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October 25, 2006

Ms. Marlene H. Dortch, Secretary
Office of the Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

RE: Developing a Unified Intercarrier
Compensation Regime
CC Docket No. 01-92

Dear Ms. Dortch:

Enclosed please find comments of the Virginia State Corporation Commission Staff in the above referenced case.

Very truly yours,

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

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

COMMENTS OF THE VIRGINIA STATE CORPORATION COMMISSION STAFF

Introduction

The Division of Communications of the Virginia State Corporation Commission ("VSCC Staff") respectfully submits these Comments in response to the Federal Communication Commission's ("FCC") Public Notice ("FCC Notice") issued on July 25, 2006, in CC Docket No. 01-92 and the extension order released August 29, 2006. The FCC Notice seeks comment from interested parties on the intercarrier compensation reform plan ("Missoula Plan" or "Plan") filed on July 24, 2006, by the National Association of Regulatory Utility Commissioners' Task Force on Intercarrier Compensation ("NARUC Task Force").

General

While we applaud the efforts of the NARUC Task Force and industry participants, the VSCC Staff has a number of concerns with the Missoula Plan. Overall, we find little in this Plan that warrants serious consideration by the FCC. Moreover, we believe adopting this Plan could cause serious harm to consumers and various telecommunications industry players in Virginia and elsewhere.

The Missoula Plan claims to unify rates paid by carriers to each other for both originating and terminating traffic, and to reduce arbitrage opportunities. The scope of the Plan involves interstate access charges, intrastate access charges, reciprocal compensation, wireless traffic, and internet traffic.[1] It creates a tiered structure (called Tracks) of carriers and requires carriers in each Track to follow a transition schedule to reduce and equalize rates to a certain level dependent on that carrier's assigned Track (there are three Tracks). Carriers in Track 1 consist of all Regional Bell Operating Companies ("RBOCs"), competitive local exchange carriers ("CLECs"), interexchange carriers ("IXCs") and Commercial Mobile Radio Service ("CMRS") or wireless carriers. Track 2 companies are mid-sized rural carriers and Track 3 companies are smaller rate-of-return regulated rural carriers. Ultimately, all Track 1 carriers will have the same unified rate within that Track. Track 2 companies may have some differences as three separate unified structures apply dependent on the carrier's form of FCC regulation. Track 3 companies will be required to set their rates at their individual interstate switched access charge levels (rates for all Track 3 carriers would not be unified as a whole).

[1] The Missoula Plan does not appear to integrate fully or unify applicable compensation for Voice over Internet Protocal ("VoIP") traffic.

Intercarrier compensation reform is an important issue. However, the Missoula Plan fails to fix the system for numerous reasons. It is without any real or quantifiable details with respect to its impact on carriers and consumers. Furthermore, the proposed compensation rates by carrier and by Track are not based on any carrier's actual costs. They vary significantly between the Tracks and only in Track 3 are there any individual carrier specific "unified" rates. In fact, the proposed $.0005 compensation rate for Track 1 carriers is particularly suspect as it is likely below incremental cost for many carriers and, therefore, could be viewed as confiscatory.[2]

The breadth and complexity of the provisions of the Missoula Plan are staggering and we are unable to address fully all issues given the scope of our resources and time constraints in preparing our comments. Numerous parties have already spoken out against the Missoula Plan (or its various provisions) for a variety of reasons. The diversity of the parties opposing the Missoula Plan, which include consumer groups, CLECs, cable companies, CMRS carriers, and even some incumbent local exchange carriers ("ILECs") including a major RBOC, should send a very strong message to the FCC. We expect that many of these other interested parties will identify and more fully discuss many other areas of concerns.

Our evaluation of the Missoula Plan focuses on several key areas:

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[2] By Final Order dated April 15, 1997, in Case No. 1997-0005, the VSCC used forward-looking total long run, incremental costs to set termination rates for Bell Atlantic-Virginia (now Verizon Virginia Inc.) at $.000927 per minute for calls terminating at an end office and $.00159 for calls delivered to the tandem.

- The substantial and disparate increases in residential subscriber line charges ("SLC").
- A 32 percent increase ($2.225B) in funding to the federal universal service fund ("USF").
- The proposal for federal preemption of longstanding state jurisdiction over intrastate access charges and reciprocal compensation.
- Establishing a $1.5B Restructure Mechanism ("RM").

- The inequity and lack of detail associated with the Early Adopter Fund ("EAF").
- The "bully" approach to co-opt state commissions' participation.

