Overview of the Universal Service Funds and the FCC's Reforms

Christine Aarnes, Chief of Telecommunications
Before the Senate Utilities Committee
February 7, 2013

Kansas Corporation Commission

Universal Service

Both the Kansas Telecommunications Act of 1996 and the Federal Telecommunications Act of 1996 contain provisions to develop universal service funds to maintain and enhance universal service.

- Federal Universal Service Fund (FUSF) - 47 U.S.C.   254
- Kansas Universal Service Fund (KUSF) – K.S.A. 66-2008

Federal Universal Service Fund

The goals of federal Universal Service, as mandated by the 1996 Federal Act (47 U.S.C. 254), are to:

- Promote the availability of quality services at just, reasonable and affordable rates for all consumers;
- Increase nationwide access to advanced telecommunications services;
- Advance the availability of such services to all consumers, including those in low income, rural, insular, and high cost areas at rates that are reasonably comparable to those charged in urban areas;
- Increase access to telecommunications and advanced services in schools, libraries, and rural health care facilities; and
- Provide equitable and non-discriminatory contributions from all providers of telecommunications services to the fund supporting universal service programs.

Federal Universal Service Fund

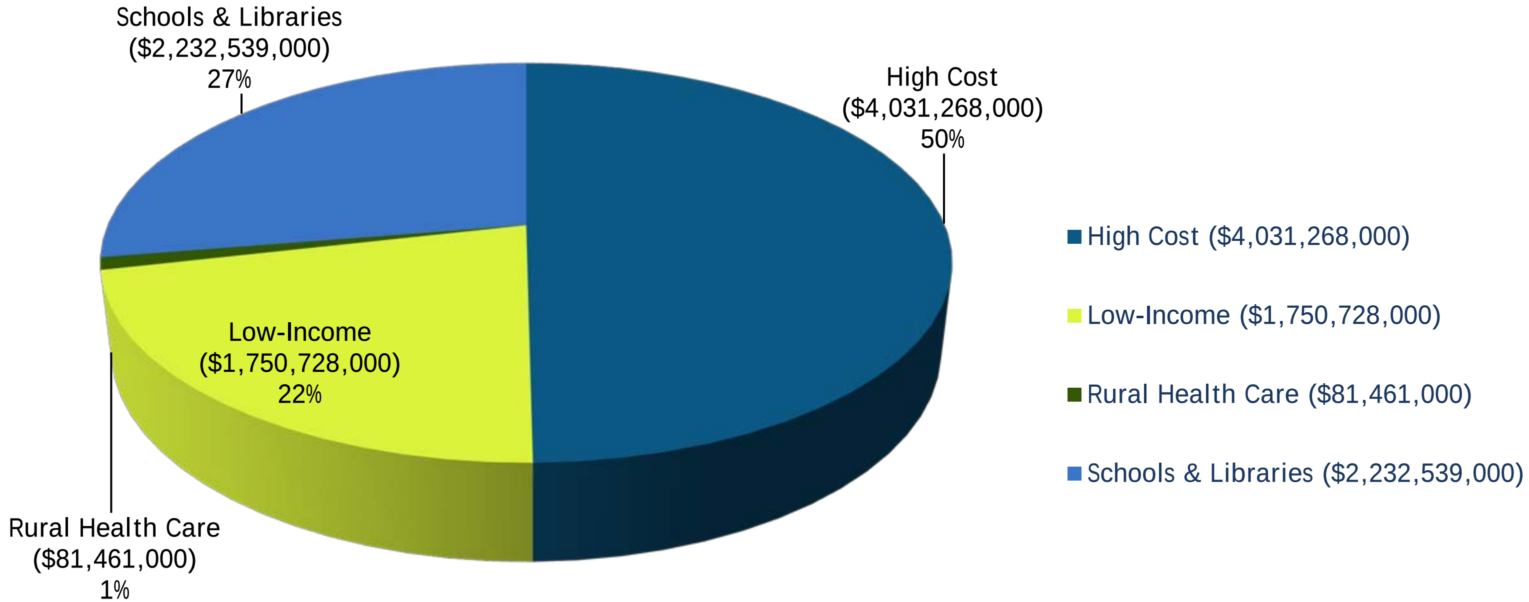
The Federal Communications Commission (FCC) established four programs to fulfill these goals. They are:

- The **High-Cost** program
- The **Lifeline (low income)** program, including initiatives for Native Americans
- The **Schools and Libraries** program, commonly referred to as E-rate
- The **Rural Health Care** program

These programs are funded by the FUSF. Telecommunications providers must contribute to the FUSF through an assessment on their interstate and international revenues. The assessment rate for the 1st quarter 2013 is 16.1%.

Federal Universal Service Fund

Total 2011 Fund Size
$8.10 billion



Federal Universal Service Fund

- Federal High-Cost Support

  1996 --- $1.2 billion

  2011 --- $4.0 billion

- Kansas is the 11th Largest Recipient of all Federal USF Programs

  $213.3 million in 2011

- Kansas is the 4th Largest Recipient of High Cost Support

  $190.7 million in 2011

- Kansas is the 33th Largest Recipient of Low-Income Support

  $7.0 million in 2011

National Broadband Plan

- In early 2009, Congress directed the FCC to develop a National Broadband Plan (NBP) to ensure ubiquitous access to broadband services.
- FCC released NBP on March 16, 2010.

National Broadband Plan

Excerpts from Executive Summary

- Infrastructure networks unite us as a country, bringing together parents and children, buyers and sellers, and citizens and governments in ways once unimaginable. Ubiquitous access to infrastructure networks has continually driven American innovation, progress, prosperity and global leadership.
- Like electricity a century ago, broadband is a foundation for economic growth, job creation, global competitiveness and a better way of life. It is enabling entire new industries and unlocking vast new possibilities for existing ones. It is changing how we educate children, deliver health care, manage energy, ensure public safety, engage government, and access, organize and disseminate knowledge.
- But broadband in America is not all it needs to be. Approximately 100 million Americans do not have broadband at home.
- Broadband is the great infrastructure challenge of the early 21st century.
- The NBP shall seek to ensure that all people of the United States have access to broadband capability.

National Broadband Plan & USF/ ICC Reform

Primary issues being addressed at FCC:

- Convert the “legacy” high-cost component of the USF to the Connect America Fund (CAF)
- Create CAF to support broadband
- Create a Mobility Fund to support 3G (or better) wireless coverage
- Reform Intercarrier Compensation (payments between carriers)
- Expand Lifeline program to allow subsidies to be provided for broadband
- Broaden the USF contribution base to ensure sustainability

FCC adopted USF/ICC Reform Order and FNPRM October 27, 2011. Order released on November 18, 2011.

