

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of	)	WC Docket No. 10-90
Connect America Fund	)	
ETC Annual Reports and Certifications	)	WC Docket No. 14-58
	)	
Establishing Just and Reasonable Rates for Local	)	
Exchange Carriers	)	WC Docket No. 07-135
	)	
Developing a Unified Intercarrier Compensation	)	
Regime	)	CC Docket No. 01-92

**COMMENTS OF FWA, INC**

**Introduction**

FWA, Inc. (FWA) is a financial and regulatory consulting firm that represents several rate-of-return carriers that operate primarily in Arkansas, Kansas, Oklahoma and Texas. FWA's clients rely on Federal High Cost support to provide affordable voice and broadband services throughout their rural study areas. FWA's clients provide service in 12 study areas. Three of the study areas receive federal high cost support based on the A-CAM model. The remaining nine study areas receive high-cost support based on the legacy rate-of-return mechanisms. These consist of High Cost Loop Support (HCLS), Safety Valve Support (SVS), and Broadband Loop Support (BLS). Table 1, based on USAC disbursement data, provides a summary of the 2017 federal high cost support, net of BCM, for FWA's clients.

**TABLE 1 – SUMMARY OF FEDERAL HIGH COST SUPPORT FOR FWA CLIENTS**

<b>Study Area Code</b>	<b>HCLS &amp; SVS</b>	<b>BLS</b>	<b>A-CAM</b>	<b>Total</b>	<b>Lines</b>	<b>Per Line/Month</b>
310542	\$278,905	\$41,172	N/A	\$320,077	153	\$174
401704	\$747,739	\$546,531	N/A	\$1,294,270	967	\$112
411808	N/A	N/A	1,002,330	1,002,330	2,142	\$41
411781	\$324,593	\$356,712	N/A	\$681,305	698	\$81
411817	\$880,287	\$2,741,034	N/A	\$3,621,321	9,295	\$32
411840	\$1,715,919	\$2,299,710	N/A	\$4,015,629	5,161	\$65
412230	N/A	N/A	1,587,418	1,587,418	803	\$162
431704	\$572,813	\$470,073	N/A	\$1,042,886	925	\$94
432017	\$1,943,931	\$2,438,562	N/A	\$4,382,493	4,874	\$75
432022	N/A	N/A	1,418,685	1,418,685	5,369	\$21
432030	\$761,967	\$590,811	N/A	\$1,352,778	1,568	\$72
442038	\$687,543	\$527,357	N/A	\$1,214,900	763	\$133

As shown in the table, FWA clients federal high cost support per-line is significant and necessary for provision of affordable services in the rural areas they serve. Sufficient and predictable federal high cost support is also critical to the deployment and maintenance of networks that provide quality services and can provide broadband services. Most FWA clients have deployed broadband services to a large portion or throughout their study areas. The availability of broadband services in the rural areas served by FWA clients wouldn't be possible without sufficient federal high cost support.

FWA applauds the Commission's efforts in the recently released Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking.<sup>1</sup>

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<sup>1</sup> *Connect America Fund; ETC Annual Reports and Certifications; Establishing Just and Reasonable Rates for Local Exchange Carriers; Developing a Unified Intercarrier Compensation Regime*; WC Docket Nos. 10-90, 14-58, and 07-135, CC Docket No. 01-92; Report and Order, Third Order on Reconsideration and Notice of Proposed Rulemaking, FCC 18-29 (Released March 23, 2018) (*Order and NPRM*)

There were important items adopted in the Report and Order and Third Order on Reconsideration that will provide greater certainty and predictability for rate-of-return carriers and aid in sustaining and providing for expansion of affordable voice and broadband services. These included:

- The addition of \$36.5 Million of funding for A-CAM companies
- An infusion of \$180 million of funding to mitigate the impact of the budget control mechanism (BCM) for July 2017 through June 2018
- Adjustment of the operating expense limitation for the impact of inflation
- Inclusion of data only broadband lines for the calculation of the corporate expense cap

In the companion NPRM, the Commission is seeking comment on several key items that will impact rate-of-return carriers' future support levels. These include proposals to increase and stabilize the rate-of-return high cost support budget and provide additional offers to rate-of-return carriers of A-CAM based support. The adverse impacts of the BCM have been immediate and must be curbed. FWA's comments support the Commission's efforts to modify the rate-of-return budget. Budget increases and associated reductions of the BCM impact will assist rate-of-return carriers in obtaining sufficient and predictable universal service funding. FWA's comments also provide information regarding how the Commission's proposals in the NPRM impact its clients.

Additionally, FWA is providing comments on other proposals contained in the NPRM.

**FWA Supports Increases in the Budget for Rate-of-Return Carriers**

The Commission seeks comment on increasing the rate-of-return budget from \$2 billion in the 2012 budget year to \$2.193 billion in the 2018 budget year.<sup>2</sup> Also, comments are sought regarding, once the new budget is set, increasing it for inflation going forward.<sup>3</sup> FWA endorses measures that will increase the current budget for rate-of-return carriers. Budget increases will help to soften the potentially significant support reductions imposed by the BCM and help spur broadband deployment and sustain affordable rates.

The Commission in the Order on Reconsideration recognized the adverse impact of the BCM and eliminated its effect for the current budget period (June 2017 to July 2018). In support of this action the Commission agreed that the current \$2.0 billion budget is insufficient and wishes to address it going forward.<sup>4</sup> Without future relief from the BCM through budget increases, FWA's clients and their customers will be severely impacted. The reductions in high cost support will stifle the ability of FWA's clients to invest in their networks and place significant pressure for increases to rates for broadband services.

It is difficult to project the future demand for high cost funding. However, FWA has identified several items, based on the current rules, that will cause an increase in high cost funding demand. Impacts associated with the BCM could be magnified, especially over the next few years. Attachment 1 contains a paper, prepared by FWA, that analyzes the current impact of the BCM on FWA's clients and provides additional reasons why FWA believes the demand for high cost funding will increase.

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<sup>2</sup> Order and NPRM, para. 107

<sup>3</sup> Order and NPRM, para. 114

<sup>4</sup> Order and NPRM, paras. 81 and 82

In summary, the paper shows that:

- In less than two years since inception, the amount of the BCM adjustment has increased dramatically. The adjustment has grown from approximately \$82 million to over \$227 million and represents an increase of 277 percent.
- The current combined high cost support reduction for FWA's RLEC clients due to the current BCM is over \$3.0 million. The study area reductions range from approximately \$49,000 to over \$830,000 annually. The percentage reductions in study area support range from 11.6% to 19.8%. These reductions have been significant and immediate and have reduced cost recovery necessary for provision and expansion of services.
- The ability to recover these impacts from other sources is impractical and at best very limited. While some States have universal service funds, the availability of funding in most is restricted and uncertain. Local rate increases are not practical as customer demand for land-line voice service is declining. Broadband rate increases for FWA's clients would need to range from \$11 to over \$42 per month to recover the impact of the current budget reductions. These increases combined with further BCM impacts would cause broadband rates to escalate to unaffordable levels for most customers.
- The amounts of future budget related adjustments are uncertain. FWA analyses demonstrates there are several factors primarily related to conversion from voice loops to data only broadband lines, that will likely increase the demand for federal high cost funding, especially over the next few years. These will likely drive additional support reductions due to application of the BCM.

