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# SPECIAL BULLETIN

## FCC RoR Carrier USF Reform

***The FCC adopted the long-awaited reforms designed to increase the availability of broadband services in areas served by RoR carriers. The Order, adopted unanimously, implements a two path approach where each RoR carrier will choose future support based on the FCC's cost model or on a revised legacy support mechanism. Along with this major decision, the FCC made several other related decision, including a reduction in the interstate rate of return to 9.75%***

### Executive Summary

As expected, the FCC, with substantial industry input, adopted a two path approach that features an election for each rate-of-return carrier (not affiliated with a price cap carrier) that will affect universal service support for the next ten years. One option will base all USF on what is determined by the FCC's Alternative Connect America Model (A-CAM). The other option is to have support based on a substantially-revised legacy mechanism, which includes the formation of Broadband Loop Support (BLS) in replacement of Interstate Common Line Support (ICLS). In addition, the FCC adopted buildout obligations for all RoR carriers, whether the A-CAM or legacy path is chosen.

Given that this decision will affect support for a decade, carriers should carefully review the process adopted by the FCC, analyze the results of both paths, and determine if all obligations (buildout and service-related) can be met.

### Voluntary Model Path

The A-CAM option will involve an offer of support for a term of ten years, with the FCC to determine what happens after ten years during year eight of the plan. The support will be determined by the latest version of the A-CAM, with a 9.75% cost of capital, a $52.50 funding threshold, and a $200 per location cap on support. All census blocks served with 10/1 broadband by FTTP or cable modem technology will be excluded, as will census blocks served by unsubsidized competition.

*Election*. Carriers considering the A-CAM path will have two decision points: (1) Once the final A-CAM results are released, carriers will have 90 days to elect the model-based support. After the group of electing carriers is known, the Bureau will re-run the model to determine the final amount of necessary support for the group of electing carriers. Then, (2) carriers will have 30 days to make a final decision. It should be noted that in between decisions (1) and (2), it is possible that the offer of support will decrease, thus the final decision process. The FCC decided to use $150m of CAF reserves (up to $200m if necessary) to fund the A-CAM path.

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Some important features of and issues surrounding the A-CAM path are:

- ⇒ Election to participate in the A-CAM path is on a state-level basis
- ⇒ Performance obligations include 10/1 mbps broadband to all locations, and:
  - * In areas with household per square mile density of >10, 25/3 mbps service must be provided to 75% of these locations by the end of the 10 year term.
  - * In areas with density between 5 and 10, 25/3 broadband must be deployed to 50% of locations by the end of year 10.
  - * In areas with density of 5 or less, 25/3 must be available to 25% of locations by the end of year 10. (*The Bureau will release a list of state-level density figures before the final model results*)
- ⇒ There will be no offer of support for areas where the carrier has deployed 10/1 broadband to 90% or more of the locations
- ⇒ There will be no support for census blocks covered by unsubsidized competition
  - * The FCC adopted a limited challenge process, based on the most recently-available Form 477 data
- ⇒ Buildout obligations for locations not fully funded—Unlike the price cap carrier system (CAF Phase II), locations in RoR areas that are above the $200 per location funding cap will still receive support, albeit at $200 per location and not a fully-funded level. For these locations, the FCC adopted a separate buildout obligation:
  - * Carriers with state-level households per square mile density of more than 10 will be required to offer at least 4/1 broadband to 50% of those locations by the end of year 10.
  - * Carriers with density of 10 or less will be required to offer 4/1 broadband to 25% of those locations by the end of year 10.
- ⇒ Deployment Milestones
  - * 10/1 must be made available to 40% of the requisite locations by the end of year 4
  - * The milestone increases by 10% per year, with 100% reached by the end of year 10
  - * Flexibility—carrier is in compliance if up to 95% of locations are served with 10/1 broadband by the end of year 10, with remaining 5% subject to capped location rules (4/1).
- ⇒ Tiered Transition, for carriers with A-CAM support less than legacy support (i.e., HCLS, ICLS)
  - * Tier 1: If 10% difference between model and legacy, 50% of difference plus model support in year one, and model support years 2 – 10.
  - * Tier 2: If difference is >10% but less than 25%, transition payment of 20% per year and then model support years 5 – 10. Provided that the 20% phase down is >5% of total legacy support.
  - * Tier 3: if difference is >25%, then 9 year transition of 10% per year and model support in year 10. Provided that phase down is greater than 5% of total legacy support.
- ⇒ The next version of the A-CAM (2.2) is expected to be released this week.
- ⇒ ACAM support is not expected to be available until the end of 2016, at the earliest.