FCC Order – USF Reform

Principles and Goals

- Support for broadband-capable networks as an express universal service principle under Section 254(b)
- Set the following performance goals to ensure reforms are achieving intended purposes:
  - Preserve and advance universal availability of voice service;
  - Ensure universal availability of modern networks capable of providing voice and broadband service to homes, businesses and community anchor institutions;
  - Ensure universal availability of modern networks capable of providing advanced mobile and broadband service;
  - Ensure that rates for broadband services and rates for voice services are reasonably comparable in all regions of the nation; and
  - Minimize the universal service contribution.

FCC Order – USF Reform

Budget

- Set at $4.5 billion for initial 6 years with an automatic review trigger if the budget is threatened to be exceeded.
- FCC anticipates it may need to revisit and adjust the appropriate size of the programs by the end of the 6 year period based on market developments, efficiencies realized, and further evaluation of the effect of the programs in achieving FCC's goals.

FCC Order – USF Reform for Price Cap Carriers

Price Cap Reforms – Phase 1

- Existing legacy high-cost support frozen at 2011 levels.
- Additional $300 million in CAF support made available, but carriers accepted only $115 million.
  - AT&T declined $47.9 million offered.
  - CenturyLink accepted $35 million, but indicated if FCC grants its waiver petition to deploy in areas served by Wireless Internet Service Providers, it would accept a total of $81.4 million.
  - No CAF Phase 1 support will be invested in Kansas.
- Any carrier that elects to receive additional support will be required to provide broadband with actual speeds of 4Mbps/1Mbps and deploy broadband to at least one currently unserved location for each $775 in additional high-cost support it receives.

FCC Order – USF Reform for Price Cap Carriers

Price Cap Reforms – Phase 2

- Combination of forward-looking cost model and competitive bidding will be used to distribute CAF support.
- FCC is undertaking a public process to develop the model.
- Support will be provided in areas without an unsubsidized competitor.
- In each state, each incumbent price cap carrier will be asked to undertake a "state-level commitment" to provide affordable broadband to all high-cost locations in its service territory in that state.
- If the incumbent declines the state-level commitment, CAF support will be distributed through competitive bidding.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to:

1) Eliminate support in areas that are overlapped by an unsubsidized competitor
2) Cap total FUSF support at $250/line per mo.
3) Eliminate Safety Net Additive (SNA)
4) Reduce high-cost loop support for carriers that maintain artificially low end-user voice rates, with a three-step phase-in beginning July 1, 2012.
5) Transition Local Switching Support (LSS) to ICC Reform
6) Limit “excessive” capital investment and corporate operations expense for High Cost Loop Support (HCLS).
7) Limit corporate operations expense and investment for Interstate Common Line Support (ICLS).

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to:

1) Eliminate support in study areas that are overlapped completely by an unsubsidized facility-based terrestrial competitor providing voice and fixed broadband throughout ILEC service area.
   - If 100% overlap occurs, support will be phased-out over a three year period. At this time, this does not affect any KS ROR carrier.
   - FCC considering elimination of FUSF support in an area that partially overlaps the ILEC's study area.
2) Total FUSF support capped at $250/line per mo., with a gradual phase-down to the cap over a 3-year period. This reform may impact 2-3 ROR carriers in KS. The cap will be phased in as follows:
   - July 1, 2012: FUSF limited to $250 per line per month plus 2/3 of the difference between the uncapped per-line FUSF support and $250.
   - July 1, 2013: FUSF support limited to $250 per line per month plus 1/3 of the difference between the uncapped per-line FUSF and $250.
   - July 1, 2014: FUSF cannot exceed $250 per line per month.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to: (cont'd)

3) Eliminate Safety Net Additive (SNA)
   - Carriers receiving SNA for investment will continue to receive for applicable 5-year period.
   - Carriers receiving SNA for line loss had their SNA support reduced by 50% July 1, 2012 and all SNA will be eliminated July 1, 2013.

4) Reduce high-cost loop support for carriers that maintain artificially low end-user voice rates, with a three-step phase-in beginning July 1, 2012.
   - Rate floor benchmark $10, effective July 1, 2012
   - Rate floor benchmark $14, effective July 1, 2013.
   - Rate floor benchmark expected to be around $15.62 on July 1, 2014.

FCC Order – USF Reform for ROR Carriers

The FCC adopted new rules to: (cont'd)

5) Transition Local Switching Support (LSS) to ICC Reform
   - LSS ended as a stand-alone USF support mechanism on July 1, 2012
   - Limited recovery of costs previously covered by LSS available pursuant to FCC's ICC recovery mechanism.
6) Limit "excessive" capital investment and corporate operations expense for HCLS.
   - Modified FCC corporate expense formula
   - Regression analysis
7) Limit corporate operations expense and investment for ICLS
   - Regression analysis

FCC Order – USF Reform for ROR Carriers

Rate of Return (ROR) Carrier Broadband Requirement

- ROR carriers receiving legacy high-cost support or CAF support to offset lost intercarrier compensation revenues must offer broadband service with actual speeds of at least 4Mbps/1Mbps, upon their customers' reasonable request.

FCC Order – USF Reform

Identical Support Rule for Competitive Eligible Telecommunications Carriers (CETCs)

- Identical support frozen per study area as of year-end 2011 and existing support will be phased-down over a 5-year period beginning on July 1, 2012.
- The phase down, in conjunction with the new funding provided by Mobility Fund Phase I and II, will provide an average of $900 million to mobile carriers for each of the first 4 years of the reform.
- The phase-down of CETC support will end if Mobility Phase II is not operational by June 30, 2014.

FCC Order – USF Reform

CAF Mobility Fund – Phase 1

- Up to $300 million in one-time support awarded through a nationwide reverse auction held on September 27, 2012.
- Eligible areas include census blocks unserved today by mobile broadband services, and carriers may not receive support for areas they have previously stated they plan to cover.
- Winners will be required to deploy 3G service within two years and 4G service within 3 years.
- Separate Tribal Mobility Fund – one-time funding of $50 million.

FCC Order – USF Reform

CAF Mobility Fund – Phase II

- Will provide up to $500 million per year in on-going support to ensure universal availability, including $100 million for Tribal areas.
- FCC planned to implement Phase II in 2013.
- CAF Phase II support recipients are eligible, but carriers will not be allowed to receive redundant support for the same service in the same areas.
- Mobility Fund recipients will be subject to public interest obligations, including data roaming and collocation requirements.

FCC Order – USF Reform

Remote Areas Fund

- The FCC will allocate at least $100 million annually to ensure that even Americans living in the most remote areas of the nation, where the cost of providing wireline or cellular terrestrial broadband service is extremely high, can obtain service.
- Support will be provided to provide broadband service through alternative technology platforms, including satellite and unlicensed wireless.
- FCC requested comments on issues including identification of areas eligible for Remote Areas Fund support and implementation of the subsidy. Comments due February 19, 2013 and Reply Comments due March 18, 2013.
- Expected to be implemented in 2013.

