would be most efficient if, among other things, it allowed financial POIs to coincide with workable physical POIs in as many circumstances as possible – or, to put the same point another way, if it prescribed a default rule for transport responsibility that, ***without any needforfurther negotiation,*** produced a non-wasteful transport outcome in the majority of cases. Such a rule would permit carriers to get on with their business immediately; only later would they need to engage, at their option, in the time-consuming exercise of negotiating ways to reach even more efficient solutions to their individualized problems than the one prescribed by the default rule. To the extent, however, that this approach would permit an originating carrier to relinquish responsibility for transport at the edge of the terminating carrier's network, it would present significant practical concerns that the Commission should carefully consider, **as** discussed below

B. The DeGraba and Atkinson/Barnekov proposals.

The NPRM describes two alternative solutions to the transport problem. First, under the DeGraba proposal for "central office bill-and-keep" ("COBAK'), the originating carrier in a two-carrier call would bear total responsibility for delivering a call to the terminating carrier's end office, thereby inducing each carrier to employ efficient switching technology." If there is no competitive market for such transport, then, under DeGraba's proposal, the rates that the terminating carrier may charge the originating carrier would be subject to regulation. See DeGraba ¶¶ 120-21. In a three-carrier call involving an intermediate carrier (such as an IXC) with which the caller has an independent contractual relationship, the originating carrier would

[13] Depending on the Commission's ultimate solution to the question of transport, the terminating access problem discussed in section I(A) above may persist in somewhat attenuated form in light of the terminating carrier's "bottleneck control over the trunk port at the central office." *NPRM* ¶ 53. If the DeGraba proposal were accepted in its entirety – a course that Qwest does not recommend – it might need to be supplemented with an additional rule permitting access to the trunk port at non-monopolistic rates.

bear responsibility for delivering the call to the point of presence of the IXC, and the IXC would then be responsible for delivering the call to the terminating carrier's end office. ***See id.*** ¶¶ 23-30. Whether a particular call should be treated as a two-carrier or a three-carrier call for these purposes ultimately turns on whether any intermediate carrier has an independent contractual relationship with, and thus the ability to recover transport costs from, the calling party.[14]

Under the Atkinson/Barnekov proposal, interconnecting carriers would evenly split the costs "solely incremental to interconnection." The Atkinson/Barnekov paper itself (at ¶¶ 71 and 72) leaves it somewhat unclear whether the interconnection costs to be split evenly would include the cost of transport outside of a local calling area. Also, even though their paper does not itself say so, the Atkinson/Barnekov proposal for splitting costs has led some to suggest that, when carriers disagree about the proper designation of the transport facilities for which they both must pay, they would routinely seek regulatory intervention to resolve the dispute. Indeed, in the

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[14] In the ***NPRM,*** the Commission attributed to Qwest the suggestion that "a bill-and-keep arrangement does not work when three carriers are involved in the transport and termination of traffic, because the middle carrier that transports the traffic from one LEC to the other does not really have a 'customer' involved in the call from which it can recover costs." ***NPRM*** ¶ 71. Three-carrier scenarios fall into two categories: those in which the end user has an independent relationship with the intermediate carrier (such as an IXC), and those in which it does not. Where the end user *does* have an independent relationship with the intermediate carrier, the sole obligation of the originating carrier under bill-and-keep is to transport the call to a point of interconnection with that intermediate carrier, which must terminate the call to the third carrier and recover its own transport costs from the end user. In contrast, the concern identified by Qwest and addressed by the Commission arises only with respect to the ***second*** category of three-carrier scenarios, in which the end user *lacks* an independent relationship with the intermediate carrier. In a typical example, a "transiting" LEC provides transport functions for the originating carrier without an opportunity to recover the costs of those functions from any relevant end user customer. In that context, a sensible bill-and-keep approach, such as DeGraba's, would treat this as a ***two-currier*** call: it would require the originating carrier to ensure transport – through one means or another – to some point of interconnection with the terminating carrier. The originating carrier may choose to provide that transport itself, or it may choose to use the transport services of a transiting carrier. If it chooses the latter option, it must of course pay the transiting carrier for providing those services.

absence of additional clarification, it is difficult to see how implementation of this cost-sharing approach could proceed without either a cumbersome bidding process or some other form of substantial regulatory oversight.

All other things being equal, the DeGraba proposal appears more likely than the Atkinson/Barnekov alternative to avoid unnecessary regulation, and many of the comparative benefits of the DeGraba proposal are simply the product of avoiding the regulatory indeterminacy that would arise under the Atkinson/Barnekov framework, at least as we understand it. Under that latter framework, as DeGraba observes, "if one network wanted to interconnect at a single point, while the second carrier wanted to interconnect at multiple points, it is not clear how an arbitrator would decide this issue." DeGraba ¶ **69.** Similarly, it would be exceedingly difficult, in practice, for regulators to identify the costs that are properly designated as the "incremental cost[s] of transport." See *id.* In contrast, the DeGraba default rule would lead to private negotiations that could produce efficient interconnection arrangements: Where "two networks both originate and terminate traffic, it generally will be in their mutual interest to negotiate a meet-point interconnection arrangement, since it is generally cheaper to build a single transport trunk than for each individually to construct a separate transport trunk" (the default consequence upon impasse). *Zd.* ¶ 73.

