FCC Modifies Universal Service System to Provide Subsidies for Broadband Services

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Significant Reform of Intercarrier Compensation System – Eventual Move to “Bill-and-Keep”

The FCC today voted on a package of reforms of the universal service system and the intercarrier compensation regime, combining some specific actions to deal with immediate problems with a set of steps to phase out intercarrier compensation payments entirely over time, and move to a “bill-and-keep” system.

The FCC did not release the text of its actual order, which is reported to be 500 or more pages in length. We will provide a detailed summary and analysis of that order when it is released. However, the FCC did release an “Executive Summary” of its to-be-issued ruling. This update is based on the Executive Summary. As always, the devil will be in the details.

Universal Service Reform

The order will reform and re-purpose the high cost programs of the federal Universal Service Fund (USF) to support deployment of fixed and mobile broadband services in unserved areas of the country. There will be two new funds. The Connect America Fund (CAF) will provide new funding, mostly to incumbent local exchange carriers (ILECs), to build and maintain broadband facilities. The Mobility Fund will support mobile broadband networks.

Mobile broadband interests can claim a victory for convincing the FCC to increase the annual Mobility Fund to $500 million (up from preliminary proposals of $300 million), but the bulk of the funding under the new regime will support wireline broadband networks, mostly those of the ILECs. Total high-cost funding (the existing funds plus the new CAF) will be fixed at the current funding level of $4.5 billion annually over the next six years. This is a victory of sorts for those concerned that adding broadband would increase the overall size of the USF, but a loss for those who believed that the fund had already grown too large and should be cut back, and for those who were hoping for even more funding to support broadband deployment.

Connect America Fund (CAF)

Over time the CAF will replace existing high-cost support mechanisms and utilize incentive-based policies, including some competitive bidding, to distribute funds. Support under this program will differ depending upon whether the ILEC is a “price cap” carrier (most large ILECs) or a “rate of return” carrier (most small ILECs).

First, existing legacy high-cost support to price cap carriers will be frozen, but an additional $300 million in CAF funding will be available for “unserved” areas. It remains to be seen how “unserved” will be defined (e.g., whether a provider will get funding for a zip code, census tract, or other area that is partly served but partly unserved). Carriers seeking support under this new mechanism will have to deploy broadband with actual speeds of at least 4 Mbps downstream and 1 Mbps upstream, and will be subject to other performance criteria.

In the second phase of the CAF plan, the FCC will use a combination of a forward-looking broadband cost model and competitive bidding to support deployment of networks providing both voice and broadband service for five years. The FCC will conduct further proceedings to develop the cost model used to set this funding. The second-phase CAF will distribute up to $1.8 billion annually for areas with no unsubsidized broadband competitor. The FCC expects the cost model and competitive bidding processes for this phase will be adopted by December, 2012, with disbursements beginning in 2013.

The Executive Summary states that the CAF will only provide support in those areas where a federal subsidy is deemed necessary to ensure the build-out and operation of broadband networks. The CAF will not provide support to price cap carriers in areas where unsubsidized competitors are providing broadband service. Also, CAF recipients will have to meet broadband service requirements, including interim and final build-out requirements in years 3 and 5.

The Executive Summary does not use this specific phrase, but it appears that ILECs will have a “right of first refusal” for subsidies in any particular area. If they decline, the FCC will use a competitive bidding process to distribute support. Specific details of the competitive bidding mechanism will be determined in a further rulemaking. However, the order appears to limit bidding to entities that have already been designated as an eligible telecommunications carrier (ETC), meaning that a potential bidder would have to obtain ETC status from their state utility commission rather than waiting to obtain ETC status if they win the bid. This seems peculiar since the Executive Summary also indicates that all ETCs will need to commit to provide broadband, which a prospective bidder may not wish to do in advance.

In conjunction with these changes, the FCC will also eliminate the identical support rule, which determines the amount of support competitive ETCs (mobile and wireline) receive under the high cost fund today. This will almost certainly result in reduced funding for most competitive ETCs receiving high cost funding. There will also be a gradual phase down of existing support to competitive providers over a five year period beginning on July 1, 2012.

Mobility Fund

The FCC is also establishing a new Mobility Fund, designed to ensure availability of mobile broadband service in currently unserved areas. The creation of this new support mechanism does not automatically change existing legacy support, as mobile broadband carriers will continue to receive legacy support during the transition to the Mobility Fund.

This new fund will be introduced in two phases. In Phase 1, the FCC will designate up to $300 million in one-time support to immediately accelerate deployment of networks for mobile voice and broadband services in unserved areas. These funds will be awarded through a nationwide reverse auction, which the FCC expects to occur in the third quarter of 2012. Auction winners will be required to deploy 4G service within three years, or 3G service within two years. In addition, in Phase 1 the FCC will designate up to $50 million in additional universal service funding for Tribal lands.

In Phase 2, the Mobility Fund will provide up to $500 million per year in ongoing support. Funding under this phase will focus on mobile voice and broadband services in communities in which service would be unavailable absent federal support. The $500 million budget will include up to $100 million in annual support for service on Tribal lands.

