NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
The Voice of Rural Telecommunications
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December 20, 2010

***Ex Parte* Notice**

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

***A National Broadband Plan for Our Future,* GN Docket No. 09-51; *Connect America Fund,* WC Docket No. 10-90; *High-Cost Universal Service Support,* WC Docket No. 05-337; *Universal Contribution Methodology,* WC Docket No. 06-122**

Dear Ms. Dortch:

On Friday, December 17, 2010, Jill Canfield, Director of Legal & Industry for the National Telecommunications Cooperative Association ("NTCA"), and the undersigned met with Carol Mattey, Elise Kohn, Trent Harkrader, and Vickie Robinson (via telephone), all of the Wireline Competition Bureau, to review and discuss the attached presentation. NTCA provided several recommendations as to how the Federal Communications Commission (the "Commission") might address both supply *and* demand issues that place increasing pressures on the universal service fund ("USF") and the USF contribution factor.

With respect to supply issues, NTCA noted that increases in the USF contribution factor over the past several years are linked in large part to declines in the assessable base of interstate and international telecommunications revenues. To stabilize the USF, NTCA recommended that the Commission broaden the USF contribution base by including additional service revenues such as those described further in the attached presentation. Broadening the contribution base as suggested by NTCA is supported by both law and policy as explained in the attached presentation and in prior NTCA comments and *ex parte* correspondence. Moreover, building upon and firming up the existing revenues-based system (rather than creating a new contribution system from whole cloth) would better position the Commission to achieve important and evolving universal service objectives.

With respect to demand issues, NTCA highlighted that rural incumbent local exchange carriers ("Rural ILECs") have been efficient and responsible stewards of USF support, relying upon very modest increases in support over the past 5 years (up only 3% or $78 Million since 2005) to enable deployment and maintenance of multi-use plant that makes DSL or higher-speed broadband services available to more than 90% of their customers. Instead, growth in the USF over the past 5 years can be linked primarily to increases in the amounts directed to competitive eligible telecommunications carriers ("CETCs") (up 89% or $675 Million since 2005), Lifeline/Linkup providers (up 72% or $588 Million), and Rural Health Care recipients (up 395% or $131 Million). NTCA urged the Commission to address these demand pressures by: (1) immediately basing CETC support on actual costs; (2) examining the rapid growth in these other programs to ensure that funds are being used appropriately; and (3) ensuring that any further expansion of these programs is "paid for" and does not come at the expense of Rural ILECs who have relied – and continue to rely – on USF support to sustain existing investment, upgrade their networks, and make affordable services available to rural consumers and businesses.

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS with your office. If you have any questions, please do not hesitate to contact me at (703) 351-2016 or mromano@ntca.org.

Sincerely,

/s/ Michael R. Romano
Michael R. Romano

Senior Vice President - Policy

Enclosure

cc: Carol Mattey
Elise Kohn
Trent Hardraker
Vickie Robinson

USF Contribution and Distribution: *Fiction and Facts*

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USF Contributions Rising to 15.5%

- This is an issue that warrants a meaningful solution.
- But it's important too to keep this in perspective.
  - The Contribution Factor is largely applied to interstate and international long distance service charges – perhaps only a few $ per month for most consumers.
- It's also crucial to *separate fact from fiction* and *avoid knee-jerk reactions* that won't fix the fundamentals.
- A meaningful solution must address both Supply and Demand:
  - Identify and Implement Reasonable Ways to Improve the Contribution Mechanisms
    - *Broaden the Base!*
  - Identify *With Specificity* and Address those Issues that are Driving Demand and Placing Pressure on the USF
    - *Look Closely at where Growth Has and Will Come From!*

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How Did This Happen?
Supply Fiction and Facts

- *Fiction*: *The substantial increases in the Contribution Factor arise simply because the total size of the USF has increased dramatically.*
- *Fact*: The Contribution Base is declining and things will get worse absent Contribution reform.
  - Quarterly Telecommunications Revenues have declined by **almost 12%** over just the past 2 years (1Q09 to Est. 1Q11).
  - In the past quarter alone, Telecommunications Revenues *declined by **more than 4%** ($767 Million)*!
  - Continuing to stake USF Supply to a declining Contribution Base is risky and jeopardizes Universal Service.

Sources: All USF-related figures in this presentation are derived from USAC Quarterly Filings.

