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

In the Matter of

Developing a Unified Intercarrier Compensation Regime	CC Docket No. 01-92

REPLY COMMENTS OF THE OFFICE OF PUBLIC UTILITY COUNSEL OF TEXAS

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The Office of Public Utility Counsel of Texas ("OPUCT") hereby submits the following reply comments in response to the Federal Communications Commission's ("FCC's") Notice of Proposed Rulemaking in CC Docket No. 01 – 92, *In the Matter of Developing a Unified Intercarrier Compensation Regime,* hereinafter referred to as the "*NPRM*."

I. EXECUTIVE SUMMARY

In its comments, OPUCT discussed a number of concerns regarding the FCC's bill-and-keep proposals. Reading the comments filed in this proceeding, OPUCT finds that similar concerns have been raised by a large number of other parties. Below is a brief list of the concerns discussed by OPUCT in its initial comments:

- *Unified Intercarrier Compensation Regime Issues:* The FCC's proposals for mandatory bill and keep will *fracture* the larger regime of total element long run incremental cost ("TELRIC")-based rates that provides consistency across various proceedings involving cost concepts, such as universal service fund ("USF") proceedings, alternative regulation proceedings (with cost-based competitive safeguards) and unbundled network element ("UNE") cost proceedings. It would be far better to extend the current regime of cost-based rates to all aspects of intercarrier compensation and to ensure that costs are determined based on the FCC's TELRIC methodology, as discussed in its *Local Competition Order.* [1]

- *Universal Service and Consumer Issues:* The proposals for mandatory bill and keep will force carriers to recoup the costs of terminating traffic from their end-users. This will almost certainly *hurt the preservation and promotion of universal service* and create various other undesirable consumer issues. It may also lead to significant and

[1] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499, 15509, (1996) *("Local Competition First Report and Order*")

inappropriate cross-subsidies from low-volume users to high-volume users; these cross-subsidies would contravene state and federal universal service policies.

- *Policy Precedents:* To motivate its proposed departure from CPNP, the FCC provides a number of observations: certain incumbent local exchange carriers ("ILECs") have proposed bill-and-keep arrangements for certain classes of traffic[2]; large Internet backbone providers often enter into peering arrangements that are based on bill and keep[3]; OPP working papers discussed in the *NPRM* have suggested justifications for bill-and-keep arrangements[4]; bill-and-keep proposals may be seen as following the precedent of the Commission's 1980 *Computer II* decision that deregulated CPE.[5] None of these observations is particularly convincing.

- *ISP Intercarrier Compensation Issues:* To the extent that the *NPRM* is motivated by a concern about reciprocal compensation payments from ILECs to competitive local exchange carriers ("CLECs") for Internet service providers ("ISP") bound traffic, this issue is far better resolved by a *market-based approach* that forces ILECs to compete for ISPs. This would preserve the independent ISP industry, now threatened with extinction.

- *Arbitrage Issues and Regulatory Efficiency:* The proposals for mandatory bill and keep will create a host of arbitrage opportunities. Eventually, tariff arbitrage may force companies and regulators to revert to cost-based rates, contributing to further regulatory uncertainty in the CLEC industry. By contrast, an emphasis on TELRIC-based rates and competition will gradually diminish the role of regulators and resolve issues far more efficiently and satisfactorily than regulators could.

- *Regulatory Stability:* The intercarrier compensation reductions ordered by the FCC and some state commissions have already contributed to a significant decline in CLEC market capitalization. The proposed policy changes will cause regulatory instability and further threaten the economic viability of the ailing CLEC industry.

- *Competitive Issues:* ILECs will be able to shift the costs for terminating traffic to high volume business customers onto residential end-users. This places CLECs at a distinct disadvantage (and will hurt residential rate payers in the process.) The bill-and-keep proposals will also undermine the unbundled network element platform ("UNE-P") as an efficient means of market entry by eliminating sources of revenue but not the associated costs. Ultimately, as the Regional Bell Operating Companies' ("RBOCs'") 271

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[2] *NPRM* paragraph 43.

[3] *NPRM* paragraph 43.

[4] *NPRM* paragraph 43.

[5] *NPRM* paragraph 41.

approvals dilute the jurisdictional distinction between local and long distance calls, the FCC's proposals may destroy the economic viability of interexchange carriers ("IXCs"), one of the few areas of competition in the telecommunications industry.

- *Legal Issues:* There appears to be no support in the Telecommunications Act of 1996 for the FCC's mandatory bill-and-keep proposals. For local traffic, the Telecommunications Act of 1996 specifically notes that reciprocal compensation should be for the "additional cost of terminating such traffic." One can argue that bill-and-keep provides for reciprocal compensation only *when traffic is approximately in balance.* If traffic is significantly out of balance, or one-way, then bill and keep leaves the terminating carrier grossly under-compensated. For non-local traffic, such as ISP-bound traffic, carriers are also entitled to compensation from the cost causers.

As noted the issues listed above are echoed in the comments filed by various parties. Most importantly, parties whose explicit objective is to represent the public interest, as opposed to the narrower interests of stockholders, such as National Association of State Utility Consumer Advocates ("NASUCA"), National Association of Regulatory Utility Commissioners ("NARUC") and various state commissions and consumer counsels have all objected to the FCC's bill-and-keep proposals based on arguments similar to those discussed by OPUCT. Valid concerns about the FCC's bill-and-keep proposals have also been expressed, however, by numerous other parties, such as large IXCs, CLECs, and smaller, rural LECs.

