

# **EXHIBIT 1**

## **INDEPENDENT WIRELESS CARRIERS' INTERCARRIER COMPENSATION REFORM PLAN**

**Developed by**

**Western Wireless Corporation**

**And**

**SunCom Wireless, Inc.**

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**Table of Contents**

<b>I.</b>	Introduction and Summary .....	3
<b>II.</b>	Reform Principles .....	5
	<b>A.</b> Unified Compensation .....	3
	<b>B.</b> Originating Network Pays.....	3
	<b>C.</b> Symmetrical .....	3
	<b>D.</b> Forward Looking .....	3
	<b>E.</b> Technology And Competitively-Neutral .....	4
<b>III.</b>	Reform Objectives.....	4
	<b>A.</b> Consumer Benefits.....	4
	<b>B.</b> Economic Efficiency.....	4
	<b>C.</b> Competitive and Technological Neutrality .....	4
	<b>D.</b> Carrier Self-Reliance .....	5
	<b>E.</b> Preserve and Advance Universal Support.....	5
	<b>F.</b> Minimize Administrative Costs and Burdens.....	5
	<b>G.</b> Regulatory Certainty .....	6
<b>IV.</b>	Intercarrier Compensation Reform.....	6
<b>V.</b>	Network Routing Responsibilities. ....	12
	<b>A.</b> Principles for Network Routing Responsibility.....	12
	<b>B.</b> Default Traffic Exchange.....	12
	<b>C.</b> Originating and Terminating Carrier Responsibility.....	14
	<b>D.</b> Transit Carrier Oversight.....	16
	<b>E.</b> Default Cost Sharing for SS7.....	16
<b>VI.</b>	Transition Plan.....	17
	<b>A.</b> Intercarrier Compensation Transition.....	17
	<b>B.</b> Universal Service Transition.....	18
	<b>C.</b> Additional Regulation Reform.....	19
	<b>1.</b> Rate of Return Regulation.....	19
<b>VII.</b>	USF Reform.....	20
	<b>A.</b> Universal Service Reform Must Be Guided by Pro-Competitive Principles.....	20

## **I. INTRODUCTION AND SUMMARY**

This intercarrier compensation reform plan was developed by Western Wireless Corporation (“Western Wireless”) and SunCom Wireless, Inc. (“SunCom Wireless”) (jointly referred to as “Independent Wireless Carriers”).

Intercarrier compensation reform is one of the most important decisions facing the telecommunications industry. The outcome of reform efforts will determine the shape of the telecommunications industry in the coming decades. Decisive action to eliminate existing compensation biases and irrational pricing schemes is long overdue. The current broken system inhibits the ability of telecommunications carriers to obtain investment, deploy new technology, and deliver additional consumer value. Swift action is necessary to abolish existing distinctions based on technology, political boundaries, and obsolete network architectures and to adopt new rules that anticipate and facilitate changing technologies and services.

Independent Wireless Carriers' intercarrier compensation plan will promote economic efficiency, competition, and technological innovation, while protecting universal service and reducing bureaucratic overhead. The flaws of the existing system are too well known to require extensive elaboration, but, in sum, these flaws include rates that are unrelated to costs, rates for similar (or identical) services that vary depending on the type of customer purchasing them and the nature of that customer's traffic, and extensive arbitrage resulting from these disparities between prices and costs. Independent Wireless Carriers' plan unifies the existing disparate compensation schemes, thereby eliminating technological discrimination and opportunities for uneconomic

arbitrage. Independent Wireless Carriers' plan also eliminates above-cost compensation obligations, which uneconomically depress network usage.

Independent Wireless Carriers' plan also ensures that universal service is preserved and maintained in accordance with national policy objectives. The time has come, however, to establish a unified, principled, and competitively-neutral system of high-cost support based on forward-looking economic cost. Independent Wireless Carriers' Plan offers both intercarrier compensation reforms and universal service reforms that are rooted on principles of economic efficiency and consumer welfare, thereby promoting the interests of consumers (not particular groups of carriers) and targeting support so as to avoid undue fund growth. Absent from Independent Wireless Carriers' Plan are revenue guarantees for ILECs because such guarantees to one segment of the telecommunications industry have no principled basis and lead to treating different categories of carriers differently based on their divergent histories and technologies, which would introduce uneconomic distortions into the competitive marketplace and explode the size of the fund

The Independent Wireless Carriers' Plan is also most consistent with the direction of the telecommunications industry. Historically, the access charge and reciprocal compensation systems have been designed based upon the presumed cost and traffic characteristics of circuit-switched voice traffic, which is increasingly becoming obsolete. Although voice services will continue to be a heavy user of the converged networks of the near future, they will certainly not be the only or even predominant use of those networks. Therefore, Independent Wireless Carriers' Plan takes into account existing,

emerging, and future services, including voice, data, and video, and new network designs, including voice over packet-switched networks.

## **II. REFORM PRINCIPLES**

Independent Wireless Carriers' Plan is based upon the following principles:

### **A. Unified Compensation**

Compensation should not differ due to jurisdiction (inter/intra LATA or inter/intra state), distance (local or long distance, intra or interMTA), or status of the service provider (*e.g.*, ILEC, rural LEC, CLEC, CMRS, VoIP).

