

VERIZON PENNSYLVANIA INC. AND VERIZON NORTH INC.  
STATEMENT NO. 1:0 Remand

7/19/05 Hbg TX

AT&T COMMUNICATIONS OF PENNSYLVANIA, INC.

V.

VERIZON NORTH INC.

DOCKET NO. C-20027195

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VERIZON PENNSYLVANIA INC.

VERIZON NORTH INC.

STATEMENT NO. 1:0 Remand

(DIRECT TESTIMONY)

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WITNESS: James J. Kane

DATED: June 8, 2005

**EXPURGATED VERSION**

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1 **I. INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS, AND**  
3 **IDENTIFY THE PARTY ON BEHALF OF WHOM YOU ARE**  
4 **SUBMITTING THIS TESTIMONY.**

5 A. My name is James. J. Kane. My business address is 2 Waterview Terrace,  
6 Southboro, MA, 01772. I am submitting this testimony on behalf of Verizon  
7 Pennsylvania Inc. ("Verizon PA") and Verizon North Inc. ("Verizon North")  
8 (collectively "Verizon").

9 **Q. WHAT IS YOUR CURRENT OCCUPATION?**

10 A. I am an employee of VOLT Information Sciences. I am currently contracting with  
11 Verizon on a number of wholesale services projects as well as acting as a switched  
12 access expert witness.

13 **Q. PLEASE DESCRIBE THOSE ASPECTS OF YOUR PROFESSIONAL**  
14 **BACKGROUND MOST PERTINENT TO YOUR TESTIMONY.**

15 A. I received a Bachelor of Sciences Degree in Electrical Engineering from Lowell  
16 Technological Institute, Lowell, Massachusetts in June 1969 and a Masters in  
17 Business Administration Degree from Worcester Polytechnic Institute, Worcester,  
18 Massachusetts in June 1997.

19           Until my retirement from Verizon in November of 2003, I worked for 31  
20 years for Verizon and its predecessor companies in various capacities of increasing  
21 responsibility. I joined the New England Telephone and Telegraph Company (NET)  
22 in 1972 as an Associate Engineer in the Technical Planning Division of the Network

1 Department. While with NET's Technical Planning Division I was primarily  
2 responsible for performing local switch replacement economic cost studies. In 1979  
3 I was promoted to Manager and joined the Revenue Matters Department of NET. In  
4 that capacity I was responsible for developing methods and performing and  
5 supervising the preparation of cost of service studies associated with Local, Toll and  
6 Access Services. I joined the Access Services Division of NET in 1982 and was  
7 promoted to District Manager - Switched Access in 1983. From 1984 to 1990, I was  
8 responsible for supervising cost of service studies, demand forecasting and analysis  
9 and product line management for Switched Access Services in NYNEX. I accepted  
10 a position in NYNEX's Quality Institute in mid-1990, where I was responsible for  
11 the training and support of numerous Quality Improvement Teams for a number of  
12 Departments in NYNEX. I returned to the NYNEX Access Services Division in  
13 1993 as the District Manager - Switched Access Product Line Management (PLM)  
14 and continued on that assignment for NYNEX, Bell Atlantic and Verizon until my  
15 retirement from Verizon in November, 2003. At that time I was responsible for  
16 supervising all interstate and intrastate Switched Access PLM functions including  
17 product development, pricing (including Price Caps filings), demand forecasting &  
18 analysis, providing comments relative to the filing of and responding to regulatory  
19 petitions, etc. for the entire Verizon footprint.

20           Upon my retirement from Verizon, I joined Lavastorm Technologies, Inc. in  
21 Boston, Massachusetts working as an independent contractor for the greater part of  
22 2004, during which I was responsible for working with Lavastorm's software

1 engineers in developing billing and revenue assurance software products primarily  
2 for the Telecom Industry. I joined VOLT Information Sciences in October 2004.

3 While with Verizon and its predecessor companies, I completed the Greater  
4 Boston Executive Development Program at the MIT Sloan School of Management  
5 (Cambridge, Massachusetts) in May, 1989 and also attended numerous company-  
6 sponsored training programs, seminars and conferences in the following areas  
7 related to Telecommunications - local switching design, long range technical  
8 planning, economics, accounting, service costs and marketing.

9 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

10 A. No, I have not. However, I have previously filed testimony and represented Verizon  
11 as a switched access expert witness in regulatory proceedings in the states of Maine,  
12 Massachusetts and New York.

13 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

14 A. The purpose of my testimony is to provide additional information that the  
15 Commission should consider in connection with its review of the issues that were  
16 remanded to the Office of Administrative Law Judge (OALJ) by the Commission's  
17 July 28, 2004 Order, and to address the new issue added to this proceeding by the  
18 Commission's January 18, 2005 Order, relating to the potential impact on this Phase  
19 II remand proceeding of new developments in the federal arena.<sup>1</sup>

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<sup>1</sup> My remand direct testimony is based on the understanding that all of the testimony submitted by Verizon in Phase I of this proceeding continues to be in the record and available for citation and consideration in this Phase II remand without repeating it

1    **Q.    PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE**  
2    **ISSUES ON REMAND AND THE NEW ISSUE THE COMMISSION**  
3    **ADDED TO THIS PROCEEDING.**

4    A.    In this remand proceeding, the Commission must decide whether there is any  
5    compelling reason to rush to implement additional access rebalancing for the  
6    Verizon companies before the FCC completes its pending intercarrier compensation  
7    proceeding. That FCC case, which is in the comment stage now, proposes to reform  
8    comprehensively all intercarrier compensation, including intrastate and interstate  
9    access rates. The FCC is currently considering whether to preempt this  
10   Commission's jurisdiction over the very intrastate access charges that are the subject  
11   of this proceeding. At the very least, the FCC's decisions regarding reform will  
12   likely provide guidance to the states as to whether and how they should alter  
13   intrastate access rates. My testimony and the pertinent portions of Verizon's Phase I  
14   testimony demonstrate that this Commission should wait for the FCC to complete its  
15   proceeding, and no additional rebalancing should be required at this time.

16           The only parties insisting that the Commission plow ahead with this state  
17   proceeding are the three large interexchange carriers (IXCs) operating in  
18   Pennsylvania – Qwest, AT&T and MCI. Of course, these carriers do so for a narrow

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here. See Verizon St. 1.0 (Direct Testimony of Berry and Wirl), June 25, 2003; Verizon St. 2.0 (Direct Testimony of Sanford and Dean), June 25, 2003; Verizon St. 1.1 (Surrebuttal Testimony of Berry and Wirl), August 4, 2003; Verizon St. 2.1 (Surrebuttal Testimony of Sanford and Dean), August 4, 2003; Verizon St. 3.0 (Surrebuttal Testimony of Taylor), August 4, 2003. See also Transcript of Evidentiary Hearings, August 25-26, 2003.

1           and self-interested reason: access reductions for these companies directly increase  
2           their profit margins, and they stand to benefit dollar for dollar from immediate  
3           access reductions. But while the position of the IXCs may be in their own corporate  
4           interest, it does not represent the best interests of Pennsylvania consumers, and it is  
5           this public interest that the Commission must consider. The Commission should  
6           also be aware that the IXCs' insistence of prematurely resolving this issue is directly  
7           at odds with the position that they have taken before the FCC. As I discuss below,  
8           the IXCs are urging the FCC to preempt this Commission's jurisdiction over  
9           intrastate access charges and are seeking an extended transition period to do so.

10                        The facts overwhelmingly demonstrate that there is no reason to rush to  
11           further rebalance Verizon's intrastate access rates now.

12                        First, the IXCs have just received approximately \$50 million in annual cost  
13           savings in Pennsylvania from the Verizon access reductions ordered in Phase I – and  
14           further reductions will not benefit the public interest. Verizon already rebutted all of  
15           their arguments in favor of further reductions in its Phase I testimony, and will  
16           address in its Phase II rebuttal any additional arguments they might raise.

17                        Second, retail customers have just experienced rate increases to off-set that  
18           access reduction, which were implemented only four months ago. Under the  
19           recently enacted Act 183, any future cost savings to the IXCs in the form of  
20           Commission-mandated access revenue reductions must also be done on a revenue-  
21           neutral basis.

1           Third, the FCC has already concluded that comprehensive reform of the  
2 existing interstate and intrastate intercarrier compensation systems is needed, and the  
3 FCC is examining proposals for a unified intercarrier compensation regime. The  
4 FCC may completely preempt this Commission's jurisdiction over intrastate access  
5 rates, or, at the very least, may provide guidance to this Commission on the manner  
6 in which such rates should be altered. The Commission should allow the FCC to  
7 finish its investigation and issue its comprehensive reform decision before taking  
8 any further action. At that time the Commission may assess, first, whether it still has  
9 jurisdiction over intrastate access rates, and, second, whether any alterations are  
10 necessary.

11 **II. BACKGROUND**

12 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE RELEVANT**  
13 **BACKGROUND OF THIS PHASE II REMAND PROCEEDING.**

14 A. Based on the record developed in Phase I, by Order entered July 28, 2004 this  
15 Commission approved a rate rebalancing for the Verizon companies that resulted in  
16 annual cost savings to the IXCs through substantial access rate reductions of  
17 approximately \$50 million. Those reductions were offset with retail rate increases to  
18 Verizon basic exchange customers. Both the access reductions and rate increases  
19 were implemented in February of 2005. I will describe this rebalancing in more  
20 detail later in my testimony.

21           The July 28, 2004 Order also remanded to the OALJ "for the further  
22 development of the record and the issuance of a recommended decision concerning

1        those policy issues and other access charge concerns that were raised by the IXCs in  
2        their Exceptions but which were not specifically resolved by a recommendation in  
3        this instant proceeding.” Those issues “include, but are not limited to, AT&T’s  
4        two-step access charge reduction proposal, the removal of all implicit subsidies from  
5        access charges, the reduction and possible elimination of the Carrier Charge.”  
6        (7/28/04 Order at 17). In other words, the Commission directed the ALJ to make a  
7        recommendation on the question of whether there should be further access  
8        rebalancing at this time, but did not pre-judge the answer to that question.

9        In a January 18, 2005 Order, the Commission denied the IXCs’ request that  
10       the Commission itself decide the need for further access rate rebalancing without a  
11       remand to the OALJ for further development of the record, and also denied the  
12       IXCs’ request to direct the OALJ to “expedite” the remand. The Commission did,  
13       however, “encourage” the OALJ “to endeavor to issue a Recommended Decision on  
14       Remand as expeditiously as possible.” (1/18/05 Order at 14).

15       In the January 18 Order, the Commission recognized the potential impact on  
16       this remand proceeding of new developments in the federal arena, and expanded the  
17       scope of the remand, noting that “[w]e are especially concerned about any impact  
18       that the proposed ICF [Intercarrier Compensation Forum] proposal, if it is ultimately  
19       approved by the FCC, may have jurisdictionally on access charge regulation in  
20       Pennsylvania, our ability to further reduce or restructure intrastate access charges,  
21       and whether any FCC action may lead to a double recovery by the LECs in  
22       Pennsylvania in light of the remanded proceeding, and if the FCC permits intrastate

1 access charges to be offset by increases to the federal SLC.” The Commission  
2 therefore expanded the scope of this Phase II remand proceeding to “address[] the  
3 impact the FCC action may have on our jurisdictional responsibilities, as well as its  
4 relationship to the final recommended decision on access rates arising from this  
5 remand proceeding.” (1/18/05 Order at 14).

6 **III. THE PHASE I RATE REBALANCING**

7  
8 **Q. PLEASE DESCRIBE IN MORE DETAIL THE ACCESS RATE**  
9 **REBALANCING THAT OCCURRED AS A RESULT OF THE**  
10 **COMMISSION’S JULY 28, 2004 ORDER.**

11 A. Phase I was initiated by Verizon’s petition filed to comply with this Commission’s  
12 condition of its approval of the Bell Atlantic/GTE merger, requiring Verizon to  
13 achieve access rate parity for Verizon PA and Verizon North. Ultimately there was  
14 a partial settlement and the Commission directed Verizon to implement the  
15 rebalancing jointly proposed by the OCA, OSBA and Verizon. The rebalancing  
16 resulted in uniform access rates and rate structure for the two Verizon companies  
17 and reduced the IXC-portion of Verizon North’s Carrier Charge from \$7.40 per line  
18 per month to equal Verizon PA’s Carrier Charge of \$0.58. The resulting access rates  
19 are depicted on Exhibit Kane-1. As a result of the rebalancing, the revenue that  
20 IXCs pay to Verizon through access rates decreased significantly by approximately  
21 \$50 million.<sup>2</sup> The Verizon companies’ average rate per minute as a result of the

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<sup>2</sup> These figures are based on an updated estimate using actual volumes through August 2004.

1 rebalancing is now [**BEGIN VERIZON PROPRIETARY**] [END  
2 **VERIZON PROPRIETARY**]. Although the access revenue reduction resulted  
3 from the reduction of Verizon North's access rates (primarily its Carrier Charge), the  
4 Commission minimized the impact of the revenue neutral offset to retail end users  
5 by spreading the recovery over the end-user lines of both Verizon companies. The  
6 increase to non-package residential and business monthly dial tone line rates was  
7 \$0.80.

8 **Q. WHEN DID THE REBALANCING TAKE EFFECT?**

9 A. Both the access decreases and the retail rate increases took effect in February of  
10 2005.

11 **Q. HOW DO VERIZON'S CURRENT ACCESS RATES COMPARE TO**  
12 **THOSE OF OTHER PENNSYLVANIA ILECS?**

13 A. Even before the rebalancing, Verizon PA's access rates were among the lowest in  
14 the state. After the substantial reduction to Verizon North's rates, the current  
15 intrastate access rates for both Verizon North and Verizon PA are among the very  
16 lowest ILEC access rates in the state. The majority of other Pennsylvania ILECs  
17 have Carrier Charges many multiples of Verizon's \$0.58 carrier charge. For  
18 example, there are several ILECs with Carrier Charge rates over \$10.00.<sup>3</sup> The  
19 larger Pennsylvania ILECs still have significantly higher Carrier Charges than

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<sup>3</sup> For example, based on their publicly available Pennsylvania Telephone Association (PTA) access tariff, Palmerton has a Carrier Charge of \$11.28, South Canaan has a Carrier Charge of \$11.35, Citizens of Kecksburg has a Carrier Charge of \$11.18, Yukon Waltz has a Carrier Charge of \$11.45, Armstrong PA has a Carrier Charge of \$15.11 and Ironton has a Carrier Charge of \$17.99.

1 Verizon PA and Verizon North. According to their tariffs, Sprint's Carrier Charge is  
2 \$7.19, Alltel's is \$4.88 and Commonwealth's is \$7.00.

3 **IV. THE FCC'S PENDING INTERCARRIER COMPENSATION**  
4 **PROCEEDING**

5  
6 **Q. IN ITS JANUARY 18, 2005 ORDER THE COMMISSION REFERRED TO**  
7 **AN FCC INTERCARRIER COMPENSATION PROCEEDING. WHAT IS**  
8 **THAT PROCEEDING?**

9 A. As the Commission has already recognized, the FCC has embarked upon its own  
10 investigation of intercarrier compensation that may impact intrastate access charges  
11 and constrain the Commission's actions on this remand. This FCC proceeding has  
12 progressed since the Commission issued its January 18 Order. Specifically, on  
13 March 3, 2005 the FCC issued its Further Notice of Proposed Rulemaking  
14 ("FNPRM") in its investigation of intercarrier compensation that was referred to in  
15 this Commission's Order.<sup>4</sup> Comments were filed on May 23, 2005 with Reply  
16 Comments due on or before July 20, 2005 (a change in the FCC's schedule). While  
17 the FCC has not set a deadline for its own action, statements by individual  
18 Commissioners have urged that the FCC reach a resolution by the end of this year.<sup>5</sup>

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<sup>4</sup> *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (Rel. March 3, 2005).

<sup>5</sup> For example, when the FCC announced its FNPRM, FCC Commissioner Copps issued a statement that "[i]ntercarrier compensation is a must-do item for this Commission this year. It should be our number one telecommunications priority." See also *Speech of Commissioner Copps to Federal Communications Bar Association*, TR Daily, March 28, 2005.

1 Q. WHAT IS THE NATURE OF THE ISSUES BEING CONSIDERED IN THE  
2 FCC'S FNPRM?

3 A. The FNPRM seeks comments from the industry on a number of issues that could  
4 impact the very same intrastate access charges that are the subject of this proceeding  
5 and could alter or eliminate this Commission's jurisdiction over these issues. For  
6 example, the FCC seeks comments on its own legal authority to reform intrastate  
7 compensation mechanisms that have traditionally been handled by state  
8 commissions. (¶35, 80, 82). The FCC notes that some of "the industry proposals  
9 call for a cooperative process between the Commission and states," which if  
10 implemented would have to be accounted for in the result of this proceeding. (¶ 81).  
11 It specifically asks the parties to comment on whether the FCC has authority to  
12 replace intrastate access regulation with some alternative mechanism. (¶79). The  
13 FCC also asks the parties to comment on how it might offset any revenues lost from  
14 reductions to intrastate access rates, including the possibility of subscriber charges  
15 and universal service funding, (¶114), and whether the FCC should create a federal  
16 mechanism to offset any lost intrastate revenues, or whether the states should be  
17 responsible for establishing alternative cost recovery mechanisms for LECs within  
18 the intrastate jurisdiction. (¶115).

19 Q. WHAT IS THE STATUS OF THE FCC PROCEEDING?

20 A. Approximately 100 parties filed comments on May 23, 2005. Reply Comments  
21 must be filed by July 20, 2005.

1 **Q. DID VERIZON FILE COMMENTS?**

2 A. Yes. Verizon's comments are attached hereto as Exhibit Kane-2. In its comments,  
3 Verizon endorsed the use of commercial agreements between interconnecting  
4 carriers as the preferred long-term solution to the complex issues associated with the  
5 current intercarrier compensation mechanisms. However, if the FCC were to require  
6 an interim plan to transition from access tariffs to commercial agreements, Verizon  
7 provided certain critical principles/criteria that any transitional intercarrier  
8 compensation default rules must satisfy to be acceptable. Verizon did not support  
9 adoption of any of the plans included in the FCC's FNPRM since none of the plans  
10 satisfied all of the principles/criteria specified in its Comments.

11 **Q. HAVE THE IXC PARTIES TO THIS CASE FILED COMMENTS IN THE**  
12 **FCC PROCEEDING?**

13 A. Yes. AT&T, MCI and Qwest – the large IXCs that have demanded further access  
14 rebalancing through this remand – all filed comments before the FCC on May 23,  
15 2005. AT&T and MCI are members of the Intercarrier Compensation Forum  
16 (“ICF”). The ICF comments are attached as Exhibit Kane-3. Qwest filed its own  
17 comments, which are attached as Exhibit Kane-4.

18 **Q. WHAT ARE THE IXCS ARGUING TO THE FCC REGARDING THIS**  
19 **COMMISSION'S JURISDICTION OVER INTRASTATE ACCESS RATES?**

20 A. While these carriers are demanding immediate action by this Commission with  
21 regard to intrastate access rates and have resisted every effort to establish a schedule  
22 that would allow the Commission to await the outcome of the FCC proceeding, they

1 are simultaneously arguing to the FCC that the FCC should assume jurisdiction over  
2 intrastate access rates and preempt this Commission. AT&T and MCI argue that the  
3 FCC should “preempt intrastate access regimes *in toto*,” and that “every intrastate  
4 intercarrier compensation mechanism across the country must be made identical, not  
5 just to each other, but to the federal system as well.” (ICF Comments at 76).

6 Similarly Qwest argues that “[t]he FCC has plenary jurisdiction over” state access  
7 charges and, if necessary, the FCC also “has the authority to preempt state access  
8 charges.” (Qwest Comments at 5). Qwest argues that all access payments should  
9 “be subject to federal jurisdiction,” which “includes replacement of intrastate access  
10 tariffs . . . with the charging structure described herein.” (Id.). If the FCC accepts  
11 these arguments, all of the Commission and party efforts expended in this case could  
12 be wasted because the Commission will lose its authority over intrastate access rates.

13 **Q. ARE THE IXCS DEMANDING IMMEDIATE INTRASTATE ACCESS**  
14 **REDUCTIONS FROM THE FCC, AS THEY ARE HERE?**

15 A. No. While the IXCs are insisting that this Commission take action immediately and  
16 that the matter is so urgent that the Commission cannot even wait for the outcome of  
17 the FCC proceeding, which could be concluded this year, they are not demanding  
18 the same rushed process from the FCC. Rather, the AT&T/MCI plan allows a  
19 phase-down with three years to achieve a single termination rate for all traffic, and  
20 then a transition period where this uniform rate is gradually reduced to “shift[] cost  
21 recovery to end users” culminating in a bill and keep regime as of July 1, 2011.  
22 (ICF Comments at 6 and Appendix C at 6). Qwest also allows for a transition period

1 of three years. (Qwest Comments at 7). Since they are willing to have the FCC  
2 assume jurisdiction over intrastate access rates and take from three to six years to  
3 reduce them, then their claims that it is urgent for this Commission to act  
4 immediately without awaiting the outcome of the FCC case lack credibility.

5 Moreover, while the IXCs are urging this Commission to get ahead of the  
6 FCC on this issue, they are also urging the FCC to take “rapid and decisive action,”  
7 (Qwest Comments at 1), which only increases the likelihood that the efforts before  
8 this Commission will be wasted.

9 **Q. HAS VERIZON TAKEN A POSITION ON THE FCC’S FNPRM AS IT**  
10 **PERTAINS TO INTRASTATE ACCESS CHARGES?**

11 A. Yes. As described in its Comments, Verizon’s position is that any significant  
12 change in intercarrier compensation must include both interstate and intrastate  
13 services and be consistent in order to achieve comprehensive reform.

14 **Q. WOULD IMMEDIATE REDUCTION OF VERIZON’S INTRASTATE**  
15 **ACCESS RATES IN PENNSYLVANIA TO MIRROR ITS CURRENT**  
16 **INTERSTATE ACCESS RATES, AS QWEST DEMANDS, BE**  
17 **CONSISTENT WITH VERIZON’S FCC COMMENTS?**

18 A. No. Because the FCC is in the process of reforming the existing intercarrier  
19 compensation regime, any short term effort to change intrastate access rates to  
20 mirror current interstate access rates would be a shortsighted measure, for the  
21 interstate rates may well be altered beyond recognition, and possibly before the  
22 Commission even rules in this proceeding. Even if this Commission retains

1 jurisdiction over intrastate rates, and even if it determines that it wants to follow the  
2 structure and magnitude of interstate rates, it still should wait for the outcome of the  
3 FCC's proceeding, which would at least provide guidance on how to achieve that  
4 objective.

5 **Q. THE COMMISSION DIRECTED THE ALJ TO ANALYZE "THE IMPACT**  
6 **THE FCC ACTION MAY HAVE ON OUR JURISDICTIONAL**  
7 **RESPONSIBILITIES, AS WELL AS ITS RELATIONSHIP TO THE FINAL**  
8 **RECOMMENDED DECISION ON ACCESS RATES." (1/18/05 ORDER P.**  
9 **14). DO YOU HAVE ANY COMMENT ON THAT ANALYSIS?**

10 **A.** Yes. Clearly if the IXCs prevail in their arguments that the FCC should preempt  
11 state jurisdiction over intrastate access rates, the FCC's action will have significant  
12 impact on the Commission's jurisdictional responsibilities. Even if the FCC leaves  
13 some role for the states, the FCC's decision will at least likely provide guidance on  
14 whether and how states should alter their intrastate rates. It would be  
15 counterproductive for this Commission to take action before the FCC has ruled.

16 **V. THE IXCS HAVE PROVIDED NO BASIS TO RUSH ANY FURTHER**  
17 **REBALANCING OF VERIZON'S ACCESS RATES**

18  
19 **Q. HAS THERE BEEN A CHANGE IN PENNSYLVANIA STATUTORY LAW**  
20 **THAT THE COMMISSION SHOULD CONSIDER IN CONNECTION**  
21 **WITH THIS REMAND PROCEEDING?**

22 **A.** Yes. While I am not a lawyer, it is my understanding that, as a result of the  
23 Pennsylvania General Assembly's passage of Act 183, revenue neutrality is now

1 required by law. Act 183, a revision to the statute that governs telecommunications  
2 in Pennsylvania, was signed into law on November 30, 2004. Section 3017 of that  
3 new law provides that “[t]he commission may not require a local exchange  
4 telecommunications company to reduce access rates except on a revenue-neutral  
5 basis.” 66 Pa. C.S. § 3017. Thus, if any alterations to Verizon’s access rates result  
6 from this Phase II remand proceeding, the Commission *must* comply with that  
7 statutory directive. To the extent that a challenge to revenue-neutrality was one of  
8 the exceptions raised by the IXCs, this issue has been resolved by the General  
9 Assembly and is no longer subject to debate.

10 **Q. HAVE RETAIL CUSTOMERS JUST EXPERIENCED A RATE**  
11 **INCREASE?**

12 A. Yes. In February of 2005 Verizon’s residential and business customers experienced  
13 a \$0.80 rate increase to off-set the substantial access reductions directed in Phase I of  
14 this proceeding.

15 **Q. HAS THERE BEEN SUFFICIENT TIME TO ASSESS THE IMPACT OF**  
16 **THE LAST ACCESS RATE REDUCTION ON TOLL RATE LEVELS?**

17 A. No. At the writing of this testimony the reductions have only been in place for four  
18 months. Moreover, the evidence in Phase I indicated that the IXCs price their toll  
19 rates and packages on a national basis without regard to any particular local  
20 jurisdiction’s reduction in access rates. (See Verizon St. 3.0 (Taylor Surrebuttall) at  
21 34).

1 Q. HAVE THE IXCS DEMONSTRATED ANY REASON FOR URGENCY IN  
2 ADDITIONAL INTRASTATE ACCESS REDUCTIONS?

3 A. No. The IXCs have not demonstrated that end-users would experience any benefit  
4 from such reductions. The record from Phase I indicates that the *only* parties that  
5 would benefit from such reductions would be the IXCs.

6 The IXCs have not pledged to pass through further access reductions to end-  
7 users, nor have they demonstrated or indicated that their access savings would result  
8 in lower toll rates or in any other benefit in toll options to end-users. Although  
9 Verizon is not seeking a flow-through of cost savings condition, the Commission  
10 should at least be aware that the revenue lost from access reductions is going directly  
11 to increase IXC profit levels in determining whether further reductions in intrastate  
12 access charges are warranted without waiting for the FCC.

13 Q. DOES VERIZON BELIEVE THE COMMISSION IS BOUND TO REMOVE  
14 "ALL IMPLICIT SUBSIDIES" FROM ACCESS RATES?

15 A. No. It clearly is *not* bound to do so. As discussed at length in Phase I, this  
16 Commission has the discretion to price intrastate access above cost. (See Verizon  
17 Phase I Reply Brief at 6-7, 10). This Commission has consistently held that access  
18 service should continue to make a contribution toward joint and common costs of  
19 the business. The Commonwealth Court, in approving this Commission's decision  
20 in the *Global Order* to continue to price access above its cost, confirmed this  
21 Commission's discretion to exercise its specialized expertise in this area, cautioning  
22 that "the cost of excessively priced elements must be reduced to a point *nearer* to

1 actual incremental cost, but not so greatly as to eliminate the support such revenue  
2 provides to other areas of the system that need that support.”<sup>6</sup> Clearly it is within  
3 this Commission’s discretion to leave Verizon’s intrastate access rates at their  
4 present level until the FCC rules in its intercarrier compensation proceeding.  
5 Moreover, even if the Commission determined that access rates exceed direct costs,  
6 that still does not demonstrate that access is actually “subsidizing” other services  
7 because it is appropriate for access service to contribute to the joint and common  
8 costs and profits of the business.

9 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

10 **A.** Yes, it does.

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<sup>6</sup> *Bell Atlantic-Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 763 A.2d 440, 480 (Pa. Commw. 2000) (emphasis added).

# EXHIBIT 1

REC'D  
2005 JUN 26 5:01 PM '07  
SECURITY BUREAU

**Verizon Pennsylvania and Verizon North - Pennsylvania  
Intrastate Switched Access Rates as of Feb. 2005**

**Exhibit Kane-1**

**Local Transport**

**Entrance Facilities**

2-Wire (Verizon North)	\$21.92
Cell 1 (Verizon PA)	\$21.92
Cell 2 (Verzion PA)	\$31.12
Cell 3 (Verzion PA)	\$38.22
Cell 4 (Verzion PA)	\$43.12
4-Wire (Verizon North)	\$35.00
Cell 1 (Verizon PA)	\$35.00
Cell 2 (Verzion PA)	\$36.62
Cell 3 (Verzion PA)	\$49.12
Cell 4 (Verzion PA)	\$57.57
DS1 (Verizon North)	\$210.00
Cell 1 (Verizon PA)	\$210.00
Cell 2 (Verzion PA)	\$225.00
Cell 3 (Verzion PA)	\$240.00
Cell 4 (Verzion PA)	\$270.00
DS3	
Electrical	\$3,130.00
Optical	\$2,980.00
DS-3 to DS-1 Mux	\$500.00
DS-1 to VG Mux	\$118.00

**Direct Trunk Transport**

DS-3 Fixed	\$900.00
DS-3 per mile	\$180.00
DS-1 Fixed	\$75.00
DS-1 per mile	\$25.00
VG Fixed	\$16.00
VG per mile	\$2.50
DS-3 to DS-1 Mux	\$500.00
DS-1 to VG Mux	\$118.00

**Tandem Switched Transport**

Tdm Switching/MOU	\$0.000983
Tdm Fixed/ MOU	\$0.000195
Tdm per/MOU/mile	\$0.000045
Ded Trk Ports (per trunk)	\$12.00
Host/Remote	
Fixed	\$0.000195
Per mile	\$0.000045

**END OFFICE**

Local Switching/MOU	
Verizon North	\$0.006212
Verizon PA	
FGD, Term FGB	\$0.006212
Lineside BSA	\$0.010331
Orig FGA, Orig FGB	\$0.010787
Term FGA	\$0.018430
Trunkside BSA-950 Option	\$0.010698
Trunkside BSA-101XXXX Option	\$0.012486
WATS, Toll Free, 900	\$0.011859
Shared EO Trk Port/MOU	\$0.001598
Dedicated EO Trk Port (per trunk)	\$12.00

**CARRIER CHARGE**(per line or trunk/month) **\$0.58**  
(applicable to IXCs)

# EXHIBIT 2

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Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, DC 20554

In the Matter of

Developing a Unified Inter-carrier  
Compensation Regime

CC Docket No. 01-92

**COMMENTS OF VERIZON**  
**IN RESPONSE TO FURTHER NOTICE OF PROPOSED RULEMAKING**

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May 23, 2005

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- ATTACHMENT C Verizon and BellSouth Supplemental White Paper, CC Docket Nos. 96-98, 99-68 (filed July 20, 2004)
- ATTACHMENT D Verizon and BellSouth Further Supplemental White Paper, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004)

Before the  
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In the Matter of

Developing a Unified Inter-carrier  
Compensation Regime

CC Docket No. 01-92

**COMMENTS OF VERIZON<sup>1</sup>**  
**IN RESPONSE TO FURTHER NOTICE OF PROPOSED RULEMAKING**

**INTRODUCTION AND SUMMARY**

The goal of any intercarrier compensation reform should be the replacement of the existing regimes of top-down regulation with negotiated, commercial agreements between interconnecting carriers. The Commission has repeatedly recognized that such market-based solutions are preferable to regulation and consistent with the deregulatory emphasis of the Telecommunications Act of 1996 (“1996 Act”). A market-based approach, relying upon negotiated, commercial agreements, is the best long-term solution to ensuring the efficiency of the telecommunications markets in the face of substantial technological change. Such an approach permits carriers to craft interconnection agreements that reflect the particular characteristics of the traffic exchanged between them. Moreover, market-based agreements are inherently more flexible and can be modified more easily than complex regulatory regimes, enabling carriers to adapt more quickly to emerging technologies. Indeed, negotiated interconnection arrangements have proven successful in a variety of circumstances – most

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<sup>1</sup> The Verizon telephone companies (“Verizon”) are identified in Appendix A to these comments.

notably in the Internet – in the absence of either rate regulation or a regulatory mandate to enter into such arrangements in the first place.

By contrast, any attempt to create a one-size-fits-all solution through regulatory mandates, such as a mandatory bill-and-keep regime, cannot produce efficient results given the complexities of today's telecommunications markets. The Commission's experience with the existing intercarrier compensation rules has demonstrated that regulatory compensation regimes, no matter how well-intentioned, can be manipulated by carriers in ways that were unforeseeable at the time the rules were created in order to obtain profits. These manipulations create market inefficiencies that harm consumers. The Commission should abandon such rigid regulatory mandates for intercarrier compensation and instead allow interconnection arrangements to be based on market forces and negotiated commercial agreements.

Given the success of negotiated agreements in other contexts, it is far from clear that a new regulatory regime needs to be created in order for the industry to transition to a regime of negotiated arrangements. Indeed, while much has been made of arbitrage problems under the existing rules, the principal source of that arbitrage has been carriers that have ignored or tried to evade those rules. As an initial matter, therefore, the Commission should make clear that all providers of voice telephone service that use the public switched network are subject to the existing access charge regime, while also expressly allowing carriers to voluntarily negotiate compensation arrangements that depart from the existing rules. Moreover, if the Commission concludes that some transitional default rules are appropriate during the shift to negotiated agreements – whether those rules take the form of a default rate structure or a process for resolving disputes that may arise in negotiations – the Commission should ensure that any such rules are consistent with the following five principles.

*First*, any such default rule must account for the fact – already reflected in market-based arrangements – that interconnection does not always benefit both networks equally. Carriers make different decisions with regard to the significant investment required to build and improve networks. As a result, although interconnection may result in an equal exchange of value in some cases, in other cases interconnection may provide greater benefits to one of the interconnecting carriers. Commercially negotiated agreements in the context of the Internet recognize this fact, as companies agree to forgo intercarrier compensation where they perceive interconnection as providing equal value to each, but insist on some form of compensation when that is not the case. A default rule that does not recognize this principle – such as a rule imposing a bill-and-keep arrangement for *all* traffic – provides disincentives for investment in network improvements, as network operators will be unable to recoup the value created by those investments and other providers will have strong incentives to free ride on the investments of the network operators.

*Second*, any transitional default rule should preserve existing negotiated arrangements and facilitate additional ones. In particular, default rules should not interfere with the commercially negotiated arrangements that currently exist between and among the networks that make up the Internet. Nor should default rules apply where networks exchange packets on an Internet protocol (“IP”) basis without using the circuit-switched network – regardless of whether the packets are carrying voice, data, or video, and regardless of the carrier involved. Because the goal of any new regime should be to encourage carriers exchanging circuit-switched wireline and wireless traffic to adopt similar negotiated arrangements, the Commission must ensure that any default rule does not become a mandatory rule in practice. This will occur if the default rule

enables one class of carriers to insist on results that could not be obtained through commercial, market-based negotiations.

*Third*, any default rule the Commission establishes should provide for positive rates and a more uniform rate structure for various types of traffic than exists currently. The desirability of these features follows from the first two principles. Positive rates reflect the market outcome that one network is compensated when interconnection does not result in an equal exchange of value and provide appropriate investment incentives, while greater uniformity for various types of traffic reduces opportunities for carriers to benefit from non-compliance with existing rules. In contrast, the default bill-and-keep rule proposed by some would encourage a whole new host of arbitrage opportunities. Nor is there any merit to claims that bill-and-keep is superior from the perspective of regulatory efficiency. In any event, virtually all of the benefits claimed to flow from a bill-and-keep regime actually trace to the establishment of a more *uniform* rate structure for various types of traffic (as opposed to a one-size-fits-all solution for all carriers or all networks). Default rules that provide for positive rates have the significant advantage of avoiding the arbitrage opportunities that would be created by a mandatory bill-and-keep regime for all traffic and all providers.

*Fourth*, any transitional default rules should provide sufficient flexibility to ensure that carriers can recover the costs currently recovered through intercarrier compensation and can be compensated for the value provided by interconnection with other networks. Intercarrier compensation reform provides the opportunity for the Commission to promote competition and eliminate regulatory arbitrage; the purpose of such reform is not to reduce carrier revenues or end-user rates. The Commission has recognized as much in past reforms of intercarrier compensation and should do so here as well. Therefore, the Commission should ensure that it

provides carriers with opportunities to recover costs currently recovered through intercarrier compensation through some combination of intercarrier compensation and end-user charges (whether called retail basic service rates, subscriber line charges (“SLCs”), or otherwise). There is no one-size-fits-all approach applicable to all carriers in all markets, as competitive market conditions will sharply limit many carriers’ ability to recover revenues through increases in end-user charges.

*Fifth*, the Commission should avoid disruptive changes to existing interconnection architectures as it implements intercarrier compensation reform. Carriers have been interconnecting their networks for nearly a decade under the rules implementing the 1996 Act – and for much longer in the case of interLATA and wireless calls. After considerable litigation about the requirements of the statute and the Commission’s rules, most of those requirements are settled and have been internalized by market participants. Adoption of a new set of interconnection rules would serve primarily to upset settled expectations. Adapting to those rules, at the same time carriers are transitioning to a new intercarrier compensation regime, will impose significant costs on carriers that will likely outweigh any benefits provided by those rules, while inevitably creating new arbitrage opportunities to be exploited.

All of the proposals made thus far fail to satisfy one or more of these principles. The Intercarrier Compensation Forum (“ICF”) proposal, for example, would simultaneously transition to a bill-and-keep system and dramatically restructure carriers’ interconnection obligations. This combination would create a host of new arbitrage opportunities, while at the same time failing to provide carriers with a realistic opportunity to recoup the costs currently recovered through intercarrier compensation. Others, such as the National Association of State Utility Consumer Advocates (“NASUCA”) and Cost-Based Intercarrier Compensation Coalition

(“CBICC”) proposals, assume that all carriers – in all markets – can pass on to consumers a substantial portion (or even all) of the costs currently recovered through intercarrier compensation. It would be error for the Commission to adopt any of them as proposed.

Finally, the Commission should not attempt to create new intercarrier compensation rules unless it applies those rules at both the interstate and intrastate levels. As the Commission has recognized, many of the concerns regarding the current regulatory scheme – and some of the primary opportunities for arbitrage – are rooted in the efforts by some carriers to evade the current rules in order to exploit the disparity between the interstate rates regulated by the Commission and the intrastate and local rates currently regulated by state commissions. The Commission therefore cannot remedy those concerns unless it first concludes that it can preempt state regulation and assume control of all intercarrier compensation issues. While this admittedly raises a non-trivial legal issue as to the Commission’s authority, there are reasonable arguments supporting preemption of existing state commission authority that are consistent with the statute and Commission precedent. If the Commission nevertheless concludes that it lacks preemptive authority over intrastate traffic, it should not resort to half-measures by adopting new rules for interstate traffic only. Rather, if the Commission concludes that transitional default rules are needed, then under these circumstances it should first seek exclusive authority over intercarrier compensation from Congress, including both interstate and intrastate traffic.

**I. INTERCARRIER COMPENSATION SHOULD BE ESTABLISHED THROUGH NEGOTIATED, COMMERCIAL ARRANGEMENTS**

In the 1996 Act, Congress sought to create a pro-competitive, deregulatory framework for the provision of local telephone service that reflects the “virtues of negotiated competition.” *Verizon North Inc. v. Strand*, 367 F.3d 577, 585 (6th Cir. 2004). For this reason, courts have rightly rejected regulations that would “place[] a thumb on the negotiating scales.” *Wisconsin*

*Bell, Inc. v. Bie*, 340 F.3d 441, 444 (7th Cir. 2003), *cert. denied*, 540 U.S. 1142 (2004).

Consistent with these principles, the Commission recently eliminated the pick-and-choose rule, precisely because it had proved to be an impediment to voluntary negotiations between incumbents and competitors.<sup>2</sup> In the context of intercarrier compensation as well, the Commission has recognized that negotiated, commercial solutions are superior to regulatory prescriptions, finding that “negotiated agreements between carriers are more consistent with the pro-competitive process and policies reflected in the 1996 Act.”<sup>3</sup> Indeed, the Commission routinely recognizes that “the best way to achieve reliable, ubiquitous service . . . is to encourage further reliance on negotiation and market-based solutions to the fullest extent possible.”<sup>4</sup>

Consistent with this precedent, the Commission should hold here that comprehensive intercarrier compensation reform will be attained through commercial, “negotiated agreements between carriers,” rather than a new set of “detailed rules and regulations.”<sup>5</sup> *FNPRM* ¶ 33.<sup>6</sup> Indeed, it is clear from the history of the Commission’s various attempts to regulate intercarrier compensation that one-size-fits-all regulatory solutions cannot fully address the complexities of today’s telecommunications markets. Such rules have been – and will continue to be – gamed by carriers keen on exploiting arbitrage opportunities rather than engaging in actual competition.

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<sup>2</sup> See Second Report and Order, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 19 FCC Rcd 13494, ¶¶ 12-13 (2004).

<sup>3</sup> Declaratory Ruling and Report and Order, *Developing A Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, FCC 05-42, ¶ 14 (rel. Feb. 24, 2005).

<sup>4</sup> Report and Order, *Cellular Service and Other Commercial Mobile Radio Services in the Gulf of Mexico*, 17 FCC Rcd 1209, ¶ 27 (2002).

<sup>5</sup> The Commission should waive, modify, or forbear from existing rules to the extent necessary to enable carriers to enter into commercially negotiated intercarrier compensation arrangements.

<sup>6</sup> Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685 (2005) (“*FNPRM*”).

By contrast, a market-based approach, based upon negotiated, commercial agreements, is the best long-term solution to ensuring the efficiency of the telecommunications markets in the face of substantial technological change. Commercial solutions are desirable because they permit interconnecting carriers to develop terms of service between them that reflect the economic substance of their exchanges of traffic. This is because markets are “economizers of information,”<sup>7</sup> enabling parties to reach an efficient outcome through negotiation even when they lack complete information, as each party can use information about its own network to estimate the value of interconnection with another network. Moreover, a market-based approach, by virtue of being technologically neutral, adapts more easily to changing technologies, encouraging their introduction without the need for modification of regulatory regimes.<sup>8</sup>

**A. Negotiated, Commercial Arrangements Between Interconnecting Carriers Have Proven Successful**

Today’s marketplace provides numerous examples of different networks interconnecting on commercially negotiated terms in the absence not only of any regulation of the rates on which they exchange traffic, but also in the absence of any regulatory mandate to interconnect in the first place. The most relevant example for these purposes is the Internet. What is commonly referred to as “the Internet” in fact consists of a series of individual networks, owned and operated by many different entities, that have entered into purely voluntary interconnection arrangements. See Declaration of Lyman Chapin ¶¶ 5-8 (“Chapin Decl.”) (attached hereto as Attach. A). The structure of this “network of networks” ensures that traffic can flow between

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<sup>7</sup> See, e.g., Vernon L. Smith, *Markets as Economizers of Information: Experimental Examination of the Hayek-Hypothesis*, 20 *Econ. Inquiry* 165 (1982).

<sup>8</sup> See, e.g., Memorandum Opinion and Order, *Petition of SBC Communications Inc. for Forbearance from the Application of Title II Common Carrier Regulation to IP Platform Services*, WC Docket No. 04-29, FCC 05-95, ¶ 14 (rel. May 5, 2005) (noting that SBC sought regulatory relief for “newly constructed . . . IP networks that SBC plans to roll out later this year”) (“*IP Platform Forbearance Order*”).

any two end points on the Internet, irrespective of whether their service providers are directly connected. *See id.* ¶¶ 11-12, 28. This is made possible through interconnection arrangements entered between various networks, which specify where and how traffic will be exchanged, and whether and how compensation will be paid for the exchange of traffic. *See id.* ¶ 36. Different arrangements can contain vastly different terms, based on the needs of the networks involved, and their assessment of the value that each obtains from interconnecting with the other. *See id.* ¶¶ 36-40.

All such arrangements – whether a simple bilateral agreement to deliver traffic to and from each others’ end-user customers or a multi-party agreement to exchange traffic destined to end-user customers of the parties to the agreement as well as other end-users served by non-party networks – are made on the basis of a perceived equitable exchange of value between the interconnecting parties. *See id.* ¶¶ 40. If the parties agree that each network receives equal value from the simple fact of interconnection, they may agree to exchange traffic on what is, in effect, a barter system known as “peering” and that can be more accurately described as an “exchange of value,” pursuant to which the parties agree that the exchange of traffic itself provides an equitable exchange of value and therefore require no additional compensation. *See id.* ¶ 39. In other cases, interconnection is not perceived as an equitable exchange; instead, one network is perceived as receiving greater value from interconnection, based on one or more of a variety of characteristics of the two networks. *See id.* ¶¶ 39-40. In these cases, the network receiving the higher value will compensate the network with which it interconnects, on a cash or other basis, through commercial “paid peering” or “transit” arrangements. *See id.* Although the various determinants of value gained by interconnecting any two networks are unique to each particular

interconnection, the market has become increasingly transparent and participatory, with many networks openly publishing their interconnection and peering policies. *See id.* ¶ 40 nn.15-16.

