BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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

INITIAL COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

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EXECUTIVE SUMMARY

The Commission should adopt a plan for reform of intercarrier compensation which reduces, but does not eliminate, disparities in intercarrier compensation rates over an interim five-year period. As the disparity among intercarrier compensation rates is reduced, and as the total amount of revenue at issue declines, carriers will have greater incentive to enter into negotiated bill and keep arrangements. Incentives to bypass the public switched telephone network will be reduced.

The phase-down of intercarrier compensation rates does not represent the ultimate solution to intercarrier compensation pricing. Because of the pace of technological and market change, it is not advisable to adopt a permanent solution now. At the end of five-years, the Commission can reassess the issue of intercarrier compensation. At that time, it may be appropriate to move to an intercarrier compensation system based on capacity of carrier interconnections.

In establishing target rates during the phase-down, the Commission should respect the current federal/state jurisdictional dichotomy as set forth in the Communications Act.

The Commission should exercise control over interstate rates and provide guidance to the states in regard to annual target rates. States would retain control over intrastate local and access rates, and would be expected to meet the target rates in their own way. However, the Commission could establish a temporary, transitional fund within the federal Universal Service Fund to provide inducement to the states to reach the target levels in a timely manner.

There is no necessity to change the current interconnection rules, or redefine network "edges" or wholesale/retail relationships. Neither is there a need for substantial changes to the federal Universal Service Fund. In addition to the transitional state inducement fund, the Commission should consider changes to local switching support for rural carriers so that eligibility for support is based on cost, rather than carrier size.

The phase-down of intercarrier compensation rates will maintain intercarrier compensation as a revenue source for carriers, but at a reduced level. If the reduction in interstate rates causes a demonstrated need for additional funding, such funding shortfall should be handled through the federal Universal Service Fund. There should be no increase in the current caps for the subscriber line charge. Any demonstrated need for additional revenue caused by reduction in intrastate rates should be recovered from local rates and state universal service funding.

Proposals to reform intercarrier compensation by adopting mandatory bill and keep arrangements for all carriers should be rejected. Such proposals ignore cost causation, are economically inefficient, and are contrary to long-standing Commission policy. Adoption of mandatory bill and keep would also require preemption of state authority over intrastate rates, which is contrary to the Communications Act. Likewise, proposals to automatically replace all revenue lost by carriers as a result of intercarrier compensation reform should be rejected. Such proposals lock in past levels of revenues, are unfair to customers, and do not promote efficiency.

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I. INTRODUCTION

On March 3, 2005, the Federal Communications Commission ("FCC" or "Commission") released a Further Notice of Proposed Rulemaking ("FNRPM") seeking comments on various proposals to move to a unified system of intercarrier compensation ("ICC"). The National Association of State Utility Consumer Advocates ("NASUCA")[1] previously submitted its proposal for reform of ICC to the Commission, and the proposal was included as part of the FNRPM.[2] NASUCA hereby submits these initial comments to provide further detail for NASUCA's ICC reform proposal, to respond to Commission

[1] NASUCA is a voluntary association of 44 advocate offices in 41 states and the District of Columbia, incorporated in Florida as a non-profit corporation. NASUCA's members are designated by the laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts. See, e.g., Ohio. Rev. Code Chapter 4911; 71 Pa.Cons.Stat. Ann. § 309-4(a); Md. Pub.Util.Code Ann. § 2-205; Minn. Stat. § 8.33; D.C. Code Ann. § 34-804(d). Members operate independently from state utility commissions as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (e.g., the state Attorney General's office). NASUCA's associate and affiliate members also serve utility consumers but are not created by state law or do not have statewide authority.

[2] FNPRM at ¶56. Parties other than those identified in the FNPRM have also submitted proposals. See. e.g., Frontier *Ex Parte* (May 10, 2005). NASUCA's comments here are confined to the proposal identified in the FNPRM. If the Commission wishes comments on these other proposals, it should issue a Public Notice to that effect. Otherwise, these other proposals cannot legitimately be considered.

questions set forth in the FNRPM, and to respond to other proposals to reform ICC.[3] As set forth below, NASUCA believes that its proposal -- which will establish lower target ICC rates over an interim five-year period – will achieve the Commission's goals, will minimize the disparity among ICC rates, will respect state authority over intrastate rates, and will minimize the impact on local rates and the federal universal service fund.

II. Discussion of NASUCA ICC Principles and Reform Proposal

A. The Need for Intercarrier Compensation Reform

Intercarrier compensation is the system of payments among telecommunications carriers for interconnection and carriage of other carriers' telecommunications traffic. At paragraphs 5-14 of the FNPRM the Commission discussed the need for reform of the current intercarrier compensation regime. NASUCA agrees that the current regime of widely varying rates for the same functionality depending on the type of call and the carriers involved, creates opportunities for abuse and arbitrage, and cannot be sustained in the long run. As a result, NASUCA agrees that reform is needed. However, that reform need not be radical. Moreover, the reduction of disparity among intercarrier rates need not automatically or substantially impact end user charges, nor substantially impact the universal service fund.[4] NASUCA believes that rationalizing ICC can in fact be accomplished while minimizing the impact on carriers and customers alike.

NASUCA believes that radical changes to the current ICC regime are not advisable because the pace of technological and market change is so rapid that it would

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[3] Numerous representatives of various NASUCA offices contributed to these comments. NASUCA's project leader was Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division.

[4] See NASUCA *Ex Parte* of December 17, 2004.

be folly to adopt a so-called "ultimate solution" to ICC at this time. NASUCA's plan will reduce ICC ceiling rates in a gradual manner over five years, will reduce arbitrage opportunities, and will allow the FCC to evaluate the need for further steps at the end of the phase-down.

The FNPRM identifies three issues as reasons why the current regime is not sustainable: First, "existing compensation regimes are based on jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services."[5] NASUCA agrees with this rationale. Second, "advancements in telecommunications infrastructure affect the way carrier costs are incurred and call into question the use of per-minute pricing."[6] NASUCA believes that empirical evidence shows that network costs are actually becoming more traffic-sensitive as packet-switching becomes more prevalent.[7] However, NASUCA agrees that at the end of the five-year phase-down period called for in its plan, it may be appropriate to migrate the pricing of ICC from a per-minute basis to a capacity basis.[8] And third, "[d]evelopments in the ability of consumers to manage their own telecommunications services undermine the premise that the calling party is the sole cost causer and should be responsible for all

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[5] FNPRM, ¶ 15.

[6] *Id.*, ¶ 16.

[7] In order to investigate the economic aspects of issues raised by the Commission in the FNPRM, NASUCA retained the services of Dr. David Gabel. The Affidavit of Dr. Gabel is attached hereto as Attachment 4.

[8] NASUCA takes issue, however, with the statement that "the ability to shift costs to competitors through intercarrier charges increasingly distorts the competitive process." *Id.* As discussed throughout these comments, requiring carriers to pay for their use of other carriers' networks is consistent with an efficient competitive process.

the costs of a call."[9] As discussed in Section III.A. below, these developments do not obscure the fact that for almost all calling, the calling party causes the call.

B. NASUCA's Principles

The NASUCA ICC proposal minimizes the disparity among existing ICC rates and reduces ICC ceiling rates to a uniform level over a five year period. The NASUCA proposal is based on the following principles which were embodied in a formal resolution adopted by NASUCA in 2004.[10]

Principle 1: *Any proposal for intercarrier compensation reform should recognize that originating, transiting and terminating telecommunications traffic imposes costs on originating, transporting and terminating carriers.*

Telecommunications carriers have historically compensated each other for traffic carried on each others' networks. NASUCA believes any plan for ICC reform must recognize that a carrier that originates, transits or terminates traffic on the network of another carrier imposes costs on that carrier. As a result, the cost of carrier interconnection and carriage cannot be zero, and likewise the intercarrier compensation rate cannot be zero. Therefore, NASUCA proposes a target ICC rate of $0.0055 per minute of use ("MOU") by the end of the fifth year. In recognition of the higher costs of smaller rural carriers, NASUCA proposes a target rate of $0.0095 per MOU for rural carriers by the end of the fifth year. Carriers would remain free to enter into negotiated bill and keep arrangements. At the end of the five-year phase down period, it may be appropriate to move to capacity-based pricing for ICC.

Principle 2: *Any proposal for intercarrier compensation reform should treat all telecommunications traffic in an equitable and non-discriminatory manner.*

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[9] *Id.*, ¶ 17.

[10] See Attachment 1, NASUCA Resolution on Intercarrier Compensation, Approved by NASUCA, Austin, Texas, June 15, 2004. See also NASUCA *Ex Parte*, December 17, 2004.

The current widely varying rates for intercarrier compensation create arbitrage opportunities and treat different types of carriers differently. NASUCA's proposal would minimize, but not eliminate, these disparities in ICC rates over an interim five year period. In particular, under NASUCA's proposal, each year a new target ICC rate would be established by the FCC. Interstate ICC rates above this target would step down to the target level; rates below the target rate would be maintained. In recognition of states' jurisdiction over intrastate access rates, NASUCA proposes that states be encouraged to match the target rate for intrastate rates with each state retaining authority to reach the target rate in its own way.[11]

NASUCA's proposal recognizes that as the disparity among ICC rates is reduced, and as the total amount of revenue at issue declines, carriers will have greater incentive to enter into negotiated bill and keep arrangements. In addition, incentives to bypass the public switched telephone network or mislabel inter-network traffic will be reduced.

Principle 3: *Any proposal for intercarrier compensation reform should include verification of costs and consideration of earnings of carriers.*

NASUCA's proposal calls for carriers to demonstrate a need to replace any revenue lost as a result of reductions in ICC rates. No carrier should be guaranteed replacement of revenue by being able to automatically increase subscriber line charges and/or local rates, or through automatic increases in state or federal universal service funding. While some carriers may demonstrate they have a justifiable need to replace lost ICC revenue in order to keep their rates just and reasonable, other carriers may be enjoying a windfall due to current access rates being far above cost. Revenue lost due to

[11] See Section II.E.2., for a discussion of possible inducements to states to achieve target ICC rates.

ICC rate reductions should not be recovered unless it has been determined that a financial need exists.

Principle 4: *Any proposal for intercarrier compensation reform should fairly allocate costs so that residential customers do not pay more than their fair share of the costs of the telecommunications network.*

NASUCA's proposal recognizes that the telecommunications network is not free and all who use a particular carrier's network should pay a portion of the cost of that network. Accordingly, both end users and carriers should pay for access to the network. This prevents large shifts in revenue responsibility away from high-usage customers and onto low-usage customers, and from business customers to residential customers. In contrast, a mandatory bill and keep[12] ICC regime would require all carriers to recover all of the costs of their networks from their end-user consumers, and/or would require increases in the federal subscriber line charge, and/or would transfer a large portion of the revenue currently provided by intercarrier compensation to the federal universal service fund. The result of mandatory bill and keep -- at least as proposed in this proceeding -- would, therefore, shift revenue responsibility to low-usage and residential customers through higher charges for access to the public switched telecommunications network ("PSTN") in the form of higher subscriber line charges and higher universal service fund surcharges. Low-usage residential customers have already experienced large increases in the price of access to the PSTN through previous efforts to reform access charges on both the federal and state level, such that further government-mandated increases in the price

[12] "Under a bill-and-keep approach, neither of the interconnecting networks charges the other network for terminating traffic that originates on the other carrier's network. Rather, 'each network recovers from it sown end users the cost of both originating traffic delivered to the other network, and terminating traffic received from the other network.'" FNPRM, ¶ 37 (internal citations and footnotes omitted).

of access to the PSTN would be unreasonable and could adversely affect subscribership to the network, especially among low-income consumers.

