Small Company Coalition

Universal Service Fund Broadband Proposal

Wireline Competition Bureau Meeting

July 29th, 2014

Discussion Points

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- Conceptual Framework
- Mechanics
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- Walk Through Example
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FCC Objectives

FCC Orders indicate the following concerns:

- Universal Support Funds should have a total cap
- Rural consumers should pay their fair share
- Support to individual companies/areas should be equitable
- Uneconomic funding and improper incentives should be avoided
- USF reforms should reflect the fundamental shifts in technology, consumer behavior, and competition

Conceptual Framework

The SCC Universal Broadband Service proposal consists of the following three components:

1. *The Broadband High Cost Loop Fund (BHCLF).* This includes a comprehensive solution solely for rate of return (RoR) regulated carriers. The Fund provides support for the deployment of broadband services as well as current voice telephony services (phased down over time), as follows:
   – Support is based on actual costs and calculated through a modified high cost loop model designed to incorporate broadband costs
   – Effectively replaces a) the current High Cost Loop Support (HCLS) fund; and b) Interstate Common Line Support (ICLS)
   – Combines HCLS and ICLS
   – Provides cost recovery of legacy investment; support for ongoing operating costs; and funding for new broadband investment
2. *Rate of Return Carrier-Specific Funding.* The model is premised off of an “RACPL” (Rate of Return, or Rural, Average Cost Per Loop)

Conceptual Framework

3. *<u>The Broadband High Cost Loop Recovery Adjustment.</u>* The SCC recognizes that interstate broadband equipment included in 47 CFR Part 36 categories is currently recovered through interstate special access charges. Consequently, an adjustment to the calculation of special access charges is needed to avoid duplicate and excessive cost recovery. The proposed BHCLF algorithm would identify and quantify support attributed to the broadband equipment Part 36 Separations categories. This amount is reduced from the 47 CFR Part 69 interstate special access rate element and added to the BHCLF in a manner similar to the way line port costs are shifted in the MAG adjustment. Following are stakeholders that would benefit under the new model:
   - Consumers in rural America (via lower and more competitive end user prices);
   - NECA and its member companies (via lower tariffed rates); and
   - Carriers on their own tariff

Conceptual Framework

- Support would be available to 1) build-out to customers without adequate availability to broadband service from a competitor; and/or 2) maintain a broadband-centric network, thereby insuring efficient use of fund resources
  - The term "adequate availability" would be determined by the Commission on a periodic basis (i.e., annually, biannually, etc.) in light of technological advances and the needs for broadband service by rural Americans
- The SCC also contends that the definition of "access lines", which currently includes TDM-based/Voice lines, must be modified to incorporate "connections", including stand alone broadband connections

Capping Mechanism

- The SCC understands that a capped fund should assist in promoting fiscal responsibility
- The SCC recommends the Commission consider specific criteria that would effectively define “high cost carriers”, in accordance with the intent of Section 254

Capping Mechanism

The SCC suggests that criteria used to define “high cost” can generally be grouped into four areas:

1. Number of combined access line & broadband “connections” per square mile served
   - ✓ For example, a smaller carrier with fewer connections in their service area, but with a large area to serve, will arguably have higher study area-specific costs than a larger carrier with more connections serving a relatively smaller service area
2. For OpEx: in RoR study areas, high cost allowance for 2014 and future years should be based upon 2013 grown at the rate of inflation
3. For Capx: percent of IP/broadband versus non-IP/broadband plant in a given network. If a carrier is deemed to need significant upgrades to transition to IP/broadband, that carrier would be entitled to greater spending limits. Current loan needs to be funded through the end of the loan term
4. Extreme weather conditions and/or other unique circumstances

The SCC believes these characteristics and attributes more appropriately define what necessitates otherwise similar RoR carriers from being high cost versus “average” or “lower” cost carriers. Under this approach, for example, instead of financially benchmarking a RoR carrier in Alaska to a RoR carrier in Virginia, the criteria above would be used to determine if a carrier was “high cost”

Walk Through Example

- Under the SCC's updated ideology to present a long term Connect America Fund for RoR carriers, the following example (next slides) walks through how the fund disbursements and allocations would work
- The SCC recommends one combined fund for HCLS and ICLS, called the "Broadband High Cost Loop Fund"
- The SCC also recommends using a "top down" approach under its modified ideology

Walk Through Example

- Assumptions Used:
  - $2B total annual fund. Includes HCLS; ICLS; SNA; ICC CAF
  - SNA = $15M annually (average per 7th Order on Recon over four years)
  - ICC CAF = $300M annually (estimation)
  - Combined HCLS/ICLS = residual of $1.685B annually
  - # of "Voice Access Lines" in RoR areas = 4.1M (based on NECA published data for year end 2012)
  - # of Stand Alone Broadband Connections in RoR areas = 5%, or 205,000. Total take rate for broadband service is 72%, or ~ 2.9M (both broadband statistics based on NTCA 2013 broadband availability report)