### **B. Originating Network Pays**

To the extent there is any compensation obligation at all, it should be imposed solely on the originating carrier, which in turn has the opportunity to recover its costs from its end user. This operational standard would continue to apply to determine compensatory obligations in any carrier-carrier traffic exchange relationship.

### **C. Symmetrical**

This principle insures that one party is not advantaged in a bilateral traffic exchange relationship.

### **D. Forward Looking**

Costs must be based on a forward looking additional cost standard. Any other method serves to subsidize less efficient networks and impede motivation to deploy more efficient technologies.

### **E. Technology And Competitively-Neutral**

Intercarrier compensation reform must be technology and competitively-neutral, meaning all carriers should be treated similarly and no carrier should be eligible for benefits not available to another class of carriers.

## **III. REFORM OBJECTIVES**

Independent Wireless Carriers' Plan achieves the following objectives:

### **A. Consumer Benefits**

Intercarrier compensation reform should result in sustainable benefits to consumers achieved through further progression to a competitive market environment. The focus of reform should be on consumers, rather than any particular carrier.

### **B. Economic Efficiency**

Intercarrier compensation reform must apply economically efficient principles and free carriers from unnecessary burdens in delivering service to customers. The incentives for arbitrage must be eliminated by overhauling the divergent array of rules that unfairly discriminate among various classes of service providers. A single standard should apply to all intercarrier traffic that is transported and terminated. Similarly, universal service rules that promote inefficiency or that interfere with competition should be reformed.

### **C. Competitive and Technological Neutrality**

Intercarrier compensation reform must remove the safety nets, the barriers, and the subtle and overt distinctions that have biased and often compromised the expansion of

sustainable competition and migration to new technologies. Reform must eliminate rules that confer advantages on one category of carrier over another. The exchange of digital data and video have already nurtured their own form of intercarrier relationships. The shift to software controlled voice platforms, especially VoIP, may completely change how the voice segment of the industry operates. Rules that inhibit this evolution must be avoided.

#### **D. Carrier Self-Reliance**

Each carrier must become self reliant by removing cross-subsidies imposed on consumers and wholesale pricing relationships. After the end of a transition period, each carrier should recover its network costs from its own end-users. Carriers should also have flexibility in determining how to recover their costs from their end users.

#### **E. Preserve and Advance Universal Support**

Intercarrier compensation must ensure that support goes to benefit consumers, rather than a means for revenue maintenance for selected carriers. A unified and competitively neutral system of universal service support must not unduly favor one class of ETC over another. Universal service must remain portable and should be based on forward-looking costs, in order to empower consumers to decide from whom to purchase supported service.

#### **F. Minimize Administrative Costs and Burdens**

Intercarrier compensation reform must eliminate layers of unnecessary administration both within the regulatory agencies and within and among the carriers that

are subjected to it. While overall FCC policy guidance is needed, there is no need to control every step of the process.

### **G. Regulatory Certainty**

A successful reform plan must be clear about the rules that apply and must be accomplished in a fixed timeframe that does not further compromise competitive and technological evolution important to the U.S. economy. Critical defaults should be established to expedite transitions. Local rate rebalancing and/or relaxed rate regulation should also be part of reform. Reform should be incented by using a strong carrot and/or stick approach. For example access to federal USF support is a significant and meaningful "carrot".

## **IV. INTERCARRIER COMPENSATION REFORM**

Reforming monetary compensation is a significant and highly visible component of intercarrier compensation reform, but not the only objective. Reform must also address network routing and retail pricing.

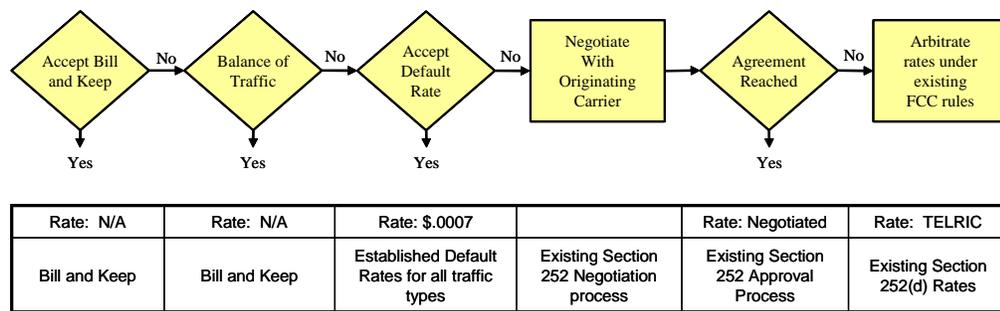
The web of complicated traffic classification and compensation has evolved from a series of significant but uncoordinated events over a period of decades. The result is an arcane compensation system unique from any other competitive market or any other telecom regime in the world. To achieve true reform, the legacy must be put aside and the aforementioned principles and objectives must be adhered to.