In general, the concerns of the parties opposing the FCC's bill-and-keep proposals stem from the problem that bill and keep fails to provide for adequate compensation when traffic flows are unbalanced, as is the case with certain CLECs and for all switched access traffic.[6] The large array of other problems associated with mandatory bill and keep that parties identify, such

[6] Switched access traffic is always one-way since originating and terminating access traffic do not off-set one another. As a result, under CPNP, the LECs' switched access revenues are the sum and not the difference of originating and terminating traffic revenues.

as inefficient price signals, failure to follow cost causation and the creation of new arbitrage opportunities, ultimately all stem from the fact that bill-and-keep is simply not compensatory when traffic flows are out of balance.

The revenue shortfall for CLECs, as a result of eliminating reciprocal compensation payments, has been estimated by the FCC itself at $2 billion annually.[7] The comments of the small rural LECs and the USTA now provide the FCC also with estimates of the revenue shortfall for ILECs if bill-and-keep replaces switched access charges. The per-line per-month loss in revenues can be as high as $124.15 for smaller carriers and will at a minimum be $7.82 for larger ILECs.[8] These revenue deficiencies, whatever their magnitude, will invariably result in higher end-users charges for local service.

In any event, these estimates are ominous and provide support for OPUCT's contention that the FCC's bill-and-keep proposals pose a serious threat to the promotion and preservation of universal service, an issue discussed at considerable length in OPUCT's comments and in those of various other parties, such as NASUCA, NARUC, other consumer counsels and state commissions. While the FCC may counter that in the final analysis end-users pay for all network costs, whether through direct charges assessed by their local carrier or through charges assessed by their long distance carrier, this possible FCC rejoinder misses the point: an efficient system of cost recovery should follow cost causation and assign costs to cost causers: bill and

[7] *Intercarrier Compensation for ISP-Bound Traffic* Order, paragraph 5.

[8] Comments of the United States Telecom Association, page 23.

keep fails on this score. As a result, low-volume end-user will almost certainly end up subsidizing high-volume end-users, an outcome directly at odds with universal service policies. This issue has been discussed by OPUCT and other parties, such as NASUCA and NARUC. Again, the comments by small rural LECs and the USTA now provide the FCC estimates of how seriously detrimental its bill-and-keep policies will be to the promotion and preservation of universals services.

While the FCC should not base public policy on the number of "yeas and nays" it receives in response to its NPRMs, it is instructive to note that the FCC's bill-and-keep proposals have received a negative response from the vast majority of parties. The parties opposing the FCC's bill-and-keep proposals include most public agencies, such as state commissions and consumer advocates, and their organizations, such as NARUC and NASUCA, as well as most CLECs, IXCs, cable companies, and small ILECs. Supporting the FCC's bill-and-keep proposals are for the most part companies that have a vested interested in eliminating their reciprocal compensation payments to other carriers. Naturally, the large ILECs, SBC, Verizon and BellSouth, are delighted by the prospect that the FCC will save them from their failure to effectively compete for ISPs. As the FCC is well aware, the problem of the ever-growing reciprocal compensation deficits experienced by these large carriers is possibly their top issue of concern. Mandatory bill and keep would solve the large ILECs' problem rather nicely and conclusively. Also in favor of the FCC's bill-and-keep proposals are the wireless carriers. Wireless carriers have and will continue to run reciprocal compensation deficits with wireline carriers. Naturally, bill and keep would be quite a windfall for such carriers. Their support was predictable too.

The fact that the FCC's supporters and detractors follow policies that so predictably and obviously fit their narrow business interests should be an issue of concern to the FCC. Public policy should not play favorites. Instead, it should be based on sound principles of law and economics. To this purpose, OPUCT again offers the following guiding principles to the FCC in designing intercarrier compensation regulations:

(1) Intercarrier compensation regulation should promote *economic efficiency*. Consistent with how this term is generally defined in economic theory, this means that intercarrier compensation arrangements should send the right price signals to economic agents about the true economic and social costs associated with decisions regarding interconnection. Economic efficiency also requires that intercarrier compensation regulation lead to efficient retail/end-user pricing and an efficient use of networks.

(2) Intercarrier carrier compensation regulation should be consistent with the *promotion of competition*.[9] This implies, among other things, that an intercarrier compensation regime be *competitively neutral*[10] *and compensatory*. The competitive neutrality requirement should also extend to the unbundled network element platform, the ILECs' UNE-P offerings. (Remarkably, the *NPRM* does not explicitly explore the impact of bill-and-keep proposals on the economic viability of the UNE-P offerings, offerings vital to the further development of competition.)

(3) Intercarrier carrier compensation regulation should (a) maintain and promote *universal services*, and (b) be consistent with *just, reasonable, and affordable end-user rates*.[11]

(4) Further, intercarrier compensation regulations should be *legal* both under the Telecommunications Act of 1996 and other provisions of federal law and the United States Constitution.

[9] Any set of intercarrier compensation regulations should further the pro-competitive intent of the Telecommunications Act of 1996.

[10] Competitively neutral means that the intercarrier compensation regime neither favors nor disadvantages certain carriers.

[11] In general, intercarrier compensation regulations should be consistent with the universal service principles identified in Section 254 of the Telecommunications Act of 1996.

(5) Intercarrier compensation regulation should lead to *regulatory stability and consistency* in the application of regulatory principles, such as TELRIC-based rates. While this objective might be listed under the promotion of competition, it is sufficiently important to be identified individually. Intercarrier compensation should be consistent across *all forms* of intercarrier compensation and regulatory proceedings that critically depend on costs concepts.

