

## Connect America Fund & Intercarrier Compensation Reform Order and FNPRM

### Executive Summary

#### Universal Service Reform

1. *Principles and Goals.* We begin by adopting support for broadband-capable networks as an express universal service principle under section 254(b) of the Communications Act, and, for the first time, we set specific performance goals for the high-cost component of the Universal Service Fund (USF) that we are reforming today, to ensure these reforms are achieving their intended purposes. The goals are: (1) preserve and advance universal availability of voice service; (2) ensure universal availability of modern networks capable of providing voice and broadband service to homes, businesses, and community anchor institutions; (3) ensure universal availability of modern networks capable of providing advanced mobile voice and broadband service; (4) ensure that rates for broadband services and rates for voice services are reasonably comparable in all regions of the nation; and (5) minimize the universal service contribution burden on consumers and businesses.

2. *Budget.* We establish, also for the first time, a firm and comprehensive budget for the high-cost programs within USF.<sup>1</sup> The annual funding target is set at no more than \$4.5 billion over the next six years, the same level as the high-cost program for Fiscal Year 2011, with an automatic review trigger if the budget is threatened to be exceeded. This will provide for more predictable funding for carriers and will protect consumers and businesses that ultimately pay for the fund through fees on their communications bills. We are today taking important steps to control costs and improve accountability in USF, and our estimates of the funding necessary for components of the Connect America Fund (CAF) and legacy high-cost mechanisms represent our predictive judgment as to how best to allocate limited resources at this time. We anticipate that we may revisit and adjust accordingly the appropriate size of each of these programs by the end of the six-year period, based on market developments, efficiencies realized, and further evaluation of the effect of these programs in achieving our goals.

3. *Public Interest Obligations.* While continuing to require that all eligible telecommunications carriers (ETCs) offer voice services, we now require that they also offer broadband services. We update the definition of voice services for universal service purposes, and decline to disrupt any state carrier of last resort (COLR) obligations that may exist. We also establish specific and robust broadband performance requirements for funding recipients.

4. *Connect America Fund.* We create the Connect America Fund, which will ultimately replace all existing high-cost support mechanisms. The CAF will help make broadband available to homes, businesses, and community anchor institutions in areas that do not, or would not otherwise, have broadband, including mobile voice and broadband networks in areas that do not, or would not otherwise, have mobile service, and broadband in the most remote areas of the nation. The CAF will also help facilitate our intercarrier compensation (ICC) reforms. The CAF will rely on incentive-based, market-driven policies, including competitive bidding, to distribute universal service funds as efficiently and effectively as possible.

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<sup>1</sup> While we recognize that over time several of our existing support mechanisms will be phased down and eliminated, for purposes of this budget, the term “high-cost” includes all support mechanisms in place as of the date of this Order, specifically, high-cost loop support, safety net support, safety valve support, local switching support, interstate common line support, high cost model support, and interstate access support, as well as the new Connect America Fund, which includes funding to support and advance networks that provide voice and broadband services, both fixed and mobile, and funding provided in conjunction with the recovery mechanism adopted as part of intercarrier compensation reform.

5. *Price Cap Territories.* More than 83 percent of the approximately 18 million Americans that lack access to residential fixed broadband at or above the Commission’s broadband speed benchmark live in areas served by price cap carriers—Bell Operating Companies and other large and mid-sized carriers. In these areas, the CAF will introduce targeted, efficient support for broadband in two phases.

6. *Phase I.* To spur immediate broadband buildout, we will provide additional funding for price cap carriers to extend robust, scalable broadband to hundreds of thousands of unserved Americans beginning in early 2012. To enable this deployment, all existing legacy high-cost support to price cap carriers will be frozen, and an additional \$300 million in CAF funding will be made available. Frozen support will be immediately subject to the goal of achieving universal availability of voice and broadband, and subject to obligations to build and operate broadband-capable networks in areas unserved by an unsubsidized competitor over time. Any carrier electing to receive the additional support will be required to deploy broadband and offer service that satisfies our new public interest obligations to an unserved location for every \$775 in incremental support. Specifically, carriers that elect to receive this additional support must provide broadband with actual speeds of at least 4 Mbps downstream and 1 Mbps upstream,<sup>2</sup> with latency suitable for real-time applications and services such as VoIP, and with monthly usage capacity reasonably comparable to that of residential terrestrial fixed broadband offerings in urban areas. In addition, to ensure fairness for consumers across the country who pay into USF, we reduce existing support levels in any areas where a price cap company charges artificially low end-user voice rates.

