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47 CFR Parts 0, 1, 20, et al.
Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Final Rule

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Parts 0, 1, 20, 36, 51, 54, 61, 64, and 69

[WC Docket Nos. 10–90, 07–135, 05–337, 03–109; GN Docket No. 09–51; CC Docket Nos. 01–92, 96–45; WT Docket No. 10–208; FCC 11–161]

Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support

AGENCY: Federal Communications Commission.

ACTION: Final rule; policy statement.

SUMMARY: In a rule published November 29, 2011, the Federal Communications Commission (Commission) comprehensively reformed and modernized the universal service and intercarrier compensation systems to ensure that robust, affordable voice and broadband service, both fixed and mobile, are available to Americans throughout the nation. The Commission adopted fiscally responsible, accountable, incentive-based policies to transition these outdated systems to the Connect America Fund, ensuring fairness for consumers and addressing the communications infrastructure challenges of today and tomorrow. The Commission uses measured but firm glide paths to provide industry with certainty and sufficient time to adapt to a changed regulatory landscape, and establish a framework to distribute universal service funding in the most efficient and technologically neutral manner possible, through market-based mechanisms such as competitive bidding. This document provides additional information to the final rule document published on November 29, 2011.

DATES: Effective December 29, 2011.

FOR FURTHER INFORMATION CONTACT: Amy Bender, Wireline Competition Bureau, (202) 418–1469, Victoria Goldberg, Wireline Competition Bureau, (202) 418–7353, and Margaret Wiener, Wireless Telecommunications Bureau, (202) 418–2176 or TTY: (202) 418–0484.

SUPPLEMENTARY INFORMATION: This is a summary of the Commission's Report and Order (R&O) in WC Docket Nos. 10–90, 07–135, 05–337, 03–109; GN Docket No. 09–51; CC Docket Nos. 01–92, 96–45; WT Docket No. 10–208; FCC 11–161, released on November 18, 2011. The executive summary of the R&O, and the final rules adopted by the R&O were published in the **Federal Register** on November 29, 2011, 76 FR 73830. The full text of this document is available for public inspection during regular business hours in the FCC Reference Center, Room CY–A257, 445 12th Street SW., Washington, DC 20554. Or at the following Internet address: *http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-11-161A1.pdf.*

I. Adoption of a New Principle for Universal Service

1. In November 2010, the Federal-State Joint Board on Universal Service (Joint Board) recommended that the Commission ''specifically find that universal service support should be directed where possible to networks that provide advanced services, as well as voice services,'' and adopt such a principle pursuant to its 47 U.S.C. 254(b)(7) authority. The Joint Board believes that this principle is consistent with 47 U.S.C. 254(b)(3) and would serve the public interest. The Commission agrees. 47 U.S.C. 254(b)(3) provides that consumers in rural, insular and high-cost areas should have access to ''advanced telecommunications and information services * * * that are reasonably comparable to those services provided in urban areas.'' 47 U.S.C. 254(b)(2) likewise provides that ''Access to advanced telecommunications and information services should be provided in all regions of the Nation.'' Providing support for broadband networks will further all of these goals.

2. Accordingly, the Commission adopts ''support for advanced services'' as an additional principle upon which the Commission will base policies for the preservation and advancement of universal service, and thereby act on one of the Joint Board's 2010 recommendations. For the reasons discussed above, the Commission finds, per 47 U.S.C. 254(b)(7), that this new principle is ''necessary and appropriate.'' Consistent with the Joint Board's recommendation, the Commission defines this principle as: ''Support for Advanced Services—Universal service support should be directed where possible to networks that provide advanced services, as well as voice services.''

II. Goals

3. *Discussion.* The Commission adopts five performance goals to preserve and advance service in high cost, rural, and insular areas through the Connect America Fund and existing support mechanisms. The Commission also adopts performance measures for the first, second, and fifth of these goals, and direct the Wireline Competition Bureau and the Wireless Telecommunications Bureau (Bureaus) to further develop other measures. The Commission delegates authority to the Bureaus to finalize performance measures as appropriate consistent with these goals.

4. *Preserve and Advance Voice Service.* The first performance goal is to preserve and advance universal availability of voice service. In doing so, the Commission reaffirms its commitment to ensuring that all Americans have access to voice service while recognizing that, over time, voice service will increasingly be provided over broadband networks.

5. As a performance measure for this goal, the Commission will use the telephone penetration rate, which measures subscription to telephone service. The telephone penetration rate has historically been used by the Commission as a proxy for network deployment and, as a result, will be a consistent measure of the universal service program's effects. The Commission will also continue to use the Census Bureau's Current Population Survey (CPS) to collect data regarding telephone penetration. Although CPS data does not specifically break out wireless, VoIP, or over-the-top voice options available to consumers, a better data set is not currently available. In recognition of the limitations of existing data, the Commission is considering revising the types of data it collects, and the Commission anticipates further Commission action in this proceeding, which may provide more complete information that can be used to evaluate this performance goal.

6. *Ensure Universal Availability of Voice and Broadband to Homes, Businesses, and Community Anchor Institutions.* The second performance goal is to ensure the universal availability of modern networks capable of delivering broadband and voice service to homes, businesses, and community anchor institutions as now defined in 47 CFR 54.5. All Americans in all parts of the nation, including those in rural, insular, and high-cost areas, should have access to affordable modern communications networks capable of supporting the necessary applications that empower them to learn, work, create, and innovate. The Commission uses the term ''modern networks'' because supported equipment and services are expected to change over time to keep up with technological advancements.

7. As an outcome measure for this goal, the Commission will use the number of residential, business, and community anchor institution locations

that newly gain access to broadband service. As an efficiency measure, the Commission will use the change in the number of homes, businesses, and community anchor institutions passed or covered per million USF dollars spent. To collect data, the Commission will use the National Broadband Map and/or Form 477. The Commission will also require CAF recipients to report on the number of community anchor institutions that newly gain access to fixed broadband service as a result of CAF support. Although these measures are imperfect, the Commission believes that they are the best available. Other options, such as the Mercatus Centers' suggestion of using an assessment of what might have occurred without the programs, are not administratively feasible at this time. But the Bureaus are directed to revisit these measures at a later point, and to consider refinements and alternatives.

8. *Ensure Universal Availability of Mobile Voice and Broadband Where Americans Live, Work, or Travel.* The third performance goal is to ensure the universal availability of modern networks capable of delivering mobile broadband and voice service in areas where Americans live, work, or travel. Like the preceding parallel goal, the third performance goal is designed to help ensure that all Americans in all parts of the nation, including those in rural, insular, and high-cost areas, have access to affordable technologies that will empower them to learn, work, create, and innovate. But the Commission believes that ensuring universal advanced mobile coverage is an important goal on its own, and that the Commission will be better able track program performance if the Commission measures it separately.

9. The Commission declines to adopt performance measures for this goal at this time but direct the Wireless Telecommunications Bureau to develop one or more appropriate measures for this goal.

10. *Ensure Reasonably Comparable Rates for Broadband and Voice Services.* The fourth performance goal is to ensure that rates are reasonably comparable for voice as well as broadband service, between urban and rural, insular, and high cost areas. Rates must be reasonably comparable so that consumers in rural, insular, and high cost areas have meaningful access to these services.

11. The Commission also declines to adopt measures for this goal at this time. Although the Commission proposed one outcome measure and asked about others in the *USF/ICC Transformation NPRM,* 75 FR 26906, May 13, 2010, the Commission received only limited input on that proposal. The Mercatus Center agrees that ''[t]he ratio of prices to income is an intuitively sensible way of defining 'reasonably comparable''' but cautions that, again, the real challenge is crafting measures that distinguish how the programs affect rates apart from other factors. The Bureaus may seek to further develop the record on the performance and efficiency measures suggested by the Mercatus Center, the Commission's original proposals, and any other measures commenters think would be appropriate. In undertaking this analysis, the Commission directs the Bureau to develop separate measures for (1) broadband services for homes, businesses, and community anchor institutions; and (2) mobile services.

12. *Minimize Universal Service Contribution Burden on Consumers and Businesses.* The fifth performance goal is to minimize the overall burden of universal service contributions on American consumers and businesses. With this performance goal, the Commission seeks to balance the various objectives of 47 U.S.C. 254(b) of the Act, including the objective of providing support that is sufficient but not excessive so as to not impose an excessive burden on consumers and businesses who ultimately pay to support the Fund. As the Commission has previously recognized, ''if the universal service fund grows too large, it will jeopardize other statutory mandates, such as ensuring affordable rates in all parts of the country, and ensuring that contributions from carriers are fair and equitable.''

13. As a performance measure for this goal, the Commission will divide the total inflation-adjusted expenditures of the existing high-cost program and CAF (including the Mobility Fund) each year by the number of American households and express the measure as a monthly dollar figure. This calculation will be relatively straightforward and rely on publicly available data. As such, the measure will be transparent and easily verifiable. By adjusting for inflation and looking at the universal service burden, the Commission will be able to determine whether the overall burden of universal service contribution costs is increasing or decreasing for the typical American household. As an efficiency measure, the Mercatus Center suggests comparing the estimate of economic deadweight loss associated with the contribution mechanism to the deadweight loss associated with taxation. The Commission anticipates that the Bureaus may seek further input on this option and any others commenters believe would be appropriate.

14. *Program Review.* Using the adopted goals and measures, the Commission will, as required by GPRA, monitor the performance of the universal service program as the Commission modernizes the current high-cost program and transition to the CAF. If the programs are not meeting these performance goals, the Commission will consider corrective actions. Likewise, to the extent that the adopted measures do not help us assess program performance, the Commission will revisit them as well.

III. Legal Authority

15. *47 U.S.C. 254.* The principle that all Americans should have access to communications services has been at the core of the Commission's mandate since its founding. Congress created this Commission in 1934 for the purpose of making ''available * * * to all the people of the United States * * * a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges.'' In the 1996 Act, Congress built upon that longstanding principle by enacting 47 U.S.C. 254. Section 254 of the Act sets forth six principles upon which the Commission must ''base policies for the preservation and advancement of universal service.'' Among these principles are that ''[q]uality services should be available at just, reasonable, and affordable rates,'' that ''[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation,'' and that ''[c]onsumers in all regions of the Nation * * * should have access to telecommunications and information services, including * * * advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas'' and at reasonably comparable rates.

16. Under 47 U.S.C. 254, the Commission has express statutory authority to support telecommunications services that the Commission has designated as eligible for universal service support. Section 254(c)(1) of the Act defines ''[u]niveral service'' as ''an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services.'' As discussed more fully below, in this R&O, the Commission adopts the proposal to simplify how the Commission describes the various

supported services that the Commission historically has defined in functional terms (*e.g.,* voice grade access to the PSTN, access to emergency services) into a single supported service designated as ''voice telephony service.'' To the extent carriers offer traditional voice telephony services as telecommunications services over traditional circuit-switched networks, the authority to provide support for such services is well established.

17. Increasingly, however, consumers are obtaining voice services not through traditional means but instead through interconnected VoIP providers offering service over broadband networks. As AT&T notes, ''[c]ircuit-switched networks deployed primarily for voice service are rapidly yielding to packet-switched networks,'' which offer voice as well as other types of services.'' The data bear this out. As the Commission observed in the *USF/ICC Transformation NPRM,* ''[f]rom 2008 to 2009, interconnected VoIP subscriptions increased by 22 percent, while switched access lines decreased by 10 percent.'' Interconnected VoIP services, among other things, allow customers to make real-time voice calls to, and receive calls from, the PSTN, and increasingly appear to be viewed by consumers as substitutes for traditional voice telephone services. Our authority to promote universal service in this context does not depend on whether interconnected VoIP services are telecommunications services or information services under the Communications Act.

18. Section 254 grants the Commission the authority to support not only voice telephony service but also the facilities over which it is offered. Section 254(e) makes clear that ''[a] carrier that receives such [universal service] support shall use that support only for the provision, maintenance, and upgrading of *facilities and services* for which the support is intended.'' By referring to ''facilities'' and ''services'' as distinct items for which federal universal service funds may be used, the Commission believes Congress granted the Commission the flexibility not only to designate the types of telecommunications services for which support would be provided, but also to encourage the deployment of the types of facilities that will best achieve the principles set forth in 47 U.S.C. 254(b) and any other universal service principle that the Commission may adopt under 47 U.S.C. 254(b)(7). For instance, under the longstanding ''no barriers'' policy, the Commission allows carriers receiving high-cost support ''to invest in infrastructure capable of providing access to advanced services'' as well as supported voice services. That policy furthers the policy Congress set forth in 47 U.S.C. 254(b) of ''ensuring access to advanced telecommunications and information services throughout the nation.'' While this policy was enunciated in an Order adopting rule changes for rural incumbent carriers, by its terms it is not limited to such carriers. The ''no-barriers'' policy has applied, and will continue to apply, to all eligible telecommunications carriers (ETCs), and the Commission codifies it in the rules. Section 254(e) thus contemplates that carriers may receive federal support to enable the deployment of broadband facilities used to provide supported telecommunications services as well as other services.

19. The Commission further concludes that the authority under 47 U.S.C. 254 allows the Commission to go beyond the ''no barriers'' policy and require carriers receiving federal universal service support to invest in modern broadband-capable networks. Nothing in 47 U.S.C. 254 requires the Commission simply to provide federal funds to carriers and hope that they will use such support to deploy broadband facilities. To the contrary, the Commission has a ''mandatory duty'' to adopt universal service policies that advance the principles outlined in 47 U.S.C. 254(b), and the Commission has the authority to ''create some inducement'' to ensure that those principles are achieved. Congress made clear in 47 U.S.C. 254 that the deployment of, and access to, information services—including ''advanced'' information services—are important components of a robust and successful federal universal service program. Furthermore, the Commission adopts the recommendation of the Federal-State Joint Board on Universal Service to establish a new universal service principle pursuant to 47 U.S.C. 254(b)(7) that universal service support should be directed where possible to networks that provide advanced services, as well as voice services.'' In today's communications environment, achievement of these principles requires, at a minimum, that carriers receiving universal service support invest in and deploy networks capable of providing consumers with access to modern broadband capabilities, as well as voice telephony services. Accordingly, as explained in greater detail below, the Commission will exercise the authority under 47 U.S.C. 254 to require that carriers receiving support—both CAF support, including Mobility Fund support, and support under the existing high-cost support mechanisms—offer broadband capabilities to consumers. The Commission concludes that this approach is sufficient to ensure access to voice and broadband services and, therefore, the Commission does not, at this time, add broadband to the list of supported services, as some have urged.

20. *47 U.S.C. 1302.* The Commission also has independent authority under 47 U.S.C. 1302 of the Telecommunications Act of 1996 to fund the deployment of broadband networks. In 47 U.S.C. 1302, Congress recognized the importance of ubiquitous broadband deployment to Americans' civic, cultural, and economic lives and, thus, instructed the Commission to ''encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans.'' Of particular importance, Congress adopted a definition of ''advanced telecommunications capability'' that is not confined to a particular technology or regulatory classification. Rather, '''advanced telecommunications capability' is defined, without regard to any transmission media or technology, as high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video communications using any technology.'' Section 1302 of the Act further requires the Commission to ''determine whether advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion'' and, if the Commission concludes that it is not, to ''*take immediate action* to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market.'' The Commission has found that broadband deployment to all Americans has not been reasonable and timely and observed in its most recent broadband deployment report that ''too many Americans remain unable to fully participate in our economy and society because they lack broadband.'' This finding triggers the duty under 47 U.S.C. 1302(b) to ''remov[e] barriers to infrastructure investment'' and ''promot[e] competition in the telecommunications market'' in order to accelerate broadband deployment throughout the Nation.

21. Providing support for broadband networks helps achieve 47 U.S.C. 1302(b)'s objectives. First, the Commission has recognized that one of the most significant barriers to investment in broadband infrastructure

is the lack of a ''business case for operating a broadband network'' in high-cost areas ''[i]n the absence of programs that provide additional support.'' Extending federal support to carriers deploying broadband networks in high-cost areas will thus eliminate a significant barrier to infrastructure investment and accelerate broadband deployment to unserved and underserved areas of the Nation. The deployment of broadband infrastructure to all Americans will in turn make services such as interconnected VoIP service accessible to more Americans.

22. Second, supporting broadband networks helps ''promot[e] competition in the telecommunications market,'' particularly with respect to voice services. As the Commission has long recognized, ''interconnected VoIP service 'is increasingly used to replace analog voice service.''' Thus, the Commission previously explained that requiring interconnected VoIP providers to *contribute* to federal universal service support mechanisms promoted competitive neutrality because it ''reduces the possibility that carriers with universal service obligations will compete directly with providers without such obligations.'' Just as ''we do not want contribution obligations to shape decisions regarding the technology that interconnected VoIP providers use to offer voice services to customers or to create opportunities for regulatory arbitrage,'' the Commission does not want to create regulatory distinctions that serve no universal service purpose or that unduly influence the decisions providers will make with respect to how best to offer voice services to consumers. The ''telecommunications market''—which includes interconnected VoIP and by statutory definition is broader than just telecommunications services—will be more competitive, and thus will provide greater benefits to consumers, as a result of the decision to support broadband networks, regardless of regulatory classification.

23. By exercising the authority under 47 U.S.C. 1302 in this manner, the Commission furthers Congress's objective of ''accelerat[ing] deployment'' of advanced telecommunications capability ''to all Americans.'' Under the approach, federal support will not turn on whether interconnected VoIP services or the underlying broadband service falls within traditional regulatory classifications under the Communications Act. Rather, the approach focuses on accelerating broadband deployment to unserved and underserved areas, and allows providers to make their own judgments as to how best to structure their service offerings in order to make such deployment a reality.

24. The Commission disagrees with commenters who assert that the Commission lacks authority under 47 U.S.C. 1302(b) to support broadband networks. While 47 U.S.C. 1302(a) imposes a general duty on the Commission to encourage broadband deployment through the use of ''price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment,'' 47 U.S.C. 1302(b) is triggered by a specific finding that broadband capability is not being ''deployed to all Americans in a reasonable and timely fashion.'' Upon making that finding (which the Commission has done), 47 U.S.C. 1302(b) requires the Commission to ''take immediate action to accelerate'' broadband deployment. Given the statutory structure, the Commission reads 47 U.S.C. 1302(b) as conferring on the Commission the additional authority, beyond what the Commission possesses under 47 U.S.C. 1302(a) or elsewhere in the Act, to take steps necessary to fulfill Congress's broadband deployment objectives. Indeed, it is hard to see what additional work 47 U.S.C. 1302(b) does if it is not an independent source of statutory authority.

25. The Commission also rejects the view that providing support for broadband networks under 47 U.S.C. 1302(b) conflicts with 47 U.S.C. 254, which defines universal service in terms of telecommunications services. Information services are not excluded from 47 U.S.C. 254 because of any policy judgment made by Congress. To the contrary, Congress contemplated that the federal universal service program would promote consumer access to both advanced telecommunications and advanced information services ''in all regions of the Nation.'' When Congress enacted the 1996 Act, most consumers accessed the Internet through dial-up connections over the PSTN, and broadband capabilities were provided over tariffed common carrier facilities. Interconnected VoIP services had only a nominal presence in the marketplace in 1996. It was not until 2002 that the Commission first determined that one form of broadband—cable modem service—was a single offering of an information service rather than separate offerings of telecommunications and information services, and only in 2005 did the Commission conclude that wireline broadband service should be governed by the same regulatory classification. Thus, marketplace and technological developments and the Commission's determinations that broadband services may be offered as information services have had the effect of removing such services from the scope of the explicit reference to ''universal service'' in 47 U.S.C. 254(c). Likewise, Congress did not exclude interconnected VoIP services from the federal universal service program; indeed, there is no reason to believe it specifically anticipated the development and growth of such services in the years following the enactment of the 1996 Act.

26. The principles upon which the Commission ''shall base policies for the preservation and advancement of universal service'' make clear that supporting networks used to offer services that are or may be information services for purposes of regulatory classification is consistent with Congress's overarching policy objectives. For example, 47 U.S.C. 254(b)(2)'s principle that ''[a]ccess to advanced telecommunications and *information services* should be provided in all regions of the Nation'' dovetails comfortably with 47 U.S.C. 1302(b)'s policy that ''advanced telecommunications capability [be] deployed to all Americans in a reasonable and timely fashion.'' Our decision to exercise authority under 47 U.S.C. 1302 does not undermine 47 U.S.C. 254's universal service principles, but rather ensures their fulfillment. By contrast, limiting federal support based on the regulatory classification of the services offered over broadband networks as telecommunications services would exclude from the universal service program providers who would otherwise be able to deploy broadband infrastructure to consumers. The Commission sees no basis in the statute, the legislative history of the 1996 Act, or the record of this proceeding for concluding that such a constricted outcome would promote the Congressional policy objectives underlying 47 U.S.C. 254 and 1302.

27. Finally, the Commission notes the limited extent to which the Commission is relying on 47 U.S.C. 706(b) in this proceeding. Consistent with the longstanding policy of minimizing regulatory distinctions that serve no universal service purpose, the Commission is not adopting a separate universal service framework under 47 U.S.C. 1302(b). Instead, the Commission is relying on 47 U.S.C. 1302(b) as an alternative basis to 47 U.S.C. 254 to the extent necessary to ensure that the

federal universal service program covers services and networks that could be used to offer information services as well as telecommunications services. Carriers seeking federal support must still comply with the same universal service rules and obligations set forth in 47 U.S.C. 254 and 214, including the requirement that such providers be designated as eligible to receive support, either from state commissions or, if the provider is beyond the jurisdiction of the state commission, from this Commission. In this way, the Commission ensures that exercise of 47 U.S.C. 1302(b) authority will advance, rather than detract from, the universal service principles established under 47 U.S.C. 254 of the Act.

IV. Public Interest Obligations

A. Voice Service

28. *Discussion.* The Commission determines that it is appropriate to describe the core functionalities of the supported services as ''voice telephony service.'' Some commenters support redefining the voice functionalities as voice telephony services, while others oppose the change, arguing that the current list of functionalities remains important today, the term ''voice telephony'' is too vague, and such a modification may result in a lower standard of voice service. Given that consumers are increasingly obtaining voice services over broadband networks as well as over traditional circuit switched telephone networks, the Commission agrees with commenters that urge the Commission to focus on the functionality offered, not the specific technology used to provide the supported service.

29. The decision to classify the supported services as voice telephony should not result in a lower standard of voice service: Many of the enumerated services are universal today, and the Commission requires eligible providers to continue to offer those particular functionalities as part of voice telephony. Rather, the modified definition simply shifts to a technologically neutral approach, allowing companies to provision voice service over any platform, including the PSTN and IP networks. This modification will benefit both providers (as they may invest in new infrastructure and services) and consumers (who reap the benefits of the new technology and service offerings). Accordingly, to promote technological neutrality while ensuring that the new approach does not result in lower quality offerings, the Commission amends 47 CFR 54.101 of the Commission rules to specify that the functionalities of eligible voice telephony services include voice grade access to the public switched network or its functional equivalent; minutes of use for local service provided at no additional charge to end users; toll limitation to qualifying low-income consumers; and access to the emergency services 911 and enhanced 911 services to the extent the local government in an eligible carrier's service area has implemented 911 or enhanced 911 systems. The Commission finds that changes in the marketplace allow for the elimination of the requirements to provide single-party service, operator services, and directory assistance.

30. Today, all ETCs, whether designated by a state commission or this Commission, are required to offer the supported service—voice telephony service—throughout their designated service area. ETCs also must provide Lifeline service throughout their designated service area. In the *USF/ICC Transformation FNPRM,* the Commission seeks comment on modifying incumbent ETCs' obligations to provide voice service in situations where the incumbent's high-cost universal service funding is eliminated, for example as a result of a competitive bidding process in which another ETC wins universal support for an area and is subject to accompanying voice and broadband service obligations. (Throughout this R&O, unless otherwise specified, the term ''ETC'' does not include ETCs that are designated only for the purposes of the low income program.)

31. As a condition of receiving support, the Commission requires ETCs to offer voice telephony as a standalone service throughout their designated service area, meaning that consumers must not be required to purchase any other services (*e.g.,* broadband) in order to purchase voice service. As indicated above, ETCs may use any technology in the provision of voice telephony service.

32. Additionally, consistent with the 47 U.S.C. 254(b) principle that ''[c]onsumers in all regions of the Nation * * * should have access to telecommunications and information services * * * that are available at rates that are reasonably comparable to rates charged for similar services in urban areas,'' ETCs must offer voice telephony service, including voice telephony service offered on a standalone basis, at rates that are reasonably comparable to urban rates. The Commission finds that these requirements are appropriate to help ensure that consumers have access to voice telephony service that best fits their particular needs.

33. The Commission declines to preempt state obligations regarding voice service, including COLR obligations, at this time. Proponents of such preemption have failed to support their assertion that state service obligations are inconsistent with federal rules and burden the federal universal service mechanisms, nor have they identified any specific legacy service obligations that represent an unfunded mandate that make it infeasible for carriers to deploy broadband in high-cost areas. Carriers must therefore continue to satisfy state voice service requirements.

34. That said, the Commission encourages states to review their respective regulations and policies in light of these changes and revisit the appropriateness of maintaining those obligations for entities that no longer receive federal high-cost universal service funding, just as the Commission intends to explore the necessity of maintaining ETC obligations when ETCs no longer are receiving funding. For example, states could consider providing state support directly to the incumbent LEC to continue providing voice service in areas where the incumbent is no longer receiving federal high-cost universal service support or, alternatively, could shift COLR obligations from the existing incumbent to another provider who is receiving federal or state universal service support in the future.

35. *Voice Rates.* The Commission will consider rural rates for voice service to be ''reasonably comparable'' to urban voice rates under 47 U.S.C. 254(b)(3) if rural rates fall within a reasonable range of urban rates for reasonably comparable voice service. Consistent with the existing precedent, the Commission will presume that a voice rate is within a reasonable range if it falls within two standard deviations above the national average.

36. Because the data used to calculate the national average price for voice service is out of date, the Commission directs the Wireline Competition Bureau and the Wireless Telecommunications Bureau to develop and conduct an annual survey of voice rates in order to compare urban voice rates to the rural voice rates that ETCs will be reporting to us. The results of this survey will be published annually. For purposes of conducting the survey, the Bureaus should develop a methodology to survey a representative sample of facilities-based fixed voice service providers taking into account the relative categories of fixed voice providers as determined in the most recent FCC Form 477 data collection. In the *USF/*

ICC Transformation FNPRM, the Commission seeks comment on whether to collect separate data on fixed and mobile voice rates and whether fixed and mobile voice services should have different benchmarks for purposes of determining reasonable comparability.

B. Broadband Service

37. As a condition of receiving federal high-cost universal service support, all ETCs, whether designated by a state commission or the Commission, will be required to offer broadband service in their supported area that meets certain basic performance requirements and to report regularly on associated performance measures. Although the Commission does not at this time require it, the Commission expects that ETCs that offer standalone broadband service in any portion of their service territory will also offer such service in all areas that receive CAF support. By standalone service, the Commission means that consumers are not required to purchase any other service (*e.g.,* voice or video) in order to purchase broadband service. ETCs must make this broadband service available at rates that are reasonably comparable to offerings of comparable broadband services in urban areas.

38. In developing these performance requirements, the Commission seeks to ensure that the performance of broadband available in rural and high cost areas is ''reasonably comparable'' to that available in urban areas. All Americans should have access to broadband that is capable of enabling the kinds of key applications that drive efforts to achieve universal broadband, including education (*e.g.,* distance/online learning), health care (*e.g.,* remote health monitoring), and person-to-person communications (*e.g.,* VoIP or online video chat with loved ones serving overseas).

1. Broadband Performance Metrics

39. Broadband services in the market today vary along several important dimensions. As discussed more fully below, the Commission focuses on speed, latency, and capacity as three core characteristics that affect what consumers can do with their broadband service, and the Commission therefore includes requirements related to these three characteristics in defining ETCs' broadband service obligations.

40. For each of these characteristics, the Commission requires that funding recipients offer service that is reasonably comparable to comparable services offered in urban areas. By limiting reasonable comparability to ''comparable services,'' the Commission is intending to ensure that fixed broadband services in rural areas are compared to fixed broadband services in urban areas and mobile broadband services in rural areas are compared to mobile broadband services in rural areas. The actual download and upload speeds, latency, and usage limits (if any) for providers' broadband must be reasonably comparable to the typical speeds, latency, and usage limits (if any) of comparable broadband services in urban areas. Funding recipients may use any wireline, wireless, terrestrial, or satellite technology, or combination of technologies, to deliver service that satisfies this requirement.

41. *Speed.* Users and providers commonly refer to the bandwidth of a broadband connection as its ''speed.'' The bandwidth (speed) of a connection indicates the rate at which information can be transmitted by that connection, typically measured in bits, kilobits (kbps), or megabits per second (Mbps). The speed of consumers' broadband connections affects their ability to access and utilize Internet applications and content. To ensure that consumers are getting the full benefit of broadband, the Commission requires funding recipients to provide broadband that meets performance metrics for actual speeds, measured as described below, rather than ''advertised'' or ''up to'' metrics.

42. In the past two Broadband Progress Reports, the Commission found that the availability of residential broadband connections that actually enable an end user to download content from the Internet at 4 Mbps and to upload such content at 1 Mbps over the broadband provider's network was a reasonable benchmark for the availability of ''advanced telecommunications capability,'' defined by the statute as ''high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology.'' This conclusion was based on the Commission's examination of overall Internet traffic patterns, which revealed that consumers increasingly are using their broadband connections to view high-quality video, and want to be able to do so while still using basic functions such as email and web browsing. The evidence shows that streaming standard definition video in near real-time consumes anywhere from 1–5 Mbps, depending on a variety of factors. This conclusion also was drawn from the National Broadband Plan, which, based on an analysis of user behavior, demands this usage places on the network, and recent experience in network evolution, recommended as a national broadband availability target that every household in America have access to affordable broadband service offering actual download speeds of at least 4 Mbps and actual upload speeds of at least 1 Mbps.

43. Given the foregoing, other than for the Phase I Mobility Fund, the Commission adopts an initial minimum broadband speed benchmark for CAF recipients of 4 Mbps downstream and 1 Mbps upstream. Broadband connections that meet this speed threshold will provide subscribers in rural and high cost areas with the ability to use critical broadband applications in a manner reasonably comparable to broadband subscribers in urban areas. Requiring 4 Mbps/1 Mbps to be provided to all locations, including the more distant locations on a landline network and regardless of the served location's position in a wireless network, implies that customers located closer to the wireline switch or wireless tower will be capable of receiving service in excess of the this minimum standard.

44. Some commenters, including DSL and mobile wireless broadband providers, observe that the 1 Mbps upload speed requirement in particular could impose costs well in excess of the benefits of 1 Mbps versus 768 kilobits per second (kbps) upstream. In general, the Commission expects new installations to provide speeds of at least 1 Mbps upstream. However, to the extent a CAF recipient can demonstrate that support is insufficient to enable 1 Mbps upstream for all locations, temporary waivers of the upstream requirement for some locations will be available. The Commission delegates authority to the Wireline Competition Bureau and Wireless Telecommunications Bureau to address such waiver requests. The Commission expects that those facilities that are not currently capable of providing the minimum upstream speed will eventually be upgraded, consistent with the build-out requirements adopted below, with scalable technology capable of meeting future speed increases.

45. *Latency.* Latency is a measure of the time it takes for a packet of data to travel from one point to another in a network. Because many communication protocols depend on an acknowledgement that packets were received successfully, or otherwise involve transmission of data packets back and forth along a path in the network, latency is often measured by round-trip time in milliseconds. Latency affects a consumer's ability to use real-time applications, including interactive

voice or video communication, over the network. The Commission requires ETCs to offer sufficiently low latency to enable use of real-time applications, such as VoIP. The Commission's broadband measurement test results showed that most terrestrial wireline technologies could reliably provide latency of less than 100 milliseconds.

46. *Capacity.* Capacity is the total volume of data sent and/or received by the end user over a period of time. It is often measured in gigabytes (GB) per month. Several broadband providers have imposed monthly data usage limits, restricting users to a predetermined quantity of data, and these limits typically vary between fixed and mobile services. The terms of service may include an overage fee if a consumer exceeds the monthly limit. Some commenters recommended the Commission specifies a minimum usage limit.

47. Although at this time the Commission declines to adopt specific minimum capacity requirements for CAF recipients, the Commission emphasizes that any usage limits imposed by an ETC on its USF-supported broadband offering must be reasonably comparable to usage limits for comparable broadband offerings in urban areas (which could include, for instance, use of a wireless data card if it can provide the performance characteristics described herein). In particular, ETCs whose support is predicated on offering of a fixed broadband service—namely, all ETCs other than recipients of the Phase I Mobility Funds—must allow usage at levels comparable to residential terrestrial fixed broadband service in urban areas. The Commission defines terrestrial fixed broadband service as one that serves end users primarily at fixed endpoints using stationary equipment, such as the modem that connects an end user's home router, computer or other Internet access device to the network. This term includes fixed wireless broadband services (including those offered over unlicensed spectrum).

48. In 2009, residential broadband users who subscribed to fixed broadband service with speeds between 3 Mbps and 5 Mbps used, on average, 10 GB of capacity per month, and annual per-user growth was between 30 and 35 percent. AT&T's DSL usage limit is 150 GB and its U-Verse offering has a 250 GB limit. Since 2008, Comcast has had a 250 GB monthly data usage threshold on residential accounts. Without endorsing or approving of these or other usage limits, the Commission provides guidance by noting that a usage limit significantly below these current offerings (*e.g.,* a 10 GB monthly data limit) would not be reasonably comparable to residential terrestrial fixed broadband in urban areas. (This should not be interpreted to mean that the Commission intends to regulate usage limits.) A 250 GB monthly data limit for CAF-funded fixed broadband offerings would likely be adequate at this time because 250 GB appears to be reasonably comparable to major current urban broadband offerings. The Commission recognizes, however, that both pricing and usage limitations change over time. The Commission delegates authority to the Wireline Competition Bureau and Wireless Telecommunications Bureau to monitor urban broadband offerings, including by conducting an annual survey, in order to specify an appropriate minimum for usage allowances, and to adjust such a minimum over time.

49. Similarly, for Mobility Fund Phase I, the Commission declines to adopt a specific minimum capacity requirement that supported providers must offer mobile broadband users. However, the Commission emphasizes that any usage limits imposed by a provider on its mobile broadband offerings supported by the Mobility Fund must be reasonably comparable to any usage limits for mobile comparable broadband offerings in urban areas.

50. *Areas with No Terrestrial Backhaul.* Recognizing that satellite backhaul may limit the performance of broadband networks as compared to terrestrial backhaul, the Commission relaxes the broadband public interest obligation for carriers providing fixed broadband that are compelled to use satellite backhaul facilities. The Regulatory Commission of Alaska reports that ''for many areas of Alaska, satellite links may be the only viable option to deploy broadband.'' Carriers seeking relaxed public interest obligations because they lack the ability to obtain terrestrial backhaul—either fiber, microwave, or other technology—and are therefore compelled to rely exclusively on satellite backhaul in their study area, must certify annually that no terrestrial backhaul options exist, and that they are unable to satisfy the broadband public interest obligations adopted above due to the limited functionality of the available satellite backhaul facilities. Any such funding recipients must offer broadband service speeds of at least 1 Mbps downstream and 256 kbps upstream within the supported area served by satellite middle-mile facilities. Latency and capacity requirements discussed above will not apply to this subset of providers. Buildout obligations—which are dependent on the mechanism by which a carrier receives funding—remain the same for this class of carriers. The Commission will monitor and review the public interest obligations for satellite backhaul areas. To the extent that new terrestrial backhaul facilities are constructed, or existing facilities improve sufficiently to meet the public interest obligations, the Commission requires funding recipients to satisfy the relevant broadband public interest obligations in full within twelve months of the new backhaul facilities becoming commercially available. This limited exemption is only available to providers that have no access in their study area to any terrestrial backhaul facilities, and does not apply to any providers that object to the cost of backhaul facilities. Similarly, providers relying on terrestrial backhaul facilities today will not be allowed this exemption if they elect to transition to satellite backhaul facilities.

51. *Community Anchor Institutions.* The Commission expects that ETCs will likely offer broadband at greater speeds to community anchor institutions in rural and high cost areas, although the Commission does not set requirements at this time, as the 4 Mbps/1 Mbps standard will be met in the more rural areas of an ETC's service territory, and community anchor institutions are typically located in or near small towns and more inhabited areas of rural America. There is nothing in this R&O that requires a carrier to provide broadband service to a community anchor institution at a certain rate, but the Commission acknowledges that community anchor institutions generally require more bandwidth than a residential customer, and expect that ETCs would provide higher bandwidth offerings to community anchor institutions in high-cost areas at rates that are reasonably comparable to comparable offerings to community anchor institutions in urban areas.

52. The Commission also expects ETCs to engage with community anchor institutions in the network planning stages with respect to the deployment of CAF-supported networks. The Commission requires ETCs to identify and report on the community anchor institutions that newly gain access to fixed broadband service as a result of CAF support. In addition, the Wireline Competition Bureau will invite further input on the unique needs of community anchor institutions as it develops a forward-looking cost model to estimate the cost of serving locations, including community anchor locations, in price cap territories.

53. *Broadband Buildout Obligations.* All CAF funding comes with obligations to build out broadband within an ETC's service area, subject to certain limitations. The timing and extent of these obligations varies across the different CAF mechanisms. However, all broadband buildout obligations for fixed broadband are conditioned on not spending the funds to serve customers in areas already served by an ''unsubsidized competitor.'' The Commission defines an unsubsidized competitor as a facilities-based provider of residential terrestrial fixed voice and broadband service. The best data available at this time to determine whether broadband is available from an unsubsidized competitor at speeds at or above the 4 Mbps/1 Mbps speed threshold will likely be data on broadband availability at 3 Mbps downstream and 768 kbps upstream, which is collected for the National Broadband Map and through the Commission's Form 477. Such data may therefore be used as a proxy for the availability of 4 Mbps/1 Mbps broadband. Depending on the anticipated reform to the Form 477 data collection, the Commission may have additional data in the future upon which the Commission may rely.

54. The Commission limits this definition to fixed, terrestrial providers because the Commission thinks these limitations will disqualify few, if any, broadband providers that meet CAF speed, capacity, or latency minimums for all locations within relevant areas of comparison, while significantly easing administration of the definition. For example, the record suggests that satellite providers are generally unable to provide affordable voice and broadband service that meets the minimum capacity requirements without the aid of a subsidy: Consumer satellite services have limited capacity allowances today, and future satellite services appear unlikely to offer capacity reasonably comparable to urban offerings in the absence of universal service support. Likewise, while 4G mobile broadband services may meet the speed requirements in many locations, meeting minimum speed and capacity guarantees is likely to prove challenging over larger areas, particularly indoors. And because the performance offered by mobile services varies by location, it would be very difficult and costly for a CAF recipient or the Commission to evaluate whether such a service met the performance requirements at all homes and businesses within a study area, census block, or other required area. A wireless provider that currently offers mobile service can become an ''unsubsidized competitor,'' however, by offering a fixed wireless service that guarantees speed, capacity, and latency minimums will be met at all locations with the relevant area. Taken together, these considerations persuade us that the advantages of limiting the definition of unsubsidized providers outweigh any potential concerns that the Commission may unduly disqualify service providers that otherwise meet the performance requirements. As mobile and satellite services develop over time, the Commission will revisit the definition of ''unsubsidized competitor'' as warranted. Recognizing the benefits of certainty, however, the Commission does not anticipate changing the definition for the next few years.

55. Because most of these funding mechanisms are aimed at immediately narrowing broadband deployment gaps, both fixed and mobile, their performance benchmarks reflect technical capabilities and user needs that are expected at this time to be suitable for today and the next few years. However, the Commission must also lay the groundwork for longer-term evolution of CAF broadband obligations, as the Commission expects technical capabilities and user needs will continue to evolve. The Commission therefore commits to monitoring trends in the performance of urban broadband offerings through the survey data the Commission will collect and rural broadband offerings through the reporting data the Commission will collect, and to initiating a proceeding no later than the end of 2014 to review the performance requirements and ensure that CAF continues to support broadband service that is reasonably comparable to broadband service in urban areas.

56. In advance of that future proceeding, the Commission relies on its predictive judgment to provide guidance to CAF recipients on metrics that will satisfy the expectation that they invest the public's funds in robust, scalable broadband networks. The National Broadband Plan estimated that by 2017, average advertised speeds for residential broadband would be approximately 5.76 Mbps downstream. Applying growth rates measured by Akamai, one finds a projected average actual downstream speed by 2017 of 5.2 Mbps, and a projected average actual peak downstream speed of 6.86 Mbps.

57. Based on these projections, the Commission establishes a benchmark of 6 Mbps downstream and 1.5 Mbps upstream for broadband deployments in later years of CAF Phase II.

2. Measuring and Reporting Broadband

58. The Commission will require recipients of funding to test their broadband networks for compliance with speed and latency metrics and certify to and report the results to the Universal Service Administrative Company (USAC) on an annual basis. These results will be subject to audit. In addition, as part of the federal-state partnership for universal service, the Commission expects and encourage states to assist us in monitoring and compliance and therefore require funding recipients to send a copy of their annual broadband performance report to the relevant state or Tribal government.

59. Commenters generally supported testing and reporting of broadband performance. While some preferred only certifications without periodic testing, the Commission finds that requiring ETCs to submit verifiable test results to USAC and the relevant state commissions will strengthen the ability of this Commission and the states to ensure that ETCs that receive universal service funding are providing at least the minimum broadband speeds, and thereby using support for its intended purpose as required by 47 U.S.C. 254(e).

60. The Commission adopts the proposal in the *USF/ICC Transformation NPRM* that actual speed and latency be measured on each ETC's access network from the end-user interface to the nearest Internet access point. The end-user interface end-point would be the modem, the customer premise equipment typically managed by a broadband provider as the last connection point to the managed network, while the nearest Internet access point end-point would be the Internet gateway, the closest peering point between the broadband provider and the public Internet for a given consumer connection. The results of Commission testing of wired networks suggest that ''broadband performance that falls short of expectations is caused primarily by the segment of an ISP's network from the consumer gateway to the ISP's core network.''

61. In the *USF/ICC Transformation FNPRM,* the Commission seeks further comment on the specific methodology ETCs should use to measure the performance of their broadband services subject to these general guidelines, and the format in which funding recipients should report their results. The Commission directs the Wireline Competition Bureau, the Wireless Telecommunications Bureau, and the Office of Engineering and Technology to work together to refine the methodology

for such testing, which the Commission anticipates will be implemented in 2013.

3. Reasonably Comparable Rates for Broadband Service

62. As with voice services, for broadband services the Commission will consider rural rates to be ''reasonably comparable'' to urban rates under 47 U.S.C. 254(b)(3) if rural rates fall within a reasonable range of urban rates for reasonably comparable broadband service. However, the Commission has never compared broadband rates for purposes of 47 U.S.C. 254(b)(3), and therefore the Commission directs the Bureaus to develop a specific methodology for defining that reasonable range, taking into account that retail broadband service is not rate regulated and that retail offerings may be defined by price, speed, usage limits, if any, and other elements. In the *USF/ICC Transformation FNPRM,* the Commission seeks comment on how specifically to define a reasonable range.

63. The Commission also delegates to the Wireline Competition Bureau and Wireless Telecommunications Bureau the authority to conduct an annual survey of urban broadband rates, if necessary, in order to derive a national range of rates for broadband service. The Commission does not currently have sufficient data to establish such a range for broadband pricing, and are unaware of any adequate third-party sources of data for the relevant levels of service to be compared. The Commission therefore delegates authority to the Bureaus to determine the appropriate components of such a survey. By conducting its own survey, the Commission believes it will be able to tailor the data specifically to the need to satisfy the statutory obligation. The Commission requires recipients of funding to provide information regarding their pricing for service offerings, as described more fully below. The Commission also encourages input from the states and other stakeholders as the Bureaus develop the survey.

V. Establishing the Connect America Fund

A. The Budget

64. *Discussion.* For the first time, the Commission now establishes a defined budget for the high-cost component of the universal service fund. 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.

65. The Commission believes the establishment of such a budget will best ensure that the Commission has in place ''specific, predictable, and sufficient'' funding mechanisms to achieve the universal service objectives. The Commission is taking important steps to control costs and improve accountability in USF, and the estimates of the funding necessary for components of the CAF and legacy high-cost mechanisms represent its predictive judgment as to how best to allocate limited resources at this time. The Commission anticipates that it may revisit and adjust accordingly the appropriate size of each of these programs by the end of the six-year period the Commission budgets for today, based on market developments, efficiencies realized, and further evaluation of the effect of these programs in achieving the goals.

66. Importantly, establishing a CAF budget ensures that individual consumers will not pay more in contributions due to these reforms. Indeed, were the CAF to significantly raise the end-user cost of services, it could undermine the broader policy objectives to promote broadband and mobile deployment and adoption.

67. The Commission therefore establishes an annual funding target, set at the same level as the current estimate for the size of the high-cost program for FY 2011, of no more than $4.5 billion. The $4.5 billion budget includes only disbursements of support and does not include administrative expenses, which will continue to be collected consistent with past practices. Similarly, the $4.5 billion budget does not include prior period adjustments associated with support attributable to years prior to 2012. To the extent that those true-ups result in increased support for 2010, those disbursements would not apply to the budget discussed here.

68. This budgetary target will remain in place until changed by a vote of the Commission. The Commission believes that setting the budget at this year's support levels will minimize disruption and provide the greatest certainty and predictability to all stakeholders. The Commission does not find that amount to be excessive given the reforms the Commission adopts today, which expand the high-cost program in important ways to promote broadband and mobility; facilitate intercarrier compensation reform; and preserve universal voice connectivity. At the same time, the Commission does not believe a higher budget is warranted, given the substantial reforms the Commission concurrently adopts to modernize the legacy funding mechanisms to address long-standing inefficiencies and wasteful spending. The Commission concludes that it is appropriate, in the first instance, to evaluate the effect of these reforms before adjusting the budget.

69. The total $4.5 billion budget will include CAF support resulting from intercarrier compensation reform, as well as new CAF funding for broadband and support for legacy programs during a transitional period. As part of this budget, the Commission will provide $500 million per year in support through the Mobility Fund, of which up to $100 million in funding will be reserved for Tribal lands. Throughout this document, ''Tribal lands'' include any federally recognized Indian tribe's reservation, pueblo or colony, including former reservations in Oklahoma, Alaska Native regions established pursuant to the Alaska Native Claims Settlements Act (85 Stat. 688), and Indian Allotments, 47 CFR 54.400(e), as well as Hawaiian Home Lands—areas held in trust for native Hawaiians by the state of Hawaii, pursuant to the Hawaiian Homes Commission Act, 1920, Act July 9, 1921, 42 Stat. 108, *et seq.,* as amended. The Commission adopts a definition of ''Tribal lands'' that includes Hawaiian Home Lands, as the term was used in the *USF/ICC Transformation NPRM.* The Commission notes that Hawaiian Home Lands were not included within the Tribal definition in the 2007 order that adopted an interim cap on support for competitive eligible telecommunications carriers, with an exemption of Tribal lands from that cap. The Commission agrees with the State of Hawaii that Hawaiian Home Lands should be included in the definition of Tribal lands in the context of these comprehensive reforms for the universal service program.

70. The Commission will also provide at least $100 million to subsidize service in the highest cost areas. The remaining amount—approximately $4 billion—will be divided between areas served by price cap carriers and areas served by rate-of-return carriers, with no more than $1.8 billion available annually for price cap territories after a transition period and up to $2 billion available annually for rate-of-return territories,

including, in both instances, intercarrier compensation recovery. The Commission also institutes a number of safeguards in this new framework to ensure that carriers that warrant additional funding have the opportunity to petition for such relief. Although the Commission expects that in some years CAF may distribute less than the total budget, and in other years slightly more, the Commission adopts mechanisms later in this R&O to keep the contribution burden at no more than $4.5 billion per year, plus administrative expenses, notwithstanding variations on the distribution side. Meanwhile, the Commission will closely monitor the CAF mechanisms for longer-term consistency with the overall budget goal, while ensuring the budget remains at appropriate levels to satisfy the statutory mandates.

B. Providing Support in Areas Served by Price Cap Carriers

1. Immediate Steps To Begin Rationalizing Support Levels for Price Cap Carriers

71. *Discussion.* Effective January 1, 2012, the Commission freezes all support under the existing high-cost support mechanisms, HCLS, forward-looking model support (HCMS), safety valve support, LSS, IAS, and ICLS, on a study area basis for price cap carriers and their rate-of-return affiliates. On an interim basis, the Commission will provide this ''frozen high-cost support'' to such carriers equal to the amount of support each carrier received in 2011 in a given study area. Frozen high-cost support amounts will be calculated by USAC, and will be equal to the amount of support disbursed in 2011, without regard to prior period adjustments related to years other than 2011 and as determined by USAC on January 31, 2012. USAC shall publish each carrier's frozen high-cost support amount 2011 support, as calculated, on its Web site, no later than February 15, 2012. As a consequence of this action, rate-of-return operating companies that will be treated as price cap areas will no longer be required to perform cost studies for purposes of calculating HCLS or LSS, as their support will be frozen on a study area basis as of year-end 2011.

72. Frozen high-cost support will be reduced to the extent that a carrier's rates for local voice service fall below an urban local rate floor that the Commission adopts below to limit universal service support where there are artificially low rates. In addition to frozen high-cost support, the Commission will distribute up to $300 million in ''incremental support'' to price cap carriers and their rate of return affiliates using a simplified forward-looking cost estimate, based on the existing cost model.

73. This simplified, interim approach is based on a proposal in the record from several carriers. Support will be determined as follows: First, a forward-looking cost estimate will be generated for each wire center served by a price cap carrier. Our existing forward-looking cost model, designed to estimate the costs of providing voice service, generates estimates only for wire centers served by non-rural carriers; it cannot be applied to areas served by rural carriers without obtaining additional data from those carriers. The simplest, quickest, and most efficient means to provide support solely based on forward-looking costs for both rural and non-rural price cap carriers is to extend the existing cost model by using an equation designed to reasonably predict the output of the existing model for wire centers it already applies to, and apply it to data that are readily available for wire centers in all areas served by price cap carriers and their affiliates, including areas the current model does not apply to. Three price cap carriers submitted an estimated cost equation that was derived through a regression analysis of support provided under the existing high-cost model, and they submitted, under protective order, the data necessary to replicate their analysis. No commenter objected to the proponents' cost-estimation function. Following its own assessment of the regression analysis and the proposed cost-estimation function, the Commission concludes that the proposed function will serve the purpose well to estimate costs on an interim basis in wire centers now served by rural price cap carriers, and the Commission adopts it. That cost-estimation function is defined as:

$$\begin{aligned}\ln(\text{Total cost}) = {} & 7.08 + 0.02 * \ln(\text{distance to nearest central office in feet} + 1) \\ & - 0.15 * \ln(\text{number of households + businesses in the wire center} + 1) \\ & + 0.22 * \ln(\text{total road feed in wire center} + 1) \\ & + 0.06 * (\ln(\text{number of households + businesses in wire center} + 1)) \wedge 2 \\ & - 0.01 * (\ln(\text{number of businesses in wire center} + 1)) - 2 \\ & - 0.07 * \ln((\text{number of households + businesses})/\text{square miles}) + 1)\end{aligned}$$

74. The output of the cost-estimation function will be converted into dollars and then further converted into a per-location cost in the wire center. The resulting per-location cost for each wire center will be compared to a funding threshold, which, as explained below, will be determined by the budget constraint. Support will be calculated based on the wire centers where the cost for the wire center exceeds the funding threshold. Specifically, the amount by which the per-location cost exceeds the funding threshold will be multiplied by the total number of household and business locations in the wire center.

75. The funding threshold will be set so that, using the distribution process described above, all $300 million of incremental support potentially available under the mechanism would be allocated. The Commission delegates to the Wireline Competition Bureau the task of performing the calculations necessary to determine the support amounts and selecting any necessary data sources for that task. In the event the Wireline Competition Bureau concludes that appropriate data are not readily available for these purposes for certain areas, such as some or all U.S. territories served by price cap carriers, the Bureau may exclude such areas from the analysis for this interim mechanism, which would result in the carriers in such areas continuing to receive frozen support. The Bureau will announce incremental support amounts via Public Notice; the Commission anticipates the Bureau will complete its work and announce such support amounts on or before March 31, 2012. USAC will disburse CAF Phase I funds on its customary schedule.

76. The Commission intends for CAF Phase I to enable additional deployment beyond what carriers would otherwise undertake, absent this reform. Thus, consistent with the other reforms, the Commission will require carriers that accept incremental support under CAF Phase I to meet concrete broadband deployment obligations. The Commission acknowledges that the existing cost model, on which the distribution mechanism for CAF Phase I incremental funding is based, calculates the cost of providing voice service rather than broadband service, although the Commission is requiring carriers to meet broadband deployment obligations if they accept CAF Phase I incremental funding. The Commission finds that using estimates of the cost of deploying voice service, even though the Commission imposes broadband deployment obligations, is reasonable in the context of this interim support mechanism.

77. Specifically, the Bureau will calculate, on a holding company basis, how much CAF Phase I incremental support price cap carriers are eligible for. Carriers may elect to receive all, none, or a portion of the incremental support for which they are eligible. A

carrier accepting incremental support will be required to deploy broadband to a number of locations equal to the amount it accepts divided by $775. For example, a carrier projected to receive $7,750,000 will be permitted to accept up to that amount of incremental support. If it accepts the full amount, it will be required to deploy broadband to at least 10,000 unserved locations; if it accepts $3,875,000, it will be required to deploy broadband to at least 5,000 unserved locations. To the extent incremental support is declined, it may be used in other ways to advance the broadband objectives pursuant to the statutory authority. For instance, the funds could be held as part of accumulated reserve funds that would help minimize budget fluctuations in the event the Commission grants some petitions for waiver. Also, a number of parties have urged us to use high-cost funding to advance adoption programs. The Commission notes that the Commission has an open proceeding to reform the low income assistance programs, which specifically contemplates broadband pilots in the Lifeline and LinkUp programs. To the extent that savings were available from CAF programs, the Commission could reallocate that funding for broadband adoption programs, consistent with the statutory authority, while still remaining within the budget target. Alternatively, savings could be used to reduce the contribution burden.

78. Our objective is to articulate a measurable, enforceable obligation to extend service to unserved locations during CAF Phase I. For this interim program, the Commission is not attempting to identify the precise cost of deploying broadband to any particular location. Instead, the Commission is trying to identify an appropriate standard to spur immediate broadband deployment to as many unserved locations as possible, given the budget constraint. In this context, the Commission finds that a one-time support payment of $775 per unserved location for the purpose of calculating broadband deployment obligations for companies that elect to receive additional support is appropriate.

79. To develop that performance obligation, the Commission considered broadband deployment projects undertaken by a mid-sized price cap carrier under the Broadband Initiatives Program (BIP). The average per-location cost of deployment for those projects—including both the public contribution and the company's own capital contribution—was $557, significantly lower than $775 per-location—which does not include any company contribution. Analysis indicated that the per-location cost for deployments funded through the BIP program varied considerably. In addition, the BIP program's requirements differ from these requirements. Specifically, carriers could obtain BIP funding for improving service to underserved locations as well as deploying to unserved locations, while carriers can meet their CAF Phase I deployment obligations only by deploying broadband to unserved locations. For these reasons, while the Commission finds this average per-location cost to be relevant, the Commission declines to set the requirement at a per-location cost of $557.

80. In addition, the Commission considered data from the analysis done as part of the National Broadband Plan. The cost model used in developing the National Broadband Plan estimated that the median cost of upgrading existing unserved homes is approximately $650 to $750, with approximately 3.5 million locations whose upgrade cost is below that figure.

81. Commission staff also conducted an analysis using the ABC plan cost model, which calculates the cost of deploying broadband to unserved locations on a census block basis. Commission staff estimated that the median cost of a brownfield deployment of broadband to low-cost unserved census blocks is $765 per location (*i.e.,* there are 1.75 million unserved, low-cost locations in areas served by price cap carriers with costs below $765); the cost of deploying broadband to the census block at the 25th percentile of the cost distribution is approximately $530 per location (under this analysis, there are 875,000 such locations whose cost is below $530). Although the Commission does not adopt the proposed cost model to calculate support amounts for CAF Phase II, these estimates provide additional data points to consider.

82. In addition, the Commission notes that several carriers placed estimates of the per-location cost of extending broadband to unserved locations in their respective territories into the record. While several carriers claim that the cost to serve unserved locations is higher than the figure the Commission adopts, those estimates did not provide supporting data sufficient to fully evaluate them.

83. Taking into account all of these factors, including the cost estimates developed in the course of BIP applications as well as the flexibility the Commission provides to carriers accepting such funding to determine where to deploy and the expectation that carriers will supplement incremental support with their own investment, the Commission concludes that the $775 per unserved location figure represents a reasonable estimate of an interim performance obligation for this one-time support. The Commission also emphasizes that CAF Phase I incremental support is optional—carriers that cannot meet the broadband deployment requirement may decline to accept incremental support or may choose to accept only a portion of the amount for which they are eligible.

84. The Commission find that, in this interim support mechanism, setting the broadband deployment obligations based on the costs of deploying to lower-cost wire centers that would not otherwise be served, even though the Commission bases support on the predicted costs of the highest-cost wire centers, is reasonable because the Commission is trying to expand voice and broadband availability as much and as quickly as possible. The Commission distributes support based on the costs of the highest-cost wire centers because the ultimate goal of the reforms is to ensure that *all* areas get broadband-capable networks, whether through the operation of the market or through support from USF. In this interim mechanism, the Commission distributes funding to those carriers that provide service in the highest-cost areas because these are the areas where the Commission can be most confident, based on available information, that USF support will be necessary in order to realize timely deployment. Thus, the Commission can be confident the Commission is allocating support to carriers that will need it to deploy broadband in some portion of their service territory. At the same time, to promote the most rapid expansion of broadband to as many households as possible, the Commission wishes to encourage carriers to use the support in lower-cost areas where there is no private sector business case for deployment of broadband, to the extent carriers also serve such areas. Although at this time the Commission lacks data sufficient to identify these areas, the Commission can encourage this use of funding by setting the deployment requirement based on the overall estimate of upgrade costs in lower cost unserved areas, while providing carriers flexibility to allocate funding to these areas, rather than the highest cost wire centers identified by the cost-estimation equation. Accordingly, while the Commission allocates CAF Phase I support on the basis of carriers' service to the highest-cost areas, the

Commission allows carriers to use that support in lower-cost areas, and sizes their deployment obligations accordingly. The Commission notes that, historically, carriers have always been able to use support in wire centers other than the ones for which support is paid, and nothing in the Act constrains that flexibility such that it applies only within state boundaries. Accordingly, in the context of this interim mechanism, the Commission will permit carriers to continue to have such flexibility.

85. Within 90 days of being informed of the amount of incremental support it is eligible to receive, each carrier must provide notice to the Commission, the Administrator, the relevant state or territorial commission, and any affected Tribal government, identifying the amount of support it wishes to accept and the areas by wire center and census block in which the carrier intends to deploy broadband to meet its obligation, or stating that the carrier declines to accept incremental support for that year. Carriers accepting incremental support must make the following certifications. First, the carrier must certify that deployment funded through CAF Phase I incremental support will occur in areas shown on the most current version of the National Broadband Map as unserved by fixed broadband with a minimum speed of 768 kbps downstream and 200 kbps upstream, and that, to the best of the carrier's knowledge, are, in fact, unserved by fixed broadband at those speeds. Second, the carrier must certify that the carrier's current capital improvement plan did not already include plans to complete broadband deployment to that area within the next three years, and that CAF Phase I incremental support will not be used to satisfy any merger commitment or similar regulatory obligation.

86. Carriers must complete deployment to no fewer than two-thirds of the required number of locations within two years, and all required locations within three years, after filing their notices of acceptance. Carriers must provide a certification to that effect to the Commission, the Administrator, the relevant state or territorial commission, and any affected Tribal government, as part of their annual certifications pursuant to new 47 CFR 54.313 of the rules, following both the two-thirds and completion milestones. To fulfill their deployment obligation, carriers must offer broadband service of at least 4 Mbps downstream and 1 Mbps upstream, with latency sufficiently low to enable the use of real-time communications, including VoIP, and with usage limits, if any, that are reasonably comparable to those for comparable services in urban areas. Carriers failing to meet a deployment milestone will be required to return the incremental support distributed in connection with that deployment obligation and will be potentially subject to other penalties, including additional forfeitures, as the Commission deems appropriate. If a carrier fails to meet the two-thirds deployment milestone within two years and returns the incremental support provided, and then meets its full deployment obligation associated with that support by the third year, it will be eligible to have support it returned restored to it.

87. Our expectation is that CAF Phase II will begin on January 1, 2013. However, absent further Commission action, if CAF Phase II has not been implemented to go into effect by that date, CAF Phase I will continue to provide support as follows. Annually, no later than December 15, the Bureau will announce via Public Notice CAF Phase I incremental support amounts for the next term of incremental support, indicating whether support will be allocated for the full year or for a shorter term. The Commission delegates to the Wireline Competition Bureau the authority to adjust the term length of incremental support amounts, and to pro-rate obligations as appropriate, to the extent Phase II CAF is anticipated to be implemented on a date after the beginning of the calendar year. The amount of incremental support to be distributed during a term will be calculated in the manner described above, based on allocating $300 million through the incremental support mechanism, but that amount will be reduced by a factor equal to the portion of a year that the term will last. Within 90 days of the beginning of each term of support, carriers must provide notice to the Commission, the relevant state commission, and any affected Tribal government, identifying the amount of support it wishes to accept and the areas by wire center and census block in which the carrier intends to deploy broadband or stating that the carrier declines to accept incremental support for that term, with the same certification requirements described above. For purposes of this R&O, a carrier accepting incremental support in terms after 2012 will be required to deploy broadband to a number of locations equal to the amount of incremental support it accepts divided by $775, similar to the obligation for accepting support in 2012.

88. CAF Phase I will also begin the process of transitioning all federal high-cost support to price cap carriers to supporting modern communications networks capable of supporting voice and broadband in areas without an unsubsidized competitor. Consistent with the goal of providing support to price cap companies on a forward-looking cost basis, rather than based on embedded costs, the Commission will, for the purposes of CAF Phase I, treat as price cap carriers the rate-of-return operating companies that are affiliated with holding companies for which the majority of access lines are regulated under price caps. That is, the Commission will freeze their universal service support and consider them as price cap areas for the purposes of the new CAF Phase I distribution mechanism. Effective January 1, 2012, the Commission requires carriers to use their frozen high-cost support in a manner consistent with achieving universal availability of voice and broadband. If CAF Phase II has not been implemented to go into effect on or before January 1, 2013, the Commission will phase in a requirement that carriers use such support for building and operating broadband-capable networks used to offer their own retail service in areas substantially unserved by an unsubsidized competitor.

89. Specifically, in 2013, all carriers receiving frozen high-cost support must use at least one-third of that support to build and operate broadband-capable networks used to offer the provider's own retail broadband service in areas substantially unserved by an unsubsidized competitor. For 2014, at least two-thirds of the frozen high-cost support must be used in such fashion, and for 2015 and subsequent years, all of the frozen high-cost support must be spent in such fashion. Carriers will be required to certify that they have spent frozen high-cost support consistent with these requirements in their annual filings pursuant to new 47 CFR 54.313 of the rules.

90. These interim reforms to the support mechanisms for price cap carriers are an important step in the transition to full implementation of the Connect America Fund. While the Commission intends to complete implementation of the CAF rapidly, the Commission finds that these interim reforms offer immediate improvements over the existing support mechanisms. First, existing support for price cap carriers will be frozen and no longer calculated based on embedded costs. Rather, the Commission begins the process of transitioning all high-cost support to forward-looking costs and

market-based mechanisms, which will improve incentives for carriers to invest efficiently. Second, these reforms begin the process of eliminating the distinction, for the purposes of calculating high-cost support, between price cap carriers that are classified as rural and those that are classified as non-rural, a classification that has no direct or necessary relation to the cost of providing voice and broadband services. In this way, the support mechanisms will be better aligned with the text of 47 U.S.C. 254, which directs us to focus on the needs of consumers in ''rural, insular, and high cost *areas*'' but makes no reference to the classification of the *company* receiving support. In addition, the Commission notes that the reforms the Commission adopts today, which include providing immediate support to spur broadband deployment, can be implemented quickly, without the need to overhaul an admittedly dated cost model that does not reflect modern broadband network architecture. Thus, although the simplified interim mechanism is imperfect in some respects, it will allow us to begin providing additional support to price cap carriers on a more efficient basis, while spurring immediate and material broadband deployment pending implementation of CAF competitive bidding- and model-based support for price cap areas.

91. *No Effect on Interstate Rates.* Historically, IAS was intended to replace allowable common line revenues that otherwise are not recovered through SLCs, while some carriers received frozen ICLS because, due to the timing of their conversion to price cap regulation, they could not receive IAS. The Commission notes that many price cap carriers did not object to the elimination of the IAS mechanism, as long is it did not occur before the implementation of CAF. The Commission has no indication that these price cap carriers expect to raise their SLCs, presubscribed interexchange carrier charges, or other interstate rates as a result of any reform that would eliminate IAS. For clarity, however, the Commission specifically notes that while carriers receive support under CAF Phase I, the amount of their frozen high cost support equal to the amount of IAS for which each carrier was eligible in 2011 as being received under IAS, including, but not limited to, for the purposes of calculating interstate rates will be treated as IAS for purposes of the existing rules. To the extent that a carrier believes that it cannot meet its obligations with the revenues it receives under the CAF and ICC reforms, it may avail itself of the total cost and earnings review process described below.

92. *Elimination of State Rate Certification Filings.* Under 47 CFR 54.316 of the existing rules, states are required to certify annually whether residential rates in rural areas of their state served by non-rural carriers are reasonably comparable to urban rates nationwide. As part of these reforms, however, the Commission requires carriers to file rate information directly with the Commission. For this reason, the Commission concludes that continuing to impose this obligation on the states is unnecessary, and the Commission relieves state commissions of their obligations under that provision.

93. *Hawaiian Telcom Petition for Waiver.* Hawaiian Telcom, a non-rural price cap incumbent local exchange carrier, previously sought a waiver of certain rules relating to the support to which it would be entitled under the high-cost model. As Hawaiian Telcom explained, it received no high-cost model support at all because support under the model was based not on the estimated costs of individual wire centers but rather the statewide average of the costs of all individual wire centers included in the model. In its petition, Hawaiian Telcom requested that its support under the model be determined on a wire center basis, without regard to the statewide average of estimated costs calculated under the high-cost model.

94. In light of these reforms for support to price cap carriers, the Commission denies the Hawaiian Telcom petition. These reforms are largely consistent with the thrust of Hawaiian Telcom's petition. Phase II support will not involve statewide averaging of costs determined by a model, but instead will be determined on a much more granular basis. In Phase I, the Commission adopts, on an interim basis, a new method for distributing support to price cap carriers. While the Commission freezes existing support, the Commission provides incremental support to price cap carriers through a mechanism that, consistent with Hawaiian Telcom's proposal, identifies carriers serving the highest-cost wire centers but does not average wire center costs in a state. The Commission therefore believes that these reforms will achieve the relief Hawaiian Telcom seeks in its waiver petition and that, to the extent they do not, Hawaiian Telcom may seek additional targeted support through a request for waiver.

2. New Framework for Ongoing Support in Price Cap Territories

a. Budget for Price Cap Areas

95. Within the total $4.5 billion annual budget, the Commission sets the total annual CAF budget for areas currently served by price cap carriers at no more than $1.8 billion for a five-year period. For purposes of CAF Phase II, consistent with the approach in CAF Phase I, the Commission will treat as price cap carriers the rate-of-return operating companies that are affiliated with holding companies for which the majority of access lines are regulated under price caps. A ''price cap territory'' therefore includes a study area served by a rate-of-return operating company affiliated with price cap companies.

96. In 2010, the most recent year for which complete disbursement data are available, price cap carriers and their rate-of-return affiliates received approximately $1.076 billion in support. Collectively, more than 83 percent of the unserved locations in the nation are in price cap areas, yet such areas currently receive approximately 25 percent of high-cost support.

97. The Commission concludes that increased support to areas served by price cap carriers, coupled with rigorous, enforceable deployment obligations, is warranted in the near term to meet the universal service mandate to unserved consumers residing in these communities. At the same time, the Commission seeks to balance many competing demands for universal service funds, including the need to extend advanced mobile services and to preserve and advance universal service in areas currently served by rate-of-return companies. Budgeting up to $1.8 billion for price cap territories, in the judgment, represents a reasonable balance of these considerations. The Commission also stresses that these subsidies will go to carriers serving price cap areas, not necessarily incumbent price cap carriers. Before 2018, the Commission will re-evaluate the need for ongoing support at these levels and determine how best to drive support to efficient levels, given consumer demand and technological developments at that time.

b. Price Cap Public Interest Obligations

98. Price cap ETCs that accept a state-level commitment must provide broadband service that is reasonably comparable to terrestrial fixed broadband service in urban America. Specifically, price cap ETCs that receive model-based CAF support will be required, for the first three years they receive support, to offer broadband at

actual speeds of at least 4 Mbps downstream and 1 Mbps upstream, with latency suitable for real-time applications, such as VoIP, and with usage capacity reasonably comparable to that available in comparable offerings in urban areas. By the end of the third year, ETCs must offer at least 4 Mbps/1 Mbps broadband service to at least 85 percent of their high-cost locations—including locations on Tribal lands—covered by the state-level commitment, as described below. By the end of the fifth year, price cap ETCs must offer at least 4 Mbps/1 Mbps broadband service to all supported locations, and at least 6 Mbps/1.5 Mbps to a number of supported locations to be specified.