Walk Through Example

- Calculation: $1.685B / 4,305,000 *connections* = ~ $391 RACPL
- Using a $391 RACPL, and considering RoR carriers that would qualify as a high cost carrier versus non-high cost carrier under the SCC's recommended criteria (and also under the broadband high cost loop fund algorithm, including the 115% and 150% thresholds), carriers that are lower cost will not need as much funding and carriers that qualify as high cost will be permitted additional funding
  - ➢ Using a $391 RACPL creates fund needs of approximately $2.2B. Difference between $2.2B and $1.685B assessed as end user broadband surcharge (discussed later)
  - ➢ Part 36 Separations categorization, by company, needs to be obtained from NECA to determine specific results by company

Benefits of Updated SCC Proposal

- Many benefits to the SCC's modified proposal can be gained:
  - Establishes a Connect America Fund specifically for RoR carriers
  - End users will benefit via lower broadband prices, ensuring that all consumers have access to reasonably comparable services at reasonably comparable rates
  - End users would pay a fair share via a broadband end user surcharge
  - USF/CAF is modernized to include funding for broadband
  - Carriers are incentivized to invest in broadband technologies and networks
  - The model works within the $2B capped fund and can be modified to accommodate a larger or smaller fund size
  - Funding is predictable and sufficient
  - The existing HCLS algorithm is retained, leveraging this mechanism for a short/turn key transition period. This creates efficiency as the existing algorithm has been utilized for decades and is understandable
  - HCLS and ICLS are combined into one fund, creating less administrative work for all parties to maintain multiple funds

Benefits of Updated SCC Proposal

- After implementation, the RACPL could be frozen in the same manner as published in the 7th Order on Recon (para 262)
- RoR carriers will be compensated based on legitimate high cost criteria
- Meets the Commission's overall objective to support both voice and broadband-capable networks in areas without adequate availability from a competitor
- Accommodates voice, voice/data, and stand-alone broadband services
- Basing on connections, and not access lines, alleviates concerns of a carrier losing a voice line and the associated increase in per line costs
- Under this proposal, ICC rate and phased down reductions could continue
- Discourages inefficiencies via high cost criteria

SCC Proposal Works With ITTA Proposal

- Voluntary option under ITTA allows RoR carriers to choose which model works best for them. While the SCC argues that forward looking model-based support will not work as a general rule, RoR carriers should be allowed to weigh their options
- In the 7th Order on Recon, para 278, the Commission concedes that a participating carrier could opt in for model-based support "for a subset of its study areas". Thus a carrier could bifurcate its study area between the SCC proposal and ITTA plan
- As noted earlier, the SCC proposal leverages an existing mechanism, thereby allowing a speedy transition. This could work hand in hand with ITTA's proposal, again under the auspices that RoR carriers be given the option to choose which plan best fits their company-specific circumstances

Concerns of Forward Looking Cost Model

- Track record:
  - CACM, for example, provides no track record
  - QRA did not fulfill intended purpose
  - Embedded costs have a significant track record
- Previous recommendations (Joint Board; RTF; NARUC) advise against forward looking models in RoR areas
- Section 254 of the Act does not contemplate forward-looking costs, but rather "high cost"
- Works in price cap areas because they are larger in size and geographic footprint makes is easier to "smooth out" lack of precision
- Location and allocation of households within a forward looking model for RoR carriers is critical for accurately modeled costs

Tribal Considerations

- The Commission recognized, and necessarily created an allowance for, a "Tribal Coefficient" within QRA, which provided for additional funding within the USF. The SCC believes a similar additional consideration needs to be resurrected for Tribal RoR ILEC carriers
  - $250/line/month rule
- To recognize economic circumstances that warrant special consideration, and correspondingly create allowances to assist in providing affordable broadband connectivity on Tribal lands, the SCC believes a carve out should be implemented to reimburse the broadband end user surcharge (discussed later) to Tribal carriers similar to how Lifeline works today
- The SCC believes that residents on Tribal lands be considered a qualifying low-income consumer (under 47 CFR Section 54.409(a)(1)) if the consumer's household income is equal to or less than 150% of the Federal Poverty Guidelines, instead of 135% as the rule exists today

Other Points

A. *<u>$250/Line/Month Cap: </u>*This cap, in its current form, should be modified as the allowable level of funding decreases with access line losses. However if "connections" replace access lines in their application within funding mechanisms, smaller companies with legitimate high costs would be provided an additional USF funding allowance

- Fully phased in as of 7/1/2014

Other Points

B. *Transitional Period.* The SCC understands and realizes the need to phase down funding for legacy voice networks and phase in funding for broadband-capable networks. The SCC hereby believes its proposal addresses many industry concerns, including Commission concerns, and agrees to a reasonable transition period of 10 years for this conversion from voice to broadband to take place (also in agreement with the 7th Order on Recon, para 280)

C. Broadband End User Surcharge. In accordance with earlier statements in this presentation, the SCC believes customers should be liable and responsible for their fair share in addressing the "comparable services at reasonably comparable rates" standard. With this, the SCC proposes the implementation of a broadband end user surcharge, rate banded based on bandwidth take rates, to help offset the additional funding necessary with broadband costs now being recovered through the BHCLF

- Initial projections show a generalized broadband end user surcharge of approximately $14.80/broadband customer/month ($515,000,000 / 2.9M connections/12)

Questions?

James Kail, Executive Committee
jjkail@lhtot.com
Godfrey Enjady, Executive Committee
genjady@matinetworks.net
Glenn Lovelace, Executive Committee
GLovelace@pvt.com
Douglas K. Kitch, CPA
doug@alexicon.net
719-531-6342