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Recent FCC Actions Align Regulatory Focus on Rural Issues, ILECs

A series of actions at the Federal Communications Commission (FCC) in recent months promise to challenge rural incumbent local exchange carriers (ILECs) with a number of significant changes to how these companies operate and how they are perceived by their customers. After a five-year respite, it seems that the stars in the regulatory heavens have re-aligned to bring focus on issues that play a key role in rural ILEC efforts to provide the best telecommunications service possible to their customers. Not since divestiture have the issues lined up in such an array to establish major reform in how ILECs operate and how they meet the telecommunications needs of their end-user customers. This edition of *News & Commentary* highlights three critical issues and the challenges they present to JSI clients.

Interstate Access Changes

The year began with the implementation of the first of the MAG Order reforms for interstate access. On January 1, many end-user customers saw an increase in their subscriber line charges (SLCs) for the first time: Residential and single-line business customers went from \$3.50 to \$5.00; multi-line businesses, from \$6.00 to \$9.20. Additional increases are expected for both types of SLCs. The FCC rules allow for increases due to inflation for the residential and multi-line business SLCs, and the residential and single-line business SLC may rise to \$6.00 on July 1. The July increase remains uncertain because the FCC must first approve a price-cap-LEC cost study justifying a SLC rate above \$5.00 before ILECs' SLCs can exceed \$5.00. In the event that the FCC approves the price-cap study, the ILEC SLC rate for residential and single-line business will increase to \$6.00 on July 1, and increase again to \$6.50 on July 1, 2003.

In addition to the SLCs, ILEC end-user customers also must contend with the Federal Universal Service Charge (FUSC) assessed to ILECs based on interstate revenue. The National Exchange Carrier Association (NECA) has transformed this carrier assessment into a residential end-user, per-line charge of \$0.37 per month (other rates apply to business lines). The residential FUSC rose from \$0.34 to \$0.37 per month on April 2, the increase due to the higher contribution assessment for the second quarter. On July 1, customers will see another increase in the FUSC to a yet undetermined amount, but perhaps as high as \$0.60 per line, per month. A July increase in the per-line FUSC will result from the increased end-user interstate revenues ILECs receive from customers in the form of higher SLCs, as well as increased universal service funding needs.

One consequence of shifting common-line costs to end users in the form of the SLC is that ILECs' interstate revenues go up and the corresponding universal service charge assessment that is based on interstate and international revenues increases in step.

The FCC's apparent motivation for the MAG Order reform springs from its conclusion that the local loop is used exclusively by the end-user customer, and the end-user customer is therefore the sole cost-causer. The end user should pay for the loop through a flat-rate, or per-line, per-month rate, rather than a variable per-minute rate. (A per-minute rate is considered a subsidy from high-volume long-distance users to low-volume customers.) While there is considerable debate among ILECs whether this conclusion is valid given longstanding federal policy that recovers costs via per-minute access rates, the FCC appears determined to reform interstate access charges so that interexchange carriers (IXCs) pay no per-minute or per-line charges for the recovery of ILEC common-line costs. The decision to assess end users all common-line costs leapfrogs the price-cap reform plan that initiated a flat-rate, per-line, primary interexchange carrier charge (PICC). The PICC was assessed to IXCs on a per-line basis, and the IXCs thereupon passed it through to their customers. The FCC prematurely abandoned the PICC on residential and single-line price-cap access lines when it adopted the CALLS plan and moved \$650 million of price-cap costs to an explicit federal universal service high-cost program called Interstate Access Support (IAS).

Another change in ILEC cost support will occur on July 1, 2002, when a portion of common-line cost will be transferred to an explicit federal universal service high-cost program called Interstate Common Line Support (ICLS). Despite their disparate origins, there is a similarity between the IAS and the ICLS: Both are explicit federal universal service supports for what appear to be similar common-line costs. Thus, the FCC has attempted to be consistent in its reform for both price-cap carriers and rural ILECs. The FCC's view is that interstate common-line costs are end-user costs and should be recovered through interstate flat-rate charges from customers or through explicit federal universal service support programs. These changes require ILECs to address significant cost recovery shifts from IXCs to end users and federal universal service support.

