

Rural Health Care, and low-income programs. For instance, would funding only one CAF provider per geographic area, at most, reduce the number of carriers that bid to provide services to schools, libraries, and health care providers eligible for funding from the E-rate or Rural Health Care programs? Should we designate “Lifeline Only” ETCs to ensure that all low-income consumers have access to the low-income program?⁵⁷⁸

409. We also seek comment on whether any funding is appropriate in an area if high-quality voice service and broadband Internet access services are provided today by an operator without universal service support. If long-term funding is based on census blocks, how should we establish that an area is served today by an unsubsidized provider? Is the existence of unsubsidized competition today a reliable indicator that future funding will not be necessary? How can we ensure that the unsubsidized provider will continue to provide an evolving level of voice and broadband services? We seek comment on whether model-based support or a reverse auction approach would sufficiently avoid providing support to areas in which no funding is necessary due to existing unsubsidized service.

410. We also seek comment on how to address situations where no entity wishes to serve an area. Section 214(e)(3) provides that “[i]f no common carrier will provide the services that are supported by Federal universal service support mechanisms under section 254(c) . . . to an unserved community,” the Commission or a state commission, as appropriate, “shall determine which common carrier or carriers are best able to provide such service to the requesting unserved community . . . and shall order such carrier or carriers to provide such service.”⁵⁷⁹ If the Commission makes broadband a supported service, should the Commission or a state commission require a particular provider (wireline or wireless) to provide broadband service in all areas? What factors should be applied in determining which provider is “best able to provide” supported broadband service? What relative roles should the Commission and the states play in determining which carriers are best able to provide the supported services in unserved areas? We seek comment on whether a consistent, national approach is necessary to further the universal service goals of the Act or to provide certainty to eligible entities regarding the possible application of this important provision.

411. To the extent we ultimately provide ongoing support to only one provider in each geographic area where support is available, we seek comment on whether there should be exceptions to the rule that only one provider should receive ongoing CAF support. For example, we seek comment above on whether any reduction in competitive ETC support should include an exception for carriers serving Tribal lands.⁵⁸⁰ We seek comment on whether there are unique circumstances in Tribal lands and Alaska Native Regions that would require ongoing funding of more than one provider, after the CAF is fully implemented. If commenters believe that unique circumstances require ongoing funding for multiple providers in those areas, they should provide detailed explanation, data and analysis to support their contentions.

B. Sizing the Federal Commitment to Universal Service

412. The Commission has had a long-standing commitment to providing support that is sufficient but not excessive.⁵⁸¹ As the United States Court of Appeals for the Fifth Circuit held in *Alenco*, “[t]he agency’s broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service.”⁵⁸² The

⁵⁷⁸ See AT&T Dec. 6, 2010 *Ex Parte* Letter.

⁵⁷⁹ *Id.* § 214(e)(3).

⁵⁸⁰ See *supra* note 4.

⁵⁸¹ See *2010 Order on Remand*, 25 FCC Rcd at 4088, para. 29 (concluding that a determining the sufficiency of support must also take into account the Commission’s generally applicable responsibility to be a prudent guardian of the public’s resources).

⁵⁸² *Alenco*, 201 F.3d at 620-21.

Alenco court also found that “excessive funding may itself violate the sufficiency requirements,”⁵⁸³ while the United States Court of Appeals for the Tenth Circuit has stated that “excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in [section] 254(b)(1).”⁵⁸⁴ As we undertake reform, we remain committed to controlling the size of the federal universal service fund, and expect the reforms we propose today will result in more efficient use of federal support.

413. The National Broadband Plan recommended that the Commission take steps to manage the fund so that its total size remains close to its current level (in 2010 dollars) to minimize the burden of increasing universal service contributions on consumers.⁵⁸⁵ In the *USF Reform NOI/NPRM*, we sought comment on capping high-cost support provided to incumbent telephone companies at 2010 levels.⁵⁸⁶ Some commenters supported this proposal,⁵⁸⁷ while other commenters argued that the benefits of broadband envisioned in the National Broadband Plan will not be realized without increasing the size of the fund.⁵⁸⁸

414. In 2010, the current high-cost program disbursed roughly \$4.3 billion and was projected to disburse roughly the same amount in 2011.⁵⁸⁹ We seek comment on a proposal to set an overall budget for the CAF such that the sum of the CAF and any existing high-cost programs (however modified in the future) in a given year are equal to the size of the current high-cost program in 2010. Alternatively, if the Commission were to set an overall budget, should it use a different year as the relevant baseline, and under what circumstances (if any) should the Commission adjust the baseline? For instance, should the baseline be adjusted for inflation? In the alternative, is a smaller amount of total funding appropriate to ensure support is sufficient, but not excessive, and the contribution obligation of consumers is minimized? On the other hand, in light of the high costs required to deploy ubiquitous mobile coverage

⁵⁸³ *Alenco*, 201 F.3d at 620.

⁵⁸⁴ *Qwest II*, 398 F.3d at 1234.

⁵⁸⁵ National Broadband Plan at 149-50; see also *Joint Board 2007 Recommended Decision*, at 20484, paras. 26-27 (recommending overall cap on the high-cost fund and a transition in which existing funding mechanisms would be reduced, and all, or a significant share of savings transferred to proposed new funds for broadband and mobility); New Jersey Division of Rate Counsel Comments in re NBP PN #19 at 5,7 (filed Dec. 7, 2009) (arguing the FCC should cap the high-cost fund and transition to a Mobility Fund, a Broadband Fund, and a Provider of Last Resort Fund, such that combined total of the three stays within the cap).

⁵⁸⁶ *USF Reform NOI/NPRM*, 25 FCC Rcd at 6677-78, paras. 51-52.

⁵⁸⁷ See, e.g., Comments of Verizon and Verizon Wireless, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 10 (filed July 12, 2010); Comments of the American Cable Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3 (filed July 12, 2010); Comments of Comcast Corporation, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3-4 (filed July 12, 2010); Comments of the Public Service Commission of the State of Missouri, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 6 (filed July 12, 2010).

⁵⁸⁸ See, e.g., Joint Comments of the National Exchange Carrier Association, Inc., National Telecommunications Cooperative Association, Organization for the Promotion and Advancement of Small Telecommunications Companies, Western Telecommunications Alliance, and the Rural Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 10 (filed July 12, 2010) (cautioning that “the benefits envisioned by the Plan will not be fully realized, and the Plan itself is at risk of failure, because of the Commission’s perplexing insistence that nationwide broadband deployment can be accomplished without the size of the USF growing in real terms”); Comments of the Nebraska Telecommunications Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 3 (filed July 12, 2010).

⁵⁸⁹ This estimate is based on annualizing USAC estimated demand for the first quarter of 2011. See *Federal Universal Service Support Mechanisms Fund Size Projections for First Quarter 2011*, Universal Service Administrative Company, Appendix HC01 (Nov. 2, 2010), <http://www.usac.org/about/governance/fcc-filings/2011/quarter-1.aspx> (projecting first quarter 2011 demand of approximately \$1.1 billion).

and very-high-speed broadband to every American and the length of the transition to the proposed Connect America Fund, we also seek comment on whether additional investments in universal service may be needed to accelerate network deployment.

415. What factors should the Commission consider in sizing the CAF? We note that there are many levers that could impact the level of financial commitment required from the federal universal service fund to achieve our goals, including: how we define affordability; the extent of broadband coverage; our benchmark for broadband capability; whether we fund more than one network per area; the level of financial co-investment from carriers and, potentially, states and localities; the existence of unsubsidized competition; the technologies used to deliver service; the respective roles of satellite and terrestrial technologies; prioritization for certain unserved areas (such as Tribal lands); and the timeframe for extending facilities to unserved areas.

416. We also note that the Commission's high-cost universal service support is only one of the four federal universal service support programs designed to advance the statutory goals of universal service. The Commission developed four universal service disbursement mechanisms – high-cost, low income, schools and libraries, and rural health care – to implement all of the statutory requirements set forth in section 254 of the Act.⁵⁹⁰ We seek comment on whether, in determining the size and role of the CAF, we should take into account the cumulative effect of the four support programs, acting together, to achieve the goals of universal service. Should the Commission be focused on sizing the CAF to ensure that the total universal service program, not just the high-cost program, remains at its current size?

C. Alternative Approaches for Targeting and Distribution of CAF funds

417. The National Broadband Plan recommended that by 2020, the existing high-cost programs would be eliminated, and all funding for supported services would be provided through the Connect America Fund.⁵⁹¹ We seek comment below on alternative approaches for determining ongoing CAF support that ultimately would replace all remaining high-cost funding in stage two. In addition, we seek comment on whether these proposals would be effective on Tribal lands, given the low telephone and broadband penetration rate and the associated demographic challenges.

1. Competitive Bidding Everywhere

418. We seek comment on using a competitive bidding mechanism to award funding to one provider per geographic area in all areas designated to receive CAF support. This competitive bidding mechanism would be designed to maximize the number of households passed by broadband networks while ensuring that Americans retain access to voice service, without exceeding any defined budget for the CAF. We could use a competitive bidding mechanism that would simultaneously select the providers of both broadband and voice or, if necessary to avoid growing the size of the CAF, in some areas voice-only providers that would receive ongoing CAF support. Providers could submit bids for the “complete package,” which includes broadband and voice, bids for voice only, or bids for both options.⁵⁹² Any carrier that plans to use technology that can meet or exceed the proposed performance requirements and accepts the associated public interest obligations would be eligible for support. Ultimately, the carrier would decide what technology or combination of technologies is most appropriate to serve its own territory. In addition, the process could be designed in a way that allows a carrier to use technologies that

⁵⁹⁰ 47 U.S.C. § 254(b); *2010 Order on Remand*, 25 FCC Rcd at 4086-87, paras. 26-27. (describing interrelation of four universal service disbursement programs in advancing the statutory goals of universal service).

⁵⁹¹ See National Broadband Plan at 150 (Recommendation 8.13).

⁵⁹² We note that although a single-round auction is the simplest to run, it could deprive bidders of potentially useful information compared to a multiple round format.

may not meet the minimum performance requirements in place at that time, such as satellite technologies, for the most costly housing units to serve, in order to manage the overall size of the Fund.⁵⁹³

419. Bids for the “complete package” in any area would be selected to maximize the number of households and businesses passed. When none of the bids overlap (cover the same geographic area), bids would be ranked by dollars per households passed from lowest to highest, starting with the lowest. This approach would identify the providers that propose to achieve the greatest broadband coverage with the limited funding available.⁵⁹⁴ Because bidders would be in direct competition with bidders in every area in the nation where support is offered, they should have incentives to limit the amount of support they seek. Participation could be open to all types of providers, provided that they are ETCs (or become ETCs) that meet the public policy parameters for broadband (e.g., speed, coverage, latency) and voice (e.g., outages, E911, COLR obligations) in the areas where they will be providing service.

