Overview of the Universal Service Funds and the FCC's Reforms

Christine Aarnes, Chief of Telecommunications

Before the House Utilities & Telecommunications Committee

January 28, 2013

Kansas Corporation Commission

Universal Service

Both the Kansas Telecommunications Act of 1996 and the Federal Telecommunications Act of 1996 contain provisions to develop universal service funds to maintain and enhance universal service.

- Federal Universal Service Fund (FUSF) - 47 U.S.C. 254
- Kansas Universal Service Fund (KUSF) – K.S.A. 66-2008

Federal Universal Service Fund

The goals of federal Universal Service, as mandated by the 1996 Federal Act (47 U.S.C. 254), are to:

- Promote the availability of quality services at just, reasonable and affordable rates for all consumers;
- Increase nationwide access to advanced telecommunications services;
- Advance the availability of such services to all consumers, including those in low income, rural, insular, and high cost areas at rates that are reasonably comparable to those charged in urban areas;
- Increase access to telecommunications and advanced services in schools, libraries, and rural health care facilities; and
- Provide equitable and non-discriminatory contributions from all providers of telecommunications services to the fund supporting universal service programs.

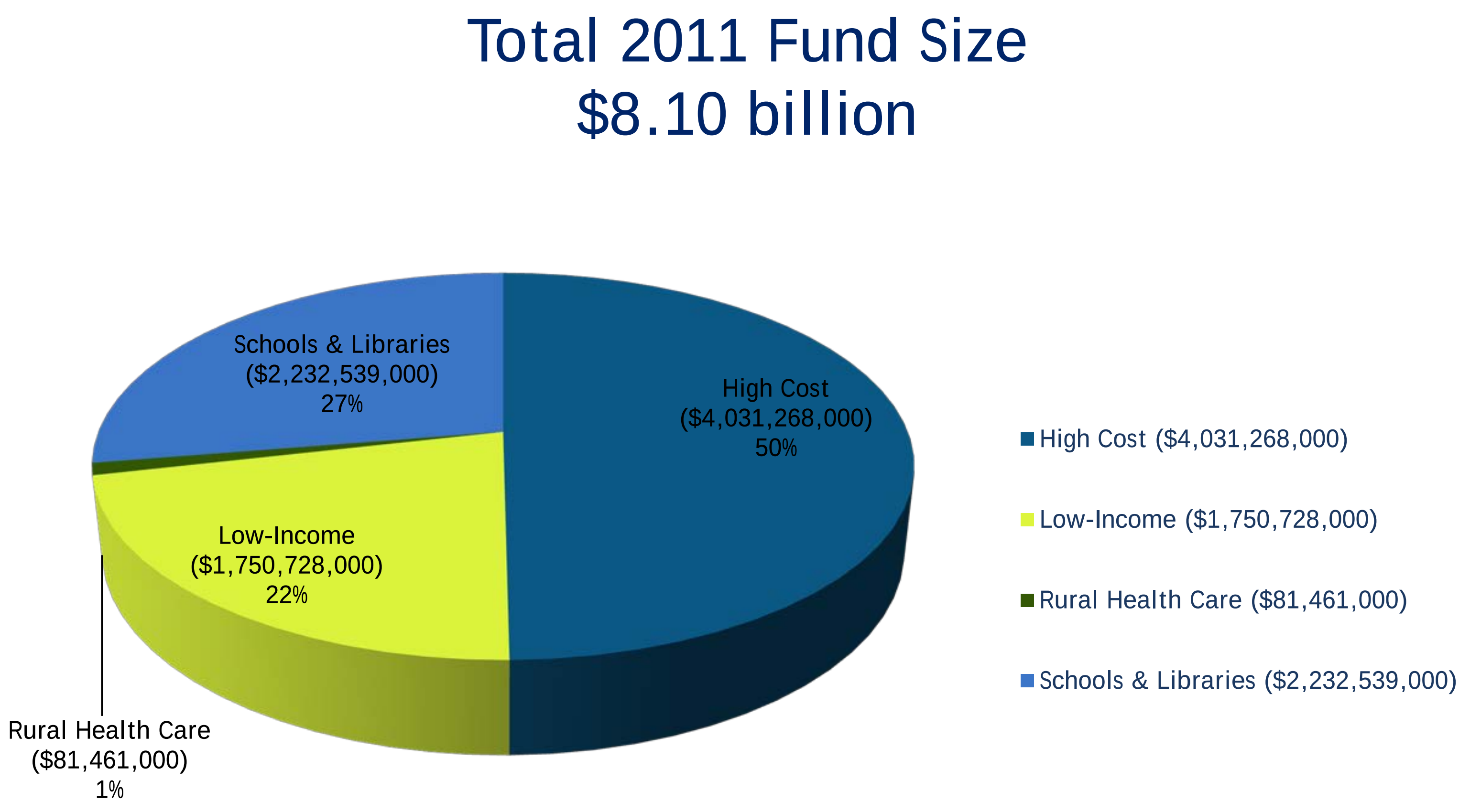
Federal Universal Service Fund

The Federal Communications Commission (FCC) established four programs to fulfill these goals. They are:

- The **High-Cost** program