Dramatic steps can be taken to simplify intercarrier compensation by removing historical and, increasingly meaningless, distinctions of traffic. Many of these distinctions only exist to serve regulatory processes that were initiated for the purposes of

monitoring the de-monopolization of the local and long-distance markets. Specifically, the age-old distractions that no longer have a place in today's telecommunication market include:

- Inter/intra State and inter/intra LATA distinctions. These distinctions exist only to serve regulatory processes, not customers. These are artificial traffic distinctions that have little or no sustaining value, no inherent technical or cost basis, and no consumer value.
- Inter/intra MTA distinction (only after access charges are eliminated and bill-and-keep is implemented). The industry has not developed a way to measure this distinction in real time or post call record processing, so the time is right to eliminate this distraction, but only if access charges are eliminated.
- Local/toll distinction on carrier settlements. This will eliminate a significant amount of arbitrage and litigation, and enable more efficient interconnection trunks (*e.g.*, larger trunks groups that combine local, eas, and access traffic would be more efficiently sized than separate trunk groups for each traffic classification).
- Carrier classifications. There are no technical or economic reasons to distinguish intercarrier compensation by type of carrier or the nature of the origination or termination of the traffic exchanged.

Independent Wireless Carriers propose the adoption of a simple plan to deal with the inter-carrier compensation relationship during a four-year period of transition to ultimate bill and keep for wholesale traffic exchange relationships. Based on their own experience in dealing with inter-carrier compensation, Independent Wireless Carriers believe this plan is the most workable system for the industry: The plan can be summarized as follows:



This approach is simple, straightforward, and uses many principles embedded in the Act, FCC rules, and industry practice. The Plan assumes bill and keep unless extraordinary circumstances exist. The plan also ensures that the extraordinary circumstances are material in nature because this approach requires a carrier seeking monetary compensation from another carrier to demonstrate the extraordinary circumstances.

The Plan will serve to eliminate most of the compensation contention between carriers by establishing clear defaults coupled with a requirement to provide a threshold of evidence to overcome default compensation arrangements. The Plan works this way:

**Consideration #1. Applicability of Bill-and-Keep**

Bill and Keep is the appropriate long term default solution for intercarrier compensation. This solution is in place today between many carriers in both formal and informal traffic exchange relationships. In today's networks, the vast majority of real costs associated with processing traffic are the costs of handling traffic to accommodate peak hour demand. Since peak hour communications serves both the called and the calling party (or the originator and the terminator), by definition, the traffic is of shared value to each party's customers. Bill and keep is a simple recognition of this.

Today, bill and keep is viewed as the default traffic exchange relationship by most carriers. No action is required for a carrier entering a service area to establish this default arrangement with other carriers. Unless other arrangements are made between two carriers, this default will prevail. If a carrier is not satisfied with bill and keep, that carrier has an option to pursue monetary compensation.

**Consideration #2. Determination of Traffic Balance**

A balance of traffic threshold is a good way to ensure that a carrier's desire for compensation is justified by actual network operating conditions. A carrier that is unwilling to accept bill-and-keep should be required to prove an imbalance of traffic overall exists within its network. Even if such imbalance exists, then the carrier must be required to prove an imbalance of traffic exists with respect to an individual carrier.

Incremental variations in traffic should not drive public policy<sup>1</sup>. In most cases, those carriers that have unique and sustainable businesses (*i.e.*, non-arbitrage based) that

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<sup>1</sup> *The reality is that most carriers operate with a reasonably balanced traffic exchange profile in the aggregate. Although there may be variations in individual bilateral traffic exchange relationships, incrementalizing traffic at that level is not something that efficient traffic markets will do (e.g., internet peering).*

experience an imbalance of traffic can address their traffic exchange needs through negotiations rather than additional rule-making. Implementing a balance of traffic threshold prior to a carrier seeking monetary compensation will significantly reduce the amount of uneconomic compensation disputes that occur under today's irrational traffic classifications.

**Consideration #3. Application of Default Rates**

In the event a carrier demonstrates an imbalance of traffic, a default compensation rate should be available to streamline the establishment of compensation relationships. The proposed \$.0007 per minute of use target default rate is in the range of forward looking transport and termination costs attainable by carriers today, and is based on the default rate set by the FCC for Internet-bound reciprocal compensation. This default rate would provide sufficient compensation for most parties to resolve compensation matters while providing sufficient incentive for (or, at least, not retard) carriers to move to efficient network configurations. In the event that a carrier has proven an imbalance of traffic and is not satisfied with the default compensation rate, a carrier has an option to trigger existing rules to develop a carrier specific compensation rate.

**Consideration #4. Negotiations**

Existing rules for interconnection and reciprocal compensation negotiations work effectively. The intercarrier compensation regime should continue to rely on bi-lateral negotiations between carriers to resolve traffic exchange and compensation issues.

**Consideration #5. Arbitration**

Existing arbitration rules pursuant to Section 251/252 should be maintained, including recognition of the delegated authority for states to act as the arbitrator under these rules.

**Consideration #6. Establishment of Rates Based Upon Forward--Looking Costs**

The FCC should clarify additional standards relative to the derivation of forward looking "additional cost" standard in the Act. Establishment of clear and simple standards would reduce the contention over the appropriate forward looking methodology to be applied.