These negotiated, commercial agreements – which capitalize on networks’ strong incentives to interconnect – have been tremendously successful and have been credited for the rapid growth in the capacity of the Internet. *See id.* ¶¶ 42-43.<sup>9</sup> These agreements, moreover, have ensured that the Internet is always fully interconnected – any end-user connected to the Internet can communicate with any other end-user – regardless of whether any particular pair of networks is directly interconnected. *See id.* ¶ 43. As a result of the availability of connection points and the architecture of the Internet, there is virtually no possibility that a network could find itself disconnected from the Internet, even if one or many other networks refused to interconnect with it, as is their right. *See id.*

Moreover, the success of negotiated interconnection arrangements on the Internet is highly relevant to the Commission’s approach to intercarrier compensation in the context of the circuit-switched telephone network. The experience of the Internet demonstrates not just that negotiated agreements can work. Rather, the Internet experience demonstrates that, because carriers have strong incentives to interconnect their networks and to do so in an economically efficient manner, negotiated agreements among carriers are the most effective way of ensuring efficient interconnection arrangements and efficient network development. The Internet

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<sup>9</sup> This is true worldwide. For example, the Internet developed later and less rapidly outside North America, such that for a time, networks overseas connected to the Internet through North America. *See Chapin Decl.* ¶ 46. Although there was some pressure, as recently as five years ago, for international regulation of interconnection between North American networks and networks in other countries, market demands for more efficient interconnections overseas led to the development of dozens of viable regional Internet exchanges outside of North America. Thus, market forces and the competitive process, rather than regulation, created more efficient means of connecting overseas networks to the Internet, and any pressure for international regulators to step in dissipated. *See id.* ¶¶ 46-47.

therefore provides a model for a deregulatory approach to network interconnection that this Commission should follow in its review of intercarrier compensation.

**B. One-Size-Fits-All Regulatory Regimes Have Not Proven Successful**

In contrast to the success of negotiated commercial agreements, one-size-fits-all regulatory regimes have not proven successful. Top-down attempts to craft intercarrier compensation rules to apply to all network interconnections will necessarily fail to foresee how those rules will apply (and can be evaded or misapplied) in all situations. Arbitrage is therefore the inevitable result of any attempt to impose a one-size-fits-all regulatory scheme across the board. This is particularly true in the case of today's telecommunications industry, which is experiencing swift and far-reaching changes driven by constantly evolving technology. Neither regulators nor carriers can possibly foresee the ways in which new technologies may present opportunities for creative carriers to manipulate the regulatory regime in order to obtain arbitrage profits. For this reason, the Commission should not attempt to create a new one-size-fits-all approach to intercarrier compensation, but rather should allow more efficient and effective market forces to drive negotiated commercial agreements.

The Commission's experience with the current intercarrier compensation rules illustrates the difficulties inherent in one-size-fits-all regulatory solutions. For example, carriers have engaged in regulatory arbitrage by camouflaging or denying the true nature of traffic exchanged with other carriers in order to manipulate the current system and receive more favorable treatment under the current rate structure. Some carriers have simply asserted that some feature of their internal network configuration exempts their traffic from certain intercarrier compensation obligations. AT&T, for example, asserted that it could evade its obligation to pay access charges on long-distance calls simply by converting a call that originated and terminated as a circuit-switched call to IP format at some point in the middle. See IP-in-the-Middle Order

¶ 11.<sup>10</sup> The Commission rejected AT&T's claim, finding that AT&T was engaging "in arbitrage at the cost of what other parties are entitled to under the statute and our rules." *Id.* ¶ 17. Other interexchange carriers have been sued for engaging in this same ploy. The Commission similarly rejected another recent attempt by AT&T to avoid complying with existing rules, this time asserting that it was entitled to pay the lower interstate access charges rather than the higher intrastate access charges, because it made the business decision to route calling card calls through a centralized advertising platform. See AT&T Calling Card Order ¶¶ 6-7.<sup>11</sup> The Commission rejected all of the various grounds on which AT&T asserted that its call routing decisions exempted it from paying intrastate access charges and found, moreover, "that AT&T had no reasonable basis to expect to avoid [existing] obligations merely by adding an unsolicited advertising message to its prepaid calling card service." *Id.* ¶¶ 22-29, 32.

Other competitors have widely employed virtual NXX service, which enables them to disguise calls between customers in different local calling areas – and even in different states – and to make such calls appear to be local calls for which the competitor would be entitled to compensation.<sup>12</sup> The purpose of these arrangements, as one competitor candidly admitted, is to "prevent [the incumbent's] switching equipment from identifying the call as crossing a local calling area," because then the incumbent would properly "impose access charges on a call

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<sup>10</sup> Order, *Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, 19 FCC Rcd 7457 (2004) ("IP-in-the-Middle Order").

<sup>11</sup> Order and Notice of Proposed Rulemaking, *AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services; Regulation of Prepaid Calling Card Services*, 20 FCC Rcd 4826 (2005) ("AT&T Calling Card Order").

<sup>12</sup> See Memorandum Opinion and Order, *Application by Verizon Maryland Inc., et al. To Provide In-Region, InterLATA Services in Maryland, Washington, D.C., and West Virginia*, 18 FCC Rcd 5212 ¶ 149 (2003) (describing virtual NXX arrangements).

crossing local calling areas.”<sup>13</sup> Where these arrangements went undetected, competitors were able to receive compensation on calls for which they should have been paying compensation under existing rules. Other carriers have routed calls, or tampered with data identifying calls, to obtain the same benefits.

Still other carriers have attempted to use consumers’ desire to utilize developing technologies – specifically the Internet – to create the largest and most anti-competitive of the arbitrage opportunities to have arisen as a result of the 1996 Act. These carriers exist primarily – or even exclusively – to deliver calls to Internet Service Providers (“ISPs”) for further transit onto the Internet, erroneously claiming entitlement to reciprocal compensation on the grounds that they are purportedly terminating local calls.<sup>14</sup> As this Commission has recognized, “convincing evidence” demonstrates that requiring payment of compensation for ISP-bound calls “create[s] opportunities for regulatory arbitrage and distort[s] the operation of competitive markets.” *ISP Remand Order* ¶¶ 2, 81.<sup>15</sup> Those arbitrage opportunities “created incentives for inefficient entry of [competitors] intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act.” *Id.* ¶¶ 21, 70. Those arbitrage opportunities have also thwarted technological advancement, as the carriers

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<sup>13</sup> Brief for Plaintiff-Appellant at 3-4, *Global NAPs, Inc. v. Verizon New England Inc.*, No. 04-4685 (2d Cir. filed Nov. 22, 2004).

<sup>14</sup> As Verizon has demonstrated in prior filings, these carriers’ claims to reciprocal compensation are entirely unfounded. *See generally* Verizon and BellSouth White Paper, CC Docket Nos. 96-98, 99-68 (filed May 17, 2004) (attached hereto as Attach. B); Verizon and BellSouth Supplemental White Paper, CC Docket Nos. 96-98, 99-68 (filed July 20, 2004) (“Verizon/BellSouth Supp. White Paper”) (attached hereto as Attach. C); Verizon and BellSouth Further Supplemental White Paper, CC Docket No. 96-98, 99-68 (filed Sept. 27, 2004) (attached hereto as Attach. D).

<sup>15</sup> Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 (2001) (“*ISP Remand Order*”), remanded, *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), cert. denied, 538 U.S. 1012 (2003).

profiting from serving dial-up ISPs promoted dial-up traffic at the expense of broadband, thereby undermining fundamental Commission policies. Despite growth in broadband deployment, dial-up ISP-bound minutes have not declined substantially: indeed, traffic from Verizon to competitors still exceeds traffic in the other direction by a ratio of 14:1 – proof that competitors continue to exploit the windfall of serving ISPs.<sup>16</sup>

These and other problems that the Commission and carriers have faced under the current regime are the inevitable result of top-down attempts to create a regulatory regime to govern all traffic exchanges. Any such attempt at one-size-fits-all regulation would suffer the same flaw, with variations only in the specific way in which the regulation could be gamed. Contrary to the claims of some, a mandatory bill-and-keep regime is no exception; bill-and-keep is no panacea to the problems of arbitrage and fraud. On the contrary, a bill-and-keep regime will spawn its own arbitrage opportunities and uneconomic investment incentives, only some of which can already be predicted today. For example, a bill-and-keep regime will likely lead to arbitrage opportunities that are the mirror image of the problem that the Commission has already seen with ISP-bound traffic. There, carriers attempted to take advantage of rules that imposed a standard per-minute fee for terminating traffic by serving only customers with a high volume of in-bound traffic: ISPs. By contrast, carriers will likely attempt to take advantage of a bill-and-keep regime by serving only customers with a high-volume of outgoing calls, such as telemarketers and other call centers. This is because under a bill-and-keep regime, carriers will be able to hand off their traffic to other networks without paying compensation. Carriers that serve only high-volume callers will therefore be able to pass off a substantial portion of their costs to other networks, by aggregating a large volume of outgoing traffic and handing it off to points on other

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<sup>16</sup> See Letter from Donna Epps, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 03-171, Attach. at 4-6 (filed Dec. 17, 2004).

networks that are as close to their switch as possible to minimize their own transport obligations. The other networks will be forced to bear substantial costs associated with transporting and terminating those calls, yet will receive no compensation from the carrier profiting from serving those high-volume callers. Indeed, this is a key reason that peering arrangements are not extended to all providers under the compensation scheme that prevails in the Internet, and backbone providers typically include a certain ratio of incoming to outgoing traffic in their peering policies.

Nor is bill-and-keep any more deregulatory in nature than other options. Adopting a bill-and-keep regime would necessarily require the Commission to make substantial regulatory determinations about the exchange of value provided by interconnection. In a bill-and-keep system, the exchange is still priced, but in terms of barter rather than money (while erroneously assuming that all traffic exchanges resulting from interconnection provide equal value). The Commission would therefore still be called upon to establish the terms of the barter – such as limitations on the network location or locations where traffic can be exchanged in order to obtain “free” exchange, technological standards for such exchanges, and the like. Indeed, the lengthy and detailed rules of the ICF plan make clear that a broad and complex new set of regulations would accompany any “deregulatory” bill-and-keep approach and would require the Commission to resolve a host of disputes about the application of those new rules.

## **II. PRINCIPLES FOR THE ADOPTION OF ANY TRANSITIONAL INTERCARRIER COMPENSATION DEFAULT RULES**

In the event that the Commission concludes that some modification to existing rules is necessary for use as a default during the transition to a regime of negotiated arrangements, the default rules that it adopts as a backstop to commercial negotiations must be carefully structured. The wrong reforms of intercarrier compensation rules could exacerbate existing arbitrage

opportunities or replace current problems with new ones that are equally bad or worse. Thus, the Commission must ensure that any reforms it adopts provide better overall incentives – not merely different incentives – for carriers and, therefore, better outcomes for consumers. Among other things, the more complex the new rules required to implement “reform,” the greater the likelihood for imprecision and ambiguity to give rise to disputes and unforeseen arbitrage opportunities. Below, Verizon addresses five principles for the creation of any such default rules.

**A. Any Transitional Inter-carrier Compensation Default Rules Should Recognize, As The Market Does, That Different Networks Have Different Values**

To the extent the Commission adopts new, transitional inter-carrier compensation default rules to allow for a transition to negotiated agreements, the Commission – no different from the market – should acknowledge the economic truth that interconnection does not always benefit both networks equally. That is because different networks have different values, which arise from the significant investment necessary to build and enhance those networks. The relevant characteristics of a network include the relative volume of traffic exchanged, the technological sophistication of the network, the particular geographic areas covered, the number of customers served, the characteristics of those customers, the data and other content available on the network, and the overall reliability, quality, and speed of the network. These characteristics ultimately reflect the payoff from a varying array of network-specific investment decisions and are not necessarily correlated with one another. The Commission must be careful in adopting changes to the current system of inter-carrier compensation not to upset the incentives to invest in order to enhance and improve existing networks and to build new ones.

The fact that interconnection can provide the interconnecting networks with an equal *or an unequal* exchange of value is reflected in the market-based arrangements discussed above for

Internet networks and for wireless carriers. Networks in each of these industries willingly enter into “peering” or “paid-peering” arrangements – that is, they agree to interconnect either without compensation or with compensation depending on their perception of the value that each network obtains from interconnecting with the other. Any default rule the Commission adopts as a transition to market-based arrangements should reflect this salient feature of network interconnection that is well-recognized in the market.

A transitional default rule that acknowledges that different networks can receive different values from interconnection ensures that all network operators will have the appropriate economic incentives with respect to further investments in their networks, as they negotiate commercial intercarrier compensation arrangements. Networks that provide more value can be assured that they will recoup investments in improving the attributes of their network both by attracting new customers and because they can charge other networks that have not made comparable investments. Similarly, less valuable networks will have appropriate incentives at the make-or-buy point – balancing the cost of paying others to accept their traffic against the cost of investing to increase the value of their network and, thereby, their number of potential peers. On the other hand, if the Commission adopted a transitional default rule that presumed that interconnection always provides both networks with equal value – so that no network has to provide any additional compensation to the other – network operators will have a reduced incentive to invest in network improvements. This is true for all networks, as such a default rule will eliminate the competitive advantages that, as the market recognizes, result from such investments and warrant compensation from interconnecting carriers. *See, e.g., Chapin Decl.* ¶ 40.

Some of the proposals that have been made to the Commission acknowledge the basic principle that interconnecting networks can receive different value from the exchange of traffic, but they fail adequately to ensure that carriers are compensated when, through interconnection, they provide more value than they receive. For example, the ICF proposal, like others, distinguishes between hierarchical networks, which include network access tandems subtended by end offices, and non-hierarchical networks, which do not.<sup>17</sup> Nonetheless, the ICF proposal would require all networks to pay the same amount – nothing – when they exchange traffic. Although this may be the outcome that results from voluntary negotiations between comparable networks, it provides no recognition of the unequal exchange of value that may occur when different networks interconnect, depending on the characteristics of each of the networks. The CBICC proposal also ignores the value of networks and interconnection by basing all intercarrier compensation on TELRIC rates.<sup>18</sup> By requiring that all networks exchange traffic at below cost rates, the CBICC proposal fails to compensate carriers for the different levels of value provided through interconnection. Because the proposals currently before the Commission do not recognize and compensate for the possibility of unequal exchanges of value in interconnection, all should be rejected.

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<sup>17</sup> See Letter from Gary Epstein, counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Appendix A at 9-10 (filed Oct. 5, 2004) (“ICF Proposal” or “ICF Ex Parte Brief”); see also Letter from David Sieradzki, counsel for Western Wireless Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at Slide 12 (filed Feb. 3, 2005) (“Western Wireless Ex Parte”).

<sup>18</sup> See Letter from Richard Rindler, counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at 1 (filed Sept. 2, 2004) (“CBICC Ex Parte Materials”) (TELRIC pricing).

**B. Any Transitional Intercarrier Compensation Default Rules Should Facilitate And Not Impede Commercially Negotiated Arrangements**

To the extent the Commission establishes new, transitional default rules, the Commission should both refrain from interfering with existing commercial arrangements and ensure that any rules that it adopts as a “default” do not become mandatory in practice.

First, the Commission should take no action to regulate the existing regime of negotiated compensation arrangements between carriers that exchange traffic on an IP-to-IP basis. As explained above, these arrangements, particularly in the context of the Internet, have proved robustly successful without any regulation at all, and would be harmed by the overlay of a new federal regulatory regime. *See Chapin Decl.* ¶¶ 9, 48-52. Such top-down regulation would surely fail in its aim of “improving” upon existing commercial arrangements, as top-down regulation is inherently contrary to the decentralized manner in which the Internet ensures universal connectivity. *See id.* As Chairman Martin recently reiterated, it is the “removal of legacy regulations” that will “spur investment and the deployment of new packetized networks and facilities that will bring new broadband services to all Americans throughout the nation.” *IP Platform Forbearance Order*, Sep. Statement of Chairman Martin (emphasis added). The Commission, moreover, should strive to “creat[e] a level-playing field for the provision of advanced services by similarly situated service providers” by ruling that all traffic exchanged on an IP-to-IP basis – regardless whether the packets are carrying voice, data, or video, and regardless of the carrier involved – shall have the advantages of the same deregulatory framework that applies today to the Internet. This is especially necessary given the rapid convergence of voice and data being transmitted on the same IP basis as all other Internet traffic.

Second, with respect to the circuit-switched networks that will be transitioning to these voluntary, commercial arrangements, the Commission must be careful that any default rules it

adopts do not in practice degenerate into mandatory rules with results that are inconsistent with efficient, market-based intercarrier compensation arrangements. For example, if the networks that make up the Internet always had the “default” option of entering into a non-paid peering agreement, there would be no economic incentive for the network that receives greater value from interconnection to consider any arrangement that would compensate the network that provides that value – the so-called “default” would quickly devour all possible bargaining alternatives even if such alternatives were efficiency-enhancing. Networks of equal value would continue to enter into peering arrangements under such a hypothetical “default” option, but a default is not necessary to ensure that efficiency-enhancing outcome, as the market has demonstrated. As a result, any default rule the Commission may adopt for circuit-switched networks should enable carriers to depart from those rules to make alternative arrangements that the parties deem appropriate given the relative value provided by interconnection between them.

The proposals currently before the Commission are not consistent with this principle. To be sure, many of these proposals describe their rules as mere default rules and state that carriers are free to negotiate alternative arrangements.<sup>19</sup> But the relevant question is not whether carriers are permitted to negotiate around the default rule, it is whether *both* parties to the negotiation will have the incentive to pursue such alternative arrangements. Where a default rule unduly benefits one class of carriers, those carriers are unlikely to enter into negotiated agreements that give up those benefits, even if such agreements are efficiency-enhancing.

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<sup>19</sup> See, e.g., ICF Proposal, Appendix A at 2; Letter from Glenn Brown, EPG Facilitator, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92, at 6, 15 n.10 (filed Nov. 2, 2004) (“EPG Ex Parte Materials”); CBICC Ex Parte Materials at 2; Letter from Philip F. McClelland for NASUCA, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92, at 1 (filed Dec. 14, 2004) (“NASUCA Ex Parte Materials”); Western Wireless Ex Parte at Slide 8.

That is the case with the proposals currently pending before the Commission. As discussed above, these proposals – such as the “bill-and-keep” proposals of the ICF and Western Wireless – fail to implement the principle that interconnection does not always result in an equal exchange of value between networks. Instead, they treat all networks identically (save for a carve out for rural networks), thereby foreclosing any incentive for lower value networks to negotiate alternative arrangements that result in payment of compensation to the higher value network, as would occur in a market-based system.

**C. Any Transitional Intercarrier Compensation Default Rules Should Provide For A Positive Default Rate**

Consistent with the principles discussed above, to the extent the Commission adopts default rules for use as a backstop during the transition to commercial arrangements, whether structured as default rates or as processes to resolve disputes, those default rules should provide for *positive* rates that are *more uniform* for various types of traffic than the current regimes. Any default rules should require that networks pay for the extent of their use of another network if they cannot reach agreement on an alternative arrangement. Such rules would ensure that the default replicates the result that would occur in the market in such circumstances. At the same time, such a default will do nothing to alter the incentive of comparable networks to negotiate peering-style arrangements, when it is efficient to do so, based on their recognition that interconnection provides each with roughly equal value and their desire to avoid the transaction costs associated with billing for the traffic they exchange.<sup>20</sup>

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<sup>20</sup> Any default rules adopted by the Commission should not, however, require any payment of intercarrier compensation for so-called “local” calls delivered to ISPs for further transit onto the Internet. As discussed above, ISP-bound traffic has proven to be the largest and most troublesome example of arbitrage under the 1996 Act. See *ISP Remand Order* ¶¶ 2, 21, 71, 80.

A default rate structure that is more uniform and positive will also provide a more efficient outcome than other alternatives, while substantially reducing opportunities for uneconomic arbitrage. Indeed, the current variety of intercarrier compensation regimes serves primarily to provide incentives for carriers to flout the existing rules and assert the right to pay (or to receive) more advantageous rates. A more uniform rate structure not only will reduce opportunities for carriers to benefit through non-compliance with current rules, but also will “be more technologically and competitively neutral than the current regimes.” *FNPRM* App. C at 104. Indeed, as the staff report rightly notes, such benefits will exist, “as compared to the current regimes, [with] *any unified approach*.” *Id.* (emphasis added). The decision whether to adopt a default rate structure with positive rates or to require bill-and-keep, therefore, is entirely independent of the benefits of default rules that contain a more uniform rate structure than currently exists.

A bill-and-keep regime – regardless of whether it is mandated by rule or in practice – also creates a host of new arbitrage opportunities and inefficiencies, thereby undermining the purpose of intercarrier compensation reform to create a more efficient system that promotes competition and consumer welfare. Any regime that requires networks to interconnect without regard to whether they provide each other with an equivalent exchange of value – and implicitly to let one network pay nothing for any additional benefits it receives – will lead to economically inefficient behavior. In the context of intercarrier compensation, a bill-and-keep regime would give less valuable networks a free ride on more valuable networks, which would bear the additional cost of carrying such calls with no offsetting compensation for the greater investments they have made in improving their networks in any of the various ways that give networks value. The free

ride would lead to overuse by other networks, and the uncompensated costs would lead to diminished investment and innovation in networks.

Supporters of a default bill-and-keep rule for virtually all traffic overlook these costs, but identify two grounds on which bill-and-keep is purportedly the superior default rate. *First*, they claim that bill-and-keep is simpler from a regulatory perspective, as it “eliminates the need for regulators to set the level and structure of termination rates.” *E.g., id.* at 106. But this argument proceeds from a fundamental mistake. Bill-and-keep involves a decision about the proper “level and structure of termination rates,” namely, whether carriers that obtain the lion’s share of the benefit from interconnection should have to compensate the other carrier for that benefit – as occurs in market-based arrangements – or may obtain it at no cost. The Commission will therefore be required to defend any decision to permit such carriers to obtain something for nothing – or, alternatively, the plainly erroneous premise that interconnection always provides roughly equivalent benefits to the interconnecting carriers – under the same standards that would apply were it to choose any positive rate.<sup>21</sup> In light of the flaws inherent in bill-and-keep regimes, including the disincentives to investment, the failure to provide compensation for value provided, and the institution of new arbitrage opportunities, a bill-and-keep default rule for virtually all traffic is not a legally defensible outcome.

Nor, contrary to the claims of some, would the establishment of a default rate structure that utilizes positive rates raise insurmountable difficulties. The Commission can craft such default rates from the variety of different rate levels in effect today that, taken together, attempt to provide carriers with compensation for the value provided for their networks. Indeed, any

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<sup>21</sup> *See, e.g., Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 543-44, 552-53 (8th Cir. 1998); *People of State of Cal. v. FCC*, 75 F.3d 1350, 1363-64 (9th Cir. 1996); *Aeronautical Radio, Inc. v. FCC*, 642 F.2d 1221, 1243-44 (D.C. Cir. 1980).

overhaul of intercarrier compensation should look to all existing rates in crafting a more unified rate scheme that will adequately compensate networks for their value.

*Second*, supporters of a bill-and-keep regime claim that, once the transition to bill-and-keep is complete, it would “dispose of most, if not all, of the existing compensation disputes between carriers,” by virtue of “eliminat[ing] intercarrier compensation payments.” *FNPRM* App. C at 109. On the contrary, as discussed above, disputes would simply shift to other areas, including over the terms on which carriers interconnect and the alternative methods by which carriers will be permitted to recoup the costs currently recovered through intercarrier compensation. In any event, any social benefits from reducing the total number of intercarrier disputes that might result from the adoption of a bill-and-keep rule would easily be outweighed by the social harms of bill-and-keep, discussed above.

For the foregoing reasons, the default rules in the various proposals presented to the Commission should be rejected. The ICF and Western Wireless proposal can be rejected out of hand because, although they establish a uniform rate structure, they do so through a bill-and-keep regime for virtually all traffic. Other proposals fail to establish a more uniform rate structure. Under the CBICC and NASUCA proposals, there would be a gap – and, therefore, an arbitrage opportunity – between interstate and intrastate rates, because they permit state commissions to adopt rates for intrastate traffic different from those applicable to interstate traffic.<sup>22</sup> Because none of the plans presented to the Commission provide for more uniform, positive rates for various types of traffic, the Commission should reject them.

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<sup>22</sup> See CBICC Ex Parte Materials at 1-2 (state-established intrastate access rates may not match interstate rates); NASUCA Ex Parte Materials at 1 (“encourag[ing]” states to meet interstate access rates, but leaving those rates in states’ discretion).

**D. Any Transitional Intercarrier Compensation Default Rules Should Provide Flexibility For Carriers To Recover Costs Currently Recovered Through Intercarrier Compensation**

The purpose of comprehensive intercarrier compensation reform, as the Commission has long explained, is to “encourage [the] efficient use of, and investment in, telecommunications networks, and the efficient development of competition.” *NPRM* ¶ 2.<sup>23</sup> The Commission recently reiterated “that any new approach should promote economic efficiency.” *FNPRM* ¶ 31. New rules, therefore, should “encourage[] the development of efficient competition, [which] is consistent with the goals of the 1996 Act,” and should “accommodate continuing change in the marketplace and . . . not distort the opportunity for carriers using different and novel technologies to compete for customers.” *Id.* ¶¶ 31, 33. In short, the goal of intercarrier compensation reform is to modify the sources from which carriers recover the costs currently recovered through the variety of current intercarrier compensation regimes.

Contrary to the claims of some, the goal of such reform is not to reduce carriers’ revenues or end-user rates. In past decisions restructuring intercarrier compensation rules, the Commission has repeatedly recognized that such rule changes should “generate workable competition,” which in turn will cause rates “to be driven to competitive levels,” and has rejected claims that it should prescribe rate reductions. *Access Charge Reform Order* ¶ 48.<sup>24</sup> That is because rules that encourage the “development and operation of competitive markets, . . . will maximize the efficient allocation of telecommunications services and promote consumer welfare.” *Id.* ¶ 260. Rule changes that directly cause “a substantial decrease in revenue for

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<sup>23</sup> Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610 (2001) (“*NPRM*”).

<sup>24</sup> First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Charges*, 12 FCC Rcd 15982 (1997) (“*Access Charge Reform Order*”).

incumbent LECs,” on the other hand, “could prove highly disruptive to business operations.” *Id.*

¶ 46. The Commission followed this approach in adopting the CALLS proposal, noting that it had “compared LEC revenues over the five-year period under the modified CALLS Proposal with what their revenues would be under the status quo, and conclude[d] that they are roughly the same.” *CALLS I Order* ¶ 41.<sup>25</sup> The Commission had done the same thing earlier in its Local Transport Restructure proceeding, when it adopted the residual interconnection charge and instituted a “transitional measure” – the “TIC” – that ensured that the “transport rate restructure” would leave LECs with roughly the same revenue as under the old rules.<sup>26</sup> And the D.C. Circuit has upheld the Commission’s prior refusals to transform proceedings designed to rationalize intercarrier compensation into proceedings designed to decrease LEC revenues and end-user charges. *See NASUCA v. FCC*, 372 F.3d 454, 459-60 (D.C. Cir. 2004).

The Commission should follow the same course here, and should reject calls by some to require substantial reductions in the amounts LECs currently receive through intercarrier compensation or that end-users currently pay through flat-rated charges. Indeed, such drastic changes in the way in which revenues are recovered would raise “serious constitutional questions” if the Commission did not provide alternatives through which carriers can recover amounts that had been obtained under prior rules. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315 (1989). As the D.C. Circuit has explained, such changes in rate methodologies can be “of

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<sup>25</sup> Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; Eleventh Report and Order in CC Docket No. 96-45, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962 (2000) (“*CALLS I Order*”), *aff’d in part, remanded in part, Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

<sup>26</sup> *See* Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; Usage of the Public Switched Network by Information Service and Internet Access Providers*, 11 FCC Rcd 21354, ¶ 96 (1996).

constitutional significance when [adopted] in isolation,” but will “have no constitutional effect if they are compensated by countervailing factors in some other aspect.” *Illinois Bell Tel. Co. v. FCC*, 911 F.2d 776, 780 (D.C. Cir. 1990) (internal quotation marks omitted). In other words, the Commission cannot, in adopting new rules, ignore that carriers made investments in light of the current rules, with the perfectly reasonable expectation that regulators would allow them an opportunity to recover their costs. For this reason, the Commission has previously recognized that it would have to consider explicit compensation for incumbent LECs if a “transformation” in the existing intercarrier compensation rules meant they would “have no reasonable opportunity to recover” “any historical costs.” *Access Charge Reform Order* ¶ 49.

For these reasons, to the extent it adopts transitional intercarrier compensation default rules, the Commission should again ensure that it provides carriers with opportunities to recover costs currently recovered through intercarrier compensation. These costs can be recovered through some combination of intercarrier compensation and end-user charges (whether retail rates, SLCs, or other charges). The Commission should provide carriers with sufficient flexibility to utilize all of these methods, because no one approach will be appropriate for all carriers in all markets. In particular, the Commission cannot blithely assume that carriers will be able to increase charges to end-user customers where other sources of compensation are reduced. *See, e.g., FNPRM App. C* at 104 (deeming it a “benefit of a bill-and-keep regime” that all carriers “must recover their own costs from their own retail customers,” without addressing the mechanism through which this could lawfully and practically be accomplished).

The plans currently before the Commission do not abide by this principle. Instead, all of the plans assume that carriers would be able to pass a substantial portion (or even all) of the costs

currently recovered through intercarrier compensation to end-users, with little regard for the different regulatory and associated competitive conditions in different markets.<sup>27</sup>

For example, consistent with its past efforts to use intercarrier compensation reform as a means of reducing LEC revenue, NASUCA's proposal provides no opportunity for carriers to recover the costs currently recouped through intercarrier compensation. Indeed, the NASUCA proposal would substantially reduce interstate rates, stripping carriers of much of the revenues currently used to cover network costs, while providing no alternative federal mechanism for the recovery of those costs. NASUCA goes so far as to urge states to reduce intrastate rates by an even greater margin, again without providing an alternate recovery scheme.<sup>28</sup> But as the Supreme Court has held, and the Commission has recognized, regulators cannot simply take for granted that other regulators will devise some opportunity for carriers to recover amounts previously recovered through the old regulatory regime.

The bill-and-keep proposals before the Commission pose similar problems. The ICF proposal would eliminate intercarrier access and reciprocal compensation revenues entirely, assuming that the bulk of the costs now covered by those charges could be passed to consumers through SLC increases.<sup>29</sup> Western Wireless similarly assumes that substantial costs can be shifted to end-user customers through SLC increases, and provides that carriers' only avenue for

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<sup>27</sup> See Letter from Keith Oliver, Home Telephone Company, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at Slide 8 (filed Nov. 9, 2004) (end-user "access" charge); NASUCA Ex Parte Materials at 1 (assuming state-authorized retail rate increases); Western Wireless Ex Parte at 6 (retail rate increases); ICF Proposal, Appendix A at 62-69 (SLCs); Letter from Wendy Thompson Fast and Ken Pfister for the Alliance for Rational Intercarrier Compensation, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at 60-67 (filed Oct. 25, 2004) (retail rate "rebalancing"); EPG Ex Parte Materials at 23-26 (retail rate "benchmarks"); CBICC Ex Parte Materials at 2 (end-user charge).

<sup>28</sup> See NASUCA Ex Parte Materials at 1-2.

<sup>29</sup> See ICF Proposal, Appendix A at 62-68.

recovering costs associated with carrying others' traffic would be to increase end-user charges.<sup>30</sup> These proposals do not provide the necessary flexibility that different carriers will need in different markets. As a result, even where they promise opportunities for cost recovery on paper, the proposals are certain to fall short of the mark in practice.

**E. The Commission Should Preserve Established, Working Interconnection Arrangements**

In 1996, the Commission established a comprehensive set of rules governing the interconnection of incumbent and competitor networks. Except for some occasional modifications to those rules in the intervening years – predominantly with respect to collocation – the 1996 regulations continue to govern carriers' obligations with respect to interconnection architecture. Incumbents and competitors have negotiated, arbitrated, and litigated against this background, entering into thousands of interconnection agreements. Those agreements, and the rights and duties they impose upon the parties, often differ by state and even by carrier, reflecting the various interconnection arrangements that these carriers have put in place. Although some litigation over the scope of carriers' obligations continues, most of the hotly disputed issues have been resolved at the state and federal levels. These include, for example, whether state commissions can require a competitor to establish multiple points of interconnection in a LATA,<sup>31</sup> whether an incumbent can charge a competitor for costs resulting from the competitor's chosen point of interconnection ("POI"),<sup>32</sup> and when a competitor must deliver traffic to an

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<sup>30</sup> See *Western Wireless Ex Parte* at 14-18.

<sup>31</sup> See, e.g., *MCI Telecomm. Corp. v. Bell Atlantic Pa.*, 271 F.3d 491, 517-18 (3d Cir. 2001).

<sup>32</sup> See, e.g., *MCImetro Access Transmission Servs., Inc. v. Bellsouth Telecomms., Inc.*, 352 F.3d 872, 881 (4th Cir. 2003); *Southwestern Bell Tel. Co. v. Public Utils. Comm'n of Tex.*, 348 F.3d 482, 484 (5th Cir. 2003); see also *NPRM* ¶ 113.

incumbents' end office rather than requiring the incumbent to switch that traffic at a tandem.<sup>33</sup>

Although these issues have not been resolved to the uniform satisfaction of incumbents or competitors, they have been resolved, providing carriers with necessary certainty.

New regulations that require modification to existing interconnection arrangements would not only upset settled expectations, but also impose significant costs on carriers. Relocating POIs, redeploying facilities, and establishing trunk groups require carriers to expend resources – in terms of money, equipment, and time – that could better be used to provide newer and better services to end-user customers. Even if new rules only reallocate the financial responsibility for existing interconnection arrangements, carriers would likely be required to expend resources negotiating, arbitrating, and litigating amendments to interconnection agreements. In all events, because interconnection architecture is a highly carrier-specific, technical, and fact-intensive issue, any modification to the rules inevitably will create unintended opportunities for regulatory arbitrage.

Such arbitrage opportunities are exacerbated if the Commission engages in wholesale modification of its interconnection architecture rules at the same time it is implementing intercarrier compensation reform. As the Commission has previously recognized, the two sets of rules are interrelated and “the interplay of [interconnection architecture] rules and . . . compensation rules may lead to the deployment of inefficient or duplicative networks.” *NPRM* ¶ 114. That is because these rules assign financial responsibility for both the traffic that carriers

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<sup>33</sup> See, e.g., Arbitration Order, *Petition of Cablevision Lighthouse, Inc., Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration To Establish an Intercarrier Agreement with Verizon New York Inc.*, Case 03-C-0578, at 6-9 (NY PSC Oct. 24, 2003). Memorandum Opinion and Order, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, 17 FCC Rcd 27039, ¶¶ 88-91 (2002).

exchange and the facilities over which that traffic is exchanged, and the combination of the rules can reduce the cost of, and therefore encourage, inefficient network deployment. For example, the result of the combination of the Commission's single-POI-per-LATA rule and the reciprocal compensation obligation has been to require incumbents to subsidize a competitor when it decides to serve an end-user customer located a substantial distance from its switch. Although the competitor bears the cost of transporting the call between its switch and its end-user customer, the incumbent finds itself required to transport across a LATA a call that, in fact, is between two neighbors. By insulating competitors from this cost, competitors' incentives are skewed in favor of deploying transport and loops and against deploying additional switches.

To reduce arbitrage opportunities from the concurrent introduction of two sets of rules that have never been tested in the real world, and subjected to the creativeness of competitors, the Commission should largely hold its existing interconnection rules constant, while allowing carriers to negotiate agreements that vary from those rules. Indeed, the Commission should reject any intercarrier compensation reform plan that would require – or would provide overwhelming economic incentives for – carriers to engage in simultaneous and extensive network modifications.

Many of the plans proposed to the Commission, however, contemplate just such simultaneous, radical reform of both sets of rules. The ICF, for example, proposes to introduce the new concept of a "Network Edge" to the interconnection architecture rules. Under that proposal, a carrier would designate one or more Network Edges per LATA, irrespective of the number of points at which that carrier's network is interconnected with other carriers' networks,

and irrespective of the locations of those points. Originating carriers would then be required to hand off traffic at the terminating carrier's Network Edge, if they desired to do so at no charge.<sup>34</sup>

The introduction of the Network Edge concept would lead to substantial reconfiguration of existing interconnection arrangements – and similarly significant changes to their respective financial obligations for the facilities used to interconnect those networks. For example, current regulations provide for points of interconnection at any technically feasible point within an incumbent's network. *See* 47 C.F.R. § 51.305(a)(2). Under the ICF proposal, Network Edges are limited to a far smaller set of "Functional Network Locations" – which excludes many incumbents' end office switches, contrary to current Commission rules, *see id.* § 51.305(a)(2)(i) – but at the same time permits competitors to insist on a Network Edge that is outside the incumbent's network.<sup>35</sup> Although the ICF proposal permits carriers to exchange at other locations, it provides substantial incentives to exchange traffic only at Network Edges, by imposing no charge for traffic exchanged at an Edge. Thus, carriers that previously found it economic to interconnect with incumbents at an end office, for example, would have every incentive to re-route that traffic through a tandem to avoid paying intercarrier compensation. But tandem-routing is often inefficient and places unnecessary strain on the incumbents' network, while at the same time eliminating the obligation to pay compensation for this use of that network.

In addition, some opportunities for gaming this new Network Edge concept are readily apparent; others are likely less so. For example, a competitor could seek to sign up only those end-users located close to the incumbents' Network Edge. If that competitor then identified its

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<sup>34</sup> *See* ICF Proposal, Appendix A at 2. Western Wireless adopts this aspect of the ICF Proposal. *See* Western Wireless Ex Parte at 12.

<sup>35</sup> *See* ICF Proposal, Appendix A at 2-10.

own Network Edge at a point adjacent to the incumbents', the competitor would essentially eliminate its costs of transporting calls exchanged with the incumbent in that LATA. On outbound calls, the competitor would be responsible for carrying the traffic the very short distance to the incumbent's Network Edge, with the incumbent then responsible for transporting the traffic to end-users located throughout the LATA. Although the competitor would not receive compensation on inbound calls, it would receive those calls at a point close to its end-user customers' premises, while the incumbent, again, would bear the costs of hauling traffic from across the LATA to the competitor's Network Edge. Such a competitor would retain all of the revenues from its end-users, while shifting the costs of those customers' outbound calls to another carrier.

### **III. THE COMMISSION'S LEGAL AUTHORITY TO ADOPT COMPREHENSIVE INTERCARRIER COMPENSATION REFORM IS UNCERTAIN**

The Commission should not adopt new rules regarding intercarrier compensation unless it applies those rules to both interstate and intrastate traffic. If the Commission were to adopt new intercarrier compensation rules on a transitional or other basis, a primary reason for doing so would be to move toward a more uniform intercarrier compensation regime for various types of traffic, in order to provide fewer opportunities for arbitrage. Comprehensive reform, therefore, would have to address intercarrier compensation for both interstate and intrastate traffic.

While this admittedly raises a non-trivial legal issue, there nonetheless are reasonable arguments supporting the Commission's authority to establish an intercarrier compensation regime that applies to all traffic in today's environment. Under the existing Communications Act, Congress has expressly given the Commission direct authority to regulate intercarrier compensation for interstate and wireless traffic. The Commission can also regulate intercarrier compensation for non-local, intrastate traffic in certain circumstances, where the Commission

preempts the states' historical authority over such traffic. For example, it is beyond question that the Commission has authority over interstate and intrastate voice over IP ("VoIP") and wireless traffic. In addition, there is a reasonable argument, detailed below, that the same principles that provide the basis for the Commission's authority over all VoIP and wireless traffic also give the Commission authority over interstate and intrastate intercarrier compensation in today's increasingly complex technological and market environment. If the Commission concludes that new, transitional rules are warranted but that the Commission does not have the authority to assume jurisdiction over both interstate and intrastate intercarrier compensation, it should seek such authority from Congress. Most importantly, the Commission should not attempt to reform intercarrier compensation on a piecemeal basis, crafting new compensation rules to apply to interstate traffic while leaving compensation for intrastate traffic in the hands of more than 50 states and territories.

What is certain is that the Commission should reject arguments by some parties that it can regulate intercarrier compensation for all traffic through 47 U.S.C. § 251(b)(5). Properly interpreted, § 251(b)(5) reaches only intraexchange traffic exchanged between two local telephone companies. In any event, the Commission has authority only to establish general rules governing intercarrier compensation for traffic subject to § 251(b)(5); the state commissions have the authority to apply those general rules and set the actual rates. Reliance on § 251(b)(5), therefore, would destroy the Commission's ability to establish any kind of uniform intercarrier compensation regime and would instead create more than 50 separate state regimes.

**A. The Commission's Authority To Establish Rules Governing Intercarrier Compensation For All Traffic In Today's Environment**

As noted above, comprehensive intercarrier compensation reform must address intercarrier compensation for both interstate and intrastate traffic. Congress has explicitly given

the Commission authority over intercarrier compensation for interstate traffic. *See* 47 U.S.C. § 201(b).<sup>36</sup> Congress has also expressly extended the Commission’s authority under § 201(b) to all wireless traffic. *See* 47 U.S.C. § 332(c)(1).<sup>37</sup> In particular, because Congress has expressly preempted state “regulat[ion] [of] . . . the rates charged by any commercial mobile service,” “[n]otwithstanding section[] 2(b),” the Commission also has sole authority to regulate intercarrier compensation for intrastate wireless traffic.<sup>38</sup>

To the extent that any new intercarrier compensation rules address other forms of intrastate traffic, those rules would have to be reconciled with § 2(b), which generally prevents the Commission from regulating “charges . . . for or in connection with intrastate communication service.” 47 U.S.C. § 152(b). As the Supreme Court has explained, § 2(b) is “not only a substantive jurisdictional limitation on the FCC’s power, but also a rule of statutory construction,” and will normally “den[y] the FCC the power to preempt state regulation of . . . intrastate ratemaking.” *Louisiana Pub. Serv. Comm’n v. FCC*, 476 U.S. 355, 373 (1986). While any attempt by the Commission to regulate intrastate traffic would admittedly raise a non-trivial legal question, the Supreme Court has not interpreted § 2(b) as an absolute bar on the preemption of state regulation of intrastate traffic. Rather, the Court has recognized that the Commission

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<sup>36</sup> *See* Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd 10175, ¶ 7 (1997) (“[N]o one has questioned (or plausibly could question)” that § 201(b) provides the Commission with “authority over interstate access charges”); Seventh Report and Order and Notice of Proposed Rulemaking, *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, 16 FCC Rcd 9923, ¶ 21 (2001) (§ 201(b) provides Commission with authority over CLEC interstate access charges); *FNPRM* ¶ 78.

<sup>37</sup> *See* Declaratory Ruling, *Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, 17 FCC Rcd 13192, ¶¶ 8-12 (2002); Second Report and Order, *Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Services*, 9 FCC Rcd 1411, ¶ 179 (1994).

<sup>38</sup> *See Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (subsequent history omitted); *NPRM* ¶ 82.

properly preempts state authority “where it [is] not possible to separate the interstate and intrastate components” of the services at issue. *Id.* at 375-76 n.4. Thus, the D.C. Circuit in *Public Service Commission of Maryland v. FCC*, 909 F.2d 1510, 1515 (D.C. Cir. 1990), upheld the Commission’s authority to preempt state regulation of rates LECs charged IXCs for disconnect-for-nonpayment (“DNP”) service. The D.C. Circuit noted that it had “frequently held that services provided locally by the LECs which support access to the interstate communications network have interstate as well as intrastate aspects.” *Id.* at 1515. The D.C. Circuit held that disconnection of local service “falls within the FCC’s regulatory jurisdiction because it would be impossible to separate the interstate and intrastate components of DNP,” in light of the Commission’s finding that “disconnecting a customer’s local service for nonpayment . . . must also disconnect his interstate service.” *Id.* at 1516. The D.C. Circuit has similarly held that the Commission can issue “a valid . . . preemption order” with respect to state regulation of inside wiring, if that order is limited to state rules “that would necessarily thwart or impede the operation of a free market in the installation and maintenance of inside wiring.” *NARUC v. FCC*, 880 F.2d 422, 430 (D.C. Cir. 1989). The Ninth Circuit has upheld the Commission’s preemption of information services that have both interstate and intrastate components on the same grounds. *See California v. FCC*, 39 F.3d 919, 932 (9th Cir. 1994).

