

# NEWS & COMMENTARY

## ANALYSIS OF A CHANGING INDUSTRY

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### FEDERAL UNIVERSAL SERVICE REFORM: MAKING SENSE OF THE CHATTER

In January, the Federal Communications Commission (FCC) issued three Notices of Proposed Rulemaking (NPRMs) concerning the federal universal service high-cost support program. Specifically, the three NPRMs addressed the identical support rule, reverse auctions, and long-term reform recommended on Nov. 20, 2007 by the Federal State Joint Board on Universal Service. Not surprisingly, a large number of industry participants filed initial comments in these proceedings, and JSI expects no drop-off when it comes to the reply comments currently scheduled to be filed on June 2.

Adding to the ongoing discussion of federal universal service reform, the FCC finally responded to the “urgent” interim and emergency actions recommended by the Joint Board on May 1, 2007. One year to the day later, on May 1 of this year, the FCC released an order placing a cap on federal universal service support distributed to competitive eligible telecommunications carriers (CETCs). In this issue of *News & Commentary*, JSI offers our take on the order and seeks to place it within the context of the overall review of federal reform efforts. In so doing, we hope to make sense of all the hubbub and predict – as best we can – what manner of reforms may await us throughout the rest of the year. All the while, we hold close the sage counsel once penned by Benjamin Franklin: “Never confuse motion with action.” Our intent is to ferret out the likely actions to be taken by the FCC and sketch their future implications for rural incumbent local exchange carriers (ILECs).

### The CETC Cap Order

We begin with a brief review of the CETC cap order. FCC Chairman Kevin Martin was more than ready to impose the interim CETC cap six months ago, and Commissioner Deborah Tate, the federal chair of the Joint Board, has long supported a cap. One other member of the FCC, however, had to be cajoled into voting for the cap. When Commissioner Robert McDowell finally voiced support for the CETC cap, the order was adopted on a 3-2 vote. (For several reasons, commissioners Michael Copps and Jonathan Adelstein voted against the order.)

The order attempts to justify the cap as being consistent with the Telecommunication Act. To this end, the FCC discussed at length *Allenco Communications, Inc. v FCC*, a case heard by the U.S. Court of Appeals for the Fifth Circuit in 2000. According to the FCC, the case provides justification for capping federal support in the face of a congressional mandate to ensure sufficiency of funds for universal service goals. (We discuss *Allenco* in greater detail below.)

For each state (and we presume each U.S. territory), the FCC imposed a cap to limit federal high cost support for all CETCs. The cap will work to reduce CETC support disbursements in a state if the uncapped support for all CETCs – calculated under the current per-line mechanism – exceeds the state’s March 2008 eligible distribution amount. A factor will be applied to all CETCs in a state to reduce support levels to the March 2008 cap. Of course, if the uncapped support amount for CETCs in a state does not exceed the March 2008 cap, there would be no reduction in support for CETCs in that state. A reduction factor for each state will be calculated quarterly, throughout the duration of the CETC cap.

The FCC made a clear distinction between “eligible” to receive support and “entitled” to receive support. High cost support, the FCC concluded, falls into the “eligible” category, and it stated that a carrier eligible to receive support does not “automatically entitle a carrier to receive universal service support.” JSI observes that contrasting “eligible” and “entitled” in this manner portends consequences for rural ILECs into the future as the industry debates a cap on all ILEC support.

### **Limited Exceptions to CETC Cap**

In a curious and apparently confusing manner, the FCC adopted two “limited” exceptions to the operation of the interim CETC cap. The first, we’ll call the Cost Based Exception, and it states the cap is not applied if a “CETC submits its own costs.” The FCC said, “Specifically, a CETC will not be subject to the interim cap to the extent that it files cost data demonstrating that its costs meet the support threshold in the same manner as the incumbent LEC.” The second limited exception the FCC made to the interim cap, which we’ve labeled the Covered Location Exception, is for CETCs that “serve tribal lands or Alaska native regions.”

