



The Time is Now: Making Informed Judgments on Next Steps with Respect to Universal Service and Intercarrier Compensation Reform

As rumors swirl regarding a potential “industry consensus” framework for universal service fund (USF) and intercarrier compensation (ICC) reform, we thought it would be important for members to hear “both sides of the story” – both the benefits and downsides of potentially joining a larger group framework. We hope this will help you make a balanced and informed analysis as we all weigh next steps.

- *Putting Options into Perspective – Recent History*

The choices we are faced with today must be considered in historical context. When the National Broadband Plan (NBP) was released, estimates were that the NBP would slash the typical rural telco’s USF/ICC revenues, result in half of the rural telco community being cash-flow negative by 2015, and drive nearly 90% of rural telcos cash-flow negative by 2020. Through extensive advocacy efforts, we were able to see some improvement in the FCC’s subsequent Notice of Proposed Rulemaking (NPRM), which proposed at least to retain rate-of-return regulation and make more targeted changes to USF support in the near term. But even the NPRM left several important USF reforms undefined, and it also left a gaping hole with respect to what might happen on ICC revenues. Indeed, analysis of the NPRM proposals indicated that, just from two of the proposals alone, the typical telco would lose over 5% of USF revenues – and that was before the very real possibility of all traffic dropping quickly to a very low ICC rate with inadequate restructuring opportunity, inadequate action on phantom traffic, and a lack of any action on VoIP traffic.

Since release of the NPRM, NTCA, OPASTCO, and WTA have continued to press for a better reform alternative. In cooperation with members, consultants, and state associations, we filed a joint reform plan that represents a more realistic and reasonable path for USF and ICC reform. To be candid, the reception of that plan by the FCC has been in part positive and in part negative. We have been working to educate the FCC on the strengths of that plan and in particular how it presents a reasonable balance between stimulating new investment and preserving the opportunity to recover existing investment. But this effort remains a work in progress, and we have been told many times over that the FCC is drafting an order that in many respects resembles the NPRM. Indeed, we have heard that any upcoming FCC order could include many of the worst proposals from the NBP and the NPRM, including a “hard cap” on total high-cost funding support in the future, negative (or no) action on VoIP traffic, and a quick decline to a very low ICC rate.

Because of this feedback, we have pressed members to come in and share their stories and data with the FCC – to show how the NPRM proposals would affect their operations. Moreover, we recently started our “Save Rural Broadband” campaign as an effort to fend off the worst potential outcomes of the NPRM. We are pleased by the initial success and visibility of this campaign, and we think that it can play an essential longer-term role in any continuing debates about how to reform these programs.

- *Industry Discussions*

At the same time as we press aggressively for “reform done right” through our advocacy efforts, we have been actively engaged in discussions with other stakeholders throughout the industry on a potential

alternative reform proposal that would reflect the consensus of many different industry segments. We understand that many of you may see it as hard to work with carriers and other companies who often look to undermine the support networks that are essential to operation in rural areas. We understand too that it is difficult to sit at the table with larger carriers whose primary interest would be in obtaining more of the support that today goes to your operations. But walking away from such discussions would have been a substantial risk, as we would all be left “on the outside looking in” while others in the industry come up with proposals that could shape the direction of USF and ICC reform. As RUS Administrator Adelstein said just today at OPASTCO’s meeting, “Decisions made without you are often decisions made against you.”

We have made substantial progress in recent weeks toward a potential industry consensus framework that could preserve many of the key components of the USF and ICC reforms that work so well. It is important to understand that, at this point, no party has agreed to any such proposal but highlights of the proposal we have suggested include:

- Maintain rate-of-return cost recovery, using the reform plan that we already filed as a baseline for USF/Connect America Fund support
- Enable cost recovery that starts in the aggregate from current funding levels received by rate-of-return ILECs
- Enable reasonable, measured growth in funding over time that is not subject to a cap
- Restructure terminating local switching ICC rates over an 8-year transition period
- Enable continued charging of ICC for terminating transport and tandem switching functions at current interstate levels
- Provide sufficient funding for access restructuring
- Include VoIP within the ICC framework
- Adopt strict phantom traffic rules that would require identification of the true calling and called parties

- *So What Are the Right Next Steps?*

To be sure, there are trade-offs in any steps forward. We discuss below the “give-and-take” of many of the most important issues to consider.