Applying these principles, the Commission has asserted unquestionable preemptive authority over intrastate traffic in the context of VoIP and wireless telecommunication. Most recently, in the *Vonage Order*, the Commission concluded that preemption was appropriate in the context of Vonage’s VoIP service because there was no “plausible approach to separating

DigitalVoice into interstate and intrastate components.” *See Vonage Order* ¶ 23.<sup>39</sup> As the Commission explained, information regarding the jurisdiction of calls was not “reliably obtainable,” and the “significant costs and operational complexities” of attempting to track, record, and process jurisdictional information were prohibitive. *See id.* ¶¶ 23, 25. Similar inseparability concerns formed the basis of the Commission’s preemption of state authority with regard to wireless communications. *See Local Competition Order* ¶ 1044 (recognizing that, among other things, “it may be difficult for CMRS providers to determine, in real time, . . . the customer’s specific geographic location”)<sup>40</sup>; *NPRM* ¶ 80 (noting prior observation that “preemption of intrastate regulation [of compensation for LEC-CMRS traffic] may be warranted on the basis of inseparability”).

Relying on this precedent, the Commission can reasonably assert preemption over state regulation of intrastate access charges. The same inseparability concerns that gave rise to the Commission’s preemption authority with regard to VoIP and wireless calls increasingly apply to all telecommunications traffic. As telephone numbers become increasingly detached from their historical, geographic affiliations – through consumers’ increasing use of wireless and VoIP services, which offer both mobility and the assignment of telephone numbers unrelated to the subscriber’s residence – it will become increasingly difficult to separate traffic into intrastate and interstate components. Consumers’ ability to port telephone numbers between different modes of telecommunication will also increasingly frustrate any ability to separate intrastate wireless and IP-enabled traffic – all of which is subject to the Commission’s authority – from intrastate

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<sup>39</sup> Memorandum Opinion and Order, *Vonage Holdings Corporation, Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404 (2004) (“*Vonage Order*”).

<sup>40</sup> First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) (“*Local Competition Order*”) (subsequent history omitted).

wireline communications, which currently is not. As was the case in the *Vonage Order*, the “significant costs and operational complexity” that would be associated with modifying or supplementing carriers’ systems for tracking and segregating these different categories of traffic would serve “no legitimate policy purpose.” See *Vonage Order* ¶¶ 23, 25. The Commission therefore has good grounds for preempting state authority over intrastate intercarrier compensation. But, if the Commission were to conclude for any reason that it lacks authority to regulate intercarrier compensation for intrastate traffic, the Commission should seek such authority from Congress so that the Commission could address issues related to intercarrier compensation comprehensively, rather than piecemeal.

**B. The Commission Should Reject Arguments That § 251(b)(5) Authorizes It To Adopt Rules To Govern Intercarrier Compensation For All Traffic Exchanged Between Carriers**

Some have suggested that the Commission could (and should) avoid § 2(b) by reading § 251(b)(5) to cover all traffic exchanged between and among all carriers. See, e.g., ICF Ex Parte Brief at 28-35. They do so because the Supreme Court, in *Iowa Utilities Board*, held that the Commission has authority to regulate intrastate traffic in the course of prescribing rules, under § 201(b), to implement the provisions added by the 1996 Act, including §§ 251 and 252. See *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-81 (1999). But reliance on § 251(b)(5) would create more than 50 separate state intercarrier compensation regimes, rather than a single federal regime, because § 251(b)(5) does not authorize the Commission to regulate intercarrier compensation directly. In any event, § 251(b)(5) cannot lawfully be read to apply to long-distance and other interexchange traffic. The Commission, therefore, should reject any suggestion that it find in § 251(b)(5) authority to adopt comprehensive intercarrier compensation reform.

Although the Supreme Court held in *Iowa Utilities Board* that the Commission can regulate intrastate traffic when it implements the local competition provisions of the 1996 Act, the Court did not read those provisions to give the Commission direct control over intrastate rates. Instead, in the related context of the Commission’s authority to implement § 252(d)(1),<sup>41</sup> the Court held that the “Commission has jurisdiction to design a pricing methodology.” *Iowa Utils. Bd.*, 525 U.S. at 385. But it “is the States that will apply th[e] [statutory pricing] standards and implement th[e] [Commission’s] methodology, determining the concrete result in particular circumstances.” *Id.* at 384 (emphasis added).

No different from the Supreme Court, the Commission has recognized as a general matter that “the obligations created by section 251 and our rules are effectuated through the process established in section 252,” which envisions state commission arbitration of disputes about the implementation of the § 251 obligations and the Commission’s rules implementing them.<sup>42</sup> Courts of appeals have similarly held that “[i]nterconnection agreements are . . . the vehicles chosen by Congress to implement the duties imposed in § 251.” *Verizon Md. Inc. v. Global NAPs, Inc.*, 377 F.3d 355, 364 (4th Cir. 2004); see *BellSouth Telecomms. Inc. v. MCI Metro Access Transmission Servs., Inc.*, 317 F.3d 1270, 1278 (11th Cir. 2003) (en banc) (“Interconnection agreements are tools through which the [1996 Act is] enforced”).

Therefore, if the Commission were to interpret § 251(b)(5) to apply to all traffic, it would be limited to designing a “pricing methodology” for state commissions to follow; but it would be

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<sup>41</sup> Just as Congress gave state commissions the authority to “[d]etermin[e] . . . the just and reasonable rate for network elements,” it gave those commissions the authority to determine whether “the terms and conditions for reciprocal compensation [in an interconnection agreement are] just and reasonable.” 47 U.S.C. § 252(d)(1), (2)(A).

<sup>42</sup> Memorandum Opinion and Order, *Core Communications, Inc. v. SBC Communications Inc.*, 18 FCC Rcd 7568, ¶ 30 (2003) (emphasis added), vacated and remanded on other grounds, *SBC Communications Inc. v. FCC*, No. 03-1147, 2005 U.S. App. LEXIS 8404 (D.C. Cir. May 13, 2005).

the various state commissions that would each have the authority to implement that methodology and determine the “concrete result” in any case through the § 252 process. *Iowa Utils. Bd.*, 525 U.S. at 384-85. The federal district courts, not the Commission, would have the authority to review such state commission decisions for compliance with the Commission’s regulations. *See* 47 U.S.C. § 252(e)(6). For these reasons, reliance on § 251(b)(5) would doom any effort to establish a uniform intercarrier compensation regime, and would instead create more than 50 separate regimes, outside of the Commission’s direct control.

In addition, because state commissions have authority over *any* traffic that the Commission concludes is subject to § 251(b)(5), embracing arguments that interstate traffic comes within § 251(b)(5) would give states authority over compensation for traffic that has previously been within the Commission’s exclusive control, including Internet traffic and interstate long distance traffic. Therefore, while there is no question of the Commission’s authority, today, to establish a single regime for interstate traffic, interpreting § 251(b)(5) to apply to all traffic exchanged between all carriers would spread the *disuniformity* inherent in the § 252 process to these other types of traffic.

In any event, the Commission cannot rely on § 251(b)(5) as a source of authority to regulate all traffic. Verizon has previously catalogued at length the various reasons that § 251(b)(5), along with § 252(d)(2), can only be read to apply to traffic that originates on the network facilities of one local exchange carrier and terminates on the network facilities of an interconnecting local exchange carrier within the same local calling area.<sup>43</sup> While we will not repeat that entire discussion here, the salient points can be briefly summarized as follows:

- *First*, the express terms of the 1996 Act make clear that reciprocal compensation applies only to traffic that *terminates* on the network of an

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<sup>43</sup> *See supra* note 14 & Attachs. B-D.

interconnecting local exchange carrier and that excludes long-distance traffic, which does not terminate on the LEC network. See §§ 251(b)(5), 252(d)(2)(A).

- *Second*, historical background and the legislative history reinforce the conclusion that § 251(b)(5) is limited to local telecommunications: reciprocal compensation was intended to fill a gap by addressing compensation for calls exchanged between local carriers competing in the same calling area; Congress did not intend for § 251(b)(5) to modify the existing compensation regimes for long-distance and other interexchange calls, which were already well established.
- *Third*, the reciprocal compensation obligation imposed by § 251(b)(5) applies to “[e]ach local exchange carrier”; it would be unworkable to read that provision as applying to traffic that LECs exchange with IXCs, because IXCs have no obligation under that provision to agree to pay LECs for the termination of traffic.
- *Fourth*, § 251(g) further emphasizes that Congress did not intend reciprocal compensation to displace the existing access regimes – to the contrary, given the care that Congress took to preserve the access regimes, it would be bizarre to read § 251(b)(5) to convert traffic for which LECs had long *received* originating access charges into traffic for which LECs would be required to *pay* reciprocal compensation.
- *Fifth*, this conclusion is still further reinforced by § 251(i), which says that nothing in § 251 shall be construed to limit or otherwise affect the Commission’s authority under § 201. Extending § 251(b)(5) to interstate access traffic would be flatly inconsistent with that rule of construction, because, as explained above, it would subject that traffic to reciprocal compensation at rates set *by the states*, not by the Commission, thereby limiting the Commission’s prior authority under § 201 – the very result that Congress barred.

See Verizon/BellSouth Supp. White Paper at 17.

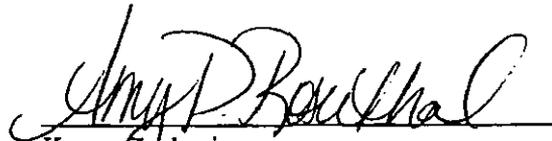
The Commission itself concluded in the *Local Competition Order* that § 251(b)(5) cannot be read to preempt state authority to establish intrastate access charges, and that conclusion was never challenged. See *Local Competition Order* ¶¶ 732, 1033. Instead, as the Commission has repeatedly held – and, as the D.C. Circuit noted, “everyone agrees” – § 251(b)(5) “doesn’t apply” to an “interexchange carrier phone call,” whether interstate or intrastate. Transcript of Oral Argument, *WorldCom, Inc. v. FCC*, Nos. 01-1218 *et al.*, at 9-10 (D.C. Cir. Feb. 12, 2002);

see also *ISP Remand Order* ¶ 37 n.66 (“we again conclude that it is reasonable to interpret section 251(b)(5) to exclude traffic subject to parallel intrastate access regulations”). Any attempt to expand the reach of § 251(b)(5) to cover all traffic could not be squared with these statutory provisions or the Commission’s prior rulings.<sup>44</sup>

**CONCLUSION**

For the foregoing reasons, the Commission should resolve the issues in this proceeding in accordance with these Comments.

Respectfully submitted,



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May 23, 2005

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<sup>44</sup> Nor can § 254 provide the Commission with sufficient authority to require bill-and-keep for all intrastate access traffic. See *FNPRM* ¶ 82. Indeed, commenters that support this view argue only that *existing* intrastate access charge regimes are inconsistent with § 254. See ICF Ex Parte Brief at 35-38. But that is a far cry from proving that *any* state regulation of intercarrier compensation for intrastate traffic is inconsistent with § 254 and must be preempted.

**APPENDIX A**

**THE VERIZON TELEPHONE COMPANIES**

The Verizon telephone companies are the local exchange carriers affiliated with Verizon

Communications Inc. They are:

Contel of the South, Inc. d/b/a Verizon Mid-States  
GTE Southwest Incorporated d/b/a Verizon Southwest  
The Micronesian Telecommunications Corporation  
Verizon California Inc.  
Verizon Delaware Inc.  
Verizon Florida Inc.  
Verizon Maryland Inc.  
Verizon New England Inc.  
Verizon New Jersey Inc.  
Verizon New York Inc.  
Verizon North Inc.  
Verizon Northwest Inc.  
Verizon Pennsylvania Inc.  
Verizon South Inc.  
Verizon Virginia Inc.  
Verizon Washington, DC Inc.  
Verizon West Coast Inc.  
Verizon West Virginia Inc.

# EXHIBIT 3

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**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of

Developing a Unified Intercarrier  
Compensation Regime

CC Docket No. 01-92

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**COMMENTS OF THE INTERCARRIER COMPENSATION FORUM**

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**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of

Developing a Unified Intercarrier  
Compensation Regime

CC Docket No. 01-92

**Comments of the Intercarrier Compensation Forum**

The Intercarrier Compensation Forum (“ICF”), by the undersigned, hereby offers these comments on the Commission’s recent Further Notice of Proposed Rulemaking (“Further Notice”) in the above-captioned proceeding.<sup>1</sup> We urge the Commission to engage in comprehensive, fundamental, and concurrent reform of the Commission’s intercarrier compensation, network interconnection, and universal service rules by adopting the ICF Plan for reform<sup>2</sup> without modification and without delay.

To date, ICF has submitted two major *ex parte* filings that offer detailed and comprehensive descriptions and analyses of the ICF Plan. Those filings are attached as appendices.<sup>3</sup> In these comments, we respond to the Commission’s observations and

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<sup>1</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 05-33, 20 FCC Rcd 4685 (2005) (“Further Notice”).

<sup>2</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Gary M. Epstein and Richard R. Cameron to Marlene H. Dortch (filed Nov. 5, 2004) (the “ICF Plan” or “the Plan”).

<sup>3</sup> Attached as Appendices are the following: Appendix A is a comprehensive legal analysis, expanding on the discussion *infra* at Part III, explaining the Commission’s jurisdictional and substantive authority to implement the ICF Plan in its entirety; Appendix B is a model demonstrating the results of the Plan; Appendix C is a summary of the Plan highlighting the Plan’s major components; Appendix D is the

questions in its March 3, 2005, Further Notice of Proposed Rulemaking, and demonstrate why the ICF Plan is the best proposal to guide America's intercarrier compensation system into the future.

### **INTRODUCTION AND SUMMARY**

We live in a new telecommunications world in which recent strides in technology have fundamentally altered the landscape. In particular, wireless and VOIP services are becoming immensely popular and are revolutionizing how millions of Americans communicate. With these two services growing exponentially, and new technologies on the horizon, the telecommunications industry stands on the threshold of a new era of unprecedented opportunities for innovation and growth.

Yet, outdated regulations are robbing consumers of the full benefits of these advances. The access charge and reciprocal compensation systems were developed years ago and implemented piecemeal in response to discrete regulatory needs. The Commission and the states have struggled—often on a technology-by-technology basis—to determine when access charges apply, when reciprocal compensation applies, and when or if there are circumstances where neither applies. Ad hoc implementation has produced compensation rules that “apply different cost methodologies to similar services based on traditional regulatory distinctions that may have no bearing on the cost of providing service.”<sup>4</sup> The systems' increasingly arbitrary regulatory distinctions have created uncertainty that hobbles the widespread deployment of broadband and suppresses incentives to develop new technologies.

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actual ICF Plan; and Appendix E is a series of diagrams depicting the interconnection arrangements under the current system, and under the ICF Plan.

<sup>4</sup> Further Notice ¶ 5

The current compensation systems also guarantee massive transaction costs from the continual, intrusive economic regulation necessary to establish and enforce the distinctions between the current intercarrier compensation systems. Radically different obligations—including whether a carrier must pay or be paid by another carrier—can turn on the regulatory “boxes” in which carriers and their traffic are classified. As a result, providers spend millions of dollars each year disputing which rates apply to specific traffic, and the amount and structure of those rates. By at least one estimate, industry participants now spend more money each year litigating disputes than they do on research and development of new or improved products.<sup>5</sup>

Rural customers are particularly vulnerable to the irrational distinctions embedded in the current intercarrier compensation regime because the vast majority of the carriers that serve them remain highly dependent on a revenue stream—high access charges—that the market is rejecting. A substantial amount of wireless traffic lies outside the access charge system, and competition for high-volume and business customers that pay above-cost rates is eroding wireline access charges as a source of revenue, thereby reducing any implicit support for universal service embedded in those charges. Moreover, the revenue sources for the system’s explicit universal service contributions are also declining as customers shift to service substitutes that are not subject to the universal service contribution obligations placed on interstate telecommunications.

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<sup>5</sup> Dr. Charles H. Ferguson, Brookings Institution, “Broadband Policy and the Future of American Information Technology,” Testimony Before the Senate Commerce Committee, Apr. 28, 2004.

Any effort to reform the intercarrier compensation system must recognize that a paradigm shift has occurred. It is not just that the current rules were created in a world that did not have to contemplate how to compensate a carrier when a VOIP user in Manhattan with a California area code calls a wireless subscriber based in Louisiana who is roaming in Brooklyn. It is also that consumers no longer view their telecommunications services (if they ever did) from the regulator's legacy perspective in which the calling party is the sole beneficiary of a call. With technological advances that allow called parties to screen out any unwanted calls, consumers increasingly view their connections to the network as allowing them to send *and receive* communications, and are willing to pay for this capability.<sup>6</sup> Consumers also no longer see the local/long-distance distinction as fundamental, or believe that piece-by-piece access to the network is the preferred way to buy service. They increasingly demand services that sell comprehensive connectivity through geographically unrestricted calling plans with unlimited quantity, rather than incremental, minute-based access to the network.

The Commission, state regulators, and every sector of the industry have long recognized the need for comprehensive reform.<sup>7</sup> It is now time to act. Of course, today's regulatory framework may eventually collapse under its own weight or be rendered irrelevant by new technologies. But the Commission cannot simply stand at the sidelines and wait for that to happen. Every day, this broken system fosters massive economic waste and inhibits innovation, harming consumers and producers alike.

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<sup>6</sup> See, e.g., Further Notice, Appendix C at 100-101.

<sup>7</sup> Further Notice Part 2(a), ¶¶ 15-17 (citing the comments of numerous industry members, coalitions, and regulators urging comprehensive reform).

With these concerns in mind, the ICF assembled more than two years ago to design a balanced plan for comprehensive reform. Its members—drawn from every sector of the industry—engaged in a rigorous, deliberative, eighteen-month process to create a global solution to the interrelated network interconnection and intercarrier compensation issues pending before the Commission. Over time, some participants dropped out, while others joined or rejoined, but all offered their diverse perspectives.<sup>8</sup> The ICF Plan incorporates input from all these participants. It is a balanced plan that does not tilt in favor of any one industry segment.

The ICF Plan solves the problems in the current system by proposing a comprehensive framework for direct, end-user payments that fosters competition, empowers consumers, and encourages the development of new services and technologies. The Plan establishes easily administered, competitively neutral rules that will promote efficient competition and create stability in the market, with minimal regulatory oversight. It also satisfies the unique needs of rural customers and carriers, without sacrificing the efficiency or sustainability needed for successful reform. The Plan reforms universal service, creating a stable and fair contribution methodology based on numbers and connections and explicit support mechanisms to replace the current unsustainable reliance on implicit support. Finally, the ICF Plan is authorized by existing law.

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<sup>8</sup> The current ICF members include AT&T Corp.; General Communications, Inc.; Global Crossing North America Inc.; Iowa Telecom; Level 3 Communications LLC; MCI, Inc.; SBC Communications Inc.; Sprint Corporation; and Valor Telecommunications, LLC.

The ICF realized that carrier interconnection arrangements, and the rules and practices governing those arrangements, are inextricably intertwined with the rules for intercarrier compensation. The Plan thus creates neutral default rules to establish a uniform interconnection platform for all current and future technologies, eliminating the need for carriers to deploy separate interconnection networks for local exchange and interexchange traffic. It establishes the concept of network “Edges,” which are specified points at which networks interconnect and transfer financial responsibility for traffic. Carriers are free to negotiate alternatives to these default rules, but in the absence of agreement, the rules ensure that calls will go through. The Plan creates incentives for carriers to engineer their networks based on engineering principles rather than intercarrier compensation rules.

The ICF also recognized the urgency of implementing uniform intercarrier compensation rules. Within three years, the ICF Plan prescribes a single termination rate for all traffic, whether it is today considered access or non-access traffic. Termination rates are then eliminated entirely over a transition period, shifting cost recovery to end users and eradicating the terminating monopoly problem and attendant regulatory quagmire. Crucially, the Plan tackles both interstate and intrastate compensation rules. No plan can succeed unless it replaces the present system in both jurisdictions. The ICF Plan’s uniformity—across jurisdictions and among carrier rate levels and rate structures—will create certainty in the industry that will promote competition and eliminate opportunities to exploit regulatory disparities.

At the same time, the ICF Plan recognizes the special needs of rural customers and carriers, and thus contains substantial protections for rural America,

including a more measured transition for rural customers and a continuing optional *terminating transport revenue stream for rural carriers*. The Plan also revitalizes universal service, replacing the implicit support in today's intercarrier compensation scheme with two new explicit support mechanisms. ICF's approach stabilizes and broadens the universal service funding base, and modifies distribution to enhance incentives for investment in technologies and services that will benefit rural consumers.

Alone among those proposing intercarrier compensation reform, the ICF has created a model to show the effects of its Plan at each step of the transition it proposes on an aggregated, nationwide basis.<sup>9</sup> Among the key findings that this model reveals are:

- That the ICF Plan would create roughly \$2.7 billion in explicit universal service support by replacing support that is implicit in intercarrier charges today and improving existing mechanisms;
- That roughly two-thirds of this support will flow to rural carriers;
- That, in the aggregate, large carriers will be required to seek recovery of over 80 percent of their current intercarrier compensation revenues from their own end users (to the extent the market allows them to do so), while the remainder is split roughly evenly between explicit universal service support and remaining intercarrier charges; and
- That the ICF Plan successfully addresses rural carriers' concerns by *converting just over half of their current intercarrier compensation revenues to explicit universal service support*, requiring them to seek recovery of only about one quarter of these current revenues from their own end users, and preserving the remaining quarter as a substantial continuing intercarrier compensation revenue stream.
- That the ICF Plan puts universal service funding on firm footing for the future by creating a stable funding base that relies upon affordable contribution obligations.

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<sup>9</sup> See Model, Appendix B.

None of the competing plans offer such fundamental or concrete reform, and none are proposals that can be implemented today.<sup>10</sup> Many are simply recitations of principles, and all lack the rigorous analyses necessary to assess their viability, as well as the detail and specification necessary to craft workable implementing regulations. Those that provide some detail seek in one form or another to shore up the flawed legacy system in an effort to avoid making tough choices to rationalize the framework governing the exchange of traffic between service providers in an increasingly competitive marketplace. These plans would perpetuate the need for endless regulatory proceedings to determine costs and cost structures, and thereafter to set rates, based on obsolete notions about the state of technology and competition. They continue, for example, to engage in the exercise of deciding whether VOIP calls are local or long-distance, or whether they are “information services,” without recognizing that there is no good reason to have a compensation system that raises these questions in the first place.<sup>11</sup>

The competing plans also fail in other major areas. None adequately addresses disparities in *intrastate* compensation, which are perhaps the most significant disparities in the current system. The few competing plans that even address intrastate compensation inexplicably do so *without* ensuring consistency of rates among carriers within the same state, or from one state to the next, or between the state and federal jurisdictions. Moreover, the other plans pay scant attention to the disparities in network

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<sup>10</sup> In these comments, we analyze the various competing proposals referenced in the Commission’s March 3, 2005 Further Notice. We will address any subsequently submitted proposals, or changes to existing proposals, in our reply.

<sup>11</sup> Nuechterlein & Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* 305 (2005).

interconnection rules that sow confusion and inhibit competition.<sup>12</sup> Because it is impossible to meaningfully determine compensation obligations without knowing where and how carriers interconnect, many of the competing proposals leave uncertainty in the marketplace that will provoke ongoing and extensive disputes among carriers.

The competing proposals also fail to ensure stable funding for universal service. Several maintain the implicit support system that has undermined universal service, and they impede carriers' ability to offer services at reasonable rates to rural and high-cost customers. Others offer essentially no plan at all to preserve universal service, ignoring the unsustainability of the current, revenue-based contribution system. Finally, several of the proposals for addressing universal service are patently unlawful.

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At bottom, this is a proceeding about how carriers should recover the costs of generating and terminating calls that pass through more than one network—especially the switch and loop costs associated with the origination and termination functions. End users as a group inevitably will pay for those costs one way or another. They can continue to pay the costs inefficiently and indirectly through shifting support and unpredictable rates subject to perpetual regulatory intervention. Or, alternatively, they can pay the costs efficiently to their own carriers supplying their network connection, with rates established by a competitive market, with a predictable universal service safety net.

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<sup>12</sup> Cf. Further Notice ¶ 34 (“any proposal for reform of compensation mechanisms should address the impact of such change on network interconnection rules”).

The ICF's proposal maps out the latter course. It is a pragmatic and commercially reasonable solution that, if adopted, will greatly benefit the public by promoting efficient competition and facilitating innovation with minimal ongoing regulation. We urge the Commission to implement the ICF Plan in its entirety.

## DISCUSSION

### I. The Goals Of Reform

The ICF Plan is the only proposal that satisfies all of the Commission's goals for reform. The ICF Plan will:

- Create uniformity through an approach that is "competitively and technologically neutral," "accommodate[s] continuing changes in the marketplace," and "provides regulatory certainty."<sup>13</sup> The Commission has urged that "similar types of traffic should be subject to similar rules," and "similar types of functions should be subject to similar cost recovery."<sup>14</sup> Moreover, the Commission has made clear that it is "interested in not only similar *rates* for similar functions, but also in a regime that would *apply* these rates in a uniform manner for all traffic."<sup>15</sup>
- Promote market-oriented solutions by "promot[ing] economic efficiency" and "facilities-based competition in the marketplace," "limit[ing] ... the

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<sup>13</sup> Further Notice ¶ 33.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

need for regulatory intervention,” and relying on negotiated agreements where possible.<sup>16</sup>

- Preserve and enhance universal service as part of the development of any new intercarrier compensation regime.<sup>17</sup>
- Address the special concerns of rural consumers and carriers by being “particularly sensitive to the interests of rural and high-cost communities” and ensuring “that any reform of compensation mechanisms does not jeopardize the ability of rural consumers to receive service at reasonable rates.”<sup>18</sup>

**A. Create Uniformity**

The current rules create competitive distortions that harm consumers, while arbitrarily favoring or disfavoring carriers on an ad hoc basis. For example, calls terminating to a LEC customer may be governed by no fewer than five different rates depending on the carrier or location of the calling party, even though each call uses the same switch and loop, and the carriers’ ability to recover compensation will vary depending on their regulatory classification. The compensation rules differentiate arbitrarily between “intrastate” and “interstate”; local and interexchange; intraLATA and interLATA; intraMTA and interMTA; and wireline/fixed wireless and mobile wireless. Inconsistencies among interconnection rules create uncertainty even on the fundamental question of which carrier bears financial responsibility for the carriage of traffic at any

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<sup>16</sup> *Id.* ¶¶ 31, 33.

<sup>17</sup> *Id.* ¶ 31.

<sup>18</sup> *Id.* ¶ 32.

given point in the network. Each of these regulatory disparities creates opportunities for unnecessary network and operational expense, generates ongoing disputes among carriers, and skews the economic incentives of carriers to provide consumers with services they demand, such as flat-rated, nationwide calling.

The Commission has recognized the need “to replace the existing patchwork of intercarrier compensation rules with a unified approach.”<sup>19</sup> A uniform regime must apply the same rate consistently across all carriers, technologies, and services, unify interstate and intrastate compensation systems, and rationalize network interconnection rules, ending “artificial regulatory distinctions.”<sup>20</sup> Such an approach will promote consumer welfare by encouraging true competition on the merits rather than rewarding efforts to game the system.

It is also important that “new rules accommodate continuing change in the marketplace and do not distort the opportunity for carriers using different and novel technologies to compete for customers.”<sup>21</sup> Among the blossoming technologies are wholly IP-based services, *i.e.*, IP-enabled services that do not interconnect with circuit-switched networks. These IP-based services have developed flat-rated pricing structures in which end users purchase two-way Internet connectivity that may be symmetric or asymmetric, and may be of differing capacities, but it is the customer that chooses the nature of that connectivity. Under such pricing structures, cost recovery is direct from the user and scaled in relation to the user’s anticipated two-way uses, both for receiving

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<sup>19</sup> Further Notice ¶ 3.

<sup>20</sup> Further Notice ¶ 33.

<sup>21</sup> *Id.*

and sending communications. This approach in many ways is inconsistent with the legacy calling-party's-network-pays ("CPNP")-based rules, since under the access charge regime, recovery of the costs for the end user's network connectivity is split between the providers of retail network connectivity (e.g., LECs), and the providers of applications that use that connectivity (e.g., IXC). Compensation reform must include uniform rules that address and reconcile this inconsistency while enabling IP services to flourish.

**B. Promote Market-Oriented Solutions**

Any cost recovery system must grapple with two related phenomena that enable carriers to charge supracompetitive rates for handling other carriers' traffic. The first of these is the "terminating access monopoly"—the fact that, even in otherwise competitive markets, a terminating carrier has both the incentive and the ability to charge the calling party's carrier (whether a LEC or an IXC) above-cost rates for call termination. This phenomenon arises because the terminating carrier controls the only line associated with a given telephone number and typically lacks any direct relationship with, and thus any accountability to, the calling party who triggers the termination charges by placing a call to that number.<sup>22</sup>

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<sup>22</sup> *In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, 16 FCC Rcd. 9923, 9934-5 ¶ 28 (2001) ("CLEC Access Charge Order") ("The Commission has previously noted the unique difficulties presented by the case of terminating access, where the called party is the one that chooses the access provider, but it neither pays for terminating access service, nor does it pay for, or choose to place, the call. It further complicates the case of terminating access that an IXC may have no prior relationship with a CLEC, but may incur access charges simply for delivering a call to the access provider's customer. In these circumstances, providers of terminating access may be particularly insulated from the effects of competition in the market for access services. The party that actually chooses the terminating access provider does not also pay the provider's access charges and therefore has no incentive to select a provider with low rates. Indeed, end users may have the incentive to choose a CLEC with the

A second, similar problem can arise on the *originating* end of a long distance call handled by an IXC that, while serving the calling party, is unaffiliated with the calling party's LEC.<sup>23</sup> Theoretically, in unregulated competitive markets, there should be no such problem, because the IXC could pass any above-cost origination charge back to the particular end user who triggers that charge, and that end user could then hold its own LEC accountable for imposing it in the first place. But the rate averaging requirements of section 254(g) frustrate this market dynamic by prohibiting IXCs from passing through higher rates to the specific customers served by the LECs that impose high access charges. The current calling-party's-network-pays ("CPNP") regimes<sup>24</sup> therefore require regulators continually to regulate the origination and

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highest access rates because greater access revenues likely permit CLECs to offer lower rates to their end users.") (notes omitted).

<sup>23</sup> *Id.* at 9935-9936 ¶ 31 ("On further consideration, it appears that the CLECs' ability to impose excessive access charges is attributable to two separate factors. First, although the end user chooses her access provider, she does not pay that provider's access charges. Rather, the access charges are paid by the caller's IXC, which has little practical means of affecting the caller's choice of access provider (and even less opportunity to affect the called party's choice of provider) and thus cannot easily avoid the expensive ones. Second, the Commission has interpreted section 254(g) to require IXCs geographically to average their rates and thereby to spread the cost of both originating and terminating access over all their end users. Consequently, IXCs have little or no ability to create incentives for their customers to choose CLECs with low access charges. Since the IXCs are effectively unable either to pass through access charges to their end users or to create other incentives for end users to choose LECs with low access rates, the party causing the costs--the end user that chooses the high-priced LEC--has no incentive to minimize costs. Accordingly, CLECs can impose high access rates without creating the incentive for the end user to shop for a lower-priced access provider.") (notes omitted).

<sup>24</sup> We use the term "CPNP" to include both access charge regimes and reciprocal compensation schemes in which a positive charge is assessed for termination, but not for origination.

termination rates that may be charged, because the market has not provided an effective check on these rates.<sup>25</sup>

In a theoretical world of zero transaction costs and perfect information, this regulatory approach might be effective. But in the real world, neither condition exists. CPNP requires regulators to delve intrusively into the details of telecommunications networks with diverse technologies and services to identify, evaluate, and perpetually reevaluate costs and cost structures. The absence of consensus over the appropriate cost base and structure, information limitations, and evolving technologies make it implausible that regulators can establish objectively “correct” rates in *any* CPNP system. And when the regulators’ cost structures and rates inevitably fail to match up with the “actual” cost structure and level, their regulatory intervention creates market distortions. Moreover, the endless rate proceedings themselves create massive transaction costs and harmful uncertainty. These problems afflict not only the current CPNP-based system, but also all of the proposals in this proceeding that retain a CPNP model.

A market-based solution would rationalize the treatment of all technologies and reduce the need for burdensome regulatory and judicial proceedings that create uncertainty and inhibit innovation. By requiring carriers to recover the costs of providing network connectivity from their end user customers, carriers would be required to develop

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<sup>25</sup> *Id.* at 9336 ¶32 (“We now acknowledge that the market for access services does not appear to be *structured* in a manner that allows competition to discipline rates”), ¶ 34 (“we conclude that some action is necessary to prevent CLECs from exploiting the market power in the rates that they tariff for switched access services”).

end user rates that more accurately reflect the level and structure of the underlying costs, while at the same time responding more efficiently to changes in consumer preferences.<sup>26</sup>

### **C. Preserve and Enhance Universal Service**

Uniformity and economic efficiency are not the only goals for reform of the intercarrier compensation system. As the Commission emphasized in its Further Notice, universal service has played a crucial role in addressing the needs of rural and high cost communities, and our nation has made a fundamental commitment to ensuring that *all communities* can receive service at reasonable rates.<sup>27</sup> Universal service also generates network effects that benefit all subscribers nationwide. A goal for reform must be to preserve and enhance universal service without distorting the marketplace while ensuring a long-term, stable funding source.

Any such reform must eliminate current regulatory distinctions that discriminate illogically among service providers and artificially limit the pool of contributors to universal service. For example: (1) while DSL providers are now required to contribute to universal service, providers of comparable cable modem services are exempt; and (2) while providers of interstate circuit-switched telephony are now required to contribute to universal service, VOIP providers today largely are not required to make direct contributions. Universal service funding should not depend on arbitrary classifications that unfairly burden certain carriers and provide others an unwarranted economic advantage in the marketplace.

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<sup>26</sup> See Further Notice, Appendix C at 104.

<sup>27</sup> Further Notice ¶ 32.

Reform is also needed to address the erosion of implicit support in the current system. In the Telecommunications Act of 1996 ("1996 Act"), Congress mandated that universal service support "should be explicit,"<sup>28</sup> recognizing, as the Commission itself has acknowledged, that implicit support is not sustainable in today's competitive marketplace.<sup>29</sup> Nevertheless, state PUCs and the Commission continue to rely heavily on implicit support to fund universal service and keep basic local rates low. LECs and IXC's are still subject to geographic rate averaging rules; business rates and, in many areas, subscriber line charges are still significantly above those paid by residential customers; and LECs still recover a substantial portion of their network costs through per-minute charges to other carriers.<sup>30</sup> As the high-volume and business customers that pay implicit support migrate to services and technologies that do not pay such charges, rates for the remaining customers rise, and carriers have fewer resources to invest in the network.

Simply eliminating implicit support and arbitrary contribution classifications, however, is not enough. A true commitment to universal service requires securing a long-term, stable funding source. A plan should create an explicit funding mechanism that will ensure reasonable end-user rates for all users. Effective reform will protect all Americans' access to affordable telecommunications and information services.

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<sup>28</sup> 47 U.S.C. § 254(e).

<sup>29</sup> *E.g.*, *Federal-State Joint Board on Universal Service*, Report and Order, 12 FCC Rcd 8776, 8787 (1997), at para. 17 (subsequent history omitted).

<sup>30</sup> Further Notice ¶¶ 23-24.

#### **D. Address The Concerns Of Rural Customers And Carriers**

Rural carriers have special concerns arising from the costs and operational complexities of serving rural communities. Although rural carriers and the communities they serve are extremely diverse, rural providers face common challenges associated with offering a panoply of telecommunications services at reasonable rates.

The erosion of implicit support coupled with the rate averaging and rate integration requirements of the 1996 Act threaten rural areas with a potential for dramatically higher rates and fewer service providers, especially in the toll market.

AT&T has already announced its withdrawal from the consumer, circuit-switched long distance market.<sup>31</sup> MCI has also cut back substantially on its efforts to attract new individual consumers.<sup>32</sup> While these withdrawals are national, they have a greater proportionate impact on rural customers. Because rural local exchange carriers charge substantially higher access rates than the national average, without the presence of national carriers to offer nationwide averaged retail rates, the long distance rates offered to rural consumers by any regional IXC serving predominantly rural consumers can be expected to rise to reflect these higher rural LEC access rates. These higher prices in turn

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<sup>31</sup> See Press Release, AT&T Corp., AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets, (July 22, 2004) available at <http://www.att.com/news/2004/07/22-13163> (announcing that "AT&T will no longer be competing for residential local and standalone long distance (LD) customers").

<sup>32</sup> See MCI/Verizon Application for Transfer of Control, Public Interest Statement, p. 35 (noting that MCI has a "diminishing legacy customer base, and it has cut back substantially on any efforts to attract new mass-market customers") available at [http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=6517495215](http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6517495215).

depress demand and stimulate migration to wireless and VOIP alternatives, further eroding access minutes on which rural LECs rely for revenue.

Today's patchwork system also harms rural consumers by creating incentives for rural carriers to carve out artificially small local calling areas, which force consumers to make a greater proportion of their calls at toll rates designed to generate additional revenue. Further, the upgraded broadband network facilities some rural carriers have deployed threaten to undermine the same carriers' access and toll revenues through VOIP competition enabled by the carriers' broadband investment.

A plan for reforming the intercarrier compensation system should promote robust competition in rural markets, and create incentives for rural carriers to invest in new technologies. New compensation rules should also encourage broadband deployment in rural communities without loss of revenue and ensure that rural customers can obtain a spectrum of telecommunications services comparable to those available in urban areas, at comparable rates.<sup>33</sup>

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*It is crucial for reform to achieve all these goals because many of the problems in the current regime arise from the disparity among its different elements. A plan that does not address intrastate compensation, for example, does not unify network*

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<sup>33</sup> In addition, any reform effort must also recognize the unique nature of the Alaska market. There are no LATAs in Alaska, and the entire state is one MTA. Most interexchange traffic is carried between LECs by either GCI or AT&T/Alascom over costly satellite facilities. Broadband services to the over 227 rural communities must travel by satellite in most cases, making its transit more costly than if fiber was available. The clarity and uniformity provided by the ICF plan, coupled with expansion of the contribution base to include all telecommunications, would reduce the risks of investment in rural areas.

connection rules, or does not create stable, explicit funding for universal service, would leave intractable problems in place and ultimately undermine the proposed solution.

## **II. The ICF Plan Creates A Comprehensive Solution That Achieves All The Commission's Objectives**

In contrast to the other proposals, the ICF Plan is a comprehensive solution that will achieve *all* of the Commission's objectives for reform.<sup>34</sup> The Plan achieves uniformity by establishing clear interconnection obligations and compensation rules that establish a platform for competition and innovation. It uses market-based solutions—including a system of direct, market-based cost recovery—to promote consumer choice and welfare, and provide stability and certainty to the industry. It strengthens universal service with a robust, expansive program of explicit contributions and distributions. And it addresses the special concerns of rural customers.

### **A. The ICF Plan Creates Uniform, Neutral Rules For Network Interconnection And Intercarrier Compensation**

When two networks interconnect, it is not inherently clear where they should interconnect or whether (or what) compensation should flow between them. But the answers to these questions have a profound impact on the telecommunications market, and the consequences of getting them wrong are grave.

#### **1. Uniform Network Interconnection**

It is simply not possible to define compensation obligations without also defining where and how carriers interconnect and the length and scope of the transport

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<sup>34</sup> See Further Notice ¶¶ 29-36 (recognizing goals of promoting economic efficiency, creating competition in the marketplace, preserving universal service, achieving technological and competitive neutrality, reducing regulatory intervention, addressing the impact of interconnection rules, and ensuring the Commission's legal authority to implement changes).

that each carrier is obligated to provide. Network interconnection rules are a primary factor in determining the costs a carrier must incur to receive traffic from and deliver traffic to other carriers. Any lack of uniformity in these rules, therefore, has profound economic impacts that impede efficient competition and sap consumer welfare.

Yet only the ICF Plan offers a proposal to establish clear, explicit and uniform default technical and financial rules to govern the efficient interconnection of diverse carrier networks.<sup>35</sup> These rules necessarily are quite detailed, to provide clear guidance to all parties and avoid the continuous litigation that has occurred under the existing rules. The Commission should not confuse this detail with complexity; the ICF's rules are simple and neutral, and will create a competitive environment that will facilitate and reward innovation.

The ICF's rules are based on network "Edges," which are designated points at which a carrier must accept financial responsibility for carrying traffic it receives from other carriers.<sup>36</sup> When a call originates and terminates on different networks, the carrier sending the traffic must bear the financial responsibility for delivering the call to the Edge the recipient carrier has designated. This responsibility is unaffected by any decision of the carriers to interconnect physically at a different point.<sup>37</sup>

Edges are entirely neutral as to both technologies and services. The Edge rules are based on a classification of three categories of networks—hierarchical, non-

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<sup>35</sup> These rules would take effect in Year 3, to give carriers time to negotiate alternatives and plan for implementation of the default rules if such negotiations fail.

<sup>36</sup> See Diagrams, attached at Appendix E.

<sup>37</sup> Thus, carrier rights and responsibilities under Section 251(c)(2)(B), which authorizes interconnection with an incumbent LEC at "any technically feasible point within the carrier's network," are unaffected. 47 U.S.C. § 251(c)(2)(B).

hierarchical, and rural. These categories, pointedly, are *not* based on particular types of technologies or services, but instead apply to all providers depending on the structure of the network each provider chooses to employ. The Edge system thus creates a uniform, predictable basis for interconnecting all traffic. It creates a platform for innovation, unhampered by arbitrary distinctions that discourage implementation of new technologies.

The Edge concept effects clear, bright-line default rules, while allowing carriers to depart from these rules by mutual agreement.<sup>38</sup> The Edge concept's simplicity and predictability will permit carriers efficiently to negotiate different network interconnection arrangements. And at the same time, its bright-line default rules will permit carriers to interconnect without regulatory involvement when they are unable to reach an alternative financial responsibility agreement.

The Edge proposal was developed to balance several important goals, and without sacrificing the value of uniformity fully accommodates the different types of service providers who have different types of networks. For example, the ICF recognized that large, established carriers typically have hierarchical networks, and that new entrants usually do not have extensive facilities-based networks with which to interconnect with other carriers at many locations. Therefore, the ICF Plan establishes Edge locations that are fair to both of these very different kinds of networks. The ICF Plan also achieves technological neutrality by recognizing the differences between wireline circuit-switched

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<sup>38</sup> These arrangements are similar to arrangements freely entered into between Internet backbone providers. Because they developed in the absence of regulation, and in the absence of market power by any one firm, the arrangements between Internet backbone providers can be viewed as a model to be emulated.

networks, wireless networks, and IP-backbone networks and separately defining legitimate functional Edge locations applicable to each type of network. And the ICF Plan is neutral as to carrier size: it recognizes that the appropriate geographic area for network interconnection is generally the LATA, and that it would be unfair for a national carrier to be permitted to establish a single nationwide point of interconnection, to which regional carriers would be required to transport traffic over long distances.

The ICF Plan also accommodates differences between rural and non-rural carriers. The ICF recognizes that rural carriers face unique demands that should be addressed—but without compromising the other important public policy goals the ICF plan will advance. For example, the ICF Plan provides rural carriers the option of compensation for terminating interconnection transport links—but it also requires those carriers to permit interconnection of other carriers that may compete to provide those transport links. It relieves rural carriers from having to provide transport to non-rural carriers that do not have a physical presence within the rural carrier's territory. And it recognizes that carriers rely heavily on transit service to exchange traffic with rural carriers, and therefore includes rules ensuring that carriers continue to have transit available at reasonable rates.

In addition, the ICF Plan provides solutions to accommodate the efficient exchange of differing amounts of traffic over short or long distances. As noted, it contains rules requiring that transit service be made available at reasonable rates, and it requires all carriers to provide options for physical interconnection to any requesting carrier so interconnecting carriers have choices enabling lower interconnection costs. At the same time, the ICF Plan contains measures to ensure the preservation of network

reliability in recognition of the importance of ensuring that network interconnection rules not concentrate traffic to so few points that network reliability becomes compromised. The ICF Plan addresses this by adding rules that specify that network interconnection should be accomplished within each LATA, while permitting the growth of a competitive market for transit.

Taken all together, the default network interconnection rules in the ICF Plan provide any two carriers comparable negotiating leverage, creating an environment that will promote mutually agreed to arrangements for both direct and indirect interconnection rather than litigation. The Plan facilitates efficient interconnection on an indirect basis by detailing the responsibilities of both transit providers and transit customers to avoid gaming. The Plan would also provide certainty about the framework for the provision of transiting. Transit providers are protected from abuses of their service and exhaustion of transit tandem switching capacity. And the ICF plan promotes the provision of transiting by incumbent carriers as well as the entry of competitors to the transit market.

Moreover, because the ICF's network interconnection rules were developed by a diverse group of carriers representing a broad cross-section of the industry, the ICF Plan has already anticipated ways in which the rules could be gamed or abused and has included safeguards against such disputes. For example, the Plan contains a number of rules that prevent the inappropriate proliferation of Edges; the rules strike a careful balance so as not to create undue incentives or disincentives to create Edges. The ICF Plan also permits six different default methods of network interconnection in order to encourage efficient arrangements, allow different types of

carriers to lower their interconnection costs, and prevent carriers from extending the termination monopoly into interconnection transport and transit markets. Thus, every Edge owner is required to provide interconnection of fiber optic and electrical cabling and must also offer two additional methods from a list of four, and ILECs will continue to provide interconnection at any technically feasible point on their network pursuant to section 251(c)(2) of the Act (although the ILEC is not required to provide discounted interconnection transport to such locations that are not also ILEC edges).

