



The New Reality:

How the FCC's Regulations Will
Fundamentally Change Your Business

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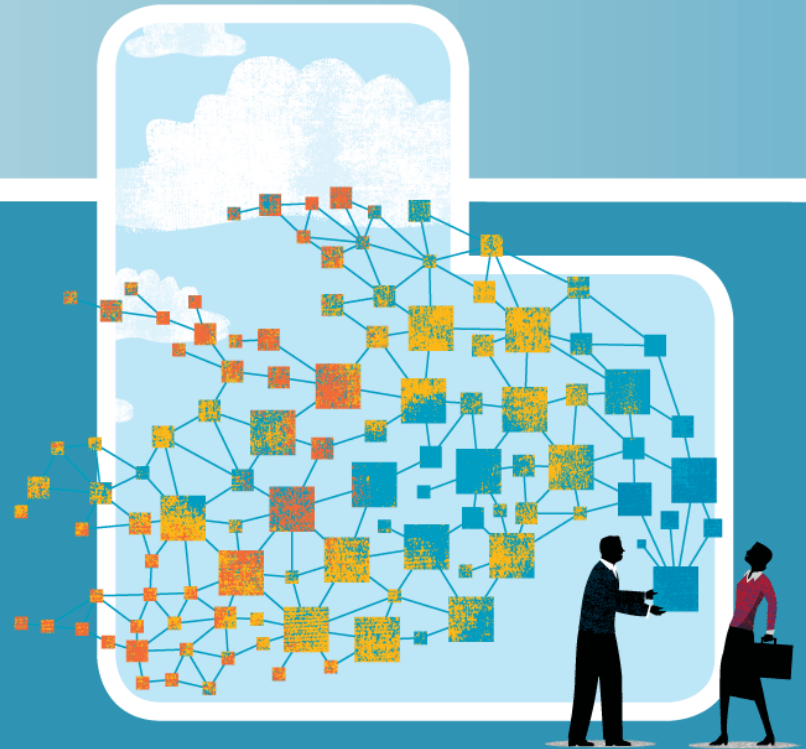
WHY ARE THE ICC/USF RULES CONSIDERED OUTDATED?

- Part 69 – Access Charges was added to the CFR in February of 1983
 - 29 Years Ago
- The foundation for today's USF was laid in 1984
 - 28 Years Ago

WHAT WAS GOING ON IN 1983 & 1984?

- Ronald Reagan was president
- Camcorders & compact discs were introduced
- U.S. invades Grenada
- HIV/AIDS is discovered
- Cost of a gallon of gas - \$1.20
- Average price of a new car - \$11,375
- 1st Megabit chip is produced at Bell Labs
- 1st infomercials on TV due to de-regulation by the FCC
- Apple Computer releases the Macintosh personal computer
- 1st cell phone introduced by Motorola
- Internet still not available for commercial use...No DSL

CAF & ICC REFORM ORDER



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CAF & ICC REFORM ORDER

- Connect America Fund (CAF) and Intercarrier Compensation (ICC) Reform Order and FNPRM
 - Approved October 27, 2011
 - Released November 18, 2011
 - Order primarily addresses long term ICC and interim USF reform
 - Proposed effective dates beginning in 2012
 - FNPRM primarily addresses long term USF reform

CAF & ICC REFORM ORDER

- Identifies 5 Goals
 - Preserve & enhance universal availability of voice
 - Universal availability of networks capable of providing voice and broadband
 - Universal availability of networks capable of providing mobile voice and broadband
 - Ensure that rates for voice and broadband are reasonably comparable across the U.S.
 - Minimize USF burden on consumers