Two simple rules, consistent with sound economic policy, would go a long way to simplifying arbitration cost proceedings:

- Eliminate 'end office termination' costs as a component of forward looking cost analysis. The FCC and several states<sup>2</sup> have already performed this analysis and have come to the same conclusion: end office switching costs (or their equivalent) are not usage sensitive. Of course, loop costs (or their equivalent) would continue to be excluded.
- Define how transport investment and operating costs are to be allocated in a multi-service environment. In an environment where network transport costs are driven by bandwidth requirements for the combination of voice, data, and video (some of which is switched, much of which is not), the allocation of transport costs to specific traffic types is increasingly difficult. In fact, the rendering of these infrastructure investments and operating costs to develop a per minute

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<sup>2</sup> *Illinois Commerce Commission On Its Own Motion -vs- Illinois Bell Telephone Company, Investigation into Tariff Providing Unbundled Local Switching with Shared Transport Case 00-0700, July 10, 2002, pages 4-6; In the Matter of In the Matter of Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration (CC Docket No. 00-218) In the Matter of Petition of AT&T Communications of Virginia Inc., Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia Corporation Commission Regarding Interconnection Disputes With Verizon Virginia Inc. CC Docket No. 00-218 (CC Docket No. 00-251), Memorandum Opinion and Order, August 28, 2003. (FCC's Virginia Arbitration Order) FCC's Virginia Arbitration Order, ¶ 458-459 and ¶ 463-465; In the Matter of the Determination of the Cost of the Unbundled Loop of Qwest Corporation Public Service Commission of Utah, Docket No. 01 049 85, Report and Order, May 5, 2003, pages 16-18.*

charge for the termination of a traditional circuit switched voice call is an exercise in creative accounting. Clear cost allocation rules should be established for interoffice transport in a multi-service environment.

#### **Consideration #7. Most Favored Nation Treatment**

In the event a non-default compensation rate arrangement is made between two carriers, non-discriminatory provisions should apply and any resulting agreement should be filed and offered for others to opt-in pursuant to Section 252(i).

Independent Wireless Carriers believe that, at a fixed future point in time, bill and keep become the sole default system of intercarrier compensation. All rules related to 'access' pricing and 'reciprocal compensation' would then sunset. Carriers, however, would be permitted to voluntarily enter into business arrangements that provided alternate compensation.

### **V. NETWORK ROUTING RESPONSIBILITIES**

Intercarrier compensation reform must also include a clear definition of default network routing requirements. In many cases, network routing has as much an economic and competitive impact as monetary arrangements. Establishing demarcation points for the exchange of traffic between networks should take into consideration a wide range of technical feasibility points, the validity of efficient indirect traffic exchange, and efficient defaults when relatively small traffic volumes are exchanged between two carriers.

#### **A. Principles for Network Routing Responsibility**

This plan is based on the following key legal and operating principles:

- service providers have the statutory right to interconnect directly or indirectly with other telecommunication carrier networks;
- common/Shared transport is more efficient for all carriers when traffic volumes are low;

- Intermediate or 'transit' carriers serve a valuable role in the efficient exchange of traffic; and
- originating carrier and transit carrier must maintain the integrity of call record information to allow terminating carrier to properly record the traffic.

## **B. Default Traffic Exchange**

The originating carrier is technically and financially responsible for delivering traffic to the terminating carrier within a defined geographic area. Because there is no universal optimal geographic area for all carriers, the LATA is the most suitable geographic scope to apply as a limit to originating carrier obligation to deliver to a terminating carrier at this time. Any other geographic scope will result in expensive network reconfigurations for some carriers which will likely never result in improved efficiency for that will be realized by consumers. Unless there is mutual agreement between originating and terminating carriers to establish alternative traffic exchange (*e.g.*, direct connections), the LATA tandem should be designated as the default point of interconnection for all carriers.

A non-negotiated bi-lateral default traffic exchange relationship should be limited to one network edge per LATA. Establishment of a designated LATA tandem as the default point of interconnection eliminates issues of inefficiently sized networks and provides for consistent network edge delivery obligations for all carriers. The advantages of this approach are significant:

- defines default traffic exchange by region, not by carrier type;
- immediately resolves traffic pick-up and delivery responsibility (serving as comfort for many carriers and motivating others to seek an alternative negotiated solution with one or more specific carriers);
- reduces costs for carriers operating in rural areas or with small carriers (including new market entrants) where traffic volumes are low since it uses efficient shared facilities for traffic exchange;

- facilitates entry into a new market through the establishment of a single point of interconnection (POI) in a service area;
- maintains use of shared transport facilities which are widely used by carriers today as an efficient traffic aggregation method;
- avoids potentially massive obligations on carriers to contract or pay for extensive new dedicated facilities;
- reduces the need for policing action relative to network edge issues, the burden of determining what network and what legal entity should be obligated to establish a POI is an unnecessary regulatory and operational burden; and
- drives carriers to establish alternative direct and indirect traffic exchange relationships as those alternatives become economically efficient.

Economically efficient carriers that exchange high volumes of traffic have already established some form of direct or hybrid traffic exchange relationship. A default traffic exchange relationship is intended to deal only with the myriad of small volume traffic relationships which do not warrant the establishment of direct interconnections.

The recognition of tandem efficiencies for exchanging relatively small traffic volumes has long been recognized. Rural LECs have depended on tandem switching for efficient aggregation and distribution of traffic. Only revenue arbitrage, due to current carrier compensation rules, has motivated some LECs to establish less efficient routing. Other LECs have chosen to replace RBOC provided tandem solutions with their own consortium networks<sup>3</sup>. In fact, these consortium networks include many single exchange telcos where it would be highly inefficient to exchange traffic directly with such telcos if direct "edge" connections were required.

