

NEWS & COMMENTARY

ANALYSIS OF A CHANGING INDUSTRY

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LIGHTS, CAMERA, NO ACTION!

FCC Fails to Vote on Comprehensive ICC/USF Reform

November 4, Election Day, has come and gone. In the midst of an historic presidential campaign and with political gamesmanship taking center stage, we suspect that some in the industry may have missed all the limelight illuminating the Federal Communications Commission (FCC) in the past fortnight. While the build-up at the FCC and the interplay between the two national associations have been intense, it pales in comparison to the significant political developments we witnessed last Tuesday. Yet, in some ways, there is a real convergence between rural carrier interests and the actions in the larger, more prominent political theater: Both share the pressing, immediate need to begin reconstructing basic economic foundations and industry relations.

Prologue

To recap, in mid-October, FCC Chairman Kevin Martin circulated a draft order among his fellow commissioners that addressed comprehensive intercarrier compensation (ICC) and federal universal service fund (USF) reform. The chairman did not make the details of his proposal public, nor until November 5 was the draft order even circulated outside the FCC. Nevertheless, Chairman Martin held a press conference to discuss the major provisions in his proposal and held a variety of *ex parte* meetings with industry representatives to discuss his plan. From reports of these meetings and the press conference, JSI came to understand that Martin's plan sought to reform fundamentally all major ICC components, as well as the mechanisms of federal USF. Based on the available information, JSI concluded that the Martin plan proposed to give every industry group a benefit and require from every industry group a sacrifice. Subsequent to the actual release of the draft order, our conclusions appear to be confirmed.

Some of the proposed sacrifices assigned to rural carriers, JSI notes, were significant and onerous. For example, Martin initially proposed to impose a cap on all current federal universal service disbursements based on 2008 distributions. This proposal created significant concern, given its seemingly unfair treatment of carriers that have recently invested in infrastructure and that would not be eligible to receive federal USF support, based on current rules, due to the reporting and distribution lags in the high-cost support program. Further, the Martin plan required that all rural carriers seeking to receive their capped study-area federal USF support (*i.e.*, high-cost, local switching, and interstate common-line) commit to deliver "basic" broadband capability to 100 percent of their study areas in no more than five years. (The FCC

would consider individual waivers on a case-by-case basis). If a carrier failed to make this commitment, the FCC would conduct a reverse auction to find a service provider that would. If no service provider volunteered, the incumbent carrier would receive its capped study area support on an ongoing basis.

In addition, given the available information, it was unclear to JSI exactly how interstate rate-of-return regulation would operate under the Martin plan. The plan proposed to freeze current interstate and intrastate access revenues, with rural carriers receiving a new federal USF support amount to make them whole. Furthermore, the current federal USF support mechanisms were to be frozen. With all interstate revenue mechanisms frozen (subscriber line charges were proposed to increase and remain capped), JSI concluded that the interstate rate of return regime for *switched* access service would be *discarded*. Moreover, we observed that the only component of interstate service that would remain under a rate-of-return construct would be special-access services. If additional infrastructure investments were going to receive rate-of-return treatment, we could only envision large increases in special-access service rates, a development that would discourage deployment of the very broadband services Chairman Martin wanted to encourage.

The Plot Thickens

Adding to the chairman's motivation for a suitable conclusion was a time-sensitive plot device, the November 5 deadline imposed by the U.S. Court of Appeals, D.C. Circuit, in the matter related to its consideration of the FCC's *ISP Remand Order*. Earlier this year Core Communications, Inc. received a writ of *mandamus* from the D.C. Court against the FCC. The Appeals Court was sympathetic to Core's request, given the FCC's six+-year delay in providing legal justification of its treatment of ISP-bound traffic. The Court's growing impatience with the FCC was evident: "Having repeatedly, and mistakenly, put our faith in the Commission, we will not do so again. If the FCC cannot, within six months, explain its legal authority for the interim rules, we can only presume that this is because there is in fact no such authority."

Without the FCC's notification that it had adopted a valid legal justification, the Appeals Court would vacate the *ISP Remand Order* on November 6. Such a *vacatur* of the FCC's rules would mean the rule never existed, and the RBOCs would be liable for reciprocal compensation to Core, and presumably to other CLECs, for the period since 2001. This would constitute a considerable liability for the RBOCs and any other incumbent carriers opting into the \$0.0007 reciprocal compensation rate regime for ISP-bound traffic. The Martin plan provided legal justification for its actions regarding ISP-bound traffic by addressing intercarrier compensation comprehensively.

Preparing for Opening Night

With the stage set, various players began to enter stage left and right to audition the Martin plan. The RBOCs supported the proposal, primarily, JSI believes, because it was to their benefit to support the interim ISP remand provisions. The Cellular Telecommunications and Internet Association (CTIA) also supported the plan. While the individual state public service commissions were given considerable authority to set rates for interstate services, their national association, NARUC, urged the FCC to release the entire plan to allow open discussion of its

provisions. Consumer advocates joined in the chorus, urging the FCC to delay its scheduled vote and allow all parties to examine the proposal, because they believed the increases in end-user charges needed additional vetting. And, lastly, rural carrier interests were split: NTCA and NECA urged delay, while OPASTCO – after having been able to successfully modify the original Martin plan to correct defects it observed (including those mentioned above) – offered its conditional support of the modified plan.

