

Executive Summary

The Maryland Office of the People's Counsel (OPC) strongly opposes the DeGraba and Atkinson-Barnekov proposals.

1. Neither of these proposals can even be reasonably considered. They would turn the telephone system into a government give-away program. Rule 1 contained in the DeGraba proposal is:

No carrier may recover any costs of its customers' local access facilities from an interconnecting carrier. (Paragraph 24, DeGraba)

In plain English, this means customers that are considered to be "carriers" would receive unlimited use of certain local exchange carrier (LEC) facilities absolutely for free. However, customers that are considered "end users" have to pay for those same LEC facilities. This discriminatory treatment creates huge new incentives to arbitrage. As shown on Attachment A, by converting from an "end user" to a "carrier" classification, (1) the customer would change from paying the usage costs on their outgoing traffic, to paying no usage cost on either incoming or outgoing traffic. (See pages 1 and 3 of Attachment A); and (2) the customer would change from having to pay for all of the loops coming to and going from their premise, (page 3 of Attachment A) to paying for only part of the cost of the facilities between their location and the LEC (page 1, of Attachment A). In addition, providing the above-referenced free services to customers considered to be "carriers" requires that those free services be supported by "implicit subsidies" from other customers. The Atkinson-Barnekov proposal has the same problem. (See pages 2 and 3 of Attachment A) We strongly urge the FCC to examine the discrimination and huge new arbitrage incentive that are demonstrated on Attachment A. These problems by themselves require that these proposals be rejected.

2. A second fatal flaw in Staff's proposals is that they propose to fragment the responsibility for each call. Currently, the interexchange carrier (IXC) is responsible for a toll call from end-to-end. However, under Staff's proposals, no company would have end-to-end responsibility. Under DeGraba, the LEC would be responsible for carrying the call only to the point of presence (POP), and would bill the end user for that part of the call. The IXC would be responsible only between the POP and the terminating central office, and would bill the end user for that part of the call. The receiving LEC would be responsible for the call from the end office to the terminating premises, and would bill the receiving end user separately for that part of the call. Atkinson-Barnekov's proposal also would fragment the responsibility for each call.

Fragmenting responsibility results in end users being billed three times by three different companies for each call, which is confusing, and economically inefficient. In addition, the IXC and the two involved LECs would "point fingers" at each other pertaining to any quality of service problem.

The IXC and the two LECs each would have a strong financial incentive to minimize their own costs, even if that increased the costs of the other carriers involved in the call. For example, an IXC might utilize only one POP in a LATA instead of several. Having only one POP would reduce the IXC's costs, and therefore give it a competitive advantage over other IXCs. Having one POP in a LATA instead of several would increase the access costs of the originating LEC, because of the longer average distance to reach that one POP. However, increasing the access cost of the LEC would no longer

have any financial impact on the IXC, because under these Staff proposals, the IXC would no longer be paying for the access cost. The regulators would have to deal with these and numerous other “demarcation” point issues, since the regulators would have to assume the end-to-end responsibility for the calls under Staff’s proposals.

This problem does not exist under the current rate structure. Currently, if the IXC decides to use an LEC for access, the IXC chooses where the POP or other interconnection points will be. Under the current rate structure, if an IXC creates high LEC access costs by minimizing its’ POPs, it is the IXC that has to pay the resulting high LEC access costs. This forces the IXC to make decisions that are overall efficient.

3. The proposed fragmentation of the network is not similar to when customer premises equipment (CPE) was separated from the telephone network. CPE could be separated from the rest of the network for regulatory purposes, only because the wall jacks allowed the end user to physically separate the CPE from the rest of the system to isolate the responsibility for service problems. Likewise, inside wiring could be separated from the rest of the network for pricing and regulatory purposes, only because the jacks located in the network interface device (NID) allowed the end user to physically separate inside wiring from the rest of the system to isolate the responsibility for service problems. However, it is not technically possible to provide an end user accessible “jack” at the POP or terminating central office to allow the customer to disconnect their service at that point to isolate the source of trouble. Therefore, there would be no way for the end user to assign responsibility for service problems under the fragmented network that is being proposed.

4. These proposals are clearly designed to destroy the Internet by charging Internet service providers (ISPs) for “receiving” traffic. Since ISPs receive huge volumes of calls (while originating little or no traffic) charging to “receive” traffic will drastically increase the cost to the ISPs, and thereby basically destroying the Internet as a service that can economically be provided to the general public. Placing huge additional “receiving traffic” charges on the ISPs, and thereby harming the Internet, is not in the public interest. Section 230(b) of the Telecommunications Act of 1996 (TA96) states it is the “policy of the United States” to “promote” and “preserve” the Internet “unfettered by Federal or State regulation.”

5. In many cases, the customer receiving the call does not benefit. Receiving a telemarketing call is a key example of this. In addition, standard economic theory on the efficient use of resources requires (1) the price must reasonably reflect the resources used, and (2) the customer making the purchase decision must be aware of the benefit of the service that they would receive. The originating customer is the only customer that knows what the content of the call will be, and therefore knows the benefit of the call. Before they answer, the customer receiving the call does not know the content, and therefore benefit, of the call. The receiving customer is not in the position to make an economically efficient decision, only the calling customer is. Staff’s proposals create economic inefficiency.

6. The Staff proposals would subsidize telemarketers, and stimulate telemarketing calling. The rates charged to telemarketers would not cover the full cost of the traffic sensitive costs that the telemarketers caused, because the receiving customers would pay part of those costs. Staff’s proposals would require the receiving customers to subsidize the traffic sensitive costs that are caused by the telemarketers who are placing

calls. Subsidizing the telemarketer's usage would be an incentive for telemarketers to further increase that subsidized usage of the network.

7. The reason that are no or few cellular telephone books is because cellular customers must pay to "receive" their calls, and therefore they do not want their number publicly available. The same thing would happen to the wireline network if customers were charged to receive their calls. Likewise, many cellular customers turn their phones off so that they will not receive unwanted calls. Wireline customers would do the same if charged to receive their calls. They might also eliminate their answering machines to avoid paying unwanted "receiving" charges. The Staff proposals would greatly reduce the usefulness of the network. If customers answered, but hung up quickly when they discovered it was an unwanted call, their LEC would still incur the significant "setup" cost of that call, which the receiving customers would be responsible for under Staff's proposals.

8. Under current "bill and keep", the end users are not being charged for receiving calls. The network that originates the call pays the terminating network for termination with "payment in kind." This is why the current bill and keep arrangements are generally accepted only if "traffic is relatively balanced." However, under Staff's proposals, no "balance" in traffic is required. These proposals simply require carriers to provide free service to other carriers, with no requirement that those other carriers provide an equivalent amount of offsetting service in "payment in kind." Instead, those free services would have to be subsidized by other customers.

9. It is correct that certain competitive local exchange carriers (CLECs) were charging excessive rates for terminating interconnection, and those excessive rates created problems. The correct solution is to replace charges that are excessive with charges that are reasonable. However, instead Staff proposes going to the other extreme by making certain services free, which causes new problems, including implicit subsidies and arbitrage.

10. Staff admits that their proposals would result in higher rates in high cost and rural areas than in urban areas. This is contrary to the concept set forth in Section 254(g) of TA96, which requires "The rates charged...to subscribers in rural and high cost areas shall be no higher than ...in urban areas." Under Staff's proposal, if an IXC chose to locate its POP 30 miles away from a rural customer, then the rural customer would be responsible for paying for all costs to transport that call from the customer premises to the IXC's POP that is 30 miles away.

11. CLECs would probably not now exist had these proposals been in effect in the past. The IXCs encourage the creation and growth of competitive access providers (CAPs) as a way of minimizing the access expense that the IXCs pay. Those CAPs are what we now call CLECs. IXC access services are still a significant portion of their revenues. These proposals are anti-competitive.

12. Staff's proposals acknowledge that the regulators would still have to regulate "dominant" carriers' access and transport rates. These proposals would not end the need for regulators to regulate rates. The fact that the access services and transport would be billed to end users instead of to IXCs does not absolve the regulators from the responsibility of seeing that those charges are reasonable. In addition, Staff's proposals would not eliminate "monopoly" power. For most customers, there is only one company that has a loop to the premise. The company that has that loop is the only company that

can reasonably provide access service to and from the premises. That monopoly power will still exist regardless of whether the DeGraba, Atkinson-Barnekov, or some similar proposal is adopted.

13. Staff's proposals propose unreasonable allocation of the common costs. Although the interconnection services utilize the switch, Atkinson-Barnekov propose that zero percent of the "common costs" of the switch be recovered from interconnection services, and therefore 100% of those switch "common costs" would have to be recovered from the other services that also utilize that switch. This is an unjust, unreasonable, and unsupported common cost allocation proposal. This would over-allocate common costs to universal services, which would be in violation of Section 254(k) of TA96. Standard economic theory holds that prices in a competitive market will cover both incremental and common costs, or else even efficient firms would go bankrupt.

These Staff proposals claim that they must be adopted to eliminate the carrier common line charge (CCLC), and to otherwise stop the alleged recovery of loop costs in traffic sensitive charges. However, prior FCC orders have effectively eliminated the interstate CCLC. As a result of prior orders, both the interstate loop and interstate non-traffic sensitive central office equipment (NTS-COE) costs are now recovered in fixed monthly charges, primarily the subscriber line charge (SLC)/end user common line (EUCL) charge that is billed to end users.

14. Atkinson-Barnekov claim that interconnection costs can be calculated solely by knowing the number of customers ("n"). This does not work. The sizing of interconnection facilities, and therefore their costs, depend largely on the level of traffic. All customers are not equal. A telemarketer will generate far more traffic than the average residential customer. Distance is another major consideration. It costs far more to build an interconnection facility that is 100 miles long than one that is one mile long. In addition, a customer is more likely to call a pharmacy that is located in their town than one that is 100 miles away. The interconnection costs cannot be calculated simply by knowing the number of customers that will be interconnected.

