WTA-Advocates for Rural Broadband
Spring Meeting, May 4, 2015
Palm Springs, California
Presentation of Commissioner James H. Cawley, Pa. PUC

DISCLAIMER: These are my personal opinions and viewpoints and not those of the Pa. PUC as an agency, nor those that are collectively or individually held by other members of the Federal-State Joint Board on Universal Service.

I. THE FEDERAL UNIVERSAL SERVICE FUND AND SUPPORT DISTRIBUTIONS

A. FEDERAL PRICE CAP CARRIERS

1. **Cost Model Support:** On April 29, 2015, the Federal Communications Commission (FCC) announced the Connect America Fund Phase II (CAF II) cost model based support distributions to federal price cap carriers. The annual level of support will amount to $1.675 billion annually for the next six (6) calendar years (2015-2020).[1] Naturally, the calculation of this annual distribution support amount is influenced by a number of factors, including the presence of the "unsubsidized competitors" in relevant census blocks. Whether the "unsubsidized competitor" has carrier of last resort obligations (COLR) is of course a totally different story.

2. **Support Means Deployment Commitments:** Naturally, acceptance of the CAF II support monies entails corresponding acceptance of certain federal broadband deployment standards. These are evolving from an initial level of 4 Mbps and 1 Mbps download and upload speeds respectively for incumbent local exchange carriers (ILECs), to a level of 10 Mbps for downstream and 1 Mbps for upstream broadband access. Federal price cap ILECs "accepting a state-level commitment will be required to offer at least 10/1 Mbps broadband service to the requisite number of high-cost locations in a given state by the end of the support term."[2] The 10 Mbps download speed standard may not pose significant technological challenges. However, the upload 1 Mbps speed standard may be giving some food for thought to some of the price cap ILECs that traditionally have served and continue to serve mainly rural high-cost areas. Furthermore, the latest FCC actions in February 2015 are pushing the federal definition standards for broadband speeds to 25 Mbps for downloads and 3 Mbps for uploads. I wonder what the potential implementation of these standards would mean for the corresponding federal universal service fund (USF) and CAF support distribution requirements if the computation of such requirements is revisited any time soon.

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[1] FCC Public Notice, *Wireline Competition Bureau Announces Connect America Phase II Support Amounts Offered to Price Cap Carriers to Expand Rural Broadband*, WC Docket No. 10-90, DA 15-509, April 29, 2015, and accompanying spreadsheet information.

[2] *In re Connect America Fund; ETC Annual Reports and Certifications, et al.*, WC Docket Nos. 10-90 & 14-58 *et al.*, (FCC, Rel. Dec. 18, 2014), Report and Order, FCC 14-190, ¶¶ 15 & 20, at 6, 8 (FCC Dec. 2014 Order).

3. **Acceptance of Support:** The availability of the model support is only one part of the equation. A number of federal price cap ILECs have already accepted various CAF I support levels and most likely will do the same for CAF II. However, a major price cap ILEC (Verizon) did not accept any CAF I monies and, if I were to hazard a guess, it will continue to refrain from accepting any CAF II model support, thus foregoing the corresponding wireline network broadband deployment obligations under the FCC's standards. This does not mean that CAF II support amounts are somehow "lost" for the individual states in question. It means that the competitive bidding process with its own vagaries and uncertainties will kick in for the allocation of the annual support amounts. For example, a total amount of $50.97 million for annual model support has been allocated to Pennsylvania federal price cap ILECs. However, $23.27 million or 45.66% is allocated to an ILEC that has so far declined to accept any CAF I support (Verizon North).

4. **FCC Forbearance & ETC Designation for Federal Price Cap Carriers:** The same FCC December 2014 Order that increased the broadband speed standards for the federal price cap ILECs, also exercised limited forbearance for the federal price cap ILECs "from the federal high-cost obligation to offer voice service throughout the service territory because enforcement of that obligation is unnecessary to preserve voice service."[3] This may not mean much for States that continue to have and police carrier of last resort (COLR) obligations for ILECs operating in their jurisdictions. However, in a number of States the regulation of retail telecommunications services and COLR obligations have legislatively evaporated.

B. FEDERAL RATE OF RETURN (ROR) CARRIERS

1. **Federal USF Support Does Not Offset Access Revenue Losses:** The continuous level of federal USF support naturally does not offset the ever declining level of switched access charge revenues for terminating traffic both on the intrastate and interstate levels as we move to the zero ($0) rate of the "bill and keep" regime. The same also holds true for certain of the federal price cap ILECs that serve largely rural and high-cost areas. Similarly, the federal end-user common line charge and the access recovery charge (ARC) do not and cannot substitute for the continuously declining switched access revenues nor are they capable of covering total fixed network costs. Although the quantile regression analysis (QRA) determined support has largely been put to rest, it is still unclear what is going to replace it.