Principle 5: *Any proposal for intercarrier compensation reform should recognize the appropriate role of state government in establishing rates charged to end-user consumer in each state.*

NASUCA's proposal preserves the current federal/state jurisdictional dichotomy as set forth in federal law. The FCC would exercise control over interstate rates and provide guidance to states in regard to annual target ICC rates. States would retain control over intrastate local and access rates.

Principle 6: *Any proposal for intercarrier compensation reform should avoid increases in unavoidable monthly line charges for end-use consumers.*

NASUCA's proposal does not call for mandatory increases to the subscriber line charge. Any demonstrated need for additional intrastate funding created by a reduction in intercarrier compensation rates should first be recovered through local rates or state universal service funds, as determined by the states.

Principle 7: Any proposal for intercarrier compensation reform should avoid the need for new interstate universal service funding of carriers.

The NASUCA ICC proposal will maintain intercarrier compensation as a revenue source for carriers, although at a reduced level. If the reduction in ICC rates creates a demonstrated need for additional interstate funding for rural carriers, it should be recovered primarily through existing universal service mechanisms. Local switching support could be amended to allow recovery of a portion of the revenue shortfall related to switching, and a temporary, transitional state inducement fund could be created to provide incentives to state's to reach the ICC target rates.

C. NASUCA's Proposal

1. Target Rates

The current widely varying rates for intercarrier compensation create arbitrage opportunities and treat different types of carriers differently, even though the same functionality is being provided to these carriers. The NASUCA proposal would minimize, but not eliminate, these disparities over an interim five year period, by using annual target rates. Each year a new target ICC rate would be established by the FCC. Interstate ICC rates above this target would step down to the target level; rates below the target level would be maintained. The final target rate for the fifth year for non-rural carriers would be $0.0055 per MOU. The final target rate for rural carriers would be $0.0095 per MOU. These are the same targets currently used for traffic sensitive interstate access rates of price cap carriers under the CALLS plan.[13] Using these same rates as targets for ICC reform means that there will be very little interstate revenue impact for non-rural carriers. Any revenue shifts will be caused by reduced intrastate access rates for all carriers, and reduced interstate access rates for rural carriers.[14]

Shown below is a proposed progression of ICC ceiling target rates which would be established by the FCC. The rates shown are per MOU.

[13] The so-called Coalition for Affordable Local and Long Distance Service plan. See, *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, 15 FCC Rcd 12962 (2000).

[14] As explained below, the selection of the target rate results in a revenue shift under the NASUCA plan of $3 billion ($4.9 billion including MOU erosion) compared to $8.4 billion under the ICF bill and keep plan.

Intercarrier Compensation Target Rates

	Non-Rural	Rural
Year 1	$0.0250	$0.0500
Year 2	$0.0200	$0.0400
Year 3	$0.0150	$0.0300
Year 4	$0.0100	$0.0200
Year 5	$0.0055	$0.0095

States would be expected to match the target rates by the end of the five-year phase-down period. However, because many states have procedural barriers to changing ICC rates or changing them in a timely manner, it would not be expected that states would precisely match the ICC rates established for the interim years. Nevertheless, NASUCA's plan provides strong incentives for states to bring intrastate ICC rates to the final target rates as rapidly as possible. As discussed below, a state inducement fund would provide pre-allocated annual amounts of additional support to states that reach the final target rates.

As the disparity among ICC rates is reduced, and as the total revenue at issue declines, carriers will have greater incentive to enter into negotiated agreements, especially bill and keep arrangements. Negotiated bill and keep arrangements between carriers would not result in unavoidable increases in local rates as under the Intercarrier Compensation Forum ("ICF") plan, which calls for mandated increases in the subscriber line charge ("SLC").[15] Carriers negotiate bill and keep interconnection agreements today with little or no impact on basic rates.

At paragraph 113 of the FNPRM the Commission asks whether it should direct how carriers achieve targeted ICC rates. NASUCA believes that just as in the *CALLS*

[15] ICF *Ex Parte*, Oct. 5, 2004, Appendix A, Section III.F.

regime,[16] carriers should have the discretion to establish their own rate structures, so long as the average of all transport, origination and termination rates divided by minutes of use does not exceed the target ceiling rate for that carrier.

ICC rates under the NASUCA plan -- whether default target rates or negotiated rates -- will recognize that carriers that use another carrier's network to originate, terminate, or transit traffic impose costs on that other carrier. As a result, incentives for economically inefficient use of the public switched network will be minimized. In other words, while rate disparities will be reduced, there will be no free ride on any carrier's network.

2. Network Management Issues

A basic component of any ICC system should be truthful labeling of all calls, whether circuit-switched or packet-switched. Removal of carrier identification headers should be explicitly prohibited and subject to substantial and effective sanctions. In addition, all calls that originate, terminate, or transit the PSTN should pay the ICC rates applicable, regardless of whether the call originates or terminates through an ISP. In other words, the Commission should eliminate the ISP exemption from ICC rates for calls that originate, terminate or transit the PSTN. Adoption of such a rule will create a level playing field for all telecommunications providers that access the PSTN, while preserving the ISP exemption where the PSTN is not involved.

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[16] The Commission ruling in the *Multi-Association Group (MAG) Order* established an access charge regime for non-price cap carriers that was similar to the CALLS Order. See, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 19613 (2001) ("*MAG Order*").

3. State Inducements

a. Targets for State ICC Rates

As shown in Section V.C. below, under current law states have authority over intrastate access rates. The FCC should encourage states to mirror the target interstate access rates established by the FCC. However, each state should retain authority to reach the final target rates in its own way.

Only about half the states retain traditional rate-base rate-of-return control over telecom rates. Some states have statutory rate caps or retail rate deregulation, while others have rate caps by on-going stipulations. NASUCA concludes that since states are responsible for intrastate rates and are also responsible for whatever rate regime they currently operate under, they should be given first responsibility to get their intrastate ICC house in order.

b. State Inducement Fund.

NASUCA recommends establishment of a state inducement fund as part of the USF. States reaching target levels of ICC established by FCC could receive funding, which would act as a temporary transitional means of replacing a portion of lost intrastate ICC revenues. For example, a $200 million fund could be established, with each state's share pre-allocated and targeted to companies within that state. The allocation could be based on percentage of access lines within a state compared to the national total, or on the amount of a state's access revenues (interstate and intrastate) compared to the national total.[17] A state's share of the inducement fund would only be available on a going-forward basis once a state certifies that it has reached the final target ICC rate levels.

[17] The allocation could also be based on a blend of these two factors.

Further, as discussed in subsection 4.b. below, access to the inducement fund would be predicated on a state having a state USF. The inducement fund should not become a permanent entitlement, but should have a predetermined life span. For example, the inducement fund could expire three years after the end of the five-year phase down of ICC rates.

Such an inducement fund would address the issue of states that have already gone through restructuring to reduce intrastate ICC rates. Those states would qualify for their share of the inducement fund earlier than states that still have a lot of work to be done. States that have restructured intrastate access rates have already dealt with the revenue impact of that restructuring in their own way. As a result, those states should have proportionately less access revenue to deal with than states that have not restructured.

4. Revenue Impact of NASUCA Plan

Intercarrier compensation revenues amounted to approximately $9.6 billion during 2003.[18] These ICC revenues are paid from carrier to carrier and constitute a cost of doing business which is currently recovered in revenues received from end-users. The 2003 ICC revenues represented approximately 4% of total annual end-user telecommunications revenues.[19]

The level of ICC revenues is not static, however. Since 2000, access minutes of use and access lines have declined substantially. For example, in 2000 incumbent LEC's served 188.5 million access lines and switched 792.3 billion MOU on the PSTN. By the end of 2003 these figures had dropped to 172.4 million access lines, and 614.0 billion

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[18] ICF *Ex Partes* of December 4 and 17, 2004.

[19] $9.6 billion intercarrier revenues/$230.7 billion total end user revenues = 4.16%. *Id.*; *Telecommunications Industry Revenues 2003*, Wireline Competition Bureau, IAD (March 2005), Table 1.

MOU.[20] These trends are continuing. The primary reasons for these declines have been the downturn in the economy, wireless substitution, dropping of second lines, and the advent of e-mail, instant messaging and voice over Internet protocol.

Considering these trends, NASUCA estimates that access minutes of use for non-rural companies will continue to decline at a rate of 5% per year.[21] As shown below, this means that the $9.6 billion in 2003 ICC revenue will shrink to $7.7 billion in 2010, even with no change in ICC rates. All of this decline is attributable to reductions in minutes of use for non-rural carriers. Minutes of use for rural companies are expected to remain flat throughout this period.

ACCESS REVENUES - BASE CASE							
	2003			2010			2010
Type of	($ Millions)			($ Millions)			Change from
Company	Interstate	Intrastate	Total	Interstate	Intrastate	Total	2003
Non-Rural	$2,557	$4,637	$7,194	$1,791	$3,484	$5,275	$1,919
Rural	$757	$1,627	$2,384	$757	$1,627	$2,384	$0
Total	$3,314	$6,264	**$9,578**	$2,548	$5,111	**$7,659**	**$1,919**

This ongoing nationwide decline in MOU and revenues must be incorporated into whatever revenue estimates are used by the FCC for ICC reform. Proposals by carriers for revenue neutrality based on historical levels of ICC revenue will always overstate current ICC revenue and will cement an obsolete and economically inefficient level of ICC revenue into going-forward rates.

NASUCA estimates the revenue impact of its plan using as the base case the estimated 2010 revenues of $7.7 billion annually. These revenues reflect the continuation

[20] NECA 2001 and 2004 USF Submissions; NECA MOU Studies; *Trends in Telephone Service*, Wireline Competition Bureau, IAD (May 2004), Table 10.2. See also, ICF *Ex Parte* Brief (Oct. 5, 2004), pp. 3; 16, ftn. 26.

[21] This projection is conservative given the fact that access MOU have fallen by 25% in the last four years. See also, ICF *Ex Parte* Brief (Oct. 5, 2004), p.16, ftn. 26.

of current market evolution. Phasing down to the recommended NASUCA target rate levels by 2010 will remove approximately $3 billion from both interstate and intrastate ICC revenues. As shown below, this will leave $4.7 billion in residual ICC revenues, which represents approximately 2% of 2003 total telecommunications revenues.[22]

ACCESS REVENUES - NASUCA TARGETS							
	2010	Base	Case	2010	NASUCA	Targets	2010
Type of	($ Millions)			($ Millions)			Change from
Company	Interstate	Intrastate	Total	Interstate	Intrastate	Total	Base Case
Non-Rural	$1,719	$3,484	$5,275	$1,791	$1,499	$3,290	$1,985
Rural	$757	$1,627	$2,384	$445	$923	$1,368	$1,016
Total	$2,548	$5,111	**$7,659**	$2,236	$2,422	**$4,658**	**$3,001**

5. Recovery of Lost Revenues

Reduction of ICC rates will necessarily reduce revenues of carriers. Whether any particular loss of revenue should be replaced in whole or in part should always be a question of fact, not of right. Any demonstrated need for additional revenue as a direct result of ICC reform should be recovered first from local rates,[23] next from state universal service funds, and finally from the federal universal service fund.

a. Recovery from Increases in Local Rates

If a carrier suffers an unacceptable revenue loss as a result of lower ICC rates, the carrier's first recourse for additional revenues should be from its own customers. The universe for local revenue recovery would include both residential and business and the full range of the carrier's services. Since access charge revenues result from calls made

[22] $4.7 billion/$230.7 billion = 2.04%. This calculation assumes that overall telecommunications revenues stay flat over the period.