99. The Commission establishes the 85 percent third-year milestone to ensure that recipients of funding remain on track to meet their performance obligations. While a number of parties agreed generally with the concept of setting specific, enforceable interim milestones to safeguard the use of public funds, there are few concrete suggestions in the record on what those intermediate deadlines should be. The Commission agrees with the State Members of the Joint Board that there should be intermediate milestones for the required broadband deployment obligations. The Commission sets an initial requirement of offering broadband to at least 85 percent of supported locations by the end of the third year, and to all supported locations by the end of the fifth year. As set forth more fully below, recipients of funding will be required annually to report on their progress in extending broadband throughout their areas and must meet the interim deadline established for the third year, or face loss of support.

100. Before the end of the fifth year, the Commission expects to have reviewed the minimum broadband performance metrics in light of expected increases in speed, and other broadband characteristics, in the intervening years. Based on the information before us today, the Commission expects that consumer usage of applications, including those for health and education, may evolve over the next five years to require speeds higher than 4 Mbps downstream/1 Mbps upstream. For this reason, the Commission expects ETCs to build robust, scalable networks that will provide speeds of at least 6 Mbps/1.5 Mbps to a number of supported locations to be determined in the model development process, as set forth more fully below.

101. After the end of the five-year term of CAF Phase II, the Commission expects to be distributing all CAF support in price cap areas pursuant to a market-based mechanism, such as competitive bidding. However, if such a mechanism is not implemented by the end of the five-year term of CAF Phase II, the incumbent ETCs will be required to continue providing broadband with performance characteristics that remain reasonably comparable to the performance characteristics of terrestrial fixed broadband service in urban America, in exchange for ongoing CAF Phase II support.

c. Methodology for Allocating Support

102. *Discussion.* The Commission concludes that the Connect America Fund should ultimately rely on market-based mechanisms, such as competitive bidding, to ensure the most efficient and effective use of public resources. However, the CAF is not created on a blank slate, but rather against the backdrop of a decades-old regulatory system. The continued existence of legacy obligations, including state carrier of last resort obligations for telephone service, complicate the transition to competitive bidding. In the transition, the Commission seeks to avoid consumer disruption—including the loss of traditional voice service—while getting robust, scalable broadband to substantial numbers of unserved rural Americans as quickly as possible. Accordingly, the Commission adopts an approach that enables competitive bidding for CAF Phase II support in the near-term in some price cap areas, while in other areas holding the incumbent carrier to broadband and other public interest obligations over large geographies in return for five years of CAF support.

103. Specifically, the Commission adopts the following methodology for providing CAF support in price cap areas. First, the Commission will model forward-looking costs to estimate the cost of deploying broadband-capable networks in high-cost areas and identify at a granular level the areas where support will be available. Second, using the cost model, the Commission will offer each price cap LEC annual support for a period of five years in exchange for a commitment to offer voice across its service territory within a state and broadband service to supported locations within that service territory, subject to robust public interest obligations and accountability standards. Third, for all territories for which price cap LECs decline to make that commitment, the Commission will award ongoing support through a competitive bidding mechanism.

104. The Commission anticipates adoption of the selected model by the end of 2012 for purposes of providing support beginning January 1, 2013.

105. *Determination of Eligible Areas.* The Commission will use a forward-looking cost model to determine, on a census block or smaller basis, areas that will be eligible for CAF Phase II support. In doing so, the Commission will allocate the budget of no more than $1.8 billion for price cap areas to maximize the number of expensive-to-serve residences, businesses, and community anchor institutions that will have access to modern networks providing voice and robust, scalable broadband. Specifically, the Commission will use the model to identify those census blocks where the cost of service is likely to be higher than can be supported through reasonable end-user rates alone, and, therefore, should be eligible for CAF support. The Commission will also use the model to identify, from among these, a small number of extremely high-cost census blocks that should receive funding specifically set aside for remote and extremely high-cost areas, as described below, rather than receiving CAF Phase II support, in order to keep the total size of the CAF and legacy high-cost mechanisms within the $4.5 billion budget.

106. This methodology balances the desire to extend robust, scalable broadband to all Americans with the recognition that the very small percentage of households that are most expensive to serve via terrestrial technology represent a disproportionate share of the cost of serving currently unserved areas. In light of this fact, the State Members of the Joint Board propose that universal service support be limited to not more than $100 per high-cost location per month, which they suggest is somewhat higher than the prevailing retail price of satellite service. Similarly, ABC Plan proponents recommend an alternative technology benchmark of $256 per month based on the plan proponents' cost model—the CostQuest Broadband Analysis Tool (CQBAT)—which would limit support per location to no more than $176 per month ($256–$80 cost benchmark). The Commission agrees that the highest cost areas are more appropriately served through alternative approaches, and in the *USF/ICC Transformation FNPRM* the Commission seeks comment on how best to utilize at least $100 million in annual CAF funding to maximize the availability of affordable broadband in such areas. Here, the Commission adopts a methodology for calculating support that will target support to areas that exceed a specified cost benchmark, but not provide support for areas that

exceed an ''extremely high cost'' threshold.

107. The Commission delegates to the Wireline Competition Bureau the responsibility for setting the extremely high-cost threshold in conjunction with adoption of a final cost model. The threshold should be set to maintain total support in price cap areas within the up to $1.8 billion annual budget.

108. In determining the areas eligible for support, the Commission will also exclude areas where, as of a specified future date as close as possible to the completion of the model and to be determined by the Wireline Competition Bureau, an unsubsidized competitor offers affordable broadband that meets the initial public interest obligations that the Commission establishes in this R&O for CAF Phase I, *i.e.,* speed, latency, and usage requirements. The model scenarios submitted by the ABC Plan proponents excluded areas already served by a cable company offering broadband. State Members propose, at a minimum, excluding areas with unsubsidized wireline competition, and suggested that areas with reliable 4G wireless service could also be excluded. In an ''Amended ABC Plan,'' NCTA proposes to exclude areas where there is an unsupported wireline or wireless broadband competitor, and areas that received American Recovery and Reinvestment Act stimulus funding from Rural Utilities Service (RUS) or NTIA to build broadband facilities. The Commission concludes, on balance, that it would be appropriate to exclude any area served by an unsubsidized competitor that meets the initial performance requirements, and the Commission delegates to the Wireline Competition Bureau the task of implementing the specific requirements of this rule.

109. *State-Level Commitment.* Following adoption of the cost model, which the Commission anticipates will be before the end of 2012, the Bureau will publish a list of all eligible census blocks associated with each incumbent price cap carrier within each state. After the list is published, there will be an opportunity for comments and data to be filed to challenge the determination of whether or not areas are unserved by an unsubsidized competitor. Each incumbent carrier will then be given an opportunity to accept, for each state it serves, the public interest obligations associated with all the eligible census blocks in its territory, in exchange for the total model-derived annual support associated with those census blocks, for a period of five years. The model-derived support amount associated with each census block will be the difference between the model-determined cost in that census block, provided that cost is below the highest-cost threshold, and the cost benchmark used to identify high-cost areas. If the incumbent accepts the state-level broadband commitment, it shall be subject to the public interest obligations described above for all locations for which it receives support in that state, and shall be the presumptive recipient of the model-derived support amount for the five-year CAF Phase II period. In meeting its obligation to serve a particular number of locations in a state, an incumbent that has accepted the state-level commitment may choose to serve some census blocks with costs above the highest cost threshold instead of eligible census blocks (*i.e.,* census blocks with lower costs), provided that it meets the public interest obligations in those census blocks, and provided that the total number of unserved locations and the total number of locations covered is greater than or equal to the number of locations in the eligible census blocks.

110. Carriers accepting a state-level commitment will receive funding for five years. At the end of the five-year term, in the areas where the price cap carriers have accepted the five-year state level commitment, the Commission expects to use competitive bidding to award CAF support on a going-forward basis, and may use the competitive bidding structure adopted by the Commission for use in areas where the state-level commitment is declined.

111. The Commission concludes that the state-level commitment framework the Commission adopts is preferable to the right of first refusal approach proposed by the Commission in the *USF/ICC Transformation NPRM,* which would have been offered at the study area level, and to a right of first refusal offered at the wire center level, as proposed by some commenters. Both of these approaches would have allowed price cap carriers to pick and choose on a granular basis the areas where they would receive model-based support within a state. This would allow the incumbent to cherry pick the most attractive areas within its service territory, leaving the least desirable areas for a competitive process. This concern was greatest with the ABC proposal, under which carriers would have been able to exercise a right of first refusal on a wire center basis, but also applies to the study area proposal in the *USF/ICC Transformation NPRM.* Although for some price cap carriers, their study areas are their entire service area within a state, other carriers still have many study areas within a state. These carriers may have acquired various properties over time and chosen to keep them as separate study areas for various reasons, including potentially to maximize universal service support. Rather than enshrine such past decisions in the new CAF, the Commission concludes that it is more equitable to treat all price cap carriers the same and require them to offer service to all high-cost locations between an upper and lower threshold within their service territory in a state, consistent with the public interest obligations described above, in exchange for support. Requiring carriers to accept or decline a commitment for all eligible locations in their service territory in a state should reduce the chances that eligible locations that may be less economically attractive to serve, even with CAF support, get bypassed, and increase the chance such areas get served along with eligible locations that are more economically attractive.

112. In determining how best to award CAF support in price cap areas, the Commission carefully weighed the risks and benefits of alternatives, including using competitive bidding everywhere, without first giving incumbent LECs an opportunity to enter a state-level service commitment. The Commission concludes that, on balance, the approach the Commission adopts will best ensure continued universal voice service and speed the deployment of broadband to all Americans over the next several years, while minimizing the burden on the Universal Service Fund.

113. In particular, several considerations support the determination not to immediately adopt competitive bidding everywhere for the distribution of CAF support. Because the Commission excludes from the price cap areas eligible for support all census blocks served by an unsubsidized competitor, the Commission will generally be offering support for areas where the incumbent LEC is likely to have the only wireline facilities, and there may be few other bidders with the financial and technological capabilities to deliver scalable broadband that will meet the requirements over time. In addition, it is the predictive judgment that the incumbent LEC is likely to have at most the same, and sometimes lower, costs compared to a new entrant in many of these areas. The Commission also weighs the fact that incumbent LECs generally continue to have carrier of last resort obligations for voice services. While some states are beginning to re-evaluate those obligations, in many states the incumbent carrier still has the continuing obligation to provide voice service and cannot exit the marketplace

absent state permission. On balance, the Commission believes that that the approach best serves consumers in these areas in the near term, many of whom are receiving voice services today supported in part by universal service funding and some of whom also receive broadband, and will speed the delivery of broadband to areas where consumers have no access today.

114. The Commission disagrees with commenters who assert that the principle of competitive neutrality precludes the Commission from giving incumbent carriers an opportunity to commit to deploying broadband throughout their service areas in a state in exchange for five years of funding. The principle of competitive neutrality states that ''[u]niversal service support mechanisms and rules should be competitively neutral,'' which means that they should not ''unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another.'' The competitive neutrality principle does not require all competitors to be treated alike, but ''only prohibits the Commission from treating competitors differently in 'unfair' ways.'' Moreover, neither the competitive neutrality principle nor the other 47 U.S.C. 254(b) principles impose inflexible requirements for the Commission's formulation of universal service rules and policies. Instead, the ''promotion of any one goal or principle should be tempered by a commitment to ensuring the advancement of each of the principles'' in 47 U.S.C. 254(b).

115. As an initial matter, the Commission notes that the USF reforms generally advance the principle of competitive neutrality by limiting support to only those areas of the nation that lack unsubsidized providers. Thus, providers that offer service without subsidy will no longer face competitors whose service in the same area is subsidized by federal universal service funding. Especially in this light, the Commission concludes that any departure from strict competitive neutrality occasioned by affording incumbent LECs an opportunity to commit to deploying broadband in their statewide service areas is outweighed by the advancement of other 47 U.S.C. 254(b) principles, in particular, the principles that ''[a]ccess to advanced telecommunications and information services should be provided in all regions of the Nation,'' and that consumers in rural areas should have access to advanced services comparable to those available in urban areas. Although other classes of providers may be well situated to make broadband commitments with respect to relatively small geographic areas such as discrete census blocks, the purpose of the five-year commitment is to establish a limited, one-time opportunity for the rapid deployment of broadband services over a large geographic area. The fact that incumbent LECs' have had a long history of providing service throughout the relevant areas—including the fact that incumbent LECs generally have already obtained the ETC designation necessary to receive USF support throughout large service areas—puts them in a unique position to deploy broadband networks rapidly and efficiently in such areas. The Commission sees nothing in the record that suggests a more competitively neutral way of achieving that objective quickly, without abandoning altogether the goal of obtaining large-area build-out commitments or substantially ballooning the cost of the program.

116. Moreover, it is important to emphasize the limited scope and duration of the state-level commitment procedure. Incumbent LECs are afforded only a one-time opportunity to make a commitment to build out broadband networks throughout their service areas within a state. If the incumbent declines that opportunity in a particular state, support to serve the unserved areas located within the incumbent's service area will be awarded by competitive bidding, and all providers will have an equal opportunity to seek USF support, as described below. Furthermore, even where the incumbent LEC makes a state-level commitment, its right to support will terminate after five years, and the Commission expects that support after such five-year period will be awarded through a competitive bidding process in which all eligible providers will be given an equal opportunity to compete. Thus, the Commission anticipates that funding will soon be allocated on a fully competitive basis. In light of all these considerations, the Commission concludes that adhering to strict competitive neutrality at the expense of the state-level commitment process would unreasonably frustrate achievement of the universal service principles of ubiquitous and comparable broadband services and promoting broadband deployment, and unduly elevate the interests of competing providers over those of unserved and under-served consumers who live in high-cost areas of the country, as well as of all consumers and telecommunications providers who make payments to support the Universal Service Fund.

117. *Competitive Bidding.* In areas where the incumbent declines a state-level commitment, the Commission will use a competitive bidding mechanism to distribute support. In the *USF/ICC Transformation FNPRM,* the Commission proposes to design this mechanism in a way that maximizes the extent of robust, scalable broadband service subject to the budget. Assigning support in this way should enable us to identify those providers that will make most effective use of the budgeted funds, thereby extending services to as many consumers as possible. The Commission proposes to use census blocks as the minimum geographic unit eligible for competitive bidding and seek comment on ways to allow aggregation of such blocks. Although the Commission proposes using the same areas identified by the CAF Phase II model as eligible for support, the Commission also seeks comment on other approaches—for example, excluding areas served by any broadband provider, or using different cost thresholds. The Commission also seeks targeted comment on other issues, including bidder eligibility, auction design, and auction process.

118. *Transition to New Support Levels.* Support under CAF Phase II will be phased in, in the following manner. For a carrier accepting the state-wide commitment, in the first year, the carrier will receive one-half the full amount the carrier will receive under CAF Phase II and one-half the amount the carrier received under CAF Phase I for the previous year (which would be the frozen amount if the carrier declines Phase I or the frozen amount plus the incremental amount if the carrier accepts Phase I); in the second year, each carrier accepting the state-wide commitment will receive the full CAF Phase II amount. To the extent a carrier will receive less money from CAF Phase II than it will receive under frozen high-cost support, there will be an appropriate multi-year transition to the lower amount. It is premature to specify the length of that transition now, before the cost model is adopted, but it will be addressed in conjunction with finalization of the cost model that will be developed with public input.

119. For a carrier declining the state-wide commitment, the carrier will continue to receive support in an amount equal to its CAF Phase I support amount until the first month that the winner of any competitive process receives support under CAF Phase II; at that time, the carrier declining the state-wide commitment will cease to receive high-cost universal service support. No additional broadband obligations apply to funds received during the transition period. That is, carriers accepting the

state-wide commitment are obliged to meet the Phase II broadband obligations described above, while carriers declining the state-wide commitment will be required to meet their pre-existing Phase I obligations, but will not be required to deploy additional broadband in connection with their receipt of transitional funding.

d. Forward-Looking Cost Model

120. *Discussion.* Although the Commission agrees with both the State Members and the ABC Plan proponents that the Commission should use a forward-looking model to assist in setting support levels in price cap territories, the Commission does not adopt the CQBAT cost model proposed by the ABC Coalition, nor does the Commission accept the State Board's proposal that the Commission simply update the existing cost model. Instead, the Commission initiates a public process to develop a robust cost model for the Connect America Fund to accurately estimate the cost of a modern voice and broadband capable network, and delegate to the Wireline Competition Bureau the responsibility of completing it.

121. In light of the limited opportunity the public has received to review and modify the ABC Coalition's proposed CQBAT model, the Commission rejects the group's suggestion that the Commission adopts that model at this time. The Commission has previously held that before any cost model may be ''used to calculate the forward-looking economic costs of providing universal service in rural, insular, and high cost areas,'' the ''model and all underlying data, formulae, computations, and software associated with the model must be available to all interested parties for review and comment. All underlying data should be verifiable, engineering assumptions reasonable, and outputs plausible.'' The Commission sees no reason to depart from this conclusion here, and the CQBAT model, as presented to the Commission at this time, does not meet this requirement.

122. The Commission likewise rejects the State Members' proposal to modify the Commission's existing cost model to estimate the costs of modern voice and broadband-capable network. The Commission's existing cost model does not fully reflect the costs associated with modern voice and broadband networks because the model calculates cost based on engineering assumptions and equipment appropriate to the 1990s. In addition, modeling techniques and capabilities have advanced significantly since 1998, when the Commission's existing high cost model was developed, and the new techniques could significantly improve the accuracy of modeled costs in a new model relative to an updated version of the Commission's existing model. For example, new models can estimate the costs of efficient routing along roads in a way that the older model cannot. The Commission sees the benefits of leveraging the existing model to rapidly deploy interim support, and does just that for Phase I of the CAF. For the longer-term disbursement of support, however, the Commission concludes that it is preferable to use a more accurate, up to date model based on modern techniques.

123. To expedite the process of finalizing the model to be used as part of the state-level commitment, the Commission delegates to the Wireline Competition Bureau the authority to select the specific engineering cost model and associated inputs, consistent with this R&O. For the reasons below, the model should be of wireline technology and at a census block or smaller level. In other respects, the Commission directs the Wireline Competition Bureau to ensure that the model design maximizes the number of locations that will receive robust, scalable broadband within the budgeted amounts. Specifically, the model should direct funds to support 4 Mbps/1 Mbps broadband service to all supported locations, subject only to the waiver process for upstream speed described above, and should ensure that the most locations possible receive a 6 Mbps/1.5 Mbps or faster service at the end of the five year term, consistent with the CAF Phase II budget. The Wireline Competition Bureau's ultimate choice of a greenfield or brownfield model, the modeled architecture, and the costs and inputs of that model should ensure that the public interest obligations are achieved as cost-effectively as possible.

124. *Geographic Granularity.* The Commission concluded that the CAF Phase II model should estimate costs at a granular level—the census block or smaller—in all areas of the country. Geographic granularity is important in capturing the forward-looking costs associated with deploying broadband networks in rural and remote areas. Using the average cost per location of existing deployments in large areas, even when adjusted for differences in population and linear densities, presents a risk that costs may be underestimated in rural areas. Deployments in rural markets are likely to be subscale, so an analysis based on costs averaged over large areas, particularly large areas that include both low- and high-density zones, will be inaccurate. A granular approach, calculating costs based on the plant and hardware required to serve each location in a small area (*i.e.,* census block or smaller), will provide sufficient geographic and cost-component granularity to accurately capture the true costs of subscale markets. For example, if only one home in an area with very low density is connected to a DSLAM, the entire cost of that DSLAM should be allocated to the home rather than the fraction based on DSLAM capacity. Furthermore, to the extent that a home is served by a long section of feeder or distribution cabling that serves only that home, the entire cost of such cabling should be allocated to the home as well.

125. *Wireline Network Architecture.* The Commission concludes that the CAF Phase II model should estimate the cost of a wireline network. For a number of reasons, the Commission rejects some commenters' suggestion that the Commission should attempt to model the costs of both wireline and wireless technologies and base support on whichever technology is lower cost in each area of the country.

126. For one, the Commission has concerns about the feasibility of developing a wireless cost model with sufficient accuracy for use in the CAF Phase II framework. The Commission recognizes that all cost models involve a certain degree of imprecision. As the Commission noted in the *USF Reform NOI/NPRM,* 75 FR 26906, May 13, 2010, however, accurately modeling wireless deployment may raise challenges beyond those that exist for wireline models, particularly where highly localized cost estimates are required. For example, the availability of desirable cell sites can significantly affect the cost of covering any given small geographic area and is challenging to model without detailed local siting information. Propagation characteristics may vary based on local and difficult to model features like foliage. Access to spectrum, which substantially affects overall network costs, varies dramatically among potential funding recipients and differs across geographies. Because the cost model for CAF Phase II will need to calculate costs for small areas (census-block or smaller), high local variability in the accuracy of outputs will create challenges, even if a cost model provides high quality results when averaged over a larger area. In light of the issues with modeling wireless costs, the Commission remains concerned that a lowest-cost technology model including both wireless and wireline

components could introduce greater error than a wireline-only model in identifying eligible areas. The Commission does not believe that delaying implementation of CAF Phase II to resolve these issues serves the public interest.

127. Finally, the record fails to persuade us that, in general, the costs of cellular wireless networks are likely to be significantly lower than wireline networks for providing broadband service that meets the CAF Phase II speed, latency, and capacity requirements. In particular, the Commission emphasizes that, as described above, carriers receiving CAF Phase II support should expect to offer service with increasing download and upload speeds over time, and that allows monthly usage reasonably comparable to terrestrial fixed residential broadband offerings in urban areas. The National Broadband Plan modeled the nationwide costs of a wireless broadband network dimensioned to support typical usage patterns for fixed services to homes, and found that the cost was similar to that of wireline networks. None of the parties advocating for the use of a wireless model has submitted into the record a wireless model for fixed service and, therefore, the Commission has no evidence that such service would be less costly.

128. *Process for Adopting the Model.* The Commission anticipates that the Wireline Competition Bureau will adopt the specific model to be used for purposes of estimating support amounts in price cap areas by the end of 2012 for purposes of providing support beginning January 1, 2013. Before the model is adopted, the Commission will ensure that interested parties have access to the underlying data, assumptions, and logic of all models under consideration, as well as the opportunity for further comment. When the Commission adopted its existing cost model, it did so in an open, deliberative process with ample opportunity for interested parties to participate and provide valuable assistance. The Commission has had three rounds of comment on the use of a model for purposes of determining Connect America Fund support and remains committed to a robust public comment process. To expedite this process, the Commission delegates to the Wireline Competition Bureau the authority to select the specific engineering cost model and associated inputs, consistent with this R&O. The Commission directs the Wireline Competition Bureau to issue a public notice within 30 days of release of this R&O requesting parties to file models for consideration in this proceeding consistent with this R&O, and to report to the Commission on the status of the model development process no later than June 1, 2012.

129. The Commission notes that price cap carriers serving Alaska, Hawaii, Puerto Rico, the U.S. Virgin Islands and Northern Marianas Islands argue they face operating conditions and challenges that differ from those faced by carriers in the contiguous 48 states. The Commission directs the Wireline Competition Bureau to consider the unique circumstances of these areas when adopting a cost model, and further directs the Wireline Competition Bureau to consider whether the model ultimately adopted adequately accounts for the costs faced by carriers serving these areas. If, after reviewing the evidence, the Wireline Competition Bureau determines that the model ultimately adopted does not provide sufficient support to any of these areas, the Bureau may maintain existing support levels, as modified in this R&O, to any affected price cap carrier, without exceeding the overall budget of $1.8 billion per year for price cap areas.

C. Universal Service Support for Rate-of-Return Carriers

1. Public Interest Obligations of Rate-of-Return Carriers

130. The Commission recognizes that, in the absence of any federal mandate to provide broadband, rate-of-return carriers have been deploying broadband to millions of rural Americans, often with support from a combination of loans from lenders such as RUS and ongoing universal service support. The Commission now requires that recipients use their support in a manner consistent with achieving universal availability of voice and broadband.

131. To implement this policy, rather than establishing a mandatory requirement to deploy broadband-capable facilities to all locations within their service territory, the Commission continues to offer a more flexible approach for these smaller carriers. Specifically, beginning July 1, 2012, the Commission requires the following of rate-of-return carriers that continue to receive HCLS or ICLS or begin receiving new CAF funding in conjunction with the implementation of intercarrier compensation reform, as a condition of receiving that support: Such carriers must provide broadband service at speeds of at least 4 Mbps downstream and 1 Mbps upstream with latency suitable for real-time applications, such as VoIP, and with usage capacity reasonably comparable to that available in residential terrestrial fixed broadband offerings in urban areas, upon reasonable request. The Commission thus requires rate-of-return carriers to provide their customers with at least the same initial minimum level of broadband service as those carriers who receive model-based support, but given their generally small size, the Commission determines that rate-of-return carriers should be provided greater flexibility in edging out their broadband-capable networks in response to consumer demand. At this time the Commission does not adopt intermediate build-out milestones or increased speed requirements for future years, but the Commission expects carriers will deploy scalable broadband to their communities and will monitor their progress in doing so, including through the annual reports they will be required to submit. The broadband deployment obligation the Commission adopts is similar to the voice deployment obligations many of these carriers are subject to today.

132. The Commission believes these public interest obligations are reasonable. Although many carriers may experience some reduction in support as a result of the reforms adopted herein, those reforms are necessary to eliminate waste and inefficiency and improve incentives for rational investment and operation by rate-of-return LECs. The Commission notes that these carriers benefit by receiving certain and predictable funding through the CAF created to address access charge reform. In addition, rate-of-return carriers will not necessarily be required to build out to and serve the most expensive locations within their service area.

133. Upon receipt of a reasonable request for service, carriers must deploy broadband to the requesting customer within a reasonable amount of time. The Commission agrees with the State Members of the Federal-State Joint Board on Universal Service that construction charges may be assessed, subject to limits. In the Accountability and Oversight section of this R&O, the Commission requires ETCs to include in their annual reports to USAC and to the relevant state commission and Tribal government, if applicable, the number of unfulfilled requests for service from potential customers and the number of customer complaints, broken out separately for voice and broadband services. The Commission will monitor carriers' filings to determine whether reasonable requests for broadband service are being fulfilled, and the Commission encourages states and Tribal governments to do the same. As

discussed in the legal authority section above, the Commission is funding a broadband-capable voice network, so the Commission believes that to the extent states retain jurisdiction over voice service, states will have jurisdiction to monitor these carriers' responsiveness to customer requests for service.

134. The Commission recognizes that smaller carriers serve some of the highest cost areas of the nation. The Commission seeks comment in the *USF/ICC Transformation FNPRM* below on alternative ways to meet the needs of consumers in these highest cost areas. Pending development of the record and resolution of these issues, rate-of-return carriers are simply required to extend broadband on reasonable request. The Commission expects that rate-of-return carriers will follow pre-existing state requirements, if any, regarding service line extensions in their highest-cost areas.

2. Limits on Reimbursable Capital and Operating Costs

135. *Discussion.* The Commission concludes that the Commission should use regression analyses to limit reimbursable capital expenses and operating expenses for purposes of determining high-cost support for rate-of-return carriers. The methodology will generate caps, to be updated annually, for each rate-of-return company. This rule change will place important constraints on how rate-of-return companies invest and operate that over time will incent greater operational efficiencies. The Commission delegates authority to the Wireline Competition Bureau to implement a methodology and expect that limits will be implemented no later than July 1, 2012.

136. Several commenters support the proposal to impose reasonable limits on reimbursable capital and operating expenses. Although many small rate-of-return carriers seem to imply that the Commission should not adopt operating expense benchmarks because their operating expenses are ''fixed,'' other representatives of rural rate-of-return companies support the concept of imposing reasonable benchmarks. The Rural Associations concede that ''[t]o the extent any 'race to the top' occurs, it undermines predictability and stability for current USF recipients.''

137. The Commission sets forth in the *USF/ICC Transformation FNPRM* and Appendix H a specific methodology for capping recovery for capital expenses and operating expenses using quantile regression techniques and publicly available cost, geographic and demographic data. The net effect would be to limit high-cost loop support amounts for rate-of-return carriers to reasonable amounts relative to other carriers with similar characteristics. Specifically, the methodology uses National Exchange Carrier Association (NECA) cost data and 2010 Census data to cap permissible expenses for certain costs used in the HCLS formula. The Commission invites public input in the accompanying *USF/ICC Transformation FNPRM* on that methodology and anticipates that HCLS benchmarks will be implemented for support calculations beginning in July 2012.

138. The Commission sets forth here the parameters of the methodology that the Bureau should use to limit payments from HCLS. The Commission requires that companies' costs be compared to those of similarly situated companies. The Commission concludes that statistical techniques should be used to determine which companies shall be deemed similarly situated. For purposes of this analysis, the Commission concludes the following non-exhaustive list of variables may be considered: Number of loops, number of housing units (broken out by whether the housing units are in urbanized areas, urbanized clusters, and nonurban areas), as well as geographic measures such as land area, water area, and the number of census blocks (all broken out by urbanized areas, urbanized clusters, and nonurban areas). The Commission grants the Bureau discretion to determine whether other variables, such as soil type, would improve the regression analysis. The Commission notes that the soils data from the Natural Resource Conservation Service (NRCS) that the Nebraska study used to generate soil, frost and wetland variables do not cover the entire United States. These data, called the Soil Survey Geographic Database or SSURGO, do not cover about 24 percent of the United States land mass, including Puerto Rico, Guam, American Samoa, U.S. Virgin Islands and Northern Mariana Islands as well as Alaska. The Commission seeks comment in the *USF/ICC Transformation FNPRM* on sources of other publicly available soil data. The Commission delegates authority to the Bureau to adopt the initial methodology, to update it as it gains more experience and additional information, and to update its regression analysis annually with new cost data.

139. Each year the Wireline Competition Bureau will publish in a public notice the updated capped values that will be used in the NECA formula in place of an individual company's actual cost data for those rate-of-return cost companies whose costs exceed the caps, which will result in revised support amounts. The Commission directs NECA to modify the high-cost loop support universal service formula for average schedule companies annually to reflect the caps derived from the cost company data.

140. The Commission concludes that establishing reasonable limits on recovery for capital expenses and operating expenses will provide better incentives for carriers to invest prudently and operate efficiently than the current system. Under the current HCLS rules, a company receives support when its costs are relatively high compared to a national average—without regard to whether a lesser amount would be sufficient to provide supported services to its customers. The current rules fail to create incentives to reduce expenditures; indeed, because of the operation of the overall cap on HCLS, carriers that take prudent measures to cut costs under the current rules may actually lose HCLS support to carriers that significantly increase their costs in a given year.

141. Under the new rule, the Commission will place limits on the HCLS provided to carriers whose costs are significantly higher than other companies that are similarly situated, and support will be redistributed to those carriers whose unseparated loop cost is not limited by operation of the benchmark methodology. The Commission notes that the fact that an individual company will not know how the benchmark affects its support levels until after investments are made is no different from the current operation of high-cost loop support, in which a carrier receives support based on where its own cost per loop falls relative to a national average that changes from year to year. Even today, companies can only estimate whether their expenditures will be reimbursed through HCLS. In contrast to the current situation, the new rule will discourage companies from over-spending relative to their peers. The new rule will provide additional support to those companies that are otherwise at risk of losing HCLS altogether, and would not otherwise be well-positioned to further advance broadband deployment.

142. The Commission rejects the argument that imposing benchmarks in this fashion would negatively impact companies that have made past investments in reliance upon the current rules or the ''no barriers to advanced services'' policy. 47 U.S.C. 254 does not mandate the receipt of support by any particular carrier. Rather, as the Commission has indicated

and the courts have agreed, the ''purpose of universal service is to benefit the customer, not the carrier.'' That is, while 47 U.S.C. 254 directs the Commission to provide support that is sufficient to achieve universal service goals, that obligation does not create any entitlement or expectation that ETCs will receive any particular level of support or even any support at all. The new rule will inject greater predictability into the current HCLS mechanism, as companies will have more certainty of support if they manage their costs to be in alignment with their similarly situated peers.

143. Our obligation to consumers is to ensure that they receive supported services. Our expectation is that carriers will provide such services to their customers through prudent facility investment and maintenance. To the extent costs above the benchmark are disallowed under this new rule, companies are free to file a petition for waiver to seek additional support.

144. The Commission finds that the approach—which limits allowable investment and expenses with reference to similarly situated carriers—is a reasonable way to place limits on recovery of loop costs. The Rural Associations propose an alternative limitation on capital investment that would tie the amount of a rural company's recovery of prospective investment that qualifies for high-cost support to the accumulated depreciation in its existing loop plant. Their proposal would limit only future annual loop investment for individual companies by multiplying (a) the ratio of accumulated loop depreciation to total loop plant or (b) twenty percent, whichever is lower, times (c) an estimated total loop plant investment amount (adjusted for inflation). This proposal would do little to limit support for capital expenses if past investments for a particular company were high enough to be more than sufficient to provide supported services, and would do nothing to limit support for operating expenses, which are on average more than half of total loop costs. In addition, it would likely be administratively impracticable for the Commission to verify the inflation adjustments each company would make for various pieces of equipment acquired at various times.

145. The Commission also concludes that the approach can be more readily implemented and updated than the specific proposal presented by the Nebraska Companies. Consultants for the Nebraska Companies, in their regression analyses, used proprietary cost data. Because the proprietary cost data were not placed in the record, Commission staff was not able to verify the results of the Nebraska Companies' studies. The Nebraska Companies subsequently proposed that the Commission begin collecting similar investment and operating expense data, as well as independent variables such as density per route mile, to be used in similar regression analyses. For example, they suggest that ''[o]ne useful source for this data would be the investment costs associated with actual broadband construction projects that meet or exceed current engineering standards.'' Although the Nebraska Companies' proposal shares objectives similar to the methodology, it would require the collection of additional data that the Commission does not currently have, which would lead to considerable delay in implementation. The Commission also is concerned about the difficulty in obtaining a sufficiently representative and standardized data set based on construction projects that will vary in size, scope and duration. Moreover, regressions based on such data could not easily be updated on a regular basis without further data collection and standardization. On balance, the Commission does not believe that any advantages of the Nebraska Companies' approach outweigh the benefits of relying on cost data that the Commission already collects on a regular basis. As explained in detail in the accompanying *USF/ICC Transformation FNPRM* and Appendix H, Commission staff used publicly available NECA cost data and other publicly available geographic and demographic data sets to develop the proposed benchmarks.

146. Finally, the Commission notes that while the methodology in Appendix H is specifically designed to modify the formula for determining HCLS, the Commission concludes that the Commission should also develop similar benchmarks for determining ICLS. The Commission directs NECA to file the detailed revenue requirement data it receives from carriers, no later than thirty days after release of this R&O, so that the Wireline Competition Bureau can evaluate whether it should adopt a methodology using these data. Over time, benchmarks to limit reimbursable recovery of costs will provide incentives for each individual company to keep its costs lower than its own cap from prior years, and more generally moderate expenditures and improve efficiency, and the Commission believes these objectives are as important in the context of ICLS as they are for HCLS. The Commission seeks comment in the *USF/ICC Transformation FNPRM* on ICLS benchmarks.

147. The Commission delegates authority to the Wireline Competition Bureau to finalize a methodology to limit HCLS and ICLS reimbursements after this further input.

3. Corporate Operations Expense

148. *Discussion.* As supported by many parties, the Commission will adopt the more modest reform proposal to extend the limit on recovery of corporate operations expense to ICLS effective January 1, 2012. The Commission concluded in the *Universal Service First Report and Order,* 62 FR 32862, June 17, 1997, that the amount of recovery of corporate operations expense from HCLS should be limited to help ensure that carriers use such support only to offer better service to their customers through prudent facility investment and maintenance, consistent with their obligations under 47 U.S.C. 254(k). The Commission now concludes that the same reasoning applies to ICLS. Extending the limit on the recovery of corporate operations expenses to ICLS likewise furthers the goal of fiscal responsibility and accountability.

149. The Commission notes, however, that the current formula for limiting the eligibility of corporate operations expenses for HCLS has not been revised since 2001. The initial formula was implemented in 1998, based on 1995 cost data. In 2001, the formula was modified to reflect increases in Gross Domestic Product-Chained Price Index (GDP–CPI), but has not been updated since then.

150. There have been considerable changes in the telecommunications industry in the last decade, given the ''ongoing evolution of the voice network into a broadband network,'' and the Commission believes updating the formula based on more recent cost data will ensure that it reflects the current economics of serving rural areas and appropriately provides incentives for efficient operations. Therefore, the Commission now updates the limitation formula based on an analysis of the most recent actual corporate operations expense submitted by rural incumbent LECs. As set forth in Appendix C of the Report and Order, which is available in its entirety at *http://transition.fcc.gov/Daily_Releases/Daily_Business/2011/db1122/FCC–11-161A1.pdf*, and as summarized below in section V.C.3.a, the basic statistical methods for developing the limitation formula and the structure of the formula are the same as before. The Commission also concludes that the updated formula the Commission adopts should include a

growth factor, consistent with the current formula that applies to HCLS.

151. Accordingly, effective January 1, 2012, the Commission modifies the existing limitation on corporate operations expense formula as follows:

- For study areas with 6,000 or fewer total working loops the monthly amount per loop shall be (a) $42.337 − (.00328 × number of total working loops), or (b) $63,000/number of total working loops, whichever is greater;
- For study areas with more than 6,000, but fewer than 17,887 total working loops, the monthly amount per loop shall be $3.007 + (117,990/number of total working loops); and
- For study areas with 17,887 or more total working loops, the monthly amount per loop shall be $9.56;
- Beginning January 1, 2013, the monthly per-loop limit shall be adjusted each year to reflect the annual percentage change in GDP–CPI.

a. Explanation of Methodology for Modifications to Corporate Operations Expense Formulae

152. *The Basic Formulae.* The Commission conducted a statistical analysis using actual incumbent local exchange carrier data submitted by NECA. The Commission used statistical regression techniques that focused on corporate operations expense per loop and the number of loops, in which the cap on corporate operations expense per loop declines as the number of loops increases so that economies of scale, which are evident in the data, can be reflected in the model. As in the previous corporate operations expense limitation formulae, the linear spline model developed has two line segments joined together at a single point or knot. In general, the linear spline model allows the per-line cap on corporate operations expense to decline as the number of loops increases for the smaller study areas having fewer loops than the knot point. Estimates produced by the linear spline model suggest that the per-loop cap on corporate operations expense for study areas with a number of loops higher than the spline knot is constant.

153. The linear spline model requires selecting a knot, the point at which the two line segments of differing slopes meet. The Commission retained the knot point at 10,000 loops from the Commission's previous analysis. The regression results are as follows:

- For study areas having fewer than 10,000 total working loops, the projected monthly corporate operations expense per-loop equals $36.815 − 0.00285 × (number of working loops);
- For study areas with total working loops equal or greater than 10,000 loops, the projected monthly corporate operations expense per-loop equals $8.12.

154. *Correcting for Non-monotonic Behavior in the Model's Total Corporate Operations Expense.* The linear spline model has one undesirable feature. For a certain range, it yields a total allowable corporate operations expense that declines as the number of working loops increases. This occurs because multiplying the linear function that defines the first line segment of the estimated spline model (36.815 − (0.00285 × the number of loops)) by the number of loops defines a quadratic function that determines total allowable corporate operations expense. This quadratic function produces a maximum value at 6,459 loops, well below the selected knot point of 10,000. To correct this problem, we refined the formulae to ensure that the total allowable corporate operations expense always increases as the number of loops increases. The Commission chose a point to the left of the point at which the total corporate operations expense estimate peaks. At that selected point, the slope of the function defining total corporate operations expense is positive. We then calculated the slope at that point and extended a line with the same slope upward to the right of that point until the line intersected the original estimated total operations expense, which is represented by 8.315 × the number of loops. Thus, the Commission we created a line segment with constant slope covering the region over which the original model of corporate operations expenses declines so that total corporate operations expense continues to increase with the number of loops. The Commission chose the point that leads to a line segment that yields the highest R^2.

155. Using this procedure, the Commission selected 6,000 as the point. The slope of total operations expense at this point is 2.615 and the line extended intersects the original total operations expense model at 17,887. Accordingly, the line segment formed for total corporate operations expenses, to be applied from 6,000 loops to 17,887 loops, is $2.615 × the number of working loops + $102,600. Dividing this number by the number of working loops defines the maximum allowable corporate operations expense per-loop for the range from 6,000 to 17,887 working loops, *i.e.,* $2.615 + ($102,600/number of working loops). Therefore, the projected per-loop corporate operations expense formulae are:

- For study areas having fewer than 6,000 total working loops, the projected monthly corporate operations expense per-loop equals $ 36.815 − 0.00285 × (number of total working loops);
- For study areas having 6,000 or more total working loops, but less than 17,887 total working loops, the projected monthly corporate operations expense per-loop equals $2.615 + (102,600/number of total working loops);
- For study areas having total working loops greater than or equal to 17,887 total working loops, the projected monthly corporate operations expense per-loop equals $8.315.

156. The Commission concluded previously that the amount of corporate operations expense per-loop that is supported through our universal service programs should fall within a range of reasonableness. Consistent with the formulae currently in place, we define this range of reasonableness for each study area as including levels of reported corporate operations expense per-loop up to a maximum of 115 percent of projected level of corporate operations expense per-loop. Therefore, each of the above formulae is multiplied by 115 percent to yield the maximum allowable monthly per-loop corporate operations expense as follows:

- For study areas having fewer than 6,000 total working loops, the maximum allowable monthly corporate operations expense per-loop equals $42.337 − 0.00328 × number of total working loops;
- For study areas having 6,000 or more total working loops, but fewer than 17,887 total working loops, the maximum allowable monthly corporate operations expense per-loop equals $3.007 + (117,990/number of total working loops);
- For study areas with total working loops greater than or equal to 17,887 total working loops, the maximum allowable monthly corporate operations expense per-loop equals $9.562.

157. Consistent with the existing rules, we will adjust the monthly per-loop limit to reflect the annual change in GDP–CPI.

4. Reducing High Cost Loop Support for Artificially Low End-User Rates

158. *Discussion.* The Commission now adopts a rule to limit high-cost support where end-user rates do not meet a specified local rate floor. This rule will apply to both rate-of-return carriers and price cap companies. 47 U.S.C. 254 obligates states to share in the responsibility of ensuring universal service. The Commission recognizes some state commissions may not have

examined local rates in many years, and carriers may lack incentives to pursue a rate increase when federal universal service support is available. Based on evidence in the record, however, there are a number of carriers with local rates that are significantly *lower* than rates that urban consumers pay. Indeed, there are local rates paid by customers of universal service recipients as low as $5 in some areas of the country. For example, the Commission notes that two carriers in Iowa and one carrier in Minnesota offer local residential rates below $5 per month. The Commission does not believe that Congress intended to create a regime in which universal service subsidizes artificially low local rates in rural areas when it adopted the reasonably comparable principle in 47 U.S.C. 254(b); rather, it is clear from the overall context and structure of the statute that its purpose is to ensure that rates in rural areas not be significantly *higher* than in urban areas.

159. The Commission focuses here on the impact of such a rule on rate-of-return companies. Data submitted by NECA summarizing residential R–1 rates for over 600 companies—a broad cross-section of carriers that typically receive universal service support—show that approximately 60 percent of those study areas have local residential rates that are below the 2008 national average local rate of $15.62. Most rates fall within a five-dollar range of the national average, but more than one hundred companies, collectively representing hundreds of thousands of access lines, have a basic R–1 rate that is significantly lower. This appears consistent with rate data filed by other commenters.

160. It is inappropriate to provide federal high-cost support to subsidize local rates beyond what is necessary to ensure reasonable comparability. Doing so places an undue burden on the Fund and consumers that pay into it. Specifically, the Commission does not believe it is equitable for consumers across the country to subsidize the cost of service for some consumers that pay local service rates that are significantly lower than the national urban average.

161. Based on the foregoing, and as described below, the Commission will limit high-cost support where local end-user rates plus state regulated fees (specifically, state SLCs, state universal service fees, and mandatory extended area service charges) do not meet an urban rate floor representing the national average of local rates plus such state regulated fees. Our calculation of this urban rate floor does not include federal SLCs, as the purposes of this rule change are to ensure that *states* are contributing to support and advance universal service and that consumers are not contributing to the Fund to support customers whose rates are below a reasonable level.

162. The Commission will phase in this rate floor in three steps, beginning with an initial rate floor of $10 for the period July 1, 2012 through June 30, 2013 and $14 for the period July 1, 2013 through June 30, 2014. Beginning July 1, 2014, and in each subsequent calendar year, the rate floor will be established after the Wireline Competition Bureau completes an updated annual survey of voice rates. Under this approach, the Commission will reduce, on a dollar-for-dollar basis, HCLS and CAF Phase I support to the extent that a carrier's local rates (plus state regulated fees) do not meet the urban rate floor.

163. To the extent end-user rates do not meet the rate floor, USAC will make appropriate reductions in HCLS support. This calculation will be pursuant to a rule that is separate from the existing rules for calculation of HCLS, which is subject to an annual cap. As a consequence, any calculated reductions will not flow to other carriers that receive HCLS, but rather will be used to fund other aspects of the CAF pursuant to the reforms the Commission adopts today.

164. This offset does not apply to ICLS because that mechanism provides support for interstate rates, not intrastate end-user rates. Accordingly, the Commission will revise the rules to limit a carrier's high-cost loop support when its rates do not meet the specified local urban rate floor.

165. Phasing in this requirement in three steps will appropriately limit the impact of the new requirement in a measured way. Based on the NECA data, the Commission estimates that there are only 257,000 access lines in study areas having local rates less than $10—which would be affected by the rule change in the second half of 2012—and there are 827,000 access lines in study areas that potentially would be affected in 2013. The Commission assumes, however, that by 2013 carriers will have taken necessary steps to mitigate the impact of the rule change. By adopting a multi-year transition, the Commission seeks to avoid a flash cut that would dramatically affect either carriers or the consumers they serve.

166. In addition, because the Commission anticipates that the rate floor for the third year will be set at a figure close to the sum of $15.62 plus state regulated fees, the Commission is confident that $10 and $14 are conservative levels for the rate floors for the first two years. $15.62 was the average monthly charge for flat-rate service in 2008, the most recent year for which data was available. Under the definition of ''reasonably comparable,'' rural rates are reasonably comparable to urban rates under 47 U.S.C. 254(b) if they fall within a reasonable range above the national average. Under this definition, the Commission could set the rate floor *above* the national average urban rate but within a range considered reasonable. In the present case, the Commission is expecting to set the end point rate floor *at* the average rate, and the Commission is setting rate floors well *below* the current best estimate of the average during the multi-year transition period.

167. Although the high-cost program is not the primary universal service program for addressing affordability, the Commission notes that some commenters have argued that if rates increase, service could become unaffordable for low-income consumers. However, staff analysis suggests that this rule change should not disproportionately affect low-income consumers, because there is no correlation between local rates and average incomes in rate-of-return study areas—that is, rates are not systematically lower where consumer income is lower and higher where consumer income is higher. The Commission further notes that the Commission's Lifeline and Link Up program remains available to low-income consumers regardless of this rule change.

168. In 2010, 1,048 rate-of-return study areas received HCLS support. Using data from the NECA survey filed pursuant to the Protective Order in this proceeding and U.S. Census data from third-party providers, the Commission analyzed monthly local residential rate data for 641 of these study areas and median income data for 618 of those 641 study areas. Based on the 618 study areas for which the Commission has both local rate data and median income data, when the Commission sets one variable dependent upon the other (price as a function of income), the Commission does not observe prices correlating at all with median income levels in the given study areas. The Commission observes a wide range of prices—many are higher than expected and just as many are lower than expected. In fact, some areas with extremely low residential rates exhibit higher than average consumer income.

169. To implement these rule changes, The Commission directs that all carriers receiving HCLS must report their basic voice rates and state regulated fees on an annual basis, so

that necessary support adjustments can be calculated. In addition, all carriers receiving frozen high-cost support will be required to report their basic voice rates and state regulated fees on an annual basis. Carriers will be required to report their rates to USAC, as set forth more fully below. As noted above, the Commission has delegated authority to the Wireline Competition Bureau and the Wireless Telecommunications Bureau to take all necessary steps to develop an annual rate survey for voice services. The Commission expects this annual survey to be implemented as part of the annual survey described above in the section discussing public interest obligations for voice telephony. The Commission expects the initial annual rate survey will be completed prior to the implementation of the third step of the transition.

170. Finally, the Commission notes that the Rural Associations contend that a benchmark approach for voice services fails to address rate comparability for broadband services. Although the Commission addresses only voice services here, elsewhere in this R&O the Commission addresses reasonable comparability in rates for broadband services. The Commission believes that it is critical to reduce support for voice—the supported service—where rates are artificially low. Doing so will relieve strain on the USF and, thus, greatly assist the efforts in bringing about the overall transformation of the high-cost program into the CAF.

5. Safety Net Additive

171. *Discussion.* The Commission concludes the safety net additive is not designed effectively to encourage additional significant investment in telecommunications plant, and therefore eliminate the rule immediately. The Commission grandfathers existing recipients and begin phasing out their support in 2012.

172. Several commenters suggest that rather than eliminate the safety net additive, the Commission revises the rule to base qualification on the *total* year-over-year changes in TPIS, rather than on *per-line* change in TPIS. The Commission declines to adopt this suggestion, and the Commission concludes instead that it should phase out safety net additive rather than modify how it operates. While revising the rule as some commenters suggested would address one deficiency with safety net additive support, doing so would not address the overarching concern that safety net additive as a whole does not provide the right incentives for investment in modern communications networks. It does not ensure that investment is reasonable or cost-efficient, nor does it ensure that investment is targeted to areas that would not be served absent support. For example, even if the Commission changed the rule as proposed, safety net additive could continue to allow incumbent LECs to get additional support if, for instance, they choose to build fiber-to-the-home on an accelerated basis in an area that is also served by an unsubsidized cable competitor. That said, the Commission does modify the proposed phase out of safety net additive based on the record.

173. The Commission concludes that beneficiaries of safety net additive whose total TPIS increased by more than 14 percent over the prior year at the time of their initial qualification should continue to receive such support for the remainder of their eligibility period, consistent with the original intent of the rule. For the remaining beneficiaries of safety net, the Commission finds that such support should be phased down in 2012 because such support is not being paid on the basis of significant investment in telecommunications plant. Specifically, for the latter group of beneficiaries, the safety net additive will be reduced 50 percent in 2012, and eliminated in 2013. The Commission does not provide any new safety net support for costs incurred after 2009.

6. Local Switching Support

174. *Discussion.* The Commission agrees with the Rural Associations that reforms to LSS should be integrated with reforms to ICC and the accompanying creation of a CAF to provide measured replacement of lost intercarrier revenues. The Commission continues to believe that the rationale for LSS has weakened with the advent of cheaper, more scalable switches and routers. The Commission also agrees with the Ad Hoc Telecommunications Users Committee that the LSS funding mechanism provides a disincentive for those carriers owning multiple study areas in the same state to combine those study areas, potentially resulting in inefficient, costly deployment of resources. Further, because qualification is solely based on the number of lines in the study area, LSS does not appropriately target funding to high-cost areas, nor does it target funding to areas that are unserved with broadband.

175. At the same time, the Commission recognizes that today many small companies recover a portion of the costs of their switching investment, both for circuit switches and recently purchased soft switches, through LSS. LSS is a form of explicit recovery for switching investment that otherwise would be recovered through intrastate access charges or end user rates. As such, any reductions in LSS would result in a revenue requirement flowing back to the state jurisdiction.

176. For all of these reasons, the Commission concludes that it is time to end LSS as a stand-alone universal service support mechanism, but that, as discussed in more detail in the ICC section of this R&O, limited recovery of the costs previously covered by LSS should be available pursuant to the ICC reform and the accompanying creation of an ICC recovery mechanism through the CAF. Effective July 1, 2012 the Commission will eliminate LSS as a separate support mechanism. In order to simplify the transition of LSS, beginning January 1, 2012 and until June 30, 2012, LSS payments to each eligible incumbent LEC shall be frozen at 2011 support levels subject to true-up based on 2011 operating results. To the extent that the elimination of LSS support affects incumbent LECs interstate switched access revenue requirement, the Commission addresses that issue in the ICC context.

7. Other High-Cost Rule Changes

a. Adjusted High Cost Loop Cap for 2012

177. *Discussion.* NECA projects that the high-cost loop cap will be $858 million for all rural incumbent LECs for 2012, which is $48 million less than the $906 million projected to be disbursed in 2011. Due to the elimination of HCLS for price cap companies as discussed above, the Commission is lowering the HCLS cap for 2012 by the amount of HCLS support price cap carriers would have received for 2012. The Commission resets the 2012 high-cost loop cap to the level that remaining rate-of-return carriers are projected to receive in 2012. Although price cap holding companies currently receive HCLS in a few rate-of- return study areas, as a result of the rule changes discussed above, all of their remaining rate-of-return support will be distributed through a new transitional CAF program, rather than existing mechanisms like HCLS. Accordingly, NECA is required to re-calculate the HCLS cap for 2012 after deducting all HCLS that price cap carriers and their affiliated rate-of-return study areas would have received for 2012. NECA is required to submit to the Wireline Bureau the revised 2012 HCLS cap within 30 days of the release of this R&O. NECA shall provide to the Wireline Bureau all calculations and

assumptions used in re-calculating the HCLS cap.

b. Study Area Waivers

i. Standards for Review

178. *Discussion.* The Commission concludes that the one-percent guideline is no longer an appropriate guideline to evaluate whether a study area waiver would result in an adverse effect on the fund and, therefore, eliminate the one-percent guideline in evaluating petitions for study area waiver. Therefore, on a prospective basis, the standards for evaluating petitions for study area waiver are: (1) The state commission having regulatory authority over the transferred exchanges does not object to the transfer and (2) the transfer must be in the public interest. As proposed in the *USF/ICC Transformation NPRM,* the evaluation of the public interest benefits of a proposed study area waiver will include: (1) the number of lines at issue; (2) the projected universal service fund cost per line; and (3) whether such a grant would result in consolidation of study areas that facilitates reductions in cost by taking advantage of the economies of scale, *i.e.,* reduction in cost per line due to the increased number of lines. The Commission stresses that these guidelines are only guidelines and not rigid measures for evaluating a petition for study area waiver. The Commission believes that this streamlined process will provide greater regulatory certainty and a more certain timetable for carriers seeking to invest in additional exchanges.

ii. Streamlining the Study Area Waiver Process

179. *Discussion.* To more efficiently and effectively process petitions for waiver of the study area freeze, the Commission adopts the proposal to streamline the study are waiver process. Upon receipt of a petition for study area waiver, a public notice shall be issued seeking comment on the petition. As is the usual practice, comments and reply comments will be due within 30 and 45 days, respectively, after release of the public notice. Absent any further action by the Bureau, the waiver will be deemed granted on the 60th day after the reply comment due date. Additionally, any study area waiver related waiver requests that petitioners routinely include in petitions for study area waiver and the Commission routinely grants—such as requests for waiver of 47 CFR 69.3(e)(11) (to include any acquired lines in the NECA pool) and 69.605(c) (to remain an average schedule company after an acquisition of exchanges)—will also be deemed granted on the 60th day after the reply comment due date absent any further action by the Bureau. Should the Bureau have concerns with any aspect of the petition for study area waiver or related waivers, however, the Bureau may issue a second public notice stating that the petition will not be deemed granted on the 60th day after the reply comment due date and is subject to further analysis and review.

c. Revising the ''Parent Trap'' Rule, Section 54.305

180. *Discussion.* The Commission finds that the proposed minor revision to the rule will better effectuate the intent of 47 CFR 54.305 that incumbent LECs not purchase exchanges merely to increase their high-cost universal service support and should not dissuade any transactions that are in the public interest. Therefore, effective January 1, 2012, any incumbent LEC currently and prospectively subject to the provisions of 47 CFR 54.305, that would otherwise receive no support or lesser support based on the actual costs of the study area, will receive the lesser of the support pursuant to 47 CFR 54.305 or the support based on its own costs.

181. The Commission notes that above, the Commission freezes all support under the existing high-cost support mechanisms on a study area basis for price cap carriers and their rate-of-return affiliates, at 2011 levels, effective January 1, 2012. The modification of the operation of 47 CFR 54.305 is not intended to reduce support levels for those companies; they will receive frozen high-cost support equal to the amount of support each carrier received in 2011 in a given study area, adjusted downward as necessary to the extent local rates are below the specified urban rate floor.

8. Limits on Total per Line High-Cost Support

182. *Discussion.* After consideration of the record, the Commission finds it appropriate to implement responsible fiscal limits on universal service support by immediately imposing a presumptive per-line cap on universal service support for all carriers, regardless of whether they are incumbents or competitive ETCs. For administrative reasons, the Commission finds that the cap shall be implemented based on a $250 per-line monthly basis rather than a $3,000 per-line annual basis because USAC disburses support on a monthly basis, not on an annual basis. The Commission finds that support drawn from limited public funds in excess of $250 per-line monthly (not including any new CAF support resulting from ICC reform) should not be provided without further justification.

183. This rule change will be phased in over three years to ease the potential impact of this transition. From July 1, 2012 through June 30, 2013, carriers shall receive no more than $250 per-line monthly plus two-thirds of the difference between their uncapped per-line amount and $250. From July 1, 2013 through June 30, 2014, carriers shall receive no more than $250 per-line monthly plus one-third of the difference between their uncapped per-line amount and $250. July 1, 2014, carriers shall receive no more than $250 per-line monthly.

184. The Rural Associations argue that a cap on total annual per-line high-cost support should not be imposed without considering individual circumstances and that if such a cap is imposed only on non-tribal companies located in the contiguous 48 states, about 12,000 customers would experience rate increases of $9.24 to $1,200 per month and the overall effect would reduce high-cost disbursements by less than $15 million. The Rural Associations also point out while that it is reasonable to ask whether it makes sense for USF to support extremely high per-line levels going forward, the Commission must consider the consequences of imposing such a limit on companies with high costs based on past investments.

185. The Commission emphasizes that virtually all (99 percent) of incumbent LEC study areas currently receiving support are under the $250 per-line monthly limit. Only eighteen incumbent carriers and one competitive ETC today receive support in excess of $250 per-line monthly, and as a result of the other reforms described above, the Commission estimates that only twelve will continue to receive support in excess of $250 per-line monthly.

186. The Commission also recognizes that there may be legitimate reasons why certain companies have extremely high support amounts per line. For example, some of these extremely high-cost study areas exist because states sought to ensure a provider would serve a remote area. The Commission estimates that the cap the Commission adopts today will affect companies serving approximately 5,000 customers, many of whom live in extremely remote and high-cost service territories. That is, all of the affected study areas total just 5,000 customers. Therefore, as suggested by the Rural Associations, the Commission will consider individual circumstances when applying the $250

per-line monthly cap. Any carrier affected by the $250 per-line monthly cap may file a petition for waiver or adjustment of the cap that would include additional financial data, information, and justification for support in excess of the cap using the process set forth below. The Commission does not anticipate granting any waivers of undefined duration, but rather would expect carriers to periodically re-validate any need for support above the cap. The Commission also notes that even if a carrier can demonstrate the need for funding above the $250 per-line monthly cap, they are only entitled to the amount above the cap they can show is necessary, not the amount they were previously receiving.

187. Absent a waiver or adjustment of the $250 per-line monthly cap, USAC shall commence reductions of the affected carrier's support to $250 per-line monthly six months after the effective date of these rules. This six month delay should provide an opportunity for companies to make operational changes, engage in discussions with their current lenders, and bring any unique circumstances to the Commission's attention through the waiver process. To reach the $250 per-line cap, USAC shall reduce support provided from each universal support mechanism, with the exception of LSS, based on the relative amounts received from each mechanism.

9. Elimination of Support in Areas With 100 Percent Overlap

188. *Discussion.* Providing universal service support in areas of the country where another voice and broadband provider is offering high-quality service without government assistance is an inefficient use of limited universal service funds. The Commission agrees with commenters that ''USF support should be directed to areas where providers would not deploy and maintain network facilities absent a USF subsidy, and not in areas where unsubsidized facilities-based providers already are competing for customers.'' For this reason, the Commission excludes from the CAF areas that are overlapped by an unsubsidized competitor (*see infra* Section VII.C). Likewise, the Commission does not intend to continue to provide current levels of high-cost support to rate-of-return companies where there is overlap with one or more unsubsidized competitors.

189. At the same time, the Commission recognizes that there are instances where an unsubsidized competitor offers broadband and voice service to a significant percentage of the customers in a particular study area (typically where customers are concentrated in a town or other higher density sub-area), but not to the remaining customers in the rest of the study area, and that continued support may be required to enable the availability of supported voice services to those remaining customers. In those cases, the Commission agrees with the Rural Associations that there should be a process to determine appropriate support levels.

190. Accordingly, the Commission adopts a rule to phase out all high-cost support received by incumbent rate-of-return carriers over three years in study areas where an unsubsidized competitor—or a combination of unsubsidized competitors—offers voice and broadband service at speeds of at least 4 Mbps downstream/1 Mbps upstream, and with latency and usage limits that meet the broadband performance requirements described above, for 100 percent of the residential and business locations in the incumbent's study area.

191. The *USF/ICC Transformation FNPRM* seeks comment on the methodology and data for determining overlap. Upon receiving a record on those issues, the Commission directs the Wireline Competition Bureau to publish a finalized methodology for determining areas of overlap and to publish a list of companies for which there is a 100 percent overlap. In study areas where there is 100 percent overlap, the Commission will freeze the incumbent's high-cost support at its total 2010 support, or an amount equal to $3,000 times the number of reported lines as of year end 2010, whichever is lower, and reduce such support over three years (*i.e.* by 33 percent each year). For this purpose, ''total 2010 support'' is the amount of support disbursed to carrier for 2010, without regard to prior period adjustments related to years other than 2010 and as determined by USAC on January 31, 2011. In addition, in the *USF/ICC Transformation FNPRM,* the Commission seeks comment on a process for determining support in study areas with less than 100 percent overlap.

10. Impact of These Reforms on Rate-of-Return Carriers and the Communities They Serve

192. The Commission agrees with the Rural Associations that ''there is * * * without question a need to modify certain of the existing universal service mechanism to enhance performance and improve sustainability.'' The Commission takes a number of important steps to do so in this R&O, and the Commission is careful to implement these changes in a gradual manner so that the efforts do not jeopardize service to consumers or investments made consistent with existing rules. It is essential that the Commission ensures the continued availability and affordability of offerings in the rural and remote communities served by many rate-of-return carriers. The existing regulatory structure and competitive trends have placed many small carriers under financial strain and inhibited the ability of providers to raise capital.

193. The Commission reaffirms its commitment to these communities. The Commission provides rate-of-return carriers the predictability of remaining under the legacy universal service system in the near-term, while giving notice that the Commission intends to transition to more incentive-based regulation in the near future. The Commission also provides greater certainty and a more predictable flow of revenues than the status quo through the intercarrier compensation reforms, and set a total budget to direct up to $2 billion in annual universal service (including CAF associated with intercarrier compensation reform) payments to areas served by rate-of-return carriers. The Commission believes that this global approach will provide a more stable base going forward for these carriers, and the communities they serve.

194. Today's package of universal service reforms is targeted at eliminating inefficiencies and closing gaps in the system, not at making indiscriminate industry-wide reductions. Many of the rules addressed today have not been comprehensively examined in more than a decade, and direct funding in ways that may no longer make sense in today's marketplace. By providing an opportunity for a stable 11.25 percent interstate return for rate-of-return companies, regardless of the necessity or prudence of any given investment, the current system imposes no practical limits on the type or extent of network upgrades or investment. Our system provides universal service support to both a well-run company operating as efficiently as possible, and a company with high costs due to imprudent investment decisions, unwarranted corporate overhead, or an inefficient operating structure.

195. In this R&O, the Commission takes the overdue steps necessary to address the misaligned incentives in the current system by correcting program design flaws, extending successful safeguards, ensuring basic fiscal

responsibility, and closing loopholes to ensure the rules reward only prudent and efficient investment in modern networks. Today's reforms will help ensure rate-of-return carriers retain the incentive and ability to invest and operate modern networks capable of delivering broadband as well as voice services, while eliminating unnecessary spending that unnecessarily limits funding that is available to consumers in high-cost, unserved communities.

196. Because the approach is focused on rooting out inefficiencies, these reforms will not affect all carriers in the same manner or in the same magnitude. After significant analysis, including review of numerous cost studies submitted by individual small companies and cost consultants, NECA and USAC data, and aggregated information provided by the RUS on their current loan portfolio, the Commission is confident that these incremental reforms will not endanger existing service to consumers. Further, the Commission believes strongly that carriers that invest and operate in a prudent manner will be minimally affected by this R&O.

197. Indeed, based on calendar year 2010 support levels, the analysis shows that nearly 9 out of 10 rate-of-return carriers will see reductions in high-cost universal service receipts of less than 20 percent annually, and approximately 7 out of 10 will see reductions of less than 10 percent. In fact, almost 34 percent of rate-of-return carriers will see no reductions whatsoever, and more than 12 percent of providers will see an increase in high-cost universal service receipts. This, coupled with a stabilized path for ICC, will provide the predictability and certainty needed for new investment.

198. Looking more broadly at all revenues, the Commission believes that the overall regulatory and revenue predictability and certainty for rate-of-return carriers under today's reforms will help facilitate access to capital and efficient network investment. Specifically, it is critical to underscore that legacy high-cost support is but one of four main sources of revenues for rate-of-return providers: universal service revenues account for approximately 30 percent of the typical rate-of-return carrier's total revenues. Today's action does not alter a provider's ability to collect regulated or unregulated end-user revenues, and comprehensively reforms the fourth main source of revenues, the intercarrier compensation system. Importantly, ICC reforms will provide rate-of-return carriers with access to a new explicit recovery mechanism in CAF, offering a source of stable and certain revenues that the current intercarrier system can no longer provide. Taking into account these other revenue streams, and the complete package of reforms, the Commission believes that rate-of-return carriers on the whole will have a stronger and more certain foundation from which to operate, and, therefore, continue to serve rural parts of America.

199. The Commission is, therefore, equally confident that these reforms, while ensuring significant overall cost savings and improving incentives for rational investment and operation by rate-of-return carriers, will in general not materially impact the ability of these carriers to service their existing debt. Based on an analysis of the reform proposals in the Notice, RUS projects that the Times Interest Earned Ratio (TIER) for some borrowers could fall below 1.0, which RUS considers a minimum baseline level for a healthy borrower. However, the package of reforms adopted in this R&O is more modest than the set proposed in the Notice. In addition, companies may still have positive cash flow and be able to service their debt even with TIERs of less than 1.0. Indeed of the 444 RUS borrowers in 2010, 75 (17 percent) were below TIER 1.0. Moreover, whereas RUS assumed that all USF reductions directly impact borrowers' bottom lines, in fact the Commission expects many borrowers affected by the reforms will be able to achieve operational efficiencies to reduce operating expenses, for instance, by sharing administrative or operating functions with other carriers, and thereby offset reductions in universal service support.

200. The Commission, therefore, rejects the sweeping argument that the rule changes the Commission adopts today would unlawfully necessarily affect a taking. Commenters seem to suggest that they are entitled to continued USF support as a matter of right. Precedent makes clear, however, that carriers have no vested property interest in USF. To recognize a property interest, carriers must ''have a legitimate claim of entitlement to'' USF support. Such entitlement would not be established by the Constitution, but by independent sources of law. 47 U.S.C. 254 does not expressly or impliedly provide that particular companies are entitled to ongoing USF support. Indeed, there is no statutory provision or Commission rule that provides companies with a vested right to continued receipt of support at current levels, and the Commission is not aware of any other, independent source of law that gives particular companies an entitlement to ongoing USF support. Carriers, therefore, have no property interest in or right to continued USF support.

201. Additionally, carriers have not shown that elimination of USF support will result in confiscatory end-user rates. To be confiscatory, government-regulated rates must be so low that they threaten a regulated entity's ''financial integrity'' or ''destroy the value'' of the company's property. Carriers face a ''heavy burden'' in proving confiscation as a result of rate regulation. To the extent that any rate-of-return carrier can effectively demonstrate that it needs additional support to avoid constitutionally confiscatory rates, the Commission will consider a waiver request for additional support. The Commission will seek the assistance of the relevant state commission in review of such a waiver to the extent that the state commission wishes to provide insight based on its understanding of the carrier's activities and other circumstances in the state. The Commission does not expect to routinely grant requests for additional support, but this safeguard is in place to help protect the communities served by rate-of-return carriers.

D. Rationalizing Support for Mobility

202. Mobile voice and mobile broadband services are increasingly important to consumers and to our nation's economy. Given the important benefits of and the strong consumer demand for mobile services, ubiquitous mobile coverage must be a national priority. Yet despite growth in annual funding for competitive ETCs of almost 1000 percent over the past decade, there remain many areas of the country where people live, work, and travel that lack any mobile voice coverage, and still larger geographic areas that lack current generation mobile broadband coverage. To increase the availability of current generation mobile broadband, as well as mobile voice, across the country, universal service funding for mobile networks must be deployed in a more targeted and efficient fashion than it is today.

203. With the R&O, the Commission adopts reforms that will secure funding for mobility directly, rather than as a side-effect of the competitive ETC system, while rationalizing how universal service funding is provided to ensure that it is cost-effective and targeted to areas that require public funding to receive the benefits of mobility.

204. To accomplish the universal service goal of ubiquitous availability of mobile services, the Commission establishes the Mobility Fund. The first

phase of the Mobility Fund will provide one-time support through a reverse auction, with a total budget of $300 million, and will provide the Commission with experience in running reverse auctions for universal service support. The Commission expects to distribute this support as quickly as feasible, with the goal of holding an auction in 2012, with support beginning to flow no later than 2013. As part of this first phase, the Commission also designates an additional $50 million for one-time support for advanced mobile services on Tribal lands, for which the Commission expects to hold an auction in 2013. The second phase of the Mobility Fund will provide ongoing support for mobile service with the goal of holding the auction in the third quarter of 2013 and support disbursed starting in 2014, with an annual budget of $500 million. This dedicated support for mobile service supplements the other competitive bidding mechanisms under the CAF.

