

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

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

**REPLY COMMENTS OF
THE UNITED STATES TELECOM ASSOCIATION
ON THE
FURTHER NOTICE OF PROPOSED RULEMAKING**

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Summary of Comments

The comments filed in this proceeding with the Federal Communications Commission in response to the Further Notice of Proposed Rulemaking (*FNPRM*) show nearly universal agreement that reform is urgently needed for the current intercarrier compensation regimes, under which traffic is treated differently depending on the identities of the carriers, the jurisdiction of the call, and the underlying technology of the network on which the call originated. The comments also show a great deal of agreement on most of the fundamental principles and the core elements of the rules the Commission should adopt to reform intercarrier compensation. Although there remain areas of significant disagreement, the comments and plans submitted in the docket show even greater agreement than before. Accordingly, the United States Telecom Association (USTelecom) asks the Commission to move intercarrier compensation from the complicated, regulation-driven markets of today to the competitive, consumer-driven markets of the future.

In these Reply Comments, USTelecom shows: (1) there is agreement on the need for reform and the framework for the appropriate solution; (2) the Commission clearly has the authority to preempt inconsistent state regulation of intercarrier compensation; (3) intercarrier compensation reform must not itself harm network owners; and (4) telecommunications providers must follow intercarrier compensation rules without requiring local network owners to bear burdensome enforcement costs.

1. The 3000 pages of comments filed in response to the *FNPRM* show great support for intercarrier compensation reform, both in substance and volume. There is agreement that arbitrage and competitive distortions produced by the current intercarrier compensation regimes' disparate treatment of traffic are causing inefficiency and harming the public interest. Network

owners are seeing increasing threats to their opportunity to recoup their investments as traffic is routed to avoid lawful charges established for cost recovery. The unpredictability and risk associated with arbitrage and competitive distortion, therefore, are harming network investment and innovation. In addition, as rural networks are even more dependent on intercarrier compensation than are networks in more densely-populated areas, the current problems are threatening universal service. Finally, this government-managed competition is thwarting the development of truly competitive markets.

Time is of the essence because the transition to a sustainable intercarrier compensation regime is growing more difficult. As more traffic is routed, or technologies are selected, based on arbitrage opportunities, it becomes more difficult to remove those arbitrage opportunities. Moreover, the inefficient incentives created by the problems with today's intercarrier compensation regimes are actually impacting the very evolution of competition and new technologies themselves. Accordingly, the Commission must adopt a sustainable legal framework for intercarrier compensation that is consistent for all competitors.

USTelecom has five core recommendations for the Commission, and these recommendations are supported by the weight of the comments filed in response to the FNPRM:

- A. The Commission Should Minimize Regulatory Arbitrage with a Default Intercarrier Rate Structure that Treats Traffic Uniformly.
- B. The Commission Must Integrate Universal Service Reform with Intercarrier Compensation Reform, Paying Particular Attention in Both Cases to the Unique Needs of Rural, Insular, and 2% Service Providers.
- C. The Commission Should Rely in the First Instance on Competition and Commercial Agreements Where Possible To Determine Market Outcomes.
- D. The Commission Should Ensure that the Restructuring of Intercarrier Compensation Should Not Itself Cause Additional Reductions in Net Revenue To Make Certain that LECs Are Compensated for the Use of Their Networks.
- E. The Commission Should Facilitate Indirect Interconnection by Ensuring that Transit Service Is Available for Voice Traffic.

2. There is substantial agreement that the Commission can and should ensure that intercarrier compensation policy is uniform across jurisdictions. In fact, a review of the legal arguments shows that the Commission plainly has the authority to preempt inconsistent state, regulation pursuant to the Inseverability and Mixed Use doctrines. Arguments to the contrary are unpersuasive, and many are just plain wrong or irrelevant. Finally, the voluntary approach proposed by the National Association of Regulatory Utility Commissioners is unworkable as it will establish a new form of regulatory arbitrage under which consumers will bear the costs of intercarrier reform without reaping many of the benefits.

3. Intercarrier compensation reform will not achieve its objectives unless network owners have a reasonable opportunity for full recovery of lost access revenue. For decades, the legal structure for telecommunications has been based on the Calling Party Network Pays (CPNP) model, which has necessarily involved net intercarrier compensation payments to higher-cost networks. Current network owners invested in their networks based in reliance on the CPNP legal structure. Fundamental fairness requires, therefore, that regulatory decisions reducing or eliminating net intercarrier compensation payments afford those network owners the opportunity to recover lost revenue opportunities through other means.

As USTelecom has pointed out before, not only would it be fundamentally unfair to deny reasonable revenue recovery opportunities to network owners, it would also run directly counter to the Commission's expressed goal of promoting broadband deployment. The very same companies that some parties appear to be targeting for revenue reductions are among the principal providers of broadband services in their communities, and the Commission's hopes for promoting broadband rest in significant measure on continued investment by these companies. Guaranteed revenue reductions resulting from regulatory actions in pursuit of intercarrier

compensation reform, however, necessarily will reduce the amount of capital available for these companies to invest in broadband.

Similarly, carriers' ability to recover lost access revenue will impact investor expectations and drive future investment. Importantly, should the Commission undertake intercarrier compensation reform without providing reasonable assurances that network owners can turn elsewhere to profit from their investments, it will damage access to capital for all telecommunications providers. Should it change the rules and fail to provide reasonable revenue recovery opportunities, the Commission would be sending a powerful message that investing in telecommunications networks is risky. Increasing regulatory risk in this manner clearly would increase the cost of capital for all telecommunications providers which, in turn, would necessarily reduce investment in, and deployment of, broadband facilities.

Other arguments against revenue recovery are specious. Access revenue, for many carriers, is a fundamental revenue source for building and maintaining networks that provide consumers with a growing number of services; to call it an entitlement is erroneous. Providing a reasonable opportunity for recovery of lost access revenue with support from a cost recovery mechanism is not subsidization of artificially low end user rates in high-cost areas. Finally, revenue recovery should not depend on verification of costs or audits of earnings.

Revenue recovery is not counterproductive to competitive neutrality or an efficient marketplace. Rather, providing a reasonable opportunity for revenue recovery will ensure the success of intercarrier compensation reform. A combination of revenue recovery sources – rate reform, an access restructure mechanism, universal service support, and where appropriate, intercarrier compensation payments – is the best method to accomplish intercarrier compensation reform. No source of revenue recovery should be based on alleged forward-looking costs, and

there is no need to make support from an ARM portable. Finally, neither moderate increases in end user rates nor contributions to fund an ARM will harm consumers.

4. Many USTelecom members have experienced increasing amounts of terminating traffic being delivered to them without adequate information from the originating carrier to permit them to identify either the carrier sending the traffic or the appropriate intercarrier charge. This traffic, often referred to as “phantom traffic,” results in significant revenue losses and enforcement expenses for those USTelecom members. The Commission should investigate these allegations to determine if any rules are being broken. Our telecommunications infrastructure is owned and operated by many carriers, and the system will not operate efficiently and serve the public interest unless market participants follow the rules of the market (including property, contract, and communications laws). Accordingly, the Commission should work to enforce its rules, keeping in mind the need to minimize enforcement and transaction costs. The phantom traffic problem should also be ameliorated by positive intercarrier compensation reform, as moving to a uniform default rate structure will reduce incentives for arbitrage and fraud.

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**REPLY COMMENTS OF THE UNITED STATES TELECOM ASSOCIATION
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The comments filed with the Federal Communications Commission (Commission) in response to the Further Notice of Proposed Rulemaking (FNPRM)¹ show nearly universal agreement that reform is urgently needed for the current intercarrier compensation regimes, under which traffic is treated differently depending on the identities of the carriers, the jurisdiction of the call, and the underlying technology of the network on which the call originated. The comments also show a great deal of agreement on most of the fundamental principles and the core elements of the rules the Commission should adopt to reform intercarrier compensation. Although there remain areas of significant disagreement, the comments and plans submitted in the docket show even greater agreement than before. Accordingly, the United States Telecom Association (USTelecom)² asks the Commission to move quickly to move intercarrier compensation from the complicated, regulation-driven markets of today to the competitive, consumer-driven markets of the future.