[23] In most cases, this will involve review of the level of earnings of the carrier involved. It is possible that carriers with excessive earnings would not require any increase in local rates to replace lost access revenues. Review of local rates will also allow state commissions to decide which set of services should appropriately be responsible to covering any lost revenue.

and received by all classes of customers, all classes should share in any recovery of access revenues lost as a result of reduced ICC rates.

Any increase in local rates should be based on a demonstration to the state regulatory authority that such increase is necessary to provide quality service and maintain a reasonable return (or such other indicia of sufficiency as are allowed under each state's individual rate regime). Only when local rates have reached the reasonable comparability benchmark[24] should there be recourse to other sources of revenue replacement. The reasonable comparability benchmark represents a level beyond which rates in rural and high-cost areas may not rise without violating the reasonable comparability standard set forth in Section 254(b)(3) of the Act. As set forth in Section II.C.4.c.ii. below, NASCUA recommends that the rate comparability benchmark and supplemental rate support already established for non-rural carriers be extended to rural carriers.

b. State Universal Service Funds

In the *1997 Access Charge Order*, the Commission addressed implicit universal service support embedded in intrastate access charges, and stated:

> Congress intended that states, acting pursuant to section 254(f) of the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. …[A]s states implement their universal service plans, we will be able to assess whether additional federal universal service support is necessary to ensure that quality services remain "available at just, reasonable and affordable rates.[25]

[24] NASUCA is aware that the specific rate comparability benchmark previously established for non-rural carriers was remanded by the 10th Circuit in the case of *Qwest v. FCC*, 398 F.3d 1222, 1236-1237 (10th Cir. 2005) ("*Qwest II*"). However, the Court did not object to a rate comparability benchmark *per se*, but rather to the high level of the benchmark.

[25] *In the Matter of Access Charge Reform*, CC Docket Nos. 94-1, 96-262, 91-213 and 95-72, First Report and Order, 12 FCC 15982 (1997) ("*1997 Access Charge Order*")., at ¶11.

Although the FCC and federal courts have also recognized that attaining universal service goals is a joint effort of both state and federal governments,[26] there has previously been no requirement that states demonstrate that they are contributing any level of state funding to universal service as a prerequisite for receipt of federal universal service.[27]

As a result, carriers in several states currently receive large amounts of federal universal service without any showing that the carriers' rates are not reasonably comparable or not affordable, or that the state has implemented a state universal service fund to assist in provision of service in high-cost and rural areas. For example, Mississippi receives $187 million in annual federal high-cost support ($11.32 per line per month), yet Mississippi does not have a state universal service fund to support high-cost areas within its borders.[28]

As previously discussed, the Commission should create a targeted transitional universal service funding mechanism to induce states to reach the target ICC rates. This fund would provide supplemental funding to help offset the revenue loss resulting from the reduction in ICC ceiling rates. A prerequisite for eligibility of carriers in that state for support from the inducement fund should be creation and operation of a state USF pursuant to Section 254(f) of the Act to provide support for rural and high-cost areas within that state.

[26] *Qwest v. FCC*, 258 F.3d 1191, 1203-1204 (10th Cir. 2001) ("*Qwest I*"); *Qwest II*, 398 F.3d at 1232..

[27] In a FNPRM the Commission did ask for comments on the provision of additional targeted support to states that established explicit universal service support mechanisms. *See*, *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order on Remand, FCC 03-249 (rel. Oct. 27, 2003) at ¶¶126-132.

[28] Given the high level of federal support received under the current system, it is doubtful Mississippi has any incentive to ever create such a state fund.

c. Federal Universal Service Fund

NASUCA recognizes that after recourse to local rates and state universal service funds to recover revenues lost as a result of ICC reform, there will be some carriers – principally smaller, rural carriers – that will need federal assistance to ensure just and reasonable, reasonably comparable and affordable rates. In order that the federal USF provide an adequate backup for rural carriers and their customers, NASUCA recommends modification of the Local Switching Support ("LSS") mechanism, and extension of supplemental rate support to rural carriers. NASUCA also recommends that any proposed changes to the federal USF be referred to the Federal-State Joint Board on Universal Service prior to implementation.

i. Local Switching Support

Rural carriers currently recover a portion of revenues related to non-traffic sensitive costs through the current Interstate Common Line Support mechanism. However, recovery of traffic-sensitive costs is more problematic. The current LSS mechanism for rural carriers is based on the number of access lines served by a carrier, rather than the carrier's actual switching costs. Only rural carriers serving 50,000 lines or less within a study area are currently eligible for LSS. As a result, small carriers with low switching costs may receive support, while carriers serving over 50,000 lines in a study area do not receive support, even if they have very high switching costs.[29] This limitation effectively precludes recovery from the federal USF of traffic-sensitive costs

[29] The rationale for the LSS size limitation is that it is generally believed that switching costs increase with smaller service territories. While this may be true, it is not necessarily always the case. For example, assume carrier A has a service territory with one switch serving 9,500 lines and carrier B has a service area with 15 switches serving 60,000 lines. In all likelihood, carrier B would have higher average switching costs than carrier A. However, under the current LSS rules, carrier A would receive switching support while carrier B would receive no support.

which may be lost by some rural carriers, even if such recovery is appropriate. As a result, NASUCA would support modification of the LSS mechanism to a cost basis.

Obtaining cost information necessary to transform the LSS mechanism is very simple. Under the high cost loop ("HCL") mechanism, the National Exchange Carrier Association ("NECA") currently collects cost information for all cost carriers. It then follows a twenty-six step algorithm to determine the service territory unseparated loop revenue requirement. To transform the loop algorithm into a switching algorithm, it is only necessary to replace data line 250 category 4.13 central office equipment investment with category 3 local switching central office equipment investment and to set data line 710 category 1 cable and wire facilities investment equal to zero. The local switching category 3 investment is currently collected by the Universal Service Administrative Company ("USAC") as part of the LSS mechanism. The USAC form is completed by all carriers with less than 50,000 lines. Large price-cap carriers report category 3 local switching investment in their ARMIS 43-04 report. However, mid-sized carriers are exempt from filing the ARMIS 43-04 report. Therefore, the only additional information needed to use the adjusted high cost loop algorithm to determine switching cost would be to obtain the category 3 local switching investment for those mid-size carrier service territories that are larger than 50,000 lines.

An alternative method could be used to estimate the embedded cost of switching. The unseparated switching revenue requirement for each rural company could be calculated using the current LSS method. For large price-cap carriers the information required to estimate this revenue requirement is available in the ARMIS 43-04. The mid-size carriers would, however, have to complete the entire LSS data collection form rather than provide only category 3 local switching investment in order for the FCC to have a complete set of data. Moreover, the LSS method of determining cost is not consistent with the HCL method. In particular, the LSS method of determining cost includes marketing and customer operations expenses, and General Support Facilities capital costs, that are not included in the HCL mechanism. Because marketing costs are usually incurred to develop and sell vertical features and other services that are not part of the definition of supported services, NASUCA does not believe that it is reasonable to include such costs in a universal mechanism. Moreover, the LSS method adds items to the rate base, such as the telephone plant adjustment and plant held for future use, that traditionally are not part of the rate base in many jurisdictions.

For purposes of comparison, Attachment 2 is a table that shows the switching costs for seventy large carriers that complete the ARMIS 43-04. Both forward-looking and embedded costs have been calculated for these carriers. The average embedded switching cost using the HCL method of determining cost is \$5.64 per line per month; the average cost using the LSS method is \$8.61per line per month, over 50% higher. The difference between these estimates is due to the inclusion of marketing and other expenses in the LSS method of determining costs.

In comparison to the HCL and LSS estimates of embedded switching costs, Attachment 2 shows that the forward-looking switching costs for these seventy large carriers are substantially less, averaging only \$2.22 per line per month. In order to have a switching support mechanism for rural carriers that recognizes the large disparity between embedded and forward-looking switching costs, the Commission will have to devise a mechanism with appropriate support benchmarks and appropriate levels of support for companies with costs above the benchmarks.

The impact of using cost instead of line size in determining switching support cannot be estimated at this time because the data for the small carriers are not available. To perform that analysis USAC would have to release the data it collects on the LSS data collection form. These data are not proprietary. Large carriers already report the information in the ARMIS 43-04 report. Therefore, NASUCA requests the FCC to direct USAC to release this information so that NASUCA and other parties can estimate the cost of local switching for the universe of rural carriers. However, determination of the cost of switching is merely the first step. Only after compiling data on the cost of switching for the universe of carriers can proposals for a revised switching support mechanism be developed. As mentioned above, because of the great disparity between embedded and forward-looking switching costs evident in companies already studied, it is likely that a cost-based switching support mechanism will likely be substantially different from current embedded support mechanisms for loop support.

ii. Supplemental Rate Support

In the *Tenth Circuit Remand Order*, the Commission established an expanded state certification process which involved rate review, and the opportunity for states to request supplemental support if local rates of non-rural carriers exceeded the FCC's rate benchmark.[30] So far, one state – Wyoming – has filed a request for supplemental support

[30] *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, CC Docket 96-45, 18 FCC Rcd 22559 (2003*) ("Tenth Circuit Remand Order"*), at ¶¶93-96.

under the procedure outlined in the Tenth Circuit Remand Order.[31] Although portions of the Tenth Circuit Remand Order have been remanded to the Commission again, the expanded state certification and supplemental rate review procedures were upheld.[32] Offsetting the loss of access revenue with increases in local rates and universal service funding may result in rates for some rural carriers that are above the Commission's rate comparability benchmark. In order that states may have an avenue to seek supplemental support for rural carriers with excessive rates, the Commission should extend the supplemental support procedures to rural carriers as part of the reform of ICC rates.

d. NASUCA Estimate of Recovery of Lost Revenues

NASUCA estimates that revenues lost as a result of lowering ICC ceiling rates will be recovered by carriers at the end of the fifth year of the ICC rate phase-down as follows:

1	2	3	4	5	6	7	8	9
($ Millions)		At Target Rates		Recovery of Residual Revenue				
		Remaining	Residual	Basic				Unrecovered
Base Period		Intercarrier	Revenue	Local		State	Federal	Revenue
Access Revenue		Payments	(2-3)	Rates	SLC	USF	USF	(4-[5+6+7+8])
Non-Rural	$5,275	$3,290	$1,985	$200	$0	$100	$178	$1,507
Rural	$2,384	$1,368	$1,016	$350	$0	$300	$272	$ 94
Total	$7,659	$4,658	**$3,001**	$550	$0	$400	$450	**$1,601**

By the end of the fifth year of the NASUCA plan, $3 billion will have been shifted out of access revenues. Some $2.0 billion of this revenue loss is associated with non-rural carriers, and $1 billion with rural carriers.