7. *Phase II.* The next phase of the CAF will use a combination of a forward-looking broadband cost model and competitive bidding to efficiently support deployment of networks providing both voice and broadband service for five years. We expect that the CAF will expand broadband availability to millions more unserved Americans.

8. We direct the Wireline Competition Bureau to undertake a public process to determine the specific design and operation of the cost model to be used for this purpose, with stakeholders encouraged to participate in that process. The model will be used to establish the efficient amount of support required to extend and sustain robust, scalable broadband in high-cost areas. 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, excluding extremely high cost areas as determined by the model. Importantly, the CAF will only provide support in those areas where a federal subsidy is necessary to ensure the buildout and operation of broadband networks. The CAF will not provide support in areas where unsubsidized competitors are providing broadband that meets our definition. Carriers accepting the state-level commitment will be obligated to meet rigorous broadband service requirements—with interim buildout requirements in three years and final requirements in five years—and will receive CAF funding, in an amount calculated by the model, over a five-year period, with significant financial consequences in the event of non- or under-performance. We anticipate that CAF obligations will keep pace as services in urban areas evolve, and we will ensure that CAF-funded services remain reasonably comparable to urban broadband services over time. After the five-year period, the Commission will use competitive bidding to distribute any universal service support needed in those areas.

9. In areas where the incumbent declines the state-level commitment, we will use competitive bidding to distribute support in a way that maximizes the extent of robust, scalable

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<sup>2</sup> Upon a showing that the specified support amount is inadequate to enable build out of broadband with actual upstream speeds of at least 1 Mbps to the required number of locations, a carrier may request a waiver.

broadband service subject to an overall budget. In the Further Notice of Proposed Rulemaking (FNPRM) that accompanies today's Order, we propose a structure and operational details for the competitive bidding mechanism, in which any broadband provider that has been designated as an ETC for the relevant area may participate. The second phase of the CAF will distribute a total of up to \$1.8 billion annually in support for areas with no unsubsidized broadband competitor. We expect that the model and competitive bidding mechanism will be adopted by December 2012, and disbursements will ramp up in 2013 and continue through 2017.

10. *Rate-of-Return Reforms.* Although they serve less than five percent of access lines in the U.S., smaller rate-of-return carriers operate in many of the country's most difficult and expensive areas to serve. Rate-of-return carriers' total support from the high-cost fund is approaching \$2 billion annually. We reform our rules for rate-of-return companies in order to support continued broadband investment while increasing accountability and incentives for efficient use of public resources. Rate-of-return carriers receiving legacy universal service support, or CAF support to offset lost ICC revenues, must offer broadband service meeting initial CAF requirements, with actual speeds of at least 4 Mbps downstream and 1 Mbps upstream, upon their customers' reasonable request. Recognizing the economic challenges of extending service in the high-cost areas of the country served by rate-of-return carriers, this flexible approach does not require rate-of-return companies to extend service to customers absent such a request.

11. Alongside these broadband service rules, we adopt reforms to: (1) establish a framework to limit reimbursements for excessive capital and operating expenses, which will be implemented no later than July 1, 2012, after an additional opportunity for public comment; (2) encourage efficiencies by extending existing corporate operations expense limits to the existing high-cost loop support and interstate common line support mechanisms, effective January 1, 2012; (3) ensure fairness by reducing high-cost loop support for carriers that maintain artificially low end-user voice rates, with a three-step phase-in beginning July 1, 2012; (4) phase out the Safety Net Additive component of high-cost loop support over time; (5) address Local Switching Support as part of comprehensive ICC reform; (6) phase out over three years support in study areas that overlap completely with an unsubsidized facilities-based terrestrial competitor that provides voice and fixed broadband service, beginning July 1, 2012; and (7) cap per-line support at \$250 per month, with a gradual phasedown to that cap over a three-year period commencing July 1, 2012. In the FNPRM, we seek comment on establishing a long-term broadband-focused CAF mechanism for rate-of-return carriers, and relatedly seek comment on reducing the interstate rate-of-return from its current level of 11.25 percent. We expect rate-of-return carriers will receive approximately \$2 billion per year in total high-cost universal service support under our budget through 2017.

12. *CAF Mobility Fund.* Concluding that mobile voice and broadband services provide unique consumer benefits, and that promoting the universal availability of such services is a vital component of the Commission's universal service mission, we create the Mobility Fund, the first universal service mechanism dedicated to ensuring availability of mobile broadband networks in areas where a private-sector business case is lacking. Mobile broadband carriers will receive significant legacy support during the transition to the Mobility Fund, and will have opportunities for new Mobility Fund dollars. The providers receiving support through the CAF Phase II competitive bidding process will also be eligible for the Mobility Fund, 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.