One flaw in DeGraba's proposal, however, is that the default outcome it prescribes is a penalty default: *i.e.*, it is explicitly inefficient because it would usually make no sense for each carrier to build its own transport facilities all the way to each other carrier's central office to carry only the traffic it originates, and carriers would therefore be required to negotiate around the rule. (Put another way, the *financial* POI prescribed by DeGraba's approach would almost never coincide with any sensible physical POI.) Although private negotiations are often better than regulation as a means of resolving difficult problems, the very process of negotiation imposes significant costs, and the optimal default rule would avoid ***both*** regulation ***and*** negotiations whenever possible. For example, the DeGraba approach might not effectively restrain any incentives carriers have to delay negotiations in various circumstances – or to refuse to engage in them altogether – to the detriment of their competitors.

There are other, related respects as well in which DeGraba's proposal fails to resolve important questions. In particular, while DeGraba gives a sound justification for adopting some clear financial POI – *i.e.,* some clear default rule subjecting an originating carrier to all the costs of transport up to a defined point of interconnection – he provides less justification for designating the terminating carrier's "central office" (or "end office") as that point. Requiring the originating carrier to deliver calls so deeply into the terminating carrier's network may be problematic, Among other concerns, it increases the likelihood that, at some point in the call's path, there may be few transport alternatives outside of the terminating carrier's network, and that in turn would inevitably lead to calls for regulatory intervention in the rates the terminating carrier may charge for providing that transport. ***See generally*** DeGraba ¶¶ **120-21.** And DeGraba's use of the "central office" as the demarcation point in carrier responsibility for a call would inevitably lead to difficult implementation questions concerning which facilities, in fact, would qualify as central offices, a point that DeGraba himself acknowledges. ***See id.*** ¶¶ **103-08.** The Commission should hesitate before adopting an interconnection rule for the **21**st century that incorporates, as a key element, a technological convention of the **20**th century.

One imaginable alternative would be "POIBAK' (rather than DeGraba's "COBAK') – a responsibility to deliver traffic only to the *physical* point of interconnection established through any existing POI designation process. That approach would at least have the advantage of familiarity. But because many of the existing physical POIs were never intended to coincide with financial POIs, it is at best unclear thus far whether mechanically designating any existing physical POI as the relevant financial POI would generally produce fair or efficient results. More fundamentally, since the POI designation procedures differ for LEC-to-IXC, LEC-to-CMRS, and LEC-to-LEC traffic, and because they tend to require significant regulatory involvement, there would also be significant questions about whether complete adoption of those procedures here would be consistent with principles of technological neutrality and regulatory non-intervention.

C. The elements of a sensible transport solution.

Although the DeGraba proposal is a useful starting point for further discussion, it does not provide a complete and satisfactory answer to the problem of transport. The Commission should develop a fuller record before adopting any ultimate solution, and it should focus further comment by embracing the following three principles.

First, an optimal solution to the transport problem would reduce, to a bare minimum, any role for regulatory intervention to mediate particular carrier disputes. **As** DeGraba recognizes, the best way to achieve that goal is to prescribe a clear default rule that requires little case-by-case elaboration. That, as discussed, is the principal advantage of the DeGraba proposal over the Atkinson/Barnekov alternative.

Second, to reduce the need for time-consuming *negotiation,* the specified default outcome should be not just clear, but also *efficient* in most cases: it should be an outcome that usually makes sense as an economic and technological matter. It therefore should not be, as in DeGraba's proposal, a penalty default that parties are inevitably required to circumvent through negotiation, with all of its attendant transactions costs, and it also should not be a default outcome that carriers could manipulate simply to impose anticompetitive costs on their rivals. *That* goal and the separate goal of reducing regulatory involvement may be in some tension, but they are not in irreconcilable conflict, and harmonizing them is one of the principal challenges of this proceeding.

Finally, any transport solution should preserve appropriate incentives for the development of facilities-based competition in the provision of transport services. The DeGraba version of bill-and-keep would leave a significant role for regulation in determining transport rates, at least where the terminating carrier exercises market power in the provision of transport. ***See*** DeGraba ¶ 121. But just as regulation should always be the exception rather than the rule, the Commission should minimize the circumstances in which one carrier's entitlement to another's existing transport facilities at forward-looking cost would deprive the first carrier of an adequate incentive to build facilities of its own. In a growing number of areas, facilities-based providers have built, or have announced plans to build, competitive transport facilities. Facilities-based competition in the provision of such services should eliminate the need for regulatory intervention. The rules the Commission adopts in this proceeding should be built to last indefinitely, and they should be written on the assumption that facilities-based competition, particularly in the provision of transport, will and should be an increasingly pervasive feature of the telecommunications landscape.