Concerns regarding the rapid escalation of the BCM adjustments were expressed in a recent statement by Chairman Ajit Pai. In this statement, the Chairman acknowledged that the current budget reduction factor exceeds 15.5%. He further stated that the “budget control mechanism has created constant uncertainty for small, rural carriers, endangering their ability to make long-term investment decisions to bring high-speed broadband to the millions of Americans who still lack it.”<sup>5</sup>

As mentioned by the Chairman, FWA clients have been cautious about making investments in their networks. Table 3 below displays network investment levels for FWA’s clients that are subject to the legacy rate-of-return support mechanisms.

**TABLE 3 – FWA Clients – Network Plant In Service (COE and C&WF)**

<b>Study Area Code</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
310542	\$4,307,322	\$3,945,702	\$3,607,974	\$3,260,194
401704	\$4,542,415	\$4,058,891	\$3,837,549	\$3,479,814
411781	\$3,453,227	\$3,217,417	\$2,881,104	\$2,604,551
411817	\$8,390,594	\$9,009,292	\$8,788,483	\$11,662,759
411840	\$32,696,626	\$32,540,000	\$28,553,000	\$26,615,420
431704	\$3,459,826	\$3,109,931	\$2,759,100	\$2,509,413
432017	\$21,893,581	\$19,535,263	\$18,435,994	\$18,555,421
432030	\$8,440,955	\$8,455,271	\$7,988,919	\$7,158,757
442038	\$3,586,979	\$5,665,972	\$5,743,410	\$5,292,683
<b>Total</b>	<b>\$90,771,525</b>	<b>\$89,537,631</b>	<b>\$82,595,852</b>	<b>\$81,139,012</b>

The table shows that overall, total network investments are declining. Combined with uncertainty surrounding the availability of federal high cost support and the recent implementation of the BCM, there is much less incentive to invest in the network.

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<sup>5</sup> STATEMENT OF CHAIRMAN AJIT PAI ON PROJECTED USF BUDGET CUTS FOR SMALL, RURAL CARRIERS, WASHINGTON, May 1, 2018

For two carriers the investment increased due to implementation of projects already planned prior to imposition of the BCM. The remaining carriers have reduced network investment levels. Since 2014, the total network net investment dropped by approximately \$9.6 million or 11 Percent. If the two carriers that implemented projects planned prior to imposition of the BCM are removed, the reduction in network investment is 18.5 percent. This information supports Chairman Pai's observations. Without relief from the adverse impacts of the BCM, it is probable that rural LECs will continue to reduce levels of network investments.

FWA's analyses substantiate that the current budget control mechanism impacts have had substantial adverse impacts on its clients. Increases to the high cost support budget is necessary to sustain sufficient funding to maintain affordable rates and to encourage additional network investments to enhance services and provide broadband to areas where it is lacking. The Commission's proposed increase to the rate-of-return budget of \$193 million softens the negative impacts associated with the BCM. Depending on other measures taken by the Commission such as additional A-CAM funding, further budget increases may be warranted.

Since the Commission is considering future increases in A-CAM funding, this could place additional demand on the budget. The projected rate-of-return carrier budget shortfall for June 2018 through July 2019, assuming a 2.0 billion budget amount, is over \$227 million.<sup>6</sup> FWA anticipates increases in funding demand, especially in the near the future.

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<sup>6</sup> *Id.*

The Commission's proposed increase of \$193 million, while helpful, will fall short of closing the funding gap. FWA supports increasing the legacy rate-of-return budget to \$227 million to put it on equal footing with the demand for funding. FWA cautions that use of any potential budget increase to fund additional A-CAM support, would enhance the budget shortfall for legacy rate-of-return carriers. Consequently, the Commission should consider further budget increases for funding any additional A-CAM support.

FWA supports that once the budget is set that it should be increased for inflation going forward. Rate-of return carriers are not immune from cost increases caused by inflation and budget adjustments accounting for its impacts are appropriate. Moreover, other USF programs such as the Schools and Libraries program and the Lifeline program are adjusted for inflation annually.<sup>7</sup> The high cost program treatment is critical to affordable and quality services in rural America and deserves consistent treatment.

A separate budget for HCLS and BLS, as proposed by the Commission in the NPRM,<sup>8</sup> appears to fall significantly short of providing predictable and sufficient support. With a current budget of \$1.23 billion and an inflation adjusted budget of \$1.35 billion, the derivation of a separate budget amount appears to fall significantly short of covering the projected funding demand of over \$1.46 billion.<sup>9</sup>

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<sup>7</sup> See, e.g., Public Notice (*Wireline Competition Bureau Announces E-Rate Inflation-Based Cap for Funding Year 2018*), CC Docket No. 02-6, DA 18-163, released February 20, 2018; Public Notice (*Wireline Competition Bureau Announces Updated Lifeline Minimum Service Standards and Indexed Budget Amount*), WC Docket No. 11-42, DA 17-619, released June 26, 2017.

<sup>8</sup> *Order and NPRM*, para. 109

<sup>9</sup> <https://www.usac.org/hc/program-requirements/budget-control-rate-of-return.aspx>, 2018-2019 Budget Analysis, See "Demand Calcs" tab



As discussed previously, the future demand for funding is expected to increase. Use of a single budget appears to be the more workable approach. Under this approach currently employed by USAC, the A-CAM, Alaska Plan and CAF-ICC amounts are subtracted from the total budget amount to derive the budget amount for legacy rate-of-return carriers. Since typically A-CAM and Alaska plan amounts are fixed and the CAF ICC amount is declining over time, overall budget increases would be directed to legacy rate-of-return carriers. This is appropriate since A-CAM and Alaska companies have agreed to fixed levels of support and are not subject to funding cuts through application of the BCM.

The Commission proposed in the NPRM to review the budget every six years.<sup>10</sup> FWA is concerned that this is too much time before conducting a budget review. As discussed previously, FWA anticipates an escalation in the demand for funding over the next few years due to deployment of data only broadband services. To avoid potential adverse impacts being imposed by the BCM, FWA recommends that the Commission should conduct another budget review no later than three years after any budget changes are adopted as a result of proposals in this NPRM.

#### **FWA Agrees with the Commission's Proposals to Provide Additional A-CAM Offers**

The NPRM proposes three additional offers of A-CAM based support:

1. Glide Path Model Offer - extend a new model offer to carriers willing to accept lower support amounts in exchange for increased certainty of funding<sup>11</sup>

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<sup>10</sup> Order and NPRM, para. 116

<sup>11</sup> Order and NPRM, para. 117

2. Fully Fund Existing A-CAM Carriers with support up to \$200 per location<sup>12</sup>
3. Initiating a Broader New Model Offer – not just those for whom the offer of A-CAM support is less than the legacy support received<sup>13</sup>

FWA supports the Commission's efforts to provide additional offers of model-based support. While the A-CAM is not a workable basis to determine support for all rural carriers, it is a viable option for many. The predictability offered by providing fixed support levels is attractive to rural carriers and lessens the difficulty of planning network upgrades for the expansion and improvement of services. As long as the Commission takes a voluntary approach to A-CAM based offers of support, FWA views such offers as a reasonable process.

