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November 5.2001

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND
Magalie Roman Salas, Esquire
Secretary
Federal Communications Commission
The Portals
445 12th Street, SW, Room TWB204
Washington: D.C. 20554

Re: CC Docket 01-92
Developing a Unified Intercarrier Compensation Regime
Reply Comments of SureWest Communications

Dear Ms. Salas:

On behalf of SureWest Communications, I am enclosing original and 4 copies of the Reply Comments of SureWest Communications in the above-caption proceeding.

Please contact me if you have any questions.

Very truly yours,

Paul Feldman

Paul J. Feldman
Counsel for SureWest Communications

PJF:jpg

Enclosures

cc: Certificate of Service
Mr. Michael Campbell
Mr. Jack Day
Mr. Glenn H. Brown

ORIGINAL

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

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

REPLY COMMENTS OF
<u>SUREWEST COMMUNICATIONS</u>

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November 5,2001

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Summary

SureWest Communications believes that most of the issues and concerns identified by the Commission and the parties in this proceeding are due to the fatigue and strains caused by continuing to apply a pricing structure and regulatory paradigms of a monopoly, analog, circuit-switched and copper past to a new world that is competitive, digital, packetized and increasingly fiber and wireless. The contemplation of Bill and Keep or any other unified intercarrier compensation environment, exposes all of the implicit subsidies, support flows and jurisdictional inefficiencies inherent in the current system. These must be fixed if an efficient intercarrier compensation environment is to evolve. Finding solutions that will provide affordable basic telecom services to consumers will require industry and regulators to think in new ways regarding how we regulate and price services and how we compensate companies, and to implement these changes in a timely manner. Preparing for this new environment will require fundamental changes in how telecommunications services are regulated, and a growing reliance on markets to shape customer choices and prices.

Based upon our analysis of these comments and our understanding of these issues, SureWest asserts that the record supports the following five basic recommendations:

1. The paradigm that has guided regulation of “basic” residential phone service must be fundamentally changed to place less reliance on artificial ultra-low rates and more reliance on appropriate measures of affordability.
2. To the greatest extent possible, market mechanisms, not regulatory fiat, should shape the evolution to a more unified intercarrier compensation environment.
3. The arbitrary imposition of Bill and Keep for all market segments would not be in the public interest.
4. Contrary to the allegations AT&T, TELRIC would be harmful to true local competition and investment in facilities-based networks.

5. There must be a consistency and harmonization of regulation between the interstate and intrastate jurisdictions, and between the regulation of competing service providers using different technologies.

Adoption of the above principles would best address the five pressing issues underlying the need for reform of intercarrier compensation, as identified by the Commission in paragraphs 11-18 of the *Notice of Proposed Rulemaking.* First, the primary reliance on market mechanisms, and the harmonization of different regulations, would largely eliminate the opportunities for regulatory arbitrage. Second, the "monopoly" in terminating access will be ameliorated as efficient market-based intercarrier compensation mechanisms based on an affordability benchmark encourage true facilities-based competition in the local market. Third, while the Commission has noted that problems in the current system arise out of differing costs of interconnection through use of different competing technologies, use of market-based pricing mechanisms will most efficiently address any such differing costs. Fourth, if there are inefficiencies in the use of traffic-sensitive rates based on forward looking incremental costs to recover non-traffic-sensitive costs, then the use of market-based mechanisms will create strong incentives for carriers to recover costs more efficiently. Fifth, the reliance on market-based mechanisms and the elimination of regulations that promote arbitrage will create disincentives for distorted subscription decisions, such as entities declaring themselves to be carriers rather than end-users. Lastly, adoption of the above principles would further the ability of the Commission to realize the unmet public interest goals of the Telecommunications Act of 1996.

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
SUREWEST COMMUNICATIONS

SureWest Communications' hereby submits its Reply Comments pursuant to the Commission's Notice of Proposed Rulemaking released April 27,2001 in the above-captioned proceeding *("Notice").* In these Reply Comments, SureWest addresses the concerns expressed by numerous commenters, as well as by the Commission in the *Notice*.

I. <u>Introduction and Summary</u>

On August 21,2001 over 70 parties filed comments with the Commission in response to the *Notice*. In that *Notice,* the Commission asked for comments on two Staff working papers outlining potential Bill and Keep pricing plans,[2] as well as a number of specific questions relating to the establishment of a unified intercarrier compensation regime to replace different and disparate compensation mechanisms that exist today. A review of the comments reveals a wide range of concerns surrounding the evolution to a unified intercarrier compensation regime.