FCC Order – ICC Reform

Comprehensive Intercarrier Compensation (ICC) Reform

- Bill-and-keep methodology for all ICC traffic as the end state.
- Multi-year transition
  - Initial reforms focus on terminating switched access.
  - Carriers are required to cap most rates as of Dec. 29, 2011.
  - Transition to parity with interstate in 2 steps by July 1, 2013.
  - Thereafter, carriers are required to reduce rates to bill-and-keep within 6 years for price cap carriers and 9 years for ROR carriers.

FCC Order – ICC Reform

New Recovery Mechanism

- Access Recovery Charge (ARC)
  - Incumbent carriers allowed to charge ARC on wireline service, with a maximum annual increase of $.50 per month for consumers and small businesses and $1 for multi-line businesses to partially offset ICC revenue declines.
  - Ceiling prevents carriers from assessing any ARC for any consumer whose total monthly rate for local telephone service, inclusive of various rate-related fees, is at or above $30.
  - Carriers prevented from charging ARC on Lifeline customers.
  - ARC plus Subscriber Line Charge (SLC) cannot exceed $12.20 per line for multi-line business customers.

FCC Order – ICC Reform

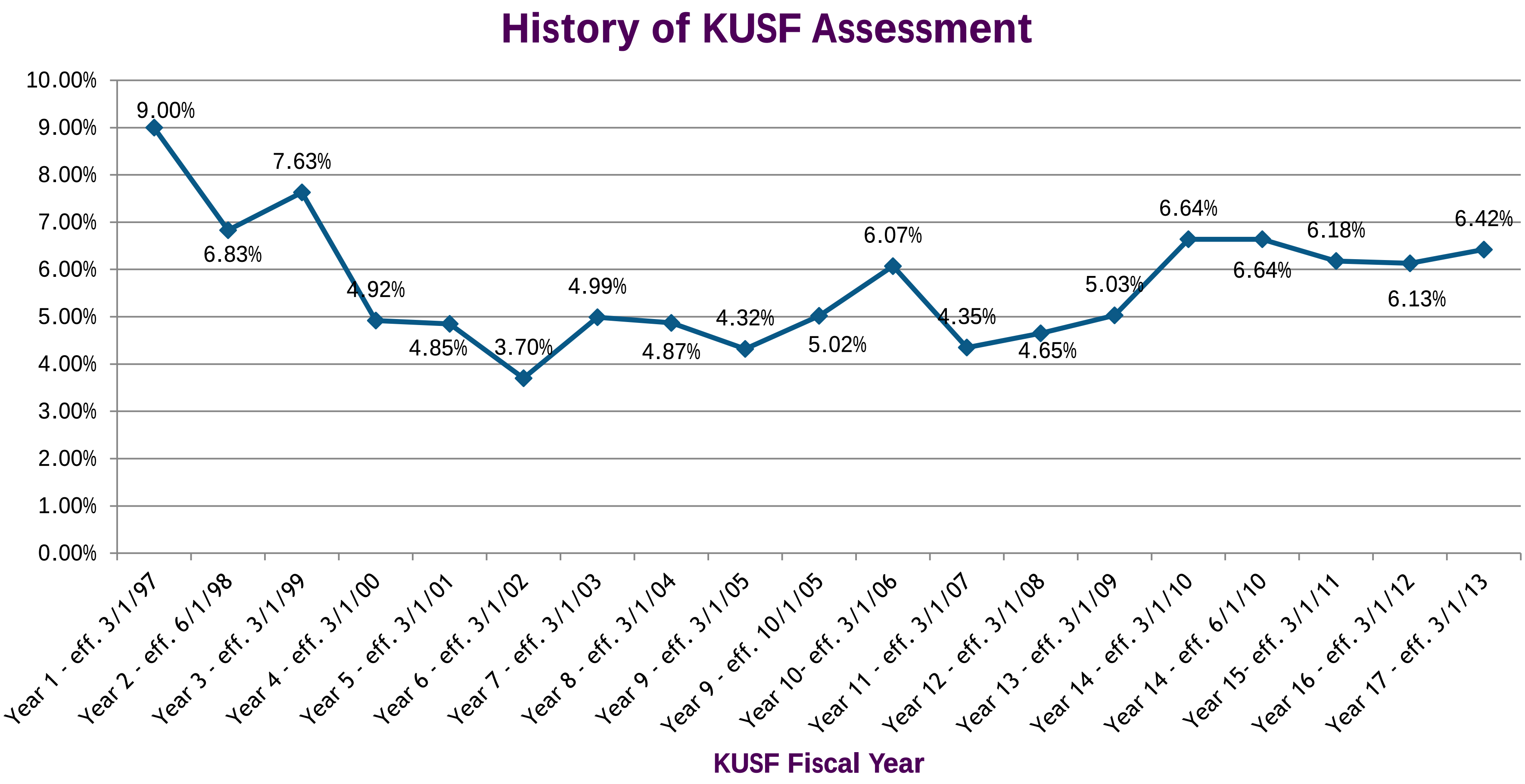
New Recovery Mechanism (cont'd)

- Carriers may receive CAF support for otherwise-eligible revenue not recovered by ARC.
  - Price cap carriers baseline recovery amounts begin at 90%, subject to a 10% annual decline. All price cap CAF recovery will phase out over a 3-year period beginning in 6th year of reform.
  - ROR carriers recovery reduced by 5% annually.