OPUCT believes, as discussed in its comments, that in the long run, society's interests are better served by a three-pronged approach: TELRIC-based rates for all intercarrier wholesale transactions; vigorous promotion of competition; and efficient, adequate, and competitively neutral universal service policies.

II. REPLY COMMENTS TO SPECIFIC PARTIES

In this section, OPUCT will provide reply comments to issues raised in the comments of various parties. As discussed in the introduction to these reply comments, most parties filed comments supporting positions that were most advantageous to their own situation; where appropriate and instructive, OPUCT will note the self-serving nature of the comments filed by certain parties. Further, in these reply comments, OPUCT will respond, either to rebut or support, to some of the more important issues raised in the comments from a representative array of parties.

A. Reply Comments to Issues Raised by NASUCA

NASUCA's comments echo many of the same concerns expressed in OPUCT's comments. Like OPUCT's comments, NASUCA's comments correctly point out the following objections to the FCC's bill-and-keep proposals:[12]

> Mandatory bill and keep is inconsistent with the provisions of the Telecommunications Act of 1996 regarding reciprocal compensation.
>
> The FCC's bill-and-keep proposals violate the traditional and sound principles regarding cost causation and the recovery of traffic sensitive versus non-traffic sensitive costs.
>
> Mandatory bill and keep will shift cost burdens onto the called party, thus discouraging the use of telecommunications.
>
> Mandatory bill and keep when traffic flows are not balanced fails to provide for adequate compensation and amounts to confiscation.

[12] Comments of the National Association of State Utility Consumer Advocates, pages 3-5.

> The effects of bill and keep will be that low-volume users have to subsidize high-volume users as carriers will seek to increase end-user rates irrespective of the volume of incoming traffic to individual customers.

OPUCT agrees with these and other observations in NASUCA's comments and has discussed many of the same issues and concerns in its comments. OPUCT also agrees with NASUCA that the mandatory bill-and-keep proposals discussed in the NPRM are not in the public interest and should be rejected.

B. Reply Comments to Issues Raised by NARUC and Various State Commissions

OPUCT generally agrees with the NARUC comments and NARUC's resolution of July 21, 2001, attached to its comments. NARUC correctly points out that the FCC's bill and keep proposals will adversely impact universal service.[13] Further, NARUC's resolution appropriately raises concerns about the merits of bill and keep in view of such important considerations as: (1) fair compensation to each carrier, especially when traffic is not in balance; (2) the link between cost causer and cost payer; (3) appropriate economic signals to carriers and customers; (4) cross-subsidies between low and high volume customers and between customer classes; and (5) perverse incentives regarding infrastructure developments. OPUCT has discussed each of these issues in its comments and demonstrated that the FCC's bill and keep proposals fail to be optimal in view of these considerations. Instead of bill and keep, OPUCT believes, as discussed in its

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[13] Initial Comments of the National Association of Regulatory Utility Commissioners, page 3.

comments, that in the long run, society's interests are better served by a three pronged approach: TELRIC-based rates for all intercarrier wholesale transactions; vigorous promotion of competition; and efficient, adequate, and competitively neutral universal service policies.

C. Reply Comments to Issues Raised by United States Telecom Association

The comments filed by the United States Telecom Association ("USTA") are perhaps the best illustration of the fact that most parties support positions and proposals that best suit their situation. Given that the USTA members consist of, among others, large ILECs, such as SBC, Verizon, and BellSouth, smaller independent and rural LECs and a select group of CLECs (as part of USTA's CLEC Counsel), it is not surprising that the USTA is having difficulties staking its position as firmly as most other parties. For example, the USTA comments speak in diplomatic terms such as "regulatory arbitrage opportunities and old regulatory distinctions that no longer make sense should be eliminated." As long as one does not too clearly specify which regulatory arbitrage and distinctions one is talking about, almost everybody can agree on this language.

The most interesting and noteworthy tension in the USTA comments is perhaps those between the large ILECs and the smaller rural LECs. SBC, Verizon, and BellSouth all support the FCC's proposal to order mandatory bill and keep, for virtually all types of traffic. Clearly, all three have their own problems with reciprocal compensation deficits and see bill and keep as a quick and definitive solution to this troublesome success of CLECs. As for switched access traffic, they are willing to follow the FCC's lead as long as there is an adequate *quid pro quo* in terms of increases in end-users rates and, if they are really lucky, pricing flexibility for retail and wholesale services. By contrast, the small rural LECs have a very different set of incentives. Most of them do not compete with CLECs and make little or no reciprocal compensation payments to CLECs. On the other hand, revenues from access charges are the lifeblood of such small rural LECs. It is obvious from the USTA comments and the comments filed by individual small rural LECs, such as Ronan Telephone Company, that the very thought of loosing their access revenues as a result of some regulatory experiment with bill and keep is not being well received by these small rural LECs.

As a result of these tensions, the USTA's comments very carefully navigate around the more contentious aspects of the FCC's proposals. This effort, however, is not always successful. For example, while the USTA proposes some form of bill and keep, it also states in their comments that "the proposals to change the CPNP regime contained in the *NPRM* should be rejected.[14]" It appears that the USTA here wants to have it both ways.

The FCC should pay specific attention to the USTA's estimates of how LECs will be impacted by mandatory bill and keep for switched access traffic. Assuming that the USTA has its numbers right, elimination of intrastate switched access results in a minimum loss of $0.12 per line per month for large companies and a maximum of $88.05 per line per month for smaller companies.[15] Elimination of interstate access charges may result in a minimum loss of $7.70 per

[14] Comments of the United States Telecom Association, page iv.