The Commission recently released A-CAM based support for a potential Glide Path offer. The offer, based on initial review is unworkable for FWA clients' legacy ROR study areas. Based on the data provided by the Commission,<sup>14</sup> three study areas don't qualify for the offer since the A-CAM based support exceeds the 2017 legacy support claims. For the remaining six clients the support reductions are likely too significant for the companies to opt into the Glide Path offer. The support reductions range from approximately 19% to over 94% annually.

FWA, on behalf of its clients, looks forward to evaluating additional offers of model-based support for both the existing A-CAM carriers and new offers for legacy rate-of-return carriers.

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<sup>12</sup> *Order and NPRM*, para. 142

<sup>13</sup> *Order and NPRM*, para. 144

<sup>14</sup> *Public Notice*, Released May 11, 2018, WIRELINE COMPETITION BUREAU RELEASES ILLUSTRATIVE MODEL RESULTS TO AID PREPARATION OF COMMENTS IN RESPONSE TO 2018 RATE-OF-RETURN REFORM NPRM, WC Docket No. 10-90

FWA asserts that the offers of additional A-CAM support should be carefully balanced with the available rate-of-return budget. The offers of A-CAM support shouldn't negatively impact the availability of funding for legacy rate-of-return carriers. As discussed above, the legacy rate-of-return carriers have already been adversely impacted by the imposition of budget controls. The Commission should carefully consider additional increases to the rate-of-return budget to fund any offers of A-CAM based support that causes increases in high cost funding demand. Otherwise, offers and acceptance of A-CAM support could negatively impact the affordability and availability of services in legacy rate-of-return areas.

**FWA Supports Establishment of a Threshold level of Support Not Subject to BCM**

FWA agrees with the Commission's acknowledgment in the NPRM that the BCM is leading to unpredictability and may make capital planning difficult.<sup>15</sup> As shown above, for FWA's clients, the current budget control reductions have ranged from 11.6% to 19.8%. The BCM reductions have escalated to these levels over roughly a 15-month period. With the continued uncertainty of their ability to recover costs of providing service, as explained previously, FWA clients are cautious about making substantial network investments. FWA welcomes measures taken by the Commission that will provide for long-term stability and predictability for legacy rate-of-return carriers. In the NPRM, the Commission proposed two changes to the budget control mechanism.

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<sup>15</sup> *Order and NPRM*, para. 148

First, the Commission proposed to modify the budget control mechanism to use only a pro rata reduction applied as necessary to achieve the target amount and no longer include a per line reduction.<sup>16</sup> Based on the most recent budget cuts, FWA estimates this proposal would impact its clients as shown in Table 4 below.<sup>17</sup>

**TABLE 4 – FWA Clients - Comparison of 2018-2019 Budget Cuts with Pro-Rata Only Cuts**

Study Area Code	Current % Cut	Pro-Rata % Cut Only	Change
401704	12.7%	15.5%	2.8%
411781	13.9%	15.5%	1.6%
411817	19.8%	15.5%	(4.3%)
411840	13.3%	15.5%	2.2%
431704	13.2%	15.5%	2.3%
432017	14.1%	15.5%	1.4%
432030	13.7%	15.5%	1.8%
442038	11.6%	15.5%	3.9%
<b>Total</b>	<b>14.4%</b>	<b>15.5%</b>	<b>1.1%</b>

As shown in the table, abandoning the per-line adjustment component and the sole use of the pro-rata cut adversely impacts eight out of nine FWA legacy rate-of-return clients. This is primarily attributable to the fact that FWA's clients are small companies and don't serve a significant number of access lines. One client, that serves over 9,000 access lines, which is relatively large, would experience a lower budget cut if only the pro-rata reduction is used. Perhaps a threshold budget mechanism, discussed below, could protect small companies from significant budget cuts.

<sup>16</sup> *Order and NPRM*, para. 150

<sup>17</sup> Study Area 310542 is not shown since the impact of the BCM has been waived for a period of three years. See *In the Matter of Connect America Fund Allband Communication Cooperative Petition for Waiver of Certain High-Cost Universal Service Rules*, WC Docket No. 10-90, Order (February 22, 2018), DA 18-177, Footnote 48

Until the impacts of such a mechanism are known and can be evaluated, the Commission should maintain the per-line adjustment component of the BCM to avoid adversely impacting smaller rate-of-return carriers.

Second, the Commission proposes to provide legacy providers a threshold level of annual support that would not be subject to a budget cap and thus provide more predictability.<sup>18</sup> This mechanism would potentially prevent legacy carriers' high cost support from being reduced to unreasonable levels. FWA supports the concept of a threshold level of support not being subject to the BCM. This will provide carriers more certainty regarding future support amounts and make capital planning less difficult. The Commission proposes the following alternatives for setting the budget threshold:

1. Set at 80% of ACAM support assuming a \$146.10 per location funding cap.<sup>19</sup>
2. Employ the 5-year CAF BLS forecast developed by NECA for carrier specific deployment obligations.<sup>20</sup>
3. Base the amount on a fraction, e.g. 70%, of unconstrained 2016 or 2017 claims.<sup>21</sup>
4. If the per line component of the BCM reduction is retained, limit any specific carrier reduction to no more than twice the budget adjustment factor.<sup>22</sup>

Of the four alternatives proposed, FWA supports the third alternative, which would base the threshold on a percentage of unconstrained 2016 or 2017 claims, as the most workable.

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<sup>18</sup> *Order and NPRM*, para. 151

<sup>19</sup> *Order and NPRM*, para. 152

<sup>20</sup> *Order and NPRM*, para. 153

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

FWA also recommends that the Commission consider a per line amount as a backstop for potential support reductions. A per-line backstop would work in concert with the budget threshold and deter unreasonable increases to rates for voice and broadband services. Basing the threshold on actual support payments received by carriers best aligns with the cost recovery necessary for sustaining affordable rates. It may be desirable to update the threshold periodically for future cost changes. Keeping the threshold at a constant level for a long period of time could deter network investments, especially, if the carrier's 2017 support claims don't account for recent network upgrades. For its clients, FWA has analyzed the potential impact on its clients of various percentage thresholds utilizing 2017 claims. Table 5 displays the results of using a threshold of 90 percent and 80 percent of 2017 support claims or a maximum budget reduction of 10 percent and 20 percent, respectively.

Table 5 shows that if FWA clients were reduced to a budget threshold of 90 percent or 80 percent, there would be significant impacts per line and potential rate increases necessary that adversely impact the affordability of services. If a threshold of 90 percent is set and the budget reduction hits that amount, FWA clients' support reduction per line impacts, for voice and broadband lines combined, range from \$2.35 to \$10.00. If the reduction is attributed to only broadband lines, the per line impacts range from \$5.75 to \$29.45. If the threshold were set at 80 percent, the support reductions and impacts would double.