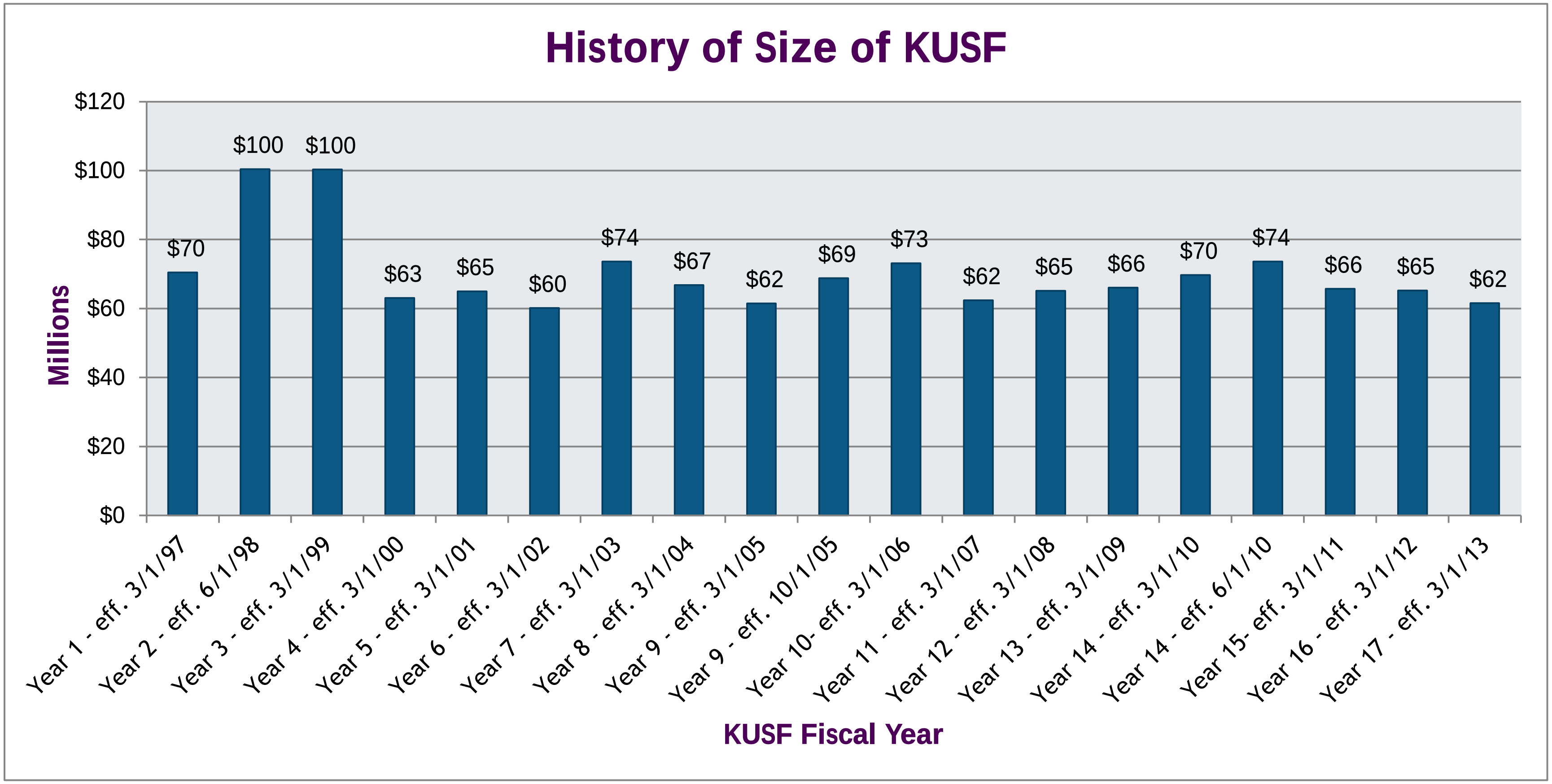
Kansas Universal Service Fund

- KUSF was created by the KCC and implemented March 1, 1997, as required by K.S.A. 66-2008.
- Purpose of the KUSF is to assure quality services are made available to all Kansans at affordable rates.
- Pursuant to K.S.A. 66-2008(a), all Interexchange Carriers (long distance), Incumbent Local Exchange Carriers (ILECs), Electing Carriers, Competitive Local Exchange Carriers (CLECs), Wireless, and Interconnected Voice over Internet Protocol (VoIP) providers must contribute to the KUSF. The assessment may be passed through to customers.
- Current assessment rate is 6.13% on intrastate revenues. As of March 1, 2013, the assessment rate will be 6.42%.

Kansas Universal Service Fund



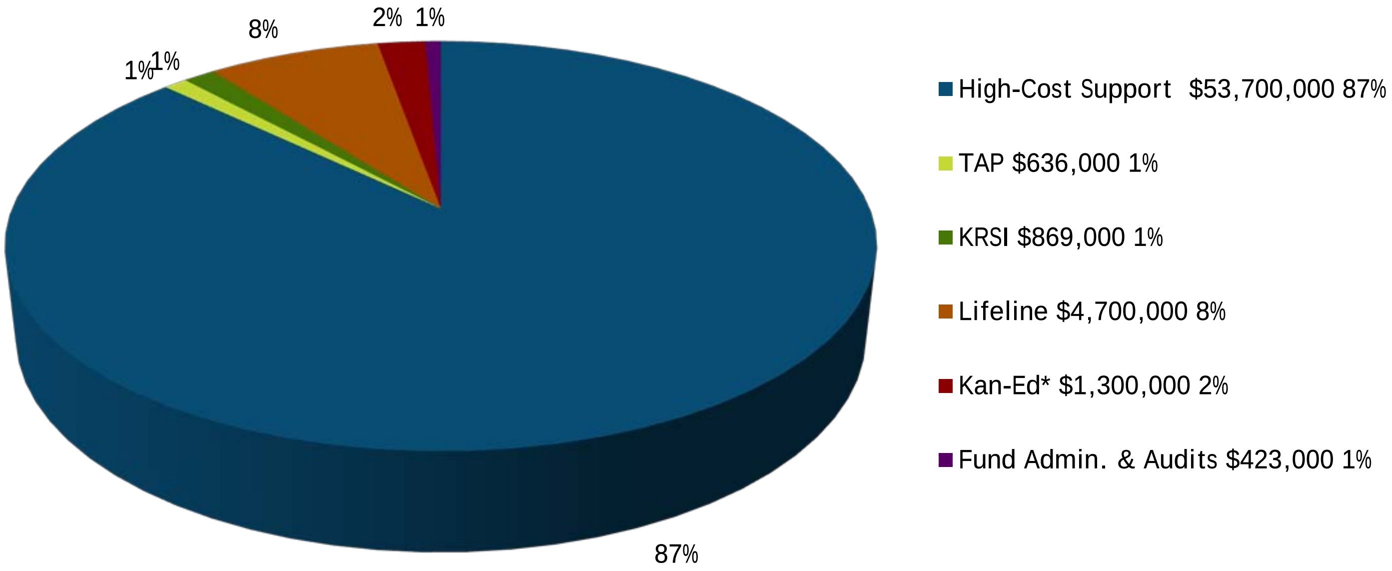
Kansas Universal Service Fund



Additional information available at: http://kcc.ks.gov/telecom/kusfhistory.pdf

Kansas Universal Service Fund

KUSF
Gross Fund Size - March 1, 2013
$61.6 million



•Annual Kan-Ed support was reduced from $6M to $3.75M as of 7/1/12. $1.3 million represents the remaining amount to be paid between 3/1/13 and 6/30/13.

