

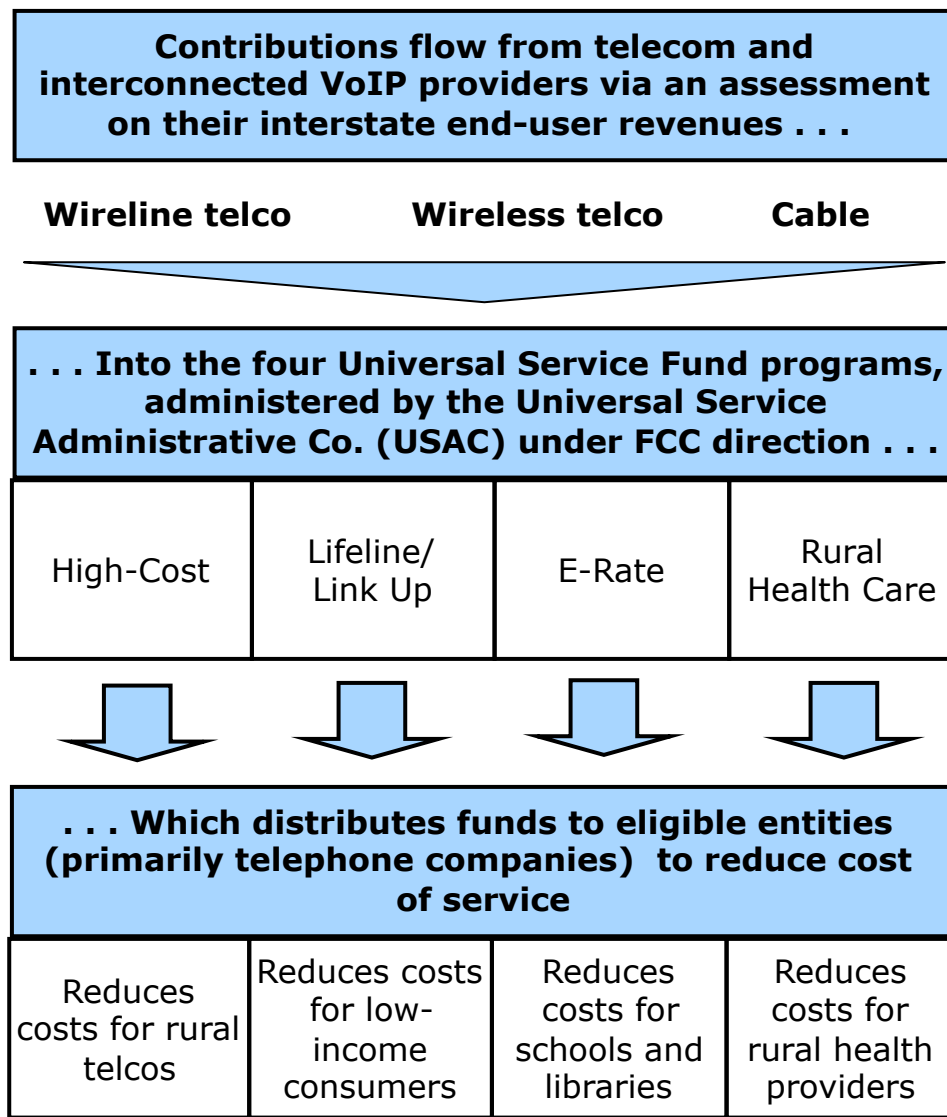


The Connect America Fund &
Intercarrier Compensation
Reform Notice of Proposed
Rulemaking