The Theater Goes Dark

In a surprising turn of events, on the day prior to the scheduled curtain raiser, November 3, all four of Chairman Martin’s fellow commissioners rejected the plan and urged consideration of its provisions in December. With his defeat in attempting to pass comprehensive reform on Nov. 4 apparent, the chairman pulled the item from the open meeting agenda, vowing to address the legal justification for the *ISP Remand Order*.

The Post Opening Surprise

Holding to his word, Chairman Martin circulated an order on November 5 that addressed the *ISP Remand Order*, as well as the Federal State Joint Board on Universal Service recommendations filed last November. The FCC adopted this order in what was reported to be “late evening” that Wednesday. In the order, the FCC adopted a legal justification to attempt to uphold the *ISP Remand* decision establishing interim rules, including the \$0.0007 per-minute rate for terminating ISP-bound traffic.

In summary, the FCC reaffirmed the interstate nature of ISP-bound traffic and concluded that ISP bound traffic is subject to Sec. 251(b)(5) reciprocal compensation. As for the pricing of reciprocal compensation of ISP-bound traffic, rather than follow the specific and explicit price standard for reciprocal compensation found in Sec. 252(d)(2), the FCC concluded that a savings provision found in Sec. 251(i), which holds that nothing in Sec. 251 shall limit or otherwise affect the FCC’s authority under Sec. 201, allows the FCC to disregard the explicit pricing standard and apply its interim rules using as justification its general authority found in Sec. 201 which relates to interstate services and charges. To quote the FCC, “The Commission thus retains full authority to regulate charges for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework.”

Only time will tell whether the Court will consider this reasoning valid, inasmuch as it appears to JSI that the FCC failed to discuss why the explicit price standard found in Sec. 252(d)(2) should not be used for reciprocal compensation; and, instead, replaced with interim rules now established under general Sec. 201 authority. Regardless, now that the FCC has spoken, the matter rests with Core Communication and the Appeals Court.

In addition to the order, the FCC adopted a Further Notice of Proposed Rulemaking containing the Martin Plan as originally written, a narrow universal service reform proposal, and the “Modified” Martin Plan, with changes based in part on the *ex parte* discussions held with OPASTCO and WTA. The details of these plans are most assuredly worthy of study and

consideration, and we will report on the details of these plans in a soon-to-be-forthcoming edition of *JSI News & Commentary*. For now, however, we return to our drama.

The Critics' Review

During the latter part of October leading up to the November 4 vote (*i.e.*, the one at the FCC), bitter feelings between the two rural associations were evident as both OPASTCO and NTCA attacked the actions of the other. Both associations viewed their strategy differently. OPASTCO apparently saw the Martin plan as a significant opportunity for rural carriers and attempted to modify the more onerous parts of the plan to the benefit of rural carriers. For its part, NTCA saw the plan as a non-starter and an ominous threat to rural interests.

Notwithstanding the animosity, time is now critical since as the FCC plans to fast-track comments on these plans and could vote on a plan as early as December 18. As we wait to see what new plot twists might emerge in Act 2 of the current drama, the rural carrier industry needs to regroup and focus our efforts on reconstruction: reconstruction of a plan that addresses rural interests and reconstruction of joint association efforts in the hope of offering a unified rural voice at the FCC and before the new Congress. It should be obvious that it is critical that the national associations find a way to work together for the benefit of all rural carriers. Our objective should be to explain to a new administration and Congress the importance of rural telecommunications and broadband service to the repair and advancement of rural and national economies and communities. If our voice is not unified, JSI believes, it will go unheard, and we will be impaired in developing rural policies directed at moving forward with sustainable infrastructure deployment to meet the needs of citizens living in rural areas of our nation.

For more information about this article or if you have any questions about the reform drama, contact Manny Staurulakis (mstaurulakis@jsitel.com) in JSI's Maryland office, at 301-459-7590, or Douglas Meredith (dmeredith@jsitel.com) in Utah, at 801-294-4576.

THE DTV TRANSITION REACHES THE HOMESTRETCH

The FCC wants no one to forget that among the major events to affect our nation's history over the next few months, one of the most important will be the digital television (DTV) transition. Indeed, the FCC and other government agencies have poured vast amounts of money and resources into ensuring that all Americans understand that on February 17, 2009, all full-power TV stations will cease transmitting signals in analog and begin to transmit in digital format only. Yet, for many Americans, this transition will have no impact, because the only consumers affected will be those who receive over-the-air broadcast signals; the DTV transition will not affect the vast majority of Americans who receive the signals *via* video/cable or satellite TV services.