Kansas Universal Service Fund

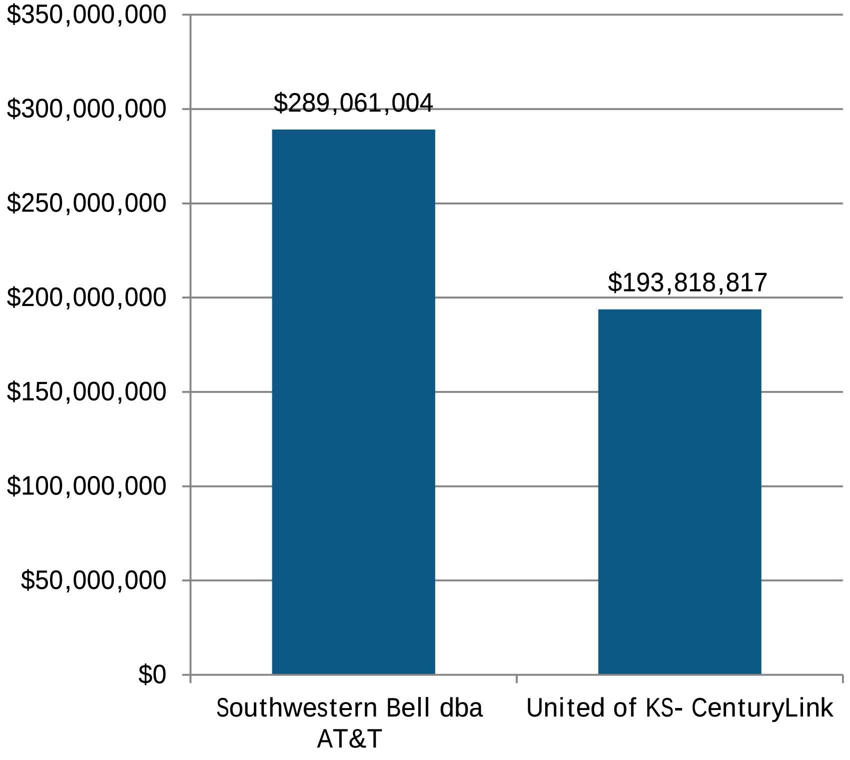
- Initial KUSF high-cost support amount available for incumbent local exchange carriers was equal to the revenue lost when access charge reductions were implemented pursuant to state statute.
- While the initial amount of KUSF support was set to replace lost access revenues, which was revenue-neutral and not necessarily cost-based, K.S.A. 66-2008(c) requires that the Commission periodically review the KUSF to determine if the cost to provide service justifies modification of support.

Kansas Universal Service Fund

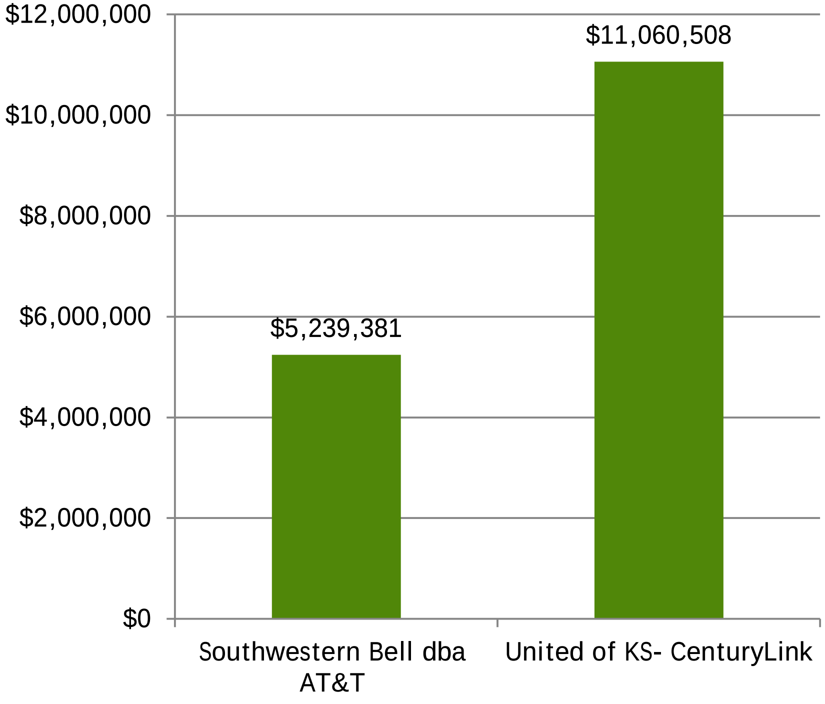
- Implementing a cost-based KUSF – Price Cap Carriers
  - FCC determined that support for price cap carriers, such as AT&T & CenturyLink, should be based on the cost to provide service if the network were being built given current technology rather than based on historical costs. The FCC developed a model to determine the forward looking costs of providing service and support.
  - The Commission followed suit with the KUSF high-cost model for AT&T & CenturyLink.

Kansas Universal Service Fund

Total High-Cost KUSF Received by Price Cap Carriers Since Fund Inception



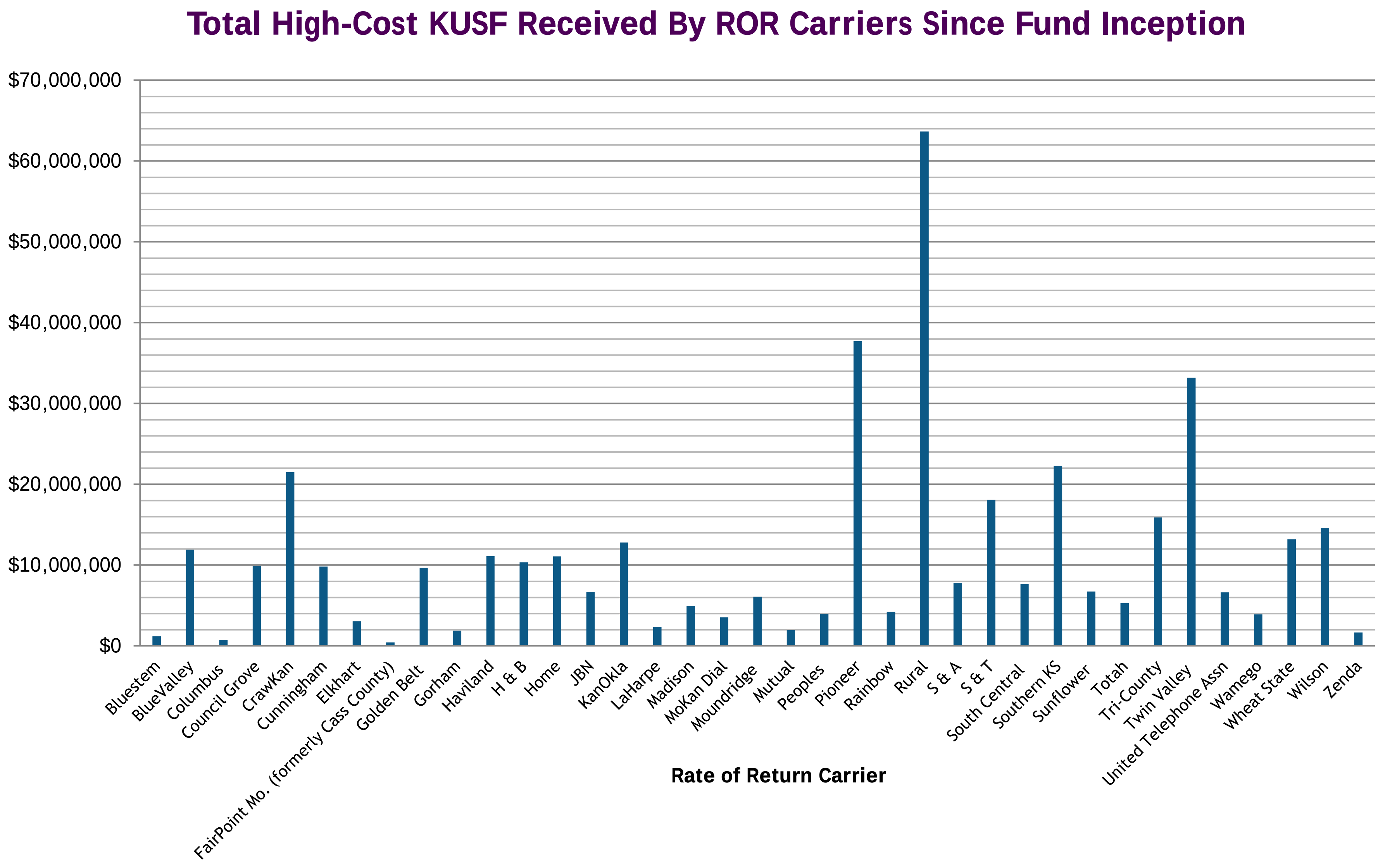
Annual High-Cost KUSF to be Received by Price Cap Carriers beg. 3/1/13