In these Reply Comments, USTelecom will show: (1) there is agreement on the need for reform and the framework for the appropriate solution; (2) the Commission clearly has the

¹ *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (March 3, 2005).

² The United States Telecom Association used the acronym USTA in its prior filings in this docket. In this and subsequent filings, the association will refer to itself as USTelecom.

authority to preempt inconsistent state regulation of intercarrier compensation; (3) intercarrier compensation reform must not itself harm network owners; and (4) telecommunications providers must follow intercarrier compensation rules without requiring local network owners to bear burdensome enforcement costs.

I. THERE IS AGREEMENT ON THE NEED FOR REFORM AND THE FRAMEWORK FOR THE APPROPRIATE SOLUTION

A. The Consensus Agrees with USTelecom's Fundamental Principles for Intercarrier Compensation Reform.

USTelecom set forth three fundamental principles for intercarrier compensation reform in its Comments on the FNPRM: (1) companies investing in and operating telecommunications networks need to have meaningful opportunities to be fully compensated for the value of their networks; (2) the ubiquitous reach of our nation's telecommunications infrastructure and the universal availability of high quality, affordable telecommunications services are great achievements that strongly contribute to the health of the American economy, so they must be preserved and advanced; and (3) market-based competition generally produces outcomes superior to those produced by regulatory fiat and, therefore, the Commission should endeavor to allow the competitive process to govern market outcomes wherever possible.³ There is broad support for these principles in the comments on the FNPRM.

Companies must be compensated for the value of their networks. There is no real dispute in the comments on the FNPRM about the need for networks. Like USTelecom, many parties

³ As USTelecom noted in its FNPRM Comments, markets may not always meet social goals, such as universal service, consumer safeguards, disabilities access, and public safety objectives. Comments of the United States Telecom Association on the Further Notice of Proposed Rulemaking, at 3 n.2, *Developing a Unified Intercarrier Compensation Regime*, CC Dkt. No. 01-92 (filed May 23, 2005)(USTA Comments on the FNPRM). Accordingly, the Commission may need to take limited ongoing actions to serve the public interest, even in otherwise deregulated markets.

support the creation of some form of access restructuring mechanism (ARM) to substitute for revenue lost from intercarrier compensation reform.⁴ Other parties support allowing providers to make up for lost revenue through increased end user charges.⁵

Some parties, however, disavow creating opportunities for recovery of lost revenue, or essentially recommend overall revenue reductions for incumbent LECs as a consequence of intercarrier compensation reform.⁶ Not only would this be bad policy, it would also be arbitrary and capricious. For decades, the legal structure for telecommunications has been based on the Calling Party Network Pays (CPNP) model, which has necessarily involved net intercarrier compensation payments to higher-cost networks. Current network owners invested in their networks in reliance on the CPNP legal structure. Fundamental fairness requires, therefore, that regulatory decisions reducing or eliminating net intercarrier compensation payments afford those network owners the opportunity to recover lost revenue opportunities through other means.

⁴ *E.g.*, Cincinnati Bell FNPRM Comments, at 11; Coalition for Capacity-Based Pricing FNPRM Comments, at 20-22; CompTel/ALTS FNPRM Comments, at 7 (implicitly); Frontier Communications FNPRM Comments, at 10-15; Intercarrier Compensation Forum (ICF) FNPRM Comments, at 32-33; National Telecommunications Cooperative Association FNPRM Comments, at 26; Rural Alliance FNPRM Comments, at 73 (implicitly); TDS Telecommunications FNPRM Comments, at 25-28; Verizon FNPRM Comments, at 25-29.

⁵ *E.g.*, BellSouth FNPRM Comments, at 29; CenturyTel FNPRM Comments, at iv; ICF FNPRM Comments (ICF proposal contains SLC increases); National Association of Regulatory Utility Commissioners (NARUC) FNPRM Comments (NARUC's proposal contains SLC increases); National Cable Telecommunications Association (NCTA) FNPRM Comments, at 9-11 (but see opposition to making carriers whole); NEXTEL FNPRM Comments, at 24-25 (but see opposition to making carriers whole); T-Mobile FNPRM Comments, at 26-30; Time Warner Telecom/Conversent/Cbeyond/Lightship FNPRM Comments, at 36; XO FNPRM Comments, at 16-20 (but see opposition to making whole).

⁶ *E.g.*, Ad Hoc Telecommunications Users Committee FNPRM Comments at 10-17; Cox FNPRM Comments, at 11-14, CTIA FNPRM Comments, at 31-34; NCTA FNPRM Comments, at 9-12; NEXTEL FNPRM Comments, at 19-29; Ohio PUC FNPRM Comments, at 21-22; PacWest/US LEC FNPRM Comments, at 49-51; XO FNPRM Comments, at 16-20.

As USTelecom has pointed out before,⁷ not only would it be fundamentally unfair to deny reasonable revenue recovery opportunities to network owners, it would also run directly counter to the Commission's expressed goal of promoting broadband deployment. The very same companies that some parties appear to be targeting for revenue reductions are among the principal providers of broadband services in their communities, and the Commission's hopes for promoting broadband rest in significant measure on continued investment by these companies. Guaranteed revenue reductions resulting from regulatory actions in pursuit of intercarrier compensation reform, however, necessarily will reduce the amount of capital available for these companies to invest in broadband. Importantly, should the Commission undertake intercarrier compensation reform without providing reasonable assurances that network owners can turn elsewhere to profit from their investments, it will damage access to capital for *all* telecommunications providers. By changing the rules and failing to provide reasonable revenue recovery opportunities, the Commission would be sending a powerful message that investing in telecommunications networks is risky. Increasing regulatory risk in this manner clearly would increase the cost of capital for all telecommunications providers which, in turn, would have to reduce investment in, and deployment of, broadband facilities.

Accordingly, as USTelecom stated in its Comments on the FNPRM,⁸ the Commission's decisions in this proceeding will affect more than just those companies that have made substantial investments in the past. These decisions also will have a powerful impact on future investment as the outcome will affect investor expectations for the foreseeable future. In sum, the Commission must recognize the value of companies' networks and work to ensure reasonable opportunities to realize competitive returns on those investments.

⁷ USTA Comments on FNPRM, at 17-18.

⁸ USTA Comments on FNPRM, at 3.

Universal service is a great achievement that must be preserved. There is very little in the record disagreeing with the importance of universal service. While some parties may argue that customers can be protected without universal service support for high-cost networks,⁹ their arguments are unpersuasive and largely unsupported by evidence or other comments. Wireline networks are the heart of telecommunications, and they will remain so for the foreseeable future. Even the rapidly growing wireless and Internet Protocol (IP)-enabled networks require substantial physical infrastructure just like traditional telecommunications networks. If the wireline networks in high-cost areas are not adequately supported, all providers will be affected and customers in high-cost areas will suffer reduced service quality.

As USTelecom explained in its Comments on the FNPRM,¹⁰ universal service support makes up the difference between end-user and intercarrier revenues on the one hand, and network and operational costs on the other hand. Therefore, reductions in intercarrier revenues are likely to impact universal service needs. Accordingly, the Commission should ensure that universal service mechanisms are adequate and sustainable during and after the intercarrier compensation reform process. Similarly, it is imperative that the Commission reform the current contribution methodology to make it sustainable going forward.

Market-based competition generally produces outcomes superior to those produced by regulatory fiat. There is nearly uniform support among comments addressing the issue for the idea that the Commission should create an environment in which commercial transactions between private parties can thrive.¹¹ In this regard, the record supports making competitive

⁹ See, e.g., sec. III.B.2, *infra*.

¹⁰ USTA Comments on FNPRM, at 4.

¹¹ E.g., Comporium FNPRM Comments, at 14-15; ICF FNPRM Comments, at 29-31; NARUC FNPRM Comments, at 2; NYPSA FNPRM Comments, at 5; SBC FNPRM Comments, at 9;

processes and commercial negotiation the preferred outcome where possible, with government mandates and regulation serving as facilitating mechanisms. Not only is this the best available approach for promoting efficiency and universal service, it is also the one most consistent with the Telecommunications Act of 1996.