420. Bids for “voice only” would compete only against other bids for serving the same area (except for satellite bids that are independent of geography), because voice service must be provided in every area. Participation could be open to all types of providers, provided that they are ETCs (or become ETCs) that can meet voice COLR obligations in the areas where they would be providing service. Using satellite voice service as a backstop effectively would set a maximum bid price for voice service because satellite voice service would be available everywhere but at a high bid price. Bids for satellite providers could be in the form of a “per household” price of voice-only service independent of geography

421. We seek comment on whether we should use bidding credits for bids to provide service exceeding the minimum requirements for features such as higher speed, latency, mobility, or upgrade potential, or to provide preferences to carriers serving Tribal lands or insular areas. We seek comment on how competitive bidding processes may properly involve Tribal governments and what impact these processes will have on the provision of CAF-supported services on Tribal lands.

422. We also seek comment on alternative competitive bidding mechanisms to maximize the number of households passed by broadband networks while ensuring that voice service remains available everywhere without exceeding any defined budget for the CAF. Is there some sequential approach that would first determine the least cost method for ensuring that voice service remains available everywhere and then maximizes broadband coverage subject to a budget constraint by substituting bids for the “complete package” of broadband and voice service for voice only bids?

423. *Geographic Areas for Auction.* We seek comment on defining areas for bidding that are aggregations of census blocks. The Commission could use the same Commission-defined geographic areas for complete package and voice only bids to ensure that continued access to voice service everywhere. In contrast to the right of first refusal alternative discussed below, the Commission-defined areas would not have to account for study area boundaries that intersect census block boundaries.⁵⁹⁵

424. *Role of Satellite.* As discussed above, satellites are ideally suited to serve housing units that are the most expensive to reach via terrestrial technologies (assuming available coverage and capacity), because there is little marginal cost to add a subscriber, assuming capacity is available.⁵⁹⁶ Thus, serving the most expensive locations with satellite would reduce the overall support levels needed. For example, using the assumptions made in developing the National Broadband Plan, Commission staff estimated that the \$24 billion broadband availability gap could be reduced by more than half if the

⁵⁹³ We seek comment above on alternative methods of establishing coverage requirements that CAF recipients must achieve. See *supra* at paras. 129-136. 135.

⁵⁹⁴ See *USF Reform NOI/NPRM*, 25 FCC Rcd 6657, at Appendix B (71 Economists’ Proposal).

⁵⁹⁵ See *infra* Section VII.C.2.

⁵⁹⁶ See *supra* paras. 133, 272.

250,000 most expensive housing units were served by satellite.⁵⁹⁷ Because satellite capacity is limited, the number of broadband subscribers that satellite can support depends on the evolution of residential users' demand for bandwidth, and the number and capabilities of the satellites themselves. Regardless, there could be benefits in terms of the size and efficiency of the CAF if our rules were designed to support the use of satellite for the housing units that are most expensive to reach via terrestrial technologies.⁵⁹⁸ The most costly-to-reach housing units in any given area, however, may not be among the most expensive nationally; in another area, a large fraction of the housing units could be among the most expensive. One possible approach to aligning the use of satellite capacity with the areas of greatest cost would be to limit support for any line with cost over a specified threshold (e.g., five times the national average cost per line) to the amount of support needed to serve the housing unit with satellite. An alternative would be to allow providers to use satellite to serve the most expensive homes. We seek comment on these and other methods for effectively using funding for satellite.

425. A judicious use of support for satellite service could reduce costs associated with building out networks. There are several approaches for how best to capture these potential savings in a competitive bidding process. One approach would be to allow satellite providers to bid on areas against other providers. For larger geographies, however, this approach could become problematic, because any given area is likely to contain a mix of high- and low-cost lines. In addition, as the number of housing units in the area increases, the aggregate demand could outstrip a single spot-beam's capacity. Satellite companies could respond by deploying narrower spot beams in that area, but that would require designing the satellite for that specific purpose.

426. A second approach could be for satellite providers to bid in the form of a per-housing-unit price of the "complete package" for a maximum number of housing units within geographic areas corresponding to the approximate coverage of their spot beams. This would allow satellite providers to bid in a simple way that accounts for possible capacity constraints within a given area. The auction mechanism would optimally allocate these bids to geographic areas in which competing bids are higher than the satellite bid.⁵⁹⁹

427. A third approach would be to exclude satellite operators from bidding, but allow winning bidders complete freedom in their choice of technology. Where satellite is the most cost-effective solution, the winning bidders would have economic incentives to subcontract with satellite providers. This would allow the market to find the lowest cost solutions for many geographies, but could lead to sub-optimal use of satellite capacity – for example, a large national carrier could lock-in more capacity for its most expensive-to-serve housing units leaving no capacity for a rural carrier with homes that are more costly to serve than the larger carrier's most expensive-to-serve housing units. We seek comment on which of these approaches, or any others, might be best suited to making the best use of satellite capacity with competitive bidding.

⁵⁹⁷ See National Broadband Plan at 138; OBI, Broadband Availability Gap at 5, 89. The \$24 billion broadband availability gap represents the difference between the incremental costs of deploying and operating broadband networks in unserved areas and the incremental revenues generated by those networks. See National Broadband Plan at 136-37.

⁵⁹⁸ Serving an area with satellite may provide only limited savings, however, if there is ongoing support for the existing twisted-pair infrastructure.

⁵⁹⁹ More specifically, in all geographic areas in which the minimum bid by a non-satellite bidder is less than or equal to the satellite bid, these bids would be accepted. If the total number of households in the remaining geographic areas is less than the maximum number of households specified in the satellite bid, then each of these would be served by satellite. If the number of remaining households is greater than the satellite maximum, then the geographic areas with the highest non-satellite bid would be served up to the satellite maximum, and the remaining geographic areas would be served by non-satellite bidders, but at a bid greater than the satellite bid.

428. Although we recognize that currently unserved areas may be more economically served by satellite, we do not believe that consumers currently served by terrestrial broadband or voice services should lose access to their terrestrial service. How do we structure our support to ensure this result?

429. Some satellite providers have argued that the ETC designation process imposes burdens on carriers that are interested in providing supported services in multiple states.⁶⁰⁰ Commenters have suggested that, to address this concern, the Commission should designate ETCs on a nationwide basis.⁶⁰¹ Although we recognize that the Act assigns, in the first instance, each state the authority to designate as ETCs those carriers that seek to provide service within that state,⁶⁰² we seek comment on whether the Commission nevertheless possesses authority to act on applications for designation that cover service areas in multiple states. If so, what is the legal basis for that authority? We also seek comment on how the Commission should evaluate such applications if the Commission were to find that it had authority to grant them. Moreover, to the extent a provider seeks to become an ETC to provide only broadband services, would the Commission have exclusive jurisdiction to rule on such applications?

430. *Price-Cap Areas First.* We seek comment on whether we should implement a competitive bidding process for ongoing CAF support on a phased basis, beginning with price cap service areas. If we were to follow such a staged approach, we presumably would need to determine how to divide the CAF between the price cap territories and the rate-of-return territories, so that we could maintain our overall budget for the CAF. How would we do so? Would it make sense to differentiate between Bell Operating Companies and mid-size price cap carriers if we were adopt a staged approach? Commenters should address whether this would limit the pool of eligible bidders in a way that undermines the benefits of allowing the market to drive support levels down. We also seek comment on how a staged approach would impact the timeline for comprehensive reform and transition to the CAF. If we were to adopt such an approach, rate-of-return service areas would continue to receive support under the current high-cost programs, subject to any modification described above,⁶⁰³ while this approach is implemented first in areas served by price-cap companies.

2. Right of First Refusal Everywhere, Followed by Competitive Bidding Where Necessary

431. *Right of First Refusal.* In the alternative, we seek comment on an approach under which, in each service area designated to receive CAF support, the Commission would offer the current COLR for voice services (i.e., most likely a wireline incumbent LEC) support through a “right of first refusal” (ROFR) to provide both voice and broadband to customers in the area for a specific amount of ongoing support.⁶⁰⁴ If the current COLR accepts the ROFR, that carrier would commit to deploying a network capable of delivering both broadband and voice services throughout its service area, consistent with the coverage requirements and other public interest obligations of CAF fund recipients discussed above.⁶⁰⁵ An incumbent LEC with the broadband public interest and voice COLR obligations could deploy any technology (e.g., terrestrial wireless) to build out in unserved areas, and would not be required to extend

⁶⁰⁰ See Letter from John P. Janka, Counsel for ViaSat, Inc. and WildBlue Communications, Inc., to Marlene Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 05-337, 10-90, Attach. at 2 (filed Nov. 2, 2010).

⁶⁰¹ See *id.*; see also Letter from L. Charles Keller, Wilkinson Barker Knauer, LLP, Counsel for DISH Network and EchoStar Satellite Services, to Marlene Dortch, Secretary, FCC, WC Docket Nos. 10-90, 05-337, Attach. at 7 (filed Nov. 11, 2010).

⁶⁰² 47 U.S.C. § 214(e)(2).

⁶⁰³ See *supra* Section VI.

⁶⁰⁴ As noted above, that amount of support would not be guaranteed in future years, but rather would be obligated only after a Commission determination that the recipient has complied with all program requirements. See *supra* para. 362.

⁶⁰⁵ See *supra* Section V.D.

its wireline network. As discussed above, for the most expensive areas to serve, the carrier may have the option of using technologies that may not meet the minimum performance requirements in place at that time for broadband service, such as satellite technologies.⁶⁰⁶ We also seek comment on alternative ways to conduct the ROFR. For example, instead of the Commission making an all-or-nothing offer to the current COLR, should the Commission request that the current COLR make an offer of the support level it believes it needs, which the Commission will either accept or reject?

432. *Use of a Cost Model.* The Commission would determine the amount of CAF support to be offered to the current COLR using a cost model developed in an open, deliberative, and transparent process with ample opportunity for interested parties to participate and verify model results. The amount of support offered would be determined by comparing the cost of serving the COLR's service area compared to a national cost benchmark. Support would be provided for costs above the benchmark. Total CAF support (assuming all COLRs accepted the ROFR) could be estimated by adjusting the benchmark.