Intercarrier Compensation Reform

The order will effectuate a number of fundamental reforms in intercarrier compensation, some effective immediately, others phased in over time. While the Executive Summary does not provide the FCC’s legal reasoning, it is clear that the FCC will be attempting to preempt traditional state authority with respect to intercarrier compensation for intrastate traffic, i.e., traffic that begins and ends in the same state. This will be quite controversial and will likely be appealed to the courts by the states and others.

Immediate Steps

1. Reduce Access Stimulation. Access stimulation refers to local exchange carriers (LECs) encouraging the flow of inbound long distance calls in order to collect access charge revenues while sharing those revenues with the entity providing the "lure" for the calls – a chat service, overseas calling service, etc. (This is also referred to as "traffic pumping") If a LEC has a revenue sharing arrangement, and if it either (a) sees a large year-over-year increase in traffic or (b) exceeds a three-to-one ratio of terminating to originating minutes, the LEC will have to lower its access charges. The Summary does not specify what rate will apply.

2. Reduce Phantom Traffic. LECs cannot properly bill for traffic they receive without call identifying information. The FCC is now requiring carriers to include the calling party's telephone number in the signaling information associated with a call and forbidding any carriers involved in handling the call from deleting or altering this information.

3. Wireless Traffic. The order affirms the current rule that calls that begin and end in the same "major trading area" (MTA) are subject to reciprocal compensation rates "without exception."

4. VoIP Traffic. In addition to establishing some transition rules for traffic coming from VoIP services onto the public switched telephone network (PSTN), the order holds that effective immediately on a prospective basis, calls exchanged between LECs and other carriers in normal PSTN format, even if they originated in IP format, are subject to compensation. Without resolving past disputes (which have been going on for years), this will put an end to future claims by some carriers that they do not owe any terminating compensation on calls that originated in IP format on some other network.

5. IP-to-IP Interconnection. The FCC will conduct a further rulemaking to formulate policies governing IP interconnection for the exchange of voice traffic. But even while the rulemaking is pending, the FCC expects "all carriers to negotiate in good faith in response to requests for IP-to-IP interconnection for the exchange of voice traffic." This statement would appear to forbid LECs from asserting (as some have done) that they have no obligation under the Communications Act even to discuss IP-to-IP interconnection.

6. Cap Current ICC Rates. LECs must "cap" "all interstate rate elements and most intrastate rate elements," although the Executive Summary does not identify which intrastate rate elements are exempt from the cap or at what level rates are to be capped.

Longer-Term Reform

For decades the theory underlying most intercarrier compensation has been that the "calling party's network pays." That is, the network on which a call originates is responsible for paying something to any networks involved in transporting the call to its destination, as well as paying the network serving the called party. The FCC is now formally abandoning that model, noting (correctly) that the party receiving a call typically benefits as well. This shift in economic thinking justifies the FCC in adopting bill-and-keep as the national framework for intercarrier compensation, in which each carrier is required to pay its own way without burdening other carriers.

Transition to a uniform bill-and-keep system will take years. The first step is to lower intrastate access rates to interstate levels, which will occur by July 2013. The transition to bill-and-keep for call termination (but not, apparently, origination or transport) will occur "within six years" for large carriers (those under the FCC's price cap system) and nine years for smaller carriers (those with rates set on the basis of cost). It appears (but the Executive Summary is not clear) that the six- and nine-year periods start as of July 2013. By that date, and possibly before (the Executive Summary again is not clear), all "toll" VoIP traffic

will be subject to interstate access rates, with all other VoIP traffic subject to reciprocal compensation rates. There will be further comment on whether and how to eliminate originating access charges, i.e., LEC charges on long distance carriers picking up outbound calls. This will be particularly controversial, and the states will complain that their authority is being usurped.

The FCC will allow ILECs to impose additional flat monthly fees on their end-users to make up for some of the intercarrier compensation revenues that will be lost as rates decline. These new fees cannot increase by more than $0.50 per year for residential and single-line business customers or $1.00 per year for multiline business customers, subject to some caps on the total amounts being charged to residential and small business customers, and some rules to ensure that large customers bear their fair share of any rate increases. These new permitted rate increases are not intended to fully offset lost intercarrier compensation revenues, but rather only to mitigate the negative impact of those lost revenues.

As noted above, intraMTA wireless-to-landline traffic is subject to reciprocal compensation, “without exception.” Compensation for interMTA traffic is not directly specified, although there is no reason to suspect that it would not be subject to a transition to bill-and-keep on some appropriate schedule as well. To the extent that any wireless-to-landline traffic is subject to access charges today, those rates would certainly phase down with the access phase-down described above. The order will also apparently address some additional issues (not well-specified in the Executive Summary) regarding the setting of wireless-LEC compensation rates.

Finally, the FCC will seek additional comment on developing an appropriate “policy framework” with respect to IP-to-IP interconnection for voice traffic.

We will provide a more detailed summary and analysis of the full order when it is released. In the meantime, please contact us for further details on this and other recent developments.

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