February 13, 2011

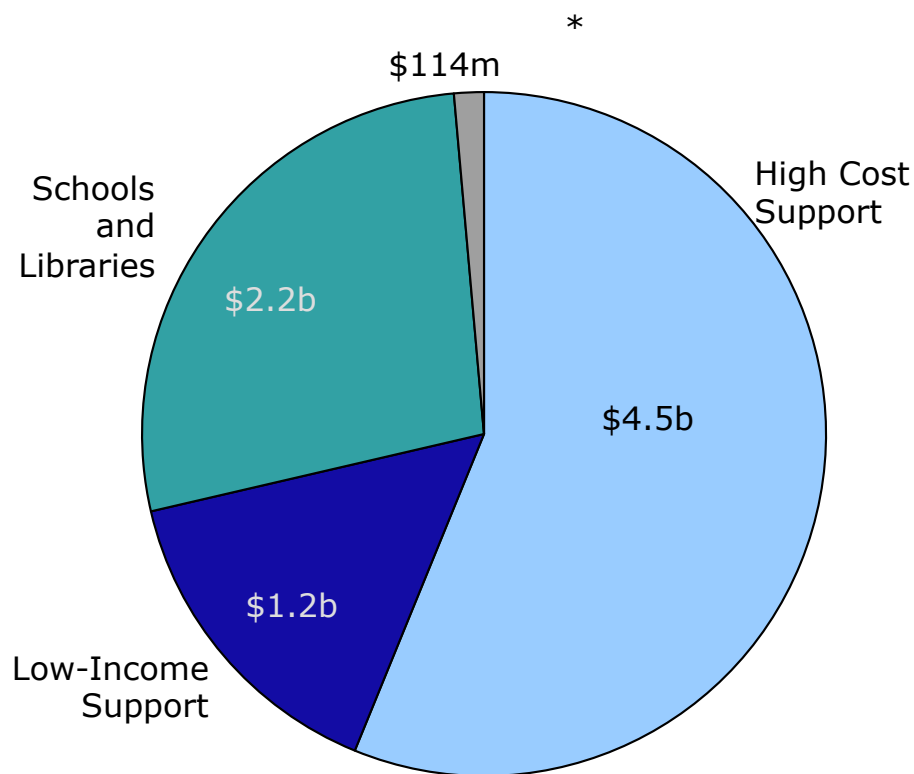
What Is Universal Service?

- Historic commitment to universal service
- Expanded in Telecommunications Act of 1996; Congress established Federal-State Joint Board on Universal Service
- Statutory Goals:
 - Promote **availability of quality services** at just, reasonable & affordable rates **for all consumers**
 - Provide **nationwide** access to advanced telecom and information services
 - Make available such services to all consumers, including **low income** and those in **rural, insular, & high-cost areas** at rates reasonably comparable to those charged in urban areas
 - Increase access to advanced telecom services in **schools, libraries & rural health care facilities**
 - Require equitable and non-discriminatory **contributions from all telecom providers** to the fund supporting universal service programs



What Universal Service Supports

Relative size of federal USF programs,
FY 2010 Total Outlays
(100% = \$8.0 billion)



- **High Cost** focuses on service to all consumers (both residential and business) in high cost, rural and insular areas
- **Low Income (Lifeline/Link Up)** makes basic, local telephone service affordable for low-income consumers (vouchers)
- **Schools and Libraries (E-rate)** enables schools and libraries to connect to the Internet (discounts/matching funds)
- **Rural Health Care** provides reduced rates to rural health care providers (discounts/matching funds)