[31] See, Joint Petition of Wyoming Public Service Commission and Wyoming Office of Consumer Advocate for Supplemental Federal Universal Service Funds, CC Docket No. 96-45 (Dec. 21, 2004).

[32] *QwestII*, 398 F.3d at 1238 (10th Cir. 2005)

NASUCA estimates that non-rural carriers will only be able to justify recovery of a small amount of this lost revenue. In other words, the gradual loss in access revenues over the five-year period will not be sufficient to offset productivity gains experienced by these larger carriers. As a result, it will be difficult for larger carriers to demonstrate a need for additional revenues from local rates, state USFs, or the federal USF.

On the other hand, NASUCA estimates that rural carriers will recover almost all of their revenue loss from local rates, state USF and the federal USF. This reflects the fact that smaller carriers will not experience the same level of productivity gains as larger carriers.

The figures above also include the $200 million state inducement fund allocated 89% to non-rural carriers and 11% to rural carriers. The actual allocation may vary. At the end of the phase-down period, NASUCA estimates that $1.4 billion of lost revenue will be recovered by carriers from local rates, state and federal USFs, while $1.6 billion of lost revenue will not otherwise be recovered and will not have to be replaced.

D. Consistency of NASUCA's Plan with FCC Goals of ICC Reform

At paragraphs 31-33 of the FNPRM, the Commission identifies three goals that ICC reform must meet. These goals are promoting economic efficiency, preservation of universal service, and competitive and technological neutrality. NASUCA's proposal meets all three goals, and does not violate any of them.

1. Promotion of Economic Efficiency

Economic efficiency is enhanced by bringing carrier-to-carrier charges closer to cost and requiring carriers that use other carriers' networks to pay charges to recover that cost; in other words, by setting and using a proper price signal. Economic efficiency is **not** enhanced by shifting recovery of costs caused by other telecommunications carriers to end users. Nor is economic efficiency enhanced by automatic recovery of carrier revenues lost when the rates are brought closer to cost. Achieving uniformity by dropping ICC rates to zero through mandatory bill and keep creates other incentives which are not economically efficient.[33] These issues are discussed extensively in Sections III-VII of the Affidavit of Dr. David Gabel, Attachment 4 hereto.

2. Preservation of Universal Service

Addressing the universal service implications of ICC reform, NASUCA's proposal most closely tracks the statutory purpose of ensuring reasonable, affordable and reasonably comparable rates by not providing assistance to any carrier unless -- absent current intercarrier revenues -- the carrier's basic service rates are no longer reasonable, affordable, or reasonably comparable. The USF should not become a revenue guarantor.

3. Competitive and Technological Neutrality

NASUCA recognizes that a carrier that originates, terminates or transits on another carrier's network imposes costs on the other carrier. NASUCA also recognizes that different carriers have different costs for performing each of these intercarrier network functions. Establishing uniform ICC rates for all carriers' networks minimizes opportunities for abuse and arbitrage, although such an approach does not base rates strictly on cost.

NASUCA's proposal balances these competing concerns by reducing ICC rates over a five year period to lower target rates, but maintaining a higher target rate for smaller rural carriers than for larger non-rural carriers, in recognition of the higher costs

[33] Specifically, under mandatory bill and keep, where the rate for origination and termination is set at zero, the economic signal is that there is no cost to using another carrier's network. Accordingly, there will be great incentives for carriers to use the networks of other carriers to provide, for example, unlimited switched access rather than special access.

of rural carriers.. On the other hand, unifying each carrier's terminating charges, so that all carriers terminating traffic on that carrier's network pay the same amount regardless of the type of call, is competitively and technologically neutral.

4. NASUCA's Plan is Clearly Within the Commission's Authority

At paragraph 35 of the FNPRM, the Commission asked that any party advancing an ICC reform proposal set forth the Commission's legal authority to adopt that proposal. NASUCA's proposal calls for the FCC to establish target rates for interstate ICC rates, and to encourage states to adopt and mirror those same rates. The NASUCA plan recognizes that states retain authority over intrastate ICC rates, and that different states will take different routes to achieving the target rates. Revenue losses caused by ICC reform can be accommodated without major change to the federal USF. As a result, the NASUCA plan lies clearly within the existing authority of the FCC over interstate rates and the federal USF, and does not alter the roles of the Federal-State Joint Boards on Separations and Universal Service. NASUCA's proposal to lower interstate access rates is similar in nature to the *CALLS* and *MAG* plans which have been previously upheld by the courts.[34]

As shown in Section VI. below, many of the ICC proposals of other parties contain provisions that are clearly outside the Commission's existing authority, calling for example, for the complete overturning of separate jurisdiction of state and the federal governments over access services, and the establishment of federal rate elements to recover intrastate revenues. These proposals also ignore the role of the Federal-State Joint Boards on Separations and Universal Service.

[34] See, *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (2001).

III. Costing Principles Fundamental to Intercarrier Compensation Reform

A. Calling Party Pays

Intercarrier compensation is based on the fact that carriers use other carriers' networks for the benefit of the first carrier's customers. That applies to originating charges (where long distance calls begin on a local network, dictating compensation from the long distance carrier to the local carrier), to terminating charges (where calls from a customer's carrier are completed over a local carriers' network), and to transit charges (where the carrier "passes through" traffic originated on one network and terminated on a third network).

A fundamental principle of intercarrier compensation is that carriers whose networks are used by other carriers should be compensated for the use of their network. Proponents of radical restructuring of the current system of ICC raise a number of arguments as to why this should not be the case.

The current typical arrangement is known as "calling party pays" or, more accurately, "calling party's network pays" ("CPNP").[35] Thus the long distance carrier typically compensates the local network over which a call is terminated, and one local carrier compensates another local carrier when a local call terminates on the second local carrier's network.

The reason for this CPNP arrangement is variously referred to as "calling party cost causation" and "calling party benefits." Those who seek other arrangements often attempt to show that the called party also benefits from receiving a call. They point to the

[35] In the U.S. wireless environment, arrangements are different. Unlike in the wireline world, a customer receiving a call also has to pay for this privilege. In other words, the called party, as well as the calling party, pays. On the wireline side, special arrangements such as "800" numbers and collect calling require the called party to pay. Of course, the **customer** payment responsibility does not necessarily track the **carrier** payment responsibility.

ability of customers to screen their calls -- through Caller ID, for example -- as evidence that both calling and called parties benefit, which, in their view, supports the notion that both parties' networks should share in bearing the cost of a call.

As pointed out in Section V of the Affidavit of Dr. David Gabel, a calling party pays system stimulates subscription and usage, and is considered the most fair and equitable system by customers.[36] Moreover, a CPNP system appropriately places cost responsibility on the cost causer and leads to more efficient pricing of telecommunications services. The availability of call control technologies, such as Caller ID, does not change these fundamental relationships and are more costly and less efficient than imposition of rational ICC rates.[37]

This notion of assigning or dividing the benefit of a call actually misses the point. Almost without exception, it is the calling party -- and the calling party's network -- that **causes** the call. The called party may benefit from the call -- as in the case of the notification of a family event -- or may not benefit -- as in the case of an annoying telemarketing call. This cannot obscure the fact that the calling party first picked up the telephone and dialed the called party's number.[38]

The Commission dwells on a variety of subsets of consumers, some who take bundles of services,[39] some who are served by the most efficient switches,[40] and those

[36] Attachment 4, pp. 35-41.

[37] Attachment 4, pp. 41-44.

[38] This is even true for calls made in response to other calls.

[39] FNPRM, ¶ ¶ 19-20.

[40] Id., ¶ 23.

who maximize their ability to screen their calls,[41] for example, and assumes that these service arrangements have substantial penetration and are ubiquitous. It does not appear, however, that these subsets add up to anywhere near a majority of consumers. Nor do these arrangements change the fundamental fact that the calling party initiates the call in all cases. Thus, the current arrangement of CPNP makes the most sense for the network, while mandatory bill and keep regimes make little sense.

B. The Nature of Packet Switching Costs

At paragraph 23 of the FNPRM the Commission questions whether it is proper to conclude that switching, especially packet switching costs, should continue to be recovered on a traffic-sensitive basis. As set forth in Section IV of the Affidavit of Dr. David Gabel, the traffic sensitive costs of both digital circuit switching and packet switching are currently substantial.[42] It appears that as the network evolves, the magnitude of these costs will decline in absolute terms, but not as a percentage of overall switching costs. However, more of the network's costs will be related to the cost of interconnection. This means that it may be appropriate to move recovery of at least a portion of ICC rates to a capacity basis at the end of the five-year rate phase down called for in the NASUCA plan. The capacity cost recovery regime should be based on the incremental cost of the capacity required by each carrier at time of peak usage.[43] This capacity charge could be tiered, based on the capacity of the port providing interconnection, similar to the proposal of the Expanded Portland Group.

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[41] *Id.*, ¶ 25.

[42] Attachment 4, pp. 12-35.

[43] *Id.*, p. 45.

C. Network Interconnection Issues

At paragraphs 91-97 the Commission asks whether it is appropriate to change current rules on points of interconnection ("POI") and allocation of transport costs. NASUCA does not believe that its plan for reform of ICC rates requires a fundamental redefinition of wholesale/retail relationships, or of network "edges" or points of interconnection. The reduction in ICC target rates over time should reduce arbitrage opportunities related to network and/or relationship definitions, and encourage business-to-business agreements on interconnection within the context of well-understood existing rules. On the other hand, mandatory bill and keep requires a radical restructuring of network relationships to combat the incentives for inefficient and inappropriate uses of the network created by elimination of virtually all charges on carriers using the network of another carrier.

IV. ILEC Revenue Neutrality and the Public Interest

At paragraphs 98-115 of the FNPRM, the FCC asked for comments on the whether and how revenues that are lost as a result of ICC reform should be replaced. As previously discussed in relation to NASUCA's plan, recovery of lost revenue should be based on facts specific to each carrier, and should not be an automatic entitlement.

A. It is Not the Purpose of Regulation to Guarantee Recovery of Revenues

A central tenet of most ICC reform plans proposed by groups representing carriers is revenue neutrality for the carriers; i.e., the guarantee that virtually every dollar lost as a result of ICC reform will be recovered by concomitant increases in other funding sources, such as subscriber line charges or revenue replacement USF funds. At paragraphs 99-100 the Commission asks whether it has a legal obligation to provide alternative cost recovery mechanisms as a part of ICC reform, and whether those mechanisms should assure revenue neutrality for carriers. As to rates, the Commission's charge under Section 201(b) of the Act is to establish rates that are "just and reasonable." Historically, the courts have given the FCC wide latitude in determining just and reasonable rates.[44] However, there are no provisions in the Telecommunications Act that require provision of alternative recovery mechanisms, or that require revenue neutrality. It has never been the purpose of ratemaking or of the federal universal service fund to guarantee recovery of 100% of a particular level of revenues for any carrier, large or small.

B. Increasing the SLC Serves as a Pricing Umbrella

Several carrier ICC reform plans - most notably the ICF plan – call for substantial increases in the SLC as a means to recover the majority of the revenue loss caused by reduction or elimination of ICC rates.[45] Other parties, such as the NARUC ICC Task Force, have proposed an even higher SLC cap than the ICF.[46]

Proponents of increasing the SLC argue that the SLC would be capped, and would be subject to competitive pressures. These were the same arguments put forward five years ago in the *CALLS* proceeding to justify an increase in the SLC cap to $6.50.[47]

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[44] "This 'just and reasonable' standard gives the FCC discretion in structuring the access charges." *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 324 (2001) (hereinafter "*TOPUC*")..