An alternative means of achieving the same objective – reducing regulatory intervention in the provision of transport – is to give an originating carrier some flexibility in deciding for itself where to deliver traffic in the terminating carrier's network; the terminating carrier would then assume full responsibility for transporting the call from that point to its own end office and, ultimately, the called party. (In contrast, under DeGraba's approach, the originating carrier would be responsible for transport deep into the terminating carrier's network – indeed, all the way to the central office serving the called party.) This alternative approach would present a mix of advantages and disadvantages. First, the closer to the edge of the terminating carrier's network the call is dropped off, the less need there will be for regulatory oversight of the transport rates needed to deliver the traffic to its ultimate destination. Similarly, by requiring the terminating carrier to internalize the costs of transporting a larger portion of the call, such an approach may have the desirable consequence of forcing that carrier to optimize the efficiency of its network, and it would reduce the extent to which one carrier could be held captive to another carrier's choice of network architecture.[15] Finally, the less specific an originating or transiting carrier's responsibility to transport a call to a defined point within a terminating carrier's network, the less need there will be to resolve such conundrums as whether (under the DeGraba proposal) a particular switching facility constitutes a "central office." *Cf.* DeGraba ¶¶ 103-08.

On the other hand, limiting the originating carrier's transport responsibilities to the edge of the terminating carrier's network could pose significant concerns as well. Without some limiting principle, permitting a carrier to drop a call off ***anywhere*** in a terminating carrier's network may not be an optimally efficient solution for a typical circuit-switched telecommunications network, in which predictability of transmission paths remains a critical component of network planning. *Cf.* note 11, ***supra.*** One variation that might help address that concern would be to allow each carrier, for termination purposes, to designate a minimum number of points within a prescribed geographical area at which any other carrier may deliver

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[15] In some contexts, and under any approach, it might be necessary to require any terminating carrier to locate at least one point of presence in a defined geographic area that it serves (or alternatively to pay for the costs of transport), so as to avoid situations in which the originating carrier must subsidize long-distance transport to a terminating carrier's remote switch simply to complete a truly local call. ***See*** DeGraba ¶ 111.

traffic. For these purposes, the relevant geographical area could be defined on a variety of levels: as a metropolitan statistical area ("MSA"); as a **LATA;** as a state; or as a multi-state region.

There may be other possibilities as well, and Qwest's goal here is primarily to stimulate further discussion of the transport issue, to which Qwest will return in its future submissions. Because the questions presented here are extraordinarily complex, the Commission should likewise seek more specific comment, in light of the principles discussed above, on how to design a transport rule that will ensure the development of efficient network architectures driven by 21st century technology rather than by legacy regulation.

111. The Commission Should Lay the Groundwork for Resolving a Number of Implementation Issues Related to the Adoption of Bill-And-Keep.

Under any approach to intercarrier compensation for interexchange calls, network costs will ultimately be borne by end users (in the aggregate). The only questions are (a) whether those costs will be recovered from end users directly or indirectly, and (b) how much regulatory intervention will distort economically efficient recovery of those costs. The adoption of bill-and-keep for all traffic, including conventional access traffic, would ensure economic efficiency in the long term. But it would also create a need for significant restructuring of end user charges and universal service.

A. The Commission should accompany any move to bill-and-keep with a commitment to flexibility in the regulation of end user charges.

Bill-and-keep would not eliminate the underlying costs traditionally recovered through access charges; it would simply remove the IXC from the picture and require LECs to recover the costs of access directly from end users (rather than, as now, indirectly from end users through the IXC).[16] That approach would present the most immediate advantages in competitive settings, where the rates that carriers charge their end users are unregulated and subject to market pressures. But for bill-and-keep to achieve all that is expected of it, all carriers, including those traditionally subject to regulation as "dominant" carriers, will need greater flexibility in the charges they assess their end users. A switch to bill-and-keep would fail to achieve many of the advantages discussed above if the Commission were simply to retain essentially the current access charge rate structure (with all of its inefficiencies) but shift the payment obligation from IXCs to end users. Indeed, if that were the only step the Commission took, many of the same arbitrage opportunities that exist today would persist: for example, many end users would still choose Internet telephony to avoid, through the ESP exemption, the inefficiently structured per-minute access charges associated with the public switched network. And, although it would be approving rates for end users rather than carriers, the Commission would still have to fit the square peg of per-minute access charges into the round hole of the way transport and termination costs are actually incurred.

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[16] **As** DeGraba observes (at ¶ 125):

> It **is** important to recognize that shifting the recovery of these costs from carriers to end users should not, on average, increase the total costs faced by end users. This is *so* because carriers that currently pay inter-carrier charges, like long-distance carriers, pass these costs on to end-user customers in the form of higher rates. Thus, although a customer may see an increase in the bill he receives from his LEC, he should see a corresponding decrease in other charges, such as lower charges from his long-distance carrier. Of course, to the extent that the existing interconnection regime (and the current geographic averaging requirement for long-distance carriers) involves implicit subsidies, a shift to COBAK may result in some shift in costs among specific groups of consumers, such as raising slightly the costs of customers in high cost areas. Any undue additional burden, however, should be able to be addressed through targeted universal service or other support.

The solution to this problem is to permit all carriers, including dominant carriers, to design menus of different retail rate options from which their customers may choose.[17] We are *nut* suggesting that, where customers lack choices, dominant carriers should be freed from all regulatory oversight in their assessment of end user charges. We are, however, contending that the current rate structure for the recovery of access-related costs inaccurately represents the ways that those costs are actually incurred – and that it is never optimal, even where rate regulation is required, for regulators to pick *any **one*** rate structure to straitjacket an entire class of services. The best evidence of an efficient solution to the problem of cost recovery comes from industry segments in which end user rates are *nut* heavily regulated, such as wireless or long-distance. In those settings, carriers tend to offer their end users not one rate plan but choices among a number of different price structure options, ranging from plans featuring minimal flat fees and significant per-minute charges to plans featuring higher flat fees combined with large buckets of free minutes. There is no reason why, while maintaining an appropriate oversight role, the Commission could not afford LECs similar flexibility in recovering from end users (under bill-and-keep) the network costs that LECs now recover from IXCs.