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How Did This Happen?
Demand Fiction and Facts

- *Fiction*: *The increase in the Contribution Factor must be due to "waste, fraud, and abuse" by allegedly inefficient recipients of high-cost support.*
- *Fact*: Frequent audits of Rural ILECs confirm that waste, fraud, or abuse is not a concern.
- *Fact*: Rural ILEC demand on and use of USF has been relatively stable and very efficient.
  - Rural ILECs' total draw on USF increased by **only 3%** between 2005 and 2010.
  - Meanwhile, from 2000 to 2009, Rural ILEC DSL penetration increased from a small percentage to 92%.*

**Source: NECA Trends 2009 Report*

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How Did This Happen?
Demand Fiction and Facts (cont.)

- *Fiction*: *Even if it's not due to inefficiency or abuse, the increase in the Contribution Factor must be due to ever-increasing Rural ILEC demand.*
- *Fact*: From 2005 to 2010 –
  – CETC Total Draw on USF increased by **89%**
  – Lifeline/Linkup Draw on USF increased by **72%**
  – RHC Draw on USF increased by **395%**
  – *Compare*: Rural ILEC Draw on USF increased by **3%**

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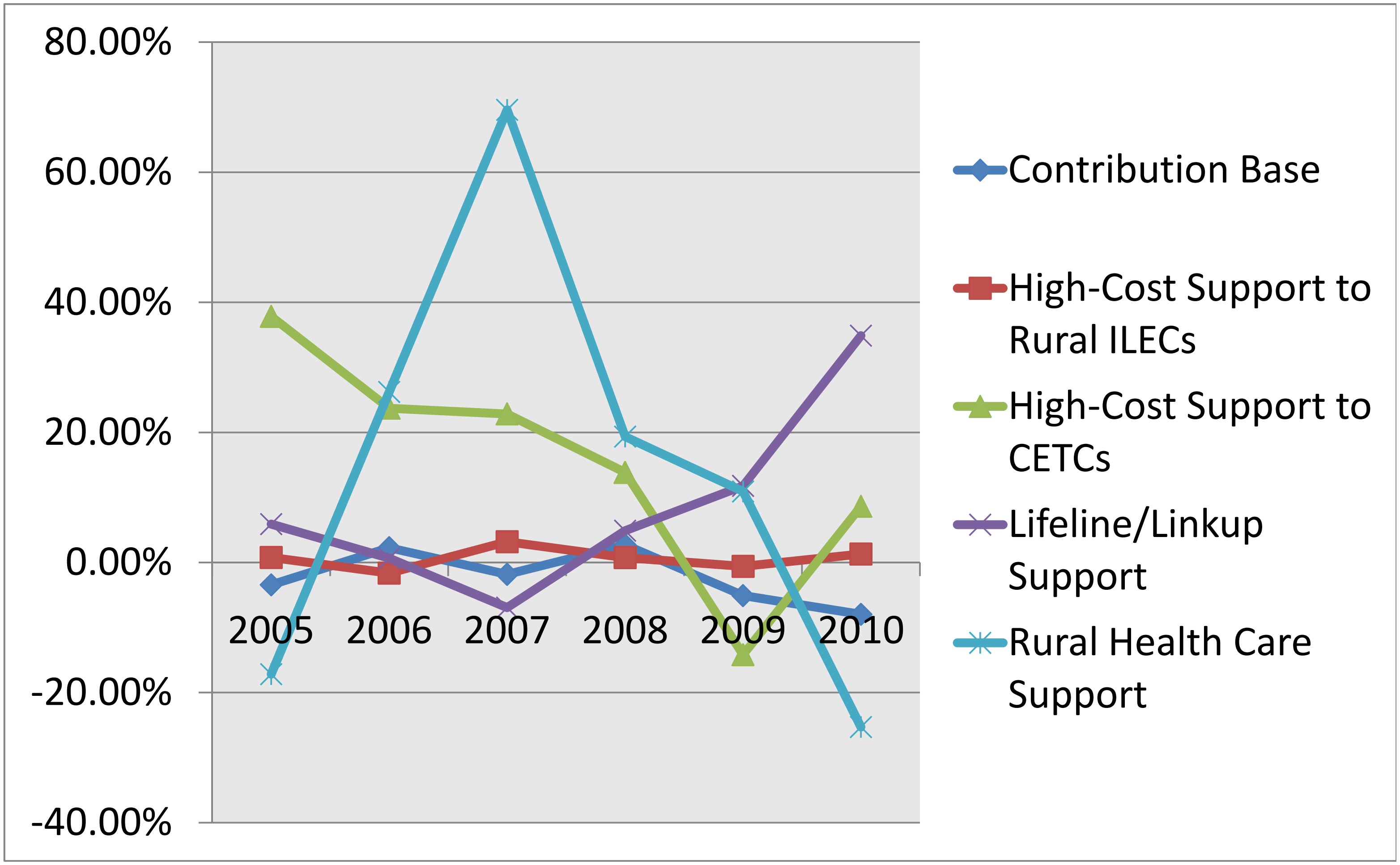
How Did This Happen?
Demand Fiction and Facts (cont.)