[45] As shown in the ICF *Ex Partes* in this proceeding of December 6 & 14, 2004, approximately $8.35 million in ICC revenues would be shifted from ICC rates as a result of the ICF plan. Of this amount, over 75% ($6.34 billion) would be recovered through increased SLCs on end users.

[46] See, NARUC ICC Task Force *Ex Parte*, March 1, 2005.

[47] *In the Matter of Deployment of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Distance Users, and Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, 15 FCC Rcd 12962 (May 31, 2000) (*CALLS Order*),, at ¶89. The *CALLS Order* was upheld by the Fifth Circuit, which stated: "The newly entering LECs are not required to charge the SLC. Thus, the FCC held that competitive pressure could force ILECs to reduce the SLC through efficiency gains." *TOPUC*, 265 F.3d at 323.

Actual experience with the SLC has shown that it is immune to competition and operates as a pricing umbrella, allowing competitors to impose an additional charge on consumers in the guise of a government-imposed surcharge. Many competitive carriers - for example, ACN, Affinity, Comcast, Homefield, MCI, Ntelos, RCN, Trinsic and USA Telephone - impose a SLC on customers equal to the SLC imposed by the incumbent ILEC.[48] However, other CLECs - such as Cavalier, Excel, Sage and Vartec - impose a SLC even higher than those charged by the incumbent.[49] These competitive carriers impose a SLC even though they are not required to impose such a charge, and have no end-user access charges imposed on them which could arguably be included in a SLC. These CLECs charge the maximum SLC -- and above the maximum -- simply because they can.[50]

NASUCA adamantly opposes any increase in the SLC as part of any ICC reform plan. The SLC represents an unavoidable monthly charge on end user bills which has proved to be immune to competition. An increase in the SLC for ILECs will

[48] A listing of CLEC SLC charges in SBC service territory in one state, Ohio, along with copies of SLC pricing information for Sage Telecom and Vartec, are attached hereto as Attachment 3.

[49] Cavalier imposes an "End User Common Line Charge" of $7.00 in Delaware, even though the incumbent Verizon has a SLC of only $6.42. Sage imposes a SLC of $8.38 in Ohio, even though incumbent SBC has a SLC of only $5.39, while Vartec and Excel impose SLCs of $9.50 nationwide.

[50] In its Order in the 2002 cost review proceeding following the CALLS Order, the Commission noted that: "Competitive LECs also may impose SLCs on their end-user customers. Although the Commission has, in many instances, chosen not to regulate the rates charged by competitive LECs, including SLCs, we note that competitive LECs may look to the SLCs assessed by incumbent LECs as a benchmark in setting their own SLCs. Therefore, although the instant order specifically addresses only incumbent LEC SLC caps, the proceeding may affect competitive LEC SLCs as well." *In the Matter of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, Order, 17 FCC Rcd 10868, 10870, ¶ 2 fn. 8 (2002). Contrary to the Commission's speculation, CLECs are obviously not constrained by the SLCs charged by ILECs. NASUCA urges the Commission to revise its rules to limit CLEC SLCs to no more than that charged by the incumbent LEC. This would make the rule for end user access charges the same as for terminating access charges imposed on other carriers.

inexorably lead to an increase in rates for all customers, even though the ICC costs imposed on carriers will actually be reduced.

In addition, any increase in the SLC will continue and exacerbate the shift in network cost recovery away from large users of the network and onto small users. Finally, as discussed below, starting with the fifth yearly step under the ICF plan, the SLC cap unreasonably operates solely as a generator of revenue for price cap carriers, divorced from any cost recovery, or recovery of lost revenue.

C. Automatic Recovery of Lost Revenue Dramatically Deviates from Past Commission Policy to Move Access Charges to Cost

As discussed in Section III of the Affidavit of Dr. David Gabel, it has long been the policy of the Commission to move access charges towards economic cost.[51] Beginning in 1991, price cap carriers were required to adjust access charges each year by the rate of inflation minus productivity offsets (known as the "X-factor.")[52] This X-factor was adjusted periodically. The combination of price caps and an ever increasing X-factor divorced access charges from traditional rate-of-return recovery mechanisms, and inexorably moved access charges downward. In its *Price Cap Review Order of 1997*, the FCC set the X-factor at 6.5%.[53] On appeal, the D.C. Circuit remanded this portion of the FCC Order for further explanation and justification.[54]

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[51] Attachment 4, pp. 5-12.

[52] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990). See also, *1997 Access Charge Order*, 12 FCC Rcd at 16002-03.

[53] *Price Cap Performance Review for Local Exchange Carrier*s, CC Docket Nos. 94-1, 96-262, 12 FCC Rcd 16642, 16649 (1997) ("*1997 Price Cap Review Order*").

[54] *USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

Rather than directly responding to the remand, the Commission included the X-factor as part of the *CALLS Order*. In the *CALLS Order* the Commission reaffirmed its commitment to moving access rates to economic cost:

> [In this Order] we are implementing transitional rates to reduce access charges closer to cost-based rates. …Regulatory structures that base a firm's allowable rates directly on the reported costs of the individual firm can create perverse incentives, because reimbursing the firm's costs removes the incentive to reduce costs and improve productive efficiency.[55]

As a result of the *CALLS Order*, the Commission adopted a five-year transitional plan (which ends June 30, 2005), which initially targeted the X-factor to rate reductions and then set the X-factor equal to inflation for the rest of the *CALLS* period. In the current proceeding the Commission is faced with developing an ICC regime to replace the *CALLS* plan.

Almost all of the ICC plans put forward by industry groups abandon the Commission's past goal of moving access charges to economic cost, and instead focus on recovery of access revenues received during some past period. None of these plans make any pretense of basing increases in the end user access charges on carriers' costs. The proposed increases in the SLC are intended simply to provide dollar for dollar recovery of revenues previously recovered in switched access rates. Moreover, proposals to move switched access rates to zero through adoption of a mandatory bill and keep system fall well below any reasonable estimate of the economic cost of interconnection.

In developing a unified regime of ICC, the Commission must keep in mind its previously declared goal of moving access rates to economic cost, and avoid uneconomic

[55] *CALLS Order*, 15 FCC Rcd 12962 at ¶¶ 13; 179; *see also*, *Verizon v. FCC*, 535 U.S. 467, 486-488 (2002).

increases in end user access rates. Such non-cost-based rates will produce the same perverse incentives which the Commission has long sought to avoid.

D. Automatic Recovery of Lost Revenue Effectively Eliminates Productivity Offsets

The various proposals to freeze access revenues at some past level and move their recovery to end user charges implicitly assume that there will be no future productivity gains in access services, or that those gains will be equal to the annual rate of inflation. In fact, because the ICF plan allows the $10.00 SLC cap to grow at the annual rate of inflation after its fourth step, that plan assumes that future telecom productivity gains will grow no faster than the rest of the economy. There is no basis for such assumptions, especially in light of the Commission's prior findings that a 6.5% differential was appropriate.

In the *CALLS Order*, the Commission accepted the proposal to use the X-factor to initially reduce switched access rates to certain target rates and then to be set as equal to the rate of inflation for the remainder of the CALLS plan. However, the Commission made clear that it was not eliminating the X-factor: "The compromise advocated by CALLS will provide a solution to the contentious X-factor prescription proceeding <u>for the term of the CALLS Proposal</u> for those price cap LECs that do not elect to set rates based on a cost study proceeding."[56] As previously noted, the *CALLS Order* ends on June 30, 2005.

While there may be disagreement over the exact level or range of productivity gains in the telecommunications industry, there is surely agreement that telecom productivity gains exist, i.e., are greater than zero. In fashioning a unified ICC regime,

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[56] *CALLS Order*, 15 FCC Rcd 12962 at ¶160. [Emphasis added.]

the Commission must continue to recognize and incorporate the effect of continuing productivity gains. Adoption of a plan that replaces access revenues achieved in some past period is obviously contrary to past Commission policy regarding the ongoing impact of productivity gains.

V. Legal Issues

A. FCC Authority to Mandate a Unified ICC Regime

At paragraphs 63-86 of the FNPRM the Commission asks a series of questions concerning its legal authority to implement a unified ICC regime. NASUCA believes the FCC has plenary authority to implement reform of interstate access charges under Section 201 of the Act. However, the Commission's ability to change the standards for reciprocal compensation is constrained by Section 251(b)(5) of the Act.

Most importantly, Congress did not give the FCC authority to change intrastate access charges. If Congress had desired to abrogate long-standing state authority over intrastate access services, it certainly could have done so. However, there is no directive to that effect to be found in the Act, nor any indication of this intent in the legislative history of the Act.

In fact, Section 251(d)(3) of Act specifically preserves state authority over intrastate access charges. This section, coupled with the general savings clause in Section 152(b) of Act stand as a substantial bulwark against the FCC's assertion of jurisdiction over intrastate rates. As the Supreme Court ruled in *Louisiana PSC v. FCC*: "While it is, no doubt, possible to find some support in the broad language of the section for respondents' position, we do not find the meaning of the section so unambiguous or straightforward as to override the command of §152(b) that '*nothing* in this chapter shall be construed to apply or to give the Commission jurisdiction' over intrastate service."[57]

Although the FCC does not have authority to compel states to adopt the same ICC rates as adopted for interstate services, it does have authority to establish target ICC rates which it can specifically encourage the states to adopt. Moreover, in the classic federal model, it can incent the states to adopt these target rates by establishing the state inducement fund called for in NASUCA's plan. The setting of target ICC rates by the FCC for interstate services is fully within the legal authority of the Commission and builds on previous rulings establishing similar target rates for access services, such as in the *CALLS Order*.

B. Mandatory Bill and Keep for Exchange of Local Traffic Is Not Consistent with the Commission's Legal Authority

1. Section 252(d)(2) "Additional Cost" Standard for Reciprocal Compensation

At paragraphs 64-73 of the FNPRM the Commission asks for comments on how the various ICC Plans meet the "additional cost" standard for reciprocal compensation found in Section 252(d)(2) of the Act. That section requires that reciprocal compensation rates established under Section 251(b)(5) be based on "a reasonable approximation of the additional costs of terminating such calls." In discussing this issue, the Commission addresses the fact that local reciprocal compensation rates have previously been determined under the total element long-run incremental cost (TELRIC) standard, while access charges have been based on embedded costs modified over time by the operation

[57] *Louisiana PSC v. FCC*, 476 U.S. 355, 377 (1986) ("*Louisiana PSC*") (emphasis in original).

of price caps.[58] This dichotomy was also noted in the *CALLS Order*: "The Commission has recognized that, as a legal matter, transport and termination of local traffic are different services than access service for long-distance telecommunications and therefore are regulated differently."[59]

While reciprocal compensation and access rates have been established under different standards, this does not impact NASUCA's proposal. As previously noted, NASUCA's plan would establish declining target ICC rates and maintain ICC rates which were already below the targets. Existing reciprocal compensation rates already include a reasonable approximation of additional costs imposed by termination of other carrier traffic,[60] and are generally lower than NASUCA's target rates. As a result, NASUCA's plan is consistent with the requirements of Section 252(d)(2).