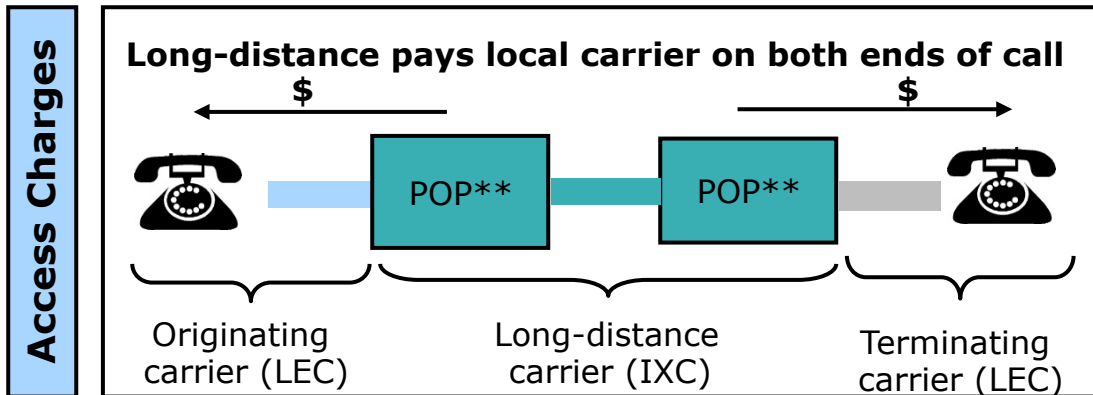
Source: USAC data

High Cost: Support For Rural Areas

(\$ in millions)	High-Cost Model Support	Interstate Access Support (capped)	High-Cost Loop Support (capped)	Local Switching Support	Interstate Common Line Support	Total
Total Support	\$310	\$545	\$1,379	\$359	\$1,675	\$4,268
Incumbent Support	\$157	\$458	\$1,024	\$276	\$1,141	\$3,055
Competitive ETC Support (capped)	\$153	\$88	\$355	\$83	\$533	\$1,213
Who receives	Large "non-rural" incumbents (Bell operating companies and mid-size telcos) and competitive ETCs operating in their territories	Large incumbents (price cap companies) and competitive ETCs operating in their territories	Small incumbents (mostly rate of return but some mid-size companies), and competitive ETCs operating in their territories	Small incumbents (mostly rate of return, but some price cap companies) and competitive ETCs operating in their territories	Small "rural" incumbents (rate of return companies and recent mid-size price cap converts) and competitive ETCs operating in their territories	
What it supports	Subsidizes intrastate loop, switching, and interoffice transport costs based on forward looking cost model	Interstate access revenue replacement targeted to UNE zones where carrier cannot recoup revenues through SLCs	Subsidizes intrastate loop costs based on embedded (actual) costs of the carrier	Helps cover fixed intrastate switching costs for operating companies with less than 50,000 lines	Interstate revenue recovery when SLC cap does not permit full recovery of common line revenues	

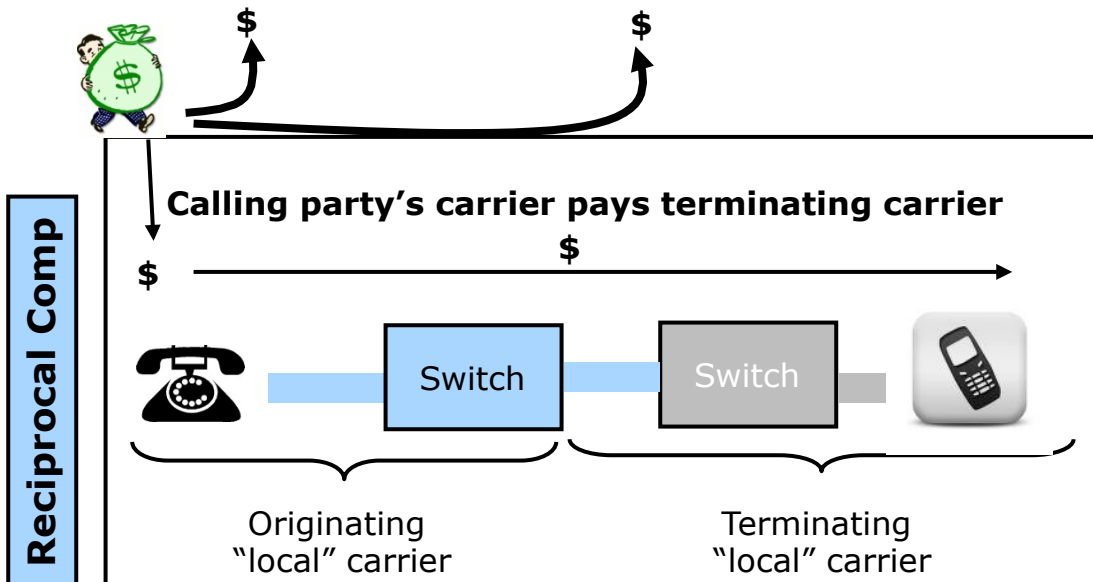
Role Of Intercarrier Compensation (ICC)

ICC = Payments between carriers to deliver telephone calls



Access Charges (c. 1984)

- Dual jurisdiction: States regulate intrastate access charges; FCC regulates interstate access charge.
- After break up of AT&T, separate long distance and local carriers.
- ICC rates above cost and served as an implicit subsidy to keep local rates low.