The key provisions governing these limited exceptions are paragraphs 33 and 34 of the order. Because of their importance in understanding the proposed mechanics of the exceptions, we quote these paragraphs in their entirety:

33. Participation in this limited exception to the interim cap is voluntary and will be elected by the competitive ETC on a study area by study area basis. Therefore, any competitive ETC that does not or cannot opt into the limited exception, or that does not or cannot opt into the limited exception for a particular Covered Location, will remain subject to the interim cap as described herein. Support for competitive ETCs that do opt into the limited exception will continue to be provided pursuant to section 54.307 of the Commission’s rules, except that the uncapped per line support is limited to one payment per each residential account. If a competitive ETC serves lines in both Covered Locations and non-Covered Locations (or only Covered Locations), the universal service administrator shall determine the amount of additional support – after application of the interim cap – necessary to ensure that a competitive ETC receives the same per-line support amount as the incumbent LEC for the lines qualifying for the exception.

34. Finally, compliance with the terms of this limited exception will be verified through certification and reporting requirements. Specifically, a competitive ETC seeking to receive high-cost support pursuant to this limited exception must certify the number of

lines that meet the limited exception requirements. The competitive ETC also must provide a specific description of how it confirmed that it had met the certification threshold.

JSI believes there are two possible interpretations of Paragraph 33. The first is that the phrase, “this limited exception,” used at the very beginning of Paragraph 33 refers only to the Covered Location Exception. The second interpretation is that the phrase refers to both types of exceptions, the Covered Location Exception and the Cost-Based Exception. Under the first interpretation, the FCC states that a CETC serving a covered location could opt into the limited exception, meaning not all tribal lands and Alaska native regions would automatically be exempt from the cap. JSI wonders why the FCC made this exception voluntary and leads us to question exactly why a CETC serving a covered location would not opt into the exception.

If a CETC were to opt into the limited exception, its support would be based on Sec. 54.307 of the FCC’s rules, meaning that the CETC would receive the per-line support of the ILEC. However, the FCC made one very important change regarding per-line support for CETC electing to use the exception. The FCC stated that Sec. 54.307 rules would apply “except that the uncapped per line support is limited to one payment per each residential account.” This unique wrinkle in the operation of the exception introduces a “one-line support” concept into the debate. No doubt, one-line support rings quite similar to “primary-line” support, and most JSI clients will recall the extensive and emotional debates of past years on this very issue. By adding this clause, the FCC has reintroduced the concept that support should be limited to one per-line support amount for a residence. And we note this has been done *without* recommendation by the Joint Board or discussion in the order – in fact, JSI finds it curious that what we have quoted above is all that one will find in the order about this very important policy issue.

If one accepts the interpretation that Paragraph 33 applies only to Covered Location, then we find no discussion on the operation of the Cost-Based Exception. We are left wondering exactly how the Cost-Based Exception would function, but we think it is relatively clear that it removes the CETC interim cap. Curiously, this implies that a CETC which provides cost support would be placed back under the identical support rule and receive support based on the ILEC’s per-line support, just as was done before the interim cap was imposed. Nowhere in the order does the FCC suggest that a CETC opting into the Cost-Based Exception would receive support based on its supporting documentation – even though it would have filed this cost-based information.

The other interpretation of Paragraph 33 would entail everything noted above about the Covered Location Exception and apply it equally to the Cost-Based Exception. This interpretation requires that we conclude that the phrase, “this limited exception,” should have been written by the FCC as “these limited exceptions.” Under this view of the order, Sec. 54.307 would apply to both the Cost-Based and the Covered Location exceptions – something that already appears to be the case if the CETC cap were removed from a carrier. More importantly, the “one per-line payment per account” would apply to the Cost-Based exception as well. This view of the order would apply the one per-line payment per residence to all CETCs seeking to be excluded from the interim cap. We would imagine this interpretation is the more correct version – even though the order is not clear – because, among other reasons, we do not believe the FCC intended to uniquely “penalize” Covered Locations given its long-standing policies favoring tribal lands. JSI

expects to see petition(s) for clarification and/or reconsideration filed by CETCs that want to clarify the mechanics of opting into the Cost-Based Exception.