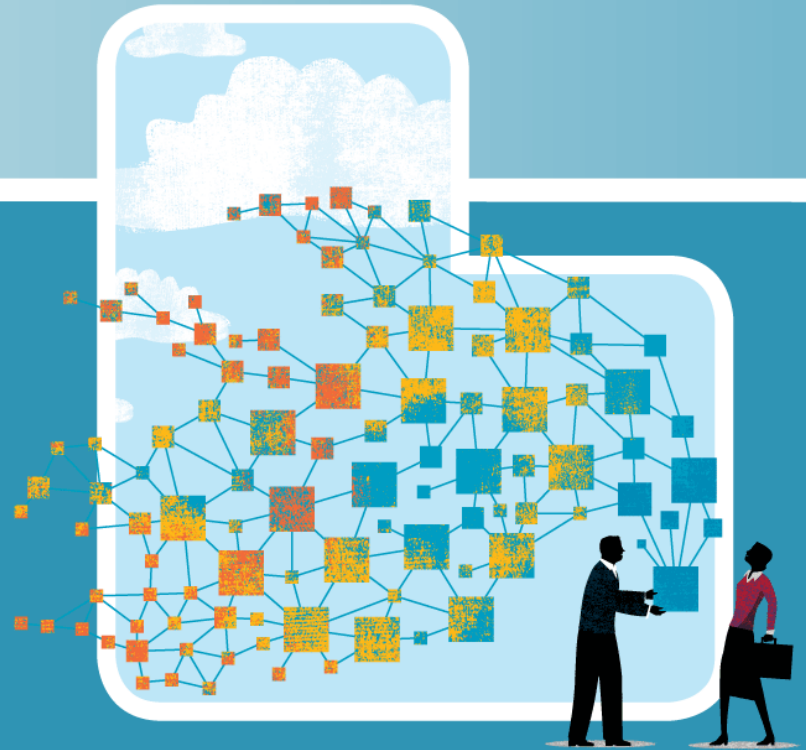
CAF & ICC REFORM ORDER

- Guided by 4 Principles
 - Modernize USF & ICC for Broadband
 - Fiscal Responsibility – control the size of the fund
 - Accountability – for recipients and government administrators
 - Incentive Based Policies

CAF & ICC REFORM ORDER

- Budget
 - Up to \$4.5B each year
 - \$1.8B for Price Cap carriers
 - \$500M Mobility Fund
 - \$100M Remote Areas Fund
 - \$2.0B for Rate of Return carriers
 - Includes HCLS, ICLS, SNA, SVS, and ICC CAF
 - Funding in a given year could be more or less
 - Contribution will not exceed \$4.5B + expenses

USF REFORM



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USF REFORM

- Voice Service Requirements
 - Similar requirement as today, with one exception:
 - Voice must be offered as a standalone service
- Broadband Service Requirements
 - Rates reasonably comparable to urban rates
 - 4 Mbps download/1 Mbps upload
 - Latency sufficiently low to enable real time applications
 - Generally less than 100 milliseconds

USF REFORM

- Rate of Return Carriers
 - Limitations on capital and operating expenses
 - Implemented no later than 7/1/2012
 - Additional comment as part of FNPRM
 - Regression analysis using publicly available cost, geographic and demographic data
 - Comparison of costs to similarly situated companies
 - Annual publication of capped costs that will be used in place of actual costs that exceed the cap
 - Focused initially on HCLS, but FNPRM directs similar benchmarks for ICLS

USF REFORM

- Rate of Return Carriers
 - Extends Corporate Operations Expense limitation to ICLS
 - Effective 1/1/2012
 - Minor updates to the formula
 - Loops \leq 6,000 Loops – monthly per loop expense = greater of
 - » $\$42.337 - (.00328 * \text{working loops})$
 - » $\$63,000/\text{working loops}$
 - $6,000 \geq$ Loops \leq 17,887 – monthly per loop expense =
 - » $\$3.007 + (117,990/\text{working loops})$
 - Loops \geq 17,887 – monthly per loop expense =
 - » $\$9.56$
 - Adjusted by change in GDP-CPI, beginning 1/1/2013

USF REFORM

- Rate of Return Carriers
 - Reduces HCLS for carriers with artificially low voice rates
 - 3 step phase in beginning 7/1/2012
 - 7/1/2012 – 6/30/2013 = \$10.00
 - 7/1/2013 – 6/30/2014 = \$14.00
 - Thereafter, determined by WCB annual survey of voice rates
 - » 2008 national average = \$15.62
 - Includes state SLC, state USF fees and mandatory EAS
 - Dollar for dollar reduction in HCLS
 - Requires annual submission of rates and fees to USAC

USF REFORM

- Rate of Return Carriers
 - Safety Net Additive grandfathered or phased out
 - Effective 1/1/2012
 - Eligibility a result of 14% increase in TPIS
 - Support grandfathered for the remainder of eligibility period
 - No new support for costs incurred after 2009
 - Eligibility as a result of loss of access lines
 - Support phased out over 2 years
 - » 50% of calculated support in 2012
 - » Support eliminated in 2013

USF REFORM

- Rate of Return Carriers
 - Eliminate LSS as a separate support mechanism
 - Effective 7/1/2012
 - Ongoing recovery through ICC recovery mechanism
 - 5% annual reduction
 - Support frozen at 2011 support levels for 1/1/2012 – 6/30/2012
 - Subject to true up based on actual 2011 operating costs