2. **Federal USF Support Entails Broadband Deployment Commitments:** Federal USF high-cost support to the federal ROR ILECs also comes with broadband deployment commitments and obligations. These revolve around the 4 Mbps downstream and 1 Mbps upstream standard but they also must accommodate "reasonable requests" for broadband

[3] FCC Dec. 2014 Order, ¶ 65, at 25.

access services under the 10/1 Mbps standard.[4] A 2013 NTCA *Broadband/Internet Availability Survey Report* indicated that there is a 66% availability level for downstream broadband access speeds in excess of 10 Mbps.[5] Thus, the FCC's 10 Mbps downstream speed standard does not appear to pose a significant technological challenge for the federal ROR ILECs, especially for those that have already made considerable broadband modernization capital investments in their wireline networks. For example, the same 2013 NTCA survey indicated that 29% of the respondents' customers are served by fiber to the home (FTTH) and an additional 12% are served by fiber to the node (FTN).[6] This is a significant accomplishment for these ILECs in rural America. The question of course remains whether the same companies and cooperatives will be able to keep up with the provision of their voice and broadband access services while further upgrading their respective wireline networks in the future.

C. THE FEDERAL USF MECHANISM AND POLITICAL TENSIONS

1. **The Modified Universal Service Concept and the Federal USF:** The modified universal service concept (inclusion of supported broadband access services), and the operation of the federal USF that supports this concept ***must be above partisan politics***. Anyone can choose his or her own political affiliation in our great Republic. However, in this modern age all of us need **broadband** access to the Internet no matter whether we live in rural high-cost America or in an urban environment — which, by the way, depending where it is located, may not have multiple and truly competitive choices of wireline broadband access providers. Therefore, I view with a great deal of skepticism — if not with outright disappointment — utterly misplaced statements, debates devoid of meaningful substance, and unnecessary proposed legislation in our nation's Capital that hold or create negative implications for the federal USF funding mechanism. The unfounded comparisons between the federal USF mechanism and the Net Neutrality debate may create interesting sound bites — "taxing the Internet" is a favorite but empty slogan — but do not provide any impetus for the reforms that are needed for the federal USF. Rather, this unhelpful (and largely uninformed) noise obstructs sound discussion on the design and ***timely*** implementation of such reforms. The universal service concept is rooted at least as far back as the 1913 Kingsbury Commitment. Its core values remain unaffected by such buzzwords as "changing technology," "broadband," "Internet Protocol," "technology transition," and "competition." If we are truly committed to the core values of the universal service concept — and legally we have no other choice but to have such a commitment under applicable federal and State law — this unnecessary and politically driven noise must cease. I believe that both the FCC and the States are looking to bridge the "digital divides" in this country and **not** to make them permanent fixtures so that rural and high-cost America, its citizens, and its economy become more isolated.

[4] FCC Dec. 2014 Order, ¶ 20, at 8.
[5] NTCA, *NTCA 2013 Broadband/Internet Availability Survey Report*, (Washington, D.C, May 2014), Fig. 2, at 7.
[6] *Id*., Fig. 1, at 6.

Yes, I come from a State that is a **net contributor** to the federal USF mechanism to the tune of approximately $136.37 million annually.[7] However, having been involved in the field of public utility and telecommunications regulation for a considerable period of time, I am not prepared to denigrate or discard the universal service concept and its core values.

2. **The FCC's Net Neutrality Decision and USF Mechanisms:** On February 26, 2014, the FCC made a dramatic reversal of past policy and reclassified broadband Internet access service (BIAS) as a "Title II – common carrier – telecommunications" service in order to safeguard Internet openness.[8] The FCC also adopted a regime of light regulation for BIAS through the use of federal forbearance from certain of its regulations. The FCC Net Neutrality Order relies in large part on federal law (Section 706) that contemplates a **joint** federal **and** state role in **broadband deployment**. I am not going to address the Net Neutrality Order in any great detail. It is a well-structured document of about 400 pages that speaks highly of the professionalism of the FCC Staff. We may disagree with them at times, but no one can take issue with their professional dedication. Later, I will address certain connections between the Net Neutrality Order and the efforts to reform the federal USF contribution mechanism.