433. In the *USF Reform NOI/NPRM*, the Commission sought comment on whether we should develop a nationwide broadband model to estimate support levels for the provision of broadband and voice services in areas that are currently served by broadband with the aid of existing high-cost support, as well as areas that are unserved.⁶⁰⁷ Among other things, the Commission asked whether it should develop a forward-looking economic cost model that estimates the costs of all technologies currently being (or soon to be) deployed that are capable of providing voice service and broadband service that meets whatever standard the Commission ultimately adopts for broadband.⁶⁰⁸ We seek comment on using a model that would estimate the forward-looking economic costs of providing broadband and voice service. The model could estimate costs of providing service over a wireline network; alternatively, the model could estimate costs of providing service using the lowest-cost (or lowest-net-cost, if revenues are taken into account) technology capable of providing the required minimum level of voice and broadband service for each area, which may be wireless in some areas and wireline in others. Under the second alternative, if the model determined that service could be provided to an area more cost effectively using wireless technology, the wireline incumbent might choose to accept the offer of support and find a wireless company to partner with for at least some of its service area, or it might prepare to offer wireless service itself in some or all of its service area, provided it could obtain access to the necessary inputs, including spectrum.⁶⁰⁹ The duration of the transition period to new funding levels and new broadband service obligations may be a key factor in determining the feasibility of this latter approach for wireline incumbents. We seek comment on the relative merits of these two alternatives. Below, we seek comment on specific proposals regarding how a model based on a wireline network could be developed. However, we do not intend to suggest that the amount of support offered under the ROFR would necessarily be

⁶⁰⁶ We seek comment above on alternative methods of establishing coverage requirements that CAF recipients must achieve. See *supra* paras. 129-136.

⁶⁰⁷ See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6665, para. 17. Although some parties provided useful comments about the use of a model in response to the *USF Reform NOI/NPRM*, there was some confusion about the relationship of the National Broadband Plan model to any model the Commission might ultimately adopt in conjunction with a distribution mechanism for CAF support. For example, some commenters claimed that they could not provide detailed comments on using a model, because they did not have access to the proprietary data used in the National Broadband Plan model. See, e.g., AT&T July 12, 2010 Comments at 14. The intent of the NOI was to solicit comment on certain threshold design issues, and we clarify here that we do not intend to use the National Broadband Model to determine ongoing support amounts under the CAF.

⁶⁰⁸ See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6668, para. 25.

⁶⁰⁹ We note that Verizon Wireless recently announced an "LTE in Rural America" initiative that would make spectrum and LTE equipment available to companies seeking to offer 4G (LTE) wireless service in rural America beyond the reach of Verizon's 4G (LTE) network. See Verizon Wireless, LTE in Rural America, available at <http://aboutus.vzw.com/rural/Overview.html>.

based on the specific model described below. If the Commission were to use a model to determine the amount of support offered under a ROFR, we seek comment on how such support should be adjusted if the Commission adopts a coverage requirement that is less than 100 percent of the ROFR area, or permits carriers to provide some form of high speed Internet access service that may not meet the broadband performance metrics adopted by the Commission.⁶¹⁰

434. If we were to use a wireline-only model, we seek comment on how we should define the forward-looking economic costs of a wireline broadband network and what types of costs we should include in the model, if we were to take such an approach. In the *USF Reform NOI/NPRM*, we sought comment on whether the Commission should consider any existing plant.⁶¹¹ We noted that the Commission's hybrid cost proxy model (HCPM) adopted a "scorched node" approach, which, while not a total-green field approach, assumes as given only incumbent LEC central office (switch) locations.⁶¹² We also sought comment on whether the Commission should use a cost model that estimates the total costs of broadband-capable networks, rather than the incremental costs of upgrading or extending existing networks to provide broadband in unserved areas.⁶¹³

435. In considering what types of costs to include in a broadband cost model, there are two basic approaches. One approach is to assume that only no, or very limited, network facilities exist currently; this green-field approach includes the costs of building, maintaining and operating a network.⁶¹⁴ The second approach is to assume that some form of network currently exists; this brown-field approach includes the cost of upgrading, maintaining and operating a network to offer the required level of service.⁶¹⁵ Each of these approaches has some advantages.

436. The green-field approach, because it includes the cost of the entire initial build-out, would include the cost of connecting each home. This would eliminate concerns expressed by commenters about the size and quality of copper gauge in existing network deployments.⁶¹⁶ Over the lifetime of a network, the cost of a fiber-to-the-premises (FTTP) and short-loop (12,000-foot) DSL network may be basically equal,⁶¹⁷ meaning that green-field costs are equivalent to those for an FTTP deployment. The potential downside to using a model based on the green-field approach is that it would

⁶¹⁰ See *supra* paras. 129-134.

⁶¹¹ See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6668-69, para. 27.

⁶¹² See *id.*

⁶¹³ See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6670-71 paras. 33-34. We explained that the National Broadband Plan model estimates the incremental costs and revenues associated with new broadband deployment, but does not take into account any current universal service support in either served or unserved areas. In contrast, HCPM estimates the total local exchange network costs of providing telephone service to all households and businesses within a geographic area. *Id.*

⁶¹⁴ One common approach is a "scorched node" approach where the location of incumbent central offices is taken as fixed; another approach is a "scorched earth" approach where no facilities are taken as fixed.

⁶¹⁵ The National Broadband Plan model took a particular brown-field approach where the costs of maintaining and operating the existing network were allocated to existing products. This approach makes sense when evaluating a new-product launch – allocating existing operating costs to a not-yet-launched product would worsen its viability and likelihood of being launched – and calculating the value such a new product would bring to a company. We are not proposing to follow such an approach here for ongoing support under the CAF.

⁶¹⁶ See, e.g., AT&T July 12, 2010 Comments, at 16.

⁶¹⁷ Commission staff analyzed data from the model used to create the NBP, comparing the cost of a FTTP build to every housing unit with the cost of a green-field 12,000-foot-loop DSL build to every home; we note that the latter calculation was not part of the analysis done for the NBP. The analysis showed that the costs associated with FTTP were higher up-front, but those costs are offset by savings over the lifetime of the network. This is consistent with the description of FTTP economics in OBI Tech Paper #1. See OBI, Broadband Availability Gap, at 96.

provide support to a carrier to build a completely new network, regardless of whether the carrier actually deployed a new network or merely upgraded portions of the existing network.

437. The brown-field approach assumes the existence of a last-mile copper network.⁶¹⁸ Upgrading an existing network to support broadband involves pushing fiber deeper into the network, and adding electronics capable of supporting broadband. The costs associated with upgrading the network include the cost to build, maintain, and operate the new components of the network. In addition, one can include the cost to maintain and operate the un-upgraded, last-mile portion of the network.⁶¹⁹ This brown-field approach ensures that the value of (sunk) private investment is captured in the cost calculation, and thereby limits the support required. However, this approach likely underestimates costs in some areas (where the last-mile network is not capable of delivering broadband service); and would likely overestimate costs in other areas because it would fail to take account of areas where carriers have already upgraded networks.

438. Despite certain drawbacks, if we adopt this alternative, we propose to use a green-field, “scorched node,” approach in developing a broadband cost model. A number of commenters suggest that any model used to estimate ongoing CAF support, which would replace current high-cost support, should estimate the total forward-looking economic costs of deploying networks capable of providing broadband and voice services.⁶²⁰ We therefore seek more focused comment on developing a total cost model.

439. In the *USF Reform NOI/NPRM*, the Commission also sought comment on whether the Commission should consider revenues, as well as costs, in determining CAF support.⁶²¹ Despite the advantages of including demand-side metrics in the determination of which areas are truly uneconomic to serve, we recognize that there could be difficulties in accurately estimating and modeling revenues. We seek comment on these issues.

440. The Commission is committed to a robust public comment process, and commenters have asserted that developing an engineering cost model, such as the Commission’s existing HCPM, through a full comment process is a difficult, time-consuming effort.⁶²² We seek comment on whether there are other approaches to modeling that would be both data-based and rigorous on the one hand, and provide a means to move forward more quickly and easily on the other.

441. As discussed above, to set reasonable limits on existing high-cost support for rate-of-return carriers, we propose to use regression analysis to develop formulas that estimate the operating costs and investment requirements associated with serving specific geographic areas.⁶²³ We seek comment on whether we should use this approach for purposes of determining ongoing support under the CAF for all companies, calculating cost as a function of density and other variables that are shown to have predictive value. Such a model could calculate the costs for a small geographic area, e.g., census blocks, which

⁶¹⁸ One could, in theory, capture actual network deployments and therefore calculate the costs required for this upgrade at a local level. However, this approach is administratively complex and is likely impractical; the focus here is on modeling what networks currently exist and what would have to be upgraded.

⁶¹⁹ We note that the National Broadband Plan model did not include these costs, allocating them instead to existing products.

⁶²⁰ See, e.g., Comments of Windstream Communications, Inc., WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 11 (filed July 12, 2010); Comments of the Independent Telephone & Telecommunications Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 16-18 (filed July 12, 2010).

⁶²¹ See *USF Reform NOI/NPRM*, 25 FCC Rcd at 6671-40, paras. 35-40.

⁶²² See, e.g., Comments of the Independent Telephone & Telecommunications Alliance, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 6, 10 (filed July 12, 2010); Comments of the National Cable & Telecommunications Association, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 05-337, at 18-20 (filed July 12, 2010).

⁶²³ See *supra* para. 203.

could then be aggregated to larger, relevant geographies, e.g., COLR service areas for the ROFR. Of course any regression-based model will include some level of error – some amount of variation that is not explained by the regression. Averaged over any large number of measurements, this error should disappear, as over- and under-estimates cancel one another out.⁶²⁴ We seek comment on this approach and on whether such a model would be sufficiently reliable to use for determining the amount of CAF support offered under a ROFR. In particular, we seek comment from those who may have experience with using this approach to calculate support. In addition, as noted above, such an approach would require an appropriate source data set in order to be effective. The Commission would need to calculate support for both large carriers and small carriers operating in rural areas in a wide variety of terrains. We seek comment on what data, from what network operators, could be used as an appropriate data set; and on any difficulties the Commission could face in compiling such a source data set.

442. Alternatively, the Commission could develop a cost model more similar to HCPM or the model created for the NBP. In such a model, the costs of each area would be calculated from the local conditions – including whatever information is available about the location of homes and roads, soil type, presence of aerial plant, etc. This approach, more similar to traditional engineering-cost models, is likely more time-consuming to develop, and given that there are more model inputs and more model code, would likely require more input from the public. However, such a model would avoid the issues noted above about statistically driven errors (noting that any model will have some level of errors driven by, at the very least, imperfect input data). We seek comment on the trade-offs between a larger investment, both in time and in effort, of an engineering cost model approach relative to a regression-based model.