- *Phase I.* We provide up to \$300 million in one-time support to immediately accelerate deployment of networks for mobile voice and broadband services in unserved areas. Mobility Fund Phase I support will be awarded through a nationwide reverse auction, which we expect to

occur in third quarter 2012. Eligible areas will 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. The auction will maximize coverage of unserved road miles within the budget, and winners will be required to deploy 4G service within three years, or 3G service within two years, accelerating the migration to 4G. We also establish a separate and complementary one-time Tribal Mobility Fund Phase I to award up to \$50 million in additional universal service funding to Tribal lands to accelerate mobile voice and broadband availability in these remote and underserved areas.

- *Phase II.* To ensure universal availability of mobile broadband services, the Mobility Fund will provide up to \$500 million per year in ongoing support. The Fund will expand and sustain mobile voice and broadband services in communities in which service would be unavailable absent federal support. The Mobility Fund will include ongoing support for Tribal areas of up to \$100 million per year as part of the \$500 million total budget. In the FNPRM we propose a structure and operational details for the ongoing Mobility Fund, including the proper distribution methodology, eligible geographic areas and providers, and public interest obligations. We expect to adopt the distribution mechanism for Phase II in 2012 with implementation in 2013.

13. *Identical Support Rule.* In light of the new support mechanisms we adopt for mobile broadband service and our commitment to fiscal responsibility, we eliminate the identical support rule that determines the amount of support for mobile, as well as wireline, competitive ETCs today. We freeze identical support per study area as of year end 2011, and phase down existing support over a five-year period beginning on July 1, 2012. The gradual phase down we adopt, in conjunction with the new funding provided by Mobility Fund Phase I and II, will ensure that an average of over \$900 million is provided to mobile carriers for each of the first four years of reform (through 2015). The phase down of CETC support will stop if Mobility Fund Phase II is not operational by June 30, 2014, ensuring approximately \$600 million per year in legacy support will continue to flow until the new mechanism is operational.

14. *Remote Areas Fund.* We allocate at least \$100 million per year to ensure that Americans living in the most remote areas in the nation, where the cost of deploying traditional terrestrial broadband networks is extremely high, can obtain affordable access through alternative technology platforms, including satellite and unlicensed wireless services.<sup>3</sup> We propose in the FNPRM a structure and operational details for that mechanism, including the form of support, eligible geographic areas and providers, and public interest obligations. We expect to finalize the Remote Areas Fund in 2012 with implementation in 2013.

15. *Reporting and Enforcement.* We establish a national framework for certification and reporting requirements for all universal service recipients to ensure that their public interest obligations are satisfied, that state and federal regulators have the tools needed to conduct meaningful oversight, and that public funds are expended in an efficient and effective manner. We do not disturb the existing role of states in designating ETCs and in monitoring that ETCs within their jurisdiction are using universal service support for its intended purpose. We seek comment on whether and how we should adjust federal obligations on ETCs in areas where legacy funding is phased down. We also adopt rules to reduce or eliminate support if public interest obligations or other requirements are not satisfied, and seek comment on the appropriateness of additional enforcement mechanisms.

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<sup>3</sup> We note that satellite broadband providers and wireless Internet service providers (WISPs) are not confined to participating only in this component of the CAF; they are eligible to participate in any CAF program for which they can meet the specified performance requirements.

16. *Waiver*. As a safeguard to protect consumers, we provide for an explicit waiver mechanism under which a carrier can seek relief from some or all of our reforms if the carrier can demonstrate that the reduction in existing high-cost support would put consumers at risk of losing voice service, with no alternative terrestrial providers available to provide voice telephony.

### **Intercarrier Compensation Reform**

17. *Immediate ICC Reforms*. We take immediate action to curtail wasteful arbitrage practices, which cost carriers and ultimately consumers hundreds of millions of dollars annually:

- *Access Stimulation*. We adopt rules to address the practice of access stimulation, in which carriers artificially inflate their traffic volumes to increase ICC payments. Our revised interstate access rules generally require competitive carriers and rate-of-return incumbent local exchange carriers (LECs) to refile their interstate switched access tariffs at lower rates if the following two conditions are met: (1) a LEC has a revenue sharing agreement and (2) the LEC either has (a) a three-to-one ratio of terminating-to-originating traffic in any month or (b) experiences more than a 100 percent increase in traffic volume in any month measured against the same month during the previous year. These new rules are narrowly tailored to address harmful practices while avoiding burdens on entities not engaging in access stimulation.
- *Phantom Traffic*. We adopt rules to address “phantom traffic,” *i.e.*, calls for which identifying information is missing or masked in ways that frustrate intercarrier billing. Specifically, we require telecommunications carriers and providers of interconnected VoIP service to include the calling party’s telephone number in all call signaling, and we require intermediate carriers to pass this signaling information, unaltered, to the next provider in a call path.