15. The Atkinson-Barnekov proposal assumes a "fully provisioned network" which is assumed to consist of "primarily capacity costs", and "this latter assumption eliminates the need for traffic sensitive interconnection charges." However, the above conclusions are not reflective of actual costs or networks. The network design actually used to provide telephone service is the "star" network, which is only mentioned in a footnote in the Atkinson-Barnekov proposal, and is not included in any significant way in their analysis. In the real world, the telephone company runs a loop from each customer premise to the central office, and the switch in the central office connects the customers. In an exchange with 5,000 lines, only 5,000 active loops are used.

The networks used in the Atkinson-Barnekov analysis are fictional networks that have nothing to do with efficient or real world costs. In the hypothetical "mesh" network used in the Atkinson-Barnekov analysis, for an exchange containing 5,000 customer lines, 24,997,500 loops allegedly would be required, and there would be "no switching capability at all." This fictional system would cost \$50,000 per line per month. In the hypothetical "linear" network used in the Atkinson-Barnekov analysis, 6,250,000 loops would be required to connect 5,000 subscribers, along with a small amount of switching.

In the real world, 5,000 loops and switching equipment (which is traffic sensitive) are actually used to provide service in a 5,000 line exchange.

16. Interstate traffic sensitive costs should not be recovered in flat rate charges to customers. First of all, such pricing would not recognize the true manner in which the costs were incurred, and therefore is economically inefficient. In any given month, 38% of the residential customers placed no interLATA interstate calls. To charge mandatory flat rates for interstate toll usage would require those customers with little or no usage to subsidize high toll users. For example, the low use customers would subsidize telemarketers, which are high volume users. The proposed mandatory flat rates to recover the average interstate traffic sensitive costs would effectively increase the cost for a customer to obtain even just basic exchange service. This would harm affordability and universal service. The Internet flat rate charges are optional charges. Since the Internet flat rate charges are optional, there is nothing that forces low or non-users to pay these charges. State commissions that allow a flat rate local service option generally also have a measured local service option, so paying the flat rate is not mandatory. However, Staff's proposals would impose a mandatory interstate flat rate usage charge on everyone, not just those who have so elected.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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

**INITIAL COMMENTS OF THE
MARYLAND OFFICE OF THE PEOPLE’S COUNSEL**

The Maryland Office of the People’s Counsel (OPC) appreciates the opportunity to comment on the Federal Communications Commission’s (FCC) Notice of Proposed Rulemaking (NPRM), in the above styled matter released April 27, 2001. This NPRM seeks comment on proposals contained in two FCC Staff papers, one of which is referred to as “COBAK” written by Patrick DeGraba (hereinafter referred to as DeGraba), and one that is sometimes referred to as “BASICS” written by Jay Atkinson and Christopher Barnekov (hereinafter referred to Atkinson-Barnekov). Although some details of these two Staff proposals differ, they both conclude that (1) certain local exchange carrier (LEC) facilities would be paid for entirely by billing to customers that are considered to be “end users”; however, customers considered to be “carriers” would use those same facilities at no charge; and (2) instead of keeping one company (such as an interexchange carrier (IXC)) responsible for a call end-to-end, each call would be divided into segments, with different companies being responsible for different segments of the same call.

The Comments contained herein are not meant to be critical of the FCC Staff. In many cases, the FCC Staff discussion papers presented claims that had been made by

others. The Maryland OPC understands those claims were presented for the purpose of receiving comments from other parties.

1. BOTH STAFF PROPOSALS HAVE A FATAL FLAW: PROVIDING SERVICE FREE TO CERTAIN CUSTOMERS REQUIRES IMPLICIT SUBSIDIES AND WILL CREATE ARBITRAGE.

1.a. These Staff proposals create arbitrage.

Both staff proposals have a fatal flaw. They discriminate in charging based on the classification of the customer. For example, all local switching costs of an LEC would be paid for by customers that were considered “end user” customers of that LEC. But if the customer is considered a “carrier”, that customer would use the LEC’s local switching equipment at no charge. Because of this discriminatory treatment, end users could avoid these charges by presenting themselves as a competitive local exchange carrier (CLEC) (or working with an existing CLEC). Discriminatory treatment based upon the classification of a customer creates arbitrage.

Take an example of a large business that has a PBX switch. As an “end user,” they must help pay for the LEC’s local switching costs.¹ However, under either Staff proposal, this customer could avoid all of the LEC local switching charges, and instead receive use of the LEC switch for free. To do so, they make themselves into a "CLEC", or work with a CLEC. There is great incentive for a customer to arbitrage the DeGraba proposal. By converting from an "end user" to a "carrier" classification, (1) the customer would change from paying the usage costs on at least their outgoing traffic, to paying no usage cost on either incoming or outgoing traffic. (See pages 1 and 3 of Attachment A);

¹ This customer is shown on Attachment A. This example deals with the charges for local interconnection or local service in an exchange served by one LEC central office.

and (2) the customer would change from having to pay for all of the loops coming to and going from their premise, (page 3 of Attachment A) to paying for only part of the cost of the facilities between their location and the LEC (page 1, of Attachment A).

Rule 1 contained in the DeGraba proposal is:

No carrier may recover any costs of its customers' local access facilities from an interconnecting carrier. (Paragraph 24, DeGraba)

In plain English, this means customers that are considered to be carriers have unlimited use of certain LEC facilities absolutely for free. Under the DeGraba proposal, "local access facilities" include both the loops and the LEC's central office switches that serve those loops. (Paragraph 23, DeGraba proposal) Therefore, the LEC's central office switching equipment would handle unlimited traffic both to and from the CLEC at no charge, as is shown on page 1 of Attachment A. As an "end user", this same customer with the same traffic would have been responsible for paying at least the traffic sensitive costs associated with outgoing traffic, as is shown on page 3 of Attachment A.

The second DeGraba rule is:

The calling party's network is responsible for the cost of transporting the call to the called party's central office. (Paragraph 24, DeGraba proposal)

In this example, since the CLEC's switch (the PBX) is located in the business, this means the LEC is responsible for the full cost of the facilities that are used to transport traffic to that location (similar to "loops" for incoming service). The business pays nothing for these interconnection facilities used for incoming traffic. (See Attachment A, page 1) As is shown on page 1 of Attachment A, after becoming a "CLEC", the only LEC services or facilities the business would pay for is the cost of

those facilities that go from the business premises to the central office that are used for the outgoing calls (similar to loops for outgoing service).²

Under Atkinson-Barnekov, there is also a large incentive for a customer to convert from an “end user” to a “carrier” classification. By doing so, (1) the customer would change from paying the usage costs on at least their outgoing traffic, to paying no usage cost on either incoming or outgoing traffic. (See pages 2 and 3 of Attachment A); and (2) the customer would change from having to pay for all of the loops coming to and going from their premise (page 3 of Attachment A), to paying for only part of the cost of the facilities between their location and the LEC (page 2 of Attachment A).

These results come directly from the Atkinson-Barnekov rules. Rule 1 is that “only the costs incremental to interconnection should be split” equally between the two interconnecting networks. (Paragraph 40, Atkinson-Barnekov) In our example, the incremental cost to connect these two “networks” are the facilities that connect between the CLEC and the LEC central office (similar to loops). Therefore, these costs are split equally as shown on page 2 of Attachment A. In this example, the only charge that the “CLEC” would pay under Atkinson-Barnekov is for half of the cost of the facilities that connect between the “CLEC” and the LEC’s central office.³

The remainder of Atkinson-Barnekov’s rule is:

...each network collects all remaining costs (those not incremental to interconnection) from its own subscribers. (Paragraph 40, Atkinson-Barnekov)

² This is true for the interconnection or local service shown on Attachment A, which is for an exchange (local service area) served by one LEC central office. Similar arbitrage exists in more complex interconnections.

³ This is true for the interconnection or local service shown on Schedule A, which is for an exchange (local service area) served by one LEC central office. Similar arbitrage exists in more complex interconnections.

In plain English, this means that customers who are considered to be carriers (IXCs, CLECs, and other LECs) are allowed unlimited use of certain LEC facilities absolutely for free. In this example, this would result in the LEC collecting all of its central office costs from its “end users,” while collecting none of them from customers considered “CLECs.” By moving from being an “end user” to be a “CLEC”, this business would shed itself of the responsibility of paying for any of the LEC’s local switching costs.

It should be noted that to receive this arbitrage benefit the customer would not have to have unbalanced traffic or be unusual in any way. Attachment A displays interconnection of local service for an exchange served by one LEC central office. Staff’s proposals create similar arbitrage opportunities in more complex interconnections as well. A company can easily arbitrage the DeGraba or Atkinson-Barnekov proposals, and receive free service from the LEC. These arbitrage opportunities result from the rules that require customers who are “end users” to pay for services whereas customers who are “carriers” do not pay for those similar services. In addition, it would not be necessary for a customer to become a CLEC; instead, they could work out cooperative arrangements with an existing CLEC to gain similar arbitrage advantages.

1.b. DeGraba acknowledges that the Staff proposals could be arbitrated

The DeGraba proposal acknowledges that the proposal can result in arbitrage.

If an entity can qualify as a network, it can avoid paying business line rates (and, as a carrier, be entitled to have calls transported to the business’s switch).

However, DeGraba alleges that these arbitrage incentives exist in the current network, and that the Staff proposal does not “induce any new distortions.” (Paragraph 88) This is incorrect.

Under the current methods, there is no way for a customer (either end user, CLEC, or IXC) to obtain free use of the LEC’s local switching equipment for both incoming and outgoing calls.⁴

DeGraba expresses the hope that the cost of switching equipment may deter customers from converting to CLECs. (Paragraph 116, DeGraba) However, that is not realistic. Many large businesses already have PBXs. PBXs are switches. In addition, key equipment used even by small businesses includes switching capabilities. In addition, new programs are now emerging that use a standard personal computer as the major component of an inexpensive switch (or “soft switch.”)⁵ Telcordia Technologies, Inc. description of its “soft switch” includes the statement that it includes “all the features necessary to become a licensed carrier.”⁶

1.c. Supporting the new free services requires new implicit subsidies.