Finally, the ICF Plan provides for a smooth transition from today's CPNP interconnection architecture to the Edge architecture. Any plan that would encourage or require massive network rearrangements to implement a new network interconnection regime would fail the public interest. The ICF avoids this first by allowing carriers to mutually agree to leave physical interconnection arrangements in place and devise financial solutions in lieu of physical network reconfiguration. Moreover, the ICF Plan establishes default values for pre-existing interconnection facilities to support carriers' effort to leave pre-existing interconnection in place until a more efficient arrangement is developed and agreed to.

## **2. Uniform Intercarrier Compensation**

A central question in this proceeding is who should pay for costs incurred by carriers in originating calls from and terminating calls to one of their end users subscribers, when those calls are also handled by other networks. While the intercarrier charges will inevitably be passed on to end users in one form or another, this can be done efficiently and directly or inefficiently and indirectly. As explained above, the current CPNP system has carriers paying each other in inconsistent and often arbitrarily different ways. The system ensures unending regulation because of the terminating monopoly problem, which causes

significant transaction costs and reduces consumer choice and welfare. It also presumes that only calling parties benefit from calls.

The ICF Plan replaces the CPNP system with a uniform system under which origination and termination intercarrier charges are unified and then eliminated, and the end user purchases a two-way connection to the network that allows her to make calls to and receive calls from any carrier's network. The Plan creates a transition to a regime in which carriers substantially recover their own costs from their own customers in the form of SLCs and, where necessary to ensure that rates are affordable and reasonably comparable, universal service. By moving to a uniform bill-and-keep approach, the Plan eliminates the legacy system's irrelevant distinctions between local and toll calls,<sup>39</sup> and abolishes the two disparate systems of reciprocal compensation and access that shift costs from certain customers to others. The Plan allows all terminating carriers, regardless of technology, to recover costs directly from end users without having to depend on uncertain regulations. The Plan also includes uniform regulatory treatment of circuit-switched services and packet-switched services, thereby lessening the pressure for economic regulation of VOIP.

The Plan envisions that the end user's carrier will recover its costs at the market rate for that connection. In this way, the ICF Plan achieves neutrality among carriers and traffic types, and minimizes transaction costs, by replacing regulated pricing among carriers with competitive market pricing to the end user. Further, by replacing regulated intercarrier charges with capped end-user fees and other new explicit funding, the ICF Plan

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<sup>39</sup> CTRCs will have the option to take terminating transport rates to an average of up to \$0.0095 per terminating minute.

also permits competition to discipline telecommunications markets in lieu of regulatory intervention, offering the Commission the opportunity, for the first time, to achieve the deregulatory goals of the 1996 Act.

The ICF Plan thus resolves the tension between Internet pricing and legacy pricing of end user network connections by transitioning the legacy pricing model to one that is consistent with the system used by the Internet. Under the ICF Plan, the end user selects and pays the entire cost of her connectivity, save what is paid by the Universal Service Fund to ensure affordable and reasonably comparable rates.<sup>40</sup> Unlike the legacy access model, the ICF Plan does not rely on a portion of those costs being recovered from other application providers that traverse the end user's two-way network connection.

The Plan does retain some intercarrier charges, but only for facilities that have the potential to be provided on a competitive basis once the end user has selected her network connectivity provider, such as interconnection transport or tandem transiting services. It places charges for last-mile facilities, such as the loop and local switch, on the end user, who ultimately has the power to choose providers and services that efficiently meet his needs. And it allows carriers to replace lost revenue from today's intercarrier charges by increasing the SLC caps and creating new federal universal service support. Carriers can also earn revenue where other carriers elect to use their interconnection transport and transiting

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<sup>40</sup> Of course, if the end user connection provider voluntarily creates a loss leader or otherwise structures its packages to reduce the end user charge, it may do so.

services, revenue from a transitional uniform termination charge, and terminating transport revenues for a Covered Rural Telephone Company (“CRTC”) (*see infra* Part II.C).<sup>41</sup>

Although the default SLCs rise in measured increments, consumers should not see any significant increase in their overall telephone bills as a result of this restructuring. Most default SLCs will remain capped at \$10.00 per month (*i.e.*, \$3.50 above the current residential and single line business cap),<sup>42</sup> while CTRCs will retain a cap of \$9.00 per month for rural consumers.<sup>43</sup> Caps, however, are not rates: while the SLC caps will increase, SLCs for many customers will not increase to the full extent permitted because enhanced competition, particularly from cable-telephony and wireless providers, will constrain carriers’ ability to raise end-user prices. Thus, while increases in the SLC cap provide LECs a reasonable opportunity to recover their forgone intercarrier revenues, the market will ultimately decide how much they recover. In addition, toll expenditures will likely decline as local calling scopes expand and toll rate levels and structures adjust to reductions in intercarrier compensation.

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<sup>41</sup> The ICF Plan defines a “Covered Rural Telephone Company” as “an ILEC that, as of July 1, 2005 . . . , (a) meets the definition of a “Rural Telephone Company” in Section 3(37) of the Communications Act of 1934, as amended, 47 U.S.C. § 153(37), and is not a Bell Operating Company or affiliate thereof, and, in such study areas (“COSAs”), serves fewer than one million access lines; or (b) qualifies as a two percent carrier under the criteria established in Section 251(f)(2) of the Communications Act, 47 U.S.C. § 251(f)(2) with a holding company average of fewer than 19 switched access end user common lines per square mile. A CRTC shall not be treated as a CRTC with respect to customers it serves outside its ILEC serving area.” ICF Plan at 19.

<sup>42</sup> Beginning in Year 5, non-CRTC SLC caps are indexed for inflation.

<sup>43</sup> Subject to consumer protection safeguards, the Plan also provides increased price cap carrier pricing flexibility for price cap ILECs.

## B. The ICF Plan Promotes Market-Based Solutions

The ICF Plan advances the deregulatory goals of the 1996 Act by establishing clear and uniform framework that will allow the system to operate without constant regulatory intervention.

In particular, the ICF Plan addresses the terminating monopoly problem and the current lack of an effective market-based check on originating access rates without requiring regulators perpetually to supervise origination and termination rates, and without forbearing from enforcement of Section 254(g). Rather, the Plan obligates carriers to recover their termination costs from their own end users, who, in a competitive marketplace, will be able to choose efficient providers. By aligning cost recovery with the party who has the ability to choose the provider, the Plan allows market forces to efficiently govern rates and drive them towards efficient levels. The Plan thus avoids the massive transaction costs and expensive litigation that arise from regulatory alternatives. Under the ICF approach, the market eliminates the burden that the Commission and state regulators have borne for decades.<sup>44</sup>

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<sup>44</sup> In this respect, the ICF Plan is the natural conclusion of the process the Commission began when it created the SLC as a flat-rated charge on end-users for use of the local loop to originate and terminate traffic. *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, FCC 82-579, 93 F.C.C.2d 241 (1983) (creating subscriber line charge), *modified*, 97 FCC 2d 682 (1983), *further modified*, 92 FCC 2d 834 (1984), *aff'd in principal part and remanded in part sub nom. NARUC v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984), cert. denied, 469 US 1227 (1985); *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 16012-13 (1997), at ¶¶ 75-76 (raising non-primary residential and single line business SLC), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 153 F3d 523 (8th Cir 1998); *Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (CALLS Order) (increasing primary residential SLC for price cap carriers), *aff'd in relevant part sub nom. Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001); *Multi-*

The Plan thus recognizes that the competitive market naturally produces efficient results when consumer payments are directly linked to consumer choices. The Plan promotes consumer welfare by enabling carriers to offer the services that consumers demand. Providers in a bill-and-keep system compete for customers based solely on differences like service quality and bundled packages that consumers desire, rather than based largely on strategies for shifting network costs on to other carriers, as they would under most of the competing plans. Providers will also have incentives to reduce their own costs of providing service to maximize the returns they receive from customers, further reducing economic waste.

The Commission notes that “bundled offerings and novel services blur traditional industry and regulatory distinctions among various types of services and service providers, making it increasingly difficult to enforce the existing compensation regimes.”<sup>45</sup> The regulatory morass is steadily worsening, and under the current system the Commission will continually have to determine into which traditional classification it should squeeze the newest unclassifiable technology. The ICF Plan ends this problem, creating certainty so innovators will no longer wonder which set of rules will apply to their new technologies and services.

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*Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256 , Fifteenth Report and Order in CC Docket No. 96-45, Report and Order in CC Docket No. 98-77, Report and Order in CC Docket 98-166, 16 FCC Rcd 19613 (2001) (increasing residential SLC cap for rate-of-return carriers).*

<sup>45</sup> Further Notice ¶ 21.

**C. The ICF Plan Preserves And Ensures A Stable Funding Source For Universal Service**

The ICF Plan tackles current Universal Service Fund contribution and distribution challenges while advancing the 1996 Act's mandate for preserving and fostering universal service.

On the contribution side, the ICF Plan creates a new, robust, sustainable contribution mechanism that will ensure the necessary funding in an equitable and nondiscriminatory manner. The Plan creates a new uniform universal service contribution methodology based on "units" applied to telephone numbers and high-capacity network connections. Each unique working telephone number is assessed one unit, and the Plan allows CMRS carriers, CRTC's, and CRTC competitors to phase this assessment in for additional numbers in a residential household account. Residential DSL, cable modem, and other high-speed, non-circuit-switched connections are also assessed one unit, harmonizing today's disparate treatment of DSL and cable modem services. For business connections, the Plan establishes a four-tiered system of assessments for non-switched, dedicated network connections ranging from one to 100 units depending on capacity.

The Plan thus significantly broadens the range of contributors and eliminates the current system's arbitrary exemptions from contribution obligations. In addition, its new contribution mechanism would eliminate the enormous administrative and compliance difficulties that regulators now face when seeking to apply current rules to carriers whose revenues from service packages do not break down neatly into legacy regulatory categories, such as "telecommunications services" versus "information services," and interstate versus intrastate services. Finally, the ICF Plan's contribution

mechanism relies on a base—working telephone numbers and network connections—that will be stable or growing for the foreseeable future, mitigating the problems created by today's spiraling percentage contribution factor. These reforms are critical. By Year 5, the ICF Plan replaces with explicit funding some \$2.7 billion in implicit universal service support, yet its new funding mechanism keeps individual subscriber universal service contributions manageable, at roughly \$1.31 per working telephone number.<sup>46</sup>

On the distribution side, the Plan eliminates the implicit support historically provided by disparate intercarrier compensation regimes, which were eroding anyway as a result of competition. In lieu of revenue from intercarrier compensation, the ICF Plan creates two new universal service mechanisms to provide explicit support for intercarrier compensation amounts otherwise not recoverable under the Plan's rate restructuring rules. One mechanism, known as the Intercarrier Compensation Recovery Mechanism ("ICRM"), provides support to BOCs and other non-CRTC ILECs. The other, the Transitional Network Recovery Mechanism ("TNRM"), applies to areas served by CTRCs. Price cap LECs can receive support from either mechanism, but on a per-line basis, meaning that support will vary directly with their line counts.

The primary difference between the two funding mechanisms is the extent of their availability to those competitive eligible telecommunications carriers ("CETCs") that today cannot collect access charges under tariff. The ICRM funding is available, on a per-eligible-line basis, to all CETCs. During a transitional period, the TNRM funding, by contrast, is only available to CETCs that would lose access charge revenues under the Plan. Because wireless carriers may not tariff switched access charges, the transitional

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<sup>46</sup> See Model, Appendix B, at 1, 15.

restriction is intended to allow only wireline CETCs to receive support, on a per-eligible line basis.

Moreover, the Plan retains rate of return principles for ILECs that are currently regulated under rate of return regulations, so those RLECs will continue to have the opportunity fully to recover their costs, including their authorized rate of return, even if they lose lines. But unlike today, the per-line amount available to CETCs receiving TNRM support will not vary with such changes to the RLECs line counts, although it may increase or decrease in proportion to the applicable ILEC revenue requirement. The Plan calls for the FCC to review whether additional eligible carriers should receive support from the TNRM at the conclusion of the initial term of the ICF Plan, in 2013.<sup>47</sup>

The Plan thus strengthens support mechanisms and stabilizes funding sources that ensure reasonable rates for high-cost customers. By making explicit that support which is implicit in intercarrier compensation rates today, the ICF Plan fulfills the mandate of the 1996 Act<sup>48</sup> and preserves and enhances universal service support for the future.

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<sup>47</sup> Further, the Plan makes several improvements to existing universal service support mechanisms, including the rural high cost loop support mechanism and the safety valve support mechanism. The Plan also provides an option for price cap CRTCs to elect to receive support under the non-rural, model-based high cost mechanism. Finally, the Plan provides that the existing per-line universal service support will remain portable to competitive eligible telecommunications carriers, subject again to the proviso that CETC per-line support should not grow simply because the number of ILEC access lines falls.

<sup>48</sup> See 47 U.S.C. § 254(b)(5) (requiring the Commission to ensure that there are “specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service”).

**D. The ICF Plan Addresses The Special Concerns Of Rural Consumers And Carriers**

Because of the high cost structures and implementation complexities confronted by rural carriers, rural consumers have traditionally faced the prospect of fewer services at higher prices. The ICF Plan includes specific provisions that address the special needs and circumstances of rural consumers. These steps will stabilize rural markets, preserve and enhance universal service, and facilitate the development of rural services reasonably comparable to those in urban areas, at reasonably comparable prices.

The ICF Plan maintains reasonable retail prices for rural consumers in several ways. *First*, the ICF Plan ensures affordable rural LEC end user rates by permitting CRTC's to maintain lower residential and single line business SLC caps than non-CRTC's. In doing so, the ICF Plan addresses rural carrier concerns surrounding the current disparity between rural and non-rural SLCs.

*Second*, the ICF Plan provides substantial new explicit universal service support for rural carriers. Indeed, of the roughly \$2.7 billion in new explicit universal service support contemplated by the ICF Plan, over \$1.7 billion—roughly two thirds—would flow to rural carriers.<sup>49</sup> This majority of this support—some \$1.24 billion—is provided through the TNRM which, for an interim period of eight years, is available only to those carriers that would lose access charge revenue as a result of the implementation of the ICF Plan. The Plan's Safety Valve provisions promote investment in rural infrastructure by removing the one year waiting period and including upgrades in local switching facilities. In addition, the ICF Plan also removes the current caps on the

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<sup>49</sup> See Model, Appendix B at 6.

federal high cost loop support fund, and eliminates the rule reducing high cost loop support for rural carrier study areas with over 200,000 access lines. These increases in support translate into lower charges for consumers, higher quality services, and greater ability for rural carriers to invest in new and improved infrastructure and services.

*Third*, the ICF Plan's network interconnection rules are explicitly designed to protect universal service in rural America by establishing modified default rules to apply to networks operated by a CRTC. A CRTC is not required to deliver traffic to an interconnecting carrier at a point outside of the contiguous portion of its study area where the traffic originates, except to reach another CRTC within the same LATA. In doing so, the ICF Plan ensures that, with limited exception, CRTCs will not be obligated to construct transport facilities outside of their local exchange service areas or purchase such transport capacity from other carriers. Further, the ICF Plan ensures, as a general matter, that CRTCs will not bear the cost of transiting traffic.

*Fourth*, the ICF Plan provides an important additional transport revenue stream for CRTCs by providing a framework for interconnecting carriers to discharge their Edge responsibilities by using CRTC terminating transport facilities to deliver traffic to CRTC edges within each contiguous portion of the CRTC's study area.<sup>50</sup> This interconnection scheme provides CRTCs substantial new revenue from inbound switched interconnection services, at up to \$0.0095 per terminating minute on average within a holding company.<sup>51</sup> The ICF projects that this revenue stream will generate roughly \$573

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<sup>50</sup> CRTC terminating transport facilities provide connectivity between a meet point and the CRTC Edge.

<sup>51</sup> These rates can be averaged within a holding company to provide carriers with flexibility to account for mileage differences.

million annually for CTRCs, or roughly one quarter of today's interstate and intrastate access revenue.<sup>52</sup> Thus, the ICF Plan ensures that CTRCs retain three substantial and diverse revenue streams, just as they have today, and consequently will not solely rely on revenue from end user charges and universal service.

*Fifth*, the ICF Plan creates incentives for larger calling areas that will result in fewer high-cost toll bills for rural customers. For outbound calls, CTRCs need only transport calls their customers originate (other than calls destined for customers of other CRTC companies within the same LATA) to the boundary of the contiguous portion of their service territory where the call originated, allowing them to share the costs of originating traffic with connecting carriers. The ICF Plan thus allows the marketplace, rather than regulatory history, to determine local calling scopes and service areas.

*Sixth*, the Plan promotes investment in the development of new technologies and services for rural subscribers. By using rate-of-return principles to calculate universal service distribution for carriers currently governed by rate-of-return rules, the Plan ensures that rural carriers will have incentives to invest in their facilities and develop their broadband networks.

*Seventh*, the ICF Plan not only accommodates the rate integration goals of section 254(g), but, unlike today's system, preserves IXCs' incentives to continue serving rural customers at reasonable rates. The Plan eliminates disparities in originating access that, in a competitive market, put upward pressure on rural long distance rates and are causing some national IXCs to leave the rural markets altogether. The Plan abolishes the

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<sup>52</sup> Model, Appendix B at 5.

implicit support that forces consumers in other areas to subsidize the costs of rural networks.

Taken together, these provisions reflect the Commission's commitment to rural consumers and carriers. The ICF Plan facilitates the development of new services, promotes carriers' ability to offer bundled packages consumers prefer, and ensures that rural customers will receive an array of telecommunications services at reasonable prices.

### **III. The ICF Plan Is Authorized By Existing Law**

The two central legal issues before the Commission are its ability to implement a uniform regime that applies to both interstate and intrastate traffic,<sup>53</sup> and its ability to mandate reform based on bill-and-keep principles. The ICF's legal analysis of these two crucial points is set forth below, explaining why our Plan is uniquely within the Commission's jurisdictional and substantive authority to implement.

In addition, ICF has set forth in Appendix A additional legal bases for the Commission to implement the remaining components of the ICF Plan, including the Commission's authority to implement new universal service mechanisms, its authority to adopt the ICF's proposed universal service contribution methodology, its authority to adopt the ICF's network interconnection rules, and its authority to require the provision of transit and regulate the rates therefor.

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<sup>53</sup> Further Notice, ¶¶ 63, 79-82 (recognizing that intercarrier compensation regime requires reform of intrastate access charges, and seeking comment on the Commission's legal authority to implement such reform).

**A. The Commission Has Full Jurisdiction Under the Communications Act, as Amended by the 1996 Act, to Establish Uniform Intercarrier Compensation Rules for All Classes of Traffic**

Section 201(b) of the Communications Act authorizes the Commission to “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 confirmed in *Iowa Utilities Board*, the Commission’s section 201(b) rulemaking jurisdiction is not limited to jurisdictionally interstate matters covered elsewhere in section 201. Instead, it extends to *all* provisions of the Communications Act, including the provisions added by the 1996 Act that encompass matters that, before 1996, fell within the exclusive jurisdiction of the states.<sup>54</sup> It is thus undisputed that the Commission may adopt rules implementing section 251(b)(5) and the other statutory provisions governing carrier interconnection with respect to all traffic—interstate and intrastate—within the scope of those provisions. This authority permits the Commission to implement the ICF Plan’s comprehensive approach to intercarrier compensation for any exchange of telecommunications traffic.

Congress drafted section 251(b)(5) expansively to bring national consistency to questions of intercarrier compensation. By its terms, this provision extends to all compensation issues relating to the transport and termination of “telecommunications” involving any local exchange carrier. The breadth of that language is significant in three principal respects. *First*, and perhaps most important, section 251(b)(5) makes no distinctions among traffic on the basis of jurisdiction (“local,” “toll,” “intrastate,” “interstate”) or service definition (*e.g.*, “exchange access,” “information access,” or “exchange service”). All such traffic is plainly

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<sup>54</sup> *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-86 (1999).

“telecommunications.” In its *ISP Remand Order* in 2001, the Commission was thus entirely correct in concluding that “[w]e were mistaken [in the *Local Competition Order*] to have characterized” section 251(b)(5) as limited to local traffic, given that “‘local’ . . . is not a term used in section 251(b)(5) or section 251(g).”<sup>55</sup> The D.C. Circuit left this conclusion intact on review, although it took issue with other aspects of the *ISP Remand Order*.<sup>56</sup>

If it had wished, of course, Congress could have limited the scope of this provision to “local telecommunications,” to “telecommunications that originate and terminate within the same local calling area,” or to “telecommunications handed off from one LEC directly to another LEC.” But Congress included no such limitations on the scope of section 251(b)(5). Instead, it drafted section 251(b)(5) broadly to address all “telecommunications,” the most expansive of the statute’s defined terms.<sup>57</sup>

Despite the clarity of this statutory language, some continue to argue that the Commission’s jurisdiction to implement section 251(b)(5) extends only to “local” traffic and that the Commission thus lacks authority under that provision to address intercarrier compensation issues relating to any category of traffic that is deemed to be neither “local” nor “interstate.” This misguided effort to carve up the Commission’s rulemaking authority on the basis of such legacy jurisdictional categories is not just irreconcilable with the plain language of section 251(b)(5), but strikingly similar to the unavailing attacks in the 1990s on the Commission’s jurisdiction to implement sections

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<sup>55</sup> See *ISP Remand Order* at 9167, 9172 ¶¶ 34, 45.

<sup>56</sup> See *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

<sup>57</sup> See 47 U.S.C. § 153(43).

251 and 252 more generally. Here, as in that context, the attempt to “produce[] a most chopped-up statute” along jurisdictional lines is flawed both because it violates the statutory text and because it is “most unlikely that Congress created such a strange hodgepodge.”<sup>58</sup>

*Second*, as the Commission has further found, section 251(b)(5) applies not just to the exchange of traffic between two LECs, but more broadly to the exchange of any traffic involving a LEC at one end.<sup>59</sup> In other words, although the obligation to establish reciprocal compensation arrangements for the transport and termination of telecommunications falls on LECs, Congress did not limit to other LECs the class of potential *beneficiaries* of that obligation.

*Third*, as the Commission has further indicated, section 251(b)(5) covers intercarrier compensation issues on the originating end of a call as well as the terminating end, even though it explicitly addresses only the “transport and termination of telecommunications.” As the Commission recognized in the *Local Competition Order*, because section 251(b)(5) provides for intercarrier compensation only for termination of traffic and does not authorize charges for originating traffic, LECs could no longer charge CMRS providers or other carriers for LEC-originated traffic.<sup>60</sup> Thus, with the exception

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<sup>58</sup> *Iowa Utils. Bd.*, 525 U.S. at 381 n.8.

<sup>59</sup> See *Local Competition Order* at 16016 ¶ 1041 (“Although section 251(b)(5) does not explicitly state to whom the LEC’s obligation runs, we find that LECs have a duty to establish reciprocal compensation arrangements with respect to local traffic originated by or terminating to *any* telecommunications carriers,” including non-LEC CMRS providers) (emphasis added). Where Congress intended LECs’ 1996 Act obligations to run only to a limited class of carriers, it did so explicitly. See, e.g., 47 U.S.C. § 251(b)(3) (“The duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service. . .”).

<sup>60</sup> *Local Competition Order* at 16016 ¶ 1042.

of pre-1996 Act compensation rules temporarily grandfathered by section 251(g), section 251(b)(5) is properly read to bar carriers from imposing any charges, including access charges, for the costs of originating traffic.

Because the statutory language itself compels the conclusion that the Commission's section 251(b)(5) authority extends to *all* telecommunications involving a LEC, the Commission would face formidable litigation risks were it now to reverse course yet again on the scope of section 251(b)(5). Indeed, as the D.C. Circuit recently admonished, "[e]ven under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term."<sup>61</sup> The statutory context in which the D.C. Circuit enforced that principle is closely analogous to the statutory context here. Just as the court applied that principle to reject the Commission's "argument that long distance services are not 'telecommunications services'" for purposes of section 251(d)(2), so too is the Commission barred from finding that particular categories of "telecommunications" do not *count* as "telecommunications" for purposes of section 251(b)(5).

Were there any remaining question about the Commission's jurisdiction to address all telecommunications under section 251(b)(5), including access traffic, it would be resolved by section 251(g). That provision singles out access traffic for special treatment and temporarily grandfathers the pre-1996 rules applicable to such traffic, including rules governing "receipt of compensation."<sup>62</sup> There would have been no need

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<sup>61</sup> *USTA v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004).

<sup>62</sup> 47 U.S.C. § 251(g).

for Congress to have preserved those compensation rules against the effects of section 251 if section 251(b)(5) did not in fact address the “receipt of compensation” for the traffic covered by section 251(g)—*i.e.*, access traffic. Because Congress is presumed not to have wasted its breath, the only sensible interpretation of section 251(g) confirms what section 251(b)(5) already makes clear on its face: that intercarrier compensation for all access traffic falls within the broad scope of the Commission’s jurisdiction to implement section 251.

In a footnote of the *ISP Remand Order*, the Commission obliquely suggested that “ambiguity” in the scope of “telecommunications” might support a construction that *intrastate* access traffic falls outside of section 251(b)(5).<sup>63</sup> As noted, however, there is no such ambiguity: the statutory definition of “telecommunications” straightforwardly encompasses all access traffic. Moreover, there is no basis for the apparent policy concern that motivated the Commission to look for ambiguity in this unambiguous language—*i.e.*, a concern that (i) section 251(g) preserves only the *interstate* access charge regime (until the adoption of superseding Commission regulations) but not the parallel *intrastate* access regime and (ii) Congress should be presumed not to have intended to have undercut the latter regime immediately upon enacting the 1996 Act.<sup>64</sup> No less than its interstate counterpart, the *intrastate* access charge regime derives from the 1982 AT&T consent decree and the subsequent GTE decree.<sup>65</sup> Contrary to the Commission’s apparent belief, therefore, the *intrastate* access

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<sup>63</sup> See *ISP Remand Order* at 9168 ¶ 37 n.66.

<sup>64</sup> See *id.*

<sup>65</sup> Before 1982, compensation for interexchange access was generally derived through an AT&T-administered system of settlements and division of revenues. Second

regime falls squarely within the ambit of section 251(g), which grandfathers “equal access and nondiscriminatory interconnection . . . obligations (including receipt of compensation) . . . under any court order, consent decree,” or FCC order. Indeed, it would have been perverse for Congress to have authorized the Commission to reform intercarrier compensation rules relating to “local” and “interstate” traffic but *not* the rules applicable to the one class of traffic—intrastate access—that is subject to the *highest* above-cost charges and that is generally thought to be most laden with unsustainable implicit support.

In any event, even if section 251(g) were read *not* to grandfather intrastate access charges, that reading would raise no pragmatic concerns about the broad scope of section 251(b)(5), for the Commission could still exercise its well-established authority to impose interim rules ensuring a smooth transition to a new regulatory regime. Indeed, in a variety of contexts, and particularly in matters of intercarrier compensation, the courts

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Supplemental Notice of Inquiry and Proposed Rulemaking, *MTS and WATS Market Structure*, 77 F.C.C.2d 224, 227-28, 234 ¶¶ 15-19, 47 (1980). The AT&T consent decree replaced that system with a regime of federal *and* intrastate access charges. See *United States v. AT&T Co.*, 552 F. Supp. 131, 227, 233 (D.D.C. 1982); Third Report and Order, *MTS and WATS Market Structure*, 93 F.C.C.2d 241, 246 ¶ 11 (1983). The court order accompanying the consent decree made clear that the decree required access charges to be used in both the interstate and intrastate jurisdictions: “Under the proposed decree, state regulators will set access charges for intrastate interexchange service and the FCC will set access charges for interstate interexchange service.” *AT&T*, 552 F. Supp. at 169 n.161. Thus, both interstate and intrastate access charges were borne of the same “consent decree,” and both are preserved under section 251(g). There is also no evidence in the legislative history that Congress intended to treat intrastate access charges any differently, for grandfathering purposes, from interstate access charges. To the contrary, the House Conference Report broadly states that “the substance of this new statutory duty” under section 251(g) “shall be the equal access and nondiscrimination restrictions and obligations, including receipt of compensation, that applied to the local exchange carrier immediately prior to the date of enactment, *regardless of the source.*” H.R. CONF. REP. NO. 104-458, at 123 (1996) (emphasis added).

have long upheld the Commission's expansive authority to take reasonable transitional measures needed to protect the industry from sudden disruptions.<sup>66</sup> The Commission's authority to adopt similar measures to manage the transition from access charges to a unified section 251(b)(5) regime forecloses any claim that Congress must have meant to exclude intrastate access charges permanently from the scope of section 251(b)(5). And this same authority permits the Commission to adopt the ICF Plan's proposed transition from the present schemes of intercarrier compensation to a unified system based on bill-and-keep principles.

**B. The Commission Has Substantive Authority to Impose Bill and Keep for All Telecommunications Traffic and to Impose the ICF Plan's Proposed Transition from Current Rates to Bill and Keep**

The Commission not only has *jurisdiction* to impose a unified intercarrier compensation system for all traffic, but also the authority to prescribe a transition to substantive compensation rules based primarily on bill and keep, even for "unbalanced" traffic subject to the pricing rules of sections 251(b)(5) and 252(d)(2).

In the *Local Competition Order*, at the same time that the Commission erroneously limited the scope of section 251(b)(5) to local traffic, it also found—more as a matter of policy than of statutory interpretation—that bill and keep was inappropriate for unbalanced traffic.<sup>67</sup> In the present context of comprehensive intercarrier compensation reform of *all* traffic, including access traffic, the Commission now should focus more carefully on the breadth of its statutory authority and reach the contrary

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<sup>66</sup> See, e.g., *CompTel v. FCC*, 309 F.3d 8, 15 (D.C. Cir. 2002); *CompTel v. FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997).

<sup>67</sup> See *Local Competition Order* at 16054-55 ¶¶ 1111-12.

conclusion—namely, that the text of section 252(d)(2) permits the Commission to order bill and keep for all traffic, including unbalanced traffic.<sup>68</sup>

As an initial matter, section 252(d)(2)(A) directs the Commission and the states (i) to “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) to “determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls.” This language is perfectly consistent with a regime, such as bill and keep, in which each carrier is afforded an opportunity for “recovery” of those costs from its own end users.<sup>69</sup>

If there were any question on this point, it would be answered by the “bill-and-keep savings clause.” Section 252(d)(2)(B)(i) expressly authorizes all regulatory “arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements).” The “bill-and-keep”-like provisions of the ICF Plan entitle carriers to the “mutual recovery of costs” by permitting them to recover those costs through end user charges and, where necessary, universal service. As the legislative history confirms, this clause thus permits “a range of compensation schemes, such as an in-kind exchange of traffic without cash payment (known as bill-and-keep

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<sup>68</sup> See *WorldCom*, 288 F.3d at 434.

<sup>69</sup> See *Local Competition Order* at 16055 ¶ 1112 (“bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs”) (emphasis added).

arrangements).”<sup>70</sup> Importantly, the D.C. Circuit has already indicated its support for the same conclusion, noting the “non-trivial likelihood that the Commission has authority to elect” a bill-and-keep regime for section 251(b)(5) traffic under the terms of section 252(d)(2)(B)(i), which the court specifically cited.<sup>71</sup> Although section 252(d)(2), like the 1996 Act as a whole, “is in many important respects a model of ambiguity or indeed even self-contradiction,” Congress “is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency.”<sup>72</sup> Here, the Commission can and should resolve any ambiguity in this statutory language in favor of an appropriately robust construction of the bill-and-keep savings clause.

Reading section 252(d)(2) to preserve the Commission’s discretion in this respect does *not* reduce the pricing standards of section 252(d)(2) to surplusage. That provision is properly understood to require the Commission to choose, for all traffic within the scope of section 251(b)(5), *either* bill and keep, so long as carriers may recover their costs from end users directly (or, where appropriate, from universal service support), *or* a genuinely cost-based CPNP regime. Section 252(d)(2) still precludes *non*-cost-based compensation rules as well as arrangements (common before 1996) under which an *originating* carrier charges a *terminating* (or intermediate) carrier for handing off calls to it. And the Commission’s choice of a bill-and-keep-type methodology rather than a CPNP rule is particularly reasonable now, since eight years of experience have shown that CPNP creates the potential for serious market distortions and that it is too

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<sup>70</sup> S. REP. NO. 104-230, at 120 (1996).

<sup>71</sup> See *WorldCom*, 288 F.3d at 434.

<sup>72</sup> *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 397.

costly (if possible at all) to ensure “perfect” cost-based rates. The Commission is thus more than free to revisit and reject its unelaborated assumption in the *Local Competition Order* that Congress meant to lock in those distortions forever through the relevant statutory language.<sup>73</sup>

In addition, as the D.C. Circuit further suggested in citing the bill-and-keep savings clause as a basis for remanding but not vacating the *ISP Remand Order*, the Commission would not overstep any *jurisdictional* boundaries established in *Iowa Utilities Board* by prescribing bill and keep for all traffic. Under *Iowa Utilities Board*, the Commission has plenary jurisdiction to make very specific methodological decisions about the implementation of section 251, and a choice of bill and keep is precisely such a decision, even though it has the effect of producing specific outcomes in matters of intercarrier compensation. Indeed, the Commission cannot *avoid* prescribing the circumstances in which bill and keep is appropriate if it is to play its statutorily assigned role in interpreting the scope of the bill-and-keep savings clause of section 252(d)(2).

For all of these reasons, sections 252(d)(2) and 251(b)(5) pose no obstacle to an FCC-mandated transition to the ICF Plan. Finally, this transition would not occur in one step. As noted, the Commission has ample authority to avoid sudden industry

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<sup>73</sup> See *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 863-64 (1984) (agency is free to change mind on matters of statutory interpretation); *Smiley v. Citibank*, 517 U.S. 735, 742 (1996) (“[C]hange is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by ambiguities of a statute with the implementing agency.”); see also *Independent Bankers Ass'n v. Farm Credit Administration*, 164 F.3d 661, 668 (D.C. Cir. 1999).

disruptions by adopting the Plan's proposal for a transitional glide-path from existing intercarrier compensation rates to a unified regime.<sup>74</sup>

**IV. No Other Plan Currently Before The Commission Offers A Comprehensive, Detailed, Legal Solution That Serves The Public Interest And Meets The Commission's Reform Goals**

Although the Commission has received alternative reform proposals from a range of single-interest groups, those proposals suffer from at least four fatal flaws:

(1) None of the alternative proposals offers a comprehensive or balanced solution to the full range of issues before the Commission.

(2) All but one of the other proposals would continue to subject identical uses of the network to radically different regulatory regimes – one of the principal problems this proceeding was initiated to solve.

(3) All of the other plans would require massive and burdensome proceedings and litigation to implement – and many of the contemplated proceedings would be unlawful.

(4) None of the other plans would adequately protect universal service.

**A. No Other Proposal Offers Either a Comprehensive or Balanced Solution.**

Each of the other reform proposals contains numerous specific, substantive flaws, which we discuss in detail below. At the outset, however, it is important to emphasize that each of the other plans suffers from two fundamental and ultimately fatal flaws: none is either *comprehensive* or *balanced*. Given the urgent need

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<sup>74</sup> See *CompTel*, 117 F.3d at 1074-75; see also *CompTel*, 309 F.3d at 15 (“the Commission can justify a policy by reference to the purposes of avoiding disruption pending a broader reform”).

for a truly unified system of intercarrier compensation, these sketchy and unbalanced proposals cannot solve the problems this rulemaking proceeding is meant to address.

*First*, no other proposal before the Commission is adequately comprehensive or detailed. The issues involved in this proceeding are among the most difficult and complex in the communications regulatory world today. The highly interrelated nature of these issues demands a comprehensive solution that addresses network interconnection, intercarrier compensation, and universal service reform in a coherent, coordinated manner. The ICF Plan is the only plan before the Commission that accomplishes this goal.

Indeed, four of the seven other “proposals” identified in the Notice—those of NASUCA, CTIA, Western Wireless, and CBICC—are simply lists of general principles that the proponents suggest should guide the Commission’s reform efforts.<sup>75</sup> And ARIC and EPG—two of the groups that have submitted more detailed proposals—

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<sup>75</sup> See, e.g., *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Steve Largent, President and CEO, CTIA, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Nov. 29, 2004) (“CTIA principles”) (3 pages); *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from David L. Sieradzki, Counsel for Western Wireless Corp. to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Dec. 1, 2004) (“Western Wireless proposal”) (5 pages); *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Richard M. Rindler to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Sept. 2, 2004) (“CBICC proposal”) (4 pages, and an additional 4 of rhetoric opposing bill-and-keep); National Association of Regulatory Utility Commissioners Study Committee on Intercarrier Compensation Goals for a New Intercarrier Compensation System, May 5, 2004 (“NARUC principles”) (4 pages). After the Commission issued its Notice, NARUC also submitted a draft proposal from its Intercarrier Compensation Task Force, discussed below. The NARUC principles were attached to this draft task force proposal.

have now issued their own list of common principles, but no common or detailed plan for their implementation.<sup>76</sup>

These lists of general principles, while conceptually important, by themselves are of limited value to the Commission, and the Commission should accordingly give them little weight in its actions in this docket. Inevitably, they contain insufficient detail to give carriers clear guidance as to their responsibilities or to permit the Commission to write substantive rules. Indeed, many of them raise more questions than they answer and, in leaving important questions unanswered, invite protracted negotiation, arbitration and litigation among carriers seeking competitive advantage. The Commission's goal to minimize disputes and to develop a clear plan that is easy to administer can be achieved only with a plan, like the ICF's, that is detailed enough to define clearly each carrier's responsibilities, keeping ambiguity to a minimum.

To contribute meaningfully to the public debate and the Commission's analysis, the operation of broad principles in real-world situations must be explained at a granular level that permits the Commission to issue detailed implementing rules. Until this has occurred, the Commission has little basis on which to choose one set of principles over another, as the public interest implications only become clear once the principles have been reduced to an operational proposal for concrete reform. Indeed, until that process has occurred, there is little evidence that even the proponents themselves fully understand the implications of what they are asking.

*Second*, no other proposal offers a balanced solution crafted with the public interest paramount. To ensure balance and minimize the risk of unintended

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<sup>76</sup> See Rural Alliance Press Release at 1.

consequences, a comprehensive plan for reform must consider diverse perspectives, with the ultimate goal of advancing the Commission's mandate to serve the public interest. Only the checks and balances inherent in a cross-industry, collaborative process can ensure that the resulting plan will appropriately balance competing interests, address all of the interrelated aspects of comprehensive reform and minimize unintended consequences.

The ICF Plan is the only reform proposal before the Commission that was developed in this way. Each of the other proposals each represents an attempt by an individual company or homogeneous group to advance a limited set of parochial interests. The resulting proposals, unsurprisingly, advocate outcomes on particular issues that would benefit the proponents, but fail to offer a solution that could remotely be considered fair, balanced or complete with respect to the full spectrum of interrelated issues before the Commission.

For example, the ARIC, EPG, and Home/PBT proposals represent a narrow perspective on the nation's overall telecommunications needs. Rural ILECs serve a small fraction of the nation's lines and carry a small fraction of the nation's telecommunications traffic. The Commission certainly should consider their unique circumstances and concerns, and the ICF Plan incorporates rural perspectives as one of many, given that some ICF members serve rural areas. The ICF Plan, as a result, strikes an appropriate balance among all competing interests, including those of rural America. But the discrete interests of a small percentage of rural ILECs should not be permitted to dictate overall policy and derail needed reforms for the large majority of the country.

Moreover, it is not even clear that the ARIC, EPG, and Home/PBT plans have broad support even among rural ILECs. ARIC characterizes itself as “a group of small rural, high-cost telecommunications companies from across the country,”<sup>77</sup> but, other than two rural Nebraska ILECs, Great Plains Communications and Consolidated Telecommunications Company, it has failed to identify any party that supports adoption of its proposal.<sup>78</sup> Similarly, EPG lists 23 small rural ILECs and five rural ILEC consulting firms that “participated in the development of” its proposal, without clearly identifying which, if any, support the final product.<sup>79</sup> Among the participants EPG lists is Home Telephone Company, Inc., one of two small, rural South Carolina companies that also developed and publicly support the Home/PBT proposal.<sup>80</sup> As noted above, ARIC and EPG recently further complicated matters by announcing that they had united to form the “Rural Alliance,” despite substantial conflicts between their two reform proposals.<sup>81</sup>

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<sup>77</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Ex Parte* filing of the Alliance for Rational Intercarrier Compensation (filed Oct. 25, 2004) at 5 (“ARIC proposal”).

<sup>78</sup> *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Ken Pfister, Vice President – Strategic Policy, Great Plains Communications, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Jan. 26, 2005).

<sup>79</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Glenn H. Brown, EPG Facilitator, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Nov. 2, 2004) (“EPG proposal”), at 35.

<sup>80</sup> *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Letter from Keith Oliver, Vice President-Finance, Home Telephone Company, Inc. and Ben Spearman, Vice President, Chief Regulatory Officer, PBT Telecom, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Nov. 2, 2004) (“Home/PBT proposal”).

<sup>81</sup> Press Release, *EPG and ARIC Unite to Form a “Rural Alliance” for Intercarrier Compensation and Universal Service Reform*, rel. Feb. 14, 2005, available at [http://www.arictelecom.com/pdf/ARIC\\_&\\_EPG\\_Unite\\_2-14-05.pdf](http://www.arictelecom.com/pdf/ARIC_&_EPG_Unite_2-14-05.pdf).

They issued a two-page list of principles that they agree should govern intercarrier compensation and universal service reform, but made no other effort to harmonize these conflicts. Indeed, it is not clear what parts of either the ARIC or EPG will be incorporated in the “Rural Alliance” proposal.

The CBICC and Western Wireless proposals are similarly lopsided in favor of CLECs and wireless carriers, respectively. The only competing proposal that makes any pretense of balance at all is the NARUC Task Force’s draft-in-progress. The NARUC Task Force on Intercarrier Compensation (“Task Force”) has begun work to develop a detailed and comprehensive reform proposal, and submitted an initial draft proposal on March 1, 2005 (the “Task Force Draft”). NARUC acknowledges that “discussions continue on the Task Force proposal in an attempt to reach a still broader consensus on key issues.”<sup>82</sup> The ICF commends the Task Force’s effort as one that is attempting to craft a comprehensive plan that acknowledges the needs and concerns of a diverse group of stakeholders. The Task Force has convened a series of six workshops involving a diverse group of industry stakeholders, a representative of consumer interests, and state commissioners and staff, and the ICF has participated in these workshops and shared its ideas, goals and concerns with the Task Force and the other workshop participants.

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<sup>82</sup> Letter from Robert B. Nelson, Commissioner, Michigan Public Service Commission, Elliott G. Smith, Board Member, Iowa Utilities Board, and Ray Baum, Commissioner, Oregon Public Utility Commission to Michael Powell, Chairman, Federal Communications Commission, CC Docket No. 01-92 (filed Mar. 1, 2005) at 2 (quoting NARUC Resolution on the NARUC Intercarrier Compensation Task Force (Feb. 16, 2005)).

The ICF supports some of the Task Force's early, high-level conclusions. For example, the Task Force Draft correctly recognizes the need for coordinated and concurrent action to reform network interconnection, intercarrier compensation, and universal service support mechanisms. The Task Force Draft endorses much of ICF's network interconnection proposal, stating that, "a complete proposal must address the issues of transport and tandem transit."<sup>83</sup> Similarly, the Task Force Draft recognizes that, "the current interstate revenue base of the Federal Universal Service Fund cannot be relied upon for the future."<sup>84</sup>

Despite the considerable effort the Task Force has made, however, ICF cannot endorse the Task Force Draft. Significant elements of the proposal remain tentative or incomplete, such as whether the Task Force will endorse eliminating or retaining originating access charges, how universal service should be funded, and other critical items. Moreover, the ICF has seen little evidence that the Task Force's efforts have produced any meaningful consensus on a concrete and integrated reform proposal. Rather, after hearing from all sides, the Task Force members have acted in a role akin to that of arbitrators, deciding on an issue-by-issue basis which aspects of each competing plan to adopt. The Task Force Draft, while proposing some new ideas, is largely an amalgamation of individual pieces of the proposals developed by other stakeholders. Because it was not developed holistically, it is unlikely that its individual elements will operate well together as a complete working system. And, at least as currently structured, the Task Force Draft suffers from a number of disabling flaws. The ICF does believe,

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<sup>83</sup> Task Force Draft at 11.

<sup>84</sup> Task Force Draft at 8.

however, that the Task Force is sensitive to the need to harmonize all parts of their ultimate proposal, and to ensure that it can be implemented.