The FCC commissioners, however, have not let this disparity deter them from making DTV education one of their top priorities. For example, during September and October, the commissioners traveled to 22 cities making DTV outreach presentations, despite facing pressing deadlines in November to act on overhauling intercarrier compensation and universal service. In

addition, in September, the FCC spent an enormous amount of time and resources testing the DTV transition in Wilmington, North Carolina, where out of an estimated 180,000 TV households, only 14,000 receive TV signals over the air. Further, during this time, the commission also engaged in such “worthwhile” educational pursuits as sponsoring NASCAR Driver David Gilliland’s Car #38 for DTV outreach.

... But I Play One on TV

While to many the DTV transition may not seem as important as reforming intercarrier compensation or universal service because of the limited impact it will have on consumers, the FCC is taking the matter very seriously. In fact, the FCC must take the matter seriously due to the intense focus that Congress has placed on the transition. Over the last several months, Congress has held numerous hearings in which FCC Chairman Kevin Martin and other commissioners have been called upon to testify. Adding to this intensity is a recent finding by the Government Accountability Office (GAO) in which the DTV transition was listed among the top 13 items needing the attention of President-Elect Obama and the next Congress. According to the GAO, "ensuring an effective transition to digital TV" is listed among the other 12 critical areas that include: the oversight of financial institutions, U.S. efforts in Iraq and Afghanistan, protecting the homeland, caring for service members, retirement of the space shuttle, and rebuilding the country’s military readiness.

Thus, any rules that the FCC has made regarding the transition must be carefully followed. To illustrate, in September, the FCC ruled that Qwest had “apparently willfully and repeatedly” failed to send monthly DTV transition notices to certain Lifeline customers and was fined \$51,000. JSI urges all clients to ensure that they are in full compliance with all the FCC’s DTV transition rules that apply to telecommunications providers and video/cable providers, which we’ve summarized as follows:

- Notification Requirements – all eligible telecommunications carriers (ETCs) that receive universal service funds, as well as all video/cable providers and other multichannel video programming distributors (MVPDs), must notify their customers about how the upcoming digital television (DTV) transition deadline will affect them. The notices must be made monthly and appear in bills through March 2009.
- Viewability Requirements - provides two options as to how operators can carry the digital signal to subscribers that have analog TV sets:
 - (1) downconvert the digital signal to analog format;
 - or,
 - (2) carry the signal only in digital format, provided that all subscribers have the necessary equipment to view the broadcast content
- Requirements Related to Carriage of High Definition (HD) broadcast signals – requires video/cable systems to carry HD broadcast signals in HD format, unless either an exemption applies or a waiver is granted.

- A system is exempted from this HD carriage requirement if it has an activated channel capacity of 552 MHz or less, or it has 2,500 or fewer subscribers.
 - If the system does not qualify for the exemption, but has 5,000 or fewer subscribers, the system can take advantage of an expedited waiver review process.
- Reporting Requirements – entities that were awarded licenses in the most recent 700 MHz auction (Auction 73) must file quarterly reports indicating whether outreach efforts have been taken to educate consumers about the DTV transition and if so, explain these efforts.

If you have any questions or would like assistance with compliance efforts for any of these requirements, please contact John Kuykendall (jkuykendall@jsitel.com) in JSI's Maryland office at 301-459-7590.

WEBINAR REMINDER: JSI TO ASSIST CLIENTS WITH AUDIT PREPARATION THURSDAY, DEC. 4

With Round 2 of the FCC OIG - USAC Universal Service Fund audits drawing to a close, plans are already underway to select companies for Round 3. The regulators insist that the selection process is random and that selection or exclusion from a previous round does not exempt a company for selection in the next round. JSI expects that another 400 companies could be selected for Round 3.

Since companies must adhere to some very strict time-sensitive data collection deadlines, a review of the audit process will provide you with an understanding of the procedures that must be followed, as well as many of the items auditors will be requesting. JSI will offer a step-by-step overview of the audit process, as well as background and general requirements of GAO Government Auditing Standards in a webinar scheduled for December 4, from 2:00 p.m. - 4:00 p.m. (EST). The cost of the webinar is \$249 per company, which includes up to five separate Internet connections per registration.

Companies interested in participating in the webinar should contact Leah Yoakum (lyoakum@jsitel.com) in JSI's Maryland office, at 301-459-7590 to register. If you have questions regarding the webinar, contact Steve Meltzer (smeltzer@jsitel.com) or Brian Sullivan (bsullivan@jsitel.com) in the Maryland office; Gordon Dauchy (gdauchy@jsitel.com) in our Minnesota office, at 651-452-2660; or James West (jwest@jsitel.com) in our Texas office, at 512-338-0473. Clients interested in the webinar but unable to attend due to a scheduling conflict, should contact JSI so that we can let you know when the next Audit Preparation webinar will be scheduled.

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As this issue of our newsletter indicates, events are reaching a boil for JSI clients. Thus, it's critical for you and other key staff to stay abreast of developments. Are there others at your company that should be getting the *JSI News & Commentary*? Has your e-mail address changed since our last issue? We try to keep our database accurate, but things change. If we do not have your correct e-mail address, or if others at your company may also like to receive our newsletter *via* e-mail, please complete the following information and fax it back to us, at 301-577-5575, or simply use the e-mail link to provide the information directly.

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