Since the CLECs and IXCs would receive free local switching for both incoming and outgoing traffic, the obvious question is who pays for the cost of their usage of the

⁴ If they are an end user, they must pay either measured usage rates or flat usage rates for outgoing traffic for local service. If customers pay local flat rates, those local flat rates specifically contain a component that is used to pay for traffic sensitive usage costs. If they are an IXC or CLEC, they must pay "local switching" access rates or terminating interconnection usage charges to use the LEC’s switch. Under bill and keep arrangements, the use of the local switch is not free. The only difference is that instead of paying in money, the other party must “pay in kind.” That is, they must provide approximately the same volume of terminating services in return for the terminating services they receive. (Appropriate balance is required.) However, no such traffic “balance” requirement exists under the DeGraba or Atkinson-Barnekov proposals.

⁵ www.telcordia.com/products-services/networksystem/softswitch/index.html.

⁶ www.telcordia.com/products-services/networksystem/softswitch/description.html.

LECs local switch?⁷ The answer is the local switch costs would be paid for by the naïve customers that had not yet learned how to arbitrage these staff proposals. Under both Staff proposals, although both “carriers” and “end users” would place traffic through the LEC’s switches, the only customers that would be paying for those LEC switches would be those customers classified as “end users,” whereas the customers that were using the switches but were classified as “carriers,” would not be paying for those switches.

For outside plant, the “CLEC” would also only pay a portion of the cost of the facilities between its itself and the LEC’s central office. The remaining portion of the cost of those facilities would also have to be covered by the “naïve” customers who had not learned how to arbitrage these Staff proposals. Of course, as more and more customers learn how to arbitrage these proposals, the number of customers actually contributing to the cost of the LEC’s switching equipment (and paying all of their loop costs) would decline, and therefore the cost per naïve customer would have to increase until a breaking point was reached.

2. THE SECOND FATAL FLAW IN THE STAFF PROPOSALS: THE FRAGMENTATION OF THE RESPONSIBILITY FOR EACH CALL

Both Staff proposals propose to fragment the responsibility for each call. Currently one company is responsible for each call from end-to-end. For toll calls, the IXC is responsible for that call from end-to-end. For local calls, the originating LEC is responsible for that call from end-to-end. That one company is responsible for deciding how the call will be transported from end-to-end. For example, they could build their own facilities end-to-end. If an IXC does choose to utilize other companies (such as

⁷ This statement is true for the one central office exchange example that is shown on Attachment A.

LECs) to assist them, those companies are essentially “sub-contractors.” The IXC decides the demarcation point where the “subcontractor” transport will commence, and will take action if those “sub-contractors” are not fulfilling their obligations to the IXC. Since the IXC (or originating LEC for local calls) is paying all costs end-to-end, they have a great incentive to look for more efficient ways to provide the service end-to-end.

However, under the Staff proposals, no company would have end-to-end responsibility. For example, under the DeGraba proposal, for a long distance call, three different carriers would each have responsibility for different sections of the same call.

The calling party’s local carrier is responsible for delivering the call to the point of presence or POP ... and can only recover its cost from the end user ... The calling party’s IXC is then responsible for delivering the call to the central office serving the called party. It recovers its cost from its customer, the calling party. ... Finally, the terminating local carrier serving the called party is responsible for delivering the call from the central office to the called party, and recover its termination costs from the end user, the called party. (Paragraph 38, DeGraba)

The IXC would be responsible for the call only from the point of presence (POP) to the called party’s central office. That is all it would be paid to do. It would have no responsibility for the call on either end. Likewise, the originating and terminating LECs would be responsible for only their segment of the call.

Likewise, the Atkinson-Barnekov proposal is based upon independent networks, each interconnecting only by splitting the cost of the interconnection facilities. Other than that, they would be totally independent. Therefore, under this proposal as well, no company would have overall responsibility for the call which transverses more than one network.

Similar arbitrage opportunities exist for the more complex examples.

Therefore, numerous “end-to-end” responsibility decisions that are now made by the IXC (or originating LEC for local calls) would have to be made by the FCC, other regulators, or end users.

2.a. If the quality of a toll call is bad, who does the end user call?

Assume a toll call placed was noisy, or did not go through due to lack of facilities. Who should the end user call to get correction of these problems? At the present time, the end user calls the IXC. The IXC is responsible for the call end-to-end. Therefore, the IXC will take whatever actions are necessary to correct this problem, such as determining where the problem exists and requiring that it be corrected. For example, if one of the LECs’ “subcontractors” did not have adequate facilities to provide the quality of service paid for by the IXC, the IXC has the technical capabilities to locate this problem, and to communicate (and if necessary enforce) the requirements on that LEC.

However, under these Staff proposals, responsibility would be fragmented. Therefore, the IXC and the two LECs involved could point fingers at each other, and it would be up to the end user, FCC, or other regulatory agencies to determine in which segment of the call the problem had arisen, and who therefore was responsible. Of course, the end user would have no way of knowing where in the call the problem existed. This is an impossibly complex mess that must be avoided by rejecting these proposals.

2.b. End users would be billed three times for the same call.

Presently only the IXC bills for a given interexchange call. However, under the DeGraba proposal, the end users would receive three bills for each call—(1) the originating end user would be billed by the IXC for the portion of the segment of the call

that the IXC had carried, (2) that same end user would be billed by the originating LEC for the originating portion of that same call, and (3) the end user that received the call would be billed by its LEC for the terminating portion of that same call. Similar multi-billing for the same call would occur under Atkinson-Barnekov.

2.c. Multiple billing for the same call is economically inefficient.

Three different companies billing for three different parts of the same call creates needless billing and collection costs. The current method, in which only one company bills for a given call, is much more efficient.

2.d. Multiple billing for the same call also creates customer confusion.

Two companies (the IXC and the original LEC) would bill the originating caller for the exact same toll call. This would create customer confusion and dissatisfaction. Many consumers seeing that two companies were billing them for the same toll call might reasonably contact one or both companies, or regulators, complaining that they were being double billed. Answering such customer inquiries (which there would be a lot of under these circumstances), are all real costs that the companies must incur. Of course, that end user would also be receiving bills for calls they received, and possibly did not want at all, such as telemarketing or harassing calls. That would be yet another cause for customer concern, and dissatisfaction.

2.e. Demarcation point problems.

Currently, if the IXC uses an LEC's service, the IXC determines where it will hand off the call from the IXC facilities to the LEC facilities. Since the IXC is paying both the access charges billed by the LEC, and for its own interexchange facilities, the IXC can make the analysis of the proper hand off point based upon economic analysis.

For example, in determining whether to have one POP or several POPs in a LATA, the IXC would consider whether the higher cost they paid to establish more POPs would be offset by reduced access charges that they would pay to the LECs. However, under these two Staff proposals, the location of the POP would no longer be subject to such reasonable economic analysis, because no one company would be paying for all of the services. Instead, it would be to the IXC's advantage to minimize its costs, even if that increased the costs to the LECs. For example, the IXC might utilize only one POP in a LATA instead of several. Having only one POP would reduce the IXC's costs, and therefore allow the IXC to charge its customer less, thereby gaining a competitive advantage over other IXCs. Of course, having one POP in a LATA instead of several would increase the access costs of the originating LEC, since the originating LEC would have to transport the calls a longer average distance to reach that one POP. However, increasing the access cost of the LEC would no longer have any financial impact on the IXC, because under these two Staff proposals the IXC would no longer paying the access costs of the LECs. The LEC could properly complain that the IXC's selection of POP locations raised the LEC's cost. Since no company would have end-to-end responsibility, the regulators would have to step in and make these determinations.

2.f. These proposals are highly “technology dependent.”

Under the DeGraba proposal, the location of the central office identifies the demarcation point between the IXC's and terminating LEC's responsibility. However, the definition of a “central office” is highly technology dependent, and can shift as technology shifts. For example, some remote terminals have switching capability. They are connected to and controlled by a switch, but that switch may be a “remote switch”

that is connected to, and to some extent controlled by, a “host” switch. For this technology, there could be significant debate as to which of these three switches are in the “central office.” In addition, the equipment now in use by some companies to provide telephone service over coaxial cable uses switching equipment that is in the “set top” box, or otherwise located at the customer’s premises. This switching equipment at the customer’s premises switches that customer’s traffic onto one of the available “channels” on the coax. Therefore, these technologies actually use switching equipment at the customer premises. It is to the terminating LEC’s advantage to push that definition as close to the customer as possible, because that minimizes the cost that they are responsible for, (although it increases the cost that the IXC is responsible for).

The incentive for the IXC is in the exact opposite direction. Under these two Staff proposals, there would be no carrier with overall responsibility for a call, and therefore regulators would have the responsibility of determining each demarcation point. Regulators would not only have to establish definitions of terminology, they would also have to settle numerous application questions for numerous locations. Of course, those determinations would only be valid using the technology that existed at the time the evidence for the determination was gathered. Once a new technology appeared, those determinations would have to be reargued and readdressed. For example, packet switching technology is much different than the technology now used for voice telephone service. With no carrier having overall responsibility, the regulators would have to assume that “first level” end-to-end management role. Clearly, this is not the most efficient use of resources for any regulatory body.

It is important to realize that these demarcation point problems would be new problems. Under the current rate structure, if an IXC creates high LEC access costs by minimizing its' POPs, it is the IXC that has to pay the resulting high LEC access costs. This forces the IXC to make decisions that are overall efficient. This would end under both Staff proposals.

2.g. The Atkinson-Barnekov proposal has similar problems.