USF REFORM

- Rate of Return Carriers
 - Adjusted HCLS Cap
 - Effective 1/1/2012
 - Elimination of HCLS for Price Cap carriers requires that the overall size of the fund be reduced
 - Includes Rate of Return study areas affiliated with Price Cap carriers
 - NECA required to submit revised cap within 30 days

USF REFORM

- Rate of Return Carriers
 - Cap per line support at \$250 a month
 - Effective 7/1/2012
 - Applies to both ETCs and CETCs
 - Applies to all High Cost Support, excluding CAF ICC support
 - 3 year phase in of cap
 - 7/1/2012 – 6/30/2013 = \$250/line + 2/3 of difference
 - 7/1/2013 – 6/30/2014 = \$250/line + 1/3 of difference
 - 7/1/2014 = No more than \$250/line
 - Carriers may file a petition for waiver or adjustment

USF REFORM

- Rate of Return Carriers
 - Unsubsidized Competition
 - Effective 7/1/2012
 - Eliminates support where unsubsidized competitor(s) offer voice and broadband to 100% of the study area
 - Incumbent support phased out over 3 years
 - Support frozen at the lesser of 2010 support or \$3,000/line
 - Support reduced by 33% each year
 - FNPRM seeks comment on process for determining support in study areas with less than 100% overlap

USF REFORM

- Waivers
 - Waiver process to seek relief from some or all USF reforms
 - FCC does not expect to grant waivers routinely
 - Subject to a total company earnings review
 - Carrier must demonstrate that reduction in existing support would put voice service at risk
 - No mention of broadband at risk
 - Consideration given if reform would cause a provider to default on existing loans or become insolvent

USF REFORM

- Accountability and Oversight
 - ETCs to provide annual reports and certifications by April 1st of each year, starting in 2012
 - Underlying support for annual ETC certification (10/1)
 - Extends current federal reporting requirements to all ETCs
 - Reporting Requirements
 - Speed and Latency – annual performance results (2013)
 - Capacity – certify comparable to urban areas (2013)
 - Build-out/Service – new 5-year build-out plan by 4/1/2013, updated annually

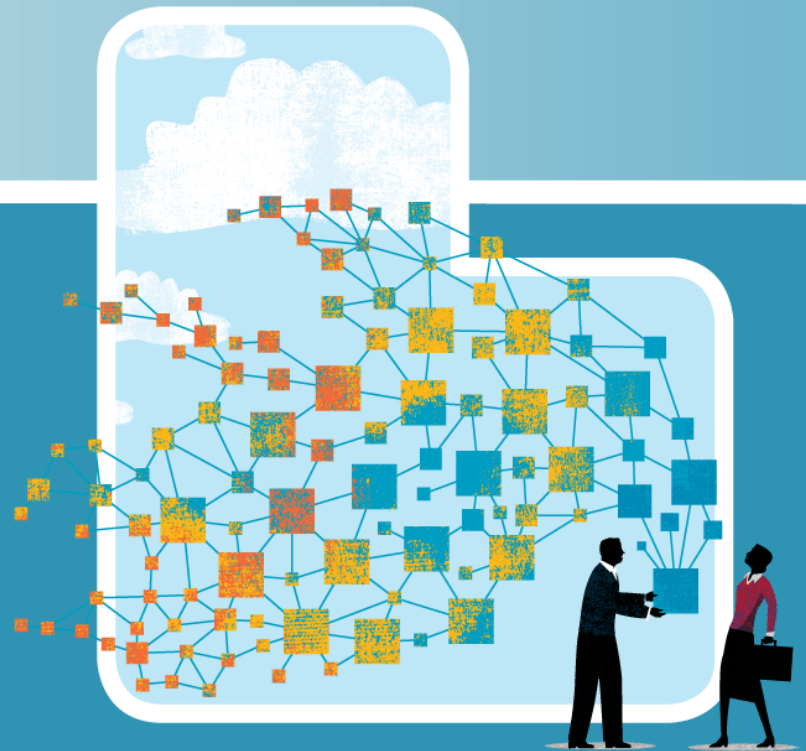
USF REFORM

- Accountability and Oversight
 - Reporting Requirements
 - Rate of return carriers must self-certify that they are taking reasonable steps to offer broadband at requirements
 - Pricing
 - All ETCs must self certify that their voice service is priced no more than 2 standard deviations above the national average
 - Annually submit pricing information for voice and broadband