- The **Lifeline (low income)** program, including initiatives for Native Americans
- The **Schools and Libraries** program, commonly referred to as E-rate
- The **Rural Health Care** program

These programs are funded by the FUSF. Telecommunications providers must contribute to the FUSF through an assessment on their interstate and international revenues. The assessment rate for the 1st quarter 2013 is 16.1%.

Federal Universal Service Fund



Federal Universal Service Fund

- Federal High-Cost Support

  1996 --- $1.2 billion

  2011 --- $4.0 billion

- Kansas is the 11th Largest Recipient of all Federal USF Programs

  $213.3 million in 2011

- Kansas is the 4th Largest Recipient of High Cost Support

  $190.7 million in 2011

- Kansas is the 33th Largest Recipient of Low-Income Support

  $7.0 million in 2011

Kansas Universal Service Fund

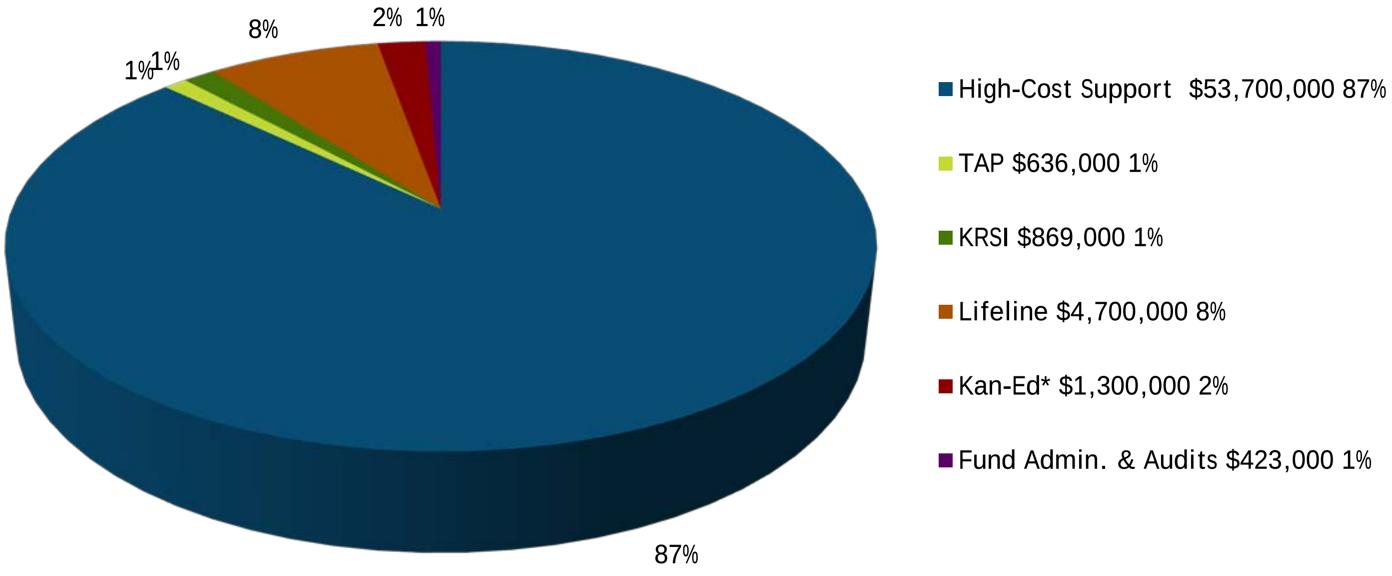
- KUSF was created by the KCC and implemented March 1, 1997, as required by K.S.A. 66-2008.
- Purpose of the KUSF is to assure quality services are made available to all Kansans at affordable rates.
- Pursuant to K.S.A. 66-2008(a), all Interexchange Carriers (long distance), Incumbent Local Exchange Carriers (ILECs), Electing Carriers, Competitive Local Exchange Carriers (CLECs), Wireless, and Interconnected Voice over Internet Protocol (VoIP) providers must contribute to the KUSF. The assessment may be passed through to customers.
- Current assessment rate is 6.13% on intrastate revenues. As of March 1, 2013, the assessment rate will be 6.42%.