The Atkinson-Barnekov proposal requires that each network be responsible for its own costs, similar to the DeGraba proposal. That requires defining demarcation points of each network. In addition, under Atkinson-Barnekov, since two companies share the interconnection facilities' cost, they would also have to agree on how that facility would be configured. The interconnection facility would essentially be "designed by committee." Any change in any existing interconnection facilities would have to be agreed to by all companies involved. For example, if one company wanted to upgrade an interconnection facility, then the other party that shares the cost of that facility would have to agree. If the other company did not agree, then the facility could not be upgraded, since the other company is responsible for one-half of the cost of the interconnection facility. This is clearly an inefficient proposal, that would delay or prevent the introduction of new facilities and new technologies.

2.h. These Staff proposals would reduce efficiency.

At the present time, the IXC is responsible for the call end-to-end, and is paid to carry the call end-to-end. To the extent that the IXC uses any "sub-contractors" (such as LECs), it is the IXC who must pay those sub-contractors, and therefore the IXC puts pressure on those sub-contractors to provide the service as efficiently and at the lowest

possible cost. The IXC is in a strong position to pressure the sub-contractors (such as LECs) because the IXC has resources and technology to build its own facilities if it chooses to do so, has a detailed technical understanding of the cost of providing services, and has strong representation with legislators and regulators.

Under both Staff proposals, all IXC concerns about the efficiency of access would end. Under the Staff proposals, the IXCs would not be paying any access charges to the LECs, and therefore would have no reason to be concerned if the LEC's charges for those services were excessive. Instead, the LEC's access charges would be billed to the end users. The end users generally are not in the telephone business, do not have the ability to build their own facilities to circumvent the LEC, and do not have knowledgeable telephone lobbyists and experts representing their telephone interests before legislators and regulators to the extent the IXCs do. Individual end users do not have the purchasing power, and therefore negotiating strength, that an IXC has when dealing with the LECs. Unfortunately in the real world, there is little local service competition in many areas, as the FCC is well aware.

2.i. Both Staff proposals would greatly reduce competition.

These proposals are anti-competitive. Had these proposals been in effect in prior years, CLECs probably would not exist. Many CLECs are companies that used to be called competitive access providers (CAPs). Their primary business was providing access services to the IXCs in competition with the LECs. Because the IXCs were responsible for the cost of the call end-to-end, the IXCs were constantly looking for ways to reduce costs end-to-end. In many instances, the IXC encouraged the formation of CAPs, contracted with CAPs and even encouraged CAPs to enter new markets, as a way

for the IXCs to minimize their access costs. Even today, the access charges paid by the IXCs to the CLECs are a major source of CLEC revenue. The CAP industry, which subsequently became the CLEC industry, exists in large part because the IXCs had the end-to-end responsibility of providing a call, and would receive financial benefit if they could increase the efficiency of toll calls from end-to-end. Under either Staff proposal, the IXC's end-to-end responsibility would terminate, and there would no longer be any financial reason for IXCs to care about the continued existence of CAPs/CLECs, or to urge CAPs/CLECs to expand to new areas.

2.i. CPE could be separated from other services only because the end user could disconnect it at the jack; However, there is no way the end user can disconnect their service at the POP

The Staff proposals allege that the fragmentation of responsibility they propose is similar to when customer premise equipment (CPE) was separated from local service. (Pages ii and 6, Atkinson-Barnekov) However, the segregation of CPE for regulatory purposes is possible only because of the wall jacks that allow the end user to disconnect the telephones from the rest of the network. The ability to disconnect the telephones allows the end user to determine the responsibility for problems. If a customer plugs a different telephone into the jack and it works, that means any problem was in the original telephone. If they plug in a different telephone and the problem still exists, the problem is not in the telephone. Likewise, the separation of inside wire for regulatory purposes from the rest of the network also depends upon the existence of the disconnection jacks at the network interface device (NID). The jacks at the NID allow the end user to separate the inside wire from the telephone network, and therefore determine whether a problem is in the inside wiring or in the network. Without the ability to make such separation, it

would not have been reasonably possible to separate the pricing or responsibility for inside wiring from the rest of the network, because there would be no way for the end user to assign the responsibility for problems.

However, it is not possible to install customer accessible jacks at the new demarcation points that the Staff proposals present. As a result, there would be no way for the end user to assign the responsibility for problems. DeGraba proposes that an LEC be responsible for an originating toll call until it reaches the POP, where the IXC would assume responsibility. Unlike CPE and the inside wiring, there is no practical way that a disconnection jack can be made available to the end user at the POP. First of all, the POP may be located many miles from the end users. In addition, by the time a customer's call gets to the POP, it is "multiplexed," which means that call is in a data stream that includes bits from a large number of other calls. There is no way an end user in any simple matter could disconnect their LEC from the IXC at the POP, or assign responsibility for problems. To assign responsibility for problems at this level requires sophisticated test equipment and trained personnel.

DeGraba proposes that the IXC's responsibility end at the central office, and the terminating LEC's responsibility commence there. It is not possible to install a customer accessible jack at that demarcation point, for the same reasons discussed above pertaining to the "POP." In short, the ability of the end user to physically separate CPE and inside wiring from the remainder of the network so that the end user could determine responsibility, is what made it possible to separate CPE and inside wiring from the remainder of the network for pricing and regulatory purposes. However, end user accessible disconnection capability is not possible for the new demarcation points that

Staff proposes. In the above discussion, I have used DeGraba as an example, but similar demarcation point problems exist in the Atkinson-Barnekov proposal. When you eliminate end-to-end responsibility, that requires the establishment of arbitrary and debatable “demarcation” points.

3. STAFF’S PROPOSALS DO NOT REFLECT THE REALITY OF COMPETITIVE MARKETS.

In competitive markets, the one company that sells products or services to the end user generally is responsible for making arrangements with any subcontractors or suppliers it utilizes. For example, when a retail customer buys a hammer in a store, that customer pays a price to the store. The retail customer does not have to negotiate with the factory that manufactures the hammer, and separately negotiate with the company that transported the hammer. It would not be economically efficient to require all customers to develop the ability to deal with all wholesale suppliers and manufacturers. Therefore, that inefficient solution is not what occurs in competitive markets. The retail customer deals only with the store that sells the hammer, and it is up to that store to work out the arrangements with any suppliers that it utilizes. The current telephone system, in which one company has overall responsibility for a given service, is similar to what occurs in competitive markets. Staff’s proposal wherein the provision of one service is fragmented, and the end user is required to deal with each step of the supply process, is not what generally occurs in competitive markets.

4. THESE PROPOSALS WOULD DESTROY THE INTERNET FOR THE GENERAL PUBLIC.

4.a. The proposal to charge for receiving calls would greatly increase ISP's costs.

Both Staff proposals discuss at length the problem that the Internet has caused the FCC and the FCC Staff. (Paragraphs 83-85, Atkinson-Barnekov; Paragraphs 81-83, DeGraba) Both proposals propose effectively to kill the Internet for the general public by charging Internet service providers (ISPs) to receive calls. Since ISPs receive huge volumes of calls, while originating little or no traffic, this proposal will drastically increase the cost to the ISPs, and basically destroy the Internet as a service that can economically be provided to the general public. The ISPs are the gateways through which the general public connects to the Internet.

It is clear that increasing the charges to the ISPs is one of the goals of both of these proposals. Both proposals recognize that ISPs receive a high volume of traffic (while originating little or none). The proposals to charge customers to receive calls is clearly aimed at raising the cost to the ISP, since the ISPs are the major type of customer that receives far more traffic than it originates.⁸

Charging customers to receive calls is clearly part of both of these proposals.

Much of the analysis of this paper assumes that the called party benefits from received calls and therefore should share in the cost of such calls. (Paragraph 117, DeGraba)

The Atkinson-Barnekov proposal states:

⁸ Some sales organizations, such as airline ticket sales, may also receive high volumes of incoming traffic, but they typically use "800" (or "888") numbers, and therefore would not be significantly affected by this Staff proposed change. Such "sales" calls are of such short duration that paying to receive them by paying

One network should recover all intra network costs from their end user customers. (Paragraph 25, NPRM)

Therefore, the receiving LEC would have to recover its costs of receiving this traffic from the receiving end users. Since a huge volume of traffic is being received by ISPs, charging to receive calls would greatly increase the charges to the ISPs.

Currently, ISPs virtually always subscribe to measured local service, and therefore pay little or no usage costs. (Flat rates include recovery of usage costs.) Measured service rates have a “line charge” plus additional usage charges for outgoing traffic. Since virtually all of the traffic to the ISP is incoming, those outgoing usage charges generally do not apply to the ISP.⁹

4.b. Destroying the Internet for the general public is not in the public interest.

Pricing the general public off of the Internet is not in the public interest. Placing additional “receiving traffic” charges on the ISPs, and thereby harming the Internet is not in the public interest. In fact, the Telecommunications Act of 1996 (TA96) establishes the promotion of the Internet as part of the “policy of the United States.” Section 230(b) of TA96 states,

POLICY.--It is the policy of the United States--

- (1) to promote the continued development of the Internet and other interactive computer services and other interactive media;
- (2) to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation;

for 800 service is not a major obstacle when selling a \$1,000 airline ticket, for example. However, an ISP paying to receive all of the traffic that it receives would create a huge increase in costs to the ISPs.

⁹ In many major cities, flat rate service is not available for business services while measured service is mandatory. Even when flat rate service is available, the ISPs will opt for the optional measured service because the line charge under measured service is lower than the charge under flat rate service, because the flat rate charge includes the charge to recover the cost of outgoing usage. The ISPs have little or no outgoing traffic to which the measured traffic sensitive charges would apply.

Of course, both Staff proposals are clearly designed to “fetter” the ISPs by imposing a huge new charge on them for “receiving” traffic. It has been the FCC’s stated goals to facilitate Internet growth. In the Access Charge Reform Order, FCC 97-158, released May 16, 1997 paragraph 334 states:

We conclude that the existing pricing structure for ISPs should remain in place, and incumbent LECs will not be permitted to assess interstate per-minute access charges on ISPs. We think it possible that had access rates applied to ISPs over the last 14 years, the pace of development of the Internet and other services may not have been so rapid. Maintaining the existing pricing structure for these services avoids disrupting the still-evolving information services industry and advances the goals of the 1996 Act to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation." (footnotes omitted)

5. THESE TWO PROPOSALS ARE ATTACKING THE WRONG PROBLEM-IF THE PRICE IS EXCESSIVE, THEN CORRECT THE PRICE. IT IS REASONABLE TO CHARGE REASONABLE RATES FOR PROVIDING TERMINATION SERVICE.