**TABLE 5 – IMPACT OF POTENTIAL BUDGET THRESHOLDS OF 90 PERCENT AND 80 PERCENT**

SAC	2017 Projected Legacy Claims without Budget Control	90% Threshold - 10% Support Reduction			80% Threshold - 20% Support Reduction		
		Amount	Impact Per Ln./Mo. - Voice and Broadband	Impact Per Ln./Mo. - Broadband Only	Amount	Impact Per Ln./Mo. - Voice and Broadband	Impact Per Ln./Mo. - Broadband Only
401704	1,401,162	140,116	\$ 7.72	\$ 20.27	280,232	\$ 15.43	\$ 40.54
411781	738,144	73,814	\$ 5.40	\$ 13.70	147,629	\$ 10.79	\$ 27.40
411817	3,879,528	387,953	\$ 2.35	\$ 6.13	775,906	\$ 4.70	\$ 12.25
411840	4,347,486	434,749	\$ 4.13	\$ 9.17	869,497	\$ 8.25	\$ 18.34
431704	1,160,094	116,009	\$ 3.70	\$ 5.75	232,019	\$ 7.40	\$ 11.51
432017	4,665,846	466,585	\$ 4.57	\$ 11.09	933,169	\$ 9.15	\$ 22.17
432030	1,492,278	149,228	\$ 5.11	\$ 13.73	298,456	\$ 10.22	\$ 27.45
442038	1,339,578	133,958	\$ 10.00	\$ 29.45	267,916	\$ 20.01	\$ 58.91

It is difficult for the rural carriers to increase voice rates since demand for those services are declining. It is likely that the only rates that could potentially increase are broadband rates. As shown in Table 5 the impacts per line of support reductions may force increases to broadband rates that would be unaffordable to many customers. Basing the budget threshold only on a percentage of legacy support, even as high as 90 percent of claims, may be insufficient.

The Commission should consider adoption of a per line backstop to protect small rural carriers' customers from unaffordable rate increases. For example, the Commission could implement a per-line backstop, based on total voice and broadband lines, so that the BCM impact would not exceed \$5.00 per month. FWA would encourage the Commission to analyze and consider the adoption of a per-line backstop mechanism, in addition to a budget threshold mechanism.

Regarding the other methods proposed by the Commission, FWA has concerns. Basing the threshold on 80% of the A-CAM at the \$146.10 funding cap would cause the support threshold to be significantly below legacy support levels for several FWA clients.

Specifically, for five out of eight clients' study areas, the threshold could push support levels to amounts that are below half of legacy support levels. Three of these five carriers could experience thresholds that are below 25 percent of legacy support levels. Basing the threshold on A-CAM is an unreasonable long-term approach for several FWA clients. Employment of the five-year NECA forecast for BLS appears to not capture any support associated with HCLS and would result in a threshold that fails to capture a significant amount of high cost support. All FWA clients currently receive significant amounts of high cost loop support and one client receives a significant level of safety valve support. A threshold that doesn't include these amounts would fall significantly short of the mark. Finally, limiting the per line reduction, if retained, to no more than twice the budget adjustment factor would likely fail to ensure affordable rates for FWA clients. While FWA supports a per-line control as a reasonable approach of controlling adverse impacts of budget adjustments, it isn't clear at this time whether the Commission will retain the per-line budget component. Further, doubling the current budget cut would still represent potential impacts on carrier rates of over 30%. Cuts of this magnitude would stifle network investments and lead to unaffordable rates.

## **Other Reforms**

### ***FWA Opposes Lowering the Monthly Per-Line Limit on Universal Service Support***

The Commission seeks comment on lowering the \$250 per-line monthly limit on support to \$225 or \$200. The Commission notes that only 18 incumbent rate-of-return carriers received more than \$250 per loop and estimated that only 12 will be subject to the limit after other USF reforms were applied.<sup>23</sup>

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<sup>23</sup> *Order and NPRM*, para. 158



The Commission notes that lowering the limit to \$200 would currently affect approximately 25 study areas not already subject to the \$250 limit and the waiver process is available to all affected study areas.<sup>24</sup>

FWA opposes lowering the \$250 per-line monthly limit on support. This mechanism primarily impacts the smallest carriers and the resulting support reductions can have extensive adverse impacts on the financial condition of the company and customer rates. Subjecting 25 more companies to the cap will adversely impact additional small carriers that typically lack extensive resources. The waiver process is both expensive and takes a significant amount of time for Commission review and potential approval. Based on FWA's past experience with waivers of the \$250 cap, the waiver process can easily take more than a year to complete. Most small companies, assuming they could show good cause for a waiver, can't afford to have support payments limited for this amount of time. For example, some carriers have loan payment obligations for past network upgrades. In securing loans and repayment commitments, companies are relying on minimal disruptions to support payments. Lowering the \$250 cap could jeopardize the ability of companies to repay loans and cause defaults.

### ***Simplification of Legacy Support Mechanisms Should be Deferred***

FWA isn't opposed to simplification of legacy support mechanisms, but it appears this issue should be deferred until a reasonable amount of transition to stand-alone broadband services has occurred.

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<sup>24</sup> Order and NPRM, para. 159

Further, since the HCLS mechanism is tied to the recovery of intrastate costs and jurisdictional allocations, a joint board review of specific proposals to modify it may be necessary.

The Commission seeks comment on whether incorporating standalone broadband service into HCLS and ICLS would be less complex than the CAF BLS program adopted by the Commission in 2016.<sup>25</sup> Incorporation of standalone broadband into the HCLS and ICLS mechanisms is problematic. The Commission has already implemented funding of standalone broadband as part of the CAF BLS program. Under this approach, 100 percent of the broadband loop costs are assigned and conceivably recovered from interstate CAF BLS funding and the Consumer Broadband Only Loop (CBOL) charge. These mechanisms are isolated to the Interstate jurisdiction. The HCLS mechanism is necessary for the recovery of intrastate costs determined through the Part 36 jurisdictional separations process and typically, is balanced with other intrastate recovery mechanisms such as local rates and intrastate universal service funds. Incorporating standalone broadband into the HCLS algorithm would likely fail to provide sufficient cost recovery, since that mechanism only recovers a portion of the high costs that may otherwise not be recovered from intrastate services. Moreover, assuming that standalone broadband was incorporated into HCLS, the associated support would have to be separated out from the loops that carry voice services since it is solely assignable to interstate services. This would impose additional complexity for the HCLS algorithm. Companies have already begun implementing plans to convert lines to standalone broadband services that customers are demanding.

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<sup>25</sup> *Order and NPRM*, para. 164

Changes in the funding mechanisms and amounts, especially during the significant transition that is likely to occur over the next few years, could be disruptive to this process and deter the expansion of broadband services.

The Commission also asks if alternatively, is there a way to treat voice and broadband lines similarly that could be incorporated into the CAF BLS Program.<sup>26</sup> Since the CAF BLS Program is solely an interstate program, it appears incorporation of voice lines for which costs are largely assigned to the intrastate jurisdiction would raise jurisdictional separations issues and may require review by a Joint Board.

FWA recommends the Commission defer any changes or simplification until a significant amount of transition to standalone broadband service occurs. Three to five years may be a reasonable amount of time for the transition to occur. FWA expects during this period that HCLS funding will decline significantly while CAF BLS funding increases. The Commission could possibly conduct a future proceeding while a review of the budget is performed.

FWA has a concern regarding the HCLS mechanism. Due to the application of a pro-rata factor to meet the HCLS budget (prior year amount indexed to the rural growth factor). There could be extraordinary reductions imposed on HCLS funding. The current pro-rata reduction factor applicable to HCLS is approximately 20 percent. This reduction is in addition to decreases imposed by the BCM. Thus, for HCLS funding, a carrier's support is first reduced by approximately 20% and then reduced by the BCM factor which currently averages over 15%. As additional conversion to standalone broadband occurs, the HCLS pro-rata factor could increase significantly due to the significant decline in voice lines.