[15] Id, page 23.

line per month for large companies and a maximum of $46.10 per line per month for smaller companies (depending on the level of SLC assumed in the calculation.).[16]

The implications are ominous: if the FCC follows through with its bill-and-keep proposals, these revenue shortfalls will, almost certainly, be shifted onto the end users. This means, as predicted, that mandatory bill and keep for various forms of intercarrier traffic will place significant upward pressure on end-user rates. Needless to say, this will have significant and negative impact on universal service.

The USTA's comments are most confused where it concerns a proposal discussed in the *NPRM* to adopt TELRIC based rates for switched access traffic. The USTA argues that such an approach would only serve to make CPNP a "less functional compensation regime.[17]" According to the USTA, "the use of TELRIC to determine access charges and reciprocal compensation would eliminate incentives to be efficient, to upgrade networks, to provide advanced services and to invest in new technologies.[18]" These claims are peculiar. First, the comments contain no discussion why the USTA believes that this is so, even though the USTA must be aware that the FCC has adopted TELRIC-based rates in a variety of settings precisely because they do provide incentives "to be efficient, to upgrade networks, to provide advanced services and to invest in new technologies." That is, the USTA's claims on this issue are surely controversial and one

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[16] Id, page 23.

[17] Comments of the United States Telecom Association, page 30.

[18] Id, page 31.

would think that some explanation be in order. Second, it is difficult to see how eliminating access charges – as proposed under the USTA's modified bill-and-keep regime – would provide more of an incentive for efficiency than afforded under a TELRIC regime.

Last, it is clear that the USTA envisions that ultimate cost recovery burdens will be shifted to end-users. The USTA notes:

> Carriers that rely on revenues received from current compensation arrangements that could be displaced must have an equal opportunity to recover costs from alternate sources. *End user pricing flexibility will be required.*[19] (Emphasis added.)

The end-user pricing flexibility sought by USTA and by other LECs is profoundly disturbing. Experience with premature pricing flexibility, when significant competition is absent, has taught regulators that it is typically used to raise prices and not to lower them. In view of this, it would be very unwise for the FCC to seriously consider these types of requests. This is particularly true given the upward pressure on end-user rates already associated with the FCC's bill-and-keep proposals.

D. Reply Comments to Issues Raised by SBC Communications, Inc.

As noted in the introduction to these reply comments, most parties have filed comments supporting proposals that suit their own situation best. This is true for SBC as well. SBC

[19] Comments of the United States Telecom Association, page ii.

declares itself in support of bill and keep where it concerns local traffic and ISP bound traffic, traffic for which SBC has incurred significant deficits in reciprocal compensation payments. However, where it concerns switched access traffic, the company is quick to point out that any loss in revenues as a result of bill and keep must be made up through other means. This position is obviously internally inconsistent and self-serving. To be sure, SBC is entirely unconcerned about the loss in revenues that CLECs will experience when compensation for local and ISP-bound traffic is eliminated by the FCC's bill-and-keep proposals; however, where it concerns SBC's lost revenues for switched access traffic, as a result of the same bill-and-keep proposals, the company insists that it be kept whole.

There are a number of issues raised in SBC's comments that require rebuttal or otherwise deserve additional comment. First, SBC's comments underscore the effect that OPUCT fears most: bill and keep, as a method for intercarrier compensation, will invariably lead to higher end-user rates. SBC notes:

> Pursuant to Sections 251(i) and 201(a), the Commission is responsible for replacing interstate carrier access charges with comparable recovery from *end-users*. This can be accomplished by various mechanisms (e.g., by increasing the existing Subscriber Line Charge), but the most pro-competitive approach would be for the Commission to *give all carriers the flexibility* to determine how to recover these interstate costs from end-users.[20] (Emphasis added.)

Thus, SBC demonstrates – which OPUCT points out in its comments as well – that as a result of bill and keep, which provides no cost recovery at all (if traffic is not balanced), the cost

[20] Comments of SBC Communications, Inc., page 42.

recovery shortfall for terminating traffic (incoming calls) must now be made-up by end-users. In simplest of terms, this means that rates for basic local service have to go up. As discussed in considerable detail in OPUCT's comments, the proposed FCC's bill and keep arrangements and associated increases in end-user rates will hurt the preservation and promotion of universal service. For a number of obvious reasons, discussed in OPUCT comments, OPUCT believes that such increases are undesirable and not in the public interest.

Further, OPUCT fundamentally disagrees with SBC's proposition – echoing the FCC's sentiments expressed in the NPRM – that the current system of intercarrier compensation is inadequate. SBC notes:

> The current complex system of intercarrier compensation rules, whereby different rules apply depending on the carrier and the nature of the traffic involved, is unsustainable over the long run and, like reciprocal compensation, also invites inefficiency and arbitrage.[21]

While it is true that the current system of intercarrier compensation needs to be adjusted and unified, the underlying principle that rates be costs based -- which in some form or another has guided public policy makers since the Telecommunications of 1996 – *is sound*. As OPUCT discusses in considerable detail in its comments, the FCC's proposals for mandatory bill and keep, which SBC supports, will *fracture* the larger regime of TELRIC-based rates that provides consistency across various proceedings involving cost concepts, such as USF proceedings, alternative regulation proceedings (with cost-based competitive safeguards) and UNE cost

[21] Comments of SBC Communications, Inc., page 2.

proceedings. Again, OPUCT believes that it would be far better to extend the current regime of cost-based rates to all aspects of intercarrier compensation and to ensure that costs are determined based on the FCC's TELRIC methodology, as discussed in its *Local Competition Order*. *Again, an intercarrier compensation scheme of cost based rates, as determined by the FCC's TELRIC methodology, is theoretically sound, consistent with the Telecommunications Act of 1996, prior FCC rulings, and state commission TELRIC proceedings, and will promote predictable and economically efficient cost recovery mechanisms.* As such, a cost-based intercarrier compensation scheme will optimally promote local competition as well as preserve and promote universal service.