1. Mobility Fund Phase I

a. Overall Design of Mobility Fund Phase I

i. Legal Authority

205. In other parts of the R&O, the Commission discussed its authority to provide universal service funding to support the provision of voice telephony services. The Commission explained that, pursuant to its statutory authority, it may require that universal service support be used to ensure the deployment of broadband networks capable of offering not only voice telephony services, but also advanced telecommunications and information services, to all areas of the nation, as contemplated by the principles set forth in 47 U.S.C. 254(b). In this section of the R&O, the Commission applies the legal analysis of its statutory authority to the establishment of Phase I and II of the Mobility Fund.

206. As an initial matter, it is wholly apparent that mobile wireless providers offer ''voice telephony services'' and thus offer services for which federal universal support is available. Furthermore, wireless providers have long been designated as ETCs eligible to receive universal service support. Nonetheless, a number of parties responding to the *Mobility Fund NPRM,* 75 FR 67060, November 1, 2010, question the Commission's authority to establish the Mobility Fund as described below. The Commission rejects those arguments.

207. First, the Commission rejects the argument that it may not support mobile networks that offer services other than the services designated for support under 47 U.S.C. 254. Under its longstanding ''no barriers'' policy, the Commission allows carriers receiving high-cost support ''to invest in infrastructure capable of providing access to advanced services'' as well as supported voice services. Moreover, 47 U.S.C. 254(e)'s reference to ''facilities'' and ''services'' as distinct items for which federal universal service funds may be used demonstrates that the federal interest in universal service extends not only to supported services, but also the nature of the facilities over which they are offered. Specifically, the Commission has an interest in promoting the deployment of the types of facilities that will best achieve the principles set forth in 47 U.S.C. 254(b) (and any other universal service principle that the Commission may adopt under 47 U.S.C. 254(b)(7)), including the principle that universal service program be designed to bring advanced telecommunications and information services to all Americans, at rates and terms that are comparable to the rates and terms enjoyed in urban areas. Those interests are equally strong in the wireless arena. The Commission thus concludes that USF support may be provided to networks, including 3G and 4G wireless services networks, that are capable of providing additional services beyond supported voice services.

208. For similar reasons, the Commission rejects arguments made by MetroPCS, NASUCA, and US Cellular that the Mobility Fund would impermissibly support an ''information service;'' by Free Press and the Florida Commission that establishment of the Mobility Fund would violate 47 U.S.C. 254 because mobile data service is not a supported service; and by various parties that 47 U.S.C. 254(c)(1) prohibits funding for services to which a substantial majority of residential customers do not subscribe. All of these arguments incorrectly assume that the Mobility Fund will be used to support mobile data service as a supported service in its own right. To the contrary, the Mobility Fund will be used to support the provision of ''voice telephony service'' and the underlying mobile network. That the network will also be used to provide information services to consumers does not make the network ineligible to receive support; to the contrary, such use directly advances the policy goals set forth in 47 U.S.C. 254(b), the new universal service principle recommended by the Joint Board, as well as 47 U.S.C. 1302.

209. The Commission also rejects the argument that the Mobility Fund violates the principle in 47 U.S.C. 254(b)(5) that ''[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.'' The Commission disagrees with commenters argue that non-recurring funding won in a reverse auction is not ''predictable'' because the final amount of support is not known in advance of the bidding or ''sufficient'' because non-recurring funding will not meet recurring costs. The terms ''predictable'' and ''sufficient'' modify ''Federal and State mechanisms.'' Reverse auction rules establish a predictable mechanism to support universal service in that the carrier receiving support has notice of its rights and obligations before it undertakes to fulfill its universal service obligations. Moreover, this interpretation of the statute was upheld by the Fifth Circuit's decision in *Alenco Communications* v. *FCC,* 201 F.3d 608 (5th Cir 2000).

210. The mechanism adopted in the R&O is also ''sufficient.'' The auction process is effectively a self-selecting mechanism: Bidders are presumed to understand that Mobility Fund Phase I will provide one-time support, that bidders will face recurring costs when providing service, and that they must tailor their bid amounts accordingly. The Commission declines to interpret the ''sufficiency'' requirement so broadly as to require it to guarantee that carriers who receive support make the correct business judgments in deciding how to structure their bids or their service offerings to consumers.

211. The Commission also disagrees with Cellular South's contention that ''by collecting USF contributions from all ETCs and awarding distributions to only a limited set of ETCs, support auctions would transform the Fund into an unconstitutional tax.'' As the Supreme Court explained in *United States* v. *Munoz-Flores,* 495 U.S. 385, 398 (1990), ''a statute that creates a particular governmental program and that raises revenue to support that program, as opposed to a statute that raises revenue to support Government generally, is not a 'Bil[l] for raising Revenue' within the meaning of the Origination Clause.'' This analysis clearly applies to the sections of the Telecommunications Act of 1996 authorizing the Universal Service Fund, including the Mobility Fund. Moreover, the Commission concludes that the Fifth Circuit's analysis of this issue in *Texas Office of Public Utility Counsel et al* v. *FCC,* 183 F.3d 393, 428 (5th Cir. 1999), with respect to paging carriers applies equally to all carriers. As that court explained: ''universal service contributions are part of a particular

program supporting the expansion of, and increased access to, the public institutional telecommunications network. Each paging carrier directly benefits from a larger and larger network and, with that in mind, Congress designed the universal service scheme to exact payments from those companies benefiting from the provision of universal service.'' Finally, there is always likely to be a disparity between the contributions parties make to the USF and the amounts that they receive from the USF. Indeed, 47 U.S.C. 254(d) requires contributions from ''every telecommunications carrier that provides interstate telecommunications services,'' not just ETCs or funding recipients.

ii. Size of Mobility Fund Phase I

212. The Commission concludes that $300 million is an appropriate amount for one-time Mobility Fund Phase I support, and is consistent with the goal of swiftly extending current generation wireless coverage in areas where it is cost effective to do so with one-time support. The Commission believes that there are unserved areas for which such support will be useful, and that competition among wireless carriers for support to serve these areas will be sufficient to ensure that the available funds are distributed efficiently and effectively. The Commission concludes that a one-time infusion of $300 million should be sufficient to enable the deployment of 3G or better mobile broadband to many of the areas where such services are unavailable, while at the same time ensuring adequate universal service monies are available for other priorities, including broader reform initiatives to address ongoing support.

iii. Basic Structure for Mobility Fund Phase I

213. The Commission declines to adopt the structure of the current competitive ETC rules, which provide support for multiple providers in an area. That structure has led to duplicative investment by multiple competitive ETCs in certain areas at the expense of investment that could be directed elsewhere, including areas that are not currently served. Therefore, as a general matter, the Commission should not award Mobility Fund Phase I support to more than one provider per area unless doing so would increase the number of units (road miles) served, as is possible with partially overlapping bids. Priority in awarding USF support should be to expand service; permitting multiple winners as a routine matter in any geographic area to serve the same pool of customers would drain Mobility Fund resources with limited corresponding benefits to consumers. In certain limited circumstances, however, the most efficient use of resources may result in small overlaps in supported service. Thus, the Commission delegates to the Bureaus, as part of the auctions procedures process, the question of the circumstances, if any, in which to allow overlaps in supported service to permit the widest possible coverage given the overall budget.

214. While 47 U.S.C. 214(e) allows the states to designate more than one provider as an eligible telecommunications provider in any given area, nothing in the statute compels the states (or this Commission) to do so; rather, the states (and this Commission) must determine whether that is in the public interest. Likewise, nothing in the statute compels that every party eligible for support actually receive it.

215. In the past, the Commission concluded that universal service subsidies should be portable, and allowed multiple competitive ETCs to receive support in a given geographic area. Based on the experience of a decade, however, this prior policy of supporting multiple networks may not be the most effective way of achieving universal service. In this case, the Commission chooses not to subsidize competition through universal service in areas that are challenging for even one provider to serve. Given that Mobility Fund Phase I seeks to expand the availability of current and next generation services, it will be used to offer services where no provider currently offers such service. The public interest is best served by maximizing the expansion of networks into currently unserved communities given the available budget, which will generally result in providing support to no more than one provider in a given area.

216. Participation in Mobility Fund Phase I, however, is conditioned on collocation and data roaming obligations designed to minimize anticompetitive behavior. Recipients must also provide services with Mobility Fund Phase I support at reasonably comparable rates. These obligations should help address the concerns of those that argue for continued support of multiple providers in a particular geographic area and further the goal to ensure the widest possible reach of Phase I of the Mobility Fund.

iv. Auction To Determine Awards of Support

217. The goal of Mobility Fund Phase I is to extend the availability of mobile voice service on networks that provide 3G or better performance and to accelerate the deployment of 4G wireless networks in areas where it is cost effective to do so with one-time support. The purpose of the mechanism the Commission chooses is to identify those areas where additional investment can make as large a difference as possible in improving current-generation mobile wireless coverage. The Commission adopts a reverse auction format because it believes such a format is the best available tool for identifying such areas—and associated support amounts—in a transparent, simple, speedy, and effective way. In such a reverse auction, bidders are asked to indicate the amount of one-time support they would require to achieve the defined performance standards for specified numbers of units in given unserved areas. A reverse auction is the best way to achieve the Commission's overall objective of maximizing consumer benefits given the available funds.

218. Objections to using a competitive bidding mechanism largely challenge or misunderstand the goals of the instant proposal. Mobility Fund Phase I is focused solely on identifying recipients that can extend coverage with one-time support. Phase I has a limited and targeted purpose and is not intended to ensure that the highest cost areas receive support. Those issues are addressed separately in the sections of the R&O discussing Mobility Fund Phase II and other aspects of CAF, as well as in the *USF/ICC Transformation FNPRM.*

219. Others contend that funding will be directed to areas that will be built out with private investment even without support. The goal in establishing the Mobility Fund, however, is to provide the necessary ''jump start'' to accelerate service to areas where it is cost effective to do so. The Commission will also exclude from auction those areas where a provider has made a regulatory commitment to provide 3G or better wireless service, or has received a funding commitment from a federal executive department or agency in response to the carrier's commitment to provide 3G or better service. Taken together, these measures provide sufficient safeguards to exclude funding for areas that would otherwise be built with private investment in the near term.

220. *Delegation of Authority.* The Commission delegates to the Bureaus authority to administer the policies, programs, rules and procedures to implement Mobility Fund Phase I. In addition to the specific tasks noted elsewhere in the R&O, such as identifying areas eligible for Mobility Fund support and the number of units associated with each, this delegation includes all authority necessary to conduct a Mobility Fund Phase I auction and conduct program administration and oversight consistent with the policies and rules adopted in the R&O.

v. Identifying Unserved Areas Eligible for Support

(a) Using Census Blocks To Identify Unserved Areas

221. The Commission will identify areas eligible for Mobility Fund Phase I support at the census block level. Such a granular review will allow the Commission to identify unserved areas with greater accuracy than if it used larger areas. Although census blocks, particularly in rural areas, may include both served and unserved areas, it is not feasible to identify unserved areas on a more granular level for Mobility Fund Phase I, since as noted, census blocks are the smallest unit for which the Census Bureau provides data.

(b) Identifying Unserved Census Blocks

(i) Using American Roamer Data

222. American Roamer data is the best available choice at this time for determining wireless service at the census-block level. American Roamer data is recognized as the industry standard for the presence of service, although commenters note that the data may not be comprehensive and accurate in all cases. The Bureaus will exercise their delegated authority to use the most recent American Roamer data available in advance of a Phase I auction in 2012. In so doing, they should use the data to determine the geographic coverage of networks using EV–DO, EV–DO Rev A, UMTS/HSPA, or better technologies. In identifying unserved census blocks, the Commission will exclude census blocks that are served by 3G or better service. Better than 3G service would include any 4G technologies, including, for example, HSPA+ or LTE.

223. Some commenters to the *Mobility Fund NPRM* observe that American Roamer data relies on reporting by existing providers and therefore may tend to over-report the extent of existing coverage. While the Commission intends to be as accurate as possible in determining the extent of coverage, perfect information is not available, and the Commission knows of no data source that is more reliable than American Roamer, nor does the record reflect any other viable options.

224. Several commenters note that the potential for error is unavoidable and therefore advocate that some provision be made for outside parties to appeal or initiate a review of the initial coverage determination for a particular area. The Commission will, within a limited timeframe only, entertain challenges to its determinations regarding unserved geographic areas for purposes of Mobility Fund Phase I. Specifically, the Commission will make public a list of unserved areas as part of the pre-auction process and afford parties a reasonable opportunity to respond by demonstrating that specific areas identified as unserved are actually served and/or that additional unserved areas should be included. The Commission's goal is to accelerate expanded availability of mobile voice service over current-generation or better networks by providing one-time support from a limited source of funds, and any more extended pre-auction review process might risk undue delay in making any support available. Providing for post-auction challenges would similarly inject uncertainty and delay into the process. It is important to provide finality prior to the auction with respect to the specific unserved census blocks eligible for support. Accordingly, the Bureaus will finalize determinations with respect to which areas are eligible for support in a public notice establishing final procedures for a Mobility Fund Phase I auction.

(ii) Other Service-Related Factors

225. The Commission will not consider the presence in a census block of voice or broadband services over non-mobile networks in determining which census blocks are unserved. Mobile services provide benefits, consistent with, and in furtherance of the principles of 47 U.S.C. 254, not offered by fixed services. The ability to communicate from any point within a mobile network's coverage area lets people communicate at times when they may need it most, including during emergencies. The fact that fixed communications may be available nearby does not detract from this critical benefit. Moreover, the Internet access provided by current and next generation mobile networks renders them qualitatively different from existing voice-only mobile networks. Current and next generation networks offer the ability to tap resources well beyond the resources available through basic voice networks. Accordingly, in identifying blocks eligible for Mobility Fund support, the Commission will not consider whether voice and/or broadband services are available using non-mobile technologies or pre-3G mobile wireless technologies.

226. To help focus Mobility Fund Phase I support toward unserved locations where it will have the most significant impact, the Commission provides that support will not be offered in areas where, notwithstanding the current absence of 3G wireless service, any provider has made a regulatory commitment to provide 3G or better wireless service, or has received a funding commitment from a federal executive department or agency in response to the carrier's commitment to provide 3G or better wireless service.

227. To implement this decision, the Commission will require that all wireless competitive ETCs that receive USF high cost support, under either legacy or reformed programs, as well as all parties that seek Mobility Fund support, review the list of areas eligible for Mobility Fund support when published by the Commission and identify any areas with respect to which they have made a regulatory commitment to provide 3G or better wireless service or received a federal executive department or agency funding commitment in exchange for their commitment to provide 3G or better wireless service. A regulatory commitment ultimately may not result in service to the area in question. Nevertheless, given the limited resources provided for Mobility Fund Phase I and the fact that the commitments were made in the absence of any support from the Mobility Fund, it would not be an appropriate use of available resources to utilize Mobility Fund support in such areas.

(iii) Using Centroid Method

228. The Commission will consider any census block as unserved, if the American Roamer data indicates that the geometric center of the block—referred to as the centroid—is not covered by networks using EV–DO, EV–DO Rev A, or UMTS/HSPA or better. Employing the centroid method is relatively simple and straightforward, and will be an effective method for determining whether a block is uncovered. The centroid method is an administratively simple and efficient approach that, when used here, will permit the Commission to begin distributing this support without undue delay.

(c) Offering Support for Unserved Areas by Census Block

229. The census block should be the minimum geographic building block for defining areas for which support is provided. Using census blocks as the minimum geographic area gives the Commission and bidders more flexibility to tailor their bids to their business plans. Because census blocks are numerous and can be quite small, the Commission will need to provide at the auction for the aggregation of census blocks for purposes for bidding. Therefore, the Commission delegates to the Bureaus, as part of the auctions procedures process, the task of deciding whether to provide a minimum area for bidding comprised of an aggregation of eligible census blocks or whether to permit bidding on individual census blocks and provide bidders with the opportunity to make ''all-or-nothing'' package bids on combinations of census blocks. Package bidding procedures could specify certain predefined packages, or could provide bidders greater flexibility in defining their own areas, comprised of census blocks. However, any aggregation, whether predetermined by the Bureaus or defined by bidders, should not exceed the bounds of one Cellular Market Area (CMA).

230. The unique circumstances raised by the large size of census areas in Alaska may require that bidding be permitted on individual census blocks, rather than a larger pre-determined area, such as a census tract or block group. In Alaska, the average census block is more than 50 times the size of the average census block in the other 49 states and the District of Columbia, such that the large size of census areas poses distinctive challenges in identifying unserved communities and providing service.

(d) Establishing Unserved Units

231. The Commission will use the number of linear road miles—rather than population, as proposed in the *Mobility Fund NPRM*—as the basis for calculating the number of units in each unserved census block. This decision is based on a number of factors. First, requiring additional coverage of road miles more directly reflects the Mobility Fund's goal of extending current generation *mobile* services. Using road miles, rather than population, as a unit for bids and awards of support is also more consistent with the Commission's decision to measure mobile broadband service based on drive tests and to require coverage of a specified percentage of road miles. Moreover, using per-road mile bids as a basis for awarding support implicitly will take into account many of the other factors that commenters argue are important—such as business locations, recreation areas, and work sites—since roads are used to access those areas. Because bidders are likely to take potential roaming and subscriber revenues into account when deciding where to bid for support under Mobility Fund Phase I, support will tend to be disbursed to areas where there is greater traffic, even without our factoring traffic into the number of road mile units. Further, using road miles as the basic unit for the Mobility Fund Phase I will be relatively simple to administer, since standard nationwide data exists for road miles, as it does for population. In both cases, the data can be disaggregated to the census block level.

232. The TIGER road miles data made available by the Census Bureau can be used to establish the road miles associated with each census block eligible for Mobility Fund Phase I support. TIGER data is comprehensive and consistent nationwide, and available at no cost. As with the standard for identifying census blocks that will be eligible for Phase I support, the Bureaus will, in the pre-auction process, establish the road miles associated with each and identify the specific road categories considered—for example, interstate highways, *etc.*—to be consistent with the performance requirements and with the goal of extending coverage to the areas where people live, work, and travel.

(e) Distributing Mobility Fund Phase I Support Among Unserved Areas

233. The Commission creates a separate Mobility Fund Phase I to support the extension of current generation wireless service in Tribal lands. For both general and Tribal Mobility Fund Phase I support, providers seeking to serve Tribal lands must engage with the affected Tribal governments, where appropriate. The Commission will also provide a bidding credit for Tribally-owned and controlled providers seeking to serve Tribal lands with which they are associated. Apart from these provisions, the Commission concludes that it should not attempt to prioritize within the areas otherwise eligible for support from Phase I.

(ii) Public Interest Obligations

(a) Mobile Performance Requirements

234. In addition to the public interest obligations applicable to all recipients of CAF support, mobile service providers receiving non-recurring Mobility Fund Phase I support will be obligated to provide supported services over a 3G or better network that has achieved particular data rates under particular conditions. Specifically, Phase I recipients will be required to specify whether they will be deploying a network that meets 3G requirements or 4G requirements in areas eligible for support as those requirements are detailed here.

235. Recognizing the unavoidable variability of mobile service within a covered area, the Commission proposed and adopted performance standards that will adopt a strong floor for the service provided. Consequently, many users may receive much better service when, for example, accessing the network from a fixed location or when close to a base station. In light of this fact, and the decision to permit providers to elect whether to provide 3G or 4G service, the Commission is adopting different speeds than originally proposed for those providing 3G, while retaining the original proposal for those that offer 4G.

236. For purposes of meeting a commitment to deploy a 3G network, providers must offer mobile transmissions to and from the network meeting or exceeding an outdoor minimum of 200 kbps downstream and 50 kbps upstream to handheld mobile devices.

237. Recipients that commit to provide supported services over a network that represents the latest generation of mobile technologies, or 4G, must offer mobile transmissions to and from the network meeting or exceeding the following minimum standards: outdoor minimum of 768 kbps downstream and 200 kbps upstream to handheld mobile devices.

238. For both 3G and 4G networks, the data rates should be achievable in both fixed and mobile conditions, at vehicle speeds consistent with typical speeds on the roads covered. These minimum standards must be achieved throughout the cell area, including at the cell edge.

239. With respect to latency, in order to assure that recipients offer service that enables the use of real-time applications such as VoIP, the Commission also requires that round trip latencies for communications over the network be low enough for this purpose.

240. With respect to capacity, the Commission declines at this time to adopt a specific minimum capacity requirement that supported providers must offer mobile broadband users. However, any usage limits imposed by a provider on its mobile broadband offerings supported by the Mobility

Fund must be reasonably comparable to any usage limits for comparable mobile broadband offerings in urban areas.

241. Recipients that elect to provide supported services over 3G networks will have two years to meet their requirements and those that elect to deploy 4G networks will have three years. At the end of the applicable period for build-out, providers will be obligated to provide the service defined above in the areas for which they receive support, over at least 75 percent of the road miles associated with census blocks identified as unserved by the Bureaus in advance of the Mobility Fund Phase I auction. The Commission delegates to the Bureaus the question of whether a higher coverage threshold should be required should the Bureaus permit bidding on individual census blocks. A higher coverage threshold may be appropriate in such circumstances because bidders can choose the particular census blocks they can cover. Presumably, this would allow them to choose areas in which their coverage can be 95 to 100 percent, as suggested by the *Mobility Fund NPRM.*

242. Should the Bureaus choose to implement a coverage area requirement of less than 100 percent, a recipient will receive support only for those road miles actually covered and not for the full 100 percent of road miles of the census blocks or tracts for which it is responsible. For example, if a recipient covers 90 percent of the road miles in the minimum geographic area (and it meets the threshold), then that recipient will receive 90 percent of the total support available for that area. To the extent that a recipient covers additional road miles, it will receive support in an amount based on its bid per road mile up to 100 percent of the road miles associated with the specific unserved census blocks covered by a bid.

243. In contrast to other support provided under CAF, support provided through Mobility Fund Phase I will be non-recurring. Consequently, the Commission does not plan to modify the service obligations of providers that receive Phase I support.

(b) Measuring and Reporting Mobile Broadband

244. As proposed in the *Mobility Fund NPRM,* Mobility Fund support recipients must demonstrate that they have deployed a network that covers the relevant area and meets their public interest obligations with data from drive tests. The drive test data satisfying the requirements must be submitted by the deadline for providing the service. Drive test data must also be submitted to demonstrate the recipient has met the 50 percent minimum coverage requirement to receive the second payment of Mobility Fund Phase I support.

245. The requirement regarding drive tests demonstrating data speeds ''to the network'' means to the physical location of core network equipment, such as the mobile switching office or the evolved packet core. Therefore, a test server utilized to conduct drive tests should be at such a central location rather than at a base station, so that the drive test results take into account the effect of backhaul on communication speeds.

(c) Collocation

246. Recipients of Mobility Fund support must allow for reasonable collocation by other providers of services that would meet the technological requirements of the Mobility Fund on newly constructed towers that Mobility Fund recipients own or manage in the unserved area for which they receive support. This includes a duty: (1) To construct towers where reasonable in a manner that will accommodate collocations; and (2) to engage in reasonable negotiations on a not unreasonably discriminatory basis with any party that seeks to collocate equipment at such a site in order to offer service that would meet the technological requirements of the Mobility Fund. Furthermore, Mobility Fund recipients must not enter into arrangements with third parties for access to towers or other siting facilities wherein the Mobility Fund recipients restrict the third parties from allowing other providers to collocate on their facilities.

247. These collocation requirements are in the public interest because they will help increase the benefits of the expanded coverage made possible by the Mobility Fund, by facilitating service that meets the requirements of the Mobility Fund by providers using different technologies. Mobility Fund recipients will not be required to favor providers of services that meet Mobility Fund requirements over other applicants for limited collocation spaces.

248. The Commission agrees with those commenters that attempting to specify collocation practices that are applicable in all circumstances may unduly complicate efforts to expand coverage, and thus declines to adopt more specific requirements for collocation by any specific number of providers or require any specific terms or conditions as part of any agreement for collocation.

(d) Voice and Data Roaming

249. Recipients of Mobility Fund support must comply with the Commission's voice and data roaming requirements on networks that are built through Mobility Fund support. Specifically, recipients of Mobility Fund support must provide roaming pursuant to 47 CFR 20.12 on networks that are built through Mobility Fund support.

250. Some commenters responding to the *Mobility Fund NPRM* contend that there is no need to adopt a data roaming requirement specifically for Mobility Fund recipients because the Commission's general data roaming rules already address the issue or that such a requirement is unrelated to the goals of the Mobility Fund. Making compliance with these rules a condition of universal service support, however, will mean that violations can result in the withholding or clawing back of universal service support—sanctions based on the receipt of federal support—that would be in addition to penalties for violation of the Commission's generally applicable data roaming rules. Moreover, in addition to the sanctions that would apply to any party violating the general requirements, Mobility Fund recipients may lose their eligibility for future Mobility Fund participation as a consequence of any violation. Recipients shall comply with these requirements without regard to any judicial challenge thereto.

251. Consistent with the R&O, any interested party may file a formal or informal complaint using the Commission's existing processes if it believes a Mobility Fund recipient has violated the Commission's roaming requirements. As noted, the Commission intends to address roaming-related disputes expeditiously. The Commission also has the authority to initiate enforcement actions on its own motion.

(e) Reasonably Comparable Rates

252. The Commission will evaluate the rates for services offered with Mobility Fund Phase I support based on whether they fall within a reasonable range of urban rates for mobile service. To implement the statutory principle regarding comparable rates while offering Mobility Fund Phase I support at the earliest time feasible, the Bureaus may develop target rate(s) for Mobility Fund Phase I before fully developing all the data to be included in a determination of comparable rates with respect to other CAF support. Mobility Fund Phase I recipients must certify annually that they offer service in areas with support at rates that are within a

reasonable range of rates for similar service plans offered by mobile wireless providers in urban areas. Recipients' service offerings will be subject to this requirement for a period ending five years after the date of award of support. The Bureaus, under their delegated authority, may define these conditions more precisely in the pre-auction process. The Commission will retain its authority to look behind recipients' certifications and take action to rectify any violations that develop.

b. Mobility Fund Phase I Eligibility Requirements

253. The Commission proposed that to be eligible for Mobility Fund support, entities must (1) be designated as a wireless ETC pursuant to 47 U.S.C. 214(e) by the state public utilities commission (''PUC'') (or the Commission, where the state PUC does not have jurisdiction to designate ETCs) in any area that it seeks to serve; (2) have access to spectrum capable of 3G or better service in the geographic area to be served; and (3) certify that it is financially and technically capable of providing service within the specified timeframe. With a limited exception, the Commission adopts these requirements.

254. The Commission also adopts a two-stage application filing process for participants in the Mobility Fund Phase I auction, similar to that used in spectrum license auctions, which will, among other things, require potential Mobility Fund recipients to make disclosures and certifications establishing their eligibility. Specifically, in the pre-auction ''short-form'' application, a potential bidder will need to establish its eligibility to participate in the Mobility Fund Phase I auction and, in a post-auction ''long-form'' application, a winning bidder will need to establish its eligibility to receive support. Such an approach should provide an appropriate screen to ensure serious participation without being unduly burdensome.

(i) ETC Designation

255. Mobility Fund Phase I participants must be ETCs prior to participating in the auction. As a practical matter, this means that parties that seek to participate in the auction must be ETCs in the areas for which they will seek support at the deadline for applying to participate in the auction. As discussed elsewhere in the R&O, the Commission provides a narrow exception to permit participation by Tribally-owned or controlled entities that have filed for ETC designation prior to the short-form application deadline. An ETC must be designated (or have applied for designation under the exception) with respect to an area that includes area(s) on which it wishes to receive Mobility Fund support. Moreover, a recipient of Mobility Fund support will remain obligated to provide supported services throughout the area for which it is designated an ETC if that area is larger than the areas for which it receives Mobility Fund support.

256. By statute, the states, along with the Commission, are empowered to designate common carriers as ETCs. In light of the roughly comparable amounts of time required for the Commission and states to process applications to be designated as an ETC and the time required to move from the adoption of the R&O to the acceptance of applications to participate in a Mobility Fund Phase I auction, parties contemplating requesting new designations as ETCs for purposes of participating in the auction should act promptly to begin the process. The Commission will make every effort to process such applications in a timely fashion, and it urges the states to do likewise.

257. The Commission retains existing ETC requirements and obligations, in addition to requiring that parties be ETCs in the area in which they seek Mobility Fund support. It is sufficient for purposes of an application to participate in the Mobility Fund Phase I auction, however, that the applicant has received its ETC designation conditioned only upon receiving Mobility Fund Phase I support.

258. The Commission generally will not allow parties to bid for support prior to being designated an ETC because such an approach would inject uncertainties as to eligibility that could interfere with speedy deployment of networks by those that are awarded support, or disrupt the Mobility Fund auction. Moreover, requiring that applicants be designated as ETCs prior to a Mobility Fund Phase I auction may help ensure that the pool of bidders is serious about seeking support and meeting the obligations that receipt of support would entail.

(ii) Access to Spectrum

259. Any applicant for a Mobility Fund Phase I auction must have access to the necessary spectrum to fulfill any obligations related to support. Thus, those eligible for Mobility Fund Phase I support include all entities that, prior to an auction, hold a license authorizing use of appropriate spectrum in the geographic area(s) for which support is sought. The spectrum access requirement can also be met by leasing appropriate spectrum, prior to an auction, covering the relevant geographic area(s). Spectrum access through a license or leasing arrangement must be in effect prior to auction for an applicant to be eligible for an award of support. Regardless of whether an applicant claims required access to spectrum through a license or a lease, it must retain such access for at least five years from the date of award of Phase I support. For purposes of calculating term length, parties may include opportunities for license and/or lease renewal.

260. Further, parties may satisfy the spectrum access requirement if they have acquired spectrum access, including any necessary renewal expectancy, that is contingent on their obtaining support in the auction. Other contingencies, however, will render the relevant spectrum access insufficient for the party to meet the Commission's requirements for participation.

261. Entities seeking to receive support from the Mobility Fund must certify that they have access to spectrum capable of supporting the required services. While the Commission declines to restrict the frequencies applicants must use to be eligible for Mobility Fund Support, certain spectrum bands will not support mobile broadband (for example, paging service). Applicants will be required to identify the particular frequency bands and the nature of the access on which they assert their eligibility for support, and the Commission will assess the reasonableness of eligibility certifications based on information submitted in short- and long-form applications. Should entities make this certification and not have access to the appropriate level of spectrum, they will be subject to the penalties described elsewhere in the R&O.

(iii) Certification of Financial and Technical Capability

262. Each applicant for Mobility Fund Phase I support must certify, in its pre-auction short-form application and in its post-auction long-form application, that it is financially and technically capable of providing 3G or better service within the specified timeframe in the geographic areas for which it seeks support. Given that Mobility Fund Phase I provides non-recurring support, applicants for Phase I funds need to assure the Commission that they can provide the requisite service without any assurance of ongoing support for the area in question after Phase I support has been exhausted.

263. Applicants making certifications to the Commission expose themselves to

liability for false certifications. Applicants should take care to review their resources and their plans before making the required certification and be prepared to document their review, if necessary.

(iv) Other Qualifications

264. The Commission will not impose any additional eligibility requirements to participation in the Mobility Fund, with one exception. One commenter to the Mobility Fund NPRM questions whether the Mobility Fund should be available to parties in particular areas if the party previously (that is, without respect to Mobility Fund support) indicated an intention to deploy wireless voice and broadband service in that area. The Commission concludes that this concern has merit and it will restrict parties from bidding for support in certain limited circumstances to assure that Mobility Fund Phase I support does not go to finance coverage that carriers would have provided in the near term without any subsidy. In particular, an applicant for Mobility Fund Phase I support must certify that it will not seek support for any areas in which it has made a public commitment to deploy 3G or better wireless service by December 31, 2012. This restriction will not prevent a provider from seeking and receiving support for a geographic area where another carrier has announced such a commitment to deploy 3G or better, but it may conserve funds and avoid displacing private investment by making a carrier that made such a commitment ineligible for Mobility Fund Phase I support with respect to the identified geographic area(s). Because circumstances are more likely to change over a longer term, providers should not be held to statements for any time period beyond December 31, 2012.

c. Reverse Auction Mechanism

265. In the R&O, the Commission establishes program and auction rules for the Mobility Fund Phase I, to be followed by a process conducted by the Bureaus on delegated authority identifying areas eligible for support, and seeking comment on specific detailed auction procedures to be used, consistent with the R&O. This process will be initiated by the release of a Public Notice announcing an auction date, to be followed by a subsequent Public Notice specifying the auction procedures, including dates, deadlines, and other details of the application and bidding process.

(i) Basic Auction Design

266. A single-round sealed bid format appears to be most appropriate for a Mobility Fund Phase I reverse auction, although the Commission does not make a final determination in the R&O, but delegates such determination to the Bureaus, to be addressed in the pre-auction development of specific procedures.

(ii) Application Process

267. The Commission adopts a two-stage application process. In the first stage Mobility Fund auction short-form application, each auction applicant must provide information to establish its identity, including disclosure of parties with ownership interests, consistent with the ownership interest disclosure required in 47 CFR part 1 for applicants for spectrum licenses, and any agreements the applicant may have relating to the support to be sought through the auction. With respect to eligibility requirements relating to ETC designation and spectrum access, applicants will be required to disclose and certify their ETC status as well as the source of the spectrum they plan to use to meet Mobility Fund obligations in the particular area(s) for which they plan to bid. Specifically, applicants will be required to disclose whether they currently hold or lease the spectrum, or have entered into a binding agreement, and have submitted an application with the Commission, to either hold or lease spectrum. Moreover, applicants will be required to certify that they will retain their access to the spectrum for at least five years from the date of award of support. The Bureaus should exercise their delegated authority to establish the specific form in which such information will be collected from applicants.

(iii) Bidding Process

268. The Commission delegates authority to the Bureaus to administer the policies, programs, rules, and procedures for Mobility Fund Phase I and take all actions necessary to conduct a Phase I auction. The Bureaus should exercise this authority by conducting a pre-auction notice-and-comment process to establish the specific procedures for the auction. Such procedures will enable the establishment of procedures for reviewing bids and determining winning bidders. The overall objective of the bidding in this context is to maximize the number of units to be covered in unserved areas given the overall budget for support. The Bureaus have discretion to adopt the best procedures to achieve this objective during the pre-auction process taking into account all relevant factors, including the implementation feasibility and the simplicity of bidder participation.

269. *Maximum Bids and Reserve Prices.* The Commission adopts its proposed rule to provide for maximum acceptable per-unit bid amounts and reserve amounts, separate and apart from any maximum opening bids, and to provide that those reserves may be disclosed or undisclosed and anticipates that, as detailed procedures for a Mobility Fund Phase I auction are established during the pre-auction period, the Bureaus will consider all proposals with respect to reserve prices in light of the specific timing of and other circumstances related to the auction.

270. *Aggregating Service Areas and Package Bidding.* The Bureaus will address issues relating to package bidding as part of the pre-auction process, which is consistent with the way the Commission approaches this issue for spectrum auctions. Interested parties will have an opportunity to comment on the desirability of package bidding in the pre-auction process in connection with the determination of the minimum area for bidding. Potential bidders will be able to provide input on whether specific package bidding procedures would allow them to formulate and implement bidding strategies to incorporate Mobility Fund Phase I support into their business plans and capture efficiencies, and on how well those procedures will facilitate the realization of the Commission's objectives for Mobility Fund Phase I.

271. *Refinements to the Selection Mechanism to Address Limited Available Funds.*

272. The Commission adopts a rule that would provide the Bureaus with discretion to establish procedures in the pre-auction process to deal with the possibility that funds may remain available after the auction has identified the last lowest per-unit bid that does not assign support exceeding the total funds available. The Commission also proposed a rule to give discretion to address a situation where there are two or more bids for the same per-unit amount but for different areas (''tied bids'') and remaining funds are insufficient to satisfy all of the tied bids. The Bureaus should develop appropriate procedures to address these issues during the pre-auction notice-and-comment process. These procedures shall be consistent with the objective of awarding support so as to maximize the number of units that will

gain coverage in unserved areas subject to the overall budget for support.

273. *Withdrawn Bids.* In the R&O, the Commission adopts a rule to provide for procedures for withdrawing provisionally winning bids, but does not expect the Bureaus to permit withdrawn bids, particularly if the Mobility Fund Phase I auction will be conducted in a single round.

274. *Preference for Tribally-Owned or Controlled Providers.* The Commission adopts a 25 percent bidding credit for Tribally-owned or controlled providers that participate in a Mobility Fund Phase I auction. The preference would act as a ''reverse'' bidding credit that would effectively reduce the bid amount by 25 percent for the purpose of comparing it to other bids, thus increasing the likelihood that a Tribally-owned or controlled entity would receive funding. The preference would be available solely with respect to the eligible census blocks located within the geographic area defined by the boundaries of the Tribal land associated with the Tribal entity seeking support.

(iv) Information and Competition

275. The Commission adopts rules to prohibit applicants competing for support in the auction from communicating with one another regarding the substance of their bids or bidding strategies and to limit public disclosure of auction-related information as appropriate. These rules are similar to those used for spectrum license auctions, and the Bureaus should seek comment during the pre-auction procedures process and decide on the details and extent of information to be withheld until the close of the auction.

(v) Auction Cancellation

276. The Commission adopts a rule to provide discretion to delay, suspend, or cancel bidding before or after a reverse auction begins under a variety of circumstances, including natural disasters, technical failures, administrative necessity, or any other reason that affects the fair and efficient conduct of the bidding. Based on its experience with a similar rule for spectrum license auctions, the Commission concludes that such a rule is necessary.

d. Post-Auction Long-Form Application Process

(i) Long-Form Application

277. The Commission adopts the long-form application process proposed in the *Mobility Fund NPRM* and delegates to the Bureaus responsibility for establishing the necessary FCC application form(s). After bidding for Mobility Fund Phase I support has ended, the Commission will declare the bidding closed and identify and notify the winning bidders. Unless otherwise specified by public notice, within 10 business days after being notified that it is a winning bidder for Mobility Fund support, a winning bidder will be required to submit a long-form application, providing certain information described below.

(ii) Ownership Disclosure

278. The Commission adopts for the Mobility Fund the existing ownership disclosure requirements in 47 CFR part 1 that already apply to short-form applicants to participate in spectrum license auctions and long-form applicants for licenses in the wireless services. Thus, an applicant for Mobility Fund support will be required to fully disclose its ownership structure as well as information regarding the real party- or parties-in-interest of the applicant or application. Wireless providers that have participated in spectrum auctions will already be familiar with these requirements, and are likely to already have ownership disclosure information reports (FCC Form 602) on file with the Commission, which may simply need to be updated. To minimize the reporting burden on winning bidders, applicants will be able to use ownership information stored in existing Commission databases and update that ownership information as necessary.

(iii) Eligibility To Receive Support

279. *ETC Designation.* The Commission will, with a limited exception, require any entity bidding for Mobility Fund support to be designated an ETC prior to the Mobility Fund auction short-form application deadline. A winning bidder will be required to submit with its long-form application appropriate documentation of its ETC designation in all of the areas for which it will receive support. However, in the event that a winning bidder receives an ETC designation conditioned upon receiving Mobility Fund support, it may submit documentation of its conditional designation, provided that it promptly submits documentation of its final designation after its long-form application has been approved but before any disbursement of Mobility Fund funds.

280. *Access to Spectrum.* Applicants for Mobility Fund support must also identify the particular frequency bands and the nature of the access (for example, licenses or leasing arrangements) on which they assert their eligibility for support. Because not all spectrum bands are capable of supporting mobile broadband, and leasing arrangements can be subject to a wide variety of conditions and contingencies, before an initial disbursement of support is approved, the Commission will assess the reasonableness of these assertions. An applicant whose access to spectrum derives from a spectrum manager leasing arrangement pursuant to 47 CFR 1.9020 may have a greater burden than other licensees and spectrum lessees to demonstrate through the execution of contractual conditions in its leasing arrangements that it has the necessary access to spectrum required to qualify for disbursement of Mobility Fund support. Should an applicant not have access to the appropriate level of spectrum, it will be found not qualified to receive Mobility Fund support and will be subject to an auction default payment.

(iv) Project Construction

281. A winning bidder's long-form application must include a description of the network it will construct with Mobility Fund support. Carriers must specify on their long-form applications whether the supported project will qualify as either a 3G or 4G network, including the proposed technology choice and demonstration of technical feasibility. Applications should also include a detailed description of the network design and contracting phase, construction period, and deployment and maintenance period. Applicants must also provide a complete projected budget for the project and a project schedule and timeline. Recipients will be required to provide updated information in their annual reports and in the information they provide to obtain a disbursement of funds. In addition, winning bidders of areas that include Tribal lands must comply with Tribal engagement obligations to demonstrate that they have engaged Tribal governments in the planning process and that the service to be provided will advance the goals established by the Tribe.

(v) Financial Security and Guarantee of Performance

282. Winning bidders for Mobility Fund support must provide the Commission with an irrevocable stand-by Letter of Credit (''LOC'') issued by a bank that is acceptable to the Commission, in an amount equal to the amount of support as it is disbursed, plus an additional percentage of the amount of support disbursed which shall serve as a default payment, which percentage will be determined by the

Bureaus in advance of the auction. The LOC should be in substantially the same form as set forth in the model LOC provided in Appendix N to the R&O and must be acceptable in all respects to the Commission.

283. The Commission is primarily concerned with protecting the integrity of the USF funds disbursed to the recipient. Should a recipient default on its obligations under the Mobility Fund, the priority should be to secure a return of the USF funds disbursed to it for this purpose, so that the Commission can reassign the support consistent with its goal to maximize the number of units covered given the funds available. A Mobility Fund recipient's failure to fulfill its obligations may also impose significant costs on the Commission and higher support costs for USF. Therefore, the Commission also concludes that it is necessary to adopt a default payment obligation for performance defaults.

284. Consistent with its goal of using the LOC to protect the government's interest in the funds it disburses in Mobility Fund Phase I, the Commission will require winning bidders to obtain an LOC in an amount equal to the amount of support it receives plus an additional percentage of the amount of support disbursed to safeguard against costs to the Commission and the USF. The precise amount of this additional percentage will not exceed 20 percent and will be determined by the Bureaus as part of its process for establishing the procedures for the auction. Thus, before an application for Mobility Fund support is granted and funds are disbursed, each winning bidder must provide an LOC in the amount of the first one-third of the support associated with the unserved census tract that will be disbursed upon grant of its application, plus the established additional default payment percentage. Before a participant receives the second third of its total support, it will be required to provide a second LOC or increase the initial LOC to correspond to the amount of that second support payment such that LOC coverage will be equal to the total support amount plus the established default payment percentage. The LOC(s) will remain open and must be renewed to secure the amounts disbursed as necessary until the recipient has met the requirements for demonstrating coverage and final payment is made. This approach will help to reduce the costs recipients incur for maintaining the LOCs, because they will only have to maintain LOCs in amounts that correspond to the actual USF funds as they are being disbursed.

285. Consistent with the purpose of the LOC, recipients must maintain the LOC in place until at least 120 days after they have completed their supported expansion to unserved areas and received their final payment of Mobility Fund Phase I support. Under the terms of the LOC, the Commission will be entitled to draw upon the LOC upon a recipient's failure to comply with the terms and conditions upon which USF support was granted. The Commission, for example, will draw upon the LOC when the recipient fails to meet its required deployment milestone(s). Failure to satisfy essential terms and conditions upon which USF support was granted or to ensure completion of the supported project, including failure to timely renew the LOC, will be deemed a failure to properly use USF support and will entitle the Commission to draw the entire amount of the LOC. Failure to comply will be evidenced by a letter issued by the Chief of either the Wireless Bureau or Wireline Bureau or their designees, which letter, attached to an LOC draw certificate, shall be sufficient for a draw on the LOC. In addition, a recipient that fails to comply with the terms and conditions of the Mobility Fund support it is granted could be disqualified from receiving additional Mobility Fund support or other USF support.

286. In the *Mobility Fund NPRM,* the Commission sought comment on the relative merits of performance bonds and LOCs and the extent to which performance bonds, in the event of the bankruptcy of the recipient of Mobility Fund support, might frustrate the Commission's goal of ensuring timely build-out of the network. The Commission concludes that an LOC will better serve its objective of minimizing the possibility that Mobility Fund support becomes property of a recipient's bankruptcy estate for an extended period of time, thereby preventing the funds from being used promptly to accomplish the Mobility Fund's goals. It is well established that an LOC and the proceeds thereunder are not property of a debtor's estate under 11 U.S.C. 541 (the ''Bankruptcy Code''). In a proper draw upon an LOC, the issuer honors a draft under the LOC from its own assets and not from the assets of the debtor who caused the LOC to be issued. Because the proceeds under an LOC are not property of the bankruptcy estate, absent extreme circumstances such as fraud, neither the LOC nor the funds drawn down under it are subject to the automatic stay provided by the Bankruptcy Code.

287. In the long-form application filing, each winning bidder must submit a commitment letter from the bank issuing the LOC. The commitment letter will at a minimum provide the dollar amount of the LOC and the issuing bank's agreement to follow the terms and conditions of the Commission's model LOC, found in Appendix N to the R&O. The winning bidder will, however, be required to have its LOC in place before it is authorized to receive Mobility Fund Phase I support and before any Mobility Fund Phase I support is disbursed. Further, at the time it submits its LOC, a winning bidder must provide an opinion letter from legal counsel clearly stating, subject only to customary assumptions, limitations and qualifications, that in a proceeding under the Bankruptcy Code, the bankruptcy court would not treat the LOC or proceeds of the LOC as property of winning bidder's bankruptcy estate, or the bankruptcy estate of any other bidder-related entity requesting issuance of the LOC, under 11 U.S.C. 541.

(vi) Other Funding Restrictions

288. While the Commission agrees with commenters that Mobility Fund recipients might benefit if they were able to leverage resources from other federal programs, it must also take care to ensure that USF funds are put to their most efficient and effective use. Therefore, the Commission will exclude all areas from the Mobility Fund where, prior to the short-form filing deadline, any carrier has made a regulatory commitment to provide 3G or better service, or has received a funding commitment from a federal executive department or agency in response to the carrier's commitment to provide 3G or better service.

(vii) Post-Auction Certifications

289. Prior to receiving Mobility Fund support, an applicant must certify in its long-form application to the availability of funds for all project costs that exceed the amount of support to be received from the Mobility Fund and certify that they will comply with all program requirements.

290. As discussed elsewhere in the R&O, recipients of Mobility Fund support are required by statute to offer services in rural areas at rates that are reasonably comparable to those charged to customers in urban areas. Accordingly, the post-auction certifications made in the long-form application will include a certification that the applicant will offer services in rural areas at rates that are reasonably comparable to those charged to customers in urban areas.

(viii) Auction Defaults

291. *Auction Default Payments.* The Commission will impose a default payment on winning bidders that fail to timely file a long-form application. Such a payment is also appropriate if a bidder is found ineligible or unqualified to receive Mobility Fund support, its long-form application is dismissed for any reason, or it otherwise defaults on its bid or is disqualified for any reason after the close of the auction.

292. Failures to fulfill auction obligations may undermine the stability and predictability of the auction process, and impose costs on the Commission and higher support costs for USF. In the case of a reverse auction for USF support, a default payment is appropriate to ensure the integrity of the auction process and to safeguard against costs to the Commission and the USF. The size of the payment and the method by which it is calculated may vary depending on the procedures established for the auction, including auction design. In advance of the auction, the Bureaus will determine whether a default payment should be a percentage of the defaulted bid amount or should be calculated using another method, such as basing the amount on differences between the defaulted bid and the next best bid(s) to cover the same number of road miles as without the default. If the Bureaus establish a default payment to be calculated as a percentage of the defaulted bid, that percentage will not exceed 20 percent of the total amount of the defaulted bid. However it is determined, agreeing to that payment in event of a default will be a condition for participating in bidding. The Bureaus may determine prior to bidding that all participants will be required to furnish a bond or place funds on deposit with the Commission in the amount of the maximum anticipated default payment. A winning bidder will be deemed to have defaulted on its bid under a number of circumstances if it withdraws its bid after the close of the auction, it fails to timely file a long-form application, it is found ineligible or unqualified to receive Mobility Fund Phase I support, its long-form application is dismissed for any reason, or it otherwise defaults on its bid or is disqualified for any reason after the close of the auction. In addition to being liable for an auction default payment, a bidder that defaults on its bid may be subject to other sanctions, including but not limited to disqualification from future competitive bidding for USF support.

293. The Commission distinguishes between a Mobility Fund auction applicant that defaults on its winning bid and a winning bidder whose long-form application is approved but subsequently fails or is unable to meet its minimum coverage requirement or demonstrate an adequate quality of service that complies with Mobility Fund requirements. In the latter case of a recipient's performance default, in addition to being liable for a performance default payment, the recipient will be required to repay all of the Mobility Fund support it has received and, depending on the circumstances involved, could be disqualified from receiving any additional Mobility Fund or other USF support. The Commission may obtain its performance default payment and repayment of a recipient's Mobility Fund support by drawing upon the irrevocable stand-by LOC that recipients will be required to provide in the full amount of support received.

294. *Undisbursed Support Payments.* When a winning bidder defaults on its bid or is disqualified for any reason after the close of the auction, the funds that would have been provided to such an applicant will be used in a manner consistent with the purposes of the Universal Service program.

e. Accountability and Oversight

295. In the *Mobility Fund NPRM,* the Commission sought comment on issues relating to the administration, management and oversight of the Mobility Fund. On a number of these issues, the Commission adopts uniform requirements that will apply to all recipients of high-cost and CAF support, including recipients of Mobility Fund Phase I support. Recipients of Phase I support will be subject generally to the reporting, audit, and record retention requirements that are discussed in the Accountability and Oversight section of the R&O. In addition, recipients of Mobility Fund Phase I support will be subject to certain aspects of support disbursement and annual reporting and record retention requirements.

(i) Disbursing Support Payments

296. Mobility Fund Phase I support will be provided in three installments. This approach strikes the appropriate balance between advancing funds to expand service and assuring that service is actually expanded. Specifically, each party receiving support will be eligible to receive from USAC a disbursement of one-third of the amount of support associated with any specific census tract once its long-form application for support is granted. To qualify for the second installment of support, a recipient will be required to demonstrate it has met 50 percent of its minimum coverage requirement using the same drive tests that will be used to analyze network coverage to provide proof of deployment at the end of the project to receive its final installment of support. The report a recipient files for this purpose will be subject to review and verification before support is disbursed. A party will receive the remainder of its support after filing with USAC a report with the required data that demonstrates that it has deployed a network covering at least the required percent of the relevant road miles in the unserved census block(s) within the census tract. This data will be subject to review and verification before the final support payment for an unserved area is disbursed to the recipient. A party's final payment would be the difference between the total amount of support based on the road miles of unserved census blocks actually covered, *i.e.,* a figure between the required percent and 100 percent of the road miles, and any support previously received.

297. To minimize that risk of lost funds to parties that ultimately fail to meet their obligations, the Commission is requiring participants to maintain their LOCs in place until after they have completed their supported network construction and received their final payment of Mobility Fund Phase I support. In addition, participants must certify that they are in compliance with all requirements for receipt of Mobility Fund Phase I support at the time that they request disbursements.

(ii) Annual Reports

298. Parties receiving Mobility Fund support must file annual reports with the Commission demonstrating the coverage provided with support from the Mobility Fund for five years after the winning bidder is authorized to receive Mobility Fund support. The reports must include maps illustrating the scope of the area reached by new services, the population residing in those areas (based on Census Bureau data and estimates), and the linear road miles covered. In addition, annual reports must include all coverage test data for the supported areas that the party receives or makes use of, whether the tests were conducted pursuant to Commission requirements or any other reason. Further, annual reports will include any updated project information including updates to the project description, budget and schedule.

299. However, to the extent that a recipient of Mobility Fund support is a carrier subject to other existing or new annual reporting requirements under 47 CFR 54.313 based on their receipt of

USF support under another high cost mechanism, it will be permitted to satisfy its Mobility Fund Phase I reporting requirements by filing a separate Mobility Fund annual report or by including this additional information in a separate section of its other annual report filed with the Commission. Mobility Fund recipients choosing to fulfill their Mobility Fund reporting requirements in an annual report filed under 47 CFR 54.313 must, at a minimum, file a separate Mobility Fund annual report notifying us that the required information is included the other annual report.

(iii) Record Retention

300. Elsewhere in the R&O, the Commission adopts revised requirements that extend the record retention period to ten years for all recipients of high-cost and CAF support, including recipients of Mobility Fund Phase I. This new retention period will be adequate to facilitate audits of Mobility Fund program participants, with one clarification regarding the required retention period: for the purpose of the Mobility Fund program, the ten-year period for which records must be maintained will begin to run only after a recipient has received its final payment of Mobility Fund support. That is, because recipients will receive Mobility Fund support in up to three installments, but recipients that ultimately fail to deploy a network that meets the Commission's minimum coverage and performance requirements or otherwise fail to meet their Mobility Fund public interest obligations will be liable for repayment of all previously disbursed Mobility Fund support, recipients must retain records for ten years from the receipt of the final disbursement of Mobility Fund funds.

2. Service to Tribal Lands

a. Tribal Mobility Fund Phase I

301. The Commission establishes a separate Tribal Mobility Fund Phase I to provide one-time support to deploy mobile broadband to unserved Tribal lands, which have significant telecommunications deployment and connectivity challenges. The Commission anticipates that an auction will occur as soon as feasible after a general Mobility Fund Phase I auction, providing for a limited period of time in between so that applicants that may wish to participate in both auctions may plan and prepare for a Tribal Phase I auction after a general Phase I auction. The decision to establish a Tribal Mobility Fund Phase I stems from the Commission's policy regarding ''Covered Locations,'' and represents its commitment to Tribal lands, including Alaska.

302. The Commission allocates $50 million from universal service funds reserves for Tribal Mobility Fund Phase I, separate and apart from the $300 million allocated for the general Mobility Fund Phase I. Providers in Tribal lands will be eligible for both the general and Tribal Mobility Fund Phase I auctions. Consistent with the general Mobility Fund Phase I, the Commission delegates to the Bureaus authority to administer the policies, programs, rules and procedures to implement Tribal Mobility Fund Phase I as established in the R&O. The Commission determines that allocating $50 million from universal service fund reserves to support the deployment of mobile broadband to unserved Tribal lands is necessary, separate and apart from the $300 million we are allocating for Mobility Fund Phase I, because of special challenges involved in deploying mobile broadband on Tribal lands. Various characteristics of Tribal lands may increase the cost of entry and reduce the profitability of providing service, including: ''(1) The lack of basic infrastructure in many tribal communities; (2) a high concentration of low-income individuals with few business subscribers; (3) cultural and language barriers where carriers serving a tribal community may lack familiarity with the Native language and customs of that community; (4) the process of obtaining access to rights-of-way on tribal lands where tribal authorities control such access; and (5) jurisdictional issues that may arise where there are questions concerning whether a state may assert jurisdiction over the provision of telecommunications services on tribal lands.''

303. Promoting the development of telecommunications infrastructure on Tribal lands is consistent with the Commission's unique trust relationship with Tribes. The Commission previously observed that ''by increasing the total number of individuals, both Indian and non-Indian, who are connected to the network within a tribal community the value of the network for tribal members in that community is greatly enhanced.'' By structuring the support to benefit Tribal lands, rather than attempting to require wireless providers to distinguish between Tribal and non-Tribal customers, the Commission will ''reduc[e] the possible administrative burdens associated with implementation of the enhanced federal support, [and] eliminate a potential disincentive to providing service on Tribal lands.'' Support for Tribal lands generally will be awarded on the same terms and subject to the same rules as general Mobility Fund Phase I support. Therefore, the Commission incorporates by reference the eligible geographic area, provider eligibility, public interest obligations, auction and post-auction processes, and program management and oversight measures established for Phase I of the Mobility Fund. However, in some instances, a more tailored approach is appropriate and the Commission adopts modest revisions to its general rules. As discussed in the USF–ICC Transformation FNPRM, the Commission also proposes an ongoing support mechanism for Tribal lands in Phase II of the Mobility Fund, as well as a separate CAF mechanism to reach the most remote areas, including Tribal lands.

304. *Size of Fund.* The Commission dedicates $50 million in one-time support for the Tribal Mobility Fund Phase I, which should help facilitate mobile deployment in unserved areas on Tribal lands. This amount is in addition to the $300 million to be provided under the general Mobility Fund Phase I, for which qualifying Tribal lands would also be eligible, and is in addition to the up to $100 million in ongoing support being dedicated to Tribal lands in the Tribal Mobility Fund Phase II. A one-time infusion of $50 million through the Tribal Mobility Fund can make a difference in expanding the availability of mobile broadband in Tribal lands unserved by 3G. The more targeted nature of this support will enhance the impact of this significant one-time addition to current support levels. At the same time, this funding level is consistent with the Commission's commitment to fiscal responsibility and the varied objectives the Commission has for its limited funds, including its proposals for ongoing support for mobile services as established below.

305. *Mechanism To Award Support.* Consistent with the general approach to awarding Phase I support, to maximize consumer benefits, the Commission generally will award support to one provider per qualifying area by reverse auction and will only award support to more than one provider per area where doing so would cover more total units given the budget constraint. In certain limited circumstances, however, depending on the bidding at auction, allowing small overlaps in support could result in greater overall coverage.

306. Because it is essential to award support in a way that respects and reflects Tribal needs, the Commission adopts Tribal engagement obligations to

ensure that needs are identified and appropriate solutions are developed. The Commission also adopts a bidding credit for Tribally-owned or controlled providers seeking to expand service on their Tribal lands. A reverse auction mechanism, together with the Tribal engagement and preferences adopted in the R&O, would best achieve the Commission's goals in expanding service to Tribal lands in a respectful, fair, and fiscally responsible manner.

307. *Establishing Unserved Units.* For purposes of determining the number of unserved units in a given geographic area, the Commission concludes that, for a Tribal Phase I auction, a population-based metric is more appropriate than road miles, which will be used in a general Mobility Fund Phase I auction. In light of this conclusion, the ''drive tests'' used to demonstrate coverage supported by Tribal Mobility Fund Phase I may be conducted by means other than in automobiles on roads. Providers may demonstrate coverage of an area with a statistically significant number of tests in the vicinity of residences being covered. Moreover, equipment to conduct the testing can be transported by off-road vehicles, such as snow-mobiles or other vehicles appropriate to local conditions.

b. Tribal Engagement Obligation

308. The Commission agrees with commenters that have repeatedly stressed the essential role that Tribal consultation and engagement plays in the successful deployment of mobile broadband service. Therefore, for both the general and Tribal Mobility Fund Phase I auctions, the Commission encourages applicants seeking to serve Tribal lands to begin engaging with the affected Tribal government as soon as possible but no later than the submission of its long-form application. Any such engagement, however, must be done consistent with the Commission's auction rules prohibiting certain communications during the competitive bidding process.

309. Moreover, any bidder winning support for areas within Tribal lands must notify the relevant Tribal government no later than five business days after being identified by Public Notice as such a winning bidder. Thereafter, at the long-form application stage, in annual reports, and prior to any disbursement of support from USAC, Mobility Fund Phase I winning bidders will be required to comply with the general Tribal engagement obligations discussed *infra.*

c. Preference for Tribally-Owned or Controlled Providers

310. The Commission adopts a preference for Tribally-owned or controlled providers seeking general or Tribal Mobility Fund Phase I support. Eligible entities include Tribes or tribal consortia, and entities majority owned or controlled by Tribes. The preference will act as a ''reverse'' bidding credit that will effectively reduce the bid amount of a qualified Tribally owned- or controlled provider by a designated percentage for the purpose of comparing it to other bids, thus increasing the likelihood that Tribally-owned and controlled entities will receive funding. The preference will be available with respect to the eligible census blocks located within the geographic area defined by the boundaries of the Tribal land associated with the Tribal entity seeking support. In the spectrum auction context, the Commission typically awards small business bidding credits ranging from 15 to 35 percent, depending on varying small business size standards. The Commission believes that a bidding credit in that range would further Tribal self-government by increasing the likelihood that the bid would be awarded to a Tribal entity associated with the relevant Tribal land, without providing an unfair advantage over substantially more cost-competitive bids. Accordingly, it adopts a 25 percent bidding credit.

d. ETC Designation for Tribally-Owned or Controlled Entities

311. To afford Tribes an increased opportunity to participate at auction, in recognition of their interest in self-government and self-provisioning on their own lands, the Commission will permit a Tribally-owned or controlled entity that has an application for ETC designation pending at the relevant short-form application deadline to participate in an auction to seek general and Tribal Mobility Fund Phase I support for eligible census blocks located within the geographic area defined by the boundaries of the Tribal land associated with the Tribe that owns or controls the entity. Allowing such participation at auction in no way prejudges the ultimate decision on a Tribally-owned or controlled entity's ETC designation and that support will be disbursed only after it receives such designation.

e. Tribal Priority

312. Further comment is warranted before the Commission moves forward with any Tribal priority process that would afford Tribes ''priority units'' to allocate to areas of particular importance to them. Therefore, the Commission seeks additional input on this proposal in the context of the Tribal Mobility Fund Phase II. In the meantime, the Tribal engagement obligations adopted in the R&O, combined with build-out obligations, will ensure that Tribal needs are met in bringing service to unserved Tribal communities in the Mobility Fund Phase I.

3. Mobility Fund Phase II

313. In addition to Phase I of the Mobility Fund, the Commission also establishes in the R&O Phase II of the Mobility Fund, which will provide ongoing support for mobile services in areas where such support is needed. Whereas Mobility Fund Phase I will provide one-time funding for the expansion of current and next generation mobile networks, Phase II of the Mobility Fund recognizes that there are areas in which offering of mobile services will require ongoing support.

314. The Commission designates $500 million annually for ongoing support for mobile services, to be distributed in Phase II of the Mobility Fund. Of this amount, the Commission anticipates that it would designate up to $100 million to address the special circumstances of Tribal lands. The Commission sets a budget of $500 million to promote mobile broadband in these areas, where a private sector business case cannot be met without federal support. Although the budget for fixed services exceeds the budget for mobile services, significantly more Americans at this time have access to 3G mobile coverage than have access to residential broadband via fixed wireless, DSL, cable, or fiber. The Commission expects that as 4G mobile service is rolled out, this disparity will persist—private investment will enable the availability of 4G mobile service to a larger number of Americans than will have access to fixed broadband with speeds of at least 4 Mbps downstream and 1 Mbps upstream.

315. In 2010, wireless ETCs other than Verizon Wireless and Sprint received $921 million in high-cost support. Under 2008 commitments to phase down their competitive ETC support, Verizon Wireless and Sprint have already given up significant amounts of the support they received under the identical support rule, and there is nothing in the record showing that either carrier is reducing coverage or shutting down towers even as this support is eliminated. Nor is there anything in the record that suggests

AT&T or T-Mobile would reduce coverage or shut down towers in the absence of ETC support. It reasonable to assume that the four national carriers will maintain at least their existing coverage footprints even if the support they receive today is phased out. In 2010, $579 million flowed to regional and small carriers, *i.e.,* carriers other than the four nationwide providers. Of this $579 million, in many instances this support is being provided to multiple wireless carriers in the same geographic area. The State Members of the Federal State Joint Board on Universal Service have proposed that the Commission establish a dedicated Mobility Fund that would provide $50 million in the first year, $100 million in the second year, and then increase by $100 million each year until support reaches $500 million annually. A $500 million annual budget should be sufficient to sustain and expand the availability of mobile broadband. Moreover, mobile providers may also be eligible for support in CAF 1 in areas where price cap carriers opt not to accept the state-level commitment, in addition to Mobility Fund Phase II support.

316. Some small proportion of geographic areas may be served by a single wireless ETC, which might reduce coverage if it fails to win ongoing support within the $500 million budget. But the current record does not persuade the Commission that the best approach to ensure continuing service in those instances is to increase its overall $500 million budget. Rather, the Commission has established a waiver process as discussed elsewhere in the R&O that a wireless ETC may use to demonstrate that additional support is needed for its customers to continue receiving mobile voice service in areas where there is no terrestrial mobile alternative.

317. Of the $500 million, the Commission sets aside up to $100 million for a separate Tribal Mobility Fund, for the same reasons articulated with respect to the Tribal Mobility Fund Phase I. In addition, many Tribal lands require ongoing support in order to provide service and therefore the Commission designates a substantial level of funding to ensure that these communities are not left behind. This amount is roughly equivalent to the amount of funding currently provided to Tribal lands in the lower 48 states and in Alaska, excluding support awarded to study areas that include the most densely populated communities in Alaska.

4. Eliminating the Identical Support Rule

318. *Discussion.* The Commission eliminates the identical support rule. Based on more than a decade of experience with the operation of the current rule and having received a multitude of comments noting that the current rule fails to efficiently target support where it is needed, the Commission reiterates the conclusion that this rule has not functioned as intended. As described in more detail below, identical support does not provide appropriate levels of support for the efficient deployment of mobile services in areas that do not support a private business case for mobile voice and broadband. Because the explicit support for mobility the Commission adopts today will be designed to appropriately target funds to such areas, the identical support rule is no longer necessary or in the public interest.

319. The Commission anticipated that universal service support would be driven to the most efficient providers as they captured customers from the incumbent provider in a competitive marketplace. It originally expected that growth in subscribership to a competitive ETC's services would necessarily result in a reduction in subscribership to the incumbent's services. Instead, the vast majority of competitive ETC support has been attributable to the growing role of wireless in the United States. Overwhelmingly, high-cost support for competitive ETCs has been distributed to wireless carriers providing mobile services. Although nearly 30 percent of households nationwide have cut the cord and have only wireless voice service, many households subscribe to both wireline voice service and wireless voice service. Moreover, because households typically have multiple mobile phones, wireless competitive ETCs have been able to receive multiple subsidies for the same household. Although the expansion of wireless service has brought many benefits to consumers, the identical support rule was not designed to efficiently provide appropriate levels of support for mobility.

320. The support levels generated by the identical support rule bear no relation to the efficient cost of providing mobile voice service in a particular geography. In areas where the incumbent's support per line is high, a competitive ETC will receive relatively high levels of support per line, while it would receive markedly less support in an adjacent area with the same cost characteristics, if the incumbent there is receiving relatively little support per line. This makes little sense. Demographics, topography, and demand by travelers for mobile coverage along roads, as opposed to residences, are considerations that may create different business cases for fixed vs. mobile voice services in different areas, with a resulting effect on the level of need for subsidization. As a result of these and other differences in cost and revenue structures, the per-line amounts received by competitive ETCs are a highly imperfect approximation of the amount of subsidy necessary to support mobile service in a particular geographic area and such structures have simply missed the mark.

321. Given the way the identical support rule operates, wireless competitive ETCs often do not have appropriate incentives for entry. Some areas with per-line support amounts that are relatively high may be attracting multiple competitive ETCs, each of which invests in its own duplicative infrastructure. Indeed, many areas have four or more competitive ETCs providing overlapping service. These areas may be attracting investment that could otherwise be directed elsewhere, including areas that are not currently served. Conversely, in some areas the subsidy provided by the identical support rule may be too low, so that no competitive ETCs seek to serve the area, resulting in inadequate mobile coverage.

322. Moreover, today, competitive ETC support is calculated, and lines are reported, according to the billing address of the subscriber. Although the identical support rule provides a per-line subsidy for each competitive ETC handset in service, the customer need not use the handset at the billing address in order to receive support. Indeed, mobile competitive ETCs may receive support for some customers that rarely use their handsets in high-cost areas, but typically use their cell phones on highways and in towns or other places in which coverage would be available even without support. As currently constructed, the rule fails to ensure that facilities are built in areas that actually lack coverage.

323. The Commission rejects contentions that competitive ETCs serving certain types of areas should be exempted from elimination of the identical support rule. For example, a number of commenters from Alaska suggest that Alaska should be excluded altogether from today's reforms, and that high-cost support should generally continue in Alaska at existing levels with redistribution of that support within the state. The Commission appreciates and recognizes that Alaska

faces uniquely challenging operating conditions, and agrees that national solutions may require modification to serve the public interest in Alaska. The Commission does not, however, believe that the Alaskan proposals ultimately best serve the interest of Alaskan consumers. The Commission believes that the package of reforms adopted in the R&O targeting funding for broadband and mobility, eliminating duplicative support, and ensuring all mechanisms provide incentives for prudent and efficient network investment and operation is the best approach for all parts of the Nation, including Alaska.

324. That said, it is important to ensure our approach is flexible enough to take into account the unique conditions in places like Alaska, and the Commission makes a number of important modifications to the national rules, particularly with respect to public interest obligations, the Mobility Funds, and competitive ETC phase down, to account for those special circumstances, such as its remoteness, lack of roads, challenges and costs associated with transporting fuel, lack of scalability per community, satellite and backhaul availability, extreme weather conditions, challenging topography, and short construction season. Further, to the extent specific proposals have a disproportionate or inequitable impact on any carriers (wireline or wireless) serving Alaska, the Commission notes that it will provide for expedited treatment of any related waiver requests for all Tribal and insular areas. The Commission believes this approach, on balance, provides the benefits of our national approach while taking into account the unique operating conditions in some communities. Analogous proposals to maintain existing wireline and wireless support levels in other geographic areas, including the U.S. Territories and other Tribal lands, suffer the same infirmities as the proposals related to Alaska, and are also rejected.

325. The Commission notes that the elimination of the identical support rule applies also to competitive ETCs providing fixed services, including competitive wireline service providers. The reforms the Commission adopts elsewhere in the R&O are designed to achieve nearly ubiquitous broadband deployment. In those states where the incumbent price cap carrier declines to make a state-level commitment to build broadband in exchange for model-based support, all competitive ETCs will have the opportunity to compete to provide supported services. In other areas, where the incumbent service providers will be responsible for achieving the universal service goals, the Commission finds it would not be in the public interest to provide additional support to carriers providing duplicative services. In addition, in areas where unsubsidized providers have built out service, no carrier—incumbent or competitive—will receive support, placing all providers on even footing.

