

November 27, 2007

MEMORANDUM TO CLIENTS

Re: USF Board Recommends Fundamental USF Reform

OVERVIEW

The Federal-State Joint Board on Universal Service (the “Joint Board”) has released its recommendation in *In the Matter of High-Cost Universal Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, FCC 074-4, Recommended Decision (rel. Nov. 20, 2007) (“*Recommended Decision*”), in which it recommends that the Federal Communications Commission (the “Commission”) address the long-term reform issues facing the high-cost universal service support system and make fundamental revisions in the structure of existing universal service mechanisms. Overall, the recommendations negatively impact cable MSOs, competitive carriers, and wireless carriers, while generally protecting the incumbents.

More specifically, the Joint Board recommends:

- Establishing three separate high-cost universal service “funds” with distinct budgets and purposes.
- Methods of transitioning from existing support mechanisms to the new funding structure, at approximately the current fund size.
- Caps on the total amount of money distributed by the high-cost support mechanism.
- Methods of administering the new broadband and mobility funding in ways that strengthen the universal service partnership between the Commission and the states and that avoid using universal service to subsidize competition or build duplicate networks.
- Making a formal change to the definition of services supported by Section 254 funding. Joint Board now recommends that the nation’s communications goals include achieving universal availability of mobility services (defined as wireless voice), universal availability of broadband Internet services, and voice services at affordable and comparable rates for all rural and non-rural areas.
- That the Commission eliminate the identical support rule.
- That the Commission consider reverse auctions, among others, as a distribution mechanism for high-cost support distribution.

FUNDAMENTAL HIGH-COST DISTRIBUTION REFORM

Scope of Reform

The Joint Board recommends that high-cost universal service support in the future be delivered through three distinct “funds,” each with separate distribution mechanisms and separate funding

allocations. These three funds would operate within an overall funding cap that is consistent with the current amount of high-cost funding. Support under existing programs would be transitioned over a period of years to the new three-part funding structure.

The Broadband Fund: The Broadband Fund would be tasked primarily with facilitating construction of facilities for new broadband services to unserved areas. The Joint Board concludes that states are better suited than the Commission to effectively administer the new Broadband Fund grant program. Accordingly, the Joint Board recommends that the available pool of Broadband Fund monies first be allocated to the states, and thereafter awarded by designated state agencies to finance particular construction projects or the operations of broadband providers. States would award Broadband Fund dollars primarily to assist in the construction of new facilities in unserved areas. Funding would normally be awarded on a project-by-project basis. States would be permitted to award Broadband Fund grants to only one provider in any geographic area. States should be allowed to use any suitable procedure for awarding grants that will ensure efficient and effective use of the funds, *e.g.*, the use of reverse auctions or requests for proposal to serve specified geographic areas.

The Mobility Fund: The Mobility Fund would be tasked primarily with disseminating wireless voice services to unserved areas. Most Mobility Fund support would be expended as subsidies for construction of new facilities in unserved areas. In this context, “unserved area” would mean areas with a significant population density but without wireless voice service. The Joint Board believes that states should be responsible partners with the Commission in administering Mobility Fund awards.

The Provider of Last Resort Fund: The Joint Board does not offer the outline of any new and unified system for Providers of Last Resort (“POLR”) because the members failed to reach agreement on specific changes to the legacy support mechanisms that today provide support for incumbent local exchange carriers (“LECs”). Therefore, the Joint Board’s recommendation is more general. For now, the Joint Board recommends that the POLR Fund be comprised of the sum of all existing Incumbent LEC support mechanisms. Except for possible funding reductions, these programs would be left intact for the present. The Joint Board recommends that the Commission establish a process and a timetable so that it will review and modernize the existing high-cost mechanisms for rural and non-rural carriers, with the objective of developing a coherent system that can be applied to all incumbent carriers.

Funding Levels, Caps, and Transition

Funding Cap: The Joint Board recommends an overall cap on high-cost funding. The Joint Board believes that the Commission should impose a cap on the total amount of high-cost funding at \$4.5 billion, which is approximately equal to the 2007 level of high-cost funding. Over the longer term, the Joint Board anticipates that total funding can and should be decreased as broadband and wireless infrastructure deployment becomes widespread throughout the country.

Transition: The Joint Board also recommends a transition during which existing funding mechanisms would be reduced, and all, or at least a significant share, of the savings transferred to the new Funds and mechanisms described above. During the transition period, gradual elimination of support from the identical support rule will provide a source of funding for the Mobility and Broadband Funds. The Joint Board has not reached consensus on the transition, and recommends that the FCC seek further comment on the issue.