While rate structure flexibility is a necessary condition for a truly rational intercarrier compensation scheme, it is by no means a sufficient one; the adoption of bill-and-keep is independently necessary as well, for the reasons addressed in Section I above. It is worth adding that, for reasons related to those just discussed, section 254(g) itself provides another important reason why bill-and-keep would create the most efficient means of recovering the costs of interexchange calls. **As** noted, section 254(g) requires IXCs to average their rates among their

[17] Of course, Qwest and other carriers would need a reasonable implementation period after any Commission order in which to establish the recording, billing, and other back office changes necessary to implement the new rate plans.

entire subscriber base. Thus, *under the access charge regime,* that provision creates an implicit and economically inefficient cross-subsidy running from end users in low cost areas to those in high cost areas, because the LECs in the latter areas must impose high access charges on IXCs, which the IXCs must then recover nationwide. By shifting payment obligations from IXCs to end users, bill-and-keep would remove the costs of access from the scope of that national averaging requirement and would therefore permit a more efficient allocation of those costs to the specific end users that cause them.

Finally, it also bears emphasis that, in the long term, there will be more competition, fewer dominant carriers, and thus fewer contexts in which regulators will *need* to regulate retail rates *at all.* That is particularly so in this era of convergence, in which telephone companies, cable operators, and wireless providers (to name a few) have entered into increasing competition for the provision of substitutable services to end users. Where consumer choices have eliminated the need for retail rate regulation, **a** shift to bill-and-keep would mean *no* role for regulation (with respect to termination costs), whereas retention of CPNP or the conventional access charge regime would mean a significant *continued* role for regulation (because someone would have to devise an intercarrier cost recovery plan for termination costs). This Commission stands on the threshold of a new century, and it is now writing the rules that will apply decades into the future. Bill-and-keep is the ideal regime for that increasingly competitive, and increasingly deregulated, world.

B. The Commission should accompany any move to bill-and-keep with appropriate adjustments to universal service mechanisms.

As discussed, access charges are a mechanism for recovering from end users indirectly (through their IXCs) certain network costs that LECs would otherwise need to collect from them directly. Bill-and-keep would remove the IXC from this money flow, with two consequences.

First, the rates IXCs charge end users would likely drop significantly, because competitive pressures would drive an IXC's rates down towards its costs, and because, once access charges are eliminated, those costs would generally consist only of the internal costs of the IXC's network and any applicable transport costs. *Second*, LECs would need to raise end user charges to ensure adequate cost recovery.[18] Any replacement of access charges with assessments on end users would lead to elimination of some cross-subsidies and, in some cases, to a need to replace those cross-subsidies with explicit universal support mechanisms.

That need derives in particular from the present operation, under the conventional access charge regime, of section 254(g), which, as previously noted, provides "that the rates charged by [IXCs] to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas." 47 U.S.C. § 254(g). IXCs typically pay higher-than-average access charges to LECs that exclusively serve sparsely populated areas, because the network costs of the LECs in serving those areas are in fact high. Under section 254(g), the IXCs must spread recovery of those high charges across their national subscriber base; they may not pass them back specifically to the callers who make and receive the high-cost calls. If access charges were eliminated, IXCs would no longer need to recover those charges at all, and end users in high-cost areas would be required to bear much greater responsibility for these increased costs on their own. As a result, there may be a need for targeted increases in the level of universal service funding to help subsidize basic telephone service for those end users

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[18] **As** a definitional matter, these increases would not strictly be increases to the "subscriber *line* charge," because the charges at issue would relate not specifically to the loop (*i.e.,* the "line"), but to such functions as switching, the costs for which have often been viewed as usage-sensitive, albeit lumpy. Of course, so long as LECs are regulated as dominant carriers, they are entitled to at least a constitutionally compensatory rate of return, and that fact alone would require a new cost-recovery mechanism to make up for the elimination of access charges.

whose *aggregate* (local plus interexchange) telephone rates have dramatically increased as a result of a switch to bill-and-keep. *See generally* DeGraba ¶ 125.

Current law provides that "[c]onsumers in all regions of the Nation, including . . . those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services . . . that are available at rates that are reasonably comparable to rates charged for similar services in urban areas." 47 U.S.C. 254(b)(3). Although the Commission has recently focused on subsidizing services to end users to cover *costs* that exceed a designated benchmark, there is no sound basis for using federal support mechanisms to underwrite any service to high cost users unless their overall *rates* would also exceed an appropriate benchmark. Because, however, the Commission will need to examine these and other issues on remand from the Tenth Circuit's recent decision in *Qwest Corp. v. FCC,* Nos. 99-9546, 99-9547, 00-9505, 2001 WL 864222 (10th Cir. July 31, 2001), we defer until then a fuller exposition of the relationship between a move to bill-and-keep on the one hand and state and federal universal service programs on the other. The Commission should of course coordinate the two proceedings to ensure that the concerns raised in one are taken into account in the other.