USF REFORM

- Accountability and Oversight
 - Reporting Requirements
 - Annual Financial Reporting
 - Privately held, rate of return carriers must submit audited financial statements annually
 - » RUS borrowers may submit RUS financial report
 - Financial disclosures to be made publicly available
 - Annual Ownership Information
 - Holding company, operating companies, affiliates, and DBAs
 - Report USF identifiers for each study area code

ICC REFORM



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ICC REFORM

- Underlying Principles
 - Phase out of per minute ICC charges
 - Migrate to bill and keep
 - Promote the transition to IP networks
 - Provide a more predictable path for the industry and investors
 - Eliminate hidden subsidies in current system

ICC REFORM

- Rate of Return Carriers
 - Transition terminating switched access to bill and keep
 - Cap all interstate switched access rates
 - Effective 12/29/11
 - Originating and terminating
 - » End Office Access Service
 - » Tandem Switched Transport Access Service
 - » Dedicated Transport Access
 - » Other interstate switched access rate elements
 - Carrier Common Line, as applicable
 - Information Surcharge

ICC REFORM

- Rate of Return Carriers
 - Transition terminating switched access to bill and keep
 - Cap intrastate switched access rates
 - Effective 12/29/11
 - Terminating only
 - » End Office Access Service
 - » Tandem Switched Transport Access Service
 - Includes reciprocal compensation
 - No adjustment required/allowed if intrastate is already lower than interstate

ICC REFORM

- Rate of Return Carriers
 - Transition terminating switched access and reciprocal compensation to bill and keep
 - Step 1 (July 1, 2012) – 50% transition to interstate
 - May maintain intrastate switched access rate structure; or
 - Apply interstate rate structure for intrastate rates
 - » Immediately migrate to interstate rates
 - » Apply a transitional rate equal to 50% of the difference
 - Step 2 (July 1, 2013) – 100% transition to interstate

ICC REFORM

- Rate of Return Carriers
 - Transition terminating switched access and reciprocal compensation to bill and keep
 - Step 3 (July 1, 2014) – 1/3 of difference between interstate and \$0.005
 - Step 4 (July 1, 2015) – 2/3 of difference between interstate and \$0.005
 - Step 5 (July 1, 2016) – \$0.005

ICC REFORM

- Rate of Return Carriers
 - Transition terminating switched access and reciprocal compensation to bill and keep
 - Step 6 (July 1, 2017) – 1/3 of difference between \$0.005 and \$0.0007
 - Step 7 (July 1, 2018) – 2/3 of difference between \$0.005 and \$0.0007
 - Step 8 (July 1, 2019) – terminating switched end office access rates @ \$0.0007
 - Step 9 (July 1, 2020) – bill and keep
 - Tariff filings to remove charges for Terminating End Office Access Charges

ICC REFORM

- Rate of Return Carriers
 - Other Issues
 - Reforms do not automatically replace existing contracts or interconnection agreements
 - Left to “change of law”, renegotiation and termination clauses in agreements
 - Originating Access left to FNPRM, beyond cap
 - Transport (originating and terminating) left to FNPRM, beyond cap
 - Other rate elements left to FNPRM, beyond cap

ICC REFORM

- Rate of Return Carriers
 - Eligible Recovery
 - Rate of Return Baseline
 - 2011 Interstate Switched Access Revenue Requirement*
 - + 2011 Intrastate Switched Access Revenues
 - + 2011 Net Reciprocal Compensation Revenues
 - 5% annual reduction
 - Recovered from 3 sources
 - Intercarrier Compensation Revenues
 - Access Recovery Charge (ARC)
 - Connect America Fund (CAF)

* Revenue requirement submitted to NECA for 2011 tariff filing

ICC REFORM

- Rate of Return Carriers
 - Access Recovery Charge (ARC)
 - Residential & SLB = \$0.50/year for up to 6 years for a max of \$3.00
 - MLB = \$1.00/year for up to 6 years for a max of \$6.00
 - SLC + ARC may not exceed \$12.20
 - Local Rate + SLC + EAS + Surcharges + ARC \leq \$30.00
 - Residential, no benchmark for SLB & MLB