Specific Funding: The Joint Board anticipates about \$1.0 billion of funding per year eventually being distributed through the new Mobility Fund. Since the overall fund size will be capped at \$4.5 billion, any reductions in support for wireless carriers in year 1 will be available for disbursements from the Mobility Fund in year 2, and so forth. The Joint Board estimates a reasonable federal funding level for the Broadband Fund to be \$300 million per year. Not all of the financing need be accomplished with

newly raised dollars or solely from federal sources, however. Revenues for the Broadband Fund could come from other sources, *e.g.*, funding could be increased by imposing state matching requirements. The Joint Board also recommends that, during the transition period, each of the five major current support mechanisms be separately capped at their 2007 levels. Once the transition period is complete, the overall cap of \$4.5 billion would apply to the three remaining restructured funds.

CETC Reform and the Elimination of Identical Support Rule

The Joint Board recognizes that the identical support rule has resulted in the subsidization of multiple voice networks in numerous areas and greatly increased the size of the high-cost fund. High-cost support has been rapidly increasing in recent years due to increased support provided to competitive ETCs. These carriers receive high-cost support based on the per-line support that the incumbent LECs receive rather than the competitive ETCs' own costs. Accordingly, the Joint Board recommends that the Commission eliminate the identical support rule.

LEC Reform and the Provider of Last Resort Fund

The Joint Board believes it is in the public interest to maintain, for the present, the existing RLEC support mechanisms, distributed through the proposed POLR Fund. The Joint Board recommends that the POLR Fund provide support for only one carrier in any geographic area. Initially this will be an incumbent LEC providing voice service over traditional landline facilities in each of the existing incumbent LEC study areas. Recognizing that this single carrier recommendation eventually would exclude existing CETCs, some of whom are wireline CETCs, the Joint Board recommends that the Commission examine the possibility of continuing support to these entities (both wireline and wireless CETCs) during the transition period.

Supported Services and Carrier Eligibility

The Joint Board recommends the Commission revise the current definition of supported services to include broadband Internet service. The Joint Board also recommends that mobility be added to the list of supported services.

ETC Designations and Support Eligibility

Currently all ETCs must provide all of the services supported by universal service. Although the Joint Board recommends expanding the list of supported services, the Joint Board does not intend that a carrier must offer all supported services (voice, mobility, and broadband) in order to receive any high-cost support. Rather, the three-fund approach envisions separate funds for each type of service, with no overlaps in support across the funds.

Issues for Further Comment

Recognizing that several of its recommendations require more development and public comment, the Joint Board recommends that the Commission seek further comment on, among other things: the most effective mechanism to determine the appropriate allocation of funds among the states; the most effective method to determine unserved areas for both broadband and wireless coverage; the appropriate level of broadband service for which universal service support would be eligible; whether Lifeline/Link-Up customers may be negatively affected by any aspects of the transition to the new three fund approach; how best to create as clear a transition path as possible for all providers; how to implement the transition of support from current areas that no longer need support, to areas unserved by either broadband or mobility providers, including timelines; whether a five-year transition is desirable; whether a review should occur after three or five years, and what issues should be addressed during this review; and any aspects of the three funds approach which would require reconciliation with federal law.

ANALYSIS

The Joint Board's recommendations appear to be an attempt to balance the concerns of wireless and wireline carriers. However, it would appear that cable MSOs, wireless providers, and competitive carriers have the most at risk here, particularly in light of the Joint Board's recommendation to do away with the identical support rule and its POLR rules.

The recommendations raise many questions. For example, it remains to be seen whether the current recipients of funding would keep that funding, much less grow it, under the Joint Board's recommendations. It is clear that funding on the mobility side would shift among providers. Since only one CETC would be funded in a given geographic area, some current players would lose funding in their current service areas but might or might not gain funding in new-build areas. Consequently, under the Joint Board's recommendations, non-ILEC recipients would probably not receive additional funds or maintain current funding levels over the long term unless they qualified for the new broadband funding.

On the wireline side, it appears much more likely that the current provider would remain the long-term POLR. However, that is not a given since any carrier that is willing to assume POLR obligations could participate in a reverse auction. It must be noted that it is far from certain that the Commission will ultimately adopt the reverse auction proposal.

On the positive side, however, the recommendations recognize that broadband services must be made available to all Americans across the nation, and would likely jumpstart deployment of broadband to unserved areas. We anticipate that the creation of the new Broadband Fund will provide new universal support opportunities for MSOs, wireless providers, competitive carriers, and others, that are planning to deploy broadband service in certain areas of the country.

The Commission has a year to act on the Joint Board's recommendations, and has no obligation to implement it, in whole or in part.

We would be pleased to respond to any questions regarding this matter.

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