326. The Commission rejects any arguments that the Commission may not eliminate the identical support rule because doing so would prevent some carriers from receiving high-cost support. 47 U.S.C. 254 does not mandate the receipt of support by any particular carrier. Rather, as the Commission has indicated and the courts have agreed, the ''purpose of universal service is to benefit the customer, not the carrier.'' ETCs are not entitled to the expectation of any particular level of support, or even any support, so long as the level of support provided is sufficient to achieve universal service goals. As explained above, the Commission finds that the identical support rule does not provide an amount to any particular carrier that is reasonably calculated to be sufficient but not excessive for universal service purposes.

327. For all of these reasons, the Commission finds the identical support rule does not effectively serve the Commission's goals, and the Commission eliminates the rule effective January 1, 2012.

5. Transition of Competitive ETC Support to CAF

328. *Discussion.* The Commission transitions existing competitive ETC support to the CAF, including our reformed system for supporting mobile service over a five-year period beginning July 1, 2012. The Commission finds that a transition is desirable in order to avoid shocks to service providers that may result in service disruptions for consumers. Several commenters supported longer transition periods, but the Commission does not find their arguments compelling. The Commission understands that current recipients would prefer a slower, longer transition that provides them with more universal service revenues under the current system. The Commission finds, however, that a five-year transition will be sufficient for competitive ETCs that are currently receiving high-cost support to adjust and make necessary operational changes to ensure that service is maintained during the transition.

329. Moreover, during this period, competitive ETCs offering mobile wireless services will have the opportunity to bid in the Mobility Fund Phase I auction in 2012 and participate in the second phase of the Mobility Fund in 2013. Competitive ETCs offering broadband services that meet the performance standards described above will also have the opportunity to participate in competitive bidding for CAF support in areas where price cap companies decline to make a state-level broadband commitment in exchange for model-determined support, as described above, in 2013. With these new funding opportunities, many carriers, including wireless carriers, could receive similar or even greater amounts of funding after our reforms than before, albeit with that funding more appropriately targeted to the areas that need additional support.

330. For the purpose of this transition, the Commission concludes that each competitive ETC's baseline support amount will be equal to its total 2011 support in a given study area, or an amount equal to $3,000 times the number of reported lines as of year-end 2011, whichever is lower. For the purpose of this transition, ''total 2011 support'' is the amount of support disbursed to a competitive ETC for 2011, without regard to prior period adjustments related to years other than 2011 and as determined by USAC on January 31, 2012. Using a full calendar year of support to set the baseline will provide a reasonable approximation of the amount that competitive ETCs would currently expect to receive, absent reform, and a natural starting point for the phase-down of support.

331. In addition, the Commission limits the baseline to $3,000 per line in order to reflect similar changes to our rules limiting support for incumbent wireline carriers to $3,000 per line per year. For the purpose of applying the $3,000 per line limit, USAC shall use the average of lines reported by a competitive ETC pursuant to line count filings required for December 31, 2010, and December 31, 2011. This will provide an approximation of the number of lines typically served during 2011. As discussed above, the per-line amounts received by competitive ETCs are a highly imperfect approximation of the amount of subsidy necessary to support mobile service in a particular geographic area. There is no indication in the record before us that competitive ETCs need support in excess of $3,000 per line to maintain existing service pending transition to the Mobility Fund. Moreover, if the Commission did not apply the $3,000 per line limit to the baseline amount for competitive ETCs, their baselines could, in some circumstances, be much higher than the amount that they would have been

permitted had the Commission retained the identical support rule going forward, due to other changes that may lower support for the incumbent carrier.

332. Because the amount of Mobility Fund Phase II support provided will be designed to provide a sufficient level of support for a mobile carrier to provide service, the Commission finds there is no need for any carrier receiving Mobility Fund Phase II support to also continue receiving legacy support. Therefore, any such carrier will cease to be eligible for phase-down support in the first month it is eligible to receive support pursuant to the Mobility Fund Phase II. The receipt of support pursuant to Mobility Fund Phase I will not impact a carrier's receipt of support under the phase-down. Similarly, the receipt of support pursuant to Mobility Fund Phase II for service to a particular area will not affect a carrier's receipt of phase-down support in other areas.

333. The Commission notes that, pursuant to 47 U.S.C. 214(e) of the Act, competitive ETCs are required to offer service throughout their designated service areas. This requirement remains in place, even as support provided pursuant to the identical support rule is phased down. A competitive ETC may request modification of its designated service area by petitioning the entity with the relevant jurisdictional authority. In considering such petitions, the Commission will examine how an ETC modification would affect areas for which there is no other mobile service provider, and the Commission encourages state commissions to do the same.

334. Competitive ETC support per study area will be frozen at the 2011 baseline, and that monthly baseline amount will be provided from January 1, 2012 to June 30, 2012. Each competitive ETC will then receive 80 percent of its monthly baseline amount from July 1, 2012 to June 30, 2013, 60 percent of its baseline amount from July 1, 2013, to June 30, 2014, 40 percent from July 1, 2014, to June 30, 2015, 20 percent from July 1, 2015, to June 30, 2016, and no support beginning July 1, 2016. The Commission expects that the Mobility Fund Phase I auction will occur in 2012, and that ongoing support through the Mobility Fund Phase II will be implemented by 2013, with $500 million expressly dedicated to mobility. If the Mobility Fund Phase II is not operational by June 30, 2014, the Commission will halt the phase-down of support until it is operational. The Commission will similarly halt the phase-down of support for competitive ETCs serving Tribal lands if the Mobility Fund Phase II for Tribal lands has not been implemented at that time. The Commission anticipates that any temporary halt of the phase-down would be accompanied by additional mobile broadband public interest obligations, to be determined. The temporary halt will apply to wireline competitive ETCs as well as competitive ETCs providing mobile services.

335. The Commission notes that Verizon Wireless and Sprint will continue to be subject to the phase-down commitments they made in the November 2008 merger Orders. Consistent with the process set forth in the *Corr Wireless Order,* their specific phase downs will be applied to the revised rules of general applicability the Commission adopts today. As a result, each carrier will have its baseline support calculated based on disbursements, with a 20 percent reduction applied beginning July 1, 2012. Sprint, which elected Option A described in the *Corr Wireless Order,* will, in 2012, have an additional reduction applied as necessary to reduce its support to 20 percent of its 2008 baseline amount. Verizon Wireless, which elected Option B, will, in 2012, have an 80 percent reduction applied to the support it would otherwise receive. In 2013, neither carrier will receive phase down support, consistent with the commitments. To the extent that they qualify by remaining ETCs or obtaining ETC designations and agreeing to the obligations imposed on all Mobility Fund recipients, they will be permitted to participate in Mobility Fund Phases I and II.

336. In determining this transition process, the Commission also considered (a) applying the reduction factors to each state's interim cap amount, or (b) converting each competitive ETC's baseline amount to a per-line amount, to which the reduction factor would be applied. The Commission rejects these alternatives because they would provide less certainty regarding support amounts for competitive ETCs during the transition and would create greater administrative burdens and complexity. Under the first alternative, an individual competitive ETC's support would continue to be affected by line counts, support calculations and relinquishments for other, unrelated carriers within the state. Under the second alternative, a competitive ETC's support would fluctuate based on line growth or loss. The Commission believes, on balance, that the additional certainty to all competitive ETCs and the administrative efficiencies for USAC of freezing study area support as the baseline, particularly at a time when considerable demands will be placed on USAC to implement an entirely new support mechanism, outweigh the potential negative impact to any individual competitive ETCs that otherwise might receive greater support amounts during the transition to the CAF. In addition, competitive ETCs will be relieved of the obligation to file quarterly line counts, which will reduce their administrative burden as well.

337. In the *USF/ICC Transformation NPRM,* the Commission sought comment on whether exceptions to the phase down or other modified transitions should be permitted for some carriers. Although the Commission adopts limited exceptions for some remote parts of Alaska described below and for one Tribally-owned carrier whose ETC designation was modified after release of the *USF/ICC Transformation NPRM,* the Commission declines to adopt any general exceptions to our transition. Although some commenters have argued that broad exceptions will be needed, they did not generally provide the sort of detailed data and analysis that would enable us to develop a general rule for which carriers would qualify. The purpose of the phase down is to avoid unnecessary consumer disruption as the Commission transitions to new programs that will be better designed to achieve universal service goals, especially with respect to promoting investment in and deployment of mobile service to areas not yet served. The Commission does not wish to encourage further investment based on the inefficient subsidy levels generated by the identical support rule. The Commission concludes that phasing down and transitioning existing competitive support will not create significant or widespread risks that consumers in areas that currently have service, including mobile service, will be left without any viable mobile service provider serving their area.

338. The Commission will, however, consider waiver requests on a case-by-case basis. Consistent with the phase-down support's purpose of protecting existing service during the transition to the Mobility Fund programs, the Commission would not find persuasive arguments that waivers are necessary in order to expand deployment and service offerings to new areas. The Commission anticipates that future investment supported with universal service support will be provided pursuant to the new programs.

339. The Commission will carefully consider all requests for waiver of the phase down that meet the requirements

described above. The Commission expects that those requests will not be numerous. The Commission notes that two of the four nationwide carriers—Verizon Wireless and Sprint—have already given up significant amounts of the support they received under the identical support rule, and there is no indication in the record before us that those companies have turned off towers as a consequence of relinquishing their support.

340. The Commission notes that the transition the Commission adopts here will include those carriers currently receiving support under the Covered Locations exception to the interim cap and those carriers that have sought to take advantage of the own-costs exception to the cap. In adopting the Covered Locations exception to the funding cap in the *2008 Interim Cap Order,* the Commission recognized that penetration rates for basic telephone service on Tribal lands were lower than for the rest of the Nation, and the Commission concluded that competitive ETCs serving those areas were not merely providing complementary services. Under this exception, competitive ETCs serving Tribal lands have operated without a cap, and have benefited from significant funding increases. Indeed, support provided for service in Covered Locations has nearly doubled, from an estimated $72 million in 2008 to an estimated $150 million in 2011, while competitive ETC high-cost support for the remainder of the nation was frozen.

341. A significant number of supported lines under the Covered Locations exception are in larger cities in Alaska where multiple competitive ETCs often serve the same area. The result is that a significant amount of support in Alaska is provided to competitive ETCs serving the three largest Alaskan cities, Anchorage, Fairbanks, and Juneau.

342. The interim cap—along with its exceptions—was intended to be in place only until the Commission adopted comprehensive reforms to the high-cost program. The Commission adopts those reforms today. It is therefore appropriate, as the Commission transitions away from the identical support rule and the interim cap to a new high-cost support mechanism, including for mobile services, that this transition should begin for all competitive ETCs, including those that previously received uncapped support under exceptions to the interim cap.

343. With respect to Covered Locations, the Commission recognizes the significant strides that competitive ETCs have made in Covered Locations in the last two years, and that more still must be done to support expanded mobile coverage on Tribal lands. But, as with the rest of the Nation, the Commission concludes that the most effective way to do so will be through mechanisms that specifically and explicitly target support to expand coverage in Tribal lands where there is no economic business case to provide mobile service, not through the permanent continuation of the identical support rule. Our newly created Mobility Funds will provide dedicated funding to Tribal lands in a manner consistent with the policy objectives underlying our Covered Locations policy to continue to promote deployment in these communities.

344. The Commission therefore lifts the Covered Locations exception, and concludes that those carriers serving Tribal lands will be subject to the national five-year transition period. The Commission finds persuasive, however, arguments that carriers serving remote parts of Alaska, including Alaska Native villages, should have a slower transition path in order to preserve newly initiated services and facilitate additional investment in still unserved and underserved areas during the national transition to the Mobility Funds. Over 50 remote communities in Alaska have no access to mobile voice service today, and many remote Alaskan communities have access to only 2G services. While carriers serving other parts of Alaska will be subject to the national five-year transition period, the Commission is convinced a more gradual approach is warranted for carriers in remote parts of Alaska. For purposes of this R&O, the Commission will treat as remote areas of Alaska all areas other than the study areas, or portions thereof, that include the three major cities in Alaska with over 30,000 in population, Anchorage, Juneau, and Fairbanks. With respect to Anchorage, the Commission excludes the ACS of Anchorage study area (SAC 613000) as well as Eagle River Zones 1 and 2 and Chugiak Zones 1 and 2 of the Matanuska Telephone Authority study area (SAC 619003). For Fairbanks, the Commission excludes zone 1 of the ACS of Fairbanks (SAC 613008), and for Juneau, the Commission excludes the ACS Alaska-Juneau study area (SAC 613012). The Commission notes that ACS and GCI concur that the study areas, or portions thereof, that include these three cities are an appropriate proxy for non-remote areas of Alaska. There is no evidence on the record that any accommodation is necessary to preserve service or protect consumers in these larger Alaskan communities.

345. Specifically, in lifting the Covered Locations exception, the Commission delays the beginning of the five-year transition period for a two-year period for remote areas of Alaska. As a result, the Commission expects that ongoing support through the Mobility Fund Phase II, including the Tribal Mobility Fund Phase II, will be implemented prior to the beginning of the five-year transition period in July 2014 for remote parts of Alaska, providing greater certainty and stability for carriers in these areas. During this two-year period, the Commission establishes an interim cap for remote areas of Alaska for high-cost support for competitive ETCs, which balances the need to control the growth in support to competitive ETCs in uncapped areas and the need to provide a more gradual transition for the very remote and very high-cost areas in Alaska to reflect the special circumstances carriers and consumers face in those communities. This cap will be modeled on the state-by-state interim cap that has been in place under the *Interim Cap Order.* Specifically, the interim cap for remote areas of Alaska will be set at the total of all competitive ETC's baseline support amounts in remote areas of Alaska using the same process described above. On a quarterly basis, USAC will calculate the support each competitive ETC would have received under the frozen per-line support amount as of December 31, 2011 capped at $3000 per year, and then, if necessary, calculate a state reduction factor to reduce the total amount down to the cap amount for remote areas of Alaska. Specifically, USAC will compare the total amount of uncapped support to the interim cap for remote areas of Alaska. Where the total uncapped support is greater than the available support amount, USAC will divide the interim cap support amount by the total uncapped amount to yield the reduction factor. USAC will then apply the reduction factor to the uncapped amount for each competitive ETC within remote areas of Alaska to arrive at the capped level of high-cost support. If the uncapped support is less than the available capped support amount, no reduction will be required.

346. In addition, the Commission adopts a limited exception to the phase-down of support for Standing Rock Telecommunications, Inc. (Standing Rock), a Tribally-owned competitive ETC that had its ETC designation modified within calendar year 2011 for the purpose of providing service throughout the entire Standing Rock Sioux Reservation. The Commission recognizes that Tribally-owned ETCs

play a vital role in serving their communities, often in remote, low-income, and unserved and underserved regions. The Commission finds that a tailored approach in this particular instance is appropriate because of the unique federal trust relationship the Commission shares with federally recognized Tribes, which requires the federal government to adhere to certain fiduciary standards in its dealings with Tribes. In this regard, the federal government has a longstanding policy of promoting Tribal self-sufficiency and economic development, as embodied in various federal statutes. As an independent agency of the federal government, ''the Commission recognizes its own general trust relationship with, and responsibility to, federally recognized Tribes.'' In keeping with this recognition, the Commission has previously taken actions to aid Tribally-owned companies, which are entities of their Tribal governments and instruments of Tribal self-determination. For example, the Commission has adopted licensing procedures to increase radio station ownership by Tribes and Tribally-owned entities through the use of a ''Tribal Priority.''

347. A limited exception to the phase-down of competitive ETC support will give Standing Rock, a nascent Tribally-owned ETC that was designated to serve its entire Reservation and the only such ETC to have its ETC designation modified since release of the *USF/ICC Transformation NPRM* in February 2011, the opportunity to ramp up its operations in order to reach a sustainable scale to serve consumers in its service territory. The Commission finds that granting a two-year exception to the phase-down of support to this Tribally-owned competitive ETC is in the public interest. For a two-year period, Standing Rock will receive per-line support amounts that are the same as the total support per line received in the fourth quarter of this year. The Commission adopts this approach in order to enable Standing Rock to reach a sustainable scale so that consumers on the Reservation can realize the benefits of connectivity that, but for Standing Rock, they might not otherwise have access to.

348. The Commission concludes that carriers that have sought to take advantage of the ''own-costs'' exception to the existing interim cap on competitive ETC funds should not be exempted from the phase down of support. The ''own costs'' exception was intended to exempt carriers filing their own cost data from the interim cap to the extent their costs met an appropriate threshold. Because the Commission is transitioning away from support based on the identical support rule and toward new high-cost support mechanisms, the Commission sees no reason to continue to make the exception available going forward.

E. Connect America Fund in Remote Areas

349. In this section of the R&O, the Commission establishes a budget for CAF support in remote areas. This reflects the Commission's commitment to ensuring that Americans living in the most remote areas of the nation, where the cost of deploying wireline or cellular terrestrial broadband technologies is extremely high, can obtain affordable broadband through alternative technology platforms such as satellite and unlicensed wireless. As the National Broadband Plan observes, the cost of providing service is typically much higher for terrestrial networks in the hardest-to-serve areas of the country than in less remote but still rural areas. Accordingly, the Commission has exempted the most remote areas, including fewer than 1 percent of all American homes, from the home and business broadband service obligations that otherwise apply to CAF recipients. By setting aside designated funding for these difficult-to-serve areas, however, and by modestly relaxing the broadband performance obligations associated with this funding to encourage its use by providers of innovative technologies like satellite and fixed wireless, which may be significantly less costly to deploy in these remote areas, the Commission can ensure that those who live and work in remote locations also have access to affordable broadband service.

350. Although the Commission seeks further comment on the details of distributing dedicated remote-areas funding in the Further Notice of Proposed Rulemaking accompanying the R&O, the Commission sets as the budget for this funding at least $100 million annually. The choice of budget necessarily involves the reasonable exercise of predictive judgment, rather than a precise calculation: Many of the innovative, lower-cost approaches to serving hard to reach areas continue to evolve rapidly; the Commission is not setting the details of the distribution mechanism in the R&O; and the Commission is balancing competing priorities for funding. Nevertheless, a budget of at least $100 million per year is likely to make a significant difference in ensuring meaningful broadband access in the most difficult-to-serve areas.

351. Based on the RUS's prior experience with dedicated satellite funding to remote areas, a budget of at least $100 million could make a significant difference in expanding availability of affordable broadband service at such locations. Satellite broadband is already available to most households and small businesses in remote areas, and is likely to be available at increasing speeds over time, but current satellite services tend to have significantly higher prices to end-users than terrestrial fixed broadband services, and include substantial up-front installation costs. To help overcome these barriers in the RUS's BIP satellite program, supported providers received a one-time upfront payment per location to offer service for at least one year at a reduced price. There has been substantial consumer participation in this program, with providers estimating that they would be able to provide service to approximately 424,000 people at the reduced rates. Were the Commission to take a similar approach in distributing the $100 million set aside for remote areas funding, it could, in principle, provide a one-time sign-up subsidy to *almost all* of the estimated 670,000 remote, terrestrially-unserved locations within 4 years.

352. Such a calculation is only illustrative. For one, the Commission does not anticipate restricting the technology that can be used for remote area support. To the contrary, it seeks to encourage maximum participation of providers able to serve these most difficult to reach areas. In addition, the Commission may choose to disburse funding for remote areas in ways that either increase or decrease the dollars per supported customer, as compared to the RUS program. For example, the Commission may choose to provide ongoing support, in addition to or instead of a one-time subsidy, or it may adopt a means-tested approach to reducing the cost of service in remote areas, to target support to those most in need. The Commission seeks comment on each of these approaches in the Further Notice.

353. Notwithstanding this uncertainty, however, the record is sufficient for the Commission to conclude that a budget of at least $100 million falls within a reasonable initial range for a program targeted at innovative broadband technologies in remote areas. The Commission expects to revisit this decision over time, and will adjust support levels as appropriate.

F. Petitions for Waiver

354. During the course of this proceeding, various parties, both incumbents and competitive ETCs, have argued that reductions in current support levels would threaten their financial viability, imperiling service to consumers in the areas they serve. The Commission cannot, however, evaluate those claims absent detailed information about individualized circumstances, and conclude that they are better handled in the course of case-by-case review. Accordingly, the Commission permits any carrier negatively affected by these universal service reforms to file a petition for waiver that clearly demonstrates that good cause exists for exempting the carrier from some or all of those reforms, and that waiver is necessary and in the public interest to ensure that consumers in the area continue to receive voice service.

355. The Commission does not, however, expect to grant waiver requests routinely, and caution petitioners that the Commission intends to subject such requests to a rigorous, thorough and searching review comparable to a total company earnings review. In particular, the Commission intends to take into account not only all revenues derived from network facilities that are supported by universal service but also revenues derived from unregulated and unsupported services as well. The intent of this waiver process is not to shield companies from secular market trends, such as line loss or wireless substitution. Waiver would be warranted where an ETC can demonstrate that, without additional universal service funding, its support would not be ''sufficient to achieve the purposes of [section 254 of the Act].'' In particular, a carrier seeking such waiver must demonstrate that it needs additional support in order for its customers to continue receiving voice service in areas where there is no terrestrial alternative. The Commission envisions granting relief only in those circumstances in which the petitioner can demonstrate that the reduction in existing high-cost support would put consumers at risk of losing voice services, with no alternative terrestrial providers available to provide voice telephony service using the same or other technologies that provide the functionalities required for supported voice service. The Commission envisions granting relief only in those circumstances in which the petitioner can demonstrate that the reduction in existing high-cost support would put consumers at risk of losing voice services, with no alternative terrestrial providers available to provide voice telephony service to consumers using the same or other technologies that provide the functionalities required for supported voice service. The Commission will also consider whether the specific reforms would cause a provider to default on existing loans and/or become insolvent. For mobile providers, the Commission will consider as a factor specific showings regarding the impact on customers, including roaming customers, if a petitioner is the only provider of CDMA or GSM coverage in the affected area.

356. Petitions for waiver must include a specific explanation of why the waiver standard is met in a particular case. Conclusory assertions that reductions in support will cause harm to the carrier or make it difficult to invest in the future will not be sufficient.

357. In addition, petitions must include all financial data and other information sufficient to verify the carrier's assertions, including, at a minimum, the following information:

- Density characteristics of the study area or other relevant geographic area including total square miles, subscribers per square mile, road miles, subscribers per road mile, mountains, bodies of water, lack of roads, remoteness, challenges and costs associated with transporting fuel, lack of scalability per community, satellite and backhaul availability, extreme weather conditions, challenging topography, short construction season or any other characteristics that contribute to the area's high costs.
- Information regarding existence or lack of alternative providers of voice and whether those alternative providers offer broadband.
- (For incumbent carriers) How unused or spare equipment or facilities is accounted for by providing the Part 32 account and Part 36 separations category this equipment is assigned to.
- Specific details on the make-up of corporate operations expenses such as corporate salaries, the number of employees, the nature of any overhead expenses allocated from affiliated or parent companies, or other expenses.
- Information regarding all end user rate plans, both the standard residential rate and plans that include local calling, long distance, Internet, texting, and/or video capabilities.
- (For mobile providers) A map or maps showing (1) the area it is licensed to serve; (2) the area in which it actually provides service; (3) the area in which it is designated as a CETC; (4) the area in which it is the sole provider of mobile service; (5) location of each cell site. For the first four of these areas, the provider must also submit the number of road-miles, population, and square miles. Maps shall include roads, political boundaries, and major topographical features. Any areas, places, or natural features discussed in the provider's waiver petition shall be shown on the map.
- (For mobile providers) Evidence demonstrating that it is the only provider of mobile service in a significant portion of any study area for which it seeks a waiver. A mobile provider may satisfy this evidentiary requirement by submitting industry-recognized carrier service availability data, such as American Roamer data, for all wireless providers licensed by the FCC to serve the area in question. If a mobile provider claims to be the sole provider in an area where an industry-recognized carrier service availability data indicates the presence of other service, then it must support its claim with the results of drive tests throughout the area in question. In the parts of Alaska or other areas where drive testing is not feasible, a mobile provider may offer a statistically significant number of tests in the vicinity of locations covered. Moreover, equipment to conduct the testing can be transported by off-road vehicles, such as snow-mobiles or other vehicles appropriate to local conditions. Testing must examine a statistically meaningful number of call attempts (originations) and be conducted in a manner consistent with industry best practices. Waiver petitioners that submit test results must fully describe the testing methodology, including but not limited to the test's geographic scope, sampling method, and test set-up (equipment models, configuration, *etc.*). Test results must be submitted for the waiver petitioner's own network and for all carriers that the industry-recognized carrier service availability data shows to be serving the area in which the petitioner claims to be the only provider of mobile service.
- (For mobile providers). Revenue and expense data for each cell site for the three most recent fiscal years. Revenues shall be broken out by source: End user revenues, roaming revenues, other revenues derived from facilities supported by USF, all other revenues. Expenses shall be categorized: Expenses that are directly attributable to a specific cell site, network expenses allocated among all sites, overhead expenses allocated among sites. Submissions must include descriptions the manner in which shared or common costs and corporate overheads are allocated to specific cell sites. To the extent that a mobile provider makes arguments in its

waiver petition based on the profitability of specific cell sites, petitioner must explain why its cost allocation methodology is reasonable.

• (For mobile providers) Projected revenues and expenses, on cell-site basis, for 5 years, with and without the waiver it seeks. In developing revenue and expense projections, petitioner should assume that it is required to serve those areas in which it is the sole provider for the entire five years and that it is required to fulfill all of its obligations as an ETC through December 2013.

• A list of services other than voice telephone services provided over the universal service supported plant, *e.g.,* video or Internet, and the percentage of the study area's telephone subscribers that take these additional services.

• (For incumbent carriers) Procedures for allocating shared or common costs between incumbent LEC regulated operations, competitive operations, and other unregulated or unsupported operations.

• Audited financial statements and notes to the financial statements, if available, and otherwise unaudited financial statements for the most recent three fiscal years. Specifically, the cash flow statement, income statement and balance sheets. Such statements shall include information regarding costs and revenues associated with unregulated operations, *e.g.,* video or Internet.

• Information regarding outstanding loans, including lender, loan terms, and any current discussions regarding restructuring of such loans.

• Identification of the specific facilities that will be taken out of service, such as specific cell towers for a mobile provider, absent grant of the requested waiver.

• For Tribal lands and insular areas, any additional information about the operating conditions, economic conditions, or other reasons warranting relief based on the unique characteristics of those communities.

358. Failure to provide the listed information shall be grounds for dismissal without prejudice. In addition to the above, the petitioner shall respond and provide any additional information as requested by Commission staff. The Commission will also welcome any input that the relevant state commission may wish to provide on the issues under consideration, with a particular focus on the availability of alternative unsubsidized voice competitors in the relevant area and recent rate-setting activities at the state level, if any.

359. The Commission delegates to the Wireline Competition and Wireless Telecommunications Bureaus the authority to approve or deny all or part of requests for waiver of the phase-down in support adopted herein. Such petitions will be placed on public notice, with a minimum of 45 days provided for comments and reply comments to be filed by the general public and relevant state commission. The Commission directs the Bureaus to prioritize review of any applications for waiver filed by providers serving Tribal lands and insular areas, and to complete their review of petitions from providers serving Tribal lands and insular areas within 45 days of the record closing on such waiver petitions.

G. Enforcing the Budget for Universal Service

1. Creating New Flexibility To Manage Fluctuations in Demand

360. *Discussion.* The Commission adopts the proposed amendment to 47 CFR 54.709(b) to permit the Commission to instruct USAC to take alternative action with regard to prior period adjustments when making its quarterly demand filings. Currently, the section requires that excess contributions received in a quarter ''will be carried forward to the following quarter.'' The Commission amends the rule to add paragraph 54.709(b)(1), which shall read, ''The Commission may instruct USAC to treat excess contributions in a manner other than as prescribed in paragraph (b). Such instructions may be made in the form of a Commission Order or a Public Notice released by the Wireline Competition Bureau. Any such Public Notice will become effective fourteen days after release of the Public Notice, absent further Commission action.''

361. Permitting the Commission to modify its current treatment of excess contributions as necessary on a case-by-case basis will permit it to better manage the effects of one-time and seasonal events that may create undue volatility in the contribution factor. Programmatic changes, one-time distributions of support (such as Mobility Fund Phase I), and other transitional processes will likely cause the quarterly funding demands to fluctuate considerably until the transitions are complete, similarly to how large, unforecasted one-time contributions have caused significant fluctuations in the past. The ability to provide specific, case-by-case instructions will allow the Commission to smooth the effects of such events on the contribution factor, rendering it more predictable for the consumers who ultimately pay for universal service.

362. In response to the *USF/ICC Transformation NPRM* seeking comment on whether to modify 47 CFR 54.709(b), some commenters raise questions about whether 47 U.S.C. 254 of the Act provides the Commission the authority to establish a broadband reserve fund intended to make disbursements according to rules that were, at the time, not yet adopted. As RICA put it, 47 U.S.C. 254 requires carriers to contribute to the ''specific, predictable, and sufficient mechanisms established (not *to be* established) by the Commission to preserve and advance Universal Service.'' Verizon, similarly, suggests that 47 U.S.C. 254's reference to '''specific' and 'predictable' USF programs and support—and contributions collected for 'established' universal service mechanisms—counsels against reserving support for mechanisms that do not yet exist.'' Nevertheless, for the reasons set forth below, the Commission concludes that a broadband reserve account is consistent with 47 U.S.C. 254 of the Act.

363. The Commission does not read 47 U.S.C. 254(d) as limiting the Commission's authority to require contributions only to support specific mechanisms that are already established at the time the contributions are required, for several reasons.

364. Broadly speaking, the Commission understands 47 U.S.C. 254(d) to be directed to explaining *who* must contribute to the Federal universal service mechanisms—specifically, telecommunications carriers that provide interstate telecommunications services, unless exempted by the Commission, as well as other providers of interstate telecommunications if the Commission determines the public interest so requires. The reference in 47 U.S.C. 254(d) to ''the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service'' is not, as these commenters suggest, a limitation on what kinds of mechanisms—*i.e.,* already-established mechanisms—will be supported; it is instead a reference to language in 47 U.S.C. 254(b), which directs the Commission (as well as the Joint Board) to be guided by several principles in establishing universal service policies, including the principle that ''[t]here should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.'' In other words, it merely requires that contributions under 47 U.S.C. 254 are to be used to support the Federal mechanisms that are established under 47 U.S.C. 254.

365. The Commission also finds that commenters' argument is unpersuasive given the grammatical construction of the relevant section of the law. In the phrase ''mechanisms established by the Commission,'' the clause ''established by the Commission'' functions as an adjectival phrase identifying which mechanisms are funded through 47 U.S.C. 254(d). Specifically, the mechanisms funded by 47 U.S.C. 254(d) are the mechanisms ''established by the Commission'' consistent with the principles of 47 U.S.C. 254(b) (that they be specific, predictable, and sufficient). When used in this way, the word ''established'' is not a word in the past tense; it is not a word that signifies any particular tense at all. Commenters who read the word ''established'' as signifying the past tense are, the Commission concludes, improperly reading ''already'' into the phrase, so that it would read ''mechanisms already established by the Commission.'' Congress could have written the statute that way, but it did not. Admittedly, Congress could have written the statute in yet other ways that would have made clearer that these commenters' concerns are misplaced. But that indicates only that the statute is amenable to various interpretations. And for the reasons explained here, the Commission concludes its interpretation is the better reading of the statute.

366. These commenters' view also raises troubling questions of interpretation, which the Commission believes Congress did not intend. That is, under these commenters' reading of the statute, contributions may only be collected to fund a mechanism that has already been established. Broadly speaking, all of the rule changes that the Commission has implemented since the 1996 Act, including those adopted in this R&O, have been to effectuate the general statutory directive that consumers should have access to telecommunication and information services in rural and high cost areas. As such, the entire collection of rules can be viewed as the ''high-cost mechanism,'' and the specific existing programs, as well as the Connect America Fund, are part of that high-cost mechanism.

367. To read the statute in any other way would create significant administrative issues that the Commission cannot believe Congress would have intended. How would the Commission—or a court— decide whether a modified mechanism is a new, not-yet-established mechanism (which could not provide support until new funds are collected for it), or whether the modifications are minor enough such that the mechanism, although different, is still the mechanism that was already established? The Commission does not believe that Congress intended either the Commission or a court to be required to wrestle with such questions, which serve no obvious congressional purpose. Alternatively, any change, no matter how minor, could transform the mechanism into one that was not-yet-established. Interpreting the statute in that way would similarly serve no identifiable congressional purpose, but would serve only to slow down and complicate reforms to support mechanisms that the Commission determines are appropriate to advance the public interest. Significantly in this regard, Congress in 47 U.S.C. 254 specifically contemplated that universal service programs would change over time; reading the statute the way these commenters suggest would add unnecessary burdens to that process.

2. Setting Quarterly Demand To Meet the $4.5 Billion Budget

368. *Discussion.* Various parties have submitted proposed budgets into the record suggesting that the Commission could maintain an overall $4.5 billion annual budget by collecting that amount in the near term, projecting that actual demand will be lower than that amount, and using those funds in subsequent quarters to address actual demand that exceeds $1.125 billion. The Commission is persuaded that, on balance, it would be appropriate to provide greater flexibility to USAC to use past contributions to meet future program demand so that the Commission can implement the Connect America Fund in a way that does not cause dramatic swings in the contribution factor. The Commission now sets forth general instructions to USAC on how to implement the $4.5 billion budget target.

369. First, beginning with the quarterly demand filing for the first quarter of 2012, USAC should forecast total high-cost universal service demand as no less than $1.125 billion, *i.e.,* one quarter of the annual high-cost budget. To the extent that USAC forecasts demand will actually be higher than that amount, USAC should reflect that higher forecast in its quarterly demand filing. If high-cost demand actually exceeds $1.125 billion, no additional funds will accumulate in the reserve account for that quarter and, consistent with the third instruction below, the reserve account will be used to constrain the high-cost demand in the contribution factor. USAC should no longer forecast total competitive ETC support at the original interim cap amount, as previously instructed, but should forecast competitive ETC support subject to the rules the Commission adopts today. Specifically, USAC shall forecast competitive ETC demand as set by the frozen baseline per study area as of year end 2011, as adjusted by the phase-down in the relevant time period.

370. Second, consistent with the newly revised section 54.709(b) of the rules, the Commission instructs USAC not to make prior period adjustments related to high-cost support if actual contributions exceed demand. Excess contributions shall instead be credited to a new Connect America Fund reserve account, to be used as described below.

371. Third, beginning with the second quarter of 2012, the Commission directs USAC to use the balances accrued in the CAF reserve account to reduce high-cost demand to $1.125 billion in any quarter that would otherwise exceed $1.125 billion.

372. The Commission expects the reforms the Commission adopts today to keep annual contributions for the CAF and any existing high-cost support mechanisms to no more than $4.5 billion. And through the use of incentive-based rules and competitive bidding, the fund could require less than $4.5 billion to achieve its goals in future years. However, if actual program demand, exclusive of funding provided from the CAF or *Corr Wireless* reserve accounts, for CAF and existing high-cost mechanisms exceed an annualized $4.5 billion over any consecutive four quarters, this situation will automatically trigger a process to bring demand back under budget. Specifically, immediately upon receiving information from USAC regarding actual quarterly demand, the Wireline Competition Bureau will notify each Commissioner and publish a Public Notice indicating that program demand has exceeded $4.5 billion over the last four quarters. Then, within 75 days of the Public Notice being published, the Bureau will develop options and provide to the Commissioners a recommendation and specific action plan to immediately bring expenditures back to no more than $4.5 billion.

3. Drawing Down the Corr Wireless Reserve Account

373. *Discussion.* In order to wind down the current broadband reserve account, the Commission provides the following instructions to USAC.

374. First, the Commission directs USAC to utilize $300 million in the *Corr Wireless* reserve account to fund

commitments that the Commission anticipates will be made in 2012 to recipients of the Mobility Fund Phase I to accelerate advanced mobile services. The Commission also directs USAC to use the remaining funds and any additional funding necessary for Phase I of the CAF for price cap carriers in 2012. Those actions together should exhaust the *Corr Wireless* reserve account.

375. Second, the Commission instructs USAC not to use the *Corr Wireless* reserve account to fund inflation adjustments to the e-rate cap for the current 2011 funding year. Inflation adjustments to the e-rate cap for Funding Year 2011 and future years shall be included in demand projections for the e-rate program.

VI. Accountability and Oversight

376. The billons of dollars that the Universal Service Fund disburses each year to support vital communications services come from American consumers and businesses, and recipients must be held accountable for how they spend that money. This requires vigorous ongoing oversight by the Commission, working in partnership with the states, Tribal governments, where appropriate, and U.S. Territories, and the Fund administrator, USAC. Because the CAF, including the Mobility Fund, are part of USF, the Commission concludes that USAC shall administer these new programs under the terms of its current appointment as Administrator, subject to all existing Commission rules and orders applicable to the Administrator. The Commission hereby designates the Wireless Telecommunications Bureau as a point of contact, in addition to the Wireline Competition Bureau, on policy matters relating to USF administration.

A. Uniform Framework for ETC Oversight

1. Need for Uniform Standards for Accountability and Oversight

377. *Discussion.* A uniform national framework for accountability, including unified reporting and certification procedures, is critical to ensure appropriate use of high-cost support and to allow the Commission to determine whether it is achieving its goals efficiently and effectively. Therefore, the Commission now establishes a national framework for oversight that will be implemented as a partnership between the Commission and the states, U.S. Territories, and Tribal governments, where appropriate. As set forth more fully in the subsections immediately following, this national framework will include annual reporting and certification requirements for all ETCs receiving universal funds—not just federally-designated ETCs—which will provide federal and state regulators the factual basis to determine that all USF recipients are using support for the intended purposes, and are receiving support that is sufficient, but not excessive. The Commission has authority to require all ETCs to comply with these national requirements as a condition of receiving federal high-cost universal service support. (For purposes of this section, the references to ETCs include those ETCs that receive high-cost support pursuant to legacy high-cost programs and CAF programs adopted in this R&O. It does not generally include ETCs that receive support solely pursuant to Mobility Fund Phase I, which has separate reporting obligations. Where the requirements discussed in this section also apply to ETCs receiving only Phase I Mobility Fund support, the Commission specifically states so. In the *USF/ICC Transformation FNPRM,* the Commission seeks comment on alternative reporting requirements for Mobility Fund support to reflect basic differences in the nature and purpose of the support provided for mobile services.)

378. The Commission clarifies that the specific reporting and certification requirements adopted below are a floor rather than a ceiling for the states. In 47 U.S.C. 254(f), Congress expressly permitted states to take action to preserve and advance universal service, so long as not inconsistent with the Commission's universal service rules. The statute permits states to adopt additional regulations to preserve and advance universal service so long as they also adopt state mechanisms to support those additional substantive requirements. Consistent with this federal framework, state commissions may require the submission of additional information that they believe is necessary to ensure that ETCs are using support consistent with the statute and the implementing regulations, so long as those additional reporting requirements do not create burdens that thwart achievement of the universal service reforms set forth in this R&O.

379. The Commission notes, however, that one benefit of a uniform reporting and certification framework for ETCs is that it will minimize regulatory compliance costs for those ETCs that operate in multiple states. ETCs should be able to implement uniform policies and procedures in all of their operating companies to track, validate, and report the necessary information. Although the Commission adopts a number of new reporting requirements below, the Commission concludes that the critical benefit of such reporting—to ensure that statutory and regulatory requirements associated with the receipt of USF funds are met—outweighs the imposition of some additional time and cost on individual ETCs to make the necessary reports. Under this uniform framework, ETCs will provide annual reports and certifications regarding specific aspects of their compliance with public interest obligations to the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate by April 1 of each year. These annual reporting requirements should provide the factual basis underlying the annual 47 U.S.C. 254(e) certification by the state commission (or ETC in the case of federally designated ETCs) by October 1 of every year that support is being used for the intended purposes.

2. Reporting Requirements

380. *Discussion.* First, the Commission extends the current federal annual reporting requirements to all ETCs, including those designated by states. These requirements will now be located in new 47 CFR 54.313. Specifically, the Commission concludes that all ETCs must include in their annual reports the information that is currently required by 47 CFR 54.209(a)(1)–(a)(6)—specifically, a progress report on their five-year build-out plans; data and explanatory text concerning outages; unfulfilled requests for service; complaints received; and certifications of compliance with applicable service quality and consumer protection standards and of the ability to function in emergency situations. If ETCs are complying with any voluntary code (*e.g.,* the voluntary code of conduct concerning ''bill shock'' or the CTIA Consumer Code for Wireless Service), they should so indicate in their reports. The Commission concludes that it is necessary and appropriate to obtain such information from all ETCs, both federal- and state-designated, to ensure the continued availability of high-quality voice services and monitor progress in achieving the broadband goals and to assist the FCC in determining whether the funds are being used appropriately. As the Commission said at the time the Commission adopted these requirements for federally-designated ETCs, these reporting requirements ensure that ETCs comply with the conditions of the ETC designation and that universal service funds are used for

their intended purposes. They also help prevent carriers from seeking ETC status for purposes unrelated to providing rural and high-cost consumers with access to affordable telecommunications and information services. Accordingly, the Commission now concludes that these requirements should serve as a baseline requirement for all ETCs.

381. All ETCs that receive high-cost support will file the information required by new 47 CFR 54.313 with the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate. USAC will review such information as appropriate to inform its ongoing audit program, in depth data validations, and related activities. 47 CFR 54.313 reports will be due annually by April 1, beginning on April 1, 2012. (The Commission delegates authority to the Wireline Competition Bureau to modify the initial filing deadline as necessary to comply with the requirements of the Paperwork Reduction Act.) The Commission will also require that an officer of the company certify to the accuracy of the information provided and make the certifications required by new 47 CFR 54.313, with all certifications subject to the penalties for false statements imposed under 18 U.S.C. 1001.

382. Second, the Commission incorporates new reporting requirements described below to ensure that recipients are complying with the new broadband public interest obligations adopted in this R&O, including broadband public interest obligations associated with CAF ICC. This information must be included in annual 47 CFR 54.313 reports filed with Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate. However, some of the new elements are tied to new public interest obligations that will be implemented in 2013 or a subsequent year and, therefore, they need not be included until that time, as detailed below.

383. Competitive ETCs whose support is being phased down will not be required to submit any of the new information or certifications below related solely to the new broadband public interest obligations, but must continue to submit information or certifications with respect to their provision of voice service.

384. The Commission delegates to the Wireline Competition Bureau and Wireless Telecommunication Bureaus the authority to determine the form in which recipients of support must report this information.

385. *Speed and latency.* Starting in 2013, the Commission will require all ETCs to include the results of network performance tests conducted in accordance with the requirements of this R&O and any further requirements adopted after consideration of the record received in response to the FNPRM. Additionally, in the calendar year no later than three years after implementation of CAF Phase II, price cap recipients must certify that they are meeting all interim speed and latency milestones, including the 4 Mbps/1 Mbps speed standard required by this R&O. In the calendar year no later than five years after implementation of CAF Phase II, those price cap recipients must certify that they are meeting the default speed and latency standards applicable at the time.

386. *Capacity.* Starting in 2013, the Commission requires all ETCs to include a self-certification letter certifying that usage capacity limits (if any) for their services that are subject to the broadband public interest standard associated with the type of funding they are receiving are reasonably comparable to usage capacity limits for comparable terrestrial residential fixed broadband offerings in urban areas, as set forth in the Public Interest Obligations sections above. ETCs will also be required to report on specific capacity requirements (if any) in conjunction with reporting of pricing of their broadband offerings that meet the public interest obligations, as discussed below.

387. *Build-out/Service.* Recognizing that existing five-year build out plans may need to change to account for new broadband obligations set forth in this R&O, the Commission requires all ETCs to file a new five-year build-out plan in a manner consistent with 54.202(a)(1)(ii) by April 1, 2013. Under the terms of new 47 CFR 54.313(a), all ETCs will be required to include in their annual 54.313 reports information regarding their progress on this five-year broadband build-out plan beginning April 1, 2014. This progress report shall include the number, names, and addresses of community anchor institutions to which the ETCs newly offer broadband service. As discussed above, the Commission expects ETCs to use their support in a manner consistent with achieving universal availability of voice and broadband. Incumbent carriers, both rate-of-return and price cap, should make certifications to that effect beginning April 1, 2013 for the 2012 calendar year.

388. In addition, all ETCs must supply the following information:

(a) *Rate-of-Return Territories.* The Commission requires all rate-of-return ETCs receiving support to include a self-certification letter certifying that they are taking reasonable steps to offer broadband service meeting the requirements established above throughout their service area, and that requests for such service are met within a reasonable amount of time. As noted above, these carriers must also notify the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate, of all unfulfilled requests for broadband service meeting the 4 Mbps/1 Mbps standard the Commission establishes as the initial CAF requirement, and the status of such requests.

(b) *Price Cap Territories.* The Commission requires all ETCs receiving CAF support in price cap territories based on a forward-looking cost model to include a self-certification letter certifying that they are meeting the interim deployment milestones as set forth in the Public Interest Obligations section above and that they are taking reasonable steps to meet increased speed obligations that will exist for a specified number of supported locations before the expiration of the five-year term for CAF Phase II funding. ETCs that receive CAF support awarded through a competitive process will also be required to file such self-certifications, subject to any modifications adopted pursuant to the FNPRM below.

389. In addition, as discussed above, price cap ETCs will be able to elect to receive CAF Phase I incremental funding under a transitional distribution mechanism prior to adoption and implementation of an updated forward-looking broadband-focused cost model for CAF Phase II. As a condition of receiving such support, those companies will be required to deploy broadband to a certain number of unserved locations within three years, with deployment to no fewer than two-thirds of the required number of locations within two years and to all required locations within three years after filing their notices of acceptance. As of that time, carriers must offer broadband service of at least 4 Mbps downstream and 1 Mbps upstream, with latency sufficiently low to enable the use of real-time communications, including VoIP, and with usage limits, if any, that are reasonably comparable to those in urban areas. As noted above, no later than 90 days after being informed of its eligible incremental support amount, each price cap ETC must provide notice to the Commission and to the relevant state commission, relevant authority in a U.S. Territory, or

Tribal government, as appropriate, identifying the areas, by wire center and census block, in which the carrier intends to deploy broadband to meet this obligation, or stating that the carrier declines to accept incremental support for that year.

390. The carrier must also certify that (1) deployment funded by CAF Phase I incremental support will occur in areas shown as unserved by fixed broadband on the National Broadband Map that is most current at that time, and that, to the best of the carrier's knowledge, are unserved by fixed broadband with a minimum speed of 768 kbps downstream and 200 kbps upstream, and that, to the best of the carrier's knowledge, are, in fact, unserved by fixed broadband at those speeds; and (2) the carrier's current capital improvement plan did not already include plans to deploy broadband to that area within three years, and that CAF Phase I support will not be used to satisfy any merger commitment or similar regulatory obligation. In addition, carriers must certify that: (1) Within two years after filing a notice of acceptance, they have deployed to no fewer than two-thirds of the required number of locations; and (2) within three years after filing a notice of acceptance, they have deployed to all required locations and that they are offering broadband service of at least 4 Mbps downstream and 1 Mbps upstream, with latency sufficiently low to enable the use of real-time communications, including VoIP, and with usage limits, if any, that are reasonably comparable to those in urban areas. These certifications must be included in the first annual report due following the year in which the carriers reach the required milestones.

391. In addition, price cap carriers that receive frozen high-cost support will be required to certify that they are using such support in a manner consistent with achieving universal availability of voice and broadband. Specifically, in the 2013 certification, all price cap carriers receiving frozen high-cost support must certify to the Commission, the relevant state commission, relevant authority in a U.S. Territory, and to any affected Tribal government that they used such support in a manner consistent with achieving the universal availability of voice and broadband. In the 2014 certification, all price cap carriers receiving frozen high-cost support must certify that at least one-third of the frozen-high cost support they received in 2013 was used to build and operate broadband-capable networks used to offer the provider's own retail broadband service in areas substantially unserved by an unsubsidized competitor. In the 2015 certification, carriers must certify that at least two-thirds of the frozen high-cost support the carrier received in 2014 was used in such fashion, and for 2016 and subsequent years, carriers must certify that all frozen high-cost support they received in the previous year was used in such fashion. These certifications must be included in the carriers' annual reports due April 1 of each year. Price cap companies that receive CAF ICC also are obligated to certify that they are using such support for building and operating broadband-capable networks used to offer their own retail service in areas substantially unserved by an unsubsidized competitor.

392. *Price.* The Commission requires all ETCs to submit a self-certification that the pricing of their voice services is no more than two standard deviations above the national average urban rate for voice service, which will be specified annually in a public notice issued by the Wireline Competition Bureau. This certification requirement begins April 1, 2013, to cover 2012.

393. ETCs receiving only Mobility Fund Phase I support will self-certify annually that they offer service in areas with support at rates that are within a reasonable range of rates for similar service plans offered by mobile wireless providers in urban areas. ETCs receiving any other support will submit a self-certification that the pricing of their broadband service is within a specified reasonable range. That range will be established and published as more fully described above for recipients of high-cost and CAF support, other than Mobility Fund Phase I. This certification requirement begins April 1, 2013, to cover 2012.

394. ETCs must also report pricing information for both voice and broadband offerings. They must submit the price and capacity range (if any) for the broadband offering that meets the relevant speed requirement in their annual reporting. In addition, beginning April 1, 2012, subject to PRA approval, all incumbent local exchange company recipients of HCLS, frozen high-cost support, and CAF also must report their flat rate for residential local service to USAC so that USAC can calculate reductions in support levels for those carriers with R1 rates below the specified rate floor, as established above. Carriers may not request confidential treatment for such pricing and rate information.

395. *Financial Reporting.* The Commission sought comment on requiring all ETCs to provide financial information, including balance sheets, income statements, and statements of cash flow.

396. Upon consideration of the record, the Commission now adopts a less burdensome variation of this proposal. The Commission concludes that it is not necessary to require submission of such information from publicly traded companies, as we can obtain such information directly for SEC registrants. Likewise, the Commission concludes at this time it is not necessary to require the filing of such information by recipients of funding determined through a forward-looking cost model or through a competitive bidding process, even if those recipients are privately held. The Commission expects that a model developed through a transparent and rigorous process will produce support levels that are sufficient but not excessive, and that support awarded through competitive processes will be disciplined by market forces. The design of those mechanisms should drive support to efficient levels.

397. The Commission emphasizes, however, that it may request additional information on a case-by-case basis from all ETCs, both private and public, as necessary to discharge the universal service oversight responsibilities.

398. For privately-held rate-of-return carriers that continue to receive support based in part on embedded costs, the Commission adopts a more limited reporting requirement, beginning in 2012. The Commission requires all privately-held rate-of-return carriers receiving high-cost and/or CAF support to file with the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate beginning April 1, 2012, subject to PRA approval, a full and complete annual report of their financial condition and operations as of the end of their preceding fiscal year, which is audited and certified by an independent certified public accountant in a form satisfactory to the Commission, and accompanied by a report of such audit. The annual report shall include balance sheets, income statements, and cash flow statements along with necessary notes to clarify the financial statements. The income statements shall itemize revenue by its sources.

399. The ETCs subject to this new requirement are all already subject to the Uniform System of Accounts, which specifies how required financial information shall be maintained in accordance with Part 32 of the Commission's rules. Because Part 32 of the rules already requires incumbent carriers to break down accounting by study area, it should provide an

accurate picture of how recipients are using the high-cost support they receive in particular study areas. Additionally, Part 32 provides a uniform system of accounting that allows for an accurate comparison among carriers. ETCs that receive loans from the Rural Utility Service (RUS) are already required to provide RUS with annual financial reports maintained in accordance with Part 32. The Commission will allow these carriers to satisfy their financial reporting obligation by simply providing electronic copies of their annual RUS reports to the Commission, which should not impose any additional burden. All other rate-of-return carriers, in their initial filing after adoption of this R&O, shall provide the required financial information as kept in accordance with Part 32 of the Commission's rules.

400. The Commission delegates to the Wireline Competition Bureau the authority to resolve all other questions regarding the appropriate format for carriers' first financial filing following this R&O, as well as the authority to set the format for subsequent reports. The Commission may in future years implement a standardized electronic filing system, and the Commission also delegates to the Wireline Competition Bureau the task of establishing an appropriate format for transmission of this information.

401. The Commission does not expect privately held ETCs will face a significant burden in producing the financial disclosures required herein because such financial accounting statements are normally prepared in the usual course of business. In particular, because incumbent LECs are already required to maintain their accounts in accordance with Part 32, the required disclosures are expected to impose minimal new burdens. Indeed, for the many carriers that already provide Part 32 financial reports to RUS, there will be no additional burden.

402. Finally, the Commission concludes that these carriers' financial disclosures should be made publicly available. The only comment the Commission received on this issue came from NASUCA, which strongly urged the Commission to require public disclosure of all financial reports. NASUCA rightly observed that recipients of high-cost and/or CAF support receive extensive public funding, and therefore the public has a legitimate interest in being able to verify the efficient use of those funds. Moreover, by making this information public, the Commission will be assisted in its oversight duties by public interest watchdogs, consumer advocates, and others who seek to ensure that recipients of support receive funding that is sufficient but not excessive.

403. *Ownership Information.* The Commission now adopts a rule requiring all ETCs to report annually the company's holding company, operating companies, affiliates, and any branding (a ''dba,'' or ''doing-business-as company'' or brand designation). In addition, filers will be required to report relevant universal service identifiers for each such entity by Study Area Codes. This will help the Commission reduce waste, fraud, and abuse and increase accountability in the universal service programs by simplifying the process of determining the total amount of public support received by each recipient, regardless of corporate structure. Such information is necessary in order for the Commission to ensure compliance with various requirements adopted today that take into account holding company structure. For purposes of this requirement, affiliated interests shall be reported consistent with 47 U.S.C. 3(2) of the Communications Act of 1934, as amended.

404. *Tribal Engagement.* ETCs serving Tribal lands must include in their reports documents or information demonstrating that they have meaningfully engaged Tribal governments in their supported areas. The demonstration must document that they had discussions that, at a minimum, included: (1) A needs assessment and deployment planning with a focus on Tribal community anchor institutions; (2) feasibility and sustainability planning; (3) marketing services in a culturally sensitive manner; (4) rights of way processes, land use permitting, facilities siting, environmental and cultural preservation review processes; and (5) compliance with Tribal business and licensing requirements.

405. *Elimination of Certain Data Reporting Requirements.* Finally, as discussed above, the Commission is eliminating LSS and IAS as standalone support mechanisms. This obviates the need for reporting requirements specific to 54.301(b) and 54.802 of the rules (and 54.301(e) after December 31, 2012).

406. Overall, the changes to the reporting requirements do not impose an undue burden on ETCs and that the benefits outweigh any burdens. Given the extensive public funding these entities receive, the expanded goals of the program, and the need for greater oversight, as noted by the GAO, it is prudent to impose narrowly tailored reporting requirements focused on the information that will demonstrate compliance with statutory requirements and the implementing rules. These specific reporting requirements are tailored to ensure that ETCs are complying with their public interest obligations and using support for the intended purposes, as required by 47 U.S.C. 254(e) of the Act. Where possible, the Commission is minimizing burdens by requiring certifications in lieu of collecting data, and by allowing the filing of reports already prepared for other government agencies in lieu of new reports. Moreover, the Commission is eliminating some of the existing requirements, which will reduce burdens for some ETCs. Finally, to the extent ETCs currently provide information either to their state or to the Commission, they will not bear any significant additional burden in now also providing copies of such information to the other regulatory body.

3. Annual Section 254(e) Certifications

407. *Discussion.* First, the Commission requires that states—and entities not falling within the states' jurisdiction (*i.e.,* federally-designated ETCs)—certify that all federal high-cost and CAF support was used in the preceding calendar year *and* will be used in the new calendar year only for the provision, maintenance, and upgrading of facilities and services for which the support is intended, regardless of the rule under which that support is provided. This corrects a defect in the current rules, which require only a certification with respect to the coming year. The certifications required by new 47 CFR 54.314 will be due by October 1 of each year, beginning with October 1, 2012. The certification requirement applies to all recipients of high-cost and CAF support, including those that receive only Phase I Mobility Fund support.

408. Second, the Commission maintains states' ongoing role in annual certifications. Several commenters take the position that responsibility for ensuring USF recipients comply with their public interest obligations should remain with the states. As discussed above, the Commission agrees that the states should play an integral role in assisting the Commission in monitoring compliance, consistent with an overarching uniform national framework. States will continue to certify to the Commission that support is used by state-designated ETCs for the intended purpose, which is modified to include the provision, maintenance, and upgrading of facilities capable of delivering voice and broadband services to homes, businesses and community anchor institutions.

409. Under the reformed rules, as before, some recipients of support may be designated by the Commission rather than the states. States are not required to file certifications with the Commission with respect to carriers that do not fall within their jurisdiction. However, consistent with the partnership between the Commission and the states to preserve and enhance universal service, and the recognition that states will continue to be the first place that consumers may contact regarding consumer protection issues, the Commission encourages states to bring to its attention issues and concerns about all carriers operating within their boundaries, including information regarding non-compliance with the rules by federally-designated ETCs. The Commission similarly encourages Tribal governments, where appropriate, to report to the Commission any concerns about non-compliance with the rules by all recipients of support operating on Tribal lands. Any such information should be provided to the Wireline Competition Bureau and the Consumer & Governmental Affairs Bureau. Through such collaborative efforts, the Commission will work together to ensure that consumer interests are appropriately protected.

410. Third, the Commission clarifies that it expects a rigorous examination of the factual information provided in the annual 47 CFR 54.313 reports prior to issuance of the annual 47 U.S.C. 254(e) certifications. Because the underlying reporting requirements for recipients of Mobility Fund Phase I support differ from the reporting requirements for ETCs receiving other high-cost support, Mobility Fund Phase I recipients' certifications will be based on the factual information they provide in the annual reports they file pursuant to 47 CFR 54.1009 of the Mobility Fund rules. Because ETCs of Mobility Fund Phase I support that receive support pursuant to other high-cost mechanisms are subject to the reporting requirements of new 47 CFR 54.313, those companies' certifications will be based on the factual information in the annual reports they file pursuant to both new 47 CFR 54.313 and 47 CFR 54.1009 of the Mobility Fund rules.

411. The Commission expects that states (or the ETC if the state lacks jurisdiction) will use the information reported in April of each year for the prior calendar year in determining whether they can certify that carriers' support has been used and will be used for the intended purposes. In light of the public interest obligations the Commission adopts in this R&O, a key component of this certification will now be that support is being used to maintain and extend modern networks capable of providing voice and broadband service. Thus, for example, if a state commission determines, after reviewing the annual 47 CFR 54.313 report, that an ETC did not meet its speed or build-out requirements for the prior year, a state commission should refuse to certify that support is being used for the intended purposes. In conjunction with such review, to the extent the state has a concern about ETC performance, the Commission welcomes a recommendation from the state regarding prospective support adjustments or whether to recover past support amounts. As discussed more fully below, failure to meet all requirements will not necessarily result in a total loss of support, to the extent the Commission concludes, based on a review of the circumstances, that a lesser reduction is warranted. Likewise, the Commission will look at ETCs' annual 54.313 reports to verify certifications by ETCs (in instances where the state lacks jurisdiction) that support is being used for the intended purposes.

412. Fourth, the Commission streamlines existing certifications. Today, the Commission has two different state certification rules, one for rural carriers and one for non-rural carriers. There is no substantive difference between the existing certification rules for the two classes of carriers, and as a matter of administrative convenience, the Commission consolidates all certifications into a single rule. Moreover, because the net effect of the changes that the Commission is implementing to the high-cost programs is, as a practical matter, to shift the focus from whether a company is classified as ''rural'' versus ''non-rural'' to whether a company receives all support through a forward-looking model or competitive process or, instead, based in part on embedded costs, it does not make sense to maintain separate certification rules for ''rural'' and ''non-rural'' carriers. The Commission sees no substantive difference in the certifications that should be made. Thus, the Commission eliminates the certification requirements currently found in 47 CFR 54.313 and 54.314 of the rules and implement new 47 CFR 54.314.

413. Finally, the Commission also eliminates carriers' separate certification requirements for IAS and ICLS. As discussed above, the Commission is eliminating IAS as a standalone support mechanism, and this obviates the need for IAS-specific certifications. Although ICLS will remain in place for some carriers, those carriers will certify compliance through new 47 CFR 54.314. However, to ensure there is no gap in coverage, those carriers will file a final certification under 47 CFR 54.904 due June 30, 2012, covering the 2012–13 program year. Thus, by this R&O, the Commission eliminates 47 CFR 54.809 and, effective July 2013, 47 CFR 54.904 of the rules. And as discussed above, the Commission also eliminates 47 CFR 54.316 of the rules, relating to rate comparability.

B. Consequences for Non-Compliance With Program Rules

414. *Discussion.* Effective enforcement is necessary to ensure that the reforms R&O achieve their intended goal. Our existing rules already have self-effectuating mechanisms to incent prompt filing of requisite certifications and information necessary to calculate support amounts, as companies lose support to the extent such information is not provided in a timely fashion. While the Commission needs such information to ensure that support is being used for the intended purposes, consistent with 47 U.S.C. 254(e) of the Act, the Commission also needs to ensure that such certifications, which will be based upon the certifications and information provided in the new 47 CFR 54.313 annual reports, adequately address all areas of material non-compliance with program obligations.

415. The Commission believes that in the majority of cases involving repeated failures to timely file certifications or data, the Commission's existing enforcement procedures and penalties will adequately deter noncompliance with the Commission's rules, as herein amended, regarding high-cost and CAF support. The Commission adopts the provisions of 47 CFR 54.209(b) in new 47 CFR 54.313, which provides for reductions in support for failing to file the reports required by 47 CFR 54.209(a) in a timely fashion, and extend those provisions to all recipients of high-cost support. The Commission also adopts new 47 CFR 54.314, which provides for a similar reduction in support for the late filing of annual certifications that the funds received were used in the preceding calendar year and will be used in the coming calendar year only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. The rules also provide for debarment of those convicted of or found civilly liable for defrauding the high-cost support program, and the Commission emphasizes that those rules apply with

equal force to CAF, including the Mobility Fund Phase I.

416. To further ensure that the recipients of existing high-cost and/or CAF support use those funds for the purposes for which they are provided, the Commission creates a rule that entities receiving such support will receive reduced support should they fail to fulfill their public interest obligations, such as by failing to meet deployment milestones, to provide broadband at the speeds required by this R&O, or to provide service at reasonably comparable rates. This is consistent with the suggestions of the State Members of the Federal-State Joint Board on Universal Service, who further note that revoking a carrier's ETC designation is too blunt an instrument. The Commission agrees that revoking a carrier's ETC status is not an appropriate consequence for noncompliance, except in the most egregious circumstances. In the FNPRM, the Commission seeks comment on appropriate enforcement options for partial non-performance. The Commission does not rule out the option of revoking an ETC's status, but the Commission seeks comment on what circumstances would justify such a remedy and what alternatives might be appropriate in other circumstances. The Commission delegates to the Wireline Competition Bureau and Wireless Telecommunications Bureau the task of implementing reductions in support based on the record received in response to the FNPRM.

C. Record Retention

417. *Discussion.* The Commission finds that the current record retention requirements, although adequate to facilitate audits of program participants, are not adequate for purposes of litigation under the False Claims Act, which can involve conduct that relates back substantially more than five years. Thus, the Commission revises the record retention requirements to extend the retention period to ten years.

418. Additionally, the Commission believes the record retention requirements need clarification. The current record retention requirements appear in 47 CFR 54.202(e) of the Commission's rules. 47 CFR 54.202 is entitled: ''Additional requirements for Commission designation of eligible telecommunications carriers.'' Subsections (a) through (d) of that section apply, by their terms, only to ETCs designated under 47 U.S.C. 214(e)(6) of the Act—*i.e.,* ETCs designated by the Commission rather than by the states. Subsection (e), however, is not so limited. Indeed, the Commission intended the requirements of 47 CFR 54.202(e) to apply to all recipients of high-cost support. To fully support ongoing oversight, the record retention requirements must apply to all recipients of high-cost and CAF support. Thus, by this R&O, the Commission amends the rules by re-designating 47 CFR 54.202(e) as new 47 CFR 54.320 to clarify that these ten-year record retention requirements apply to all recipients of high-cost and CAF support. To ensure access to documents and information needed for effective ongoing oversight, the Commission includes in new 47 CFR 54.320 a requirement that all documents be made available upon request to the Commission and any of its Bureaus or offices, the Administrator, and their respective auditors.

D. USAC Oversight Process

419. *Discussion.* As noted in the *USF/ICC Transformation NPRM,* audits are an essential tool for the Commission and USAC to ensure program integrity and to detect and deter waste, fraud, and abuse. In the *USF/ICC Transformation NPRM,* the Commission discussed the concerns expressed by the GAO in 2008 regarding, among other things, the audit process that existed at the time. The *USF/ICC Transformation NPRM* also acknowledged USAC's December 2010 Final Report, which detailed the findings of the audits conducted at the direction of the Commission's Office of Inspector General.

420. As directed by the Commission's Office of the Managing Director, USAC now has two programs in place to safeguard the Universal Service Fund—the Beneficiary/Contributor Compliance Audit Program (BCAP) and Payment Quality Assurance (PQA) program. The Commission created these programs, in conjunction with USAC, in order to address the shortcomings of the audit processes discussed in the GAO High-Cost Report and USAC's December 2010 Final Report. The PQA program was launched in August 2010, and the first round of BCAP audits were announced on December 1, 2010. OMD oversees USAC's implementation of both programs.

421. The Commission directs USAC to review and revise the BCAP and PQA programs to take into account the changes adopted in this R&O. The Commission directs USAC to annually assess compliance with the new requirements established for recipients, including for recipients of CAF Phase I and Phase II. For CAF Phase I, the Commission establishes above a requirement that companies have completed build-out to two-thirds of the requisite number of locations within two years. The Commission directs USAC to assess compliance with this requirement for each holding company that receives CAF Phase I funds. ETCs that receive CAF Phase I funding should ensure that their underlying books and records support the assertion that assets necessary to offer broadband service have been placed in service in the requisite number of locations. The Commission also directs USAC to test the accuracy of certifications made pursuant to the new reporting requirements. Any oversight program to assess compliance should be designed to ensure that management is reporting accurately to the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate, and should be designed to test some of the underlying data that forms the basis for management's certification of compliance with various requirements. This list is not intended to be exhaustive, but rather illustrative of the modifications that USAC should make to its existing oversight activities. The Commission directs USAC to submit a report to WCB, WTB, and OMD within 60 days of release of this R&O proposing changes to the BCAP and PQA programs consistent with this R&O.

422. To assist USAC's audit and review efforts, the Commission clarifies in new 47 CFR 54.320 that all ETCs that receive high-cost support are subject to random compliance audits and other investigations to ensure compliance with program rules and orders.

E. Access to Cost and Revenue Data

423. *Discussion.* The Commission takes two steps to facilitate the exchange of information needed to administer and oversee universal service programs. First, the Commission the rules to clarify that USAC has a right to obtain—at any time and in any unaltered format—all cost and revenue submissions and related information that carriers submit to NECA that is used to calculate payments under any of the existing programs and any new programs, including the new CAF ICC (access replacement) support.

424. Second, the Commission modfies the rules to ensure that the Commission has timely access to relevant data. Specifically, the Commission requires that USAC (and NECA to the extent USAC does not directly receive such information from carriers) provide to the Commission upon request all underlying data collected from ETCs to calculate payments under current support mechanisms—specifically,

HCLS, ICLS, LSS, SNA, SVS, HCMS and IAS—as well as to calculate CAF payments. This includes information or data underlying existing and future analyses that USAC uses to determine the amount of federal universal service support disbursed in the past or the future, including the new CAF.

425. The Commission anticipates that NECA and USAC will submit summary filings to the Commission on a regular basis, and the Commission delegates to the Wireline Competition Bureau authority to determine the format and timing of such summary filings, but the Commission emphasizes that USAC and NECA must timely provide any underlying data upon request. The Commission also modifies the rules to require rate-of-return carriers to submit to the Commission upon request a copy of all cost and revenue data and related information submitted to NECA for purposes of calculating intercarrier compensation and any new CAF payments resulting from intercarrier compensation reform adopted in this R&O.

VII. Additional Issues

A. Tribal Engagement

426. The deep digital divide that persists between the Native Nations of the United States and the rest of the country is well-documented. Many residents of Tribal lands lack not only broadband access, but even basic telephone service. Throughout this reform proceeding, commenters have repeatedly stressed the essential role that Tribal consultation and engagement play in the successful deployment of service on Tribal lands. For example, the National Tribal Telecommunications Association, the National Congress of American Indians, and the Affiliated Tribes of Northwest Indians have stressed the importance of measures to ''specifically support and enhance tribal sovereignty, with emphasis on consultation with Tribes.''

427. The Commission agrees that engagement between Tribal governments and communications providers either currently providing service or contemplating the provision of service on Tribal lands is vitally important to the successful deployment and provision of service. The Commission, therefore, will require that, at a minimum, ETCs to demonstrate on an annual basis that they have meaningfully engaged Tribal governments in their supported areas. At a minimum, such discussions must include: (1) A needs assessment and deployment planning with a focus on Tribal community anchor institutions; (2) feasibility and sustainability planning; (3) marketing services in a culturally sensitive manner; (4) rights of way processes, land use permitting, facilities siting, environmental and cultural preservation review processes; and (5) compliance with Tribal business and licensing requirements. Tribal business and licensing requirements include business practice licenses that Tribal and non-Tribal business entities, whether located on or off Tribal lands, must obtain upon application to the relevant Tribal government office or division to conduct any business or trade, or deliver any goods or services to the Tribes, Tribal members, or Tribal lands. These include certificates of public convenience and necessity, Tribal business licenses, master licenses, and other related forms of Tribal government licensure.