Reciprocal Compensation Rates (c. 1996)

- Reciprocal payments for "local" calls (originating carrier pays terminating carrier).
- FCC set rate methodology ; implementation by states led to widely varying rates.
- Some carriers use "bill and keep" when traffic is balanced.

** Interexchange carrier point of presence

Problems With USF And ICC

- Outdated design based on 20th century technology, markets
 - Up to 24 million Americans left out of broadband transformation
 - Rural/Rural divide
- Inefficient and sometimes wasteful
 - Today, the fund pays more than \$2000 per month for some households to have phone service
 - Support for multiple competitors in same geographic area
- Perverse incentives and outcomes
 - E.g. a capped fund that stimulates a “race to the top” (HCLS)
 - Gaming of ICC system: “traffic pumping,” “phantom traffic”
 - Can cost more to call across the state than across the world

FCC Joint Statement On Broadband

“The nearly \$9 billion Universal Service Fund (USF) and the intercarrier compensation (ICC) system should be comprehensively reformed to increase accountability and efficiency, encourage targeted investment in broadband infrastructure, and emphasize the importance of broadband to the future of these programs”

Connect America Fund: Pillars Of Reform

1. Reform USF and ICC to Focus on Modern Networks

- Explicitly support universal availability of bb and voice service
- Target funds to areas otherwise uneconomic to serve
- Accelerate transition to IP networks

2. Fiscal Responsibility

- Eliminate waste, inefficiency, and redundancy
- Create incentives for efficient operations and prudent investment
- Constrain size of fund