Policing what constitutes a network edge is not an effective use of regulator or industry resources. Carriers today have multiple affiliations operating in multiple telecom domains. Carriers may have LEC, wireless, CLEC, ISP, and IXC networks

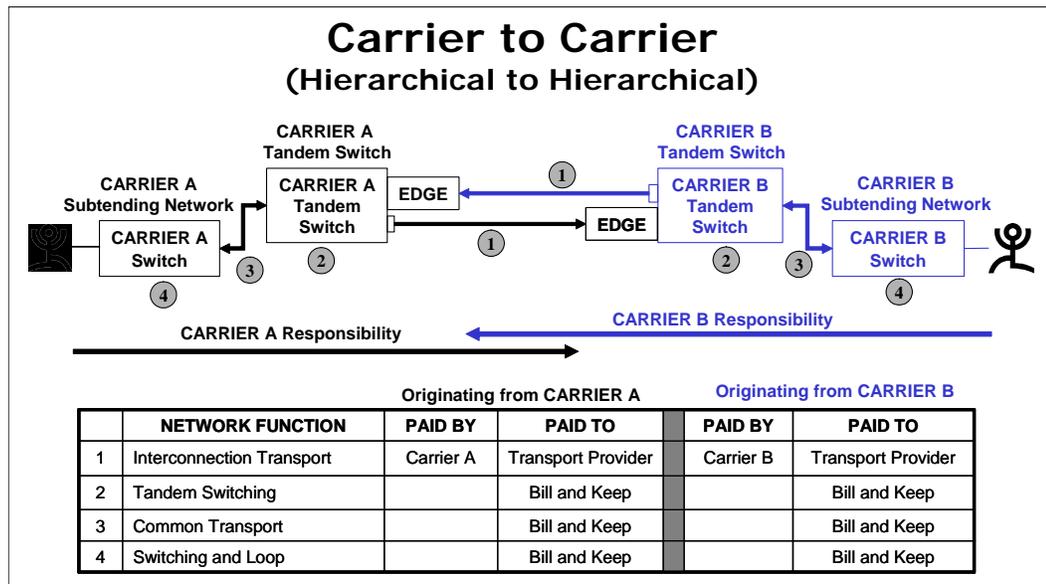
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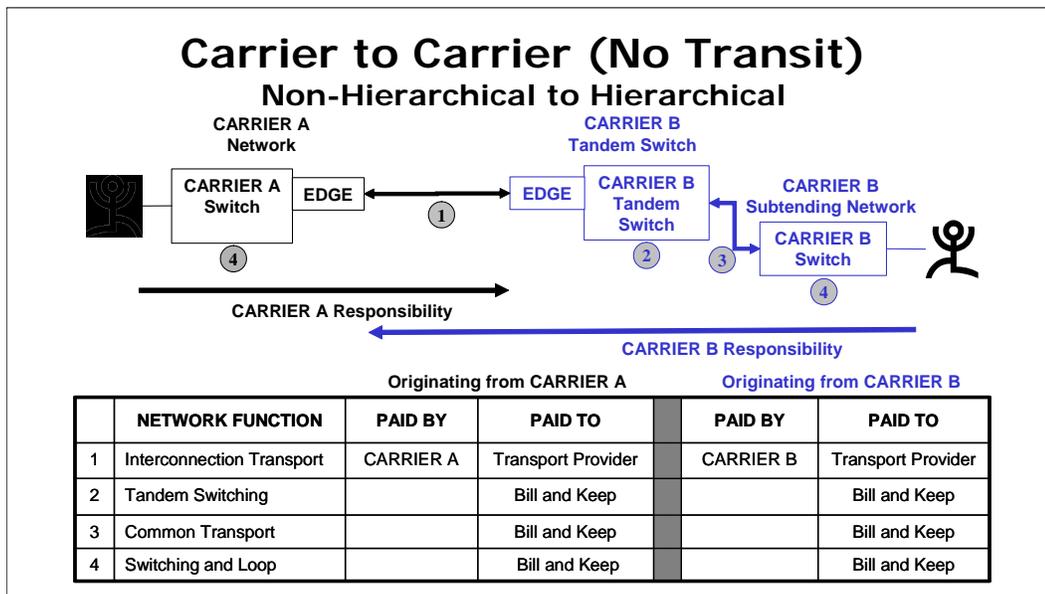
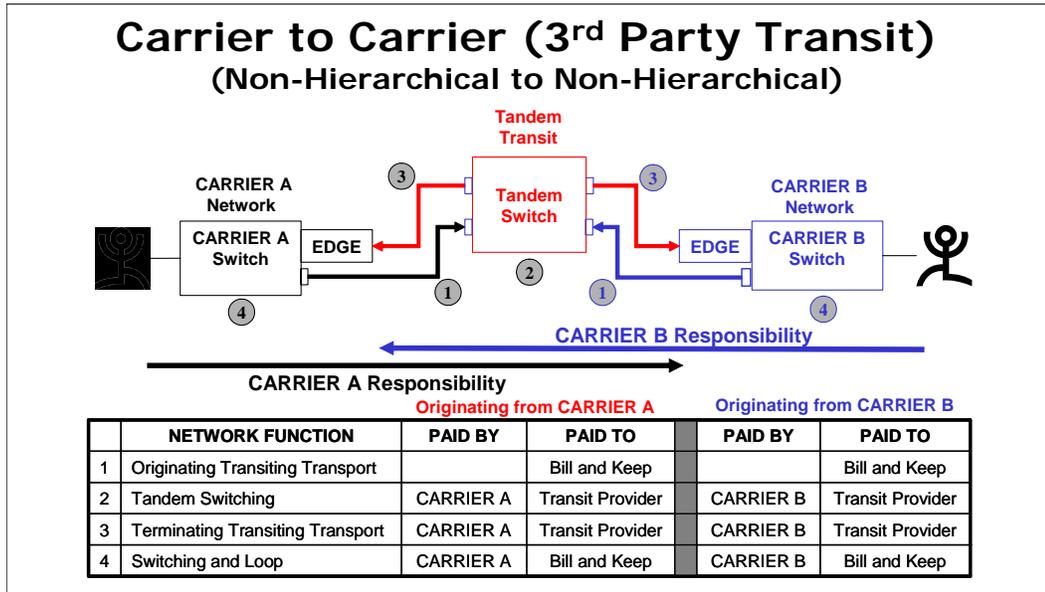
<sup>3</sup> See [www.indatel.org](http://www.indatel.org). This trade association represents many ILEC based consortiums that operate many state and regional transport and tandem switching networks. The site provides links to many of its members' consortium websites which provide more detailed descriptions of this extended capability.