428. In requiring Tribal engagement, the Commission does not seek to supplant the Commission's own ongoing obligation to consult with Tribes on a government-to-government basis, but instead recognize the important role that all parties play in expediting service to Tribal lands. As discussed above, support recipients will be required to submit to the Commission and appropriate Tribal government officials an annual certification and summary of their compliance with this Tribal government engagement obligation. Appropriate Tribal government officials are elected or duly authorized government officials of federally recognized American Indian Tribes and Alaska Native Villages. In the instance of the Hawaiian Home Lands, this engagement must occur with the State of Hawaii Department of Hawaiian Home Lands and Office of Hawaiian Affairs. Carriers failing to satisfy the Tribal government engagement obligation would be subject to financial consequences, including potential reduction in support should they fail to fulfill their engagement obligations. The Commission envisions that the Office of Native Affairs and Policy (''ONAP''), in coordination with the Wireline and Wireless Bureaus, would utilize their delegated authority to develop specific procedures regarding the Tribal engagement process as necessary.

B. Interstate Rate of Return Prescription

429. In the *USF/ICC Transformation Notice,* the Commission sought comment on whether to initiate a proceeding to represcribe the authorized interstate rate of return for rate-of-return carriers if it determines that such carriers should continue to receive high-cost support under a modified rate-of-return system. The Commission has not revisited the current 11.25 percent rate of return for over 20 years. Several commenters supported our proposal to initiate a represcription proceeding. Others offered comments on how the Commission should proceed in the event it does initiate such a proceeding. We, therefore, conclude that the Commission should represcribe the authorized interstate rate of return for rate-of-return carriers, and we initiate that represcription process today. In the FNPRM, we propose that the interstate rate of return should be adjusted to ensure that it more accurately reflects the true cost of capital today. Based on our preliminary analysis and record evidence, we believe the current rate of return of 11.25 percent is no longer consistent with the Act and today's financial conditions. In this Order, we find good cause to waive certain procedural requirements in the Commission's rules relating to rate represcriptions to streamline and modernize this process to align it with the current Commission practice.

1. Represcription

430. Section 205(a) of the Act authorizes the Commission, on an appropriate record, to prescribe just and reasonable charges of common carriers. The Commission last adjusted the authorized rate of return in 1990, reducing it from 12 percent to 11.25 percent. In 1998, the Commission initiated a proceeding to represcribe the authorized rate of return for rate-of-return carriers. However, in the *MAG Order,* the Commission terminated that prescription proceeding. Given the time that has elapsed since the authorized rate of return was last prescribed, and the major changes that have occurred in the market since then, we find that the authorized interstate rate of return should be reviewed and begin that process, seeking the information necessary to prescribe a new rate of return.

431. The Commission's rules provide that the trigger for a new prescription proceeding is satisfied if the monthly average yields on ten-year United States Treasury securities remain, for a consecutive six month period, at least 150 basis points above or below the average of the monthly average yields in effect for the consecutive six month period immediately prior to the effective date of the current prescription. The monthly average yields for the past six months have been over 450 basis points below the monthly average yields in the six months immediately prior to the last prescription. Our trigger is easily

satisfied, and we initiate the represcription now.

2. Procedural Requirements

432. Section 205(a) requires the Commission to give ''full opportunity for hearing'' before prescribing a rate. However, a formal evidentiary hearing is not required under section 205, and we have on multiple occasions prescribed individual rates in notice and comment rulemaking proceedings. Although we have found it useful in the past to impose somewhat more detailed requirements in rate of return prescription proceedings, we have expressly rejected the proposition that we could not ''lawfully use simple notice and comment procedures to prescribe the rate of return authorized for LEC interstate access services.'' Accordingly, in the FNPRM we initiate a new rate of return prescription proceeding using notice and comment procedures, and on our own motion, we waive certain existing procedural rules to facilitate a more efficient process.

433. The Commission's current interstate rate of return represcription rules in Part 65 contemplate a streamlined paper hearing process. These procedural rules are more specific and detailed than the Commission's rules for filing comments, replies, and written *ex parte* presentations in permit-but-disclose proceedings. The Part 65 rules require that:

—An original and four copies of all submissions must be filed with the Secretary (rule 65.103(d)),

—All participants in the proceeding state in their initial pleading whether they wish to receive service of documents filed in the proceeding (rule 65.100(b)), and filing parties must serve copies of their submissions (other than initial submissions) on all participants who properly so requested (rule 65.103(e)),

—Parties may file ''direct case submissions, responses, and rebuttals,'' with direct case submissions due 60 days after the beginning of the proceeding, responses due 60 days thereafter, and rebuttals due 21 days thereafter (rule 65.103(b),

—Direct case submissions and responses are subject to a 70-page limit, and rebuttals to a 50-page limit (rule 65.104(a)–(c)),

—Parties must file copies of all information (such as financial analysts' reports) that they relied on in preparing their submissions (rule 65.105(a)), and

—Parties may file written interrogatories and discovery requests directed at any other party's submissions, and the submitting parties may oppose those requests (rule 65.105(b)–(f)).

434. We find good cause to waive some of these procedural requirements on our own motion. We find that these procedures would be onerous and are not necessary to ensure adequate public participation. For instance, there is no need for parties to file an original plus four copies of submissions with the Secretary. The Commission recently revised its rules to encourage electronic filing of comments and replies whenever technically feasible, and to require that *ex parte* submissions be filed electronically unless doing so poses a hardship. Given the vast improvements to the electronic filing system, and the usual practice now of many parties to file documents electronically rather than on paper, we see no reason to require the submission of paper copies. Rather, parties to this proceeding may comply with our usual procedures in permit-but-disclosure proceedings. Pleadings other than *ex parte* submissions may be filed electronically or may be filed on paper with the Secretary's office. If they are filed on paper, the original and one copy should be provided.

435. The Part 65 rules also contemplate that all parties to the proceeding will be served with copies of all other parties' submissions. Again, this is no longer necessary. Before the greater and more accepted use of electronic filing, service may have been a reasonable requirement to assure timely distribution of relevant materials. However, our electronic filing system generally makes filings available within 24 hours, and the vast majority of parties have access to these materials via the Internet. We, therefore, find that service is not required, and we waive the requirement. Any party that wishes to receive an electronic notification when new documents are filed in the proceeding may subscribe to an RSS feed, available from ECFS.

436. In addition, we waive the specific filing schedule contained in section 65.103(b) of the Commission's rules so that comments may be filed pursuant to the pleading cycle adopted for sections XVII.A–K of the FNPRM. We also find the page limits applicable to rate represcription proceedings to be inappropriate here. Lastly, we waive the requirement in section 65.301 that the Commission publish in this notice the cost of debt, cost of preferred stock, and capital structure computed under our rules, because, as detailed in the FNPRM, the data set necessary to calculate those formulas is no longer collected by the Commission. We seek comment in the FNRPM on those calculations and the related data and methodology issues.

C. Pending Matters

437. The Commission also denies four pending high-cost maters currently pending before the Commission: two petitions for reconsideration of the *Corr Wireless Order;* Puerto Rico Telephone Company, Inc.'s petition to reconsider the decision declining to adopt a new high-cost support mechanism for non-rural insular carriers; and Verizon Wireless's Petition for Reconsideration of the Wireline Competition Bureau's letter directing the USAC to implement certain caps on high-cost universal service support for two companies, known as the ''company-specific caps.''

D. Deletion of Obsolete Universal Service Rules and Conforming Changes to Existing Rules

438. As part of comprehensive reform, the Commission makes conforming changes to delete obsolete rules from the Code of Federal Regulations. Specifically, we eliminate the rules governing Long Term Support, which the Commission eliminated as a discrete support program in the *MAG Order,* and Interim Hold Harmless Support for Non-Rural Carriers, which addressed non-rural carriers' transition from high-cost loop support to high-cost model support. Because these rules are obsolete, the Commission finds good cause to delete them without notice and comment. The Commission also makes conforming changes to existing rules to ensure they are consistent with changes made in this R&O.

VIII. Measures To Address Arbitrage

A. Rules To Reduce Access Stimulation

439. In this section, the Commission adopts revisions to its interstate switched access charge rules to address access stimulation. Access stimulation occurs when a LEC with high switched access rates enters into an arrangement with a provider of high call volume operations such as chat lines, adult entertainment calls, and ''free'' conference calls. The arrangement inflates or stimulates the access minutes terminated to the LEC, and the LEC then shares a portion of the increased access revenues resulting from the increased demand with the ''free'' service provider, or offers some other benefit to the ''free'' service provider. The shared revenues received by the service provider cover its costs, and it therefore may not need to, and typically does not, assess a separate charge for the service it is offering. Meanwhile, the wireless

and interexchange carriers (collectively IXCs) paying the increased access charges are forced to recover these costs from all their customers, even though many of those customers do not use the services stimulating the access demand.

440. Access stimulation schemes work because when LECs enter traffic-inflating revenue-sharing agreements, they are currently not required to reduce their access rates to reflect their increased volume of minutes. The combination of significant increases in switched access traffic with unchanged access rates results in a jump in revenues and thus inflated profits that almost uniformly make the LEC's interstate switched access rates unjust and unreasonable under section 201(b) of the Act, 47 U.S.C. 201(b). Consistent with the approach proposed in the *USF/ICC Transformation NPRM,* the Commission adopts a definition of access stimulation that includes two conditions. If a LEC meets those conditions, the LEC generally must reduce its interstate switched access tariffed rates to the rates of the price cap LEC in the state with the lowest rates, which are presumptively consistent with the Act. This will reduce the extent to which IXC customers that do not use the stimulating services are forced to subsidize the customers that do use the services.

441. Based on the record received in response to the single-pronged trigger proposed in the *USF/ICC Transformation NPRM,* the Commission modifies its approach from defining an access stimulation trigger to defining access stimulation. The access stimulation definition the Commission adopts now has two conditions: (1) A revenue sharing condition, revised slightly from the proposal in the *USF/ICC Transformation NPRM;* and (2) an additional traffic volume condition, which is met where the LEC either: (a) Has a three-to-one interstate terminating-to-originating traffic ratio in a calendar month; or (b) has had more than a 100 percent growth in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year. If both conditions are satisfied, the LEC generally must file revised tariffs to account for its increased traffic.

442. Adoption of the definition of access stimulation with two conditions will facilitate enforcement of the new access stimulation rules in instances where a LEC meets the conditions for access stimulation but does not file revised tariffs. In particular, IXCs will be permitted to file complaints based on evidence from their traffic records that a LEC has exceeded either of the traffic measurements of the second condition, *i.e.,* that the second condition has been met. If the IXC filing the complaint makes this showing, the burden will shift to the LEC to establish that it has not met the access stimulation definition and therefore that it is not in violation of its rules. This burden-shifting approach will enable IXCs to bring complaints based on their own traffic data, and will help the Commission to identify circumstances where a LEC may be in violation of its rules.

443. The Commission concludes that these revised interstate access rules are narrowly tailored to minimize the costs of the rule revisions on the industry, while reducing the adverse effects of access stimulation and ensuring that interstate access rates are at levels presumptively consistent with section 201(b) of the Act, 47 U.S.C. 201(b).

1. Discussion

a. Need for Reform To Address Access Stimulation

444. The record confirms the need for prompt Commission action to address the adverse effects of access stimulation and to help ensure that interstate switched access rates remain just and reasonable, as required by section 201(b) of the Act, 47 U.S.C. 201(b). Commenters agree that the interstate switched access rates being charged by access stimulating LECs do not reflect the volume of traffic associated with access stimulation. As a result, access stimulating LECs realize significant revenue increases and thus inflated profits that almost uniformly make their interstate switched access rates unjust and unreasonable.

445. Access stimulation imposes undue costs on consumers, inefficiently diverting capital away from more productive uses such as broadband deployment. When access stimulation occurs in locations that have higher than average access charges, which is the predominant case today, the average per-minute cost of access and thus the average cost of long-distance calling is increased. Because of the rate integration requirements of section 254(g) of the Act, 47 U.S.C. 254(g), long-distance carriers are prohibited from passing on the higher access costs directly to the customers making the calls to access stimulating entities. Therefore, all customers of these long-distance providers bear these costs, even though many of them do not use the access stimulator's services, and, in essence, ultimately support businesses designed to take advantage of today's above-cost intercarrier compensation rates.

446. The record indicates that a significant amount of access traffic is going to LECs engaging in access stimulation. TEOCO estimates that the total cost of access stimulation to IXCs has been more than $2.3 billion over the past five years. Verizon estimates the overall costs to IXCs to be between $330 and $440 million per year, and states that it expected to be billed between $66 and $88 million by access stimulators for approximately two billion wireline and wireless long-distance minutes in 2010. Other parties indicate that payment of access charges to access stimulating LECs is the subject of large numbers of disputes in a variety of forums. When carriers pay more access charges as a result of access stimulation schemes, the amount of capital available to invest in broadband deployment and other network investments that would benefit consumers is substantially reduced.

447. Access stimulation also harms competition by giving companies that offer a ''free'' calling service a competitive advantage over companies that charge their customers for the service. For example, conference calling provider ZipDX indicates that, by not engaging in access stimulation, it is at a disadvantage vis-à-vis competitors that engage in access stimulation. Providers of conferencing services, like ZipDX, are recovering the costs of the service, such as conference bridges, marketing, and billing, from the user of the service rather than, as explained above in the case of access stimulators, spreading those costs across the universe of long-distance subscribers. As a result, the services offered by ''free'' conferencing providers that leverage arbitrage opportunities put companies that recover the cost of services from their customers at a distinct competitive disadvantage.

448. How access revenues are used is not relevant in determining whether switched access rates are just and reasonable in accordance with section 201(b), 47 U.S.C. 201(b). In addition, excess revenues that are shared in access stimulation schemes provide additional proof that the LEC's rates are above cost. Moreover, Congress created an explicit universal service fund to spur investment and deployment in rural, high cost, and insular areas, and the Commission is taking action here and in other proceedings to facilitate such deployment.

(i) Access Stimulation Definition

449. The Commission adopts a definition to identify when an access

stimulating LEC must refile its interstate access tariffs at rates that are presumptively consistent with the Act. After reviewing the record, the Commission makes a few changes to the *USF/ICC Transformation NPRM* proposal, including defining access stimulation as occurring when two conditions are met. The first condition is that the LEC has entered into an access revenue sharing agreement, and the Commission clarifies what types of agreements qualify as ''revenue sharing.'' The second condition is met where the LEC either has had a three-to-one interstate terminating-to-originating traffic ratio in a calendar month, or has had a greater than 100 percent increase in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year. The Commission adopts these changes to ensure that the access stimulation definition is not over-inclusive and to improve its enforceability.

450. *Definition of a Revenue Sharing Agreement.* After reviewing the record, the Commission clarifies the scope of the access revenue sharing agreement condition of the new access stimulation definition. The access revenue sharing condition of the access stimulation definition the Commission adopts herein is met when a rate-of-return LEC or a competitive LEC: ''has an access revenue sharing agreement, whether express, implied, written or oral, that, over the course of the agreement, would directly or indirectly result in a net payment to the other party (including affiliates) to the agreement, in which payment by the rate-of-return LEC or competitive LEC is based on the billing or collection of access charges from interexchange carriers or wireless carriers. When determining whether there is a net payment under this rule, all payments, discounts, credits, services, features, functions, and other items of value, regardless of form, provided by the rate-of-return LEC or competitive LEC to the other party to the agreement shall be taken into account.''

451. This rule focuses on revenue sharing that would result in a net payment to the other entity over the course of the agreement arising from the sharing of access revenues. The use of ''over the course of the agreement'' does not preclude an IXC from filing a complaint if the traffic measurement condition is met. The agreement is to be interpreted in terms of what the anticipated net payments would be over the course of the agreement. The Commission clarifies that patronage dividends paid by cooperatives generally do not constitute revenue sharing as contemplated by this definition. However, a cooperative, like other LECs, could structure payments in a manner to engage in revenue sharing that would cause it to meet the definition as discussed herein. The Commission intends the net payment language to limit the revenue sharing definition in a manner that, along with the traffic measurements discussed below, best identifies the revenue sharing agreements likely to be associated with access stimulation and thus those cases in which a LEC must refile its switched access rates. Revenue sharing may include payments characterized as marketing fees or other similar payments that result in a net payment to the access stimulator. However, this rule does not encompass typical, widely available, retail discounts offered by LECs through, for example, bundled service offerings.

452. If a LEC's circumstances change because it terminates the access revenue sharing agreement(s), it may file a tariff to revise its rates under the rules applicable when access stimulation is not occurring. As part of that tariff filing, an officer of the LEC must certify that it has terminated the revenue sharing agreement(s).

453. As proposed in the *USF/ICC Transformation NPRM,* the Commission does not declare revenue sharing to be a *per se* violation of section 201(b) of the Act, 47 U.S.C. 201(b). A ban on all revenue sharing arrangements could be overly broad, and no party has suggested a way to overcome this shortcoming. Nor does the Commission find that parties have demonstrated that traffic directed to access stimulators should not be subject to tariffed access charges in all cases. The Commission notes that the access stimulation rules it adopts in this R&O are part of the Commission's comprehensive intercarrier compensation reform. That reform will, as the transition unfolds, address remaining incentives to engage in access stimulation.

454. The rules adopted here pursuant to sections 201 and 202 of the Act, 47 U.S.C. 201, 202, address conferencing services being provided by a third party, whether affiliated with the LEC or not. Section 254(k), 47 U.S.C. 254(k), would apply to a LEC's operation of an access stimulation plan within its own corporate organization. In that context, as the Commission has found in other proceedings, terminating access is a monopoly service. The conferencing activity, as portrayed by the parties engaged in access stimulation, would be a competitive service. Thus, the use of non-competitive terminating access revenues to support competitive conferencing service within the LEC operating entity would violate section 254(k), 47 U.S.C. 254(k), and appropriate sanctions could be imposed.

455. *Addition of a Traffic Measurement Condition.* After reviewing the record, the Commission agrees that it is appropriate to include a traffic measurement condition in the definition of access stimulation. Accordingly, in addition to requiring the existence of a revenue sharing agreement, the Commission adds a second condition to the definition requiring that a LEC: ''Has either an interstate terminating-to-originating traffic ratio of at least 3:1 in a calendar month, or has had more than a 100 percent growth in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year.'' The addition of a traffic measurement component to the access stimulation definition creates a bright-line rule that responds to record concerns about using access revenue sharing alone. The Commission concludes that these measurements of switched access traffic of all carriers exchanging traffic with the LEC reflect the significant growth in traffic volumes that would generally be observed in cases where access stimulation is occurring and thus should make detection and enforcement easier. Carriers paying switched access charges can observe their own traffic patterns for each of these traffic measurements and file complaints based on their own traffic patterns. Thus, this will not place a burden on LECs to file traffic reports, as some proposals would.

456. The record offers support for both a terminating-to-originating traffic ratio and a traffic growth factor. The Commission adopted a 3:1 ratio in its 2001 *ISP-Remand Order* to address a similar arbitrage scheme based on artificially increasing reciprocal compensation minutes. Further, the Wireline Competition Bureau employed a 100 percent traffic growth factor as a benchmark in a tariff investigation to address the potential that some rate-of-return LECs might engage in access stimulation after having filed tariffs with high switched access rates. In each case, the approach was largely successful in identifying and reducing the practice.

457. The Commission concludes that the use of a terminating-to-originating traffic ratio in conjunction with a traffic growth factor as alternative traffic measures addresses the shortcomings of using either component separately. A few parties argue that carriers can game the terminating-to-originating traffic

ratio component by simply increasing the number of originating MOU. The traffic growth component protects against this possibility because increasing the originating access traffic to avoid tripping the 3:1 component would likely mean total access traffic would increase enough to trip the growth component. The terminating-to-originating traffic ratio component will capture those current access stimulation situations that already have very high volumes that could otherwise continue to operate without tripping the growth component. For example, a LEC that has been engaged in access stimulation for a significant period of time would have a high terminating traffic volume that, under a traffic growth factor alone, could continue to expand its operations, possibly avoiding the condition entirely by controlling its terminating traffic. Because these alternative traffic measurements are combined with the requirement that an access revenue sharing agreement exist, the Commissions reduces the risk that the terminating-to-originating traffic ratio or traffic growth components of the definition could be met by legitimate changes in a LEC's calling patterns. The combination of these two traffic measurements as alternatives is preferable to either standing alone, as some parties have urged. A terminating-to-originating traffic ratio or traffic growth condition alone could prove to be overly inclusive by encompassing LECs that had realized access traffic growth through general economic development, unaided by revenue sharing. Such situations could include the location of a customer support center in a new community without any revenue sharing arrangement, or a new competitive LEC that is experiencing substantial growth from a small base. State Joint Board Members propose a condition for access stimulation based on a terminating ratio one standard deviation above the national average terminating ratio annually. Under their proposal, a carrier meeting this condition would set new rates so that the terminating revenue for any carrier equals the carrier's initial rate times its originating minutes times the terminating ratio at the one standard deviation point. The Commission declines to adopt this proposal because it is unclear that using originating traffic volumes would produce a rate that adequately reflects the increased terminating traffic volumes sufficient to ensure that rates are just and reasonable as required by Section 201(b) of the Act, 47 U.S.C. 201(b).

(ii) Remedies

458. If a LEC meets both conditions of the definition, it must file a revised tariff except under certain limited circumstances. As explained in more detail below, a rate-of-return LEC must file its own cost-based tariff under section 61.38 of the Commission's rules, 47 CFR 61.38, and may not file based on historical costs under section 61.39 of the Commission's rules, 47 CFR 61.39, or participate in the NECA traffic-sensitive tariff. If a competitive LEC meets the definition, it must benchmark its tariffed access rates to the rates of the price cap LEC with the lowest interstate switched access rates in the state, rather than to the rates of the BOC or the largest incumbent LEC in the state (as proposed in the *USF/ICC Transformation NPRM*). The Commission concludes, however, that if a LEC has terminated its revenue sharing agreement(s) before the deadline the Commission establishes for filing its revised tariff, or if the competitive LEC's rates are already below the benchmark rate, such a LEC does not have to file a revised interstate switched access tariff. However, once a rate-of-return LEC or a competitive LEC has met both conditions of the definition and has filed revised tariffs, when required, it may not file new tariffs at rates other than those required by the revised pricing rules until it terminates its revenue sharing agreement(s), even if the LEC no longer meets the 3:1 terminating-to-originating traffic ratio condition of the definition or traffic growth threshold. As price cap LECs reduce their switched access rates under the ICC reforms the Commission adopts herein, competitive LECs must benchmark to the reduced rates.

459. *Rate-of-Return Carriers Filing Tariffs Based on Historical Costs and Demand: 47 CFR 61.39.* The Commission adopts its proposal in the *USF/ICC Transformation NPRM* that a LEC filing access tariffs pursuant to 47 CFR 61.39 would lose its ability to base its rates on historical costs and demand if it is engaged in access stimulation. Incumbent LECs filing access tariffs pursuant to 47 CFR 61.39 of the Commission's rules currently base their rates on historical costs and demand, which, because of their small size, generally results in high switched access rates based on the high costs and low demand of such carriers. The limited comment in the record was supportive of the Commission's proposal for the reasons set forth in the *USF/ICC Transformation NPRM.* The Commission accordingly revises 47 CFR 61.39 to bar a carrier otherwise eligible to file tariffs pursuant to 47 CFR 61.39 from doing so if it meets the access stimulation definition. The Commission also requires such a carrier to file a revised interstate switched access tariff pursuant to 47 CFR 61.38 within 45 days after meeting the definition, or within 45 days after the effective date of this rule in cases where the carrier meets the definition on that date.

460. *Participation in NECA Tariffs.* In the *USF/ICC Transformation NPRM,* the Commission proposed that a carrier engaging in revenue sharing would lose its eligibility to participate in the NECA tariffs 45 days after engaging in access stimulation, or 45 days after the effective date of this rule in cases where it currently engages in access stimulation. A carrier leaving the NECA tariff thus would have to file its own tariff for interstate switched access, pursuant to section 61.38 of the rules, 47 CFR 61.38.

461. The record is generally supportive of this approach for the reasons stated in the *USF/ICC Transformation NPRM,* and the Commission adopts it, subject to one modification. The Commission clarifies that, pursuant to 47 CFR 69.3(e)(3) of the rules, a LEC required to leave the NECA interstate tariff (which includes both switched and special access services) because it has met the access stimulation definition must file its own tariff for both interstate switched and special access services. USTelecom suggests that given that shared revenues are not appropriately included in a carrier's revenue requirement, the Commission does not need to address eligibility for participation in NECA tariffs in its access stimulation rules—a carrier would either stop sharing, or file its own tariff without any mandate to do so. The Commission disagrees, because current rules only provide for a participating carrier to leave the NECA tariff at the time of the annual tariff filing. A rule prohibiting LECs from further participating in the NECA tariff when the definition is met, and providing for advance notice to NECA, spells out the procedure.

462. The Commission also adopts a revision to the proposed rule similar to a suggestion by the Louisiana Small Carrier Committee, which recommends that rate-of-return carriers be given an opportunity to show that they are in compliance with the Commission's rules before being required to file a revised tariff. Accordingly, the Commission concludes that if a carrier sharing access revenues terminates its access revenue sharing agreement before the date on which its revised tariff must be filed, it does not have to file a revised

tariff. The Commission believes that when sharing agreements are terminated, in most instances traffic patterns should return to levels that existed prior to the LEC entering into the access revenue sharing agreement. This eliminates a burden on such carriers when there is no ongoing reason for requiring such a filing.

463. *Rate of Return Carriers Filing Tariffs Based On Projected Costs and Demand: 47 CFR 61.38.* In the *USF/ICC Transformation NPRM,* the Commission proposed that a carrier filing interstate switched access tariffs based on projected costs and demand pursuant to 47 CFR 61.38 of the rules be required to file revised access tariffs within 45 days of commencing access revenue sharing, or within 45 days of the effective date of the rule if the LEC on that date is engaged in access revenue sharing, unless the costs and demand arising from the new revenue sharing arrangement had been reflected in its most recent tariff filing. The Commission further proposed that payments made by a LEC pursuant to an access revenue sharing arrangement should not be included as costs in the rate-of-return LEC's interstate switched access revenue requirement because such payments have nothing to do with the provision of interstate switched access service and are thus not used and useful in the provision of such service. Thus, the Commission proposed to clarify prospectively that a rate-of-return carrier that shares access revenue, provides other compensation to an access stimulating entity, or directly provides the stimulating activity, and bundles those costs with access, is engaging in an unreasonable practice that violates 47 U.S.C. 201(b) and the prudent expenditure standard. The prudent expenditure standard is associated with the ''used and useful'' doctrine, which together are employed in evaluating whether a carrier's rates are just and reasonable.

464. The Commission adopts the approach proposed in the *USF/ICC Transformation NPRM.* Commenters that addressed this issue support the approach. In particular, the Commission adopts a rule requiring carriers filing interstate switched access tariffs based on projected costs and demand pursuant to 47 CFR 61.38 of the rules to file revised access tariffs within 45 days of commencing access revenue sharing, or within 45 days of the effective date of the rule if the LEC on that date was engaged in access revenue sharing, unless the costs and demand arising from the new access revenue sharing agreement were reflected in its most recent tariff filing. This tariff filing requirement provides the carrier with the opportunity to show, and the Commission to review, any projected increase in costs, as well as to consider the higher anticipated demand in setting revised rates. If the access revenue sharing agreement(s) that required the new tariff filing has been terminated by the time the revised tariff is required to be filed, the Commission will not require the filing of a revised tariff, as the proposal would have. A refiling in that instance would be unnecessary because the original rates will now more likely reflect the cost/demand relationship of the carrier. If a LEC, however, subsequently reactivates the same telephone numbers in connection with a new access revenue sharing agreement, the Commission will presumptively treat that action to be furtive concealment resulting in the loss of deemed lawful status for the LEC's tariff, as discussed below in conjunction with the discussion of section 204(a)(3) of the Act, 47 U.S.C. 204(a)(3). As described therein, a carrier may be required to make refunds if its tariff does not have deemed lawful status. This will prevent a LEC from entering into a series of access revenue sharing agreements to avoid the 45-day filing requirement, while benefiting from the advertising of those telephone numbers used under previous agreements.

465. The Commission also adopts the proposal that payments made by a LEC pursuant to an access revenue sharing agreement are not properly included as costs in the rate-of-return LEC's interstate switched access revenue requirement. This proposal received broad support in the record.

466. The rule the Commission adopts will require 47 CFR 61.38 carriers to set their rates based on projected costs and demand data.

467. *Competitive LECs.* In the *USF/ICC Transformation NPRM,* the Commission proposed that when a competitive LEC is engaged in access stimulation, it would be required to benchmark its interstate switched access rates to the rate of the BOC in the state in which the competitive LEC operates, or the independent incumbent LEC with the largest number of access lines in the state if there is no BOC in the state, and if the competitive LEC is not already benchmarking to that carrier's rate. Under the proposal, a competitive LEC would have to file a revised tariff within 45 days of engaging in access stimulation, or within 45 days of the effective date of the rule if it currently engages in access stimulation.

468. After reviewing the record, the Commission adopts its proposal with one modification to ensure that the LEC refiles at a rate no higher than the lowest rate of a price cap LEC in the state. In so doing, the Commission concludes that neither the switched access rate of the rate-of-return LEC in whose territory the competitive LEC is operating nor the rate used in the rural exemption is an appropriate benchmark when the competitive LEC meets the access stimulation definition. In those instances, the access stimulator's traffic vastly exceeds the volume of traffic of the incumbent LEC to whom the access stimulator is currently benchmarking. Thus, the competitive LEC's traffic volumes no longer operationally resemble the carrier's traffic volumes whose rates it had been benchmarking because of the significant increase in interstate switched access traffic associated with access stimulation. Instead, the access stimulating LEC's traffic volumes are more like those of the price cap LEC in the state, and it is therefore appropriate and reasonable for the access stimulating LEC to benchmark to the price cap LEC.

469. Although many parties support using the switched access rates of the BOC in the state, or the rates of the largest independent LEC in the state if there is no BOC, as the Commission proposed, the Commission concludes that the lowest interstate switched access rate of a price cap LEC in the state is the rate to which a competitive LEC must benchmark if it meets the definition. Generally, the BOC will have the lowest interstate switched access rates. However, the record reveals that in California, Pacific Bell's interstate switched access rates are higher than those of other price cap LECs in the state, as well as being higher than the interstate switched access rates of price cap LECs in other states. Benchmarking to the lowest price cap LEC interstate switched access rate in the state will reduce rate variance among states and will significantly reduce the rates charged by competitive LECs engaging in access stimulation, even if it does not entirely eliminate the potential for access stimulation. However, should the traffic volumes of a competitive LEC that meets the access stimulation definition substantially exceed the traffic volumes of the price cap LEC to which it benchmarks, the Commission may reevaluate the appropriateness of the competitive LEC's rates and may evaluate whether any further reductions in rates is warranted. In addition, the Commission believes the reforms it adopts elsewhere in this R&O will, over time, further reduce intercarrier payments and the incentives for this type of arbitrage.

470. The Commission requires a competitive LEC to file a revised interstate switched access tariff within 45 days of meeting the definition, or within 45 days of the effective date of the rule if on that date it meets the definition. A competitive LEC whose rates are already at or below the rate to which they would have to benchmark in the refiled tariff will not be required to make a tariff filing.

471. The Commission's benchmarking approach addresses access stimulation within the parameters of the existing access charge regulatory structure. The Commission expects that the approach it adopts will reduce the effects of access stimulation significantly, and the intercarrier compensation reforms the Commission adopts should resolve remaining concerns.

472. *Section 204(a)(3), 47 U.S.C. 204(a)(3) (''Deemed Lawful'') Considerations.* The Commission concludes that the policy objectives of this proceeding can be achieved without creating an exception to the statutory tariffing timelines. LECs that meet the access stimulation trigger are required to refile their interstate switched access tariffs as outlined above. Any issues that arise in these refiled tariffs can be addressed through the suspension and rejection authority of the Commission contained in section 204 of the Act, 47 U.S.C. 204, or through appropriate enforcement action.

473. The Commission concludes that a LEC's failure to comply with the requirement that it file a revised tariff if the trigger is met constitutes a violation of the Commission's rules, which is sanctionable under section 503 of the Act, 47 U.S.C. 503. Section 503(b)(2)(B) of the Act, 47 U.S.C. 503(b)(2)(B), authorizes the Commission to assess a forfeiture of up to $150,000 for each violation, or each day of a continuing violation, up to a statutory maximum of $1,500,000 for a single act or failure to act by common carriers, 47 CFR 1.80(b)(2). In 2008, the Commission amended its rules to increase the maximum forfeiture amounts in accordance with the inflation adjustment requirements contained in the Debt Collection Improvement Act of 1996, 28 U.S.C. 2461. The Commission also concludes that such a failure would constitute ''furtive concealment'' as described by the DC Circuit in *ACS of Anchorage, Inc.* v. *FCC,* 290 F.3d 403 (D.C. Cir. 2002). In 2002, the United States Court of Appeals for the D.C. Circuit, in reversing a Commission decision that had found a tariff filing did not qualify for deemed lawful treatment and was thus subject to possible refund liability, noted that it was not addressing ''the case of a carrier that furtively employs improper accounting techniques in a tariff filing, thereby concealing potential rate of return violations.'' The Commission therefore puts parties on notice that if it finds in a complaint proceeding under sections 206–209 of the Act, 47 U.S.C 206–209, that such ''furtive concealment'' has occurred, that finding will be applicable to the tariff as of the date on which the revised tariff was required to be filed and any refund liability will be applied as of such date. The Commission concludes that this approach will eliminate any incentives that LECs may have to delay or avoid complying with the requirement that they file revised tariffs. Several parties support this approach.

474. All American Telephone Co. filed a petition for declaratory ruling requesting that the Commission find that commercial agreements involving the sharing of access revenues between LECs and ''free'' service providers do not violate the Communications Act. In this R&O, the Commission adopts a definition of access revenue sharing agreement and prescribe that a LEC meeting the conditions of that definition must file revised tariffs. Given the findings and the rules adopted in this R&O, the Commission declines to address the All American petition and it is dismissed.

(iii) Enforcement

475. The revised interstate access rules adopted in this R&O will facilitate enforcement through the Commission's complaint procedures, if necessary. Given the two-year statute of limitations in section 405 of the Act, 47 U.S.C. 405, a complaining IXC would have two years from the date the cause of action accrued (the date after the tariff should have been filed) to file its complaint. Because the rules the Commission adopts are prospective, they will have no binding effect on pending complaints. A complaining carrier may rely on the 3:1 terminating-to-originating traffic ratio and/or the traffic growth factor for the traffic it exchanges with the LEC as the basis for filing a complaint. This will create a rebuttable presumption that revenue sharing is occurring and the LEC has violated the Commission's rules. The LEC then would have the burden of showing that it does not meet both conditions of the definition. The Commission declines to require a particular showing, but, at a minimum, an officer of the LEC must certify that it has not been, or is no longer engaged in access revenue sharing, and the LEC must also provide a certification from an officer of the company with whom the LEC is alleged to have a revenue sharing agreement(s) associated with access stimulation that that entity has not, or is not currently, engaged in access stimulation and related revenue sharing with the LEC. If the LEC challenges that it has met either of the traffic measurements, it must provide the necessary traffic data to establish its contention. With the guidance in this R&O, the Commission believes parties should in good faith be able to determine whether the definition is met without further Commission intervention.

476. *Non-payment Disputes.* Several parties have requested that the Commission address alleged self-help by long distance carriers who they claim are not paying invoices sent for interstate switched access services. As the Commission has previously stated, ''[w]e do not endorse such withholding of payment outside the context of any applicable tariffed dispute resolution provisions.'' The Commission otherwise declines to address this issue in this R&O, but cautions parties of their payment obligations under tariffs and contracts to which they are a party. The new rules the Commission adopts in this R&O will provide clarity to all affected parties, which should reduce disputes and litigation surrounding access stimulation and revenue sharing agreements.

(iv) Conclusion

477. The rules the Commission adopt in this section will require rates associated with access stimulation to be just and reasonable because those rates will more closely reflect the access stimulators' actual traffic volume. Taking this basic step will immediately reduce some of the inefficient incentives enabled by the current intercarrier compensation system, and permit the industry to devote resources to innovation and investment rather than access stimulation and disputes. The Commission has balanced the need for the new rules to address traffic stimulation with the costs that may be imposed on LECs and have concluded that the benefits justify any burdens. The Commission's new rules will work in tandem with the comprehensive intercarrier compensation reforms the Commission adopts below, which will, when fully implemented, eliminate the incentives in the present system that give rise to access stimulation.

B. Phantom Traffic

478. In this portion of the R&O, the Commission amends the Commission's rules to address ''phantom traffic'' by ensuring that terminating service

providers receive sufficient information to bill for telecommunications traffic sent to their networks, including interconnected VoIP traffic. The amendments the Commission adopts close loopholes that are being used to manipulate the intercarrier compensation system.

479. ''Phantom traffic'' refers to traffic that terminating networks receive that lacks certain identifying information. In some cases, service providers in the call path intentionally remove or alter identifying information to avoid paying the terminating rates that would apply if the call were accurately signaled and billed. For example, some parties have sought to avoid payment of relatively high intrastate access charges by making intrastate traffic appear interstate or international in nature. Parties have also disguised or routed non-local traffic subject to access charges to avoid those charges in favor of lower reciprocal compensation rates. Collectively, problems involving unidentifiable or misidentified traffic appear to be widespread. Parties have documented that phantom traffic is a sizeable problem, with estimates ranging from 3–20 percent of all traffic on carriers' networks, which costs carriers—and ultimately consumers—potentially hundreds of millions of dollars annually. In turn, carriers are diverting resources to investigate and pursue billing disputes, rather than use such resources for more productive purposes such as capital investment. This sort of gamesmanship distorts the intercarrier compensation system and chokes off revenue that carriers depend on to deliver broadband and other essential services to consumers, particularly in rural and difficult to serve areas of the country.

480. Based on the record developed in this proceeding, the Commission now adopts its original proposal with the minor modifications described in further detail below. Service providers that originate interstate or intrastate traffic on the PSTN, or that originate inter- or intrastate interconnected VoIP traffic destined for the PSTN, will now be required to transmit the telephone number associated with the calling party to the next provider in the call path. Intermediate providers must pass calling party number or charge number signaling information they receive from other providers unaltered, to subsequent providers in the call path. These requirements will assist service providers in appropriately billing for calls traversing their networks.

481. By ensuring that the calling party telephone number information is provided and transmitted for all types of traffic originating or terminating on the PSTN, the revised rules will assist service providers in accurately identifying and billing for traffic terminating on their networks, and help to guard against further arbitrage practices. These measures will work in tandem with the Commission's reforms adopted elsewhere in this R&O, which, by minimizing intercarrier compensation rate differences, promise to eliminate the incentive for providers to engage in phantom traffic arbitrage. Together, these changes will benefit consumers by enabling providers to devote more resources to investment and innovation that would otherwise have been spent resolving billing disputes.

1. Revised Call Signaling Rules

482. The Commission adopts the proposal contained in the *USF/ICC Transformation NPRM* to require that the CN be passed unaltered where it is different from the CPN. The Commission believes that this requirement will be an adequate remedy to the problem of CN number substitution that disguises the characteristics of traffic to terminating service providers. Additionally, the Commission notes that the CN field may only be used to contain a calling party's charge number, and that it may not contain or be populated with a number associated with an intermediate switch, platform, or gateway, or other number that designates anything other than a calling party's charge number. The Commission is not persuaded by objections to this requirement. First, unsupported objections that there may be ''circumstances where a CN may be different from the CPN but cannot be easily transmitted'' are unpersuasive without more specific evidence. Second, the Commission notes that it addressed similar circumstances in *Regulation of Prepaid Calling Card Services,* WC Docket No. 05–68, Declaratory Ruling and Report and Order, 71 FR 43667, Aug. 2, 2006 (*Prepaid Calling Card Order*), and prohibited carriers that serve prepaid calling card providers from passing the telephone number associated with the platform in the charge number parameter. In this case, the Commission agrees with the analysis of the *Prepaid Calling Card Order* that ''[b]ecause industry standards allow for the use of CN to populate carrier billing records * * * passing the number of the [] platform in the parameters of the SS7 stream to carriers involved in terminating a call may lead to incorrect treatment of the call for billing purposes.'' In sum, the record demonstrates that CN substitution is a technique that leads to phantom traffic, and the proposed rules are a necessary and reasonable response.

483. The Commission amends its rules to require service providers using MF signaling to pass the number of the calling party (or CN, if different) in the MF ANI field. This requirement will provide consistent treatment across signaling systems and will ensure that information identifying the calling party is included in call signaling information for all calls. Moreover, this requirement responds to the concerns expressed in the record that MF signaling can be used by ''unscrupulous providers'' to engage in phantom traffic practices. The previous record concerning the technical limitations of MF ANI appears to be mixed. In balancing the need for a rule that covers all traffic with the technical limitations asserted in the record, the Commission concludes that the approach most consistent with its policy objective is not to exclude the entire category of MF traffic. Such a categorical exclusion could create a disincentive to invest in IP technologies and invite additional opportunities for arbitrage. Although the rules will apply to carriers that use or pass MF signaling, the Commission does not mandate any specific method of compliance. Carriers will have flexibility to devise their own means to pass this information in their MF signaling. Nevertheless, to the extent that a party is unable to comply with the rule as a result of technical limitations related to MF signaling in its network, it can seek a waiver for good cause shown, pursuant to section 1.3 of the Commission's rules, 47 CFR 1.3.

484. *IP Signaling.* Consistent with the proposal in the *USF/ICC Transformation NPRM,* the rules the Commission adopts also apply to interconnected VoIP traffic. Failure to include interconnected VoIP traffic in the signaling rules would create a large and growing loophole as the number of interconnected VoIP lines in service continues to grow. Therefore, VoIP service providers will be required to transmit the telephone number of the calling party for all traffic destined for the PSTN that they originate. If they are intermediate providers in a call path, they must pass, unaltered, signaling information they receive indicating the telephone number, or billing number if different, of the calling party. Because IP transmission standards and practices are rapidly changing, the Commission refrains from mandating a specific compliance method and instead leaves to service providers using different IP technologies the flexibility to determine how best to comply with this requirement.

485. In extending its call signaling rules to interconnected VoIP service providers, the Commission acknowledges that it has not classified interconnected VoIP services as ''telecommunications services'' or ''information services.'' The Commission needs not resolve this issue here, for the Commission would have authority to impose call signaling on interconnected VoIP providers even under an information service classification. Additionally, as the Commission has previously found, section 706, 47 U.S.C. 1302, provides authority applicable in this context.

2. Prohibition of Altering or Stripping Call Information

486. In the *USF/ICC Transformation NPRM,* the Commission also sought comment on a proposed rule that would prohibit service providers from altering or stripping relevant call information. More specifically, the Commission proposed to require all telecommunications providers and entities providing interconnected VoIP service to pass the calling party's telephone number (or, if different, the financially responsible party's number), unaltered, to subsequent carriers in the call path. Commenters overwhelmingly supported this proposal. The Commission believes that a prohibition on stripping or altering information in the call signaling stream serves the public interest. The prohibition should help ensure that the signaling information required by its rules reaches terminating carriers. Therefore, the Commission adopts its proposal to prohibit stripping or altering call signaling information with the modifications discussed below.

487. In response to comments in the record, the Commission makes several clarifying changes to the text of the proposed rules in this section. First, commenters objected to the use of the undefined term ''financially responsible party'' in the proposed rules. The Commission agrees with the concerns and clarify that providers are required to pass the billing number (*e.g.,* CN in SS7) if different from the calling party's number. For similar reasons, for purposes of this rule, the Commission adds the following definition of the term ''intermediate provider'' to the rules: ''any entity that carries or processes traffic that traverses or will traverse the PSTN at any point insofar as that entity neither originates nor terminates that traffic.'' The Commission finds that adding this definition will eliminate potential ambiguity in the revised rule. As provided in Appendix A, the Commission also makes modest adjustments to the rules proposed in the *USF/ICC Transformation NPRM.* Specifically, the Commission clarifies that the obligation to pass signaling information applies to the telephone number or billing number, and the Commission clarifies that the revised rules apply to telecommunications carriers and providers of interconnected VoIP services. Finally, because, as discussed below, the waiver process is available to parties seeking exceptions to the revised rule, the Commission removes the proposed rule language limiting applicability in relation to industry standards. With these minor changes, the Commission adopts the proposed prohibition on stripping or altering information regarding the calling party number.

3. Exceptions

488. The Commission declines to adopt any general exceptions to its new call signaling rules at this time. Parties seeking limited exceptions or relief in connection with the call signaling rules the Commission adopts can avail themselves of established waiver procedures at the Commission. To that end, the Commission delegates authority to the Wireline Competition Bureau to act upon requests for a waiver of the rules adopted herein in accordance with existing Commission rules.

4. Signaling/Billing Record Requirements

a. Discussion

489. After considering the substantial record received in response to the *USF/ICC Transformation NPRM,* the Commission determines that limiting the scope of the rules it adopts to address phantom traffic to CPN and CN signaling is consistent with the goal of helping to ensure complete and accurate passing of call signaling information, while minimizing disruption to industry practices or existing carrier agreements. The revised and expanded requirements with regard to CPN and CN will ensure that terminating carriers will receive, via SS7, MF, or IP signaling, information helpful in identifying carriers sending terminating traffic to their networks. This information, in combination with billing records provided to terminating carriers in accordance with industry standards, should significantly reduce the amount of unbillable traffic that terminating carriers receive.

b. Enforcement

490. Commenters to the *USF/ICC Transformation NPRM* urged the Commission to consider a number of measures to ensure compliance with the Commission's new rules. As explained below, however, there is no persuasive evidence that existing enforcement mechanisms and complaint processes are inadequate. The Commission therefore declines to adopt these enforcement proposals. Parties aggrieved by violations of the phantom traffic rules have a number of options, such as filing an informal or formal complaint. In addition, the Commission has broad authority to initiate proceedings on its own motion to investigate and enforce its phantom traffic rules.

IX. Comprehensive Intercarrier Compensation Reform

491. Consistent with the National Broadband Plan's recommendation to phase out regulated per-minute intercarrier compensation charges, in this section the Commission adopts bill-and-keep as the default methodology for all intercarrier compensation traffic. The Commission believes that setting an end state for all traffic will promote the transition to IP networks, provide a more predictable path for the industry and investors, and anchor the reform process that will ultimately free consumers from shouldering the hidden multi-billion dollar subsidies embedded in the current system.

492. Under bill-and-keep arrangements, a carrier generally looks to its end-users—which are the entities and individuals making the choice to subscribe to that network—rather than looking to other carriers and their customers to pay for the costs of its network. To the extent additional subsidies are necessary, such subsidies will come from the CAF, and/or state universal service funds. Wireless providers have long been operating pursuant to what are essentially bill-and-keep arrangements, and this framework has proven to be successful for that industry. Bill-and-keep arrangements are also akin to the model generally used to determine who bears the cost for the exchange of IP traffic, where providers bear the cost of getting their traffic to a mutually agreeable exchange point with other providers.

493. Bill-and-keep has significant policy advantages over other proposals in the record. A bill-and-keep methodology will ensure that consumers pay only for services that they choose and receive, eliminating the existing opaque implicit subsidy system under which consumers pay to support other carriers' network costs. This subsidy system shields subsidy recipients and their customers from price signals associated with network

deployment choices. A bill-and-keep methodology also imposes fewer regulatory burdens and reduces arbitrage and competitive distortions inherent in the current system, eliminating carriers' ability to shift network costs to competitors and their customers. The Commission has legal authority to adopt a bill-and-keep methodology as the end point for reform pursuant to its rulemaking authority to implement sections 251(b)(5), 47 U.S.C. 251(b)(5), and 252(d)(2), 47 U.S.C. 252(d)(2), in addition to authority under other provisions of the Act, including 47 U.S.C. 201 and 332.

494. The Commission also adopts in this section a gradual transition for terminating access, providing price cap carriers, and competitive LECs that benchmark to price cap carrier rates, six years and rate-of-return carriers, and competitive LECs that benchmark to rate-of-return carrier rates, nine years to reach the end state. The Commission believes that initially focusing the bill-and-keep transition on terminating access rates will allow a more manageable process and will focus reform where some of the most pressing problems, such as access charge arbitrage, currently arise. Additionally, the Commission believes that limiting reform to terminating access charges at this time minimizes the burden intercarrier compensation reform will place on consumers and will help manage the size of the access replacement mechanism adopted herein. The Commission recognizes, however, that it needs to further evaluate the timing, transition, and possible need for a recovery mechanism for those rate elements—including originating access, common transport elements not reduced, and dedicated transport—that are not immediately transitioned; the Commission addresses those elements in the *USF/ICC Transformation FNPRM.* The transition the Commission adopts sets a default framework, leaving carriers free to enter into negotiated agreements that allow for different terms.

A. Bill-and-Keep as the End Point for Reform

1. Bill-and-Keep Best Advances the Goals of Reform

495. The Commission adopts a bill-and-keep methodology as a default framework and end state for all intercarrier compensation traffic. The Commission finds that a bill-and-keep framework for intercarrier compensation best advances the Commission's policy goals and the public interest, driving greater efficiency in the operation of telecommunications networks and promoting the deployment of IP-based networks.

496. *Bill-and-Keep Is Market-Based and Less Burdensome than the Proposed Alternatives.* Bill-and-keep brings market discipline to intercarrier compensation because it ensures that the customer who chooses a network pays the network for the services the subscriber receives. Specifically, a bill-and-keep methodology requires carriers to recover the cost of their network through end-user charges, which are potentially subject to competition. Under the existing approach, carriers recover the cost of their network from competing carriers through intercarrier charges, which may not be subject to competitive discipline. Thus, bill-and-keep gives carriers appropriate incentives to serve their customers efficiently.

497. Bill-and-keep is also less burdensome than approaches that would require the Commission and/or state regulators to set a uniform positive intercarrier compensation rate, such as $0.0007. In particular, bill-and-keep reduces the significant regulatory costs and uncertainty associated with choosing such a rate, which would require complicated, time consuming regulatory proceedings, based on factors such as demand elasticities for subscription and usage as well as the nature and extent of competition. As the Commission has recognized with respect to the existing reciprocal compensation rate methodology, ''[s]tate pricing proceedings under the TELRIC [Total Element Long Run Incremental Cost] regime have been extremely complicated and often last for two or three years at a time. * * * The drain on resources for the state commissions and interested parties can be tremendous.'' Indeed, the cost of implementing such a framework potentially could outweigh the resulting intercarrier compensation revenues for many carriers. Moreover, in setting any new intercarrier rate, it would be necessary to rely on information from carriers who would have incentives to maximize their own revenues, rather than ensure socially optimal intercarrier compensation charges. Thus, the costs of choosing a new positive intercarrier compensation rate would be significant, and a reasonable outcome would be highly uncertain.

498. *Bill-and-Keep Is Consistent with Cost Causation Principles.* As the *USF/ICC Transformation NPRM* observed, ''[u]nderlying historical pricing policies for termination of traffic was the assumption that the calling party was the sole beneficiary and sole cost-causer of a call.'' However, as one regulatory group has observed, if the called party did not benefit from incoming calls, ''users would either turn off their phone or not pick up calls.'' This is particularly true given the prevalence of caller ID, the availability of the national do-not-call registry, and the option of having unlisted telephone numbers. More recent analyses have recognized that both parties generally benefit from participating in a call, and therefore, that both parties should split the cost of the call. That line of economic research finds that the most efficient termination charge is less than incremental cost, and could be negative.

499. Moreover, the subscription decisions of the called party play a significant role in determining the cost of terminating calls to that party. A consequent effect of the existing intercarrier compensation regime is that it allows carriers to shift recovery of the costs of their local networks to other providers because subscribers do not have accurate pricing signals to allow them to identify lower-cost or more efficient providers. By contrast, a bill-and-keep framework helps reveal the true cost of the network to potential subscribers by limiting carriers' ability to recover their own costs from other carriers and their customers, even as the Commission retains beneficial policies regarding interconnection, call blocking, and geographic rate averaging.

500. The Commission rejects claims that bill-and-keep does not allow for sufficient cost recovery. In the past, parties have argued that a bill-and-keep approach somehow results in ''free'' termination. But bill-and-keep merely shifts the responsibility for recovery from other carrier's customers to the customers that chose to purchase service from that network plus explicit universal service support where necessary. Such an approach provides better incentives for carriers to operate efficiently by better reflecting those efficiencies (or inefficiencies) in pricing signals to end-user customers.

501. To the extent carriers in costly-to-serve areas are unable to recover their costs from their end users while maintaining service and rates that are reasonably comparable to those in urban areas, universal service support, rather than intercarrier compensation should make up the difference. In this respect, bill-and-keep helps fulfill the direction from Congress in the 1996 Act that the Commission should make support explicit rather than implicit.

502. *Consumer Benefits of Bill-and-Keep.* Economic theory suggests that carriers will reduce consumers' effective price of calling, through reduced

charges and/or improved service quality. The Commission predicts that reduced quality-adjusted prices will lead to substantial savings on calls made, and to increased calling. Economic theory suggests that quality-adjusted prices will be reduced regardless of the extent of competition in any given market, but will be reduced most where competition is strongest. These price reductions will be most significant among carriers who, by and large, incur but do not collect termination charges, notably CMRS and long-distance carriers. The potential for benefits to wireless customers is particularly important, as today there are approximately 300 million wireless devices, compared to approximately 117 million fixed lines, in the United States. Lower termination charges for wireless carriers could allow lower prepaid calling charges and larger bundles of free calls for the same monthly price. For example, carriers presently offer free ''in-network'' wireless calls at least in part because they do not have to pay to terminate calls on their own network. Lower termination charges could also enable more investment in wireless networks, resulting in higher quality service—*e.g.,* fewer dropped calls and higher quality calls—as well as accelerated deployment of 4G service. Similarly, IXCs, calling card providers, and VoIP providers will be able to offer cheaper long-distance rates and unlimited minutes at a lower price.

503. Moreover, as carriers face intercarrier compensation charges that more accurately reflect the incremental cost of making a call, consumers will see at least three mutually reinforcing types of benefits. First, carriers operations will become more efficient as they are able to better allocate resources for delivering and marketing existing communications services. Specifically, as described below, bill-and-keep will over time eliminate wasteful arbitrage schemes and other behaviors designed to take advantage of or avoid above-cost interconnection rates, as well as reducing ongoing call monitoring, intercarrier billing disputes, and contract enforcement efforts. Second, carrier decisions to invest in, develop, and market communications services will increasingly be based on efficient price signals.

504. Third, and perhaps most importantly, the Commission expects carriers will engage in substantial innovation to attract and retain consumers. New services that are presently offered on a limited basis will be expanded, and innovative services and complementary products will be developed. For example, with the substantial elimination of termination charges under a bill-and-keep methodology, a wide range of IP-calling services are likely to be developed and extended, a process that may ultimately result in the sale of broadband services that incorporate voice at a zero or nominal charge. All these changes will bring substantial benefits to consumers.

505. The impact of the Commission's last substantial intercarrier compensation reform supports its view that consumers will benefit significantly from the R&O's reforms. In 2000, the *CALLS Order, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers,* CC Docket Nos. 96–262 and 94–1, Sixth Report and Order, *Low-Volume Long-Distance Users,* CC Docket No. 99–249, Report and Order, *Federal-State Joint Board on Universal Service,* CC Docket No. 96–45, Eleventh Report and Order, 65 FR 57739, Sept. 26, 2000 (*CALLS Order*), reduced interstate access charges. At the same time, in ways similar to the present reforms, we imposed modest increases in the fixed charges faced by end users. In the *CALLS Order,* the Commission forecasted that reduced interstate access rates would bring a range of efficiency benefits. Although some of these forecasts were met with initial skepticism, end-users in fact realized benefits that exceeded most expectations. In particular, the *CALLS Order* resulted in substantial decreases in calling prices, but in largely unexpected ways. As a result of the *CALLS Order,* retail toll charges fell sharply, bringing average customer expenditures per minute of interstate toll calling down 18 percent during the year 2000. However, rather than merely reducing per-minute rates, wireless carriers started offering a new form of pricing, a fixed fee for a ''bucket'' of minutes, and ended distance-based pricing. As a result of these price declines, the gains in consumer surplus for wireless users in the United States from the *CALLS Order* were estimated to be about $115 billion per year. Competitive pressure from wireless providers brought similar changes to fixed line carriers, who began offering unlimited domestic calls. These price declines and innovations also had important indirect effects, allowing end-users to fundamentally change the way they used telephony services. For example, lower calling charges enabled a substantial and ongoing shift from landlines to wireless. In short, the Commission's prior intercarrier compensation reform led to more convenient access to telecommunication services and substantially lower costs for long-distance calls.

506. *Bill-and-Keep Eliminates Arbitrage and Marketplace Distortions.* Bill-and-keep will address arbitrage and marketplace distortions arising from the current intercarrier compensation regimes, and therefore will promote competition in the telecommunications marketplace. Intercarrier compensation rates above incremental cost have enabled much of the arbitrage that occurs today, and to the extent that such rates apply differently across providers, have led to significant marketplace distortions. Rates today are determined by looking at the average cost of the entire network, whereas a bill-and-keep approach better reflects the incremental cost of termination, reducing arbitrage incentives. For example, based on a hypothetical calculation of the cost of voice service on a next generation network providing a full range of voice, video, and data services, one study estimated that the incremental cost of delivering an average customer's total volume of voice service could be as low as $0.000256 per month; on a per minute basis, this incremental cost would translate to a cost of $0.0000001 per minute. Moreover, non-voice traffic on next generation networks (NGNs) is growing much more rapidly than voice traffic, and under any reasonable methods of cost allocation, the share of voice cost to total cost will continue to be small in an NGN. Record evidence indicates that the incremental cost of termination for circuit-switched networks is likewise extremely small.

507. The conclusion that the incremental cost of call termination is very nearly zero, coupled with the difficulty of appropriately setting an efficient, positive intercarrier compensation charge, further supports the adoption of bill-and-keep. The Commission notes that the statutory text of 47 U.S.C. 252(d)(2) provides that the methodology for reciprocal compensation should allow for the recovery of the ''additional costs'' of a call which equals incremental cost, not the average or total cost of transporting or terminating a call. Exact identification of efficient termination charges would be extremely complex, and considering the costs of metering, billing, and contract enforcement that come with a non-zero termination charge, the Commission finds that the benefits obtained from imposing even a very careful estimate of the efficient interconnection charge would be more than offset by the considerable costs of doing so. The Commission acknowledges that it is also possible that, in some instances, the efficient

termination rates of preceding models would not allow overall cost recovery. In that case, while the efficient *cost-covering* termination rate could lie above incremental cost, the Commission also concludes that it is more efficient to ensure cost recovery via direct subsidies, such as the CAF, than by distorting usage prices.

508. Some parties have expressed concerns that bill-and-keep arrangements will encourage carriers to ''dump'' traffic on other providers' terminating network, because the cost of termination to the carrier delivering the traffic will be zero. Such concerns, however, appear to be largely speculative; no commenter has identified a concrete reason why any carrier would engage in such ''dumping'' or how it would do so. Indeed, there has been no evidence that any such ''dumping'' has occurred in the wireless industry, which has operated under a similar framework. Even so, if a long distance carrier decided to deliver all of its traffic to a terminating LECs' tandem switch, that practice could result in tandem exhaust, requiring the terminating LEC to invest in additional switching capacity. To help address this concern, the Commission confirms that a LEC may include traffic grooming requirements in its tariffs. These traffic grooming requirements specify when a long distance carrier must purchase dedicated DS1 or DS3 trunks to deliver traffic rather than pay per-minute transport charges, a determination based on the amount of traffic going to a particular end office. The Commission believes this accountability and additional information will deter concerns regarding traffic dumping.

509. *Bill-and-Keep Is Appropriate Even If Traffic Is Imbalanced.* The Commission initially permitted states to impose bill-and-keep arrangements on providers, but did so with the caveat that traffic should be roughly in balance. At the time, the Commission reasoned that carriers incur costs for terminating traffic, and bill-and-keep may not enable the recovery of such costs from other carriers. The Commission also expressed concern that, in a reciprocal compensation arrangement, bill-and-keep may ''distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic.''

510. In light of technological advancements and the rejection of the calling party network pays model in favor of a model that better tracks cost causation principles, the Commission revisits its prior concerns and conclusions supporting the ''balanced traffic limitation.'' First, the Commission rejects claims that, as a policy matter, bill-and-keep is only appropriate in the case of roughly balanced traffic. Concerns about the balance of traffic exchanged reflect the view that the calling party's network should bear all the costs of a call. Given the understanding that both the calling and called party benefit from a call, the ''direction'' of the traffic—*i.e.,* which network is originating or terminating the call—is no longer as relevant. Under bill-and-keep, ''success in the marketplace will reflect a carrier's ability to serve customers efficiently, rather than its ability to extract payments from other carriers.'' Additionally, bill-and-keep is most consistent with the models used for wireless and IP networks, models that have flourished and promoted innovation and investment without any symmetry or balanced traffic requirement.

511. Second, as already explained, the Commission rejects the assertion that bill-and-keep does not enable cost recovery. Although a bill-and-keep approach will not provide for the recovery of certain costs via *intercarrier* compensation, it will still allow for cost recovery via end-user compensation and, where necessary, explicit universal service support. The Commission finds that although the statute provides that each carrier will have the opportunity to recover its costs, it does not entitle each carrier to recover those costs from another carrier, so long as it can recover those costs from its own end users and explicit universal service support where necessary.

512. As a result, the Commission departs from the Commission's earlier articulated concern that bill-and-keep distorts carriers incentives. To the contrary, the Commission concludes, based on policy and economic theory, that bill-and-keep best addresses the significant arbitrage incentives inherent in today's system.

513. These conclusions are consistent with the Commission's more recent consideration of bill-and-keep arrangements in the context of ISP-bound traffic. Specifically, in the *2001 ISP Remand Order, Intercarrier Compensation for ISP-Bound Traffic,* CC Docket Nos. 96–98, 99–68, Order on Remand and Report and Order, 66 FR 26800, May 15, 2001 (*2001 ISP Remand Order*), the Commission stated that its initial ''concerns about economic inefficiencies associated with bill and keep missed the mark'' because they incorrectly assumed that the ''calling party was the sole cost causer of the call.'' The Commission tentatively concluded that bill-and-keep would provide a viable solution to the market distortions caused by ISP-bound traffic. Indeed, the Commission's experience with ISP-bound traffic suggests that a bill-and-keep approach may be most efficient where the traffic is not balanced because the obligation to pay reciprocal compensation in such situations may give rise to uneconomic incentives. The Commission therefore concludes it is appropriate to repeal section 51.713 of its rules, 47 CFR 51.713.

2. Legal Authority

514. The Commission's statutory authority to implement bill-and-keep as the default framework for the exchange of traffic with LECs flows directly from sections 251(b)(5) and 201(b) of the Act, 47 U.S.C. 251(b)(5), 201(b). The Commission has additional statutory authority under 47 U.S.C. 332 to regulate interconnection arrangements involving CMRS providers. Section 251(b)(5), 47 U.S.C. 251(b)(5), states that LECs have a ''duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.'' Section 201(b), 47 U.S.C. 201(b), grants the Commission authority to ''prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.'' In *AT&T Corp.* v. *Iowa Utilities Board,* 525 U.S. 366, 378 (1999), the Supreme Court held that ''the grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252.'' As discussed below, the Commission may exercise this rulemaking authority to define the types of traffic that will be subject to 47 U.S.C. 251(b)(5)'s reciprocal compensation framework and to adopt a default compensation mechanism that will apply to such traffic in the absence of an agreement between the carriers involved.

515. *The Scope of 47 U.S.C. 251(b)(5).* Section 251(b)(5), 47 U.S.C. 251(b)(5) imposes on all LECs the ''duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.'' The Commission initially interpreted this provision to ''apply only to traffic that originates and terminates within a local area.'' In the *2001 ISP Remand Order,* however, the Commission noted that its initial reading is inconsistent with the statutory terms. The Commission explained that 47 U.S.C. 251(b)(5) does not use the term ''local,'' but instead speaks more broadly of the transport and termination of

''telecommunications.'' As defined in the Act, the term ''telecommunications'' means the ''transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received'' and thus encompasses communications traffic of any geographic scope (*e.g.,* ''local,'' ''intrastate,'' or ''interstate'') or regulatory classification (*e.g.,* ''telephone exchange service,'' ''telephone toll service,'' or ''exchange access''). The Commission reiterated this interpretation of 47 U.S.C. 251(b)(5) in its *2008 Order and ICC/USF FNPRM, High-Cost Universal Service Support,* WC Docket No. 05–337, 03–109, 06–122, 04–36, CC Docket No. 96–45, 99–200, 96–98, 01–92, 99–68, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 73 FR 66821, Dec. 12, 2008 (*2008 Order and ICC/USF FNPRM*), and the Commission proposed in the *ICC/USF Transformation NPRM* to make clear that 47 U.S.C. 251(b)(5) applies to ''all telecommunications, including access traffic.''

516. After reviewing the record, the Commission adopts its proposal and concludes that 47 U.S.C. 251(b)(5) applies to traffic that traditionally has been classified as access traffic. Nothing in the record seriously calls into question the Commission's conclusion that access traffic is one form of ''telecommunications.'' By the express terms of 47 U.S.C. 251(b)(5), therefore, when a LEC is a party to the transport and termination of access traffic, the exchange of traffic is subject to regulation under the reciprocal compensation framework.

517. The Commission recognizes that the Commission has not previously regulated access traffic under 47 U.S.C. 251(b)(5). The reason, as the Commission has previously explained, is section 251(g), 47 U.S.C. 251(g). Section 251(g), 47 U.S.C. 251(g), is a ''transitional device'' that requires LECs to continue ''provid[ing] exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation)'' previously in effect ''until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission.'' Section 251(g), 47 U.S.C. 251(g), thus preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing ''receipt of compensation,'' and thereby precluded the application of 47 U.S.C. 251(b)(5) to such traffic ''unless and until the Commission by regulation should determine otherwise.''

518. In this R&O, the Commission explicitly supersedes the traditional access charge regime and, subject to the transition mechanism outlined below, regulates terminating access traffic in accordance with the 47 U.S.C. 251(b)(5) framework. Consistent with its approach to comprehensive reform generally and the desire for a more unified approach, the Commission finds it appropriate to bring all traffic within the 47 U.S.C. 251(b)(5) regime at this time, and commenters generally agree. Doing so is key to advancing the Commission's goals of encouraging migration to modern, all IP networks; eliminating arbitrage and competitive distortions; and eliminating the thicket of disparate intercarrier compensation rates and payments that are ultimately borne by consumers. Even though the transition process detailed below is limited to terminating switched access traffic and certain transport traffic, the Commission makes clear that the legal authority to adopt the bill-and-keep methodology described herein applies to all intercarrier compensation traffic. As noted below, the Commission seeks comment on the transition and recovery for originating access and transport in the *USF/ICC Transformation FNPRM.*

519. The Commission rejects arguments that 47 U.S.C. 251(b)(5) does not apply to intrastate access traffic. Like other forms of carrier traffic, intrastate access traffic falls within the scope of the broad term ''telecommunications'' used in 47 U.S.C. 251(b)(5). ''Had Congress intended to exclude certain types of telecommunications traffic,'' such as ''local'' or ''intrastate'' traffic, ''from the reciprocal compensation framework, it could have easily done so by using more restrictive terms to define the traffic subject to 47 U.S.C. 251(b)(5).'' Nor does the Commission believe that section 2(b) of the Act, 47 U.S.C. 152(b), which generally preserves state authority over intrastate communications, bears on its interpretation of 47 U.S.C. 251(b)(5). As the Supreme Court noted, ''[s]uch an interpretation [of 47 U.S.C. 152(b)] would utterly nullify the 1996 amendments, which clearly 'apply' to intrastate services, and clearly confer 'Commission jurisdiction' over some matters.'' Indeed, if 47 U.S.C. 152(b) limited the scope of 47 U.S.C. 251(b)(5), the Commission could not apply the reciprocal compensation framework even to local traffic between a CLEC and an ILEC—the type of traffic that has been subject to the reciprocal compensation rules since the Commission implemented the 1996 Act. The Commission sees no reason to adopt such an absurd reading of the statute.

520. The Commission also rejects arguments that 47 U.S.C. 251(g) and 251(d)(3) somehow limit the scope of the ''telecommunications'' covered by 47 U.S.C. 251(b)(5). Whatever protections these provisions provide to state access regulations, it is clear that those protections are not absolute. As noted above, 47 U.S.C. 251(g) preserves access charge rules only during a transitional period, which ends when the Commission adopts superseding regulations. Accordingly, to the extent 47 U.S.C. 251(g) has preserved state intrastate access rules against the operation of 47 U.S.C. 251(b)(5) until now, this rulemaking R&O supersedes that provision.

