

STATE MEMBERS
FEDERAL STATE JOINT BOARD ON UNIVERSAL SERVICE
1101 VERMONT AVENUE, NW
WASHINGTON, DC 20005

July 14, 2011

NOTICE OF ORAL EX PARTE CONTACT

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

Re: State Members of the Universal Service Joint Board notice of oral ex parte contact involving the proceedings captioned: *In the Matter(s) of the Connect America Fund, WC Docket No. 10-90, National Broadband Plan for Our Future, GN Docket No. 09-51, Establishing Just and Reasonable Rates for Local Exchange Carriers, WC Docket No. 07-135, High-Cost Universal Service Support, WC Docket No. 05-337, Developing an Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Lifeline and Link-Up, WC Docket No. 03-109*

Dear Secretary Dortch:

Although the *State Members* of the Federal State Joint Board on Universal Service have a statutory right to deliberate with the Commission in these proceedings,¹ they have chosen to file an *ex parte* notice of a July 11, 2011 meeting with two of their federal colleagues on the Joint Board and their staffs: *Commissioner Mignon Clyburn*, the FCC Chair of the Universal Service Joint Board, and *Commissioner Michael Copps*, along with *Angela Kronenberg*, *Wireline Legal Advisor to Commissioner Clyburn*, and *Margaret McCarthy*, *Wireline Policy Advisory to Commissioner Copps*.

State Chair James Cawley (PA) and *Commissioner John Burke (VT)*, joined by *Labros Pilalis (PA)*, *Brad Ramsay (State Member counsel)*, and *Dr. Bob Loube (State Member consultant)* attended the meeting at the FCC. *Commissioners Larry Landis (IN)* and *Anne Boyle (NE)*, along with Board member *Simon ffitch* joined by phone along with their staffs – *Earl Poucher (FL)*, *George Young (VT)*, *Brian Mahern (IN)*, and *Pam Taber(IN)*.

The State Members presented the attached advocacy outline and discussed the following:

- The *State Members* have presented an integrated plan (*State Plan*) that actually accomplishes the FCC goals to increase broadband deployment while reforming intercarrier compensation and the federal universal service fund (USF) program.
- The framework underlying the US Telecom Association (USTA)-mediated reform proposal simply cannot achieve those goals.

¹ See, 47 U.S.C. § 410(c) (“The Commission shall also afford the State members of the Joint Board an opportunity to participate in its deliberations, but not vote, when it has under consideration...further decisional action that may be required in the proceeding.”)

- The USTA proposal, which is centered on a nationally uniform intercarrier compensation rate of \$0.0007/MOU and annual increases to the federal subscriber line charge (SLC), is inimical to end-user consumers and ultimately undermines the FCC’s stated goals. The \$0.0007 rate is not compensatory, will unquestionably have detrimental effects on the financial stability and network reliability of providers with carrier of last resort obligations serving rural areas that have already, and will continue to, invest in broadband deployment. It will also place unmanageable pressure on limited federal USF funding resources.
- The *State Plan* favors parties that provide broadband service in unserved areas. If a non-rural ILEC or a cable company or anyone else is willing to provide service in unserved areas, the *State Plan* favors them. Some argue the *State Plan* favors current rural broadband providers. It does not. It only appears to do so because those carriers have done the best job of deploying advanced services in high cost areas. There has been wide-spread and extensive criticism of the identical support rule because it gives federal USF support to wireless/other CETC providers based on the costs of incumbents’ networks rather than the costs actually incurred by the CETC in providing service. The USTA-mediated effort appears to adopt the same rationale as the basis for its uniform access charge rate. The *State Plan*, in contrast, suggests migration to a carrier-specific uniform intercarrier compensation rate to avoid the unlawful arbitrage opportunities that many carriers utilize today. Except for the non-probative and necessarily self-serving statements of interested parties, there is NO record evidence – no empirical data – no actual cost studies - to support imposing a single industry-wide \$0.0007 rate as compensatory. As noted, *supra*, everyone recognizes that access costs both differ based on the underlying technology and are a function of (related to) the size of the exchange and the traffic load on switching equipment. For example, the Michigan Commission has approved reciprocal compensation rates for Verizon (now Frontier) and for small rural carriers. The local termination rate for Verizon is \$0.003461 and the local termination rate for the small carrier is \$0.00703. To obtain the final reciprocal compensation rate, local transport is added to the local termination rate. The transport rates vary according to whether the transport is dedicated transport or tandem transport. The rates are based on proprietary forward-looking cost studies and, in the case of the small carrier, the forward looking cost was based on an IP soft switch. Unlike the speculative statements pressed in the current proceeding, those rates were based on actual forward-looking economic cost studies (using a TELRIC standard). There seems to be an unstated supposition in the USTA proposal that, if there are “carrier specific uniform” but high (or at least higher than .0007) access charges, *that this will retard the ultimate transition of the network to soft-switches and IP-based services*. Again, there is zero empirical evidence in the record to suggest a causal link. There is no evidence in the record that compares access rates and IP networks. Indeed, the only available evidence suggests the opposite. For example, the Wyoming Commission’s report on universal service in that State shows convincingly that small rural rate-of-return (ROR) carriers, who tend to have much higher access charges, are the only ones to have deployed soft switches. The report suggests that Qwest-CenturyLink-Embarq have zero soft switches. Thus, the linkage between access rates and adoption of IP networks is not supported by the Wyoming experience. Before proposing any revised access rates, the FCC should investigate the relationship between access rates and soft switch deployment.² The distinctions between ROR regulation, which provides an incentive to invest, and price cap regulation, which does not provide similar investment