Any need for increased universal service subsidies for high-cost areas would trigger a related need to revisit the *contribution* mechanisms that underlie the federal subsidy programs. In particular, any expansion of federal universal service subsidies should be accompanied by a commensurate expansion in the class of entities that contribute to the federal subsidy mechanisms. It is economically irrational to impose on "telecommunications carriers" alone the burden of contributing to a fund that may, in turn, be used to subsidize a wide variety of services that ***use*** telecommunications but may not qualify as *telecommunications services* under the statutory definition.[19] The Commission has broad discretion to extend federal contribution obligations not just to providers of "interstate telecommunications *services,*" but also to "[a]ny other provider of interstate *telecommunications.*" 47 U.S.C. § 254(d) (emphasis added).

As the Fourth and Ninth Circuits have held, the provision of cable modem service includes an essential "telecommunications" component, whether or not the finished service is appropriately characterized as a "telecommunications service."[20] And, because cable modem service is an economic substitute for digital subscriber line ("DSL") services, and because DSL revenues add to a LEC's contribution obligations, insulating cable modem service from similar obligations contradicts principles of technological neutrality. Likewise, to the extent that **ISPs** provide telecommunications as part of their provision of information services, the Commission should consider whether they too should bear an appropriate share of universal service obligations.[21] These issues – the distinction between "telecommunications" and "telecommunications services" and the relevance of that distinction in allocating responsibility for funding federal universal service mechanisms – present some of the most difficult problems facing the Commission today, and the Commission should seek further comment on them. Of

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[19] ***See*** 47 U.S.C. § 254(b)(3); *compare* 47 U.S.C. § 153(43) (defining "telecommunications") *with* 47 U.S.C. § 153(46) (defining "telecommunications service").

[20] ***See*** *MediaOne Group Znc. v. County* ***of*** *Henrico*, Nos. 00-1680, 00-1709, 00-1719, 2001 WL 788864 (4th Cir. July 11,2001); *AT&T v. Portland*, 216 F.3d 871 (9* Cir. 2000); *see also* Brief of the FCC as Amicus Curiae at 19, *Mediaone, supra* (No. 00-1680 *et al.)* ("the challenged ordinance [mandating 'open access' for cable modem service] requires MediaOne to provide 'telecommunications facilities' – facilities that ISPs would use solely for purposes of transmission or 'telecommunications'"). The Commission has sought further comment on these issues in its pending *Inquiry Concerning High-speed Access to the Internet* ***Over*** *Cable and Other Facilities,* Notice of Inquiry, 15 FCC Rcd 19287, 19294-96 ¶¶ 18-20 (2000).

[21] ***See*** *generally Implementation of the Non-Accounting Safeguards* ***of*** *Section 271 and 272 of the Communications Act* ***of*** *1934 as amended,* Order on Remand, CC Docket No. 96-149, FCC 01-140 (rel. Apr. 27,2001) ¶¶ 38-39.

course, the Commission need not await the final resolution of this proceeding before alleviating the current anomalies in the way federal universal service programs are funded.

Although adjusting the contribution mechanisms would remove some of the obvious competitive inequalities of the day, the basic long-term dilemma would persist: regulation cannot keep pace with the evolution of technologies and services to ensure permanent competitive neutrality in the design of contribution mechanisms. At bottom, the only way to eradicate that dilemma at its source **is** to revisit first principles. It is widely understood that, from an economic efficiency perspective, it is less sensible to derive universal service contributions from telecommunications-related revenues than from general tax revenues.[22] And there is no apparent reason why, in this respect, public funding for the nation's telecommunications needs should be treated differently from funding for such other public goods as streets and highways. Although that is an issue that must ultimately be taken up by Congress, and although its resolution is obviously separable from the questions presented in this proceeding, complete regulatory rationality in this industry may never be achieved until this most fundamental anomaly is uprooted.

C. The Commission should allow market forces to deal with the problem of "unwanted calls."

As discussed above, the premises of bill-and-keep are, among others, (1) that both parties to a call are free to end it at any point; **(2)** that each party thus "causes" some portion of the cost of the call past the first instant of connection; and (3) that each should therefore bear a portion of the call's costs. It may be unavoidable, however, that carriers will end up incurring call set-up

[22] *See, e.g.,* Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies,* 16 Yale J. on Reg. 19, **30** (1999) ("[t]he alternative of subsidizing universal services through general tax revenues" is "a good option from the standpoint of efficient public finance").

costs for some unwanted calls even if the called party hangs up as soon as the call is placed. That is the case whether or not the called party is exempted from any retail charge for the first minute of a call; even if so, the terminating carrier must absorb the cost and will presumably pass it on to all customers in the form of slightly higher rates. *Cf.* DeGraba ¶ 118.

