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November 5, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

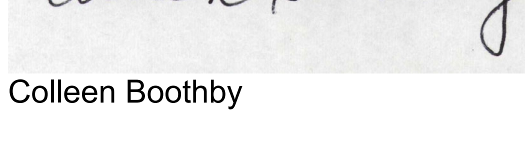
Re: Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92.

Dear Ms. Salas,

Pursuant to Sections 1.41, 1.415, and 1.419 of the Commission's Rules, enclosed please find the Reply Comments of the Ad Hoc Telecommunications Users Committee in the above-captioned matter.

If you have any questions regarding this filing, please do not hesitate to contact me.

Sincerely,



Colleen Boothby

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

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| Developing a Unified Intercarrier | ) | CC Docket No. 01-92 |
| Compensation Regime | ) | |
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# REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE


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November 5, 2001

## Summary

The Commission should not implement a new intercarrier compensation system on a piece meal basis. Although the focus of the *NPRM* is on the narrow issue of reciprocal compensation for calls to ISPs, the Commission's focus should instead be on developing and implementing a thoughtful and comprehensive payment regime applicable to *all* traffic for which intercarrier compensation is required. Even the author of one of the Commission's white papers that proposed bill-and-keep as an intercarrier compensation mechanism has objected on the record of this proceeding to piece meal implementation. Partial implementation of intercarrier compensation reform that ignores access charge issues will:

- exacerbate any uneconomic arbitrage among services whose costs are identical;
- saddle carriers and consumers with unrecoverable compliance costs;
- ignore the far more damaging and long-standing distortions in access pricing; and
- be unsustainable in the face of changes in technology and competitive market structures.

The Commission obviously feels some urgency to address the controversies that have erupted around the ILECs' reciprocal compensation payments for ISP-bound traffic. However, giving higher priority to those issues, and delaying any solution to the fundamentally uneconomic pricing of access

charges, would be the tail wagging the dog. A precipitous response to protect the parochial interests of ILECs, who are making disproportionate reciprocal compensation payments simply because they were caught flat-footed by the growth of Internet access services and have been unable to compete with CLECs for ISP customers, would stand in stark and suspicious contrast to the Commission's leisurely pace for addressing the far more costly access issues that have plagued end users for nearly twenty years.

The *NPRM*'s bill-and-keep proposal is based on untested and incorrect assumptions regarding the "equal benefits" of and "equal responsibility" for calls between end users. These assumptions are inherently illogical, demonstrably wrong, and lacking in any empirical basis. In addition, the bill-and-keep proposal poses a serious threat to toll-free calling, a service whose value to commerce and consumers is indisputable. The Commission must ensure that any new compensation regime has no adverse impact on the viability toll-free services, and bill-and-keep can't meet that standard.

Finally, the credibility of the ILECs supporting bill-and-keep most vociferously in this proceeding has been severely undermined by their conflicting and self-serving flip-flops on these issues in earlier proceedings, reflectng whether they expect to be a net recipient or a net payor of reciprocal compensation. Their prior criticisms of bill-and-keep as an uneconomic and unacceptable compensation mechanism have gone unanswered in this record.

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## REPLY COMMENTS OF THE AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee ("the Committee" or "Ad Hoc") hereby submits its Reply Comments in response to the April 27, 2001 Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.[1]

## I. INTRODUCTION

In its initial comments,[2] Ad Hoc urged the Commission to continue its efforts to develop a unified intercarrier compensation regime that would apply cost-based pricing principles to all forms of traffic, *i.e.,* interstate and intrastate access as well

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[1] *Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, FCC 01-132, Notice of Proposed Rulemaking (released Apr. 27, 2001) ("*NPRM*").

[2] Comments of the Ad Hoc Telecommunications Users Committee, CC Docket No. 01-92 (filed August 21, 2001) ("Ad Hoc Comments").

as ISP-bound local traffic and non-ISP-bound local traffic.[3] But the Committee also pointed out that the "bill-and-keep" proposals advanced in the *NPRM* are not consistent with cost-based pricing and are based upon several faulty assumptions.[4] The Committee noted that, if the adoption of a mandatory bill-and-keep regime for intercarrier compensation is to provide sufficient net benefits to be in the public interest – although this record indicates that that is *not* the case for the services at issue in this proceeding – then the regime must be applied comprehensively to all categories of service: interstate and intrastate, carrier access and local, "ordinary" and "ISP-bound." [5]

The *NPRM* on the other hand, focuses upon how bill-and-keep might be applied to ISP-bound calls, and/or other forms of local exchange traffic in the near-term, and assumes that any transition from the current access charge regime (at least for jurisdictionally interstate traffic) would occur *after* the expiration of the CALLS settlement which will not occur for at least four or five years.[6]

The initial comments filed by other parties reinforce Ad Hoc's view that it would be a mistake to take such an approach. As discussed below, parties from a diverse range of stakeholders, including ILECs, their competitors, rural carriers, state PUCs, and consumer advocate agencies, provide additional support for Ad Hoc's positions.