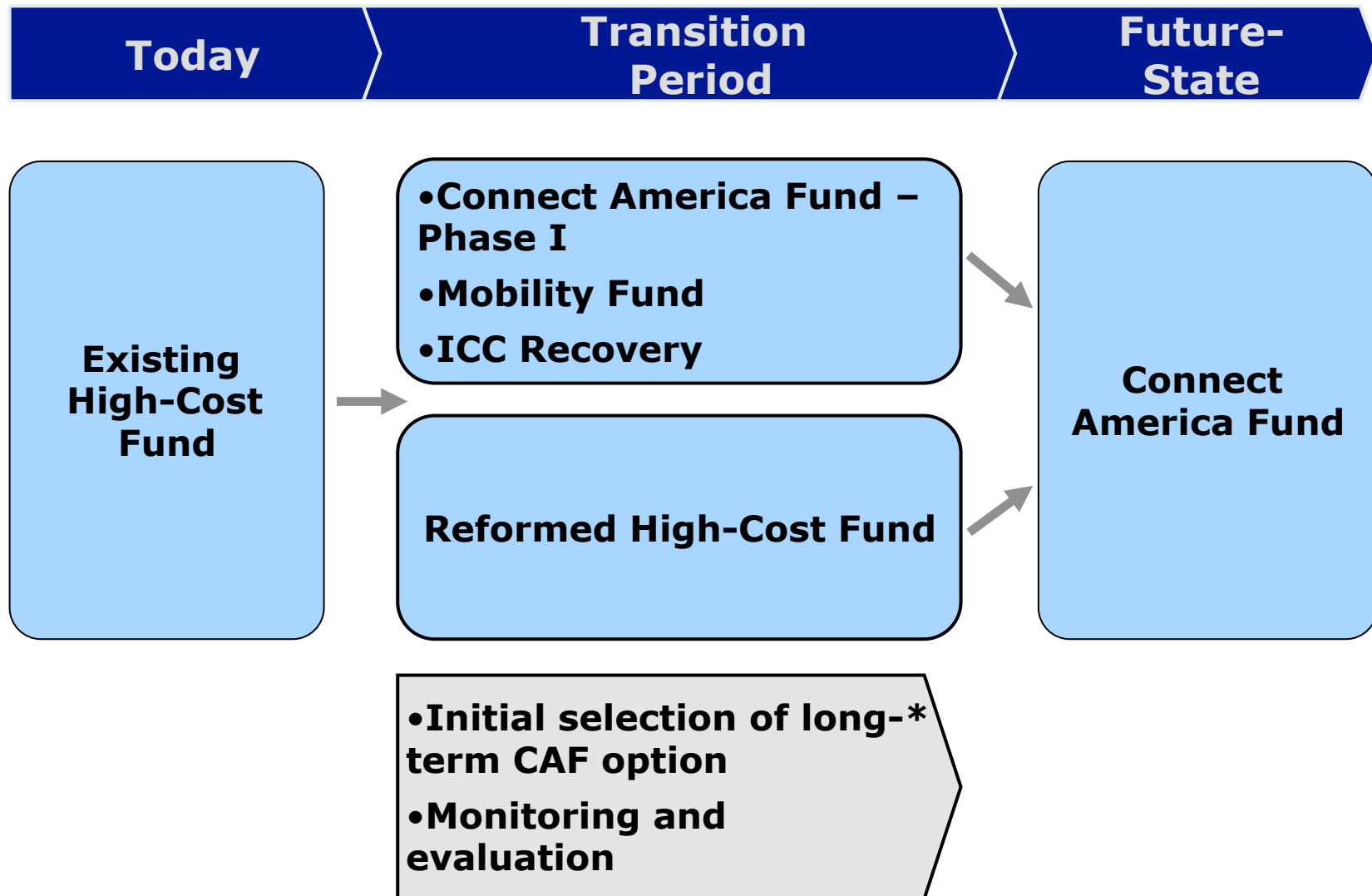
3. Demand Accountability

- Improved performance metrics and obligations

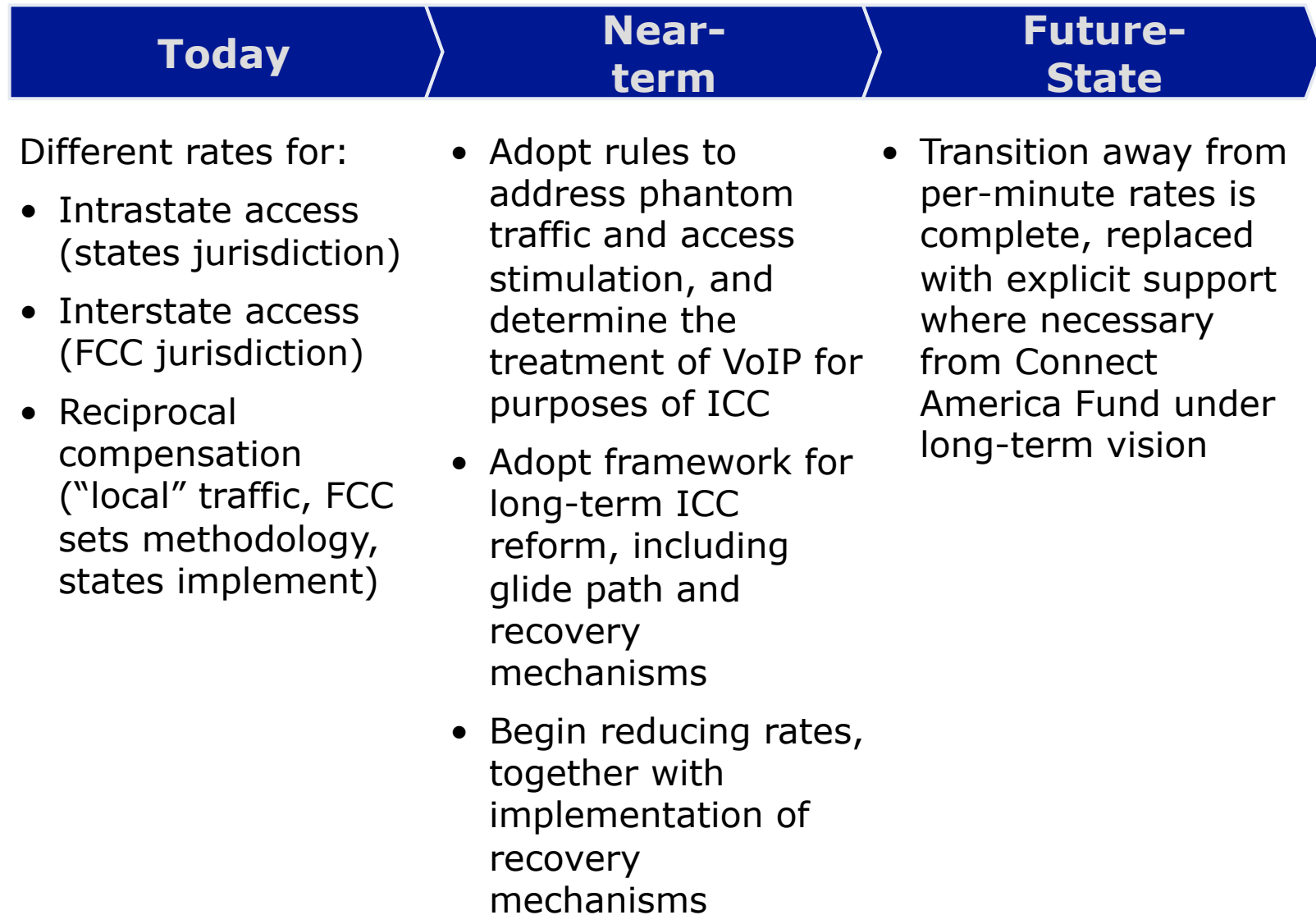
6. Market-driven and Incentive-based Policies