It is unclear that this will be a significant problem in practice. Even under bill-and-keep, originating carriers must bear a substantial portion of the costs of a call; efficient originating callers will thus often have adequate incentives not to let unwanted calls proliferate. In any event, to the extent that there is concern about non-trivial termination costs for certain kinds of unwanted calls (such as telemarketing calls), carriers have already devised some mechanisms (such as caller identification, privacy messages, and non-solicitation messages) that are effective in screening calls in certain circumstances, and more technologies might be deployed in the future to block additional categories of calls until after the called party has specifically authorized their transmission. In sum, there is no reason for regulatory concern about this set of issues at this point, and, if any such concern arises later, it can be addressed then.[23]

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[23] **As** DeGraba discusses, bill-and-keep would not "entirely eliminate the incentive for a business that only receives calls to claim to be a network," because the business could then "avoid having to pay a subscription fee (*i. e.,* purchase business service from the interconnecting carrier)." DeGraba ¶ 115. For that reason, DeGraba aptly observes that a business claiming to be a network should be entitled to the rule prohibiting the originating carrier from charging for interconnection only if that business "exhibits characteristics of a network, such as ownership of a switch" and "interconnecti[on] with the incumbent's signaling system." DeGraba ¶¶ 115-1**16.** For these purposes, regulators would need to distinguish between true "switches" (comparable in complexity and functionality to switches owned by even the smallest carriers) and private branch exchanges ("PBXs"), which are owned by most large non-carrier businesses. In any event, no matter how this "sham network" problem is resolved, bill-and-keep would mark at least an incremental improvement over the CPNP regime, in which a "sham" carrier not only avoids subscription charges but also ***receives money*** from the originating carrier.

IV. The Commission Has Legal Authority To Impose Bill-and-Keep.

As shown above, sound public policy supports the adoption of bill-and-keep as the unifying intercarrier compensation scheme for all traffic over the public switched network. The Commission has also sought comment on whether it has *legal authority* to impose bill-and-keep across the board. Two central questions govern that issue. *First,* does the Commission have *jurisdiction* to promulgate *any* rules to address a given class of traffic – either (1) because the traffic falls within the scope of section 251(b)(5), which the Commission has jurisdiction to implement in light of the Supreme Court's decision in ***AT&T** v. Iowa Utils. Bd.,* 525 **U.S.** *366* (1999), or (2) because the traffic falls within the scope of the FCC's general interstate regulatory authority under section 201? And, *second,* is bill-and-keep consistent with the *substantive* requirements of the Communications Act, including, with respect to traffic covered by section 251(b)(5), the accompanying pricing standards of section 252(d)(2)?

With respect to most telecommunications traffic, the answer to both of these questions is yes. Although it is unclear whether the Commission has authority to impose bill-and-keep for conventional *intrastate* access traffic, that uncertainty should not deter the Commission from imposing bill-and-keep to the limits of its jurisdictional authority.

A. The Commission has authority to impose bill-and-keep for traffic falling within section 251(b)(5).

The Commission has determined that, when viewed in combination with section 251(g), the "reciprocal compensation" provision of section 251(b)(5) is properly construed to apply to all telecommunications traffic involving at least one LEC except "access" traffic (including "information access"). *See ISP Reciprocal Compensation Order* ¶¶ 34-41; *Local Competition Order*, 11 FCC Rcd at 15997 ¶ 1008. Thus, section 251(b)(5) covers most non-ISP-bound LEC-to-LEC and most LEC-to-CMRS traffic, including paging traffic. *See, e.g., Local Competition*

Order, 11 FCC Rcd at 15997¶ 1008. Over time, as the FCC exercises its authority to "supersede[] by regulation[]" the grandfathering provisions of section 251(g), the class of traffic subject to section 251(b)(5) may increase in size.[24]

The "reciprocal compensation" obligation of section 251(b)(5) is fleshed out in section 252(d)(2). Section 252(d)(2)(A) provides:

> For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5) of this title, a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless – (i) [they] . . . provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) [they] . . . determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls.

Section 252(d)(2)(B) further provides, however, that section 252(d)(2)(A) "shall not be construed . . . to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)."

In the *Local Competition Order,* the FCC construed section 252(d)(2) to permit bill-and-keep for balanced traffic but not for unbalanced traffic. *See* 11 FCC Rcd at 16055¶ 1112. The Commission should now revisit and reverse that conclusion. First, as discussed above, the Commission has *already* rejected its stated policy basis for limiting bill-and-keep to balanced traffic: *i.e.*, the concern that, absent such a limitation, carriers would have artificial incentives

[24] Section 251(g) preserves the pre-1996 Act regulatory status quo with respect to the matters included within its scope until the grandfathered rules "are explicitly superseded by regulations prescribed by the Commission." In theory, therefore, if a class of traffic is properly deemed to fall both within the scope of section 251(b)(5) and within the class of grandfathered regulations under section 251(g), that traffic would be subject to the substantive standards of section 251(b)(5) if, and only if, the Commission specifically determines, through superseding regulations, that it should be subject to those standards. *See generally ISP Reciprocal Compensation Order* ¶ 40; *but cf. id.* ¶ 37 n.66.

only to originate traffic. *See ISP Reciprocal Compensation Order* ¶¶ 72-73. Second, the Commission provided no substantial legal analysis to support its suggestion that the statute prohibits bill-and-keep for unbalanced traffic: it simply assumed, without explaining why, that section 252(d)(2) is satisfied only when an originating carrier pays money to cover the transport and termination costs of another carrier whenever the traffic between the two is asymmetrical. *See Local Competition Order*, 11 FCC Rcd at 16055 ¶ 1112. **As** we now discuss, the statute, while highly ambiguous on this point, can reasonably be, and should be, read *not* to contain such a prohibition.