Kansas Universal Service Fund

- Initially, KUSF high-cost support based on access charge reductions.
- Moving toward a cost-based KUSF.
  - AT&T's & CenturyLink's support based on high-cost model
  - Rate of Return (ROR) carriers' support based on embedded costs (K.S.A. 66-2008(e)).
    - ✓ Completed 44 ROR carrier audits, including 2nd audits of some carriers.
    - ✓ Last 2 ROR carrier audits to determine cost-based support are in progress.
    - ✓ 3 ROR carrier requests for additional KUSF support filed in 4th Q 2012.
- All KUSF Eligible Telecommunications Carriers (ETCs) are eligible to receive support from the KUSF. This includes 38 incumbent carriers and 11 competitive ETCs.

Kansas Universal Service Fund

KUSF
Gross Fund Size - March 1, 2013
$61.6 million



•Annual Kan-Ed support was reduced from $6M to $3.75M as of 7/1/12. $1.3 million represents the remaining amount to be paid between 3/1/13 and 6/30/13.

Kansas Universal Service Fund

High-Cost Support – March 1, 2013

$53.7 million*

Rural (ROR) Carriers	$26.2 million
AT&T	$5.2 million
CenturyLink	$11.0 million
Competitive ETCs	$11.2 million

* Total support amount differs from individual amounts due to rounding

National Broadband Plan & USF/ ICC Reform

- In early 2009, Congress directed the FCC to develop a National Broadband Plan (NBP) to ensure ubiquitous access to broadband services.
- FCC released NBP on March 16, 2010.

National Broadband Plan & USF/ ICC Reform

Primary issues being addressed at FCC:

- Convert the “legacy” high-cost component of the USF to the Connect America Fund (CAF)
- Create CAF to support broadband
- Create a Mobility Fund to support 3G (or better) wireless coverage
- Reform Intercarrier Compensation (payments between carriers)
- Expand Lifeline program to allow subsidies to be provided for broadband
- Broaden the USF contribution base to ensure sustainability

FCC adopted USF/ICC Reform Order and FNPRM October 27, 2011. Order released on November 18, 2011.

FCC Order – USF Reform

Principles and Goals

- Support for broadband-capable networks as an express universal service principle under Section 254(b)
- Set the following performance goals to ensure reforms are achieving intended purposes:
  - ➢ Preserve and advance universal availability of voice service;
  - ➢ Ensure universal availability of modern networks capable of providing voice and broadband service to homes, businesses and community anchor institutions;
  - ➢ Ensure universal availability of modern networks capable of providing advanced mobile and broadband service;
  - ➢ Ensure that rates for broadband services and rates for voice services are reasonably comparable in all regions of the nation; and
  - ➢ Minimize the universal service contribution.