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[3] Ad Hoc Comments at 10.

[4] *Id*. at 2.

[5] *Id*. at 8-9.

[6] *See NPRM* at para. 97.

## II. DISCUSSION

### A. The Record Does Not Support Piece-Meal Implementation of A New Intercarrier Compensation Regime

Ad Hoc has been an active participant in the Commission's access charge reform proceeding [7] and has strongly supported the Commission's efforts to bring interstate access charges into closer conformity with cost-based pricing principles. In particular, Ad Hoc has encouraged the Commission to apply a forward-looking, long-run incremental cost standard to access charges because, in the absence of widespread, price-constraining competition, that standard is the best means of replicating the economic benefits that such competition would otherwise produce.[8] The Commission's objective in the instant proceeding should be the same; any action it takes in this docket should not undermine the progress it has made on access reform.

The *NPRM* focuses on controversies surrounding a relatively narrow issue: the reciprocal compensation framework that is applied to local exchange calls, particularly dial-up calls destined for Internet Service Providers ("ISPs"). While the *NPRM* also sought comment on reforms applicable to a broad range of interconnection arrangements -- including LEC-to-CLEC, LEC-to-CMRS, and LEC-to-IXC – it makes a specific proposal to apply bill-and-keep in only one case, namely, ISP-bound traffic.[9] The *NPRM* generally relegates consideration of bill-

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[7] *See Access Charge Reform: Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262.

[8] *See, e.g.*, Comments of the Ad Hoc Telecommunications User Committee, CC Docket No. 96-262 (filed January 29, 1997) at 35-38.

[9] *NPRM* at para. 66.

and-keep for access charges to several years in the future, after the CALLS plan has run its course.[10] Yet all of these other forms of interconnection involve traffic exchanges that are supposed to be compensated on the basis of cost, with access charges arguably deviating the most from economic cost levels.

Some commenters, notably Verizon, contend that the Commission should adopt mandatory bill-and-keep for ISP-bound traffic "as soon as possible," before reaching conclusions as to the best long-term compensation regime for other types of traffic.[11] This would be a serious policy error and one that could prove to be enormously costly to carriers and consumers alike. The Commission should not adopt an untested, radically different compensation regime such as mandatory bill-and-keep for a single narrow traffic category before it identifies a unified, economically rational intercarrier compensation framework for *all* traffic subject to regulation. In addition to undermining local exchange service competition at its most fundamental level, piecemeal introduction of bill-and-keep would inevitably lead to even more of the so-called "regulatory arbitrage" about which the ILECs so vociferously complain.

If bill-and-keep were adopted on a mandatory basis only for ISP-bound calls, for example, carriers and consumers can be expected to invest substantial effort and financial resources to implement and adjust to the new framework. ILECs and CLECs would need to modify their rate structures and billing systems in order to charge ISP customers for the termination costs previously recovered from interconnecting carriers through reciprocal compensation payments. In addition,

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[10] *Id.* at para. 97.

ISPs would be forced to develop and seek consumer acceptance of the new pricing plans that would recover those costs from their subscribers. Finally, ISP end users would be forced to re-evaluate their services, seek out alternatives, and perhaps curtail their usage and reconfigure their services if the new system pushed end user Internet access prices up. All of these transition-related activities generate mostly one-time, sunk costs, which cannot be recouped later if the Commission ultimately concludes that an alternative to bill-and-keep is preferable for a unified intercarrier compensation system applicable to all traffic.

The Committee understands that the Commission feels some urgency to address the controversies that have erupted around reciprocal compensation arrangements, especially those requiring payments by incumbent LECs for ISP-bound traffic. However, giving higher priority to those issues, instead of addressing the underlying and long-standing issues of access charge reform, would be the tail wagging the dog: because CLECs have thus far made only small inroads into the local exchange market, the disputed revenues produced by reciprocal compensation are much smaller than those at issue in the access services market[12] and should not drive policy decisions that may later apply to access charges. Indeed, a precipitous response to protect the parochial interests of ILECs, who are making disproportionate reciprocal compensation payments simply because they were caught flat-footed by the growth of Internet access

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[11] Verizon Comments at pages 1-4.

[12] According to the Commission's latest industry trends report, total CLEC revenues from all services (of which only a fraction would be attributable to reciprocal compensation payments) were some $6.3 billion in 1999, whereas total access charge revenues (including subscriber line charges paid directly by end users) were roughly $29 billion. See Common Carrier Bureau, Industry

services, would stand in stark and suspicious contrast to the Commission's leisurely pace for addressing the far more costly access issues that have plagued end users for nearly twenty years.