The ICF is the only group that represents a broad cross-section of the industry *and* has reached a balanced consensus among the parties on a detailed, comprehensive plan. That consensus and any fair reading of the ICF Plan provides objective evidence that its plan is balanced, adequately addresses the concerns of all parties and, most importantly, would serve the public interest.

**B. The Other Plans Would All Continue To Subject Identical Uses of the Network to Radically Different Regulatory Regimes.**

One of the principal purposes of this proceeding is to institute a *unified* intercarrier compensation regime: one that does away with the hodgepodge of different regulatory regimes that apply to essentially identical uses of the network. Such a uniform regime, built on simple and predictable rules, is critically important to ensure market-oriented outcomes and to eliminate incentives to design business plans to take advantage of regulatory disparities. The ICF proposal is the *only* plan that accomplishes that goal. All of the remaining plans merely nibble at the edges of this problem. With the exception of the Western Wireless plan, all of the other plans fundamentally retain today's outdated calling-party-network-pays philosophy, and continue to place identical uses of the network in different regulatory "boxes" depending on the type of services or type of carrier at issue. And while the Western Wireless plan purports to transition toward uniform *compensation* rules, it fails to resolve in any meaningful way the interconnection issues that equally important to efficient, uniform, competitively neutral outcomes. In other words, each of the other proposals leaves in place the fundamental problems this proceeding is meant to address—and, accordingly, each would be doomed to failure.

Many of these flaws stem from the fact that these plans cling to today's outdated CPNP philosophy. As the Commission has recognized, CPNP is no longer an appropriate or workable underpinning for the Commission's intercarrier compensation rules. The *Notice* points out that, "[d]evelopments in the ability of consumers to manage their own telecommunications services undermine the premise that the calling party is the sole cost causer and should be responsible for all the costs of the call."<sup>85</sup> Moreover, in a world of rapidly advancing technology, identifying the "calling party's network" is rapidly becoming an exercise in futility guaranteed to provoke wasteful litigation. Indeed, the current rules fail to define the "calling party's network" in a uniform manner even for today's technologies. The rules require regulators to distinguish calls where the calling party's LEC is said to provide "retail" network connectivity from other calls where the calling party's LEC provides identical functionality but is classified as a "wholesale" provider of such connectivity. Under the current access charge system, when a network sells connectivity "wholesale" to an interconnected carrier (such as an IXC), that "wholesale" purchaser becomes the "calling party's network," despite lacking any direct network connection to the subscriber, and must assume the payment obligation for termination as well as paying the wholesaler an origination fee.

This retail/wholesale dichotomy between minutes of use provided over the same network facilities cannot be sustained in a world where consumers have multiple alternative routes to access the PSTN. Inefficiency and implicit support inherent in the wholesale access model are driving customers to VOIP, wireless, and other services that operate under simpler, more market-based rules. Nevertheless, the ARIC, EPG,

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<sup>85</sup> Notice at ¶ 17.

Home/PBT, CBICC, and NASUCA proposals all effectively retain this retail/wholesale dichotomy, thus impeding any effort to eliminate the distinction between local and toll traffic that today is based entirely on the historical local calling areas established by regulators. As the Commission has already recognized in many contexts, however, it is no longer routinely possible to identify the location of a called or calling party.

As explained below, each of the competing plans retains different regulatory regimes for similar and competing traffic, and thus would perpetuate precisely the problems this proceeding is meant to eliminate.

**NARUC.** NARUC's Task Force Draft fails to ensure national uniformity. Although the Task Force Draft *strives* for uniform rates and creates incentives for states to participate,<sup>86</sup> its reforms are optional in the sense that each state is free to adopt or reject them, in whole or in part, as it sees fit. Undoubtedly, some states will opt out. The result will be a nationwide patchwork little better than the failed framework that carriers and consumers face today. If even one state were to retain the legacy system, it would create administrative burdens and intercarrier disputes for carriers across the country, because traffic that originated from or terminated to customers in that state would travel nationwide. To be successful, intercarrier compensation reform must be nationwide and must establish a truly uniform system for all services in all states.

**ARIC.** ARIC's proposal tackles only one aspect of the lack of uniformity in today's intercarrier compensation regime: the disparities among interstate access, intrastate access, and reciprocal compensation rates. ARIC would preserve virtually all other aspects of the legacy, CPNP-based regulatory structure, including dual regimes for

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<sup>86</sup> Task Force Draft at 5, 10.

network interconnection and originating access charges that impose differing financial obligations on an interconnecting carrier and substantial rate disparities among carriers.

Even while acknowledging the need for greater uniformity, ARIC's proposal retains many of the fundamental inconsistencies inherent in the current calling party network pays scheme. The ARIC plan would maintain a distinction between local and toll calling, although it has rephrased that as a distinction based on which carrier provides "retail service." It would apply varying rates depending on the type of carrier—IXC, CMRS, CLEC and LEC—exchanging traffic, thereby continuing implicit support and arbitrage. It would impose a single statewide SLC rate by permitting price cap LECs to increase their SLCs to offset lower intercarrier rates, and then permitting rural companies to decrease their SLCs to the weighted average for price cap companies within the state. And it would fail entirely to address the issues arising from different calling scopes for CLECs and wireless carriers, the jurisdictional issues surrounding VOIP, or current disputes over transport obligations arising from the network configurations of new entrants.

The ARIC proposal is only a half-answer even with respect to the one problem it does address—the disparity between interstate and intrastate access rates. The ARIC plan seeks "uniformity" by attempting to create access charge rate levels and structures that do not differ between the state and interstate jurisdictions. But while ARIC unifies *access* rate structures and levels between the state and federal jurisdictions, it fails to make those rate levels uniform among different types of carriers. That disparity itself will create substantial litigation and dispute over the structure and level of costs of various carriers—even if the analysis is limited to ILECs because traffic will be

exchanged between carriers operating in neighboring territories. This approach ensures that there will continue to be a need for substantial regulatory intervention, rather than “limit[ing] both the need for regulatory intervention and arbitrage concerns arising from regulatory distinctions unrelated to cost difference.”<sup>87</sup>

Even more significantly, however, ARIC fails feasibly to implement the FCC’s direction that it is interested “in not only similar rates for similar functions, but also in a regime that would apply these rates in a uniform manner for all traffic.”<sup>88</sup> ARIC fails to recognize that the procedures needed to distinguish, delineate, and enforce when the access and reciprocal compensation mechanisms apply are the source of much of the economic inefficiency, arbitrariness, and dispute within the current regimes.

ARIC insists that it creates uniform application by using its “retail service provider pays” formulation, but this uniformity of application is illusory. What reveals ARIC’s true objective is the output of its proposal: ARIC seeks to replicate and to permanently enshrine the existing access revenue flows from unaffiliated interexchange carriers to the originating LEC. But the “retail service provider pays” instruction is no simpler than trying to distinguish between “access” and “non-access” traffic. For example, there is no clear line to delineate when a user of the network is merely a user, and not subject to ARIC’s intercarrier compensation scheme, versus when the user of a network is required to pay. ARIC, for example, asserts that dial-up ISPs are carriers, but provides no analysis to distinguish the dial-up ISP from an audiotex provider, telemarketer or pizza delivery company that earns revenue from the use of the network.

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<sup>87</sup> Further Notice at ¶ 33.

<sup>88</sup> *Id.*

Furthermore, there can be multiple entities with multiple end user retail relationships for a single call. A traditional interstate long distance call today involves at least three retail relationships: the originating LEC with the originating caller, which charges the SLC to cover the interstate loop and port costs; the IXC with the originating caller, which charges a toll rate to cover the costs from originating end office switch through the terminating end office switch; and the terminating LEC, which charges the SLC to the terminating caller to recover the interstate terminating loop and port costs. By attempting to define each “retail service,” and then trying to identify the “provider” of that service, ARIC essentially slaps a new coat of paint on today’s worn-out regulatory jalopy and promises that, with a little work, she will be as good as new. By perpetuating this framework, and the substantial rate disparities between different kinds of traffic, ARIC would only perpetuate the sources of many of today’s ongoing disputes.<sup>89</sup>

Of all the other plans, the ARIC plan is the only one that expressly attempts to address the conflict between the Internet model and the legacy model. But ARIC does so by trying to have the government mandate that the legacy revenue flows of the PSTN be replicated for IP-based services. Notwithstanding the fact that such charges have not evolved for DSL services to date, ARIC asks the Commission to create mandatory per-session fees that a LEC would charge to an ISP—and ARIC anticipates

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<sup>89</sup> In addition, by substantially *increasing* the rate level applicable to local interconnection traffic, ARIC’s proposal is directly contrary to the Commission’s sound policy, established for over two decades, of steadily decreasing intercarrier compensation rates. See, e.g., *Policies and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6799 (1990), at ¶ 100 (adopting productivity offset as part of new price cap rate regulation rules) and cases cited at note 44, above.

that the ISP would then bill that session charge to the end user.<sup>90</sup> The clear intent of ARIC's proposal is to use government regulation forcibly to shift cost recovery for IP-based services away from today's Internet model toward a regime that would raise complex cost-recovery questions and would inevitably result in the need for comprehensive regulatory oversight and intervention.

As the Commission recognized, to achieve true uniformity and competitive neutrality, the Commission must do more than simply unify the access and intercarrier compensation rate levels charged by each carrier. It must apply those rates in a uniform manner, rather than subjecting some traffic to origination charges while other traffic is delivered to interconnecting carriers without charge.<sup>91</sup> It must also make those rate levels uniform *among* carriers; otherwise disparities among termination rates will continue to frustrate the rate averaging and rate integration goals of Section 254(g). By failing to create uniform rates across carriers, ARIC's plan will impede the rate integration and rate averaging goals of § 254(g), just as steep differentials among access rates charged by various LECs do today.

*EPG.* The EPG plan also fails to provide needed uniformity. The EPG plan is structured in three steps. In Step 1, EPG would require all traffic to be properly labeled to permit accurate billing of intercarrier compensation; messages that are not properly labeled would be billed at the highest prevailing rate to the interconnecting carrier that delivered the traffic, and ultimately might be blocked.

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<sup>90</sup> ARIC proposal at 97.

<sup>91</sup> Further Notice ¶ 33.

In Step 2, EPG would unify LEC intrastate and interstate access charges and reciprocal compensation at the interstate access charge rate level currently charged by each LEC. In addition, EPG would introduce an “access restructure charge” (“ARC”) that would replace any additional revenue formerly recovered from intercarrier charges. The ARC would be a charge based on the number of working telephone numbers in service and would be collected based on a pooling mechanism that would average the recovery across all participants in NECA’s “access tariff.” Full eligibility for ARC funding would be contingent on a carrier exceeding a specified residential and single line business end user rate benchmark of \$21.07 per month.<sup>92</sup>

In Step 3, EPG would replace existing rate structure with a series of capacity-based charges consisting of “Port” and “Link” charges, while preserving minute-of-use based pricing for tandem-routed switched access traffic. Interconnecting carriers would purchase “ports” and “links” that would allow them to originate or terminate a given amount of traffic to or from the ILEC’s network. In addition, EPG would also introduce quality-of-service rate elements, if necessary to address packet-based services.<sup>93</sup>

Because the EPG proposal pursues the same kind of misguided “uniformity” as the ARIC proposal—unifying intrastate and interstate access rates without addressing the many other egregious fractures in the current system—it suffers from the same failings. Like ARIC, EPG fails to recognize the futility of any attempt objectively to identify a different “retail service provider” for every call and therefore

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<sup>92</sup> EPG plan at 3-4.

<sup>93</sup> EPG plan at 5.

fails to achieve a uniform rate structure for “access” and “local interconnection” traffic, fails to create a uniform intercarrier compensation rate level applicable to all carriers, and fails to create uniform network interconnection rules. Moreover, while the EPG proposal ultimately would migrate the industry to a system of interconnection based on “ports” and “links” that interconnecting carriers would purchase from the ILEC, it does not appear to contemplate that the ILEC would purchase any “ports” or “links” from other carriers. Thus the ILEC alone would be entitled to recover a portion of the costs of its network from users of other networks. Such asymmetrical interconnection obligations are the very antithesis of uniformity.

*Home/PBT.* The Home/PBT proposal is similar to EPG’s proposal in many respects. Like EPG, Home/PBT would transition intercarrier compensation to a system of capacity-based charges, but would do so immediately, and would eliminate per-minute charges as an alternative. Under the Home/PBT proposal, these capacity-based fees would be established based on national averages, with the difference made up through a “high cost connection fund” (“HCCF”) charge, similar to EPG’s ARC charge. In addition, carriers owning tandem switches would be required to tariff an “access tandem connection” fee that would apply to traffic that transits the tandem owner’s network en route to the terminating rural carrier.

Thus, the Home/PBT proposal fails to achieve the uniformity in intercarrier compensation rate structures and levels needed to achieve meaningful reform. Recognizing a need for more uniformity in the Commission’s network interconnection rules, Home/PBT makes a nascent proposal for network interconnection reform. Unfortunately, it is lopsided and woefully incomplete. Home/PBT proposes that each

carrier make available at least one POI within each LATA.<sup>94</sup> Under Home/PBT's proposal, rural carriers would specifically be entitled to establish a POI in each local calling area and interconnecting carriers would bear all costs of transporting traffic to or from that POI, effectively relieving the rural carrier of any financial obligation to transport traffic outside of any of its local calling areas, no matter where the traffic is destined to terminate.

With respect to other carriers, the proposal is far too vague to be implemented. After specifying the "at least one POI per LATA" rule, the proposal is entirely silent on whether any carrier faces a maximum number of POIs, and on the terms under which these POIs would be interconnected.<sup>95</sup>

**CBICC.** CBICC, a group composed largely of unnamed competitive LECs, would base all intercarrier compensation—access in addition to reciprocal compensation—on TELRIC rates.<sup>96</sup> Although marketed as a "uniform" system, the CBICC proposal, in fact, would maintain many of the disparities that plague the system today.

In particular, the CBICC retains the basic CPNP system. The CBICC proposal thus requires regulators to continue to differentiate when a LEC is acting as a "retail" provider of service to its end user and when it is acting as "wholesale" provider

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<sup>94</sup> Presumably, a carrier that does not operate in a LATA would not be subject to this obligation in that LATA, although the proposal is not clear on this point.

<sup>95</sup> Home/PBT proposal at 13-14.

<sup>96</sup> CBICC submitted its proposal attached to an *ex parte* letter that indicated that representatives from Pac-West Telecomm, Inc., US LEC Corp., and Eschelon Telecom, Inc. had met with Commission representatives "on behalf of" CBICC, without providing the names of any other members. *See* CBICC proposal (cover letter).

of access to an IXC. Thus it would maintain originating access charges, and it would preserve substantial rate disparities among terminating carriers. It would also require the same type of “retail service provider pays” approach as the ARIC and EPG plans, with the same inevitable disputes and disparities as to who must pay whom. Thus, the CBICC proposal will do little to solve the problems the current system produces.

Moreover, as discussed previously with respect to the ARIC proposal, any “uniformity” from calculating all intercarrier rates based on TELRIC, without also addressing the application of those rates “in a uniform manner to all traffic,” is illusory.<sup>97</sup> Under the CBICC proposal, individual state commissions would determine the TELRIC rates, and past experience starkly demonstrates that such rates would vary considerably from state to state. Rate levels would be uniform only for each ILEC within each state (even within a state, as rates would vary among ILEC service areas) or not among all carriers and among all the states—which would, among other things, perpetuate the rate disparities that are undermining the rate integration requirements of § 254(g).<sup>98</sup>

Some of the most serious problems with the current system spring from its disparate treatment of carriers and traffic types by maintaining differing network interconnection and rate structure rules, as well as its reliance on disparate pricing methodologies for setting “local” and “access” intercarrier compensation rates. Unifying rates at TELRIC levels attempts to address, at best, only one aspect of this overall problem. In that respect, the CBICC proposal is simply another example of one slice of the industry seeking to promote its own narrow parochial interests, with no thought to

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<sup>97</sup> Further Notice at ¶ 33.

<sup>98</sup> See CBICC proposal at 1 (“[a] single rate for each relevant function would be set for each ILEC in each state”).

balancing the needs of the entire industry. Indeed, the CBICC's insistence on retaining the CPNP rate structure, with all of its problems that this proceeding was convened to correct, seems aimed principally at allowing these CLECs permanently to maintain or increase their ISP-bound traffic and CLEC access charge payment streams to the maximum extent possible.<sup>99</sup>

*Western Wireless.* Western Wireless, alone among the other proposals, proposes a transition to a bill and keep system that would eliminate intercarrier payments and thus end today's system of similar traffic subject to different regulatory regimes. Western Wireless also acknowledges that uniform network interconnection rules are essential to such a system.<sup>100</sup> But Western Wireless's proposal fails entirely to provide the detail that would be needed to ensure uniform interconnection rules. The Western Wireless plan fails to specify, for example, (1) what constitutes an "edge"; (2) how many a carrier may designate; (3) what carriers are "hierarchical"; (4) how the transport rate for carriage of traffic between edges is calculated; (5) what rate (e.g., local, intrastate, or interstate) is the "current switched dedicated transport rate" for purposes of computing the discount on interconnection transport; or (6) the basis for hierarchical ILEC transiting rates. As explained above, the details of the default network interconnection rules are critically important in establishing a functioning system that eliminates the disparities in

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<sup>99</sup> See, e.g., CBICC proposal at 2 (ISP-bound traffic moves to baseline state-adjudicated TELRIC rates, which often far exceed the current ISP-bound rates).

<sup>100</sup> Western Wireless proposal at 2. Under Western Wireless's proposal, a carrier would bear financial responsibility for delivering its originating traffic to another carrier's edge in a LATA or, at the option of the originating carrier, to a mutual meet point at a hierarchical ILEC's access tandem in the LATA. Non-ILECs interconnecting with a hierarchical carrier also have the option of requiring the hierarchical carrier to carry the traffic both ways between networks, for which the non-ILEC would pay 50% of the "current switched dedicated transport rate."

today's outdated CPNP regime. Without such "details," Western Wireless's proposal will not produce uniformity and indeed, cannot be meaningfully evaluated.

*NASUCA*. *NASUCA*'s one-page list of principles offers the Commission no solution to the daunting problems with intercarrier compensation, network interconnection, and universal service that it now faces. It would fail to achieve comprehensive reform or neutrality, with respect either to intercarrier compensation rate structure and rate levels or network interconnection rules. Instead, *NASUCA* would retain today's patchwork network interconnection rules and, largely, today's interstate access rates,<sup>101</sup> with all of their attendant flaws, achieving nothing approaching the comprehensive reform needed to fix the current system. States would be encouraged, through unspecified means, to adopt similar rates, but that obviously cannot provide the needed assurance that uniformity will, in fact, be achieved.

**C. The Other Plans Would Require Massive and Burdensome Proceedings to Implement and Would Provoke Endless Litigation.**

Implementation of the other plans would also require extensive and burdensome litigation at both the federal and state levels. Most of these plans would also guarantee ongoing litigation, because they fail truly and unambiguously to unify the compensation regime.

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<sup>101</sup> *NASUCA* proposes interstate intercarrier compensation rates of \$0.0055 per minute for non-rural carriers and create a target rate of \$0.0095 for rural carriers, which roughly match the current price cap target rates under the *CALLS* rules. See 47 C.F.R. § 61.3(qq). The FCC, however, never found that the *CALLS* rate caps would be appropriate as permanent rates. *CALLS* did not purport to be a permanent intercarrier compensation plan.

*NARUC.* The NARUC Task Force Draft expressly contemplates extensive state commission proceedings, formal referrals of issues to both the Federal-State Joint Board on Jurisdictional Separations and the Federal-State Joint Board on Universal Service, and potential referrals to one or more Joint Conferences. Indeed, the task Force Draft contemplates *two* successive rounds of referrals: it requires a referral to the Joint Boards on Separations and Universal Service prior to the adoption of a new intercarrier compensation regime, and then it requires a second set of referrals to both Joint Boards for Recommended Decisions on “implementation issues.” These successive referrals would undoubtedly take years, and would substantially delay implementation of reforms that are needed immediately.

Similarly, as noted above, the Task Force Draft allows individual states to opt into or out of the new intercarrier compensation regime, and there would inevitably be litigation before the state commissions as each state makes its opt-in decision. The task Force Draft also gives each state considerable latitude on issues such as how universal service funding would be deployed, which would also inevitably lead to significant litigation. The sheer number and magnitude of the proceedings to implement the NARUC plan make it extremely doubtful that it could be implemented before the end of the decade.

*ARIC.* The ARIC proposal also does nothing to relieve the ongoing regulatory bickering that today saps carrier resources and, instead, proposes massive new regulatory proceedings that will make matters far worse. By failing to create fully uniform rules at either the state or federal level, the ARIC proposal would perpetuate features of today’s system that create massive dispute resolution costs, rob the industry of

stability it so desperately needs, and threaten to undermine decades of effort to achieve universal service.

The ARIC proposal, like the NARUC Task Force Draft, contemplates additional proceedings that will take years to complete—and then full-scale ongoing regulation at every level to administer—without even a nod to the 1996 Act’s deregulatory goals. Implementation of the ARIC proposal would require extensive proceedings by the Commission to adopt implementing rules, the Federal-State Joint Board on Jurisdictional Separations to recommend rules for joint state and federal review of tariffs, the Federal-State Joint Board on Universal Service to establish local rate benchmark floors and ceilings for residential service,<sup>102</sup> and every state public utility commission to rebalance local rates and conduct ongoing review of tariff filings. In essence, ARIC’s proposal would put every one of the country’s ILECs through a rate proceeding covering both the interstate and intrastate jurisdictions.

*EPG.* Likewise, the EPG proposal would require massive regulatory proceedings to implement. EPG’s plan would initially move intrastate switched and special access rate structures and levels to match those at the interstate level.<sup>103</sup> Within two years, EPG would convert dedicated services to a system of “port” and “link” charges.<sup>104</sup> EPG urges that the Commission and state commissions adopt these changes through an undefined “collaborative process that would not necessarily involve

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<sup>102</sup> ARIC proposal at 61.

<sup>103</sup> EPG proposal at 3.

<sup>104</sup> *Id.* at 4, 31.

preemption by the FCC.”<sup>105</sup> It would most certainly take years just to create such a process—if it could be created at all—before any movement to implement either of the major reforms EPG proposes. Moreover, even once that work was complete, “port” and “link” charges, no less than other charges for termination monopolies, would require constant, ongoing oversight from regulators.

*CBICC.* The CBICC proposal contemplates that all intercarrier compensation would be determined by the state commissions in accordance with the Commission’s TELRIC methodology. As previously mentioned, this is a recipe for massive litigation.

First, carriers would be continually mired in litigation before every state commission in the country to determine the appropriate TELRIC rates in those states. This would cover not just those ILECs for which TELRIC rates have been established since the 1996 Act, but also LECs that have been exempt from such requirements. Such proceedings would take on increased importance, since the outcome of those proceedings would determine intercarrier rates for all traffic, not just reciprocal compensation for “non-access” traffic. States also typically revisit TELRIC rates roughly every few years, and such proceedings would also inevitably be subject to a constant stream of motions to re-open settled issues or to adjudicate new twists. Given the stakes, carriers would also be embroiled in endless appeals: the last ten years’ federal reporters are filled with appeals of TELRIC-derived rates to the federal courts, with carriers challenging many minute details of the application of that methodology. And as noted above, the states and federal courts would inevitably adopt differing approaches to many of these issues of

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<sup>105</sup> *Id.* at 28.

implementation and ratesetting, with the result that TELRIC rates would vary substantially across the country.

Moreover, the CBICC plan contemplates additional litigation for intrastate rates. Under its plan, interstate rates would immediately shift to the TELRIC baseline, but intrastate rates would be referred to the state commissions and the Joint Board. Accordingly, there would be substantial proceedings before the Joint Board, which could establish a different transition period to TELRIC rates (thus exacerbating the rate disparities that the CBICC plan already leaves in place). And there would be litigation before the state commissions, which could move intrastate rates “to or toward” the TELRIC baseline according to a different transition period. CBICC proposal at 2. Notably, this means that the most egregious and visible disjuncture in the current regimes—the gap between interstate and intrastate access rates—will not be resolved for years, if ever.

Furthermore, making state-determined TELRIC rates the foundation of all intercarrier rates would almost certainly re-open the currently dormant debate over the proper components of the TELRIC methodology itself. There is substantial disagreement in the industry over many fundamental aspects of TELRIC, and the Commission has an open rulemaking proceeding to reconsider several aspects of that methodology. Adoption of the CBICC plan would renew pressure to reconsider TELRIC itself, which would only lead to additional multi-year litigation and debilitating uncertainty hanging over the industry. The ICF plan avoids these problems entirely.

***Western Wireless.*** Western Wireless’s proposal seeks to eliminate rate-of-return regulation for all ILECs, to base all universal service support on forward-

looking costs, and to ensure portability of all universal service funding to “competitive” ETCs, specifically wireless carriers.<sup>106</sup> CTIA also submitted a brief list of broad principles that is largely consistent with Western Wireless’s position and which also incorporates these goals.<sup>107</sup>

These pet projects of Western Wireless go well beyond the scope of what the Commission needs to accomplish in this proceeding. ICF members are concerned that if this proceeding is expanded to include the issues of whether to base rural carrier universal service support on forward-looking costs, or whether to eliminate rate-of-return regulation, the reforms of intercarrier compensation that are urgently needed will be further delayed. Ironically, the ICF proposal itself—by creating a rate structure that eliminates the LEC’s ability to leverage its terminating bottleneck and by putting market discipline on the recovery of both origination and termination costs—would go a long way toward meeting the goals underlying the Western Wireless proposal, without unduly expanding or derailing this proceeding into lengthy litigation over issues that can be resolved separately.

**D. The Other Plans Would Not Adequately Address or Protect Universal Service.**

The other reform proposals are especially deficient when it comes to universal service.

*ARIC.* The ARIC proposal would actually harm rural customers by maintaining both originating access charges and significant rate disparities among LECs,

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<sup>106</sup> *E.g.*, Western Wireless proposal at 4, 15, 18.

<sup>107</sup> CTIA principles at 1-3.

which would frustrate the rate averaging and rate integration goals of the 1996 Act.<sup>108</sup> Already, nationwide long distance providers are withdrawing from rural America, and access rate disparities create disincentives to marketing the most aggressive long distance pricing plans in rural America. By failing to solve this problem, the ARIC proposal would consign rural America to a future of continued small local calling areas, high toll rates, and less competition. Moreover, by subjecting all traditional dial-up ISP service to per-minute access charges,<sup>109</sup> both proposals would substantially increase the cost of access to the Internet for millions of Americans. Rural consumers would suffer the greatest harm, because it is in rural areas that access charges are highest.<sup>110</sup>

On the contribution side, ARIC offers no solution to the difficult and increasingly acute deterioration of today's interstate revenue-based mechanism. Without such reform, the system will continue to destabilize and the competitive asymmetries between, for example, cable modem and DSL providers, will continue to plague the industry.

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<sup>108</sup> 47 U.S.C. § 254(g).

<sup>109</sup> *E.g.*, ARIC proposal at 54 (“ISPs that carry voice traffic must pay exchange access to LECs for traffic terminated on LECs’ networks.”), 51 (“When an ISP’s customer uses dial-up Internet service, the ISP owes the underlying network carriers exchange access”). ARIC has a provision that purports to preserve the ESP exemption for dial-up Internet access, but even a cursory examination reveals that provision to be not competitively neutral. ARIC would permit ISPs to purchase local exchange service from the ILEC, in lieu of paying access charges. ARIC proposal at 53. But if the ISP purchases local exchange service from a CLEC, the ISP would pay access charges to the ILEC in addition to whatever charges it paid the CLEC. *Id.*

<sup>110</sup> *See, e.g.*, Global Internet Policy Initiative, *Flat Rate versus Per Minute Charges for Telephone Service: The Relationship between Internet Access and Telephone Tariffs* at 3 (Dec. 4, 2001) (“[V]arious studies indicate that the type of telecommunications pricing that is used in connection with Internet access (*e.g.*, flat rate or metered pricing) greatly influences the growth of the Internet in a particular market.”), available at <http://www.internetpolicy.net/practices/perminutepricing.pdf>.

*EPG.* The EPG proposal would also do nothing to preserve or enhance universal service. As a practical matter, the substantial implicit support flows that EPG would keep embedded in intercarrier rates would simply be unsustainable as competition develops. By proposing that all intercarrier compensation rates be reinitialized at interstate levels, EPG makes no pretense of seeking cost-based rates that could be sustained in an efficient market. While interstate access rate levels are generally lower than intrastate, there is no basis for a national finding that they perfectly represent the actual cost to any carrier of originating or terminating a call, particularly in light of the Commission's interim freeze, established in 2001, of the Part 36 category relationships and jurisdictional allocation factors for price cap carriers and the allocation factors only for rate-of-return carriers.<sup>111</sup>

On the contribution side, EPG (like ARIC) utterly ignores the crumbling of today's interstate telecommunications revenue-based system, making no reform proposal whatsoever.

*CBICC.* CBICC has essentially no plan to preserve universal service. All intercarrier rates would move to TELRIC – which would represent a substantial decrease in many intercarrier rates. CBICC says only that these decreases would be offset by a “capped increase in an end user charge, and the availability of USF funds in the unusual circumstance of the need to recover any remaining shortfall.” See CBICC proposal at 2. CBICC has not calculated the increases in the end user charges that would be necessary under its plan, nor has it calculated the necessary increases to the USF (although it

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<sup>111</sup> *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Report and Order, 16 FCC Rcd 11382 (2001), at para. 9.

believes that only rural carriers would “possibly” need USF funding and such funding would last only long enough to phase in increased end user charges). And CBICC has no proposal to address the unsustainability of the current, revenue-based contribution system. By failing to provide for universal service support to offset reductions in intercarrier compensation revenues, the CBICC proposal risks “reverse rate shock” to the carrier, potentially impairing its ability to continue to provide service, invest in its network, and develop and deploy new and innovative services.

*Western Wireless.* The Western Wireless proposal would eliminate ILEC intercarrier compensation revenues without concurrently either providing alternative avenues for recovery of this revenue or materially deregulating such recovery.<sup>112</sup> Its proposal would reduce all intercarrier compensation rates to zero over four years (longer for some rural carriers), while permitting limited SLC increases and transitioning universal service support levels to ones based on forward-looking economic costs, but without regard for the resulting consumer impact if carriers cannot provide service or invest in their networks subject to these constraints, or if the resulting revenues available are too low to attract competitive entry.

This aspect of the Western Wireless proposal is fundamentally irresponsible. ICF, by contrast, has carefully crafted a detailed USF proposal that is fully sufficient to preserve universal service. The Western Wireless proposal is merely another example of a narrow group trying to promote its own parochial interests—here, maximizing funding from the USF for rural competitive wireless providers (like Western

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<sup>112</sup> Western Wireless plan at 2-3.

Wireless) while reducing and minimizing such funding for their competitors, the rural ILECs. The Commission should reject that approach in favor of the balanced ICF plan.

*NASUCA.* NASUCA would apparently create a new threat to universal service by maintaining existing SLC caps and *reducing* explicit universal service support in the face of any reductions in intercarrier compensation that result from its proposal.<sup>113</sup>

**E. Several Of The Competing Proposals Are Unlawful**

Core aspects of many of the competing plans would violate the Communications Act.

*ARIC.* To the extent ARIC's proposal contemplates preempting state commission rate structures and establishing a joint access charge rate setting process governed by federal rules, the scheme would violate Sections 2(b), 201, 202, 252, and 254 of the Communications Act.

*First,* while Section 251(b)(5) clearly provides the Commission with authority to preempt intrastate access regimes *in toto* in order to replace them with a uniform intercarrier compensation system based on bill-and-keep, Sections 2(b) of the Communications Act just as clearly reserves to the state commissions the authority to establish intrastate access rate structures and levels until such preemption occurs. It is axiomatic that, to achieve meaningful *uniformity*, every intrastate intercarrier compensation mechanism across the country must be made identical, not just to each other, but to the federal system as well. The ICF Plan proposes the only reform solution

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<sup>113</sup> *Developing a Unified Intercarrier Compensation Regime* CC Docket No. 01-92, Letter from Philip F. McClelland, Senior Assistant Consumer Advocate to Marlene H. Dortch, Secretary Federal Communications Commission (filed Dec. 14, 2004), Attachment at 1.

that achieves this goal in a manner explicitly contemplated by the Communications Act, *i.e.*, replacement of the existing intrastate access rate structure with a new system based on the reciprocal compensation provisions of Section 251(b)(5) and using a pricing methodology based on bill-and-keep, as explicitly contemplated by Section 252(d)(2)(B)(i).

The ARIC proposal, in contrast, proposes to achieve even the limited aspects of uniformity it embraces through Commission rules requiring state commissions to adopt the Commission's federal Part 69 interstate access charge rules.<sup>114</sup> The Commission has no power to do that. Unless the Commission invokes its authority pursuant to Section 251(g) to terminate the interstate and intrastate access regimes, and thus acts pursuant to 251(b)(5), the Commission's Part 69 rules have always been and will be founded on its authority over interstate ratemaking conferred by Section 201 and 202, both of which are limited to the interstate sphere by Section 2(b). Absent exercise of its 251(b)(5) authority, the Commission may not breach the Section 2(b) fence, and especially may not do so simply to substitute its judgment, on a non-transitional basis, as to the proper intrastate access rate structure for that of the state commission.<sup>115</sup>

*Second*, the Commission may not delegate its Section 201 and 202 authority over interstate ratemaking to state commissions, as ARIC would propose.<sup>116</sup> The ICF Plan would replace intrastate access charges with a holistic intercarrier compensation regime pursuant to Section 251(b)(5), with offsetting revenue from SLCs

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<sup>114</sup> ARIC proposal at 39.

<sup>115</sup> *See Louisiana PSC*, 476 U.S. 355 (1986).

<sup>116</sup> *USTA v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).

and federal universal service support, and would not impermissibly delegate federal authority to the state commissions. To the extent that ARIC would instead give state commissions an essential role in approving rates to be charged in the interstate jurisdiction without terminating the interstate access charge regime and regulating pursuant to Sections 251(b)(5) and 252, it would impermissibly subdelegate the Commission's power to an outside party.<sup>117</sup>

*Third*, to the extent that the Commission would retain ultimate ratesetting authority over positive reciprocal compensation rates (*i.e.*, not based on bill-and-keep principles), the ARIC proposal would violate Section 252(d)(2)(A), at least with respect to traffic that is not also subject to the Commission's Section 201 authority. Section 252(d)(2)(A) reserves to the state commissions the authority to set positive reciprocal compensation rates, at least absent a national finding by the Commission that the "additional costs of termination" are *de minimis*.<sup>118</sup> Although the Commission has clear authority to impose a national pricing rule adopting reciprocal compensation based on the bill-and-keep standard of Section 252(d)(2)(B)(i) for all traffic, the ARIC plan would instead provide the Commission with an essential (but impermissible) role in actually setting cost-based reciprocal compensation rates.

Further, the centerpiece of ARIC's universal service proposal is flatly unlawful. ARIC proposes a federally established, state-specific universal service mechanism (the State Equalization Fund "SEF"). ARIC contemplates that, in states that do not establish a SEF, the Commission would impose "a federally-mandated end user

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<sup>117</sup> *Id.*

<sup>118</sup> 47 U.S.C. § 252(d)(2)(A)(ii).

Access Equalization Charge (“AEC”) to make up the revenue shortfall” a LEC may experience as a result of intercarrier compensation rate changes. ARIC proposes that the AEC be collected “from all retail service providers for each of their working telephone numbers *in the state.*”<sup>119</sup>

That mechanism is not authorized by the Communications Act. If it were considered a universal service mechanism, then it would violate Section 254, as it is not funded through equitable and nondiscriminatory contributions from all telecommunications providers nationwide, but rather is a state-specific mechanism funded through charges levied *only on retail service providers in that state.* If it were, instead, viewed as a federally-imposed end user charge for the direct recovery of intrastate costs, then it would violate the plain terms of Section 2(b),<sup>120</sup> absent a showing that the charge is part of a fundamental restructuring under the reciprocal compensation provisions of Section 251(b)(5) and the bill-and-keep savings clause of Section 252(d)(2)(B)(i).<sup>121</sup>

**EPG.** Although considerably less detailed than the ARIC proposal, the EPG proposal would also unify state and federal rates based on the federal Part 69 rate structure. Thus, it suffers from the same jurisdictional infirmities that plague the ARIC proposal. Nor do these federally mandated rate structures for intrastate services become

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<sup>119</sup> ARIC proposal at 84 (emphasis added).

<sup>120</sup> 47 U.S.C. § 152(b).

<sup>121</sup> In contrast, the ICF explicitly recognizes the ICRM and TNRM are explicit universal service mechanisms created under Section 254 and funded through equitable and nondiscriminatory contributions from users of working telephone numbers and network connections nationwide.

any more lawful when they are eventually converted into capacity-based “port” and “link” charges.

EPG’s essential universal service mechanism is unlawful. At the second stage of the EPG plan, all intercarrier rates would be reinitialized at interstate access charges, and the lost revenues would be replaced by an Access Restructure Charge (ARC). Although EPG asserts that the ARC is not intended to be an explicit universal service mechanism,<sup>122</sup> the ARC rate element clearly violates Sections 254(b)(5) and 254(e) of the Communications Act, which require federal universal service support to be specific, predictable, sufficient, and explicit. By establishing a bulk-billed, pooled rate element that is recovered through the NECA “access tariff” from carriers nationwide, the ARC represents an enormous implicit universal service subsidy, in that it cannot be associated with the costs of providing service incurred by any particular carrier on whose behalf it is collected.

Moreover, if the ARC is not a universal service mechanism, then the Commission plainly lacks authority to authorize its tariffing in the federal jurisdiction. EPG has identified no source of authority in the Communications Act that would allow the Commission to impose such a charge for the recovery of intrastate costs and, indeed, *there is none*.

To the extent that the ARC would be properly classified as a universal service support mechanism—as ICF believes it is, because the ARC is designed to permit recovery of carrier costs that, in EPG’s judgment, cannot otherwise be recovered consistent with the affordability and reasonably comparability criteria of Section

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<sup>122</sup> EPG proposal at 22-23.

254(b)(1) and 254(b)(3)—it violates Section 254. Specifically, it would violate both the plain terms of Section 214(e), and the competitive neutrality principle recognized under Section 254(b)(7),<sup>123</sup> because EPG would expressly and permanently limit eligibility for all ARC support to rural ILECs.

The EPG proposal regarding mislabeled or unlabeled traffic<sup>124</sup> would require the Commission to engage in patently arbitrary and capricious decisionmaking. For mislabeled or unlabeled traffic, EPG asks the Commission to impose the highest applicable rate on transiting carriers, which have no control over the labeling of traffic. EPG essentially asks the Commission to impose a punitive charge on an innocent party, with no grounds for punishment and no beneficial deterrence effect. Because the Commission could offer no rational explanation for imposing such punitive charges, the EPG proposal must be rejected. *See Environmental Defense Fund, Inc. v. Costle*, 657 F.2d 275, 283 (D.C. Cir. 1981) (to discharge its duty satisfactorily, an agency must at least engage in “reasoned decisionmaking”).

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<sup>123</sup> *Federal-State Joint Board on Universal Service*, First Report and Order, 12 FCC Rcd 8776, 8801 (1997), at ¶ 47 (subsequent history omitted).

<sup>124</sup> *See* EPG proposal at 17.

**CONCLUSION**

For the foregoing reasons, the Commissions should adopt the ICF Plan for network interconnection, intercarrier compensation, and universal service reform without modification and without delay.

Respectfully submitted,

THE INTERCARRIER COMPENSATION FORUM



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# Appendix A

## APPENDIX A- The ICF Plan Is Consistent with Existing Law

The ICF Plan as a whole, as well as each of its component parts, is consistent with existing law and the Commission has jurisdictional and substantive authority to implement the Plan in its entirety.

### **A. The Commission Has Full Jurisdiction Under the Communications Act, as Amended by the 1996 Act, to Establish Uniform Intercarrier Compensation Rules for All Classes of Traffic**

Section 201(b) of the Communications Act authorizes the Commission to “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 confirmed in *Iowa Utilities Board*, the Commission’s section 201(b) rulemaking jurisdiction is not limited to jurisdictionally interstate matters covered elsewhere in section 201. Instead, it extends to *all* provisions of the Communications Act, including the provisions added by the Telecommunications Act of 1996 that encompass matters that, before 1996, fell within the exclusive jurisdiction of the states.<sup>1</sup> It is thus undisputed that the Commission may adopt rules implementing section 251(b)(5) and the other statutory provisions governing carrier interconnection with respect to all traffic—interstate and intrastate—within the scope of those provisions. This authority permits the Commission to implement the ICF Plan’s comprehensive approach to intercarrier compensation for any exchange of telecommunications traffic.

Congress drafted section 251(b)(5) expansively to bring national consistency to questions of intercarrier compensation. By its terms, this provision extends to all

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<sup>1</sup> *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-86 (1999).

compensation issues relating to the transport and termination of “telecommunications” involving any local exchange carrier. The breadth of that language is significant in three principal respects. *First*, and perhaps most important, section 251(b)(5) makes no distinctions among traffic on the basis of jurisdiction (“local,” “toll,” “intrastate,” “interstate”) or service definition (e.g., “exchange access,” “information access,” or “exchange service”). All such traffic is plainly “telecommunications.” In its *ISP Remand Order* in 2001, the Commission was thus entirely correct in concluding that “[w]e were mistaken [in the *Local Competition Order*] to have characterized” section 251(b)(5) as limited to local traffic, given that “‘local’ . . . is not a term used in section 251(b)(5) or section 251(g).”<sup>2</sup> The D.C. Circuit left this conclusion intact on review, although it took issue with other aspects of the *ISP Remand Order*.<sup>3</sup>

If it had wished, of course, Congress could have limited the scope of this provision to “local telecommunications,” to “telecommunications that originate and terminate within the same local calling area,” or to “telecommunications handed off from one LEC directly to another LEC.” But Congress included no such limitations on the scope of section 251(b)(5). Instead, it drafted section 251(b)(5) broadly to address all “telecommunications,” the most expansive of the statute’s defined terms.<sup>4</sup> Despite the clarity of this statutory language, some continue to argue that the Commission’s jurisdiction to implement section 251(b)(5) extends only to “local” traffic and that the Commission thus lacks authority under that provision to address intercarrier

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<sup>2</sup> See *ISP Remand Order* at 9167, 9172 ¶¶ 34, 45.

<sup>3</sup> See *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

<sup>4</sup> See 47 U.S.C. § 153(43).

compensation issues relating to any category of traffic that is deemed to be neither “local” nor “interstate.” This misguided effort to carve up the Commission’s rulemaking authority on the basis of such legacy jurisdictional categories is not just irreconcilable with the plain language of section 251(b)(5), but strikingly similar to the unavailing attacks in the 1990s on the Commission’s jurisdiction to implement sections 251 and 252 more generally. Here, as in that context, the attempt to “produce[] a most chopped-up statute” along jurisdictional lines is flawed both because it violates the statutory text and because it is “most unlikely that Congress created such a strange hodgepodge.”<sup>5</sup>

*Second*, as the Commission has further found, section 251(b)(5) applies not just to the exchange of traffic between two LECs, but more broadly to the exchange of any traffic involving a LEC at one end.<sup>6</sup> In other words, although the obligation to establish reciprocal compensation arrangements for the transport and termination of telecommunications falls on LECs, Congress did not limit to other LECs the class of potential *beneficiaries* of that obligation.

*Third*, as the Commission has further indicated, section 251(b)(5) covers intercarrier compensation issues on the originating end of a call as well as the terminating end, even though it explicitly addresses only the “transport and termination of telecommunications.” As the Commission recognized in the *Local Competition Order*,

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<sup>5</sup> *Iowa Utils. Bd.*, 525 U.S. at 381 n.8.

<sup>6</sup> See *Local Competition Order* at 16016 ¶ 1041 (“Although section 251(b)(5) does not explicitly state to whom the LEC’s obligation runs, we find that LECs have a duty to establish reciprocal compensation arrangements with respect to local traffic originated by or terminating to *any* telecommunications carriers,” including non-LEC CMRS providers) (emphasis added). Where Congress intended LECs’ 1996 Act obligations to run only to a limited class of carriers, it did so explicitly. See, e.g., 47 U.S.C. § 251(b)(3) (“The duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service. . .”).

because section 251(b)(5) provides for intercarrier compensation only for termination of traffic and does not authorize charges for originating traffic, LECs could no longer charge CMRS providers or other carriers for LEC-originated traffic.<sup>7</sup> Thus, with the exception of pre-1996 Act compensation rules temporarily grandfathered by section 251(g), section 251(b)(5) is properly read to bar carriers from imposing any charges, including access charges, for the costs of originating traffic.

Because the statutory language itself compels the conclusion that the Commission's section 251(b)(5) authority extends to *all* telecommunications involving a LEC, the Commission would face formidable litigation risks were it now to reverse course yet again on the scope of section 251(b)(5). Indeed, as the D.C. Circuit recently admonished, “[e]ven under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term.”<sup>8</sup> The statutory context in which the D.C. Circuit enforced that principle is closely analogous to the statutory context here. Just as the court applied that principle to reject the Commission's “argument that long distance services are not ‘telecommunications services’” for purposes of section 251(d)(2), so too is the Commission barred from finding that particular categories of “telecommunications” do not *count* as “telecommunications” for purposes of section 251(b)(5).