18. *Comprehensive ICC Reform*. We adopt a uniform national bill-and-keep framework as the ultimate end state for all telecommunications traffic exchanged with a LEC. Under bill-and-keep, carriers look first to their subscribers to cover the costs of the network, then to explicit universal service support where necessary. Bill-and-keep has worked well as a model for the wireless industry; is consistent with and promotes deployment of IP networks; will eliminate competitive distortions between wireline and wireless services; and best promotes our overall goals of modernizing our rules and facilitating the transition to IP. Moreover, we reject the notion that only the calling party benefits from a call and therefore should bear the entire cost of originating, transporting, and terminating a call. As a result, we now abandon the calling-party-network-pays model that dominated ICC regimes of the last century. Although we adopt bill-and-keep as a national framework, governing both inter- and intrastate traffic, states will have a key role in determining the scope of each carrier’s financial responsibility for purposes of bill-and-keep, and in evaluating interconnection agreements negotiated or arbitrated under the framework in sections 251 and 252 of the Communications Act. We also address concerns expressed by some commenters about potential fears of traffic “dumping” and seek comment in the FNPRM on whether any additional measures are necessary in this regard.

19. *Multi-Year Transition*. We focus initial reforms on reducing terminating switched access rates, which are the principal source of arbitrage problems today. This approach will promote migration to all-IP networks while minimizing the burden on consumers and staying within our universal service budget. For these rates, as well as certain transport rates, we adopt a gradual, measured transition that will facilitate predictability and stability. First, we require carriers to cap most ICC rates as of the effective date of this Order. To reduce the disparity between intrastate and interstate terminating end office rates, we next require carriers to bring these rates to parity within two steps, by July 2013. Thereafter, we require carriers to reduce their termination (and for some carriers also transport) rates to bill-and-keep, within six years for price

cap carriers and nine for rate-of-return carriers. The framework and transition are default rules and carriers are free to negotiate alternatives that better address their individual needs. Although the Order begins the process of reforming all ICC charges by capping all interstate rate elements and most intrastate rate elements, the FNPRM seeks comment on the appropriate transition and recovery for the remaining originating and transport rate elements. States will play a key role in overseeing modifications to rates in intrastate tariffs to ensure carriers are complying with the framework adopted in this Order and not shifting costs or otherwise seeking to gain excess recovery. The FNPRM also seeks comment on interconnection issues likely to arise in the process of implementing a bill-and-keep methodology for ICC.

20. *New Recovery Mechanism.* We adopt a transitional recovery mechanism to mitigate the effect of reduced intercarrier revenues on carriers and facilitate continued investment in broadband infrastructure, while providing greater certainty and predictability going forward than the *status quo*. Although carriers will first look to limited increases from their end users for recovery, we reject notions that all recovery should be borne by consumers. Rather, we believe, consistent with past reforms, that carriers should have the opportunity to seek partial recovery from all of their end user customers. We permit incumbent telephone companies to charge a limited monthly Access Recovery Charge (ARC) on wireline telephone service, with a maximum annual increase of \$0.50 for consumers and small businesses, and \$1.00 per line for multi-line businesses, to partially offset ICC revenue declines. To protect consumers, we adopt a strict ceiling that 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. Although the maximum ARC is \$0.50 per month, we expect the actual average increase across all wireline consumers to be no more than \$0.10-\$0.15 a month, which translates into an expected maximum of \$1.20-\$1.80 per year that the average consumer will pay.<sup>4</sup> We anticipate that consumers will receive more than three times that amount in benefits in the form of lower calling prices, more value for their wireless or wireline bill, or both, as well as greater broadband availability. Furthermore, the ARC will phase down over time as carriers' eligible revenue decreases, and we prevent carriers from charging any ARC on Lifeline customers or further drawing on the Lifeline program, so that ICC reform will not raise rates at all for these low-income consumers. We also seek comment in the FNPRM about reassessing existing subscriber line charges (SLCs), which are not otherwise implicated by this Order, to determine whether those charges are set at appropriate levels.