² The last big change-out of switches was during 1985 to 1995. The FCC “encouraged” retirement of electro-mechanical switches that could not provide equal access by providing accelerated amortization and recovery through access rates. This suggests, if the FCC wants to promote IP adoption, one way might be to include a surcharge on access rates rather than reduce them to below compensatory levels.

incentives, might well be a more important determinant of Internet Protocol or IP-enabled soft switch adoption.³

The *State Plan* provides sufficient incentives and relevant support mechanisms for price cap companies to invest in broadband deployment under State oversight and enforcement. Rural ILECs in Pennsylvania have invested in broadband deployment under State law and under an incentive price cap mechanism. The FCC should reexamine the price cap mechanism that is applicable to its jurisdiction, e.g., price cap productivity factor. An *increase* in the SLC to offset losses in traffic-sensitive access revenue contradicts the basic principle of FCC subsidy policy because it requires a non-traffic sensitive rate element to pay for a traffic sensitive cost – effectively creating a subsidy. Moreover, the USTA plan to increase the SLC squeezes consumers between ballooning revenue replacement demands caused by artificially low access charges and a narrow contribution base of legacy phone customers. Revising the federal USF contribution base is a critical element of ICC and USF reform that the FCC must deal with. All network users should support the network. The USTA-mediated proposal does not appear to provide adequate funding for operations and maintenance (O&M), as well as the servicing of debt issued by RLECs to fund the deployment of existing broadband infrastructure, in many of the rural areas that now have broadband and where there is no competing provider. Related reductions in revenues as a result of this plan could lead to unprofitable companies and ultimately poor/deteriorating service. It is also not clear how the USTA-plan addresses the federal TA-96 statutory requirements for reasonable comparability of services and rates.

- One reason given for supporting reduction in access rates is that the larger carriers endorsing the USTA mediated proposal contend that such reductions will give them additional revenues and allow them to provide more advanced services in rural areas. History suggests policy makers should be skeptical of such promises. Large ILEC promises to build fiber to the home – or in the case of Project Pronto – to bring advanced services to everyone – premised on allowing, e.g., accelerated depreciation of copper plant, yellow pages profits, a merger, or other regulatory relief – remain largely unfulfilled.
- The *State Plan* does not include auctions. The plan opposes the specific auction mechanism outlined in the FCC’s NPRM because it disadvantages carriers that have built out broadband facilities in the majority of their unserved areas (logically leaving the most expensive unserved areas for last) in favor of those that have not built out. The *State Plan* alternative to the FCC auction proposal is to do the auction in tranches, e.g., carriers with 95% build out, carriers with 80-95% build out, etc. This requires carriers with similar build-out costs to bid against each other, ensuring that the bids would be efficient least cost bids. Second, this approach reserves funding to support carriers that already advanced the Commission’s goal of a ubiquitous broadband network rather than providing build-out grant funds only to carriers that have limited their investments in the most rural areas of America.
- States have demonstrated that they can affirmatively balance the interests of competition through intrastate access charge reform that takes into consideration broadband deployment initiatives and the maintenance of a potentially redefined universal service. The FCC should respect the

³ ROR carriers have an incentive to invest. Once they fully depreciate a switch, they will put in another one and put it in rate base. In contrast, the overriding incentive for price cap carriers is to cut costs. There is also a plethora of literature about the linkages between price cap regulation schemes and service quality degradation.