As Ad Hoc and others have emphasized in their initial comments,[13] the current intercarrier compensation "problem" was caused in large part by the ILECs' insistence upon compensation arrangements that are not even remotely cost-based. ILECs, who assumed they would be net recipients of local intercarrier traffic, challenged the Commission's original "proxy rates" of $0.002 to $0.004 for local terminations[14] and demanded higher reciprocal compensation rates at multiples of these (then) cost-based levels. Responding to the above-cost "reciprocal" prices that the ILECs had themselves established, a number of CLECs who could terminate inbound calls at lower cost than the ILEC-dictated reciprocal compensation rates, developed business plans aimed at attracting customers with disproportionate inbound calling requirements, many of whom happened to be ISPs. What the ILECs pejoratively characterize as "regulatory arbitrage" is in reality merely the result of their utter indifference to this segment of the market and their failure to accurately spot and respond to the growth of the Internet.

Moreover, the cost/price disparities and putative distortions in marketplace incentives attributed to reciprocal compensation rates pale when compared to the

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Analysis Division, *Trends in Telephone Service*, August 2001 (*Trends* report), at Tables 9.6 and 16.2.

[13] Ad Hoc Initial Comments at 2.

[14] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, rel. August 8, 1996, 11 FCC Rcd 15499, 15905-15908 (*Local Competition Order*), *aff'd in part and vacated in part sub nom.*, *Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) and *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part and remanded*, *AT&T v. Iowa Utils. Bd.,* 119 S. Ct. 721 (1999).

nearly two-decades-old policy of deliberately creating access prices substantially in excess of the cost of switched access services. The termination by a LEC of an interexchange call handed off by an interexchange carrier ("IXC") involves exactly the same network functions and entails exactly the same economic cost as the termination of an intercarrier local or ISP-bound call handed-off to one LEC by another (the originating) LEC. Yet the prevailing access charge "policy," as most recently reasserted in the CALLS settlement,[15] is to use access services as a source of implicit subsidy to support other ILEC services. Even though carrier switched access charges have been substantially decreased since their initial adoption in 1984, the current $0.0055 "target rate" is still many multiples of the actual forward-looking traffic-sensitive cost for switched access.

While the persistence of excessive and non-cost-based access charges may have perhaps been tolerable in the past (insofar as it was intended to achieve certain "public interest" goals of below-cost basic local exchange service), the evolution of competing technologies, such as IP telephony, and entry by the BOCs into the interexchange service business make above-cost access charges inimical to competition and a source of serious distortions in both the technology and provider choices made by users. [16]

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[15] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers,* CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low –Volume Long Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (2000).

[16] It also creates the artificial distinction between "local" and "toll" services whose effect has been, as Ad Hoc has pointed out to the Commission in several other proceedings, to produce the serious and costly numbering resources crisis that exists at this time. *See*, *e.g.*, *Number Resource Optimization,* CC Docket 99-200, Comments of the Ad Hoc Telecommunications Users Committee (released February 12, 2001) at 14-22 and Attachment A, "Petition for Rulemaking" (artificial local v. toll distinctions require CLECs to obtain excessive numbering resources in order to offer service in multiple "rate centers").

In short, affording some sort of "priority" or ascribing some sort of "urgency" to dealing with "ISP-bound" traffic, while deferring indefinitely any further effort to eliminate the persistent economic distortions in access charge prices, amounts to nothing short of pandering to ILEC interests while ignoring the detrimental impact of uneconomic access charges on users and the development of competition.

In addition to Ad Hoc, many other parties to this proceeding have urged the Commission to take a more thoughtful and comprehensive approach to these issues. NASUCA raises no fewer than nine implementation issues that it believes would have to be addressed before any of the *NPRM's* bill-and-keep variations could be adopted. [17] Among the most important of these issues are (1) evaluating the implications for universal service; and (2) coordinating any significant changes with state regulators who, NASUCA correctly points out, will need to have more input into the process than that made available through a notice and comment proceeding such as this. Similarly, NARUC believes that any actions by the Commission to establish mandatory bill-and-keep should be undertaken only after consultation with state regulators through the existing Federal-State Joint Boards addressing universal service and jurisdictional separations matters, as bill-and-keep would have "a wide range of potential impacts on state policy concerning rates, universal service, cost allocation issues, infrastructure development, network structures, and various other state policies."[18]

[17] NASUCA Comments at 26-27.

[18] NARUC Comments at 6-7. See also the Wisconsin PSC Comments, at 6 for comparable views.