Both of these proposals are based upon the concept that charging carriers for terminating services is somehow improper. These documents state that certain CLECs were charging excessive rates for terminating interconnection. (Paragraph 18, DeGraba; Paragraph 8, Atkinson-Barnekov) As a result of their excessive terminating interconnection rates, the CLECs generated excessive access revenues for terminating traffic. The correct solution to charges that are excessive is to replace them with charges that are reasonable. But that is not what the Staff proposes. Instead they propose going to the other extreme by making some services to certain categories of customers free.

It is correct that excessive rates cause problems. It is just as true that free service causes problems, including implicit subsidies and arbitrage. The correct solution is to have reasonable rates. Reasonable rates that properly recover the cost of service compensate the companies for the costs they incur, do not cause arbitrage, and do not require implicit subsidies.

The Staff proposals mention ISP telephony as a concern. (Paragraph 84, Atkinson-Barnekov; Paragraphs 17 and 78, DeGraba) However, DeGraba acknowledges that ISP telephony provides poor quality service. (Footnote 62 and Paragraph 78, DeGraba) It is similar to ham radio in that the quality of service is poor. ISP telephony, e-mail, CB radios, wireless/cellular services, ham radios, and many other items can be presented as “threats” to the existing telephone system. However in spite of the existence of all of these alleged “threats” over the years, the number of interstate toll minutes, number of local minutes, and wireline loops in service, all continue to increase year after year.¹⁰ As additional services become available, they supplement the wireline service, but do not significantly replace them. For example, with the Internet and e-mail, it has become easier to become acquainted with people who live in other states, or even other countries. Such personal e-mail is not necessarily replacing toll calls (because otherwise you would not even have known these people). In fact, after becoming acquainted with new people in other states through the Internet and e-mail, they might actually call each other as well. In addition, neither ISP telephony nor e-mail use the LEC’s switch for free. If an e-mail or ISP telephone call goes to an ISP through a cable modem, it is correct that call will not support any portion of the cost of the LEC’s local switch.

¹⁰ Table 8.4 (Total U.S. Telephone Lines) and Table 8.6 (Total Interstate Access Minutes by Study Area), Universal Service Monitoring Report, CC Docket No. 98-202, September, 2000.

However, the fact that such a call does not pay for any part of an LEC switch is appropriate, because it does not use the LEC switch.

6. THESE PROPOSALS MISSTATE THE NATURE OF THE CURRENT “BILL AND KEEP” ARRANGEMENTS.

Paragraph 15 of the DeGraba proposal alleges that under existing bill and keep arrangements, “the called party’s carrier must recover the cost of termination from its end-user customer.” This is a misunderstanding of current “bill and keep.” Under current “bill and keep,” the end users are not being charged for receiving calls. The network that originates the call pays the network that terminates the call for those terminating services. However, instead of sending money, they make “payment in kind” by providing an approximately similar amount of offsetting terminating services in return. If you traded a TV for a stereo, no money changed hands, but the stereo was not “free.” Upon observing such a transaction, one might pass a law that requires that the owners of stereos would have to give the stereos away free. However, such a law would not be reflective of what actually occurred in that transaction. As stated in Paragraph 12 of the DeGraba proposal, current bill and keep arrangements are generally accepted only if “traffic is relatively balanced.” The “balance” requirement means that the originating carriers are making a “payment in kind” for the terminating services they have received.

The Staff proposals are not based upon the current “bill and keep” (“payment in kind”) arrangements. No "balance" in traffic of any kind is required in the Staff proposals. The Staff proposals involve simply providing free service to other carriers, with no requirement that those other carriers pay for those services either using money or by providing an equivalent amount of offsetting service in “payment in kind.” Instead,

those free services would simply have to be subsidized by other customers, which requires implicit subsidies.

7. RURAL CUSTOMERS WOULD PAY HIGHER TOLL RATES THAN URBAN CUSTOMERS

The DeGraba proposal acknowledges that it will result in higher charges to customers in high cost areas than in urban areas:

A shift to COBAK may result in some shift in costs among specific groups of customers, such as raising slightly the cost of customers in high cost areas. (Paragraph 125, DeGraba)

The DeGraba proposal gives no reason to believe that this shift would be only a “slight” shift. Higher rates for toll service for rural, high cost customers than for urban customers is not acceptable. Section 254(g) of the Telecommunications Act of 1996 (TA96) requires that the toll rates charged to rural customers be no higher than the toll rates charged to urban customers:

The rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by such providers to its subscribers in urban areas.

Both the DeGraba and Atkinson-Barnekov proposals have the effect of increasing the costs for interexchange toll service to customers in high cost areas, thereby making their rates higher than the costs that customers in urban areas pay. One reason that the rates for rural customers would be higher than for urban customers under the Staff proposals is that the rural customers would be required to pay the costs caused by the IXCs’ decisions as to where to locate the POPs. The IXCs tend to locate the POPs in urban areas. Because of where the IXCs choose to locate the POPs, it might be a very

short distance from an urban customer's premise to the IXC's POP, but it might be a long distance from a rural customer's premise to the IXC's POP.

Under the current rules, the rural customers are not harmed by the IXC's decision to locate the POPs further away from rural customers than they do from urban customers, because the IXCs pay access charges for the costs incurred to get from the end users to the IXC's POP. Therefore, under current rules, if an IXC decides to locate a POP a considerable distance away from rural customers, it is the IXC that pays the cost caused by that IXC decision, not the rural customers. However, under the DeGraba proposal, the rural customers would be directly billed for the cost of the originating access needed to get to the IXC's POP. Under the DeGraba proposal, if an IXC chose to locate a POP one mile away from a customer, then that customer would be responsible for paying the LEC access charges to cover that one mile distance. However, if the IXC chose to locate its POP 30 miles away from a rural customer, then the rural customer would be responsible for paying for all costs to transport that call from the customer premises to the IXC's POP that is 30 miles away. Under the DeGraba proposal, it is the rural customer, not the IXC, that would bear the access cost caused by the IXC's decision as to where to locate the POP. The Atkinson-Barnekov proposal has similar problems. It would charge the end users all costs on their LEC's network up to the point of "interconnection."

8. CHARGING CUSTOMERS TO RECEIVE CALLS

8.a. These proposals send the wrong "price signal."

Standard economic theory is that the efficient use of resources will be obtained if the price to a customer properly reflects the resources that would be used if that service is provided. With such a proper "price signal," the customer will only choose to purchase

the service if the benefit to the customer is greater than the cost of the resources required to provide this service.¹¹ This results in economic efficiency.

In order for this principle to work, two conditions must exist: (1) the price must reasonably reflect the resources that will be used if the service is provided, and (2) the customer making the purchase decision must be aware of the benefit of the service that they would receive.

However, the two Staff proposals would abandon these principles by (1) establishing prices (such as the free service to “carriers”, see Attachment A) that do not reflect the cost of the resource being used, and (2) requiring customers who do not know of the benefit of the service to make the purchase decision. Under both Staff proposals, customers receiving a call would be charged for receiving the call, but they would not know the “benefit” of the incoming call until after they had decided to accept (purchase) the call.

8.b. The receiving customer cannot make an economically efficient decision because they do not have the information as to the benefit to be received before answering the call.

The originating customer is the only customer that is in the position to make the efficient decision. The originating customer knows what the content of the call will be, and therefore knows the benefit of the call. If that customer is also presented with a price that properly reflects the cost of the call, then the originating customer has the information to make an economically efficient decision. If the benefit from the call is not worth the price, they will not make the call. If the benefit exceeds the price, the customer

¹¹ Of course, other considerations are also involved. For example, common costs must be recovered in order to avoid companies from going bankrupt. Therefore, the price generally properly includes some recovery of common costs.

will make the call. The current practice of having the originating customer pay for the call is designed to result in efficient decision making.

However, under Staff's proposals, the customer that receives the call would be forced to decide whether to receive the call or not. That customer would be presented with a price; however, they would not know the content, and therefore the benefit, of the call. Since they do not know the benefit, they are not in the position to make an economically efficient decision. If they decide to answer a call, and it was a telemarketer, that would generally have been a wasted call, and an inefficient use of resources.

The present concept is much more likely to lead to efficient decision making than the proposed concepts. Under the present concept, the originating customer is presented with the price. Since the customer placing the call knows the value of the call, they can rationally decide whether that call is or is not worth the price. Under Staff's proposals, the customer receiving the call would have to make at least part of the purchase decision, but they cannot do so efficiently since they do not know the benefit of the incoming call until after they have answered it. The Staff proposals create economic inefficiency.

8.c. The calling customer would also make uneconomic decisions, because their price would not reflect the full cost of the call.

A corollary to the above problem is that under Staff's proposals, the calling customer would also make uneconomic decisions. Under Staff's proposals, the receiving customer would be paying part of the cost caused by that call, and therefore the price charged to the originating customer would be less than the full cost that would be caused by that call. This is an improper price signal. As a result, customers would place calls

where the benefit of the call to them was less than the total cost caused by that call, thereby wasting resources. This is harmful to the economy, and is inefficient.

Another practical impact of this inefficiency is that it would stimulate inefficient telemarketer calling. Only a small percent of telemarketer calls are successful. Therefore, when deciding to telemarket a product, the product sold must be profitable enough to cover all of the cost incurred to telemarket that product, including the cost of the numerous telephone calls that are required in order to obtain one sale. If the price of the telephone calls to the telemarketer reflects the full cost that would be incurred, and the benefit to the telemarketer is not great enough to cover those costs, then the telemarketer will not sell that product through telemarketing. However, if the price presented to a telemarketer does not reflect the full cost (which is what would occur under Staff's proposals), then the telemarketer would telemarket products or make calls where the benefit even to the telemarketer is less than the actual cost of the calls.

