Item 35
(9530)

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

M E M O R A N D U M

Date : **July 2, 2010**

To : **The Commission**
(Meeting of July 8, 2010)

From : **Gretchen Dumas**
Public Utilities Counsel V

Subject: **Filing of Comments in Response to FCC's NPRM and NOI to Transition the Current Federal High Cost Support Mechanism to Fund Only Broadband Service in Unserved and High Cost Areas**

RECOMMENDATION: The CPUC should file brief comments in response to the Federal Communications Commission's (FCC) Notice of Inquiry (NOI) and Notice of Proposed Rulemaking (NPRM) which the FCC states is the first step toward implementation of the National Broadband Plan's (NBP) recommendation that the Commission "…replace all of the legacy [Federal Universal Service Fund (USF)] High-Cost programs with a new program that preserves the connectivity that Americans have today and advances universal broadband in the 21st century …."[1] The NBP urges the FCC to "adopt cost-cutting measures for existing voice support in high cost areas and create the Connect America Fund (CAF) to support the provision of broadband communications in areas that would be unserved without such support or that depend on universal service support for the maintenance of existing broadband service."[2] Comments are due on July 12, 2010.

BACKGROUND: The purpose of high-cost universal service support is to help ensure that consumers have access to telecommunications services in areas where the cost of providing such services would otherwise be prohibitively high.[3] Such support also seeks

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[1] *In the Matter of Connect America Fund, A National Broadband Plan for Our Future, High-Cost Universal Service Support*, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, NOI and NPRM, rel. April 21, 2010, para. 10 (NOI and NPRM).

[2] *Id*, para. 3.

[3] *Id*.

to fulfill the congressional mandate that a carrier's rural rates be comparable to its urban rates.[4]

The current federal High-Cost Support Mechanism is a complex scheme that includes five major components, and two supplemental components. Prior to the Telecommunications Act of 1996, federal high-cost support was based on embedded costs. In 1997, the FCC ordered that support for the larger, non-rural carriers be based on forward-looking economic costs. The FCC intended to eventually move to a scheme that would solely base rural carrier support on forward looking costs also, but it never took such action.[5]

Between 1997 and 1999, the FCC developed a Hybrid Cost Proxy Model to estimate the forward looking economic cost of providing universal service in high-costs areas to ensure economically efficient levels of support.[6] This model is now out of date. And only voice is a supported service under the current scheme, so the federal high-cost support mechanism does not now ensure that support is targeted toward extending broadband service to unserved areas. As noted by the FCC "[n]ot only are the model inputs out-of-date," the model also "estimates the costs of a narrowband, circuit switched network that provides plain old telephone service, whereas today's most efficient providers are constructing fixed or mobile networks that are capable of providing broadband as well as voice services, but the technology assumed by the model no longer reflects "the least-cost, most-efficient" reasonable technology for providing the supported services that is currently being deployed."[7]

Also, as the FCC points out, "some of the current high-cost programs do not provide support in an economically efficient manner. For example, eligibility for certain types or levels of support is based on company size or regulatory classification, rather than the cost of serving the area. In addition, several programs provide support based on an incumbent carrier's embedded costs, whether or not a competitor provides, or could provide, service at a lower cost."[8]

The National Broadband Plan (NBP), released by the FCC on March 16, 2010, recommends that the FCC direct public investment toward meeting an initial national broadband availability target of 4 Mbps of actual download speed and 1 Mbps of actual upload speed. The NBP estimated that 14 million people living in seven million housing units in the United States currently do not have access to terrestrial broadband

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[4] *See* 47 U.S.C. § 254.

[5] NOI and NPRM, paras. 4, 5, and 6.

[6] *Id*, para. 4.

[7] *Id*, para. 7

[8] *Id*, para. 3.

infrastructure capable of meeting this target, described as "the broadband availability gap".[9] The NBP also recommends that the FCC phase out legacy high cost support over a ten-year period and establish a high cost support program only for broadband via the creation of a Connect America Fund (CAF).

DISCUSSION: In the proceeding addressed by this Memo of Recommendation, the FCC seeks comment on both a Notice of Inquiry (NOI) and Notice of Proposed Rulemaking (NPRM).

NOI

The National Broadband Plan (NBP) states that the long range goal [of high-cost support reform] should be to replace all the legacy High-Cost programs with a new program that preserves the connectivity that Americans have today and advances universal broadband in the 21st century. To accomplish this goal the NBP recommends establishing the Connect America Fund (CAF) to support universal access to broadband and voice services, including providing any ongoing support necessary to sustain service in areas that already have broadband because of the existing high-cost universal service program.[10] Thus the FCC is proposing to gradually end legacy high-cost support and transition over a ten-year period to funding of broadband only via a new Connect America Fund (CAF).

The NBP recommends that the CAF should adhere to the following principles: (1) CAF should only provide funding in geographic areas where there is no private sector business case to provide broadband and high-quality voice-grade service; (2) there should be at most one subsidized provider of broadband per geographic area; (3) the eligibility criteria for obtaining broadband support from CAF should be company- and technology-agnostic so long as the service provided meets the specifications set by the FCC; (4) the FCC should identify ways to drive funding to efficient levels, including market-based mechanisms where appropriate, to determine the firms that will receive CAF support and the amount of support they will receive; and (5) recipients of CAF support must be accountable for its use and subject to enforceable timelines for achieving universal access. In addition, the NBP recommends that the FCC create a fast-track program in CAF for providers to receive targeted funding for new broadband construction in unserved areas. [11]

In the Notice of Inquiry, the FCC seeks comment on use of a model as a competitively neutral and efficient tool for helping it to quantify the minimum amount of universal service support necessary to support networks that provide broadband and voice

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[9] *Id*, para 9.