FCC Order – USF Reform

Budget

- Set at $4.5 billion for initial 6 years with an automatic review trigger if the budget is threatened to be exceeded.
- FCC anticipates it may need to revisit and adjust the appropriate size of the programs by the end of the 6 year period based on market developments, efficiencies realized, and further evaluation of the effect of the programs in achieving FCC's goals.

FCC Order – USF Reform for Price Cap Carriers

Price Cap Reforms – Phase 1

- Existing legacy high-cost support frozen at 2011 levels.
- Additional $300 million in CAF support made available, but carriers accepted only $115 million.
  - AT&T declined $47.9 million offered.
  - CenturyLink accepted $35 million, but indicated if FCC grants its waiver petition to deploy in areas served by Wireless Internet Service Providers, it would accept a total of $81.4 million.
  - No CAF Phase 1 support will be invested in Kansas.
- Any carrier that elects to receive additional support will be required to provide broadband with actual speeds of 4Mbps/1Mbps and deploy broadband to at least one currently unserved location for each $775 in additional high-cost support it receives.

FCC Order – USF Reform for Price Cap Carriers

Price Cap Reforms – Phase 2

- Combination of forward-looking cost model and competitive bidding will be used to distribute CAF support.
- FCC is undertaking a public process to develop the model.
- Support will be provided in areas without an unsubsidized competitor.
- In each state, each incumbent price cap carrier will be asked to undertake a “state-level commitment” to provide affordable broadband to all high-cost locations in its service territory in that state.
- If the incumbent declines the state-level commitment, CAF support will be distributed through competitive bidding.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to:

1) Eliminate support in areas that are overlapped by an unsubsidized competitor
2) Cap total FUSF support at $250/line per mo.
3) Eliminate Safety Net Additive (SNA)
4) Reduce high-cost loop support for carriers that maintain artificially low end-user voice rates, with a three-step phase-in beginning July 1, 2012.
5) Transition Local Switching Support (LSS) to ICC Reform
6) Limit “excessive” capital investment and corporate operations expense for High Cost Loop Support (HCLS).
7) Limit corporate operations expense and investment for Interstate Common Line Support (ICLS).

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to:

1) Eliminate support in study areas that are overlapped completely by an unsubsidized facility-based terrestrial competitor providing voice and fixed broadband throughout ILEC service area.
   - If 100% overlap occurs, support will be phased-out over a three year period. At this time, this does not affect any KS ROR carrier.
   - FCC considering elimination of FUSF support in an area that partially overlaps the ILEC's study area.
2) Total FUSF support capped at $250/line per mo., with a gradual phase-down to the cap over a 3-year period. This reform may impact 2-3 ROR carriers in KS. The cap will be phased in as follows:
   - July 1, 2012: FUSF limited to $250 per line per month plus 2/3 of the difference between the uncapped per-line FUSF support and $250.
   - July 1, 2013: FUSF support limited to $250 per line per month plus 1/3 of the difference between the uncapped per-line FUSF and $250.
   - July 1, 2014: FUSF cannot exceed $250 per line per month.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to: (cont'd)

3) Eliminate Safety Net Additive (SNA)
   - Carriers receiving SNA for investment will continue to receive for applicable 5-year period.
   - Carriers receiving SNA for line loss had their SNA support reduced by 50% July 1, 2012 and all SNA will be eliminated July 1, 2013.

4) Reduce high-cost loop support for carriers that maintain artificially low end-user voice rates, with a three-step phase-in beginning July 1, 2012.
   - Rate floor benchmark $10, effective July 1, 2012
   - Rate floor benchmark $14, effective July 1, 2013.
   - Rate floor benchmark expected to be around $15.62 on July 1, 2014.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to: (cont'd)

5) Transition Local Switching Support (LSS) to ICC Reform
   - LSS ended as a stand-alone USF support mechanism on July 1, 2012
   - Limited recovery of costs previously covered by LSS available pursuant to FCC's ICC recovery mechanism.