- *Fiction*: *Percentages don't tell the real story in terms of increasing demands on the USF.*
- *Fact*: From 2005 to 2010 –
  - CETC Total Draw on USF increased by a total of **$675M**
  - Lifeline/Linkup Draw on USF increased by a total of **$588M**
  - RHC Draw on USF increased by a total of **$131M**
  - Rural ILEC Draw on USF increased by a total of **$78M**
- *Fact*: Proposals to expand RHC and Lifeline/Linkup could increase USF demand by Billions of Dollars more over the next several years.
  - FCC looking for ways to promote up to $400M per year for RHC through revitalized program.
  - Lifeline/Linkup could exceed $2B per year in just a few years, *even without* reform proposals to expand it.

The <u>Facts</u> on USF Supply and Demand in "Black and White" (Expressed as % Change Over Prior Period)



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Fixing USF Supply

- Focusing on the Facts Shows That:
  - Policy-makers need to address the shrinking Contribution Base or Universal Service will be at risk.
  - Just as Americans support the Interstate Highway System, the FCC should broaden support for the U.S. Information Infrastructure that benefits all Americans.
    - Australia just committed $35 Billion to Broadband!
    - U.S. has nearly 14 times the population of Australia – as relative/rough perspective, $483 Billion would be the equivalent U.S. commitment.
  - The FCC can dramatically improve the Supply equation by including the following in the Contribution Base:
    - *Fixed and Mobile Retail Broadband Internet Access Revenues* – Est. $32 Billion Market in 2007* and likely increasing. (Assessing such contributions may also help address Smartphone bundles.)
    - *Texting Revenues* – Est. $11.3 Billion Market in 2008* – almost certainly larger now and increasing. Clarify contribution obligation.
    - Non-Interconnected (1-way) VoIP Service Revenues
    - Consider ways to ensure that web-based enterprises that place substantial burdens on networks but do not pay for assessable broadband or telecommunications services will contribute to USF and help sustain those networks.

*Sources: PWC (Hamilton Consultants) presentation; CTIA Mid-Year 2009 Wireless Indices Report

Fixing USF Supply (cont.)

- The FCC Has Ample Authority and Good Policy Reasons to Expand the Contribution Base:
  - Section 254(d) permits assessment on any provider of interstate telecommunications.
  - If broadband deployment will be funded through USF, it makes sense as a matter of policy and equity that broadband should also support USF.
    - Adding more than $32 Billion in Retail Broadband Internet Access Revenues to the Contribution Base would allow the FCC to cut the Contribution Factor substantially and still enable constrained but reasonable growth in USF over time to support broadband.
  - Non-interconnected VoIP and Texting rely upon supported networks, and should contribute to such support.
    - 2-Way VoIP contributes to USF today – it makes no sense that these other communications streams do not.
    - VoIP and texting are increasingly becoming substitutes for traditional voice services – *e.g.*, the FCC has recognized that consumers should be permitted to text 911.

Fixing USF Demand

- Focusing on the Facts Shows That:
  - Policy-makers should be looking very carefully at precisely where the growth in the USF has come from, rather than responding or resorting to rhetoric.
  - The FCC can address issues in the Demand equation by being prudent in near-term reform:
    - As State Members of the Joint Board have warned, there is risk in expanding programs and/or placing even greater pressures on the USF *before* the FCC determines how to reform USF.
    - Policy-makers should consider whether the rapid increase in certain USF programs is justified. *See, e.g.*, GAO Report 11-11.
    - The FCC should eliminate the Identical Support Rule immediately and base CETC support on actual costs.
  - But the Facts show that the FCC should not gut High-Cost USF or punish RLECs and their rural customers – their draw on USF has been stable and led to *early-stage* successes in deploying affordable broadband in hard-to-serve areas.

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Conclusion

- It is Essential to Focus on Facts and not Fiction in USF Reform and Addressing the Contribution Factor.
- Rural ILECs are not the Source of Pressure on the USF – they have been Stable Recipients and Responsible and Effective Stewards of USF Support.
  - *High-Cost USF is an Availability and Adoption Program!*
- The FCC Should Identify and Remedy Existing Pressures on the USF, rather than Creating New Pressures.
- Policy-makers Should Make Fixes Based Upon the Facts:
  - Expand the Contribution Base
  - Provide Support Based on Actual Costs
  - Hold Off on Any Expansion of USF Support Programs Until USF/ICC Reforms are Complete

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