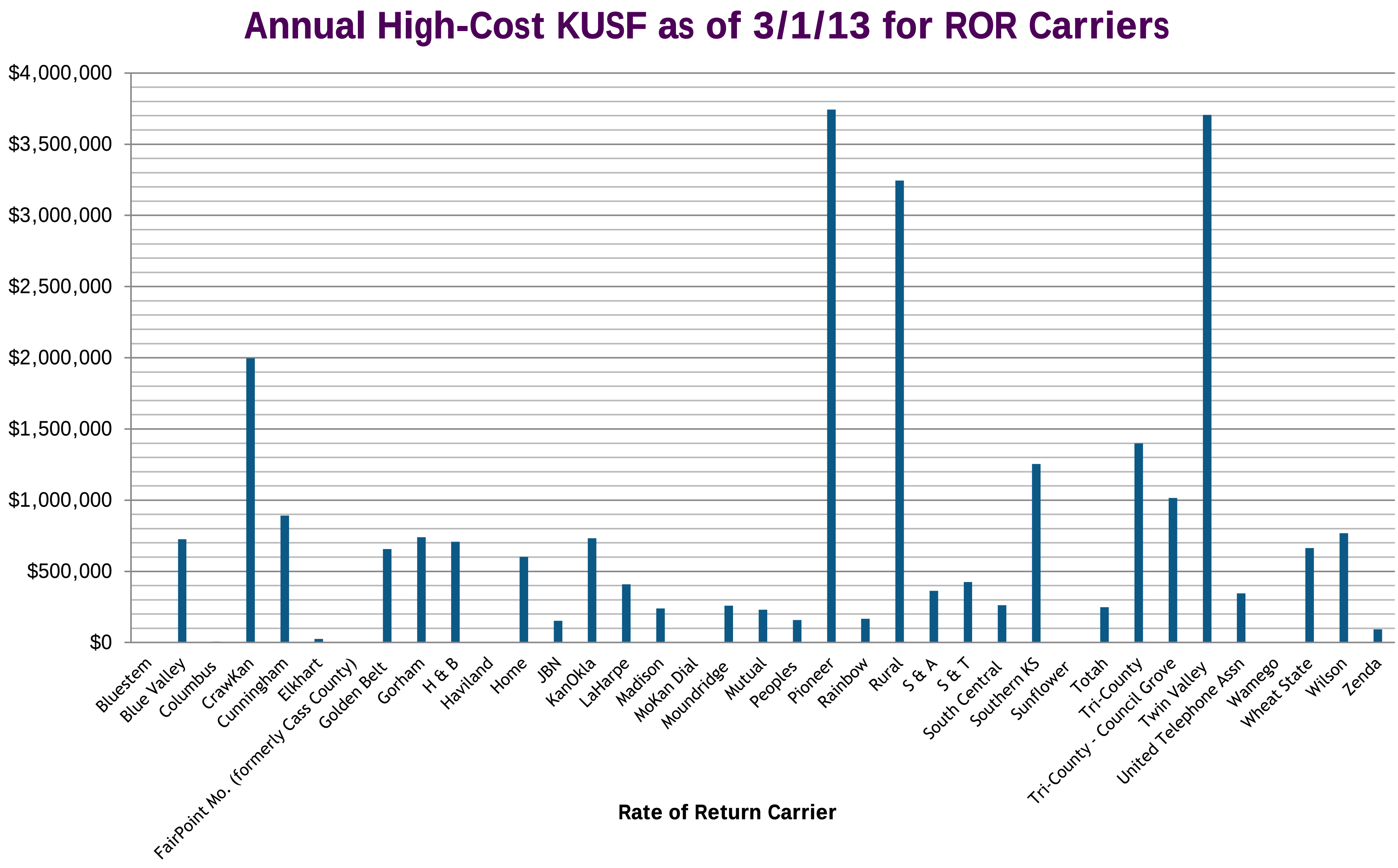
Kansas Universal Service Fund

- Implementing a cost-based KUSF – Rate of Return Carriers
  - Rate of Return (ROR) carriers' support based on embedded costs (K.S.A. 66-2008(e)).
    - ✓ Completed 44 ROR carrier audits, including 2nd audits of some carriers.
    - ✓ Last 2 ROR carrier audits to determine cost-based support are in progress.
    - ✓ 3 ROR carrier requests for additional KUSF support filed in 4th Q 2012.