NRTA and OPASTCO point out that mandatory bill-and-keep could have major repercussions for rural carriers, such as threatening the continued viability of the National Exchange Carrier Association (NECA) interstate access revenue pools and tariffs. These groups counsel the Commission that "a major task lies ahead to identify, consider, and resolve the many unknowns that are inevitable with far-reaching changes such as those proposed in the NPRM." [19]

Even SBC, who generally supports mandatory bill-and-keep (except, apparently, when it would require payments *by* SBC[20]) urges that, "before the Commission can implement a uniform bill-and-keep regime, it finally must tackle the difficult issues of implicit subsidies and universal service reform."[21] SBC observes that the states would need considerable time to address and resolve those issues, and thus SBC concludes that a comprehensive bill-and-keep solution could not be implemented before July 2005.[22] SBC also recognizes that any selective application of mandatory bill-and-keep to individual categories of service before it was applied to all types of services would be counterproductive, because such "bifurcation would create additional arbitrage opportunities."[23] While SBC made this point in the context of interstate vs. intrastate access charges, it applies with equal force to any attempt to apply mandatory bill-and-keep only to locally-rated calls terminating to ISPs.

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[19] NRTA and OPASTCO Comments at 6-7.

[20] As discussed below in section I.D., SBC strenuously opposed mandatory bill-and-keep on economic, policy, and legal grounds in the Commission's LEC-CMRS interconnection proceeding in CC Docket 95-185. For that traffic, of course, the balance of traffic between cellular phones and wireline phones makes SBC a net recipient rather than a net payor of reciprocal compensation.

[21] Comments of SBC Communications, August 21, 2001, at pages 1-2.

[22] *Id.* at page 22.

Ad Hoc concurs with these assessments of the complexity that the NPRM's proposals would involve, and consequently the need for their full deliberation before the Commission can make an informed decision to adopt or modify the proposals. Ad Hoc agrees with Time Warner that "any selective application of bill-and-keep to some, but not other, kinds of traffic would do more harm than good by creating new inefficient arbitrage incentives."[24]

Finally, Ad Hoc agrees with the observation made by the Texas Office of Public Utility Counsel (Texas OPUC) that the Commission, and the industry as a whole, have already made great strides towards a unified intercarrier compensation framework founded on economic costs (as developed through the Commission's TELRIC costing principles).[25] After years of painstaking effort by the Commission and affected stakeholders, the Commission has also expanded the application of economic costing principles to the parallel arena of universal service funding determinations.[26] The next logical step in this overall evolution is to introduce economic cost-based pricing, TELRIC or otherwise,[27] into interstate access charges. Contrary to Verizon's view, movement in this direction would likely result in significantly lower access rates, but would not necessarily cause an

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[23] *Id.* at page 25.

[24] Time Warner Comments at iii.

[25] Texas OPUC Comments at 15-16.

[26] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 16 FCC Rcd 8776 (1997).

[27] The U.S. Supreme Court has heard oral argument concerning the finding by the Eighth Circuit Court of Appeals in *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (2000), that TELRIC violates the *1996 Telecommunications Act* by determining costs relative to a "hypothetical network," and is likely to make a ruling on this issue sometime within the next several months. *FCC v. Iowa Utilities Board,* No. 00-587, *cert. granted* 531 U.S. 1124 (2001). Ad Hoc supports pricing of access charges based on economic cost, whether or not the specific TELRIC rules already adopted by the FCC will require modification in response to a court ruling.

"underpricing of the existing network"[28] because of the continued presence of substantial subsidies in ILECs' access rates.

In light of the indisputable problems caused by adoption of a bill-and-keep alternative (some of which are discussed below), Ad Hoc urges the Commission to refocus its efforts on expanding cost-based pricing into all domains where regulatory oversight of intercarrier compensation is required, rather than short-circuiting that approach and singling out certain favored service categories for mandatory bill-and-keep, as the *NPRM* proposes.

### B. Even The Author Of The Commission's COBAK Proposal Opposes Piece-Meal Implementation

Persuasive arguments against adoption of COBAK on a piecemeal basis appear in the Declaration of Patrick DeGraba, [29] the author of the FCC white paper proposing the COBAK variation of bill-and-keep.[30] While Dr. DeGraba remains a proponent of bill-and-keep and the COBAK mechanism in particular, he expressly warns against a piecemeal implementation of the kind proposed in the *NPRM*. In Dr. DeGraba's words:

> The COBAK approach is intended to be a unified interconnection regime in which the same rules apply to all traffic, local and toll, as well as Internet. The uniform treatment of all traffic would eliminate arbitrage opportunities and create a cost assignment regime that would lead to efficient prices for all types of service and traffic. In contrast, implementing a COBAK regime for local traffic before toll traffic would leave untouched some opportunities

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[28] Verizon Comments at 19-20.

