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U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

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December 21, 2004

The Honorable Michael K. Powell
Chairman
Federal Communications Commission
445 12th Street, S.W.
Room 8-B201
Washington, DC 20554

RE: *Ex Parte* Presentation in a Non-Restricted Proceeding Developing a Unified Intercarrier Compensation Regime (CC Docket No. 01-92)

Dear Mr. Chairman:

The Office of Advocacy of the U.S. Small Business Administration ("Advocacy") submits this letter to discuss our views on the analysis required of the Federal Communications Commission ("Commission" or "FCC") by the Regulatory Flexibility Act ("RFA") in the above-captioned proceeding. Advocacy has developed a set of suggestions intended to help the FCC develop an analysis to evaluate the impact of its draft proposal on small entities.

Advocacy is taking an active role on intercarrier compensation because of its importance to small telecommunications carriers. Small carriers have stressed to Advocacy that this forthcoming rulemaking could fundamentally change how carriers interact with each other and could affect some of the foundational rules for telecommunications services. Advocacy held a roundtable in February 2004 to identify upcoming issues of importance to small businesses. A vast majority of the small carriers, both incumbent and competitive, present at the roundtable said that intercarrier compensation was one of the most important issues pending before the Commission and would have far reaching effects on their ability to compete in the telecommunications marketplace. In addition, the issue of intercarrier compensation has been raised in our discussions on other dockets at the FCC. During meetings with Commission staff on local number portability[1] and universal service,[2] we were told that compensation issues raised by small carriers in each rulemaking should be addressed in the intercarrier compensation rulemaking.

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[1] A significant issue in the local number portability rulemaking was the interconnection and compensation between small rural wireline carriers and wireless carriers. Commission staff informed Advocacy that the compensation issues for forwarding calls from the wireline carrier to the wireless carrier would be settled in the Intercarrier Compensation docket.

[2] The FCC has an ongoing rulemaking on Universal Service. Commission staff informed Advocacy that the access charge aspects of ensuring service in rural areas would be covered in the Intercarrier Compensation rulemaking.

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[4] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the

1. Advocacy Background

Congress established the Office of Advocacy in 1976 under Pub. L. No. 94-305 to represent the views and interests of small business within the Federal government. Advocacy's statutory duties include serving as a focal point for the receipt of complaints concerning the government's policies as they affect small business, developing proposals for changes in Federal agencies' policies, and communicating these proposals to the agencies.[3] Advocacy also has a statutory duty to monitor and report to Congress on Federal agency compliance with the Regulatory Flexibility Act of 1980, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA").[4] Advocacy is an independent office within the U.S. Small Business Administration ("SBA"), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration.

2. Intercarrier Compensation Plans Before the FCC

The FCC has before it intercarrier compensation plans submitted by various coalitions within the telecommunications industry. Advocacy has reviewed four of the plans, and we encourage the FCC to consider the small business impacts when reviewing additional plans. Also, the Commission may decide to adopt a hybrid or develop an intercarrier compensation scheme separate from the plans submitted by the industry. Regardless of whether the FCC proposes one of the plans submitted by industry, proposes a hybrid plan, or proposes a plan created independently of the industry recommendations, the RFA requires that the Commission analyze the impact of the plans on small businesses and consider alternatives to minimize that impact in an initial regulatory flexibility analysis ("IRFA").

The Cost-Based Intercarrier Compensation Coalition ("CBICC") filed its recommendation with the Commission on September 2, 2004.[5] The CBICC plan would require the originating carrier to compensate the terminating carrier for the cost of transport and termination. The intercarrier compensation rate would be the blended Total Element Long-Run Incremental Cost ("TELRIC") rate for tandem switching. Any loss of revenue would be offset by a capped increase in the subscriber line charge ("SLC") of 50 cents per year. The Universal Service Fund would be used as long as necessary to supplement the phase-in of the SLC.

The Intercarrier Compensation Forum ("ICF") filed its recommendation with the FCC on October 5, 2004, which proposes a compensation plan based primarily on Bill and Keep.[6] Under Bill and Keep, terminating carriers are not reimbursed for termination of traffic. Instead, each carrier would recoup their costs from their own customers through an increase in the SLC. The ICF recommendation contains an intercarrier compensation recovery mechanism to make up for revenues that would be lost when access charges are eliminated. Rural carriers would be allowed to charge a terminating fee of $0.0095 per minute of use terminated to the rural carrier.