- Facilitate deployment of technologies/services providing maximum value to consumers at lowest possible cost
- Predictable transition mechanisms – no flash cuts

Transition to Proposed Connect America Fund



Proposed Intercarrier Compensation Transition



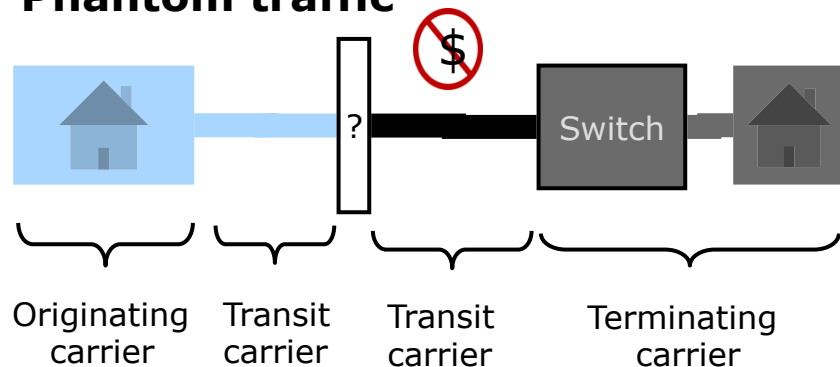
USF And ICC Reform Process

- National Broadband Plan recommendations (March, 2010)
- Notice of Inquiry/Notice of Proposed Rulemaking (April, 2010)
- Notice of Proposed Rulemaking (February 8, 2011)
- Public comment period (spring)
- Final rules

Questions?

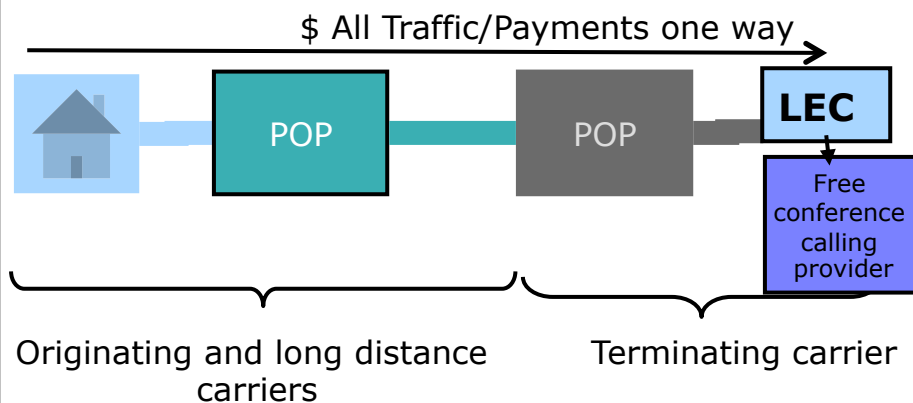
ICC arbitrage: Phantom Traffic, Access Stimulation

Phantom traffic



- Traffic is masked such that terminating carriers lack information necessary to bill the originating carrier.
- Different terminating rates create incentive to make traffic appear as if the lowest rate applies.

Access stimulation



- LEC enters into arrangement to share access revenues with a "free" conference company, sending an artificially high amount of traffic to the terminating LEC.
- Access stimulation businesses are based entirely on revenues from high ICC rates.