[29] "Implementing Bill and Keep Intercarrier Compensation When Incumbent LECs Have Market Power," Declaration of Patrick DeGraba (Charles River Associates, August 20, 2001) ("DeGraba Declaration"). This Declaration was provided as an attachment to the WorldCom Comments.

[30] Patrick DeGraba, *Bill and Keep at the Central Office as the Efficient Interconnection Regime* (Federal Communications Commission, OPP working Paper No. 33, Dec. 2000).

for arbitrage and delay realization of some efficiencies that COBAK could generate.[31]

The specific arbitrage opportunity that concerns Dr. DeGraba is that presented by Internet Protocol ("IP") telephony, to the extent that it might enable ISPs to provide interexchange telecommunications without being subject to the per-minute access charges that a traditional IXC must pay.[32] This particular form of arbitrage is not yet a serious problem. While the volume of IP telephony traffic will certainly continue to rise, interexchange telecommunications traffic completed by ISPs to date remains a tiny fraction of total traffic.[33] In addition, there remain significant barriers to the acceptance of IP telephony on a mass-market basis.[34] Nevertheless, IP telephony is instructive to consider for two reasons.

First, IP telephony arbitrage opportunities arise because the same function, namely, the completion of an interexchange call through local exchange facilities, is priced differently depending upon the nature of the entity that purchases it (*i.e.,* the IXC vs. the ISP). Therefore, it is not bill-and-keep *per se* that eliminates any arbitrage opportunity; a uniform pricing treatment *for all traffic* is required to do

31 DeGraba Declaration at page 29.

32 *Id.* at 30-31.

33 USTA presents estimates from market research firms that year 2000 IP telephony revenues were approximately $1 billion, which is about 1% of the total toll market revenues for that year of $108.2 billion (USTA Comments, at 9; *Trends* report, Table 10.7). The *Trends* report also indicates that total Dial Equipment Minutes (DEMS) for the year 1999 (the latest data available) amounted to 451 billion for intrastate toll and an additional 585 billion for interstate toll. On a conversation minute basis (given that one conversation minute equals two DEMS), this represents a total toll volume of 518 billion minutes. While the level of IP telephony traffic is difficult to ascertain, one source forecasts 6.2 billion IP telephony minutes in 2001, which represents approximately 1% of the 1999 toll traffic level. (See http://www.ctdepot.com, "Estimates for IP Telephony Minutes").

34 For example, generally at least one end of an IP interexchange call must pass through a PC or similar device with appropriate software, instead of a traditional telephone. While uniform standards for IP telephony are under development, currently not all IP telephony services and

that, which is achieved by a system of explicit, cost-based intercarrier compensation charges.

Second, Dr. DeGraba's point illustrates a defining characteristic of competition introduced into a formerly-regulated market:: competition responds to the economic signals in the marketplace above all else and thus tends not to respect artificially-imposed boundaries, such as regulatory service categories, when they are not well-aligned with the underlying economics. This is the fundamental reason why any effort by the Commission to improve the efficiency of intercarrier compensation mechanisms must address at the same time all forms of traffic that are subject to regulation,[35] and must ultimately adopt a unified solution.

Dr. DeGraba is also concerned that a piecemeal implementation of bill-and-keep would miss a significant opportunity to reduce the costs that carriers incur from provisioning the local exchange access function under multiple tariffs and with multiple back-office systems for metering, administration, etc.[36] Ad Hoc agrees that a simplification of intercarrier compensation mechanisms could increase the efficiency with which carriers can interact and thus reduce these types of transaction costs. However, an analysis of the possible efficiency gains from bill-and-keep must also take into account the effects that the regime could have on the transaction costs borne by end users.

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devices can inter-operate. *See, e.g.,* "TIA Launches Project to Create 'Wideband' Phone Standard", *TR Daily*, December 3, 1999.

[35] There may be certain types of telecommunications services for which ILECs do not have sufficient market power to dictate intercarrier compensation arrangements, such as ILEC-CMRS interconnection. In those cases, efficient outcomes can be reached via bilateral negotiation, so that regulatory imposition of a particular mechanism will not be required.

[36] DeGraba Declaration at 31-32.

Under the existing CPNP regime, end users are not billed directly for local access, whereas under bill-and-keep the LECs would presumably recover local access costs directly from the end users involved. If LECs were to bill end users on a flat-rated basis for their consumption of access, as well as local exchange calls, then arguably there could be a net reduction in transaction costs overall and an increase in efficiency. On the other hand, if LECs bill users for access on a per-minute basis, that may simply amount to a shift in billing-related transaction costs from IXCs to end users, without any real cost reductions.

Because of the difficulty in accurately quantifying in advance the cost impacts of the billing changes that would occur if bill-and-keep were adopted on a widespread basis, the Commission cannot rely on potential cost reductions and efficiency gains in this area as a justification for adopting bill-and-keep.