[1] SureWest Communications is the corporate parent of Roseville Telephone Company, an incumbent local exchange carrier serving approximately 134,000 access lines in Northern California. Other SureWest subsidiaries provide advanced wireless, broadband, interexchange and competitive local exchange services.

[2] "COBAK" and "BASICS".

SureWest believes that most of the issues identified by the FCC and the parties are due to the fatigue and strains caused by continuing to apply a pricing structure and regulatory paradigms of a monopoly, analog, circuit-switched and copper past to a new world that is competitive, digital, packetized and increasingly fiber and wireless. The contemplation of Bill and Keep or any other unified intercarrier compensation environment, exposes all of the implicit subsidies, support flows and jurisdictional inefficiencies inherent in the current system. These must be fixed if an efficient intercarrier compensation environment is to evolve. Finding solutions that will provide affordable basic telecom services to consumers will require industry and regulators to think in new ways regarding how we regulate and price services and how we compensate companies, and to implement these changes in a timely manner. Preparing for this new environment will require fundamental changes in how telecommunications services are regulated, and a growing reliance on markets to shape customer choices and prices.

Based upon our analysis of these comments and our understanding of these issues, SureWest asserts that the record supports the following five basic recommendations:

1. The paradigm that has guided regulation of "basic" residential phone service must be fundamentally changed to place less reliance on artificial ultra-low rates and more reliance on appropriate measures of affordability.[3]
2. To the greatest extent possible, market mechanisms, not regulatory fiat, should shape the evolution to a more unified intercarrier compensation environment.[4]
3. The arbitrary imposition of Bill and Keep for all market segments would not be in the public interest.[5]

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[3] Comments of SBC at 9 (hereinafter, citations are to the comments of parties, unless otherwise noted).

[4] BellSouth at 2, Verizon at 12, USTA at 19, NASUCA at 15.

[5] Office of Texas Public Utility Counsel at 7, Guyana Telephone and Telegraph at 1, KMCTelecom at 2, NYDPS at 1, Oklahoma Rural Telephone Coalition at **28, TCA** at 3.

4. Contrary to the flawed and misleading allegations AT&T,[6] TELRIC would be harmful to true local competition and investment in facilities-based networks.
5. There must be a consistency and harmonization of regulation between the interstate and intrastate jurisdictions, and between the regulation of service providers using different technologies.[7]

Each of these recommendations is discussed below.

II. The Paradigm That Has Guided Regulation of Basic Residential Phone Service Must Be Changed to Place Less Reliance on Artificial Ultra-Low Rates and More on Appropriate Measures of Affordability

For most of the past century, basic residential telephone service provided by ILECs has been treated as a natural monopoly and as a necessity. Pricing goals and structures were developed that sought to price the entry level residential product at ultra-low levels, typically below cost, so as to encourage the maximum number of subscribers to connect to the network. It was reasoned that as more subscribers joined the network, the network became more valuable to everyone, and everyone should have access to the telephone network for health and safety reasons.[8] To compensate for providing these services at a loss, long distance and business services were consciously priced above their cost. This policy objective was extremely successful, and has resulted in over 94% of American households having basic residential service.[9]

With the goal of universal service largely achieved, policy makers turned their focus to another ambitious objective – the introduction of competition into telecom

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[6] AT&T at 3.

[7] Maryland Office of People's Counsel at 2, Global Naps at 7, Office of Texas Public Utility Counsel at 37, USTA at 2, BellSouth at 6, Wisconsin PSC at 6, Texas PUC at 14.

[8] **See,** *e.g.*, MTS and WATS Market Structure, Order, *57* RR 2d 72 1,726 (1 985).

[9] *See* Phone Facts & Telecom Trends 2001 (USTA, 2001) at page 4.

markets. This effort has had mixed success, in part because regulators still cling to a relic of the monopoly past – the belief that ultra-low basic residential prices are necessary to preserve universal service. Indeed this anachronism lies at the heart of one of the often asked questions about the current competitive environment – "Why do I have multiple competing providers at work, but only one provider at home?" The ultra-low price paradigm has become so much a part of our belief structure that it is often overlooked that it is irrational for someone to invest in a new product or service when their competitor is offering the same service at below cost prices. If competition is to advance, and consumers are to share in the benefits, then a new paradigm for the pricing of residential service must be developed.