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<sup>26</sup> *Order and NPRM*, para. 164

This will cause further reductions in HCLS funding and possibly exert pressure on intrastate rates. FWA recommends that the Commission consider freezing the pro-rata factor at the current amount to stabilize HCLS funding.

***Capital and Operating Expense Limitations***

The Commission seeks comments regarding the whether the limitations on capital and operating expenditures are successfully curbing unnecessary expenditures and incentivizing prudent investments or instead creating unnecessary burdens or deterring efficient investments.<sup>27</sup>

The capital expense limitation imposes administrative burdens on carriers and FWA doesn't foresee for its clients that the mechanism will have much impact, if any. First, FWA clients have not experienced any risk of exceeding the limitations imposed by the Annual Allowed Loop Plant Investment (AALPI). Annual loop plant expenditures, since the inception of the rule, will fall substantially below the AALPI. Regarding the average per location construction loop plant investment limitation (location limit), this has imposed administrative burdens to track locations associated with projects. FWA clients are planning projects to potentially avoid exceeding the location limit. Thus far, there have been no issues where the location limit has been exceeded.

The Commission's suggestion in the NPRM that "limitations might actually lead to greater inefficiencies in overall business operations than would be the case without the constraints" is true for FWA clients.<sup>28</sup>

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<sup>27</sup> NPRM, para. 167

<sup>28</sup> *Id.*

FWA doesn't anticipate that any clients will exceed the limits in the foreseeable future, but there is a host of administrative responsibilities necessary to show compliance. First, loop expenditures must be tracked separately from non-loop expenditures. Also, the number of locations applicable must be tracked by project. This information must be summarized in a report to show that the capital investment allowances were not exceeded. If any of the limitations are exceeded, it wouldn't likely be much, but would impose significant additional accounting requirements. Clients must track specific investments that exceed the limitation, probably in separate subaccounts, and these must be accounted for in cost studies and USF submissions. This adds a whole layer of red tape to the cost studies and USF reporting processes. It is apparent to FWA that implementation of the capital investment allowance has created some significant additional tracking and reporting requirements for clients to show compliance. However, there will be very little if any plant amounts disallowed. This is the classic "dollars chasing dimes" scenario and consequently, FWA supports the elimination of the capital investment allowance.

Based on a review of information employed for 2018 HCLS payments<sup>29</sup>, 2016 calendar year data, it appears that approximately 40 companies were impacted by the operating expense limitation. The top ten companies impacted, accounted for over 70% of the total expense limitation. Small carriers represent the majority of companies impacted. The average number of loops for carriers impacted is approximately 2,200. Twenty companies impacted serve less than 1,000 loops.

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<sup>29</sup> [https://www.neca.org/Current\\_Results.aspx](https://www.neca.org/Current_Results.aspx), USF 2017 Data for Legacy ROR Study Areas (Cost and Average Schedule), USF2017LVROR17.xlsx

FWA currently has one client that is impacted by the operating expense limitation. The client serves less than 1,000 access lines dispersed over a large geographic area which contributes to it incurring higher operating expenses than the norm. Because of anticipated changes in future operating expenses, FWA expects the impact of the limitation for this client to diminish over the next few years.

Measures recently taken by the Commission will assist in reducing the impact of the operating expense limitation. The Commission in the Third Order on Reconsideration adopted an inflation adjustment for the calculation of the operating expense limitation for a period of five years.<sup>30</sup> Thereafter, the Commission stated it would revisit the inflation adjustment. Also, in the Report and Order, the Commission clarified and codified a list of ineligible expenses that aren't recoverable from the universal service high-cost program.<sup>31</sup> FWA anticipates that companies impacted by the limitation will also make reasonable efforts to reduce expense levels.

Consequently, the future impacts associated with the operating expense limitation should lessen. The Commission should reevaluate application of the operating expense limitation in the future. A review in three to five years would be appropriate and could coincide with the Commission's planned review of the inflation adjustment. In the interim, to the extent a carrier is adversely impacted by the adjustment, the waiver process is available for potential relief.

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<sup>30</sup> Order and NPRM, para. 85

<sup>31</sup> Order and NPRM, para. 17

**Conclusion**

In summary, FWA's comments support the following:

- Increases to the high cost support budget are necessary to sustain sufficient funding to maintain affordable rates and to encourage additional network investments to enhance services and provide broadband to areas where it is lacking. The Commission's proposed increase of \$193 million, while helpful, will not offset a significant portion of the current shortfall. FWA supports increasing the legacy rate-of-return budget to \$227 million to put it on equal footing with the demand for funding
- The Commission should consider additional budget increases for funding any additional A-CAM support, otherwise additional A-CAM funding causes further harm to the carriers' subject to the legacy high cost support mechanisms.
- Once the budget is set it should be increased for inflation going forward.
- A separate budget for HCLS and BLS will fall significantly short of providing predictable and sufficient support. The current method employed by USAC to determine the legacy rate-of-return budget should be retained.
- To avoid potential adverse impacts being imposed by the BCM, the Commission should conduct another budget review no later than three years after any budget changes are adopted as a result of proposals in this NPRM.
- If the Commission takes a voluntary approach to A-CAM based offers of support, FWA views such offers as a reasonable process.

- The Commission should consider retaining the per-line component of the BCM adjustment. Use of the only the pro-rata adjustment adversely impacts the majority of FWA clients.
- A budget threshold that the BCM reduction can't go below should be implemented and be based on a percentage of the carrier's historic support claims. The threshold should be updated periodically. Additionally, the Commission should consider imposing a per line back-stop for potential support reductions imposed by the BCM.
- The Commission should not lower the \$250 per-line limit on support.
- To avoid disruptions, FWA recommends the Commission defer any changes or simplification of the HCLS and BLS mechanisms to a future proceeding. An appropriate evaluation can occur after a significant amount of transition to standalone broadband service occurs. Three to five years may be a reasonable amount of time for the transition to occur.
- To stabilize HCLS funding, FWA recommends freezing the pro-rata factor at the current amount.
- The Commission should eliminate the capital investment allowance. Its implementation has created significant additional tracking and reporting requirements for compliance, but there will be very little, if any, plant amounts disallowed.
- FWA does not see an immediate need to modify the operating expense limitation. The Commission should reevaluate the operating expense disallowance in three to five years.



Respectfully Submitted,

**FWA**

121 E. College Street  
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May 25<sup>th</sup>, 2018

## **Analysis of The FCC Budget Control Mechanism**

### **I. Introduction**

FWA, Inc. (FWA) is a financial and regulatory consulting firm that represents several rate-of-return carriers that operate primarily in Arkansas, Kansas, Oklahoma and Texas. FWA's clients rely on Federal High Cost support to provide affordable voice and broadband services throughout their study areas. The Budget Control Mechanism (BCM) recently enacted by the FCC is adversely impacting Rural Local Exchange Carriers' (RLEC's) ability to adequately provide affordable voice and broadband capable networks. This paper will discuss the BCM and the adverse impacts it is having on RLECs represented by FWA and ultimately the public they are trying to serve with such services. Further, this paper supports that the amount of the BCM adjustment and the associated adverse impacts will likely continue to grow. Finally, FWA provides recommendations for adjustments to the universal service support budget and BCM to provide assurance of sufficient and predictable universal service funding.