B. Reform Is Needed Now.

The 3000 pages of comments filed in response to the FNPRM show great support for intercarrier compensation reform both in substance and volume.¹² There is widespread agreement that arbitrage and competitive distortions produced by the current intercarrier compensation regimes' disparate treatment of traffic are causing inefficiency and harming the public interest.¹³ Network owners are seeing increasing threats to their opportunity to recoup their investments as traffic is routed to avoid lawful charges established for cost recovery. The unpredictability and risk associated with arbitrage and competitive distortion, therefore, are harming network investment and innovation. In addition, as rural networks are even more

Verizon FNPRM Comments, at 6-32. *But see*, Ad Hoc Telecommunications Users FNPRM Comments, at 8.

¹² Indeed, there is very little for the proposition that intercarrier compensation reform is unnecessary. *But see*, Cincinnati Bell FNPRM Comments, at 4 (stating that little change may be needed if all users are required to pay according to the current rules); SureWest FNPRM Comments, at 3-5.

¹³ *E.g.*, Ad Hoc Telecommunications Users FNPRM Comments, at 3-7; BellSouth FNPRM Comments, at 2-5; CenturyTel Comments, at 4-9; Coalition for Capacity-Based Pricing FNPRM Comments, at 5-7; Comporium FNPRM Comments; CompTel/ALTS FNPRM Comments, at 4-5; CTIA FNPRM Comments, at 7-10; ICF FNPRM Comments, at 10-20; Ionary Consulting FNPRM Comments, at 6-8; KMC/Xspedius FNPRM Comments, at 22-24; MetroPCS Communications FNPRM Comments, at 3-9; Minnesota Independent Coalition FNPRM Comments, at 23-25; NTCA FNPRM Comments, at 2; Qwest FNPRM Comments, at 2-3; Sprint FNPRM Comments, at 2-12; SureWest FNPRM Comments, at 3-9; T-Mobile FNPRM Comments, at 10-12; Time Warner Telecom FNPRM Comments, at 6-8; Verizon Wireless FNPRM Comments, at 8-12; Western Wireless FNPRM Comments; WilTel FNPRM Comments, at 10-12; XO FNPRM Comments, at 4-7. *But see*, Alexicon Telecommunications Consulting FNPRM Comments (arguing that the problem is one of "phantom traffic"); TELETRUTH FNPRM Comments (arguing that intercarrier compensation reform is a "truth-in-advertising, data quality act violation)."

dependent on intercarrier compensation than are networks in more densely-populated areas, the current problems are threatening universal service. Finally, this government-managed competition is thwarting the development of truly competitive markets.

Time is of the essence because the transition to a sustainable intercarrier compensation regime is growing more difficult. As more traffic is routed, or technologies are selected, based on arbitrage opportunities, it becomes more difficult to remove those arbitrage opportunities. Moreover, the inefficient incentives created by the problems with today's intercarrier compensation regimes are actually impacting the very evolution of competition and new technologies themselves. Accordingly, the Commission must adopt a sustainable legal framework for intercarrier compensation that is consistent for all competitors.

C. The Record Supports USTelecom's Five Recommendations.

USTelecom made five specific recommendations in its Comments on the FNPRM, which can guide the Commission to reform intercarrier compensation successfully.¹⁴ Each of these recommendations has broad support from other parties and the logic of each recommendation is more persuasive than alternatives that have been advanced.

1. The Commission Should Minimize Regulatory Arbitrage with a Default Intercarrier Rate Structure that Treats Traffic Uniformly.

The Commission must remove the artificial incentives for regulatory arbitrage produced by disparate treatment of traffic with the same functionality, and it is clear from the record that the most effective and efficient solution is to remove arbitrary intercarrier compensation distinctions between jurisdictions, customers, or technologies when the same function is

¹⁴ USTA Comments on FNPRM, at 11.

performed in each case.¹⁵ Accordingly, the Commission should move quickly to minimize arbitrage by adopting a uniform rate structure for all telecommunications traffic regardless of the identity of the service provider, the jurisdiction of the call, or the underlying technology (e.g., wireless, wireline, cable, etc.) with which the call was made.

2. The Commission Must Integrate Universal Service Reform with Intercarrier Compensation Reform, Paying Particular Attention in Both Cases to the Unique Needs of Rural, Insular, and 2% Service Providers.

Nearly all parties addressing the issue agree that there is a strong link between intercarrier compensation and universal service, and that reform of both is necessary to alleviate current public policy problems and establish a sound framework for the future.¹⁶ Similarly, there is agreement that contributions to universal service must be fair and not distort competition. Finally, the unique needs of rural, insular, and 2% service providers are recognized repeatedly

¹⁵ *E.g.*, BellSouth FNPRM Comments (plan based on uniform rates); Coalition for Capacity-Based Pricing FNPRM Comments (plan based on uniform rates); CompTel/ALTS FNPRM Comments, at 4-5; CTIA FNPRM Comments (plan based on uniform rates); Frontier FNPRM Comments (plan based on uniform rates); ICF FNPRM Comments (plan based on uniform rates); KMC/Xspedius FNPRM Comments, at 2; MetroPCS FNPRM Comments, at 3-9; Minnesota Independent Coalition FNPRM Comments, at 12; NARUC FNPRM Comments (plan based on uniform rates); NCTA FNPRM Comments, at 8; Qwest FNPRM Comments (plan based on uniform rates); Rural Alliance FNPRM Comments (plan based on uniform rates); SBC FNPRM Comments, at 5-9; Sprint FNPRM Comments, at 12-16; T-Mobile FNPRM Comments, at 8-18; Verizon Wireless FNPRM Comments, at 8-12; Western Wireless FNPRM Comments (plan based on uniform rates). *But see* SureWest FNPRM Comments, at 4.

¹⁶ *E.g.*, CenturyTel FNPRM Comments, at 34-40; Colorado Telecom Association FNPRM Comments, at 34-38; CTIA FNPRM Comments, at 31-44; Frontier FNPRM Comments; ICF FNPRM Comments; John Stauraulakis Inc. FNPRM Comments, at 2-6; Minnesota Independent Coalition FNPRM Comments, at 39; NARUC FNPRM Comments; NASUCA FNPRM Comments; NTCA FNPRM Comments; Ohio PUC FNPRM Comments, at 22-24; Rural Alliance FNPRM Comments; South Dakota Telephone Association FNPRM Comments; T-Mobile FNPRM Comments; TCA FNPRM Comments, at 4-6; TDS Telecom FNPRM Comments; Texas Office of Public Utility Counsel FNPRM Comments; Wisconsin State Telecommunications Association FNPRM Comments; Western Wireless FNPRM Comments; Wyoming Independent Telecom Association FNPRM Comments. *But see* Ad Hoc Telecommunications Users FNPRM Comments, at 10-17; NEXTEL FNPRM Comments, at 25-29.

throughout the comments filed in response to the FNPRM;¹⁷ the Commission should follow this consensus to ensure that intercarrier compensation reform does not itself harm the universal service offered by these providers.

3. *The Commission Should Rely in the First Instance on Competition and Commercial Agreements Where Possible To Determine Market Outcomes*

The majority of parties filing comments agree with the Commission's conclusion in the *FNPRM* that reform of intercarrier compensation should promote efficient networks and foster facilities-based competition.¹⁸ There is also agreement that the Commission should rely on individual carrier commercial agreements to govern intercarrier compensation in the first instance, thereby allowing the marketplace to determine the appropriate value for traffic exchanges.¹⁹ The best policy is to allow providers the freedom to negotiate other arrangements where it makes sense as a commercial matter, not only to increase market efficiency but also to promote flexibility and innovation going forward.

Clear, predictable, and stable default rules will help accomplish a goal of relying on competition to determine market outcomes. Similarly, most parties support meaningful transition periods to will allow markets to evolve in anticipation of announced changes and better permit market competition to replace regulatory prescription to the greatest extent possible.