### C. The Bill-And-Keep Mechanisms Proposed In The *NPRM* Are Founded On Untested And Likely Incorrect Assumptions.

Ad Hoc's initial comments identified two specific assumptions that are central to the COBAK[37] and BASICS[38] versions of bill-and-keep contemplated in the *NPRM*, namely the assumptions of "equal benefits"[39] and of "equal responsibility."[40] Both assumptions have been challenged by other commenters as well.

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[37] Central Office Bill and Keep. *See NPRM* at para. 23.

[38] Bill Access to Subscribers-Interconnection Cost Split. *See NPRM* at para. 25.

[39] "Equal benefits" refers to the assumption that, on average, the benefits of telephone calls are shared equally between the calling party and the call recipient. Ad Hoc Initial Comments at 5.

[40] "Equal responsibility" is the assumption that the two end users on a call are jointly responsible for the costs associated with a call, and in fact should share that cost equally. *Id.* at 5.

NASUCA notes that the DeGraba white paper[41] "is based on the assumption that both parties benefit equally from a call, but there is no empirical basis for this assumption."[42] As NASUCA explains,

> We do not deny that the call receiver benefits from SOME calls, but it is impossible to say how the benefits of the call are shared, and therefore it is bad policy to assume that both parties benefit equally, and to base policy changes on this assumption. For example, calls from telemarketers surely benefit the caller more than the receiver, and many would argue that these calls have negative value for the receiver since he/she is likely not to be interested and is interrupted in the middle of another activity.[43]

Writing on behalf of AT&T Corp., the economists Janusz A. Ordover and Robert D. Willig similarly find that "B&K [bill-and-keep], or at least Dr. DeGraba's COBAK variant, is based upon the economic premise that each party to a call gets 50% of the benefits of a call," but "there is … little basis in logic or economics for this assumption."[44] They go on to cite specific counterexamples to this assumption, and observe that Dr. DeGraba did not provide any empirical data to support it.[45] These assessments seriously undermine the theoretical justification asserted in the *NPRM* for establishing a mandatory bill-and-keep regime.

Ordover and Willig also convincingly rebut the "equal responsibility" assumption. They first point out that "[t]he calling party 'causes,' in the plain

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This is a departure from the traditional analysis, which assumes that the party who decides to place a call is the cost-causer.

41 *See* note 26 *supra*.

42 NASUCA Comments at 33.

43 Id. at 21.

44 "Declaration of Janusz A. Ordover and Robert D. Willig on behalf of AT&T Corp." (August 2001) ("Ordover and Willig Declaration") at para. 32. This Declaration was provided as an attachment to the Comments of AT&T Corp.

45 *Id*. at para. 32.

meaning of the word, the costs associated with the call that she initiates, including the costs of terminating the call. But for the calling party's actions – *i.e.*, placing the call – none of these costs would be incurred."[46] This is particularly clear relative to the costs of establishing the call path, *i.e.*, the costs of call set-up. Even if the end user being called never picks up the telephone and thus cannot be considered to have "caused" any portion of the call, call set-up costs are incurred each time a call is placed to the recipient's telephone number. Moreover, despite Qwest's claims to the contrary[47], it is equally true for the duration of the call after its set-up. Causation is ascribed to *actions*, not potential actions, so that the fact that the called party potentially *could act* to discontinue the call at any time after its establishment does not make them causally responsible for the continuation of the call as Qwest contends, any more than it would make an outside plant repairman armed with a pair of scissors causally responsible for the continuation of the call because he *could* have acted to stop the call by cutting the line.[48]

Just as importantly, Ordover and Willig explain that, in the case of telephony, the allocation of responsibility is also driven by the externalities of telephone calls so that appropriate cost-based pricing must attempt to recognize the effects of calls (the positive or negative "externalities") on their recipients.

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46 *Id*. at para. 27.

47 Qwest Comments at 20.

48 Qwest also contends (*id.*, at 21) that bill-and-keep "gives called parties appropriate incentives to end calls earlier if their continuation would be inefficient." However, that is not necessarily true, because it depends upon the retail pricing structure faced by the called party: if the called party paid a flat fee for terminating access, then he would have no financial incentive to hang-up on a caller, and arguably would have incentives to over-use the "free" good.