overlayed and integrated in the same market area. Other carriers have affiliated legal entities that may operate using a common network. Developing rules to deal with the legal affiliate parameters is unproductive and would be subject to arbitrage as soon as they were written. All this can be avoided by identifying a default edge and letting carriers negotiate economically efficient alternatives if they desire.

**C. Originating and Terminating Carrier Responsibility**

The following diagrams depict the three typical routing scenarios that occur in telecom networks. Although the three scenarios employ different combinations of network equipment resulting in so-called 'hierarchical' and 'non-hierarchical' network topologies, these are shown for reference only. The compensation rules (*i.e.*, originating carrier is responsible for delivering traffic to terminating carriers network edge) remain the same for each scenario.





#### D. Transit Carrier Oversight

One element of intercarrier traffic exchange that will require continued monitoring is the provision of LATA transit tandem services. Residual market power and inherent economic efficiencies have limited the development of competitive transit

networks in most markets. Since these LATA transit services are of critical importance in linking carriers in an economically efficient manner, their availability at reasonable cost must be ensured for the foreseeable future. Transit service must be a required offering by existing ILEC designated LATA access tandem operators at reasonable rates. A transit provider, however, would be able to require an originating carrier to establish alternate *i.e.*, non-default) routing arrangements when traffic between two switching points exceeds a reasonable threshold for a reasonable period of time.

#### **E. Default Cost Sharing For SS7**

Where feasible, traffic exchange should be accomplished using CCS/SS7 protocol and the appropriate ISUP/TCAP message to facilitate full interoperability and billing functions. There should not be any rate or charge for the exchange of SS7 signaling data. In the circumstance where two carriers agree to directly connect SS7 networks, each carrier should assume the responsibility for provisioning one half of the required SS7 network link infrastructure and, once operational, neither party should bill the other for SS7 transport, facilities, or messages.

### **VI. TRANSITION PLAN**

#### **A. Intercarrier Compensation Transition**

The transition to a reformed compensation environment should be conducted with a sense of urgency that acknowledges that reform is overdue and prolonged continuation of the status quo negatively impacts The telecommunication industry. The transition should be accomplished as soon as possible, but consistent with the need for operational and financial adjustments by carriers.

In particular, transition to bill-and-keep should proceed as follows:

- Over a 4 year period, the maximum level of per-minute intercarrier compensation rates subject to interconnection agreements declines to zero (bill-and-keep).
- In Year 1, the maximum intercarrier compensation rate for each ILEC is that at which the ILEC would receive 80% of the interstate + intrastate carrier access revenues it received in Year 0; in Year 2, 60%; in Year 3, 40%; in Year 4, 20%, and beginning after the end of the four-year transition, zero.
- For the smallest rural ILECs (those with fewer than 30,000 lines in a state and fewer than 100,000 nationwide), these reductions would proceed on a slower time frame (e.g., six years instead of four).
- Reductions would be targeted as follows:
  - ❖ Beginning in Year 1, no non-access charge rate may exceed \$0.0015 per minute.
  - ❖ Subject to the preceding bullet point, rate reductions would be targeted so that the highest per-minute rates (typically intrastate access) come down first until they are at parity with interstate access rate levels.
- ILECs would be allowed to increase their subscriber line charges (“SLCs”) over the four-year transition period, as proposed by the ICF for non-rural ILECs, except there would be no difference between the SLC caps for rural and non-rural ILECs.
  - ❖ Beginning in Year 1, ILECs’ marketing materials (including pricing) must not break out the SLC as a regulatorily mandated add-on charge; the SLC must be marketed as part of the basic price of service.
  - ❖ SLCs will be completely deregulated at the end of the four-year transition period for any ILEC that can prove to the satisfaction of the FCC that it is subject to competition – *i.e.*, at least one facilities-based carrier is available to 50% of customers in the area, and at least 25% of customers have chosen to take service from such competing facilities-based carrier(s). If the ILEC is receiving high-cost funds, then the competing facilities-based carrier must also have ETC status and be receiving high-cost funds.

Any negotiated agreement should take precedence over compensation reform and implementation of new standards should occur as a result of the invocation of standard

termination clauses available within existing agreements. For circumstances that, at the time of adoption of these rules, are not governed by an interconnection agreement, the new intercarrier compensation plan should be in effect.