### **II. Overview of the Budget Control Mechanism**

As part of its Universal Service reforms for rate-of-return carriers, the FCC implemented the budget control mechanism to limit the amount of high cost funding for rate-of-return carriers to \$2 billion annually.<sup>1</sup> The funding subject to this restraint is High Cost Loop Support (HCLS) including Safety Valve Support, Interstate Common Line Support (ICLS) and Connect America Fund Intercarrier Compensation (CAF-ICC). ICLS has subsequently been renamed Broadband Loop Support (BLS). BLS also includes the data-only broadband support recently implemented by the FCC. Additionally, a significant portion of the Alternative Connect America Cost Model (A-CAM) based high cost support is included in the \$2 billion budget as well as support for the Alaska Plan. The budget mechanism is only applied if the demand for total funding exceeds \$2 billion. The A-CAM, CAF-ICC and Alaska Plan support mechanisms are fixed and thus not subject to BCM adjustments. Only carriers subject to the legacy rate-of-return mechanisms (HCLS and BLS) are subject to the BCM adjustments.

Beginning in September 2016, the BCM has imposed reductions to the amounts of high cost support that rate-of-return carriers receive. Reductions are applied on a per-line and a pro-rata basis. Essentially, 50 percent of the required reduction is applied as a per line adjustment and 50 percent is applied on a pro-rata basis. The reduction is applied to each rate-of-return study area that is eligible for support. The application of the budget control mechanism is explained in detail in the FCC's Universal Service Reform Order <sup>2</sup>.

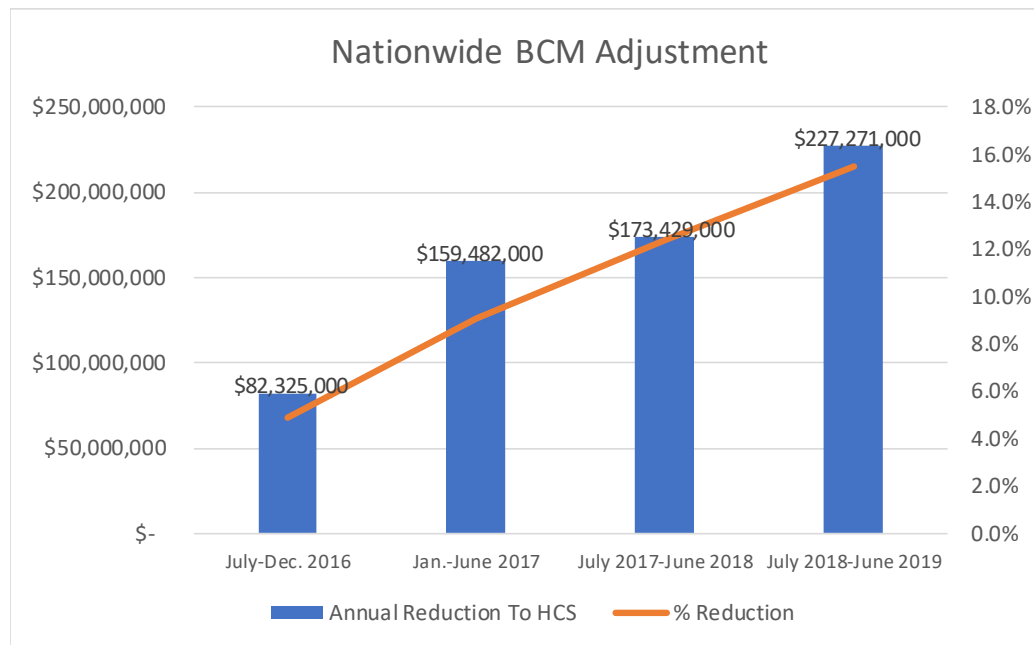
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<sup>1</sup> The amount of legacy HCLS and ICLS/BLS for companies receiving A-CAM support and included as part of the \$2 billion budget is approximately \$329 million. The FCC added approximately \$200 million to the budget and targeted it to companies that receive A-CAM based support. This brings the total budget to \$2.2 billion and the portion of annual A-CAM support to approximately \$529 million.

<sup>2</sup> See *In the Matter of Connect America Fund; ETC Annual Reports and Certifications; Developing a Unified Intercarrier Compensation Regime*; WC Docket No. 10-90, WC Docket No. 14-58 and CC Docket No. 01-92; Report and Order,

The BCM adjustment is in addition to the pro-rata adjustment that is imposed for HCLS.<sup>3</sup> The current pro-rata reduction factor for HCLS is approximately 80 percent. This factor is applied to the carrier's calculated HCLS support and reduces it by approximately 20 percent. Additionally, there are other mechanisms including the \$250 per line cap, operating expense limitation and capital expense limitation, that may impose further reductions to carriers' high cost support. While these additional support reduction mechanisms aren't specifically addressed in this paper, it is important to note that the BCM is not the only source for HCLS and BLS support reductions.

In the short amount of time since inception of the BCM, the adjustment amount has grown significantly. The chart below shows the total amount of effective annual high cost support (HCLS and BLS) reductions nationwide due to the BCM. This was obtained from information released by USAC and available on their web site<sup>4</sup>. For comparability, all amounts, that were released by USAC, were restated to reflect annual impacts.



Since its inception, the amount of the BCM adjustment has increased dramatically. The adjustment has grown from approximately \$82 million to over \$227 million. This represents an increase of 277 percent. The current average nationwide percentage high cost support reduction imposed by the BCM is approximately 15.5 percent. As will be demonstrated below, the percentage impacts of the BCM will vary by study area and some rate-of-return LECs are more significantly impacted than others.

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Order And Order On Reconsideration, And Further Notice Of Proposed Rulemaking; Released March 30, 2016 (*Rate Of Return Reform Order*), paras. 146 – 155

<sup>3</sup> See CFR §54.1310 (b)(1)

<sup>4</sup> [www.usac.org/hc/program-requirements/budget-control-rate-of-return.aspx](http://www.usac.org/hc/program-requirements/budget-control-rate-of-return.aspx)

### III. Current Impacts on RLECs

The table below summarizes HCLS and BLS funding demand, amounts after BCM reductions, and the BCM reduction amount for a sample of RLECs whom FWA represents. Also shown, is the percentage of support reduction due the BCM.