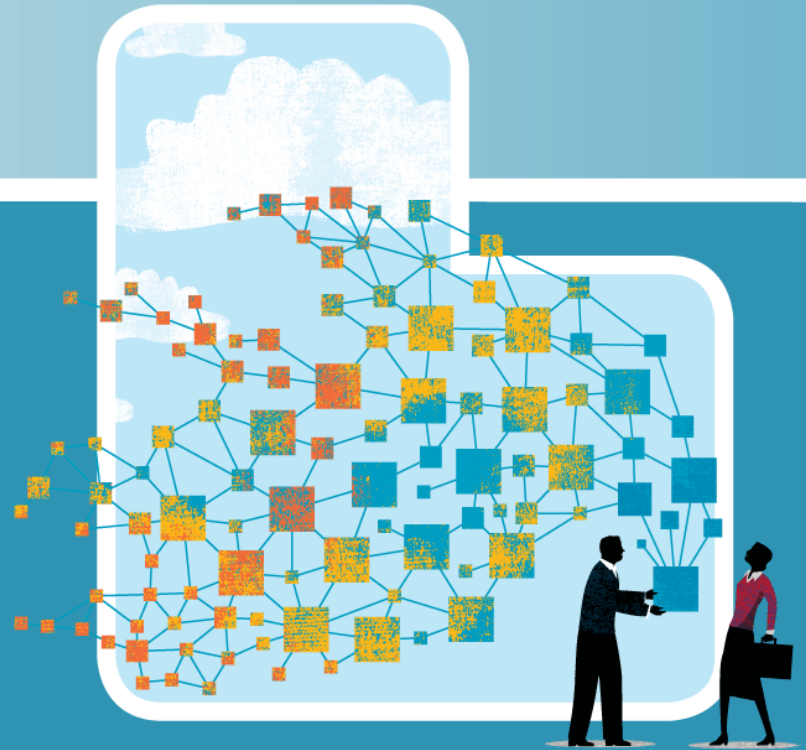
ICC REFORM

- Rate of Return Carriers
 - Connect America Fund (CAF) support
 - Eligible Recovery
 - Intercarrier Compensation Revenues
 - Access Recovery Charge Revenue
 - = CAF Support
 - Eligible Recovery is reduced by 5% each year
 - Obligation to deploy broadband upon reasonable request as a condition of ICC CAF

ICC REFORM

- Monitoring Compliance
 - Annual filing of the following data
 - ICC Rates
 - Revenues
 - Expenses
 - Demand for the preceding fiscal year
- Waiver Requirements
 - Similar to USF Reform waiver requirements
 - Total Cost and Earnings Review, including non-regulated
 - Carriers face a “heavy burden”

IMPACTS ANALYSIS



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IMPACTS ANALYSIS

- 65 Cost Company Study Areas
- 309,435 Access Lines (2012 Est.)
 - 4,761 – Average
- ≈ \$200M in 2012 USF (Est.)
- ≈ \$75M in 2012 IS SW Revenue Req. (Est.)
- ≈ \$ 35M in 2012 ST SW Revenue (Est.)
- ≈ \$900M in 2012 Rate Base (Est.)

AVERAGE TELEPHONE COMPANY - USF

USF Reform Impacts - Average (65 Companies)	Implementation Date	Annual Impact		
		2012	2013	2014
\$3,000 Total USF Cap	1/1/2012	(1,644)	(301)	(446)
"Loop" SNA Phase Down	1/1/2012	(18,128)	(31,562)	(30,921)
HCLS Corporate Cap	1/1/2012	(15,152)	(12,122)	(11,018)
ICLS Corporate Cap	1/1/2012	(45,408)	(40,768)	(39,884)
Artificially Low Local Rates	7/1/2012	(1,770)	(7,726)	(20,182)
CapX/OpX Caps HCLS	7/1/2012	-	(130,623)	(106,507)
CapX/OpX Caps ICLS	7/1/2012	(21,227)	(34,059)	(27,685)
Total USF Impacts		(103,329)	(257,160)	(236,642)

AVERAGE TELEPHONE COMPANY - USF

USF Reform Impacts/Line/Month (Average Access Lines)	Implementation Date	Annual Impact		
		2012	2013	2014
\$3,000 Total USF Cap	1/1/2012	(0.03)	(0.01)	(0.01)
"Loop" SNA Phase Down	1/1/2012	(0.32)	(0.57)	(0.57)
HCLS Corporate Cap	1/1/2012	(0.27)	(0.22)	(0.20)
ICLS Corporate Cap	1/1/2012	(0.79)	(0.73)	(0.74)
Artificially Low Local Rates	7/1/2012	(0.03)	(0.14)	(0.37)
CapX/OpX Caps HCLS	7/1/2012	-	(2.35)	(1.97)
CapX/OpX Caps ICLS	7/1/2012	(0.37)	(0.61)	(0.51)
Total USF Impacts/Line/Month		(1.81)	(4.63)	(4.38)

