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Universal Service Fund Reforms—Connect America Fund (CAF)

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Connect America Fund (CAF): The CAF is the new umbrella program that will govern the disbursement of federal universal service funding aimed at increasing access to voice and broadband services in rural and remote areas. The CAF replaces the current High Cost program. It will (a) provide support to areas that are not served by an unsubsidized competitor, (b) require funding recipients to build broadband-capable networks, and (c) eliminate the rule that funds competitive providers at the same per-line rate that the ILEC in an area receives (the "identical support" rule). Total CAF funding will be capped at $4.5 billion annually. Of this, $500 million will be dedicated to the new Mobility Fund (discussed below). The remaining $4 billion will fund wireline voice and broadband services. The overall $4.5 billion cap is intended to be permanent (although of course the FCC may modify it in the future). Individual carriers may petition for relief from the cap.

The first phase of CAF implementation involves freezing current support at 2011 funding levels, and phasing in a requirement that funding recipients offer broadband services. During this phase, current recipients will have an annual option to accept additional funds (referred to as "incremental" funding) in exchange for additional broadband build-out obligations.

All broadband build-out obligations will apply to areas in which no "unsubsidized competitor" offers service, called "unserved areas." The FCC has defined "unsubsidized competitors" as being limited to providers of fixed, terrestrial broadband services that meet minimum speed, usage and latency requirements. Fixed wireless service may qualify if the provider guarantees that it will meet these minimum requirements, but the FCC does not expect to revisit its focus on wireline-based broadband services to determine if an area is unserved for "the next few years."

The precise definition of an "area," and the assessment of whether it is "unserved," depends on the specific entity receiving the funding. As explained in our previous advisory, there are three types of CAF funds: funds for the territories of price cap ILECs, funds for the territories of rate-of-return ILECs, and funds for mobile carriers.

The Order states that more than 83% of the roughly 18 million Americans who lack access to fixed broadband live in regions served by price cap ILECs. The FCC is dedicating $1.8 billion over five years to these regions, plus a one-time injection of $300 million, in exchange for commitments to deploy broadband services in unserved census blocks in a given state. This would be an overall increase in funding for price-cap regions, which received $1.076 billion in 2010.

Broadband deployment will phase in over five years, with certain milestones. This period is CAF "Phase 1" for price cap areas. By the end of the third year, the price-cap ILEC must offer broadband speed of at least 4 Mbps downstream / 1 Mbps upstream, with latency suitable for services such as VoIP, to 85% of the areas for which the ILEC now receives high-cost funding. By the end of the fifth year, the price-cap ILEC must offer 4 Mbps / 1 Mbps broadband service to all supported locations, with higher speeds to certain selected locations. For purposes of Phase I funding, an unserved area is an area lacking broadband with speeds of at least 768 kbps, determined with reference to the National Broadband Map and the carrier's "best knowledge." Areas for which the ILEC had received funding under the Recovery Act, or which had already been included in the ILEC's capital improvement plans, are not unserved areas.

Phase II of the CAF begins at the beginning of the sixth year. In Phase II, the ILEC will have an effective right-of-first refusal to receive subsidies to provide broadband (at the required speeds and other specifications) in all census blocks in the state where no unsubsidized competitor provides broadband of at least 4 Mbps downstream / 1 Mbps, with latency low enough to support VoIP service. If the ILEC does not accept the deployment obligations for these areas, those census blocks will be subject to a competitive bidding mechanism, and the support available for them will be calculated using a forward-looking cost model.
The FCC defended providing price cap ILECs with funding for five years, and then a right-of-first refusal, as follows: (1) ILECs have a long history of serving those areas; (2) ILECs already have the required regulatory approvals (i.e., eligible telecommunications carrier (ETC) designation), which not all competitive providers have; (3) this is a "one-time opportunity" for ILECs; and (4) a perceived absence in the record of "a more competitively neutral way of achieving . . . [the objective of deploying broadband networks] quickly, without abandoning altogether the goal of

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obtaining large-area build-out commitments or substantially ballooning the cost of the program."

The FCC treats rate-of-return ILECs separately. Rate-of-return ILECs tend to be smaller than price cap ILECs, and serve some of the areas that are the most expensive to serve. The FCC did not adopt definite build-out benchmarks or speed requirements for these ILECs. Instead, the FCC expects these carriers to use CAF funding to provide customers with broadband service of 4 Mbps / 1 Mbps with latency suitable for services such as VoIP. The FCC will monitor their progress. CAF funding for rate-of-return ILECs is capped at $2 billion annually, which is approximately what they currently receive under the High Cost program. The Order states that the FCC will phase out existing high cost funding for rate of return ILECs for study areas where an unsubsidized competitor provides broadband of at least 4 Mbps downstream / 1 Mbps upstream, with latency suitable for services such as VoIP, to 100% of the residential and business locations. The Further Notice seeks comment on how to determine whether there is any such overlap with unsubsidized competitors.

The FCC also changes some of the current rules to reduce or restrict the specific ways in which rate-of-return ILECs qualify for funding for specific supported costs. Overall, the FCC has taken a very incremental approach to restructuring support provided to rate-of-return carriers.

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