¹⁷ *E.g.*, Minnesota Independent Coalition FNPRM Comments, *passim*; NTCA FNPRM Comments, *passim*; SureWest FNPRM Comments, *passim*. In this regard, USTelecom emphasizes that any Access Restructure Mechanism funds should flow to current Eligible Telecommunications Carriers providing exchange access providers regard to their eligibility to receive support under current universal service mechanisms. All such ETC providers of access that are affected by intercarrier compensation reform must have a reasonable opportunity to recover revenue lost due to Commission action without regard to their classification.

¹⁸ *FNPRM* ¶ 31.

¹⁹ *See* note 11, *supra*.

4. *The Commission Should Ensure that the Restructuring of Intercarrier Compensation Should Not Itself Cause Additional Reductions in Net Revenue To Make Certain that LECs Are Compensated for the Use of Their Networks.*

USTelecom reiterates its assertion that it is critically important that providers have comparable revenue opportunities before and after intercarrier compensation reform regardless of the regulatory construct under which they operate. While a number of parties argue against revenue neutrality,²⁰ many of their arguments either invite arbitrary and capricious rules or defy logic altogether. The restructuring of intercarrier compensation should not itself cause additional reductions in net revenue as network owners need to be adequately compensated for the use of their networks. Broadband deployment, by both LECs and competitors, will suffer should the Commission fail to minimize regulatory risk and protect investment incentives. Similarly, consumers of traditional telecommunications services will also be harmed in the absence of reasonable opportunities to recover revenue impacted by regulatory reform, as it will become increasingly difficult to maintain carrier of last resort obligations.

The record also reflects agreement that telecommunications markets should not contain regulatory obstacles to flexible pricing and service innovation. For example, many parties support allowing pricing flexibility with respect to regulated end-user rates, such as the Subscriber Line Charge (SLC).²¹

²⁰ *E.g.*, Ad Hoc Telecommunications Users FNPRM Comments, at 10-17; CompTel/ALTS FNPRM Comments, at 7-8; Cox Communications FNPRM Comments, at 11-14; CTIA FNPRM Comments, at 31-34;

²¹ *E.g.*, BellSouth FNPRM Comments; CenturyTel FNPRM Comments; NEXTEL FNPRM Comments; Verizon FNPRM Comments.

5. *The Commission Should Facilitate Indirect Interconnection by Ensuring that Transit Service Is Available for Voice Traffic.*

Finally, many of the comments recognize the importance of transit service to the continued efficient operation of competitive telecommunications networks.²² As explained in USTelecom's Comments, association members currently provide transit service under tariff and on commercially-negotiated terms. As competitive markets evolve, more transit options will become available. In the meantime, the Commission needs to accommodate existing arrangements and facilitate and not impede new ones.

D. There Is Greater Agreement than Ever Before on the Salient Points; the Commission Can and Should Resolve the Remaining Disputes.

USTelecom stated in its Comments in response to the FNPRM that there appeared to be general agreement on seven major decisions, which together can make up the framework for intercarrier compensation reform. Several new plans have been filed, and many parties' comments have provided fuller explanations of how other plans would operate. Although there is some disagreement on each of the key decision points, a review of the comments filed in response to the FNPRM shows substantial agreement on most issues, as explained throughout these Reply Comments. Accordingly, the Commission can and should act now to reform intercarrier compensation by making the following decisions and using its authority and expertise to resolve remaining disputed issues:

- a. There should be a uniform rate structure that treats functionally-equivalent traffic the same without regard to jurisdiction, service, or technology;
- b. Reform may require modest, equitable increases in end-user rates;
- c. An Access Recovery Mechanism (ARM) should be created in addition to end user rate increases;

²² *E.g.*, BellSouth FNPRM Comments, at 32-38; Cincinnati Bell FNPRM Comments, at 15-17; Cox FNPRM Comments, at 14-22; CTIA FNPRM Comments; ICF FNPRM Comments (plan addresses transit service); Iowa Network Services FNPRM Comments; NCTA FNPRM Comments, at 12; NEXTEL FNPRM Comments, at 12-19.

- d. The Commission should preempt state commission jurisdiction over intrastate access charges to the extent necessary to unify the rules for intercarrier compensation;
- e. There should not be any sudden or dramatic changes in the transiting service and the network architecture of interconnection;
- f. The base for universal service contributions must be broadened; and
- g. There must be reasonable transitions that are tailored to the needs of different classes of industry participants.

II. THE COMMISSION CLEARLY HAS THE AUTHORITY TO PREEMPT INCONSISTENT STATE REGULATION OF INTERCARRIER COMPENSATION.

A. There is Substantial Agreement that the Commission Can and Should Ensure that Intercarrier Compensation Policy is Uniform Across Jurisdictions.

A broad spectrum of carriers and coalitions agrees on the need for a national intercarrier compensation policy. Without a national policy, disparate treatment of functionally equivalent access traffic between state and federal jurisdictions will continue, resulting in growing arbitrage and inefficiency. Separate interstate and intrastate regulation of intercarrier compensation, however, will prevent realization of a national intercarrier compensation policy as state regulation conflicts with a national policy of uniformity. Frontier, Comporium, Ionary Consulting, Minnesota Independent Coalition, BellSouth, Verizon, Qwest, Time Warner, Inc., and the Intercarrier Compensation Forum,²³ to name a few, argue accordingly for preemption of inconsistent state regulation. USTelecom agrees, and maintains that the goals of the 1996 Act – promoting competition and universal service and reducing regulation – require the same treatment for interstate and intrastate traffic. Simply put, when competition is distorted, enforcement costs are high, and investment shrinks.

²³ BellSouth FNPRM Comments at 42-49; Comporium FNPRM Comments at iv, 17; Frontier FNPRM Comments at 3-4; Intercarrier Compensation Forum FNPRM Comments at 38-42; Ionary Consulting FNPRM Comments at 16; Minnesota Independent Coalition FNPRM Comments at 13-14; Qwest FNPRM Comments at 25; Time Warner, Inc. FNPRM Comments at 7; Verizon FNPRM Comments at 35-38.

B. The Commission Plainly Has the Authority to Preempt Inconsistent State, Regulation Pursuant to the Inseverability and Mixed Use Doctrines.

USTelecom believes that just as the Fourth Circuit in *North Carolina Utils. Comm'n v. FCC*²⁴ held that state regulation of the use of terminal equipment was inconsistent with valid federal regulation and, therefore, could be preempted under the inseverability doctrine, state regulation of intercarrier compensation is inconsistent with a valid federal policy for uniform intercarrier compensation and, therefore, can be preempted under the doctrine.²⁵ The United States Supreme Court's decision in *Louisiana Pub. Serv. Comm'n v. FCC*²⁶ supports preemption in these circumstances because state regulation would conflict with federal regulation.

A related basis for preemption supported by USTelecom is the mixed-use doctrine.²⁷ Under this doctrine, when it becomes impossible to separate traffic jurisdictionally, intrastate jurisdiction is preempted just as intrastate regulation of mixed-use private lines has been preempted by the Commission.²⁸

C. The Arguments that the Commission Lacks Authority Are Unpersuasive, and Many Are Just Plain Wrong or Irrelevant.

The comments do not rebut the inseverability argument. Most do not mention it – possibly due to some confusion regarding the differences between the inseverability and mixed-use doctrines.²⁹ Some commenting in this proceeding mistakenly suggest that because the

²⁴ *North Carolina Utils. Comm'n v. FCC*, 552 F. 2d 1036 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977).

²⁵ USTA Comments on the FNPRM, at 26-29.

²⁶ *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986) (*Louisiana PSC*).

²⁷ USTA Comments on the FNPRM, at 30-31.

²⁸ *See MTS and Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72, 80-286, Decision and Order, 4 FCC Rcd 5660, n.7 (1989); *see also* USTelecom Comments at 30-31.