Federal-State partnership that has been the primary mode of implementing the national goals embodied in TA-96.

If you have any questions about this letter, please do not hesitate to contact the undersigned at 202.898.2207 or jramsay@naruc.org.

Respectfully Submitted,

/s/

**James Bradford Ramsay
Counsel to State Members**

cc: *The Honorable Julius Genachowski, FCC Chairman*
The Honorable Michael Copps, FCC Commissioner
The Honorable Robert M. McDowell, FCC Commissioner
The Honorable Mignon Clyburn, FCC Commissioner
Zachary Katz, Chief Counsel & Senior Legal Advisor to the Chairman
Josh Gottheimer, Senior Counselor to the Chairman
Margaret McCarthy, Wireline Policy Advisor to Commissioner Copps
Christine D. Kurth, Policy Director & Wireline Counsel to Commissioner McDowell
Angela Kronenberg, Wireline Legal Advisor to Commissioner Clyburn
Sharon Gillett, Chief, Wireline Competition Bureau

APPENDIX

MEETING WITH FCC JOINT BOARD COMMISSIONERS (July 11, 2011)

KEY POINTS

I. THE STATE MEMBERS' PLAN ACHIEVES THE FCC GOALS

A. The States Members' Comments Have Presented An Integrated Plan

1. **The State Members' Plan Accommodates Multiple FCC Goals:** The State Members' **integrated** Plan accommodates and advances the interlinked but also competing FCC goals of broadband deployment, and intercarrier compensation and federal USF reform.
 - a. **Need for Intercarrier Compensation Reform:** The Plan recognizes the need for intercarrier compensation reform based on a single rate for each carrier that reflects costs of access services, and a cooperative approach between the FCC and the States.
 - b. **Realistic Solutions for Intercarrier Compensation:** The Plan contains realistic proposals for intercarrier compensation reform through a cooperative FCC-State approach that is **linked** with corresponding federal USF reforms. Unrealistic proposals on intercarrier compensation (e.g., "bill and keep" or \$0 and \$0.0007/MOU rates) will simply put additional and undesirable "revenue replacement" pressures on the federal USF mechanism and will retard other FCC goals, i.e., broadband loop facilities and Internet Protocol (IP) based switching deployment (soft switches).
2. **The State Members' Plan Proposed Federal USF Reforms Encourage and Enforce Concrete Commitments for Broadband Deployment:** The integrated State Members' Plan not only contains a series of proposals for federal USF reform, it also connects such proposals to concrete commitments for broadband deployment.
 - a. **The State Members' Plan and the Federal USF Support Mechanisms:** All of the State Members' Plan proposals for the three (3) federal USF support mechanisms (provider of last resort – POLR, mobility, and wireline broadband funds) contain broadband deployment, service quality and performance standard commitments that can be monitored and enforced by the States.
 - b. **The State Members' Plan Is Designed to Encourage and Maintain Broadband Deployment:** The State Members' Plan not only meets the FCC goal of encouraging broadband deployment, it is also designed to *maintain* and enhance broadband deployment, especially in rural areas.

- c. **The State Members' Plan Explicitly Recognizes VoIP and Broadband Internet Access Services as Supported Services:** The State Members' Plan recognizes Voice over the Internet Protocol (VoIP) and broadband access to the Internet services as supported services. Classification of VoIP as a telecommunications service resolves many issues both for purposes of federal USF (support for *telecommunications* services) and intercarrier compensation reform.
- d. **The State Members' Plan Seeks Expansion of the Federal USF Contribution Base and Limits the Level of High Cost Support:** The State Members' Plan seeks the expansion of the federal USF contribution base (a critical component of any federal USF reform), but also initially limits the high cost support level to \$4.2 billion per year.