In support of its recommendations for bill and keep, SBC cites the phenomenon that CLECs have attracted large numbers of ISPs. SBC notes:

> The most egregious example of regulatory arbitrage has been CLECs seeking ISP customers with high volumes of one-way traffic in order to generate billions of dollars of reciprocal compensation payments.[22]

OPUCT could not disagree more. As discussed in OPUCT's comments, many observers of the industry perceived the migration of ISPs to CLECs as a promising sign that local competition was working. Further, as OPUCT demonstrated in its comments, ILECs – including SBC -- were "*hostile, unyielding, and antagonistic*"[23] to ISPs, denying them quality service,[24]

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[22] Comments of SBC Communications, Inc., page 15.

[23] Proceeding to examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, Public Utility Commission of Texas, Docket No. 21982. TISPA Amicus Curaie Brief, page 3.

and more interested in competing against them than for them.[25] For the first time in history, however, customers had a choice, and ISPs did what every customer should have a right to do: they walked. And, competing CLECs did what they should have done: they put out their welcome mats and opened their doors. If there is market failure here, it is the ILECs' continued refusal to compete for ISPs; it is their refusal to offer efficiently priced collocation and ISDN services to ISPs (or any other carrier[26]) and to be responsive to customers' needs. Again, the FCC should not underestimate the degree to which its policies are aiding the ILECs' attempts to undermine the independent ISP industry. OPUCT is most concerned here about the potential that eventually the ILECs, having established a dominant position for Internet access, may be able to impose usage sensitive charges, which is the ILECs' longstanding policy preference.[27] In short, SBC's claim that reciprocal compensation payments for ISP-bound traffic represent a market failure that needs to be solved by mandatory bill and keep is simply wrong. These payments were and continue to be a manifestation that competition is working in select areas of the telecommunications markets. The FCC should foster such competition – not quell it, at the request of large ILECs, such as SBC, by means of ad hoc regulatory intervention. To be sure: mandatory bill and keep when traffic is not approximately balanced is a bad and irrational policy, whether it concerns, local, switched access or ISP-bound traffic.

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[24] TISPA documented the numerous "bad acts" SWBT has committed against ISPs in comments to the FCC in SBC's § 271 case. *See*, TISPA Reply Comments in CC Docket 00-04.

[25] In California, a group of ISPs plans to file a complaint with the California Commission, accusing Pacific Bell and an affiliate of engaging in anti-competitive practices. "Pacific Bell May Face Complaint," *The New York Times*, July 26, 2001, page C1.

[26] OPUCT will presently provide evidence that regulators' efforts notwithstanding, collocation rates remain excessively high relative to collocation hotels, a competitive benchmark.

SBC goes to great lengths to demonstrate that the FCC has the authority to order bill and keep and to order states to establish end-user recovery mechanisms to compensate for the resulting shortfall in cost recovery. SBC states:

> With respect to local and intrastate switched access traffic, the Commission has the authority pursuant to sections 201(b), 251(d) and 251(i) to require that states transition to bill and keep and establish end-user recovery mechanisms by a date certain to facilitate the implementation of a nationwide bill and keep regime.[28]

SBC's support for the notion that the FCC has the jurisdictional authority to impose mandatory bill and keep is based on SBC's believe that bill and keep provides for adequate compensation even when traffic is not balanced:

> SBC's bill-and-keep proposal establishes a framework that provides carriers with 'mutual and reciprocal recovery of costs' (from either end-users or other carriers), even when traffic flows are not balanced.[29]

OPUCT believes that SBC is playing a game of words here. Clearly, if traffic flows are not balanced then the carrier that terminates the balance of the traffic is left without adequate compensation. The clever caveat in SBC's argument is, of course, the parenthetical "*from either end-users or other carriers.*" Translated, this means that bill and keep is compensatory as long as the FCC and state commissions find some other party, preferably end-users, to make up the shortfall. Well, with this caveat, *any compensation scheme would be compensatory*. Moreover,

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[27] As SBC notes: *"ISPs should pay ... the costs of access ... just as IXCs do."* See, SWBT's Response to Taylor Communications group, Inc.'s Petition for Arbitration, Texas Public Utility Commission, Docket No. 21982, page 7.

[28] Comments of SBC Communications, Inc., page 42.

[29] Comments of SBC Communications, Inc., page 5.

using SBC's "logic," one could absurdly argue that setting zero dollar rates for SBC's unbundled network elements, to be used by CLECs, is also compensatory provided that the FCC and state commissions ensure cost recovery "from either end-users or other carriers." Clearly, this type of argument lacks merit and should be resisted by the FCC.

OPUCT also disagrees with SBC's immodest and gratuitous request for nearly unfettered pricing flexibility. Part of SBC's support for the FCC's bill-and-keep proposal is the following request for flexibility:

> The Commission should give all carriers pricing flexibility for wholesale and retail services. In a bill-and-keep environment, ILECs must have the same flexibility as other carriers to offer end-users a range of calling plans at market-based prices so that they can respond to market forces.[30]

First, there is nothing specific about a "bill-and-keep environment" that calls for a different form of price regulation than the ILECs, including SBC, are currently subject to.