443. Creating a model, regardless of the method chosen, does not specify support levels. Choices about the level of geographic aggregation or the type(s) of network technology supported, among many others, are large drivers of calculated support.⁶²⁵ Ensuring that all Americans have access to a modern telecommunications network while still controlling the size of the fund is challenging. There are, however, a handful of such choices that could increase the number of those with broadband access for a given level of funding. One such choice concerns the role of satellite, discussed above, in serving the most expensive-to-serve housing units.⁶²⁶ Another is the level of geographic aggregation used in calculating an area's cost. As noted above, at the simplest level, averaging over larger geographies lowers the average cost of the most expensive areas within that geography (in effect, requiring geographic cross-subsidies within a carrier's footprint). However, reducing the calculated cost by averaging means that there may be areas unserved by broadband that will not receive support. Using smaller geographies, for example by moving from study-area to wire center cost averaging, de-averages the costs of the most expensive areas to some extent. Because there is some co-linearity between the unserved and the most expensive areas, this would provide more support to unserved areas. The potential drawback is that it means fewer areas would be supported, because of the higher average cost per home in these areas. Another approach, which targets support to those areas that need it most, would be to de-average both served and unserved geographies, funding any area (regardless of whether served or unserved) that exceeds a cost threshold. Other factors, like the role of revenue in the model and the choice of network deployment are discussed above.⁶²⁷ We seek comment on the advantages and disadvantages of each of the choices mentioned and ask how that would impact our ability to maximize access to broadband for a given level of CAF funding. We also seek comment on how each of these choices would impact the provision of services on Tribal lands.

444. *Competitive Bidding if ROFR Refused.* If we were to adopt such an approach, we would also need to have a process in place to address situations where the current voice COLR refuses to accept

⁶²⁴ See OBI, *Broadband Availability Gap*, at 24.

⁶²⁵ See OBI, *Broadband Availability Gap*, at chapter 3.

⁶²⁶ See *supra* paras. 424-428.

⁶²⁷ See *supra* para. 439.

the amount of ongoing support calculated by the cost model. If the COLR refuses the ROFR, a competitive bidding mechanism could be used to provide ongoing CAF support to at most one provider in any given area. Such a competitive bidding mechanism would simultaneously select the providers of both broadband and voice, or if necessary, voice-only providers that would receive CAF support, and, as with the auction approach above, would seek to maximize the number of households passed by broadband networks while ensuring that consumers retain access to voice service. As above, we also seek comment on using alternative competitive bidding mechanisms and specifically ask whether there is a sequential approach that would first determine the least-cost method for ensuring that voice service remains available everywhere and then maximizes broadband coverage subject to a budget constraint by substituting bids for the “complete package” of broadband and voice service for voice only bids. Consistent with the proposals above,⁶²⁸ that amount of support would not be guaranteed in future years, but rather would be obligated only after a Commission determination that the recipient has complied with all program requirements.

445. *Geographic Areas for Auction.* The geographic areas where the right of first refusal is offered would necessarily be defined by the COLRs’ service areas. Despite this constraint, the areas for auction should be defined in as technology neutral a way as possible. Bidder-defined geography not exactly the same as entire study areas could increase the likely number of bidders. For example, the Commission could define areas for bidding that are aggregations of census blocks. The same Commission-defined geographic areas could be used for complete-package and voice-only bids. This way, if there is no complete package bid for an area there would be a voice-only bid for *exactly* the same area. It could avoid the problem of having to fill in an area with no complete-package bids with multiple voice-only bids that overlap with complete-package bids in adjacent areas. We seek comment on what factors the Commission should consider when defining the geographic areas for the auction, if it were to use such an approach.

446. *Transition.* We seek comment on how support under the existing programs would be transitioned to the Connect America Fund under each of the possible scenarios for the outcome of the ROFR option. We seek comment on whether a transition is necessary or appropriate in all circumstances. For example, if a COLR currently receiving support accepts a ROFR, we could presume that the amount offered is sufficient and that no transition is necessary. Similarly, if a COLR currently receiving support refuses the ROFR and subsequently wins the auction, we could presume that the bid reflects sufficient support and that no transition is necessary. If a COLR currently receiving support refuses the ROFR and subsequently does not win the auction, a transition may be appropriate because there may be a period of time before the new provider is able to build-out and serve the area. How quickly should we phase down the current COLR’s support immediately if a new provider wins the auction? How long should the current recipient be required to comply with public interest obligations, as proposed above, if it is not the ultimate recipient of ongoing support?

447. *Price-Cap Areas First.* We seek comment on whether we should implement a ROFR followed by competitive bidding on a phased basis, beginning with price cap service areas. If we were to follow such a staged approach, we presumably would need to determine how to divide the CAF between the price cap territories and the rate-of-return territories, so that we could maintain our overall budget for the CAF. How would we do so? Would it make sense to differentiate between Bell Operating Companies and mid-size price cap carriers if we were to adopt a staged approach? Would limiting the number of study areas that participate in the ROFR potentially limit the efficacy of any potential auction for companies that refuse the ROFR, due to too few bidders? We also seek comment on how a staged approach would impact the timeline for comprehensive reform and transition to the CAF. If we were to follow such an approach, pending completion of the transition to the CAF for the price cap carriers, rate-of-return companies would continue to receive support under the current high-cost programs, subject to

⁶²⁸ See *supra* para. 362.

any modification described above,⁶²⁹ while this approach is implemented first in areas served by price-cap companies.

3. Continued Rate-of-Return Reform for Certain Areas

448. We sought comment above on a package of proposals intended to improve the incentives for rational investment and operation by small companies operating in rural areas.⁶³⁰ Assuming that we adopt some or all of these reforms, we could evaluate their success in meeting these objectives before we implement stage two of our comprehensive reform package. If the Commission finds that the reforms have adequately improved the incentives for investment and operation by small, rural companies, it could determine that support for these carriers should remain based on reasonable actual investment, rather than a cost model or auction. On the other hand, the Commission previously determined that if support is based on cost, it should be based on forward-looking economic cost, not embedded costs,⁶³¹ and that “there may be significant problems inherent in indefinitely maintaining separate mechanisms based on different economic principles.”⁶³²

449. In the event that the Commission determines that it should take different approaches to implementing the Connect America Fund in different geographic areas, it could, for example, determine that only price cap territories would receive support awarded either through a ROFR, followed by competitive bidding, or through competitive bidding without a ROFR, depending on which option the Commission adopts for determining CAF support. The Commission could follow an alternative path for rate-of-return territories that would provide ongoing support based on reasonable actual investment. Should we take this approach, we seek comment on the need for possible changes to the current rate-of-return system beyond those discussed in the previous section, including capping and shifting interstate common line support to an incentive regulation framework that would establish support amounts periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue, implementing a more rigorous process to examine whether investment is used and useful, and re-examining the current 11.25 percent authorized rate of return.

450. *Capping Interstate Common Line Support and Shifting Into a New Incentive-Based Mechanism.* In April 2010, in the *USF Reform NOI/NPRM*, the Commission sought comment on shifting rate-of-return carriers to incentive regulation generally, including comment on capping ICLS.⁶³³ Specifically, we sought comment on whether we should convert ICLS to a frozen amount per line, which would have the effect of limiting growth in the existing high-cost program.⁶³⁴ We seek comment on whether capping ICLS on either a per-line, study area, or any other basis would be consistent with rate-of-return regulation or whether we would need to adopt some form of incentive regulation to accomplish the objective of limiting the size of the Fund.

⁶²⁹ See *supra* Section VI.

⁶³⁰ See *supra* Section VI.A.

⁶³¹ See, e.g., *Universal Service First Report and Order*, 12 FCC Rcd at 8899, paras. 224-25, *Rural Task Force Order*, 16 FCC Rcd at 11311-12, para. 174; *USF Reform NOI/NPRM*, 25 FCC Rcd at 6667-68, para. 23.

⁶³² *Rural Task Force Order*, 16 FCC Rcd at 11311, para. 173. Although the Commission adopted a separate mechanism for rural carriers in the *Rural Task Force Order*, it rejected arguments that only an embedded cost mechanism would provide sufficient support for rural carriers and did not find the the Rural Task Force’s analysis justified a reversal of the Commission’s position with respect to the use of forward-looking cost as a general matter. *Id.* at 11311-12, para. 174.

⁶³³ *USF Reform NOI/NPRM*, 25 FCC Rcd at 6679-80, paras. 55-56.

⁶³⁴ *Id.* at 6680, para. 56.

451. As discussed in greater detail below,⁶³⁵ this Notice seeks comment on an incentive regulation framework for any intercarrier compensation replacement funding that would be distributed through the CAF to carriers that currently set their access charges based on a rate-of-return framework. ICLS, however, would continue to be computed based on a rate-of-return framework, unless otherwise modified. We seek comment on whether the same incentive regulation framework described below in the intercarrier compensation context could also be used to replace the ICLS mechanism.⁶³⁶

452. Under an incentive regulation framework, once intercarrier compensation reform is completed, universal service distributions could be determined as part of the same CAF distribution process applicable to all carriers. Alternatively, if rate-of-return carriers are treated differently within the CAF, funding levels could be set periodically (such as every five years) to generate an appropriate forward-looking return for an efficient carrier for the investments at issue.⁶³⁷ Would that be an appropriate way for the Commission to shift from ICLS into that incentive-based universal service mechanism?

453. In addition, we also seek comment on the manner in which such funding might transition. For example, should any shifting of support from ICLS to a new recovery mechanism be accomplished in a lump-sum manner—e.g., by simply adding the then-existing level of ICLS funding, either in aggregate or on a per-carrier basis, to the revenues to be recovered through the new mechanism? Or should any shifting of support occur be phased-in over time, and if so, how would that be accomplished?

454. *Used and Useful.* Historically, the Commission's rate-of-return ratemaking policies have reflected the equitable principle that ratepayers should not be forced to pay a return except on investments that can be shown to benefit them.⁶³⁸ As a result, the Commission has allowed recovery through regulated rates for property only when it is "used and useful" in the provision of regulated services—i.e., only if it is "necessary to the efficient conduct of a utility's business, presently or within a reasonable future period."⁶³⁹ As described above, the Commission's universal service policies for rate-of-return carriers have evolved to enable them to recover through universal service support certain costs that they cannot recover from end users because of rules that cap their rates below the level that would be permitted by a rate-of-return calculation. Thus, inclusion of excess costs in a carrier's rate base—such as costs that are not "used and useful"—can increase the demands on the universal service fund, as well. We seek comment on whether more detailed, industry-wide clarifications regarding what should be deemed "used and useful" would be helpful to ensure that excess costs are not recovered through universal service (or carriers' rates). If so, what clarification would be appropriate?

⁶³⁵ See *infra* Section XIV.D-E.

⁶³⁶ For example, the Commission could adopt the incentive-based universal service distribution mechanism both for any funding to replace intercarrier compensation revenues and to replace ICLS. Alternatively, even if it were not adopted in the intercarrier compensation reform context, this mechanism theoretically still could be used to replace ICLS.

⁶³⁷ Although this mechanism would not guarantee a particular carrier a defined rate of return, it could include certain "safety valves." See *infra* Section XIV.D-E.