They conclude that when bill-and-keep is compared on that basis to traditional calling party's network pays ("CPNP") arrangements, CPNP is clearly superior:[49]

> Plainly, no single rule can ensure that all positive and negative externalities are perfectly internalized. Telephone calls may confer various degrees of positive externalities, varying levels of negative externalities, or no externalities at all; the variation from call to call is enormous; and the size of the externalities associated with any given call may bear no relation to the direct costs of originating and terminating it. As such, the search must be for the rule that minimizes negative externalities by forcing callers to at least internalize all of the direct costs associated with their calls, but is also flexible enough to allow calling and called parties to internalize positive externalities. Cost-based CPNP is that rule.[50]

A key reason for this is that mandatory bill-and-keep would limit opportunities for end users to negotiate their own allocation of cost responsibility, as occurs today through the mechanism of toll-free calling.[51] As Ordover and Willig explain, bill-and-keep is not compatible with toll-free number services and other toll-free calling arrangements. Under bill-and-keep, the toll carrier would not be charged for access on either end of the call, so that it could not offer a traditional toll-free number service in which the costs associated with all portions of the call, including originating and terminating access, are shifted to the called party.[52]

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[49] This analysis is far more substantive and persuasive than BellSouth's facile conclusion that "the simplifying assumptions of the CPNP model are outmoded in the current environment", BellSouth Comments at para. 23.

[50] Ordover and Willig Declaration at para. 29.

[51] *Id*. at paras. 30 and 35.

[52] *Id.* at para. 30, footnote 7. As explained in Ad Hoc's Initial Comments (at page 9, footnote 11), allowing the terminating carrier to bill the subscriber to the toll-free service only perpetuates a variation of the "terminating access monopoly" problem which so concerned the Commission in the *Access Charge Reform* rulemaking proceeding (*see Access Charge Reform,* CC Docket No. 96-262, Seventh Report and Order and Further Notice of Rulemaking, 14 FCC Rcd 8077 at para. 10 (2001)), and thus is not a viable option.

This is a fundamental flaw in the bill-and-keep approach that could have significant and negative ripple effects on commerce generally. According to data compiled by the Commission's Industry Analysis Division, the number of toll-free numbers in use has more than doubled in the past five years, from to $9.5 million in December 1996, to more than $23.0 million today,[53] which demonstrates the importance of these services to consumers and businesses users. Ad Hoc urges the FCC to evaluate the impact of any new intercarrier interconnection regime on the viability of toll-free calling and ensure that the new regime will not have adverse consequences for this important segment of the telecommunications market.

Proponents of bill-and-keep contend that it would increase the efficiency of intercarrier compensation arrangements, and even retail pricing, because it would more closely reflect the "equal benefits" and "equal responsibility" conditions they assume are characteristic of telephone calling.[54] If, for the reasons discussed above, these assumptions prove to be incorrect, a bill-and-keep approach would introduce significant additional inefficiencies compared to the existing CPNP system.

In a paper accompanying Time Warner's initial comments, the economists Benjamin Hermalin and Michael Katz analyze the efficiency of bill-and-keep mechanisms when the "equal benefits" and "equal responsibility" conditions are

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[53] See *Trends* report, at Table 19.2 ("Telephone Numbers Assigned for Toll-Free Service"), Working Toll-Free Number counts, including area codes 800, 888, 877, and 866.

[54] *See, e.g.*, Patrick DeGraba, OPP Working Paper No. 33, at paras. 56-62, and BellSouth Comments at 10-12.

not met.[55] The paper presents several economic models of telephone calling (and other message exchanges between two parties) wherein benefits of the communication may be shared between the two parties. One of those models is a more generalized version of the paradigm that Dr. DeGraba used to justify his COBAK variant of bill-and-keep.[56]

Hermalin and Katz demonstrate that, within the limits of this model, Dr. DeGraba's finding that a zero interconnection charge (*i.e*., a bill-and-keep regime) is an efficient solution holds only for a very narrow range of conditions, outside of which a positive interconnection charge (*i.e.,* an explicit reciprocal compensation scheme) will be the efficient solution.[57] While the authors readily point out that their models are based upon certain simplifying assumptions and could be refined in several respects, their extension of the DeGraba model clearly refutes record claims assertions that bill-and-keep is likely to improve the efficiency of intercarrier compensation and retail pricing relative to the existing CPNP system.

### D. Bill-And-Keep Proponents Have Undermined Their Credibility With Conflicting And Self-Serving Flip-Flops In Position

The Commission should also scrutinize with a high degree of skepticism the comments of ILECs who are arguing vociferously for mandatory bill-and-keep in this proceeding, but took diametrically opposite positions when the Commission's

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[55] Dr. Benjamin E. Hermalin and Dr. Michael L. Katz , "Network Interconnection with Two-Sided User Benefits" (July 2001) ("Hermalin and Katz 2001"), provided as Appendix C to Exhibit 1 of the Comments of Time Warner Telecom.

[56] Hermalin and Katz 2001 at Section 5 ("Stochastically Dependent Message Values"). In addition to allowing the marginal costs of the two interconnecting networks to vary, their model assumes that the expected values of the communication for each end user are in a linear relationship, which is an extension of Mr. DeGraba's assumption that they are equal. *Id.* at 22, 26.