The development of this new paradigm is assisted by recent technology changes that have made alternative communications services – primarily wireless for voice and cable TV for data – widely available to consumers. Over the past few years we have seen dramatic growth in these services. to near ubiquitous levels, despite price points far above basic residential ILEC rates ($30 per line per month and up).[10] This would suggest that, at least for a large portion of our society, price is not the deciding factor in the selection of basic telecom services. This, again, brings into question the need to cling to the ultra-low basic residential price paradigm.

SureWest believes that the public interest can best be served by a new paradigm where regulators focus on defining an "affordability" level for basic telecom services.

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[10] SureWest Wireless provides unlimited wireless service for $39.00 per month. Cox@Home offers a low end cable modem service at $29.95 per month in many communities.

Under such an approach, regulators would seek to define a price point at which the vast majority of consumers could afford basic service, and at a level where the cost of providing service to the average customer would be covered. Consumer income data, market data for comparable communication services, and cost data could all play a role in the development of this "affordability benchmark". Allowing prices to rise to this affordability level would have desirable benefits including:

- Competition for residential services by alternative providers and technologies would no longer be discouraged. Indeed, the resulting market dynamics will create incentives for all providers to improve quality, reduce cost and offer an ever-increasing value proposition to consumers.

- The migration to new market-based methods for intercarrier compensation (see following section) can proceed without fear of financial harm to incumbent wireline providers. As access charges are reduced, regulators can allow basic residential rates to rise towards the affordability level.

There are, however, two segments of our society where concerns about the level of price are relevant, and must be addressed. These are consumers with income levels well below the norm, and consumers in high-cost areas of the country where the cost of providing even basic service is beyond the general affordability level. There are currently federal and (in many cases) state explicit support programs to address these needs, however these programs are often constrained by a lack of available funding. Adoption of the affordability standard would facilitate the development and funding of a sufficient explicit support program.

- Under the old ultra-low price paradigm, a large percentage of residential lines benefited from implicit support. Congress and the courts have made clear that this implicit support must be eliminated and replaced by explicit support. The affordability standard will make this goal much more achievable since the number of lines receiving implicit support will be significantly reduced. This would mean that the size of the new explicit fund will be less than it would be under the old ultra-low price paradigm.[11]

- As noble as our universal service goals are, at the end of the day a way must be found to pay for them. Whenever someone receives service at less than their cost, others must pay to fund that shortfall. By raising the price of basic residential service to affordability levels, large segments of the customer base will be removed from the body of recipients of support, and will become a potential source of funding for explicit support programs. In this way scarce public support dollars can be focused on areas that truly need them – low income consumers, and service to customers in above-average cost areas.

Implementation of an affordability standard will surely involve challenges and controversy. The traditional politics of local telecom pricing have sensationalized the percentage increase from the ultra-low basic residential price. Thus, even a modest $5 per month increase to a $10 basic price[12] becomes a "50% price increase", even if it is fully offset by corresponding decreases in access, toll and other services. Regulators and policy makers must help to shift the public perception to one that values the consumer benefits that will come from a vibrant residential communications market, and that focuses on the "bang-for-the-buck" benefits of local competition and the increase in the value proposition for all consumers.

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[11] SureWest's recognition of the need for higher basic rates in this long range policy vision in no way diminishes the public interest benefit of grant of Roseville Telephone Company's Petition for Reconsideration of the <u>Tenth Report and Order</u> in CC Docket 96-45. Under that Order Roseville, a small rate-of-return carrier, has uniquely and inappropriately been subject to a forward-looking proxy model designed for price cap carriers hundreds of times its size. As a result of this mis-classification, Roseville's customers will receive less support than would the customers of any other similarly situated rate-of-return carrier. This could result in an unwarranted and unnecessary local rate increase. SureWest's recognition of the inevitable need (and benefits) of increasing basic local rates under a possible new future paradigm is not inconsistent with Roseville's Petition for two reasons. First, the migration to "affordable" basic rates will come at the same time that other rates (access, toll, etc.) are coming down, thus there will be no net increase. Second, unless the inappropriate classification of Roseville for support determination is changed, Roseville's customers will still be forced to pay higher rates than other similarly situated customers of rate-of-return carriers, no matter what basic service pricing paradigm is in place.

