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

M E M O R A N D U M

Date : **April 11, 2011**

To : **The Commission**
(Meeting of April 14, 2011)

From : **Kimberly J. Lippi**
Public Utilities Counsel IV

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Subject: **Filing of Comments in Response to Remaining Sections of the FCC's Notice of Proposed Rulemaking (NPRM) and Further Notice of Proposed Rulemaking (FNPRM) for High Cost Support Universal Service and Intercarrier Compensation Reform**

RECOMMENDATION: The CPUC should file comments on the remaining sections of the Federal Communications Commission's (FCC) NPRM/FNPRM[1] covering matters other than those specifically addressed in our earlier comments on Section XV ("Reducing Inefficiencies and Waste by Curbing Arbitrage Opportunities," filed April 1, 2011). The remaining sections of the NPRM seek comments on a wide array of issues related to a complete overhaul of Universal Service Fund (USF) high cost support mechanisms, and comprehensive reform of intercarrier compensation (ICC) to gradually reduce all per-minute charges. The goal is to create a "Connect America Fund" (CAF) which would "ultimately replace explicit support provided by the current high-cost fund as well as implicit subsidies from the ICC system."[2]

[1] *In the Matter of Connect America Fund,* WC Docket 10-90; *A National Broadband Plan for Our Future*, GN Docket 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket 07-135; *High-Cost Universal Service Support*, WC Docket 05-337; *Developing an Unified Intercarrier Compensation Regime*, CC Docket 01-92; *Federal-State Joint Board on Universal Service*, CC Docket 96-45; *Lifeline and Link-Up*, WC Docket 03-109, [1] Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, rel. Feb. 9, 2011 (NPRM).

[2] *Id*. at para. 15.

The CPUC should make the following recommendations: 1) support migration of federal high cost support to the CAF, but voice concerns about the "glide path" to this migration given staff concerns about how replacement of the current USF mechanisms for high cost support would impact customers served by California's carriers and particularly customers of California's Rate of Return carriers, both during the transition stages and once the transition is complete; and 2) express support for the FCC's proposed reform of intercarrier compensation as long as the "glide path" to the FCC's apparent objective, one rate only or bill-and-keep, is reviewed at each stage to gauge the impact of the interim steps on carrier health and traffic flows, including the important questions of how older technologies based on circuit-switching are replaced by IP-enabled services, applications, and peering arrangements.

Comments are due April 18, 2011.

BACKGROUND: In this NPRM/FNPRM, the FCC seeks comments on proposals to reform federal high cost support mechanisms and the ICC regime, including both interstate and intrastate access charges and existing reciprocal compensation relationships. The FCC's overarching purpose is to recalibrate federal high cost support for a broadband world, where the support moves from voice services exclusively to supporting broadband deployment in addition to voice services; and to adopt ICC reform that complements, not frustrates, this transition. As we noted in our Memorandum of Recommendation on Section XV, the FCC's presupposition is that "… 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."[3]

The FCC further states:

> Building on the recommendations of the National Broadband Plan and the record from the *USF Reform NOI/NPRM*,[4] we propose 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

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[3] *Id.* at para. 8.

[4] *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*).

> Fund….[W]e 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.[5]

The purpose of the high-cost portion of federal 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. Such support also seeks to fulfill the congressional mandate that a carrier's rural rates be comparable to urban rates. The current federal high cost mechanism is designed to reimburse the operating costs of networks that provide voice services in high cost areas, so the federal high-cost support mechanism does not target support toward extending or maintaining broadband service to unserved and high cost areas. The FCC's long range goal of high-cost support reform is 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.

The FCC proposes to 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 in areas that currently do not have such service. The FCC proposes to phase out legacy high cost support over a ten-year period (though this interval itself is open to adjustment) and to establish a high cost support program only for broadband (with voice as a component or "application") via the creation of a new broadband CAF.

In addition to replacing explicit support provided by the current high-cost fund, the CAF would also replace implicit subsidies from the ICC system.[6] Intercarrier compensation is a system of payments between carriers to compensate each other for the origination, transport and termination of telecommunications traffic, and includes interstate and intrastate access charges and reciprocal compensation. The rates vary depending on the type of provider and where the call originated, and there are separate rules for wireless traffic, ISP-bound traffic, and traffic on competitive networks. According to the FCC, the current ICC system hinders deployment of IP networks. The FCC further states that per-minute charges are "inconsistent with peering and transport arrangements for internet protocol (IP) networks, where traffic is not measured in minutes."[7] The FCC proposes to phase

[5] NPRM/FNPRM at para. 18.