⁶³⁸ "Equally central to the used and useful concept, however, is the equitable principle that the ratepayers may not fairly be forced to pay a return except on investment which can be shown directly to benefit them. Thus, imprudent or excess investment, for example, is the responsibility and coincident burden of the investor, not the ratepayer." *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 112 (1977) (*AT&T Phase II Order*). The benefit, however, does not have to be immediate and can include, for example, a portion of equipment that is serving as a reserve for future use. See, e.g., *Investigation of Special Access Tariffs of Local Exchange Carriers*, FCC 86-52, 1986 WL 291617, para. 41 (1985) (*Phase I Special Access Tariffs Investigation Order*), remanded on other grounds, *MCI Telecom. Corp. v. FCC*, 842 F.2d 1296 (D.C. Cir. 1988).

⁶³⁹ *American Tel. and Tel. Co.*, Phase II Final Decision and Order, 64 FCC 2d 1, at 38, para. 111 (1977) (*AT&T Phase II Order*).

455. *Authorized Rate of Return.* Rate-of-return carriers currently are permitted to charge interstate rates that will allow them the opportunity to recover their expenses, plus an 11.25 percent rate of return on their net common line investment. The Commission last adjusted the authorized rate of return in 1990.⁶⁴⁰ In 1998, the Commission initiated a proceeding to re prescribe the authorized rate of return for rate-of-return carriers.⁶⁴¹ In the *MAG Order*, the Commission terminated the prescription proceeding in CC Docket No. 98-166.⁶⁴² The Commission also stayed the effectiveness of section 65.101 of the Commission's rules, which otherwise would have required the Commission to initiate a unitary rate of return prescription proceeding immediately as a result of termination of the CC Docket No. 98-166 proceeding.

456. We seek comment on whether the Commission should initiate a proceeding to re prescribe the authorized rate of return for rate-of-return carriers if it determines that such carriers should continue to receive high-cost support under a modified rate-of-return system. We seek comment on whether these changes, or any other potential changes to rate-of-return regulation, would adversely affect the ability of rate-of-return carriers to provide voice and broadband services.

VIII. INCREASING ACCOUNTABILITY AND MEASURING PROGRESS TO ENSURE INVESTMENTS DELIVER INTENDED RESULTS

A. Increasing Transparency, Oversight and Accountability

457. Universal service represents an investment overseen by the Commission on behalf of the public as a whole. As such, the Commission has an obligation to the public to ensure that the funds are spent appropriately and efficiently. To ensure that universal service funds are spent in a fiscally responsible manner, the Commission, and USAC, must have sufficient insight into the operations and financial condition of fund recipients. To meet this obligation, we propose that the Commission require increased disclosures about the operating performance and financial condition of companies that receive universal service support.

1. Reporting Requirements

458. To improve performance management and strengthen oversight of the high-cost program – as well as to lay a solid foundation for the CAF – we propose annual data collections from current recipients of high-cost USF as well as from any future recipients of the CAF. We envision these data collections as a primary means to evaluate whether these universal service programs are meeting the performance goals proposed below. We also expect that these collections will help assess recipients' compliance with program rules and cost-effective use of program funds.⁶⁴³

459. First, beginning within six months of the effective date of an order, we propose to require all high-cost funding recipients – and ultimately CAF recipients – to report to USAC on deployment, adoption, and pricing for both their voice and broadband offerings. We note that we seek comment on related issues in the *Broadband Data NPRM*.⁶⁴⁴ We propose that the first reporting submission show operating results as of the end of the calendar year prior to the adoption of an order and then submitted

⁶⁴⁰ *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990).

⁶⁴¹ *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998).

⁶⁴² See *MAG Order*, 16 FCC Rcd at 19701, para. 208.

⁶⁴³ See *infra* para. 479 (explaining that performance goals and measures should improve program accountability).

⁶⁴⁴ See *Broadband Data NPRM*, FCC 11-14, at paras. 47-76 (seeking comment on whether and how the Commission should collect deployment and price data).

annually thereafter.⁶⁴⁵ We seek comment on whether this information would be sufficient to enable us to determine whether our proposed performance goals are being met,⁶⁴⁶ or if additional reporting requirements are needed to oversee the Universal Service Fund. To the extent that some high-cost recipients already report some of that information, such as competitive ETCs designated by the Commission,⁶⁴⁷ we seek comment on how to transition from the current reporting requirements to more competitively neutral reporting requirements that would apply to all high-cost and CAF recipients.

460. We acknowledge the statutory mandate that rates for supported services in rural areas should be reasonably comparable to rates in urban areas. We note, however, that there is evidence in the record that local rates for a number of smaller carriers that operate in rural areas may actually be lower than the national average rates of \$15.62 (excluding additional charges) and \$25.62 (including additional charges).⁶⁴⁸ Although local rates, to the extent they are regulated, are governed by state regulators, it is imperative that we gather essential information so that we can better determine the degree of federal commitment that may be required to support universal service, particularly as we transition to a world where consumers are purchasing broadband-voice packages. We also seek comment on whether the approach for collecting essential information as set forth in the *Broadband Data NPRM* is sufficient or whether a reporting requirement unique to high-cost and CAF recipients is necessary.⁶⁴⁹

461. Second, we propose to require recipient carriers to file with the Commission within 120 days of the end of each of their fiscal years a full and complete annual report of their financial condition and operations, in form and substance satisfactory to the Commission, which is audited and certified by an independent certified public accountant satisfactory to the Commission, and accompanied by a report of such audit in form and substance satisfactory to the Commission.⁶⁵⁰ The report shall include, at a minimum, balance sheets, income statements, statements of cash flow, and notes to the financial statements, if available.

462. Consistent with policies and regulations governing public equity and debt capital markets, we also seek comment on making the information included in these disclosures available to the public to promote increased transparency and efficiency.⁶⁵¹ Increased disclosure of this information may lead to more competition or the acquisition of less efficient carriers without disrupting service to consumers in areas served by those carriers. We seek comment on the confidentiality issues that public disclosure may raise.

463. We recognize the potential benefits of increased reporting and disclosure are not without cost. To minimize the cost and reporting burden on carriers, we propose to allow those carriers that are required to file financial reports with the Securities and Exchange Commission or the Rural Utilities

⁶⁴⁵ See *id.*, at para. 46 (seeking comment on frequency of filing FCC Form 477).

⁶⁴⁶ See *infra* para 489 (establishing performance goals).

⁶⁴⁷ 47 C.F.R. § 54.209; see *supra* para. 100.

⁶⁴⁸ The average local rate of \$15.62 for flat-rate service excludes Federal and State Subscriber Line Charges, taxes, 911, and other charges. With the inclusion of these additional charges, the average monthly cost for local flat-rate service is \$25.62. See 2008 Reference Book of Rates, at Table 1.1. See also Comments of The Oregon Telecommunications Association and The Washington Independent Telecommunications Association, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51 (filed July 12, 2010), Table 5 (showing local rates for independent telephone companies in the states of Washington and Oregon that are both above and below the nationwide average local rate of \$15.62).

⁶⁴⁹ See generally *Broadband Data NPRM*, FCC 11-14, at paras. 49-65.

⁶⁵⁰ See Comments of John Staurulakis, Inc., GN Docket Nos. 10-90, 09-51, WC Docket No. 05-337 (filed July 12, 2010), at 10 (stating that most state commissions require the filing of financial, demand, and service-level standards on a regular basis).

⁶⁵¹ See The Securities Exchange Act of 1934, 48 Stat. 881 (1934), 15 U.S.C. § 78 et seq.

Service to satisfy our requirement by providing electronic copies of the annual reports filed with those agencies to the Commission so long as the reports meet the minimum information requirements imposed by the Commission's rules and are filed with the Commission by the deadline imposed in accordance with this requirement.⁶⁵²

464. For SEC registrants and RUS borrowers the submission of the same data and information required by the SEC or RUS would not require any additional burden since such documents are already being prepared to satisfy other reporting requirements. For companies that are neither an SEC registrant nor an RUS borrower, such a requirement should not be a significant additional burden because such financial accounting statements are normally prepared in the usual course of business.

465. Third, we propose that all recipients report intercarrier compensation revenues and expenses as described in detail below.

466. We seek comment on these proposals. We also seek comment on reducing or suspending universal support payments for non-compliance with reporting requirements. For example, should universal service support be suspended immediately if a recipient fails to submit the required information and not restored until such information is submitted?

467. We also seek comment on codifying additional reporting requirements applicable to USAC to further assist the Commission in fulfilling its oversight responsibilities of the universal service support mechanisms. Specifically, we propose that USAC routinely provide to the Commission the data that it collects from both incumbent LECs and competitive ETCs for calculating high-cost payments, specifically, high-cost loop support, interstate common line support, local switching support, safety net, and safety valve support payments, pending any elimination of any of those programs.⁶⁵³ For example, section 54.901 of the Commission's rules requires USAC to calculate ICLS support as the difference between the common line revenue requirement and the sum of end-user common line charges and certain other revenues.⁶⁵⁴ Similarly, section 54.301 of the Commission's rules requires USAC to collect local switching revenue requirement and weighting factor data for calculating LSS.⁶⁵⁵ We propose that USAC provide to the Commission, in an electronic spreadsheet format, all data it collects from carriers with respect to HCLS, ICLS, LSS, safety net, and safety valve support mechanisms, to the extent those mechanisms continue to exist.⁶⁵⁶ We seek comment on this proposal.

2. Internal Controls

468. We propose to improve internal control mechanisms for the current high-cost program and apply such internal control mechanisms to the CAF.

469. In 2008, the GAO recommended that the FCC identify areas of risk in its internal control environment and implement mechanisms that will help ensure compliance with program rules and produce cost-effective use of program funds.⁶⁵⁷ The GAO highlighted three areas of internal controls: (1)

⁶⁵² *See id.*

⁶⁵³ The National Exchange Carrier Association (NECA) is already required to submit incumbent LEC HCLS data to the Commission. *See* 47 C.F.R. § 36.613. We propose that USAC also report HCLS data for competitive ETCs, pending any phase-out of such support is phased-out.

⁶⁵⁴ *See* 47 C.F.R. § 54.901.

⁶⁵⁵ *See* 47 C.F.R. § 54.301.

⁶⁵⁶ USAC collects projected ICLS data, actual ICLS data, projected LSS data, and actual LSS data from the carriers on FCC Forms 508, 509, and the Local Switching Support Data Collection Form, respectively.

⁶⁵⁷ United States Government Accountability Office, Report to Congressional Committees, Telecommunications: FCC Needs to Improve Performance Management and Strengthen Oversight of the High-Cost Program, at 40 (June 2008) (GAO High-Cost Report).

audits; (2) annual certifications; and (3) data validation processes. In each of these three areas, the GAO found weaknesses.⁶⁵⁸ We seek comment on measures to strengthen our internal controls in each of the areas identified for improvement by GAO.