Were there any remaining question about the Commission's jurisdiction to address all telecommunications under section 251(b)(5), including access traffic, it would

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<sup>7</sup> *Local Competition Order* at 16016 ¶ 1042.

<sup>8</sup> *USTA v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004).

be resolved by section 251(g). That provision singles out access traffic for special treatment and temporarily grandfathers the pre-1996 rules applicable to such traffic, including rules governing “receipt of compensation.”<sup>9</sup> There would have been no need for Congress to have preserved those compensation rules against the effects of section 251 if section 251(b)(5) did not in fact address the “receipt of compensation” for the traffic covered by section 251(g)—*i.e.*, access traffic. Because Congress is presumed not to have wasted its breath, the only sensible interpretation of section 251(g) confirms what section 251(b)(5) already makes clear on its face: that intercarrier compensation for all access traffic falls within the broad scope of the Commission’s jurisdiction to implement section 251.

In a footnote of the *ISP Remand Order*, the Commission obliquely suggested that “ambiguity” in the scope of “telecommunications” might support a construction that *intrastate* access traffic falls outside of section 251(b)(5).<sup>10</sup> As noted, however, there is no such ambiguity: the statutory definition of “telecommunications” straightforwardly encompasses all access traffic. Moreover, there is no basis for the apparent policy concern that motivated the Commission to look for ambiguity in this unambiguous language—*i.e.*, a concern that (i) section 251(g) preserves only the *interstate* access charge regime (until the adoption of superseding Commission regulations) but not the parallel *intrastate* access regime and (ii) Congress should be presumed not to have intended to have undercut the latter regime immediately upon enacting the 1996 Act.<sup>11</sup>

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<sup>9</sup> 47 U.S.C. § 251(g).

<sup>10</sup> See *ISP Remand Order* at 9168 ¶ 37 n.66.

<sup>11</sup> See *id.*

No less than its interstate counterpart, the intrastate access charge regime derives from the 1982 AT&T consent decree and the subsequent GTE decree.<sup>12</sup> Contrary to the Commission's apparent belief, therefore, the intrastate access regime falls squarely within the ambit of section 251(g), which grandfathers "equal access and nondiscriminatory interconnection . . . obligations (including receipt of compensation) . . . under any court order, consent decree," or FCC order. Indeed, it would have been perverse for Congress to have authorized the Commission to reform intercarrier compensation rules relating to "local" and "interstate" traffic but *not* the rules applicable to the one class of traffic— intrastate access—that is subject to the *highest* above-cost charges and that is generally thought to be most laden with unsustainable implicit support.

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<sup>12</sup> Before 1982, compensation for interexchange access was generally derived through an AT&T-administered system of settlements and division of revenues. Second Supplemental Notice of Inquiry and Proposed Rulemaking, *MTS and WATS Market Structure*, 77 F.C.C.2d 224, 227-28, 234 ¶¶ 15-19, 47 (1980). The AT&T consent decree replaced that system with a regime of federal *and* intrastate access charges. See *United States v. AT&T Co.*, 552 F. Supp. 131, 227, 233 (D.D.C. 1982); Third Report and Order, *MTS and WATS Market Structure*, 93 F.C.C.2d 241, 246 ¶ 11 (1983). The court order accompanying the consent decree made clear that the decree required access charges to be used in both the interstate and intrastate jurisdictions: "Under the proposed decree, state regulators will set access charges for intrastate interexchange service and the FCC will set access charges for interstate interexchange service." *AT&T*, 552 F. Supp. at 169 n.161. Thus, both interstate and intrastate access charges were borne of the same "consent decree," and both are preserved under section 251(g). There is also no evidence in the legislative history that Congress intended to treat intrastate access charges any differently, for grandfathering purposes, from interstate access charges. To the contrary, the House Conference Report broadly states that "the substance of this new statutory duty" under section 251(g) "shall be the equal access and nondiscrimination restrictions and obligations, including receipt of compensation, that applied to the local exchange carrier immediately prior to the date of enactment, *regardless of the source.*" H.R. CONF. REP. NO. 104-458, at 123 (1996) (emphasis added).

In any event, even if section 251(g) were read *not* to grandfather intrastate access charges, that reading would raise no pragmatic concerns about the broad scope of section 251(b)(5), for the Commission could still exercise its well-established authority to impose interim rules ensuring a smooth transition to a new regulatory regime. Indeed, in a variety of contexts, and particularly in matters of intercarrier compensation, the courts have long upheld the Commission's expansive authority to take reasonable transitional measures needed to protect the industry from sudden disruptions.<sup>13</sup> The Commission's authority to adopt similar measures to manage the transition from access charges to a unified section 251(b)(5) regime forecloses any claim that Congress must have meant to exclude intrastate access charges permanently from the scope of section 251(b)(5). And this same authority permits the Commission to adopt the ICF Plan's proposed transition from the present schemes of intercarrier compensation to a unified system based on bill-and-keep principles.

**B. The Commission Has Substantive Authority to Impose Bill and Keep for All Telecommunications Traffic and to Impose the ICF Plan's Proposed Transition from Current Rates to Bill and Keep**

The Commission not only has *jurisdiction* to impose a unified intercarrier compensation system for all traffic, but also the authority to prescribe a transition to bill and keep in particular as the substantive compensation rule, even for "unbalanced" traffic subject to the pricing rules of sections 251(b)(5) and 252(d)(2).

In the *Local Competition Order*, at the same time that the Commission erroneously limited the scope of section 251(b)(5) to local traffic, it also found—more as

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<sup>13</sup> See, e.g., *CompTel v. FCC*, 309 F.3d 8, 15 (D.C. Cir. 2002); *CompTel v. FCC*, 117 F.3d 1068, 1073-75 (8th Cir. 1997).

a matter of policy than of statutory interpretation—that bill and keep was inappropriate for unbalanced traffic.<sup>14</sup> In the present context of comprehensive intercarrier compensation reform of *all* traffic, including access traffic, the Commission now should focus more carefully on the breadth of its statutory authority and reach the contrary conclusion—namely, that the text of section 252(d)(2) permits the Commission to order bill and keep for all traffic, including unbalanced traffic.<sup>15</sup>

As an initial matter, section 252(d)(2)(A) directs the Commission and the states (i) to “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) to “determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls.” This language is perfectly consistent with a regime, such as bill and keep, in which each carrier is afforded an opportunity for “recovery” of those costs from its own end users.<sup>16</sup>

If there were any question on this point, it would be answered by the “bill-and-keep savings clause.” Section 252(d)(2)(B)(i) expressly authorizes all regulatory “arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements).” Bill and keep, as structured in the ICF Plan, entitles carriers to

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<sup>14</sup> See *Local Competition Order* at 16054-55 ¶¶ 1111-12.

<sup>15</sup> See *WorldCom*, 288 F.3d at 434.

<sup>16</sup> See *Local Competition Order* at 16055 ¶ 1112 (“bill-and-keep arrangements that lack *any* provisions for compensation do not provide for recovery of costs”) (emphasis added).

the “mutual recovery of costs” by permitting them to recover those costs through end user charges and, where necessary, universal service. As the legislative history confirms, this clause thus permits “a range of compensation schemes, such as an in-kind exchange of traffic without cash payment (known as bill-and-keep arrangements).”<sup>17</sup> Importantly, the D.C. Circuit has already indicated its support for the same conclusion, noting the “non-trivial likelihood that the Commission has authority to elect” a bill-and-keep regime for section 251(b)(5) traffic under the terms of section 252(d)(2)(B)(i), which the court specifically cited.<sup>18</sup> Although section 252(d)(2), like the 1996 Act as a whole, “is in many important respects a model of ambiguity or indeed even self-contradiction,” Congress “is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency.”<sup>19</sup> Here, the Commission can and should resolve any ambiguity in this statutory language in favor of an appropriately robust construction of the bill-and-keep savings clause.

Reading section 252(d)(2) to preserve the Commission’s discretion in this respect does *not* reduce the pricing standards of section 252(d)(2) to surplusage. That provision is properly understood to require the Commission to choose, for all traffic within the scope of section 251(b)(5), *either* bill and keep, so long as carriers may recover their costs from end users directly (or, where appropriate, from universal service support), *or* a genuinely cost-based CPNP regime. Section 252(d)(2) still precludes *non*-cost-based compensation rules as well as arrangements (common before 1996) under which an

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<sup>17</sup> S. REP. NO. 104-230, at 120 (1996).

<sup>18</sup> See *WorldCom*, 288 F.3d at 434.

<sup>19</sup> *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 397.

*originating* carrier charges a *terminating* (or intermediate) carrier for handing off calls to it. And the Commission's choice of bill and keep rather than a CPNP rule is particularly reasonable now, since eight years of experience have shown that CPNP creates the potential for serious market distortions and that it is too costly (if possible at all) to ensure "perfect" cost-based rates. The Commission is thus more than free to revisit and reject its unelaborated assumption in the *Local Competition Order* that Congress meant to lock in those distortions forever through the relevant statutory language.<sup>20</sup>

In addition, as the D.C. Circuit further suggested in citing the bill-and-keep savings clause as a basis for remanding but not vacating the *ISP Remand Order*, the Commission would not overstep any *jurisdictional* boundaries established in *Iowa Utilities Board* by prescribing bill and keep for all traffic. Under *Iowa Utilities Board*, the Commission has plenary jurisdiction to make very specific methodological decisions about the implementation of section 251, and a choice of bill and keep is precisely such a decision, even though it has the effect of producing specific outcomes in matters of intercarrier compensation. Indeed, the Commission cannot *avoid* prescribing the circumstances in which bill and keep is appropriate if it is to play its statutorily assigned role in interpreting the scope of the bill-and-keep savings clause of section 252(d)(2).

For all of these reasons, sections 252(d)(2) and 251(b)(5) pose no obstacle to an FCC-mandated transition to bill and keep for all traffic. Finally, this transition to bill and

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<sup>20</sup> See *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 863-64 (1984) (agency is free to change mind on matters of statutory interpretation); *Smiley v. Citibank*, 517 U.S. 735, 742 (1996) ("[C]hange is not invalidating, since the whole point of *Chevron* is to leave the discretion provided by ambiguities of a statute with the implementing agency."); see also *Independent Bankers Ass'n v. Farm Credit Administration*, 164 F.3d 661, 668 (D.C. Cir. 1999).

keep need not—and, under the ICF Plan, would not—occur in one step. As noted, the Commission has ample authority to avoid sudden industry disruptions by adopting the Plan’s proposal for a transitional glide-path from existing intercarrier compensation rates to a comprehensive bill-and-keep regime.<sup>21</sup>

**C. The Commission Has Authority Under Section 251(b)(5) and Section 254 to Raise the SLC and Establish the ICRM and TNRM, Even Though Those Mechanisms Will Cover Some Costs Currently Booked as “Intrastate”**

The analysis above establishes that the Commission has authority to prescribe compensation rules ensuring the mutual recovery of carriers’ costs. And it confirms that the Commission may adopt a bill-and-keep regime for that purpose. This authority necessarily includes a corollary authority to take the steps needed to ensure that, despite the transition to bill and keep, carriers actually have reasonable opportunities to recover the relevant costs, as section 252(d)(2) requires. The SLC increase and the establishment of the ICRM and TNRM constitute a clearly permissible exercise of that authority. Indeed, the Commission not only has the *authority* to establish mechanisms that provide adequate cost recovery opportunities and universal service funding through SLC increases and new explicit universal service mechanisms, but an *obligation* to do so if it eliminates the existing intercarrier compensation regimes. Precisely because section 252(d)(2) entitles carriers to the opportunity to recover their costs, the Commission could not adopt a transition to bill and keep unless it establishes alternative support mechanisms that, like these, afford carriers that opportunity.

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<sup>21</sup> See *CompTel*, 117 F.3d at 1074-75; see also *CompTel*, 309 F.3d at 15 (“the Commission can justify a policy by reference to the purposes of avoiding disruption pending a broader reform”).

The legacy jurisdictional separations regime, which divides costs and their recovery into distinct interstate and intrastate “jurisdictions,” poses no obstacle to the Commission’s adoption of these aspects of the ICF Plan. First, the ICRM and TNRM are just new support mechanisms that, like existing funding programs for rural and non-rural carriers, the Commission may adopt pursuant to its general universal service powers, including its authority to “defin[e] . . . the services that are supported by Federal universal service support mechanisms.”<sup>22</sup> In a range of contexts, the Commission has long provided *federal* funds to cover at least a portion of costs assigned to the *intrastate* side of the cost ledger.<sup>23</sup> That, for example, is the central and explicit function of the high cost fund for non-rural carriers.<sup>24</sup> If there were any legal problem with this practice from a jurisdictional separations perspective, which there is not, that same problem would afflict the very foundations of this Commission’s existing universal service programs.<sup>25</sup>

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<sup>22</sup> 47 U.S.C. § 254(a)(2).

<sup>23</sup> See Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 8807 ¶ 56 (1997) (including intrastate services among those services supported by federal universal service mechanisms); *TOPUC I*, 183 F.3d at 444 (recognizing that the Commission provides federal universal service funds to support intrastate rate discounts to schools and libraries).

<sup>24</sup> See generally Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, *Federal-State Joint Board on Universal Service*, 18 FCC Rcd 22559 (2003); Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432 (1999) (subsequent history omitted).

<sup>25</sup> The Commission has never adhered strictly to the most “accurate” apportionment between the two jurisdictions. In the past, the Commission has used the separations process to shift some intrastate costs to the interstate jurisdiction in an effort to provide implicit universal service support from interstate to intrastate services. Even before Congress enacted section 254, the D.C. Circuit upheld these Commission policies on universal service grounds. See *National Ass’n of Regulatory Utility Comm’rs v. FCC*, 737 F.2d 1095, 1105 n.6 (D.C. Cir. 1984) (“*NARUC*”) (relying on 47 U.S.C. § 151); *MCI Telecomm. Corp. v. FCC*, 750

For the same reasons, the Commission may lawfully raise the SLC to cover a portion of the costs formerly covered by intrastate access charges as an exercise of its plenary authority to ensure a sustainable and explicit universal service system. It is not possible to replace all of the implicit support embodied in intercarrier compensation with explicit federal support, because doing so would necessitate unsustainable increases to the size of the fund and would impose a tremendous burden on all providers. Nor would that approach be appropriate even if it were possible, because at least some portion of access charges is designed to recover the costs that each LEC actually bears in providing access. Since the Commission cannot unravel, in each instance, which portion is implicit support and which is compensation for the costs of serving a given end user, the only reasonable and sustainable approach is to permit carriers both to increase end user charges via the SLC—up to the caps contemplated by the Plan to the extent competition permits—and, where appropriate, to obtain additional universal service funding through the ICRM/TNRM mechanisms. The SLC increases contemplated by the Plan are thus a key factor in eliminating implicit support and transitioning to a uniform and rational bill-and-keep environment for intercarrier compensation. As discussed in Part II of this brief, moreover, this bill-and-keep approach to cost recovery—unlike existing carrier-to-carrier cost-recovery mechanisms—will permit competition to keep overall end user rates at lower, efficient levels.<sup>26</sup>

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F.2d 135, 140-41 (D.C. Cir. 1984). All of this underscores that, as the Supreme Court has noted, “extreme nicety is not required” when allocating costs. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 150 (1930).

<sup>26</sup> As the courts have consistently held, the Commission may restructure end user charges, including the SLC, to produce more efficient mechanisms for the recovery of network costs that would otherwise be recovered inefficiently through

Finally, the Commission would fully respect the states' own policy interests by adopting federal support programs to ensure adequate recovery of costs on the intrastate side of the cost ledger.<sup>27</sup> The federal revenue measures contemplated by the ICF Plan are, indeed, the very opposite of an unfunded mandate. Rather than forcing the states to assume a new burden, the Commission would achieve the goals of section 254 by lifting the states' existing obligation to arrange for recovery of certain network costs and by shifting to itself the burden of covering those costs through the combination of the new federal mechanisms and the other sources of revenue provided by the Plan. Finally,

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intercarrier compensation charges. Nothing in section 254(k) is to the contrary. *See, e.g., TOPUC II*, 265 F.3d at 323-24; *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 558-59 (8th Cir. 1998); *see also NARUC*, 737 F.2d at 1111-15 (holding that the Commission has power to impose flat-rate end user charges).

<sup>27</sup> To establish a uniform bill-and-keep regime, the Commission need not refer to the Joint Board its decisions to increase the SLC or replace interstate and intrastate switched access revenues. First, adoption of the Plan does not require a referral to a *separations* Joint Board. While changes in the separations rules must be referred to the Joint Board pursuant to 47 U.S.C. § 410(c), the Plan leaves intact the existing separations rules concerning allocation of costs and merely changes the universal service support mechanism to provide for the *recovery* of necessary access revenues through an increased SLC. *See TOPUC II*, 265 F.3d at 324 (distinguishing between cost recovery and cost allocation). Moving cost recovery to the federal SLC does not change the allocation of affected costs, and there is no other reason why federal universal service payments cannot be made to cover costs allocated to the intrastate jurisdiction. For example, section 36.631 of the Commission's rules provides federal universal service support to rural LECs on a sliding scale, based on their average loop costs, to cover a percentage of loop costs that are allocated to the intrastate jurisdiction. *See Fourteenth Report and Order, Federal-State Joint Board on Universal Service*, 16 FCC Rcd 11244, 11251-52 ¶ 13 n.19 (2001); *see also Crocket Tel. Co. v. FCC*, 963 F.2d 1564, 1570 (D.C. Cir. 1992). Similarly, section 254(a) does not require the Commission to refer the Plan to a *universal service* Joint Board. Indeed, even if the Plan were interpreted to require a change in the definition of universal service, "[t]he statute requires consultation with the Joint Board for only the initial implementation of § 254's universal service requirement. *See* 47 U.S.C. § 254(a)(1). Any consultation afterwards is permissive." *TOPUC II*, 265 F.3d at 328 n.7.

nothing in this scheme involves federal intrusion into the states' central prerogative to set their own retail rates.

The federal support programs the Plan creates are fully consistent with the requirements of section 254 of the Act. The ICRM and TNRM are explicit and predictable support mechanisms that will promote affordable quality services, including advanced and information services, across the nation. The funds are also equitable and fully portable for all non-CMRS ETCs. While in rural areas, eligibility is restricted to wireline LECs, that limitation is necessary as a transitional safeguard for rural universal service. Non-CMRS ETCs (who generally are all wireline LECs) in high cost rural areas are uniquely dependent on the support access charges now provide, and the shift to bill and keep therefore will be more disruptive to these carriers as compared to others. In order to preserve low-cost, high quality service in rural areas as rural carriers adjust to the new support mechanism, the Plan reserves the new rural fund for non-CMRS ETCs. The Plan thus would exclude CMRS carriers, who are now generally precluded from tariffing and therefore from relying on access charges—and thus will be less affected by their elimination. This limitation is discrete: it applies only to the TNRM; the ICRM is available to all carriers that qualify as ETCs; and the Plan does not affect eligibility for any pre-existing universal support funding. And the Plan further provides that the Commission will re-examine the TNRM eligibility restriction in 2013, when the same transitional concerns may no longer apply. The Commission has ample authority to

implement such a discrete, interim eligibility restriction as an appropriate transitional measure.<sup>28</sup>

**D. The Commission Has Full Authority To Adopt the ICF Plan's Contribution Methodology for Universal Service**

The Commission's universal service authority derives from two principal sources: (i) its general mandate under section 1 of the Communications Act to "regulat[e] interstate . . . commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges,"<sup>29</sup> and (ii) its mandate under section 254 to ensure that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service."<sup>30</sup> The Plan will replace the unsustainable revenue-based contribution mechanisms in effect today with a more durable methodology that assesses contributions on the basis of telephone numbers and connections to a public network. The Commission has full authority under sections 1 and 254 to make this long-overdue change.

First, the Plan's numbers/connections-based contribution methodology fully comports with the Commission's obligation under section 254(d) to require

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<sup>28</sup> See, e.g., *CompTel*, 309 F.3d at 14-15; *CompTel*, 117 F.3d at 1073-75.

<sup>29</sup> 47 U.S.C. § 151; see *NARUC*, 737 F.2d at 1108 (recognizing that section 1 contains a "prominen[t] . . . universal service objective"); *Rural Tel. Coalition v. FCC*, 838 F.2d 1307, 1315 (D.C. Cir. 1988) (declaring that "universal service is an important FCC objective" and establishment of a Universal Service Fund is "within the Commission's statutory authority" under section 1).

<sup>30</sup> 47 U.S.C. § 254(d).

telecommunications carriers to contribute to universal service on “an equitable and nondiscriminatory basis.” As discussed in Part I, the current revenue-based contribution methodology is both inequitable and unsustainable because it permits carriers to avoid or minimize their contribution obligations simply by choosing certain technologies, service configurations, or network architectures. The Plan meets the need for a new methodology by distributing the contribution burden broadly among the vast majority of telecommunications providers in a technology-neutral, non-discriminatory, and transparent manner.<sup>31</sup> LECs, traditional long-distance providers, wireless carriers, broadband providers, and VoIP providers that use telephone numbers will all be subject to the contribution obligation because each utilizes telephone numbers or provides connections to a public network (or both). And the Plan abolishes the artificial regulatory distinctions that today cause traditional IXCs to bear a disproportionately large share of the contribution obligation, even as their revenues fall and long distance traffic shifts to other networks.

The Plan’s contribution methodology is also “equitable and nondiscriminatory.”

It is true that, like any reform to the contribution methodology, the Plan’s approach

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<sup>31</sup> The Commission plainly has authority to impose a contribution obligation on all providers that use numbers or connections, even if some of those are not traditional telecommunications carriers. Section 254(d) permissively authorizes the Commission to assess contributions on “[a]ny . . . provider of interstate *telecommunications* . . . if the public interest so requires.” 47 U.S.C. § 254(d) (emphasis added). The Commission has already tentatively determined that an information service provider that owns the underlying transmission facilities on which packets are transmitted is providing telecommunications and therefore falls within the scope of the Commission’s permissive contribution authority. *Wireline Broadband NPRM* at 3032-33 ¶¶ 24-25 & n.58; Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11830, 11532-35 ¶ 66-70 & n.138 (1998).

would necessarily change the relative contribution burdens among different industry segments. For example, because assessments would no longer rest on revenues, a criterion not found in the Act, traditional IXCs would bear proportionally less of a burden than they do today. But to argue that this change makes the Plan's approach less "equitable" than the current regime incorrectly assumes that the particular burdens imposed by the present interstate-revenue-based scheme are the proper frame of reference. Because contribution obligations are ultimately passed through to consumers, the relevant question is not whether all industry segments share (in some indeterminate sense) exactly the same obligations, but whether competing providers of like services face comparable contribution burdens. Under the Plan, they do; under the current system, they do not.

Likewise, the Plan's exclusion of the handful of carriers that do not use numbers or connections is no less consistent with section 254(d)'s "every telecommunications carrier" contribution requirement than the contribution mechanism in place today. Under the Plan, every carrier that serves end users will contribute, since, with commercially insignificant exceptions, such providers will generally require some type of number or connection to reach customers. For example, independent long distance carriers will bear significant (albeit reduced) contribution obligations because, in today's all-distance environment, very few such carriers provide only transport service. Most of them also provide direct connections (such as private or special access lines) and telephone numbers (such as toll-free numbers) to various classes of customers. Further, the ICF contribution methodology itself applies to "every carrier" and does not carve out any technology and service type. *Every* carrier that provides a number or relevant connection

is required to contribute a specific amount.<sup>32</sup> Under the Plan, for example, a cable modem service provider and a DSL provider will be assessed the same number of units for every connection, thus eradicating a disparity that exists under the current funding rules.<sup>33</sup>

This Plan is also fully consistent with any jurisdictional limits that section 2(b) of the Communications Act places on the Commission's authority.<sup>34</sup> The Plan provides for a flat-rate assessment on connections that either are wholly interstate or, like special access lines, are used indivisibly for both inter- and intrastate purposes. The Commission

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<sup>32</sup> Section 251(e) answers any questions that might arise about the Commission's authority to impose contribution obligations on providers that use telephone numbers even if they are not found to provide "telecommunications." Section 251(e) empowers the Commission to "administer telecommunications numbering" and grants it "exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States." 47 U.S.C. § 251(e)(1). As the Second Circuit has observed, section 251(e) grants the Commission broad license to use its plenary authority over numbering resources to achieve the basic goals of the Act, such as promoting competition and eliminating unreasonable discrimination. *See New York PSC v. FCC*, 267 F.3d 91, 102-06 (2d Cir. 2001) (Commission may require, over state public utility commission's objection, that all customers dial a ten-digit number to make local calls to ease the introduction of an area code overlay in New York City). Here, the assessment of a small USF fee associated with the provision of one or several NANP numbers would, as noted, advance the fundamental goals of universal service articulated under sections 1 and 254 of the Act, while at the same time promoting number conservation and efficient number utilization. *See generally* Report and Order and Further Notice of Proposed Rulemaking, *Numbering Resource Optimization*, 15 FCC Rcd 7574, 7578 ¶ 3 (2000) (noting the Commission's concern over "[t]he rapid depletion of numbering resources nationwide and the potential it creates for NANP exhaust").

<sup>33</sup> *See generally* S. REP. NO. 104-23, at 27-28 (1995) (explaining that "every carrier" language is intended to "require[] . . . carriers that concentrate their marketing of services or network capacity to particular market segments, such as high volume business users," to "contribute on an equitable and nondiscriminatory basis to the preservation and advancement of universal service" so as to "prevent distortion of competitive forces").

<sup>34</sup> 47 U.S.C. § 152(b).

has indisputable regulatory jurisdiction over such dual-use facilities.<sup>35</sup> And because the assessment would not vary with a carrier's intrastate revenues, it would not violate the Fifth Circuit's prohibition on assessments that are based on such revenues.<sup>36</sup>

**E. The Commission Has Full Authority To Implement The ICF Plan's Interconnection Rules**

The Plan establishes uniform intercarrier compensation rules with a transition to bill and keep for the termination of *all* traffic delivered to another carrier's "Network Edge" in a LATA. Under the Plan, CLECs will remain free, pursuant to section 251(c)(2), to interconnect at various physical points on an ILEC's network in addition to these Network Edges (which, in the case of ILECs, will generally be tandem switches). In recognition of the financial implications of each carrier's choice of physical interconnection points, however, CLECs that choose to deliver traffic to an ILEC at physical interconnection points *other* than the ILEC's designated Network Edge will be required to compensate the ILEC for "backhauling" that traffic from the chosen physical interconnection points to the relevant "edge" of the ILEC's network. (By definition under the Plan, upon conversion to bill and keep, the compensation that one carrier owes another when depositing traffic at the latter's Network Edge is zero.)

Of course, if a carrier lacks facilities of its own to deliver traffic to the Network Edge of the terminating carrier, it may lease dedicated capacity for this purpose on the transport facilities of other entities. Moreover, if the carrier is otherwise entitled to lease dedicated transport as an unbundled network element at TELRIC-based rates, nothing in

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<sup>35</sup> *NARUC*, 737 F.2d at 1111-16 (affirming the Commission's authority, even in light of section 2(b), to impose a per-line subscriber line charge, to support universal service, on dual-use equipment).

<sup>36</sup> *TOPUC I*, 183 F.3d at 448.

the ICF Plan precludes it from doing so. The Plan simply provides that in the absence of such arrangements, a carrier that chooses to deliver traffic at a point other than the Network Edge of the terminating ILEC has the right to lease dedicated transport circuits from the ILEC as a “special access” service, currently subject to section 201 just and reasonable standards.

Thus, in the absence of independently available rights to lease transport as an unbundled network element from the ILEC pursuant to section 251(c)(3), the Plan provides that ILECs must be compensated when they use their own facilities to “backhaul” traffic to the relevant Network Edge from a separate point of handoff.<sup>37</sup> In the context of the comprehensive reform and competitively neutral compensation rules for *all* traffic contemplated by the Plan, the Commission can reasonably construe the category of “transport,” for purposes of section 251(b)(5), as limited to the function of moving traffic from the designated Network Edge to the switch serving the called party. Under this construction, this limited backhaul function would fall outside the scope of section 251(b)(5)—and thus the pricing rules of section 252(d)(2)—and under current rules would be subject to the “just and reasonable” standard of section 201. The Commission likewise has authority to rule that an obligation to backhaul traffic under the Network Edge concept embodied in the Plan is not a function of section 251(c)(2) physical “interconnection” to which the pricing standards of section 252(d)(1) apply. The traffic does clearly fall, however, within the Commission’s more traditional

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<sup>37</sup> This backhaul function should be distinguished from the “interconnection transport” function set forth in the Plan. The latter function, and its associated pricing rules, apply only to interconnection arrangements between designated Network Edges.

jurisdiction under section 201 to regulate “mixed use” facilities (since these interconnection arrangements are designed for the exchange of all traffic, whether interstate or intrastate).<sup>38</sup>

**F. The Commission May Require the Provision of Transit and Regulate Rates for Such Transit**

The Commission’s authority to prescribe transit rates is rooted in sections 201 and 251(a) of the Act. *First*, to the extent transit traffic is interstate, section 201 plainly authorizes the Commission to regulate it and to ensure that the charges are just and reasonable.<sup>39</sup> Indeed, the Commission has for years relied on its section 201 authority to require that LECs provide transit for traffic between an IXC and independent LECs, CMRS carriers, and others.<sup>40</sup> *Second*, section 251(a), which requires all telecommunications carriers to “interconnect directly or indirectly” with all other telecommunications carrier networks, authorizes the Commission to regulate *all* transit

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<sup>38</sup> Decision and Order, *MTS and WATS Market Structure, Amendment of Part 36 of the Commission’s Rules and Establishment of a Joint Board*, 4 FCC Rcd 5660, 5660-61 ¶¶ 2, 6-7 (1989) (adopting separations procedures under which mixed use special access lines are assigned to the interstate jurisdiction when interstate traffic accounts for at least ten percent of the traffic carried on those lines); Memorandum Opinion and Order, *GTE Tel. Operating Cos.*, 13 FCC Rcd 22466, 22479-80 ¶¶ 23-25 (1998) (reaffirming that, under the Commission’s mixed-use facilities rule, special access facilities are subject to federal regulation when more than ten percent of the traffic is interstate). *See generally Qwest Corp. v. Scott*, 380 F.3d 367 (8th Cir. 2004) (applying the mixed-use facilities rule).

<sup>39</sup> 47 U.S.C. § 201(a) (authorizing the Commission to require “through routes” between and among carriers for the transmission of traffic); 47 U.S.C. § 201(b) (requiring rates and practices to be just and reasonable).

<sup>40</sup> *E.g.*, Memorandum Opinion and Order, *Elkhart Tel. Co. v. SWBT*, 11 FCC Rcd 1051, 1056-57 ¶¶ 34, 37 (1995); *see, e.g.*, Report and Order, *MTS and WATS Market Structure Phase III*, 100 F.C.C.2d 860 (1985).

traffic, including intrastate traffic.<sup>41</sup> Section 251(a) requires interconnection of all carriers, but expressly gives carriers the option of relying on *indirect* interconnection to accomplish that end. Direct interconnection between each carrier and every other would be neither efficient nor feasible. *Indirect* interconnection—*i.e.*, transiting—therefore is essential to ensure the nationwide interconnectedness Congress envisioned.

As the Commission has observed, the “fundamental purpose” of section 251(a) is to “promot[e] the interconnection of all telecommunications networks by ensuring that incumbent LECs are not the only carriers that are able to interconnect efficiently with other carriers.”<sup>42</sup> *Indirect* interconnection thus plainly encompasses the provision by the “middle” carrier(s) of transit between the two indirectly interconnected carriers. Put another way, there must be an open pipe between two indirectly interconnected carriers in order for there to be indirect interconnection *at all*. And, in fact, the Commission has repeatedly recognized that transit *is* that open pipe and thus is a fundamental component of indirect interconnection.<sup>43</sup>

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<sup>41</sup> 47 U.S.C. § 251(a)(1).

<sup>42</sup> Fourth Report and Order, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 16 FCC Rcd 15435, 15478 ¶ 84 (2001) (“*Collocation Remand Order*”), *aff’d sub nom. Verizon Telephone Cos. V. FCC*, 292 F.3d 903 (D.C. Cir. 2002); *see also Local Competition Order* at 15991 ¶ 997 (noting that “the [section 251] duty to interconnect directly or indirectly is central to the 1996 Act and achieves important policy objectives.”).

<sup>43</sup> Memorandum Opinion and Order, *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia, Inc., and for Expedited Arbitration et al.*, 17 FCC Rcd 27039, 27101-02 ¶ 118 (2002) (finding that transit was key to WorldCom’s “ability to interconnect indirectly with other carriers” and serve the “interests of all end users in connectivity to the public switched network.”); Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd

Regulation of transiting pursuant to section 251(a) is perfectly consistent with the Commission's previous rulings that section 251(a) authorizes the Commission only to regulate the "physical linking of two networks."<sup>44</sup> In one case, for example, the Commission determined that 251(a) did not authorize it to require AT&T to order a CLEC's terminating access service. But, as the D.C. Circuit found in affirming the Commission's decision, the distinction the Commission drew between section 251(a) and the Act's "transport and termination" requirement does not spare any carrier from its section 251(a) obligation "to establish a physical connection with" other carriers.<sup>45</sup> As the court pointed out, despite AT&T's refusal in that case to send traffic to the plaintiff carrier—which was demanding extremely high terminating access charges—the two carriers were in fact interconnected, via indirect transit-based links provided by Southwestern Bell.<sup>46</sup>

*Total Telecom* thus supports the Commission's section 251(a) authority over transiting. The independent connections of AT&T and the plaintiffs to Southwestern Bell

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16978, 17319-20 ¶ 534 n.1640 (2003) (subsequent history omitted) (noting that "transiting" is "a means of indirectly interconnecting with other . . . carriers for the purpose of terminating local and intraLATA traffic."); *Collocation Remand Order* at 15477-78 ¶¶ 83-84 (finding that the Commission has authority to require LECs to provision a cross connection between a CLEC and a competitive transport provider because that connection is essential to the indirect interconnection required under section 251(a)).

<sup>44</sup> Memorandum Opinion and Order, *Total Telecomm. Servs. v. AT&T Corp.*, 16 FCC Rcd 5726, 5736-37 ¶ 23 (*Total Telecom Order*), *aff'd in relevant part, rev'd in part*, *AT&T v. FCC*, 317 F.3d 227 (D.C. Cir. 2003) (*Atlas Appeal*). In the *Total Telecom Order*, the Commission relied on its earlier determination in the *Local Competition Order* at 15590 ¶ 176 ("We conclude that the term 'interconnection' under section 251(c)(2) refers only to the physical linking of two networks for the mutual exchange of traffic.").

<sup>45</sup> *Atlas Appeal*, 317 F.3d at 235.

<sup>46</sup> *Id.*

could satisfy section 251(a)'s indirect interconnection requirement only if Southwestern Bell in fact provided a link between the two carriers. The mere fact that two carriers connect with a third carrier may establish the *possibility* of interconnection, but section 251(a) requires actual interconnection, and that is accomplished only where the middle link—transit—is at least offered by that third carrier. Thus, the D.C. Circuit's decision should be read to stand for the proposition that the two indirectly connected carriers cannot be forced, under section 251(a), to *utilize* their interconnection by actually sending traffic to one another. But it cannot sensibly be read to foreclose the Commission's authority to regulate—on just, reasonable, and non-discriminatory terms under section 201—the provision of the essential middle link for indirect interconnection, for that interpretation would gut section 251(a)'s indirect interconnection provision of all meaning.

# EXHIBIT 4

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

In the Matter of )  
 )  
Developing a Unified Intercarrier ) CC Docket No. 01-92  
Compensation Regime )

**COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.  
ON FURTHER NOTICE OF PROPOSED RULEMAKING**

Qwest Communications International Inc. ("Qwest") hereby submits its comments on the Further Notice of Proposed Rulemaking<sup>1</sup> in the above-captioned docket.

I. INTRODUCTION AND SUMMARY

The need for rapid and decisive action by the Federal Communications Commission ("Commission" or "FCC") to rationalize the system of intercarrier compensation is one of the most pressing issues currently before the FCC. The entire system is fatally flawed, with carriers paying and receiving vastly different amounts for services which are often functionally identical. The tariffed access structure cries out for correction, as carriers and others try to reduce costs by juggling interstate and intrastate jurisdictional issues with the end user status afforded local ISP points of presence under the ESP exemption. Access charges themselves are dramatically different than the reciprocal compensation structure pursuant to which local exchange carriers ("LEC") and commercial mobile radio service ("CMRS") carriers exchange traffic. Some services, such as Internet Protocol ("IP") voice services, are currently eligible for local interconnection (to a local Internet Service Provider ("ISP") point-of-presence ("POP")) under

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<sup>1</sup> *In the Matter of Developing a Unified Intercarrier Compensation Regime*, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (rel. Mar. 3, 2005) ("Further Notice"); a summary of the Further Notice was published in the Federal Register on Mar. 24, 2005 (70 Fed. Reg. 15030).

the so-called "ESP [enhanced service provider] exemption," despite the fact that the access services provided by an incumbent LEC ("ILEC") to terminate an IP voice call are identical to those used to terminate any other call.<sup>2</sup> In the case of ISP-bound traffic, whole industries have grown up based solely on leveraging an ILEC's obligation to pay for "termination" of an ISP call to a competitive LEC ("CLEC") customer (requiring an ILEC to actually pay another carrier for the use of the ILEC's own facilities -- skewing the market dramatically and creating an arbitrage opportunity of breathtaking proportions).<sup>3</sup>

In fact, for the most part there is almost no difference (if any) between the connecting functions among carriers involved in originating or terminating an interstate long distance call, an intrastate long distance call, an IP voice call, a local call, or any other call that makes use of local exchange switching facilities and common lines. Yet the rates for each are dramatically different.

Qwest submits that, until the Commission has acted to adopt and implement a rational and economically sound plan for intercarrier compensation, the development of a competitive

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<sup>2</sup> See *Ex Parte* Presentation of Qwest, WC Docket No. 03-266, *In the Matter of Petition of Level 3 Communications LLC for Forbearance Under 47 U.S.C. Section 160(c)* and WC Docket No. 04-36, *In the Matter of IP-Enabled Services*, dated Mar. 11, 2005, at 2-3 and Attachment A, for a description of the background of the ESP exemption and its application today to IP-enabled services.

<sup>3</sup> This is highlighted by the two massive access charge frauds perpetrated by AT&T Corp. ("AT&T"), where AT&T and others sought to manipulate the Internet Protocol and calling card platforms in an effort to reduce their switched access charges. See *In the Matter of Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457, 7465-72 ¶¶ 12-24 (2004); *In the Matter of AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services; Regulation of Prepaid Calling Card Services*, WC Docket Nos. 03-133, 05-68, Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 4826 ¶¶ 14-37 (2005); see also associated Statement of (former) Chairman Michael K. Powell. Carriers are devising ways to avoid payment of access charges by disguising the nature of their traffic, as was the case with AT&T and others. See, also, e.g., P. Huber, M. Kellogg, J. Thorne, *Federal Telecommunications Law* §§ 2.4.4.2, 2.4.4.3, 2.4.4.4, 2.4.4.5, 2.11.2.5.1 (2d ed. 1999 & Supp. 2004), for a description of the market and other distortions that have evolved along these lines.

telecommunications market in the United States will not only be dramatically retarded, but possibly endangered. The current system is so arbitrary that it simply cannot be sustained for much longer.

Qwest's solution to the intercarrier compensation morass is simple and straightforward. Called "bill and keep at the edge," Qwest's plan puts the onus on a carrier desiring to interconnect with another carrier to bring its traffic to the "edge" of the terminating carrier's network (as is defined herein), at which point the traffic is exchanged on a bill and keep basis. In those circumstances where the "edges" of the two networks are not adjacent, it is the responsibility of the originating carrier to deliver the call to the terminating carrier's edge. We recognize that a situation where two carriers were delivering their traffic independently to each others' network edges would be inefficient, a fact that we assume all other carriers would similarly recognize -- motivating them to negotiate appropriate mutual transport arrangements. Should either carrier desire to utilize the services of a transiting carrier to carry traffic to a terminating carrier, the transiting services would be available at market rates pursuant to carrier-to-carrier contracts subject to FCC jurisdiction. The structure would apply to all exchanges of traffic between carriers in which local telephone exchange or exchange access services are provided. The Qwest plan itself is described in detail below.

The Qwest bill and keep at the edge plan applies only to the exchange of traffic (and interconnection) where circuit switching by the LEC is involved. It does not displace or in any way modify LEC special access tariffs or the right of LECs to charge special access for high capacity dedicated services provided to other carriers behind the respective edges of their networks. Special access services are offered to other carriers to enable them to serve their own customers, not part of interconnection among carriers for the exchange of the traffic of the

carriers' respective customers. Special access services are not part of the bill and keep proposal described herein. What is more, as is discussed in detail below, adoption of any bill and keep plan will require substantial rate and revenue rebalancing in order to allow carriers an opportunity to recover the revenues lost from existing switched access services. If the FCC were to adopt a structure whereby ILEC special access services were brought into a bill and keep status, the financial impact that would need to be addressed would be considerably larger. Because special access services do not fit within the ambit of intercarrier compensation, which functions to permit each carrier the opportunity to service its own customers, but instead are services that permit a carrier to extend its own network to its own customers, there is no reason to include special access services in the bill and keep structure. We do not address special access further herein.

Moreover, it must be kept in mind that the bill and keep structure applies only to delivery of traffic to and exchange of traffic with other carriers. Should a carrier desire to purchase additional access services beyond the mere delivery of traffic (for example, some signaling<sup>4</sup> or information), these services would continue to be purchased pursuant to the regulatory structure the FCC establishes for them (currently tariffed Feature Group D access service provides a variety of functions beyond simple traffic delivery that interexchange carriers ("IXC") may desire to purchase outside of the bill and keep regime recommended herein).<sup>5</sup>

The Further Notice contains a detailed Staff Analysis documenting the economic principles which support a bill and keep compensation structure.<sup>6</sup> This analysis is thoughtful and

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<sup>4</sup> That is, signaling services, as opposed to the signaling information delivered as part of normal call delivery.

<sup>5</sup> For example, such services could include signaling 800 database access service, and carrier information parameters. See Qwest Corporation Tariff F.C.C. No. 1, Section 6.3.

<sup>6</sup> See Further Notice, 20 FCC Rcd 4685 at App. C (hereinafter "Staff Analysis").

thorough. Unless otherwise specified herein, Qwest supports the Staff Analysis in its entirety, and does not repeat that analysis here.

It is vital that this new plan adhere closely to the basic principles of the Act and sound economics.<sup>7</sup> It must be competitively neutral, non-subsidizing, and economically rational. Adhering to these objectives in the context of a system that has developed, in some cases, over the course of a century, will not be easy, as the length of this docket thus far amply demonstrates. The plan must also be careful not to increase the current size of the federal universal service obligations -- the size and scope of which are already well beyond anything that could rightly be considered reasonable. There will undoubtedly be some icons that get damaged in any reasonable FCC structure -- the mere fact that some aspects of the Qwest plan are controversial or potentially unpopular does not detract from their fundamental reasonableness or from the urgency of the need for true reform.

The entire structure, with the limited exceptions described below, would be subject to federal jurisdiction. This includes replacement of intrastate access tariffs and regulation of transiting with the charging structure described herein. There is no question that intercarrier compensation reform will be essentially meaningless if limited to "interstate" services, however that term may be ultimately defined. The FCC has plenary jurisdiction over the exchange of traffic involving LECs pursuant to Section 251(b)(5) of it's the Act,<sup>8</sup> and state access charges remain in place temporarily subject to that federal jurisdiction pursuant to Section 251(g) of the Act.<sup>9</sup> If necessary, the FCC has the authority to preempt state access charges in order to

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<sup>7</sup> The Further Notice spells out the perceived goals of intercarrier compensation reform at paragraphs 30-36. Qwest agrees that these goals are reasonable and appropriate. Some of these goals are discussed at page 22, *infra*.

<sup>8</sup> 47 U.S.C. § 251(b)(5).

<sup>9</sup> 47 U.S.C. § 251(g).

implement a rational intercarrier compensation regime as part of its authority over intercarrier interconnection matters generally, but we believe that exercise of federal preemptive jurisdiction is not necessary because Section 251(b)(5) of the Act is a *direct* jurisdictional grant that does not need further analysis or preemptive action.