Further, it is obvious, and well recognized by the FCC, for example, in the *UNE Remand Order*,[31] that the ILECs retain near complete monopoly power over the provision of network facilities at the wholesale level, i.e., in the provision of UNEs. Thus, absolutely no pricing flexibility is in order other than the ability to negotiate interconnection agreements with CLECs under the provisions of the Telecommunications Act of 1996.

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[30] Comments of SBC Communications, Inc., page 3.

[31] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Third Report and Order, (1999) *("UNE Remand Order*").

As for the request to receive pricing flexibility at the retail level, the FCC is presumably well aware that most states, and certainly Texas, have provisions in place under which ILECs can petition the state commission for increased pricing flexibility. Typically, such pricing flexibility provisions require a demonstration that the services for which the ILEC is seeking pricing flexibility are subject to significant competition. It would be wholly inappropriate for the FCC to completely sidestep these state provisions and to grant SBC's request without any evidentiary record on the degree of competition necessary to determine whether such flexibility is warranted. OPUCT also believes that such a broad grant of pricing flexibility would take the FCC considerably beyond its jurisdictional authority. The FCC should ignore SBC's comments on this issue.

OPUCT also disagrees with SBC's oft-repeated claim that local residential prices should be increased. SBC states:

> Nor should it be surprising that the implicit subsidies used to support below-cost residential service prices have been eroding rapidly, and that this erosion continues to accelerate due to competitive losses and arbitrage. The pro-competitive goals of the 1996 Act will never be fully realized until *local residential prices rise* to levels that are self-supporting and, therefore, attractive to competitors.[32] (Emphasis added.)

A number of observations are in order. First, SBC provides absolutely no evidence that local residential services are not self-supporting. While this claim may tap into long held believes by certain regulators, the truth is that, when challenged, this claim fails to hold up under scrutiny. Typically, when all sources of local revenues are taken into consideration, it turns out

[32] Comments of SBC Communications, Inc., page 3.

that local residential as a class of service is self-supporting. This is particularly true when one includes in the analysis revenues from vertical services, such as call waiting, caller-ID, etc., since these features generate significant revenues and cost near to nothing to offer. Of course, this is not to say that individual local residential customers are not and should not be subsidized. To the contrary, it is incontrovertible that serving certain local residential customers in rural areas, be they served by SBC, smaller independent ILECs or CLECs, involve costs significantly above average. For these instances there are and should be universal service provisions. However, for SBC these instances constitute only a relatively small portion of their 60-70 million customers base and they in no way warrant the claim that local residential service rates in general are not compensatory and need to be raised.

OPUCT has already pointed out in it comments that the FCC's bill-and-keep proposals will almost certainly place serious upward pressure on end user rates. SBC's request here, to raise local residential rates, further underscores the serious danger that the FCC's proposals pose to universal service.

E. Reply Comments to Issues Raised by BellSouth and Verizon

BellSouth and Verizon, like SBC, generally support the FCC's proposals for bill and keep. As with SBC, BellSouth's and Verizon's support appears to be largely motivated by the desire to eliminate any reciprocal compensation payments to CLECs for ISP-bound traffic. OPUCT has already discussed in its comments why it disagrees with the FCC and the large ILECs on whether or not reciprocal compensation payments constitute market failure, as the

FCC and the ILECs argue, or market success, as OPUCT would argue. At this point, OPUCT would like to reply to BellSouth's contention that bill and keep will solve all arbitrage problems. BellSouth states the following:

> Bill-and-keep eliminates the market distortions, some of which the Commission has confronted, created by carrier-to-carrier payments. Experience has shown that the system of carrier payments can be profitably manipulated in unintended ways. If the Commission does not alter the existing carrier payment regime, changes in technology will provide additional opportunities for carriers to avoid carrier payments. For example, as the use of Internet protocol proliferates in networks there will be more and more incentives for carriers to disguise their carrier operations as ISP operations in order to take advantage of the access charge exemption. The consequences of these types of movements can be far-reaching. Not only are there traditional allocative inefficiencies because economic decisions are being driven by non-economic criteria, such as manipulating regulatory disparities, but, in addition, the Commission's public policies, such as universal service, can be undermined as well.[33]

BellSouth correctly observes that increasingly carriers will seek to terminate long distance voice traffic disguised as Internet traffic into the local exchange, thus bypassing the switched access charges traditionally associated with terminating long distance calls. The incentives for this type of "arbitrage" will only increase if the FCC follows through on its proposals to impose mandatory bill and keep on certain types of traffic while maintaining a different regime for long distance traffic, as proposed in the *NPRM.*

However, as OPUCT has already discussed in its comments, the entire arbitrage problem

[33] Comments of BellSouth, page 3, paragraph 6.

would disappear if rates are appropriately cost based, as determined under the FCC's TELRIC methodology. If compensation for all intercarrier traffic is set at TELRIC, there is no incentive for carriers to disguise the nature of their traffic in an attempt to shop for cheaper tariffed rates: under the TELRIC methodology, functionality determines costs irrespective of the nature of the traffic. That is, all carriers will face the same rates when they terminate traffic on a specific carrier's network, irrespective of the nature of the traffic or the type of carrier involved, as long as they use the same network functionalities and interconnect in the same manner. As such, there are no longer any incentives for rate arbitrage.