As an initial matter, section 252(d)(2)(A), even read apart from the bill-and-keep savings clause in section 252(d)(2)(B), uses a specialized term to describe what an originating carrier must pay the terminating carrier for transport and termination costs: "a reasonable approximation of the *additional costs* of terminating such calls'' (*i.e.,* calls that the originating carrier delivers to the terminating carrier's customers). 47 U.S.C. § 252(d)(2)(ii) (emphasis added). In this context, the term "additional costs," which appears nowhere else in sections 251 and 252, could reasonably be construed to include only the short-run (per-call) incremental costs of delivering traffic to the called party. *Those* costs may well be negligible, because, as discussed above, individual calls do not typically "cause" transport and termination costs; those costs consist instead of the lumpy investments needed to ensure *peak* load capacity. For that reason alone, bill-and-keep proposals such as DeGraba's, which effectively set the termination rate at zero, are consistent with section 252(d)(2).

In any event, irrespective of what section 252(d)(2)(A) might be construed to mean in isolation, the bill-and-keep savings clause of section 252(d)(2)(B) makes clear that nothing in the statute precludes the Commission's discretion to impose bill-and-keep for any class of traffic within its jurisdiction. That savings clause provides that section 252(d)(2)(A) "shall not be construed . . . to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that *waive mutual recovery* (such as bill-and-keep arrangements)." (Emphasis added.) While this language is unclear in some respects, it could not be plainer in preserving, at a minimum, "arrangements that waive mutual recovery (such as bill-and-keep arrangements)." Nothing in that savings clause is limited to balanced traffic, a point that the Commission essentially overlooked in 1996.[25]

Read in combination, subparagraphs (A) and (B) of section 252(d)(2) thus provide a *choice* of intercarrier compensation methodologies as the default option for intercarrier compensation: *either*, under subparagraph (B), a bill-and-keep arrangement that "waive[s] mutual recovery" as between carriers *or*, under subparagraph (A), any CPNP arrangement under which an originating carrier compensates a terminating carrier for the true "additional costs" of terminating individual calls, whatever that term may be construed to signify. Viewed together, what these two provisions indisputably foreclose is any nonconsensual arrangement – common before passage of the 1996 Act *(see, e.g., Local Competition* ***Order,*** 11 FCC Rcd at 16010-11 ¶ 1030) – in which one carrier forces another to pay charges for transport and termination that are not in fact limited to the costs of providing those services, or in which an *originating* carrier (such as a LEC) charges a *terminating* carrier (such as a CMRS provider) for the costs of origination. *See, e.g.*, 47 C.F.R. § 51.703(b).

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[25] It is noteworthy that bill-and-keep, if imposed for all traffic, would remove most of the arbitrage opportunities that create large categories of unbalanced intercarrier traffic in the first place. For that reason, adoption of bill-and-keep would largely *eliminate* the very class of traffic as to which the Commission once thought the adoption of bill-and-keep would be most legally problematic.

To be sure, as the Commission itself has recognized, adoption of bill-and-keep for all traffic subject to section 251(b)(5) would mark a significant policy reversal, albeit one for which the Commission has begun laying a foundation. *See NPRM* ¶¶ 76-77. It is hornbook law that an agency is permitted to change its mind on both policy matters and on questions of statutory interpretation so long as it gives a reasoned explanation for its change in course. *See, e.g.*, *Rust v. Sullivan, 500* **U.S.** 173, 187 (1991); *Chevron* ***U.S.A. Inc.*** *v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 862 (1984). For the reasons discussed, the Commission has more than an adequate basis for rejecting its perfunctory – and already partially repudiated – rationale for precluding the use of bill-and-keep for unbalanced traffic subject to section 251(b)(5).

LEC-CMRS traffic, the legal status of which the Commission has addressed at some length in the *NPRM* (¶¶ 78-96), should be treated like any other traffic subject to section 251(b)(5). The Commission has previously subjected LEC-CMRS traffic to regulation under that provision because, although a CMRS provider is presumptively not classified as a "LEC," *see* 47 U.S.C. § 153(26), the Commission has construed section 251(b)(5) to apply to any local traffic that involves at least one LEC. *See Local Competition Order*, **11** FCC Rcd at 15997, 16016-17 ¶¶ 1008, 1043. The upshot of that determination is that the FCC has rulemaking authority to determine the appropriate methodological treatment of intercarrier compensation for that traffic no less than any other traffic included within the scope of section 251(b)(5). *See Iowa Utils Bd., 525* **U.S.** at 377-81. Since, for the reasons just discussed, bill-and-keep is appropriate for section 251(b)(5) traffic generally, it is appropriate for LEC-CMRS traffic in particular.

B. The Commission has authority to impose bill-and-keep for interstate access traffic.

1. Conventional interstate access traffic

The Commission indisputably has jurisdiction to set intercarrier rates for conventional interstate access traffic. Nothing in the Communications Act poses any substantive obstacle to the adoption of bill-and-keep (*e.g.*, some variant of the DeGraba proposal for "calls involving three carriers") for such traffic. Of course, as in all other contexts, the Commission would need to justify that policy change with a reasoned explanation. As discussed above, however, such an explanation is readily available here.