A move to bill and keep for all carrier exchange of traffic will, of necessity, require that the FCC take immediate and comprehensive action to ensure that the revenues that carriers currently receive from interstate and intrastate carrier access charges are subject to recoupment from other sources. This is an absolute requirement from both a statutory and a constitutional perspective. Qwest submits that the best replacement source for these revenues is from the customers of the affected carriers, and that the best mechanism for replacement is a flat rate charge on subscriber lines. Given the federal responsibility in this area, this charge should be a federally administered subscriber line charge increase.<sup>10</sup> In order for the FCC to accomplish this subscriber line charge increase to make up for foregone intrastate access revenues, it is necessary for the FCC to take appropriate action to assume jurisdiction over these revenues and the costs associated with them.

Qwest submits that the best approach is for the FCC to move immediately to convene a joint board pursuant to Section 410(a) of the Act to determine how to quickly accomplish the necessary jurisdictional shifts to permit implementation of a comprehensive bill and keep intercarrier compensation regime. It is apparent that this separations shift must actually be in place before actual implementation of any federal intercarrier compensation regime, and the FCC should move immediately to designate the issue for either one of the existing federal-state joint boards or to establish a new joint board for this purpose. The joint board should be given strict

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<sup>10</sup> Despite the FCC's plenary jurisdiction over intercarrier compensation matters, the Act vests no such authority in the FCC over local end user telephone rates *not in the FCC's jurisdiction*.

timelines for action in order that the federal intercarrier compensation plan is able to remain on an even jurisdictional keel and the Commission is able to fulfill its statutory mandate that carriers be afforded the opportunity to recoup lost access revenues *from other sources*.

The plan to ensure that ILECs have an opportunity to recover lost access revenues would function simply. Each ILEC would have the opportunity to increase its federal subscriber line charge ("SLC") to the level that would reflect, on a per line basis, the total amount of its annualized access revenues (including increases or decreases for reciprocal compensation). The FCC would also establish a national average "benchmark" rate set at 125% of the national weighted average of urban business and residential rates, interstate SLCs and intrastate SLCs. If the new rate (including the added federal SLC) exceeded the benchmark, the ILEC could petition the FCC to permit it to implement an interexchange termination charge that accounted for all or part of the amount in excess of the benchmark.

Qwest recognizes that a transition plan must be utilized to enable carriers and customers alike to make the adjustments necessary to implement the Qwest plan. While others have suggested protracted transition plans, Qwest suggests that a transition of no more than three years is quite sufficient to allow for full plan implementation. However, several reforms must be undertaken immediately: 1) the FCC must clarify that transiting services provided by any LEC are not part of exchange access or local exchange service as those terms are contemplated in the Act, but instead are interconnection services among carriers governed entirely by federal common carrier law (*i.e.*, Sections 201, 202 and 211(a) of the Act) as it relates to intercarrier interconnection outside of Sections 251(b) and (c) of the Act; 2) the Commission must clarify that so-called VNXX traffic must be treated as local or non-local based on the locations of the

parties (with ISP POPs continuing to be treated as end-user customers for this purpose<sup>11</sup>) rather than on the specified telephone numbers of the end users;<sup>12</sup> 3) the Commission must eliminate the intra-MTA rule for LEC-CMRS traffic and define the local service area for such traffic as the ILEC local calling area; and 4) ISP traffic must be moved to bill and keep immediately.<sup>13</sup> In addition, no plan can be implemented without first undertaking the necessary separations changes to permit ILECs to recover lost intrastate access revenues through the federal SLC.

Finally, the Commission must deal up front with the issue of compensation of independent LECs, many of whom continue to lobby for sources of funding beyond existing universal service capabilities and their own ability to charge their own customers. Qwest fully supports rational and non-discriminatory funding for universal telephone service. But there is a limit to which independent LECs can be subsidized without risk to the vitality of the entire plan, and the total size of the universal service funds cannot be increased.<sup>14</sup>

## II. THE COMMISSION SHOULD ADOPT QWEST'S BILL AND KEEP PLAN FOR INTERCARRIER COMPENSATION

### A. Qwest's Bill And Keep Plan

#### 1. Structure of Qwest's Bill and Keep Plan

Qwest's bill and keep plan is slightly different than the bill and keep at the edge plan espoused by Qwest in its initial comments in this docket. In particular, Qwest seeks to address several issues relating to smaller carriers and state jurisdiction that have become more pointed

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<sup>11</sup> As noted below, ISP "reciprocal compensation" must be terminated immediately.

<sup>12</sup> Obviously this does not apply to interconnection agreements that specify that the local telephone numbers, rather than the location of the parties, will govern compensation.

<sup>13</sup> Each of these four enumerated items can and should be enacted immediately through declaratory or other appropriate relief and, therefore, fall outside of the proposed four-step, three-year transition to bill and keep.

<sup>14</sup> Obviously the amount of lifeline funding will need to increase because of the increase in the amount of the SLC charge.

since this docket commenced.<sup>15</sup> However, Qwest continues to support bill and keep as the most economically rational approach to intercarrier compensation, and puts forth these minor modifications as a matter of necessity, not by way of concession that deviation from a pure bill and keep approach would ultimately be more efficient or better for the public or the telecommunications marketplace. Thus, we continue to find it inescapable that bill and keep is a superior method of intercarrier compensation. Qwest's bill and keep at the edge plan creates incentives for efficient network design.

The defining attribute of bill and keep is a default division of financial responsibility, at some point between two networks, for the costs of handling traffic that travels over both networks.<sup>16</sup> In the absence of a negotiated agreement between two carriers dividing the responsibilities differently, each carrier must recover from its end users, and not from other carriers, all network costs on its side of that point. Qwest has referred to this point as the "financial point of interconnection" or "financial POI."<sup>17</sup> The regulatory task in a bill and keep framework is to define a technology-neutral rule for the financial POI that would be applicable to any hand-off of telecommunications between telecommunications carriers on the public switched network. Default rules should allow the financial POIs to coincide with workable physical POIs in as many cases as possible. Such default rules would avoid the necessity of resource-consuming interconnection negotiations between carriers. Qwest believes that the best financial POI is at the "edge" of each carrier's network.

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<sup>15</sup> Qwest anticipates that its position may further evolve as it is able to internalize the thoughts of other commentors as they are filed.

<sup>16</sup> Each carrier is responsible for the physical facilities necessary to deliver the traffic to the edge of the other carrier's network as well.

<sup>17</sup> See Comments of Qwest, filed herein on Aug. 21, 2001, at 23.

Qwest believes that the appropriate default rules for designation of the POI or the "edge"

are:

1. Each carrier is responsible for recovering the costs of its own network from its own subscribers with the exception of costs associated with the provision of transiting traffic.
2. Each carrier must establish an "edge" of its own network in each LATA in which it intends to receive traffic.<sup>18</sup> At a minimum, the "edge" must be placed so that all switching type functions provided by the carrier are included within that carrier's network. For a hierarchical circuit switched network, the "edge" will be at the access tandem location serving the subscriber's local switch. For a non-hierarchical circuit switched network, the "edge" will be at the local switch location serving the subscriber. If no switch is located in the LATA to be served, an "edge" must be established in the LATA to be served. The cost of facilities between the distant switch and the "edge" are the responsibility of carrier that has chosen not to put a switch in the LATA. For an IXC, the edge will be its points of presence ("POPs") in each LATA.
3. The originating carrier is responsible for paying the cost of facilities transporting traffic to another carrier's "edge." Such cost will be recovered from the originating carrier's subscribers.
4. In the case where an originating carrier utilizes a transiting carrier for transport to another carrier's "edge," the transiting carrier may charge due compensation to the carrier originating the traffic to the transiting carrier based on reasonably negotiated contracts. Transiting should be offered via intercarrier contracts negotiated between carriers, subject to Section 201(a), 202(a) and 211(a) of the Act, but not presumptively regulated by the Commission. The originating carrier will recover such costs from its subscribers.<sup>19</sup>

These rules would apply in the absence of a negotiated agreement to the contrary. In the case of a dispute regarding the location of the POI, the carriers would have the opportunity to seek arbitration of the dispute.

Under Qwest's plan, division of responsibility at the financial POI would replace the current scheme of reciprocal compensation for local traffic and switched access for intrastate and

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<sup>18</sup> Carriers can have multiple edge locations within the LATA.

<sup>19</sup> The rules are set out in an ex parte (and attachments) from John W. Kure, Qwest to Marlene H. Dortch, FCC, filed herein on Aug. 2, 2002.

interstate interexchange traffic.<sup>20</sup> Enacting bill and keep will be a departure from the Commission's current rules for local traffic, enacted pursuant to 47 U.S.C. § 251(b)(5), under which a terminating carrier recovers transport and termination costs from the originating carrier, and its other costs from its own customers. Under bill and keep the terminating local carrier will also recover its costs of termination (and any transport from its edge) from its subscribers. Bill and keep will also be a departure from the current rules for interexchange traffic under which the IXC pays for local exchange access at both the originating and terminating points of the call. Under bill and keep the originating LEC recovers its originating access costs from its subscribers, the IXC recovers its own transport and other costs from its subscribers, and the terminating LEC recovers its terminating access costs from its subscribers. Thus, under bill and keep if a LEC has chosen an inefficient architecture the LEC must recover the costs directly from its end users, not the IXC.

Requiring the terminating carrier to internalize the costs of transporting a large portion of the call behind the edge of its network will have the desirable consequence of incenting that carrier to optimize the efficiency of its network. Thus, under Qwest's plan, one carrier cannot be forced to pay for another carrier's choice of network architecture. The most significant flaw in the current scheme, as noted in the Staff Analysis, is that a terminating carrier can essentially force an originating carrier to incur useless network inefficiencies (or, in the case of one-way traffic such as ISP traffic, to make windfall and uneconomic payments to another carrier having nothing to do with reasonable interconnection). There is, in effect, an economic incentive to be inefficient. Qwest's default rule requiring one carrier to deliver traffic to the other carrier's edge eliminates that incentive.

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<sup>20</sup> Special access is the subject of a separate proceeding, and is not at issue here. Interconnection between adjacent non-competing LECs already occurs on a bill-and-keep basis in most instances.

2. Qwest's Bill and Keep Plan Contains the Necessary Element of Revenue Neutrality

As is discussed in more detail below, the FCC has the statutory and constitutional responsibility to ensure that any intercarrier compensation plan adopted, including the Qwest bill and keep at the edge plan, permits affected carriers the reasonable opportunity to regain through other sources the interstate and intrastate access revenues lost upon implementation of the plan.<sup>21</sup> The Qwest plan addresses this issue as follows.

Under the Qwest plan, as the first and primary step for recovering forgone intercarrier compensation, the federal SLC will be permitted to increase such that the combination of the residential and business rates, any state SLC and the federal SLCs (all weighted by lines) would be increased to the lower of a national benchmark (assuming they are below the benchmark) or the level needed to recover the foregone intercarrier compensation. The national benchmark rate would be set based on the total of ILEC single line residential and business rates, intrastate SLCs and interstate SLCs for urban wire centers, weighted and calculated as of the last day of the base year. Added to this amount would be the foregone intercarrier compensation (*i.e.*, annual interstate and intrastate switched access and net reciprocal compensation) offset by any continuing transiting charges and interconnection revenues.<sup>22</sup> The benchmark rate would be set at 125% of the national average of these urban rates, including the national average of foregone compensation for urban carriers.<sup>23</sup>

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<sup>21</sup> See Section III, *infra*.

<sup>22</sup> ILECs incurring reconfiguration costs caused by the new regime could add reasonable reconfiguration costs to the amount of access charges forgone.

<sup>23</sup> For carriers whose total rates for the affected elements would exceed the benchmark if all foregone compensation were included, additional recovery mechanisms are discussed below.

At that point each ILEC<sup>24</sup> will have, for each study area, three numbers: 1) its weighted average of business and residential rates; 2) the total allowed amount for recovery of its own foregone access and reciprocal compensation net revenue; and 3) the amount of the total foregone access and reciprocal compensation payments that would not be recovered if the ILEC moved the total of its local rate, any state SLC and federal SLC to the benchmark level, including the increase in the federal SLC. If the ILEC so chose, the remainder (*i.e.*, that is not recovered by moving the combined rate to the benchmark level) could be recovered through a termination charge on interexchange traffic, upon Commission approval.

The initial differential (*i.e.*, the amount necessary to increase rates to reach the benchmark) would be recovered through the federal SLC. SLCs would increase by 25% of the ultimate level for each step in the three-year, four-step transition plan.<sup>25</sup> To the extent that an ILEC, having increased its rates to the benchmark level, still has not been able to recover the lost access revenues in its rates, the difference can be made up from an interexchange termination charge upon an appropriate showing to the Commission. This charge, which would be a federal intercarrier compensation charge assigned to carriers only, would be calculated to collect only the amount not otherwise recovered or recoverable as described above.<sup>26</sup> The termination charge would be phased in on the same percentage schedule as the other rate increases described herein.

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<sup>24</sup> Because CLEC rates are not regulated, this analysis generally applies only to ILECs.

<sup>25</sup> Independent telephone companies who participate in the NECA traffic sensitive pool will also have pooling for the increased SLC revenues that offsets foregone intercarrier compensation.

<sup>26</sup> Unregulated LECs (generally CLECs) in an area where an ILEC was charging a termination charge under these rules could charge their own termination charge up to the amount assessed by the ILEC.

Because the termination charge applies only to carriers, it would not be applicable to Information Service Providers (“ISPs”) (under a properly applied ESP exemption)<sup>27</sup> or “true VOIP” service.<sup>28</sup>

To the extent that a carrier has its local rate/SLC combination above the benchmark at the time the benchmark is calculated, it can reduce its total rates (as described above) to the benchmark and make up the difference from the interexchange termination charge on petition to the FCC.

### 3. Qwest’s Bill and Keep Plan Retains the End-User Status of ESP/ISP POPS.

Enhanced Service Providers (or Information Service Providers -- the terms are synonyms for present purposes) have, for the past twenty years, connected their local POPs to the public switched telephone network (“PSTN”) as end users rather than carriers.<sup>29</sup> When moving to bill and keep, the Commission should maintain this distinction between a carrier’s connection and an Enhanced Service Providers’ (ESP’s or ISP’s) connection based on the end-user status of an ESP or ISP POP. Accordingly, under Qwest’s plan, an ISP (including an IP-Voice provider) will not be entitled to interconnect with a LEC on a bill and keep basis like a carrier, but will continue to purchase local and toll services like any other end user. “True IP-Voice,” meaning an application that provides real-time, two-way voice capability originating in the Internet Protocol

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<sup>27</sup> The ESP exemption allows ESPs and ISPs to treat their ESP/ISP POPs as end-user premises, and to obtain local access to an exchange as any other similarly located end-user premise. Some CLECs have taken the position that the ESP exemption provides that all information service traffic, from whatever location, is “exempt” from the payment of access charges. While this argument may seem facially frivolous, as is discussed below it is a significant problem and the FCC must clarify that the ESP exemption is no broader than the simple classification of an ESP/ISP POP as an end-user premise for access charge purposes.

<sup>28</sup> “True VOIP” is a voice application that originates in IP protocol over a broadband connection. True VOIP is an information service and is entitled to the same regulatory treatment of other information services.

<sup>29</sup> *In the Matter of MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Memorandum Opinion and Order, 97 FCC 2d 682 (1983).

over a broadband connection, is an information service, rather than a telecommunications service.<sup>30</sup> Accordingly, true IP-voice providers, under Qwest's plan, will continue to connect to the PSTN as end users. In light of the industry confusion as to whether access charges apply to IP-voice calls that are carried on the PSTN, Qwest asks that the Commission immediately confirm that the ESP exemption applies to true IP-voice. However, in so clarifying, the Commission must clearly specify that the ESP exemption is in fact nothing more than an end-user classification of an ESP or ISP POP and that the POP is treated as any other end user for interconnection and carrier purposes. Accordingly, pending full implementation of bill and keep at the edge, the clarification must also specify that an ESP or ISP POP (of any nature) located outside of the local calling area of the second party to a call must be treated in the same manner as any other end-user premise for purposes of determining the appropriate access, toll or reciprocal compensation charges to be assessed.

4. Qwest's Plan Requires Coordinated Action Between the State and Federal Jurisdictions

In order for the Qwest plan, or any other plan that relies on bill and keep, to be workable, it must apply to intrastate traffic as well as interstate traffic. Moreover, state rules must conform to the bill and keep scheme in the same time frame as traffic in the interstate jurisdiction. If interstate traffic were exchanged on a bill and keep basis, while intrastate traffic were subject to a different scheme (such as the current tariff scheme), the resulting chaos and arbitrage opportunities would clearly be unacceptable. A multiplicity of access rating systems and approaches based on traffic jurisdiction would not only present a huge arbitrage opportunity, it would also be well nigh impossible to implement in Qwest's billing systems. A dual

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<sup>30</sup> See discussion in Comments of Qwest, WC Docket No. 04-36, *In the Matter of IP-Enabled Services*, filed May 28, 2004, at 14-24.

interstate/intrastate tariffed access system would be unworkable. Fraudulent presentation of traffic could potentially become more prevalent than it is today under the existing intercarrier compensation regime. For example, if interstate traffic has gone to bill and keep, but intrastate traffic remained subject to access charges, IXC's could route intra-LATA toll traffic so that the traffic appears to be interstate in an attempt to avoid intrastate access charges more easily than occurs today.

Changing the local and interstate interconnection at the same time is also essential to efficient transition of network routing, network capacity provisioning, and billing systems that changes would otherwise be complicated with the churn caused by changing interstate and intrastate interconnection at different times. For example, if interstate traffic were to move to bill and keep and intrastate traffic were to remain subject to access charges, it could be necessary to make network planning decisions based upon detailed predictions of the relative levels of interstate and intrastate traffic. Changing interstate and intrastate interconnection at the same time is vital to preventing adverse impact to carrier's end-user customers and reduces the potential impact to interconnecting carriers.

Obviously coordination between state and federal regulators is a vital element of implementing this plan. As is discussed below, the FCC has the authority to adopt a bill and keep plan for all intercarrier traffic. This is also true in the critical area of ensuring that ILECs have a reasonable opportunity to recover access charge revenues forgone in the plan from their own customers. In fact, without such an opportunity the entire plan would be unlawful. Qwest submits that, since this is a federal plan, the recovery authority and responsibility rests with the FCC, and only a federal SLC charge can reasonably be relied on to effectuate such necessary recovery. The best way to give the FCC necessary and unquestioned authority to enact a federal

compensation mechanism, while ensuring state participation in a meaningful fashion, is through a separations modification that moves the revenue, costs and investment currently recovered through intrastate access charges into the federal jurisdiction via the mechanism of a federal-state joint board convened pursuant to Section 410(a) of the Act.<sup>31</sup> Because the separations modifications necessary to the adoption of the plan must be in place before the plan can begin to be meaningfully implemented, the FCC should begin the joint board process immediately, probably by referring this issue to the federal-state joint board that is scheduled to be convened this summer.<sup>32</sup>

#### 5. Qwest's Plan Offers a Market-Based Transiting Solution

Transiting as a separate issue is discussed at some length below.<sup>33</sup> Under Qwest's plan, transiting simply becomes the vehicle by which a carrier fulfills its responsibility to transport traffic to the edge of another carrier's network. Because it is the originating carrier's responsibility to get its traffic to the edge of the terminating carrier's<sup>34</sup> network, the choice to use a transiting carrier lies with the originating carrier. This approach is the approach required by the Act and is most consistent with the important policy goals set forth in the Further Notice.

#### 6. Qwest's Bill and Keep Plan Does Not Require Additional Universal Service Funding

Qwest's bill and keep plan does not envision increasing the total amount of universal service support currently distributed from the various universal service funds. As Qwest has pointed out in other contexts, the size of the federal universal service funding efforts is already

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<sup>31</sup> See 47 U.S.C. § 410(a).

<sup>32</sup> See Notice of Public Information Collection(s), 70 Fed. Reg. 11971 (Mar. 10, 2005).

<sup>33</sup> See Section IV, *infra*.

<sup>34</sup> For these purposes an IXC is treated as a terminating carrier when traffic is destined to an IXC's network, even though it would be improper to classify an IXC as a terminating carrier for most purposes.

considerably higher than is reasonable and should not be increased. Accordingly, the Qwest plan relies on the combination of benchmark pricing evaluation, increased federal SLCs, and, where necessary, interexchange termination charges to give carriers the reasonable opportunity to recover forgone interstate and intrastate access and reciprocal compensation payments.

Universal service reform must, of course, be continued, and remains in itself an urgent matter. It is not a key element of Qwest's intercarrier compensation plan, nor should it be. In fact, Qwest submits that the total amount of universal service funding should not only not be raised as part of an intercarrier compensation reform plan, but should be formally capped to prevent inadvertent increases in the future.

We recognize that one aspect of universal service must be addressed in the context of the Qwest bill and keep plan. Qwest's plan requires an increase in the federal SLC. This increase will increase the number of people eligible for relief under federal lifeline programs, and lifeline funding should be increased accordingly.

#### 7. Qwest's Bill and Keep Plan Offers a Smooth Transition

Qwest proposes a three-year, four-step transition. During the first two years existing intercarrier compensation (including access charges and reciprocal compensation) will decrease and the federal SLC will increase towards the benchmark. Carriers will continue to physically interconnect their networks as they always have under the current Calling Party's Network Pays ("CPNP") regime. The third year there will be a "network flip." As described above, the network flip occurs when interconnection rules move from the current structure to the edge rules.

B. Qwest's Bill And Keep Plan Meets The Commission's Goals

1. Bill and Keep is the Most Economically Rational Intercarrier Compensation Scheme

Bill and keep is the most economically rational intercarrier compensation system. Qwest provided extensive analysis of the economic benefits of bill and keep in its comments and reply comments in response to the NPRM.<sup>35</sup> The Staff Analysis comprises a thorough and concise analysis of the economic rationale for choosing a bill and keep system. Accordingly, these comments simply summarize the benefits of bill and keep as the record already contains Qwest's more detailed explanation of bill and keep's merits. Briefly, bill and keep is an economically superior solution for the following reasons.

First, because both the calling party and the called party may both generally benefit from any given call, the originating and terminating networks should share the costs associated with the call by recovering their costs from their own end-user customers.<sup>36</sup> There is no rational economic nexus between cost causation and the identity of the "originating" carrier. To the contrary, in many cases, ISPs providing the most dramatic example, the major "cost causer" in a telephone call may be the terminating customer and the terminating customer's carrier. This is especially onerous and disruptive in a situation (again typified by ISP "reciprocal compensation") wherein the originating carrier is under a regulatory constraint to deliver traffic to a terminating carrier even when such delivery is not only uneconomic but potentially ruinous - in a free market the originating carrier would make the decision not to engage in such an uneconomical transaction.

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<sup>35</sup> See Comments of Qwest, filed herein on Aug. 21, 2001, at 7-21; Reply Comments of Qwest, filed herein Nov. 5, 2001, at 3-30.

<sup>36</sup> Further Notice, Staff Analysis, App. C, at p. 98.

Second, a CPNP approach allows carriers to shift costs to other carriers, which is especially problematic in a competitive market. Even a CPNP regime unified at one rate allows carriers to shift costs to their competitors, rather than recovering the costs from their subscribers. There is, of course, a very powerful economic incentive to raise the costs of one's competitors where possible, especially if such cost shifting can result in increased revenues to the cost shifter. But doing so distorts the pricing signals received by consumers. Because bill and keep puts all carriers in a position where they must recover their own costs from their own retail or wholesale customers, success in the marketplace will reflect a carrier's ability to serve customers efficiently, rather than its ability to extract payments from other carriers. The massive disruptions described in the ISP Remand Order are caused by the diseconomies inherent in a CPNP structure.<sup>37</sup>

Third, an intercarrier compensation scheme, such as CPNP, that requires termination payments create the opportunity for the terminating carrier to exploit pricing power due to the terminating monopoly.<sup>38</sup> This phenomenon has caused the Commission to regulate the maximum access charges that can be charged by CLECs, whose rates are otherwise subject to

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<sup>37</sup> *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98 and 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ("ISP Remand Order"). See Section IV.D., *infra* for a discussion on bill and keep structure for ISP traffic..

<sup>38</sup> The terminating monopoly exists because the terminating carrier has a monopoly over the facilities serving the end user who receives calls because any interconnecting carrier attempting to reach that customer must use the terminating carrier's network. Therefore, the terminating carrier may attempt to unilaterally impose unreasonable termination charges which the originating carrier cannot avoid. In many cases, because of the rate-averaging requirement, for example, the originating carrier cannot pass these charges on to the originating caller. The market fails to exert pressure to moderate these unreasonable termination rates, and regulation is needed. See Further Notice, Staff Analysis, App. C, at p. 104. The ISP reciprocal compensation problem is the most obvious, but not the only manifestation of this problem.

competitive market forces.<sup>39</sup> Under bill and keep, the terminating carrier must recover its costs from its own end-user customers. This eliminates the ability to charge unreasonable terminating rates because the end-user customer can compare prices and choose the carrier of his or her choice based on that carrier's performance. Bill and keep therefore encourages the development of competition because, as stated above, carriers must compete in the market based upon their ability to serve customers efficiently, not through regulatory arbitrage.<sup>40</sup>

Fourth, because of the terminating monopoly, there is a constant need under a CPNP system to regulate the termination rates that carriers charge each other. Experience has shown that especially in a technologically dynamic market such as the instant telecommunications market; it is simply impossible for regulators to evaluate and establish rates that accurately reflect costs. This is dangerous, because as even bill and keep's opponents acknowledge, arbitrage opportunities arise when regulated rates deviate from costs.<sup>41</sup> What is more, this arbitrage situation is aggravated by each of the factors enumerated above because disparate rates are often established for the same service, causing customers to seek to reduce costs and maximize revenues based on choosing from varying regulated prices for the same functions and services. Thus, under a CPNP system regulators must oversee retail rates, and wholesale termination rates, and expect that they will do so with only limited success in protecting the public interest. As the experience with CLEC access charges shows, the need to regulate

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<sup>39</sup> See *In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001).

<sup>40</sup> Further Notice, Staff Analysis, App. C, at pp. 103-04.

<sup>41</sup> See, e.g., Comments of AT&T, filed herein on Aug. 21, 2001, at 8. In a competitive market, prices are driven towards cost based on entirely different factors.

wholesale termination rates will never end in a CPNP regime.<sup>42</sup> Under bill and keep, regulators must oversee the transition to the wholesale bill and keep plan. After the transition is completed regulators will mildly oversee only retail rates until competition can be relied on to prevent discriminatory rate practices.

In sum, bill and keep best meets the Commission's goals of promoting economic efficiency,<sup>43</sup> being competitively and technologically neutral,<sup>44</sup> providing regulatory certainty,<sup>45</sup> eliminating arbitrage concerns,<sup>46</sup> and requiring minimal regulatory intervention.<sup>47</sup> Thus, Qwest's plan (and the other bill and keep plans) are superior to the non-bill and keep plans in meeting the aforementioned goals. Moreover, Qwest's plan meets the Commission's additional goals of maintaining reasonable and affordable end-user rates,<sup>48</sup> preserving universal service,<sup>49</sup> and providing a transition that will give carriers time to adjust their business plans.<sup>50</sup>

### III. THE FCC HAS THE STATUTORY AUTHORITY TO ADOPT THE QWEST BILL AND KEEP PLAN

Qwest submits that the FCC's authority to adopt the plan described herein is clear. This authority is essentially threefold: 1) the FCC has the jurisdiction to establish a federal structure for intercarrier compensation, that includes replacement of intrastate access charges with the federal bill and keep structure and, pursuant to different statutory provisions, to fulfill its

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<sup>42</sup> See note 37, *supra*.

<sup>43</sup> Further Notice ¶ 31.

<sup>44</sup> *Id.* ¶ 33.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.* ¶ 30.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* ¶ 36.

statutory and constitutional mandate to ensure that carriers have an opportunity to recoup lost access revenues through appropriate increases in end-user charges; 2) the FCC has the power to adopt a bill and keep structure for exchange of carrier traffic, especially traffic involving origination or termination with a LEC; and 3) the FCC has authority to adopt a transition plan that provides immediate reform and/or clarification in areas such as transiting, virtual NXX compensation, CMRS traffic, and ISP reciprocal compensation. These issues are examined herein.

A. Intercarrier Compensation Is A Federal Issue

The FCC has been granted plenary jurisdiction over intercarrier compensation matters, at least where an ILEC is involved in one end of a call.<sup>51</sup> Historically, intercarrier contracts have been subject to the FCC's jurisdiction,<sup>52</sup> and the plain language of Section 251(b)(5) of the Act ultimately rests authority for intercarrier compensation with the FCC.<sup>53</sup> State (as well as federal) tariffs for intrastate access services remain in place because of the savings language of Section 251(g) of the Act,<sup>54</sup> which contemplates ultimate supervision by the FCC. It must be remembered that the Telecommunications Act itself contemplates federal authority to enact rules and policies in the area of interconnection except in those areas where state jurisdiction is expressly recognized.<sup>55</sup>

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<sup>51</sup> Section 251(b)(5) speaks in terms of termination of traffic by LECs. Federal authority to regulate termination by non-LECs in particularly CMRS provider is established in Section 332 of the Act.

<sup>52</sup> 47 U.S.C. § 211(a).

<sup>53</sup> Section 251(b)(5) applies to all "telecommunications" terminated by a LEC. The D.C. Circuit Court of Appeals has agreed that the scope of this language is broad, although holding that the ultimate issue has not yet been determined. *See WorldCom, Inc. v. FCC*, 288 F.3d 429, 433 (D.C. Cir. 2002).

<sup>54</sup> 47 U.S.C. § 251(g).

<sup>55</sup> *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 381-86 (1999).

We recognize that, in the past, the Commission has limited the applicability of Section 251(b)(5) to “local” traffic, and distinguished local traffic from interexchange traffic.<sup>56</sup> This is a valid distinction when determining how to compensate carriers for carrying the traffic of other carriers. Indeed, it may properly be used in analyzing the ISP reciprocal compensation issue discussed below. However, the distinction cannot be read as an ultimate limitation on the jurisdiction of the Commission over interconnection between carriers and the compensation to which they are or are not entitled when they exchange traffic. This jurisdiction is federal, and the FCC’s authority to deal with the various types of interconnection within that jurisdiction in different manners (especially on a temporary basis) must be analyzed in the context of this broad statutory grant.

Because the Act assigns jurisdiction over intercarrier compensation matters (at least those involving a LEC or a wireless carrier at least one end) directly to the FCC, there is no need for the FCC to take preemptive action. Preemption is not necessary where federal jurisdiction has already been established.<sup>57</sup> However, if necessary, the FCC’s preemptive authority can also be utilized to ensure that a valid and viable intercarrier structure is established. As noted above, an interstate-only intercarrier compensation regime is simply impossible, and would tend to aggravate rather than ameliorate the arbitrage problems rampant in the current system. The FCC’s authority to preempt state rules that impede the enforcement of valid FCC rules over

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<sup>56</sup> See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd 15499, 16012-13 ¶¶ 1033-34 (1996) (“Local Competition Order”). This distinction has, in the area of reciprocal compensation, been recognized as meaningful by the Court of Appeals for the District of Columbia Circuit. See *WorldCom, Inc. v. FCC*, 288 F.3d at 430-31.

<sup>57</sup> See *Boomer v. AT&T Corporation*, 309 F.3d 404, 423-24 (7<sup>th</sup> Cir. 2002).

traffic, services and facilities within its jurisdiction is well established,<sup>58</sup> even if the state authority is otherwise valid.<sup>59</sup> In this case, the FCC's preemptive authority to adopt rules that preempt intrastate access charges because they are inconsistent with the vital nature of the bill and keep structure that the FCC is adopting would seem to be incontestable.

B. The FCC Has The Duty And The Authority To Ensure That Carriers Whose Revenues Are Reduced Through Adoption Of The Plan Have The Opportunity To Recover Those Revenues From Other Regulated Sources

When the Commission adopts a new ratemaking structure that operates to deprive regulated carriers of the opportunity to earn revenues lawfully due under the earlier rules, the Commission has a statutory and constitutional obligation to allow those carriers the opportunity to recoup those lost revenues from other sources.<sup>60</sup> This does not mean that the FCC stands as a guarantor of the carriers' profitability, or that revenue losses caused by competitive inroads by others are somehow the responsibility of the Commission. It likewise does not mean that the FCC must ensure that a carrier whose revenues come from one source (or from all of its existing sources) has the absolute right to recover those revenues elsewhere (as opposed to having a reasonable opportunity). The law simply provides that a regulator whose actions in adopting a

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<sup>58</sup> See *Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 375-76, n.4 (1986); *In the Matter of Vonage Holdings Corporation*, WC Docket No. 03-211, Memorandum Opinion and Order, 19 FCC Rcd. 22404, 22414-15 ¶ 19 (2004).

<sup>59</sup> See *Public Utility Commission of Texas v. FCC*, 886 F.2d 1325, 1332-33 (D.C. Cir. 1989).

<sup>60</sup> See *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 305, 313, 315 (1989), for a discussion of the constitutional implications of a regulator modifying a ratemaking methodology in a manner that fails to take account of cost and revenue expectations reasonably analyzed under the prior methodology. See also *Brooks-Scanlon Co. v. Railroad Commission of La.*, 251 U.S. 396 (1920).

new regulatory structure may not take or maintain actions that affirmatively impede the ability of affected carriers to recover those revenues from other sources.<sup>61</sup>

In the context of this proceeding, application of this principle is simple. The access revenues that ILECs were reasonably relying on (and which formed part of the FCC's overall ILEC regulatory scheme) will obviously disappear in a bill and keep environment. The FCC has the duty and the authority to modify the regulatory structure elsewhere to enable ILECs to have the opportunity to recover those revenues. The word "opportunity" is critical, because the market may be such that their opportunity does not materialize in its entirety. This opportunity can best be afforded through the permissible subscriber line charge increases described above. If competitive inroads into access lines reduces the revenue available from subscriber line charges in the future, or if carriers seek to prevent access line loss by charging less than the maximum authorized SLC increase, the FCC's duty has been fulfilled.<sup>62</sup>

This, of course, leaves open the jurisdictional issue of how to deal with state regulators who might decline to permit LECs to increase rates to levels that give them the necessary opportunity to recover lost intrastate access revenues. Unlike the matter of intercarrier compensation where the FCC's direct authority is sure, the FCC's jurisdiction over local end-user rates is questionable, at best. Because the lawfulness of the bill and keep structure depends *a priori* on the FCC's having taken the necessary action to ensure revenue neutrality prior to

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<sup>61</sup> See *Duquesne Light Co.*, 488 U.S. at 312, 315. See also cases prohibiting "confiscatory ratemaking," whereby a carrier is effectively precluded by regulation from operating profitably. See, e.g., *Federal Power Com'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co. v. Public Service Com'n*, 262 U.S. 679, 692 (1923).

<sup>62</sup> It should be noted that this analysis applies only to regulated services, and only where the regulator is both implementing a new regulatory scheme and potentially depriving, through regulation, the affected carriers of the opportunity to recoup lost revenues. It has no applicability to deregulated carriers and services, which are examined under a totally different analytical approach.

implementing a bill and keep plan, it is not feasible for the FCC to adopt bill and keep and then wait to see whether or not states take the necessary steps to make the plan lawful. While an argument can be made that the FCC has the authority to direct that state regulators rationalize local rates as part of the FCC's overall obligation to enforce and implement the federal universal service statutory mandate,<sup>63</sup> such a dramatic step seems unnecessary and unwise at this time.

In order to deal with this issue, Qwest recommends that the Commission convene a federal-state joint board under Section 410(a) of the Act and assign it the task of developing a plan to bring the revenues (and costs and investment) associated with intrastate access charges into the federal jurisdiction. This would ensure that the FCC could combine responsibility with authority and deal holistically with the intercarrier compensation problem. Because the FCC has the jurisdiction to treat all aspects of intercarrier compensation at the federal level, it also has the authority to take such further steps as are necessary to make its intercarrier compensation actions lawful. In this case the vehicle of a federal-state joint board seems to be the most appropriate vehicle for accomplishing this result. If the revenues at issue are assigned to the interstate jurisdiction through separations, the difficult jurisdictional issues disappear.<sup>64</sup> The existing universal service joint board has the authority to address separations changes, the CC Docket No. 80-286 separation joint board is still in existence, and the FCC has announced that it will

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<sup>63</sup> For example, the FCC's federal authority to implement the Congressional universal service mandate is extensive. See *Qwest Corporation v. FCC*, 258 F.3d 1191, 1200 (10<sup>th</sup> Cir. 2001); *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 405-07, 412, 413 (5<sup>th</sup> Cir. 1999), *cert. granted sub nom. GTE Service Corp. v. FCC*, 530 U.S. 1213 (June 5, 2000), *cert. dismissed*, 531 U.S. 975 (Nov. 2, 2000). Reformation of intercarrier compensation is vital for the preservation of universal service, and Section 254 of the Act can provide a solid basis for federal actions in areas formerly reserved to state authority.

<sup>64</sup> See *National Association of Regulatory Utility Commissioners v. FCC*, 737 F.2d 1095, 1113-14 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985).

conduct a further separations review this summer.<sup>65</sup> Thus the process could be conducted relatively quickly. The advantage of this approach is that it presents dramatically greater administrative simplicity than efforts to achieve rate rationalization through state regulators, and could simply be implemented through an addition to the federal SLC that is part of the bill and keep plan.

C. The FCC Has The Statutory Authority To Adopt A Bill And Keep Regulatory Structure For Intercarrier Compensation

It is appropriate to briefly address the legal authority of the FCC to adopt a bill and keep structure for intercarrier compensation, as several commentators in the past have argued that the Act somehow requires, as a matter of statutory imperative, that the Commission enact a regulatory structure that is based on the CPNP approach. This argument is predicated on the language in Section 252(d)(2)(A) of the Act to the effect that, for purposes of determining compliance by an ILEC with the reciprocal compensation rules applicable to all LECs, the FCC's rules must "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[.] . . ."<sup>66</sup> We submit that this language by itself gives the FCC ample opportunity to establish a bill and keep intercarrier compensation regime (subject, of course, to the caveat noted above and reinforced here that carriers must be given the opportunity to recover lost access revenues, interstate and intrastate). The statutory language simply requires that an intercarrier compensation structure permit carriers to recover their costs. A compensation scheme, that, for example, eliminated access charges but did not at the same time permit carriers to recover those lost revenues from their own customers, would

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<sup>65</sup> See note 32, *supra*.

<sup>66</sup> 47 U.S.C. § 252(d)(2)(A).

violate this Section of the Act. Shifting the source of such compensation from other carriers to customers is totally consistent with the Act.<sup>67</sup>

Moreover, the FCC was expressly empowered to adopt a bill and keep regulatory structure when it was given the power to elect “arrangements that waive mutual recovery (such as bill-and-keep arrangements)[]” or to adopt a structure such as the current one (based on mutual assessment of terminating charges).<sup>68</sup> What Section 252(d)(2) does preclude is the imposition of a non-cost based scheme or any other scheme that precludes mutual recovery of costs by carriers (a situation that actually has come to pass in many instances as the current structure is manipulated by carriers to their economic advantage).

Qwest does not believe that Section 201 of the Act provides the optimal basis for adoption of a bill and keep intercarrier structure (although it would be lawful for the Commission to rely on Section 201 if it so desired). Intercarrier compensation, along with all other intercarrier interconnection issues (except to the extent states have been delegated authority by the 1996 Act itself) is placed squarely within the federal jurisdiction by Sections 251 and 252 of the Act. The Commission’s authority under Section 251(b) and (c) (which is involved here) is greater, vis-à-vis state regulators, than is its authority under Section 201. The only reason to invoke Section 201 in this area would be if Section 251 did not give the Commission sufficient authority to act in a manner most consistent with the public interest. Since this is not the case, Qwest sees no reason to further examine Section 201. Section 251 provides the Commission with all the statutory authority that is necessary.

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<sup>67</sup> In fact, as the ISP “reciprocal compensation” issue demonstrates, it is often not feasible to determine which network is the “originating” network for many calls. In the case of an ISP call, while the call originator is generally the party initiating a call to an ISP, the economic originator (in the sense of being the “cost causer”) is the ISP. Under this analysis, the called party’s network could be held responsible for the calling party’s network costs.

<sup>68</sup> 47 U.S.C. § 252(d)(2)(B)(i).

The point is, the FCC has both the obligation to enact and the power to adopt a comprehensive intercarrier compensation plan that meets the goals of the Act and the requirements of law. Such a regime includes interstate and intrastate intercarrier compensation and a rational structure for recovery of access revenues lost because of the implementation of the new access structure. Bill and keep is not only a permissible approach to intercarrier compensation, it is expressly recognized in Section 252 of the Act as a permissible regulatory approach.

D. The Commission Should Forbear From Enforcement Of The Bulk Of The Rate Integration And Rate Averaging Rules, Leaving Them In Place Only For The Purpose For Which They Were Actually Intended

In the Further Notice, the FCC asks whether some or all of the existing rate integration and rate averaging rules should be modified or eliminated.<sup>69</sup> Qwest agrees that the existing rate averaging and rate integration rules go far beyond the intention of the statute enacting rate averaging and rate integration, and are currently anti-competitive, uneconomical and counterproductive. The FCC should, pursuant to its forbearance authority in Section 10 of the Act, eliminate all rate integration and rate averaging rules except as applied to Alaska and overseas U.S. states, territories and possessions.

The rate integration rules, which prohibit an IXC from discriminating against its subscribers in different states,<sup>70</sup> were derived from the FCC's old rate integration rules that had prohibited AT&T from including Hawaii and Alaska in its international, rather than its domestic, rate schedule.<sup>71</sup> When codified, the new law, even though clearly intended to simply continue

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<sup>69</sup> Further Notice ¶ 86.

<sup>70</sup> 47 U.S.C. § 254 (g); 47 C.F.R. § 64.1801(b).

<sup>71</sup> See *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Report and Order, 11 FCC Rcd 9564, 9568-69 ¶ 9 (1996).

the pre-existing policies,<sup>72</sup> was written so that it applied to all states, and the Commission (again based on statutory intent) extended it to all overseas U.S. possessions.<sup>73</sup> The Commission has extended the rule to include special access (including application to both terminating and originating locations).<sup>74</sup> Thus, under the current rule, an IXC offering a special promotional bonus offer in Mississippi is at legal risk unless it offers the same bonus opportunity in New York (if it also offers service in New York). As best as can be determined, the rate integration rules do not apply to contract tariffs or contract services, except that a carrier cannot offer to enter into contracts with customers in one state without similarly offering to enter into contracts with customers in all other states in which it does business. The Commission generally precludes long distance carriers from charging customers who utilize the services of a LEC with high access charges more than they charge customers using a LEC with low access charges, although it is not entirely clear whether this particular prohibition is derived from the rate integration or the rate averaging sections of the Act.<sup>75</sup> In the case of special access loops which can be charged by LECs directly to end-user customers, rate integration would not appear to require that IXCs assume control over special access prices and IXCs may charge prices which include the special access loop price on an individual basis. Given the fact that the economic milieu in which the rate integration rules operate is the highly competitive long distance market, it is clear that the rate integration rules cannot be sustained. They serve no rational purpose, and actually depress both the ability of carriers to offer attractive services in an economical manner and the incentive of carriers to serve some states altogether. There is absolutely no indication

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<sup>72</sup> *Id.*

<sup>73</sup> *Id.* at 9566-67 ¶ 5.

<sup>74</sup> *See In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, Memorandum Opinion and Order, 19 FCC Rcd 6746 6748-49 ¶ 7 (2004).

<sup>75</sup> Further Notice ¶ 85.

that there ever was a problem requiring rate integration rules within the 48 continental states.

The requirements for forbearance elucidated in Section 10(a) of the Act are clearly met by virtue of the intense competitive market forces in the long distance market place.<sup>76</sup> There is simply no conceivable need for continuance of these rules.

The one area where immediate action on rate integration would not be wise is those areas to which rate integration was initially addressed in the first place: Hawaii, Alaska, and U.S. off-shore territories and possessions. While it is not completely clear that these rules in their current form are still necessary in these areas, Qwest agrees that it would be premature to modify them without a full record. Thus, Qwest recommends that the FCC act immediately to forbear from all enforcement of the rate integration rules for the continental forty-eight states.

The rate averaging rules are not state specific, but instead require that providers of interexchange service (interstate or intrastate) average their rates in such a fashion that rates charged to subscribers in high cost areas are not greater than the rates charged to other subscribers. Because these rules do not apply to special access services, and because there are other limitations on their scope that ameliorate some of the harsher anti-competitive effects of the rate integration rules, these rules are not as disruptive as the rate integration rules. However, one aspect of the rate averaging rules should be eliminated immediately. The Commission should make clear that IXCs can pass through exchange access charges to subscribers in all instances. The current rules, which allow a LEC to charge high exchange access rates to carriers without having their customers feel the effects of those charges, make no sense.<sup>77</sup> The

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<sup>76</sup> 47 U.S.C. § 160(b).

<sup>77</sup> CLEC interstate access charges are limited by FCC rule. *In the Matter of Access Charge Reform*, CC Docket No. 96-262, 16 FCC Rcd 9923, 9941-46 ¶¶ 45-53 (2001). Independent ILEC interstate access charges are often much higher, and intrastate access charges of all LECs can be gigantic.

