



## FCC REFORM PROPOSALS FOR UNIVERSAL SERVICE FUND CONTRIBUTION REQUIREMENTS THREATEN INTERNATIONAL UNDERSEA CABLE OPERATORS

The FCC recently released a Further Notice of Proposed Rulemaking (“FNPRM”) seeking comment on various proposals to reform contribution requirements for the federal Universal Service Fund (“USF”). Comments are due by July 9, 2012, and reply comments are due by August 6, 2012.

The FNPRM has the potential to alter significantly the USF contribution obligations for operators whose undersea cables connect the United States or its territories (including American Samoa, Guam, Puerto Rico, and the U.S. Virgin Islands) to non-U.S. points. The FCC proposes to eliminate the “international-only” exemption (which exempts providers from contributing if they provide service only between the United States and foreign points) and to eliminate or substantially modify the limited international revenues exemption (which exempts providers from contributing on their international end-user revenues if their projected domestic interstate end-user revenues and those of their affiliates total in aggregate less than 12 percent of total domestic interstate plus international end-user revenues). *If the FCC eliminated these exemptions, international undersea cable operators would be required to pay an eye-watering 15.7 percent (or more, as the rate fluctuates quarterly) of total end-user revenues for services originating and/or terminating in the United States. Use of an offshore subsidiary to sell capacity would not protect an undersea cable operator from these requirements if the services originated or terminated in the United States. Consequently, operators that previously paid little or nothing would face potentially large assessments, with little prospect of recovering such charges from customers.*

### The Universal Service Fund and International Services

The USF seeks to promote the availability of quality services at just, reasonable, and affordable rates for all U.S. consumers and increase nationwide access to advanced telecommunications services. The USF subsidizes services through a variety of programs targeted at high-cost areas, low-income consumers, schools and libraries, and rural health care systems.

Section 254(d) of the Communications Act of 1934, as amended (“Section 254(d)”) requires that “every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service.” The FCC later expanded these provisions to include other providers of interstate telecommunications, even if they were not “telecommunications carriers,” *i.e.*, common carriers. All interstate common carriers, as well as those interstate providers whose contributions are projected to exceed the FCC’s *de minimis* threshold, are required to report their revenues annually to the FCC on FCC Form 499-A and to report revenues and pay USF contributions quarterly according to a fluctuating contribution factor (which has risen as high as 17.9 percent).

Over the past fifteen years, the FCC has undertaken numerous efforts to reform both how the USF is funded and how and for what purposes it should distribute its funds.

**“International-Only” Exemption:** At present, providers of exclusively international services (*i.e.*, those between the United States and foreign points) are categorically exempt from contributing to the USF. (Foreign-to-foreign revenues have never been assessable.) The FCC had previously concluded that such providers did not qualify as “interstate carriers” or other interstate providers within the meaning of Section 254(d). Consequently, operators of *non-common-carrier* undersea cables systems with exclusively international end-user revenues neither file Form 499-A nor report revenues or pay USF contributions quarterly. Operators of *common-carrier* undersea cables systems with exclusively international end-user revenues file Form 499-A but do not report revenues or pay USF contributions quarterly (as the FCC requires all common carriers to register with the Universal Service Administrative Company by filing Form 499-A).

**Limited International Revenues Exemption (“LIRE”):** At present, providers of predominantly international services between the United States and foreign points are exempt, under the LIRE, from contributing to the USF if their projected domestic interstate end-user revenues and those of their affiliates total in aggregate less than 12 percent of total domestic interstate plus international end-user revenues. The FCC developed the LIRE after the U.S. Court of Appeals for the Fifth Circuit’s 1999 decision in *Texas Office of Public Utility Counsel v. FCC* (“*TOPUC v. FCC*”). The court found that the FCC’s earlier rule, which included all interstate plus international end-user revenues within the assessable base, failed to satisfy the “equitable and non-discriminatory” requirements of Section 254(d). The court seemed particularly persuaded by the fact that the USF contribution could exceed a provider’s total domestic interstate end-user revenues, making it uneconomic to offer domestic interstate services to end users. The FCC subsequently set the threshold for the LIRE at 12 percent to match the contribution factor at the time, though the LIRE threshold has remained static while the contribution factor has since increased.

### **Proposed Changes in the Scope of Contributors**

In considering changes to the scope of who should contribute and how contributions should be assessed, the FCC has now proposed in the FNPRM to eliminate the “international-only” exemption and to eliminate or substantially modify the LIRE exemption. The FCC seems particularly troubled by what it sees as the competitive distortions caused by prepaid calling card providers offering exclusively or predominantly international services (thereby qualifying for the “international-only” exemption or the LIRE) in competition with interstate providers whose international end-user revenues are not exempt and therefore subject to USF assessments. The FCC is also enamored with the concept of increasing contributions through assessments on as-yet unassessed prepaid calling card international revenues.

To justify its proposals, the FCC offers an alternative interpretation of Section 254(d)—that the statute only intended to distinguish federal from state jurisdiction—and notes that the Fifth

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Circuit in *TOPUC v. FCC* did not address the FCC's jurisdiction over international-service revenues. The FCC also suggests that changes in the telecommunications industry and marketplace render the "international-only" exemption and the LIRE obsolete. Nowhere does the FCC make any mention of international undersea cables or their operators, though the changes would have a significant impact on such providers.

***The Unheeded Parallel with International Bearer Circuit Fees.*** Ironically, the FCC also fails to see parallels between its proposals and the now-discredited and discarded methodology it used for assessing capacity-based annual regulatory fees (the "International Bearer Circuit Fees") on undersea cable operators until the industry finally prevailed on the FCC to change its rules and methodology starting in 2009. In that reform proceeding, the FCC found that capacity-based fees created severe economic harms, strategic behavior, and infighting between undersea cable operators and their customers. Operators pointed also out to the FCC that they had a limited ability to recover their costs or pass through charges, as most undersea cable capacity is contracted on a long-term basis (without provisions for a pass-through) and much of it is sold to customers located outside the United States, who take the position that such "domestic" assessments cannot be passed through to them.

**Other Issues**

***Scope of Contributors and Services.*** The lengthy FNPRM addresses a host of proposals to change the scope of USF contributors and assessable services. With respect to specific services, the FCC asks whether it should require the USF contributions from providers of: enterprise communications services that include a provision of telecommunications; text messaging services; one-way VoIP service; and broadband Internet access service. Alternatively, the FCC asks whether it should adopt a broader definitional approach to services subject to contribution obligations. Specifically, the FCC proposes to treat as assessable any interstate information service or interstate telecommunications if the provider also provides the transmission (wired or wireless), directly or indirectly through an affiliate, to end users.

***Contribution Methodology:*** The FCC also asks about how contributions to the Fund should be calculated, whether based on revenues, connections, telephone numbers, or a hybrid system. It is not at all clear how a connections-based approach would apply to international undersea cable operators, where the originating or terminating "connection" takes place outside the United States. Presumably under a telephone numbers-based approach, international undersea cable operators would, as a practical matter, be excluded.

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For more information regarding the FCC's FNPRM or Wiltshire & Grannis's undersea cables practice, or for assistance in preparing comments to be filed in this proceeding, please contact Kent Bressie at +1 202 730 1337 or [kbressie@wiltshiregrannis.com](mailto:kbressie@wiltshiregrannis.com).

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