521. Section 251(d)(3), 47 U.S.C. 251(d)(3), states that ''[i]n prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that—(A) establishes access and interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part.'' As the Commission has previously observed, ''section 251(d)(3) of the Act independently establishes a standard very similar to the judicial conflict preemption doctrine,'' and ''[i]ts protections do *not* apply when the state regulation is inconsistent with the requirements of section 251, *or* when the state regulation substantially prevents implementation of the requirements of section 251 or the purposes of sections 251 through 261 of the Act.'' Moreover, ''in order to be consistent with the requirements of section 251 and not 'substantially prevent' implementation of section 251 or Part II of Title II, state requirements must be consistent with the FCC's implementing regulations.'' In other words, 47 U.S.C. 251(d)(3) instructs the Commission not to preempt state regulations that are consistent with and promote federal rules and policies, but it does not protect state regulations that frustrate the Act's policies or the Commission's implementation of the statute's requirements. As discussed in this R&O, the Commission is bringing all telecommunications traffic terminated on LECs, including intrastate switched access traffic, into the 47 U.S.C. 251(b)(5) framework to fulfill the

objectives of 47 U.S.C. 251(b)(5) and other provisions of the Act. Consequently, the Commission finds that, to the extent 47 U.S.C. 251(d)(3) applies in this context, it does not prevent us from adopting rules to implement the provisions of 47 U.S.C. 251(b)(5) and applying those rules to traffic traditionally classified as intrastate access.

522. Finally, the Commission rejects the view of some commenters that the pricing standard set forth in 47 U.S.C. 252(d)(2)(A) limits the scope of 47 U.S.C. 251(b)(5). As the Commission explained in the *2008 Order and ICC/USF FNPRM,* 47 U.S.C. 252(d)(2)(A)(i) ''deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies.'' The Commission noted that construing ''the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5)'' would nonsensically suggest that ''Congress intended the tail to wag the dog.'' The Commission reaffirms that conclusion here.

523. *Authority To Adopt Bill-and-Keep as a Default Compensation Standard.* The Commission concludes that it has the statutory authority to establish bill-and-keep as the default compensation arrangement for all traffic subject to 47 U.S.C. 251(b)(5). That includes traffic that, prior to this R&O, was subject to the interstate and intrastate access regimes, as well as traffic exchanged between two LECs or a LEC and a CMRS carrier.

524. Section 201(b), 47 U.S.C. 201(b) states that ''[t]he Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.'' As the Supreme Court held in *Iowa Utilities Board,* section 201(b) of the Act, 47 U.S.C. 201(b), ''means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252.'' Moreover, section 251(i) of the Act, 47 U.S.C. 251(i), states that ''[n]othing in this section [section 251] shall be construed to limit or otherwise affect the Commission's authority under section 201.'' Section 251(i), 47 U.S.C. 251(i), ''fortifies [our] position'' that the Commission has the authority to regulate the default compensation arrangement applicable to traffic subject to 47 U.S.C. 251(b)(5).

525. The Commission concludes that it has the statutory authority to establish bill-and-keep as a default compensation mechanism with respect to interstate traffic subject to 47 U.S.C. 251(b)(5). Section 201, 47 U.S.C. 201, has long conferred authority on the Commission to regulate interstate communications to ensure that ''charges, practices, classifications, and regulations'' are ''just and reasonable'' and not unreasonably discriminatory. Indeed, the D.C. Circuit recently upheld the Commission's authority under 47 U.S.C. 201 to establish interim rates for ISP-bound traffic, which the Commission had found to also be subject to 47 U.S.C. 251(b)(5).

526. In any event, the Commission concludes that it has authority, independent of its traditional interstate rate-setting authority in 47 U.S.C. 201, to establish bill-and-keep as the default compensation arrangement for all traffic subject to 47 U.S.C. 251(b)(5), including intrastate traffic. Although section 2(b), 47 U.S.C. 152(b) has traditionally preserved the states' authority to regulate intrastate communications, after the 1996 Act section 2(b) has ''less practical effect'' because ''Congress, by extending the Communications Act into local competition, has removed a significant area from the States' exclusive control.'' Thus, ''[w]ith regard to the matters addressed by the 1996 Act,'' Congress ''unquestionably'' ''has taken the regulation of local telecommunications competition away from the States,'' and, as the Supreme Court has held, ''the administration of the new *federal* regime is to be guided by federal-agency regulations.'' The rulemaking authority in section 201(b), 47 U.S.C. 152(b) ''*explicitly* gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies'' and thereby authorizes the Commission's adoption of rules to implement 47 U.S.C. 251(b)(5)'s directive that LECs have a ''duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.''

527. The Commission rejects the argument of some commenters that 47 U.S.C. 252(c) and 252(d)(2) limit its authority to adopt bill-and-keep. Section 252(c), 47 U.S.C. 252(c), provides that states conducting arbitration proceedings under section 252 shall ''establish any rates for interconnection, services, or network elements according to'' section 252(d), 47 U.S.C. 252(d). Section 252(d)(2), 47 U.S.C. 252(d), in turn, states in relevant part that ''[f]or the purposes of compliance by an *incumbent local exchange carrier* with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable'' unless they: (i) ''provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls *that originate on the network facilities of the other carrier;''* and (ii) determine such costs through a ''reasonable approximation of the additional costs of terminating such calls.'' Section 252(d)(2), 47 U.S.C. 252(d)(2), also states that the pricing standard it sets forth ''shall not be construed * * * to preclude arrangements * * * that waive mutual recovery (such as bill-and-keep arrangements).'' Although the Supreme Court made clear that the Commission may, through rulemaking, establish a ''pricing methodology'' under 47 U.S.C. 252(d) for states to apply in arbitration proceedings, the Eighth Circuit has held that ''[s]etting specific [reciprocal compensation] prices goes beyond the FCC's authority to design a pricing methodology and intrudes on the states' right to set the actual rates pursuant to § 252(c)(2).'' Commenters who cite 47 U.S.C. 252(d) as a limitation on the Commission's authority to adopt bill-and-keep argue that bill-and-keep intrudes on states' rate-setting authority by effectively setting a compensation rate of zero.

528. The Commission disagrees for two reasons. First, the pricing standard in 47 U.S.C. 252(d) simply does not apply to most of the traffic that is the focus of this R&O—traffic exchanged between LECs and IXCs. Section 252(d), 47 U.S.C. 252(d), applies only to traffic exchanged with an ILEC, so CLEC–IXC traffic is categorically beyond its scope. Even with respect to traffic exchanged with an ILEC, 47 U.S.C. 252(d) applies only to arrangements between carriers where the traffic ''originate[s] on the network facilities of the other carrier,'' *i.e.,* the carrier sending the traffic for transport and termination. IXCs, however, typically do not originate (or terminate) calls on their own network facilities but instead transmit calls that originate and terminate on distant LECs. Accordingly, to the extent the bill-and-keep rules apply to LEC–IXC traffic, the rules do not implicate any question of the states' authority under 47 U.S.C. 252(c) or (d) or the Eighth Circuit's interpretation of those provisions.

529. Second, and in any event, bill-and-keep is consistent with section 252(d)'s pricing standard. Section 252(d)(2)(B), 47 U.S.C. 252(d)(2)(B) makes clear that ''arrangements that waive mutual recovery (such as bill-and-keep arrangements)'' are consistent with section 252(d)'s pricing standard. Although bill-and-keep by definition ''waive[s] mutual recovery'' 47 U.S.C. 252(d)(2)(B)(i), in that carriers do not pay each other for transporting and terminating calls, a bill-and-keep framework provides for ''reciprocal''

recovery because each carrier exchanging traffic is entitled to recover their costs through the same mechanism, *i.e.,* through the rates they charge their own customers. As explained in the *Local Competition First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* CC Docket Nos. 96–98, 95–185, First Report and Order, 61 FR 45476, Aug. 29, 1996 (*Local Competition First Report and Order*), this provision precludes any argument that ''the Commission and states do not have the authority to mandate bill-and-keep arrangements'' or that bill-and-keep is permissible only if it is voluntarily agreed to by the carriers involved. Bill-and-keep also ensures ''recovery of each carrier of costs'' associated with transport and termination. The Act does not specify from whom each carrier may (or must) recover those costs and, under the approach the Commission adopts, each carrier will ''recover'' its costs from its own end users or from explicit support mechanisms such as the federal universal service fund. The economic premise of a bill-and-keep regime differs from the calling party network pays (CPNP) philosophy of cost causation. Under CPNP thinking, the party that initiated the call is receiving the most benefit from that call. Under the bill-and-keep methodology the economic premise is that both the calling and the called party benefit from the ability to exchange traffic, *i.e.,* being interconnected. This is consistent with policy justifications for bill-and-keep described in the *Intercarrier Compensation NPRM* in which the Commission said ''there may be no reason why *both* LECs should not recover the costs of providing these benefits directly from their end users. Bill-and-keep provides a mechanism whereby end users pay for the benefit of making *and* receiving calls.'' Thus, bill-and-keep will not limit the amount of a carrier's cost recovery, but instead will alter the source of the cost recovery—network costs would be recovered from carriers' customers supplemented as necessary by explicit universal service support, rather than from other carriers.

530. Finally, even assuming 47 U.S.C. 252(d) applies, adoption of bill-and-keep as a default compensation mechanism would not intrude on the states' role to set rates as interpreted by the Eighth Circuit. To the extent the traffic at issue is intrastate in nature and subject to 47 U.S.C. 252(d)'s pricing standard, states retain the authority to regulate the rates that the carriers will charge *their end users* to recover the costs of transport and termination to ensure that such rates are ''just and reasonable.'' Moreover, states will retain important responsibilities in the implementation of a bill-and-keep framework. An inherent part of any rate setting process is not only the establishment of the rate level and rate structure, but the definition of the service or functionality to which the rate will apply. Under a bill-and-keep framework, the determination of points on a network at which a carrier must deliver terminating traffic to avail itself of bill-and-keep (sometimes known as the ''edge'') serves this function, and will be addressed by states through the arbitration process where parties cannot agree on a negotiated outcome. Depending upon how the ''edge'' is defined in particular circumstances, in conjunction with how the carriers physically interconnect their networks, payments still could change hands as reciprocal compensation even under a bill-and-keep regime where, for instance, an IXC pays a terminating LEC to transport traffic from the IXC to the edge of the LEC's network. This statement does not suggest any particular outcome with respect to the definition of the ''edge,'' which is an issue the Commission seeks comment on in the *USF/ICC Transformation FNPRM.* Consistent with their existing role under 47 U.S.C. 251 and 252, which the Commission does not expand or contract, states will continue to have the responsibility to address these issues in state arbitration proceedings, which the Commission believes is sufficient to satisfy any statutory role that the states have under 47 U.S.C. 252(d) to ''determin[e] the concrete result in particular circumstances'' of the bill-and-keep framework the Commission adopts.

531. *Originating Access.* Some parties contend that the Commission lacks authority over originating access charges under 47 U.S.C. 251(b)(5) because that section refers only to transport and termination. Other commenters urge the Commission to act swiftly to eliminate originating access charges. Although the Commission concludes that the originating access regime should be reformed, at this time the Commission establishes a transition to bill-and-keep only with respect to terminating access charge rates. The concerns the Commission has with respect to network inefficiencies, arbitrage, and costly litigation are less pressing with respect to originating access, primarily because many carriers now have wholesale partners or have integrated local and long distance operations.

532. As discussed above, 47 U.S.C. 251(g) provides for the continued enforcement of certain pre-1996 Act obligations pertaining to ''exchange access'' until ''such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission.'' Exchange access is defined to mean ''the offering of access to telephone exchange services or facilities for the purpose of the *origination* or termination of telephone toll services.'' Thus, 47 U.S.C. 251(g) continues to preserve originating access until the Commission adopts rules to transition away from that system. At this time, the Commission adopts transition rules only with respect to terminating access and seeks comment in the *USF/ICC Transformation FNPRM* on the ultimate transition away from such charges as part of the transition of all access charge rates to bill-and-keep. In the meantime, the Commission will cap interstate originating access rates at their current level, pending resolution of the issues raised in the *USF/ICC Transformation FNPRM.*

533. *Section 332 and Wireless Traffic.* With respect to wireless traffic exchanged with a LEC, the Commission has independent authority under section 332 of the Act, 47 U.S.C. 332, to establish a default bill-and-keep methodology that will apply in the absence of an interconnection agreement. Although the Commission has not previously exercised its authority under 47 U.S.C. 332 to reform intercarrier compensation charges paid by or to wireless providers, the Commission has clear authority to do so, and this authority extends to both interstate and intrastate traffic. The Eighth Circuit has construed the Act to authorize the Commission to set reciprocal compensation rates for CMRS providers. In reaching that decision, the court relied on: (a) 47 U.S.C. 332(c)(1)(B), which obligates LECs to interconnect with wireless providers ''pursuant to the provisions of section 201;'' (b) section 2(b), 47 U.S.C. 152(b), which provides that the Act should not be construed to apply or to give the Commission jurisdiction with respect to charges in connection with intrastate communication service by radio ''[e]xcept as provided in * * * section 332;'' and (c) the preemptive language in 47 U.S.C. 332(c)(3)(A), which prohibits states from regulating the entry of or the rates charged by CMRS providers. The DC Circuit likewise recently acknowledged the Commission's authority in this regard, observing that the Commission historically had elected to leave

intrastate access rates imposed on CMRS providers to state regulation, and recognizing: ''That the FCC *can* issue guidance does not mean it must do so.'' Accordingly, the Commission concludes that it has separate authority under 47 U.S.C. 201 and 332(c) to establish rules governing the exchange of both intrastate and interstate traffic between LECs and CMRS carriers.

534. *Section 254(k).* The Commission also rejects the claims of some commenters that a bill-and-keep approach would violate 47 U.S.C. 254(k) of the Act. Section 254(k) of the Act, 47 U.S.C. 254(k), states that a telecommunications carrier ''may not use services that are not competitive to subsidize services that are subject to competition,'' and that the Commission ''shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.'' Some parties express concern that, under a bill-and-keep regime, retail voice telephone services subject to universal service support would bear more than ''a reasonable share of the joint and common costs.''

535. The United States Court of Appeals for the Eighth Circuit previously considered and rejected similar arguments concerning the reallocation of loop costs between end users and IXCs. Specifically, the court considered whether the recovery of joint and common costs must be borne mutually by end-users and by IXCs, and whether a shift in cost recovery from IXCs to end-users violated 47 U.S.C. 254(k) of the Act. As to the first provision of 47 U.S.C. 254(k), the court found that ''[s]ection 254(k) was not designed to regulate the apportionment of loop costs between end-users and IXCs because this allocation does not involve improperly shifting costs from a competitive to a non-competitive service,'' even if ''a LEC allocates all of its local loop costs to the end-user.'' Further, the court disagreed that an increase in the SLC price cap violates the second part of 254(k) by causing services included in the definition of universal service to bear more than a reasonable share of the joint and common costs of facilities used to provide those services. The court explained that the ''SLC is a method of recovering loop costs, not an allocation of costs between supported and unsupported services'' in violation of 47 U.S.C. 254(k). The Commission concurs with the Eighth Circuit's analysis and concludes that it applies equally in this context. A bill-and-keep framework resolves whether a carrier will recover its costs from its end users or from other carriers; the underlying service whose costs are being recovered is the same, however, so no costs are being improperly shifted between competitive and non-competitive services for purposes of 47 U.S.C. 254(k).

B. Federal/State Roles in Implementing Bill-and-Keep

536. The Commission now concludes that a uniform, national framework for the transition of intercarrier compensation to bill-and-keep, with an accompanying federal recovery mechanism, best advances the Commission's policy goals of accelerating the migration to all IP networks, facilitating IP-to-IP interconnection, and promoting deployment of new broadband networks by providing certainty and predictability to carriers and investors. Although states will not set the transition for intrastate rates under this approach, the Commission does follow the State Member's proposal regarding recovery coming from the federal jurisdiction. Doing so takes a potentially large financial burden away from states. States will also help implement the bill-and-keep methodology: They will continue to oversee the tariffing of intrastate rate reductions during the transition period as well as interconnection negotiations and arbitrations pursuant to 47 U.S.C. 251 and 252, and will have responsibility for determining the network ''edge'' for purposes of bill-and-keep.

537. Today, intrastate access rates vary widely. In many states, intrastate rates are significantly higher than interstate rates; in others, intrastate and interstate rates are at parity; and in still other states, intrastate access rates are below interstate levels. The varying rates have created incentives for arbitrage and pervasive competitive distortions within the industry. Equally important, consumers may not receive adequate price signals to make economically efficient choices because local and long-distance rates do not necessarily reflect the underlying costs of their calls. Depending on their regulatory classification, some carriers charge and collect intercarrier compensation charges, while other carriers do not. A bill-and-keep system will ultimately eliminate the competitive distortions and consumer inequities that arise today when different carriers that use differing technologies (wireline, wireless, VoIP) to perform the same function—complete a call—are subject to different regulatory classifications and requirements.

538. Providing a uniform national transition and recovery framework, to be implemented in partnership with the states, will achieve the benefits of a uniform system and realize the goals of reducing arbitrage and promoting investment in IP networks as quickly as possible. By transitioning all traffic in a coordinated manner, the Commission will minimize opportunities for arbitrage that could be presented by disparate intrastate rates. For example, the Commission's approach will reduce the potential for arbitrage that could result from a widening gap between intrastate and interstate rates if the Commission were to initially reduce interstate rates only. In addition, a coordinated transition involving both intrastate and interstate traffic will help to align principles of cost causation and provide appropriate pricing signals to end users. Whether completing an interstate or intrastate call, consumers will benefit from a unified system in which arbitrage opportunities that inequitably shift costs among consumers are reduced.

539. By moving in a coordinated manner to address the intercarrier compensation system for all traffic, the Commission will also help to ensure that there is no disruption in the transition to more efficient forms of all IP networks. The record suggests that a ''federally managed, geographically neutral'' intercarrier compensation regime that eliminates incentives for arbitrage will allow service providers to deploy resources in more productive ways. In addition, a unified approach for all ICC traffic will help remove obstacles to progress toward all-IP networks where jurisdictional boundaries become less relevant. In sum, the Commission's approach helps to ensure that the intercarrier compensation modernization effort will continue apace without unnecessary delays needed to harmonize disparate state actions.

540. Although several states have sought to reform intrastate access rates, significant challenges remain that could impede the comprehensive reform efforts absent a uniform, national transition. Under the direction of both state commissions and legislatures, states have taken a variety of approaches to reform. In some states, these efforts have resulted in intrastate access rate levels coming to parity with interstate levels. In other states, reform has led to reductions in intrastate rate levels, but rates remain above interstate levels. Although many states may genuinely desire to advance additional reforms,

the challenges posed by a state-by-state process would likely result in significant variability and unpredictability of outcomes. Moreover, some state commissions lack authority to address intrastate access reform, and the Commission is concerned that many states will be unable to complete reforms in a timely manner or will otherwise decline to act. Indeed, the Missouri Commission endorsed a 47 U.S.C. 251(b)(5) approach because ''states should not be allowed to delay access reform.'' The lack of certainty and predictability for the industry without a uniform framework is a significant concern. Carriers and investors need predictability to make investment and deployment decisions and lack of certainty regarding intrastate access rates or recovery hampers these efforts. In addition some parties warned that it would be ''extremely costly'' to participate in ''the multitude'' of state commission proceedings that would follow from an approach relying on dozens of different state transitions and recovery frameworks.

541. In addition, as noted above, adopting a uniform federal transition and recovery mechanism will free states from potentially significant financial burdens. The recovery mechanism will provide carriers with recovery for reductions to eligible interstate *and* intrastate revenue. As a result, states will not be required to bear the burden of establishing and funding state recovery mechanisms for intrastate access reductions, while states will continue to play a role in implementation. Furthermore, the Residential Rate Ceiling adopted as part of the recovery mechanism will help ensure that consumer telephone rates remain affordable, and will also recognize so-called ''early adopter'' states that have already undertaken reform of intrastate access charges and rebalanced rates.

542. Some commenters argued that the uniform approach the Commission takes is inappropriate because states should be allowed to pursue tailored intrastate access reforms. The Commission appreciates and respects the expertise and on-the-ground knowledge of its state partners concerning intrastate telecommunications. Indeed, as the Commission has said, states will have responsibility for implementing the bill-and-keep methodology adopted herein and will continue to oversee the tariffing of intrastate rates during the transition period and interconnection negotiations and arbitrations pursuant to 47 U.S.C. 252, as well as determine the network ''edge'' for purposes of bill-and-keep. With respect to the ultimate ICC framework and the intervening transition, however, the Commission finds that a uniform national approach will best create predictability for carriers and promote efficient pricing and new investment to the benefit of consumers.

C. Transition

543. In light of the decision to adopt a uniform federal transition to bill-and-keep, in this section the Commission sets out a default transition path for terminating end office switching and certain transport rate elements to begin that process. The Commission also begins the process of reforming other rate elements by capping all interstate rate elements as of the effective date of the rules adopted pursuant to this R&O, and capping terminating intrastate rates for all carriers. Doing so ensures that no rates increase during reform, and that carriers do not shift costs between or among other rate elements, which would be counter to the principles the Commission adopts. And, this transition will help minimize disruption to consumers and service providers by giving parties time, certainty, and stability as they adjust to an IP world and a new compensation regime.

544. The Commission sets forth a transition path for terminating end office switching and certain transport rate elements and reciprocal compensation charges in Figure 9. In brief, the transition plan first focuses on the transition for terminating traffic, which is where the most acute intercarrier compensation problems, such as arbitrage, currently arise. The Commission believes that limiting reductions at this time to terminating access rates will help address the majority of arbitrage and manage the size of the access replacement mechanism. The Commission also takes measures to start reforming other elements as well by capping all interstate switched access rates in effect as of the effective date of the rules, including originating access and all transport rates. Absent such action, rate-of-return carriers could shift costs between or among other rate elements and rates to interconnecting carriers could continue to increase as they have been in the past years, which is counter to the reform the Commission adopts. Even so, the Commission does not specify the transition to reduce these rates further at this time. Instead, the Commission seeks comment regarding the transition and recovery for such other rate elements in the *USF/ICC Transformation FNPRM.*

545. Thus, at the outset of the transition, all interstate switched access and reciprocal compensation rates will be capped at rates in effect as of the effective date of the rules. This will ensure that carriers do not seek to inflate their access charges in advance of the Commission's reforms. Specifically, the Commission caps all rate elements in the ''traffic sensitive basket'' and the ''trunking basket'' as described in 47 CFR 61.42(d)(2)–(3) unless a price cap carrier made a tariff filing increasing any such rate element prior to the effective date of the rules and such change was not yet in effect. The Commission caps these rates as of the effective date of the R&O, as opposed to a future date such as January 1, 2012, to ensure that carriers cannot make changes to rates or rate structures to their benefit in light of the reforms adopted in this R&O. For price cap carriers, all intrastate rates will also be capped, and, for rate-of-return carriers, all terminating intrastate access rates will also be capped. Consistent with many proposals in the record, the transition plan provides rate-of-return carriers, whose rates typically are higher, additional time to transition as appropriate. Specifically, the Commission concludes that a six-year transition for price cap carriers and competitive LECs that benchmark to price cap carrier rates and a nine-year transition for rate-of-return carriers and competitive LECs that benchmark to rate-of-return carrier rates to transition rates to bill-and-keep strikes an appropriate balance that will moderate potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes.

INTERCARRIER COMPENSATION REFORM TIMELINE

Effective date	For price cap carriers and CLECs that benchmark access rates to price cap carriers	For rate-of-return carriers and CLECs that benchmark access rates to rate-of-return carriers
Effective Date of the rules	All intercarrier switched access rate elements, including interstate and intrastate originating and terminating rates and reciprocal compensation rates are capped.	All interstate switched access rate elements, including all originating and terminating rates and reciprocal compensation rates are capped. Intrastate terminating rates are also capped.
July 1, 2012	Intrastate terminating switched end office and transport rates, originating and terminating dedicated transport, and reciprocal compensation rates, if above the carrier's interstate access rate, are reduced by 50 percent of the differential between the rate and the carrier's interstate access rate.	Intrastate terminating switched end office and transport rates, originating and terminating dedicated transport, and reciprocal compensation rates, if above the carrier's interstate access rate, are reduced by 50 percent of the differential between the rate and the carrier's interstate access rate.
July 1, 2013	Intrastate terminating switched end office and transport rates and reciprocal compensation, if above the carrier's interstate access rate, are reduced to parity with interstate access rate.	Intrastate terminating switched end office and transport rates and reciprocal compensation, if above the carrier's interstate access rate, are reduced to parity with interstate access rate.
July 1, 2014	Terminating switched end office and reciprocal compensation rates are reduced by one-third of the differential between end office rates and $0.0007.*	Terminating switched end office and reciprocal compensation rates are reduced by one-third of the differential between end office rates and $0.005.*
July 1, 2015	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the original differential to $0.0007.*	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the original differential to $0.005.*
July 1, 2016	Terminating switched end office and reciprocal compensation rates are reduced to $0.0007.*	Terminating switched end office and reciprocal compensation rates are reduced to $0.005.*
July 1, 2017	Terminating switched end office and reciprocal compensation rates are reduced to bill-and-keep. Terminating switched end office and transport are reduced to $0.0007 for all terminating traffic within the tandem serving area when the terminating carrier owns the serving tandem switch.	Terminating end office and reciprocal compensation rates are reduced by one-third of the differential between its end office rates ($0.005) and $0.0007.*
July 1, 2018	Terminating switched end office and transport are reduced to bill-and-keep for all terminating traffic within the tandem serving area when the terminating carrier owns the serving tandem switch.	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the differential between its end office rates as of July 1, 2016 and $0.0007.*
July 1, 2019	.....	Terminating switched end office and reciprocal compensation rates are reduced to $0.0007.*
July 1, 2020	.....	Terminating switched end office and reciprocal compensation rates are reduced to bill-and-keep.*

Figure 9
*Transport rates remain unchanged from the previous step.

546. The Commission notes that CMRS providers are subject to mandatory detariffing. Nonetheless, CMRS providers are included in the transition to the extent their reciprocal compensation rates are inconsistent with the reforms the Commission adopts here. The Commission also notes that carriers remain free to make elections regarding participation in the NECA pool and tariffing processes during the transition. *See* 47 CFR 69.601 *et seq.*

547. The Commission believes that these transition periods strike the right balance between its commitment to avoid flash cuts and enabling carriers sufficient time to adjust to marketplace changes and technological advancements, while furthering the Commission's overall goal of promoting a migration to modern IP networks. The Commission finds that consumers will benefit from this regulatory transition, which enables their providers to adapt to the changing regulatory and technical landscape and will enable a faster and more efficient introduction of next-generation services.

548. The transition the Commission adopts is partially based on a stakeholder proposal, with certain modifications, including the adoption of a bill-and-keep methodology as the end state for all traffic. As explained further below, states will play a key role in implementing the framework the Commission adopts. In particular, states will oversee changes to intrastate access tariffs to ensure that modifications to intrastate tariffs are consistent with the new framework and rules.. For example, states will help guard against carriers improperly moving costs between or among different rate elements to reap a windfall from reform.

549. Since intercarrier compensation charges are constrained by the transition glide path that the Commission adopts, the Commission will be monitoring to ensure that carriers do not shift costs to other rate elements that are not specifically covered, such as special access or common line. The Commission also clarifies that, in cases where a provider's interstate terminating access rates are higher than its intrastate terminating access rates, intrastate rate reductions shall begin to occur at the stage of the transition in which interstate rates come to parity with intrastate rate levels.

550. The transition imposes a cap on originating intrastate access charges for price cap carriers at current rates as of the effective date of the rules. The transition does not cap originating intrastate access charges for rate-of-return carriers. Rate-of-return carriers suggested that it would not be viable for them to reduce terminating switched rates, while at the same time reducing originating rates without overburdening the Universal Service Fund. In the meantime, rate-of-return carriers indicate that the wholesale long distance market will constrain originating rates. Given its commitment to control the size of the CAF and minimize burdens on consumers, the Commission does not cap intrastate

originating access charges for rate-of-return carriers at this time. As noted above, the Commission has placed priority on reform of terminating access charges and the Commission is mindful of the compromises that must be made to accomplish meaningful reform in a measured and timely manner. In the *USF/ICC Transformation FNPRM,* the Commission seeks comment on the transition of *all* originating access charges to bill-and-keep, including originating intrastate access charges for rate-of-return carriers.

551. *CMRS Providers.* As noted above, CMRS providers will be subject to the transition applicable to price cap carriers. Although CMRS providers are subject to mandatory detariffing, these providers are included to the extent their reciprocal compensation rates are inconsistent with the reforms the Commission adopts here. The Commission also addresses compensation for non-access traffic exchanged between LECs and CMRS providers herein. As the Commission details in that section, the Commission immediately adopts bill-and-keep as the default compensation methodology for non-access traffic exchanged between LECs and CMRS providers under section 20.11 of its rules, 47 CFR 20.11, and Part 51, 47 CFR part 51.

552. *Competitive LECs.* To ensure smooth operation of the transition, the Commission provides competitive LECs that benchmark their rates a limited allowance of additional time to make tariff filings during the transition period. Application of the access reforms will generally apply to competitive LECs via the CLEC benchmarking rule. In cases where more than one incumbent LEC operates within a competitive LEC's service area and those incumbent LECs are both price cap and rate-of-return regulated, a question may arise as to the appropriate transition track for the competitive LEC. If the competitive LEC tariffs a benchmarked or average rate in such circumstances, that competitive LEC shall adopt the transition path applicable to the majority of lines capable of being served in its territory. For example, if price cap carriers serve 70 percent of a competitive LEC's service territory and rate-of-return carriers serve 30 percent of the service territory, then the competitive LEC using a blended rate should follow the price cap transition. For interstate switched access rates, competitive LECs are permitted to tariff interstate access charges at a level no higher than the tariffed rate for such services offered by the incumbent LEC serving the same geographic area (the benchmarking rule). There are two exceptions to the general benchmarking rule. First, rural competitive LECs offering service in the same areas as non-rural incumbent LECs are permitted to ''benchmark'' to the access rates prescribed in the NECA access tariff, assuming the highest rate band for local switching (the rural exemption). Second, as explained above, competitive LECs meeting the access revenue sharing definition are required to benchmark to the lowest interstate switched access rate of a price cap LEC in the state. Because the Commission retains the CLEC benchmark rule during the transition, the Commission allows competitive LECs an extra 15 days from the effective date of the tariff to which a competitive LEC is benchmarking to make its filing(s). The Commission emphasizes that the rates that are filed by the competitive LEC must comply with the applicable benchmarking rate. As is the case now, the Commission declines to adopt rules governing the rates that competitive LECs may assess on their end users.

553. The Commission also declines to adopt a separate and longer transition period for competitive LECs, as suggested by some commenters. For one, competitive LEC rates are already at or near parity for many if not all access rates. Due to the operation of the Commission's CLEC benchmark rules, competitive LEC tariffed access rates are largely already at parity with incumbent LEC rates. And, in a large number of states, competitive LEC intrastate access rates are at or near parity to those of the incumbent LEC, as well. Thus, the Commission does not find a sufficient basis for creating a separate transition for competitive LECs. Moreover, the transition periods of six and nine years are sufficiently long to permit advance planning and represent a careful balance of the interests of all stakeholders. As a result, the Commission concludes that a uniform approach for all LECs is preferable and does not find compelling evidence to depart from the important policy objectives underlying the CLEC benchmarking rule. Further, new arbitrage opportunities could arise and increased regulatory oversight would be necessary were the Commission to abandon the CLEC benchmarking rule.

1. Authority To Specify the Transition

554. Specifying the timing and steps for the transition to bill-and-keep requires us to make a number of line-drawing decisions. Although the Commission could avoid those decisions by moving to bill-and-keep immediately, such a flash cut would entail significant market disruption to the detriment of consumers and carriers alike. As the DC Circuit has recognized, ''[w]hen necessary to avoid excessively burdening carriers, the gradual implementation of new rates and policies is a standard tool of the Commission,'' and the transition ''may certainly be accomplished gradually to permit the affected carriers, subscribers and state regulators to adjust to the new pricing system, thus preserving the efficient operation of the interstate telephone network during the interim.'' Thus, ''[i]t is reasonable for the FCC to take into account the ability of the industry to adjust financially to changing policies,'' and ''[i]nterim solutions may need to consider the past expectations of parties and the unfairness of abruptly shifting policies.'' In such circumstances, ''the FCC should be given 'substantial deference' when acting to impose interim regulations.''

555. In the Commission's judgment, the framework that it adopts carefully balances the potential industry disruption for both payers and recipients of intercarrier compensation as the Commission transitions to a new intercarrier compensation regime more broadly. It is particularly appropriate for the Commission to exercise its authority to craft a transition plan in this context, where the Commission is acting, as it has in prior orders, to reconcile the ''implicit tension between'' the Act's goals of ''moving toward cost-based rates and protecting universal service.''

2. Implementation Issues

556. *Role of Tariffs.* Under today's intercarrier compensation system, carriers typically tariff their access charges. To avoid disruption of these well-established relationships, the Commission preserves a role for tariffing charges for toll traffic during the transition. Pursuant to the transition set forth above, the Commission permits LECs to tariff the default charges for intrastate toll traffic at the state level, and for interstate toll traffic with the Commission, in accordance with the timetable and rate reductions set forth above. At the same time, carriers remain free to enter into negotiated agreements that differ from the default rates established above, consistent with the negotiated agreement framework that Congress envisioned for the 251(b)(5) regime to which access traffic is transitioned. As an interim matter, this new regime will facilitate the benefits that can arise from negotiated arrangements, while also allowing for revenue predictability that has been associated with tariffing. In some respects the allowance of some tariffing may be similar to the wireless

termination tariffs for non-access traffic addressed in the Commission's 2005 *T-Mobile Order, Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs,* CC Docket No. 01–92, Declaratory Ruling and Report and Order, 70 FR 49401, Mar. 30, 2005 (*T-Mobile Order*). In that decision, the Commission prohibited the filing of state tariffs governing the compensation for terminating non-access CMRS traffic because they were inconsistent with the negotiated agreement framework contemplated by Commission precedent and by Congress when it enacted 47 U.S.C. 251. The Commission does not, however, believe that the policies underlying the prohibition of wireless termination tariffs for non-access traffic in the *T-Mobile Order* preclude the allowance of certain tariffing of intercarrier compensation for toll traffic. Finally, during the transition, traffic that historically has been addressed through interconnection agreements will continue to be so addressed.

557. Because carriers will be revising intrastate access tariffs to reduce rates for certain terminating switched access rate elements, and capping other intrastate rates, states will play a critical role implementing and enforcing intercarrier compensation reforms. The Commission does not cap intrastate originating access for rate-of-return carriers in this R&O. The Commission notes that states remain free to do so, provided states support any recovery that may be necessary, and such a result would promote the goals of comprehensive reform adopted in the R&O. State oversight of the transition process is necessary to ensure that carriers comply with the transition timing and intrastate access charge reductions outlined above. Under the Commission's framework, rates for intrastate access traffic will remain in intrastate tariffs. As a result, to ensure compliance with the framework and to ensure carriers are not taking actions that could enable a windfall and/or double recovery, state commissions should monitor compliance with the rate transition; review how carriers reduce rates to ensure consistency with the uniform framework; and guard against attempts to raise capped intercarrier compensation rates, as well as unanticipated types of gamesmanship. Consistent with states' existing authority, therefore, states could require carriers to provide additional information and/or refile intrastate access tariffs that do not follow the framework or rules adopted in this R&O. Moreover, state commissions will continue to review and approve interconnection agreements and associated reciprocal compensation rates to ensure that they are consistent with the new federal framework and transition. Thus, the Commission will be working in partnership with states to monitor carriers' compliance with its rules, thereby ensuring that consumers throughout the country will realize the tremendous benefits of ICC reform.

558. *Price Cap Conversions.* The Commission has regulated the provision of interstate access services by incumbent LECs, pursuant to either rate-of-return regulation or price cap regulation. The Commission has previously described the benefits that flow from the adoption of price cap regulation, and has allowed carriers to convert from rate-of-return to price cap regulation. The Commission continues to encourage carriers to undergo such conversions. The application of the Commission's reforms to proposed conversions will be addressed in the context of those proceedings based on the individualized situation of the carrier seeking to convert to price cap regulation. Similarly, transition issues related to rate-of-return affiliates of price cap holding companies will be addressed in the context of such proceedings.

559. *Existing Agreements.* With respect to the impact of the Commission's reforms on existing agreements, the Commission emphasizes that its reforms do not abrogate existing commercial contracts or interconnection agreements or otherwise require an automatic ''fresh look'' at these agreements. As the Commission has recognized, both telecommunications carriers and their customers often benefit from long-term contracts—providers gain assurance of cost recovery, and customers (whether wholesale or end-users) may receive discounted and stable prices—and the Commission tries to avoid disrupting such contracts. Indeed, giving carriers or customers an automatic fresh look at existing commercial contracts or interconnection agreements could result in a windfall for entities that entered long-term arrangements in exchange for lower prices, as compared to other entities that avoided the risk of early termination fees by electing shorter contract periods at higher prices. Accordingly, the Commission declines to require that these existing arrangements be reopened in connection with the reforms in this R&O, and leaves such issues to any change-of-law provisions in these arrangements and commercial negotiations among the parties. The Commission does, however, make clear that its actions in this R&O constitute a change in law, and the Commission recognizes that existing agreements may contain change-of-law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.

560. *Dismissal as Moot of Pending Petitions.* The reforms adopted by this R&O render moot a petition filed by Embarq in 2008 and a petition filed by Michigan CLECs in 2010. The actions taken in this R&O, which set forth a comprehensive intercarrier compensation plan, render the Embarq petition moot and, the Commission further notes that CenturyLink has subsequently filed a letter seeking to withdraw the petition. The Michigan CLECs filed a petition asking the Commission to preempt Michigan's 2009 access restructuring law, which mandated intrastate access rate reductions and created an access restructuring mechanism that was unavailable to CLECs. Here, again, the actions the Commission takes in this R&O, which include bringing intrastate access traffic within 47 U.S.C. 251(b)(5) and subjecting that traffic to the above transition, address many of the access rates elements at issue in the Michigan CLECs' petition. To the extent that states have established rate reduction transitions for rate elements not reduced in this R&O, nothing in this R&O impacts such transitions. Nor does this R&O prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed as a result of a faster transition. The Commission therefore dismisses the petition as the reforms in this R&O and the accompanying *USF/ICC Transformation FNPRM* will render it moot.

3. Other Rate Elements

561. *Originating Access.* The Commission finds that originating charges also should ultimately be subject to the bill-and-keep framework. Some commenters urge that originating charges be retained, at least on an interim basis. Other parties express concerns with the retention of originating access charges. The legal framework underpinning the Commission's decision is inconsistent with the permanent retention of originating access charges. In the *Local Competition First Report and Order,* the Commission observed that 47 U.S.C. 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such

charges were prohibited under that provision of the Act. Accordingly, the Commission finds that originating charges for all telecommunications traffic subject to its comprehensive intercarrier compensation framework should ultimately move to bill-and-keep. Notwithstanding this conclusion, the Commission takes immediate action to cap all interstate originating access charges and intrastate originating access charges for price cap carriers. Although the Commission does not establish the transition for rate reductions to bill-and-keep in this R&O, it seeks comment in the *USF/ICC Transformation FNPRM* on the appropriate transition and recovery mechanism for ultimately phasing down originating access charges. Meanwhile, the Commission prohibits carriers from increasing their originating interstate access rates above those in effect as the effective date of the rules. This prohibition on increasing access rates also applies to any remaining Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, 47 CFR 69.153, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, 47 CFR 69.154, and the per-minute Residual Interconnection Charge in section 69.155 of the Commission's rules, 47 CFR 69.155. Price cap carriers and CLECs that benchmark to price cap rates are also prohibited from increasing their originating intrastate access rates. A cap on interstate originating access represents a first step as part of the measured transition toward comprehensive reform and helps to ensure that the initial reforms to terminating access are not undermined. Thus, interstate originating switched access rates will remain capped and may not exceed current levels until further action by the Commission addressing the appropriate transition path for this traffic.

562. *Transport.* Similarly, the transition path set forth above begins the transition for transport elements, including capping such rates, but does not provide the transition for all transport charges for price cap or rate-of-return carriers to bill-and-keep. For price cap carriers, in the final year of the transition, transport and terminating switched access shall go to bill-and-keep levels where the terminating carrier owns the tandem. However, transport charges in other instances, *i.e.,* where the terminating carrier does not own the tandem, are not addressed at this time. Meanwhile, under the transition for rate-of-return carriers, which is consistent with the transition path put forward by the Joint Letter, interstate and intrastate transport charges will be capped at interstate levels in effect as of the effective date of the rules through the transition.

563. Ultimately, the Commission agrees with concerns raised by commenters that the continuation of transport charges in perpetuity would be problematic. For example, the record contains allegations of ''mileage pumping,'' where service providers designate distant points of interconnection to inflate the mileage used to compute the transport charges. Further, Sprint alleges that current incumbent LEC tariffed charges for transport are ''very high and constitute a sizeable proportion of the total terminating access charges ILECs impose on carriers today.'' More fundamentally, if transport rates are allowed to persist, it gives incumbent LECs incentives to retain a TDM network architecture and therefore likely serves as a disincentive for incumbent LECs to establish more efficient interconnection arrangements such as IP. As a result, commenters suggest that perpetuating high transport rates could undermine the Commission's reform effort and lead to anticompetitive behavior or regulatory arbitrage such as access stimulation. The Commission therefore seeks comment on the appropriate treatment of, and transition for, all tandem switching and transport rates in the *USF/ICC Transformation FNPRM.*

564. *Other Rate Elements.* Finally, the Commission notes that the transition set forth above caps rates but does not provide the transition path for all rate elements or other charges, such as dedicated transport charges. In the *USF/ICC Transformation FNPRM,* the Commission seeks comment on what transition should be set for these other rate elements and charges as part of comprehensive reform, and how the Commission should address those elements.

4. Suspension or Modification Under Section 251(f)(2), 47 U.S.C. 251(f)(2)

565. Section 251(f)(2), 47 U.S.C. 251(f)(2), provides that a LEC with fewer than two percent of the country's subscriber lines may petition its state commission for a suspension or modification of the application to it of a requirement or requirements of 47 U.S.C. 251(b) or (c), and that the state commission shall grant such petition where it makes certain determinations. That provision further states that the state commission must act on the petition within 180 days and ''may suspend enforcement of the requirement or requirements to which the petition applies'' pending action on the petition. Parties aggrieved by a state commission decision under 47 U.S.C. 251(f) may seek review of that decision in federal district court—under 47 U.S.C. 252(e)(6) of the Act, if the decision is rendered in the course of arbitrating an interconnection agreement, or under general ''federal question'' jurisdiction if the decision arises outside of the arbitration context.

566. In *Iowa Utilities Board v. FCC,* the Eighth Circuit held that state commissions had ''exclusive authority'' to make decisions under 47 U.S.C. 251(f) and that the FCC lacked authority to prescribe ''governing standards for such determinations.'' On review, however, the Supreme Court reversed the Eighth Circuit's decision with regard to the Commission's general authority to implement Title II of the Act. The Court stated that ''the grant in section 201(b) [of the Act] means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include sections 251 and 252.'' Accordingly, the Commission finds that this general grant of rulemaking authority recognized by the Court includes the authority to adopt reasonable rules construing and implementing 47 U.S.C. 251(f).

567. In light of the Supreme Court's holding, the Commission may adopt specific, binding prophylactic rules that give content to, among other things, the ''public interest, convenience, and necessity'' standard that governs states' exercise of 47 U.S.C. 251(f)(2) authority to act on suspension/modification petitions. The Commission sought comment on specific rules in the *ICC/USF Transformation NPRM* and in the *2008 ICC NPRM.* However, given the limited record the Commission received in response, the Commission declines to adopt specific rules regarding 47 U.S.C. 251(f)(2) at this time. Nevertheless, the Commission cautions states that suspensions or modifications of the bill-and-keep methodology the Commission adopts in the R&O would, among other things, re-introduce regulatory uncertainty, shift the costs of providing service to a LEC's competitors and the competitor's customers, increase transaction costs for terminating calls, and undermine the efficiencies gained from adopting a uniform national framework. Accordingly, the Commission believes it highly unlikely that any attempt by a state to modify or suspend the federal bill-and-keep regime would be ''consistent with the public interest, convenience and necessity'' as required under 47 U.S.C. 251(f)(2)(B), and the Commission urges states not to grant any petitions seeking

to modify or suspend the bill-and-keep provisions it adopts herein. The Commission will monitor state action regarding the reforms it adopts in the R&O, and may provide specific guidance for states' review of 47 U.S.C. 251(f)(2) petitions in the future.

5. The Duty To Negotiate Interconnection Agreements

568. Because the Commission moves traffic from the access charge regime to the 47 U.S.C. 251(b)(5) framework, where payment terms are agreed to pursuant to an interconnection agreement, incumbent LECs have asked the Commission to make clear that they have the ability to compel other LECs and CMRS providers to negotiate to reach an interconnection agreement. This is a concern for incumbent LECs because under sections 251 and 252 of the Act, 47 U.S.C. 251, 252, although LECs and CMRS providers can compel incumbent LECs to negotiate in good faith and invoke arbitration if negotiations fail, incumbent LECs generally lack the ability to compel other LECs and CMRS providers to negotiate for payment for traffic that is not exchanged pursuant to a tariff. In particular, parties have asked the Commission to expand upon the Commission's findings in the *T-Mobile Order,* which found that incumbent LECs can compel CMRS providers to negotiate to reach an interconnection agreement.

569. After reviewing the record, the Commission concludes it is appropriate to clarify certain aspects of the obligations the Commission adopted in the *T-Mobile Order.* As a result, in this section, the Commission reaffirms the findings in the *T-Mobile Order* that incumbent LECs can compel CMRS providers to negotiate in good faith to reach an interconnection agreement, and makes clear the Commission's authority to do so pursuant to 47 U.S.C. 332, 201, 251 as well as its ancillary authority under 4(i). The Commission also clarifies that this requirement does not impose any 47 U.S.C. 251(c) obligations on CMRS providers, nor does it extend section 252 of the Act, 47 U.S.C. 252, to CMRS providers.

570. The Commission declines, at this time, to extend the obligation to negotiate in good faith and the ability to compel arbitration to other contexts. For example, the *T-Mobile Order* did not address relationships involving competitive LECs or among other interconnecting service providers. Subsequently, competitive LECs have requested that the Commission expand the scope of the *T-Mobile Order* and require CMRS providers to negotiate agreements with competitive LECs under the section 251/252 framework, just as they do with incumbent LECs. In addition, rural incumbent LECs urged the Commission to ''extend the T-Mobile Order to give ILECs the right to demand interconnection negotiations with all carriers.'' The Commission does not believe the record is currently sufficient to justify doing so, but ask further questions about the policy implications as well as the Commission's legal authority to do so in the *USF/ICC Transformation FNPRM.*

a. Petitions for Reconsideration of the *T-Mobile Order*

571. As described below, the Commission resolves the challenges several parties have made to the Commission's authority to adopt sections 20.11(d) and (e), 47 CFR 20.11(d), (e). The Commission concludes that the Commission has both direct and ancillary authority to permit incumbent LECs to request interconnection from a CMRS provider and invoke the negotiation and arbitration procedures of section 252 of the Act, 47 U.S.C. 252. Given this clarification of the Commission's exercise of its authority, the Commission finds that these requirements, codified in section 20.11(e) of the Commission's rules, 47 CFR 20.11(e), are consistent with the Act. The Commission also concludes that the adoption of those requirements in the *T-Mobile Order* was procedurally proper, and it consequently denies requests to reconsider that rule.

i. Authority To Adopt Section 20.11(e) of the Commission's Rules

572. In its petition for reconsideration, RCA claims that the Commission lacked authority to adopt section 20.11(e) of the Commission's rules, 47 CFR 20.11(e), arguing that the Commission cannot directly apply 47 U.S.C. 251(c) of the Act to CMRS providers by requiring them to interconnect directly with ILECs, or submit to compulsory arbitration pursuant to 47 U.S.C. 252 of the Act. RCA misinterprets the nature of the Commission's action in the *T-Mobile Order,* however, viewing it as the direct application of 47 U.S.C. 251(c) and 252 to CMRS providers. Properly understood, the Commission did not apply 47 U.S.C. 251(c) and 252 in that manner. Rather, the *T-Mobile Order* obligations imposed on CMRS providers, codified in section 20.11(e) of the Commission's rules, 47 CFR 20.11(e), implement the Commission's authority under sections 201 and 332, and are reasonably ancillary to the implementation of its statutorily mandated responsibilities under 47 U.S.C. 201, 251(a)(1), 251(b)(5) and 332.

573. *Direct Authority Under Sections 201 and 332.* Sections 201 and 332 of the Act, 47 U.S.C. 201, 332, provide a basis for rules allowing an incumbent LEC to request interconnection, including associated compensation, from a CMRS provider and invoke the negotiation and arbitration procedures set forth in 47 U.S.C. 252 of the Act. Section 332(c)(1)(B), 47 U.S.C. 332(c)(1)(B), states that ''[u]pon reasonable request of any person providing commercial mobile service, the Commission shall order a common carrier to establish physical connections with such service'' pursuant to the provisions of section 201 of the Act, 47 U.S.C. 201. Section 201(a), 47 U.S.C. 201(a), provides that ''every common carrier engaged in interstate or foreign communication by wire or radio'' shall: (i) ''furnish such communication service upon reasonable request therefore;'' and (ii) ''in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.'' Although 47 U.S.C. 201(a) requires an opportunity for hearing, the Commission's previous use of notice and comment procedures to satisfy the 47 U.S.C. 201 hearing requirement was expressly confirmed by the U.S. Court of Appeals for the Third Circuit. As discussed below, the Commission provided notice and received comment here. Consequently, the Commission rejects arguments that the Commission cannot rely on its 47 U.S.C. 201(a) authority to require interconnection through a rulemaking proceeding. The Commission has long relied on these provisions to regulate the terms of LEC–CMRS interconnection, including associated compensation.

574. Historically, interconnection requirements imposed under these provisions were understood to encompass not only the technical linking of networks, but also the associated compensation. For example, intercarrier compensation under the access charge regime had, as its origin, the need to ''ensur[e] *interconnection* at reasonable rates, as required under Section 201 of the Act, 47 U.S.C. 201.'' Likewise, the Commission previously has specified not only the intercarrier compensation required in conjunction

with interconnection by, and with, CMRS providers, but also the mechanism for implementing those compensation obligations. Even prior to the adoption of section 332 of the Act, 47 U.S.C. 332, the Commission relied on its section 201 authority to require LECs and CMRS providers to negotiate interconnection agreements in good faith governing the physical interconnections among these carriers, as well as the associated charges. Following the adoption of 47 U.S.C. 332, the Commission affirmed that ''LECs [must] provide reasonable and fair interconnection for all commercial mobile radio services,'' including ''mutual compensation'' by each interconnected carrier for ''the reasonable costs incurred by such providers in terminating traffic'' that originated on the other carrier's facilities. At that time the Commission retained its then-existing implementation framework, which primarily relied on negotiated agreements with only a limited role expressly identified for tariffing, while observing that this framework would be subject to ''review and possible revision.''

575. In the *T-Mobile Order* the Commission built upon the existing rules governing interconnection and compensation for non-access traffic exchanged between LECs and CMRS providers, incorporating the right of incumbent LECs to request interconnection with a CMRS provider, including associated compensation, and adopting an implementation mechanism. It established obligations surrounding the pre-existing duty both CMRS providers and ILECs have to establish connections between their respective networks, as well as exercising the Commission's authority over the pre-existing tariffing regime. The Commission finds, in light of the analysis and precedent above, that these actions are supported by the Commission's authority under sections 201 and 332 of the Act, 47 U.S.C. 201, 332.

576. *Ancillary Authority.* Ancillary authority also supports the *T-Mobile Order* requirement that CMRS providers comply with the negotiation and arbitration procedures set forth in section 252 of the Act, 47 U.S.C. 252. Ancillary jurisdiction may be employed, at the Commission's discretion, when two conditions are satisfied: ''(1) The Commission's general jurisdictional grant under Title I of the Act covers the regulated subject and (2) the regulations are reasonably ancillary to the Commission's effective performance of its statutorily mandated responsibilities.'' Both incumbent LECs and CMRS providers are telecommunications carriers, over which the Commission has clear jurisdiction. Further, to meaningfully implement intercarrier compensation requirements established pursuant to 47 U.S.C. 201, 332, and 251(b)(5) against the backdrop of mandatory interconnection and prohibitions on blocking traffic under 47 U.S.C. 201 and 251(a)(1), it was appropriate for the *T-Mobile Order* to impose requirements on CMRS providers beyond those expressly covered by the language of 47 U.S.C. 252.

577. As discussed above, pursuant to the authority of 47 U.S.C. 201 and 332, the Commission required interconnected LECs and CMRS providers to pay mutual compensation for the non-access traffic that they exchange. Even if 47 U.S.C. 201 and 332 were not viewed as providing direct authority to require that CMRS providers negotiate interconnection agreements with incumbents LECs for the exchange of non-access traffic under the 47 U.S.C. 252 framework, such action clearly is reasonably ancillary to the Commission's authority under those provisions, including the associated requirement to pay mutual compensation. Likewise, although 47 U.S.C. 251(b)(5) does not itself require CMRS providers to enter reciprocal compensation arrangements, the Commission brought intraMTA LEC–CMRS traffic within that framework. CMRS providers received certain benefits from this regime, and the Commission likewise anticipated that they would enter agreements under which they would both ''receive reciprocal compensation for terminating certain traffic that originates on the networks of other carriers, and * * * pay such compensation for certain traffic that they transmit and terminate to other carriers.'' Further, when carriers are indirectly interconnected pursuant to 47 U.S.C. 251(a)(1), as is often the case for LECs and CMRS providers, the carriers' interconnection arrangements can be relevant to addressing the appropriate reciprocal compensation, as the Commission recently recognized.

578. Given that the Commission prohibited tariffing of wireless termination charges for non-access traffic on a prospective basis, LECs needed to enter into agreements with CMRS providers providing for compensation under those regimes. Because LEC–CMRS interconnection is compelled by section 251(a)(1) of the Act, 47 U.S.C. 251(a)(1), and section 201 of the Act, 47 U.S.C. 201, also generally restricts carriers from blocking traffic, experience revealed that incumbent LECs would have limited practical ability to ensure that CMRS providers negotiated and entered such agreements because they could not avoid terminating the traffic even in the absence of an agreement to pay compensation. To ensure that the balance of regulatory benefits intended for each party under the LEC–CMRS interconnection and compensation regimes was not frustrated, it was necessary for the Commission to establish a mechanism by which incumbent LECs could request interconnection, and associated compensation, from CMRS providers, and ensure that those providers would negotiate those agreements, subject to an appropriate regulatory backstop. Thus, the Commission's 47 U.S.C. 154(i) authority also supports the *T-Mobile Order* requirement that CMRS providers negotiate interconnection agreements with incumbent LECs in good faith under the 47 U.S.C. 252 framework.

ii. Consistency With the Communications Act and the Administrative Procedures Act

579. In response to the concerns of some Petitioners, the Commission clarifies that the negotiation and arbitration requirements adopted for CMRS providers in the *T-Mobile Order* did not impose 47 U.S.C. 251(c) on CMRS providers. As commenters observe, with one exception, the requirements of 47 U.S.C. 251(c) expressly apply to incumbent LECs, and nothing in the *T-Mobile Order* attempts to extend those statutory requirements to CMRS providers. Nor does the reference to ''interconnection'' in § 20.11(e) of the Commission's rules, 47 CFR 20.11(e), apply to CMRS providers the statutory interconnection obligations governing incumbent LECs under 47 U.S.C. 251(c)(2). As the *T-Mobile Order* makes clear, the primary focus of that rule is to provide a mechanism to implement mutual compensation for non-access traffic between incumbent LECs and CMRS providers. However, the Commission's mutual compensation rules were adopted in the context of addressing LEC–CMRS interconnection, against a backdrop where ''interconnection'' regulations were understood to encompass not only the physical connection of networks, but also the associated intercarrier compensation. The Commission thus concludes that the definition of ''interconnection'' in § 51.5 of the Commission's rules, 47 CFR 51.5, is not dispositive of the interpretation of that term here. This rule was codified in part 20, not part 51. In addition, as the

Commission recently recognized, interconnection arrangements can bear on the resolution of disputes regarding reciprocal compensation under the 47 U.S.C. 252 framework. For example, while interconnection for the exchange of access traffic does not currently implicate 47 U.S.C. 251(b), an interconnection agreement for the exchange of reciprocal compensation traffic may contain terms relevant to determining appropriate rates under the statute and Commission rules. Moreover, § 20.11(e) of the Commission's rules, 47 CFR 20.11(e), does not supplant or expand the otherwise-applicable interconnection obligations for CMRS providers, as some contend. Thus, in response to a request by an incumbent LEC for interconnection under § 20.11(e), 47 CFR 20.11(e), CMRS providers are not required to enter into direct interconnection, and may instead satisfy their obligation to interconnect through indirect arrangements.

580. Similarly, the Commission did not interpret 47 U.S.C. 252 as binding on CMRS providers in the same manner as incumbent LECs. Rather, the Commission exercised its authority under 47 U.S.C. 201, 332, 251 and 154(i) to apply to CMRS providers' duties analogous to the negotiation and arbitration requirements expressly imposed on incumbent LECs under 47 U.S.C. 252. Although Congress did not expressly extend these requirements this broadly in section 252 of the Act, 47 U.S.C. 252, the Commission's subsequent experience with interconnection and intercarrier compensation, as described above, demonstrate the need for the duties imposed on CMRS providers in the *T-Mobile Order.* Thus, the Commission sensibly required CMRS providers to negotiate interconnection agreements with incumbent LECs in good faith, subject to arbitration by the state or, where the state lacks authority or otherwise fails to act, by the Commission. This approach also is supported by the concept of cooperative federalism, which is reasonably contemplated by sections 251 and 252 of the Act, 47 U.S.C. 251, 252. Because of the cooperative federalism embodied by 47 U.S.C. 251 and 252, and the role of the Commission in arbitrating interconnection disputes under the 47 U.S.C. 252 framework when states lack authority or otherwise fail to act, the Commission also reject claims that the *T-Mobile Order* constituted an unlawful delegation to the states.

581. The Commission also does not interpret silence in certain provisions of the Act regarding the duties of CMRS providers as precluding the Commission's action in the *T-Mobile Order.* For one, the Commission rejects requests that it ignore the Commission's experience with interconnection and intercarrier compensation and treat Congress' silence regarding the rights of incumbent LECs to invoke negotiation and arbitration in section 252 of the Act as equivalent to a statutory prohibition on extending such rights. Nor is the Commission persuaded that the language of 47 U.S.C. 332(c)(1)(B) precludes the Commission's extension of section 252-type procedures in this manner. RCA observes that 47 U.S.C. 332(c)(1)(B) only expressly discusses requests *by* CMRS providers for interconnection, and contends that precludes rules that would enable incumbent LECs to request interconnection *from* CMRS providers. As a threshold matter, the Commission observes that CMRS providers are required to interconnect with other carriers under 47 U.S.C. 251(a) of the Act, and that 47 U.S.C. 201 also provides the Commission authority to require CMRS providers to interconnect. The Commission thus disagrees with RCA's suggestion that 47 U.S.C. 332 should be read to preclude CMRS providers from being subject to such requests. With respect to the procedures for implementing such requests, however, it notes that the Commission previously has suggested ''that the procedures of section 252 are not applicable in matters involving section 251(a) alone.'' The Commission finds it appropriate to interpret the obligations imposed on CMRS providers under § 20.11(e), 47 CFR 20.11(e), in a manner consistent with the Commission's interpretation of the scope of the comparable requirements of 47 U.S.C. 252 from which it was derived. The Commission thus makes clear that § 20.11(e), 47 CFR 20.11(e), does not apply to requests for direct or indirect physical interconnection alone, but only requests that also implicate the rates and terms for exchange of non-access traffic.

582. The Commission further finds that the rules adopted in the *T-Mobile Order* were procedurally proper, contrary to the contentions of some petitioners. The Commission's 2001 *Intercarrier Compensation NPRM, Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01–92, Notice of Proposed Rulemaking, 66 FR 28410, May 23, 2001 (Intercarrier Compensation NPRM),* expressly sought ''comment on the rules [the Commission] should adopt to govern LEC interconnection arrangements with CMRS providers, whether pursuant to section 332, or other statutory authority,'' and ''on the relationship between the CMRS interconnection authority assigned to the Commission under sections 201 and 332, and that granted to the states under sections 251 and 252.'' The T-Mobile petition was incorporated into the docket in that proceeding, and in response to the Commission's request for comment on that petition, the issue of LECs being able to request interconnection negotiations with CMRS carriers was raised in the record. The Commission thus is not persuaded that parties lacked adequate notice and an opportunity to comment on the requirements ultimately imposed in § 20.11(e) of the Commission's rules, 47 CFR 20.11(e).

b. Requests for Clarification

583. A number of petitions seek clarification regarding the operation of the *T-Mobile Order* and/or the state of the law that existed prior to such decision. Except insofar as discussed above, or in the Commission's actions regarding wireless intercarrier compensation generally, the Commission declines to provide such clarification here. The Commission has discretion whether to issue a declaratory ruling, and rather than addressing these requests here, the Commission can address issues as they arise.

c. Extending *T-Mobile* to Other Contexts

584. The Commission declines, at this time, to extend the obligations enumerated in the *T-Mobile Order* to other contexts. As discussed above, the *T-Mobile Order* imposed on CMRS providers the duty to negotiate interconnection agreements with incumbent LECs under the 47 U.S.C. 252 framework. However, the *T-Mobile Order* did not address relationships involving competitive LECs or among other interconnecting service providers. Subsequently, competitive LECs have requested that the Commission expand the scope of the *T-Mobile Order* and require CMRS providers to negotiate agreements with competitive LECs under the section 251/252 framework, just as they do with incumbent LECs. In addition, rural incumbent LECs urged the Commission to ''give small carriers some legal authority to demand a negotiated interconnection agreement,'' and argued that ''the Commission should extend the *T-Mobile Order* to give ILECs the right to demand interconnection negotiations with all carriers.'' Policy and legal issues surrounding the possible extension of the *T-Mobile Order* are insufficiently addressed in the current record, and as

such the Commission seeks comment in the accompanying *USF/ICC Transformation FNPRM* on whether to extend *T-Mobile Order* obligations to other contexts.

585. However, this issue remains highly relevant notwithstanding the adoption of bill-and-keep as the default for reciprocal compensation between LECs and CMRS providers under 47 U.S.C. 251(b)(5). Under a bill-and-keep methodology, carriers still will need to address issues such as the ''edge'' for defining the scope of bill-and-keep, subject to arbitration where they cannot reach agreement. These issues do not lend themselves well to one-size-fits-all approaches as would be required under a tariffing regime. Imposing a duty to negotiate, subject to arbitration, will negate the need for Commission intervention in this context and will facilitate more market-based solutions. Because the Commission also maintains its existing requirements regarding interconnection and prohibitions on blocking traffic, its experience suggests that carriers under no legal compulsion to come to the table may have no incentive to do so, thus frustrating the efforts of interconnected carriers to resolve open questions. The section 252 framework—already in place in other contexts under the terms of the Act—may be a reasonable mechanism to use to address these situations.

X. Recovery Mechanism

A. Summary

586. The recovery mechanism has two basic components. First, the Commission defines the revenue incumbent LECs are eligible to recover, which the Commission refers to as ''Eligible Recovery.'' Second, the Commission specifies how incumbent LECs may recover Eligible Recovery through limited end-user charges and, where eligible and a carrier elects to receive it, CAF support. Competitive LECs are free to recover reduced revenues through end-user charges.

587. *Eligible Recovery.*

• Price cap incumbent LECs' Baseline for recovery will be 90 percent of their Fiscal Year 2011 (FY2011) interstate and intrastate access revenues for the rates subject to reform and net reciprocal compensation revenues. The Commission defines ''fiscal year'' 2011 for these purposes as October 1, 2010 through September 30, 2011. For price cap carriers' study areas that participated in the Commission's 2000 CALLS reforms, and thus have had interstate access rates essentially frozen for almost a decade, Price Cap Eligible Recovery (*i.e.,* revenues subject to the recovery mechanism) will be the difference between: (a) the Price Cap Baseline, subject to 10 percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on estimated MOUs multiplied by the associated default rate for that year. For carriers that have more recently converted to price cap regulation and did not participate in the CALLS plan, the Commission phases in the reductions after five years, so that the initial 10 percent reduction occurs in year six. Estimated MOUs will be calculated as FY2011 minutes for all price cap carriers, and will be reduced 10 percent annually for each year of reform to reflect MOU trends over the past several years. Because such demand reductions have applied equally to all price cap carriers, the Commission does not make any distinction among price cap carriers for purposes of this calculation. The Commission adopts this straight line approach to determining MOUs, rather than requiring carriers to report actual minutes each year, because it will be more predictable for carriers and less burdensome to administer.

• Rate-of-return incumbent LECs' Baseline for recovery, which is somewhat more complex, will be based on their 2011 interstate switched access revenue requirement (which is recovered today through interstate access revenues and local switching support (LSS), if applicable), plus FY2011 intrastate terminating switched access revenues and FY2011 net reciprocal compensation revenue. Rate-of-Return Eligible Recovery will be the difference between: (a) the Rate-of-Return Baseline, subject to five percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on actual MOUs multiplied by the associated default rate for that year. The annual Rate-of-Return Baseline reduction used in the calculation of Rate-of-Return Eligible Recovery revenue reflects two considerations. First, in recent years rate-of-return carriers' interstate switched access revenue requirements have been declining on average at approximately three percent annually due to declining regulated costs, with corresponding declines in interstate access revenues; such declines are projected to continue each year for the next several years. In addition, rate-of-return carriers' intrastate revenues have been declining on average at 10 percent per year as MOU decline, with state regulatory systems that typically do not have annual, automatic mechanisms to increase rates to account for declining demand. Weighing these considerations, the Commission finds it appropriate to reduce rate-of-return carriers' Eligible Recovery by five percent annually. This approach to revenue recovery will put most rate-of-return carriers in a better financial position—and will provide substantially more certainty—than the *status quo* path absent reform, where MOU declines would continue to be large and unpredictable and would significantly reduce intrastate revenues. This approach also provides carriers with the benefit of any costs savings and efficiencies they can achieve by enabling carriers to retain revenues even if their switched access costs decline. And it avoids creating misaligned incentives for carriers to inefficiently increase costs to grow their intercarrier compensation revenue requirement and thereby draw more access replacement from the CAF.

588. *Recovery from End Users.* Consistent with past ICC reforms, the Commission permits carriers to recover a limited portion of their Eligible Recovery from their end users through a monthly fixed charge called an Access Recovery Charge or ''ARC.'' The Commission takes measures to ensure that any ARC increase on consumers does not impact affordability of rates, including by limiting the annual increase in consumer ARCs to $0.50. The Commission also makes clear that carriers may not charge an ARC on any Lifeline customers. This charge is calculated independently from, and has no bearing on, existing SLCs, although for administrative and billing efficiencies the Commission does permit carriers to combine the charges as a single line item on a bill.

• *Recovery Fairly Balanced Across All End Users.* The Commission does not, as some commenters urge, put the entire burden of access recovery on consumers. Rather, consistent with the Commission's approach in past reforms, under which business customers also contributed to offset declines in access charges, the Order balances consumer and single-line business recovery with recovery from multi-line businesses. The Commission also adopts additional measures to protect consumers of incumbent LECs that elect not to receive CAF funding, by limiting the proportion of Eligible Recovery that can come from consumers and single-line businesses based on a weighted share of a carrier's residential versus business lines. This limitation is only necessary for carriers that are not eligible or elect not to receive CAF funding because carriers recovering from CAF will have the full ARC imputed to them.

• *Protections for Consumers Already Paying Rebalanced Rates.* To protect consumers, including in states that have already rebalanced rates through prior state intercarrier compensation reforms, the Commission adopts a Residential Rate Ceiling that prohibits imposing an ARC on any consumer paying an inclusive local monthly phone rate of $30 or more.

• *Protections for Multi-Line Businesses.* Although the Commission does not adopt a business rate ceiling, nor were there proposals in the record to do so, the R&O takes measures to ensure that multi-line businesses' total SLC plus ARC line items are just and reasonable. The current multi-line business SLC is capped at $9.20. Some carriers, particularly smaller rate of return and mid-size carriers, are at or near the cap, while larger price cap carriers may have business SLCs as low as $5.00. To minimize the burden on multi-line businesses, the Commission does not permit LECs to charge a multi-line business ARC where the SLC plus ARC would exceed $12.20 per line. This limits the ARC for multi-line businesses for entities at the current $9.20 cap to $3.00. The Commission finds this limitation for multi-line businesses consistent with the reasons the Commission places an overall limit on the residential ARCs discussed below.

• To recover Eligible Recovery, price cap incumbent LECs are permitted to implement monthly end user ARCs with five annual increases of no more than $0.50 for residential/single-line business consumers, for a total monthly ARC of no more than $2.50 in the fifth year; and $1.00 (per month) per line for multi-line business customers, for a total of $5.00 per line in the fifth year, provided that: (1) Any such residential increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20. The monthly ARC that could be charged to any particular consumer cannot increase by more than $0.50 annually, and in fact the Commission estimates that the average increase in the monthly ARC that would be permitted across all consumer lines over the period of reform, based on the amount of eligible recovery, is approximately $0.20 annually. However, the Commission expects that not all carriers will elect or be able to charge the ARC due in part to competitive pressures, and the Commission therefore predicts the average actual increase across all consumers to be approximately $0.10–$0.15 each year, peaking at approximately $0.50 to $0.90 after five or six years, and declining thereafter.

• To recover Eligible Recovery, rate-of-return incumbent LECs are permitted to implement monthly end user ARCs with six annual increases of no more than $0.50 (per month) for residential/single-line business consumers, for a total ARC of no more than $3.00 in the sixth year; and $1.00 (per month) per line for multi-line business customers for a total of $6.00 per line in the sixth year, provided that: (1) Such increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20.

• Competitive LECs, which are not subject to the Commission's end-user rate regulations today, may recover reduced intercarrier revenues through end-user charges.