## **ILEC Implications**

Right at the outset, JSI observes two very important trends in the CETC Interim Cap order that will likely affect rural ILECs. First is the FCC's application of *Allenco* to address the requirement that federal support be sufficient. The *Allenco* case is very important because it enables the FCC to look beyond the sufficiency of support for rural ILECs and base its judgment on the sufficiency of support for end-user customers. When opportunities to use VoIP applications exist in many parts of the nation, regulators may see a diminished need for the end-user customer to receive federal USF support to offset a rural ILEC's high network costs. JSI fears this is a bad omen given that the policy fails to recognize the necessity and value of the underlying ILEC wireline networks that binds the nation together. A review of the long-term reform comments recently filed with the FCC reveals rural ILECs and their advocates arguing for the need to keep investing in and maintaining rural ILEC networks. We believe that as the discussion of federal USF continues, *network* support deserves more emphasis than *retail service* support. In sum, we believe it is urgent for the rural ILEC industry to address squarely the pitfalls evident in *Allenco* and redirect efforts to explain the need to provide sufficient support to maintain and improve rural networks.

Our second global concern with the order focuses on the concept of limiting support to one line per residence; *i.e.*, establishing an "acceptable" level of federal USF support. Offshoots of this trend can be seen in all concepts designed to limit support, including but not limited to an overall cap on high-cost support, applying a primary-line restriction on support, or using reverse auctions to determine the level of support for rural ILECs insofar as the winning bidder's support is lower than the current level of support. In the order, the FCC seems to want to construct a Great Wall of China between CETC support and rural ILEC support. In the long-term recommended decisions it released in November, however, the Joint Board reversed its initial course and endorsed an overall cap on high-cost federal USF support. In taking the steps it took in its recent order, the FCC may now prefer to establish a cap on federal USF for all carriers.

Both of these trends signal changes to current federal USF programs. The Joint-Board released its decision on long-term recommendations in November 2007, and the FCC is required to act on a Joint Board-recommended decision within one year. Thus, by November 2008, we will see FCC action addressing the long-term reforms recommended by the Joint Board, including the establishment of a broadband, mobility and provider of last resort program designed to reform the current program. We don't know whether the FCC will adopt all, part, or none of these recommendations. We hope there is enough in the record to dissuade the FCC from adopting reverse auctions as a distribution mechanism for rural ILECs; however, the trend to limit, and even reduce, federal USF support may motivate regulators toward the use of reverse auctions for wireless CETCs, and this could potentially affect rural ILEC support in the long term.

Comments filed in response to the FCC's three NPRMs suggest that the battle for continued federal USF support will be waged along familiar fronts. We encourage clients to keep careful watch on the trend to cap and limit support. The rest of 2008 is poised for other reforms in

federal USF support. In this light, we urge that you remain active with your associations to convince regulators and legislators that federal USF support for rural ILECs is necessary if carriers operating in rural areas of the nation can continue to provide advanced and efficient telecom services to their customers.

If you have any questions about the Joint Board's recommendation, the FCC's order, or on USF reform in general, please contact Manny Staurulakis ([mstaurulakis@jsitel.com](mailto:mstaurulakis@jsitel.com)) in JSI's Maryland office, at 301-459-7590, or Douglas Meredith ([dmeredith@jsitel.com](mailto:dmeredith@jsitel.com)) in Utah, at 801-294-4576.

## **FCC'S ENFORCEMENT BUREAU RENDERS BAFFLING DECISION IN RESPONDING TO ALLEGED CPNI VIOLATIONS**

On April 11, the Federal Communications Commission's (FCC's) Enforcement Bureau released a decision in which it recommended that the FCC deny in part a complaint filed against Verizon by three VoIP providers, Bright House Networks, Comcast Corp., and Time Warner Cable. In their complaint, the VoIP providers alleged that Verizon's practice of "retention marketing" violated the FCC's Customer Proprietary Network Information (CPNI) rules by using CPNI in marketing campaigns designed to retain an affected customer during the time between the receipt of a request to port that customer's number and the actual execution of the port.

Prior to the issuance of the Enforcement Bureau's "Recommended Decision," it had been almost universally understood across the industry that the FCC's rules prohibited the use of CPNI to retain customers during the pendency of a number portability request. Accordingly, the Bureau's decision has generated confusion among a number of JSI clients regarding whether their companies could engage in customer retention efforts during the pendency of a number portability request. To provide clients with some guidance in light of this rather perplexing ruling, we provide the following explanation of the apparent rationale of the Bureau's conclusions and how these conclusions differ from previous FCC rulings.

### **Rules Governing the Privacy of Carrier-to-Carrier Information**

Sec. 222 of the Communications Act sets forth the regulations governing the privacy of customer information and CPNI in particular. Sec. 222(a) specifies that telecommunications carriers must protect the confidentiality of "proprietary information of other carriers, including resellers," and Sec. 222(b) prohibits the use of such proprietary information "for a carrier's own marketing efforts."

