State of California **Public Utilities Commission**
San Francisco

M E M O R A N D U M

Date: **May 18, 2007**

To: **The Commission**
(Meeting of May 24, 2007)

From: **Helen Mickiewicz – Assistant General Counsel**
Gretchen Dumas – Public Utility Counsel IV

Subject: **Re: Federal-State Joint Board on Universal Service Request for Further Comments on Universal Service High-Cost Fund Reform and on Federal-State Joint Board on Universal Service Recommended Decision to Impose Interim Cap (FCC CC Docket No. 96-45)**

RECOMMENDATION

The CPUC should file comments in response to Public Notices from the Federal Communications Commission (FCC) seeking comments *In the Matter of High-Cost Universal Service Support Federal-State Joint Board on Universal Service*; WC Docket No. 05-337; CC Docket No. 96-45.

BACKGROUND

Over the last several years, at the request of the FCC, the Federal-State Joint Board on Universal Service (Joint Board) has been reviewing the FCC's rules relating to the federal high-cost universal service support mechanisms for rural carriers and competitive eligible telecommunications carriers (ETCs), with the aim of making recommendations for comprehensive reform of the high-cost fund. The high cost fund has seen explosive growth over the last several years and there is concern that without action to restrain the growth, the fund may not be sustainable.

On May 1, 2007, the Joint Board released a Recommended Decision (FCC 07J-1) proposing that the FCC take immediate action to rein in the growth in high-cost universal service support disbursements by imposing an interim, emergency cap on the amount of high-cost support that competitive ETCs may receive. The Joint Board said it is committed to making further recommendations regarding long term, comprehensive high-cost universal service reform within six months. To assist the Joint Board in accomplishing this goal, the Joint Board also issued a Public Notice (FCC 07J-2) seeking

comment on various proposals to reform the high-cost universal service support mechanisms.

Specifically the Joint Board seeks comment on the following issues and proposals: 1) the use of reverse auctions to determine high-cost universal service support; 2) the use of GIS technology and network cost modeling to better calculate and target support at more granular levels; 3) disaggregation of support; 4) the methodology for calculating support for competitive ETCs; and 5) whether universal service funding should be used to promote broadband deployment.

DISCUSSION

Recommended Comments on Issues/Proposals in the Public Notice

(1) Reverse Auctions:

The Joint Board seeks comment on several specific proposals filed in earlier proceedings as well as a broadband auction proposal filed by Alltel. The Joint Board also invites commenters to file additional auction proposals. It also seeks comment on whether any auction proposal should include an affordability benchmark.

Staff recommends that the Commission not file comments on the reverse auction issue at this time because this is an issue before the Commission in the pending CHCF-B Order Instituting Rulemaking proceeding, R.06-06-028. Instead staff recommends that the Commission simply state its interest in this issue and inform the Joint Board that the Commission will let it know the outcome of our state proceeding once a final decision is adopted.

(2) GIS Technology and Network Cost Modeling

The Joint Board seeks comment on how GIS technology and/or network cost models could be used to more efficiently calculate and target support at more granular levels. It asks whether these tools could be used to identify those areas where competition and market forces alone will not result in the provision of services comparable to those available in more urban areas of the country, and thus where support might be most needed.

Staff recommends that the Commission file in support of the use of GIS technology and/or network cost models to calculate and target support at more granular levels, and inform the Joint Board of the efforts underway in California to provide better and more granular mapping of network penetration.

(3) Disaggregation of Support.

The Joint Board seeks comment on whether the FCC should require all carriers to disaggregate high-cost support below the study area, or wire center, level. Additionally, it asks whether all carriers should receive support on a per line basis under a disaggregation plan.

Staff recommends that the Commission file comments recommending the FCC require all carriers to disaggregate support at the Census Block Group (CBG) level.[1] The CPUC has historically determined high-cost support for non-rural carriers at the CBG level. Disaggregating support to the CBG level will enable better targeting of high-cost support. It will help to mitigate situations where one area contains both low-cost and high-cost segments, and as a consequence the low-cost segment receives support contrary to program goals. Additionally, the Census Block Group is becoming the minimum standard for related information such as the census demographic information. GIS and other research systems can readily use CBG information and it would greatly enhance impact and policy analyses regarding the federal high-cost program if the cost-support is also at this granular level.