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[3] 15 U.S.C. § 634(c)(1)-(4).

[4] Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601 et seq.) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

[5] Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene H. Dortch, Secretary, Federal Communications Commission, in CC Dkt. 01-92 (Sept. 2, 2004).

[6] Letter from Gary M. Epstein, Counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, Federal Communications Commission, in CC Dkt. 01-92 (Oct. 5, 2004).

The Alliance for Rational Intercarrier Compensation ("ARIC") filed its recommendation with the FCC on October 25, 2004.[7] This plan recommends the continuation of the "Retail Service Provider Pays" system for intercarrier compensation, which assesses on a usage-sensitive per-minute basis. A single unified rate would be achieved for each carrier by requiring joint approval by both the FCC and the state commission of rates. The plan also requires state commissions to rebalance basic local service rates to benchmark rates within a range determined by the Joint Board on Universal Service. A separate state equalization fund would be established to make up any revenue shortfall.

The Expanded Portland Group ("EPG") filed its recommendation with the FCC on November 2, 2004.[8] This plan recommends unifying the intercarrier compensation system at the interstate rates. Instead of a state equalization fund, the EPG proposed that the revenue loss would be offset by a new Access Restructure Charge. The EPG also proposes a flat-rate capacity-based intercarrier compensation plan. A flat rate would be charged for traffic sent over direct trunks and a usage-based minute of use rate would continue to be charged for traffic sent over common trunks.

All four of these recommended plans would have an economic impact on small entities, and Advocacy urges the Commission to analyze these plans for their impacts and develop less burdensome alternatives, as required by the RFA. Below, Advocacy provides suggestions intended to help the FCC develop an analysis to evaluate the impact of its draft proposal on small entities.

3. Discussions and Issues that Should Be Covered by the IRFA

Section 603 of the RFA requires agencies to consider the economic impact that a proposed rulemaking will have on small entities. Unless the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities (and provides a factual basis supporting the decision to certify), the agency is required to prepare an IRFA. The IRFA must include: (1) a description of the impact of the proposed rule on small entities; (2) the reasons the action is being considered; (3) a succinct statement of the objectives and legal basis of the proposal; (4) the estimated number and types of small entities to which the proposed rule will apply; (5) the projected reporting, recordkeeping, and other compliance requirements, including an estimate of the number of small entities subject to the requirements and the professional skills necessary to comply; (6) all relevant Federal rules which may duplicate, overlap, or conflict with the proposed rule; and (7) all significant alternatives that accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities.

[7] Letter from Wendy Thompson Fast, President, Consolidated Companies, and Ken Pfister, Vice-President, Great Plains Communications, to Marlene H. Dortch, Secretary, Federal Communications Commission, in CC Dkt. 01-92 (Oct. 25, 2004).

[8] Letter from Glenn H. Brown, EPG Facilitator, , to Marlene H. Dortch, Secretary, Federal Communications Commission, in CC Dkt. 01-92 (Nov. 2, 2004).

In preparing its IRFA, an agency may provide either a quantitative description of the effects of a proposed rule (and alternatives) or a more general description if a quantitative assessment is not practicable or reliable. The agency is required to publish the IRFA or a summary of the IRFA in the *Federal Register* at the same time the general notice of proposed rulemaking is published.

The FCC routinely satisfies the requirements for elements (2) - (4) of the IRFA. So, we discuss here items (1), (5), and (7): the need to have a description of the impacts of the proposed rule on small entities;[9] the need to have a good estimate of the reporting, recordkeeping, and other compliance requirements; and significant alternatives to minimize the impact on small entities while allowing the FCC to achieve its regulatory objective. Depending upon the elements of the plan the FCC proposes, the Commission's rulemaking on Universal Service[10] could overlap with the proposed rule and the FCC should identify it, as item (6) requires.

a. Description of the impact of the proposed rule on small entities.

