

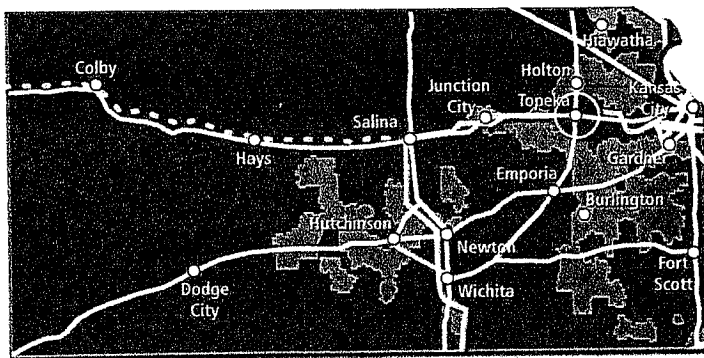
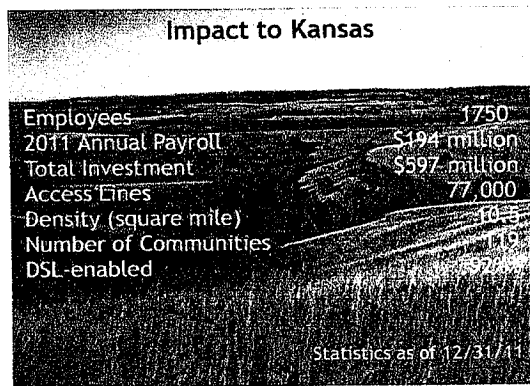
**Comments on the Kansas Rural Broadband Impacts Resulting From the  
FCC's Universal Service & Inter-carrier Compensation Reform Order**

**Testimony by CenturyLink  
John Idoux, Kansas Governmental Affairs  
Before the Kansas Legislature Special Committee on Rural Broadband  
November 14, 2012**

Thank you Chairwomen Schwartz, Vice-Chairman Emler, and members of the Special Committee on Rural Broadband. My name is John Idoux with CenturyLink's Governmental Affairs team and I appreciate this opportunity to provide CenturyLink's comments concerning the FCC's recent order on universal service and inter-carrier compensation reforms and how it has the potential to impact the provision of broadband services in rural Kansas.

**CenturyLink Introduction**

CenturyLink has provided communications services in Kansas for over 110 years and today is the third largest telecommunications company in the United States providing broadband, voice, wireless and managed services to consumers and businesses across the country. CenturyLink serves over 77,000 rural Kansans in 119 communities including Junction City, Fort Riley, Gardner, and 111 communities with less than 1000 residents. CenturyLink has deployed high speed Internet facilities to all 119 Kansas communities and today nearly 92% of CenturyLink's customers have access to broadband services. CenturyLink serves as the carrier of last resort for these 119 communities and for this obligation CenturyLink receives both federal and state universal service support to assist in providing basic voice service.



CenturyLink also provides wholesale transport services and has more than 750 route miles of fiber optics throughout Kansas. In addition, the company provides data, voice and managed services to enterprise, government and wholesale customers in local, national and select international markets through its high-quality advanced fiber optic network and multiple data centers. CenturyLink is recognized as a leader in the network services market by key technology industry analyst firms, and is a global leader in cloud infrastructure and hosted IT solutions for enterprises through Savvis, a CenturyLink company.

***Key Components of the FCC's Transformation Order***

CenturyLink is the leading rural provider of telecom services in the United States and supports the goals of Universal Service and long term investment strategies for good consumer outcomes. Everything you know about funding Universal Service obligations has been turned inside-out with the FCC's Transformational Order. However, the concept of Universal Service is far from out-dated and will play a critical role in enabling good consumer outcomes for rural America as we transition from a voice to a broadband communications platform. The FCC issued its Transformation Order in October, 2011 and the reforms fall into two key components: intercarrier compensation (ICC) and universal service fund (USF). A summary of each component is provided below.