AVERAGE TELEPHONE COMPANY - USF

USF Reform Impacts/Line/Month (Impacted Companies)	Implementation Date	Monthly Impact		
		2012	2013	2014
"Loop" SNA Phase Down	1/1/2012	(1.76)	(3.31)	(3.60)
Companies Impacted		12	11	9
Lines Impacted		55,876	51,667	46,562
HCLS Corporate Cap	1/1/2012	(0.47)	(0.44)	(0.44)
Companies Impacted		27	22	21
Lines Impacted		173,393	150,921	136,713
ICLS Corporate Cap	1/1/2012	(1.13)	(1.14)	(1.11)
Companies Impacted		31	26	27
Lines Impacted		217,451	194,432	194,426
Artificially Low Local Rates	7/1/2012	(0.27)	(0.65)	(0.94)
Companies Impacted		9	20	27
Lines Impacted		35,768	64,340	116,560
CapX/OpX Caps HCLS	7/1/2012	-	(6.09)	(5.70)
Companies Impacted		-	23	19
Lines Impacted		-	116,092	101,155
CapX/OpX Caps ICLS	7/1/2012	(1.25)	(2.03)	(1.68)
Companies Impacted		18	18	18
Lines Impacted		92,041	90,807	89,455
Impacts/Line/Mo. (x \$3K Cap)		(4.88)	(13.66)	(13.46)

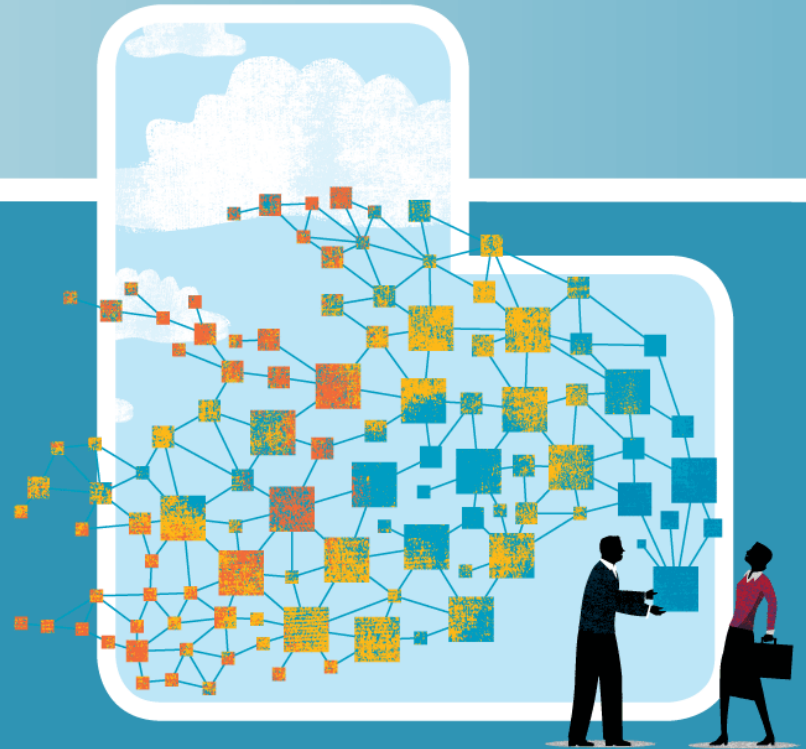
AVERAGE TELEPHONE COMPANY - ICC

ICC Reform Impacts - Average (65 Companies)	Implementation Date	Annual Impact		
		2012	2013	2014
Intrastate Terminating ICC Reductions	7/1/2012	(41,533)	(90,920)	(154,344)
Interstate Terminating ICC Reductions	7/1/2014	-	-	(15,887)
Access Recovery Charge (ARC)	7/1/2012	17,002	50,078	81,323
Connect America Fund	7/1/2012	222,966	479,887	496,532
Interstate TS Settlement Reductions	7/1/2012	(186,906)	(401,656)	(411,144)
Total ICC Impacts		11,529	37,389	(3,521)
Total USF & ICC Impacts		(91,800)	(219,771)	(240,163)