470. In the 2009 Executive Order regarding Improper Payments Information Act of 2002 (IPIA), President Obama stated that when making payments to program beneficiaries, federal government agencies “must make every effort to confirm the right recipient is receiving the right payment for the right reason at the right time.”⁶⁵⁹ Consistent with this directive and guidance from the Office of Management and Budget, in February 2010 the Commission directed USAC to implement both an improved IPIA assessment program and compliance audit programs of the universal service fund (the FCC IPIA Letter). For the high-cost program alone, the FCC IPIA Letter directed USAC to undertake 240 IPIA audits and 100 compliance audits.⁶⁶⁰

471. *Audits.* Audits are an essential tool for the Commission and USAC to ensure program integrity and to detect and deter waste, fraud, and abuse. Commission rules authorize USAC to conduct audits of carriers and contributors reporting data to USAC.⁶⁶¹ The 2008 FCC-USAC MOU requires USAC to conduct audits, including audits of Fund beneficiaries, in accordance with generally accepted government auditing standards, as required by section 54.702(n) of the Commission’s rules.⁶⁶² USAC’s audit program consists of audits by USAC’s internal audit division staff as well as audits by independent auditors under contract with USAC.⁶⁶³

472. In December 2010, as part of the Commission’s IPIA initiatives, USAC released its final report and statistical analysis for a sample of 285 of 390 beneficiaries audited previously.⁶⁶⁴ Of this

⁶⁵⁸ GAO High-Cost Report at 31.

⁶⁵⁹ President Obama further emphasized that the federal government must intensify efforts to eliminate payment error while “continuing to ensure that Federal programs serve and provide access to their intended beneficiaries.” Executive Order 13520, § at 1 (Nov. 20, 2009) (IPIA Executive Order); Feb. 12, 2010 USAC Letter; Oct. 13, 2010 USAC Letter.

⁶⁶⁰ Feb. 12, 2010 USAC Letter; OMB Circular A-123. The IPIA assessment program was developed with the following objectives: (1) separately cover all four USF programs; (2) measure the accuracy of the Administrator’s payments to program applicants; (3) evaluate the eligibility of program applicants who have received payments; (4) include high-level testing of information obtained from program participants; and (5) tailor scope of procedures to ensure reasonable cost while meeting IPIA requirements for sample size and precision. The compliance audit program was developed with the following objectives: (1) cover all four programs and contributors; (2) tailor audit type and scope to program risk elements, size of disbursement, audit timing and other specific factors; (3) keep costs reasonable in relation to overall program disbursements, amount disbursed to beneficiary being audited, and USF administrative costs; (4) spread audits throughout the year; and (5) retain capacity and capability for targeted and risk-based audits. See Feb. 12, 2010 USAC Letter at 2, 4.

⁶⁶¹ 47 C.F.R. § 54.707.

⁶⁶² 47 C.F.R. § 54.702(n).

⁶⁶³ In addition, the Commission’s OIG has conducted audits of USF program beneficiaries. See Office of Inspector General, Semiannual Report to Congress, October 1, 2009 through March 31, 2010, at 17-20. In a February 12, 2010, letter to USAC, OMD directed USAC to separate its two audit objectives into distinct programs – one focused on Improper Payments Information Act (“IPIA”) assessment and the second on auditing compliance with all four USF programs. Improper Payments Information Act of 2002, Pub.L.No. 107-300, 116 Stat. 2350 (2002). In addition to providing guidance on the implementation of the IPIA assessment program and compliance audit program, the letter informed USAC that OMD would assume responsibility for oversight of USAC’s implementation of both programs. Feb. 12, 2010 USAC Letter.

⁶⁶⁴ See *Universal Service Administrative Company, Final Report and Statistical Analysis of the 2007-08 Federal Communications Commission Office of Inspector General High-Cost Program Beneficiary* (Dec. 15, 2010), available at <http://www.fcc.gov/omd/usf-letters2011.html> (December 2010 USAC Compliance Report).

sample, USAC determined an error rate of 2.7 percent resulting in \$54.4 million in improper payments.⁶⁶⁵ According to USAC, the top issues resulting in the highest improper payments were: (1) inaccurate line counts; (2) inadequate or missing documentation; (3) accounting errors; (4) eligibility errors; and (5) subscriber list errors.⁶⁶⁶ In response, USAC has developed a set of measures to reduce improper payments associated with these issues, including, outreach, oversight and management, audits, and information technology improvements.⁶⁶⁷

473. We seek comment on the December 2010 USAC Compliance Report. In particular, we seek comment on ways to improve the audit process to further reduce improper payments and assess risks. In doing so, how can audits be targeted to better understand and discover errors associated with the top issues resulting in improper payments, discussed above? Also, what other measures, than those already implemented, can be taken to mitigate risks? How can internal controls in the program be improved in response to the December 2010 Audit Report?

474. We also seek comment on whether high-cost universal service support recipients (including CAF recipients) should be subject to additional audit requirements beyond the current compliance audits and IPIA audits described above, in light of the proposals presented in this Notice. Should audits be conducted with additional or different objectives than the current plan initiated by the FCC IPIA Letter? Should more program participants be audited? Are there other or additional oversight measures, in addition to those initiated by the FCC IPIA Letter, which would be appropriate and effective in detecting and deterring waste, fraud, and abuse?

475. *Annual Certifications.* Section 254(e) requires that a carrier shall use “support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.”⁶⁶⁸ The Commission requires annual certifications to enforce carrier accountability for use of high-cost program support.⁶⁶⁹ GAO found inconsistencies in the certification process among states and questioned whether such certifications enabled program administrators to fully assess whether carriers are appropriately using high-cost program support.⁶⁷⁰ We seek comment on how to improve the certification process to make it more meaningful in light of the increased public interest responsibilities proposed above and our objective to advance the deployment of networks that are capable of providing both broadband and voice services. In particular, we seek comment on requiring additional information from recipients concerning how funds were used and specifically what information should be submitted.

476. *Data validation.* In 2008, GAO found that “data validation processes to ensure the reliability of financial data primarily focus on the completeness of the data provided by carriers, but not the accuracy of the data.”⁶⁷¹ Specifically, NECA collects cost and line count data for the high-cost loop support mechanism, and USAC collects cost and line count data for the remaining components of the high-cost program. As GAO noted, “these data are subject to several electronic data validations for completeness.”⁶⁷² However, GAO determined that “while these validations and reviews provide NECA and USAC with opportunities to identify input errors, they do not addresses whether or not the data provided by participants are accurate or if the money spent addresses the intended purposes of the high-

⁶⁶⁵ December 2010 USAC Compliance Report at 6.

⁶⁶⁶ *Id.* at 7-8.

⁶⁶⁷ *Id.* at 8.

⁶⁶⁸ 47 U.S.C. § 254(e).

⁶⁶⁹ 47 C.F.R. §§ 54.313, 314, 809, and 904.

⁶⁷⁰ GAO High-Cost Report at 38.

⁶⁷¹ *Id.* at 37.

⁶⁷² *Id.*

cost program.”⁶⁷³ We seek comment on how to improve the data validation process to correct the weakness identified by GAO. We propose above to adopt new benchmarks for cost submissions for rate-of-return carriers. Are there specific steps that we should take to ensure that funds are spent for their intended purposes? Would the certifications regarding coverage and deployment be adequate to address this issue? Should other measures be implemented in the data certification process to mitigate the risk that funds are not used to advance modern networks capable of providing broadband and voice services?

3. Additional Monitoring Procedures

477. We seek comment on what types of procedures we should put in place to ensure that recipients provide services they have committed to provide. We propose to affirmatively confirm, in the field, that recipients have complied with their deployment obligations. What kinds of field inspections and tests are appropriate? We seek comment on whether either state commissions or RUS could play a role in confirming deployment. For instance, hundreds of smaller telephone companies are currently RUS borrowers, and required to report to RUS on their use of funds. What information-sharing mechanisms between the Commission and RUS would facilitate our ability to confirm deployment? Should we conduct different inspections depending on whether the provider has deployed a wireline or a wireless broadband system? Should we verify that each and every recipients has fulfilled its obligations, or should we conduct random audits? What additional procedures should we put in place to ensure that the public is receiving the services it has paid for?

4. Record Retention Requirements

478. In the *Universal Service Fund Oversight Order*, the Commission adopted rules establishing rigorous document retention requirements for high-cost program participants.⁶⁷⁴ We seek comment on whether to modify the current requirements or adopt additional requirements at this time in light of the changed responsibilities and expectations for Fund recipients proposed in this Notice. Are the current record retention requirements adequate to facilitate audits of program participants? Are any additional measures necessary to ensure that program participants retain relevant documentation and provide the relevant and complete documentation to auditors upon request?

IX. ESTABLISHING CLEAR PERFORMANCE GOALS AND MEASURES FOR UNIVERSAL SERVICE

479. We propose several performance goals and measures to improve program accountability. Performance goals and measures should improve program accountability by measuring whether the existing federal high-cost program and any modified or new programs (i.e. the CAF) that support high-cost areas produce public benefits.⁶⁷⁵ Consistent with the Government Performance and Results Act of 1993 (GPRA), clear performance goals and measures should enable the Commission to determine not just whether federal funding is used for the intended purposes, but whether that funding is accomplishing the intended purposes—including our objective of advancing broadband for all Americans.⁶⁷⁶ Moreover,

⁶⁷³ *Id.*

⁶⁷⁴ *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket No. 05-195, Report and Order, 22 FCC Rcd 16372, 16385, para. 24 (2007) (*Universal Service Fund Oversight Order*); 47 C.F.R. § 54.202(e).

⁶⁷⁵ See *supra* Section V.A (National Goals and Priorities for Universal Service).

⁶⁷⁶ The Government Performance and Results Act (GPRA) of 1993 established statutory requirements for federal agencies to engage in strategic planning and performance measurement. Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993). GPRA is intended to improve efficiency and effectiveness of federal programs through the establishment of specific goals for program performance. GPRA has three main requirements. Federal agencies must develop strategic plans with long-term, outcome-related goals and objectives, develop annual goals linked to the long-term goals, and measure progress toward the achievement of those goals in (continued....)

performance goals and measures may assist in identifying areas where additional action by state regulators, Tribal governments, or other entities is necessary to meet the goal of universal service. Performance goals and measures should also improve participant accountability.

480. In recent years, the Office of Management and Budget (OMB) has built upon GPRA through its Program Assessment Rating Tool (PART). OMB PART guidance sets forth three types of performance measures: (1) outcome measures; (2) output measures; and (3) efficiency measures.⁶⁷⁷ Outcome measures “describe the intended result from carrying out a program or activity.”⁶⁷⁸ Output measures describe the level of activity, such as applications process, number of housing units repaired, or number of stakeholders served by a program. Efficiency measures capture a program’s ability to perform its function and achieve its intended results relative to the resources expended.⁶⁷⁹ These performance measures should be intrinsically linked to the purpose of the program and the strategic goal to which it contributes.