## **B. Universal Service Transition**

Independent Wireless Carriers' plan provides for a three-year transition period from today's funding structure and funding levels to the new universal service funding mechanism. To ease the transition to a new universal service funding regime, existing funding mechanisms would be modified via a graduated five-step transition period, in accordance with the following plan:

- Replace all existing USF mechanisms with a unified high-cost universal service mechanism that would be fully portable to all designated ETCs operating in a geographic area, and that would calculate support for all eligible carriers based on the forward-looking economic costs of providing the supported universal service in an area using the least-cost technology.
  - ❖ If needed to facilitate intrastate rate rebalancing, additional portable funds could be disbursed in states that have statewide average forward-looking costs significantly greater than the national average (like today's High Cost Model-based support fund).
- At the end of a four-year transition period (six years for areas served by small rural ILECs), the overall size of the fund would be "right-sized," *i.e.*, targeted to be no greater than the size of today's high-cost support funds, and possibly smaller, as long as sufficient support is provided to the highest-cost areas. Individual carriers may receive more or less under the new rules than they received in the past.
- To ease the transition for rural ILECs and other ETCs in their service areas, the existing USF funds would be transitioned out, and the new funds would be transitioned in, in graduated "steps" over a four-year transition period.
  - ❖ This transition process would be extended to six years for the smallest rural ILECs (those with fewer than 30,000 lines in a state and fewer than 100,000 nationwide) and other ETCs in their service areas.

- ❖ In addition, in extraordinary circumstances, if an incumbent or competitive ETC can prove to the FCC that it faces extreme hardships and additional support is needed to avoid increasing end-user rates to “unaffordable” levels, additional “safety net” support should be available to all ETCs in the specified geographic area for a limited period of time.

### **C. Additional Regulation Reform**

Additional reform initiatives should be pursued including: considered for regulations impacting a carrier's ability to recover costs from their customers and a carrier's mandate to provide equal access to long distance services.

#### **1. Rate-of –Return Regulation**

Rate of return regulation should be abolished. Any plan that incents a carrier to maximize support by incurring or reporting more costs results in inefficiency and waste. Any region where rate of return regulation exists should be reviewed for incentive on how to encourage competitive effects to eliminate the need for rate of return regulation (e.g., implementation of reverse auctions for carrier of last resort). Local rates should reflect a competitive market, where each carrier is expected to be self reliant and where cross-subsidies are eliminated. Any other solution is unsustainable. There is universal recognition that local rates will increase for some LEC customers if LECs are to remain viable operators. Local retail rate regulation (or deregulation) should be left to state commissions with the assumption that retail rate flexibility will be granted to ILECs that face competition. State commissions will have to act quickly to ensure

regulated carriers under their purview are not disadvantaged by inaction. At the very least, ILECs should be allowed to increase their local rates to a national benchmark level. The aim is complete deregulation at the end of a transition period for any ILEC that can prove it is subject to effective competition (i.e., at least one facilities based carrier available to 50% of customers and at least 25% of customers have chosen to take competitive service) and, if ILEC is receiving USF high costs funds, then the competing facilities based carrier must also have ETC status and be receiving USF support. SLCs and any new rate increases as part of the basic price of local service should be incorporated into local rates and not be held out for interpretation as some form of regulation imposed fee or charge. Carriers should not be allowed to continue to obfuscate the truth about local rates.

## **VII. USF REFORM**

### **A. Universal Service Reform Must Be Guided by Pro-Competitive Principles**

Like all other aspects of intercarrier compensation reform, universal service reform must be guided by pro-competitive, pro-consumer public policy principles – not by mere expediency or by a desire to achieve an elusive “consensus” by accommodating various special interests. In particular, high-cost universal service reform must be targeted to achieve the following goals: (1) advancement of the interest of rural consumers, not the interests of particular groups of carriers; (2) competitive and technological neutrality; and

(3) targeting support so as to impose reasonable controls over the future growth of the universal service fund.

First, the Commission must keep in mind that “[t]he purpose of universal service is to benefit the customer, not the carrier.”<sup>4</sup> Thus, support mechanisms must be designed and targeted to ensure that consumers throughout the country have access to affordable and comparable services – not to ensure that carriers achieve their earnings targets. The purpose of funding is *not* to guarantee carriers’ recovery of their embedded-cost-based revenue requirements – incumbent and competitive ETCs, like all other companies competing in a capitalist economy, should receive revenues *only* to the extent that they manage to persuade consumers to purchase their product.<sup>5</sup> By contrast, the current rural ILEC funding mechanisms, based on rate-of-return regulation (*i.e.*, revenue guarantees) – as well as intercarrier compensation plans that would guarantee “revenue neutrality” to ILECs, but not other carriers – interfere with those carriers’ incentives to meet consumers’ needs.<sup>6</sup>

Second, as both a legal matter and a public policy matter, universal service programs must be competitively and technologically neutral. In turn, competitive and technological neutrality requires that all funding be disbursed on an explicit and fully

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<sup>4</sup> *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 621 (5th Cir. 2000) (“*Alenco*”); see also *Federal-State Joint Board on Universal Service, Recommended Decision*, CC Docket No. 96-45, 19 FCC Rcd 4257, ¶ 57 & n.146 (Fed.-State Joint Bd. 2004) (“*Primary Line/ETC Designation RD*”).