The RFA requires the FCC to identify and analyze the impact of the FCC's proposal on intercarrier compensation on small carriers in the IRFA. In addition to this analysis, the FCC should ask the public for comments on how the proposed intercarrier compensation plan impacts small businesses. As a guide to what issues the FCC should consider, Advocacy has spoken with representatives of several small telecom carriers and their organizations, including the Association for Local Telecommunications Services ("ALTS"), CompTel/Ascent, Home Telephone Company, National Telecommunications Cooperative Association ("NTCA"), Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), Pac-West Telecomm, and Waitsfield & Champlain Valley Telecom. They identified issues that will have a significant impact on small businesses. This is not intended to be an exhaustive list and additional impacts may become apparent when the FCC conducts its own analysis:

- Small rural carriers receive a significant portion of their cost recovery from intercarrier compensation.
- Larger carriers can cost-average over their service territory as they have significant metropolitan areas to offset the higher costs of operation in rural areas. Small rural carriers do not have this ability.
- According to small rural carriers, Bill and Keep forces them to incur inbound network costs without reimbursement while the financial gain goes to another carrier. Small rural carrier representatives pointed out that Bill and Keep presumes similar costs between carriers. While this may be the case between large carriers or carriers in metropolitan areas, the interconnections between rural carriers and others exhibit more asymmetries. Aside from the distance factors, rural networks cost more to build and maintain and have lower traffic volumes. The costs are not equal, which leaves the rural carrier to cover a greater share of the costs of a call, which the carrier would have to recoup from its

[9] Our letter focuses on small businesses; however, if the FCC's draft proposed rule affects small governmental jurisdictions or small non-profit organizations, the RFA requires that the IRFA should address those small entities as well.
[10] CC Dkt. No. 96-45.

customers. Bill and Keep, thus, penalizes the rural carrier for having customers located in rural areas.

- Small rural carriers said that adoption of a Bill and Keep system would lead to either large increases in end-user chargers or increases in the amount that they would need to draw from the Universal Service Fund ("USF"), as the costs to cover the network would shift from access charges to these other sources. Many small rural carriers are already dependent on the USF to cover a significant portion of their costs. They are concerned that additional costs would overburden the USF.
- Intercarrier compensation is a patchwork of different compensation schemes that has evolved over time. Charges depend upon the carrier's classification and nature of the traffic. This jumble of regulatory compensation is more difficult for smaller carriers to comply with than larger carriers as it requires sophisticated technology and significant technical expertise on the staff. In addition, small carriers said there is substantial regulatory arbitrage inherent in the current system of intercarrier compensation. Traffic is often mislabeled or not labeled at all, leaving small carriers to cover the cost of connection. The EPG plan estimated that mislabeled traffic could account for up to 20 percent of the traffic on small carriers' networks.
- Small carriers are also concerned with the impact of a higher SLC. Rural carriers have fewer customers and higher costs and, according to the ARIC plan, are already charging SLCs at their current caps. Small competitive carriers were concerned that higher SLC rates would put them at a competitive disadvantage. If cost recovery for inbound traffic is moved to the carriers and the SLC cap increased, then small rural carriers would have to keep the SLC rates at the highest allowed, leading customers in rural areas to having higher SLC rates than those in metropolitan areas.[11]

b. Description of the reporting, recordkeeping, and other compliance requirements.

The RFA requires the FCC to describe and analyze the reporting, recordkeeping, and other compliance requirements necessary to comply with a proposed rule on intercarrier compensation in the IRFA. In the course of our conversations with small telecom carriers, Advocacy has identified several aspects of an intercarrier compensation rule that could create compliance requirements on small carriers. Again, this is not intended to be an exhaustive list and additional impacts may become apparent when the FCC conducts its own analysis.

- Any funds created to cover the costs of a shortfall in revenue could create recording for small carriers. Small carriers would have to track the revenue shortfall and apply for cost recovery from whichever system the FCC adopts. While this may be necessary to achieve the reimbursement necessary to cover their costs, it will be a compliance burden which the FCC must analyze in its IRFA.

[11] Small carriers do not have the requisite resources to absorb an increase in costs. Advocacy's studies substantiate the concern that small and rural carriers will experience a heavier burden. Small businesses bear a disproportionate share of the federal regulatory burden. The costs per employee incurred by small businesses are 60 percent higher than those faced by their larger counterparts. They have a smaller number of employees, fewer resources, and any equal amount of regulation stands to affect their bottom line disproportionately. (Hopkins (1995), Crain and Hopkins (2001)), www.sba.gov\advo\stats.