8.d. Both Staff proposals would require the receiving end user to implicitly subsidize the traffic sensitive costs that are caused by telemarketers.

Under these Staff proposals, the rates charged to telemarketers would not cover the full cost of the traffic sensitive costs that the telemarketers caused by placing traffic on the network. The customer that receives the calls would be forced to support a portion of the costs of those calls from telemarketers. This would require those receiving customers to subsidize the traffic sensitive costs that are caused by the telemarketers who are placing these calls. In the vast majority of cases, telemarketing calls are undesired by the receiving party. Generally only a few percent of customers receiving such telemarketing calls buy or otherwise express interest in the product offered. For the vast

majority of customers, telemarketing calls are simply an undesirable interruption.

Subsidizing the telemarketer caused usage cost would be an incentive for telemarketers to further increase their subsidized usage of the network.

9. CHARGING CUSTOMERS TO RECEIVE CALLS WILL CREATE UNDESIRABLE SIDE EFFECTS.

As previously discussed, the receiving customer does not have the information needed to make an economically efficient decision. Only the calling customer knows the benefit of the call, as discussed in Part 7.

9.a. Requiring customers to pay to receive calls would make customers reluctant to accept calls, which would decrease the usefulness of the network.

Have you ever wondered why there are no or few cellular telephone books, but virtually every wireline telephone company publishes a telephone book? The reason is that cellular customers generally must pay for receiving calls. Therefore, many cellular customers do not want their cellular phone number made available to the public.

9.b. Most telephone numbers would no longer be publicly available.

If wireline customers were forced to pay to receive calls, then it is reasonable to expect that the wireline telephone books would either disappear or have greatly reduced listings. Likewise, many customers would not want their telephone numbers published in any Internet telephone directories, or available from the operators. Forcing customers to pay to receive calls would result in more unlisted numbers, and would greatly reduce the usefulness of the nationwide network as a public network.

9.c. Customers would turn off their phones.

Cellular customers are generally charged to receive calls. Because of this, many cellular customers turn their phones off when not placing calls, in order to avoid receiving (and therefore being forced to pay for), unwanted calls. Because of this, four times as many calls are placed from cellular phones than are received by cellular phones.

That ends up discouraging them from giving out their wireless phone number. ... the typical profile for U.S. cellular usage is about 80% outbound calls, 20% inbound,... (Page 37, America's Network, "The Keys to PCS Profitability", April 1, 1997)

Quite simply, cellular customers turn off their phones because they are charged to receive calls. This has not significantly degraded the use of the network, only because wireline customers are not charged to receive calls, and therefore are available to receive calls. However, if wireline service was priced as cellular is (with a customer paying to receive the calls), then the wireline customers would also be reluctant to receive calls. As a result, most calls simply would not go through because the receiving party would have their phones turned off or would not accept them. This would decrease the usefulness of the network.

If wireline customers are charged to receive the calls, then undoubtedly telephones would become available with "off" switches on them. Wireline customers would make a call, and then turn their phones off to avoid incurring unwanted "receive" charges, just as many cellular customers now do.

9.d. Customers would turn off or eliminate their answering machines.

Under these Staff proposals, customers would pay to receive calls, and therefore they would have to pay even if their answering machine answered an unwanted call.

Therefore, many customers would disconnect, turn off, or discard their answering machines to avoid unwanted charges. This would make it more difficult to communicate.

10. IN MANY CASES, THE CUSTOMER RECEIVING A CALL MAY NOT RECEIVE A BENEFIT FROM THAT CALL.

Many calls do not have a benefit to the receiving party. A key example of this is calls from telemarketers. Under these Staff proposals, not only would the calls from telemarketers interrupt the receiving customer, but in addition the receiving customer would have to pay for a portion of the cost of those unwanted calls. The DeGraba proposal claims that telemarketing is a “small fraction of telephone traffic.” However, no evidence of that is provided. Telemarketers can place huge volumes. Telemarketers typically utilize each of their lines several hours per day placing calls. Many of them have automated machines that dial numbers while their sales people are talking to other customers who have already answered. When a customer answers a call, the machines automatically switch those lines to a salesperson. Typically, these machines dial more numbers than the telemarketer has salespeople, to allow for those that do not answer, are busy, etc. In addition, it must be remembered that Staff’s proposal would stimulate telemarketing activity, because the telemarketers will be allowed to place calls below the true cost of those calls. This occurs because the receiving customer would also pay a portion of the cost of those calls. In addition, it is inherent fairness to cause people to pay even when they receive prank, annoying, or harassing calls.

There are examples of some customers, primarily businesses, who do wish to receive calls from other parties. The current tariff arrangements allow such customers the

opportunity to do so by subscribing to 800 (or 888) service. However, such businesses are a special circumstance. They are selling products, and therefore the cost of receiving the calls is part of the cost of selling those products. Normally, a sales call is of short duration. For example, an airline selling a \$1,000 ticket can easily afford to pay the cost of receiving a call in order to make that sale. However, no change in the present structure is needed to make such services available to customers who do wish to pay to receive calls, such services are already available. The Staff proposals essentially take away the option of not paying to receive calls. All customers would essentially be forced to have service that was somewhat similar to an 800 number service. Under Staff's proposals, the only way to avoid these "receiving" charges is to do what many cellular customers do, which is to limit the availability of their telephone number, turn their phones off, make their number unpublished, or otherwise make themselves unavailable for receiving calls.

10.a. The significant "setup" cost would be incurred even if the receiving customer quickly hung up.

The DeGraba proposal argues that a receiving customer could hang up once they realized the call was of little or no benefit. Unfortunately, a major portion of the traffic sensitive cost of a call is for the "setup" of the call. Equipment is required to set up a call that is not required to continue the call.¹² The cost to "setup" call is incurred regardless of whether the call lasts ten seconds or ten minutes. The "setup" is one of the most expensive traffic sensitive parts of a call. If a call is received by a network, that network

¹² For example, from the digits dialed one must identify where the call should be sent, and must identify a route where the switching equipment and interoffice facilities to connect the call. In addition, data for billing must be recorded. Information pertaining to the calling number for Caller ID, Call Return, or Call Trace purposes must be identified retained, and processed, etc.

has to incur those setup costs, even if the call lasts only a few seconds. When the receiving LEC's traffic sensitive costs are billed to the receiving end users, those end users will support a significant cost for receiving those unwanted calls, even if those calls last only a few seconds.

10.b. Caller ID

DeGraba argues that perhaps with Caller ID, customers could identify the benefit of the call before deciding to answer. (Paragraph 118, DeGraba) There are several problems with this argument. Customers with Caller ID look at the Caller ID number, and if they do not recognize the number, they frequently will let the call be answered by their answering machine. However, if they had to pay to receive the call, even that would still cost them. If the answering machine answers the call, that call was "received," and the customers would have to pay for it. In short, even customers with Caller ID would pay "received" charges, regardless of whether they personally answered the call or let their answering machine answer it. In addition, Caller ID service generally costs several dollars per month.

With Caller ID, the receiving party would know the telephone number and listing name of the originating telephone line, but they still would not know what the subject matter of the call was. In addition, they might refuse a call from someone they knew, if the caller was calling from a different phone (i.e. from a neighbor's, work, or payphone).

11. THE STAFF PROPOSALS ARE ECONOMICALLY INEFFICIENT.

These proposals are economically inefficient for several reasons:

(1) Providing unlimited free service to certain classifications of customers ("carriers"), as discussed in Part 1 above, and as shown on Attachment A, creates

inefficiency by providing the wrong “price signal.” Resources are required to provide calls. When a price is free, which results in several instances under Staff’s proposals, that price does not reflect the cost of resources actually utilized, and therefore sends an inefficient price signal.

(2) The provision of the free services under Staff’s proposals would require implicit subsidies from other customers, as discussed in Part 1 above, and as shown on Attachment A. These implicit subsidies are economically inefficient.

(3) As previously discussed, Staff’s proposals would eliminate any end-to-end oversight by any company. Therefore, no company would have incentive to achieve end-to-end efficiency for a call. This is discussed in more detail in Part 2.h.

(4) Under the Staff’s proposals, three different companies would bill for the same call. This is economically inefficient. This is discussed in more detail in Part 2.c. above.

(5) The customer receiving the call does not know the benefit that would be derived from the call until after they answer it. Therefore, that customer is not in the position to make the economic efficient decision as discussed in Part 8.b.

12. REGULATORS WOULD STILL HAVE TO REGULATE ACCESS AND TRANSPORT RATES-IN ADDITION, THEY WOULD HAVE TO DEAL WITH NEW PROBLEMS RELATING TO DEMARCATION AND NEWLY CREATED IMPLICIT SUBSIDIES.

The DeGraba proposal states:

COBAK eliminates the need for regulators to set prices for termination.
(Paragraph 90)

However, in the detailed discussion, the DeGraba proposal explains that this statement would be true only if there were no “dominant” carriers. Since there are dominant carriers, DeGraba acknowledges that regulation in both the access and transport charges would be required under the DeGraba proposal.

Thus, it appears appropriate to extend rate regulation of incumbent LECs, where the LEC already is regulated, to the recovery of these costs, while it appears unnecessary to regulate the rates of carriers whose end-user rates are not currently subject to regulation. (Paragraph 124, DeGraba)

And,

If, however, the only provider of transport facilities is the incumbent LEC, then there is cause for concern, because the incumbent LEC may have an incentive to charge high prices for transport in order to deter entry. In such a case, it will be necessary to regulate the price that incumbent LECs charge for transport facilities, at least until competition renders such regulation unnecessary. (Paragraph 121, DeGraba)

The Atkinson-Barnekov proposal also acknowledges that until there is full competition (which does not now exist), the certain transport rates would still have to be regulated. (Paragraph 71, Atkinson-Barnekov) Of course, if all services were competitive everywhere, the regulators would not need to regulate rates, but that would be true even without the DeGraba or Atkinson-Barnekov proposals.