AVERAGE TELEPHONE COMPANY – INCOME & RETURN ON INVESTMENT

Average Telephone Company	Consolidated	Regulated	Adjusted Regulated	Adjusted Consolidated
Regulated Revenue	4,160,000	4,160,000	3,919,837	3,919,837
Non-Regulated Revenue	1,024,000			1,024,000
Non-Operating Revenue	302,000			302,000
Total Revenue	5,486,000	4,160,000	3,919,837	5,245,837
Regulated Expense	3,610,000	3,610,000	3,610,000	3,610,000
Non-Regulated Expense	1,155,000			1,155,000
Non-Operating Expense	257,000			257,000
Total Expense	5,022,000	3,610,000	3,610,000	5,022,000
Pretax Income	464,000	550,000	309,837	223,837
Income Tax Expense	157,760	187,000	105,344	76,104
Net Income	306,240	363,000	204,492	147,732
Rate Base	5,294,602	4,993,130	4,993,130	5,294,602
Return on Rate Base	5.78%	7.27%	4.10%	2.79%

FUNDING REFORM



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FUNDING REFORM

- \$2B Annual Budget for Rate of Return
 - Approximate size of current fund
 - High Cost Loop Support
 - Interstate Common Line Support
 - Local Switching Support
 - Safety Net Support
 - Safety Valve Support
 - Supports the universal availability of voice services

FUNDING REFORM

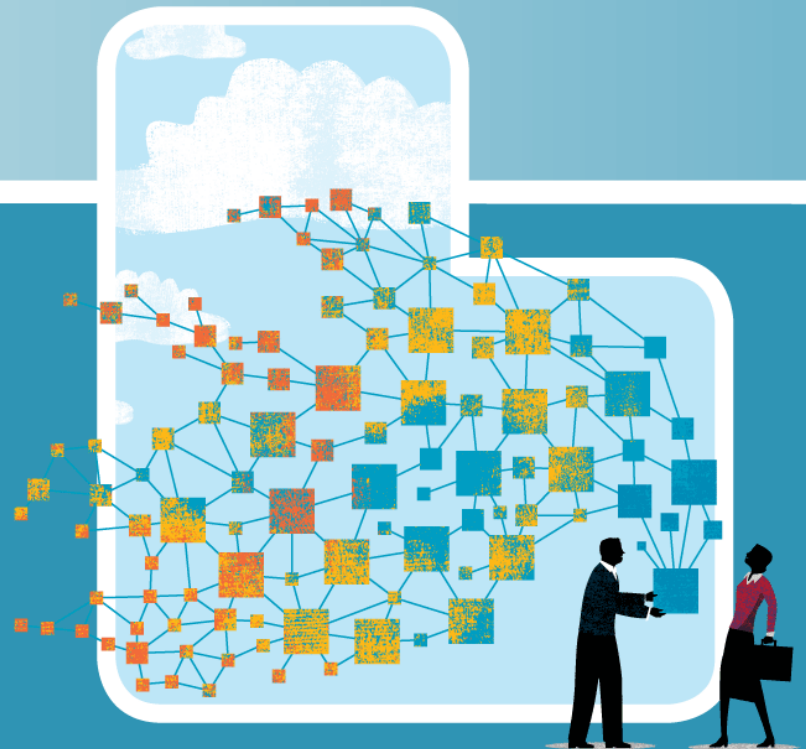
- Connect America Fund supports
 - Voice Services
 - Intercarrier Compensation Reform
 - Terminating Switched Access
 - Interstate and Intrastate
 - Originating Switched Access?
 - Broadband
 - Subscriber Loop
 - 2nd Mile and Middle Mile?

FUNDING REFORM

- How Do Additional Services Get Funded?
 - Overall cap on the size of the fund
 - Similar to current HCLS
 - Artificial cap on costs to maintain cap
 - Limitation of costs included in support
 - FCC's proposed regression analysis
 - Corporate operating expense limitations
 - Reduce support factors (65%/75% for HCLS)
 - Rate of Return prescription
 - Reduced return on investment

WHAT CAN BE DONE?