Moreover, we question the very foundation of the Missoula Plan. We had hoped that the efforts of the NARUC Task Force would have resulted in the development of an intercarrier compensation scheme that could have generated support from a much broader group of carriers and other interested groups. In fact, it appears that the NARUC Task Force's well-meant attempt to reach settlement through compromise and negotiations between the parties has backfired. Now we have an intercarrier compensation proposal that has generated considerable momentum (to the detriment of other proposals) because of its connection with the NARUC Task Force although it has little real consensus support. The Missoula Plan may have driven many parties further apart and now pits carriers against carriers and states against states.

Concerns

SLC

The Missoula Plan's proposal to increase residential SLCs is very troubling. Under the Plan, LECs will have, as a result of lowering various intercarrier compensation charges, an "opportunity to recover lost intercarrier compensation revenues through supplemental sources of recovery."[3] The principal sources of this supplemental revenue include SLC increases and a new RM which is discussed in further detail later.

[3] Missoula Plan, Executive Summary, p. 1.

The Missoula Plan would allow Track 1 carriers to increase the residential SLC from the current nationwide cap of $6.50 to $10.00 at the end of the four step transition period.[4] Then the $10.00 cap would increase with inflation in succeeding years. The proposal to increase residential SLCs is nothing more than an attempt by Missoula Plan proponents to increase local exchange service rates through the wrong jurisdictional regulatory agency.[5]

LECs should not be permitted to increase residential SLCs in order to make up or replace lost revenues resulting from decreases in switched access (particularly intrastate) and other intercarrier compensation charges.[6] First, it would not be an appropriate rate design since the SLC is intended to recover only the interstate portion of the non-traffic sensitive ("NTS") costs of a LEC's loop.[7] It was never intended to be a revenue replacement tool or a means to recover traffic sensitive ("TS") costs of providing service. Over a number of years, the FCC has taken actions proactively to remove what it viewed as implicit subsidies that were previously recovered through interstate Carrier Common Line Charges ("CCLC") by shifting all such

[4] The comparable residential SLC cap for Track 2 and 3 carriers is $8.75.

[5] It is estimated that SLC increases to endusers alone will generate approximately $4.7B in additional revenue for LECs.

[6] In addition, requiring higher SLCs could actually harm ILECs if it results in more consumers choosing other carriers or technologies (i.e. VoIP and wireless) that don't charge SLCs.

[7] If Missoula Plan proponents believed that a greater portion of LECs' loop cost should be allocated to the interstate jurisdiction, they should seek necessary separations changes in CC Docket No. 80-286: <u>In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board.</u>

subsidies to explicit end user charges (i.e. SLCs) and defined universal service support mechanisms. In a previous order, the FCC stated:

> The Commission [FCC] has long recognized that, to the extent possible, interstate access costs should be recovered in the manner in which they are incurred. In particular, non-traffic sensitive costs – costs that do not vary with the amount of traffic carried over the facilities – should be recovered through fixed, flat charges, and traffic sensitive costs should be recovered through per-minute charges.[8]

The Missoula Plan violates this FCC principle as it would shift TS costs to an "explicit" NTS subsidy recovery mechanism (i.e. the SLC). Its proponents may attempt to justify the SLC increases by arguing that local rates don't cover their assignable intrastate NTS loop costs, but they have made no effort to justify the SLC increases on any intrastate cost or earnings basis. The FCC is the wrong venue for seeking such local rate increases. If LECs need to increase local rates they should seek such through legitimate intrastate mechanisms (i.e. filings at state commissions). We note that no ILEC in Virginia has voluntarily sought to lower its intrastate access charges. If the level of intrastate access charges is such a significant problem for carriers, we suggest that a better use of time would be to seek resolution at state commissions.

<u>USF</u>

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[8] In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket 00-256, *Second Report and Order*, FCC 01-304, released November 8, 2001, ("MAG Order"), at ¶ 17.

The impact of the Missoula Plan has been estimated to be at least a $2.225B increase in the USF. This is approximately a 32 percent increase in the current fund level and would grow the USF to over $9B. This amount includes approximately $1.5B necessary to fund the RM and at least $200M for funding the EAF. In addition, there would be a $300M increase resulting form increasing the cap on the High Cost Loop Fund and an additional $ 225M to fund Low Income Support.[9]

This is an extremely significant increase (and perhaps even understated as several parties have suggested), particularly at a time when there should be more effort to reduce the size of the fund. There can be little doubt that an inordinate amount of this increased funding will come from net payer states. But ultimately, it will be consumers in all states that are forced to subsidize revenue "losses" of certain carriers. There is no real justification for any of these potential increases and, therefore, they may ultimately be unsustainable in any event. And that may create even greater financial problems for certain carriers.