***Intercarrier Compensation Reform:*** Intercarrier compensation – or ICC – refers to the access charges and other fees carriers pay other carriers for the use of the network. Access rates are assessed by local exchanges carriers to long distance providers for toll calls and the FCC's ICC reform order eliminates certain access charges over 7 years for AT&T and CenturyLink (over 9 years for rural carriers). Specifically, carriers have two years to reduce intrastate access rates to mirror federal rates in two equal steps and then the rates transition to zero in years 3-7. Reciprocal compensation refers to the rates carriers pay each other for the termination of local traffic such as when a wireless customer places a call to a business, home or other landline phone. Under the FCC's Order, reciprocal compensation was eliminated for wireless traffic effective July 1. The ICC reforms ordered by the FCC removed billions of dollars from the compensation system nationally and hundreds of millions of dollars specific to Kansas. Certain carriers – such as wireless providers and long distance providers – received a substantial cost reduction where as other carriers – local providers – experienced a substantial revenue reduction (see below for revenue offset discussion). Companies that have both wireless

and local wire line operations have an offsetting impact. CenturyLink has no wireless operations.

For incumbent local carriers such as CenturyLink, the FCC has allowed partial revenue recovery through a new temporary monthly surcharge on the customer bill of no more than \$0.50 for up to five years. While the new surcharge is intended to offset some of the lost ICC revenue, the \$0.50 monthly charge is neither full revenue neutrality nor permanent. There are also additional revenue recovery mechanisms available to rural carriers. Because of these revenue recovery mechanisms and other FCC rules, there has been no financial impact to the KUSF thus far related to the FCC's ICC reforms and CenturyLink does not foresee future impacts. However, because the recovery mechanisms allow for only partial recovery, millions of dollars are no longer available for network investment.

**Universal Service Reform:** While broadband and voice networks have not yet converged, federal funding as you know it for Universal Service is coming to an end. New and unproven mechanisms will replace that support. Federal USF is being transformed to support the build out of broadband networks but only in limited qualifying areas. For price cap carriers such as CenturyLink and AT&T, the FCC has defined the general framework but specific details about its two-phased implementation have not yet been completed. For rate of return carriers including the rural Kansas carriers, the FCC has yet to define either the general framework or the specific details at this time.

Nearly 19 million Americans remain locked out of access to broadband internet access. Almost 25% of those living in rural areas have no fast internet service to their homes. The FCC redirected existing universal service funds to launch the Connect America Fund (CAF) in 2011 which "aims to connect 7 million unserved rural Americans to broadband in six years, and puts the nation on a path to connect all 19 million unserved residents by 2020." There are many components to the FCC's Connect America Fund including a mobility fund, a satellite fund, a price-cap carrier fund and a rate-of-return carrier fund although my comments will be limited to the price-cap carrier fund.

For price cap carriers such as CenturyLink and AT&T, the FCC has established a two-phase implementation. In 2012, the FCC set up CAF Phase 1 -- a one-time allocation of \$300 million to subsidize broadband build-out in very rural areas served by the larger incumbent local exchange carriers (ILEC). The FCC has reported that 15.6 million of the almost 19 million "unserved" Americans are located in these territories. Unfortunately by establishing a "one-size fits all" subsidy of only \$775 per new location served and using a flawed National Broadband Map as its guide, the FCC handcuffed CenturyLink and other carriers and only about \$115 million of the funds are being put to use. This means about 240,000 potential locations will not be connected with CAF I funds. These numerous FCC restrictions meant that CenturyLink received only \$35 million of its original \$90 million allocation and CenturyLink did not accept any funds for Kansas. This means in tens of thousands of individuals and small businesses remain "unserved." Because CAF Phase II is taking longer to implement than originally anticipated, the FCC is considering a second "one-time" allocation process in early 2013. The proposal would add the unused funds from the first installment with an additional \$300 million in an effort to get the project off the ground. If the FCC removes the barriers that restricted the use of dollars in the first phase, hundreds of thousands of Americans can benefit. CenturyLink remains committed to add a substantial contribution of capital to an appropriate level of subsidy to ensure deployment.