²⁹ *See* USTA Comments on the FNPRM, at n.49. The inseverability doctrine applies when it may be possible to separate tariff but there is a conflict between state and federal regulation,

Supreme Court in *Louisiana PSC* ultimately reversed preemption of state-established depreciation rates based on the specific facts of that case, the Court's holding does not support preemption of state intercarrier compensation regulation. The Rural Alliance, for example, generalizes the argument, writing "The Court considered and fully rejected the argument that the Commission should be able to preempt state authority in order to foster federal policy."³⁰

The Rural Alliance ignores the fact that the Court upheld the use of preemption, writing "where it is not possible to separate the interstate and intrastate components of the asserted FCC regulation" or where a state regulation would negate a federal regulation.³¹ As Qwest and others recognize, *Louisiana PSC* actually affirms the proposition that the Commission has solid conflict preemption authority over state rules that conflict with and impede the enforcement of valid federal rules within its jurisdiction even if the state's authority in the area is otherwise valid.³² Accordingly, the inseparability doctrine is alive and well, and the Commission should preempt state regulation of intercarrier compensation so as to facilitate competitive, deregulated telecommunications markets, just as it did to facilitate competition and innovation in markets for terminal equipment.

Those condemning the mixed-use doctrine futilely cling to outdated assumptions for support that the doctrine does not apply. For example, the Maine Public Utilities Commission and the Vermont Public Service Board state, "The record and history conclusively demonstrate that it is neither impossible nor impractical to separate the interstate and intrastate usage of

whereas the mixed-use doctrine applies when it is not practical to separate intrastate and interstate traffic.

³⁰ Rural Alliance FNPRM Comments at 143. See also NASUCA FNPRM Comments at 34, citing *Louisiana PSC* to bolster its argument that section 251(d)(3) preserves state authority over intrastate access charges.

³¹ *Louisiana PSC* at 375-76 n.4. See also USTelecom Comments at 26-27.

³² Qwest FNPRM Comments at 25. See also Verizon FNPRM Comments at 37-38; Minnesota Independent Coalition FNPRM Comments at 13-14; and BellSouth FNPRM Comments at 47.

interexchange and interconnection services.”³³ But history and past practices are becoming irrelevant with increasing amounts of voice traffic moving to interstate wireless and IP-enabled services on which it is impractical to separate traffic and, indeed, where the geographical end points of calls are largely irrelevant to customer experience.³⁴ Furthermore, the mixed characteristics of certain IP-enabled services – such as the inseparability of multiple features that can be accessed simultaneously and the irrelevance of geography to use of the service – make it increasingly difficult even to distinguish interstate and intrastate use.³⁵ Therefore, the mixed-use doctrine increasingly supports preemption of state regulation of intercarrier compensation that is in conflict with federal policy.

Broad statements about reversal and the need for authority in the 1996 Act on which to base preemption are just plain wrong. The Rural Alliance, for instance, states that the Commission historically has lost cases in which it attempted to exercise preemption.³⁶ As authority for this statement, it cites a case in which the Commission was prohibited from taking any action to assert statutory jurisdiction over intrastate revenues to support federal universal service without a finding that section 254 of the Act applied.³⁷ The case cited is irrelevant to the applicability of the inseparability doctrine to intercarrier compensation because it did not involve a general discussion of preemption but, rather, a specific discussion of universal service support. According to the Fifth Circuit, “The question [was] whether § 254 does indeed ‘apply’ to

³³ Maine Public Utilities Commission and Vermont Public Service Board Comments at 12. *See also* Rural Alliance Comments at 151.

³⁴ *See* USTA Comments on the FNPRM, at 28-29.

³⁵ *See* USTA Comments on the FNPRM, at 31.

³⁶ Rural Alliance FNPRM Comments at 142-143.

³⁷ *Id.*, citing *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 423-424 (5th Cir. 1999).

intrastate matters in a sufficiently ‘unambiguous’ manner.”³⁸ Moreover, it involved statutory jurisdiction rather than conflict preemption.

The Public Utilities Commission of Ohio argues that the Commission cannot preempt state authority in areas not granted exclusively to the FCC by the 1996 Act.³⁹ This ignores the fact that even though the 1996 Act left intact Section 2(b) of the Communications Act,⁴⁰ which reserves jurisdiction over intrastate services to the states, this has no effect on conflict preemption. As Verizon points out, “In *Louisiana Public Service Commission*, the Supreme Court did not interpret section 2(b) as an absolute bar on the preemption of state regulation of intrastate traffic.”⁴¹ When there is a conflict between state and federal law, federal law prevails under the inseverability doctrine. NASUCA’s argument that Section 251(d)(3) of the 1996 Act preserves state authority over intrastate access charges⁴² misses the fundamental point that conflict preemption under the inseverability doctrine applies even where Congress did not rule out independent (not delegated) state regulation entirely (when Congress precludes state regulation entirely, it is known as “field preemption”). In this case, although Congress did not entirely rule out the possibility of state regulation of intercarrier compensation, state regulation must now give way as it conflicts with a valid federal policy of reducing arbitrage and promoting competition and telecommunications network efficiency and innovation.

D. NARUC’s Voluntary Approach Is Unworkable.

NARUC proposes that states be permitted to elect whether or not to participate in a unified intercarrier compensation regime based on “genuine federalism.” Those states choosing

³⁸ *Texas Office of Public Utility Counsel* at 459.

³⁹ Ohio PUC FNPRM Comments at 3-4.

⁴⁰ 47 U.S.C. §152(b).

⁴¹ Verizon FNPRM Comments at 33.

⁴² NASUCA FNPRM Comments.

not to participate would not be under any obligation to modify the rates charged by their carriers, and states could choose to opt out of the unified intercarrier compensation plan at any time.⁴³

NARUC says that this plan is based on a traditional form of federalism similar to that used for highways, protection of natural resources, and education.

Just as the Articles of Confederation failed to support interstate commerce, necessitating our Constitution, voluntary unification of intercarrier compensation is destined to fail.

NARUC's "federalist" arguments for voluntary unified regulation of intercarrier compensation in a manner analogous to highways, natural resources, and education are not relevant to regulation of the telecommunications industry.

The highway example is appropriate here. As the Supreme Court has recognized, the power of states to regulate the use of highways is broad and pervasive, in large part due to local safety concerns, which are not present with intercarrier compensation. According to the Court, state regulation of highways is akin to "quarantine measures, game laws, and like local regulations of rivers, harbors, piers, and docks."⁴⁴ But what the Court has recognized as the "peculiarly local nature of safety" is not particularly relevant to intercarrier compensation in the current telecommunications context, where arbitrage and inefficiency are the principal issues.

Moreover, although states have the ability to regulate highway safety in many respects, state regulation must give way where it unduly interferes with interstate commerce. One of the leading Supreme Court cases on conflict preemption arose in connection with state highway safety regulation.⁴⁵ In *Bibb v. Navajo Freight Lines*, the State of Illinois required trucks and trailers to have rear wheels equipped with contoured mudguards of a specified type. Because

⁴³ NARUC Intercarrier Compensation Proposal at 14.

⁴⁴ See, e.g., *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 524-525 (1959).

⁴⁵ *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520.

most other states required that trailers be equipped with a different type of mudguard, this meant that trailers could be operated in Illinois and other states only by changing mudguards at the border, which was costly, time-consuming, and sometimes dangerous. The state highway safety measure was, therefore, found to violate the Commerce Clause because it infringed on the free flow of goods between states.

Although the conflict of laws situation for intercarrier compensation does not arise from inconsistent regulation among the states, but rather inconsistency with federal regulation within the state, this only bolsters the case for preemption. Under the Supremacy Clause,⁴⁶ federal regulation prevails whenever it conflicts with state regulation.⁴⁷ Accordingly, state regulation of intercarrier compensation should be preempted because it conflicts with federal policies for reducing arbitrage and enhancing competition and universal service, which require a uniform intercarrier compensation rate structure. In sum, state regulation must give way and not just where states find it in their interest to cooperate.

Whereas telecommunications is indisputably interstate commerce (as evidenced by the very fact that Congress could even choose to allocate some authority to the states in section 2(b)), education and natural resources have long been recognized to implicate distinctly local concerns. With education systems, the closer regulatory authorities are to the interests to be overseen or the activities to be regulated, the better. It is true that some federal policies are implanted through an “opt in” regulatory structure under which states may choose not to go along with federal policy. Not only is education outside the scope of the Commerce Clause, however, there is no compelling reason to aggregate regulatory management of education even if conflict preemption were applicable. The same lack of a compelling reason for conflict

⁴⁶ U.S. Const., art VI, cl.2.