[12] For example, in California, Pacific Bell offers basic residential service at a price of $10.69 per line.

Without a fundamental change in the pricing paradigm for basic residential service, any movement towards Bill and Keep, or any other unified intercarrier compensation regime, the current problems will only be exacerbated, and the evolution to a truly competitive local marketplace will be delayed.

111. **To the Greatest Extent Possible, Market Mechanisms, Not Regulatory Fiat, Should Shape the Evolution to a More Unified Intercarrier Compensation Environment.**

SureWest agrees with the many commenters who urge the Commission to rely on the market mechanisms to the greatest extent possible.[13] However the belief that markets rather than regulators offer the best avenue to assure that consumers are offered the broadest array of services at the lowest possible prices is not unique to the private sector. Recent statements by federal Commissioners indicate a growing belief in the role of markets as the best way to assure the delivery of the widest array of services to consumers at the lowest cost. In a recent address to the FCBA in Chicago Commissioner Abernathy stated:

> [W]ithin the discretion afforded by the statute, I am inclined to defer to market forces rather than prescriptive regulation. Markets are the most effective way of delivering quality services to the American people at the lowest costs. And equally important, they also punish and reward faster than a regulator could even dream of.[14]

Speaking earlier to a USTA Convention she stated:

> My second core principle comes from my faith in the ability of market forces to maximize consumer welfare. Despite our best intentions, regulators cannot duplicate the ability of markets to allocate resources efficiently, to spur innovation, and to induce companies to improve services and lower their prices,[15]

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13 *See, e.g.,* Verizon at 12, USTA at 19, NASUCA at 15.

14 Remarks of Commissioner Abernathy to the Federal Communications Bar Association, Chicago, Illinois, October 24, 2001.

15 Remarks of Commissioner Abernathy to the USTA Convention, Scottsdale, Arizona, October 7,2001

In June of this year, Chairman Powell, in a speech titled *Consumer Policy in Competitive Markets,* laid out the fundamental reasons why a market-oriented policy provides the greatest benefits to consumers:

> **A** well-structured market policy is one that creates the conditions that empower consumers:
>
> - It lets consumers choose the products and services they want – which is their right as free citizens.
> - It breeds entrepreneurs – giving an opportunity for someone with a good idea the chance to build a business and acquire wealth and opportunity. Something few, if any, nations have done as well as this country.
> - It creates a fertile environment for innovation. Innovators know they have the prospect of reaping great rewards (if they take great risks) and consumers get the benefits of the latest products and latest services.
> - It allows market forces to calibrate pricing to meet supply and demand. Consumers get the most cost –efficient prices and enjoy the benefits of business efficiencies.
>
> The result for consumers is better, more cutting edge products, at lower prices."

The historical experience of the Commission with the introduction of competition into telecom markets also provides useful evidence of the benefit of the power of markets, and the risks of heavy-handed regulation. The earliest experience was with CPE competition. After early experimentation with the regulation of protective connecting devices, the Commission set generalized interconnection standards and let the markets work.[17] Today the CPE business is booming and vibrant, and the once touted concept of one "primary instrument" owned by the monopoly network provider seems genuinely

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[16] Remarks of Chairman Powell to the FCBA, Washington, D.C., June 21,2001

[17] See, Second Computer Inquiry, **Report** and Order, 77 FCC 2d 384 (1980)(deregulating the provision of CPE).

laughable. More recently, the Commission resisted the calls of many and declined to overly regulate the provision of broadband Internet services by cable providers. The result is that the cable modem platform has become the predominant platform for consumer broadband access, and cable providers are beginning to negotiate the access to their platforms by alternative Internet Service Providers.

In contrast to success enjoyed when market mechanisms are allowed to function, the prior Commission's heavy-handed approach to local wireline interconnection and network unbundling has resulted in very little facilities-based competition,[18] and a serious lag in the delivery of broadband services to consumers over this medium." As will be more fully developed shortly, this provides vivid evidence of why the claims by AT&T that TELRIC-based access prices are the most efficient form of intercarrier compensation, are dead wrong.