The second phase – referred to as CAF II – will likely commence in late 2013 or 2014. The FCC is currently debating the formula for establishing long-term subsidy amounts. The FCC will move away from the "cookie-cutter" CAF I approach, and look at real costs associated with building out to high cost areas. The model will determine which communities will benefit from CAF II. If the subsidy amount is driven by documented costs, CenturyLink will step up with a significant investment to ensure as many locations as possible receive the access to broadband service. If the FCC's cost model does not reflect the reality of build-out costs by individual location certain areas may be left behind. CenturyLink is currently working with the FCC fighting for the right model that will connect rural America. Under CAF II, federal USF will only support high cost voice networks as a secondary component of broadband network deployment and only in specific targeted areas. In the highest cost areas, (about 1.2 million US households) ALL federal USF support in these areas will be applied to satellite broadband service. There

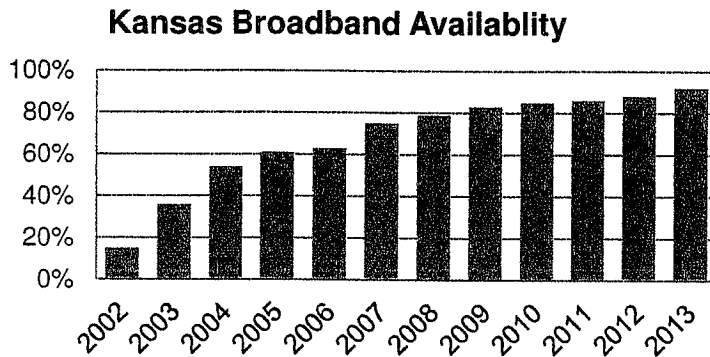
will be no federal support for voice networks in these areas. Neither will there be any federal support for continued universal voice service in the high cost areas that do not meet the definition of unserved by broadband. States without a state USF plan have no way to enable rural carriers to provide voice service to consumers living in high cost areas; accordingly, these states should eliminate COLR obligations and deregulate both services and pricing. State funds are necessary to offset reduced federal funding for voice support.

### ***CenturyLink Committed To Broadband in Kansas***

CenturyLink is the leading rural provider of telecom services in the United States and supports the goals of Universal Service and long term investment strategies for good consumer outcomes. As mentioned in the introduction, CenturyLink has deployed high speed Internet facilities to all 119 rural Kansas communities although there are technical limitations associated with broadband and not all customers live close enough to CenturyLink's facilities to order high speed Internet services. All 119 rural Kansas communities have access to Internet speeds of 10 mbps or greater although actual speed availability depends upon distance and higher speeds are not available the further away a customer resides. Today nearly 92% of CenturyLink's customers can order high speed internet services with speeds greater than 782 kbps and 75% of CenturyLink's customers have access to download speeds at or greater than 4 mbps.

CenturyLink has not received any federal or state support to deploy its broadband network to the nearly 92% of CenturyLink's Kansas customers that have access to high speed broadband. A vast majority of CenturyLink's customers have access to speeds that equal or exceed 4 Mbps downstream; however, to date CenturyLink has not engineered its network to accommodate the 1 Mbps upstream speed contemplated by the FCC. The 1Mbps upload requirement will significantly reduce the number of locations that can be reached for the same amount of money. Also, augmenting capacity requires substantial investment. In 2011, CenturyLink invested over \$2 million to increase capacity and a 5-fold increase was undertaken for 2012 to accommodate increased usage from applications such as Netflix. As CenturyLink continues to expand its broadband network in Kansas, the investment per incremental customer grows exponentially due to the rural nature of Kansas.