[6] *Id*. at para. 15.

[7] *Id*. at para. 40.

out, over a 10-year or shorter period of time, the current intrastate and interstate intercarrier compensation regime.

DISCUSSION:

1. **Universal Service Reforms**

The FCC proposes to use a competitive bidding process, or, in the alternative, an incumbent right-of-first-refusal (ROFR) process, for determining the amount of support a carrier will receive and identifying the recipient carrier. The ROFR price would be set by a regression model, or an engineering cost model, as a competitively neutral and efficient tool for helping to quantify the minimum amount of universal service support necessary to support networks that provide broadband and voice service.

The CPUC should recommend that any distribution mechanism adopted by the FCC include the following:

- A minimum level of federal funding should be first guaranteed to each state based on the state's contribution to the CAF.
- After the minimum level of funding is provided to each state, states that have programs to provide state subsidies for broadband deployment should get priority funding from the CAF.
- 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 as a technology option, and permit universal service funding for the provision of such satellite service where it meets the universal service goals.
- The FCC should require CAF recipients to offer voice as a stand-alone service, and such voice service should have service quality, access to E911, and other functions that are equivalent or better than that provided today via the PSTN.
- States should retain the ability to designate eligible telecommunications carriers (ETCs) and set their own public interest standards for such designations.
- The FCC should be cautious about how funds are spent to ensure that comparable broadband milestones are established for rural areas, so that consumers in rural areas are not subjected to a lower speed standard for Internet connection.

We further recommend that the CPUC support the FCC's proposals to strengthen anchor institutions and to promote broadband adoption, including:

- Universal service high cost support funding rules should encourage sharing of infrastructure, including by residential and anchor institution users.
- The high cost support distribution mechanism should 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 in the mechanism for assigning support.
- In determining the size and role of the new fund, the FCC should take into account the cumulative needs of the four current federal universal service programs (high-cost, low income, schools and libraries, and rural health care), acting together, to allow for possible reprioritization of CAF monies to the other programs.

2. Intercarrier Compensation Reforms

In earlier comments on Section XV of the NPRM, the FCC sought comments on immediate reforms to the ICC regime to reduce arbitrage and increase certainty in ICC payments during the transition away from the per-minute system. In the remaining sections of the NPRM, the FCC seeks comment on a long-term framework to gradually reduce all per-minute charges. The FCC seeks comment on several transition topics including these key issues: (1) the sequencing of ICC rate reductions (i.e., whether interstate and intrastate access charges change concurrently, or sequentially, with reductions in intrastate access charges to the interstate level followed by a reduction of all ICC rates) ; (2) the role of the states in reforming ICC (i.e., whether states should remain responsible for reforming intrastate access charges while the FCC simultaneously reforms interstate); 3) whether the FCC should establish a methodology which states would be required to use to reform their intrastate access charges; and (4) the appropriate timing of the overall transition so that it is consistent with implementation of long-term CAF support.

As to the end-point for comprehensive reform, the FCC appears to favor adoption of a bill-and-keep methodology, but also seeks comment on adopting flat-rated intercarrier charges, or other methodologies retaining some form of per-minute intercarrier compensation charges. The FCC also seeks comment on a number of issues in developing a CAF recovery mechanism, including threshold questions of how to evaluate the need for recovery of reduced intercarrier compensation (whether focusing on cost, revenues, or both), and how to structure such recovery.

Staff recommends that an all IP-based traffic system treat access and termination in the same way at the same rates regardless of whether the traffic is intrastate or interstate, or of who initiated it or terminated it. Staff accordingly recommends supporting the unification of all intercarrier compensation rates. Staff recommends that states remain responsible for implementing intrastate access charges in the revised environment, working cooperatively with the FCC on its “glide path” to eliminate access charges, reciprocal compensation and disparate rates for carrier and traffic types. Staff further recommends that the FCC provide positive incentives to states to act on reducing intrastate access rates, such as preference for receipt of the first phase of the CAF funds.

Staff recommends supporting a reduction in both intrastate and interstate rates spread over several years with the objective of uniform rates for both jurisdictions. As to the end-point methodology, staff recommends supporting the move to one rate only or to bill-and-keep, while conditioning this support on the success of the previous steps, with success being measured by the degree to which traffic has in fact migrated to IP and whether the compensation system is otherwise efficient for all carrier types and all end-users.

Parallel to this process of intercarrier compensation reform would be a staircase migration of carriers to the CAF such that lost intercarrier compensation does not compromise the deployment of broadband as a universal service with voice reliably provisioned to no lesser degree than it is currently.