SAC	High Cost Funding Demand (July 2018 - June 2019)				Funding After BCM Reduction (July 2018 - June 2019)				BCM Reduction	Percent Reduction
	HCLS	SVS	CAF BLS	Total	HCLS	SVS	CAF BLS	Total		
411781	231,060	-	351,869	582,929	193,981	-	308,051	502,032	80,897	13.9%
411840	452,640	1,503,264	4,290,378	6,246,282	320,318	1,289,459	3,806,343	5,416,120	830,162	13.3%
411817	1,125,072	-	2,462,480	3,587,552	856,839	-	2,020,118	2,876,958	710,594	19.8%
401704	851,832	-	527,215	1,379,047	742,785	-	460,531	1,203,316	175,731	12.7%
431704	610,956	-	520,068	1,131,024	528,247	-	453,394	981,642	149,382	13.2%
432017	1,970,664	-	2,525,919	4,496,583	1,669,849	-	2,193,358	3,863,207	633,376	14.1%
432030	847,044	-	713,168	1,560,212	728,390	-	617,668	1,346,058	214,154	13.7%
442038	881,916	-	776,487	1,658,403	773,020	-	693,528	1,466,548	191,855	11.6%
310542	295,644	-	121,266	416,910	260,702	-	107,516	368,219	48,691	11.7%
TOTAL	7,266,828	1,503,264	12,288,850	21,058,942	6,074,133	1,289,459	10,660,508	18,024,100	3,034,842	14.4%

**Note: The BCM reduction SAC 310542 was recently waived by the FCC for a period of 3 years.**

The Table shows that the combined reduction for FWA's RLEC clients is over \$3.0 million. The study area reductions range from approximately \$49,000 to over \$830,000 annually. The overall percentage reduction in high cost support due the BCM is 14.4 percent. The percentage reductions in study area support range from 11.6 percent to 19.8 percent. These reductions have been immediate and have reduced cost recovery necessary for provision and expansion of services.

These RLECs have thus far had to absorb the significant revenue and cost recovery reductions associated with the application of the BCM. The most immediate impact of the loss of funding is that it will likely reduce investments in the rural infrastructure. For some carriers, reductions in expenses may be necessary. These actions will stifle the provision and expansion of broadband services in rural areas. Moreover, the loss of funding negatively impacts the financial condition of the RLECs and makes them less attractive to lenders when obtaining loans.

### IV. Options for Recovery of BCM Impacts

Alternatives for recovery of the BCM impacts are being evaluated and pursued; however, most options are impractical. Potential alternatives for recovery of the revenue reductions imposed by the BCM are discussed below.

#### A. State Universal Service Funds

In some of the states served by FWA clients, there are State funds that could provide for partial recovery of the BCM impacts, but this is uncertain. The States with potential funding available are briefly discussed below.

**Texas** -PURA § 56.025 allows certain companies to request additional funds from the TUSF in order to offset projected revenue shortfalls resulting from regulatory actions at the federal level. Some rural Texas LECs have filed applications with the Texas Commission for recovery of the impact of the BCM. The Commission's procedures only allow recovery of a portion of the impact for FWA's client, due to significant adjustments for local rates that are below the FCC rate floor. The Texas Commission recently approved the application, and this provides for recovery of a portion of the 2017 BCM impact. If the FCC institutes revisions that impact the amount of BCM reductions, these changes will be reflected in subsequent true-ups of TUSF funding amounts.

**Oklahoma** – Like Texas, Oklahoma allows RLECs to file applications for recovery, but the Oklahoma Commission has not approved recent additional funding requests. Further, the Oklahoma Universal Service Fund (OUSF) rules are currently under review and revision. The outcome of this process and the possibility of recovery of federal impacts such as the BCM from the OUSF is ambiguous.

**Kansas** - An RLEC can request additional funding from the Kansas Universal Service Fund (KUSF) based upon its intrastate costs. The costs must be reviewed and allowed by the Kansas Commission and it takes several months for an application for additional funding to be approved by the Commission. The KUSF is capped at \$30 million annually and the fund is currently very close to this cap. Due to application of the KUSF cap, additional funding requests granted by the Kansas Commission are likely to cause offsetting reductions to RLECs' KUSF support and could frustrate efforts to obtain additional funding. Further, the KUSF intrastate cost recovery process would not allow recovery of approximately half of the funding reductions. These reductions are associated with BLS, an interstate cost recovery mechanism. Filing of applications for KUSF support are also expensive for RLECs to pursue and there is no assurance that the Kansas Commission will approve additional funding.

**Arkansas** – The Arkansas USF provides for recovery of a portion of the HCLS revenue requirement not otherwise recovered by federal funding and intrastate rates. The amount of funding from this is also capped and provides no significant relief from the budget cuts associated with BLS.

Based on the above synopsis, state funding mechanisms for FWA's clients are uncertain at this time and at best may only provide for recovery of a portion of the BCM impact.

### ***B. Increase Rates Charged to Customers***

**Voice Services** - Most of the RLECs local rates are already, at least, set at the FCC's imposed \$18 rate floor. Local rate increases are not practical as customer demand for land-line voice service is declining. Rate increases will stimulate further line loss. Consequently, it is difficult for LECs to generate additional revenue from local rate increases. The loss of lines will serve to reduce any revenue gains from rate increases. HCLS funding levels will also likely decline since it is adjusted annually to reflect changes in the number of lines.

**Broadband Rates** - Assuming the RLECs increase broadband rates to recover the BCM impact, the average rate increases would range from \$11 to over \$42 per month in order to recover the impact of the current budget reductions. Increases above these amounts would likely be required to fund future BCM impacts. Increases to broadband rates will make them less affordable and harm consumers. This is an undesirable option for the FWA RLECs.

#### **V. The Impact of the BCM Will Likely Become More Significant in the Future**

In the first year since the inception of the budget mechanism in late 2016, the percentage support reduction has increased from approximately 5% to over 15%. The amounts of the future budget related adjustments are uncertain. It is difficult to predict the demand for funding levels in the future due to ongoing changes in RLEC costs. The support amounts are directly related to the RLECs' specific investments and expenses. Reductions in investments and expenses could reduce the demand for funding while increases would have the opposite effect.

FWA analyses demonstrates there are several factors, beyond cost levels, that will likely increase the demand for federal high cost funding. These will likely drive more reductions in support due to application of the BCM. Further, FWA analyses provides evidence that the support levels for voice loops versus Data Only Broadband (DOB) loops will differ. Specifically, the available DOB support per loop, for RLECs is larger than the comparable voice support per loop. Much of this is attributable to the fact that 100 percent of the costs of broadband loops are assigned and recovered from interstate services and high cost support mechanisms, while HCLS works in concert with intrastate recovery mechanisms. Additional information regarding FWA's analyses is provided below.

##### ***A. The Interstate Support Per Loop for Data Only Broadband (DOB) Services Typically is Greater than Comparable Amounts for Voice Services***

The federal high cost support per loop for DOB services is typically higher than support for voice services. The table below shows an example that compares support for voice services (BLS and HCLS) with support for DOB services (BLS).