⁴⁷ See, e.g., *City of New York v. FCC*, 486 U.S. 57 (1988).

preemption has been true to date for the management and conservation of natural resources. Conversely, there are compelling reasons to streamline and aggregate regulation of the disparate and disparately regulated telecommunications industry. If states are not required to participate in a uniform federal intercarrier compensation regime, some will not join the unified regime. Those who are net payors will join, while those who are net recipients will not. This will lead to increased arbitrage opportunities in direct opposition to valid Commission goals of reducing arbitrage, increasing competition, preserving universal service and reducing regulation. For this reason, states should not be permitted to dictate federal policy in violation of Commission precedent, the Communications Act, and decisions of the United States Supreme Court.

III. INTERCARRIER COMPENSATION REFORM MUST NOT ITSELF HARM NETWORK OWNERS

A. Reform Will Not Achieve Its Objectives Unless Network Owners Have a Reasonable Opportunity for Full Recovery of Lost Access Revenue.

Network owners, including incumbent local exchange carriers, provide the structural foundation for all communications services. The purpose of intercarrier compensation reform, or even a result of reform, must not be to harm the network or the providers of the network. Rather, the objectives of intercarrier compensation should be to reduce arbitrage and to ensure that network providers receive fair value for the use of their network. More specifically, reform should ensure that the revenue from carriers that are avoiding payment of access, or that are paying less than other carriers, through arbitrage methods will be captured and that the cost of using the network is more equitably distributed. These objectives will not be achieved without a plan for reform that provides network owners with a reasonable opportunity for full recovery of access revenue lost through the reform process. USTelecom noted in its Comments and it bears

repeating that the “Commission’s guiding principle when contemplating intercarrier compensation reform should be ‘do no harm.’”⁴⁸

1. The Immediate and Ongoing Viability of Many Carriers Depends on Recovery of Lost Access Revenue.

Over 100 years ago ILECs began building the networks that cross this country, over which the first basic telephone services were provided to consumers, and that now offer them diverse and advanced services. ILECs were initially able, and continue to be able, to build, maintain, upgrade, and expand these critical networks because they have been able to depend on a combination of end user revenue, universal service support, and intercarrier compensation. Without the ability to recover access revenue lost through reform, the viability of many ILECs will be put in jeopardy.

Commenters such as CompTel/ALTS and the Ad Hoc Telecommunications Users Committee disavow the need for any recovery of revenue lost through intercarrier compensation reform⁴⁹ This is simply wrong. The networks and services provided by carriers that serve high cost communities have important value to consumers that live in such areas and these carriers should have a reasonable opportunity to recover their costs. Their viability depends on it. The Commission should also be concerned about the current and ongoing viability of such carriers.

⁴⁸ USTA Comments on the FNPRM, at 36.

⁴⁹ See CompTel/ALTS Comments at 7 (the “Commission should not permit incumbent LECs to capture revenue beyond that necessary to address changes to the intercarrier compensation regime simply because the Commission’s new rules eliminate outdated implicit subsidies.”) see also Ad Hoc Comments at iv.

- a) Access revenue, for many carriers, is a fundamental revenue source for building and maintaining networks that provide consumers with a growing number of services; to call it an entitlement is erroneous.

As prefaced above, access revenue is a fundamental revenue source and without a reasonably opportunity to recover such revenue lost through intercarrier compensation reform, many carriers would simply be unable to build and maintain networks, much less remain in business as going concerns. Some commenters claim that the payment of access charges “has become an entitlement program, a form of welfare.”⁵⁰ Such claims are simply false and fail to acknowledge the business need and historical and ongoing purpose for access revenue.

The Commission knows well that ILECs are regulated with a much heavier hand than their competitors, whose pricing, service offerings, and service expansion are better able to be responsive to the market. ILECs, particularly those operating in high cost areas, operate under significant regulation that limits their ability to respond to competitive market forces. Because of the high-cost nature of the areas served by many ILECs, they have been forced to rely upon support beyond what they can charge end users. Support in the form of access and universal service has been necessary for these carriers to build, maintain, upgrade, and expand their networks and to offer new and advanced services to consumers who would otherwise not have had access to such networks and services. With this in mind, the Commission must proceed with reform cautiously; it should not adopt any reform plan that would purposely reduce ILEC revenue. There will always be erosion of revenue of both regulated and unregulated carriers by virtue of the market. However, when the revenue of regulated carriers is impacted by regulatory

⁵⁰ Corr Wireless Communications Comments at 6. *See also* New Jersey Division of the Ratepayer Advocate Comments at 10 (the Commission “should not assume, *a priori*, that carriers are entitled to some particular level of revenues.”)

reform, the reform plan itself should not result in a loss of revenue that is vital and based on an established regulatory need.

- b) Providing a reasonable opportunity for recovery of lost access revenue with support from a cost recovery mechanism is not subsidization of artificially low end user rates in high-cost areas.

USTelecom does not agree with CTIA that rural end user rates are significantly lower than urban rates,⁵¹ but has advocated that intercarrier compensation reform should encompass modest and equitable increases in end user rates in conjunction with support from an Access Restructure Mechanism implemented to replace revenue lost as a result of reform, continuing support from the Universal Service Fund, and where appropriate, some continuing form of intercarrier compensation payments.⁵² In addition, USTelecom disagrees with CTIA's argument that universal service support (or as advocated by USTelecom, an alternative access revenue restructure mechanism) should not be used to subsidize what CTIA inaccurately calls artificially low end user rates.⁵³ First, and as discussed more fully below, rural end user rates are not artificially low. Second, the Act dictates that consumers in rural and high cost areas "should have access to telecommunications and information services . . . that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."⁵⁴ Any intercarrier compensation reform plan that does not provide carriers with the opportunity to recover revenue lost through reform, whether through a combination of moderate increases in end user rates,

⁵¹ See CTIA FNPRM Comments at 39.

⁵² See USTA Comments on the FNPRM, at 38-39.

⁵³ See CTIA FNPRM Comments at 39.

⁵⁴ 47 U.S.C. §254(b)(3).

support from an ARM, support from universal service, and where appropriate, some continuing form of intercarrier compensation payments will cause the end user rates of consumers in rural and high cost areas to rise beyond the level of comparability with those in urban areas. The Commission must adhere to the requirements of the Act by ensuring that reform does not disadvantage consumers in rural and high cost areas.

- c) Revenue recovery should not depend on verification of costs or audits of earnings.

A number of commenters urge the Commission that any support for lost access revenue should be based on verified costs or audited earnings.⁵⁵ These proposals would essentially force carriers to conduct rate cases before the state regulatory agencies in every state where they operate. Not only is such a prospect unduly burdensome and time consuming, but it is wholly unnecessary. Regulated ILECs have already undergone rate cases to justify their revenue needs and set acceptable rates. In addition, requiring ILECs to go through this process once again for the purpose of reforming intercarrier compensation would cause uncertainty in the investor community. There should not be any required showing to recover revenue lost through the reform process; the fact that a carrier has lost revenue through the reform process should be sufficient.⁵⁶

⁵⁵ The New Jersey Division of the Ratepayer Advocate states that “[i]t would be irresponsible to permit any further increases in consumers’ rates for basic voice grade service unless and until federal and state regulators complete examinations of incumbent local exchange carriers’ costs and revenues.” NJ Division of Ratepayer Advocate FNPRM Comments at 11. Ad Hoc maintains “there is no statutory basis for maintain existing revenue levels without cost justification.” Ad Hoc FNPRM Comments at iv. NASUCA argues that “[r]evenue lost due to ... [intercarrier compensation] rate reductions should not be recovered unless it has been determined that a financial need exists.” NASUCA FNPRM Comments at 5-6.

⁵⁶ See USTA Comments on the FNPRM, at 40-41.