Repercussions of Federal Access Reforms on State Regimes

The changes at the federal level will have significant implications for ILECs, of which one of the more significant is how individual states react to the FCC's premise that end-user customers are the sole causers of loop cost and should pay these costs directly or receive high cost universal service support. Some state regulators will ignore the FCC's conclusion; others will consider similar reforms; and still others will quickly adopt these reforms. In states in the latter two categories, ILECs will face additional challenges because of the significant amount of common-line cost recovery in interstate and intrastate access rates. As states attempt intrastate access reforms for rate-of-return ILECs, the cost shift from intrastate access to local service or to state universal service will increase either local service rates or the explicit support mechanisms within the state. In certain instances, state regulators are currently unable to establish universal service support programs in their states. ILECs in these states will find it particularly difficult to keep local service rates affordable and receive sufficient intrastate support to maintain current operations under a rate-of-return regulated environment.

Needless to say, all rural ILECs will feel the effects of interstate access reform. One particularly critical challenge will be to communicate these federal changes to your customers in a sensible – and understandable – manner, no easy task even for seasoned industry veterans. JSI encourages you to call Chris Lehner at JSI's Maryland office to discuss your options in alerting customers to these reforms and new charges.

In addition, several efforts are under way seeking reconsideration and/or appeal of the FCC's decision. JSI will keep clients apprised of these developments when we are more certain of the likelihood they will affect your business decisions. If you have specific questions regarding interstate access reform and its impact on your company, please contact your JSI representative.

Competition for Telecommunications and Information Services

All ILECs will have to assess the impact of shifting a significant portion of their revenue from access to end-user fees and universal service support. This shift will create both opportunities and threats as ILECs compete for a share of customers' telecommunications and information service business. Developments at the FCC in the area of broadband deployment portend additional significant changes for ILECs. Prior to detailed analysis, JSI simply notes here that FCC Chairman Powell has intimated that this is the year to develop and adopt a national broadband policy, and recent actions at the FCC foretell significant change in regulatory treatment for certain ILEC services.

Broadband service typically involves the delivery of high-speed transmissions to and from end users through a variety of platforms or modes. The mode most used today is cable modem service, and other modes include DSL service provided by ILECs and a variety of broadband distribution services offered by wireless carriers. The FCC is examining them all as potential avenues to increase broadband subscription nationally. The FCC is far more interested in *inter-modal* competition – that is, competition among technology platforms – than *intra-modal* competition – between similar technologies. Thus, to determine possible regulatory action directly affecting ILECs, JSI suggests that a review of what the FCC has recently done on cable modems may indicate its intent in the DSL arena.

Cable Modem Declaratory Ruling

On March 15, the FCC released a *Declaratory Ruling and Notice of Proposed Rulemaking* regarding the regulatory treatment of high-speed access to the Internet over cable facilities. After review of the comments it received from last year's *Notice of Inquiry*, the FCC classified cable modem service as an interstate information service, not as a cable service, with no separate offering of telecommunications service. Given this new classification of cable modem service, the FCC is currently seeking comments on the regulatory implications of its finding – including the extent to which state and local governments may regulate cable modem service.

The FCC took this action because it believes that Congress directed it to encourage ubiquitous availability of broadband to all Americans. The FCC wants to meet this mandate with minimal regulatory oversight, relying on competitive free markets. The FCC says it intends to create a rational regulatory framework for broadband services over a variety of technological platforms. Thus, to the extent possible, the FCC seeks to establish rational regulation for all inter-modal broadband carriers.

Subsequent to its release, many parties have appealed the FCC's decision in court. Assigned to review the case is the U.S. Court of Appeals, Ninth Circuit, located in San Francisco – the same court that opined in an Oregon case that cable modem service is a telecommunications service. Now, despite the FCC's urging otherwise, the Ninth Circuit Court will hear the consolidated appeal of the ruling declaring that cable modem service is an information service.