In reviewing these provisions in the context of establishing its CPNI rules, the FCC concluded that they prohibit carriers from using CPNI "to retain soon-to-be former customers where the carrier gained notice of a customer's imminent cancellation of service through the provision of carrier-to-carrier service." The FCC reasoned that "competition is harmed if a carrier uses carrier-to-carrier information, such as switch or PIC orders, to trigger retention marketing campaigns, and consequently prohibit such actions accordingly." Although the FCC did not

specifically reference number portability in these statements, the reference to “switch orders” has been understood to mean a number portability request.

In its recommended decision, however, the Enforcement Bureau did not agree with this interpretation. In examining the facts, the Bureau found that Verizon did indeed conduct retention marketing campaigns while port requests were pending. As part of its campaign, Verizon utilized a list of all customers that were pending disconnection, including those for which port requests had been received. It then reduced the list only to those customers with pending number portability requests for which the customers were moving to another facilities-based provider. The Bureau determined that these actions did not violate CPNI rules and denied that part of the VoIP providers’ complaint, but it deferred to the FCC on the issue regarding whether Verizon’s actions were “unreasonable,” thus violating Sec. 201(b) of the Act.

### **Did Verizon Violate the Specific Ban on Use of Carrier Information for Marketing?**

Seeking to answer this question, the Enforcement Bureau first examined the specific prohibition against the use of proprietary information for marketing purposes in Sec. 222(b). This provision stipulates that a telecom carrier that “receives or obtains proprietary information from another carrier for the purposes of providing any telecommunications service shall use such information only for such purpose, and shall not use such information for its own marketing efforts.” The Bureau found that this provision lends itself to three possible interpretations in order for the ban against the use of the information for marketing purposes applies: (1) that the carrier receiving the proprietary information must provide telecom service; (2) that the carrier submitting the information must provide telecom service; or, (3) either the carrier receiving or submitting the information provides telecom service.

The Bureau recommended that the FCC adopt the interpretation that would prohibit the use of proprietary information when the carrier receiving the information provides the telecommunications service. This was the interpretation advocated by Verizon, and the Bureau found that this interpretation “provides the most grammatically consistent reading of the statute.” Under this interpretation, Verizon would violate Sec. 222(b) only if it received the information contained in the port request for purposes of providing a telecommunications service itself. The Bureau then examined the definition of a “telecommunications service” and concluded that the role Verizon plays in the number porting process “does not involve the provision of a ‘telecommunications service’.” The Bureau based this conclusion on the fact that the number porting process does not involve “transmission” of a customer’s information and that Verizon does not charge a fee in its role porting numbers. Thus, the Bureau declared that under this interpretation of Sec. 222(b), Verizon did not violate the ban.

The Bureau then noted that even if either of the two alternative interpretations were adopted and Sec. 222(b) applied when the carrier submitting the proprietary information provides a telecommunications service, the ban would not apply to Verizon when the port requests came from Comcast or Bright House. The Bureau found that for the number portability process, these providers rely on affiliated certificated competitive local exchange carriers (CLECs) that the Bureau found were not telecommunications carriers. The Bureau observed that although the affiliated CLECs had obtained state certificates and interconnection agreements, they did not

satisfy the requirement of a "common carrier" to be classified as a telecommunications carrier. To be considered a common carrier, an entity must "hold itself out" as offering telecommunications indiscriminately to "whatever similarly situated customers might have use for such telecommunications." The Bureau found no evidence that the affiliated CLECs have ever provided telecom service to anyone other than their VoIP-provider partners.

### **Did Verizon Violate the Provision to Protect the Confidentiality of Carrier Information?**

The Bureau also examined whether Verizon violated the provision set forth in Sec. 222(a), which states that telecom carriers have "a duty to protect the confidentiality of proprietary information of, and relating to, other telecommunications carriers . . . ." The Bureau rejected the interpretation that this provision imposes a duty not to use the proprietary information for any purpose other than that for which the proprietary information was provided. Instead, the Bureau found that the "more natural reading" was that the provision "creates only a duty not to disclose the information to any third party." Under this interpretation, the Bureau found that Verizon did not violate this provision.