2. ISP-bound traffic

In the *ISP Reciprocal Compensation Order* (¶¶ 23-65), the Commission has already explained, in great detail, why section 251(g) removes ISP-bound traffic from the scope of section 251(b)(5) and why the Commission may thus regulate it pursuant to its general interstate authority under section 201. Although the Commission's decision to exclude ISP-bound traffic from the scope of section 251(b)(5) is on review in the D.C. Circuit, *WorldCom, Inc. v. FCC*, No. 01-1218 (D.C. Cir. filed May 17, 2001), the decision was correct and should be upheld. Even if the decision is not upheld, moreover, the only consequence would be that such traffic would be subject to section 251(b)(5), not that it would be immune from bill-and-keep. Because bill-and-keep is appropriate for any traffic subject to section 251(b)(5), it would be appropriate for this traffic as well, even if it were deemed to fall within the scope of that provision.

3. Intrastate access traffic

The one class of traffic that the FCC may lack clear jurisdiction to address is intrastate access traffic, and the Commission would encounter similar jurisdictional obstacles if it sought to replace intrastate access charges with an increase in end user rates on the intrastate side of the cost-recovery ledger. By definition, intrastate access traffic does not fall directly within the scope of the Commission's section 201 authority, and the Commission has previously concluded that it falls outside the scope of section 251(b)(5) as well (even though, as the Commission acknowledges, this latter conclusion may not be compelled by the statutory language).[26]

Even if the Commission lacked authority to impose bill-and-keep for intrastate access charges, however, that should not dissuade it from extending bill-and-keep to all other traffic to the fullest extent of its authority. This is an area in which the Commission's leadership is urgently needed, and many states would likely respond to that leadership by imposing bill-and-keep for intrastate access traffic on their own. And, even if they did not, their reluctance to eliminate conventional intrastate access charges would simply induce carriers, for example, to funnel all toll traffic through networks (such as the Internet) in which "the interstate and intrastate components [of the traffic] cannot be reliably separated" – and that are thus deemed categorically subject to the Commission's section 201 authority. *See* ***ZSP*** *Reciprocal Compensation Order* ¶ 52. If unaddressed, such arbitrage could dramatically narrow the class of toll traffic subject to state, rather than federal, jurisdiction, potentially leaving incumbent LECs without full recovery of their intrastate costs (because they would lose intrastate access revenues, perhaps without a corresponding increase in their end user rates).[27]

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[26] *See ISP Reciprocal Compensation Order* ¶ *37* n.66 (deeming statute "ambigu[ous]" on this point but reaffirming earlier conclusion that section 251(b)(5) excludes "traffic subject to parallel intrastate access regulations"); *see generally Louisiana* ***PSC*** *v. FCC*, **476 U.S.** 355 (1986) (holding that, under section 2(b), the FCC lacks authority over intrastate rates, subject only to a narrow "impossibility" exception).

[27] Similar jurisdictional issues could arise for any class of intrastate traffic – including traffic covered by section 251(b)(5) – as to which carriers would be required to recover from end users the network costs that they used to recover from other carriers. In particular, although the Commission has jurisdiction to regulate *intercarrier* compensation for section 251(b)(5) traffic, it may lack jurisdiction to raise end user rates on the intrastate side of the ledger to make up for

It is exceedingly unlikely that the states would do nothing in response to such arbitrage. More likely, they would follow the Commission's lead in adopting bill-and-keep as a unifying intercarrier compensation rule for all traffic. And this would not be the first time that this Commission has realized that, to eliminate legacy regulation, it must sometimes act first and rely on the resulting dynamics of the free market to restore consistency between state and federal regulation.”

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the elimination of intercarrier compensation under bill-and-keep. That fact, combined with the concerns discussed in the text, illustrates why it is important for the Commission to exercise leadership in this area and to persuade the states to adopt compensation mechanisms that accommodate a shift to bill-and-keep as the new paradigm for intercarrier compensation.

[28] *See, e.g., Federal-State Joint Board on Universal Service,* Report and Order, 12 FCC Rcd 8776, 8785-86 ¶ 14 (1997) (“[A]s competition develops, the marketplace itself will identify intrastate implicit universal service support, and . . . states will be compelled by those marketplace forces to move that support to explicit, sustainable mechanisms[.]”).

CONCLUSION

The Commission should adopt bill-and-keep for all traffic to the fullest extent of its jurisdiction, not because bill-and-keep would benefit any one class of carriers, but because the regulatory rationality it would introduce into this industry would benefit *all* carriers and, just as important, the public at large. To be sure, decisive action today may well result in short-term discomfort for some – including, in some respects, Qwest itself. But only comprehensive reform will rationalize the intercarrier compensation regime and realize the Act's goal of a technologically neutral, economically rational playing field for all segments of the telecommunications industry.

Respectfully submitted,

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August 21,2001

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I, Russell P. Hanser, do hereby certify that on this 21st day of August, 2001, I have caused true and correct copies of the foregoing Comments of Qwest Communications International, Inc., to be served by hand delivery upon the following parties:

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