For the time being at least, cable modem service is classified as a Title I service under the Communications Act of 1934, as amended. In a related proceeding, the FCC seeks comment on whether broadband service provided by telecommunications carriers should be classified as information service and what regulatory treatment to apply. Ideally, the FCC would regulate all inter-modal broadband providers equally; however, depending on the comments received in the telecommunications carriers' proceeding, the regulatory treatment may need to be modified.

The momentous decision whether broadband service provided over ILEC facilities is information service, and not a telecommunications service, will shape the regulatory landscape for years to come. The implications are significant in terms of federal vs. state regulation and the basic requirements for common carriage. The FCC's tentative decision to classify broadband as an information service with a telecommunications service component will directly affect the regulatory treatment of services provided by ILECs. Perhaps one of the most important "details" to be resolved is how NECA's pooling arrangement for DSL service can continue under the new classification. If DSL service is ordered and provided over a local loop, in the FCC's view, this loop becomes an information service and would not be regulated as a Title II service. Considering we are only at the beginning of broadband deployment, with only 7 percent of the nation connected, the deregulation or modified regulation proposed by the FCC may eventually include substantial portions of an ILEC's business.

The overarching goal of the FCC is to promote efficient competition and substantial investment in broadband infrastructure. While the FCC has not yet received comments on the classification of telecommunications carriers' broadband service, JSI notes that based on the FCC's prior notices and declarations, its predilection seems to be to regulate broadband Internet service as an information service. The resolution of this issue will reshape how the FCC intends to encourage broadband deployment nationwide.

Changes to Federal Universal Service

In addition to its aggressive broadband agenda, the FCC is seeking to change various aspects of the federal universal service program, starting with the contribution mechanism. The FCC is also in the process of determining whether information service providers should contribute to federal universal service and awaiting a recommendation from the Federal-State Joint Board on Universal Service whether broadband should be a required universal service. Lastly, while not a change *per se* of the federal universal service program, the FCC and state commissions are reviewing multiple petitions for eligible telecommunications carrier (ETC) designation.

Contribution Mechanics

As JSI reported last year, the FCC believes that the current assessment mechanism is fraught with problems. For example, although the interstate revenue assessment is near 7 percent, effective April 2, some IXC's are charging their customers more than 11 percent. Even as these IXC's try to justify the difference, the FCC is considering a complete overhaul of the contribution method, which is currently based on total interstate and international revenues. Every carrier with interstate or international end-user revenues is assessed an amount based on the quarterly contribution factor calculated by the Universal Service Administrative Co. (USAC). Typically, all carriers have shuffled this assessment to their customers. This pass-through usually occurs in two methods: a percent of total qualifying end-user revenues, or as a per-line charge.

The FCC seeks to revise this contribution method and has entertained a proposal by AT&T that would require a \$1.00 per-line, per-month assessment to all end users (wireline and wireless: paging customers would be less). The remaining required amount of support would come from a graduated assessment scale for businesses based on the amount of capacity each business has for each of its circuits. Comments regarding this proposal are due this month. At the present time, JSI does not know whether NECA will oppose or support this proposal. Since the FUSC could exceed \$1.00 in coming years, NECA members could benefit with the establishment of a set amount now and not face increases in future years. Notwithstanding the above, JSI believes that the FCC must address the problem now faced by ILECs with CENTREX service. Since the FCC has ordered that CENTREX lines be assessed the same SLC as multi-line business customers, CENTREX is at a significant disadvantage compared to PBX-type services (currently, PBX service has a 9:1 assessment ratio that gives PBX a decided advantage over CENTREX).

Contribution Base

In changing the status of cable modem service, the FCC is determining whether information service providers (InfoSPs – so as not to be confused with Internet service providers [ISPs]) should contribute to federal universal service programs. To JSI the answer is simple: InfoSPs should contribute. Since nearly half of federal universal service support is spent on broadband service to schools and libraries, there seems to be no question that InfoSPs should contribute.

