Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of	)	
	)	CC Docket No. 01-92
Intercarrier Compensation	)	

COMMENTS OF THE NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES ON THE MISSOULA PLAN

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I. INTRODUCTION AND SUMMARY

On July 26, 2005, Kevin Martin, Chairman of the Federal Communications Commission ("Commission" or "FCC"), speaking at a meeting of the National Association of Regulatory Utility Commissioners ("NARUC"), stated that any proposed solution to intercarrier compensation ("ICC") must meet three principles: (1) it must achieve a single unitary rate for all types of telecommunications traffic; (2) it must not impose large increases in end-user charges; and (3) it must not result in a large increase in the federal universal service fund ("USF").[1] Unfortunately, the so-called "Missoula Plan"[2] fails all three of these principles. The Missoula Plan does not result in unitary rates; the Missoula Plan imposes large increases on local rates in the form of increases in the federal subscriber line charge ("SLC"); and the Missoula Plan results in a huge increase in the USF – at least a 32% increase in a fund that is already bloated and

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[1] See http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-260312A1.pdf.

[2] See ex parte communication (July 24, 2006) from the NARUC Task Force on Intercarrier Compensation ("NARUC Task Force"), with "Missoula Plan" attached.

unsustainable. Accordingly, the Commission should reject the Missoula Plan out of hand.

Pursuant to the Public Notice issued by the Commission,[3] the National Association of State Utility Consumer Advocates ("NASUCA"[4]) offers these comments on the Missoula Plan.[5] The Missoula Plan is described as an "intercarrier compensation reform plan."[6] This plan -- supported by a narrow group of telecommunications carriers[7] -- "reforms" ICC by **reducing intercarrier rates $6.0 billion and paying for this decrease by increasing end-user rates by $6.9 billion. The Missoula Plan is entirely bad news for consumers.**

NASUCA opposes the Missoula Plan for a number of reasons. For all of its cost and upheaval, the Missoula Plan does not result in unitary rates. Moreover, there is no sharing between carriers and consumers of the burden of reducing ICC rates. Legacy landline carriers ensure that they are made whole, while the entire burden of reducing ICC rates ultimately falls on end users. Under the Missoula Plan, ICC rates are reduced

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[3] DA 06-1510 (rel. July 25, 2006).

[4] NASUCA is a voluntary, national association of consumer advocates in more than forty states and the District of Columbia, organized in 1979. NASUCA's members are designated by the laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts. *See, e.g.*, Ohio Rev. Code Chapter 4911; 71 Pa. Cons. Stat. Ann. § 309-4(a); Md. Pub. Util. Code Ann. § 2-205(b); Minn. Stat. Ann. Subdiv. 6; D.C. Code Ann. § 34-804(d). Members operate independently from state utility commissions, as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (*e.g.*, the state Attorney General's office). Associate and affiliate NASUCA members also serve utility consumers, but have not been created by state law or do not have statewide authority.

[5] These comments are a joint effort of NASUCA member offices. Special thanks are due the Iowa Office of Consumer Advocate and Dr. Robert Loube for invaluable assistance.

[6] DA 06-1510 at 1.

[7] The supporters of the Missoula Plan are principally at&t in its various manifestations – at&t, BellSouth & Cingular – and the Rural Alliance, an indefinite coalition of small rural telephone companies.

$6 billion,[8] and end user rates go up $6.9 billion. This increase in end user rates consists of a $4.7 billion increase in SLCs; a $1.5 billion increase in the USF in the form of the so-called "Restructure Mechanism"; a $0.3 billion increase in the USF High Cost Loop Fund; a $0.225 billion increase in the USF Low Income Fund; and a $0.2 billion increase in the USF for creation of an Early Adopter Fund. As large as these USF increases are, the numbers advertised by the Missoula proponents are grossly understated, as explained below.

Although end users will have to absorb more than $6.9 billion in additional costs under the Missoula Plan, carriers are not required to pass through any of the reductions in ICC rates to end user rates. As a result, there is no guarantee or commitment that the $6.0 billion in ICC rate reductions will find their way to customers. This is especially true because the service that will be the primary beneficiary of the ICC rate reductions -- long distance service -- has virtually ceased to exist as an independent, highly competitive market. Major retail long distance providers -- AT&T and MCI -- have been acquired by legacy landline companies SBC and Verizon, and most stand-alone long distance carriers now act as wholesale providers to other carriers.