[57] *Id.* at page 26.

bill-and-keep proposal for interconnection with commercial mobile radio service ("CMRS") providers, in CC Docket 95-185, threatened their revenue streams as terminating carriers. [58] The critiques of bill-and-keep proffered by those ILECs in that context are unanswered in this record.

For example, SBC argued in CC Docket 95-185 that mandatory bill-and-keep "would be ill-advised" because "bill and keep sends totally inappropriate pricing signals and creates disincentives to investment."[59] Specifically, SBC contended that bill-and-keep "promotes 'free riding,' in which one carrier avoids making new investments and simply takes advantage of costs incurred by others."[60] Despite SBC's forceful condemnations of mandatory bill-and-keep when bill-and-keep did not serve its financial self-interest, SBC now proposes it as a universal solution to the interconnection problem without explaining how the mere passage of time has eliminated the investment disincentives and "free-riding" problems it identified previously. In a similar vein, Qwest's predecessor ILEC, US West, insisted that "'bill and keep' would represent poor economics and even poorer public policy," and that "mandatory 'bill and keep' would be flatly inconsistent with the new Telecommunications Act."[61] Qwest now claims that mandatory bill-and-keep would have "enormous advantages" over existing CPNP arrangements, devoting

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[58] *Interconnection Between Local Exchange Carriers and Commercial Radio Mobile Service Providers*, CC Docket No. 95-185, 11 FCC Rcd 15499 (1996). In the case of LEC-CMRS interconnection, traffic tends to be imbalanced so that the preponderance of calls are terminated by the LEC, meaning that adoption of mandatory bill-and-keep would have had the effect of eliminating net payments by CMRS providers to ILECs for call termination.

[59] *Id.* at 9.

[60] *Id.*

[61] Comments of US West, Inc., CC Docket No. 95-185 (March 4, 1996), at 8. *See also id.* at 24-52 for US West's detailed arguments against mandatory bill-and-keep.

fourteen pages of its comments to the economic and policy advantages of bill-and-keep, and another four pages to a legal justification for mandatory bill-and-keep.[62] Yet nowhere does Qwest explain why its earlier critique is no longer valid.

Similar unexplained reversals in position were filed by USTA[63] and Bell Atlantic (now Verizon) [64] in the instant proceeding. Their failure to explain or refute their earlier criticisms undermines the credibility of the arguments they make in support of bill-and-keep in this proceeding.

## III. CONCLUSION

As Global NAPs observed in the comments it filed in this proceeding, bill-and-keep at its most theoretical level can be expected to produce economically equivalent outcomes to the existing system of explicit intercarrier compensation payments.[65] And the same can be said of any compensation systems, *ceteris paribus,* if they are considered without regard to the real-world context in which they must operate or to the competing policy objectives that the Commission must advance when it adopts a rule. When the various market distortions, transaction costs, end user pricing impacts, need for multi-jurisdiction concurrence, and other concerns raised by the commenters are taken into account, there is simply no

[62] Qwest Comments at i, 7-14, and 40-44, respectively.

[63] Comments of the United States Telephone Association, CC Docket 95-185 (March 4, 1996), at 21-24 ("A 'Bill and Keep' Regime for LEC-CMRS Interconnection, Even on an Interim Basis, Will Not be Administratively Simple, Will Not Permit LECs to Recover Their Costs, and Will Not be Economically Efficient"); Comments of the USTA Telecom Association, August 21, 2001, at ii ("bill and keep provides greater opportunities to achieve economic efficiency than CPNP") and 21-26

[64] Comments of Bell Atlantic, CC Docket 95-185 (March 4, 1996), at 2 ("Mandating 'bill and keep' arrangements would also violate fundamental economic principles"); Comments of Verizon, August 21, 2001, at 3-4 (supporting application of mandatory bill-and-keep to ISP-bound calls).

[65] Comments of Global NAPS, Inc., at 2-5.

basis for the Commission to find that bill-and-keep, even if implemented comprehensively and not piecemeal, would actually produce a net gain in economic efficiency overall. Long before the Commission embarks upon this highly risky and uncharted voyage, it should first ensure that there is a compelling basis for it to travel in this direction. And if the only basis for doing so is the ILECs' desire to undo the reciprocal compensation agreements they negotiated, while maintaining their above-cost, subsidy-laden access charges, then the Commission should take the high road and pursue a unified intercarrier compensation system for all carrier traffic that serves the broader public interest, not the parochial interests of the largest local exchange carriers.

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## Certificate of Service

I, Michaeleen Williams, hereby certify that true and correct copies of the preceding Reply Comments of the Ad Hoc Telecommunications Users Committee was served this November 5, 2001 via the FCC's ECFS system and first class mail upon the following:

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