What all of this says about the questions in this current NPRM about Bill and Keep as a vehicle for a unified intercarrier compensation regime is that the Commission should avoid the arbitrary and heavy-handed imposition of Bill and Keep, or any other single compensation regime. Where they can, markets should be allowed to work. Bill and Keep should always be an option in negotiations, and in certain circumstances such as ILEC – ISP and ILEC-CMRS, it may well turn out to be the preferred mechanism.

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[18] There were 193,818,048 access lines in the U.S. in the year 2000. ***See*** Phone Facts & Telecom Trends 2001, (USTA. 2001) at page 6. Of those lines, 16,397,393 were served by CLECs. *Id.* Approximately 35 percent of the CLEC lines were facilities-based. *Id.* at page 14. Using these figures, one can conclude that in the year 2000, approximately 3 percent of access lines were those of a facilities-based CLEC.

[19] CONVERGE! Network Digest specifies the number of cable modem users at **5.5** million as of June 2001. DSL was estimated at 2.8 million users with over 1 million from Verizon alone.

The role of regulation should be limited to the arbitration of disputes between carriers, and limited intervention in cases where the markets cannot be expected to work effectively (such as the terminating monopoly issue).

IV. The Arbitrary Imposition of Bill and Keep for All Market Segments Would Not Be in the Public Interest.

Several consumer groups point out that by requiring all local carriers to carry the traffic of other network providers provides the IXCs and others with a "free ride" on the ILEC's network.[20] SureWest agrees, and believes that the cost of providing this "free ride" will be substantial. It will harm the affordability vision for local service, it will harm the prospects for universal service support funding in above-average cost areas, and it will ultimately harm the development of multiple, competing, facilities-based networks.

There can be no question that the use of local connections to originate and terminate calls has a finite value to IXCs and the owners of other telecom networks.[21] If they can get these connections for free (as they would under mandatory Bill and Keep) that would be just fine for them, as it would serve to increase their profitability. In a competitive marketplace, however, owners of valuable assets are entitled to receive a fair price for the use of those assets. If network providers freely negotiate a Bill and Keep interconnection arrangement it is because both parties see benefit in such an arrangement.

[20] **See,** Maryland Office of People's Counsel at 6, NASUCA at 16, NYDPS at 2, California PSC at **6**

[21] It has value if only for the fact that without the existence of the local network, IXCs would have to build such a network themselves.

Under this new paradigm, the primary role of the regulator is to arbitrate between carriers when they cannot agree on terms. Only in cases where there is the potential for monopoly abuse (as in the previously cited terminating monopoly issue) should regulators have a role in establishing or influencing this price. Mandating a "free ride" interconnection policy in all cases would harm the Commission's pro-consumer, pro-universal service and pro-facilities-based competition goals.

Mandatory Bill and Keep will harm the goals for affordable local service since it will remove a potential revenue stream that could otherwise be used to support the cost of maintaining the local network. It could force the price of basic local service above the "affordability benchmark" levels that were discussed earlier in these comments. It would harm the goal of universal service since it would place additional burdens on an already over-burdened funding system. Finally it would disincent the construction of competing facility-based networks. If TELRIC-based pricing provides disincentives by setting the price below cost, mandatory Bill and Keep takes this to the extreme by reducing the price to zero.

SureWest believes that the public interest is best served when markets are allowed to function. and carriers are able to negotiate compensation mechanisms from which they mutually benefit. In cases where agreement cannot be reached, regulators should have the option of imposing a Bill and Keep solution, but only in cases where this serves to benefit the public interest and the interests of effective local competition.[22]

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[22] SureWest would support the application of Bill and Keep principles to ILEC-ISP and LEC-CMRS interconnection.

V. Contrary to the Flawed and Misleading Allegations of AT&T, TELFUC is Harmful to True Local Competition and Investment in Facilities-Based Networks.

AT&T has proposed that the Commission adopt TELRIC-based access prices as unified intercarrier compensation standard:

> The guiding principle for a unified approach to intercarrier compensation should be clear. As the Commission has long recognized, efficiency and competitive neutrality are fostered by intercarrier compensation that is based upon forward-looking economic costs.[23]

SureWest believes that these comments are dead wrong, and that the expansion of TELRIC principles to the access charge world would only further the TELRIC debacle. The combination of TELRIC based pricing and forced network unbundling has frustrated, not enhanced, the development of a competitive local marketplace that serves the best interest of consumers.