On the other hand, it is difficult to see how ICF's proposal to lower the reciprocal compensation rate to zero can contain any approximation of additional costs. As a result, ICF's proposal, on its face, appears to conflict with Section 252(d)(2).[61]

[58] FNPRM at ¶¶ 13; 66.

[59] *CALLS Order*, 15 FCC Rcd 12962 at ¶178, citing *Local Competition Order*, 11 FCC Rcd 15499 at 16012-13.

[60] *Local Competition Order*, 11 FCC Rcd at 16023, at ¶1054.

[61] It is important to note that, in the comments that led to the *Local Competition Order*, "[i]ncumbent LECs as well as certain other commenters contend that mandatory bill-and-keep requirements conflict with the 1996 Act." *Local Competition Order*, ¶ 1100, citing, among others, comments by Ameritech, PacTel and GTE (predecessors to SBC and Verizon). Further, the Commission noted that "[n]umerous incumbent LECs also argue that bill-and-keep arrangements fail the 'reasonable approximation of the additional costs' test of section 252(d)(2) because they would effectively price termination at zero." *Id*., citing, among others, comments by NYNEX, Ameritech, Bell Atlantic and PacTel.

2. Forbearance from Enforcement of Section 251(b)(5) Is Not Appropriate

At paragraphs 74-77 of the FNPRM the Commission asks whether it should use its authority under section 10 of the Act to forbear from enforcing certain aspects of the compensation requirement of section 251(b)(5) in order to adopt a mandatory bill and keep regime. The short answer is "no."

The FCC's authority to forbear from applying regulations or provisions of the Act is properly used only upon the determination that the criteria in Section 10(a) have been met with respect to the regulations or provisions being considered for forbearance. The Section 10(a) criteria that must be met before forbearance is appropriate include determinations that:

(1) enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;
(2) enforcement of such regulation or provision is not necessary for the protection of consumers; and
(3) The forbearance from applying such provision or regulation is consistent with the public interest.

These criteria have not been met for intercarrier compensation with respect to Section 251(b)(5). Enforcement of 251(b)(5) is necessary to ensure that charges for services, practices are just and reasonable and are not unjustly or unreasonably discriminatory. The duty of the carrier to establish reciprocal compensation arrangements for transport and termination of telecommunications traffic is vital to ensure just and reasonable rates because it directly provides for the recovery of costs from the cost causer. This promotes an efficient system of compensation allowing for competition in the market. Competition benefits carriers and consumers alike and coincides directly with the purpose of the Act by creating just and reasonable rates based on the cost of the service, protecting carriers from discriminatory practices, and properly compensating carriers for use of their networks.

The enforcement of 251(b)(5) is necessary for the protection of consumers. The reciprocal compensation arrangement requirement ensures that consumers are not burdened by the responsibility to pay the costs caused by carriers or another consumer terminating traffic on the consumers' networks. The cost causation principle is consistent with reciprocal compensation arrangements in the establishment of efficient investment in the network. This in turn protects consumers through increased competition, better service quality, and eventually lower rates. The investment in efficient services provided over an efficient network where competitive advantages and disadvantages are eliminated through the institution of just and reasonable rates based on cost causation is specifically contemplated by the enforcement of 251(b)(5). Investment in efficient networks of individual carriers also benefits the public network as a whole, which serves the public interest.

Forbearance from applying section 251(b)(5) would be inconsistent with the public interest. It is in the public interest to maintain and promote continued movement toward competition. Competition is impeded (or annihilated in some cases) when compensation for the exchange of traffic is not based on the cost of providing that service. The reciprocal compensation arrangements required by Section 251(b)(5) provides for the *mutual* recovery of costs between two carriers.[62] Proper compensation

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[62] "*Reciprocal*: Given or owed mutually as between two persons; interchanged. Reciprocal obligations are those due from one person to another and vice versa." Black's Law Dictionary, Fifth Edition. Page 1141.

for the use of any carrier's network ensures efficient investment and maintenance of the network, helps ensure financially healthy carriers, protects against anticompetitive charges for the use of the network that create market distortions, and maintains the public safety function of the network as a whole. Section 251(b) sustains the public interest by encouraging properly maintained, high-quality, reliable networks. Forbearance from enforcing carriers' duties to establish reciprocal compensation arrangements would erase the specific purpose of the provision, which affords the duty to establish a cost-based arrangement for compensation, protecting consumers and the public interest.

Adoption of a mandatory bill-and-keep regime would obviously require forbearance from the specific requirements of Section 251(b). In its *Local Competition Order*, the Commission concluded that a state-imposed bill-and-keep arrangement is a permissible reciprocal compensation arrangement, provided that the traffic exchanged between *particular pairs* of interconnecting carriers is roughly balanced.[63]

A mandatory bill-and-keep regime would not meet the requirement of the Commission that all traffic throughout the national system of telecommunications networks be roughly balanced. Carriers throughout the nation differ significantly in size and cost characteristics. There can be large differences in the distance that telecommunications traffic is transported on any one network, particularly when rural areas are compared to urban areas. In addition, no two areas are geographically identical so as to allow for a mandatory bill-and-keep regime to properly operate under the current statute.

[63] *Local Competition Order* at ¶¶ 1111 - 1118.

The statute aligns the interests of the carriers in a competitive market and ensures the viability of both the carriers and a competitive market. A mandatory bill-and-keep regime is inconsistent with, and contrary to, the Act because it effectively prevents cost recovery for services provided. Further, institution of a mandatory bill-and-keep regime under section 251(b) would effectively eliminate the states' responsibility under Section 252(d)(2) to review Section 251(b) arrangements.

Imposition of a mandatory bill-and-keep regime would affect the cost profiles and cost characteristics of various carriers differently. Under bill-and-keep, carriers would not be able to recover the cost that other carriers impose on their networks from those carriers. Rural high-cost carriers with higher relative network costs would be especially hard hit. The loss of revenues from interconnecting carriers would force recovery all network costs onto the remaining users of the network – the end users. As previously argued, this is contrary to the Act and contrary to basic principles of cost causation.

Bill-and-keep would disadvantage and distort incentives for efficient transport, as well as eliminate incentives for investment in the network for the carrier that is transporting and terminating calls. This harms consumers, carriers, and the network as a whole, which is decidedly contrary to the public interest. As a result, the Commission should not forbear from enforcing the statutory requirements of Section 251(b)(5) of the Act.

C. The Commission May Not Abrogate State Jurisdiction over Intrastate Access Charges

Since *Smith v. Illinois Bell*, jurisdictional separations have been recognized as essential to the proper operation of the parallel federal and state regulation of interstate and intrastate telecommunications required by law: "[P]roper regulation of rates can only be had by maintaining the limits of state and federal jurisdiction."[64] In the Communications Act of 1934, Congress expressly denied the FCC "jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . ."[65] The broad language of Section 152(b) "contains not only a substantive jurisdictional limitation on the FCC's power, but also a rule of statutory construction ('[N]othing in this chapter shall be construed to apply or give the Commission jurisdiction with respect to . . . intrastate communication service . . .')."[66]

The access charge regime, designed to allow local exchange carriers to recover costs incurred when an interexchange carrier originates and terminates long distance calls on the local carriers' network, has been in place since the early 1980s. The 1996 Act added exceptions -- for the establishment of local competition -- to the general "command of § 152(b) that '[N]othing in this chapter shall be construed to apply or give the Commission jurisdiction' over intrastate service."[67] However, the 1996 Act did not eliminate the preservation of state jurisdiction over intrastate access charges so clearly expressed in Section 152(b).

The 1996 Act granted jurisdiction to the FCC relating to intrastate communication service, but limited that jurisdiction to authority necessary to facilitate the development of competition in telecommunications local exchange service markets, and to preserve the

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[64] *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930).

[65] 47 U.S.C. 152(b).

[66] *Louisiana PSC*, 476 U.S. at 373.

[67] *Id.*, 476 U.S. at 377.

competition which had developed in telecommunications toll service markets.[68] The 1996 Act, however, clearly did not transfer jurisdiction of switched access service for intrastate toll service, or the regulation of prices for such service, from the states to the FCC. In fact, the FCC's attempt in the *First Report and Order* to assert regulatory jurisdiction over intrastate access charges was vacated on appeal as "…an assertion of regulatory power . . . beyond the scope of the FCC's jurisdiction" as limited by § 152(b).[69]

The Commission also asks whether it could preempt state authority over intrastate access under a "mixed use" doctrine where intrastate traffic is treated as jurisdictionally interstate "if it is impossible or impractical to separate the interstate and intrastate components."[70] The "mixed use" doctrine does not apply, however, where it remains both entirely possible and practical to identify and separate long distance calls that begin and end within a single state, as it has for years.[71] Local exchange carriers have long been able to separate traffic into intrastate and interstate components, and continue to do so.

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[68] 47 U.S.C. 251 *et seq.; see, e.g., A.T.&T. Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-82 and n.8 (1999).

[69] *Competitive Tel. Assoc. v. FCC*, 117 F.3d 1068, 1075 n.5 (8th Cir. 1997).

[70] *See*, FNPRM ¶ 80, citing *Maryland PSC v. FCC*, 909 F.2d 1510, 1515 (D.C. Cir. 1990). Preemption is appropriate where "(1) the matter to be regulated has both interstate and intrastate aspects; (2) FCC preemption is necessary to protect a valid federal regulatory objective; and (3) state regulation would negate the exercise by the FCC of its own lawful authority because regulation of the interstate aspects of the matter cannot be unbundled from regulation of intrastate aspects." (Internal quotations and citations omitted).

[71] The minor exceptions to this principle, caused by some wireless calls and some variants of voice over Internet protocol service, cannot obscure the fact that for the vast majority of calls, the end-points are easily verifiable. *In the Matter of AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services*, WC Docket No. 03-133; *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Order and Notice of Proposed Rulemaking, FCC 05-41 (rel. February 23, 2005), ¶¶ 22-29.

Preemption of state regulation of those telecommunications services[72] is not necessary under *Maryland PSC v. FCC*.[73]

D. Rate Averaging and Integration

Section 254(g) of the 1996 Act directed the Commission to

> adopt rules to require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to subscribers in any other State.

As described in the FNPRM, the Commission adopted a "geographic rate averaging rule" to accomplish Section 254(g)'s first purpose, and adopted a "rate integration rule" for the second purpose.[74] Notably, the Act does not require, and the Commission did not adopt, any support mechanism designed to ensure that the purposes of Section 254(g) are met.

At paragraph 86 of the FNPRM, the Commission expresses its concern that "[a]bsent some further reform of the access charge regime… the rate averaging and rate integration requirements eventually will have the effect of discouraging IXCs from serving rural areas." *Ceteris paribus*, that might be true, but to the extent that access charges are reduced -- a goal that all of the proposals before the Commission share[75] -- this reform will make both geographic rate averaging and rate integration easier. As

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[72] The Commission has rate and entry authority over CMRS services and has already moved to preempt most state regulation over VoIP services. As expressed in the previous footnote, the concerns expressed in FNPRM ¶80 about treatment of those services do not require that authority over other clearly intrastate services be transferred to the FCC.

[73] *Maryland PSC v. FCC*, 909 F.2d 1510, 1515 (D.C. Cir. 1990).

[74] FNPRM ¶ 83.