- *Rate-of-Return:* To help meet a “budget target” during the first 6 years following reform, small rural carriers would have to accept a 10% rate-of-return (as opposed to the current 11.25%) on interstate revenue requirements. But this is substantially better than the 8.5% or 9% rates-of-return that some have suggested the FCC use in an order.
- *Terminating ICC Reform:* This would also require a much “deeper” reduction in local switching rates than was contemplated in our initial reform proposals. Some may find the idea of charging a low rate such \$.0007 per minute for local switching to be problematic or arbitrary. But if the restructure mechanism is compensatory and funded as has been discussed in the consensus framework, this may be less of a concern for some – particularly when transport and tandem switching would not be included in the per-minute rate reduction.

- *Originating ICC Issues:* It is also unfortunate that restructuring of originating access could not be included in this proposal, since we are concerned about the implications of leaving such access without reform while terminating access is restructured. We have included steps in the proposal to ensure that originating access can continue to be charged, and also have pressed for protections to ensure that rural carriers will not be required to haul traffic to locations beyond their study areas and existing meet-points.

- *Preemption and State Issues:* The states are very concerned that the ICC transition in any industry plan might be achieved through preemption of state authority. We share this concern, and have made clear that even if the “economics” of any industry plan could work, we would not under any circumstances sign onto a filing or otherwise advocate that these reforms could be implemented without state involvement. But joining an industry consensus framework, regardless of whether we speak as to preemption, could alienate some state regulators.

You should also be aware of the political and economic climate in which these discussions take place. When defense spending, Social Security, and farm subsidies are all at substantial risk of massive cuts and even USF has been put on the table for a potential \$1 billion diversion to support deficit reduction, one Congressional staffer recently noted that any plan that enables us to: (1) retain current funding levels in the aggregate and (2) enables those funding levels to grow pursuant to a budget target (and without a firm cap) should be considered a substantial step forward – particularly when, in addition to the current political climate, one considers where this all started with the NBP and the NPRM.

Finally, we recognize that, even if an acceptable industry consensus can be reached in short order along these lines, there is the risk that the FCC could modify that framework after it is filed and thereby undermine the careful balance of the compromises struck in that framework. We have already let the FCC and Congress know that this is a substantial concern of ours in discussing any consensus plan, and that if something were to change that makes a plan to which we agreed unacceptable to small rural carriers, NTCA, OPASTCO, and WTA would be first in line to fight those changes and the framework as a whole.

- *Conclusion*

In closing, we’d note that time is of the essence in determining next steps. Because of the time frame by which the FCC would need to consider any industry consensus proposal, it needs to be filed in the very near future. Our expectation is that any consensus would be identified to the FCC and to others in the industry through a joint letter of those who support the consensus. We would not sign onto any “USTA plan,” nor would any of the USTA companies sign onto the plan we filed previously. But any joint filing would indicate to the FCC that those two plans taken together, along with very carefully defined modifications to them and specific ICC reforms and restructuring, could present a reasonable path forward for USF and ICC reform.

Staff for NTCA, OPASTCO, and WTA will not be making the decision on how to proceed next. This will be a decision made by the relevant boards and committees, in close consultation with their respective members. Please reach out to staff and/or to your board and committee representatives if you have any questions or comments. We hope you will consider the full picture – in terms of both the political climate and a comparison of the substantive merits of where we are now versus where we were (and remain) with the NBP and the NPRM – in making an informed and balanced judgment about how to proceed next. Thank you for your continuing guidance and participation in this process, and we look forward to working with you further to promote the success of the small rural telecommunications industry.

Sincerely,

Shirley Bloomfield
Chief Executive Officer
National Telecommunications Cooperative Association

John Rose
President
Organization for the Advancement and Promotion of
Small Telecommunications Companies

Kelly Worthington
Executive Vice President
Western Telecommunications Alliance