2. *Carriers' Ability to Recover Lost Access Revenue Will Impact Investor Expectations and Drive Future Investment.*

Investment in the entire communications market, not just investment in the ILEC portion of the market, will be impacted by the Commission's decisions in this proceeding. It is not difficult to understand why adoption of any plan that does not provide a reasonable opportunity for recovery of revenue lost through reform will stymie investment in those carriers losing such revenue. Carriers that are not provided a reasonable opportunity to recover lost revenue through a combination of modest and equitable increases in end user rates, support from an Access Restructure Mechanism, continued support from the Universal Service Fund, and where appropriate, some continued form of intercarrier compensation payments will be forced to recover all access revenue losses from end users and inevitably to absorb the costs that they cannot recover from end users, providing no, or limited, returns on investment. However, what may not be as readily apparent to the Commission, but requires serious consideration is that the loss of ILEC access revenue will also negatively impact investment more broadly throughout the communications market.

Loss of investment from a large segment of the communications industry – the ILEC segment – will have repercussions on investment in suppliers and ILEC competitors. Investors will see telecommunications as more risky, which is contrary to the current emphasis on broadband investment. Investment in the communications market is already in turmoil as a result of the growing use of new technologies to provide competing services. Certainly markets are always subject to such growth and fluctuations; that is the inherent risk of the marketplace. However, the market should determine the winners and losers, not regulators. There is already enough uncertainty created in the market by regulation (e.g., uncertainty caused by the arbitrage opportunities created by the current intercarrier compensation regulatory regime; uncertainty

about the sustainability of the universal service system, including contribution and distribution methodologies; uncertainty in the lack of regulatory parity for broadband providers; and uncertainty regarding required access to unbundled network elements). The Commission should not add to the natural turmoil created by the marketplace by adopting a regulatory plan that targets one segment of the industry for losses and that will ripple through to other carriers and suppliers. Reform of intercarrier compensation that does not include the opportunity for recovery of lost access revenue will harm individual participants in the communications market, but more importantly, it will harm the market as a whole.

- a) Revenue recovery is not counterproductive to competitive neutrality or an efficient marketplace.

In adopting an intercarrier compensation reform plan, the Commission should not second guess the market or force any particular market outcome. More specifically, the Commission should not make regulatory decisions that would unfairly bias the current competitive balance. Yet, that is exactly what commenters like Cox Communications and the New York Department of Public Service actually suggest. Cox urges the Commission to “resist calls for ‘revenue neutrality,’” claiming that an outcome of revenue neutrality “would skew the efficient workings of the marketplace and undermine the goal of competitive neutrality.”⁵⁷ Similarly, the New York DPS suggests that using universal service (or as USTelecom has suggested, an alternative access restructure mechanism) to recover revenue lost from intercarrier compensation reform would be an improper shield of significant ILEC revenue from competitive erosion.⁵⁸ Contrary to these claims, the exact opposite would actually occur. A fundamental shift away from a Calling Party Network Pays model without providing a reasonable opportunity for revenue recovery through a

⁵⁷ Cox Communications FNPRM Comments at 5.

⁵⁸ See New York Department of Public Service FNPRM Comments at 2.

combination of modest and equitable increases in end user rates, support from an Access Restructure Mechanism, continued support from the Universal Service Fund, and where appropriate, some continued form of intercarrier compensation payments would produce losses for companies and investors that have relied on this model in developing and implementing business plans. These losses would skew the current competitive balance to one where incumbents' ability to compete is weakened and their competitors' ability to compete is strengthened. That is not competitive neutrality. While ILECs do not seek protection against competitive erosion through revenue recovery, providing recovery does not protect ILECs against such erosion; however, by not providing recovery the Commission would actually spur such competitive erosion. Revenue recovery is essential to avoid favoring one segment of the industry over another and to guard against artificially tilting the competitive balance.

- b) Providing a reasonable opportunity for revenue recovery will ensure the success of intercarrier compensation reform.

The success of intercarrier compensation reform depends, quite simply, on whether the objectives of reform are achieved. As USTelecom discussed previously, the objectives of reform should be to reduce arbitrage and to ensure that network providers receive fair value for the use of their network. Contrary to the claims of Nextel Communications,⁵⁹ revenue recovery is an essential component for achieving the objective that carriers be adequately and properly compensated for the use of their networks. USTelecom has advocated that such recovery should come from multiple sources, specifically from modest and equitable increases in end user rates, support from an ARM, support from USF, and where appropriate, some continuing form of

⁵⁹ Nextel states that "Commission adoption of an intercarrier compensation plan that relies to any significant degree on revenue neutrality would only delay much needed reform. In addition, reliance on revenue neutrality will likely perpetuate the problems that prompted the Commission to initiate this rulemaking." Nextel FNPRM Comments at 19.

intercarrier compensation payments, to ensure that the cost of using the network is more equitably distributed. Reform that is not based on these concepts of revenue recovery likely will result in the destruction of a significant portion of the industry, which would be more harmful than the problems that prompted the Commission to initiate this rulemaking.

- c) Intercarrier compensation reform should be accomplished using the Commission's preemptive authority over the reform process, providing regulatory uniformity and stability.

As discussed more fully above, the Commission has authority to preempt states' authority over critical components of an intercarrier compensation reform plan in order to achieve uniformity and stability. States currently oversee the process for establishing intrastate and local rates and state agencies advocate for continued authority over such rate-setting.⁶⁰ USTelecom has not advocated that the Commission should trump the local end user rate-setting process. However, USTelecom has advocated that intrastate access charges must be reformed, with provision that recovery of revenue lost from such reform be replaced by a combination of sources – modest and equitable increases in end user rates, support from an ARM, continued support from the USF, and where appropriate, some continued form of intercarrier compensation payments.⁶¹ The Commission has authority to preempt states with regard to their authority over

⁶⁰ See e.g., New Jersey Division of the Ratepayer Advocate FNPRM Comments at 4 (“the FCC should recognize and respect states’ authority to set intrastate rates”) and Indiana Office of Utility Consumer Counselor FNPRM Comments at 2 (“[s]tate commissions currently have the responsibility of reviewing [rate cases]” and “the ability of the public to participate in such rate cases before local regulators provides an important safeguard to the process”).

⁶¹ See generally USTA Comments on the FNPRM, at 41-43. USTelecom proposes that the Commission should set local rate benchmarks “as the basis for determining the amount of lost revenue that would be recovered through the ARM. Support from the ARM would be provided only above the benchmark, whether that was a statewide or nationwide benchmark. If a carrier’s local rates were not increased to the determined benchmark, it would not be able to recover the difference between its rates and the benchmark level at which point support from the ARM would be provided.” USTA Comments on the FNPRM, at 42.

intrastate access charges in order to implement uniform and stable nationwide reform of the intercarrier compensation regime. Without reform of the intrastate portion of intercarrier compensation, arbitrage will continue and escalate.

B. A Combination of Revenue Recovery Sources – Rate Reform, an Access Restructure Mechanism, Universal Service Support, and Where Appropriate, Intercarrier Compensation Payments – Is the Best Method to Accomplish Intercarrier Compensation Reform.

There is sufficient agreement among the commenters that the Commission should implement reform of the intercarrier compensation regime through modest and equitable adjustments in end user rates subject to pricing flexibility, implementation of an ARM to replace revenue lost as a result of reform, continued support from the Universal Service Fund, and where appropriate, some continued form of intercarrier compensation payments.⁶²

1. No Source of Revenue Recovery Should Be Based on Forward-Looking Costs.

A number of commenters oppose adoption of a mechanism to provide revenue recovery to carriers that lose revenue as a result of intercarrier compensation reform. In addition, they urge the Commission to reform universal service by providing support to carriers based on forward-looking costs.⁶³ Such proposals completely ignore the value and the costs of building

⁶² See USTA Comments on the FNPRM, at 38-39.

⁶³ See Leap Wireless FNPRM Comments at 14 (“Leap urges the Commission to reject proposals that attempt to ensure that ILEC revenues are maintained at current levels and instead recommends that universal service be reformed based on a forward-looking, least-cost mechanism”); CTIA FNPRM Comments at 38 (“[a]n eligible carrier’s universal service support . . . would be based upon the forward-looking cost of providing service in a high-cost geographic area using the most efficient technology available for that area”); T-Mobile FNPRM Comments at 31-32 (“[h]igh cost support under the universal service program should be no higher than is necessary to ensure reasonable rates and provide incentives for carriers to operate efficiently, which will facilitate competition and, in turn, ultimately reduce carriers’ costs and their reliance on the universal service program. This could be accomplished through a single, unified high-cost support mechanism based upon the forward-looking economic costs of the most efficient technology for a particular geographic area”).

and maintaining networks in high cost areas, as well as the infeasibility of placing all of these costs on end users through significantly increased rates. Carriers that lose access revenue through intercarrier compensation reform must have a reasonable opportunity to recover such lost revenue through a combination of recovery sources to remain viable and continue offering their networks to other carriers and, more importantly, continue offering services to consumers. All sources of revenue recovery must be based on actual costs, not forward-looking costs.