The FCC should not allow the Missoula Plan proponents to destroy the USF's intended purpose by using it as a revenue replacement tool primarily for ILECs instead of a funding mechanism to support the provision and availability of certain defined services to all consumers. The 1996 Act

[9] While this may not sound reasonable, this additional funding is only "necessary" because of the increases to residential SLCs. In part, low income support goes to offsetting SLCs for low income consumers. If SLCs are not increased there would not be an additional funding need.

mandates that a carrier receiving federal USF support must "use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[10]

The Missoula Plan cannot ensure that these statutory obligations are met. In fact, state commissions (and the FCC) would be put in a difficult position during the annual eligible telecommunications carrier ("ETC") certification process since we are required to certify to both the FCC and the Universal Service Administrative Company ("USAC") that USF funds received by ETCs are used for the 1996 Act's intended purpose.[11] Funding received by ETCs as revenue replacement under the RM (and as part of USF) cannot be assumed to be consistent with that mandated certification process.

[10] § 254 (e) of the Telecommunications Act of 1996 ("1996 Act").

[11] 47 C.F.R §§ 54.313 and 54.314.

Preemption

The Missoula Plan proponents are attempting to bypass legitimate state regulation. The Plan would improperly preempt state jurisdiction over intrastate access charges. Furthermore, it attempts to bypass state (and FCC) authority over reciprocal compensation arrangements by negating good faith negotiation and arbitration processes from the 1996 Act.[12]

Proponents of the Missoula Plan have mistakenly asserted that the FCC has the authority to preempt state determination of intrastate rates for access charges paid by interexchange carriers and for the payment of reciprocal compensation paid by LECs for terminating one another's local traffic. This has never been the case.

Prior to enactment of the Communications Act of 1934, ("1934 Act") the Interstate Commerce Commission had regulated interstate telephone rates and the states had regulated intrastate rates. This arrangement was codified in the 1934 Act by § 2(b), which currently provides as follows:

> Except as provided in sections 223 through 227, inclusive, and section 332, and subject to the provisions of section 301 and title VI, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier. . . .

47 U.S.C. § 152 (b).

[12] § 251 (c) (1) of the 1996 Act.

By enacting the 1996 Act, Congress enhanced the FCC's authority over some aspects of intrastate communications, but did not disturb the fundamental authority of states to set rates for intrastate communications as mandated by § 2(b). The balance between what the 1996 Act permitted the FCC to do in the intrastate realm and what § 2(b) prohibited it from doing was carefully traced by the U.S. Supreme Court in *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 142 L Ed 2d (1999). The Court reviewed the FCC's authority, pursuant to §§ 251 and 252 of the 1996 Act, to prescribe rules for the pricing methodologies that would be used in setting rates for unbundled elements that incumbents were required to make available for new entrants, for wholesale prices of the incumbents' retail services that also must be offered to new entrants, and for the reciprocal payments that all LECs would pay one another for terminating traffic that originated on one's network and terminated on the other's. The Court affirmed the FCC's authority to adopt the pricing rules, not because § 2(b) no longer applied, but because §§ 251 and 252 of the 1996 Act explicitly authorized a rulemaking that specified a pricing methodology without interfering with the authority of states, under § 2(b), to actually establish the rates. As the Court explained, 525 U.S. at 384:

> The FCC's prescription, through rulemaking, of a requisite pricing methodology no more prevents the States from establishing rates than do the statutory "Pricing standards" set forth in § 252(d). It is the States that will apply those standards and implement that methodology, determining the

> concrete result in particular circumstances. That is enough to constitute the establishment of rates.

The Court then held, ". . . that the [FCC] has jurisdiction to design a pricing methodology." 525 U.S. at 385.

Hence, the FCC has been affirmed in its authority to prescribe cost-based pricing methodologies that have intrastate application, but the FCC is still fenced off from actually establishing intrastate access and interconnection rates.

Restructure Mechanism

A linchpin of the Missoula Plan is the RM. The RM would provide a very large pool of money (seemingly through the USF) for ILECs to draw from if their revenues from allowable SLC increases do not equal revenue reductions resulting from their intercarrier compensation rate reductions. There are numerous problems with such an approach. As mentioned previously, it would significantly increase the USF to "fund" purposes for which it is not legally intended.