589. *Explicit Support from the CAF.* The Commission has recognized that some areas are uneconomic to serve absent implicit or explicit support. ICC revenues have traditionally been a means of having other carriers (who are now often competitors) implicitly support the costs of the local network. As the Commission continues the transition from implicit to explicit support that the Commission began in 1997, recovery from the CAF for incumbent LECs will be provided to the extent their Eligible Recovery exceeds their permitted ARCs. For price cap carriers that elect to receive CAF support, such support is transitional, phasing out over three years beginning in 2017. This phase out reflects, in part, the fact that such carriers will be receiving additional universal service support from the CAF that will phase in over time and is designed to reflect the efficient costs of providing service over a voice and broadband network. For rate-of-return carriers, ICC-replacement CAF support will phase down as Eligible Recovery decreases over time, but will not be subject to other reductions.

• All incumbent LECs that elect to receive CAF support as part of this recovery mechanism will be subject to the same accountability and oversight requirements adopted above. For rate-of-return carriers, the obligations for deploying broadband upon reasonable request specified in the CAF section above apply as a condition of receiving ICC-replacement CAF. For price cap carriers that elect to receive ICC-replacement CAF support, the Commission requires such support be used for building and operating broadband-capable networks used to offer their own retail service in areas substantially unserved by an unsubsidized competitor of fixed voice and broadband services. Thus, all CAF support will directly advance broadband deployment. This approach is consistent with carriers' representations that they currently use ICC revenues for broadband deployment.

• Competitive LECs, which have greater freedom in setting rates and determining which customers they wish to serve, will not be eligible for CAF support to replace reductions in ICC revenues.

B. Policy Approach to Recovery

590. As discussed above, the Commission's reforms seek to enable more widespread deployment of broadband networks, to foster the transition to IP networks, and to reduce marketplace distortions. The Commission recognizes that this transition affects different—but overlapping—segments of consumers in different ways. The Commission therefore seeks to adopt a balanced approach to reform that benefits consumers as a whole.

591. The overall reforms adopted in this R&O will enable expanded build-out of broadband and advanced mobile services to millions of consumers in rural America who do not currently have broadband service. These ICC reforms will fuel new investment by making incumbent LECs' revenue more predictable and certain. Indeed, incumbent LECs receiving CAF support as part of this recovery mechanism will have broadband deployment obligations.

592. In addition, as discussed above, the Commission anticipates that reductions in intercarrier compensation charges will result in reduced prices for network usage, thereby enabling more customers to use unlimited all-distance service plans or plans with a larger volume of long distance minutes, and also leading to increased investment and innovation in communications networks and services. Moreover, consistent with previous ICC reforms, which gave rise to substantial benefits from lower long distance prices, the Commission expects consumers to realize substantial benefits from this reform. This is especially true for customers of carriers for which intercarrier compensation charges historically have been a significant cost, such as wireless providers and long distance carriers.

593. Today, carriers receive payments from other carriers for carrying traffic on their networks at rates that are based on recovering the average cost of the

network, plus expenses, common costs, overhead, and profits, which together far exceed the incremental costs of carrying such traffic. The excess of the payments over the associated costs constitutes an implicit annual subsidy of local phone networks—a subsidy paid by consumers and businesses everywhere in the country. This distorts competition, placing actual and potential competitors that do not receive these same subsidies at a market disadvantage, and denying customers the benefits of competitive entry.

594. As the Commission pursues the benefits of reforming this system, it also seeks to ensure that the transition to a reformed intercarrier compensation and universal service system does not undermine continued network investment—and thus harm consumers. Consequently, the recovery mechanism is designed to provide predictability to incumbent carriers that had been receiving implicit ICC subsidies, to mitigate marketplace disruption during the reform transition, and to ensure that intercarrier compensation reforms do not unintentionally undermine the Commission's objectives for universal service reform. As the State Members observe, for example, ''[b]ankers and equity investors need to be able to see that both past and future investments will be backed by long-term support programs that are predictable.'' Similarly, they note that ''abrupt changes in support levels can harm consumers.'' Predictable recovery during the intercarrier compensation reform transition is particularly important to ensure that carriers ''can maintain/enhance their networks while still offering service to end-users at reasonable rates.'' Providing this stability does not require revenue neutrality, however.

595. Ultimately, consumers bear the burden of the inefficiencies and misaligned incentives of the current ICC system, and they are the ultimate beneficiaries of ICC reform. In structuring a reasonable transition path for ICC reform, the Commission seeks to balance fairly the burdens borne by various categories of end users, including consumers already paying high residential phone rates, consumers paying artificially low residential phone rates, and consumers that contribute to the universal service fund. Given nationwide disparities in local rates, it would be unfair to place the entire burden of the ICC transition on USF contributors. Just as the Commission has undertaken some intercarrier compensation reforms since the 1996 Act, shifting away from implicit intercarrier subsidies to end-user charges and universal service for recovery, some states have done so, as well. For example, Alaska has recently reformed its intrastate access system, establishing a Network Access Fee of $5.75, and increasing the role of the Alaska USF in subsidizing carriers' intrastate revenues with a state USF surcharge of 9.4 percent. Similarly, in Wyoming, which has also rebalanced rates, many rural customers face total charges for basic residential phone service in excess of $40 per month. The Nebraska Companies note total out-of-pocket local residential rates in that state already exceed $30 per month and should not be increased under any federal reforms contemplated by the Commission. Were the Commission to place the entire burden of ICC recovery on USF contributors, not only would consumers in each of these states be forced to contribute more, but USF, which is also supported through consumer contributions, could not stay within the budget discussed above. Meanwhile, other states have retained high intrastate intercarrier compensation rates to subsidize artificially low local rates—including some as low as $5 per month—effectively shifting the costs of those local networks to long distance and wireless customers across the country. In this context, the Commission finds it reasonable to allow carriers to seek some recovery from their own customers, subject to protection for consumers already paying rates for local phone service at or near $30 per month. The Commission also prevents carriers from charging an ARC on any Lifeline customers. The Commission also protects consumers by limiting any increases in consumer ARCs based upon actual or imputed increases in ARCs for business customers.

596. Some commenters argued that a variety of other regulatory considerations should alter the Commission's approach to recovery. For example, some express concerns about the level of existing federal subscriber line charges (SLCs) and special access rates and the extent to which carriers use the ratepayer- and universal service-funded local network to provide unregulated services. Although the Commission addresses certain of those issues below, the Commission is not persuaded that it should delay comprehensive intercarrier compensation and universal reform pending resolution of those outstanding questions, given the urgency of advancing the country's broadband goals. Nor does the Commission treat those issues as a static, unchanging backdrop to the reforms the Commission adopts in the R&O. In the *USF/ICC Transformation FNPRM,* the Commission reevaluates existing SLCs, including by seeking comment on whether SLCs today are set at an excessive level and should be reduced. To attempt to account for these concerns through reduced recovery here, particularly given potential changes that the Commission might consider, would unduly complicate—and significantly delay—badly needed reform that the Commission believes will result in significant consumer benefits. Consequently, the Commission believes that the consumer protections incorporated in the recovery mechanism and the transitional nature of the recovery strike the right balance for consumers as a whole.

597. Although the preceding has been focused on the substantial benefits of the reform to consumers, in crafting these reforms the Commission also took account of costs and benefits to industry. The Commission's reforms are minimally burdensome to carriers, imposing only minor incremental costs (*i.e.,* costs that would not be otherwise incurred without the reforms). The incremental costs of reform arise primarily from implementation, meaning that they are one-time costs of the transition that are not incurred on an ongoing basis. Further, these costs are heavily outweighed by efficiency benefits that carriers, as well as other industry participants and consumers, will experience. For carriers as well as end users, these benefits include significantly more efficient interconnection arrangements. Carriers will provide existing services more efficiently, make better pricing decisions for those services, and innovate more efficiently. Carriers' incentives to engage in inefficient arbitrage will also be reduced, and carriers will face lower costs of metering, billing, recovery, and disputes related to intercarrier compensation. Further, carriers, firms more generally, and consumers, facing more efficient prices for voice services, will make more use of voice services to greater effect, and more efficient innovation will result. In contrast to the transitional, one-time costs of reform, these efficiency benefits are ongoing and will compound over time.

C. Carriers Eligible To Participate in the Recovery Mechanism

598. The Commission sought comment in the *USF/ICC Transformation NPRM* on whether recovery should be limited to certain carriers, or whether it should extend

more broadly to all LECs. The Commission extends the recovery mechanisms adopted in this R&O to all incumbent LECs because regulatory constraints on their pricing and service requirements otherwise limit their ability to recover their costs. If an incumbent LEC receives recovery of any costs or revenues that are already being recovered as Eligible Recovery through ARCs or the CAF, that LEC's ability to recover reduced switched access revenue from ARCs or the CAF shall be reduced to the extent it receives duplicative recovery. Incumbent LECs seeking revenue recovery will be required to certify as part of their tariff filings to both the FCC and to any state commission exercising jurisdiction over the incumbent LEC's intrastate costs that the incumbent LEC is not seeking duplicative recovery in the state jurisdiction for any Eligible Recovery subject to the recovery mechanism. To monitor and ensure that this does not occur, the Commission requires carriers participating in the recovery mechanism, whether ARC and/or CAF, to file data annually. All incumbent LECs have built out their networks subject to COLR obligations, supported in part by ongoing intercarrier compensation revenues. Thus, incumbent LECs have limited control over the areas or customers that they serve, having been required to deploy their network in areas where there was no business case to do so absent subsidies, including the implicit subsidies from intercarrier compensation. At the same time, incumbent LECs generally are subject to more statutory and regulatory constraints than other providers in the retail pricing of their local telephone service. This includes both Commission regulation of the federal SLC and, frequently, state regulation of retail local telephone service rates as well. Thus, incumbent LECs are limited in their ability to increase rates to their local telephone service customers as a whole to offset reduced implicit subsidies.

599. Proposals to limit the recovery mechanism to only some classes of incumbent LECs, such as rate-of-return carriers, neglect these considerations, and in particular ignore that price cap incumbent LECs typically are also subject to regulatory constraints on end-user charges. The Commission does, however, recognize the differences faced by price cap and rate-of-return carriers under the *status quo* absent reform, and therefore adopts different recovery mechanisms for price cap and rate-of-return carriers, as explained below.

600. *Competitive LECs.* The Commission declines to provide an explicit recovery mechanism for competitive LECs. Unlike incumbent LECs, because competitive carriers have generally been found to lack market power in the provision of telecommunications services, their end-user charges are not subject to comparable rate regulation, and therefore those carriers are free to recover reduced access revenue through regular end-user charges. Some competitive LECs have argued that their rates are constrained by incumbent LEC rates (as supplemented by regulated end-user charges and CAF support); to the extent this is true, the Commission would expect this competition to constrain incumbent LECs' ability to rely on end-user recovery as well. Moreover, competitive LECs typically have not built out their networks subject to COLR obligations requiring the provision of service when no other provider will do so, and thus typically can elect whether to enter a service area and/or to serve particular classes of customers (such as residential customers) depending upon whether it is profitable to do so without subsidy.

601. In light of those considerations, the Commission disagrees with parties that advocate making the recovery mechanism the Commission adopts today available to all carriers, both incumbent and competitive, or to all carriers that currently receive access charge revenues. Competitive LECs are free to choose where and how they provide service, and their ability to recover costs from their customers is generally not as limited by statute or regulation as it is for incumbent LECs.

602. The Commission likewise declines to permit competitive LECs to reduce their access rates over a longer period of time than incumbent LECs. Instead, the Commission believes that the approach adopted in the *CLEC Access Charge Order,* 66 FR 27892, May 21, 2001, under which competitive LECs benchmark access rates to incumbent LECs' rates, is the better approach. That benchmarking rule was designed as a tool to constrain competitive LECs' access rates to just and reasonable levels without the need for extensive, ongoing accounting oversight and detailed evaluation of competitive LECs' costs. Deviating from that framework for purposes of the access reform transition would create new opportunities for arbitrage and require increased regulatory oversight, notwithstanding the fact that competitive LECs' access rates under the *CLEC Access Charge Order* were not based on any demonstrated level of need associated with those carriers' networks or operations. Nor has any commenter provided sufficient evidence to warrant departure from the benchmarking approach in this context. The Commission therefore declines to adopt a separate transition path for competitive LECs. Rather, consistent with the general benchmarking rule that had been used for interstate access service, competitive LECs will benchmark to the default rates of the incumbent LEC in the area they serve as specified under this R&O.

D. Determining Eligible Recovery

603. The first step in the recovery mechanism is defining the amount, called ''Eligible Recovery,'' that incumbent LECs will be given the opportunity to recover.

1. Establishing the Price Cap Baseline

604. *Costs vs. Revenues.* The *USF/ICC Transformation NPRM* sought comment on whether, in adopting a recovery mechanism, the Commission should base recovery on carrier costs, carrier revenues, or some combination thereof. For the reasons set forth below, for price cap carriers, the Commission will provide recovery based upon Fiscal Year 2011 (''FY2011'' or ''Baseline'') access revenues that are reduced as part of the reforms the Commission adopts, plus FY2011 net reciprocal compensation revenues. Selecting FY2011 ensures that gaming or any disputes or nonpayment that may occur after the release of the R&O does not impact carriers' Baseline revenues. For rate-of-return carriers, the Commission adopts a bifurcated approach based on: (1) Their 2011 interstate switched access revenue requirement; and (2) their FY2011 intrastate switched access revenues for services with rates to be reduced as part of the reforms the Commission adopts today, plus FY2011 net reciprocal compensation revenues. For a rate-of-return carrier that participated in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement associated with the NECA 2011 annual interstate switched access tariff filing. For a rate-of-return carrier subject to § 61.38 of the Commission's rules, 47 CFR 61.38, that filed its own annual access tariff in 2010 and did not participate in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement in its 2010 annual interstate switched access tariff filing. For a rate-of-return carrier subject to § 61.39 of the Commission's rules, 47

CFR 61.39, that filed its own annual switched access tariff in 2011, its revenue requirement will be its historically-determined annual interstate switched access revenue requirement filed with its 2011 annual interstate switched access tariff filing. Carriers have not demonstrated here that the existing intercarrier compensation revenues that the Commission uses as part of the Baseline calculations are confiscatory or otherwise unjustly or unreasonably low, and the Commission thus finds them to be an appropriate starting point for calculations under the recovery mechanism. To the extent that it subsequently is determined that an incumbent LEC's rates during the Baseline time period were not just and reasonable because they were too low, that carrier may seek additional recovery as needed through the Total Cost and Earnings Review Mechanism.

605. The Commission concludes that, where it lacks data, it is preferable to rely on revenues for determining recovery, as most commenters suggest. Defining carriers' costs today would be a burdensome undertaking that could significantly delay implementation of ICC reform. ''Cost'' would first have to be defined for these purposes, which is a difficult and time-consuming exercise. Indeed, price cap carriers' access charges are not based on current costs, and reliable cost information is not readily available. It is not clear that a reliable cost study based on current network configuration could be completed without undue delay, and doing so could be a complicated, time consuming, and expensive process, nor is it clear that a regulatory proceeding could come up with a definition of ''cost'' appropriate for recovery that is any better than the revenues approach the Commission adopts.

606. Moreover, the Commission has long recognized that intercarrier compensation rates include an implicit subsidy because they are set to recover the cost of the entire local network, rather than the actual incremental cost of terminating or originating another call. Given the Commission's commitment to a gradual transition with no flash cuts, the focus on revenues is appropriate to ensure carriers have a measured transition away from this implicit support on which they have been permitted to rely for many years.

607. For rate-of-return carriers, however, interstate switched access rates today are determined based on their interstate switched access revenue requirement, which is calculated in a manner that includes their ''regulated interstate switched access costs'' as the Commission has historically defined them, plus a prescribed rate of return on the net book value of their interstate switched access investment. Although rate-of-return carriers' revenue requirement might not be based on the precise measure of cost the Commission might otherwise adopt if it were starting anew, the Commission believes that using those carriers' interstate revenue requirement is sensible for purposes of determining their Eligible Recovery. For one, this information is readily available today. The Commission will carefully monitor material changes in cost allocation to categories where recovery remains based on actual cost to ensure that carriers do not shift costs properly associated with switched access. The Commission relies on the revenue requirement information available at the time of the initial tariff filings required to implement this recovery framework. This not only enables implementation of the recovery mechanism in the specified timeframes, but also addresses possible incentives to engage in gaming if carriers were able to increase the Rate-of-Return Baseline subsequently. If a carrier subsequently can demonstrate that it is materially harmed by the use of the projected, rather than final, 2011 interstate revenue requirement, it may seek a waiver of the rule specifying the Rate-of-Return Baseline to allow it to rely on an increased Rate-of-Return Baseline amount. Any such waiver would be subject to the Commission's traditional ''good cause'' waiver standard, rather than the Total Cost and Earnings Review specified below. In addition, use of the revenue requirement avoids implementation issues surrounding disputed or uncollectable interstate access revenues, providing greater predictability and substantially insulating small carriers from the harms of arbitrage schemes such as phantom traffic. This approach likewise prevents carriers that may have been earning in excess of their permitted rate of return from locking in those revenues and continuing such overearnings in perpetuity.

608. The Commission's approach is also consistent with the reforms to local switching support (LSS) the Commission adopts above. Historically, smaller carriers have received LSS as a subsidy for certain switching costs, effectively satisfying a portion of their interstate switched access revenue requirement. As discussed above, defining Eligible Recovery based on carriers' interstate switched access requirement allows the Commission to eliminate LSS as a separate universal service support mechanism for rate-of-return carriers. Eligible Recovery will be calculated from carriers' entire interstate switched access revenue requirement—whether it historically was recovered through access charges or LSS. Thus, in essence, carriers receiving LSS today will be eligible to receive support as part of their Eligible Recovery.

609. At the same time, although rate-of-return carriers do track certain costs to establish their interstate revenue requirement for switched access services, the same information is not readily available—or necessarily relevant—for intrastate switched access services or net reciprocal compensation. As a result, their Eligible Recovery will be based on their FY2011 intrastate switched access revenues addressed as part of the reform adopted today plus FY2011 net reciprocal compensation as of April 1, 2012. Rate-of-return carriers may elect to have NECA or another entity perform the annual analysis. The underlying data must be submitted to the relevant state commissions, to the Commission, and, for carriers that are eligible for and elect to receive CAF, to USAC.

610. The *USF/ICC Transformation NPRM* also sought comment on whether, under a revenues-based approach, to base carriers' recovery on gross intercarrier revenue or alternatively to use net intercarrier compensation, defined as ''a company's total intercarrier compensation revenue * * * less its intercarrier compensation expense'' including expenses paid by affiliates. The Commission received a mixed record in response. For the reasons described below, the approach the basis for a carrier's recovery the Commission adopts is neither a pure net revenue approach nor a pure gross revenue approach.

611. Although the Commission is sympathetic to requests to determine recovery based on net revenues, the Commission declines to do so for several reasons. Most importantly, the Commission is committed to a gradual transition with sufficient predictability to enable continued investment, and a net revenue approach could reduce that predictability, especially for non-facilities-based providers of long distance service who pay intercarrier compensation expenses indirectly through their purchase of wholesale long distance service from third parties.

612. There also are other difficulties, substantive and administrative, involved in calculating net revenues, which cannot be adequately addressed based on the information in the record. For example, although reductions in an individual incumbent LEC's ICC revenue is tied to a particular study

area, its affiliated IXC or wireless carrier may operate across multiple study areas, and the record does not suggest an administrable method for accurately identifying the cost savings associated with a particular incumbent LEC. Moreover, determinations of which affiliates should be counted, whether they are fully owned by the incumbent LEC or not, and to what extent, would be highly company-specific and could lead to inequitable treatment of similarly-situated carriers.

613. Such an approach also could create inefficient incentives during the transition regarding the acquisition of exchanges with ICC revenue reductions. For example, if an incumbent LEC has a large reduction in ICC revenue that is offset by affiliates' ICC cost savings, other carriers that lack affiliates with comparable ICC cost savings will be deterred from acquiring such exchanges if they would not be able to obtain additional recovery once it acquired that exchange. Conversely, if a carrier that lacked affiliates with comparable ICC cost savings *would* be entitled to new recovery if it acquired that exchange, a net revenue recovery approach could create inefficient incentives to acquire such exchanges given the potential for expanded CAF support (and thus also risk unconstrained growth in universal service).

614. Finally, although the record does not enable the Commission to determine the precise extent to which savings will be passed through from IXC to incumbent LEC, competition in the long distance market is likely to lead IXCs to pass on significant savings to incumbent LECs, rendering 100 percent gross revenues likely more generous than necessary for incumbent LECs. This is further complicated by incumbent LECs with affiliated IXCs that provide wholesale long distance service; counting the cost savings associated with wholesale long distance service against the recovery need for the affiliated incumbent LEC could create disincentives for the IXC to simultaneously pass through those cost savings in lower wholesale long distance rates, thereby reducing the potential for lower retail long distance rates.

2. Calculating Eligible Recovery for Price Cap Incumbent LECs

615. For price cap carriers, the recovery mechanism allows them to determine at the outset exactly how much their Eligible Recovery will be each year. The certainty regarding this recovery will enable price cap carriers to better manage the transition away from intercarrier compensation for recovery. The recovery approach will use historical trends regarding changes in demand to project future changes in demand (typically MOU), in conjunction with the default rates specified by the Commission's reforms, to determine Eligible Recovery. The Commission recognizes that its transitional intercarrier compensation framework sets default rates but leaves carriers free to negotiate alternatives. The Commission's approach to recovery relies on the default rates specified by the transition and will impute those rates for purposes of determining recovery, even if carriers negotiate a lower ICC rate with particular providers. Price Cap Eligible Recovery will be calculated from a Baseline of 90 percent of relevant FY2011 revenues, reduced on a straight-line basis at a rate of ten percent annually starting in year one (2012). This is consistent with the historical trajectory of decreasing MOU, with which price cap carriers' intercarrier compensation revenues decline today. The Commission concludes that this approach provides the necessary predictability for carriers without reducing their incentives to seek efficiencies or to maximize use of their network. The Commission will not annually true-up actual MOU for price cap carriers, instead likewise using a straight line decline of 10 percent relative to FY2011 MOU, which is a more predictable and administratively less burdensome approach. If MOU decline is less than 10 percent, carriers will receive the benefit of additional revenues. Conversely, if MOU decline accelerates, the risk of decreased revenues falls on the carriers. This allocation of risk incents carriers to be more efficient and retain customers.

616. Specifically, the Price Cap Baseline for price cap incumbent LECs' recovery will be the total switched access revenues that: (1) Are being reduced as part of reform adopted today; (2) are billed for service provided in FY2011; and (3) for which payment has been received by March 31, 2012. In addition, the Baseline will include net reciprocal compensation revenues for FY2011, based on net payments as of March 31, 2012. Carriers will be required to submit to the states data regarding all FY2011 switched access MOU and rates, broken down into categories and subcategories corresponding to the relevant categories of rates being reduced. With this information, states with authority over intrastate access charges will be able to monitor implementation of the recovery mechanism and compliance with the Commission's rules, and help guard against cost-shifting or double dipping by carriers. A price cap incumbent LEC that is eligible to receive CAF shall also file this information with USAC for purposes of implementing CAF ICC support, and the Commission delegates to the Wireline Competition Bureau authority to work with USAC to develop and implement processes for administration of CAF ICC support. These figures will establish the Base Minutes for each relevant category, and shall not include disputed revenues or revenues otherwise not recovered, for whatever reason, or the MOU associated with such revenues. Every carrier, in support of its annual access tariff filing, must also provide data necessary to justify its ability to impose an ARC, including the potential impact of the ARC for residential and multi-line business customers.

617. In determining the recovery mechanism, the Commission declines to provide 100 percent revenue neutrality relative to today's revenues. Rather, the Commission adopts an approach that is informed in part based on the *status quo* path facing price cap carriers today, where intercarrier compensation revenues decline as MOU decline, but also adopt some additional reductions for carriers that have had the benefit of interstate rates essentially being frozen for almost a decade, rather than being reduced annually as would typically occur under price cap regulation. Although the Commission adopts rules to help address concerns about traffic identification and establish a prospective intercarrier compensation framework for VoIP-PSTN traffic, absent the actions in this R&O, issues regarding compensation for that traffic would not have been resolved. Because the Commission is considering the *status quo* path absent reform, its recovery framework is based on historical declining demand notwithstanding reforms that potentially could mitigate some of that decline. Thus, for study areas of carriers that participated in the CALLS plan, which is approximately 95 percent of all price cap lines, and 90 percent of all lines across the country, the Commission adopts a 10 percent initial reduction in price cap incumbent LECs' Eligible Recovery to reflect the fact that these carriers' productivity gains have generally not been accounted for in their regulated rates for many years. Incentive regulation typically provides a mechanism for sharing the benefits of productivity gains with ratepayers. Prior to the *CALLS Order,* 65 FR 38684, June 21, 2000, the Commission included a productivity adjustment to the price cap indices to

ensure that savings would be shared. The *CALLS Order* did not include a productivity-related adjustment, however, providing instead a transitional ''X-factor'' designed simply to target the lower rates specified in that reform plan. After the targeted rates were achieved, which occurred by 2002 for 96 percent of study areas for carriers participating in the CALLS plan, the X-factor was set equal to inflation for the carriers originally subject to the CALLS plan and provided no additional consumer benefit from any productivity gains. As a result, study areas of price cap LECs that participated in the CALLS plan have had no X-Factor reductions to their price cap indices (PCIs), productivity-related or otherwise, for any PCI at least since 2004, and some price cap carriers' X-Factor reductions to their switched access-related PCIs stopped even earlier than that. Because price cap carriers reached their target rates at different times, the inflation-only X-factor took effect at different times for different price cap carriers. In the *CALLS Remand Order,* 68 FR 50077, August 20, 2003, the Commission concluded that price cap carriers serving 36 percent of total nationwide price cap access lines had achieved their target rates by their 2000 annual access filing. By the 2001 annual accessing filings the number grew to carriers serving 75 percent of total access lines, and by the 2002 annual access filings, carriers serving 96 percent of total access lines had achieved their target rates.

618. The record supports the use of a productivity factor such as the X-factor previously applied to price-cap carriers to reduce the amount carriers are eligible to recover through a recovery mechanism. A productivity factor would require recovery to decrease annually by a predetermined amount designed to capture for consumers the efficiencies found to apply generally to the industry. For example, if the Commission had maintained a five percent annual X-factor, rates for carriers that had reached their target rates would have been subject to caps reduced by five percent each year, so by today those rate caps would have been reduced by approximately 30 percent. Although the record does not contain the detailed analysis required to support a particular productivity factor that would apply on an ongoing basis, the Commission finds this initial 10 percent reduction for study areas of price cap LECs that participated in the CALLS Plan to be a conservative approach given the absence of any sharing of productivity or other X-factor reductions for a number of years, particularly when supplemented by other justifications for revenue reductions that the Commission does not otherwise account for in the standard recovery mechanism.

619. The Commission recognizes, however, that the industry has changed significantly since the 2000 *CALLS Order,* with some price cap CALLS carriers merging with or acquiring carriers that did not participate in the CALLS plan and/or newly converted price cap carriers acquiring study areas that did participate in the CALLS plan. For this reason, the Commission concludes it is necessary to apply the 10 percent reduction on a study area basis for CALLS participants, which the Commission collectively defines as ''CALLS study areas.'' Thus, the Commission will apply the 10 percent reduction to all price cap study areas that participated in the CALLS plan.

620. The Commission also recognizes, however, some price cap LECs converted to price cap regulation from rate-of-return regulation within the last five years and therefore such carriers did not participate in the CALLS plan. Thus, not all price cap carriers have had the benefit of productivity gains associated with reaching their target rates by 2002. Indeed, there are a few study areas that have converted to price cap regulation in the last two years and are still in the process of reducing their interstate rates to meet their CALLS target rate. As a result, for non-price cap study areas that were not part of the CALLS plan, the Commission believes a more incremental approach is warranted. In particular, for non-CALLS study areas, the Commission will delay the implementation of the 10 percent reduction to Eligible Recovery for five years, which is approximately the difference in time between when 96 percent of study areas of CALLS price cap carriers reached their target rates in 2002 and when the non-CALLS price cap carriers began converting from rate-of-return in 2007. The Commission believes doing so enables carriers that more recently converted to price cap regulation, carriers which are typically smaller, to have additional time to adjust to the intercarrier compensation rate reductions. In year six, the 10 percent reduction to Eligible Recovery will apply equally to all price cap carriers.

621. In addition, as discussed in the *USF/ICC Transformation NPRM,* Commission data and the record confirm that carriers are losing lines and experiencing a significant and ongoing decrease in minutes-of-use. Incumbent LEC interstate switched access minutes have decreased each year since 2000, as shown in the chart below.

Interstate Switched Access Minutes for Incumbent LECs (In Billions)

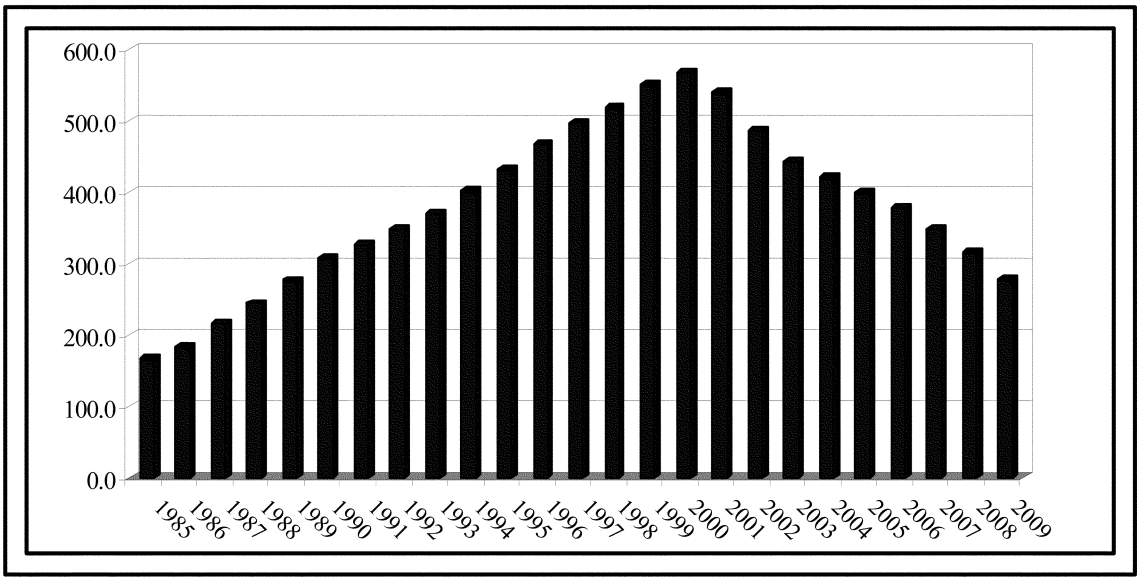

Figure 10

622. This represents an average annual decrease of over 10 percent and a total decrease of over 36 percent since 2006. Further, the percentage loss of MOU is accelerating—it increased each year between 2006 and 2010, and exceeded 13 percent in 2010. Based on the record, it is the Commission's predictive judgment that significant declines in MOU will continue. Accordingly, the Commission will reduce Price Cap Eligible Recovery by 10 percent annually for price cap carriers to reflect a conservative prediction regarding the loss of MOU, and associated loss of revenue, that would have occurred absent reform.

623. As a result, for price cap carriers, Base Minutes will be reduced by 10 percent annually beginning in 2012 to reflect decline in MOU. For example, Year One or ''Y1'' (2012) Intrastate Minutes will be .9 × Intrastate Base Minutes; Y2 (2013) Intrastate Minutes will be .81 × Intrastate Base Minutes (*i.e.,* .9 × .9 × Intrastate Base Minutes); *etc.*

624. *Price Cap Eligible Recovery.* Price Cap Eligible Recovery in a given year is the cumulative reduction in a particular intercarrier compensation rate since the base year multiplied by the pre-determined minutes for that rate for that year, as defined above.

Price Cap Example. A price cap carrier has a 2011 intrastate terminating access rate for transport and switching of $.0028, an interstate terminating access rate for transport and switching of $.0020, and 10,000,000 Intrastate Base Minutes. Its Eligible Recovery for intrastate switched access revenue would be determined as follows:

Year 1. Reduce intrastate terminating access rate for transport and switching, if above the carrier's interstate access rate, by 50 percent of the differential between the rate and the carrier's interstate access rate.

The carrier's Year 1 (Y1) Minutes equal 9,000,000 (10,000,000 × .9). Its intrastate terminating access rate for transport and switching, $.0028 in 2011, is reduced by $.0004 (($.0028–$.0020) × 50 percent)) to $.0024. Its Y1 Eligible Recovery is $3,600 ($.0004 × 9,000,000). For a CALLS study areas, Eligible Recovery would be reduced by an additional 10 percent to $3,240 ($3,600 × .9). For a non-CALLS study area, such reductions will begin in year six.

Year 2. Reduce intrastate terminating access rate for transport and switching, if above the carrier's interstate access rate, to the carrier's interstate access rate.

The carrier's Year 2 (Y2) Minutes equal 8,100,000 (9,000,000 × .9). Its intrastate terminating access rate for transport and switching is reduced by an additional $.0004 from $.0024 to $.0020, for a cumulative reduction of $.0008. Its Y2 Eligible Recovery is $6,480 ($.0008 × 8,100,000). For a CALLS study area, Eligible Recovery would be reduced by an additional 10 percent to $5,832 ($6,480 × .9). For a non-CALLS study area, such reductions will begin in year six.

This is a simplified example of the calculation of Price Cap Eligible Recovery for a price cap carrier's reduction in intrastate terminating access resulting from the reforms the Commission adopts for illustrative purposes only. It is not intended to encompass all necessary calculations applicable in determining Price Cap Eligible Recovery in the periods discussed in the example for all possible rates addressed by the R&O.

625. *This Approach to Recovery for Price Cap Carriers Provides Certainty and Encourages Efficiency.* Under the Act, the Commission has ''broad discretion in selecting regulatory tools, [which] specifically includes 'selecting methods * * * to make and oversee rates,' '' and is not compelled to follow any ''particular regulatory model.'' The approach to defining Price Cap Eligible Recovery continues to give those incumbent LECs incentives for efficiency while also providing greater predictability for carriers and consumers. Under price cap regulation, incumbent LECs already have significant incentives to control their costs associated with services provided to end-users, but have not had the same incentives to limit the costs imposed on IXCs for terminating calls on the price cap incumbent LECs' networks. These costs are ultimately borne by the IXCs' customers generally, rather than by the price cap LECs' customers specifically. By phasing out those termination charges and providing recovery in part through limited end-user charges, the Commission's reform will provide price cap LECs incentives to minimize such costs as they transition to broadband networks.

626. The Commission has considered a number of alternative proposals regarding the elimination of intercarrier terminating switched access charges and finds that the approach the Commission adopts constitutes a hybrid of a variety of proposals that best protects consumers while facilitating the reasonable transition to an all-

broadband network. Some commenters have argued that no additional recovery should be allowed absent a specific showing that denying recovery would constitute a taking. Based upon the record in this proceeding, the Commission concludes that such a denial would represent a flash-cut for price cap LECs, which is inconsistent with the Commission's commitment to a gradual transition and could threaten their ability to invest in extending broadband networks. The Commission also finds that denying any recovery pending the adjudication of a request for an exogenous low-end adjustment under the price cap rules would be unduly burdensome for carriers and for the Commission because of the number of claims the carriers would be required to file and the Commission would be required to adjudicate. The definition of Price Cap Eligible Recovery for both CALLS and non-CALLS study areas gives predictability not only to price cap carriers, but also to consumers and universal service contributors, given the fluctuations that could result from a true-up approach for these large carriers.

3. Calculating Eligible Recovery for Rate-of-Return Incumbent LECs

627. For rate-of-return incumbent LECs, the Commission adopts a recovery mechanism that provides more certainty and predictability than exists today, while also rewarding carriers for efficiencies achieved in switching costs. Specifically, the recovery mechanism will allow interstate rate-of-return carriers to determine at the outset of the transition their total ICC and recovery revenues for all transitioned rate elements, for each year of the transition: Eligible Recovery will be adjusted as necessary with annual true ups to ensure that rate-of-return carriers have the opportunity to receive their Baseline Revenue, notwithstanding changes in demand for their intercarrier compensation rates being capped or reduced under the R&O. The Commission finds that providing this greater degree of certainty for rate-of-return carriers, which are generally smaller and less able to respond to changes in market conditions than are price cap carriers, is necessary to provide a reasonable transition from the existing intercarrier compensation system.

628. As the starting point for calculating the Rate-of Return-Baseline, the Commission will use a rate of return carrier's 2011 interstate switched access revenue requirement, plus FY2011 intrastate switched access revenues and FY2011 net reciprocal compensation revenues. Average schedule carriers will use projected settlements associated with 2011 annual interstate switched access tariff filing. The Commission will then adjust this Baseline over time to reflect trends in the *status quo* absent reform. Under the interstate regulation that has historically applied to them, rate-of-return carriers were able to increase *interstate* access rates to offset declining MOU, which has averaged 10 percent per year, and consequently had insufficient incentive to reduce costs despite rapidly decreasing demand. However, the record indicates that, in the aggregate, rate-of-return carriers' interstate switched access revenue requirement has been declining approximately three percent each year, reflecting declines in switching costs. As a result, interstate switched access revenues have been declining at approximately three percent annually. NECA and a number of rate-of-return carriers project that the revenue requirement will continue to decline at approximately three percent a year over the next five years, because switching costs are declining dramatically given the availability of IP-based softswitches, which are significantly less costly and more efficient than the TDM-based switches they replace. Similarly, the record reveals that legacy LSS, which is being incorporated in the recovery mechanism for rate-of-return carriers, is projected to decline approximately two percent per year, likewise resulting in reduced interstate revenues for carriers receiving LSS.

629. In the intrastate jurisdiction, moreover, the majority of states do not have an annual true-up mechanism; intrastate rates generally do not automatically increase as demand declines and as a result, most rate-of-return carriers have been experiencing significant annual declines in intercarrier compensation revenue. In particular, aggregate data from more than 600 rate-of-return carriers reveal an average decline in intrastate MOUs of approximately 11 percent, and an average decline in intrastate access revenues of approximately 10 percent annually. The recovery mechanism accounts for this existing revenue loss, which would continue to occur under the *status quo* path absent reform, as illustrated in the figure below.

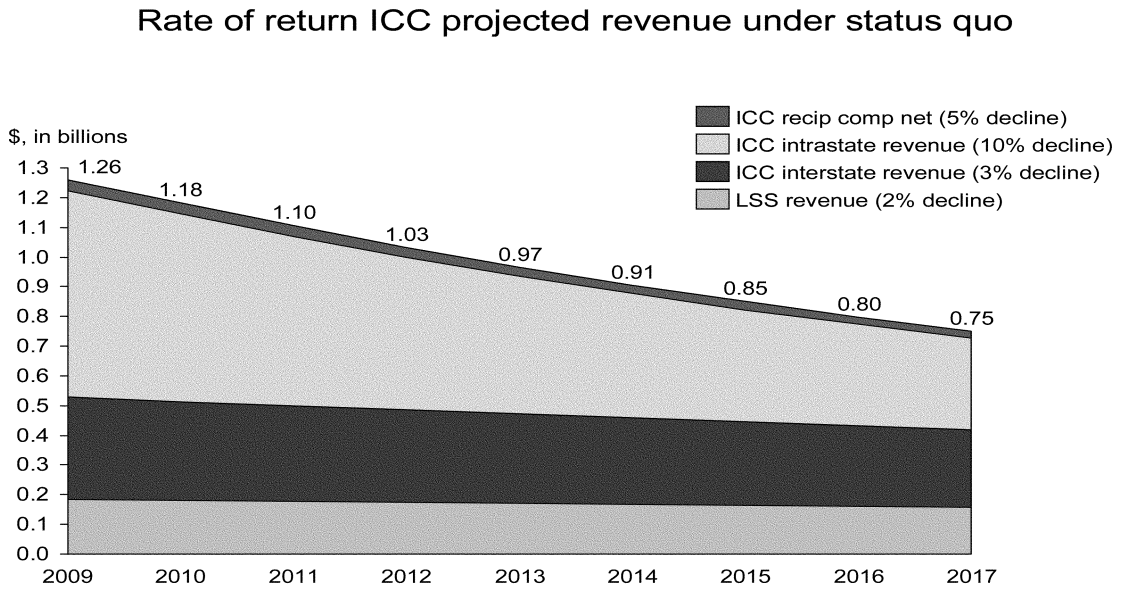

Figure 11

630. Accounting for both the declining interstate revenue requirement and the ongoing loss of intrastate revenue with declining MOU, the record establishes a range of reasonable potential annual reductions in the Baseline from which Rate-of-Return Eligible Recovery is calculated; within that range the Commission initially adopts a five percent annual decrease. At the lower end of the range, an annual decrease of three percent would represent rate-of-return carriers' approximate annual interstate revenue decline absent reform. Limiting the Baseline adjustment to three percent would make these carriers substantially better off with respect to their intrastate access revenues, however. As discussed above, carriers in many states do not have annual true-ups under state access rate regulations so as MOU decline, intrastate access revenues decline as well. Data indicate that this intrastate access revenue decline has been approximately 10 percent. Combining these interstate and intrastate declines weighted by the relative portion of aggregate rate-of-return revenues subject to the mechanism attributable to each category could justify a possible Baseline reduction of approximately seven percent annually. Because the Commission recognizes that the approach to recovery may require adjustments by rate-of-return carriers, the Commission initially adopts a conservative approach and limit the decline in the Baseline amount from which Rate-of-Return Eligible Recovery is calculated to five percent annually.

631. Moreover, the Commission notes that the annual five percent decline does not include the proposal in the *USF/ICC Transformation NPRM* and from the Rural Associations to apply the corporate operations expense limitation to LSS. LSS offsets a portion of rate-of-return carriers' interstate switched access revenue requirement. Applying the corporate operations expense limitations to LSS, or more generally to the entire switched access interstate revenue requirement, would have resulted in one-time reduction of almost three percent. By foregoing this reduction before setting the Baseline, the R&O ensures that the five percent decline is appropriately conservative, while still consistent with overall goals to encourage efficiency and cost savings.

632. Rate-of-return carriers will receive each year's Baseline revenue amount from three sources. First, they will continue to have an opportunity to receive intercarrier compensation revenues, pursuant to the rate reforms described above. Second, they will have an opportunity to collect ARC revenue from their customers, subject to the consumer protection limitations set forth below. Third, they will have an opportunity to collect any remaining Baseline revenue from the CAF. Together, the second and third sources comprise the Rate-of-Return Eligible Recovery.

633. Specifically, Rate-of-Return Eligible Recovery will be calculated from the Rate of Return Baseline by subtracting an amount equal to each carrier's opportunity to collect ICC from the rate elements reformed by this R&O. In each year, this ICC opportunity will be calculated as actual demand for each reformed rate element times the default intercarrier compensation rate for that element in that year. The intercarrier glide path adopted above sets default transitional ICC rates, and permits carriers to negotiate alternatives. In computing the opportunity to collect ICC, the Commission will use the default rates rather than any actual rate to prevent carriers from negotiating low rates simply to prematurely shift intercarrier compensation revenues to the CAF. Thus, in the event that a carrier negotiates intercarrier compensation rates lower than those specified, the Commission will still impute the full default rates, for the purpose of computing the amount each carrier has an opportunity to collect from ICC. To do so, carriers are required to file data annually to ensure that carriers do not recover more than they are entitled under the recovery mechanism.

634. Carriers will annually estimate their anticipated MOU for each relevant intercarrier compensation rate capped or reduced by this R&O. The Commission notes that carriers already use forecasts today in their annual access filings to determine interstate switched access charges and the Commission is requiring carriers to use similar methodology to forecast intercarrier compensation for use in determining Rate-of-Return Eligible Recovery. Because estimated minutes likely will differ from actual minutes, there will be a true-up in two years to adjust the carrier's Rate-of-Return

Eligible Recovery for that year to account for the difference between forecast MOU and actual MOU in the year being trued-up. These data on MOU will establish the Base Minutes for each relevant category, and shall not include MOU for which revenues were not recovered, for whatever reason. Carriers may, however, request a waiver of the rules defining the Baseline to account for revenues billed for terminating switched access service or reciprocal compensation provided in FY 2011 but recovered after the March 31, 2012 cut-off as the result of the decision of a court or regulatory agency of competent jurisdiction. The adjusted Baseline will not include settlements regarding charges after the March 31, 2012 cut-off, and any carrier requesting such modification to its Baseline shall, in addition to otherwise satisfying the waiver criteria, have the burden of demonstrating that the revenues are not already included in its Baseline, including providing a certification to the Commission to that effect. Any request for such a waiver also should include a copy of the decision requiring payment of the disputed intercarrier compensation. Any such waiver would be subject to the Commission's traditional ''good cause'' waiver standard, rather than the Total Cost and Earnings Review specified below. *See* 47 CFR 1.3. Rate-of-return carriers will be required to submit to the states the data used in these calculations, allowing state regulators to monitor implementation of the recovery mechanism. A rate-of-return incumbent LEC that is eligible to receive CAF shall also file this information with USAC, and the Commission delegates to the Wireline Competition Bureau authority to work with USAC to develop and implement processes for administration of CAF ICC support. In support of the carriers' annual access tariff filing, each carrier will provide the necessary data used to justify any ARC to the Commission.

635. *Rate-of-Return Eligible Recovery.* A rate-of-return carrier's baseline for recovery (''Rate-of-Return Baseline'') is its 2011 interstate switched access revenue requirement, plus its FY 2011 intrastate switched access intercarrier compensation revenues for rates capped or reduced by this R&O, plus its FY 2011 net reciprocal compensation revenues. A rate-of-return carrier's Eligible Recovery (''Rate-of-Return Eligible Recovery''), in turn, is: (a) Its Rate-of-Return Baseline reduced by five percent each year; less (b) its ICC recovery opportunity for that year, defined as: (i) Its estimated MOU for each rate element subject to reform times; (ii) the default transition rate for that rate element for that year; plus (3) any necessary true-ups based on the prior year's actual MOUs.

Rate of Return Example. A rate-of-return carrier has a 2011 interstate switched access revenue requirement of $200,000, FY2011 intrastate switched access revenues of $50,000, and net reciprocal compensation revenues of $5,000. Its Eligible Recovery would be determined as follows:

Year 1. The carrier is entitled to collect $242,250 ($255,000 × .95). The carrier will subtract from this total its ICC recovery opportunity from switched access charges capped or reduced in this R&O (both intrastate and interstate) and net reciprocal compensation, defined as its forecast MOU times the default rates specified by this R&O. The remainder is Eligible Recovery.

Year 2. Prior to adjustment for any under- or over-estimation of minutes in Year 1, the carrier is entitled to recover $230,137.50 ($242,250 × .95). This figure is adjusted up or down in the annual true-up to reflect any difference between forecast minutes in Year 1 and actual minutes in Year 1. For example, if the carrier had fewer minutes than estimated in Year 1, such that its ICC recovery opportunity was $500 less than forecast, its recovery in Year 2 would be adjusted upward by $500 and it would be permitted to recover $230,637.50 in Year 2 ($230,137.50 + $500). Conversely, if the carrier had a higher number of MOU than had been forecast and provided the carrier an opportunity for $500 more ICC recovery, its recovery in Year 2 would be adjusted downward to $229,637.50 ($230,137.50 − $500). The carrier will then subtract from this total its Year 2 ICC recovery opportunity, based on its Year 2 forecast minutes and the Year 2 default rates specified by this R&O. The remainder is Eligible Recovery.

This is a simplified example of the calculation of Rate-of-Return Eligible Recovery for a rate-of-return carrier's reduction in intrastate terminating access resulting from the reforms the Commission adopts for illustrative purposes only. It is not intended to encompass all necessary calculations applicable in determining Rate-of-Return Eligible Recovery in the periods discussed in the example for all possible rates addressed by the R&O.

636. *This Approach to Recovery for Interstate Rate-of-Return Carriers Provides Certainty, Minimizes Burdens to Consumers, and Constrains the Size of USF.* Exercising flexibility under the Act to design specific regulatory tools, the R&O adopts an approach to Rate-of-Return Eligible Recovery that takes interstate rate-of-return carriers off of rate-of-return based recovery specifically for interstate switched access revenues, but provides them more predictable recovery than exists under the *status quo.* In addition, to the extent that any interstate rate-of-return carriers also are subject to rate-of-return regulation at the state level, the recovery mechanism for switched access services replaces that, as well. The Commission observes that the recovery mechanism otherwise leaves unaltered the preexisting rate regulations for these carriers' other services, such as common line and special access. Nonetheless, the Commission recognizes that this approach represents a potentially significant regulatory change for those carriers and adopts a longer transition for these carriers for this reason. In addition to the benefits of the standard recovery mechanism discussed below, the Total Cost and Earnings Review mechanism the Commission adopts will ensure that this recovery mechanism will not deprive any carrier of the opportunity to earn a reasonable return. Price cap carriers today already the bear the risk that costs increase and have no true up mechanism for declines in demand. For this reason, the recovery mechanism the Commission adopts for rate-of-return carriers is different than the recovery mechanism the Commission adopts for price cap carriers. Although rate-of-return carriers have a true up process to the Eligible Recovery for actual demand, this is akin to how such carriers are regulated today. The true-up process also protects carriers resulting from changes with regard to, for example, reforms related to various arbitrage schemes. The record does not allow us to quantify with precision the impact of these arbitrage-related reforms on rate-of-return carriers. At the same time, however, the Commission declines to conduct true-ups with regard to rate-of-return carriers' switched access costs; accordingly, carriers will have incentives to become more efficient and to reduce switching costs, including by investing in more efficient technology and by sharing switches. Carriers that are more efficient will be able to retain the benefits of the cost savings. The Commission believes the rural LEC forecast with regard to reduced switched access costs is conservative, and carriers will have additional opportunities to recognize efficiencies with regard to these costs. The Commission discusses these issues in greater detail below.

637. As discussed above, incumbent LECs are experiencing consistent, substantial, and accelerating declines in demand for switched access services. The effect of current interstate rate regulation is to insulate rate-of-return carriers from revenue loss due to competitive pressures that result in declining lines and MOU, but rapidly increasing access rates have exacerbated these carriers' risk of revenue

uncertainty due to arbitrage, and carriers themselves project declining costs—and thus declining revenues—under the *status quo.* In the intrastate jurisdiction, as described above, carriers are often unable to automatically increase rates as they experience a decline in demand caused by competition and changing consumer usage, leading to declining intrastate revenues.

638. The Commission's framework allows rate-of-return carriers to profit from reduced switching costs and increased productivity, ultimately benefitting consumers. The Commission notes in this regard that the transition to broadband networks affords smaller carriers opportunities for efficiencies not previously available. For example, small carriers may be able to realize efficiencies through measures such as sharing switches, measures that preexisting regulations, such as the thresholds for obtaining LSS support, may have deterred. Under the new recovery framework, carriers that realize these efficiencies will not experience a resulting reduction in support. In addition, the new recovery framework—in conjunction with the overall reforms adopted in this Order—provides revenue certainty, stability, and predictable support, as well as promoting continued investment, consistent with advantages some historically have associated with rate-of-return regulation.

639. Importantly, the Commission's approach also avoids the risk of unconstrained escalation in the burden on end-user customers and universal service contributors. The Commission agrees with commenters that, absent incentives for efficiency, determining recovery based on the historical approach to these carriers' rate regulation could cause the CAF to grow significantly and without constraint. This prediction is consistent with the Commission's past recognition that rate-of-return regulation can create incentives for inefficient investment, which would flow through to the recovery mechanism. Although some commenters contend that Commission accounting regulations and oversight adequately protect against inefficient investment, the effectiveness of Commission accounting regulations and oversight is limited in certain respects, as the Commission itself previously has recognized. More broadly, as commenters observe, retaining rate-of-return regulation as historically employed by the Commission risks ''perpetuat[ing the] isolated, ILEC-as-an island operation,'' thus increasing the costs subject to recovery to the extent that, for example, each individual incumbent LEC purchases its own facilities, rather than sharing infrastructure with other carriers where efficient. Of particular relevance here, as one commenter observes, under the preexisting regulatory framework ''there is little evidence of shared investment in local switching, even though such sharing would be engaged in by rational carriers subject to market incentives,'' while, ''[i]n contrast, there is evidence of at least some efforts to engage in joint ventures to invest in transport and tandem switching assets for which there are fewer regulatory incentives for rate-of-return carriers to invest in their own equipment and facilities.'' The Commission is committed to constraining the growth of the CAF, and the recovery mechanism the Commission adopts for interstate rate-of-return carriers advances that goal. To this end, states that have jurisdiction over intrastate access rates should monitor intrastate tariffs filed pursuant to the rules and reforms adopted in this Order to ensure carriers do not shift costs from services subject to incentive regulation to services still subject to rate-of-return regulation.

640. The Commission declines to adopt the recovery mechanism proposed by associations of rate-of-return carriers. Although these carriers contend that their approach would allow intercarrier compensation reform for rate-of-return carriers that would limit the burdens placed on the CAF, the Commission is not persuaded by a number of the assumptions that lead them to this conclusion. The rate-of-return carriers project that their revenue requirement for switched access will decline three percent annually for the next five years. The Commission's approach locks in this historical trend, adjusted to account for the intrastate *status quo.* In the absence of locking in this historical trend, however, the Commission has concerns about whether such declines in the revenue requirement actually will occur. As commenters observe, because ICC costs will be shifted primarily to the CAF to make rate-of-return carriers whole, carriers would face incentives for inefficient investment, and such incentives could be heightened to the extent that carriers seek to offset the effects of intercarrier compensation rate reductions. A more realistic view of the assumptions underlying the associations' projections suggests that the financial impact on the CAF of the associations' proposal is likely far greater than they project. Consequently, adopting their proposal appears likely to lead to one of two results—the CAF would grow significantly, or intercarrier compensation reform would stop once CAF demands outstripped the available budget.

E. Recovering Eligible Recovery

641. The Commission now explains the two-step mechanism by which carriers will be allowed to recover their Eligible Recovery. First, incumbent LECs will be permitted to recover Eligible Recovery through limited end-user charges. If these charges are insufficient, carriers will be entitled to CAF support equal to the remaining Eligible Recovery. Carriers electing to forego recovery from the ARC or the CAF must indicate their intention to do so in their 2012 tariff filing. Carriers may also elect to forgo CAF reform in any subsequent tariff filing. A carrier cannot, however, elect to receive CAF funding after a previous election not to do so. Notwithstanding a carrier's election to forego recovery from the ARC or the CAF, tariff filings may require carriers to provide the information necessary to justify the rates and terms in the tariff. Because the Commission views the recovery mechanism as a transitional tool, the Commission implements several measures to ensure it is truly temporary in nature. First, the Eligible Recovery that incumbent LECs are permitted to recover phases down over time, based on a predetermined glide path for price cap carriers and a more gradual framework for rate-of-return carriers. Second, ICC-replacement CAF support for price cap carriers is subject to a defined sunset date. Finally, in the USF/ICC Transformation FNPRM, the Commission seeks further comment on the timing for eliminating the recovery mechanism—including end-user recovery— in its entirety. Carriers recovering eligible recovery will be required to certify annually that they are entitled to receive the recovery they are claiming and that they are complying with all rules pertaining to such recovery.

1. End User Recovery

642. The *USF/ICC Transformation NPRM* sought comment on the role that interstate SLCs should play in intercarrier compensation reform and the ongoing relevance of the SLC as the marketplace moves to IP networks. The subsequent *USF/ICC Transformation Public Notice,* 76 FR 154, August 10, 2011, sought further comment on particular alternatives for using SLCs as part of any recovery mechanism. Although the record reveals a wide variety of proposals, most parties commenting on the matter supported an

increase in end-user charges as a necessary part of ICC reform. In developing the recovery mechanism, the Commission seeks to balance the interests of both end-user customers and USF contributors. The Commission thus agrees that it is appropriate to first look to customers paying lower rates for some limited, reasonable recovery, and adopt a number of safeguards to ensure that rates remain affordable and that consumers are not required to contribute an inequitable share of lost intercarrier revenues.

643. In addition to balancing the needs of ratepayers and USF contributors, the R&O also accounts for differences among different ratepayers, adopting particular protections for consumers. For example, some proposals in the record would require that end-user recovery be borne in the first instance by consumers. Instead, acknowledging that all end users benefit from the network, and consistent with the Commission's approach to end-user recovery in prior intercarrier compensation reform, the Commission concludes that all end users should contribute to reasonable end-user recovery from the beginning of ICC reform.

644. The Commission adopts a transitional ARC that is subject to three important constraints. First, in no case will the monthly ARC increase more than $0.50 per year for a residential or single-line business customer, or more than $1.00 (per line) per year for a multi-line business customer. Price cap incumbent LECs are allowed to increase ARCs for no more than five years; rate-of-return incumbent LECs for no more than six years. The Commission believes that the consumer ARC adopted here, which, even if fully imposed, represents a smaller percentage increase than SLC increases adopted by the Commission in prior reforms, strikes the proper balance. Second, in no case will the consumer ARC increase if that increase would result in certain residential end-user rates exceeding the Residential Rate Ceiling, which the Commission discusses below. Third, ARCs can only be charged in a particular year to recover an incumbent LEC's Eligible Recovery for that year; total revenue from ARCs cannot exceed Eligible Recovery. Thus if a carrier's Eligible Recovery decreases from one year to the next, the total amount of ARCs it may charge its end users will also decrease. Importantly, carriers also are *not* required to charge the ARC.

645. To minimize the consumer burden, the R&O limits increases in the monthly consumer ARC to $0.50 per year. The Commission also makes clear that carriers may not charge any Lifeline customers an ARC. As a result, incumbent LECs' calculation of ARCs for purposes of the recovery mechanism must identify and exclude such customers. Given that the intercarrier compensation reforms also do not alter the operation of the existing SLC, these intercarrier compensation reforms will not affect the Lifeline universal service support mechanism. Furthermore, while some commenters advocate end-user charges only for residential and single-line business customers, the Commission rejects requests to place the entire recovery burden on consumers. The R&O provides for increases in the monthly ARC for multi-line business customers of $1.00 (per line) per year, and the Commission will require potential revenue from such increases to be imputed to carriers, reducing the total amount of consumer ARCs they may charge. Doing so is consistent with the Commission's prior intercarrier compensation reforms, which recognized that ''universal service concerns are not as great for multi-line business lines.'' Consequently, in previous reforms, the Commission has adopted higher increases in end-user charges for multi-line business customers than for consumers, and on a more accelerated timeline. For example, in the *Access Charge Reform Order,* 62 FR 31868, June 11, 1997, the Commission did not raise the SLC cap for primary residential and single-line business users, but concluded that universal service concerns were not as great for multi-line business users, for example, and raised the SLC caps for such users from $6.00 to $9.00 per line. In the *2008 ICC/USF Order and NPRM,* 73 FR 66821, November 12, 2008, the Commission proposed increasing the residential and single-line business and the non-primary residential line SLC by $1.50 and the multi-line business SLC by $2.30. In the *USF/ICC Transformation NPRM* the Commission sought comment on those amounts again. Commenters supported this increase. In fact, some commenters advocated for a higher SLC increase. The ARC adopted today, which is lower on an annual basis than the annual SLC increase proposed in 2008, balances the burdens on consumers and businesses. However, the Commission has taken measures to ensure that charges for multi-line businesses remain just and reasonable. In particular, to ensure that multi-line businesses' total SLC plus ARC line items are just and reasonable and to minimize the burden on businesses, the R&O limits the maximum SLC plus ARC fee to $12.20. This limits the ARC for multi-line businesses for entities at the current $9.20 cap to $3.00, comparable to the overall limit on residential ARCs.

646. The R&O permits carriers to determine at the holding company level how Eligible Recovery will be allocated among their incumbent LECs' ARCs. By providing this flexibility, carriers will be able to spread the recovery of Eligible Recovery among a broader set of customers, minimizing the increase experienced by any one customer. This also will enable carriers to more fully recover Eligible Recovery from end-users with rates below the $30 Residential Rate Ceiling, limiting the potential impact on the CAF. For carriers that elect to receive CAF support, the Commission will impute to each carrier the full ARC revenues they are permitted to collect, regardless of whether they actually collect any or all such revenues. If the imputed amount is insufficient to cover all their Eligible Recovery, they are permitted to recover the remainder from CAF ICC support.

647. In the event a carrier elects not to receive CAF ICC support, the Commission takes measures to limit the burden on residential and single-line business customers. The decision to elect not to receive ICC replacement CAF support, discussed below, is distinct from the decision to assess the full authorized ARC. Absent doing so, carriers potentially could use their holding company-level flexibility to target their ARC recovery primarily or exclusively to residential and single-line business customers, rather than larger multi-line business customers. The Commission therefore requires that a carrier allocate its Eligible Recovery by a proportion of a carrier's mix of residential versus business lines. However, because line counts alone would not reflect the fact that there is a lower cap on ARC increases for residential and single-line business lines ($0.50 per line) than for multi-line business lines ($1.00 per line), the Commission adopts a double-weighting of multi-line business lines for purposes of this calculation. The percentage of ARC revenues a carrier is eligible to recover from residential and single-line business customers cannot exceed the percentage of total residential lines assessed a SLC by such customers where multi-line business lines are given double weight. In addition, this calculation will exclude lines for Lifeline customers because the Commission prevents carriers from assessing an ARC on any Lifeline customer. For example, if a carrier had 1000 residential and single-line business lines and 200 multi-line

business lines, and Eligible Recovery of $600 monthly, under the limitation, it would be permitted to collect no more than 71.43 percent of that amount—approximately $429—from residential and single-line business customers based on the calculation: 1000 residential and single line business lines/(1000 residential and single-line business lines + 2 × 200 multi-line business lines) = 71.43 percent.

648. The Commission declines to implement end user recovery through increases to the pre-existing SLC, as some commenters suggest. SLCs today are designed to recover common line revenues as defined by Commission regulation. The Commission is not formally recategorizing any costs or revenues to be included in that regulatory category, and the calculation of Eligible Recovery for purposes of the reforms the Commission adopts is completely independent of SLC rate calculations. As a result, the Commission leaves current SLCs unmodified for now. Carriers whose current SLCs are below the caps are not otherwise permitted to increase their SLCs to recover revenues reduced by interstate and intrastate access charge reforms, *i.e.,* the Commission is not permitting carriers to raise their SLCs beyond the level they are currently authorized to charge, even if that level is below the relevant regulatory SLC cap. The Commission seeks comment in the accompanying USF/ICC Transformation FNPRM regarding whether existing regulation of SLCs is appropriate, including whether SLCs should be reduced or phased-out over time. Instead, the new ARC will be separately calculated, reduced over time, and separately tariffed and reported to the Commission to enable monitoring to ensure carriers are not assessing ARCs in excess of their Eligible Recovery. The ARC can, however, be combined in a single line item with the SLC on the customer's bill. Moreover, the Commission finds that it is appropriate to reevaluate its SLC rules, and does so in the USF/ICC Transformation FNPRM.

649. *Residential Rate Ceiling.* In the *USF/ICC Transformation Public Notice,* the Commission sought comment on the appropriate level and operation of a ceiling to limit rate increases in states that already had undertaken some intercarrier compensation reforms. To ensure that consumer telephone rates remain affordable and to recognize states that have already undertaken reform, the Commission adopts a Residential Rate Ceiling of $30 per month for all incumbent LECs, both price cap and rate-of-return. Although the Residential Rate Ceiling does not generally limit rates carriers can charge, it prevents carriers from charging an ARC on residential consumers already paying $30 or more.

650. For purposes of comparison with the Residential Rate Ceiling, the Commission considers the rate for basic local service, including additional charges that a consumer actually pays each month in conjunction with that service (referred to collectively as rate ceiling component charges). The rate ceiling component charges consist of the federal SLC and the ARC; the flat rate for residential local service, mandatory extended area service charges, and state subscriber line charges; per-line state high cost and/or access replacement universal service contributions; state E911 charges; and state TRS charges. Carriers are not permitted to charge ARCs to the extent that ARCs would result in rate ceiling component charges exceeding the Residential Rate Ceiling for any residential customer. For example, a consumer in Parsons, Kansas may have a rate of $13.90, a SLC of $6.40, a mandatory contribution to the Kansas Universal Service Fund of $6.75, a mandatory EAS charge of $1.70, and a TRS charge of $1.00—his or her aggregate rate ceiling component charges before the ARC would be $29.75. Accordingly, a carrier could only charge this consumer an ARC of $0.25 before reaching the $30 Residential Rate Ceiling. (The carrier could still charge multi-line business customers a $1.00 per line ARC, provided that any multi-line business customer's total SLC plus ARC does not exceed $12.20). Consistent with the goal of the Residential Rate Ceiling, because non-primary residential SLC lines are charged to residential customers the Commission limits carriers' ARC for non-primary residential SLC lines to an amount equal to the ARC charged for such consumers' primary residential lines. Thus, to the extent that the Residential Rate Ceiling limits the ARC that can be assessed on residential customers' primary lines, it effectively will limit the ARC that can be charged on their non-primary lines, as well. After the ARC, any additional Eligible Recovery would have to be recovered from the CAF rather than from end-users.

651. The Residential Rate Ceiling particularly helps protect consumers in states that have already begun state intercarrier compensation reform. As part of such reform, some states are rebalancing rates, with local rate increases phasing in over time, including potentially after January 1, 2012. These local rate increases will be included in the calculation of end-users rates for comparison to the Residential Rate Ceiling . Further, as part of its universal service reforms, the Commission is adopting an intrastate rate minimum benchmark designed to avoid over-subsidizing carriers whose intrastate rates are not minimally reasonable. To ensure that states are not disincented from rebalancing artificially low local retail rates after January 1, 2012, and to ensure that the Residential Rate Ceiling continues to protect consumers in those states, the Commission will use the *higher* of the relevant rates in effect on January 1, 2012 or of January 1 in the year in which the ARC is to be charged for comparison to the Residential Rate Ceiling, thus accounting for possible increases in consumer rates over time.

652. The Commission finds the $30 Residential Rate Ceiling will help ensure that consumer rates remain affordable and set at reasonable levels by preventing any ARC increases to consumers who already pay $30 or more. The Commission notes that it also adopts a ''local rate benchmark'' as part of universal service reform of HCLS and HCMS. The CAF benchmark serves a different purpose and has a different function from the Residential Rate Ceiling. The CAF benchmark is focused on ensuring that universal service does not overly subsidize carriers with artificially low local rates. As a result, it focuses more narrowly on the specific rates of concern, especially flat-rated local service charges, state SLCs, and state USF contributions and sets a lower bound to encourage carriers to charge reasonably comparable local rates. HCLS and HCMS are federal universal service mechanisms that pick up intrastate loop costs, and the Commission will not use limited universal service funding to subsidize artificially low rates. The CAF benchmark therefore serves as a floor. Although some commenters propose using a $25 (or lower) rate, the Commission notes that several states that have rebalanced rates already have rates above $30, suggesting that this rate is affordable and set at reasonable levels. To the extent that prior surveys of urban rates yielded an average of approximately $25, the Commission observes that the surveys encompassed a more limited set of charges than the Residential Rate Ceiling. As demonstrated by the rates in a number of states that have undertaken significant intercarrier compensation reform—which the Commission finds to be a more relevant data set in this context than average urban rates—rates

including the full ranges of charges can be close to or more than $30. The Commission also declines to adopt separate rate ceilings for different carriers, and instead agree with commenters that it would ''be inappropriate—and inconsistent with Section 254—for the Commission to adopt different benchmarks for different geographic areas or providers.'' Such an approach would mandate rate disparities between geographic areas, contrary to the Commission's goal of promoting reasonably comparable rates throughout the country. The Commission thus concludes that the $30 Residential Rate Ceiling strikes the right balance between ensuring that consumers pay their fair share of recovery and protecting consumers in states that already have undertaken substantial reforms.

2. CAF Recovery

653. The Commission has recognized that, as the Commission moves away from implicit support, some high cost, rural areas may need new explicit support from the universal service fund. Consequently, in the *USF/ICC Transformation NPRM,* the Commission sought comment on the appropriate role of universal service support to offset some intercarrier revenues lost through reform. The Commission agrees with the many commenters advocating that transitional recovery should, in part, come through the CAF. In particular, the limits on ARCs and the Residential Rate Ceiling place important constraints on end user recovery. Consequently, the Commission anticipates that end user recovery alone will not provide the full recovery permitted by the mechanism for many incumbent LECs, particularly rate-of-return carriers. Given the Commission's desire to ensure a measured, predictable transition, the Commission thus finds it appropriate to supplement end user recovery with transitional ICC-replacement CAF support.