- Central Office Bill and Keep requires the originating carrier to deliver traffic to the terminating carrier's end office serving the called party. Currently, small competitive carriers do not often interconnect at the end office. This requirement could impose sizable transport costs on competitive carriers by requiring them to duplicate the incumbent carrier's network.

c. Description of any significant alternatives to the proposed rule which accomplish the stated objective and which minimize any significant economic impact on small businesses.

The RFA requires the FCC to analyze significant alternatives to the FCC's proposal in an IRFA. In addition to this analysis, the FCC should ask the public for comments on how the proposed intercarrier compensation plan impacts small businesses. In particular, Advocacy recommends that the FCC analyze specific regulatory alternatives that are contained in the intercarrier compensation plans submitted to the FCC and solicit comment on additional alternatives. The following suggested alternatives are based on our conversations with small telecom carriers and their representatives:

- Unified Compensation Rate: All the small carriers (both incumbent and competitive) Advocacy contacted on this subject supported unifying rates between all types of carriers and classes of traffic. They believe that a single unified rate will simplify intercarrier relations and minimize the regulatory impact on small businesses. Both the EPG and ARIC plans would set the unified intercarrier compensation rate at the level of the current interstate access charges, which would reduce the intrastate compensation rate from 7 cents a minute to the interstate compensation rate of 3 cents per minute. In addition, small rural incumbent carriers supported a minute-based intercarrier compensation rate, as the FCC has found that switching and transport are traffic sensitive. The small competitive carriers also supported a cost-based compensation rate and recommended that TELRIC is a useful benchmark to measure costs. TELRIC has the advantage of already being in place – thereby not adding any compliance costs – and small carriers are familiar with the process.
- Rural Cost Recovery Supplementation: If the FCC reduces access charges, part of the costs of the small rural carriers' network must be supplemented. Under this alternative, the Commission would establish an explicit charge to account for a shortfall in the cost recovery by small carriers. Each of the four plans addressed in this letter has a different plan on how to establish and manage this shortfall. The FCC should ensure that the selected plan sufficiently covers revenue shortfalls, and is the least burdensome to small carriers.
- More Strenuous Billing Information: Under this alternative proposed by the EPG, the FCC would establish minimum identification requirements for traffic. Traffic must meet those minimum requirements, such as indication of the carrier responsible for the traffic and the origination and termination of the traffic. All traffic not accurately billed will be billed to the carrier delivering the traffic at the highest rate.
- Capacity Based Intercarrier Compensation Plan: A few small carrier representatives pointed out that more and more traffic is data and carriers are using packet-based switching. They believe that any update to the intercarrier compensation scheme should

account for this new system for transmitting traffic, and recognize that packet-based switching is inefficient to bill on a per minute basis. The EPG recommended a flat-rate port charge for interconnection as a way to account for packet-based switching.

Advocacy recommends that the FCC describe and analyze the foregoing and other significant alternatives to reduce the impact on small businesses. Additional alternatives may be received through small business comments on the IRFA and NPRM. When the FCC prepares a final regulatory flexibility analysis for the final rule on intercarrier compensation, section 604 of the RFA requires it to describe the "steps the agency has taken to minimize the significant economic impact on small entities." Addressing these issues in the IRFA should better ensure the FCC has the information it needs to fulfill this and other requirements in its final regulatory flexibility analysis.

3. Conclusion

We hope that the information provided in this letter is beneficial in preparing the FCC's RFA analysis for a proposed rule in the Intercarrier Compensation docket. We are available to discuss these recommendations and to assist the Commission in preparation of its IRFA. For additional information or assistance, please contact me or Eric Menge of my staff at (202) 205-6549 or eric.menge@sba.gov.

Sincerely,

Thomas M. Sullivan
Chief Counsel for Advocacy

Eric E. Menge
Assistant Chief Counsel for Telecommunications

cc:
FCC Commissioner Kathleen Q. Abernathy
FCC Commissioner Michael J. Copps
FCC Commissioner Kevin J. Martin
FCC Commissioner Jonathan Adelstein
Jeff Carlisle, Acting Bureau Chief, Wireline Competition Bureau
Dr. John D. Graham, Administrator, Office of Information and Regulatory Affairs