481. In 2008, the Government Accountability Office recommended that, in order to strengthen management and oversight of the high-cost program, the Commission should clearly define the goals of the high-cost program and subsequently develop quantifiable performance measures.⁶⁸⁰ Also in 2008, the Commission released a Notice of Inquiry, seeking comment on, among other things, how to define more clearly the goals of universal service and to identify any additional quantifiable performance measures that may be necessary or desirable.⁶⁸¹

482. We propose that funding of recipients be tied to the specific outcomes proposed below. We propose the following four specific performance goals for the current high-cost program and CAF: (1) preserve and advance voice service; (2) increase deployment of modern networks capable of supporting necessary broadband applications as well as voice service; (3) ensure that rates for broadband service are reasonably comparable in all regions of the nation, and that rates for voice service are reasonably comparable in all regions of the nation; and (4) limit universal service contribution burden on households. We request comment on these or other goals and measures commenters believe would be appropriate. We also seek comment on how our performance measures should take into account the actions of other governmental agencies, such as state regulators, that may impact the Commission’s ability to meet its universal service goals.

(Continued from previous page) _____

annual performance plans and report annually on their progress in program performance reports. *See also* GPRA Modernization Act of 2010, Pub. L. 111-352, 124 Stat. 3866 (2011).

⁶⁷⁷ *See* Memorandum from Clay Johnson III, Deputy Director for Management, Office of Management and Budget, to Program Associate Directors, Budget Data Request No. 04-31 (Mar. 22, 2003) (*OMB PART Guidance Memorandum*); *see also* ExpectMore.gov, <http://expectmore.gov> (last visited Feb. 9, 2011). The most current PART guidance, referred to herein as “2008 PART Guidance,” is available at http://www.whitehouse.gov/sites/default/files/omb/assets/performance_pdfs/part_guid_2008.pdf (last visited Feb. 9, 2011).

⁶⁷⁸ *See* 2008 PART Guidance at 9.

⁶⁷⁹ The 2008 PART Guidance states that “[m]eaningful efficiency measures consider the benefit to the customer and serve as indicators of how well the program performs.” *Id.* at 11.

⁶⁸⁰ GAO High-Cost Report) at 40.

⁶⁸¹ *Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight*, WC Docket No. 05-195, 23 FCC Rcd 13583 (2008) (*2008 Comprehensive Review NOI*). We note that, in 2007, the Commission took initial steps to improve the performance management of universal service by adopting performance measures to help ensure the program operates in an efficient, effective manner. *Universal Service Fund Oversight Order*, 22 FCC Rcd 16372. Most of these performance measures were “output measures.” At that time, the Commission declined to establish performance goals because it did not have sufficient data. The Commission did require USAC to report annually certain performance measurements related to the high-cost program on which it could base future performance goals. *Id.* at 16397-98, para. 55.

483. *Preserve and Advance Voice Service.* The first performance goal we propose is to preserve and advance voice service.⁶⁸² We anticipate that our proposals to rationalize investment in modern communications and to better target support will enable the program to meet this goal. As an outcome measure, historically, the Commission has measured telephone penetration as a proxy for network deployment.⁶⁸³ We seek comment on whether we should continue to use the telephone penetration rate, which measures subscription to voice service, or whether we should adopt a deployment measure that measures access to voice service.⁶⁸⁴ We note that the Commission's current telephone subscription penetration rate is based on the Census Bureau's Current Population Survey (CPS), which does not specifically break-out wireless, VoIP, or over-the-top voice options available to consumers.⁶⁸⁵ Are there alternative methods the Commission should use to acquire data regarding deployment of voice-capable networks?

484. Although certain segments of the population lag behind, such as low-income and Tribal consumers—and the Commission is committed to addressing those shortfalls—we note that the national voice penetration rate is at an all-time high.⁶⁸⁶ To the extent that subscription to voice services is lagging in certain areas, is that largely due to socio-economic forces such as lower household income rather than a lack of access to voice service? If so, would it be unrealistic to expect a significant increase in voice subscription even with a larger influx of high-cost funding? What role should Lifeline play in advancing the adoption of voice service? We also seek comment on an appropriate measure for whether universal service funding, from either the existing high-cost program or the CAF, is being used efficiently to achieve this performance goal.

485. *Increase Deployment of Modern Networks.* The second performance goal we propose is to increase the deployment of modern networks capable of delivering broadband and voice service, using either fixed or mobile technologies, in areas where such networks would not exist absent governmental support.⁶⁸⁷ This performance goal is directly tied to our goals for universal service reform—to ensure that all Americans in all parts of the nation, including those in rural, insular, and high-cost areas, have access to modern communications networks capable of supporting the necessary applications that empower them to learn, work, prosper and innovate. We expect that our proposals to rationalize investment in modern communications networks, to better target support, and to create the CAF to expand access to broadband, will enable the program to meet this goal. To measure this goal, we propose as an outcome measure the number of new housing units which gain access to broadband service, as benchmarked above, as a result

⁶⁸² See 47 U.S.C. § 254(b). See also Qwest 2008 Comprehensive Review NOI Comments at 4.

⁶⁸³ See Industry Analysis and Technology Division, Wireline Competition Bureau *Telephone Subscriberhip in the United States* (Sept. 2010) (Sept. 2010 Subscriberhip Report).

⁶⁸⁴ The *Broadband Data NPRM* seeks comment on whether to collect voice and broadband network deployment data. See *Broadband Data NPRM*, FCC 11-14, at paras. 49-65 (seeking comment on whether and how the Commission should collect deployment data).

⁶⁸⁵ Sept. 2010 Subscriberhip Report at 1. The specific questions asked in the CPS are: “Does this house, apartment, or mobile home have telephone service from which you can both make and receive calls? Please include cell phones, regular phones, and any other type of telephone.” And, if the answer to the first question is “no,” this is followed up with, “Is there a telephone elsewhere on which people in this household can be called?” If the answer to the first question is “yes,” the household is counted as having a telephone “in unit.” If the answer to either the first or second question is “yes,” the household is counted as having a telephone “available.” *Id.* at 3.

⁶⁸⁶ As of March 2010, the national telephone subscription penetration rate was 96%, the highest reported rate since the CPS began collecting data in 1983. *Id.* at Table 1.

⁶⁸⁷ Comments of Mercatus Center, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, at 9-10 (filed Oct. 17, 2005); Comments of TCA, WC Docket No. 05-195, at 6-7 (filed Nov. 13, 2008) (proposing a performance measure of service availability); Comments of Qwest, WC Docket No. 05-195, at 4 (filed Nov. 13, 2008); see also Comments of NECA, WC Docket No. 05-195, at 8 (filed Nov. 13, 2008) (pending rule changes, goals and performance metrics should be consistent with existing rules).

of universal service funding, whether from the existing high-cost programs or the CAF. As an efficiency measure, we propose the change in the number of homes passed or covered by these networks per million USF dollars spent. We note that this efficiency measure could be biased toward lower-cost areas. Is there an alternative measure that would fairly capture how well the CAF funding was accomplishing the goal of increasing deployment of modern networks? How will we isolate USF funding as the cause of change in deployment, to distinguish from other sources of funding, such as BTOP/BIP? How should we take into account increased deployment resulting from other regulatory actions, such as voluntary merger commitments? We seek comment on this performance goal and measures.

486. *Reasonably Comparable Rates for Broadband and Voice Services.* The third performance goal we propose is to ensure that rates for broadband service are reasonably comparable in rural, insular, and high cost areas and urban areas, and that rates for voice service are reasonably comparable in rural, insular, and high cost areas and urban areas.⁶⁸⁸ We envision that our proposals to rationalize investment in modern communications networks and to better target support will enable the program to meet this goal. As an outcome measure, we propose the ratio of the rural price to rural household disposable income should be similar to the ratio in urban areas, both for voice services and for broadband services. In other words, are rural Americans devoting a similar percentage of their disposable household income to similar services as urban Americans? Alternatively, should we instead measure the percentage of total household income devoted to these services? Or should we measure the relative actual prices of these services in rural and urban areas? For the purposes of measuring reasonable comparability, we propose to rely on the voice and broadband pricing data the Commission collects.⁶⁸⁹ We also seek comment on an appropriate measure of the efficiency of the use of universal service funding in achieving this goal.

487. *Limit Universal Service Contribution Burden on Households.* In considering reform to the current high-cost program, the Commission seeks to balance the various objectives of section 254(b) of the Act to ensure that support is sufficient to meet statutory goals, while not imposing an excessive burden on American consumers who are ultimately the payors for the Fund.⁶⁹⁰ We believe that our proposals to rationalize investment in modern communications networks, to better target support, and to employ market-based mechanisms will control costs and thereby control the contribution burden borne by consumers. We seek comment on whether to establish as a performance goal limiting the overall burden of universal service contribution costs on American households. For example, one means of measuring this goal could be to divide the total inflation-adjusted expenditures of the Fund each year by the number of American households and to express the measure as a monthly dollar figure. This calculation would be relatively straightforward and could rely on publicly available data; as such, the measure would be transparent and easily verifiable. By adjusting for inflation and looking at the universal service burden, we could determine whether or not the overall burden of universal service contributions costs is increasing or decreasing for the typical American household. For example, the Fund spent \$7.9 billion in

⁶⁸⁸ 47 U.S.C. § 254(b)(3). See Mercatus Center Oct. 17, 2005 Comments at 9-10; TCA Nov. 13, 2008 Comments at 6-7 (proposing a performance measure of comparability of service prices between urban and rural areas); Qwest Nov. 13, 2008 Comments at 4; see also NECA Nov. 13, 2008 Comments at 8.

⁶⁸⁹ See *supra* para. 137 (proposing that recipients must offer voice and broadband (individually and together) in rural areas at rates that are affordable and reasonably comparable to rates in urban areas); see also *Broadband Data NPRM*, FCC 11-14, at paras. 66-76 (seeking comment on whether and how the Commission should collect price data).

⁶⁹⁰ Contributions are assessed on the basis of a contributor's projected collected interstate and international end-user telecommunications revenues, based on a percentage or "contribution factor" that is calculated every quarter. See 47 C.F.R. § 54.709. A contributor may recover the costs of universal service contributions by passing an explicit charge through to its customers. 47 CFR § 54.712(a). See *Qwest II Remand Order*, 25 FCC Rcd at 4088, para. 29 (explaining that the Commission could not be a prudent guardian of the public's resources without taking into account the costs of universal service, alongside the benefit); *Rural Cellular Ass'n*, 588 F.3d at 1102; see also, e.g., *Alenco*, 201 F.3d at 620-21 (concluding that the Commission properly considered the costs of universal service in reforming one part of the high-cost support mechanism).