<sup>5</sup> *Policymakers must avoid “confus[ing] the requirement of sufficient support for universal service within a market in which telephone service providers compete for customers, which federal law mandates, with a guarantee of economic success for all providers [or for a selected subset of preferred providers], a guarantee that conflicts with competition.” Alenco*, 201 F.3d at 625.

<sup>6</sup> See *Elimination of Rate of Return Regulation of Incumbent Local Exchange Carriers, Western Wireless Petition for Rulemaking*, RM-10822 & CC Docket No. 96-45 (filed Oct. 30, 2003) (“*WW ROR Petition*”) at 20-24; *Economics & Technology, Inc., “Lost in Translation: How Rate of Return Regulation Transformed the Universal Service Fund for Consumers into Corporate Welfare for the RLECs,” Appendix A to Western Wireless Reply Comments*, RM-10822 & CC Docket No. 96-45 (filed Feb. 13, 2004) (“*Lost in Translation*”).

portable basis – *i.e.*, all remaining implicit subsidies must be eliminated, and the explicit fund must disburse an identical amount of support per-line or per-consumer connection to all carriers operating in a given geographic area, regardless of what technology they use and whether they are incumbents or competitive entrants. Funding portability is not optional; it is mandated by the Act's requirement that all markets be opened to competitive entry and other specific provisions of the Act,<sup>7</sup> as well as by the long-standing Commission recognition that a regulatory system that grants ILECs significantly more per-line support than CETCs would constitute an unlawful barrier to entry.<sup>8</sup> “[I]t is difficult to see how [a non-portable funding mechanism] could be considered competitively neutral” because “a mechanism that offers non-portable support may give ILECs a substantial unfair price advantage in competing for customers.”<sup>9</sup>

Moreover, as the Joint Board recently recognized, “universal service payments should not distort the development of nascent competitive markets. Universal service support should neither incent nor discourage competitive entry.”<sup>10</sup> A universal service system that, to the extent possible, avoids interfering with competitive market dynamics

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<sup>7</sup> “[P]ortability is not only consistent with [the statutory requirement of] predictability, but also is dictated by the principles of competitive neutrality and . . . 47 U.S.C. § 254(e).” *Alenco Communications, Inc. v. FCC*, 201 F.3d at 622 (emphasis added). See also *id.* at 616 (“[T]he [universal service] program must treat all market participants equally – for example, subsidies must be portable – so that the market, and not local or federal government regulators, determines who shall compete for and deliver services to customers. Again, this [portability] principle is made necessary not only by the economic realities of competitive markets but also by statute.”) (emphasis added); *id.* at 622 (“What petitioners seek is not merely predictable funding mechanisms, but predictable market outcomes. Indeed, what they wish is protection from competition, the very antithesis of the Act.”).

<sup>8</sup> See *Western Wireless Corp. Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, 15 FCC Rcd 16227, 16231-32, ¶ 10 (2000) (“Kansas USF Declaratory Ruling”).

<sup>9</sup> *Id.* The Commission also has specifically considered and rejected arguments that portable support based on ILEC costs gives an unfair advantage to competitors. *Universal Service First Report and Order*, 12 FCC Rcd at 8933, ¶ 289.

<sup>10</sup> *Primary Line/ETC Designation RD*, ¶ 96.

tends to maximize economic efficiency.<sup>11</sup> Only a mechanism that disburses equal amounts of support per customer connection to all carriers can avoid interfering with competitive dynamics, as the Commission has held.<sup>12</sup> Explicit and portable support removes an artificial barrier to competition that was imposed by the pre-existing, monopoly-oriented universal service regime.

Finally, universal service support must be targeted so as to avoid excessive and unnecessary funding growth. With a universal service contribution percentage over 11 percent and growing, the Commission cannot afford to consider plans like the ICF plan that give, in essence, a “blank check” to continue guaranteeing rural ILECs’ investments without demanding any additional accountability. Instead of trying to maintain all current revenue flows, regardless of how inefficient and potentially excessive they may be, the Commission should take this opportunity to “right-size” the level of funding. In other words, the Commission should take a “bottom-up” approach and determine how much universal service support is needed to ensure adequate and affordable service for consumers in a competitive environment, rather than worrying overmuch about impacts on particular categories of carriers due to the change from the status quo.

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<sup>11</sup> See David E. M. Sappington, “Harnessing Competitive Forces to Foster Economical Universal Service,” attached to GCI Comments, CC Docket No. 96-45 (May 5, 2003); Kansas USF Declaratory Ruling, 15 FCC Rcd at 16231, ¶ 8.

<sup>12</sup> Kansas USF Declaratory Ruling, 15 FCC Rcd at 16231, ¶ 8. *If one carrier experiences lower costs per line and therefore receives less support per line than a competing carrier, then the system effectively would penalize the more efficient carrier – and would give all carriers incentives to operate as inefficiently as possible so as to maximize their costs and their support payments. By contrast, if all eligible carriers in an area receive the same amounts of per-line support (or no support), then each competitor would have natural marketplace incentives to operate as efficiently as possible, and the carrier that is most successful in doing so would be able to exploit the benefits of its efficiency by offering higher-quality services and new technologies, cutting prices for consumers, earning greater margins, or some combination of these benefits. This, of course, is the competitive marketplace’s mechanism to give service providers incentives to deliver the highest value to consumers at the lowest price.*