### **Were Verizon's Actions Unreasonable?**

In addition to reviewing Sec. 222, the Bureau addressed the VoIP providers' allegations that Verizon's actions were "unjust and unreasonable" and thus violated Sec. 201(b) of the Act. The Bureau found that it was not able to make a determination regarding these allegations because it found that the FCC "does not yet have a consistent policy with regard to retention marketing."

In reaching this conclusion, the Bureau cited the FCC's statements made in the context of its CPNI rulings in which it prohibited the use of carrier-to-carrier information, "such as switch or PIC orders," to trigger retention marketing campaigns. The Bureau asserted that the term "switch orders" refers only to orders from CLECs reselling the services of incumbent local exchange carriers (ILECs) and not to number portability orders for which a customer is switching to another facilities-based provider. Justifying its finding, the Bureau noted the FCC's use of "retail" and "wholesale" in this context, observing that "Section 222, standing alone, may create an environment where retention marketing to customers of non-facilities-based CLECs is unlawful, while retention marketing to customers of facilities-based providers is permitted."

The Bureau also cited a petition for declaratory ruling filed by Verizon pending before the FCC that urges the FCC to declare that incumbent cable operators cannot engage in certain practices when Verizon seeks to switch a cable customer to its video service. The Bureau asserted that "regulatory parity, whether by increased regulation or deregulation, is important to ensure a level playing field" and recommended that the FCC adopt rules to ensure that retention marketing practices be treated consistently from a regulatory perspective.

### **What to Keep in Mind Moving Forward**

For a number of reasons, JSI strongly urges clients not to view this decision as an opportunity to engage in retention marketing campaigns during the pendency of port requests. First, the

decision was not a determination made by the FCC; rather, it was a set of recommendations made by the Enforcement Bureau for the FCC *to consider*. Thus, until the FCC rules on the recommendations, JSI believes the wisest course of action is to abide by the *interpretation* of the FCC's CPNI rules, which the industry has generally accepted to be that such retention marketing campaigns would violate the rules.

Second, in its decision, the Bureau considered only the specific facts set before it in the context of the complaint filed against Verizon by the three VoIP providers. Given a different set of facts, the outcome could well be different. For example, the Bureau noted that Verizon's list for its retention marketing campaigns excludes customers who are switching to a reseller. If Verizon had included such customers, the Bureau likely would have concluded that Verizon *did violate* the CPNI rules given its citation of the FCC's position that ILECs are prohibited from retention marketing campaigns when the "switch" involves a customer switching to a CLEC reselling the services of the ILEC.

Further, although the Bureau found that Verizon did not violate Sec. 222(a) and (b) of the Act, it did so by making choices to adopt an alternative interpretation which the FCC could reject. For example, the Bureau urged the FCC to adopt the interpretation of Sec. 222(b) advocated by Verizon that would prohibit the use of carrier-to-carrier proprietary information when the receiving carrier provides the telecom service. The Bureau recognized, however, that the FCC could adopt the alternative interpretation that the prohibition applies if the submitting carrier provides the telecom service. If the FCC were to adopt this alternative interpretation, Verizon would be found to be in violation of this provision if the submitting carrier is truly a telecommunications carrier.

Finally, JSI notes, the Bureau's decision does not provide the FCC with an overall recommendation to find that Verizon's actions are in accordance with the Act and the FCC's rulings. Instead, the Bureau opted not to conclude if Verizon's actions violate Sec. 201(b) by being "unreasonable" but, rather, deferred to the FCC. Indeed, the Bureau has used the deferral as an opportunity to encourage the FCC to initiate a rulemaking proceeding based on a petition filed by Verizon to ensure regulatory parity when dealing with the ability of telecom and video providers to engage in retention marketing efforts prior to the time the provider "loses" the customer. Consequently, instead of offering a firm recommendation on how the FCC should act, the Bureau presented the FCC with even more questions raised in the context of the complaint.

If you have questions about this article or would like to discuss CPNI and retention marketing in greater detail, please contact John Kuykendall ([jkuykendall@jsitel.com](mailto:jkuykendall@jsitel.com)) or Scott Duncan ([sduncan@jsitel.com](mailto:sduncan@jsitel.com)) in our Maryland office, at 301-459-7590.

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As this issue of our newsletter indicates, events seem to be heating up for rural ILECs. Thus, it's more important than ever to stay abreast of developments. Are there other staff 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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