2010;⁶⁹¹ the overall per-household burden of universal service in 2010 was thus approximately \$5.61 per month under the proposed measure, and \$3.03 per month for the high-cost program in particular.⁶⁹² In contrast, the Fund spent \$5.5 billion in 2000, adjusted for inflation, and the overall per-household burden for universal service was approximately \$4 in 2000 and \$2 per month for the high-cost program.⁶⁹³ A contribution burden measure, when considered with other measures such as average household expenditures on telecommunications as a percentage of household personal consumption expenditures, could help the Commission and other stakeholders assess the impact of universal service policy decisions over time. We seek comment on this proposed performance measure and also seek comment on an appropriate efficiency measure.

488. *Use and Re-evaluation of Performance Measures.* These performance measures are designed to track whether the program is achieving the intended purposes, as opposed to whether program recipients are using funding for the intended purposes. Above we seek comment on reporting requirements for program recipients, to ensure that they are complying with program requirements. However, we expect that the data we will collect from program recipients, in the aggregate, will provide the foundation for tracking the success of the program using these performance measures. We invite comment on whether that data will be useful for this purpose. If not, what other data would be useful as inputs to these performance measures?

489. We also propose to review annually whether the program is meeting its goals based on the results of the performance measures. If the program is not meeting its goals we intend to consider corrective actions in future rulemakings so that we achieve the intended purposes. In addition, to the extent that these performance measures do not help us assess program performance, we would revisit them as well.

X. INTERCARRIER COMPENSATION FOR A BROADBAND AMERICA

A. Steps Necessary to Achieve Our Objectives

490. In this section, we seek comment on proposals to comprehensively reform intercarrier compensation to bring the benefits of broadband to all Americans. We plan to use the same section 254-derived principles to inform our intercarrier compensation reforms that we use to guide our universal service reforms.⁶⁹⁴ Specifically, the changes to the intercarrier compensation rules discussed below will: (1) modernize our rules to make affordable broadband available to all Americans and reduce waste and inefficiency by taking steps to curb arbitrage; (2) promote fiscal responsibility; (3) require accountability; (4) transition to market-driven and incentive-based policies. In addition, we aim to create a framework and transition that is predictable to enable service providers and investors time to react and plan appropriately.

491. We first highlight inefficiencies, including distorted incentives and wasted resources, enabled by the current intercarrier compensation rules and why reform is necessary. Next we provide an

⁶⁹¹ Universal Service Administrative Company, 2009 Annual Report, at 5, *available at* http://www.usac.org/_res/documents/about/pdf/usac-annual-report-2009.pdf; *see also* Sept. 2010 Subscribership Report, Table 1 (rel. Aug. 2010).

⁶⁹² We note that this includes business contributions to USF, which households support indirectly, so the amount per month on the phone bills of individual households is lower.

⁶⁹³ Comments of USAC, WC Docket Nos. 05-195, 02-60, 03-109, CC Docket Nos. 96-45, 02-6, 97-21, App. A at 19, 23 (filed Oct. 18, 2005). Adjustments for inflation were calculated using the Bureau of Labor Statistics' Consumer Price Index Inflation Calendar, http://www.bls.gov/data/inflation_calculator.htm (last visited Feb. 9, 2011). We note that during that intervening period, as the Commission removed explicit support from access charges and made such support explicit in the high-cost program, long distance rates decreased.

⁶⁹⁴ As discussed above, section 254 of the Act lays out principles for Commission policies to preserve and advance universal service. *See supra* para. 11.

overview of the Commission's authority to pursue reform, identify certain goals of intercarrier compensation reform, and seeks comment on how possible intercarrier compensation rate methodologies would advance those goals. We also seek comment on the dimensions of the intercarrier compensation reform transition, and lay out two possible approaches for working with states to implement reform. The first approach relies on the Commission and states to act within their existing roles in regulating intercarrier compensation, such that states would remain responsible for reforming intrastate access charges. Additionally, we also seek comment on whether we should set a glide path to reform wireless termination charges, possibly including intrastate access charges paid by or to wireless providers. Under the second approach, the Commission would use the tools provided by sections 251 and 252 in the 1996 Act to unify all intercarrier rates, including those for intrastate calls, under the reciprocal compensation framework. Under this framework, the Commission would establish a methodology for intercarrier rates, which states then work with the Commission to implement. Within these approaches, we identify and develop a specific set of options for commenters to consider regarding the sequencing of reductions in specific rates. We also seek comment on the appropriate timing of the overall transition and propose to complete the transition away from per-minute rates before implementing the long-term vision for the CAF, which will ultimately make explicit all subsidies necessary to serve an area (including subsidies that are currently provided implicitly through the intercarrier compensation system).

492. Next, we seek comment on how to structure any necessary recovery mechanism for providers, including threshold questions of whether our evaluation should be based on a provider's cost of originating, transporting, and terminating a call (i.e., cost recovery) or whether we should focus recovery on replacing reduced intercarrier compensation revenues (i.e., revenue recovery) or some combination thereof. In evaluating the criteria for recovery, we seek comment on doing so through reasonable end-user charges and the CAF. If we focus on revenue recovery, we recognize that existing intercarrier compensation revenues may be a significant source of free cash flow and regulated revenues for some carriers, and we request data to help quantify the impact of intercarrier compensation reform on the industry and consumers. We also recognize that some high-cost, insular, and Tribal areas may need explicit support to maintain service because there may be no private business case to serve such areas. We seek comment on how to reform intercarrier compensation and universal service in tandem so that such areas receive any ongoing support necessary to ensure that they continue to receive quality and affordable services, and to ensure that providers serving those areas can continue to advance connectivity where it lags far behind the rest of the nation. As noted above, one of the proposed principles guiding universal service reform is controlling the size of the universal service fund and reducing waste and inefficiency. This proposed principle likewise informs our intercarrier compensation reforms, and we ask commenters how best to calibrate any intercarrier compensation recovery to be consistent with this principle.

493. Third, we seek comment on proposals to address the National Broadband Plan recommendation that the Commission adopt interim rules to reduce arbitrage and specifically seek comment on the applicability of intercarrier compensation to VoIP and measures to address phantom traffic and access stimulation. We believe that our proposals to address the treatment of VoIP traffic for purposes of intercarrier compensation and to adopt rules to address phantom traffic and access stimulation will reduce inefficient use of resources and promote investment and innovation. Service providers will benefit from increased certainty and predictability regarding future revenues and reduced billing disputes and litigation, enabling companies to direct capital resources toward broadband investment. We also seek comment on whether the actions we propose in this Notice should encourage incumbent LECs to move to IP-to-IP interconnection. Finally, we seek comment on other pending issues related to intercarrier compensation reform.

B. Why Intercarrier Compensation Must Be Reformed

494. Intercarrier compensation is a system of payments between carriers to compensate each other for the origination, transport and termination of telecommunications traffic. For example, when a family in one state makes a telephone call to their grandmother in a neighboring state, the calling family's long distance provider pays the family's local phone company a per-minute charge, which may be a few

cents a minute, for originating the call. The family's long distance provider also pays their grandmother's local phone company a per-minute charge, anywhere from less than a cent to close to 5 cents a minute, for terminating the call.⁶⁹⁵ In contrast, if the family then places a call to an uncle who lives in a different part of the state, a different set of rates apply. Here again, the calling family's long distance provider pays the family's local phone company a per-minute charge for originating the call and also must pay their uncle's local phone company a per-minute charge for terminating the call. But, in comparison to the first example, payments for calls within a state, known as intrastate access charges, are often higher than those that apply to calls across states, or interstate access charges. A long distance provider may have to pay an average rate of 13.5 cents a minute or more to the local phone company to deliver a call within a state.⁶⁹⁶ Thus, under the present system, the amounts service providers charge each other for completing such a call can vary considerably depending not on the service provided but on whether a call starts and finishes in the same state, or whether it crosses state lines.⁶⁹⁷ To complicate matters further, these charges also can vary based on what technology (e.g., wireline, wireless) is used to make a call. Industry wide, these charges add up to a significant amount of money. An estimate from 2008 indicated that all forms of intercarrier compensation result in up to \$8 billion in transfers between carriers every year.⁶⁹⁸

495. These examples highlight four fundamental problems with the current system, each of which is discussed further below: (1) the system is based on outdated concepts and a per-minute rate structure from the 1980s that no longer matches industry realities; (2) rates vary based on the type of provider and where the call originated, even though the function of originating or terminating a call does not change; (3) because most intercarrier compensation rates are set above incremental cost, they create incentives to retain old voice technologies and engage in regulatory arbitrage for profit; and (4) technological advances, including the rise of new modes of communications such as texting, e-mail, and wireless substitution have caused local exchange carriers' compensable minutes to decline, resulting in additional pressures on the system and uncertainty for carriers. Our proposals for reform would address each of these issues and create a framework for a stable, predictable transition to a new system.

496. The current intercarrier compensation framework arose primarily out of a series of regulatory choices made to implement the 1984 AT&T divestiture and the passage of the Telecommunications Act of 1996.⁶⁹⁹ As a result, the country has an intercarrier compensation system with a variety of distinct compensation rules and mechanisms: originating and terminating access charges at the state and the federal levels; reciprocal compensation; and distinct rules applicable to wireless

⁶⁹⁵ See, e.g., Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 80-286, Attach. (filed Dec. 29, 2010) (NECA Dec. 29, 2010 *Ex Parte* Letter) (providing a report showing average interstate access rates per state for NECA common line 2010 pool members as high as 6 cents per minute); Letter from Brian J. Benison, Director – Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 07-135, 05-337, 99-68, CC Docket Nos. 01-92, 96-45 Attach. at 2 (filed Jan. 6, 2010) (AT&T Jan. 6, 2010 *Ex Parte* Letter); Letter from Michael B. Hazzard, Counsel to Pac-West Telecomm, Inc., WC Docket Nos. 01-92, 07-135 Attach. at 7 (filed Oct. 28, 2010).

⁶⁹⁶ See NECA Dec. 29, 2010 *Ex Parte* Letter, Attach. (attaching a report providing average intrastate access rates per state for NECA common line 2010 pool members); AT&T Jan. 6, 2010 *Ex Parte* Letter, Attach. at 2 (noting rates as high as 35.9 cents per minute).

⁶⁹⁷ The Commission regulates the rates for interstate access charges (paid on long distance calls that cross state lines), and states regulate the rates for intrastate access charges (paid on long distance calls within a state).

⁶⁹⁸ See Letter from Ray Baum, Chairman, NARUC Communications Committee, et al., to Kevin Martin, Chairman, FCC, CC Docket Nos. 80-286, 01-92, 08-152, WC Docket Nos. 04-36, 06-122, WT Docket No. 05-194, at 1 n.1 (filed Oct. 21, 2008). We note that this estimate is from 2008 and seek data to quantify the current scope of intercarrier compensation to help formulate a recovery mechanism. See *infra* para. 572.

⁶⁹⁹ *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983); Telecommunications Act of 1996. Pub. L. No. 104-104, 110 Stat. 56 (1996).