## Revised Legacy Mechanism

Along with the model-based support path, the FCC will also offer RoR carriers an option based on a revised cost-based, legacy, system. To that end, the major change involves standalone (data only) broadband and its support through a revised (and renamed) Interstate Common Line Support mechanism. The new mechanism, dubbed Broadband Line Support (BLS), will provide cost recovery for common line costs, as ICLS does today, and will also cover line costs related to standalone broadband service previously allocated (100%) to interstate special access service. In adopting this approach, the FCC moves closer to NTCA's proposed Data Connection Support (DCS) method, and away from the more detailed "bifurcated approach" discussed by USTelecom and others.

In addition, the FCC, as expected, adopted certain limits on operating and capital expenses and will restrict support to areas (census blocks) with overlapping unsubsidized competition with a related disaggregation of support option. There will also be a control mechanism to maintain the FCC's $2b budget for the RoR high cost support programs.

For the first time, RoR carriers will be subject to specific broadband deployment obligations that will be based on expected BLS and a cost per location metric. Broadband, for the purpose of these obligations, will be based on 10/1 mbps speeds.

Some important features and issues surrounding the revised legacy system are:

⇒ **BLS will provide recovery** for the difference between a carrier's loop costs associated with broadband-only service ("consumer broadband only loop revenue requirement") and consumer broadband only loop revenues
  - The target effective date for BLS is currently 1/1/2017.
  - BLS will provide for loop cost recovery regardless of whether the loop is used for voice, voice/broadband, or broadband only service.
  - BLS will initially impute the lesser of $42 per loop per month or total consumer broadband loop revenue requirement
  - The consumer broadband only loop revenue requirement will be removed from the special access revenue requirement to avoid double recovery.

⇒ The **operating expense limitation** will be based on a statistical analysis (double log regression) that is similar to, but substantially simpler than, the Quantile Regression Analysis adopted and eliminated by the FCC previously.
  - Expected to be implemented this summer and affect less than 5% of study areas
  - The limitation will apply to all accounts used in determining HCLS and BLS (including corporate operations expense)
  - Each study area's operating expenses will be compared to the regression model-generated opex per location plus 1.5 standard deviations. *This was an area of some controversy leading up to the order. Some parties advocated for the regression model-generated results plus 2 standard deviations, which would have resulted in substantially fewer study areas experiencing limited opex cost recovery. The Commission seemingly addresses this by simply stating more study areas would be affected by using 1.5 standard deviations versus 2 (50 vs 17 study areas).*
  - The reduction will be distributed proportionally among the expense accounts used in the HCLS and BLS calculations.
  - Transition: For the first year in which the opex cap is implemented, the eligible expenses of those carriers subject to the cap will be reduced by only one-half of the percentage amount determined by the regression methodology. After that, 100% of the reduction will be applied.
  - NECA will submit a schedule of companies affected within 30 days of the effective date of the Order.

⇒ **Capital Investment Allowances** were adopted that are tied to each carrier's inflation-adjusted depreciated loop plant, and is designed to incent investment where current broadband service is not available.
  - The Capex allowance is adjusted based on the carrier's current broadband deployment as compared to a statewide average:
    - Adjusted upward by 1% for each percentage point the carrier is below the average
    - Adjusted downward by 1% for each percentage point the carrier is above the average
  - The Capex allowance is not expected to affect HCLS until 2018 and CAF BLS until 2017, at the earliest
  - There will be adjustments allowed in certain specific situations
  - NECA will submit study area specific amounts necessary to determine the capex limits within 30 days after the effective date of the Order

⇒ There will be no BLS provided in areas served by a **qualifying unsubsidized competitor**.
  - Areas subject to this rule: census blocks, based on Form 477 data
  - Competitor must offer service meeting current FCC obligations: 10/1 mbps, 150 gb monthly usage, and at a reasonably comparable rate.
  - Qualifying: Competitors must certify the ability to offer service to at least 85% of the residential locations within a given census block
  - Challenge process: There will be an opportunity for incumbents to challenge the existence of qualifying competition.
  - For any support reductions determined by the rules, there will be a phase-in of such a reduction tied to the amount of reduction expected (i.e., less than 25% and greater than 25%)
  - A review of competitive overlap will take place every 7 years

⇒ **Disaggregation of support** in areas with qualifying competition: there will be three options for carriers to utilize to ensure remaining support is targeted to areas (typically higher cost) without unsubsidized competition.
  - The relative density of competitive and non-competitive areas, based on U.S. Census housing data.