As long as there is significant monopoly power, the fact that the access services would be billed to end users instead of IXCs does not absolve the regulators from the responsibility of seeing that those charges for access services are reasonable. The end users are as deserving of protection from unreasonable access charges as are the IXCs.

13. THE ATKINSON-BARNEKOV AND DEGRABA PROPOSALS ARE NOT “LARGELY SELF-ADMINISTRATING.”

On page ii of the Executive Summary of the Atkinson-Barnekov proposal, it is stated:

The rule proposed here is a largely self-administering scheme that relies primarily on market mechanisms.

This is not correct. As discussed in Part 12 above, it would still be necessary for regulators to regulate both the transport rates and access charges, much as they do today. In addition, it would also be necessary for the regulators to deal with the new regulatory responsibilities caused by the lack of any IXC (or LEC for local service) having end-to-end responsibility. The regulators would now have to provide the first level of oversight of the network end-to-end. In addition, the new issues created by the need to establish and update demarcation points between all carriers would be a huge, new regulatory burden that does not now exist. (See Items 2.e.) Finally, the cross-subsidies required to support the provision of free service to other carriers would create new problems that the regulators would have to deal with repeatedly. (See Part 1 and Attachment A) The adoption of the Staff proposals would create huge, new arbitrage incentives that the regulators would have to continually address and attempt to resolve. (Attachment A)

14. THE DEGRABA AND ATKINSON-BARNEKOV PROPOSALS WOULD NOT ELIMINATE MONOPOLY POWER.

Another claimed advantage of the DeGraba proposal is that it “will eliminate, or significantly reduce, the terminating access monopoly problem.” (Paragraph 24, NPRM) This “monopoly” problem would not be eliminated or significantly reduced by either Staff proposal. The simple fact is that in most areas, the ability to connect traffic to and

from a premise is virtually a monopoly service. For most customers, especially residential customers, there is only one company that has a loop to the premise. The company that has that loop is the only company that can provide access service to and from the premises. That monopoly power will still exist regardless of whether the DeGraba, Atkinson-Barnekov, or some similar proposal is adopted. The only difference is that currently it is the IXCs that must deal with the fact that this access service is essentially a monopoly service. The DeGraba and Atkinson-Barnekov proposals would shift that onto the end user. The monopoly power would not be eliminated, only the party paying the access charges to the monopoly service provider would change.

15. THESE STAFF PROPOSALS WOULD NOT “AVOID” THE PROBLEM OF COMMON COST ALLOCATION ENTIRELY-INSTEAD THEY UNREASONABLY ALLOCATE ZERO PERCENT OF COMMON COSTS TO SOME SERVICES, AND 100% TO THE REMAINING SERVICES.

The Atkinson-Barnekov proposal asserts that it “avoids the problems of common cost allocation entirely.” (Paragraph 29, NPRM). In fact, this proposal does include common cost allocations, but they are unreasonable, unsupported, and unjustified common cost allocations. For example, Footnote 57 of Atkinson-Barnekov acknowledges that interconnection services would utilize the switch. But for no valid reason, Atkinson-Barnekov proposes that zero percent of the “common costs” of the switch should be recovered from those interconnection services. Recovering no portion of the “common costs” of the switch from the interconnection services that use that switch would require that 100% of those switch “common costs” be recovered from other services that also utilize that switch. This is an unjust, unreasonable, and unsupported allocation proposal. The Atkinson-Barnekov proposal presents no reasonable

justification for allocating 100% of the common costs to other services, and zero percent of the common costs to the interconnection services. Those switch common costs do have to be recovered. There is no reason that the interconnection services should not support a reasonable share of the common costs of the switching equipment which they, along with other services, utilize.

Likewise, the other common costs of the companies that provide switching or transport facilities are also costs that would have to be recovered. For example, these companies undoubtedly have executives, attorneys, accountants who prepare income tax returns, and similar common costs. There is no valid reason that the interconnection services provided by that company should be allocated zero percent of those common costs.

15.a. Section 254(k) of TA 96 requires reasonable allocation of common costs.

The Atkinson-Barnekov proposal proposes to under-allocate common costs to interconnection services (an allocation of zero). That would have the effect of over-allocating common cost recovery to the remaining services. Since it is likely that some of the other services would be “universal services,” an over-allocation of common costs to universal services would be in violation of Section 254(k) of TA96. Section 254(k) requires that only a “reasonable” allocation of joint and common costs can be made to the universal services.

Section 254(k)--SUBSIDY OF COMPETITIVE SERVICES PROHIBITED.--A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

In fact, the “zero” common cost recovery that the Atkinson-Barnekov proposal proposes is not what occurs in competitive markets. Standard economic theory does not hold that prices in a competitive market will generally equal incremental cost. Instead, standard economic theory holds that prices in a competitive market will cover the total cost of an efficient firm, which includes both the incremental and common costs. If prices did not recover the common costs, even efficient firms would go bankrupt. In fact, the FCC in its Interconnection Order found that prices should be based on the TELRIC of the service, plus a reasonable share of the joint and common costs. The FCC’s Interconnection Order states:

The Commission concludes that the prices that new entrants pay for interconnection and unbundled elements should be based on the local telephone companies Total Service Long Run Incremental Cost of a particular network element, which the Commission calls “Total Element Long-Run Incremental Cost” (TELRIC), plus a reasonable share of forward-looking joint and common costs.¹³

16. IT IS NOT NECESSARY TO ADOPT THE DEGRABA OR ATKINSON-BARNEKOV PROPOSALS TO ELIMINATE THE INTERSTATE CCLC, IT HAS ALREADY BEEN VIRTUALLY ELIMINATED.

The DeGraba proposal states that it would eliminate the carrier common line charges (CCLC).

...the IXC, under COBAK, will pay no originating access charges at all to the calling party’s local carrier, and it will pay no local switching or carrier-common-line charge to the called party’s local carrier. (Paragraph 42)

However, the interstate CCLC has already been effectively eliminated.¹⁴

The Atkinson-Barnekov proposal states:

¹³ Paragraph 29, FCC Interconnection Order, FCC 96-325

This makes most network costs, particularly loop costs, common costs to be allocated among various services ... because this cost includes an allocation of common costs the calling party's network ends up paying a share of the common cost of the called party's network. (Paragraph 9)

Both documents repeatedly claim that the loop and other non-traffic sensitive (NTS) costs are recovered in per minute access charges to the IXCs. (Paragraph 39, NPRM; Paragraph 4, page 2 of de Graba) However, significant interstate loop and NTS central office equipment (COE) costs are not being recovered in the traffic sensitive interstate access charges under the current FCC Rules. The FCC, in its CALLS Order, has established the recovery of the interstate loop costs virtually entirely from the subscriber line charge (SLC, also sometimes referred to as the end user common line (EUCL) charge), which is billed to the end users. In addition, the FCC also splits the cost of the switching equipment between the traffic sensitive and NTS COE costs. The interstate NTS COE costs of the switching equipment are part of the "common line" basket that is billed in the EUCL charge to the end users. The costs that are being billed in the traffic sensitive local switching access rates are traffic sensitive costs. The NTS costs have already been identified and are billed as fixed costs.

Both documents claim that the current traffic sensitive access charges are "above cost access charges." (Paragraphs 9, 17, and 18, de Graba) However, the FCC recently adopted the CALLS proposal which alleges determined traffic sensitive charges that were reasonable and cost based. Therefore, if CALLS establishes traffic sensitive costs that are reasonable and cost-based, it is not clear what alleged problem is being addressed, and on what basis the Staff claims that the current traffic sensitive access charges are improperly above cost.

¹⁴ The FCC commenced a phase-out of the CCLC in FCC Docket No. 97-158, and the interstate CCLC has

16.a. Local Rates

The Staff makes several references to flat rate charges for local service. (Paragraphs 77, 78, and 81, DeGraba) First of all, the local rates are under the jurisdiction of the state commissions, not the FCC. A number of state commissions allow optional flat rate service for residential customers, but do not allow it for business customers. For example, in 36 out of the 95 cities in the FCC's Reference Book of Rates, Price Indexes, and Expenditures for Telephone Service, optional flat rate service was available to residential customers, but not available to business customers.¹⁵ In addition, state commissions frequently do consider the level of usage in setting the flat rates. For example, in those areas where flat rates are available to business customers, the PBX trunk rate is generally much higher than the single line business flat rate charge because the average usage on a PBX trunk is higher than the average usage on a business line.¹⁶ Charging for local usage using flat rates is not providing local usage for free.

17. THE ATKINSON-BARNEKOV "FULLY PROVISIONED NETWORKS" DOES NOT REPRESENT REAL WORLD, EFFICIENT FACILITIES COST

Regarding the Atkinson-Barnekov proposal, the NPRM states:

The second underlying assumption is that the incremental costs of interconnection involve primarily capacity costs that should be recovered through flat charges. Accepting this latter assumption eliminates the need for traffic-sensitive interconnection charges. (Paragraph 28, NPRM)

been virtually eliminated.

¹⁵ FCC Reference Book of Rates, Price Indexes, and Expenditures for Telephone Service dated June, 1999, Tables 1.1 and 1.3.

¹⁶ FCC Reference Book of Rates, Price Indexes, and Expenditures for Telephone Service dated June, 1999, Tables 1.10 and 1.19.

Atkinson-Barnekov develop their analysis in the context of ‘fully-provisioned networks’ --i.e., networks that have sufficient capacity to allow their subscribers to make and receive all calls as they wish. (Paragraph 26, NPRM)

The “fully provisioned networks” that were primarily used in the Atkinson-Barnekov analysis are not economically efficient, and are not in any way related to the networks actually used to provide telephone service. The Atkinson-Barnekov proposal developed its assumption that there were little or no traffic sensitive interconnection costs primarily by using two network designs: a “mesh” network and a “linear” network. Both of these networks are unrealistic and inefficient networks that have little or no relationship to how a service is actually and efficiently provided. Under the hypothetical “mesh” network, if there were 5,000 customers to be connected, then every premise would have 5,000 lines coming from that premise going to every other premise.