654. To that end, as part of the new CAF universal service mechanism, the Commission permits incumbent LECs to recover Eligible Recovery that they do not have the opportunity to recover through permitted ARCs. The ICC-replacement CAF support for carriers that are eligible and elect to receive it is the remainder of Eligible Recovery not recovered through ARCs. As a result, those same data will enable USAC to calculate CAF support as well. Thus, the Commission directs carriers to file those same data with USAC for purposes of CAF distribution under the recovery mechanism. The Commission notes that although incumbent LECs will experience intercarrier compensation reductions on a study area-by-study area basis, they have flexibility at the holding company level to determine where and how to charge ARCs. Thus, USAC needs an approach to attributing those revenues to particular study areas to determine the amount of CAF funding to provide to each such area. In this regard, the Commission notes that one benefit of its universal service reform is the greater accountability associated with the CAF support mechanism. Given that, the Commission directs USAC to attribute ARC revenue to all of the holding company's study areas in proportion to the Eligible Recovery associated with that study area. This will ensure that some study areas are not insulated from the CAF accountability measures by having sufficient ARC revenue attributed to meet their entire Eligible Recovery need. The same oversight and accountability obligations the Commission adopts above apply to CAF support received as part of the recovery mechanism. In addition, all rate-of-return CAF ICC recipients, whether a current recipient of high cost universal service support or not, must satisfy the same public interest obligations as carriers receiving high-cost universal service support. All price cap CAF ICC recipients must use such support for building and operating broadband-capable networks used to offer their own retail broadband service in areas substantially unserved by an unsubsidized competitor of fixed voice and broadband services. The Commission believes it is appropriate to adopt slightly different obligations for receipt of CAF ICC support for price cap and rate-of-return carriers. For one, the price cap CAF support is transitional, and phasing out completely over time as the Commission has adopted a long-term phase II CAF support for areas served by price cap carriers. Thus, the Commission has a mechanism to advance its goal of universal voice and broadband to areas served by price cap carriers that are unserved today. For rate-of-return carriers, however, the Commission has not adopted a different long-term approach for receipt of universal service support. Therefore, the Commission believes it is appropriate to impose the same obligations that such carriers have for receipt of all universal service support that the Commission adopts above, which requires carriers to extend broadband upon reasonable request. Finally, the Commission allows a carrier to elect not to receive ICC replacement CAF support (and therefore to avoid the obligations that accompany support) even if it would otherwise be entitled to do so under the Eligible Recovery calculation. The election to decline CAF support will be made in the carrier's July 1, 2012 tariff filing. A carrier that elects not to receive CAF cannot subsequently change this election. A carrier can, however, initially elect to receive CAF support but elect to end that support at any time. Moreover, like forgone ARC recovery, forgone CAF will be imputed to a carrier seeking any additional recovery under the Total Cost and Earnings Review, discussed below.

655. Providing CAF recovery is consistent with the Commission's mandate under 47 U.S.C. 254 and the Commission's use of universal service funding as a component of prior intercarrier compensation reforms. In light of the broadband obligations the Commission adopts, the decision to establish this funding mechanism is also consistent with the Commission's general authority under section 4(i) of the Act, 47 U.S.C. 154(i), and section 706 of the 1996 Act, 47 U.S.C. 1302, because it furthers the Commission's universal service objectives and promotes the deployment of advanced services.

656. For price cap carriers that elect to receive ICC-replacement CAF support, such support is transitional and phases out in three years, beginning in 2017. Although the Commission does not adopt a similar sunset for rate-of-return carriers' ICC-replacement CAF support in this Order, the Commission seeks comment on alternatives in this regard in the *ICC/USF Transformation FNPRM.*

3. Monitoring Compliance With Recovery Mechanism

657. To monitor compliance with this R&O, the Commission requires all incumbent LECs that participate in the recovery mechanism, including by charging any end user an ARC, to file data on an annual basis regarding their ICC rates, revenues, expenses, and demand for the preceding fiscal year. The Commission also encourages, but does not require, all competitive LECs and CMRS providers to similarly file such data. All such information may be filed under protective order and will be treated as confidential.

658. These data are necessary to monitor compliance with the provisions of this R&O and accompanying rules, including to ensure that carriers are not charging ARCs that exceed their Eligible Recovery and that ARCs are reduced as Eligible Recovery decreases. The data are also needed to monitor the impact of the reforms the Commission adopts

and to enable the Commission to resolve the issues teed up in the *USF/ICC Transformation FNPRM* regarding the appropriate transition to bill-and-keep and, if necessary, the appropriate recovery mechanism for rate elements not reduced in this R&O, including originating access and many transport rates. Such data will enable the Commission to determine the impact that any transition would have on a particular carrier or group of carriers, and to evaluate the trend of ICC revenues, expenses, and minutes and compare such data uniformly across all carriers.

659. To minimize any burden, filings will be aggregated at the holding company level, limited to the preceding fiscal year, and will include data carriers must monitor to comply with the recovery mechanism rules. For carriers eligible and electing to receive CAF ICC support, the Commission will ensure that the data filed with USAC are consistent with the Commission's request, so that carriers can use the same format for both filings. To ensure consistency and further minimize any burden on carriers, the Commission delegates to the Wireline Competition Bureau the authority to adopt a template for submitting the data, which should be done in conjunction with the development of data necessary to be filed with USAC for receipt of CAF ICC support, which has also been delegated to the Wireline Competition Bureau. Given that carriers must be monitoring these data to comply with the revised tariff rules, the Commission requires incumbent LECs to file electronically annually at the same time as their annual interstate access tariff filings.

F. Requests for Additional Support

660. Although the Commission provides an opportunity for revenue recovery to promote an orderly transition away from terminating access charges, the Commission declines to adopt a revenue-neutral approach as advocated by some commenters. Rather, the Commission agrees with commenters who maintain that the Commission has no legal obligation to ensure that carriers recover access revenues lost as a result of reform, absent a showing of a taking. The Commission establishes a rebuttable presumption that the reforms adopted in the R&O, including the recovery of Eligible Recovery from the ARC and CAF, allow incumbent LECs to earn a reasonable return on their investment. The Commission establishes a ''Total Cost and Earnings Review,'' through which a carrier may petition the Commission to rebut this presumption and request additional support. The Commission believes the Total Cost and Earnings Review procedure alone is sufficient to meet its legal obligations with regard to recovery. The Commission identifies below certain factors in addition to switched access costs and revenues that *may* affect the analysis of requests for additional support, including: (1) Other revenues derived from regulated services provided over the local network, such as special access; (2) productivity gains; (3) incumbent LEC ICC expense reductions and other cost savings, and (4) other services provided over the local network. Particularly given these factors, it is the Commission's predictive judgment that the limited recovery permitted will be more than sufficient to provide carriers reasonable recovery for regulated services, both as a matter of the constitutional obligations underlying the Commission's rate regulation and as a policy matter of providing a measured transition away from incumbent LECs' historical reliance on intercarrier compensation revenues to recovery that better reflects today's marketplace. Nonetheless, the Commission also adopts a Total Cost and Earnings Review to allow individual carriers to demonstrate that this rebuttable presumption is incorrect and that additional recovery is needed to prevent a taking.

661. To show that the standard recovery mechanism is legally insufficient, a carrier would face a ''heavy burden,'' and need to demonstrate that the regime ''threatens [the carrier's] financial integrity or otherwise impedes [its] ability to attract capital.'' As the Supreme Court has long recognized, when a regulated entity's rates ''enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed,'' the company has no valid claim to compensation under the Takings Clause, even if the current scheme of regulated rates yields ''only a meager return'' compared to alternative rate-setting approaches. For the reasons described above, the Commission believes that its recovery mechanisms provide recovery well beyond any constitutionally-required minimum, and the Commission finds no convincing evidence in the record here that the standard recovery mechanism will yield confiscatory results.

662. Specifically, a carrier can petition for a Total Cost and Earnings Review to request additional CAF ICC support and/or waiver of CAF ICC support broadband obligations. In analyzing such petitions, the Commission will consider the totality of the circumstances, to the extent permitted by law. The Commission's analysis will consider all factors affecting a carrier and its ability to earn a return on its relevant investment, including the factors described below. As a result of this analysis of costs and revenues, the Commission will be able to determine the constitutionally required return and will not be bound by any return historically used in rate-setting nor any specific return resulting from the intercarrier compensation recovery mechanism adopted in this R&O, or possible rate represcription as discussed in the *USF/ICC Transformation FNPRM.* Given the extensive discussion of reform proposals over the years, a carrier could not reasonably ''rely indefinitely'' on the existing system of intercarrier compensation, ''but would simply have to rely on the constitutional bar against confiscatory rates'' in the event the Commission revised its compensation rules. *Verizon Communications Inc. v. FCC,* 535 U.S. 467, 528 (2002).

663. As the Commission seeks to protect consumers from undue rate increases or increases in contributions to USF, the Commission will conduct the most comprehensive review of any requests for additional support allowed by law. The recovery mechanism goes beyond what might strictly be required by the constitutional takings principles underlying historical Commission regulations. Therefore, although the standard recovery mechanism does not seek to precisely quantify and address all considerations relevant to resolution of a takings claim, carriers will need to address these considerations to the extent that they seek to avail themselves of the Total Cost and Earnings Review procedure based on a claim that recovery is legally insufficient.

664. *Revenues Derived from Other Regulated Services Provided Over the Local Network.* The Commission agrees with those who argue that it is appropriate for the Commission to consider the implications of services other than switched access that are provided using supported facilities, to the extent constitutionally permitted. Notwithstanding intercarrier compensation reform, carriers will continue to receive revenues from other uses of the local network. For example, although the reforms adopted in this R&O will bring many intercarrier compensation rates into a bill-and-keep framework, other intercarrier compensation rates will be subject to minimal—or no—reforms at this time. Consequently, incumbent LECs will continue to collect intercarrier

compensation for originating access and dedicated transport, providing continued revenue flows—including the underlying implicit subsidies—from those sources during the transition outlined in this R&O, although the Commission has determined that such rates ultimately will reach bill-and-keep as well. Carriers acknowledge that the subsidies in these remaining intercarrier compensation rates are used for investment in their network to provide regulated services such as special access service. In addition, there was debate in the record regarding whether, and how, to consider special access revenues in this regard. At this time the Commission does not prescribe general rules considering such revenue, but, as with other services that rely on the local network, the Commission will consider such earnings and may reconsider this decision if warranted upon conclusion of the Commission's ongoing special access proceeding.

665. *Productivity Gains.* As discussed above, although incentive regulation commonly involves sharing the benefits of productivity gains between carriers and ratepayers, such a mechanism has not been in place for many years. The standard recovery mechanism adopts a 10 percent reduction in CALLS price cap incumbent LECs' baseline revenues, initially for CALLS price cap study areas, and after five years for non-CALLS price cap study areas to reflect this. However, because the Commission believe that is a conservative approach, the Commission finds it appropriate to consider efficiency gains for particular price cap carriers on an individual basis in the Total Cost and Earnings Review, as well.

666. *LEC Cost Savings and Increased Revenue.* Currently, carriers are frequently embroiled in costly litigation over payment, jurisdiction, and type of traffic. The reforms the Commission adopts in this R&O should substantially reduce such disputes, and the Commission anticipates that comprehensive intercarrier compensation reform will further reduce carriers' costs of administering intercarrier compensation. Likewise, the Commission's actions regarding phantom traffic and intercarrier compensation for VoIP traffic may increase the proportion of traffic for which intercarrier compensation can be collected. Finally, the Commission notes that the reforms should result in expense savings in other lines of business, such as the provision of long distance services. Although the Commission does not adopt a ''net revenues'' approach as part of the standard recovery mechanism, in appropriate circumstances the Commission believes an analysis of intercarrier expenses could be warranted in the examination of an individual carrier's claim under the more fact- and carrier-specific Total Costs and Earnings Review mechanism. The Commission will consider these factors to the extent legally permissible, including but not limited to the following categories:

- *Revenue for Exchanging VoIP Traffic.* A number of carriers have alleged that they are not receiving compensation for exchanging VoIP traffic. In this R&O the Commission adopts rules clarifying the obligation of VoIP traffic to pay intercarrier compensation charges during the transition to bill and keep. The decisions the Commission adopts will provide LECs, including incumbent LECs, with more certain revenue throughout the transition, and will also allow them to avoid the litigation expense associated with attempts to collect access charges for VoIP traffic.
- *Reduced Phantom Traffic.* Similarly, the rules adopted in this R&O will enable carriers to identify and bill for phantom traffic. These rules thus should enable carriers to collect intercarrier compensation charges throughout the transition that they are not currently able to collect. The Commission also anticipates that incumbent LECs will be able to reduce administrative and litigation costs associated with such traffic.
- *Other Reduced Litigation Costs and Administrative Expenses.* In addition to reduced litigation costs and administrative expense associated with VoIP and phantom traffic as a result of the reforms the Commission adopts in this R&O, the record indicates that carriers will benefit more generally from the clarity and relative simplicity of the rules the Commission adopts. The Commission anticipates that this will be reflected in additional savings in litigation and administration costs.
- *Other Services Provided Over the Local Network.* In addition to regulated services provided over the local network, many carriers also provide unregulated services, such as broadband and video. Although parties have identified some uncertainty regarding the Commission's ability to consider revenues from such services in calculating a carrier's return on investment in the local network, the Commission will, at a minimum, carefully scrutinize the allocation of costs associated with such services. As one commenter states, ''[i]t simply no longer makes any sense (if it ever did) for the agency to allow rural carriers to spend as much as they can on their networks, earning a rate of return on these historical costs while only considering the small sliver of regulated local telephony revenues earned using these USF subsidized networks.''

667. The Commission notes that some carriers argued that the Commission should not rely on revenue from unregulated services to offset a carrier's defined eligible revenue, but that if it did, it should only use net unregulated revenue, considering both the costs and revenues from those services. In addition, although there are a range of possible approaches for allocating many types of costs, a number of commenters recognized that historical accounting underlying intercarrier compensation rates and other charges fail to reflect the marketplace reality of the number and types of services provided over the local network. For example, the record revealed concerns about the extent to which loop costs have been allocated to regulated services such as voice telephone service versus services such as broadband Internet access service. Consequently, the Commission will give appropriate consideration to these services as part of the Total Cost and Earnings Review, including an analysis of both the revenue generated by such other services and whether the cost of such services, both regulated and unregulated, have been properly allocated.

668. *Cost Allocation.* The *USF/ICC Transformation NPRM* sought comment on the implications of the jurisdictional separations process, including ongoing reform efforts, on intercarrier compensation reforms. The jurisdictional separations process, which has been frozen for some time, is currently the subject of a referral to the Separations Joint Board. Any carrier seeking additional recovery will be required to conduct a separations study to demonstrate the current use of its facilities. Although this is a burdensome requirement, it is not unduly so given the importance of protecting consumers and the universal service fund.

XI. Intercarrier Compensation for VOIP Traffic

669. Under the new intercarrier compensation regime, all traffic—including VoIP-PSTN traffic—ultimately will be subject to a bill-and-keep framework. As part of the transition to that end point, the Commission adopts a prospective intercarrier compensation framework for VoIP traffic. In particular, the Commission addresses the prospective treatment of VoIP-PSTN traffic by adopting a transitional compensation framework for such traffic

proposed by commenters in the record. Although the Commission adopts an approach similar to that proposed by some commenters, the approach to adopting and implementing this framework differs in certain respects. For one, the Commission is not persuaded on this record that all VoIP-PSTN traffic must be subject exclusively to federal regulation, and as a result, to adopt this prospective regime the Commission relies on its general authority to specify a transition to bill-and-keep for 47 U.S.C. 251(b)(5) traffic. As a result, tariffing of charges for toll VoIP-PSTN traffic can occur through both federal and state tariffs. In addition, given the recognized concerns with the use of telephone numbers and other call detail information to establish the geographic end-points of a call, the Commission declines to mandate their use in that regard. The Commission does, however, recognize concerns regarding providers' ability to distinguish VoIP-PSTN traffic from other traffic, and, consistent with the recommendations of a number of commenters, permits LECs to address this issue through their tariffs, much as they do with jurisdictional issues today.

670. The Commission believes that this prospective framework best balances the competing policy goals during the transition to the final intercarrier compensation regime. By declining to apply the entire preexisting intercarrier compensation regime to VoIP-PSTN traffic prospectively, the Commission recognizes the shortcomings of that regime. At the same time, the Commission is mindful of the need for a measured transition for carriers that receive substantial revenues from intercarrier compensation. Although the Commission's action clarifying the prospective intercarrier compensation treatment of VoIP-PSTN traffic does not resolve the numerous existing industry disputes, it should minimize future uncertainty and disputes regarding VoIP compensation, and thereby meaningfully reduce carriers' future costs.

A. Widespread Uncertainty and Disagreement Regarding Intercarrier Compensation for VoIP Traffic

671. Against this backdrop, and the fact that the current uncertainty and associated disputes are likely deterring innovation and introduction of new IP services to consumers, the Commission finds it appropriate to address the prospective intercarrier compensation obligations associated with VoIP-PSTN traffic. Indeed, despite the varied opinions in the record regarding the appropriate approach to VoIP-PSTN intercarrier compensation, there is widespread agreement that the Commission needed to act to address that issue now.

B. Prospective Intercarrier Compensation Obligations for VoIP-PSTN Traffic

1. Scope of VoIP-PSTN Traffic

672. The prospective intercarrier compensation regime the Commission adopts for a LEC's exchange of VoIP traffic with another carrier focuses on what the Commission refers to as ''VoIP-PSTN'' traffic. The Commission uses the term ''VoIP-PSTN'' as shorthand. The Commission recognizes that carriers have been converting portions of their networks to IP technology for years. Nonetheless, many carriers today continue to rely extensively on circuit-switched technology particularly for the exchange of traffic subject to intercarrier compensation rules. Likewise the definition of ''interconnected VoIP'' uses the term ''PSTN'' as distinct from at least certain types of VoIP services. Thus, in the context of VoIP-PSTN intercarrier compensation rules, the reference to ''PSTN'' refers to the exchange of traffic between carriers in (Time Division Multiplexing) TDM format. For purposes of this R&O, the Commission adopts the definition of traffic proposed in the Joint Letter: ''VoIP-PSTN traffic'' is ''traffic exchanged over PSTN facilities that originates and/or terminates in IP format.'' Although the Commission's prospective VoIP-PSTN intercarrier compensation is not circumscribed by the definition of ''interconnected VoIP service'' in section 3(25) of the Act, 47 U.S.C. 153(25) (referencing section 9.3 of the Commission's rules) or the definition of ''non-interconnected VoIP service'' in section 3(36) of the Act, 47 U.S.C. 153(36), nonetheless, informed by those definitions, the Commission believes it is appropriate to focus on traffic for services that require ''Internet protocol-compatible customer premises equipment.'' Sections 3(25) and 3(36) of the Act, 47 U.S.C.153(25), (26), were adopted in section 101 of the Twenty-First Century Communications and Video Accessibility Act of 2010, Pub. L. No. 111–260, section 103(b), 124 Stat. 2751 (2010). In this regard, the Commission focuses specifically on whether the exchange of traffic between a LEC and another carrier occurs in Time-Division Multiplexing (TDM) format (and not in IP format), without specifying the technology used to perform the functions subject to the associated intercarrier compensation charges.

673. Although the *USF/ICC Transformation NPRM* proposed focusing specifically on interconnected VoIP services, the Commission notes that its existing definition of interconnected VoIP would exclude traffic associated with some VoIP services that are originated or terminated on the PSTN, such as ''one-way'' services that allow end-users either to place calls to, or receive calls from, the PSTN, but not both. Although these one-way services do not meet the definition of interconnected VoIP, carriers are likely to be providing origination or termination functions with respect to this traffic comparable to that of ''two-way'' traffic that meets the existing definition of interconnected VoIP. Moreover, intercarrier compensation disputes have encompassed all forms of what the Commission defines as VoIP-PSTN traffic, and addressing this traffic more comprehensively helps guard against new forms of arbitrage. Various commenters recommended including such traffic within the scope of the intercarrier compensation framework for VoIP or otherwise expressed support for the approach taken in the ABC Plan and Joint Letter. Based on the foregoing considerations, the Commission is persuaded to adopt that approach.

674. The Commission agrees with concerns raised by NCTA and find it appropriate to adopt a symmetrical framework for VoIP-PSTN traffic, under which providers that benefit from lower VoIP-PSTN rates when their end-user customers' traffic is terminated to other providers' end-user customers also are restricted to charging the lower VoIP-PSTN rates when other providers' traffic is terminated to their end-user customers. The Commission thus declines to adopt an asymmetric approach that would apply VoIP-specific rates for only IP-originated or only IP-terminated traffic, as some commenters propose. The Commission has recognized concerns about asymmetric payment associated with VoIP traffic today, including marketplace distortions that give one category of providers an artificial regulatory advantage in costs and revenues relative to other market participants. An approach that addressed only IP-originated traffic would perpetuate—and expand—such concerns. Commenters advocating a focus solely on IP-originated traffic implicitly recognize as much, noting that providers with IP networks could benefit relative to providers with TDM

networks under such an intercarrier compensation regime.

2. Intercarrier Compensation Charges for VoIP-PSTN Traffic

675. The Commission adopts a prospective intercarrier compensation framework that brings all VoIP-PSTN traffic within the 47 U.S.C. 251(b)(5) framework. As discussed below, the Commission has authority to bring all traffic within the 47 U.S.C. 251(b)(5) framework for purposes of intercarrier compensation, including traffic that otherwise could be encompassed by the interstate and intrastate access charge regimes, and the Commission exercises that authority now for all VoIP-PSTN traffic.

676. The Commission adopts transitional rules specifying, prospectively, the default compensation for VoIP-PSTN traffic: Default charges for ''toll'' VoIP-PSTN traffic will be equal to interstate access rates applicable to non-VoIP traffic, both in terms of the rate level and rate structure; default charges for other VoIP-PSTN traffic will be the otherwise-applicable reciprocal compensation rates; and LECs are permitted to tariff these default charges for toll VoIP-PSTN traffic in relevant federal and state tariffs in the absence of an agreement for different intercarrier compensation.

677. The intercarrier compensation framework for VoIP-PSTN traffic will apply prospectively, during the transition between existing intercarrier compensation rules and the new regulatory regime adopted in this R&O, and is subject to the reductions in intercarrier compensation rates required as part of that transition. The Commission does not address preexisting law, including whether or how the ESP exemption might have applied previously, and the Commission makes clear that, whatever its possible relevance historically, the ESP exemption is not relevant or applicable prospectively in determining the intercarrier compensation obligations for VoIP-PSTN traffic.

a. The Prospective VoIP-PSTN Intercarrier Compensation Framework Best Balances the Relevant Policy Considerations

678. The Commission believes that its prospective, intercarrier compensation regime for VoIP-PSTN traffic best balances the relevant policy considerations of providing certainty regarding the prospective intercarrier compensation obligations for VoIP-PSTN traffic while acknowledging the flaws with preexisting intercarrier compensation regimes, and providing a measured transition to the new intercarrier compensation framework. The framework for VoIP-PSTN traffic will also reduce disputes and provide greater certainty to the industry regarding intercarrier compensation revenue streams while also reflecting the Commission's move away from the pre-existing, flawed intercarrier compensation regimes that have applied to traditional telephone service.

679. Although commenters did not all agree on the treatment of VoIP-PSTN traffic, there was widespread consensus among commenters that, whatever the outcome, it was essential that the Commission address that issue now. The framework seeks to facilitate discussions among the providers exchanging VoIP-PSTN traffic, lessening the need for prescriptive Commission regulations. At the same time, the *USF/ICC Transformation NPRM* recognized the disruptive nature of some providers' unilateral actions regarding VoIP intercarrier compensation, and we seek to prevent such actions here going forward.

680. The Commission is not persuaded by the arguments of some commenters to subject VoIP traffic to the pre-existing intercarrier compensation regime that applies in the context of traditional telephone service, including full interstate and intrastate access charges. For one, many of the advocates of such an approach subsequently endorsed the ABC Plan and Joint Letter. Further, such an outcome would require the Commission to enunciate a policy rationale for expressly imposing that regime on VoIP-PSTN traffic in the face of the known flaws of existing intercarrier compensation rules and notwithstanding the recognized need to move in a different direction. Moreover, requiring payment of all existing intercarrier compensation rates applicable to traditional telephone service traffic as part of a transitional regime for VoIP-PSTN traffic would, in the aggregate, increase providers' reliance on intercarrier compensation at the same time the Commission's broader reform efforts seek to move providers away from reliance on intercarrier compensation revenues. Nor is the Commission persuaded that such an outcome is necessary to advance competitive or technological neutrality. As discussed above, the prospective regime for VoIP-PSTN intercarrier compensation is symmetrical, and thus avoids the marketplace distortions that could arise from an asymmetrical approach to compensation. In particular, the record does not demonstrate that the approach advantages in the aggregate providers relying on TDM networks relative to VoIP providers or vice versa, nor that it advantages in the aggregate certain IXCs relative to others. The transitional VoIP-PSTN intercarrier compensation regime the Commission adopts here can reduce both the intercarrier compensation revenues and long distance and wireless costs associated with VoIP-PSTN traffic. Further, to the extent that particular carriers historically have relied on access revenues to subsidize local services, the record is clear that many providers did not pay the same intercarrier compensation rates for VoIP traffic that would have applied to traditional telephone service traffic. Additionally, the transitional VoIP-PSTN intercarrier compensation framework provides the opportunity for some revenues in conjunction with other appropriate recovery opportunities adopted as part of comprehensive intercarrier compensation and universal service reform.

681. Many of these commenters also argue that comparable uses of the network should be subject to comparable intercarrier compensation charges. The Commission agrees with that policy principle, but observes that the intercarrier compensation regime applicable to traditional telephone service—which they seek to apply to VoIP-PSTN traffic—is at odds with that policy. The pre-existing intercarrier compensation regime imposes significantly different charges for the same use of the network depending upon, among other things, the jurisdiction of the traffic at issue. A more uniform intercarrier compensation framework for all uses of the network will arise from the end-point of reform adopted in this R&O. For purposes of the transition, the Commission concludes that its approach best balances the relevant policy considerations.

682. The Commission also is unpersuaded by concerns that an intercarrier compensation regime for VoIP-PSTN traffic could lead to further arbitrage or undermine the Commission-established transition adopted for intercarrier compensation reform more broadly. An underlying assumption of those arguments is that the carriers delivering traffic for termination will be able to unilaterally determine the portion of their traffic to be subject to the VoIP-PSTN regime. As discussed in greater detail below, the implementation mechanisms for the Commission's approach protect against that outcome, both through protections that can be implemented in tariffs and through the option of negotiated agreements, subject

to arbitration, regarding the portion of traffic subject to the VoIP-PSTN intercarrier compensation regime. The Commission also permits LECs to include language in their tariffs to address the identification of VoIP-PSTN traffic, much as they do to identify the jurisdiction of traffic today.

b. Legal Authority

683. *Authority To Address VoIP-PSTN Traffic Under Section 251(b)(5).* Although the Commission has not classified interconnected VoIP services or similar one-way services as ''telecommunications services'' or ''information services,'' VoIP-PSTN traffic nevertheless can be encompassed by 47 U.S.C. 251(b)(5). As discussed in greater detail above, 47 U.S.C. 251(b)(5) includes ''the transport and termination of all telecommunications exchanged with LECs'' with the exception of ''traffic encompassed by section 251(g) * * * except to the extent that the Commission acts to bring that traffic within its scope.'' The Commission previously has recognized that interconnected VoIP providers are providers of telecommunications. Moreover, the Commission has previously concluded that interconnected VoIP services involve ''transmission of [voice] by aid of wire, cable, or other like connection'' and/or ''transmission by radio,'' and went on to conclude that ''[t]he telecommunications carriers involved in originating or terminating a [VoIP] communication via the PSTN are by definition offering 'telecommunications.' '' Further, although classification questions remain regarding retail VoIP services, commenters observe that the exchange of VoIP-PSTN traffic that is relevant to the Commission's intercarrier compensation regulations typically occurs between two telecommunications carriers, one or both of which are wholesale carrier partners of retail VoIP service providers. Nor does anything in the record persuade us that a different conclusion is warranted in the context of other VoIP-PSTN traffic.

684. *Authority To Adopt Transitional Rates for VoIP-PSTN Traffic.* The legal authority that enables us to specify transitional rates for comprehensive intercarrier compensation reform also enables the Commission to adopt its transitional VoIP-PSTN intercarrier compensation framework pending the transition to bill-and-keep. For one, the Commission's pre-existing regimes for establishing reciprocal compensation rates for 47 U.S.C. 251(b)(5) traffic have been upheld as lawful, and can be applied to non-toll VoIP-PSTN traffic as provided by the transitional intercarrier compensation rules. The Commission also has authority to adopt the transitional framework for toll VoIP-PSTN traffic based on its rulemaking authority to implement 47 U.S.C. 251(b)(5). As discussed above, interpreting the Commission's rulemaking authority in this manner is consistent with court decisions recognizing that avoiding ''market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule.'' Sections 201 and 332, 47 U.S.C. 201, 332, provide additional legal authority specifically for interstate traffic and all traffic exchanged with CMRS providers.

685. *Application of Section 251(g).* Additionally, as described above, 47 U.S.C. 251(g) supports the view that the Commission has authority to adopt transitional intercarrier compensation rules, preserving the access charge regimes that pre-dated the 1996 Act ''until [they] are explicitly superseded by regulations *prescribed by the Commission.''* The Commission rejects the claims of some commenters that VoIP-PSTN traffic did not exist prior to the 1996 Act, and thus cannot be part of the access charge regimes ''grandfathered'' by 47 U.S.C. 251(g). This argument flows from a mistaken interpretation of 47 U.S.C. 251(g). The essential question under 47 U.S.C. 251(g) is not whether a particular service, or traffic involving a particular transmission protocol, existed prior to the 1996 Act. VoIP traffic existed prior to the 1996 Act, although the record here does not reveal whether LECs were exchanging IP-originated or IP-terminated VoIP traffic at that time. Because the Commission otherwise rejects the claim that intercarrier compensation for VoIP-PSTN traffic is categorically excluded from 47 U.S.C. 251(g), the Commission needs not, and does not, consider further the nature and extent of VoIP traffic that existed prior to the 1996 Act. Rather, the question is whether there was a ''pre-Act obligation relating to intercarrier compensation for'' particular traffic exchanged between a LEC and '' 'interexchange carriers and information service providers.''' 686. *Pre-1996 Act Obligations.* Regardless of whether particular VoIP services are telecommunications services or information services, there are pre-1996 Act obligations regarding LECs' compensation for the provision of exchange access to an IXC or an information service provider. Interexchange VoIP-PSTN traffic is subject to the access regime regardless of whether the underlying communication contained information-service elements. Indeed, the Commission has already found that toll telecommunications services transmitted (although not originated or terminated) in IP were subject to the access charge regime, and the same would be true to the extent that telecommunications services originated or terminated in IP. Similarly, to the extent that interexchange VoIP services are transmitted to the LEC directly from an information service provider, such traffic is subject to pre-1996 Act obligations regarding ''exchange access,'' although the access charges imposed on information service providers were different from those paid by IXCs. Specifically, under the ESP exemption, rather than paying intercarrier access charges, information service providers were permitted to purchase access to the exchange as end users, either by purchasing special access services or ''pay[ing] local business rates and interstate subscriber line charges for their switched access connections to local exchange company central offices.'' But although the nature of the charge is different from the access charges paid by IXCs, the Commission has always recognized that information-service providers providing interexchange services were obtaining exchange access from the LECs. Accordingly, because they were subject to these exchange access charges, interexchange information service traffic was subject to the over-arching Commission rules governing exchange access prior to the 1996 Act, and therefore subject to the grandfathering provision of 47 U.S.C. 251(g).

687. The DC Circuit's *WorldCom* decision, cited by some commenters, does not compel a different result. In *WorldCom,* the court considered whether dial-up, ISP-bound traffic was covered by 47 U.S.C. 251(g)'s grandfathering provision. Consistent with the language of 47 U.S.C. 251(g), the court focused on whether there was a ''pre-Act obligation relating to intercarrier compensation for ISP-bound traffic'' and found it ''uncontested—and the Commission declared in the Initial Order''—that there was not. Although the court also stated that ''[t]he best the Commission can do'' in indentifying a pre-1996 Act obligation ''is to point to pre-existing LEC obligations to provide interstate access for ISPs,'' the discussion in the initial *ISP-Bound Traffic Order* cited by the court emphasized the uncertainty at that time regarding the regulatory classification of the functions provided by the carrier

serving the ISP—*i.e.,* whether it was providing local service, interexchange service, or exchange access. As the DC Circuit ultimately observed, the fact that the carrier serving the ISP was acting as a LEC—rather than an interexchange carrier or information service provider—would be dispositive that compensation for that traffic exchange could not be encompassed by 47 U.S.C. 251(g). Here, by contrast, there is no evidence that the exchange of toll VoIP-PSTN traffic inherently involves the exchange of traffic between two LECs. Moreover, the Commission notes that to the extent VoIP-PSTN traffic is not ''toll'' traffic, it is subject to the preexisting reciprocal compensation regime under 47 U.S.C. 251(b)(5) rather than the transitional framework for toll VoIP-PSTN traffic that the Commission adopts in this R&O.

c. Implementation

688. *Role of Tariffs.* During the transition, the Commission permits LECs to tariff reciprocal compensation charges for toll VoIP-PSTN traffic equal to the level of interstate access rates. CMRS providers currently are subject to detariffing, and nothing in the intercarrier compensation framework for VoIP-PSTN traffic disrupts that regulatory approach. Under the permissive tariffing regime, providers likewise are free not to file federal and/or state tariffs for VoIP-PSTN traffic, and instead seek compensation solely through interconnection agreements (or, if they wish, to forgo such compensation). Although the Commission is addressing intercarrier compensation for all VoIP-PSTN traffic under the 47 U.S.C. 251(b)(5) framework, the Commission is doing so as part of an overall transition from current intercarrier compensation regimes—which rely extensively on tariffing specifically with respect to access charges—and a new framework more amenable to negotiated intercarrier compensation arrangements. The Commission therefore permits LECs to file tariffs that provide that, in the absence of an interconnection agreement, toll VoIP-PSTN traffic will be subject to charges not more than originating and terminating interstate access rates. This prospective regime thus facilitates the benefits that can arise from negotiated arrangements without sacrificing the revenue predictability traditionally associated with tariffing regimes. For interstate toll VoIP-PSTN traffic, the relevant language will be included in a tariff filed with the Commission, and for intrastate toll VoIP-PSTN traffic, the rates may be included in a state tariff. In this regard, the Commission notes that the terms of an applicable tariff would govern the process for disputing charges.

689. Contrary to some proposals, however, the Commission does not require the use of particular call detail information to dispositively distinguish toll VoIP-PSTN traffic from other VoIP-PSTN traffic, given the recognized limitations of such information. For example, the Commission has recognized that telephone numbers do not always reflect the actual geographic end points of a call. Further, although the phantom traffic rules are designed to ensure the transmission of accurate information that can help enable proper billing of intercarrier compensation, standing alone, those rules do not ensure the transmission of sufficient information to determine the jurisdiction of calls in all instances. Rather, consistent with the tariffing regime for access charges discussed above, carriers today supplement call detail information as appropriate with the use of jurisdictional factors or the like when the jurisdiction of traffic cannot otherwise be determined. The Commission finds this approach appropriate here, as well.

690. The Commission does, however, clarify the approach to identifying VoIP-PSTN traffic for purposes of complying with this transitional intercarrier compensation regime. Although intercarrier compensation rates for VoIP-PSTN traffic during the transition will differ from other rates for only a limited time, the Commission recognizes commenters' concerns regarding the mechanism to distinguish VoIP-PSTN traffic, and thus sought specific comment on that issue. In response, a number of commenters argued that the industry should be permitted to ''work cooperatively'' to address this issue, recognizing that ''[o]ver the years, carriers have developed reasonable methods for distinguishing between calls for billing purposes * * * and can be expected to do so here.'' The Commission agrees that, ''to help manage the transition'' LECs should be permitted to incorporate specific tariff provisions in their intrastate tariffs that ''could, for example, require carriers delivering traffic for termination to identify the percentage of traffic that is'' subject to the transitional VoIP-PSTN intercarrier compensation regime ''and to support those figures with traffic studies or other reasonable analyses that are subject to audit.'' Just as such a tariffing framework already is used to address jurisdiction of traffic, such an approach is a reasonable tool (in addition to information the terminating LEC has about VoIP customers it is serving) to identify the relevant traffic subject to the VoIP-PSTN intercarrier compensation regime. In addition, one commenter noted the potential to rely on interconnected VoIP subscriber and wireline line count data from Form 477 to develop a safe harbor. Thus, as an alternative, the Commission permits the LEC instead to specify in its intrastate tariff that the default percentage of traffic subject to the VoIP-PSTN framework is equal to the percentage of VoIP subscribers in the state based on the Local Competition Report, as released periodically, unless rebutted by the other carrier. In particular, under this approach, the default percentage of VoIP-PSTN traffic in a state would be the total number of incumbent LEC and non-incumbent LEC VoIP subscriptions in a state divided by the sum of those reported VoIP subscriptions plus incumbent LEC and non-incumbent LEC switched access lines. Further, although the Commission does not mandate other approaches as part of its tariffing regime, individual providers remain free to rely on signaling or call detail information, or other measures, to the extent that they enter alternative compensation arrangements through interconnection agreements. In particular, contrary to some suggestions, the Commission does not require filing of certifications with the Commission regarding carriers' reported VoIP-PSTN traffic. Such certifications would be required from not only IXCs but also originating and terminating providers nationwide, even though these issues may be of little or no practical concern in states with intrastate access rates that already are at or near interstate rates. Given the likely significant overbreadth in the burden that would impose, the Commission declines to adopt such a requirement.

691. Although the Commission will allow tariffs during the transition to bill-and-keep, the Commission reaffirms its decision in the *T-Mobile Order* that good-faith negotiations generally are preferable to tariffing as a means of implementing carriers' compensation obligations. Under the circumstances here, the Commission does not believe that the policies underlying the prohibition of wireless termination tariffs for non-access traffic in the *T-Mobile Order* requires us to prohibit use of tariffs for toll VoIP-PSTN traffic during the transition. Although the Commission likewise is moving to facilitate negotiated arrangements for intercarrier compensation more broadly, significant portions of the legacy intercarrier compensation regime have

traditionally relied on tariffs, and the Commission believes flash cutting the whole industry to a new regime would be unduly disruptive. Further, in place of tariffing, the *T-Mobile Order* required CMRS providers to negotiate interconnection agreements in good faith subject to 47 U.S.C. 252 negotiation and arbitration processes at the request of incumbent LECs—a set of requirements that the Commission has not extended more broadly. Thus, maintaining a continuing role for tariffs during the transition to a new intercarrier compensation framework is a reasonable approach. Further, CMRS providers had expressed concerns about potentially excessive rates in wireless termination tariffs. Here, rates are ultimately subject to Commission oversight, including the mandated reductions in those charges as part of comprehensive intercarrier compensation reform. The Commission thus concludes that this approach strikes the right balance here.

692. *Reliance on Interconnection Agreements and SGATs.* As discussed above, the transitional intercarrier compensation framework permits tariffing of charges for toll VoIP-PSTN traffic, but permits carriers to negotiate agreements that reflect alternative rates. In the case of incumbent LECs, they must negotiate in good faith in response to requests for agreements addressing reciprocal compensation for VoIP-PSTN traffic. In this regard, the Commission notes that reciprocal compensation charges generally have been imposed through interconnection agreements or state-approved statements of generally available terms and conditions (SGATs), which carriers may accept in lieu of negotiating individual interconnection agreements. Various commenters also describe the benefits that can arise from an interconnection and intercarrier compensation framework that allows parties to negotiate mutually agreeable outcomes, rather than all parties being categorically bound to a single regime. Likewise, the interconnection and intercarrier compensation framework adopted in sections 251 and 252 of the 1996 Act, 47 U.S.C. 251, 252, reflect a policy favoring negotiated agreements, where possible.

693. The Commission recognizes the concerns of some commenters that instances of disparate negotiating leverage can occur and that, absent an appropriate regulatory backstop, a regime purely relying on commercial negotiations could systematically disadvantage providers with limited negotiating leverage. These concerns arise in part based on the variations in size and make-up of the customers of different networks, and in part based on certain underlying legal requirements, including the general policy against blocking traffic and the lack of a statutory compulsion for certain entities to enter interconnection agreements.

694. The transitional regime for VoIP-PSTN intercarrier compensation accommodates these disparities in several ways. For one, the ability to tariff these charges ensures that LECs have the opportunity to obtain the intercarrier compensation provided for by the rules. In addition, the section 252 framework applicable to interconnection agreements provides procedural protections. For example, it provides carriers the opportunity, outside the tariffing framework, to specify a mutually agreeable approach for determining the amount of traffic that is VoIP-PSTN traffic. To this end, carriers could include an alternative approach in a state-approved SGAT or negotiate such an approach as part of an interconnection agreement. To the extent that the parties pursue a negotiated agreement but cannot agree upon the particular means of determining the amount of traffic that is VoIP-PSTN traffic, this can be subject to arbitration. Although most incumbent LECs are subject to this duty by virtue of the Act, while other carriers, such as competitive LECs, are not, the Commission notes that its rules already anticipate the possibility that two non-incumbent LECs might elect to bring a reciprocal compensation dispute before a state for arbitration under the section 252 framework. To the extent that a state fails to arbitrate a dispute regarding VoIP-PSTN intercarrier compensation, it will be subject to Commission arbitration.

695. *Scope of Charges Imposed by Retail VoIP Providers' LEC Partners.* Some commenters express concern that, absent Commission clarification, certain LECs that provide wholesale inputs to retail VoIP services might not be able to collect all the same intercarrier compensation charges as LECs relying entirely on TDM networks. In particular, providers cite disputes arising from their use of IP technology as well as the structure of the relationship between retail VoIP service providers and their wholesale carrier partners. For the reasons described above, the Commission believes a symmetric approach to VoIP-PSTN intercarrier compensation is warranted for all LECs. One of the goals of the Commission's reform is to promote investment in and deployment of IP networks. Although the Commission believes that its comprehensive reforms best advance this goal, during the transition it does not want to disadvantage providers that already have made these investments. Consequently, the Commission allows providers that have undertaken or choose to undertake such deployment the same opportunity, during the transition, to collect intercarrier compensation under its prospective VoIP-PSTN intercarrier compensation regime as those providers that have not yet undertaken that network conversion. Further, recognizing that these specific questions have given rise to disputes, the Commission believes that addressing this issue under its transitional intercarrier compensation framework will reduce uncertainty and litigation, freeing up resources for investment and innovation. The Commission therefore adopts rules clarifying LECs' ability to impose charges in such circumstances under its transitional regime, as discussed below.

696. The transitional VoIP-PSTN intercarrier compensation rules focus specifically on whether the exchange of traffic occurs in TDM format (and not in IP format), without specifying the technology used to perform the functions subject to the associated intercarrier compensation charges. The Commission thus adopts rules making clear that origination and termination charges may be imposed under its transitional intercarrier compensation framework, including when an entity ''uses Internet Protocol facilities to transmit such traffic to [or from] the called party's premises.''

697. With respect to the issue of whether particular functions are performed by the wholesale LEC or its retail VoIP partner, the Commission recognizes that under the Commission's historical approach in the access charge context, when relying on tariffs, LECs have been permitted to charge access charges to the extent that they are providing the functions at issue. In light of the policy considerations implicated here, the Commission adopts a different approach to address concerns about double billing. As discussed above, the Commission brings all access traffic within 47 U.S.C. 251(b)(5). The Commission had not previously addressed LECs' rights to tariff such charges in that context. Nonetheless, for convenience, the transitional intercarrier compensation framework builds upon rules, or rule language, from the access charge context in a number of ways, and the Commission therefore modifies aspects of that language in the manner discussed above, based on the record received on this issue.

698. The Commission believes that a symmetrical approach to VoIP-PSTN

intercarrier compensation is the best policy, and thus believe that competitive LECs should be entitled to charge the same intercarrier compensation as incumbent LECs do under comparable circumstances. Because the Commission has not broadly addressed the classification of VoIP services, however, retail VoIP providers that take the position that they are offering unregulated services therefore are not carriers that can tariff intercarrier compensation charges. Consequently, just as retail VoIP providers rely on wholesale carrier partners for, among other things, interconnection, access to numbers, and compliance with 911 obligations—a type of arrangement the Commission has endorsed in the past—so too do they rely on wholesale carrier partners to charge tariffed intercarrier compensation charges. Given these distinct circumstances, the Commission adopts rules that permit a LEC to charge the relevant intercarrier compensation for functions performed by it and/or by its retail VoIP partner, regardless of whether the functions performed or the technology used correspond precisely to those used under a traditional TDM architecture. The Commission notes that, notwithstanding its rules, to the extent that these charges are imposed via tariff, a carrier may not impose charges other than those provided for under the terms of its tariff. However, the rules include measures to protect against double billing, and the Commission also makes clear that its rules do not permit a LEC to charge for functions performed neither by itself or its retail service provider partner.

699. This approach is supported by the fact that the Commission is bringing all traffic within 47 U.S.C. 251(b)(5). Under Commission precedent in that context, to the extent that a competitive LEC's rates were set based on the incumbent LEC's reciprocal compensation charges, the Commission's rules were not as limiting regarding the scope of those reciprocal compensation charges as historically was the case in the access charge context. Indeed, in addition to tariffing, providers also remain free to negotiate compensation arrangements for this traffic through interconnection agreements, and to define the scope of charges by mutual agreement or, if relevant, arbitration.

d. Other Issues

i. Interconnection and Traffic Exchange

700. *Use of Section 251(c)(2) Interconnection Arrangements.* Although the Commission brings all VoIP-PSTN traffic within 47 U.S.C. 251(b)(5), and permit compensation for such arrangements to be addressed through interconnection agreements, the Commission recognizes that there is potential ambiguity in existing law regarding carriers' ability to use existing 47 U.S.C. 251(c)(2) interconnection facilities to exchange VoIP-PSTN traffic, including toll traffic. Consequently, the Commission makes clear that a carrier that otherwise has a 47 U.S.C. 251(c)(2) interconnection arrangement with an incumbent LEC is free to deliver toll VoIP-PSTN traffic through that arrangement, as well, consistent with the provisions of its interconnection agreement. The Commission previously held that 47 U.S.C. 251(c)(2) interconnection arrangements may not be used solely for the transmission of interexchange traffic because such arrangements are for the exchange of ''telephone exchange service'' or ''exchange access'' traffic—and interexchange traffic is neither. However, as long as an interconnecting carrier is using the 47 U.S.C. 251(c)(2) interconnection arrangement to exchange some telephone exchange service and/or exchange access traffic, 47 U.S.C. 251(c)(2) does not preclude that carrier from relying on that same functionality to exchange other traffic with the incumbent LEC, as well. This interpretation of 47 U.S.C. 251(c)(2) is consistent with the Commission's prior holding that carriers that otherwise have 47 U.S.C. 251(c)(2) interconnection arrangements are free to use them to deliver information services traffic, as well. Likewise, it is consistent with the Commission's interpretation of the unbundling obligations of 47 U.S.C. 251(c)(3), where it held that, as long as a carrier is using an unbundled network element (UNE) for the provision of a telecommunications service for which UNEs are available, it may use that UNE to provide other services, as well. With respect to the broader use of 47 U.S.C. 251(c)(2) interconnection arrangements, however, it will be necessary for the interconnection agreement to specifically address such usage to, for example, address the associated compensation.

701. *No Blocking.* In addition to the protections discussed above to prevent unilateral actions disruptive to the transitional VoIP-PSTN intercarrier compensation regime, the Commission also finds that carriers' blocking of VoIP calls is a violation of the Communications Act and, therefore, is prohibited just as with the blocking of other traffic. As such, it is appropriate to discuss the Commission's general policy against the blocking of such traffic. As the Commission has long recognized, permitting blocking or the refusal to deliver voice telephone traffic, whether as a means of ''self-help'' to address perceived unreasonable intercarrier compensation charges or otherwise, risks ''degradation of the country's telecommunications network.'' Consequently, ''the Commission, except in rare circumstances[,] * * * does not allow carriers to engage in call blocking'' and ''previously has found that call blocking is an unjust and unreasonable practice under section 201(b) of the Act.'' Although the Commission generally has not classified VoIP services, as discussed above, the exchange of VoIP-PSTN traffic implicating intercarrier compensation rules typically involves two carriers. As a result, those carriers are directly bound by the Commission's general prohibition on call blocking with respect to VoIP-PSTN traffic, as with other traffic.

702. The Commission recognizes, however, that blocking also could be performed by interconnected VoIP providers, or by providers of ''one-way'' VoIP service that allows customers to receive calls from, or place calls to the PSTN, but not both. Just as call blocking concerns regarding interexchange carriers and wireless providers arose in an effort to avoid high access charges, VoIP providers likewise could have incentives to avoid such rates, which they would pay either directly or through the rates they pay for wholesale long distance service. If interconnected VoIP services or one-way VoIP services are telecommunications services, they already are subject to restrictions on blocking under the Act. If such services are information services, the Commission exercises its ancillary authority and prohibits blocking of voice traffic to or from the PSTN by those providers just as the Commission does for carriers. For example, an interexchange carrier that is a wholesale partner of such a VoIP provider could evade the directly-applicable restrictions on blocking under 47 U.S.C. 201 of the Act by having the blocking performed by the VoIP provider instead. An IXC generally would be prohibited from refusing to deliver calls to telephone numbers associated with high intercarrier compensation charges. If that IXC's VoIP provider wholesale customer were free to block calls to such numbers, the IXC thus could evade the directly-applicable restrictions on blocking (and the VoIP provider would benefit from lower wholesale long distance costs to the extent that, for

example, its agreement provided for a pass-through of the intercarrier compensation charges paid by the IXC). In addition, blocking or degrading of a call from a traditional telephone customer to a customer of a VoIP provider, or vice-versa, would deny the traditional telephone customer the intended benefits of telecommunications interconnection under 47 U.S.C. 251(a)(1).

ii. Other Pending Matters

703. The conclusions in this R&O effectively address, in whole or in part, certain pending petitions. For one, Global NAPS filed a petition for declaratory ruling regarding the manner and extent to which VoIP traffic could be subject to access charges generally, and intrastate access charges in particular. AT&T also filed a petition requesting that, on a transitional basis, the Commission declare that interstate and intrastate access charges may be imposed on VoIP traffic in certain circumstances, as well as limited waivers that would enable it to offset forgone revenues from voluntary reductions in intrastate terminating access charges. In addition, Vaya Telecom (Vaya) filed a petition seeking a declaration that ''a LEC's attempt to collect intrastate access charges on LEC-to-LEC VoIP traffic exchanges is an unlawful practice.'' Because the transitional intercarrier compensation framework for VoIP-PSTN declines to apply all existing intercarrier compensation regimes as they currently exist, Global NAPS's and Vaya's petitions are granted in part and AT&T's is denied in part. To the extent that AT&T proposes a specific approach for alternative rate reforms and revenue recovery, the Commission finds the mechanisms adopted in this R&O to be more appropriate for the reasons discussed above, and thus deny its requests in that regard. Further, Grande filed a petition seeking a Commission declaration that carriers categorically may rely on a customer's certification that traffic originated in IP and therefore is enhanced and not subject to access charges. To the extent that this would deviate from the regime the Commission adopts, the petition is denied. The Commission declines to address the classification of VoIP services generally at this time, nor does the Commission otherwise elect to grant the other requests for declaratory rulings raised by the Global NAPS, Vaya, AT&T, and Grande petitions.

XII. Intercarrier Compensation for Wireless Traffic

A. LEC–CMRS Non-Access Traffic

704. Given the adoption of a uniform, federal framework for comprehensive intercarrier compensation reform, the Commission believes it is now appropriate to clarify the system of intercarrier compensation applicable to non-access traffic exchanged between LECs and CMRS providers. As outlined above, two compensation regimes currently apply to non-access LEC–CMRS traffic, and the Commission has not clarified the intersection between the two. The Commission concludes, based on the record, that it is appropriate for the Commission to clarify the relationship between the obligations in 47 CFR 20.11 and 47 U.S.C. 251(b)(5).

705. To bring the 47 CFR 20.11 and 47 U.S.C. 251 obligations in line, the Commission first harmonizes the scope of the compensation obligations in § 20.11, 47 CFR 20.11 and those in part 51, 47 CFR part 51. The Commission accordingly concludes that 47 CFR 20.11 applies only to LEC–CMRS traffic that, since the *Local Competition First Report and Order,* has been subject to the reciprocal compensation framework under 47 U.S.C. 251(b)(5) of the Act. Thus, 47 CFR 20.11 does not apply to access traffic that, prior to this R&O, was subject to 47 U.S.C. 251(g). Furthermore, the Commission clarifies that the terms ''mutual compensation'' in § 20.11 and ''reciprocal compensation'' in 47 U.S.C. 251(b)(5) and Part 51 are synonymous when applied to non-access LEC–CMRS traffic.

706. Next, the Commission finds that it is in the public interest to establish a default federal pricing methodology for determining reasonable compensation under 47 CFR 20.11. Commenters urge the Commission to address the current absence of guidance on compensation rates for traffic between competitive LECs and CMRS providers and to address the growing problem of traffic stimulation. They argue that the decision in the *North County Order* to defer setting of reasonable compensation under 47 CFR 20.11 for intrastate traffic to the states without providing any guidance has led to CLECs seeking terminating compensation rates far above cost and to a dramatic increase in litigation as CLECs seek to establish or enforce termination rates in state administrative and judicial forums. They recommend that the Commission resolve this problem by establishing a default federal termination rate for CLEC–CMRS traffic of $0.0007 or by adopting a bill-and-keep methodology.

707. Currently, reciprocal compensation under the part 51 rules, 47 CFR part 51, is subject to a federal pricing methodology. Reciprocal compensation under 47 CFR 20.11, however, is not currently subject to a federal pricing methodology. As the Commission recently explained in the *North County Order,* it has instead traditionally regarded state commissions as the ''more appropriate forum for determining the reasonable compensation rate [under § 20.11] for * * * termination of intrastate, intraMTA traffic,'' and have to date declined to provide guidance to the states on how to carry out that responsibility. The Commission has long made clear, however, that it ''would not hesitate to preempt any rates set by the states that would undermine the federal policy that encourages CMRS providers and LECs to interconnect.'' And the Commission observed in the *North County Order* that the various ''policy arguments'' in favor of a greater federal role in implementing 47 CFR 20.11 were ''better suited to a more general rulemaking proceeding,'' citing this proceeding in particular.

708. The Commission now concludes, based on the record in this proceeding, that the Commission should establish a federal methodology for implementing 47 CFR 20.11's reasonable compensation mechanism. Although the Commission believed in the *North County Order* that the interconnection process under 47 CFR 20.11 would likely not be ''procedurally onerous,'' the record shows that the absence of a federal methodology has been a growing source of confusion and litigation. MetroPCS, for example, states that it is embroiled in disputes over traffic stimulation schemes in a number of jurisdictions and notes other proceedings in New York and Michigan. The California commission, the state commission implicated by the *North County Order,* also ''recommends that the FCC provide guidance on what factors should be considered in setting a 'reasonable rate' for such arrangements.'' Adoption of a federal pricing methodology promotes the policy goals of avoiding wasteful arbitrage opportunities caused by disparate intercarrier compensation rates and modernizing and unifying the intercarrier compensation system to promote efficiency and network investment. It is also necessary to effectuate the decision to harmonize 47 CFR 20.11 with 47 U.S.C. 251(b)(5), which, as noted, has long been governed by a federal pricing methodology.

709. The Commission has already concluded above that a bill-and-keep methodology for intercarrier compensation, including reciprocal compensation, best serves the policy goals and requirements of the Act. Consistent with that determination and the clarification above that compensation obligations under § 20.11 are coextensive with reciprocal compensation requirements, the Commission concludes that bill-and-keep should also be the default pricing methodology between LECs and CMRS providers under § 20.11 of the rules, 47 CFR 20.11. By default, the Commission means that bill-and-keep will satisfy terminating compensation obligations except where carriers mutually agree to the contrary. Thus, the Commission concludes that bill-and-keep should be the default applicable to LEC–CMRS reciprocal compensation arrangements under both 47 CFR 20.11 or part 51, 47 CFR part 51. The Commission rejects claims that a default rate set via a bill-and-keep methodology under any circumstances would be inadequate because it would be less than the actual cost of terminating calls that originate with a CMRS provider. As the Commission explains above, a bill-and-keep regime requires each carrier to recover its costs from its own end-users.

710. The Commission further concludes that, under either 47 CFR 20.11 or the Part 51 rules, 47 CFR part 51, for traffic to or from a CMRS provider subject to reciprocal compensation under either 47 CFR 20.11 or the Part 51 rules, 47 CFR part 51, the bill-and-keep default should apply immediately. Although the Commission has adopted a glide path to a bill-and-keep methodology for access charges generally and for reciprocal compensation between two wireline carriers, it finds that a different approach is warranted for non-access traffic between LECs and CMRS providers for several reasons. First, the Commission finds a greater need for immediate application of a bill-and-keep methodology in this context to address traffic stimulation. The record demonstrates there is a significant and growing problem of traffic stimulation and regulatory arbitrage in LEC–CMRS non-access traffic. In contrast, the Commission finds little evidence of such problems with regard to traffic between two LECs, where traffic stimulation appears to be occurring largely within the access regime, rather than for traffic currently subject to reciprocal compensation payments. This likely reflects in part the fact that the applicable ''local calling area'' for CMRS providers within which calls are subject to reciprocal compensation is much larger than it is for LECs. Thus, what would be access stimulation if between a LEC and an IXC will in many cases arise under reciprocal compensation when a CMRS provider is involved. For similar reasons, CMRS providers are more likely to be exposed to traffic stimulation that is not subject to the measures the Commission adopts above to address this problem within the access traffic regime. Further, although the record reflects that LEC–CMRS intraMTA traffic stimulation is growing most rapidly in traffic terminated by competitive LECs, the Commission is concerned that absent any measures to address traffic stimulation for intraMTA LEC–CMRS traffic, incumbent LECs that sought revenues from access stimulation may quickly adapt their stimulation efforts to wireless reciprocal compensation. For these reasons, the Commission finds that addressing the traffic stimulation problem in reciprocal compensation is more urgent for LEC–CMRS traffic, and the bill-and-keep default methodology the Commission adopts should eliminate the opportunity for parties to engage in such practices in connection with such traffic.

711. Although, as discussed above, the Commission finds that adopting a gradual glide path to a bill-and-keep methodology for intercarrier compensation generally, including reciprocal compensation between LECs, will help avoid market disruption to service providers and consumers, the Commission concludes that an immediate transition for reciprocal compensation traffic exchanged between LECs and CMRS providers presents a far smaller risk of market disruption than would an immediate shift to a bill-and-keep methodology for intercarrier compensation more generally. First, for reciprocal compensation between CMRS providers and competitive LECs, the Commission has until recently had no pricing methodology applicable to competitive LEC–CMRS traffic, as reflected in the fact that the carriers in the recent *North County Order* had specifically asked the Commission to establish one for the first time. Competitive LECs thus had no basis for reliance on such a methodology in their business models, and the Commission sees no reason why, in setting a methodology for the first time, it should not require competitive LECs to meet that methodology immediately, particularly given that competitive LECs are not subject to retail rate regulation in the manner of incumbents, and therefore have flexibility to adapt their businesses more quickly.

712. Even for incumbent LECs, the Commission is confident the impact is not significant, particularly when balanced against the overall benefits of providing the clarification. For one, incumbent LECs and CMRS providers that fail to pursue an interconnection agreement do not receive any compensation for intraMTA traffic today. For incumbent LECs that do have agreements for compensation for intraMTA traffic, most large incumbent LECs have already adopted $0.0007 or less as their reciprocal compensation rate. For rate-of-return carriers, there is no allegation in the record that reforming LEC–CMRS reciprocal compensation obligations in this manner would have a harmful impact on them. And, in any event, the Commission has adopted mechanisms that should address any such impacts. First, the Commission adopts a new recovery mechanism, which includes recovery for net reciprocal compensation revenues, to provide all incumbent LECs with a stable, predictable recovery for reduced intercarrier compensation revenues. Second, the Commission adopts an additional measure to further ease the move to bill-and-keep LEC–CMRS traffic for rate-of-return carriers. Specifically, the Commission limits rate-of-return carriers' responsibility for the costs of transport involving non-access traffic exchanged between CMRS providers and rural, rate-of-return regulated LECs.

713. Some commenters proposed a rule allocating the responsibility for transport costs for non-access traffic to the non-rural terminating provider, stating that in the absence of such a rule, rural LECs could be forced to incur unrecoverable transport costs at a time when ICC reforms may already have a negative impact on network cost recovery. The Commission recognizes that immediately moving to a default bill-and-keep methodology for intraMTA traffic raises issues regarding the default point at which financial responsibility for the exchange of traffic shifts from the originating carrier to the terminating carrier. Therefore, in the attached *USF/ICC Transformation FNPRM,* the Commission seeks comment on whether and how to address this aspect of bill-and-keep arrangements. The Commission finds it appropriate, however, to establish an interim default rule allocating responsibility for transport costs applicable to non-access traffic exchanged between CMRS providers and rural, rate-of-return regulated LECs to provide a gradual transition for such

carriers. Given the Commission's commitment to providing a measured transition, the Commission believes it is appropriate to help ensure no flash cuts for rate-of-return carriers. The Commission notes that price cap carriers did not raise concerns about transport costs, and the Commission concludes that no particular transition is required or warranted for traffic exchanged between CMRS providers and these carriers.

714. Specifically, for such traffic, the rural, rate-of-return LEC will be responsible for transport to the CMRS provider's chosen interconnection point when it is located within the LEC's service area. When the CMRS provider's chosen interconnection point is located outside the LEC's service area, the Commission provides that the LEC's transport and provisioning obligation stops at its meet point and the CMRS provider is responsible for the remaining transport to its interconnection point. Although the Commission does not prejudge its consideration of what allocation rule should ultimately apply to the exchange of all telecommunications traffic, including traffic that is considered access traffic today, under a bill-and-keep methodology, the Commission believes that this rule is warranted for the interim period to help minimize disputes and provide greater certainty until rules are adopted to complete the transition to a bill-and-keep methodology for all intercarrier compensation.

715. Beyond adopting these measures, the Commission also emphasizes that, although it establishes bill-and-keep as an immediately applicable default methodology, the Commission is not abrogating existing commercial contracts or interconnection agreements or otherwise allowing for a ''fresh look'' in light of the reforms. Thus, incumbent LECs may have an extended period of time under existing compensation arrangements before needing to renegotiate subject to the new default bill-and-keep methodology. As a result, while the Commission is concerned that an immediate transition from reciprocal compensation to a bill-and-keep methodology more generally would risk overburdening the universal service fund that underlies the interim recovery mechanism, the Commission thinks that the impact on the fund resulting from an immediate transition for LEC–CMRS reciprocal compensation alone will not do so. Adoption of bill-and-keep for this subset of traffic will also inform the Commission's understanding of the potential impact that the larger transition to bill-and-keep will have and, although the Commission does not envision any concerns arising based on the reforms adopted in this R&O, would enable the Commission, if necessary, to make any adjustments as part of that larger transition. For the reasons discussed, the Commission finds that an immediate transition away from reciprocal compensation to a bill-and-keep methodology in this context is practical.

716. As the Commission found above, the Commission believes that 47 U.S.C. 251 and 252 affirmatively provide us authority to establish bill-and-keep as the default methodology applicable to traffic within the scope of 47 U.S.C. 251(b)(5), including for traffic exchanged between LECs and CMRS providers. Further, as the Commission has concluded above that it has authority under 47 U.S.C. 332 to regulate intrastate access traffic exchanged between LECs and CMRS providers and thus authority to specify a transition to bill-and-keep for such traffic, the Commission concludes for similar reasons that it has the authority to regulate intrastate reciprocal compensation between LECs and CMRS providers. Indeed, in *Iowa Utilities Board,* the Eighth Circuit specifically upheld Commission rules regulating LEC–CMRS reciprocal compensation based on these provisions.

717. In the *North County Order,* the Commission found that any decision to reverse course and regulate intrastate rates under 47 CFR 20.11 at the federal level was more appropriately addressed in a general rulemaking proceeding. Now that the Commission is considering the issue in the context of this rulemaking proceeding, it finds it appropriate to take this step for the reasons discussed above, and the Commission concludes that its decision to establish a federal default pricing methodology for termination of LEC–CMRS intraMTA traffic as part of its broader effort in this proceeding to reform, modernize, and unify the intercarrier compensation system is consistent with its authority under the Act.

B. IntraMTA Rule

718. In the *Local Competition First Report and Order,* the Commission stated that calls between a LEC and a CMRS provider that originate and terminate within the same Major Trading Area (MTA) at the time that the call is initiated are subject to reciprocal compensation obligations under 47 U.S.C. 251(b)(5), rather than interstate or intrastate access charges. As noted above, this rule, referred to as the ''intraMTA rule,'' also governs the scope of traffic between LECs and CMRS providers that is subject to compensation under 47 CFR 20.11(b). The *USF/ICC Transformation NPRM* sought comment, *inter alia,* on the proper interpretation of this rule.

719. The record presents several issues regarding the scope and interpretation of the intraMTA rule. Because the changes the Commission adopts in this R&O maintain, during the transition, distinctions in the compensation available under the reciprocal compensation regime and compensation owed under the access regime, parties must continue to rely on the intraMTA rule to define the scope of LEC–CMRS traffic that falls under the reciprocal compensation regime. The Commission therefore takes this opportunity to remove any ambiguity regarding the interpretation of the intraMTA rule.

720. The Commission first addresses a dispute regarding the interpretation of the intraMTA rule. Halo Wireless (Halo) asserts that it offers ''Common Carrier wireless exchange services to ESP and enterprise customers'' in which the customer ''connects wirelessly to Halo base stations in each MTA.'' It further asserts that its ''high volume'' service is CMRS because ''the customer connects to Halo's base station using wireless equipment which is capable of operation while in motion.'' Halo argues that, for purposes of applying the intraMTA rule, ''[t]he origination point for Halo traffic is the base station to which Halo's customers connect wirelessly.'' On the other hand, ERTA claims that Halo's traffic is not from its own retail customers but is instead from a number of other LECs, CLECs, and CMRS providers. NTCA further submitted an analysis of call records for calls received by some of its member rural LECs from Halo indicating that most of the calls either did not originate on a CMRS line or were not intraMTA, and that even if CMRS might be used ''in the middle,'' this does not affect the categorization of the call for intercarrier compensation purposes. These parties thus assert that by characterizing access traffic as intraMTA reciprocal compensation traffic, Halo is failing to pay the requisite compensation to terminating rural LECs for a very large amount of traffic. Responding to this dispute, CTIA asserts that ''it is unclear whether the intraMTA rules would even apply in that case.''

721. The Commission clarifies 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. Where a provider is

merely providing a transiting service, it is well established that a transiting carrier is not considered the originating carrier for purposes of the reciprocal compensation rules. Thus, the Commission agrees with NECA that the ''re-origination'' of a call over a wireless link in the middle of the call path does not convert a wireline-originated call into a CMRS-originated call for purposes of reciprocal compensation and the Commission disagrees with Halo's contrary position.

722. The Commission also clarifies that the intraMTA rule means that all traffic exchanged between a LEC and a CMRS provider that originates and terminates within the same MTA, as determined at the time the call is initiated, is subject to reciprocal compensation regardless of whether or not the call is, prior to termination, routed to a point located outside that MTA or outside the local calling area of the LEC. Similarly, intraMTA traffic is subject to reciprocal compensation regardless of whether the two end carriers are directly connected or exchange traffic indirectly via a transit carrier.

723. Further, in response to the *USF/ICC Transformation NPRM,* T-Mobile proposed that the Commission expand the scope of the intraMTA rule to reflect the fact that CMRS licenses are now issued for REAGs, geographic areas that are larger than MTAs. T-Mobile notes that the intraMTA rule was promulgated at a time the MTA was the largest CMRS license area. T-Mobile argues that the REAG is currently the largest license being used to provide CMRS and that this change would move more telecommunications traffic under the reciprocal compensation umbrella pending the unification of all intercarrier compensation rates. The Commission declines to adopt T-Mobile's proposal. Given the long experience of the industry dealing with the current rule, the very broad scope of the changes to the intercarrier compensation rules being made in this R&O that will, after the transition period, make the rule irrelevant, and the limited support in the record for the suggested change even from CMRS commenters, the Commission does not believe it is either necessary or appropriate to expand the scope of this rule as proposed by T-Mobile.

XIII. Interconnection

724. The Commission anticipates that the reforms it adopts herein will further promote the deployment and use of IP networks. However, IP interconnection between providers also is critical. As such, the Commission agrees with commenters that, as the industry transitions to all IP networks, carriers should begin planning for the transition to IP-to-IP interconnection, and that such a transition will likely be appropriate before the completion of the intercarrier compensation phase down. The Commission seeks comment in the accompanying *USF/ICC Transformation FNPRM* regarding specific elements of the policy framework for IP-to-IP interconnection. The Commission makes clear, however, that its decision to address certain issues related to IP-to-IP interconnection in the *USF/ICC Transformation FNPRM* should not be misinterpreted to suggest any deviation from the Commission's longstanding view regarding the essential importance of interconnection of voice networks.

725. In particular, even while the *USF/ICC Transformation FNPRM* is pending, the Commission expects all carriers to negotiate in good faith in response to requests for IP-to-IP interconnection for the exchange of voice traffic. The duty to negotiate in good faith has been a longstanding element of interconnection requirements under the Communications Act and does not depend upon the network technology underlying the interconnection, whether TDM, IP, or otherwise. Moreover, the Commission expects such good faith negotiations to result in interconnection arrangements between IP networks for the purpose of exchanging voice traffic. As the Commission evaluates specific elements of the appropriate interconnection policy framework for voice IP-to-IP interconnection in the *USF/ICC Transformation FNPRM,* it will be monitoring marketplace developments, which will inform the Commission's actions in response to the *USF/ICC Transformation FNPRM.*

XIV. Procedural Matters

A. Paperwork Reduction Act Analysis

726. The Report and Order contains new information collection requirements subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104–13. The new requirements will be submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the PRA. OMB, the general public, and other Federal agencies are invited to comment on the new information collection requirements contained in this proceeding. We note that pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107–198, *see* 44 U.S.C. 3506(c)(4), we previously sought specific comment on how the Commission might ''further reduce the information collection burden for small business concerns with fewer than 25 employees.'' We describe impacts that might affect small businesses, which includes most businesses with fewer than 25 employees, in the Final Regulatory Flexibility Analysis, infra.

B. Congressional Review Act

727. On Friday December 2, 2011, the Commission sent a copy of this Report and Order to Congress and the Government Accountability Office pursuant to the Congressional Review Act, *see* 5 U.S.C. 801(a)(1)(A).

C. Final Regulatory Flexibility Analysis

[[See 76 FR 73829, 73834 (page where the FRFA starts)]]

Federal Communications Commission

Marlene H. Dortch,

Secretary.

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