Description	Voice & Voice/Data Loop			DOB Loop
	BLS	HCLS	TOTAL	
BLS Rev Req	\$50.00			\$160.00
HCLS Rev Req		\$120.00		
Funding Benchmark *	\$9.00	\$62.00		\$42.00
65% of \$ > 115% < =150% of NACPL		\$12.00		
75% of \$ > 150% of NACPL		\$29.00		
Initial Funding Before BCM	\$41.00	\$41.00	\$82.00	\$118.00
Pro Rata Factor	N/A	0.818		N/A
Support After Pro-Rata Factor	\$41.00	\$34.00	\$75.00	\$118.00
BCM	-\$4.00	-\$3.00	-\$7.00	-\$12.00
Support	\$37.00	\$31.00	\$68.00	\$106.00

\* BLS benchmark represents End User Revenue and HCLS benchmark is  $NACPL/12 \times 115\%$

The table shows the support for voice services, BLS and HCLS combined, is \$68. For the same company shown in the example, the support for DOB services is \$106 per line. The support per loop available from DOB services is significantly higher than support per loop available from voice services. This is related to several factors underlying the calculation of the support amounts, including the following:

- The HCLS revenue requirement per loop for funding calculation is lower primarily due to the exclusion of cost recovery for capital costs related to general support assets and customer service expenses. The Part 54 rules exclude these costs from the HCLS mechanism<sup>5</sup>.
- The funding benchmark for HCLS is 115% of the NACPL or \$62 ( $\$647.87/12 \times 1.15$ ). The comparable benchmark for DOB BLS is \$42.00, a \$20 difference.
- The BLS for voice services is based on a 25 percent allocation of loop or common line costs to Interstate services. The HCLS for calculation costs only considers costs that are more than 115 percent of the NACPL. This excludes 15% of the costs from the calculation of HCLS funding. Further, the HCLS mechanism limits to 65 percent, the recovery of costs between 115 percent and 150 percent of the NACPL. This excludes 10% of the costs from recovery. Due to application of these percentage limitations in the HCLS funding mechanism, a significant percentage of the costs aren't considered for funding by HCLS.

<sup>5</sup> See CFR §54.1308

For DOB BLS, 100 percent of the costs above the \$42 benchmark are considered for funding. These differences are largely attributed to HCLS cost recovery working in concert with recovery mechanisms in the intrastate jurisdiction (e.g., local rates and universal service funds) while DOB costs are solely recovered from the Interstate jurisdiction.

- The HCLS mechanism is subject to a current pro-rata factor of approximately 80%. This mechanism reduces the current HCLS funding by 20 percent. FWA expects this percentage to grow in the future. There is no pro-rata reduction applicable to the calculation of DOB support.

As companies transition to DOB services, it is reasonable to expect that high cost funding demand will increase. This will cause further support reductions due to application of the BCM and will be dependent upon the rate of transition to DOB services.

***B. Transition from Voice Services to DOB Services Will Increase the Demand for FUSF Due to Dual Funding of the Same Loop for HCLS and DOB-BLS***

Data Only Broadband is funded concurrently based on the 508 and 509 reporting processes. Payments are based on a forecast reported on the Form 508 for the July through June support year. This estimate is subsequently trued up to actuals reported on the Form 509. In contrast, HCLS is generally funded approximately two years in arrears. For example, 2017 HCLS payments are generally based on 2015 costs. With support now being available for DOB services, RLECs are beginning to convert lines to DOB. In the first two years, a converted line will be eligible for both HCLS and BLS funding which may exert extraordinary short-term demands on the required funding levels. Rapid conversion to DOB services could place pressure on funding levels due to the dual funding requirement of HCLS and BLS. In the early years of transition, this will escalate the impact of the BCM adjustment.

***C. RLECs that Previously Didn't Qualify for HCLS Will be Eligible for and Receive DOB Support***

For receipt of HCLS support, an RLEC must have an average loop cost of over \$745.00 (Frozen NACPL, \$647.00 x 115 percent). In comparison the support threshold for DOB services is \$504 (\$42/loop \* 12). Consequently, RLECs with costs above \$504.00 but less than \$745.00, that previously didn't receive HCLS, will now be eligible to receive additional support from DOB services. Based on an analysis of nationwide RLEC loop cost data (2017-1 USF Data Submission), FWA identified 113 RLECs with approximately 675,000 loops that could qualify for loop funding for DOB services. This will create additional demand for high cost funding and heighten the impact of the BCM adjustment.



***D. Potential Rapid Erosion of the Voice Fund (HCLS), May Incite More Companies to Pursue DOB Services***

The Voice fund or HCLS is indexed to line loss and inflation (GPD-CPI factor).<sup>6</sup> As lines migrate to DOB, the rural growth factor which accounts for line loss, becomes a more significant reduction. The prior year's HCLS amount is adjusted by the rural growth factor to determine the HCLS budget. A pro-rata factor is applied to the required HCLS funding amounts to adjust funding to the budget amount.

In the future, due to line loss, the funding of voice services will become lower and potentially result in insufficient amounts. Currently the pro-rata factor is approximately 80% or a 20% funding reduction. RLECs may have greater incentives to convert lines to DOB for which pro-rata reductions aren't applicable. This will increase the amount of high support demand for RLECs and increase the impact of the BCM adjustment.

**VI. An Increase to Budget Cap is Necessary to Account for Increased Support Demand**

For the annual period representing July 2017 through June 2018, the initial USAC forecast of annual BLS support for DOB loops is approximately \$111 million. The most recently released forecast shows that for July 2018 through June 2019, this amount is over \$181 million, a \$70 million or 63 percent increase. Annual amounts in the future will likely increase as more RLECs convert lines to DOB. FWA asserts that the budget cap should be immediately increased to account for new funding demands related to DOB and to avoid excessive BCM reductions and negative impacts on customers.

The Commission, in its recent Order on Reconsideration eliminated the BCM impact for July 2017 through June 2018. This one-time infusion of funding represents approximately \$180 million. This measure is interim in nature. The Commission in a companion Notice of Proposed Rulemaking is seeking comments on increasing the budget from \$2.0 billion to \$2.193 billion and going-forward adjusting the amount for the impacts of inflation. FWA supports an increase to the budget. The \$193 million increase will not fund the entire current budget shortfall of \$227 million. The FCC should consider an additional increase to the budget. FWA cautions that if budget increases are used for funding other requirements, such as increases in A-CAM support, further budget increases may be in order.

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<sup>6</sup> See CFR §54.1303

## **VII. Recommendations**

The federal statutes require that universal service funding should be predictable and sufficient. To meet this mandate, the commission must promptly increase the high cost support budget and reduce the adverse impacts on RLECs, and ultimately consumers, caused by the BCM. The FCC should ensure that RLECs have reasonable funding and that broadband services aren't impaired by the FCC budget control mechanism.

FWA recommends that the FCC:

- Immediately increase the rate-of-return budget cap. The Commission's proposed increase of \$193 million, while helpful, will not offset a significant portion of the current shortfall. FWA supports increasing the legacy rate-of-return budget to \$227 million to put it on equal footing with the demand for funding. A budget increase will provide cushion for additional funding demand related to the transition of DOB services. Further budget increases should also be considered if additional A-CAM funding is awarded to carriers.

This will help:

- Accommodate the increased funding per line for DOB BLS versus the comparable voice funding per line.
- Include funding sufficient to offset the dual funding requirement of HCLS and BLS that occurs during the first two years after lines are converted to DOB.
- Account for DOB-BLS funding for RLECs that previously didn't receive loop support.
- Consider freezing the pro-rata reduction factor for HCLS to place HCLS on a more equal footing with DOB BLS.
- Adjust the budget annually for the impact of inflation.
- In no later than three years, review budget levels and corresponding BCM impacts and correct any deficiencies.

## **VIII. Conclusion**

This paper provides information that demonstrates that the current BCM reduction is significant and FWA expects the impact will continue to escalate. Absent, revisions to the budget cap, RLECs will realize significant support reductions which will adversely impact the ability to provision and expand affordable voice and broadband services. The FCC should act promptly to raise the current budget cap, adjust the cap annually for inflation and place HCLS support on more equal footing with DOB support. The Commission should review the budget periodically and correct deficiencies.