[10] *Id*, paras. 9 and 10

[11] *Id*, para. 10.

service.[12] The idea would be to 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 legacy high-cost support, as well as areas that are unserved.[13]

In particular, the FCC seeks comment on whether it should use the National Broadband Plan model as the starting point for developing a cost model, or alternatively a cost/revenue model, to use in determining future support for broadband-capable networks that provide voice service.[14] The NBP model estimates the additional funding required to extend broadband to the estimated 5 percent, or 7 million, housing units that today do not have access to broadband at 4 Mbps actual download /1 Mbps upload speeds and acceptable quality of service. FCC staff calculated the incremental forward-looking cost of upgrading or extending existing infrastructure to provide service at these targeted levels and the incremental revenues that might be expected to be generated by the network upgrades. From this, they calculated the net present value (NPV) of the gap between incremental costs and expected incremental revenues of broadband deployments in unserved areas. This NPV represents the amount of additional funding needed to upgrade or extend existing infrastructure to the target level – the so-called "investment gap."[15]

Staff recommends that the CPUC file comments on the NOI as follows:

1. The CPUC prefers the use of market-based mechanisms or reverse auctions to determine the appropriate subsidy for high-cost areas and providers of last resort. However the CPUC realizes that in remote and difficult-to-reach areas, providers 'economies of scale in serving such areas may be diminished and thus the private sector may not have a sufficient incentive to provide service in these areas or to bid aggressively in an auction covering such high-cost regions. Therefore, we support adoption of a model to determine appropriate support in these areas.

[12] *Id*, para. 13.

[13] *Id*, para. 17. "Unserved" is defined as areas where there is no private sector business case for deployment of broadband and high quality voice service, and which do not meet the National Broadband Plan (NBP) goal of 4 Mbps down/ 1 Mbps up.

[14] *Id*, para. 14.

[15] The investment gap means the amount needed to make a business case for deployment in areas where there currently is no business case, based on the net gap between the projected incremental costs of broadband network deployment and the projected revenues from the broadband-capable network. The availability gap means areas where housing units have no access to a 4Mbps downstream/1Mbps upstream internet connection.

2. The CPUC does not take a position on use of the National Broadband Plan model. The information provided by the FCC lacks the details and specificity necessary to effectively evaluate its implications. The FCC has not provided the basic inputs to the model.

3. The CPUC recommends that any model adopted by the FCC should include the following:

   - A minimum level of federal funding should be first guaranteed to each state based on the state's contribution to the Universal Service Fund.

   - After the minimum level of funding is provided to each state, as recommended above, states that have programs to provide state subsidies for broadband deployment should get priority funding from the CAF. Under the NBP model, such states are disadvantaged.

   - Also a mechanism should be in place to incent states to invest in their own infrastructure rather than merely relying on federal support.

   - The FCC should include satellite service in the calculation of the availability and investment gaps, and permit CAF funding of such satellite service where it meets the target goals.

NPRM

In the Notice of Proposed Rulemaking (NPRM), the FCC seeks comment on specific proposals to contain growth in the legacy high-cost support mechanisms that could be initially implemented to create a pathway to a more efficient and targeted mechanism for funding broadband. The intent of these proposals is also to eliminate the indirect funding of broadband capable networks today through the federal legacy high-cost program.[16]

The FCC seeks comment on capping legacy high-cost support provided to incumbent local exchange carriers at 2010 levels,[17] adopting cost-cutting measures, and eventually transitioning, over a ten-year period, to funding only broadband and voice under a new Connect America Fund (CAF) and adopting incentive regulations for rate-of-return carriers. The FCC also proposes phasing out competitive eligible telecommunications carrier (CETC) high-cost support in five years. The FCC's proposals envision that the cost of the High-Cost program would not increase under the CAF from what it is today.

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[16] NOI and NPRM, para.53.

[17] In 2008, the FCC imposed an overall "interim" cap on high cost support for competitive eligible telecommunications carriers, pending comprehensive USF reform.

Staff recommends that the CPUC:

1. Support a cap on existing legacy high-cost support at 2010 funding levels throughout the remaining existence of the legacy high-cost support program.

2. Support the transition over a ten-year period from the funding of legacy voice wirelines to the funding of only broadband deployment and high quality voice service in high cost unserved areas[18] and for ongoing operating costs where absolutely necessary;[19]

3. Urge the FCC to amend the Separations methodology so that revenues from broadband service would be booked to the intrastate jurisdiction during the transition period;

4. Support the FCC proposal to eliminate high-cost support to competitive ETCs in five years.

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[18] Areas where there is no private sector business case for deployment of broadband and high quality voice service, and which do not meet the National Broadband Plan (NBP) goal of 4 Mbps down/ 1 Mbps up.

[19] In 2009, California ILECs received approximately $107 million dollars in federal high cost support. The rural rate-of-return carriers' share of this 2009 money was about $54 million. Under the current CPUC California High Cost Fund- A program, the CHCF-A Fund would eventually have to reimburse these rate-of-return carriers for the loss of the federal dollars.