F. Reply Comments to Issues Raised by Select CLECs

A number of CLECs, such as Focal Communications Corporation, Pac-West Telecomm, Inc., RCN Telecom Services, Inc. US LEC Corp, KMC Telecom, Inc., and Z-Tel Communications, Inc., have filed comments strenuously opposing the FCC's bill and keep proposals. As some of these parties note:

> The unspoken policy assumption of the *Intercarrier Compensation NPRM* is that only carriers with the traffic patterns and networks of ILECs should succeed. The proposals of the *Intercarrier Compensation NPRM* are thus profoundly at odds with the competitive goals of the Telecom Act.[34]

OPUCT agrees with this assessment. The very objective of Telecommunications Act of 1996 and the various provisions for diverse market entry strategies was precisely to not force

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[34] Comments of Focal, Pac-West, RCN, and US LEC, page ii.

CLECs into patterns of development that would replicate those of the existing ILECs. The CLEC's argument that the FCC's implicit policy preferences represent old pre-conceived notions of "correct" market entry are on the mark: sadly, the FCC's *NPRM* is indeed predicated on a preference for balanced traffic. The FCC, however, has put forth little substantive arguments in favor of this implied approach, as if somehow the very observation that traffic is not balanced were sufficient to convince every reasonable observer that something was amiss. But not all reasonable observers are as dismayed by this observation as the FCC. In fact, OPUCT argues, along with many parties that filed comments opposing the FCC's proposals, that traffic imbalances are just fine as long as proper compensation is awarded. Moreover, the FCC should recall that the wireless industry -- for its entire history – has experienced systemic traffic imbalances with the wireline industry and the FCC has yet to be perturbed by that. OPUCT also assumes that many wholesale carriers that sell capacity on their long distance fiber facilities to IXCs and CLECs may over select routes for certain periods of time have profound traffic imbalances with carriers on which they terminate. In short, one cannot observe this industry and conclude – without significant argument – that the only "correct" market entry strategy to serve the public interest is one that results in balanced traffic patterns. Yet, this is what the FCC has done in its NPRM and the CLECs are correctly criticizing the FCC for it.

Further, the FCC should seriously consider the warnings issued by these carriers that a fractured and bifurcated introduction of bill and keep, to apply to local and ISP bound traffic but not to access traffic, would create more perverse incentives than the FCC is hoping to solve in this NPRM. OPUCT has commented on this issue as well. OPUCT has noted that the FCC's proposals for mandatory bill and keep will create a host of arbitrage opportunities, particularly where it concern voice over IP traffic. OPUCT believes that eventually tariff arbitrage may force companies and regulators to revert from bill and keep to cost-based rates, a flip-flop in policy that certainly would contribute to further regulatory uncertainty in the CLEC industry. In any event, the comments filed by these CLECs that are in the business of spotting market opportunities should be taken seriously. If they say that the FCC is creating opportunities for arbitrage by selective mandating bill and keep, it is a good indication that the NPRM is on the wrong track.

Again, OPUCT favors an emphasis on TELRIC-based rates and competition will gradually diminish the role of regulators and resolve issues far more efficiently and satisfactorily than regulators could. This is a position also supported by many of the CLECs.

Z-Tel confirms OPUCT's own concerns, expressed in OPUCT's comments, on the lack of mention in the *NPRM* of unbundled local platform ("UNE-P") offerings.[35] Z-Tel correctly notes:

> The proposals in the NPRM are incomplete. Most importantly, despite its attempt to survey the "broad universe" of different intercarrier compensation practices, the NPRM fails to analyze the most significant and fastest-growing area of intercarrier payments – the Commission's unbundled local switching rate structure rule in 47 CFR 51.509(b).[36]

OPUCT has discussed how the FCC's bill and keep proposals could seriously undermine the

[35] The term unbundled local platform ("UNE-P") refers to a unbundled network element combination consisting of an unbundled loops, unbundled local switching and shared or common transport, as discussed in the FCC's UNE Remand Order.

[36] Comments of Z-Tel Communications, Inc., page i.

unbundled local platform by removing a source of revenue needed to offset the cost incurred by the CLEC for traffic that terminates to its UNE-P customers. The FCC's oversight here is remarkable, since at this juncture UNE-P is by far the most successful market entry strategy used by CLECs. Again, OPUCT urges the FCC to take great care to not undermine the few instances in which local competition appears to be working by the ill-considered proposals set forth in the *NPRM.*

G. Reply Comments to Issues Raised by Certain Wireless Carriers

The comments filed by most wireless carriers, such as Verizon Wireless, Inc, AT&T Wireless Services, Inc., Voice Stream Wireless, Inc., and Nextel, generally support the FCC's bill-and-keep proposals. This support is, of course, not surprising: wireless carriers have traditionally experienced significant traffic imbalances with the ILECs and continue to pay large amounts of compensation for terminating their traffic. [37] Given that bill and keep would eliminate these compensation payments, wireless carriers stand to gain significantly from the FCC's proposals. Furthermore, there is little danger that wireless carriers will become, through certain shifts in technology or calling patterns, sudden recipients of large volumes of unbalanced traffic that other carriers wish to terminate on their networks. That is, while CLECs that serve ISPs receive large volumes of traffic for which they need compensation, it is unlikely that

[37] In Texas alone, SWBT earned over $200,000,000 in intercarrier compensation from wireless carriers, a number far greater than the amount paid to CLECs for ISP-bound traffic. See, *Proceeding to examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996*, Public Utility Commission of Texas, Docket No. 21982. Taylor Post-Hearing Brief, page 14.

wireless carrier will in the foreseeable future experience such a situation where they terminate more traffic for other carriers than vice versa. This means that wireless carriers can advocate and support without further concern free termination on other carrier's networks: bill and keep. While this position makes sense for the wireless industry, the reasons for their support fail to be persuasive from a public policy perspective. Surely, good public policy should not seek to significantly favor one group of carriers over another.