According to paragraph 24 of the Atkinson-Barnekov proposal, the number of links required is $(n^2 - n/2)$. For an exchange containing 5,000 customer lines, 24,997,500 links (loops) would be required.¹⁷ Such a network would be hugely expensive. Even if each link/loop cost only \$10 per month, the monthly cost would be almost \$250 million¹⁸ to serve these 5,000 customers, or almost \$50,000 per customer per month. This “mesh” network is hugely inefficient, and is not realistic.

In reality, in an exchange with 5,000 customers, a telephone company actually uses only 5,000 active links (loops). They run one loop from each customer premise to the central office. When one customer wants to talk to another customer, the switch in the central office connects the calling customer’s loop to the called customer’s loop. Only 5,000 active loops are used, not 25 million, as is assumed in the “mesh” network.

¹⁷ $((5000)^2 - 5000/2) = 24,997,500$ links.

¹⁸ $24,997,500 \text{ lines} \times \$10 \text{ per month} = \$249,975,000 \text{ per month.}$

The “mesh” network used in this Staff analysis includes “no switching capability at all.” (Paragraph 23, Atkinson-Barnekov) The hypothetical “mesh” network avoids all switching (traffic sensitive) costs by pretending that the customers are the switch. The customer wishing to place a call would walk around their house, which contained 5,000 different jacks, and plug into the one jack that provided a direct connection to the desired customer. This is one of the absurd networks that the Atkinson-Barnekov proposal used as a basis for its claim that there are no (or little) traffic sensitive switching costs. Of course, that is not how a service is effectively provided. The switch at the central office makes the connections, not the customer.

The other hypothetical network design that the Atkinson-Barnekov proposal utilized is the “linear” network. The linear network also assumes an absurd number of links (loops or interoffice capacity) and “some” switching. (Footnote 38, Atkinson-Barnekov) In order to connect 5,000 subscribers, the fictional “linear” network would require 6,250,000 links/loops.¹⁹ This is an absurd number. In the real world, a company serving 5,000 lines uses 5,000 active loops connected to a central office that contains switching equipment. The linear network also greatly overstates the number of links needed. It creates a fictitious network that understates the true traffic sensitive switching costs.

The network design almost universally used to actually provide telephone service is the “star network.” However, the “star” network is only mentioned in a footnote in the Atkinson-Barnekov proposal, and is not included in any significant way in that analysis. (Footnote 65, Atkinson-Barnekov) In fact, Atkinson/Barnekov acknowledges the “star” network employs “more switching, fewer links” than the networks on which they based

their analysis. (Footnote 65, Atkinson-Barnekov) Therefore, the real world star network has more traffic sensitive costs than the Atkinson-Barnekov analysis assumes.

The conclusions based upon Atkinson-Barnekov's hypothetical "fully provisioned networks" are meaningless. These designs are extremely inefficient and not used in the real world to any significant extent. In the real world, and in an efficient network design, traffic sensitive switching equipment and traffic sensitive interoffice equipment are used. The traffic sensitive costs increase as the level of traffic increases. These costs are traffic sensitive costs and are appropriately recovered in traffic sensitive rates.

17.a The interconnection costs cannot be determined simply by knowing the number of customers ("n")

Atkinson-Barnekov presents formulas which they claim can be used to calculate the interconnection costs based solely on knowing the number of customers. ("n") This does not work. The sizing of the interconnection facilities, and therefore their costs, depends largely on the level of traffic. You cannot determine the level of traffic simply by knowing the number of customers, because all customers are not equal. For example, a telemarketer will generate far more traffic than the average residential customer will generate. In addition, most calls are to locations that are within a few miles of the calling party: You are far more likely to call a pharmacy that is located in your town than a pharmacy located 1,000 miles away. In addition, even if the number of "links" was known, that still does not tell you the cost, because the cost of links varies. As used in the Atkinson-Barnekov proposal, "links" could include just a loop, or a link could be a loop plus interoffice facilities several miles long, etc. Therefore, the cost "per link"

¹⁹ $(n^2/4)$ (Footnote 44, Atkinson-Barnekov proposal), $((5,000)^2/4) = 6,250,000$ links.

would also vary. A formula that includes only the number of customers cannot be used to determine, or even reasonably estimate, the interconnection costs.

18. RECOVERING INTERSTATE TOLL TRAFFIC SENSITIVE RATES IN MANDATORY FLAT RATES WOULD REQUIRE LOW USE CUSTOMERS TO SUBSIDIZE HIGH USE CUSTOMERS.

These two Staff proposals and the NPRM indicate they are considering recovering interstate traffic sensitive costs from mandatory flat rates billed to end users.

...while it is possible that, in moving to a bill-and-keep regime, carriers would simply charge existing traffic-sensitive termination charges to their end-user customers, it appears equally likely, or more likely, that carriers might modify the rate structure by moving to flat-rated charges. This likewise would result in an increase in flat-rated end-user charges.²⁰

Such a proposal would force low use toll subscribers to subsidize high use toll subscribers. There is a large variation in the level of interstate usage among customers. In any given month, 38% of the residential customers place no interLATA interstate calls.²¹ At the other extreme, large users, such as telemarketers, can place thousands of minutes per month of interstate toll traffic per line, as discussed elsewhere.²² To charge mandatory flat rates for interstate toll usage would require those customers with little or no usage to subsidize high toll users. The low users would be required to pay rates that greatly exceeded the traffic sensitive costs which they caused. Flat rate service would also mean the high users would not pay rates that cover all of the traffic sensitive costs that the high users cause. The customer producing large volumes of traffic would

²⁰ Paragraph 123, NPRM.

²¹ Reply Comments of the Consumer Federation of America, Consumers' Union, and the Texas Office of Public Utility Counsel, page 6, CC Docket No. 99-249, dated October 20, 1999.

²² Telemarketers frequently prefer to use interstate toll as opposed to locating in the same state, because in many states the interstate toll rates are lower than the intrastate toll rates.

underpay. They also would pay the same flat rate that others paid, and therefore would not pay rates that reflected the resource consumption they had caused.

Included in this cross subsidy would be the effective requirement that the low use customers subsidize telemarketers, which are high volume users. There is no valid public good that can be derived from forcing low use customers to subsidize telemarketers or other high use customers.

18.a. Mandatory flat rate charges to recover interstate traffic sensitive costs would harm affordability and universal service.

The proposed mandatory flat rate interstate usage charge would presumably be a charge that customers would be required to pay in order to receive just basic exchange service, just as the SLC/EUCL charge is. Therefore, imposing a mandatory flat rate to recover the average interstate traffic sensitive costs would effectively increase the cost for a customer to obtain even just basic exchange service. This would effectively increase the price of basic exchange service, and harm affordability and universal service. Such an unjustified increase in price is not in the public interest. As previously discussed, 38% of the residential customers place no interstate calls in a given month. Therefore, they would be paying a rate, but receiving no benefit. They would be subsidizing the high use toll customers, including telemarketers.

18.b. The Internet flat rate charges are *optional* charges—Many residential customers do not pay them.

The Staff papers rely on the fact that flat rate charges are a common form of charging by ISPs. Staff's reliance on the Internet example is totally misguided. The Internet flat rate charges are optional charges. The only people that pay the flat rate

Internet charges are those that have chosen to pay them. They will only pay them if they expect to receive enough value in return for making that payment. Since the Internet flat rate charges are optional, there is nothing that forces low or non-users to pay these charges. Many people do not pay the Internet flat rate charges, including people who do not use the Internet. People can choose to pay zero, a measured rate, or a flat rate for Internet service. The non-users are not forced to subsidize the high users. However, Staff's proposal would impose a mandatory flat rate charge on everyone, not just those who have so elected. This would place a flat rate charge to recover interstate traffic sensitive costs on even those users who make little or no use of interstate services. As discussed above, a significant portion of the population has little interest in placing or receiving interstate calls, but under Staff's proposals, these customers would be forced to pay for interstate traffic sensitive costs in order to subsidize the high use customers, including telemarketers. Not only is this unjust, but it is economically inefficient. High use customers would not be paying rates that reflect the true cost that they are causing. Therefore, they would make inefficient pricing decisions, all as previously discussed.

19. CONCLUSION

The Maryland Office of the People's Counsel strongly recommends that the FCC reject these Staff proposals. These proposals create undue discrimination in which customers considered to be "carriers" use certain LEC's facilities for free, whereas the customers considered to be "end users" would pay for those facilities, as shown on Attachment A. This would create arbitrage and require implicit subsidies. The responsibility for each call would be fragmented, with several carriers having responsibility for different segments. No company would have overall responsibility for

the call. Regulators would inherit the end-to-end responsibility. By charging ISPs to “receive” traffic, these proposals would destroy the Internet for the general public. Charging customers to receive traffic would make many customers remove their telephone numbers from public directories, turn off their answering machines, and/or refuse to take calls. Under these proposals, rural customers would pay higher toll rates than urban customers do. Regulation of access and transport rates would still be needed, and monopoly power would still exist under these proposals. These proposals are economically inefficient. These proposals mis-allocate common costs by recovering none of the common costs from interconnection services. The networks used in the Atkinson-Barnekov proposal have nothing to do with the real world networks, and are terribly inefficient. It is not possible to calculate the interconnection costs from a formula that uses only the number of customers (“n”). Recovering interstate toll traffic sensitive costs in mandatory flat rates would require low use customers to subsidize high use customers. We recommend that these Staff proposals be rejected. We strongly recommend that the FCC review Attachment A carefully to understand the subsidies and arbitrage incentives that result from either Staff proposal.

Respectfully submitted,

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