[75] See Section VI. below. These are particular concerns of the IXCs that are members of the ICF.

discussed here, NASUCA's proposal facilitates compliance with Section 254(g) with a minimum of disruption.

Because the primary cost input for long distance service -- access charges -- are higher in areas served by RLECs, the result with the geographically averaged rates required by Section 254(g) is that customers in rural areas pay less than if rates were not geographically averaged, while urban areas pay more than if there were no averaging. Some carriers argue that this is unsustainable, especially in the coming IP-based world. Unless ICC is reduced to zero, they argue, they will be forced by § 254(g) to simply cease offering service in rural areas.

The requirements of Section 254(g) have been in effect for over nine years, and rural companies' access charges -- both terminating and originating -- have always been higher than the non-rural companies that serve urban areas. However, most of the non-rural carriers' service territories include substantial portions that are aptly described as rural. Thus the risk, if it exists, is not to rural customers per se but to calling to and from customers of rural companies that have higher access charges. As a practical matter, no nationwide IXC would be able to serve customers -- whether in urban areas or in rural areas -- if it served only the customers of non-rural companies. And it would be even more impracticable for a nationwide IXC to tell its urban customers that they are not permitted to make long distance calls to the customers of rural companies. Even if IXCs stop offering long distance as a stand-alone service, the local provider of telephone service (which will presumably include long distance), will have to continue to comply with Section 254(g).

The Commission is "concerned that the competitive realities of the marketplace may drive increasing specialization of companies serving rural as opposed to non-rural areas, ultimately leading to higher costs and fewer competitive choices for rural customers."[76] As shown above, the access charge reductions discussed here will minimize this possibility. So will the sheer impracticalities of not serving customers of rural companies or not allowing non-rural companies' customers to call their friends and families in rural companies' territories. Add to those factors the fact that the competitive reality of the marketplace is, in fact, driving generalization (i.e., "one-stop shopping") rather than specialization, and the Commission's concerns are of much less import.

VI. Response to Other ICC Proposals

A. Introduction

As previously noted, there have been several well-developed proposals for ICC reform submitted to the FCC. Most of these proposals come from specific industry segments, such as rural carriers, although the ICF contains at least some representatives of multiple segments.

At paragraph 62 of the FNPRM the Commission asks whether in light of the extensive negotiations involved in many of the proposals, it is preferable to adopt a single proposal in its entirety. The Commission's task is to arrive at a plan for ICC reform which is just and reasonable and which is consistent with the requirements of the Act. It is obvious that no plan presented represents a consensus or even a majority opinion on the proper course for ICC reform. The Commission should not deceive itself that

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[76] FNPRM ¶ 86.

adoption of one plan in its entirety will reduce controversy or minimize issues in contention. However, as discussed above, adoption of the NASUCA plan will retain the current ICC structure and will entail the least disruption to the existing carrier relationships.

B. The Intercarrier Compensation Forum (ICF) Proposal

The ICF proposal requires the FCC to assert jurisdiction over all intercarrier compensation rates, both access and reciprocal compensation, and in so doing, to preempt state authority over intrastate ICC. As discussed above in Section VI.C., this violates fundamental principles of federal law.

ICF proposes that the FCC move to a mandatory bill-and-keep system of ICC, lowering most ICC rates to zero over eight yearly steps.[77] To exactly replace the $8.4 billion in ICC revenues that would be lost under the ICF proposal, ICF recommends that subscriber line charges be increased by $6.3 billion, and that new federal universal service funding be established in the amount of $2.1 billion.[78] Because ICC rates would no longer reflect the cost of using another carrier's network, normal cost-related usage incentives and disincentives are eliminated under the ICF plan. As a result, the ICF proposal also includes a radical restructuring of interconnection rules and the definition and establishment of "edges" between all carriers.

In addition to the fundamental legal flaws of the ICF plan previously discussed, NASUCA opposes key elements of the ICF plan for numerous policy reasons.

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[77] ICF *Ex Parte*, Oct. 5, 2004.

[78] ICF *Ex Partes*, Dec. 6 and 14, 2004.

- The increase in the SLC cap to $10.00 per month will impose an unwarranted basic rate increase on all subscribers, divorced from any showing of need for additional revenues by individual carriers.
- After the fourth yearly step for larger carriers,[79] the SLC ceases to be related to cost or even to revenue replacement.[80] The ability of price cap carriers to increase the SLC to $10.00 per month irrespective of cost, and then to subsequently escalate the SLC by the rate of inflation, amounts to back-door deregulation of end-user rates.
- The ICF plan to increase the SLC ignores continuing declines in ICC revenues and locks in guaranteed recovery of a past level of ICC revenue for each carrier.
- The ICF plan deviates from the Commission's previously stated goal of moving ICC rates to cost, and ignores on-going productivity gains in telecommunications.
- The virtual elimination of usage as a cost component of ICC will create new uneconomic incentives for carriers to dump traffic on the networks of other carriers.
- The ICF plan adds over $2 billion to the federal universal service fund through the creation of two new support mechanisms. The additional support is given without any showing of need by individual carriers, or

[79] The ICF Plan labels larger, mainly non-rural carriers "Non-Covered Rural Telephone Companies" or "Non-CRTCs." Smaller rural carriers are labeled "Covered Rural Telephone Companies" or "CRTCs." See, ICF *Ex Parte*, Oct. 5, 2004, Appendix A, Section II.B.1.

[80] *Id.*, Appendix A, Sections III.G.1.e. and J.2; Appendix B, pp. 7-8.

that their rates will be not reasonably comparable or unaffordable absent the revenues.

- In order to address the burden created by ICF's proposed 50% increase in the High Cost Support Fund, ICF proposes to fundamentally restructure the contribution methodology which supports the USF.[81] The movement to numbers and connections as proposed by ICF will increase the growing burden on low-usage customers.

Because of the numerous flaws and inequities in the ICF plan, NASUCA urges the Commission to reject it out of hand.

C. Rural Proposals

There have been several proposals by groups or coalitions of groups representing rural companies. In addition, two of these groups have apparently joined in a new coalition called the Rural Alliance. NASUCA will respond to any new proposals from the Rural Alliance in reply comments.

1. Alliance for Rational Intercarrier Compensation ("ARIC")

ARIC has put forward a plan for ICC reform which it calls the Fair Affordable Comprehensive Telecom Solution ("FACTS"). Under the FACTS plan, each carrier would unify its ICC rates for all types of traffic, but ICC rates would still vary widely among carriers. The FACTS plan would require local rate rebalancing by each state commission and would unify SLCs within each state. Any revenues not recovered by

[81] As previously shown by NASUCA in its comments in CC Docket No. 96-45, the current USF contribution methodology based on interstate revenues is actually better able to absorb such increases, and should be retained.

rebalanced local rates, SLC and unified ICC rates, would be paid out of a state equalization fund.

2. Expanded Portland Group ("EPG")

EPG proposed a plan of ICC reform with three phases. During the first phase, all carriers would be required to truthfully label traffic and the information service provider (ISP) exemption from ICC rates would be eliminated for traffic terminated on the PSTN. During the second phase, all traffic-sensitive ICC rates would be capped at interstate access rates, and lost revenue would be recovered through a new USF support mechanism, the Access Replacement Charge ("ARC"). Carriers would be eligible for the ARC only to the extent that their local rates met or exceeded a national rate benchmark. During the third phase of the EPG plan, all per minute rates would be changed into capacity rates for ports (interconnection charge) and links (transportation charge). The link charge would have both a capacity and distance component.

3. Home Telephone and PBT Telephone

Home Telephone Company and PBT Telephone ("Home/PBT") are two small rural carriers that have proposed a plan similar to those outlined above. Under the Home/PBT plan, current ICC rates would be replaced with connection-based rates and access tandem connection fees. Lost revenue would be recovered by raising SLCs to the current cap level, and by creation of a new High Cost Connection Fund (HCCF) which would be bulk-billed to carriers. The HCCF would be funded by an assessment on all telephone numbers.

4. NASUCA's Response to Rural Proposals

The rural proposals discussed above have developed several very useful concepts which should be explored by the Commission in developing a unified intercarrier compensation regime. For example, NASUCA agrees that there should be a minimum required level of contribution from local rates before there is recourse to additional universal service funding. NASUCA also agrees that at least a portion of ICC rates should eventually be moved to recovery on a capacity basis.[82] However, all of the rural proposals start from the assumption that all rural carriers should recover the same amount of revenue under a unified ICC scheme as they do under the current rules. As NASUCA has discussed extensively above, the need for additional funding as a result of ICC reform should be a matter of proven need, not of right. While it is likely that most rural carriers will be able to recover most, if not all, revenue lost as a result of ICC reform, such recovery should be based on a factual showing by individual carriers.

D. Cost-Based Intercarrier Compensation Coalition ("CBICC")

A group of competitive local exchange carriers prepared the CBICC proposal which calls for a unified TELRIC termination rate for interstate traffic within each geographic area. The carrier with the retail relationship with the originating end user would be responsible for paying all other carriers used to transport and terminate the call. The issue of intrastate ICC rates would be referred to a Federal-State Joint Board. Any shortfalls in revenue would be covered by increases in local rates. Additional universal service funding would be available to rural carriers. NASUCA finds much to agree with

[82] As discussed in Section II.B.2. above, NASUCA also agrees with EPG's proposal that all carriers be required to truthfully label traffic and that the information service provider (ISP) exemption from ICC rates be eliminated for traffic terminated on the PSTN. These requirements should be adopted regardless of any other plan provisions.

in CBICC's retention of cost causation principles, and CBICC's recognition of continuing state jurisdiction over intrastate ICC rates.

E. National Association of Regulatory Utility Commissioners ("NARUC")

Although NARUC has not formally endorsed any particular ICC reform plan, it has authorized its Intercarrier Compensation Task Force to submit a proposal to the Commission for consideration in this proceeding. Because the Task Force's proposals have changed so much from version to version, NASUCA will have to review whatever proposal is actually filed with the Commission before making substantive comments.

VII. Conclusion

NASUCA urges the Commission to adopt its plan for minimizing disparities in intercarrier compensation rates over a five-year period. NASUCA's plan maintains existing wholesale/retail relationships and network definitions to the extent possible, and places the least pressure on end user rates and universal service funding.