Expansion of Universal Service Definition

Concurrent with the contribution base issue, the FCC is awaiting a recommendation from the Federal-State Joint Board on Universal Service whether broadband service should be a universal service. If the recommendation is affirmative, then a following question is: Do InfoSPs that provide broadband service qualify as ETCs for all or portions of the current federal universal service high-cost programs? JSI does not know whether the FCC will create a broadband universal service program that includes a new high-cost broadband service support, current school and library support, and rural health care support. The idea has some merit because the FCC could make broadband support portable across technology modes and eliminate the portability for ICLS and existing high-cost support programs for ILECs because this support is technology specific. (Wireless support would be based on wireless costs of providing service and would be independent of the existing high-cost wireline support mechanisms.)

ETC Designation

State commissions and the FCC are fully engaged in reviewing and granting ETC designation to telecommunications carriers providing service in ILEC areas. Most recently, the activity has focused on wireless carriers. In certain instances, state commissions are making a careful and determined review of these petitions; e.g., the Utah PSC-Western Wireless decision that was recently upheld by the Utah Supreme Court. In other instances, state commissions are granting ETC designation in less than 45 days and committing irreversible procedural errors in the process; e.g., the Michigan PSC's decision in the matter of RFB Cellular. Nonetheless, the message is clear to all: ETC designation will become commonplace as most state commissions view the process as a means to jumpstart competition. (JSI hesitates to mention that in many instances ILEC areas cannot support multiple carriers of last resort. While Congress clearly foresaw this distinction, many state commissions appear oblivious to the concerns expressed and codified by Congress, evidently believing that ILEC areas are somehow un-American if there is not more than one ETC there.) JSI hopes that when certification of ETC support comes each October, state commissions will require wireless ETCs to demonstrate, as ILECs do, that their support is used for universal service where and how it is intended.

Challenging Days Ahead

As you focus on the future, the three overarching issues of access reform, broadband service, and universal service will all play prominent roles in determining how you provide service to your customers. An understanding of these issues and the underlying rationale that is apparently driving policy development in these areas suggests to JSI that rural ILECs face more challenges – with more at stake – than usual, as regulators appear to be growing increasingly frustrated that competition is creating more problems than solutions. If you have any questions or wish to express your concerns to a receptive audience, please call your JSI representative. If you have specific questions about this article or other aspects of the FCC's recent activity, contact Douglas Meredith (dmeredith@jsitel.com) in JSI's Utah office, at 801-294-4576.

Seminar Reminder

JSI reminds clients of upcoming JSI seminars. Information and registration are available online (JSI has also made several mailings) for: the final 2002 Management Seminar; the JSI CABS Seminar, presented by Creative Support Solutions; the 2002 Part 32 and Part 64 Accounting Seminar; and, our new Customer Service Seminar.

The remaining Management Seminar is scheduled for April 15-16, at the Minneapolis Airport Marriott.

The JSI CABS Seminars, which this year focus on improved billing processes and verification of factors and data, are conducted by CSS President Marnell Robertson in full-day sessions scheduled for:

- Atlanta Airport Marriott - April 23
- Marriott Rivercenter, San Antonio - May 21

The schedule for the JSI Accounting Seminar, which includes an update on the FCC's MAG and RTF orders, the Joint Board's Glide Path paper, as well as a review of FCC accounting principles and applications in a day-and-a-half session, is:

- Atlanta Airport Marriott - May 16-17
- Marriott Riverwalk, San Antonio - Oct. 3-4

Finally, JSI's newest seminar, "Thinking Outside the Customer Service Box," offers CSRs and other telco staff an overview of recent regulatory and service developments and the impact they will have on your customer retention and loyalty efforts. The sessions are scheduled for:

- Adams Mark, Columbia, SC - May 21-22
- Radisson, Greensboro, NC - May 23-24

For additional details on the program content, contact Chris Lehner or Kristin Remmers; for information on registration or hotel reservations, contact Kim Johnson. All can be reached at JSI's Seabrook, MD headquarters, at 301-459-7590.