Again, SureWest is not alone in these beliefs. In her remarks to the USTA Convention Commissioner Abernathy stated:

> The prior Commission, in my view, was overly focused on the anticipated benefits of unbundling, without considering the costs. Unless properly circumscribed, forced unbundling can impose costs and distort investment incentives. Unbundling requirements that are too broad destroy an incumbent's incentive to invest in facilities. This is because incumbents will avoid risking capital on new infrastructure if rivals can piggy-back on their facilities risk-free.[24]

At the recent National Summit on Broadband Deployment, Commissioner Martin weighed in on the role that TELRIC pricing and unbundling has had on facilities-based competition and broadband deployment:

> In the past, the Commission adopted a framework that may have discouraged facilities-based competition, allowing competitors to use every piece of the

[23] AT&T at 3.

[24] Remarks of Commissioner Abernathy to the USTA Convention, Scottsdale, Arizona, October 7,2001.

> incumbent's network at super-efficient prices. This regime creates significant disincentives for the deployment of new facilities that could be used to provide broadband.[25]

Noted technology author George Gilder, in an op/ed piece in the Wall Street Journal titled *Falling Into the Telechasm,* pulled the discussion of the impact of TELRIC pricing together quite well:

> Typical of bad regulation is a Federal Communications Commission policy called Total Element Long run Incremental Costs, or TELRIC.. .Compounding TELRIC were "open access" and "unbundling" rules that require companies installing advanced Internet gear to share pipes with others. The goal was to stop monopolies, but what regulators did was to bar Internet investment by privatizing the risks and socializing the rewards. No entrepreneurs will invest in risky, technically exacting new infrastructure when they must share it with rivals.[26]

Our recently heightened concerns about national security and the need for reliable and redundant local communications networks makes continued investment in local network infrastructure even more important. TELRIC provides exactly the opposite incentives.

As Mr. Gilder so adroitly states, TELRIC is flawed because it privatizes risks and socializes rewards. This is exactly the opposite of what Chairman Powell observed in his *Consumer Policy in Competitive Markets* speech regarding a "well-structured market policy" where he states "Innovators know they have the prospect of reaping great rewards (if they take great risks) and consumers get the benefits of the latest products and latest

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[25] Remarks of Commissioner Martin to the National Summit on Broadband Deployment, Washington, D.C., October 26, 2001.

[26] *Tumbling Into the Telechasm* by George Gilder, The Wall Street Journal, August 6,2001 page **A12.**

services".[27] SureWest is convinced that TELRIC is bad regulation, and this Commission should not compound earlier errors by extending this concept to access pricing or intercarrier compensation

VI. There Must be a Harmonization of Regulation Between the Interstate and Intrastate Jurisdiction, and Between the Regulation of Service Providers Using Different Technoloeies.

A majority of the commenters in this proceeding raise the concept of arbitrage in one form or another as a significant risk factor that regulators must address as they consider the issue of a unified intercarrier compensation regime.[28] These concerns are well placed. Arbitrage can occur whenever a similar commodity is available in different markets at different prices. Since communications purchasers are generally interested in maximizing their own economic interests, it is usually the public interest that suffers when regulators create, knowingly or unknowingly, arbitrage opportunities within the telecom market place.

There are two generalized types of arbitrage risks that regulators must be wary of as they consider a new and more unified intercarrier compensation regime: Jurisdictional Arbitrage, and Technological Arbitrage.

A. Jurisdictional Arbitrage

Jurisdictional arbitrage occurs when a service, for example access charges, is offered in the state and interstate jurisdictions at different prices. In the old circuit-switched/analog/copper environment it was relatively easy to measure the jurisdictional

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[27] Remarks of Chairman Powell to the FCBA, Washington, D.C., June 21,2001

[28] *See* Maryland Office of People's Counsel at 2, Global Naps at 7, Office of Texas Public Utility Counsel at 37, USTA at 2, Bell South at **6,** Wisconsin PSC at **6,** Texas PUC at 14.

nature (intrastate or interstate) and charge the appropriate price. In the new packet-switched/digital/fiber environment this type of jurisdictional measurement of traffic is almost impossible. Thus, absent some harmonization of prices between the two jurisdictions, the traffic will tend to migrate to (or at least be classified as) the lower cost jurisdiction.