⇒ **Budget and Budgetary Controls**
  * The FCC decided to maintain the overall $2 billion for RoR carrier high cost support
  * Amount available for HCLS and BLS is equal to total budget less CAF ICC and A-CAM support
  * If actual demand for HCLS and BLS is higher than the budget, USAC will determine a target number for each mechanism
  * Any necessary reduction in each mechanism will be determined by per-line calculation and a pro rata reduction applied to each study area.

⇒ **Broadband deployment obligations** are adopted for RoR carriers choosing the legacy path, and are measured over a five-year period
  * These obligations are based on a number of factors: (1) current 10/1 broadband deployment, (2) five year forecasted BLS, and (3) a cost per location metric.
  * Carriers with less than 80% deployment are required to use a certain percentage of BLS for 10/1 broadband deployment: <20%, use 35% of BLS; 20% - 40% deployment, use 25% of BLS; 40% - 80% deployment, use 20% of BLS.
  * Cost per location metric can be determined (at the carrier's option) in one of two ways: (1) the average cost of providing 10/1 service based on the actual cost per loop of carriers with similar density, or (2) the A-CAM calculated cost of providing 10/1 service to the unserved census blocks in the carrier's study area.
  * There is no obligation to deploy broadband in any census block if it would result in the study area exceeding the existing $250 per month per line cap on HCLS or would exceed $10,000 per location, per project.

## Cost Allocation, Pricing, and Tariffing Issues

Of course, with all the changes made to RoR support mechanisms made by the FCC, several changes to cost allocation, pricing, and tariffing rules must also be made. The biggest change to cost allocation rules will be the addition in Part 69 of a new category—"Consumer Broadband-Only Loop" - that will track the revenue requirements related to standalone broadband service to be supported by BLS. Some other key issues include:

⇒ A RoR carrier choosing the legacy support path may, but is not required to, tariff a consumer broadband-only loop charge for the consumer broadband-only loop service.
  * The charge may also be offered on a de-tariffed basis, in which case it would not be subject to federal universal service contributions.

⇒ A carrier choosing the A-CAM path may, but is not required to, develop a wholesale broadband only rate not to exceed $42 per month to assist in recovering the portion of the broadband only loop costs not covered by the model-based support.

⇒ Carriers choosing the model path with no longer be allowed to participate in the NECA common line pool, but will be allowed to utilize NECA for tariffing needs.

⇒ CAF ICC Issues
  * RoR carriers will be required to impute an amount equal to the current Access Recovery Charge (ARC) to supported consumer broadband-only lines
  * Carriers must reflect any revenues recovered for use of the facilities previously used to provide the supported service (voice or voice-broadband) as double recovery in the Tariff Review Plans filed with the Commission, which will reduce the amount of CAF ICC received.

## ETC Reporting Requirements

⇒ NEW REPORTING: RoR carries are to provide geocoded location and speed information of newly served locations no later than March 1 for the prior calendar year.

⇒ NEW ONE-TIME REPORTING: ETCs electing model-based support must provide information for locations already served with 10/1 service no later than March 1, 2019.

⇒ Five year investment plans and progress reports will no longer be required.

## Rate of Return Represcription

The FCC took the opportunity to address its long proposed reduction to the authorized interstate rate of return. The reduction from 11.25% to 9.75% will take effect on July 1, 2016, but will be phased in over a period of six years (2016-2021). For example, the authorized RoR on July 1, 2016 will be 11%, which will phase down by 25 basis points each successive July 1.

The new RoR will apply in all situations where a FCC-prescribed RoR is used including common line, special access, and universal service support. The change will not affect the calculation and recovery of amounts associated with transitioning or capped switched access rates. Presumably, this means that the calculation of interstate baseline revenues will not be affected.

## Further Notice of Proposed Rulemaking

The Commission also adopted a Further Notice of Proposed Rulemaking (FNPRM) that requests comment on a number of issues, including permitted expenses, cost allocation, and affiliate transactions. Comment is also sought on reduction support in competitive areas, as well as a proposal floated by Tribally-owned carriers for a method to target support for broadband service in Tribal areas served by RoR carriers. Finally, the Commission seeks comment on other measure to improve the RoR carrier USF system, and on ways to streamline ETC annual reporting requirements.

Comments on the FNPRM are due 30 days after publication in the Federal Register, and Replies are due 60 days after publication.

## Conclusion

We will provide further analysis of the Order's implications in the future. There are clearly many interlocking parts to not only this Order, but how it relates to previous Commission decisions and current rules, and it will take some time to sort it all out.

In the meantime, please contact us if you have any questions.