The RM is a very costly concept with the sole purpose of making ILECs whole by replacing "lost" switched access charge revenues. To a great extent, these lost revenues would be intrastate in nature (i.e. from reducing intrastate access charges). The interstate jurisdiction is not the appropriate jurisdiction to address support or revenues from intrastate services. This mechanism would require other carriers (and their customers), many of which would not be eligible for this RM funding, to pay for these "lost" revenues.[13] It would in effect require consumers in one state to support the provision of intrastate services in another state. The inequity of such a proposal should be apparent.

<u>Early Adopter Fund</u>

The EAF seems to have no purpose other than a means to obtain support for the Missoula Plan from certain state commissions. While there is little data to evaluate the cost or impact of the EAF, it appears to make funds available to ILECs only in states that have intrastate universal service funds.[14] According to the description in the Missoula Plan, the EAF is a mechanism that

> will enable States to recover some of the funding that they have distributed to carriers that have reduced their intrastate access rates. Early Adopter funding must be used to decrease the size of explicit State funding mechanisms.[15]

The Missoula Plan further describes under what circumstances a state may obtain this funding. One such criterion is that a state must agree to use the newly acquired funds from the EAF to lower the intrastate line item for its explicit state funding mechanism.[16]

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[13] The Missoula Plan states only that "Restructure Mechanism dollars will be available to other carriers in circumstances to be determined in the future." (p. 74). No other details are provided.

[14] There seems to be some conflicting language in the Missoula Plan and there is very little information on the details of the EAF. The reference to explicit State funding mechanism appears to require a state universal service fund.

[15] Missoula Plan, p. 76.

[16] Missoula Plan, p. 77.

It is incredible that such a proposal would be set forth. There is no rational or legal basis to require that some states be forced to pay for intrastate access charge reductions in another state. For over twenty years, state commissions have wrestled with the questions of how, when, and by how much to lower intrastate access charges. The solutions have been diverse. State commissions have utilized a variety of approaches such as generic access proceedings, rate cases, incentive regulatory plans, legislative mandates, and universal service proceedings to address these issues. In some instances, LECs have been permitted to raise local rates and in other instances have been required to lower intrastate access charges with no guaranteed offsets. For example, among other actions, the VSCC eliminated the "explicit" CCLCs for Verizon Virginia, Inc. and

Verizon South, Inc (collectively "Verizon"). The elimination of those CCLCs reduced Verizon's revenues by approximately $50M. However, while the VSCC authorized additional pricing flexibility to Verizon to permit recovery of some of the reductions over time, we did not allow a direct or explicit increase in local rates as part of the mandated reduction in intrastate access charges. Virginia would apparently not be eligible for additional funding from the EAF because it did the right thing for Virginia consumers. Unfortunately, neither the FCC nor other states can be fully assured that any "explicit" offsetting rate reductions in other states were necessary. Furthermore, switched access reductions that were implemented some time ago may significantly overstate their present value because of declining switched access minutes of use.

Now the Missoula Plan suggests that some states should be "rewarded" if they had previously lowered intrastate access rates, but only if done through an "explicit" state funding mechanism. The inequity of such a proposal should be obvious. In effect, the Missoula Plan argues that existing local rates in one state should be lowered at the cost of increasing local rates (i.e. interstate SLC increases) in other states. Furthermore, the Plan provides no state by state comparison of current intrastate access charges.

Both local exchange service rates and intrastate access charges are under state commission jurisdiction. It is unwarranted to suggest that the FCC should now not only set rates for specific intrastate switched access charges but also mandate local rate reductions in Early Adopter states. The Missoula Plan provides no evidence or data that any need exists for additional support in Early Adopter states. In fact, the Plan doesn't even identify those states it believes would qualify. We find no rationale for including the EAF as part of the Plan other than to garner support from certain states (i.e., those with intrastate universal service funds).

<u>State Participation</u>

The Missoula Plan cannot be successful without state commissions' participation. The Plan utilizes several strategies to coerce states to opt into the Plan.[17] Many of those approaches have been discussed above and range from the threat of federal preemption over intrastate access charges (the stick) to local rate reductions for Early Adopter states (the carrot). The Plan claims that state participation is voluntary but that is certainly not how we perceive it. There are serious penalties associated with not opting into the Plan.

For example, under the Missoula Plan, at step 1 the SLC caps will increase for Track 1 and 2 carriers in a given state whether or not a state commission has opted into the Plan. Furthermore, at step 1, implementation of the Plan's intrastate terminating access rates for Track 1 and 2 carriers is immediately mandated as well.[18] Then at step 2, apparently a party can

[17] The Missoula Plan describes these as incentives. We describe them as penalties.