As to the recovery mechanism, Staff recommends that all revenues and costs associated with supported infrastructure be considered. Staff favors the FCC’s recommendation that there be a “no barriers” approach to measuring costs and revenues by supported carriers, in that regulated and unregulated revenue are considered.[8] Heretofore, “non-regulated” revenues were not included in evaluating carrier support requirements for universal voice service.

The FCC proposes a framework for calculating intercarrier compensation replacement payments for rate-of-return carriers, but this framework is vague and requires more clarification to evaluate the effect of lost access charges. Staff’s estimate is that the impact of eliminating access charges and current federal universal service support mechanisms (without regard to their replacement by the CAF) to California’s rate of return carriers would be approximately $58-59 million annually in 2011 dollars, which represents over 50% of their total revenue, with federal universal service support alone accounting for over 35%. (See attached spreadsheet.) Depending on the role of the CAF, such a decrease in

[8] NPRM, at para. 569.

federal support would have a significant impact on draws from California's High-Cost Fund A.

The FCC states that "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."[9]

Thus, the critical questions which the FCC needs to clarify are how the CAF would support broadband deployment in practice *after* intercarrier compensation mechanisms are replaced by much reduced access rates or bill-and-keep, and how the recipients of federal support are identified, their support determined, and their performance audited when support may be detached from traditional service areas and traditional measures of quality of service.

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KJL:nas

Attachment

[9] NPRM, at para. 600; emphasis added.

The Effect of the Elimination of Federal High Cost Fund Support and Access Charges on CA Rate of Return Carriers

	High Cost Loop	Safety Net Additive	Local Switching	Interstate CL	Total High Cost	Interstate Access Charge Rev.[1]	Intrastate Access Charges Rev.[1]	Total High Cost	Total High Cost	Interstate Access Charge Rev.	Intrastate Access Charge Rev.
Study Area Name	**Monthly Support**	**Monthly Support**	**Monthly Support**	**Monthly Support**	**Monthly**	**Monthly**	**Monthly**	**2Q2011**	**Annualized[2]**	**Annualized[3]**	**Annualized[3]**
CALAVERAS TEL CO	$ 183,751	$ 7,264	$ 6,969	$ 129,631	$ 327,615	$ 11,522	$ 33,951	$ 982,845	$ 3,931,380	$ 138,262	$ 407,415
CAL-ORE TELEPHONE CO	67,035	-	44,061	50,578	161,674	18,029	14,052	485,022	1,940,088	216,347	168,622
DUCOR TELEPHONE CO	83,913	-	36,780	66,952	187,645	8,016	14,221	562,935	2,251,740	96,197	170,647
FORESTHILL TEL CO.	141,395	5,143	17,465	93,523	257,526	15,079	26,184	772,578	3,090,312	180,948	314,212
HAPPY VALLEY TEL CO	-	-	7,481	13,199	20,680	5,863	45,496	62,040	248,160	70,355	545,948
HORNITOS TEL CO	2,338	-	3,238	6,374	11,950	1,486	13,618	35,850	143,400	17,837	163,413
KERMAN TELEPHONE CO	155,083	-	11,014	159,189	325,286	19,055	21,056	975,858	3,903,432	228,657	252,670
PINNACLES TEL CO	37,974	-	9,951	18,700	66,625	1,426	1,757	199,875	799,500	17,111	21,084
PONDEROSA TEL CO	524,082	16,454	13,894	359,668	914,098	24,537	55,366	2,742,294	10,969,176	294,444	664,395
SIERRA TELEPHONE CO	317,641	-	54,172	475,266	847,079	82,858	97,023	2,541,237	10,164,948	994,294	1,164,277
SISKIYOU TEL CO	350,200	26,460	30,070	235,017	641,747	30,551	32,117	1,925,241	7,700,964	366,608	385,405
VOLCANO TEL CO	123,806	-	44,242	175,207	343,255	45,158	103,058	1,029,765	4,119,060	541,892	1,236,700
WINTERHAVEN TEL. CO.	12,197	1,070	5,347	20,467	39,081	10,809	5,595	117,243	468,972	129,714	67,144
TOTAL - ALL ROR COMPANIES	**$ 1,999,415**	**$ 56,391**	**$ 284,684**	**$ 1,803,771**	**$ 4,144,261**	**$ 274,389**	**$ 463,494**	**$ 12,432,783**	**$ 49,731,132**	**$ 3,292,665**	**$ 5,561,932**

[1] 2010 Minutes/12 * Current Access Charges
[2] 2Q11 Dollars * 4
[3] Monthly Rev. * 12