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Regulatory Update: FCC Decision Released November 5, 2008 (Order on Remand and Report and Order and Further Notice of Proposed Rulemaking)

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The FCC, on November 5, 2008, issued its Order on the various dockets which have caused so much consternation recently. The document consists of basically two parts. The first is the Commission's Order in response to the D.C. Circuit's Remand Order on compensation for CLECs serving ISPs, wherein it directed a response by November 5, 2008.

The second aspect is a request for comments on three separate proposals involving access, universal service and related topics, which are as follows:

- Appendix A, Chairman Martin's draft proposal circulated within the FCC on October 15, 2008, as was reported in various trade publications.
- Appendix B, the Universal Service Reform Proposal circulated at the FCC on October 31, 2008.
- Appendix C, the Alternative Proposal circulated by the Chairman on November 5, 2008 (ostensibly, this is the Chairman's "Plan B").

We would like to stress that the following analysis is based upon our initial impression of the Order and proposed rulemakings, which are extremely complex with many nuances. At times, our interpretation is based upon less than clear prose. A more thorough review is required before reaching any definitive opinion.

ISP REMAND

In essence, the FCC affirms the result of its prior orders, which found ISP-bound traffic to be jurisdictionally interstate and, therefore, not subject to reciprocal compensation under §251(b)(5). The FCC has twice before attempted to justify its jurisdictional decision. Now, reversing its prior rationale, the FCC finds that § 251(b)(5) "is not limited to local traffic" and, based upon various provisions of the Telecommunications Act of 1996, the Commission again finds that it has the authority to set a new compensation scheme for ISP-bound traffic. The rationale is confusing and raises more legal questions than it addresses, when, for example, it asserts that §251(b)(5) applies to all traffic, not just local. A fourth appeal will certainly follow.

INTERCARRIER COMPENSATION AND USF - APPENDIX A

This is the public's first view of Chairman Martin's October 15th proposal. Salient points appear to be as follows:

High Cost Support

- High cost support, which accounts for approximately half of total federal USF support, is capped at the amount that will be disbursed by USAC in December 2008 on an annualized basis. ¶16. Each incumbent LEC's individual high-cost support is limited to that received on December 2008 annualized on a study or service area basis. ¶30.
- Offering "Broadband Internet access service" throughout the recipient's supported study area within five (5) years is a condition of eligibility to receive high cost support. ¶20.
- Broadband definition includes access to internet service and not just broadband transmission. ¶¶24 and 28. The ETC's commitment must include download speeds equal or greater than 768 kbps and upload speeds greater than 200 kbps. ¶28. An ETC cannot use satellite technology to meet its broadband Internet access obligation. ¶27.
- If the incumbent LEC declines to make the broadband Internet access commitment, then the FCC will undertake reverse auctions to identify the lowest bidder to serve the auctioned study area. ¶33.
- The identical support rule for competitive ETCs is eliminated and support levels will be based upon the carrier's own cost. ¶17.
- A broadband lifeline/linkup pilot program will be established to support 50% of the cost of installation (up to a total of \$100) and \$10 monthly to offset recurring charges. ¶64.

Contributions

- Contributions for universal service funding are, for residential customers, to be based on a per-number assessment of \$1.00 and, for business customers, will continue to be funded based upon interstate/international revenues received. ¶92. There is no indication how similar the overall residential contribution will be under the number system, as compared to the current revenue-based system. ¶¶155-156.
- Specifically, VoIP providers will continue to be required to contribute. ¶100.
- A new reporting system to track contributions will be devised. ¶148. The new system will begin in July 2009 and revenues/numbers will be reported during the six months before and after.

Intercarrier Compensation

- Intercarrier compensation is to be reduced according to a ten year transition plan as follows:

- Stage 1 - All LECs to reduce their terminating intrastate switched access rates by 50% toward interstate switched access rates in the first year. Two years after the effective date of the Order, intrastate access will be unified with interstate rates.
- Stage 2 - Carriers will then reduce the unified access rates to an interim uniform termination rate set by the state. Within two years, the state is to adopt a uniform reciprocal compensation rate applicable to all carriers and, three years from the date of the Order, all LECs will reduce their terminating access rates by 50% of the difference between the Stage 1 unified access rate and the reciprocal compensation rate established by the state. Four years from the effective date, all terminating rates will equal the uniform reciprocal compensation rate established by the state.
- Stage 3 - For the six years following, there will be a “gradual” downward transition for the final uniform reciprocal compensation rate set by the state consistent with a cost methodology established in the order. ¶¶192-195.

Cost Methodology

- No particular methodology is prescribed to set the interim reciprocal compensation rate, but there must be “a single, state-wide interim, uniform reciprocal compensation rate during each year and each stage of the transition.” ¶195. States are permitted to establish the schedule for the final six-year “glide path.” *Id.*
- The final reciprocal compensation rate at the end of the ten year period is to be based upon a “additional cost” standard that is expected to be “or below \$.0007 per minute-of-use.” ¶202.
- The new “additional costs” methodology is to be based only upon incremental costs specifically excluding common costs and overheads. No profit is included. ¶¶262-268. The methodology will continue to be “forward-looking economic costs.” The states will be required to evaluate a network without transport and termination of other carriers’ traffic and one with such functions. The difference is the “additional cost.” ¶271.

Existing Agreement

- The Order expects that existing interconnection agreements will be modified under change of law provisions. ¶292.