Arbitrage impacts ILECs since regulated prices are set under the assumption of a certain level of demand for the various services. If the ILECs basic residential rates were set on the assumption of some historical level of intrastate access minutes, and a new compensation regime dramatically lowers interstate access prices, the resulting arbitrage can cause significant problems, including a shortfall of revenues in the intrastate jurisdiction.

A second type of arbitrage occurs when major shifts of traffic volume occur, either through changes in market demand, or when regulators shift the jurisdictional definition of a particular type of traffic. The rapid growth of Internet usage in recent years has caused significant problems in this area. ILECs can become caught in a shell game, where revenues and costs wind up in different jurisdictions, and regulatory lag makes it difficult or impossible to ever catch up.

B. Technological Arbitrage

Technological arbitrage occurs when the same transaction, occurring with different technologies or classified as different services carries a different price. The impact of such disparate pricing treatment can be a significant impact of the revenue flow of a regulated ILEC, particularly when regulated prices are established based upon one assumed outcome, and the competitive market produces another.

An example of this type of technological arbitrage is the different impact when a consumer chooses different technologies to send a long distance message. If the message goes over the traditional telephone network the ILEC receives revenue, either in the form of toll or access charges. If the message goes over a wireless service the ILEC loses the revenue it would have realized if the call were placed over the wireline network. Finally if the message goes out over the Internet the ILEC may actually be required to pay compensation to an ISP-affiliated CLEC.

The key point is that under current regulation, markets will develop by finding loopholes, either because of asymmetrical jurisdictional treatment or because of a technology that may not have existed, that can be employed to take advantage of the system. It is important to allow the marketplace to work without extensive oversight so that the possibility of this type of "system gaming" is eliminated. If there is a failure in the marketplace then a regulatory body should step in to assist in creating a fair, uniform and consistent solution without creating a cottage industry out of a new regulation loophole.

VII. Conclusion

SureWest asserts that the record in this proceeding supports major revisions to intercarrier compensation mechanisms, and to the principles that form the basis for such compensation mechanisms. SureWest has recommended that:

1. the paradigm for pricing of basic residential service must be shifted from one of artificial ultra-low rates to reliance on appropriate measures of affordability;

2. intercarrier compensation should be based wherever possible on market mechanisms, rather than regulatory fiat;

3. the arbitrary imposition of Bill and Keep on all market segments would be contrary to the public interest;

4. the use of TELRIC (or any other flawed forward-looking incremental cost mechanism) as the basis for compensation rates would be harmful to competition and investment in critical network infrastructure; and

5. there must be consistency and harmony between the regulation of intrastate and interstate services, and between the regulation of competing service providers using different technologies.

Adoption of the above principles would best address the five pressing issues underlying the need for reform of intercarrier compensation, as identified by the Commission in paragraphs 11-18 of the *Notice*. First, the primary reliance on market mechanisms, and the harmonization of different regulations, would largely eliminate the opportunities for regulatory arbitrage. Second, the "monopoly" in terminating access will be ameliorated as efficient market-based intercarrier compensation mechanisms based on an affordability benchmark encourage true facilities-based competition in the local market. Third, while the Commission has noted that problems in the current system arise out of differing costs of interconnection through use of different competing technologies, use of market-based pricing mechanisms will most efficiently address any such differing costs. Fourth, if there are inefficiencies in the use of traffic-sensitive rates based on forward looking incremental costs to recover non-traffic-sensitive costs, then the use of market-based mechanisms will create strong incentives for carriers to recover costs more efficiently. Fifth, the reliance on market-based mechanisms and the elimination of regulations that promote arbitrage will create disincentives for distorted subscription decisions, such as entities declaring themselves to be carriers rather than end-users. Lastly, adoption of the above principles would further the ability of the Commission to realize the unmet public interest goals of the Telecommunications Act of 1996. Accordingly, SureWest urges the Commission to adopt the principles and proposals set forth herein.

Respectfully submitted,

SUREWEST COMMUNICATIONS

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November 5,2001

CERTIFICATE OF SERVICE

I, Joan P. George, a secretary in the law firm of Fletcher, Heald & Hildreth, do hereby certify that a true copy of the foregoing *Reply Comments of Sure West Communications* was sent this 5th day of November, 2001 by hand where indicated and via United States First Class Mail, postage prepaid, to the following:

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