Commission should also commence a rulemaking to determine whether the rate averaging rules are productive in other respects, but, in the absence of such a proceeding, there is no reason to further modify the rate averaging rule.

IV. QWEST'S PLAN WOULD RESOLVE NUMEROUS SIGNIFICANT LEGAL AND POLICY ISSUES IMPLICATED BY OTHER INTERCARRIER COMPENSATION REFORM APPROACHES

A. The Qwest Plan Allocates Responsibility For Transiting In An Efficient Manner That Is Consistent With Carrier Obligations Set Forth In The Act

The Qwest plan for transiting, discussed below, is the approach required by the Act and is most consistent with the important policy goals set forth in the Further Notice. The Commission should clarify that this is the correct treatment of transiting traffic regardless of what it does in terms of a unified intercarrier compensation reform.

1. Qwest's Plan Allocates Financial Responsibility in a Manner that Allows for a Market-Oriented Approach to Carrier Interconnection on Both Sides of A Carrier's Network Edge

As described more fully above in Section II.A.1, Qwest's plan would identify the edge of a carrier's network as the relevant point for purposes of dividing financial responsibility between interconnecting carriers. In short, the originating carrier is responsible for paying for the costs of facilities transporting traffic from its network to another carrier's edge and will recover those costs from its own subscribers. The terminating carrier will recover from its subscribers the costs of transporting traffic from the edge to its subscriber's premises (*e.g.*, access tandem switching, transport to the local switch, local switching and the local loop). With few exceptions,<sup>78</sup> the details of transport arrangements for traffic will be accomplished by carrier negotiation.

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<sup>78</sup> Under Qwest's plan, industry-accepted engineering standards will be used to size transport, direct and overflow trunk groups, with the provisioning of trunks at a higher service level a cost

By establishing a default financial POI (the edge), the Qwest's plan is the method most likely to lead to the creation of efficient and desirable types of interconnection. Indeed, the most efficient and desirable type of interconnection is the deployment of two-way trunks between the respective networks wherever justified by traffic volumes. Under Qwest's plan, no additional regulation beyond the definition of default financial dividing lines or edges should be needed to accomplish this result. Each carrier has a foundational obligation to interconnect as set forth in Sections 201(a) and 251(a)(1) which would be implemented by the rules adopted in this proceeding. Because the edge for traffic going to carrier A from carrier B may not be the same as the edge for traffic going from carrier B to carrier A, the default result for interconnection between carriers exchanging traffic could be the required construction of separate one-way trunks. Given the increasingly competitive nature of the industry, it would be counter to the economic interests of any carrier to insist upon artificial network inefficiencies in its own network. Carriers would therefore have a strong incentive to share the costs of a single two-way trunk whenever some traffic flows in each direction between the two carriers.<sup>79</sup>

The Qwest plan employs this same market-oriented approach to transiting. Under Qwest's plan, in the transiting context, the intermediate carrier or transit service provider must be

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borne by the carrier requesting the additional trunks. Where traffic volumes justify direct trunk groups to a particular local switch, the interconnecting carrier must segregate such traffic into its own trunk group for interconnection at the local carrier's access tandem location and routing directly to the local switch. Overflow trunks between local switches and their access tandem cannot be segregated between an ILEC's affiliate IXC and its competitors. Subscriber pricing by ILECs for toll access service may not be presubscribed IXC specific.

<sup>79</sup> In any event, the designation of the edge as the financial POI should incent carriers to negotiate adequate intercarrier interconnection in most circumstances without further regulation. A more interventionist approach could be formulated with detailed, nationally uniform regulations comprehensively establishing how carriers must interconnect in specific circumstances, when two-way trunks should be required, how routing should be determined, etc. Indeed, the ICF has crafted just such a more interventionist regulatory scheme. If such a scheme is to be employed, the ICF proposal is, for the most part, acceptable to Qwest.

compensated by the originating carrier and an agreement for payment for transiting services - with pricing determined by the market - must be reached before the service is provided. This approach is, in fact, not only the most sound approach to transiting, but, as described more fully below, is the approach required by the Act and is most consistent with the important policy goals set forth in the Further Notice. This approach is also most consistent with the central premise underlying bill and keep at the edge -- that premise is that, when two carriers exchange traffic, each carrier bears total responsibility for the costs incurred in processing any given call on its side of the network edge and recovers those costs from its own end user involved in the call. In that way, each carrier is induced to employ efficient technology on its side of the network edge and all the myriad advantages of the bill and keep at the edge plan described above come into play. The carrier choosing to employ the services of a transit service provider to reach the edge of another carrier network must pay the negotiated price for that service. In the context of three-carrier calls where the intermediate carrier has no contractual relationship with the calling end user (*i.e.*, a call utilizing transiting),<sup>80</sup> the sensible bill and keep approach is to treat this effectively as a *two-carrier* call and thereby require the originating carrier to ensure transport -- through one means or another -- to some point of interconnection with the terminating carrier.

Under Qwest's plan, in a case where the originating carrier utilizes a transit service provider for transport from its network to the edge of the terminating carrier, the transit service

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<sup>80</sup> This type of three-carrier call is to be distinguished from the other type of three-carrier calls, those in which the end user has an independent relationship with the intermediate carrier (such as an IXC). Where the end user does have a relationship with the intermediate carrier (*e.g.*, a customer/IXC relationship), the sole obligation of the originating carrier under bill and keep at the edge is to transport the call to a point of interconnection with that intermediate carrier, which must terminate the call to a third carrier and recover its own transport costs from the end user. This scenario is thus wholly distinguishable from the type of three-carrier scenario discussed in the text -- transiting -- in which the end user lacks a relationship with the intermediate carrier. A transiting LEC typically provides transporting functions for the originating carrier without an opportunity to recover the costs of those functions from any relevant end user.

provider will charge due compensation to the carrier originating the traffic for all costs of transit to either an IXC's or terminating carrier's edge and the originating carrier will recover such costs from its own subscribers.<sup>81</sup> As is the case with other situations where the edge of two carriers is not adjacent, the originating and terminating carrier will have an incentive to cooperate and jointly retain a transiting carrier. It should be kept in mind that, in the transiting context, the originating carrier always has the ability to directly connect to the terminating carrier instead of using a transit carrier. However, if the originating carrier chooses to use the services of a transit service provider, it must of course pay for those services.<sup>82</sup>

2. Qwest's Transiting Proposal Is The Regulatory Treatment Required By The Act And Is Consistent With Both Prior Commission Legal Precedent And The Important Policy Goals Set Forth In The Further Notice
  - a. Transiting is an Interconnection Matter Subject to Sections 201 and 202 of the Act

As the Commission notes in the Further Notice,<sup>83</sup> certain CLECs and CMRS carriers have argued, historically, that Sections 251(a)(1)(requiring telecommunications carriers to “interconnect directly or indirectly with the facilities and equipment of other telecommunications carriers”) and 251(c)(2)(B)(requiring ILECs to provide interconnection “at any technically feasible point within the carrier’s network”) of the Act create a carrier obligation to provide transiting. These arguments ring hollow. Transiting is an interconnection service subject to Sections 201 and 202 of the Act, and is not subject to the rules related to common

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<sup>81</sup> These same principles should govern the regulatory treatment of signaling, with signaling providers able to charge the carrier originating the traffic market rates for the signaling provided in order to accomplish transport or transiting to either an IXC's or a terminating carrier's edge and the originating carrier will recover such costs from its own subscribers.

<sup>82</sup> In a situation where today two LECs provide jointly provided switched access, the new rules would treat one of the LECs as a transiting provider.

<sup>83</sup> See Further Notice ¶ 127, n.363.

carrier services offered to the public and interconnection under these circumstances can only be ordered after notice and a hearing as required under Section 201(a) of the Act.<sup>84</sup> While there might be instances where a carrier could compel transiting interconnection under the Act, those circumstances will be very limited. Certainly the record does not support a general rule on transiting requiring that it be provided on a universal basis at regulated rates.

No other provision of the Act imposes an obligation upon carriers to provide transiting services between two other carriers. Section 251(a), on its face deals only with physical connections and imposes no such duty on carriers.<sup>85</sup> Similarly, Section 251(c)(2) plainly only speaks to the ILEC duty to provide interconnection with *the ILEC's* network. Neither of these provisions can reasonably be read to obligate an ILEC or any other carrier to provide transiting between the networks of two other carriers. Indeed, as the Commission acknowledges in the Further Notice, “[t]he Commission’s rules define the term ‘interconnection’ to mean ‘the linking of two networks for the mutual exchange of traffic’ and not ‘the transport and termination of traffic.’”<sup>86</sup> As the Commission also acknowledges in the Further Notice, interpreting Section 251(a) to require transiting might be read to suggest that, if two carriers choose to meet their obligations under Section 251(a) by interconnecting directly, each might arguably be required to pass traffic to other carriers through that direct connection -- an obviously absurd result.

At bottom, a carrier obligation to provide transiting can only be founded upon the requirements of Section 201 and 202 of the Act that common carriers provide interconnection with other carriers under the circumstances described in Section 201. Contracts or tariffs for

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<sup>84</sup> See *AT&T Corporation v. FCC*, 292 F.3d 808, 812-13 (D.C. Cir. 2002).

<sup>85</sup> See *AT&T v. FCC*, 317 F.3d 227, 234-35 (D.C. Cir. 2003).

<sup>86</sup> Further Notice ¶ 128 (citing 47 C.F.R. § 51.5).

such interconnection must avoid “any unjust or unreasonable discrimination in charges...”<sup>87</sup> In other words, the Commission should allow the market to establish transiting rates and those rates should be deemed reasonable absent a showing to the contrary on a case-by-case basis.<sup>88</sup> Intercarrier contracts subject to filing under Section 211(a) are the optimal means for establishing transiting relationships.

b. The Act does not Require or Permit Non-Market Based Transiting Compensation Rates

Nor is there any basis for the argument that, if transiting is required, TELRIC or some other non-market-based pricing methodology should be used to establish regulated rates for transiting. To begin with, there is no basis whatsoever under the Act for an argument that TELRIC pricing should be applied to transiting services. Even if Section 201(a) or Section 251(a) could be read to impose an obligation on carriers to provide transiting services, the Act would not call for TELRIC pricing to be mandated for such services. Section 252(d)(1), out of which TELRIC arises, is expressly limited to Section 251(c)(2) interconnection and Section 251(c)(3) unbundled network elements and would not apply to a transit service obligation

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<sup>87</sup> 47 U.S.C. §§ 201, 202.

<sup>88</sup> As in the case of carrier interconnection and transport on the terminating carrier side of the edge, described above, a more interventionist regulatory scheme can be crafted for transiting pricing. Indeed, as in that context, the ICF has proposed such a rate scheme for transiting. However, in the transiting context, Qwest encourages the Commission to begin with a market-oriented approach based merely on the designation of the edge as the default financial POI and the express imposition on the originating carrier of the obligation to compensate the transit service provider where an originating carrier utilizes a transit service provider to transport traffic from its network to the edge of the terminating carrier -- before employing a detailed regulatory scheme. Such an approach will maximize the incentives for carriers to negotiate efficient arrangements and, where appropriate, construct new facilities. The Commission can always, at a later date, implement a more targeted, interventionist approach -- *i.e.*, only where necessary and only after further study. If, in the end, such a scheme is to be employed, the ICF proposal is, for the most part, acceptable to Qwest.

outside of those sections. Moreover, the law is clear that TELRIC is non-confiscatory in only very limited circumstances.<sup>89</sup>

No matter how this docket is ultimately resolved, the Commission should not apply reciprocal compensation to transiting services (*i.e.*, permit a terminating carrier to bill a transiting carrier). The plain language of Section 252(d)(2)(A) (requiring that reciprocal compensation pursuant to Section 251(b)(5) be priced based on “the 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”) makes clear that reciprocal compensation does not apply to transiting costs.<sup>90</sup> In the transiting context, where the transit provider is an intermediate carrier lacking a relationship with an end user involved in the traffic at issue, there simply is no issue of reciprocal compensation.

Finally, certain carriers argue that, if reciprocal compensation does not apply to transiting traffic, access charges must apply.<sup>91</sup> Even if access charges remain in any new compensation structure, there is no basis for such an argument in the language of the Act and such a novel approach to transiting would be difficult to square with either Section 251(b)(5) or 252(d)(2). Moreover, to require transit service providers to pay access charges would be an absurdly unfair result. IXCs pay access charges to LECs when they use LEC networks to either originate or terminate calls placed by the IXC’s end-user customer. IXCs then recover the costs for those access charges in the rates they charge to their end-user customers. Transit service providers accomplish the transport of traffic between carriers. They are not providing a service to an end

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<sup>89</sup> See *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 528 n.39 (2002); see also Local Competition Order, 11 FCC Rcd at 15872 ¶ 739.

<sup>90</sup> As is discussed below, the FCC has actually decided this issue.

<sup>91</sup> See Further Notice ¶ 132.

user and, in fact, have no end-user customer involved in the traffic they transit from whom they can recover the costs of access charges that they may be charged. They are entitled to fair, market-determined compensation from the originating carrier for the transiting service that they provide.

c. Immediate Clarification of Transiting Obligations in a Manner Consistent with Commission Rules and the Policy Goals of the Further Notice is Vital

Again, Qwest's proposal for the treatment of transiting traffic is to require originating carriers to pay the transit service provider market-based compensation for transiting services. Regardless of what intercarrier compensation reform is ultimately adopted, the Commission should immediately clarify that this approach is the approach required by both the relevant prior rulings of the Commission and the important policy goals set forth in the Further Notice.

The Commission's prior rulings support Qwest's proposal. The FCC addressed transiting in the *Texcom Order*. In that case, intraMTA calls, that originated on the networks of third-party carriers, transited the network of GTE North ("GTE") and terminated on the network of Answer Indiana, a CMRS provider. Answer Indiana filed a formal complaint with the Commission challenging GTE's attempt to charge it for the delivery of that traffic. In denying Answer Indiana's complaint, the Commission stated:

Currently, our rules in this area follow the cost causation principle of allocating the cost of delivering traffic to the carriers responsible for the traffic, and ultimately their customers. Thus, through reciprocal compensation payments, the cost of delivering LEC-originated traffic is borne by the person responsible for those calls, the LEC's customers. As we stated in the *Local Competition Order*, "[t]he local caller pays charges to the originating carrier, and the originating carrier must compensate the terminating carrier for completing the call"... In the case of third-party originated traffic, however, the only relationship between the [transiting carrier's] customers and the call is the fact that the call traverses the [transiting carrier's] network on its way to the terminating carrier. Where the LEC's customers do not generate the traffic at issue, those customers should not bear the cost of delivering that traffic from a CLEC's network to that of a CMRS

carrier like Answer Indiana. Thus, the originating third-party carrier's customers pay for the cost of delivering their calls to the LEC, while the terminating CMRS carrier's customers pay for the cost of transporting that traffic from the LEC's network to their network.<sup>92</sup>

On reconsideration, the FCC, in *Texcom*, also noted that "carriers are free to negotiate different arrangements for the costs associated with indirect interconnection."<sup>93</sup>

The FCC's Wireline Competition Bureau (the "Bureau") addressed a similar issue in the *FCC Virginia Arbitration Order*, issued during an FCC arbitration of interconnection agreements between AT&T and Verizon in lieu of the Virginia commission.<sup>94</sup> In that case, AT&T contended that Verizon should treat transiting traffic from third-party carriers to AT&T as Verizon's own traffic. However, the Commission ruled that "when a third-party LEC places a call that terminates to [an AT&T customer], AT&T must bill the third-party LEC directly."<sup>95</sup> While these decisions dealt directly with the liability of the third-party carrier (transit service provider) for access charges billed by the terminating carrier in a transiting context, both decisions make clear that the originating carrier is responsible for transiting costs and that carriers should be free to negotiate market-based arrangements for transiting. In the decision, the Bureau acknowledged, with respect to whether or not carriers had an obligation to provide transiting, that there is no "clear Commission precedent or rules declaring such a duty."<sup>96</sup> Finally, the Bureau also

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<sup>92</sup> *Texcom, Inc. v. Bell Atlantic Corp.*, File No. EB-00-MD-14, Memorandum Opinion and Order, 16 FCC Rcd 21493, 21495 ¶ 6 (citations omitted).

<sup>93</sup> *Texcom, Inc. v. Bell Atlantic Corp.*, Order on Reconsideration, 17 FCC Rcd 6275 6277 n.12. (citation omitted).

<sup>94</sup> *In the Matter of Petition of WorldCom, Inc., et al., Regarding Interconnection Disputes with Verizon Virginia*, CC Docket No. 00-218, Memorandum Opinion and Order, 17 FCC Rcd 27039 (2002)

<sup>95</sup> *Id.* at 27305 ¶ 544 (footnote omitted).

<sup>96</sup> *Id.* at 27101 ¶ 117; see also *In the Matter of Petition of Cavalier Telephone LLC Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia, Inc.*

concluded in that case that “any duty Verizon may have under section 251(a)(1) of the Act to provide transit service would not require that service to be priced at TELRIC” and the Bureau expressly approved Verizon’s charging of non-TELRIC rates for transiting.<sup>97</sup>

Qwest’s transiting proposal also best furthers the policy goals set forth in the Further Notice. In the Further Notice, the Commission recognizes “the importance of identifying and implementing appropriate interconnection incentives for the future.”<sup>98</sup> The Commission expressly seeks comment “on the possibility that mandated transiting or regulated rates for such service might discourage the development of this market.”<sup>99</sup> Moreover, the Commission acknowledges that “if a transit service obligation is imposed, indirectly interconnected carriers may lack the incentive to establish direct connections even if traffic levels warrant it.”<sup>100</sup> These concerns, of course, dovetail with the overall goals of intercarrier compensation reform expressed elsewhere in the Further Notice. The central goals to reform should be to promote

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*and for Arbitration*, WC Docket No. 02-359, 18 FCC Rcd 25887, 25908-09 ¶ 38 (“*Cavalier Order*”), (Wireline Bureau found there was no FCC precedent or rule holding that Verizon has a duty to provide transiting under the Act and expressly declined to create such a ruling under its delegated authority); *In the Matter of Application by Qwest Communications International, Inc. for Authorization To Provide In-Region, InterLATA Services in New Mexico, Oregon and South Dakota*, WC Docket No. 03-11, 18 FCC Rcd 7325, 7376 n. 305 (2003) (*New Mexico, Oregon and South Dakota 271 Order*) (“Although we do not address the merits of AT&T’s assertion that Commission rules require Qwest to provide transit service under section 251(c)(2), we note that the Commission has not had occasion to determine whether incumbent LECs have such a duty, and we find no clear Commission precedent or rules declaring such a duty.”).

<sup>97</sup> FCC Virginia Arbitration Order, 17 FCC Rcd at 27100 ¶ 115, 27101 ¶ 117 (approving non-TELRIC rates and stating “we decline, on delegated authority, to determine for the first time that Verizon has a section 251(c)(2) duty to provide transit service at TELRIC rates... any duty Verizon may have under section 251(a)(1) of the Act to provide transit service would not require that service to be priced at TELRIC.”) (footnote omitted).

<sup>98</sup> Further Notice ¶ 129.

<sup>99</sup> *Id.*

<sup>100</sup> *Id.* ¶ 131 (citation omitted).

economic efficiency and to promote facilities-based competition in the marketplace.<sup>101</sup> As described more fully above, Qwest's plan for transiting best serves those goals.<sup>102</sup> While transiting services generally are provided by large ILECs today, Qwest believes there is a niche market for other carriers to provide such transport particularly under Qwest's bill and keep at the edge proposal. Traffic aggregators such as Syringa Networks in Idaho and INS in Iowa and LECs such as Onvoy, Verizon and Sprint already provide transit services within Qwest's region. In addition, there are many more carriers that operate tandems which provide access services to IXCs that would develop into a transit relationship upon implementation of Qwest's bill and keep plan. Qwest has also, in some instances, already lost transiting customers to other tandem service providers such as Syringa Networks and Onvoy.

d. Transiting is an Interconnection Function Subject to the FCC's Jurisdiction

Any rule that the Commission established for transiting should apply both to interstate transiting and intrastate transiting. As discussed above, the provision of transiting is an

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<sup>101</sup> *Id.* ¶ 31.

<sup>102</sup> With respect to the Commission's request for comment as to whether or not the billing information, in the transiting context, is adequate to determine the appropriate intercarrier compensation due, *see* Further Notice ¶ 133, Qwest believes that the billing information currently available in the transiting context is adequate. Qwest specifically opposes any attempt to impose obligations on the transiting carrier to provide specific billing information in the transiting context. Again, the information currently available is adequate and, as the Bureau expressly found in the FCC Virginia Arbitration Order, 17 FCC Rcd at 27102 ¶ 119, Regional Bell Operating Companies ("RBOCs") are not required to serve as billing intermediaries between carriers who terminate traffic to another carrier by using RBOC transit services. The originating carrier should be responsible for providing billing records to both the transit provider and the terminating carrier. Qwest does offer transit records, when available, for a fee to the terminating carrier so they can bill the originating carrier for the call. Upon adoption of Qwest's plan, this matter will be moot except in those instances where a termination charge is permitted. Also, under bill and keep there is no opportunity for the terminating carrier to bill the originating carrier for the transit traffic so there is no need for the transit provider to send a transit record to the terminating carrier.

interconnection function subject to FCC jurisdiction. Moreover, this is appropriate given that it is practically impossible to distinguish intrastate and interstate transiting traffic.

B. The Commission Must Address The Problem Of VNXX, Regardless Of What Plan Is Adopted For Intercarrier Compensation

Regardless of what the Commission does with respect to intercarrier compensation, it must clarify the correct regulatory treatment of VNXX traffic. Should the Commission adopt, as Qwest advocates, a bill and keep plan, the issue of VNXX effectively disappears as an intercarrier compensation issue -- at least, once bill and keep becomes fully effective. However, even if bill and keep is adopted, the Commission still must clarify immediately that VNXX traffic is properly treated as interexchange traffic in order that it may be treated properly during any transition plan.

1. The Commission should reiterate that VNXX traffic is interexchange traffic, not local traffic.

a. VNXX Defined

VNXX describes a situation where a call originating in one local calling area, using a dialed local number, is routed to another LEC which terminates to an end user physically located in another local calling area. In other words, it is a toll call (often considered to be a foreign exchange or FX call). However, a number of CLECs claim that a call is local if the two numbers are local, regardless of where the called party is located. This is simply not an accurate assessment of the applicable rule. VNXX actually encompasses two different types of interexchange traffic. In the first situation, intraLATA VNXX, both the calling party and the called party are within the same LATA but are in different local calling areas. In the second situation, interLATA VNXX, the called party is located in a distant LATA, often in a different state. In either case, CLECs accomplish VNXX by obtaining local NPA-NXXs and filing them

in the Local Exchange Routing Guide (“LERG”) associated with the originating end-user’s rate center despite the fact that the end user associated with the NPA-NXX is connected via dedicated facilities to another location and not physically located in the same local calling area. In this way, CLECs effectively demand treatment of intraLATA or interLATA interexchange toll calls as local for purposes of determining the proper intercarrier compensation. Very often, CLECs use VNXX to service remote ISP POPs. However, VNXX is regularly used for non-ISP traffic as well. Regardless of the particular type of traffic involved, CLECs use VNXX precisely so that they might both avoid access charges (which apply to the interexchange use of ILEC local exchange networks) and collect unwarranted “reciprocal compensation” payments. This is a most serious problem when the “end user” is an ISP with a POP in a remote state or LATA. Yet, even in that circumstance, a CLEC might claim the right to receive reciprocal compensation as if the ISP POP were located locally.

b. VNXX Traffic is Interexchange Traffic Based Upon the Location of the End Points of a Call, Not the Numbers Assigned by CLECs

Both interLATA and intraLATA VNXX calls are properly classified as interexchange calls subject to access charges under the current regulatory structure. The Commission’s existing rules base the determination of whether a given call is local or interexchange upon the end points of the call. Those rules demand the result that traffic which originates and terminates in different calling areas is interexchange traffic. CLECs claim that calls to a “local” NPA-NXX should be treated as local for purposes of determining whether access charges should be billed to the IXC, regardless of the actual physical locations of the called and calling parties. These arguments are directly contrary to the law. Calls between two end points in different local calling areas are not local, no matter what numbers are assigned to those end points. Existing rules should be clarified and adequately enforced as necessary to ensure that compensation is not being claimed

or received based on a claim that a long distance call is really local because of the assigned telephone number.

Even when this VNXX traffic is Internet-bound traffic, the Commission's rules make clear that it is interexchange traffic when the ISP POP is located in a distant local calling area. The proper application of the ESP exemption recognizes (indeed requires recognition) that VNXX traffic is interexchange traffic. A number of CLECs appear to claim that the ESP exemption permits them to charge reciprocal compensation and avoid access charges for VNXX calls that are delivered to an ISP POP even when calls to other similarly located end-user premises would result in payment of access or toll charges (*e.g.*, when an ISP POP is in a remote local calling area, LATA or state). This is predicated on a misunderstanding of the ESP exemption. The ESP exemption permits enhanced service providers ("ESPs") to purchase access at local rates when they use ILEC local exchange switching facilities to originate and/or terminate interstate traffic but only when the ESP is physically located within the local calling area of a party either calling to or called from the ESP. Accordingly, the ESP exemption simply has no application to VNXX traffic. Where a call originates in one local calling area and terminates to an end user physically located in another local calling area, the call is not a local call even when the called party is an ISP/ESP.

Nor does the temporary compensation regime established by the *ISP Remand Order* change this conclusion that VNXX traffic is interexchange traffic. The findings of the *ISP Remand Order* and the decision of the United States Circuit Court of Appeals for the District of Columbia in reviewing that decision, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), were expressly confined to the limited circumstances addressed therein -- *i.e.*, the treatment of traffic where both the calling party and the ISP end user (the ISP POP) were physically located

in the same local calling area. By definition, VNXX, where a call originates in one local calling area and terminates to an end user (including an ISP POP) physically located in another local calling area, does not occur in these circumstances. In other words, the *ISP Remand Order* established rules that apply to situations where the ISP receives local traffic at its POP and delivers that traffic to the Internet or other interstate locations. If the traffic is not local when it arrives at the ISP POP (*e.g.*, when the ISP POP is remotely located in another local calling area), the normal ESP exemption rules apply and access must be paid by the IXC<sup>103</sup> because the call to the ISP POP is a long distance call. In those circumstances the call is treated as a long distance call and the originating LEC is entitled to access charges for its services, and need not pay reciprocal compensation.

Any argument that VNXX should not be subject to access charges based upon the historic treatment of ILEC Foreign Exchange (“FX”) services also fails to hold water. Certain CLECs have argued that intraLATA VNXX service should be treated (for access and reciprocal compensation purposes) as analogous to intraLATA FX service provided by an ILEC.<sup>104</sup> ILEC FX services are intraLATA services by which ILECs have permitted customers physically located in one local calling area to receive traffic originating in another local calling area by purchasing a private line transport service. ILECs historically have not been charging themselves access charges when they provide intraLATA FX services.<sup>105</sup> Certain CLECs argue that this treatment of intraLATA FX service mandates that intraLATA VNXX traffic be

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<sup>103</sup> In many cases, the CLEC and the IXC will be identical. In such an event, the CLEC/IXC pays the originating LEC for the access functions it has performed. *See, e.g., In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610, 9613 (2001).

<sup>104</sup> It is notable that this argument has no application whatsoever to interLATA VNXX, as access charges have historically been applied to interLATA FX service.

<sup>105</sup> ILECs recover those costs through private line charges to their FX customers.

permitted to be classified as a local call. Qwest agrees that the access charge treatment of intraLATA FX and VNXX services should ultimately be the same because the determinative analysis of end-user location produces the same result in each of these distinct contexts. Qwest also supports efforts to achieve parity in state regulatory proceedings for these two services. However, this conclusion does not change the fact that intraLATA VNXX is properly classified as interexchange traffic subject to access charges on the same basis as all other non-local calls.

Nor does the Commission's ruling in *Starpower Communications, LLC v. Verizon South, Inc.*, 18 FCC Rcd 23625 (2003) ("*Starpower*") change this result. In *Starpower*, the state had relinquished jurisdiction under Section 251(e)(5) of the Act to resolve a dispute arising under an interconnection agreement regarding whether or not Verizon was obligated under the interconnection agreement to pay reciprocal compensation for VNXX traffic. In ruling that Verizon was so obligated, the Commission relied, among other things, upon the fact that Verizon had rated the relevant calls local for purposes of billing to its own originating end users and the fact that Verizon also treated as "local" calls made to its own intraLATA FX customers. In the end, the Commission found that Verizon had offered "no persuasive evidence that, at the time the parties entered into the [interconnection agreement], they intended that a customer's physical location rather than number assignment would dictate compensation obligations under the Agreement."<sup>106</sup> However, the Commission resolution of the issue of the correct interpretation of the particular interconnection agreement at issue in that case has no precedential value with regard to the issue of how such traffic should be treated under the Commission's rules, generally,

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<sup>106</sup> *Starpower*, 18 FCC Rcd at 23632-33 ¶ 16.

and outside of the context of an interpretation issue brought before the Commission under Section 252(e)(5).<sup>107</sup>

2. Under Qwest's Plan, the Problems Associated with VNXX Disappear

If bill and keep is not adopted by the Commission, the Commission must clarify that VNXX traffic is properly treated as interexchange traffic<sup>108</sup> in order to end the ongoing disputes and other problems associated with intercarrier compensation for VNXX traffic. If bill and keep is adopted, the problems described above associated with disputes regarding the proper regulatory treatment of VNXX traffic go away because, under any true bill and keep regime, the distinctions between the treatment of local and interexchange traffic for purposes of intercarrier compensation go away. For example, under Qwest's plan, once the traffic is handed-off at the relevant edge, the terminating carrier becomes responsible for completing the call and neither carrier is entitled to compensation from the other. However, should the Commission adopt Qwest's bill and keep at the edge plan, or any other true bill and keep regime for that matter, the Commission still must clarify the correct regulatory treatment of this traffic in order to permit proper treatment of VNXX traffic during the transition time while the new structure is being implemented.

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<sup>107</sup> For this same reason, the FCC Virginia Arbitration Order, reflecting another 252(e)(5) arbitration decision in which the Commission found that Verizon had given the CLEC "no viable alternative to the current system" of VNXX compensation, is inapplicable to this issue as well. 17 FCC Rcd at 27181 ¶ 301. The Commission was choosing between contract interpretations, not examining how its rules function.

<sup>108</sup> Again, this is true whether the traffic is ISP-bound or not.

C. The Commission Must Address The Existing Problems Associated With CMRS Traffic, Regardless Of What Plan Is Adopted For Intercarrier Compensation

1. The Current Regulatory Treatment of CMRS Traffic Creates Rate Disparity and Arbitrage Opportunities, Primarily Because of the Disparities in Local Calling Areas

Vastly different billing practices and intercarrier compensation rules apply to ILEC and CMRS calls. Such differences are rooted in anomalies growing out of the initial Local Competition proceeding, rather than logic. For ILECs, classification of a call as “local” or “toll” generally depends on whether the call remains in a single local calling area or is carried between two different calling areas. These local calling areas are subject to oversight by state regulators. Calls originating and terminating within the same rate center, or within a cluster of rate centers comprising a local calling area, are billed as local calls. Calls between rate centers in different calling areas are typically rated and billed as toll calls. If a call terminates on the network of another wireline provider, whether LEC or IXC, the Commission’s intercarrier compensation rules follow the same local calling area conventions to determine whether the call is subject to reciprocal compensation or access charges.

Different practices and rules apply to calls involving CMRS providers, both in terms of end-user charges and intercarrier compensation payments. CMRS providers generally do not rely on rate centers to establish the geographic boundary between local and toll calls. For example, CMRS providers generally have local calling areas covering an entire Major Trading Area (“MTA”), as compared to the much smaller ILEC local calling areas. The much larger CMRS local calling areas are established by federal law.<sup>109</sup> Many CMRS providers offer flat-rate plans that do not distinguish between local and long distance calls for end-user billing purposes. For purposes of intercarrier compensation, a call originated or terminated by a CMRS provider is

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<sup>109</sup> See Local Competition Order, 11 FCC Rcd at 16014 ¶ 1036.

considered local, and therefore subject to reciprocal compensation charges rather than access charges, as long as the call stays within the same MTA, unless the call is carried by an IXC, in which case access charges apply if the IXC hands the call off to a LEC.<sup>110</sup> This is known as the “intra-MTA” rule. Of course, an ILEC may assess toll charges on its own end-user customers for “one plus” calls in the same circumstances it would for any other call, but an ILEC delivering or receiving an intra-MTA call to or from a CMRS provider within an MTA must treat the call as local.

A call to or from a wireless end user may be subject to different intercarrier compensation charges based solely on whether the call is carried by a LEC or an IXC. Moreover, the same call may be treated as a local call for purposes of intercarrier compensation and a toll call with regard to wireline end-user charges. Inevitably, these arbitrary distinctions create incentives for arbitrage. For example, by handing off an intra-MTA call destined for a wireless end user to an IXC,<sup>111</sup> an originating ILEC may be able to both avoid the duty to pay reciprocal compensation to the CMRS provider for what should have been a local call, and also collect access charges from the IXC that carries the call. On the other end of such calls, CMRS providers and IXCs continue to fight over the appropriateness of CMRS access charges.<sup>112</sup> Still other arbitrage problems are created by the fact that certain CMRS carriers are set up to receive only one-way traffic -- *i.e.*, paging carriers.

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<sup>110</sup> TSR Order, 15 FCC Rcd 11166, 11184-85 ¶ 31 (2000).

<sup>111</sup> This situation often occurs when an independent LEC is involved. The independent LEC customer dials a 1+ number. If Qwest is the designated toll carrier for the call, it receives the call and pays access at both ends of the call. On the other hand, a call from a CMRS customer to the same independent LEC end user is treated as a local call subject to reciprocal compensation.

<sup>112</sup> See *AT&T v. FCC*, 349 F.3d 692 (D.C. Cir. 2003).

Additionally, the intra-MTA rule imposes exorbitant transport costs upon ILECs which they, in turn, have no opportunity to recover under the current compensation rules. These transport costs arise from the combined impact of the disparities that exist between the geographical scope of the wireline local calling areas and that of the wireless MTA and the fact that CMRS providers need only have a single point of interconnection (SPOI) in each MTA. As a result, uncompensated transport is imposed on ILECs on wireline-CMRS traffic both when that traffic is originated by a CMRS provider and when it is originated by a wireline provider. For example, consider the state of Montana in which the entire state is a single MTA. If Qwest originates a call in the eastern-most portion of the state and the terminating CMRS provider's SPOI is located in the western-most portion of the state, Qwest must transport the call a considerable distance to that SPOI and then pay the CMRS provider to terminate that call. For traffic going the other way between those same two callers, Qwest is also penalized. The CMRS provider originates the call and hands it off to Qwest at the CMRS provider's nearby SPOI and Qwest must transport that call across the state without any compensation for that transport function.

2. Under Qwest's Plan, the Problems Associated with CMRS Traffic Disappear

Adoption of Qwest's bill and keep at the edge plan would resolve many of these issues relating to LEC-CMRS traffic. While the disparities described above do exist and have evolved over time, the Commission long ago made clear that CMRS providers are telecommunications carriers for purposes of the compensation rules created by the Act.<sup>113</sup> They are also providers of local exchange service and exchange access service, even though they are not LECs. Accordingly, CMRS providers would receive the same treatment as other carriers under Qwest's

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<sup>113</sup> Local Competition Order, 11 FCC Rcd at 15997 ¶ 1008.

bill and keep at the edge plan. Because carriers would recover the costs of their networks from their own end users, rather than from other carriers, disputes over the application of access or reciprocal compensation charges not be relevant. The default rules of Qwest's proposal work the same way in the CMRS context as they do in the wireline context -- an originating carrier would be responsible for the cost of transporting a call to the "edge" of the other carrier's network, regardless of whether that transport is accomplished through self provisioning, using the other carrier's network, or transiting over a third-party's network. Generally, the cost of this transport link would be a relatively small portion of the total cost of transporting and terminating the call, thereby diminishing the incentives for arbitrage as well as the exercise of any terminating monopoly power. By shifting recovery to the CMRS carrier's own customers, bill and keep would subject such termination rates to market forces, particularly as competition continues to develop and the need for retail rate regulation diminishes.

As described more fully above, Qwest's bill and keep proposal would also clarify and simplify the rules for transiting and interconnection upon which CMRS providers also rely. Again, under bill and keep at the edge, originating carriers would be responsible for the cost of using a transit service provider to transport a call to a terminating carrier's network. Unlike today, however, the originating carrier would have no duty to pay reciprocal compensation to the terminating carrier. Additionally, as is also described above, originating and terminating carriers, would, in the CMRS context as in other contexts, have no need to enter into negotiations with each other regarding the rates, terms and billing arrangements for compensation for the use of each other's network unless it was efficient to do so. As the Commission is well aware, today's reciprocal compensation scheme creates tenacious problems in the relationships of ILECs and CMRS providers in particular, due to the burden of establishing such rates, terms and

billing arrangements. Under Qwest's bill and keep proposal, this concern also would be eliminated.

3. The Commission Should Eliminate the Intra-MTA Rule, Regardless of What Action it Takes with Respect to Intercarrier Compensation Reform

Regardless of what the Commission does with respect to intercarrier compensation reform, the Commission should eliminate the "intra-MTA rule." Again, that rule provides that the local service area for calls originating on or terminating on CMRS networks is the MTA. The Commission, in the Local Competition Order, established this rule based on the following rationale:

Because wireless licensed territories are federally authorized, and vary in size, we conclude that the largest FCC-authorized wireless license territory (*i.e.*, MTA) serves as the most appropriate definition for local service area for CMRS traffic for purposes of reciprocal compensation under section 251(b)(5) as it avoids creating artificial distinctions between CMRS providers.<sup>114</sup>

However, while this definition may avoid creating distinctions between CMRS providers, it creates the rate disparity and arbitrage problems described above. The Commission could eliminate most of these CMRS-specific compensation problems by simply eliminating the intra-MTA rule. The Commission should rule that the local service area for CMRS-LEC traffic is the same area as it is for LEC-LEC traffic -- the ILEC local calling area.<sup>115</sup>

4. The Commission Should, in any Event, Reaffirm that Transit Service Providers are Not Responsible for Compensating the Terminating Carrier When the Originating Carrier is a CMRS Carrier

Under the intra-MTA rule, the originating CMRS carrier pays reciprocal compensation to the terminating carrier. However, when originating carriers use a transiting carrier to deliver intra-MTA traffic, terminating carriers have often sought to recover access charges from the

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<sup>114</sup> Local Competition Order, 11 FCC Rcd at 16014 ¶ 1036.

<sup>115</sup> The Commission should also eliminate the disparities that exist, in some LATAs between the defined local calling areas of ILECs and CLECs.

transiting carrier by erroneously arguing that the transiting carrier is an IXC and that the traffic is no longer local traffic. This problem often occurs where CMRS carriers are the originating carrier. Virtually every federal court to address such an argument by a terminating carrier has rejected it.<sup>116</sup> Again, however, if the Commission decides to retain the intra-MTA rule, it should reaffirm that the terminating carrier is to be compensated by the originating carrier, not by the transiting carrier.<sup>117</sup>

5. The Commission Should Clarify that Intra-MTA Traffic Need Not be Passed Through an IXC

The Further Notice notes that many rural LECs take the position that intra-MTA traffic must be passed through IXCs and therefore become subject to access charges and asks whether that rule should be eliminated to require that all such traffic go directly to/from CMRS providers and therefore become subject to reciprocal compensation.<sup>118</sup> Such an approach would be inefficient and unnecessary. The Commission should clarify that intra-MTA traffic need not be passed through an IXC to the extent that the Commission is convinced that such a clarification is necessary.<sup>119</sup>

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<sup>116</sup> See, e.g., *3 Rivers Telephone Cooperative v. US West*, 2003 U.S. Dist. LEXIS 24871 (D. Montana 2003).

<sup>117</sup> The Commission, in the Further Notice, ¶¶ 139-40, also notes that certain costs/challenges exist with respect to CMRS providers obtaining ICAs with small ILECs and asks whether it should take action to help reduce those costs/challenges. Qwest believes that the adoption of this clarification -- prohibiting terminating carriers from assessing access charges against transit service providers -- would go a long way toward eliminating this problem.

<sup>118</sup> See Further Notice ¶¶ 135-37.

<sup>119</sup> Of course, as described above, should they establish an indirect connection utilizing a transiting arrangement, the transit service provider must be compensated.

D. The FCC Should Move Immediately To Adopt A Bill And Keep Structure For ISP Traffic

No matter how this docket ultimately is worked out, the Commission must deal decisively and immediately to move *ISP-bound traffic* to bill and keep status. The Commission clearly has the authority to do so, and the Commission's finding that keeping "reciprocal compensation" for ISP traffic is an economic train wreck remains unrebutted and, indeed, largely unchallenged. The recent action expanding the scope of the ISP reciprocal compensation arbitrage opportunity in the CoreComm proceeding<sup>120</sup> simply serves to highlight the importance of eliminating this serious anomaly immediately.

In the *ISP Remand Order*,<sup>121</sup> the Commission found that reciprocal compensation for ISP-bound traffic has been destructive of local competition and thus has directly undermined the goals of the Act. The Commission found that imposition of "reciprocal compensation" for ISP-bound traffic "has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets."<sup>122</sup> In particular, the Commission observed that "[b]ecause traffic to ISPs flows one way, so does money in a reciprocal compensation regime[,] and as a result, "this lead to classic regulatory arbitrage that had two troubling effects: (1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services,

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<sup>120</sup> See *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, Order, 19 FCC Rcd 20179 (2004), *appeals pending sub nom. In re: Core Communications, Inc.*, No. 04-1368 (D.C. Cir. Oct. 27, 2004).

<sup>121</sup> *ISP Remand Order*, 16 FCC Rcd at 9186-93 ¶¶ 77-88.

<sup>122</sup> *Id.* at 9153 ¶ 2.

potentially driving ISP rates to consumers to uneconomical levels.”<sup>123</sup> In fact, the Commission found “convincing evidence in the record that at least some carriers have targeted ISPs as customers merely to take advantage of these [arbitrage opportunities].”<sup>124</sup>

Based on these findings, the Commission went on to hold that “the application of a CPNP regime, such as reciprocal compensation, to ISP-bound traffic undermines the operation of competitive markets.”<sup>125</sup> This is due to the fact that “ISPs do not receive accurate price signals from carriers that compete, not on the basis of the quality and efficiency of the services they provide, but on the basis of their ability to shift costs to other carriers.”<sup>126</sup> Alternatively, “[e]fficient prices result when carriers offer the lowest possible rates based on the costs of the service they provide to ISPs, not when they can price their services without regard to cost[,]” an opportunity that exists when reciprocal compensation is required for ISP-bound traffic.<sup>127</sup>

These critical findings were not questioned by the Court of Appeals in *WorldCom*, and form the factual predicate for any rules dealing with ISP traffic. In other words, the FCC, if it were to continue allowing (and expanding) reciprocal compensation for ISP traffic, would be countenancing rules that the Commission concedes are contrary to its statutory mandate. Obviously, the Commission is not authorized to continue for very long rules that it agrees are not lawful.

There are a number of ways to approach the ISP compensation issue under the Communications Act. The soundest is for the FCC to simply establish special ISP rules pursuant

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<sup>123</sup> *Id.* at 9162 ¶ 21.

<sup>124</sup> *Id.* at 9153 ¶ 2.

<sup>125</sup> *Id.* 9183 ¶ 71 (footnote omitted). *See also id.* at 9165 ¶ 29 (“reciprocal compensation for ISP-bound traffic distorts the development of competitive markets.”).

<sup>126</sup> *Id.* at 9183 ¶ 71.

<sup>127</sup> *Id.*

to its Section 252(b)(5) authority. As is noted above, the Commission's authority under Section 251(b)(5) extends to all intercarrier compensation matters, and the Commission is not constrained by the Act to adopt a calling party's network pays structure for intercarrier compensation. For all of the reasons correctly found in the ISP Remand Order, the FCC cannot continue its existing ISP reciprocal compensation rules. No matter how the transition to bill and keep is handled by the Commission, the ISP issue must be fixed immediately.

V. CONCLUSION

For the foregoing reasons, Qwest respectfully requests that the Commission take the actions described herein.

Respectfully submitted,

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May 23, 2005

CERTIFICATE OF SERVICE

I, Ross Dino, do hereby certify that I have caused the foregoing **COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC. ON FURTHER NOTICE OF PROPOSED RULEMAKING** to be 1) filed with the FCC via its Electronic Comment Filing System, 2) served via email on Victory Goldberg, Pricing Policy Division, Wireline Competition Bureau (at [victoria.goldberg@fcc.gov](mailto:victoria.goldberg@fcc.gov)), and 3) served via email on the FCC's duplicating contractor Best Copy and Printing, Inc. (at [fcc@bcpiweb.com](mailto:fcc@bcpiweb.com)).

/s/ Ross Dino

Ross Dino

May 23, 2005