The costs of building and maintaining ILEC networks have already been sufficiently analyzed by state regulatory agencies in the process of setting local rates in conjunction with support that carriers receive from universal service and payments that they receive for access charges. In other words, the Commission should consider revenue recovery from the basis that ILECs' network costs and services pricing are appropriate because that determination has already been made through rate regulation. There is no need to re-determine the amount of revenue recovery needed by ILECs. Rather, the Commission should focus on intercarrier compensation reform that more equitably distributes the cost of using the network through a combination of revenue recovery sources. The Commission should be clear that there is no need for any source of revenue recovery to be based on forward-looking costs. Moreover, use of forward-looking costs would not accurately or sufficiently reflect the costs of building and maintaining networks or offering basic and advanced services in high cost areas.

2. There Is No Need to Make Support From an ARM Portable.

A number of commenters also oppose adoption of a mechanism to provide revenue recovery to carriers that lose revenue as a result of intercarrier compensation reform, which includes support from universal service for this purpose, and they stress that all support that is

provided from universal service or an interim subsidy fund must be portable.⁶⁴ Again, such comments disregard the value and costs of providing networks and services in high cost areas, the need for support from an ARM, and the basis upon which support from an ARM should be provided. Support from an ARM is intended to provide carriers with partial recovery of lost access revenue. Each carrier would receive support based on the excess of lost revenue after accounting for a moderate increase in end user rates (up to the benchmark discussed in USTelecom's Comments on the FNPRM⁶⁵). Support from an ARM would be based on individual carrier needs. Thus, portability of support from an ARM makes no sense and should be excluded from intercarrier compensation reform.⁶⁶

*3. Neither Moderate Increases in End User Rates Nor
Contributions to Fund an ARM Will Harm Consumers.*

Comprehensive intercarrier compensation reform based on moderate end user rate increases, the use of an Access Restructure Mechanism for recovery of lost access revenue, continued support from the Universal Service Fund, and where appropriate, some continued form of intercarrier compensation payments provides a more equitable distribution among consumers

⁶⁴ See KMC Telecom and Xspedius Communications FNPRM Comments at 6 (“USF administration must remain consistent with the Act, and accordingly, universal service support must be explicit, remain portable, and not guarantee a level of funding to any individual carrier. . . . USF funding is not a revenue assurance plan for carriers; rather it is a mechanism that ensures that consumers have access to reasonable telecommunications services – not all possible services. Accordingly the Commission should avoid the temptation of utilizing universal service as a revenue assurance program for individual carriers in the wake of a decline in intercarrier compensation.”) and Time Warner Telecom, Conversent Communications, CBeyond Communications, and Lightship Telecom FNPRM Comments at 5-6 (“Any subsidy fund designed to compensate carriers for the loss of intercarrier compensation revenue must be strictly interim in nature and must distribute subsidies that are portable to competitors if applicable outside of areas subject to the rural exemption from local competitive under Section 251(f).”)

⁶⁵ USTA Comments on the FNPRM, at 41-42.

⁶⁶ USTelecom stated in its Comments that “[d]istributions from an ARM should only be made to carriers that have provided access services,” and further explained that competitive local exchange carriers may qualify for distributions from an ARM, but wireless carriers would not. *Id.*, at 40 and fn. 61.

of the costs of utilizing the network. In many cases, end users will have a modest increase in their rates and an ARM contribution amount that is passed through from the carrier providing service. The claims of state regulatory agencies that increased end user rates (including increased subscriber line charges (SLCs)) or increased funding for USF⁶⁷ (or as USTelecom advocates, support for lost access revenue provided by an ARM, not USF) are detrimental to consumers and carriers are unfounded.

Several carriers point out that intercarrier compensation reform should be consumer-focused, not carrier-focused.⁶⁸ What these comments seem to overlook is the fact that the needs of consumers and carriers are inextricably linked. In order to benefit and meet the needs of consumers, intercarrier compensation reform must ensure that carriers can recover revenue lost through reform by equitable means. Importantly, without revenue recovery through moderate increases in end user rates and support from an ARM, among other sources of recovery, consumers' access to and choices of services will be endangered. Without the opportunity to recover lost access revenue, carriers will not be able to build, maintain, upgrade, and expand the networks over which they provide basic and advanced services. Hence, the Commission must ensure that revenue recovery is an essential component of any intercarrier compensation reform.

IV. TELECOMMUNICATIONS PROVIDERS MUST FOLLOW INTERCARRIER COMPENSATION RULES.

Many USTelecom members have experienced increasing amounts of terminating traffic being delivered to them without adequate information from the originating carrier to

⁶⁷ See generally Indiana Office of Utility Consumer Counselor FNPRM Comments and New Jersey Board of Public Utilities FNPRM Comments.

⁶⁸ See e.g., United States Cellular Corporation FNPRM Comments at 4 (“[c]onsumer choice and affordable service, not the demands of individual carriers or particular industry segments should be the public interest mandate for this proceeding”).

permit them to identify either the carrier sending the traffic or the appropriate intercarrier charge. This traffic, often referred to as “phantom traffic,” results in significant revenue losses and enforcement expenses for those USTelecom members. The Commission should investigate these allegations to determine if any rules are being broken. Our telecommunications infrastructure is owned and operated by many carriers, and the system will not operate efficiently and serve the public interest unless market participants follow the rules of the market (including property, contract, and communications laws). Accordingly, the Commission should work to enforce its rules, keeping in mind the need to minimize enforcement and transaction costs.

The phantom traffic problem should also be ameliorated by positive intercarrier compensation reform. Moving to a uniform default rate structure will reduce incentives for arbitrage and fraud. In this regard, USTelecom observes that any new Commission rules reforming intercarrier compensation should be clear, predictable, and relatively easy to apply without substantial investment or expense.

V. CONCLUSION

The comments filed with the Federal Communications Commission (Commission) in response to the Further Notice of Proposed Rulemaking (FNPRM)⁶⁹ show nearly universal agreement that reform is urgently needed for the current intercarrier compensation regimes, under which traffic is treated differently depending on the identities of the carriers, the jurisdiction of the call, and the underlying technology of the network on which the call originated. The comments also show a great deal of agreement on most of the fundamental principles and the core elements of the rules the Commission should adopt to reform intercarrier compensation. Although there remain areas of significant disagreement, the comments and plans

⁶⁹ *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (March 3, 2005).

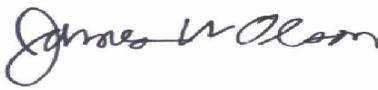
submitted in the docket show even greater agreement than before. Accordingly, USTelecom asks the Commission to move quickly to move intercarrier compensation from the complicated, regulation-driven markets of today to the competitive, consumer-driven markets of the future.

As described above, the USTelecom has five core recommendations for the Commission, which are supported by the weight of the comments filed in response to the FNPRM:

- A. The Commission Should Minimize Regulatory Arbitrage with a Default Intercarrier Rate Structure that Treats Traffic Uniformly.
- B. The Commission Must Integrate Universal Service Reform with Intercarrier Compensation Reform, Paying Particular Attention in Both Cases to the Unique Needs of Rural, Insular, and 2% Service Providers.
- C. The Commission Should Rely in the First Instance on Competition and Commercial Agreements Where Possible To Determine Market Outcomes.
- D. The Commission Should Ensure that the Restructuring of Intercarrier Compensation Should Not Itself Cause Additional Reductions in Net Revenue To Make Certain that LECs Are Compensated for the Use of Their Networks.
- E. The Commission Should Facilitate Indirect Interconnection by Ensuring that Transit Service Is Available for Voice Traffic.

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