Kansas Universal Service Fund



Kansas Universal Service Fund



Kansas Universal Service Fund

Rate Base/Rate of Return

- Revenue Requirement = (Rate Base * Rate of Return) + Operating Expenses & Maintenance (O&M) + Admin & General Expenses (A&G) +Depreciation+ Taxes
- Rate Base represents investor-supplied plant facilities and other investments required to provide utility service to consumers
- Rate of Return consists of Cost of Debt and Cost of Equity
- Cost of Equity (shareholder return) is the most contentious issue due to subjectivity
- There is an opportunity to earn a fair return but no guarantee

Kansas Universal Service Fund

Sample Revenue Requirement Schedule

LAHARPE TELEPHONE COMPANY, INC.
KANSAS JURISDICTIONAL
STAFF REVENUE REQUIREMENT
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

LINE NO. *	DESCRIPTION *	A STAFF *
1	PROFORMA RATE BASE	$1,544,801
2	STAFF RATE OF RETURN	9.2739%
3	OPERATING INCOME REQUIRED	143,263
4	PROFORMA OPERATING INCOME	261,442
5	DIFFERENCE	(118,179)
6	INCOME TAX FACTOR	1.25610
7	NET PROFORMA REVENUE INCREASE / (DECREASE)	($148,445)
8	LESS: PROFORMA INTEREST EXPENSE	0
9	NET PROFORMA REVENUE INCREASE	($148,445)

Kansas Universal Service Fund

Sample ROR Schedule

LAHARPE TELEPHONE COMPANY, INC.
DOCKET NO. 12-LHPT-875-AUD
STAFF ADJUSTED AND PRO FORMA OPERATING INCOME STATEMENT
FOR THE TEST YEAR ENDED DECEMBER 31, 2011

SCHEDULE B-1
Page 1 of 1
PASS THROUGH ENTITY

			A	B	C	D	E	F	G	H	I	J	K	L	M
Line No.	Acct. No.	Description	Applicant Book Balance	Applicant Cost Study Adjustments	Applicant Cost Study Balance	Applicant Proforma Adjustments	Applicant Proforma Balance	Staff Adjustments	Staff Adjusted Balance	/---- *Allocation* ----/ Interstate	Intrastate	Staff Adjusted Interstate Balance	Staff Adjusted Intrastate Balance	Staff Pro Forma Adjustments	Staff Pro Forma Adjusted Intrastate Balance
***	******	*************************	********	********	********	*********	*********	********	********	******	******	*********	**********	*********	**********
		Operating Revenues													
1	5001	Local Network Services Revenues	$58,350	$0	$58,350	$0	$58,350	$1,674	$60,024	0.000000	1.000000	$0	$60,024		$60,024
2	5060	Other Basic Area Revenue	42,506	0	42,506	0	42,506	0	42,506	0.000000	1.000000	$0	42,506		42,506
3	5069	Federal High Cost Loop Support	723,095	0	723,095	(360,404)	362,691	348,081	710,772	0.000000	1.000000	0	710,772		710,772
4	5100	Kansas Universal Service Support	161,317	0	161,317	0	161,317	(13,901)	147,416	0.000000	1.000000	0	147,416	(148,445)	(1,029)
5	5080	Network Access Revenue	780,164	0	780,164	(4,585)	775,579	4,585	780,164	Direct Assign		747,501	32,663		32,663
6	5100	Long Distance Network Service Rev	0	0	0	0	0	0	0	1.000000	0.000000	0	0		0
7	5270	Billing and Collection	9,068	0	9,068	0	9,068	0	9,068	Direct Assign		1,856	7,212		7,212
8	5230	Directory Revenue	915	0	915	0	915	0	915	0.000000	1.000000	-	915		915
9	5260	Misc Revenue	39	0	39	0	39	0	39	0.000000	1.000000	0	39		39
10	5280	Non-regulated revenue	(34,728)	0	(34,728)	0	(34,728)	0	(34,728)	0.000000	1.000000	(34,728)	0		0
11	5300	Uncollectible Revenue	0	0	0	0	0	0	0	Direct Assign		0	0		0
12		Total revenues	1,740,726	0	1,740,726	(364,989)	1,375,737	340,439	1,716,176			714,629	1,001,547	(148,445)	853,102
19		Total Plant Specific Operations Exp.	208,433	(6,820)	201,613	0	201,613	(4,775)	196,838			74,720	122,118	0	122,118
25		Total Plant Non-Specific Operations Exp.	351,309	(5,534)	345,775	0	345,775	4,345	350,120			113,681	236,439	0	236,439
30		Total Customer Operations Expense	34,046	(104)	33,942	0	33,942	5,613	39,555			13,879	25,676	0	25,676
34		Total Corporate Operations Expense	378,518	1,209	379,727	50,000	429,727	(61,896)	367,831			178,557	189,274	0	189,274
44		Total Oper. Taxes & Other Oper. Exp.	388,572	68,262	456,834	(120,388)	336,446	(67,086)	269,360			102,763	166,597	(30,266)	136,331
45		Total Operating Expenses	1,360,878	57,013	1,417,891	(70,388)	1,347,503	(123,799)	1,223,704			483,599	740,105	(30,266)	709,839
46		Net Operating Income	$379,848	($57,013)	$322,835	($294,601)	$28,234	$464,238	$492,472			$231,030	$261,442	($118,179)	$143,263

Kansas Universal Service Fund

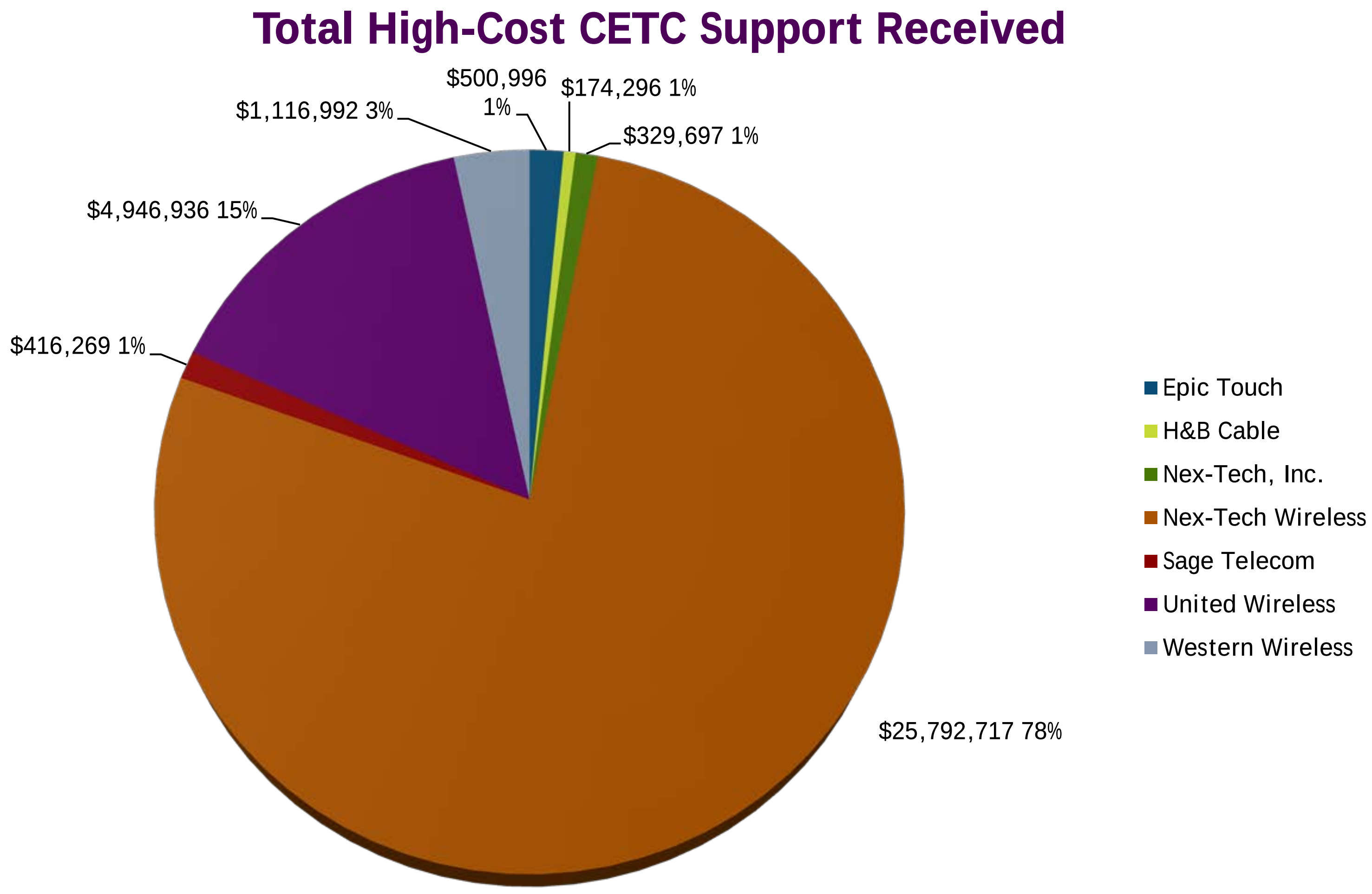
- All KUSF Eligible Telecommunications Carriers (ETCs) are eligible to receive support from the KUSF. This includes 38 incumbent carriers and 11 competitive ETCs.
- Pursuant to the Identical Support Rule, the CETCs receive the same amount of per-line support as the incumbent local exchange carrier.