II. REFORM OF THE FEDERAL USF CONTRIBUTION MECHANISM

A. THE ROLE OF THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

1. **Need for Reform of the Federal USF Contribution Mechanism:** There are multiple reasons for reforming the contribution base and mechanism of the federal USF. Some of them are summarized below:

   a. **Federal USF Contribution Base – Declining Revenues:** The conventional interstate and international telecommunications revenues that are assessed for contribution purposes to the federal USF are declining. The double digit assessment rate for the federal USF has recently reached 17.4%. At the same time, certain *retail broadband access services* are not included in the federal USF contribution assessment base.

   b. **The Changed Focus of the Federal USF and the Connect America Fund:** The CAF focus is on broadband deployment. Thus, there is increased divergence between the traditional wireline and wireless telecommunications services that contribute to the federal USF and the retail broadband access services that are being deployed with CAF funding support but do not contribute into the federal USF

[7] FCC, *Universal Service Monitoring Report*, (Washington, D.C., 2014), Table 1.9, at 18.
[8] *In re Protecting and Promoting the Open Internet*, GN Docket No. 14-28, (FCC, Rel. March 12, 2015), Report and Order on Remand, Declaratory Ruling, and Order, FCC 15-24, *appeals pending* (FCC Net Neutrality Order).

mechanism. This also creates equity issues among end-user consumers who eventually absorb the contribution assessments to the federal USF.

c. **Potentially Increasing Demand for Federal USF Support Distributions:** Although the FCC's *USF/ICC Transformation Order* of November 18, 2011, adopted the concept of a "budget" for the federal USF mechanism, there may be increasing demand for support distributions. Many of you persuasively argue that the high-cost portion of the federal USF is already insufficient under the *Transformation Order* when combined with the ill effects of the misplaced movement to the "bill and keep" access regime. Furthermore, the low income portion of the federal USF may be called to support the provision of retail broadband access services to qualified Lifeline end-users.

2. **FCC Referral to the Federal-State Joint Board on Universal Service:** The FCC formally initiated a proceeding to examine the issue of reform for the federal USF contribution mechanism in April 2012. Comments and reply comments were submitted. For example, the State Members of the Federal-State Joint Board on Universal Service submitted reply comments in August 2012. In August 2014, the FCC formally referred the matter of the federal USF contribution mechanism reform to the Federal-State Joint Board on Universal Service (Joint Board). The Joint Board and members of its FCC and State Staff have been actively engaged in discussing the issues and various alternatives that can effectuate needed reforms for the federal USF contribution base and related contribution assessment methodologies.

3. **State USF Mechanisms and the Federal USF Contribution Reform:** The operation of state USF mechanisms is not divorced from the reforms that are needed for the federal USF contribution base and methodology. Some of the relevant issues include but are not limited to the following:

   a. **State USF Reliance on Intrastate Retail Telecommunications Services Revenues:** State USF mechanisms often largely rely on the revenue base of intrastate *retail* wireline telecommunications services. Some states include wireless and/or voice over the Internet Protocol (VoIP) intrastate revenues in their USF contribution base. The reliance on traditional retail intrastate telecommunications services presents a shrinking revenue base for state USFs and correspondingly increasing contribution assessment factors. Given the increased importance of state USF mechanisms that support carriers with COLR obligations after the *Transformation Order's* imposition of "bill and keep," the continued viability and robustness of state USFs is in doubt.

   b. **State Retail Services Deregulation:** Although individual state deregulation of retail intrastate telecommunications services has not so far impacted the operation of USF mechanisms operating in the same states, such deregulatory activities may

create a negative political environment for the continuous operation of viable state USF mechanisms in the future.

4. **<u>Effects of the FCC Net Neutrality Order</u>:** The Net Neutrality Order has affected the ongoing reform efforts of the federal USF contribution mechanism reform, and may impact the operation of state USFs.

   a. **The Federal USF Contribution Mechanism:** The Net Neutrality Order preserves the *status quo* through the exercise of federal forbearance when it comes to the Section 254(d), 47 U.S.C. § 254(d), for any **<u>new</u>** contribution assessments for the federal USF that would involve broadband Internet access services (BIAS).[9] At the same time, the Net Neutrality Order acknowledges the separate referral to the Joint Board regarding the reform of the federal USF contribution base and methodology, and preserves the relevant issues for further examination in the context of this referral.[10]

   b. **The Net Neutrality Order and State USF Mechanisms:** The Net Neutrality Order presents additional challenges for state USF mechanisms. These challenges will be substantively discussed in the recommendation made by the Joint Board. Some of these challenges include:

      (1) The broadband Internet access services (BIAS) are classified as jurisdictionally interstate for regulatory purposes while also acknowledging that BIAS " '…may include an intrastate component…'."[11]

      (2) The States are bound by the Net Neutrality Order forbearance directives.[12]

      (3) The Order provides for a potential future reexamination for the role of state USFs and the newly reclassified BIAS services. However, for the time being the Order concludes "that any state requirements to contribute to state universal service support mechanisms that might be imposed on such broadband Internet access services would be inconsistent with federal policy and therefore are ***preempted*** by section 254(f) — at least until such time as the Commission [FCC] rules on whether to require federal universal service contributions by providers of broadband Internet access service."[13]

[9] FCC Net Neutrality Order, ¶ 488, at 235 (citations omitted).
[10] *Id*., ¶ 489, at 235-236, and n. 1471 at 236.
[11] *Id*, ¶ 431, at 203 (citations omitted).
[12] *Id*, ¶ 432, at 203, citing 47 U.S.C. § 160(c), n. 1281.
[13] *Id*., n. 1477, at 237 (emphasis added, citing 47 U.S.C. § 254(f): "A State may adopt regulations not inconsistent with the Commission's [FCC's] rules to preserve and advance universal service").