VoIP Traffic

- Services that originate calls on IP networks and terminate them on the PSTN (and *vice versa*) are to be classified as “information services.” ¶209. States are preempted from any effort to impose traditional telephone company regulation on IP services. States are allowed to established reciprocal compensation rates pursuant to the FCC’s new methodology on IP traffic. *Id.*

Transport Obligations

- The rules associated with the final uniform reciprocal compensation rate include an obligation of each carrier to transport “to the network edge of the called party’s service

provider.” ¶275. Also, the calling party’s service provider is responsible for payment of the uniform terminating rate to the called party’s service provider. The called party’s network edge is the location of its end office, MSC, POP or trunking media gateway. *Id.*

Recovery of Lost Access Revenue

- In order to recover the lost revenues associated with decreasing intercarrier compensation, the FCC proposes both increased end user rates and, under certain conditions, increased recovery from the federal USF.
- The SLC for residents will be increased by \$1.50 (\$6.50 to \$8.00) and for multi-line business from \$9.20 to \$11.50. ¶298.
- As a prerequisite for increases in the SLC, the state’s retail rates must “be set at the maximum level permitted under state regulations.” ¶300.
- The Separation Joint Board is enlisted to determine whether further increases in end-user rates is appropriate, including the use of a national benchmark. ¶¶306-307.
- With respect to USF support for reduced intercarrier charges, the basic rules are:
 - For price cap companies, based upon the demonstration that it will be “unable to earn a ‘normal profit,’” which is defined as the “total revenue required to cover all the costs of a firm, including its opportunity costs.” ¶323. Price cap carriers are allowed to make a one-way election of rate-of-return regulation. ¶324.
 - For rate of return incumbent LECs, based upon a demonstrate that the company “will not have a reasonable opportunity to earn its authorized rate of return...” ¶322.

Suspension/Exemption

- If a LEC obtains suspension or continues to claim the exemption under 251(f), the FCC encourages the state to apply the standards strictly and, in the event of such exemption/suspension, other carriers will be permitted to charge the rural company the same rates as it charges them (thereby removing much of the economic impetus to obtain such relief). ¶¶284-290.

Phantom Traffic

- With respect to phantom traffic, stripping or altering CPN information would be prohibited. ¶329. Moreover, a service provider passing traffic “that lacks any of the signaling information required by our rules” including transit providers “must pay the determining service provider’s highest termination rate in effect...” ¶337. This includes “intermediate service providers” (i.e., the tandem operator). ¶339.

Preemption

- The draft order asserts that are states are not preempted, since they have a role in following the new rules. ¶228.

APPENDIX B - NARROW UNIVERSAL SERVICE REFORM PROPOSAL

- This proposal addresses itself to the issue of reforming high cost support and USF contributions, without intercarrier compensation reform.
- The high cost universal fund will be capped at 2007 levels. ¶14.
- The Order proposes to use a “reverse auction” to identify recipient of high cost support, as well as the amount of support needed to achieve universal service goals. ¶18. The study area will be based upon the incumbent wireline study area. ¶22.
- The competitive ETC identical cost support rule becomes irrelevant, since competitive ETCs will be awarded support in the same manner as the incumbent LEC, that is, via the reverse auction. ¶20.
- Residential contributions to the fund will be assessed on the basis of telephone numbers, rather than revenues, and initially set at \$0.85 per number, per month. ¶52. Numbers based contribution system applies to residents only and business will be based upon a combination of numbers and “connections.” ¶¶79-80. The current revenue based system for business will be abandoned.
- The contribution will be paid regardless of technology or transmission medium used so wireline, wireless, VoIP, etc., are included. ¶74.
- A new reporting system will be devised. ¶96. The changeover will occur in July 2009, with tracking of the new contribution method as compared to the old for a period of six months before and six months after. ¶¶103-104.

APPENDIX C - ALTERNATIVE PROPOSAL

- This is the alternative proposal (“Plan B”) circulated by the Chairman on November 5, 2008. Like Appendix A, this proposal covers intercarrier compensation, USF and related topics.
- The structure of Appendix C follows that of Appendix A. We have compared the two side by side in an attempt to simply identify the differences.
- With respect to rate of return incumbents, the high cost fund will “continue to operate as [it does] today through 2010.” Support will then be frozen at 2010 levels. ¶16.
- With respect to recovery of ILEC lost revenues associated with decrease in intercarrier compensation, the paragraph requiring review of total company cost and revenues for price cap carriers (Appendix A, ¶14) is maintained, but different treatment for rate of return carriers discussion is established. ¶¶309 and 312.
- As noted in the discussion of Appendix A, incumbents must demonstrate that they are charging the maximum SLCs permitted. See discussion regarding ¶320. In Appendix C,

The requirement that an incumbent must demonstrate that it is charging the maximum SLCs permitted is applied only to price cap incumbent LECs. Compare Appendix A, ¶320 and Appendix C, ¶316.

- The discussion regarding rate of return LECs' demonstration of "an inability to earn" the authorized rate of return (Appendix A, ¶322) has been deleted from Appendix C. However, Appendix C also contains discussion, which appears to be applicable to all LECs, that total company costs and revenues, including regulated and non-regulated, would be considered. ¶318; same as Appendix A, ¶324.
- With respect to ICLS support, the Order would adopt the OPASTCO/WTA position as supplemental funding consists of a two steps. First, rural rate-of-return incumbent LECs will be compensated through the ICLS, "for all of the revenues lost as a result of the mandated reductions in intercarrier compensation rates that are not otherwise recoverable through increases in the SLCs." Secondly, these carriers will be compensated "for unrecoverable revenue losses attributable to losses in access lines and interstate and intrastate minutes of use, using 2008 as a base year" for a period of five years, prior to which the FCC will conduct a proceeding to determine what modifications might be required. ¶321.
- Competitive ETC receipts will be reduced over a five year period and eliminated. ¶17.