Wireless carriers also seek to differentiate themselves from CLECs on the use of Virtual NXXs. The ILECs have declared themselves in opposition to the use of Virtual NXXs by CLECs to allow ILEC customers to make calls rated as local to CLEC end-users even though the CLEC may not actually serve customers in the direct vicinity of the calling parties' wire center. As OPUCT has discussed in its comments, this practice is critical for CLECs and ISPs to offer economically viable service.[38] The wireless carriers also use Virtual NXXs but seek to differentiate themselves form the CLECs. The wireless carrier note, for example, that they "do not use Virtual NXXs to aggregate traffic to avoid toll.[39]" This argument is somewhat opportunistic. The local calling scope for wireless carriers greatly exceeds those typically established for CLECs and ILECs. Further, the objective to offer callers the ability to make a local call as opposed to a toll call is precisely why the Virtual NXX is important from a public policy perspective. Without the Virtual NXX, callers who call CLEC customers would far more often be faced with toll charges even though calls may be within some recognized area of

[38] As discussed in OPUCT's comments, the absence of Virtual NXXs would require CLECs to establish a point of present in each and every ILEC end-office, a requirement that would seriously impede competition.

[39] Comments Verizon Wireless, page 31.

community of interest for which local calling charges are more appropriate. The assessment of toll charges when ILEC customers call CLEC customers, of course, would also have seriously adverse effects on the further development of local competition.

H. Reply Comments to Issues Raised by AT&T and WorldCom

Both AT&T and WorldCom have filed comments opposing the FCC's proposed bill-and-keep arrangements. Their opposition to bill-and-keep is remarkable since AT&T and WorldCom both would gain significantly by a policy of bill-and-keep for switched access traffic, as they are the largest IXCs and account for the majority of the LECs' switched access revenues. That is, bill-and-keep for switched access would significantly reduce their costs of originating and terminating traffic on ILEC networks. For this reason, their comments, which in a sense do not follow their narrow self-interest, deserve special attention.

OPUCT has commented that the FCC's proposals for mandatory bill and keep will *fracture* the larger regime of TELRIC based rates that provides consistency across various proceedings involving cost concepts, such as universal service fund proceedings, alternative regulation proceedings (with cost based competitive safeguards) and UNE cost proceedings. This same sentiment is expressed by AT&T in its comments. AT&T notes that the Commission should establish "a uniform intercarrier compensation rule in which a 'minute is minute' for transport and termination purposes, regardless of its content.[40]" The company then goes on to note that this objective is best achieved by uniformly applying "forward-looking, cost based intercarrier compensation." While AT&T is careful not to use the term TELRIC, given that the ILECs continue to appeal the FCC's authority regarding this methodology, the company's recommendation is clear: rates based on forward-looking, economic costs "encourage efficient investments, discourage regulatory arbitrage, and create a level, competitively neutral playing field.[41]" OPUCT agrees with AT&T on this issue.

WorldCom also supports the use of cost based rates for intercarrier compensation, though WorldCom's recommendation is reached in large part based on the recognition that the FCC lacks the statutory authority to impose bill and keep across all forms of traffic, a fatal flaw in the FCC's attempt to tackle the radical overhaul of intercarrier compensation and the well established CPNP regime. In the final analysis, WorldCom's recommendation is the same as AT&T's:

> Because of the statutory limits on the Commission's authority to establish intercarrier compensation rules applicable to interconnection arrangements between LECs and other carriers, WorldCom recommends the adoption of a uniform rate for call termination based on the pricing principles set forth in section 251 of the Act and the FCC's implementing rules.[42]

AT&T and WorldCom get it just right on this issue. As discussed in OPUCT comments,

[40] Comments of AT&T Corp., page i.

[41] Comments of AT&T Corp., page i.

[42] Comments of WorldCom, page 4.

only rates based on forward-looking economic costs will bring about a unified regime across all forms of intercarrier compensation on the wholesale level.

III. CONCLUSION

In this *NPRM*, the FCC is discussing proposals for fundamentally overhauling the rules by which telecommunications carriers interconnect. Regardless of the merit – or lack of merit -- of the proposals, the timing for this overhaul is particularly poor. As should be apparent by now, this industry is in a state of meltdown. Most telecommunications stocks, except of those for companies with market power, are trading at all time lows and every month continues to bring the sad news of more CLECs filling for bankruptcy. Clearly, this is not the time to announce to the financial world that telecommunications companies may loose yet more revenues.

In its initial comments OPUCT has provided a large number of reasons for why the FCC's proposals are unsound. In these reply comments OPUCT has noted the comments of other parties that have concerns similar to OPUCT's. OPUCT has also rebutted the arguments by parties with which OPUCT disagrees. In general, OPUCT believes that the collective comments filed by NARUC, NASUCA, consumer counsels, state commissions, CLECs and IXCs provide the FCC with a large number of well-considered, thoughtful arguments, and a clear message: mandatory bill-and-keep is not in the public interest because it will neither promote competition nor universal service. OPUCT respectfully requests that the FCC heeds this message.