B. AN ENVIRONMENT OF CONTINUING UNCERTAINTY

1. **The *USF/ICC Transformation Order* and Appellate Litigation:** The *USF/ICC Transformation Order* of November 18, 2011, totally and successfully survived the appellate challenges by numerous parties before the U.S. Court of Appeals for the 10th Circuit, Denver, Colorado.[14] We may know as soon as today (May 4, 2015), whether the U.S. Supreme Court will grant petitions for certiorari that have been filed by the National Association of Regulatory Utility Commissioners (NARUC) and others. It is apparent that the 10th Circuit was not willing to delve into the interlocking pieces of the *Transformation Order*. Thus, the Court gave *Chevron* deference to the interpretation of the FCC's own jurisdiction to preempt the states in a wholesale fashion, as well as to the administrative expertise of the agency that essentially told us that it makes economic sense when certain entities — such as wireless carriers — can use the wireline switched access networks of other carriers either totally for free (e.g., terminating intraMTA wireless calls at a $0 rate), or, eventually, at a "bill and keep" $0 rate. The total shifting of the economic costs of wireline switched access networks only to end-user consumers is irrational, and it is unsustainable for smaller rural ILECs with COLR obligations in high-cost areas. Fortunately, the FCC has so far refrained from implementing the same erroneous economic philosophy to originating switched access rates as well.

2. **Alternative Approaches and Industry Survival:** I do not hold myself out as an expert in the financial and strategic analysis of telecommunications industry operations. I must rely on others, including the industry, for this expertise. Some trends, however, are obvious:

   a. **Continuous Capital Investment in Wireline Broadband Network Facilities:** Such investment has not ceased but it has been significantly curtailed by smaller rural ILECs. Relevant projects, e.g., for fiber facilities, must have appropriate economic and financial justification for their implementation. For example, fiber transport facilities that link the service area of one ILEC with a neighboring region can still go through. However, the same company will abstain from extending the penetration rate for fiber to the home (FTTH), or for extending fiber optic connectivity to all of its remote terminals. The low interest rates that are still prevalent in the marketplace have facilitated low cost debt financing, or the refinancing of existing long-term debt. The new FCC standards of 4/1 Mbps and especially 10/1 Mbps for the continuous receipt of federal USF and/or CAF support may complicate this picture. I have repeatedly emphasized that **continuous capital**

[14] *In re Connect America Fund, et al.*, WC Docket No. 10-90 *et al.*, (FCC, Rel. Nov. 18, 2011), Report and Order and Further Notice of Proposed Rulemaking, *slip op.* FCC 11-161, 26 FCC Rcd 17663 (2011), and subsequent Reconsideration and Clarification rulings (collectively *USF/ICC Transformation Order*), *aff'd*, *In re FCC 11-161*, 753 F.3d 1015 (10th Cir. 2014), *reh'g petitions denied*, *certiorari petitions pending*, *NARUC v. FCC*, S.Ct., No. 14-901. *Allband Com. Coop. v. FCC*, S.Ct., No. 14-900.

investment in broadband networks is an absolute necessity because technology does not cease to evolve.

b. Broadband Take Rates: This continues to be an issue. As we all know, the wholesale purchase of video content in rural high-cost areas is a major issue, and video delivery over Internet links is not yet promising because money will still need to change hands. Some of the relevant factors involved include how many vendors have control over video content, and how video programming blocks can be purchased and at what cost. The retail delivery of video services by rural ILECs continues to be an expensive and unprofitable proposition, even though the available wireline broadband access networks are perfectly capable of accomplishing the task.

c. Telephone Service Rates: Certain rural ILECs maintain rate stability because of competitive pressures, i.e., presence of intermodal competition. Others, however, need or otherwise are obliged to raise local telephone service rates because of the FCC's national rate floor and its relationship to the issue of available support from the federal USF mechanism.

d. Industry Consolidation: Not as much as I expected in the aftermath of the *Transformation Order*, but still certain merger and acquisition activity has taken place. Overall, there is the impression that valuations of smaller rural ILECs has dropped.