B. The State Members' Plan Minimizes Adverse Impacts on End-User Consumers

1. **The State Members' Plan Avoids Increases to the Federal Subscriber Line Charge:** The State Members' Plan avoids increases to the federal subscriber line charge (SLC). Thus, end-user consumers of telecommunications services avoid bearing traffic-sensitive costs of the network through an increased non-traffic sensitive charge. This minimizes the impact on end-user consumers, especially if wireless and wireline long-distance carriers do *not* pass the full access reduction savings to end-user consumers (neither the FCC nor State commissions regulate long-distance and wireless rates).
2. **The State Members' Plan Promotes Universal Service Goals:** The State Members' Plan promotes affordable universal service (the Plan contains specific service revenue benchmarks for federal USF support calculation purposes).
3. **The State Members' Plan Explicitly Recognizes COLR/POLR Obligations:** The State Members' Plan explicitly recognizes and enforces carrier / provider of last resort (COLR/POLR) public interest obligations.

II. FEDERAL PREEMPTION

A. Intercarrier Compensation

1. **There is no need for legal conflict:** There is no need for legal conflict with the States which maintain jurisdiction over **intrastate** carrier access rates and also enforce federal TA-96 reciprocal compensation arrangements for the exchange of local and other types of traffic, inclusive of IP traffic. The FCC **relies** on the States for such actions.

2. **Regulatory certainty:** Regulatory certainty for the business operations of many actors will not be attained when federal preemption will be challenged at lengthy federal court appeals.
3. **States are managing the transition of intrastate intercarrier compensation reforms:**
 - a. **States successfully manage multiple and competing goals:** States manage multiple and competing goals in transitions of intrastate intercarrier compensation mechanisms. These include competition (reductions in intrastate carrier access charges paid by IXC and inter-MTA wireless traffic), maintaining universal service goals through affordable rates by entities with COLR/POLR obligations, as well as broadband deployment (e.g., Pennsylvania and statutorily mandated broadband deployment for rural and non-rural ILECs). This includes the establishment and use of state-specific USFs.
 - b. **States are knowledgeable about local competition conditions and the scope of needed intrastate carrier access charge reform:** Through the conduct of fully adjudicated evidentiary proceedings before ALJs the States are able to effectively gauge local competition conditions and the need for local rate rebalancing. Many states are already mirroring federal interstate traffic-sensitive carrier access rates. A reformed federal USF should assist the State efforts and transition of intrastate access charge reform.
 - c. **Consumers can more easily participate in and affect state regulatory processes.**

B. FCC Forbearance for ETC Designations Unnecessarily Leads to Federal Preemption

1. There is no legal authority for the FCC to forbear from ETC designations per TA-96.
2. FCC forbearance from ETC designation leads to federal preemption of State authority to designate ETCs and actively manage and monitor such designations in terms of federal USF support and future broadband deployment. This is contrary to both the letter and the spirit of TA-96.
3. All ETCs should be required to provide voice only service. The FCC should reject any proposal to require voice only customers to subscribe to broadband.

III. INTERCARRIER COMPENSATION RATES

A. A Single Intercarrier Compensation Rate Is Not Supportable

1. A single intercarrier compensation rate does not recognize access cost differentials among carriers.
2. The \$0.0007/MOU rate proposal is not cost-based. This rate is even below TELRIC-based reciprocal compensation rates. It simply is not compensatory for access costs, especially when carriers are called to continue making substantial capital investments in order to successfully handle increased traffic demand for both retail and wholesale broadband access services.
3. Freely negotiated interconnection agreements recognize a multitude of intercarrier compensation rates for IP-based traffic, including rates that are based on conventional intrastate carrier access charges.

B. A Single Non-Compensatory Rate Will Lead to Industry Segment Financial Dislocation and Negative Consumer Impacts

1. A single non-compensatory rate (e.g., “bill and keep” or zero, \$0.0007/MOU) will lead to the financial dislocation of a significant segment of the smaller and mid-size rural ILECs. This will create adverse implications for the individuals States where such carriers operate and have COLR/POLR obligations. State USFs will be called to play additional roles that may not have been so far contemplated.
2. As the Comments of the State Members have pointed out these financial dislocation effects will be more severe in combination with the NPRM proposed federal USF reforms.
3. The effects of non-compensatory access rates (i.e., \$0 or \$0.0007) in combination with the proposed federal USF reforms will have severe financial effects for the small and mid-size rural ILECs which have already accrued debt obligations for the capital construction of broadband access facilities in the rural areas. The States will have to deal with associated effects irrespectively of whether or not the States still regulate or not the retail services of these carriers, i.e., they are still classified as “public utilities.”