Respectfully submitted,

/s/

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ATTACHMENT 1

NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES RESOLUTION ON INTERCARRIER COMPENSATION

WHEREAS, telecommunications traffic of one telecommunications carrier that originates, transits or terminates on the network of another carrier imposes costs on the carrier that originates, carries or terminates that traffic; and

WHEREAS, telecommunications carriers have historically compensated each other for originating, transiting or terminating telecommunications traffic on the network of another carrier; and

WHEREAS, the rates of compensation for originating, transiting and terminating telecommunications traffic currently vary based on the type of traffic and the type of carrier involved; and

WHEREAS, these different rates of compensation have created opportunities for uneconomic arbitrage of the intercarrier compensation system; and

WHEREAS, certain proposals before the Federal Communications Commission (FCC) to reform the current intercarrier compensation system call for implementation of a “bill and keep” system which would require all carriers to recover all of the costs of their networks from their end-user consumers, would require increases in the federal subscriber line charge, would transfer a large portion of the revenue currently provided by intercarrier compensation to the federal universal service fund, and would reduce state jurisdiction over intrastate telecommunications rates; and

WHEREAS, other proposals to reform intercarrier compensation would require development of “default” intercarrier compensation rates with recovery of remaining costs through increases in the federal subscriber line charge, increases in the universal service fund, and/or creation of new revenue preservation funds paid for by end users; and

WHEREAS, none of these proposals require audits of costs or consideration of earnings of telecommunications carriers; and

WHEREAS, consumers have historically paid for their access to the public switched telecommunications network based on their usage of the network; and

WHEREAS, proposals to go to a “bill and keep” or “default” system of intercarrier compensation would shift revenue responsibility from high-usage customers to low-usage customers, and from business customers to residential customers; and

WHEREAS, proposals to go to a “bill and keep” or “default” system of intercarrier compensation would disproportionately impact low-usage residential consumers through higher charges for access to the public switched telecommunications network and higher universal service fund surcharges; and

WHEREAS, low-usage residential customers have already experienced large increases in the price of access to the public switched telecommunications network through previous efforts to reform access charges on both the federal and state level, such that further government-mandated increases in the price of access to the public switched telecommunications network would be unconscionable and would adversely affect subscribership to the network, especially among low-income consumers:

NOW, THEREFORE, BE IT RESOLVED that the National Association of State Utility Consumer Advocates (NASUCA), urges the FCC to adopt an intercarrier compensation system that:

a) recognizes that originating, transiting and terminating telecommunications traffic imposes costs on originating, transporting and terminating carriers; and
b) treats all telecommunications traffic in an equitable and non-discriminatory manner; and
c) fairly allocates costs so that residential customers do not pay more than fair share of the costs of the telecommunications network; and
d) verifies costs and considers earnings of carriers; and
e) recognizes the appropriate role of state government in establishing rates charged to end-user consumers in each state; and
f) avoids increases in unavoidable monthly line charges for end-use consumers; and
g) avoids the need for new universal service funding of carriers.

BE IT FURTHER RESOLVED, that the Telecommunications Committee of NASUCA, with the approval of the Executive Committee of NASUCA, is authorized to take all steps consistent with this Resolution in order to secure its implementation.

Approved by NASUCA:

Place: Austin, Texas

Date: June 15, 2004

ATTACHMENT 2

TABLE OF SWITCHING COSTS

Comparison of Embedded and Forward-Looking Switching Cost				
SAC	Carrier	HCL method	LSS method	Synthesis Model
105111	VERIZON MAINE	6.67	11.31	2.20
115112	VERIZON MASS.	6.47	11.55	1.87
125113	VERIZON NEWHAMPSHIRE	5.19	9.86	2.08
135200	SOUTHERN NEW ENGLAND	4.97	10.26	2.09
145115	VERIZON VERMONT	5.37	8.45	2.43
155130	VERIZON NEW YORK	7.23	11.81	2.18
165120	VERIZON NEW JERSEY	4.09	6.78	1.89
170169	VERIZON NORTH-PA	6.92	7.96	2.49
175000	VERIZON PENNSYLVANIA	4.60	7.34	2.11
185030	VERIZON MARYLAND INC	5.96	8.35	2.17
190233	VERIZON S-VA(CONTEL)	6.82	9.94	2.36
195040	VERIZON VIRGINIA INC	6.16	8.49	2.16
205050	VERIZON W VA INC.	7.19	10.28	2.60
215191	SOUTHERN BELL-FL	5.18	7.38	2.15
225192	SOUTHERN BELL-GA	5.79	8.90	2.28
230479	VERIZON SOUTH-NC	10.34	16.17	2.32
230509	VERIZON S-NC(CONTEL)	6.59	9.39	2.29
235193	SOUTHERN BELL-NC	5.70	8.82	2.34
240479	VERIZON SOUTH-SC	8.56	11.54	2.65
245194	SOUTHERN BELL-SC	6.31	8.77	2.22
255181	SO CENTRAL BELL-AL	6.11	8.81	2.61
265182	SO CENTRAL BELL-KY	5.87	8.05	2.52
275183	SO CENTRAL BELL-LA	6.15	8.29	2.43
285184	SO CENTRAL BELL-MS	5.76	8.23	2.78
295185	SO. CENTRAL BELL -TN	5.86	8.20	2.42
300615	VERIZON NORTH-OH	6.03	8.07	2.93
305150	OHIO BELL TEL CO	5.62	8.04	2.15
310695	VERIZON NORTH-MI	5.18	7.56	2.70
315090	MICHIGAN BELL TEL CO	4.91	7.13	2.00
320772	VERIZON N-IN	7.91	11.16	2.69
320779	VERIZON N-IN(CONTEL)	6.45	7.87	3.14
325080	INDIANA BELL TEL CO	5.44	7.03	2.25
330886	VERIZON NORTH-WI	5.23	7.33	2.89
335220	WISCONSIN BELL	4.80	6.58	2.14
341015	VERIZON NORTH-IL	6.30	8.85	3.41

TABLE OF SWITCHING COSTS

Comparison of Embedded and Forward-Looking Switching Cost				
SAC	Carrier	HCL method	LSS method	Synthesis Model
341036	VERIZON N-IL(CONTEL)	6.87	9.89	4.12
345070	ILLINOIS BELL TEL CO	5.78	8.42	2.12
355141	QWEST CORP-IA	5.99	9.44	2.28
365142	QWEST CORP-MN	6.40	9.40	2.25
375143	QWEST CORP-NE	8.35	13.40	2.64
385144	QWEST CORP-ND	6.67	10.02	2.28
395145	QWEST CORP-SD	5.53	10.98	2.13
405211	SOUTHWESTERN BELL-AR	5.50	7.44	2.10
415214	SOUTHWESTERN BELL-KS	5.39	7.48	2.32
425213	SOUTHWESTERN BELL-MO	5.68	8.16	2.51
435215	SOUTHWESTERN BELL-OK	5.97	8.51	2.21
442080	GTE SW VERIZON-TX	9.00	14.19	5.26
442154	GTE-SW VERIZON-TX	7.89	12.41	2.81
445216	SOUTHWESTERN BELL-TX	6.57	9.05	2.19
455101	QWEST CORP-AZ	6.08	9.17	2.15
465102	QWEST CORP-CO	5.88	10.06	2.44
475103	QWEST CORP-ID	5.49	7.86	2.25
485104	QWEST CORP-MT	5.99	8.88	2.31
495105	QWEST CORP-NM	5.56	9.16	2.20
505107	QWEST CORP-UT	6.15	9.88	2.26
515108	QWEST CORP-WY	3.64	6.43	2.06
522416	VERIZON N'WEST-WA	9.28	13.31	2.23
525161	QWEST CORP-WA	6.03	10.09	2.09
532416	VERIZON N'WEST-OR	8.21	11.28	2.46
535163	QWEST CORP-OR	5.62	8.92	2.17
542302	VERIZON CA(CONTEL)	6.13	9.70	2.46
542319	VERIZON-CA (GTE)	5.93	8.42	1.84
545170	PACIFIC BELL	3.49	6.24	2.22
555173	NEVADA BELL	5.59	9.51	2.21
565010	VERIZON DELAWARE INC	4.67	7.20	2.16
575020	VERIZON WA, DC INC.	5.99	10.29	2.81
585114	VERIZON RHODE ISLAND	5.66	9.28	1.95
623100	VERIZON HAWAII-HI	7.45	9.78	2.80
633200	P R T C - CENTRAL	4.63	6.62	1.42
633201	PUERTO RICO TEL CO	5.64	8.36	2.12
	Average	5.64	8.61	2.22

ATTACHMENT 3

SURVEY OF CLEC
SUBSCRIBER LINE CHARGES
FOR SINGLE LINE RESIDENTIAL SERVICE
IN SBC SERVICE TERRITORY
IN OHIO

Company	Monthly SLC Charge
SBC-Ohio (Incumbent)	$5.39
Cincinnati Bell CLEC	No charge
McLeod USA	No charge
Time Warner Cable	No charge
ACCtion Communications	$5.38
New Access	$5.38
Cinergy Communications	$5.39
Comcast	$5.39
First Communications	$5.39
Insight Phone of Ohio	$5.39
Talk America	$5.39
ACN	$6.00
AT&T	$6.39
Affinity Telecom	$6.50
CoreComm	$6.50
MCI	$6.50
Power Net Global	$6.50
Sprint Communications	$6.50
Trinsic (fka Z-Tel)	$6.50
Sage Telecom	$8.38
Excel	$9.50
Vartec	$9.50

NOTE: CLEC subscriber line charges are listed under various names, such as federal access charge, FCC single line charge, end user common line charge, network access surcharge, and interstate common line charge.

Sage TELECOM

Dear Sage Customer:

Recently, you may have noticed newspaper articles about a federal court decision that overturned the rules governing local telephone service. These rules, which have been in existence since 1996, govern competitor access to the public telephone network, and the prices competitors pay the Bell telephone companies for the lines that run to your home or business.

Following the court decision, some local service providers, including AT&T, announced they would no longer compete for residential local and long distance customers.

Meanwhile, as the battle over rules was taking place in the courtroom, Sage entered into private negotiations with SBC. After several months of negotiations, Sage and SBC reached an agreement that ensures Sage customers will continue to receive service without interruption.

The agreement with SBC calls for development of new services such as high-speed Internet service as part of your local telephone service, and other enhancements such as "stutter" dial tone that alerts you to messages in your voice mailbox. These services and enhancements will be introduced in upcoming months.

The agreement also calls for an increase in the wholesale cost we pay SBC. Because of this increase in cost, it is necessary for us to raise the FCC Subscriber Line Charge $3.00 per line starting next month. Despite this small increase, we want to make sure that you know that Sage is still your best value for local phone service.

We truly appreciate your business, and especially, the trust and loyalty of our customers. As always, we remain committed to providing you with the best in local telephone service.

Sincerely,

Denny Houlihan

Dennis M. Houlihan
President & Chief Executive Officer

P.S. If you have questions or comments about these issues, please feel free to write me at the address below or email me at president@sagetelecom.net.

104212

Sage Telecom, Inc., 805 Central Expressway South, Suite 100, Allen TX 75013-2789

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VARTEC LOCAL

LOCAL SERVICE PLANS

DSL INTERNET ACCESS

DIAL-UP INTERNET ACCESS

OneChoice Local Service

FCC Approved Line Charge (impacts all customers)

Q: Why is my FCC Approved Subscriber Line Charge being increased to $9.50 (or by $3)?
A: Thank you for your flexibility regarding these new changes to your service. In response to changing business and regulatory conditions affecting the costs of competitive access to local telephone lines, we are increasing the FCC Subscriber Line Charge $3.00 per primary line and $2.50 for each additional line effective 2/17/05.

Q: What is the FCC Approved Line Charge for?
A: The FCC Approved Subscriber Line Charge is an allowed surcharge that helps telephone companies, recover the costs of the local phone network. This fee is not a government tax or charge. This fee applies whether you make long distance calls or not.

Q: Still have questions or concerns?
A: Our customer service representatives are available to answer your questions or concerns, please give us a call at 800-708-7395. We truly appreciate your loyalty and thank you for your business. As always, we remain committed to providing you a valued choice in your communications needs.

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INFORMATION FOR CUSTOMERS | INFORMATION FOR SUPPLIERS | RATE CHANGES | PRIVACY POLICY

ATTACHMENT 4

AFFIDAVIT OF DR. DAVID GABEL