6) Limit "excessive" capital investment and corporate operations expense for HCLS.
   - Modified FCC corporate expense formula
   - Regression analysis

7) Limit corporate operations expense and investment for ICLS
   - Regression analysis

FCC Order – USF Reform for ROR Carriers

Rate of Return (ROR) Carrier Broadband Requirement

- ROR carriers receiving legacy high-cost support or CAF support to offset lost intercarrier compensation revenues must offer broadband service with actual speeds of at least 4Mbps/1Mbps, upon their customers' reasonable request.

FCC Order – USF Reform

Identical Support Rule for Competitive Eligible Telecommunications Carriers (CETCs)

- Identical support frozen per study area as of year-end 2011 and existing support will be phased-down over a 5-year period beginning on July 1, 2012.
- The phase down, in conjunction with the new funding provided by Mobility Fund Phase I and II, will provide an average of $900 million to mobile carriers for each of the first 4 years of the reform.
- The phase-down of CETC support will end if Mobility Phase II is not operational by June 30, 2014.

FCC Order – USF Reform

CAF Mobility Fund – Phase 1

- Up to $300 million in one-time support awarded through a nationwide reverse auction held on September 27, 2012.
- Eligible areas include census blocks unserved today by mobile broadband services, and carriers may not receive support for areas they have previously stated they plan to cover.
- Winners will be required to deploy 3G service within two years and 4G service within 3 years.
- Separate Tribal Mobility Fund – one-time funding of $50 million.

FCC Order – USF Reform

CAF Mobility Fund – Phase II

- Will provide up to $500 million per year in on-going support to ensure universal availability, including $100 million for Tribal areas.
- FCC planned to implement Phase II in 2013.
- CAF Phase II support recipients are eligible, but carriers will not be allowed to receive redundant support for the same service in the same areas.
- Mobility Fund recipients will be subject to public interest obligations, including data roaming and collocation requirements.

FCC Order – USF Reform

Remote Areas Fund

- The FCC will allocate at least $100 million annually to ensure that even Americans living in the most remote areas of the nation, where the cost of providing wireline or cellular terrestrial broadband service is extremely high, can obtain service.
- Support will be provided to provide broadband service through alternative technology platforms, including satellite and unlicensed wireless.
- FCC requested comments on issues including identification of areas eligible for Remote Areas Fund support and implementation of the subsidy. Comments due February 19, 2013 and Reply Comments due March 18, 2013.
- Expected to be implemented in 2013.

FCC Order – ICC Reform

Comprehensive Intercarrier Compensation (ICC) Reform

- Bill-and-keep methodology for all ICC traffic as the end state.
- Multi-year transition
  - ➢ Initial reforms focus on terminating switched access.
  - ➢ Carriers are required to cap most rates as of Dec. 29, 2011.
  - ➢ Transition to parity with interstate in 2 steps by July 1, 2013.
  - ➢ Thereafter, carriers are required to reduce rates to bill-and-keep within 6 years for price cap carriers and 9 years for ROR carriers.

FCC Order – ICC Reform

New Recovery Mechanism

- Access Recovery Charge (ARC)
  - Incumbent carriers allowed to charge ARC on wireline service, with a maximum annual increase of $.50 per month for consumers and small businesses and $1 for multi-line businesses to partially offset ICC revenue declines.
  - Ceiling prevents carriers from assessing any ARC for any consumer whose total monthly rate for local telephone service, inclusive of various rate-related fees, is at or above $30.
  - Carriers prevented from charging ARC on Lifeline customers.
  - ARC plus Subscriber Line Charge (SLC) cannot exceed $12.20 per line for multi-line business customers.

FCC Order – ICC Reform

New Recovery Mechanism (cont'd)

- Carriers may receive CAF support for otherwise-eligible revenue not recovered by ARC.
  - Price cap carriers baseline recovery amounts begin at 90%, subject to a 10% annual decline. All price cap CAF recovery will phase out over a 3-year period beginning in 6th year of reform.
  - ROR carriers recovery reduced by 5% annually.

Thank you. Questions?

Christine Aarnes
Chief of Telecommunications
Kansas Corporation Commission
1500 SW Arrowhead Rd.
Topeka, KS 66614
785-271-3132
c.aarnes@kcc.ks.gov

Kansas Corporation Commission