21. Likewise, although we do not adopt a rate ceiling for multi-line businesses customers, we do adopt a cap on the combination of the ARC and the existing SLC to ensure that multi-line businesses do not bear a disproportionate share of recovery and that their rates remain just and reasonable. Specifically, carriers cannot charge a multi-line business customer an ARC when doing so would result in the ARC plus the existing SLC exceeding \$12.20 per line. Moreover, to further protect consumers, we adopt measures to ensure that carriers must apportion lost revenues eligible for ICC recovery between residential and business lines, appropriately weighting the business lines (*i.e.*, according to the higher maximum annual increase in the business ARC) to prevent carriers that elect not to receive ICC CAF from recovering their entire ICC revenue loss from consumers. Carriers may receive CAF support for any otherwise-eligible revenue not recovered by the ARC. In addition, carriers receiving CAF support to offset lost ICC revenues will be required to use the money to advance our goals for universal voice and broadband.

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<sup>4</sup> The maximum theoretical ARC for customers of price cap carriers would be \$2.50 after 5 years and for customers of rate-of-return carriers would be \$3 after 6 years, although we expect the average actual ARC to be less than half of those totals.

22. In defining how much of their lost revenues carriers will have the opportunity to recover, we reject the notion that ICC reform should be revenue neutral. We limit carriers' total eligible recovery to reflect the existing downward trends on ICC revenues with declining switching costs and minutes of use. For price cap carriers, baseline recovery amounts available to each price cap carrier will decline at 10 percent annually. Price cap carriers whose interstate rates have largely been unchanged for a decade because they participated in the Commission's 2000 CALLS plan will be eligible to receive 90 percent of this baseline every year from ARCs and the CAF. In those study areas that have recently converted from rate-of-return to price cap regulation, carriers will initially be permitted to recover the full baseline amount to permit a more gradual transition, but we will decline to 90 percent recovery for these areas as well after 5 years. All price cap CAF support for ICC recovery will phase out over a three-year period beginning in the sixth year of the reform.

23. For rate-of-return carriers, recovery will be calculated initially based on rate-of-return carriers' fiscal year 2011 interstate switched access revenue requirement, intrastate access revenues that are being reformed as part of this Order, and net reciprocal compensation revenues. This baseline will decline at five percent annually to reflect combined historical trends of an annual three percent interstate cost and associated revenue decline, and ten percent intrastate revenue decline, while providing for true ups to ensure CAF recovery in the event of faster-than-expected declines in demand. Both recovery mechanisms provide carriers with significantly more revenue certainty than the *status quo*, enabling carriers to reap the benefits of efficiencies and reduced switching costs, while giving providers stable support for investment as they adjust to an IP world.

24. *Treatment of VoIP Traffic.* We make clear the prospective payment obligations for VoIP traffic exchanged in TDM between a LEC and another carrier, and adopt a transitional framework for VoIP intercarrier compensation. We establish that default charges for "toll" VoIP-PSTN traffic will be equal to interstate rates applicable to non-VoIP traffic, and default charges for other VoIP-PSTN traffic will be the applicable reciprocal compensation rates. Under this framework, all carriers originating and terminating VoIP calls will be on equal footing in their ability to obtain compensation for this traffic.

25. *CMRS-Local Exchange Carrier (LEC) Compensation.* We clarify certain aspects of CMRS-LEC compensation to reduce disputes and address existing ambiguity. We adopt bill-and-keep as the default methodology for all non-access CMRS-LEC traffic. To provide rate-of-return LECs time to adjust to bill-and-keep, we adopt an interim transport rule for rate-of-return carriers to specify LEC transport obligations under the default bill-and-keep framework for non-access traffic exchanged between these carriers. We also clarify the relationship between the compensation obligations in section 20.11 of the Commission's rules and the reciprocal compensation framework, thus addressing growing concerns about arbitrage related to rates set without federal guidance. Further, in response to disputes, we make clear that a call is considered to be originated by a CMRS provider for purposes of the intraMTA rule only if the calling party initiating the call has done so through a CMRS provider. Finally, we affirm that all traffic routed to or from a CMRS provider that, at the beginning of a call, originates and terminates within the same MTA, is subject to reciprocal compensation, without exception.

26. *IP-to-IP Interconnection.* We recognize the importance of interconnection to competition and the associated consumer benefits. We anticipate that the reforms we adopt will further promote the deployment and use of IP networks, and seek comment in the accompanying FNPRM regarding the policy framework for IP-to-IP interconnection. We also make clear that even while our FNPRM is pending, we expect all carriers to negotiate in good faith in response to requests for IP-to-IP interconnection for the exchange of voice traffic.