The following charts illustrates CenturyLink's deployment of broadband in Kansas as measured by availability and provides a high-level cost estimate for the remaining unserved areas:



**Broadband Deployment Costs**

| To take availability from   | Incremental Investment                    |
|---|---|
| Current 86% to 90%<br>3116 lines  | <b>\$2,250 per line</b><br>\$7.0 million  |
| 90% to 95%<br>3911 lines  | <b>\$5,000 per line</b><br>\$19.6 million |
| 95% to 98%<br>2346 lines  | <b>\$7,000 per line</b><br>\$17.1 million |
| 98% to 100%<br>1564 lines (some wireless)   | <b>\$16,000 per line</b><br>\$25 million  |
| Disclaimer: Investment costs are <i>high level, best available estimates</i> using factors from the NBP and will change |   |

**Remaining Unserved Areas**

While certain parts of the country are challenged with mountains, rugged terrain or other broadband deployment challenges, Kansas' challenge is density. Over 90% of CenturyLink's Kansas territory has less than 10 households per square mile. To reach rural Kansans with broadband, CenturyLink is currently investing over \$2000 per subscribing customer. With broadband service starting at \$15/month, or \$180/year, plus the additional network and operational monthly costs to maintain a robust broadband network, the payback period for this investment is measured in decades. This is compounded by the fact that less than half of all customers who have access to broadband subscribe to broadband service. Additional deployment will be extremely difficult without the type of public-private partnership envisioned with the FCC's Connect America Fund as discussed above. CenturyLink is committed to serving rural Kansas. If the CAF process is administrated correctly, it will allow CenturyLink to invest additional resources and connect thousands of additional Kansas households in high-cost areas that will improve education, telemedicine and economic development.

**Broadband Mapping**

CenturyLink has been a full partner in state mapping initiatives. The National Broadband Map being used by the FCC, however, is littered with false or exaggerated coverage area claims made by wireless and satellite providers. Using this map only served to block residents and small businesses covered by the ILECs from receiving any CAF I benefits.

**The Future Role of KUSF**

CenturyLink is just one of many competitors in most of its service areas. Incumbent local exchange carriers (ILECs) currently provide telephone service to just 4 of 10 customers nationwide. As such, the market rather than regulation should shape services and pricing to consumers. ILECs need to be released from rules, regulations, reporting obligations and pricing constructs that were developed in a bygone era when CenturyLink had a monopoly on telecom service. In areas where competition has not developed and the high costs to serve would burden consumers, the market failure must be recognized by policymakers. A forward-looking KUSF is vital to support universal service in high cost areas in Kansas and should be recognized as a necessary element to achieve Universal Service policy objectives. Accordingly, CenturyLink calls on Kansas legislators to continue with investment incentives that will allow rural consumers to purchase reasonably comparable services at reasonably comparable prices.

KUSF support must be consistent with pricing regulation and Carrier of Last Resort (COLR) obligations. If shortfalls are not corrected, pricing regulations and COLR must be eliminated to ensure consumers benefit from equitable competition among providers. Universal service policy must not distort competitive equity; funding obligations should be borne fairly by all providers and universal service obligations should be consistent with funding received. If state policymakers decides not to support Universal Service goals, COLR must be eliminated and prices and services must be deregulated. Accordingly, policymakers will need to effectively decide that Universal Service concepts are no longer applicable in rural Kansas and that rural Kansans are best served based solely on their economic characteristics.

### ***Conclusion***

CenturyLink has provided communications services in Kansas for over 110 years and wants to continue providing service to all customers in its ILEC service areas. CenturyLink embraces free market principles and will compete aggressively for customers for voice, data, video and hosting services where regulatory outcomes permit. Each location is unique, with distinct challenges for service provisioning and broadband build-out. The final federal and state support mechanisms will determine if it is cost efficient for companies like CenturyLink to invest in order to deliver service in Kansas.