(4) Competitive ETC Support

In its 1997 Universal Service *First Report and Order*, the FCC determined that it was appropriate to calculate per-line portable universal service support for competitive ETCs based on the support that the incumbent LEC would receive for the same line (the identical support rule). In the Joint Board's Recommended Decision released on May 1, 2007, in addition to proposing an interim cap on support to competitive ETCs, the Joint Board also recommends that the FCC consider abandoning or modifying this identical support or portability rule. In the Public Notice, the Joint Board seeks comment on whether the Commission should replace the current identical support rule with a requirement that competitive ETCs demonstrate their own costs in order to receive support. In light of the uncontrolled growth in competitive ETC support in recent years, it also seeks comment on how the Joint Board should view the funding of multiple carriers in high-cost areas. The Joint Board also asks whether it needs to recommend additional principles under section 254(b)(7)[2] of the Act to govern where multiple ETCs should receive support. And it also seek comment on whether modification of the

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[1] A census block group (CBG) is a cluster of census blocks having the same first digit of their four-digit identifying numbers within a census tract. For example, block group 3 (CBG 3) within a census tract includes all blocks numbered from 3000 to 3999. BGs generally contain between 600 and 3,000 people, with an optimum size of 1,500 people. CBG is commonly referred to as a unit of about a population of 1000.

[2] Sec. 254 (b) Universal service principles: The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles -- (7) Additional principles: Such 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 chapter.

identical support rule or adoption of additional principles that could limit the number of ETCs in high-cost areas would be consistent with the principle of competitive neutrality. Because several of these issues are currently pending before the Commission in the CHCF-B OIR, staff recommends that the Commission not file a statement in support or opposition to the identical support rule at this time. However, we do recommend that the Commission file comments stating that if the FCC decides to base high-cost support for competitive ETC's on their own costs, any necessary cost studies should be conducted by the FCC, not by state commissions.

The Commission should also ask for a clarification of how this issue and the reverse auction proposals interrelate. Would there be a need for cost evaluation if reverse auctions are adopted? Would a company's cost per line be a high benchmark for auction purposes?

(5) <u>Broadband</u>

The Joint Board notes that Section 254 of the Federal Communications Act of 1934 defines universal service as "an evolving level of telecommunications services" and seeks comment on whether the Joint Board and the FCC should consider adding broadband to the list of supported services, and whether there are statutory impediments to doing so. It also seeks comment on the impact of adding broadband support on the size of the fund, and whether broadband should be a separately identified category of support apart from other high-cost support. Additionally, if support is provided for broadband, should that support be targeted to areas where there is no "broadband" deployment to date.
The Staff recommends that the Commission file comments in opposition to the addition of "broadband" to the list of supported services funded by the federal universal high-cost program. In its Recommend Decision released on May 1, 2007, the Federal-State Joint Board on Universal Service states that without immediate action to restrain growth in funding, the high-cost fund is in dire jeopardy of becoming unsustainable. This situation is true despite the fact that the most recent contribution factor for the federal universal service fund is 11% - the highest level since its inception. Adding broadband services to the fund could substantially increase the draw on the fund and thus the size of the surcharge levied on ratepayers.

Further, the Commission should recommend that if the FCC determines that broadband deployment in high cost areas should receive universal service funding, the FCC should provide this subsidy through a separate program, funded by contributions from all broadband providers. This Broadband Fund should be separate from the current high-cost fund.

Recommended Comments on Notice of Proposed Rulemaking on Joint Board Interim Cap Proposal

In the Recommended Decision, the Joint Board recommends that the FCC take immediate action to rein in the growth in high-cost universal service support disbursements by imposing an interim, emergency cap on the amount of high-cost support that competitive eligible telecommunications carriers (ETCs) may receive for each state based on the average level of competitive ETC support distributed in that state in 2006. The Joint Board commits to making further recommendations regarding comprehensive high-cost universal service reform within six months of this Recommended Decision and urges the FCC to act on these further recommendations within one year from the date of issue. Under this timetable the proposed interim cap would be in effect for at least 18 months.

The Joint Board notes in its Recommended Decision that today the universal service fund provides approximately $4 billion per year in high-cost support. In 2001 high-cost support only totaled approximately $2.6 billion. In recent years, this growth has been due to increased support provided to competitive ETCs. While support to incumbent local exchange carriers has been flat or even declined since 2003, by contrast, in the six years from 2001 through 2006, competitive ETC support grew from $15 million to almost $1 billion – an annual growth rate of over 100 percent. Based on current estimates, competitive ETC support in 2007 will reach at least $1.28 billion if the FCC takes no action to curtail this growth. Moreover, if the FCC were now to approve all competitive ETC petitions currently pending before it, high-cost support for competitive ETCs could rise to as much as $1.56 billion in 2007. High-cost support to competitive ETCs is estimated to grow to almost $2 billion in 2008 and $2.5 billion in 2009 even without additional competitive ETC designations in 2008 and 2009.[3]

Staff recommends that the Commission file comments suggesting that if a competitive ETC cap is instituted a more appropriate approach would be a national cap set at 2006 charges so that every competitive ETC's share is affected by the addition of new competitive ETCs in any state.

GTD:jmc

[3] Recommended Decision at para. 4.