industry's ability to engage in a productive dialogue and for us to achieve consensus on these difficult issues.

As a Commission, we should be open to new ideas and experiment with new approaches in response to changes in technology and the marketplace, but we must remain mindful of our duty to achieve the fundamental goals of universal service and not harm the success we have already achieved. As such, we must carefully consider whether new approaches to providing support require certain conditions that may not be achievable in those geographic areas where few have ventured to serve without financial assistance from the Fund and the ICC regime. It is my hope that we carefully test the effectiveness of new disbursement mechanisms before applying them to address the needs of all high-cost areas. In fact, from my travels across the country, including to some of the hardest-to-serve areas in our nation, a one-size-fits-all approach will not achieve the goals of universal service. The comprehensive nature of this Notice, along with the number of detailed questions and alternative proposals, underscores the complexity of reform for a nation that is so vast and geographically diverse. The Notice will afford all interested parties the chance to demonstrate which proposals will offer the most immediate benefits of both voice and broadband services to as many Americans as possible.

I believe that input from all stakeholders—providers, legislators, state regulators, RUS, and consumers—are critical as we consider the proposals for reform. Given the historical partnership this Commission has had with the states in providing universal service, as recognized in Section 254 of the Act, I am pleased that we are seeking specific input from our State Members of the Federal-State Joint Board on Universal Service with respect to the proposals in the Notice. Further, I am pleased that throughout the Notice we ask specific questions concerning the states' roles in the possible reform options. We must proceed in a thoughtful way to make sure that we are preserving the current availability of voice and broadband service to consumers, while expanding the availability of broadband service to unserved areas. I believe that having state input will assist us in that endeavor, and I encourage state commissions and consumer advocates to provide their counsel in this proceeding.

The task before us is not easy. If it were, it would have been done long ago. It is my hope, however, that this Commission and industry will help find a solution so that we can do what is required to reform the Universal Service Fund and the intercarrier compensation regime and make available both voice and affordable broadband services to all American homes. Next week, my state colleagues on the Joint Board will be in this room conducting a workshop on these issues and presenting some of their own ideas for reform. The next step in our work is to listen to our state colleagues, industry, consumers, and other interested parties. I want to thank my good friend and fellow Commissioner Michael Copps for his suggestion that we engage in consensus building and a productive dialogue with industry by conducting open and transparent workshops to be led by our staff.

To our Wireline Competition Bureau and Wireless Telecommunications Bureau staffs, I thank you for the tremendous efforts you already have made in this proceeding. I know you have made many personal sacrifices to help us achieve a very thorough NPRM. The time you have spent to review our record and listen to the numerous interested parties in this proceeding, in addition to your crafting the Notice, is very much appreciated. In many ways, however, your work is only beginning. I have instructed my staff to work diligently on these matters with you and the other 8<sup>th</sup> floor advisors so that we can advance our goals as quickly as possible. If there is one refrain I have heard repeatedly in my meetings with industry, it is to please provide the certainty they need to continue to invest in the networks and services they offer. It is my desire that we do just that.

**STATEMENT OF  
COMMISSIONER MEREDITH ATTWELL BAKER**

Re: *Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Inter-carrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109

It is far from newsworthy that our universal service and intercarrier compensation regimes are unsustainable as currently structured and overdue for a significant overhaul. The Commission has struggled for the past decade with how to reform these regimes and shift their focus to tomorrow's networks and challenges. It is also self-evident how critical these regimes have been for carriers—small, mid-sized, and large—to deliver telephone service nationwide, as well as deploy much of today's broadband infrastructure. I support the *Notice's* comprehensive approach to reform universal service and intercarrier compensation.

In this proceeding, we must resolve the intractable issues that have frustrated prior Commission reform efforts and put these programs on a path to long-term sustainability with a clear focus on a new national challenge, universal broadband availability. Newly configured and purpose-built programs will be necessary so that all Americans, particularly those in rural America, have a clear path for a bright broadband future.

Many providers are justifiably concerned about how reform could affect their network investments, service to customers, and even their financial viability. We need to move quickly to provide clarity to all providers as to future shape of these regimes, and to take full advantage of this limited window of opportunity for real reform. We have to acknowledge that the uncertainty surrounding the future of existing revenue streams has consequences on consumers today, inhibiting the ability of providers to justify network investment, slowing broadband deployment. In moving ahead with reform, we must embrace an IP-based broadband future without depriving providers overnight of existing revenues critical to private investment in our broadband infrastructure. I support the *Notice's* focus on this long-term objective with clear recognition of the need to avoid flash cuts in existing support.

I also support the sensible approach in the *Notice* to design new funding mechanisms for broadband. We should resist the urge to simply layer broadband funding on to the top of today's fractured system or to start offering duplicative broadband support in addition to existing voice-based support. We need a fresh approach that drives our telecommunications infrastructure from voice to broadband and from circuit-switched to IP. It is more fiscally responsible and prudent to craft broadband-specific programs that can better ensure accountability, efficiency, and adequate funding in areas where market forces are not sufficient to drive broadband services to America's consumers.

I also appreciate the *Notice's* overall focus on the need for cost-containment. The total universal service fund has grown from \$2.3 billion in 1998 to nearly \$9 billion today. The high-cost fund alone has increased from \$1.7 billion in 1998 to \$4.4 billion today. Consumers pay for this. The universal service contribution factor this quarter is at an all-time high of 15.5 percent. This is real money from real people. It is our obligation to ensure that money is spent wisely to achieve the goals set out by Congress. Taking affirmative steps to stop runaway growth in all parts of the universal service program is crucial, but it is not—standing-alone—sufficient reform. Simply shifting the billions spent on voice subsidies to broadband subsidies would forfeit a unique opportunity to ensure that funding is properly targeted and directed at only those communities that require ongoing support, and that the billions collected from

consumers is expended in a fiscally responsible manner.

There are significant and difficult decisions ahead, and it will be important for all of us to work together to redefine universal service and intercarrier compensation for the broadband age.