C. Access Rates Have Not Retarded Broadband Deployment or Network Transitions

1. Intercarrier compensations rates have not retarded the deployment of retail and wholesale broadband access services and facilities, *especially in rural areas*. Similarly, they have not retarded the deployment of IP-based networks.
2. A mix of funding sources, including intercarrier compensation (intra and interstate), federal and state USF support, and low cost financing (e.g., RUS),

appears to have **enabled** small and rate of return rural landline carriers to bring retail and wholesale broadband access facilities and services to rural areas and to deploy IP-based networks with soft switches in a greater proportion than non-rural and rural price-cap ILECs. In Wyoming, only rural rate-of-return ILECs have replaced circuit switches with IP switches, while the non-rural and rural price cap carriers have retained their circuit switches.

3. This provision of retail and wholesale broadband access services in the rural areas is based on a **mix** of technologies that blurs any engineering distinctions between the conventional PSTN and IP-based networks.

D. Non-Compensatory Rates Lead to Unacceptable Revenue Replacement Mechanisms Harmful to Consumers and Universal Service

1. The use of non-compensatory access rates (e.g., \$0, \$0.0007) will lead to the adoption of unacceptable revenue replacement mechanisms that will have the opposite of the intended results. This is exacerbated by the failure to reform the federal USF contribution base.
2. Annual increases of the federal subscriber line charge (SLC) will **transfer** the payment of jurisdictional network traffic-sensitive costs to a non-traffic sensitive charge that will be paid by end-users of conventional voice telephone services with potentially adverse effects on universal service. This can be expected to result in major customer opposition and likely legal challenges.
3. Price elasticity of demand effects can accelerate the withdrawal of end-users from landline networks. In short, the revenue replacement will not be realized by the intended carrier beneficiaries.
4. If interstate access does drop to a non-compensatory rate (e.g. \$0, \$0.0007), the SLC should also be eliminated in favor of a comparable uniform rate for consumers, based on including the entire interstate revenue requirement for SLC and ICC, and spreading it across a broad contribution base (all network services).

E. Wireless Carrier Traffic Cannot Be Given Additional “Special Treatment”

1. There can be no different intercarrier compensation rate treatment for wireless carrier traffic. The NPRM proposals will lead to arbitrage.
2. The treatment of wireless carrier traffic must become more aligned with the intercarrier compensation rules that apply to the traffic of other carriers.

IV. VoIP

A. VoIP Traffic and Services Are Telecommunications And Should Be Treated As Such

1. FCC decisions have already recognized that the common carrier transport and termination of IP-based traffic is telecommunications.
2. The States have been successfully resolving intercarrier compensation disputes involving the transport and termination of VoIP traffic through the use of common carrier principles and applicable state and federal law.

B. The FCC Cannot Adopt Separate Regulatory Regimes For VoIP Traffic And Services

1. The FCC has recognized the jurisdictional nature of interconnected VoIP traffic (2006 federal USF contributions and interconnected VoIP providers, 2010 FCC declaratory ruling for interconnected VoIP providers and contributions to state USFs – Nebraska PSC, Kansas Corp. Commission).
2. The FCC cannot recognize the jurisdictional nature of interconnected VoIP traffic and services for purposes of the federal and state USFs and adopt a different regulatory treatment for VoIP traffic when it comes to intercarrier compensation (e.g., use of interstate access rates for intrastate VoIP traffic).
3. The FCC cannot use the \$0.0007/MOU proposed rate for the intercarrier compensation of VoIP traffic. This will lead to significant arbitrage issues.

V. FEDERAL USF REFORMS

THE EXPANSION OF THE CONTRIBUTION BASE IS THE BIG MISSING LINK IN THE PROPOSED FCC REFORMS. The contribution mechanism should be modified to require all network users to contribute, not just legacy voice.

States must continue to have a role in assuring Universal Service for voice only, and for broadband (if a broadband fund is created).

VI. EARLY ADOPTER STATES

The State Members' Comments provide an integrated mechanism for recognizing individual state efforts in intrastate access carrier charge reforms and/or broadband deployment through the appropriate incentive connections with continuous federal USF support.