Kansas Universal Service Fund

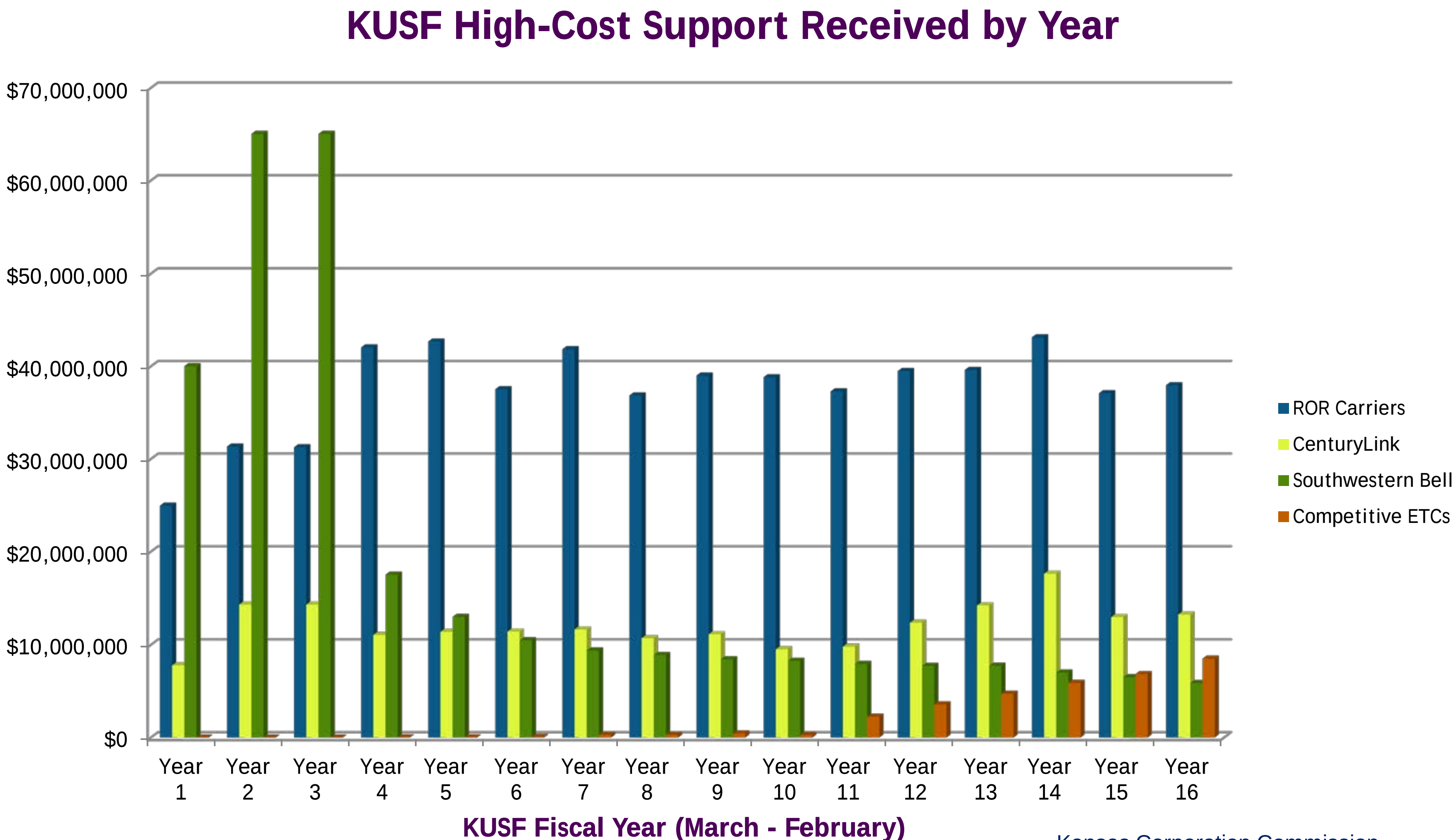
Types of KUSF support requests

- An initial KUSF support request is filed when a newly designated competitive ETC files to request KUSF for the first time.
- Supplemental KUSF may be requested pursuant to K.S.A. 66-2008(d) by AT&T, CenturyLink or a competitive ETC based upon a percentage increase in access lines over the 12-month period prior to the request. The procedures do not apply to the ROR carriers because their KUSF support is based on company-specific audits and is not adjusted for changes in access lines.
- Additional KUSF may be requested pursuant to K.S.A. 66-2008(e) by the ROR carriers. Pursuant to K.S.A. 66-2008(e), ROR regulated local exchange carriers may receive support from the KUSF based on their embedded costs, revenue requirements, investments and expenses.

Kansas Universal Service Fund



Kansas Universal Service Fund



Kansas Universal Service Fund

High-Cost Support – March 1, 2013

$53.7 million*

Rural (ROR) Carriers	$26.2 million
AT&T	$5.2 million
CenturyLink	$11.0 million
Competitive ETCs	$11.2 million

* Total support amount differs from individual amounts due to rounding

Thank you. Questions?

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