[18] The terminating intrastate access rates of Track 1 and 2 companies would be reduced whether or not a state opts into the Plan or not so is not a "voluntary" aspect of the Plan.

petition the FCC to preempt state authority over intrastate originating switched access charges of Track 1 and 2 carriers.[19] It seems the only real voluntary aspect of the Plan involves Track 3 carriers (at least through the first four steps). If a state doesn't opt into the Plan, it retains authority over Track 3 carriers' intrastate originating and terminating switched access charges (without immediate threat of preemption) and the SLC caps do not increase.[20]

The above two-tiered federal preemption strategy would seem to have a result opposite from the intended purpose of intercarrier compensation and universal service reform. It would, in effect, raise the local rates (through increased SLCs) for Track 1 and 2 carriers that are likely to be in more competitive markets. Track 1 companies are also more likely already to cover costs in providing local exchange services and may be forced under the Missoula Plan to set intercarrier compensation charges below cost. Track 3 carriers, on the other hand, are much more likely to have local service rates that don't fully cover cost and access charges set substantially above cost.

If a state commission does not opt into the Missoula Plan, that state and its carriers and customers may be severely and unfairly penalized. Beyond the obvious concern over federal preemption, carriers in a state that does not opt in would not be eligible for either the RM or EAF. Furthermore,

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[19] We find nothing that suggests whether there are any restrictions on which carriers may petition the FCC. For example, what happens if the Track 1 and 2 carriers in a state do not support the Plan and wish to remain under state jurisdiction?

the vast majority of customers in such a state would still see SLC increases (for Track 1 and 2 carriers). Even more troubling is that all consumers in a non-participating state would not be protected from paying more for universal service support because carriers' contribution percentages will likely have to increase significantly to fund the USF increases.

The Missoula Plan proponents claim that they "hope and expect that the States will implement all provisions of the Plan…"[21] That may turn out to be an accurate prediction based on the severe penalties that face state commissions that do not wish to participate. However, that does not make the Plan the best solution for intercarrier compensation reform.

Conclusion

The VSCC Staff believes it would be a very serious mistake for the FCC to adopt the Missoula Plan. It contains numerous and potentially inequitable consequences for various carriers, states, and consumers. The Plan unnecessarily and illegally attempts to usurp state authority over intrastate access charges and other intrastate rates. It has limited support from various industry players and would destroy the mandated negotiations and arbitration procedures set forth in §§ 251 and 252 of the 1996 Act.

Moreover, the Missoula Plan would dramatically increase funding to the current nearly $7.0B USF that is already straining at the seams. This

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[20] The Missoula Plan provides no rationale for this mix and match approach to its federal preemption proposal.

[21] Missoula Plan, Executive Summary, p. 2.

would unnecessarily increase prices to consumers in all states; however, consumers in net payer states will be called on once again to pay an inordinate share. This is particularly troubling because those increases will largely be a result of funding to replace "lost" intrastate revenues of ILECs in other states. Nothing in the 1996 Act suggests that the federal USF should be used for revenue replacement.

We fully support the long standing objectives for universal service, and we recognize the value to all customers nationwide (rural and urban) in having access to affordable and adequate telephone services. However, the Missoula Plan does nothing to ensure these objectives as its goal appears to be the preservation of revenues for certain ILECs and not universal service for all.

We recognize that the current intercarrier compensation regime has serious problems and that the Missoula Plan may have some acceptable provisions.[22] There is no doubt that the FCC and states could work together under a reasonable and equitable intercarrier compensation plan. However, the FCC should not adopt any proposal that illegally and unnecessarily usurps state authority over intrastate services and rates.

We appreciate the considerable efforts of the NARUC Task Force and industry participants. Unfortunately, relying too heavily on industry participants with conflicting objectives to come up with the best intercarrier

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[22] For example, the Missoula Plan has proposed a solution that may have some merit for phantom traffic.

compensation plan is unlikely to work. In any event, the FCC need look no further than its previously issued Further Notice of Proposed Rulemaking ("FNPR")[23] to realize that the Missoula Plan as currently constructed does not meet the FCC's stated goals for intercarrier compensation reform.[24]

Respectfully submitted,
Virginia State Corporation Commission Staff

William Irby
Director
Division of Communications

October 25, 2006

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[23] Released March 3, 2005, see paragraphs 29-36.

[24] Nor does the Missoula Plan come close to meeting the set of principles set forth in NARUC's "Study Committee on Intercarrier Compensation Goals for a New Intercarrier Compensation System" dated May 5, 2004.