Business Opportunities &
Best Practices



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OPPORTUNITIES & BEST PRACTICES

- 4 Principles to Consider
 - Planning is more critical than ever
 - Generally not a strong suit in the industry
 - Cost Efficiency
 - Get used to looking for ways to cut costs
 - Need to get creative & competitive
 - Again, not typically a strong suit
 - Become a strong broadband provider
 - Best connection
 - Well delivered

PLANNING FOR THE NEW FUTURE

- Strategic Management Planning
 - Develop a few core strategies
 - Keep it simple
 - Plans must be in alignment
 - Strategic plan
 - Departmental plans
 - Annual budget
 - Measure your results
 - Financial metrics and benchmarking
 - Scorecard of department and employee performance
 - Without structure you will not have a good result

COST EFFICIENCY: NETWORK

- Future proof/efficient network
 - Cuts down on future CapEx
- Fiber capacity, switching agreements, facility leases, etc.
 - Avoids large one-time costs
- Collapse multiple networks
 - Reduces maintenance and operating costs.
- Mergers, combinations & joint operations
 - Economies of scale to be gained (# of switches, etc)?

COST EFFICIENCY: CAPEX

- Critical/targeted capital budgeting
 - Drive customers or services
 - Avoid spending to maintain rate base
- Business case for non-regulated activities
 - May pursue break-even services for competitive reasons
- Implement a Project Management Process
 - Reduce cost increases and project “creep”
- Tighten inventory controls
 - Avoids waste and tying up cash

COST EFFICIENCY: OPEX

- Challenge your current and future head-count
 - Attrition without replacement
 - Targeted reductions
 - Robust performance management process
- Evaluate productivity & efficiency
 - Less customers/revenues = less cost in business?
 - Review processes and systems – automate & eliminate redundancies
- Outsourcing
 - Analyze full time employees vs. contract labor

COST EFFICIENCY: OPEX

- Restructure benefit packages – remove excess
 - Cease new entrants to pension & retiree medical plans.
 - Adjust benefit programs to be in line with market
- Consolidation/elimination of subsidiaries
- Cost sharing - merge or partner with others
 - Share costs -call/data centers, back office, executives, etc.
- Rate renegotiations with vendors & contractors

CREATIVE/COMPETITIVE: FOCUS ON SALES, MARKETING & SERVICES

- Make sales & revenue replacement a priority
 - Someone's core focus – measure & hold accountable
 - Use commission structure to reward behavior
 - Focused data mining and prospect "pipeline"
 - Retention & win back strategy
- Need a dynamic & creative bundling process
 - Constantly reassess and reengineer bundles and packages
 - Listen to the market

CREATIVE/COMPETITIVE: FOCUS ON SALES, MARKETING & SERVICES

- Look for creative new sales channels
 - Examples
 - CSR's
 - I&R Technicians
 - Service Center Technicians
 - Home builders
 - Look for opportunities to diversify revenues
 - Study financial and technical viability of services
 - Not all services will make sense
 - Beware the trap of “we have to do it or we will lose out”
 - Must fit strategically and financially
 - Focus on utilization of your broadband network/loops

CREATIVE/COMPETITIVE: SALES, MARKETING & SERVICES

- Sales funnel & innovation roadmap
 - IPTV/Cable
 - Customer/competition driven
 - Drives broadband requirements
 - Local content can be a differentiator
 - Capital, marketing and content intensive
 - New revenue stream, but appears to be a breakeven at best
 - Over the top video
 - Evolving market
 - Partner with equipment providers
 - Drives broadband usage
 - Where are the incremental revenues?

CREATIVE/COMPETITIVE: FOCUS ON SALES, MARKETING & SERVICES

- Sales funnel & innovation roadmap
 - Alarm/monitoring services
 - Utilizes the local loop
 - New investment driven by customers
 - Existing & outsourced staff
 - Smart home services
 - Evolving market
 - Drives broadband usage
 - Equipment sales and installation

CREATIVE/COMPETITIVE: FOCUS ON SALES, MARKETING & SERVICES

- Sales funnel & innovation roadmap
 - Wireless Opportunities
 - 4G/LTE partnership opportunities
 - Partner with the competition to keep them out
 - Alternate voice/broadband network
 - Edge out opportunity
 - Tower Space & Fiber Builds
 - Make wireless carriers a preferred customer
 - Significant revenue streams today
 - Wireless ISP
 - Alternate voice/broadband network
 - Potentially a lower cost alternative to physical loops
 - Edge out opportunity

CREATIVE/COMPETITIVE: FOCUS ON SALES, MARKETING & SERVICES

- Sales funnel & innovation roadmap
 - Outsourcing existing resources
 - Outsourced CIO & tech support
 - Data center
 - Customer service
 - Finance & accounting
 - Construction crew & equipment
 - Warehouse & cable yard (storage)
 - Etc.