Consumer savings claimed by the proponents of the Missoula Plan are spurious. Exhibit 1 to the Executive Summary of the Plan, which shows savings to most consumers, is totally deceptive and misleading. All savings are based on 100% flow through of access reductions to end user long distance rates, and adoption of a radically different USF assessment system, the basis of which is not revealed. **Taking the Missoula Plan exactly as written, and applying it to the current assessment system**

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[8] Missoula Plan, Appendix D at 100.

for USF, results in increases in rates for all customers, as discussed below.

To add insult to injury, ICC minutes of use ("MOU") and revenues have been declining in excess of 5% per year. Yet the Missoula Plan calls for freezing ICC revenues at a past-year level and ensures continuing recovery of all of these revenues (and more) for incumbent local exchange carriers ("ILECs") from consumers through higher SLCs and USF contributions.

Under the Missoula Plan, SLCs for Track 1 companies (88% of all lines in the United States) may increase to $10 in the fourth step of the Plan, and rise by the rate of inflation thereafter. The increase in the SLC to $10 plus inflation will most impact customers in states that currently enjoy low SLCs, such as California, Illinois and Iowa. In the District of Columbia, the SLC could rise from $3.84 to $10.00 plus inflation by the fifth step of the Missoula Plan.

Arguments that ILECs will be constrained by competition and will not be able to raise their SLCs are refuted by the fact that all current SLCs are at their maximum cap level, regardless of the current state of competition claimed by the ILECs in any particular area. Furthermore, the Missoula Plan calls for increases in the SLCs of large, non-rural carriers that are greater than those for rural carriers. These SLC increases run completely counter to cost, and improperly transform traffic-sensitive costs into non-bypassable non-traffic sensitive end user rates.

The increases in the USF imposed by the Missoula Plan are unsustainable and unreasonable. First, the basis of the Restructure Mechanism contained in the Missoula Plan is opaque, and the supporters of the Plan cannot even agree on its foundation. If the basis is Section 251 of the Telecom Act (interconnection), then there is no authority to

assess other carriers to pay for lost revenue. If the basis is Section 254 of the Telecom Act (USF), then equal support must be provided to competitive eligible telecommunications carriers ("CETCs"), ballooning the estimates of the cost of the Plan.

Second, the rebasing of the cap on the High Cost Loop Fund has nothing to do with ICC reform except as a means to get rural carrier support for the Missoula Plan. Moreover, the estimated $0.3 billion increase in the High Cost Loop Fund is understated, because it does not include equal payments to CETCs, or additional funding for other changes in the high cost fund.

Third, the addition of $0.225 billion to the USF for increased Low Income Support is improper since it amounts to a double count. Even assuming that $6 billion is the correct ICC replacement target, it should not require recovery of $6.225 billion from end-users to account for exemption of Lifeline customers.

Finally, the $0.2 billion estimate for the Early Adopter Fund is almost laughably inadequate. If the Missoula Plan truly intends to recompense the many states that have taken action to reduce intrastate access rates, the Early Adopter Fund is likely to increase tenfold.

Overall, the increase in the USF required by the Missoula Plan is unsustainable. The current USF amounts to $7 billion a year and the USF assessment factor has been over 10% since the first quarter of 2005.[9] Adoption of the Missoula Plan would result in a 32% increase in the entire USF (not just the high-cost portion), from $7 billion to $9.225 billion, with a concomitant increase in the assessment factor. A more realistic view of the increases in the High Cost Fund required by the Plan would result in an even

[9] The assessment factor for 4Q06 declined to 9.1%, although much of this reduction is due to a one-time back payment of assessments by a large carrier.

larger USF.

Despite all of this cost, at the end of the day the Missoula Plan does not result in unified rates. Although the Missoula Plan reduces the absolute level of intercarrier rates, the disparity in rates remains. The greatest disparity in ICC rates today exists among rural carriers that the Missoula Plan classifies as Track 3. This is not solved by the Missoula Plan, as great variations in rates will continue to exist between tracks and within Track 3.[10] Track 3 ICC rates are only unified at the company level; there is no national standard.[11] As a result, opportunities for arbitrage of ICC rates will continue to abound.

In order to implement the radical changes called for by the Missoula Plan, the Plan requires preemption of the authority of states over intrastate ICC rates. Although the Plan is cast as having optional elements, the Plan explicitly allows complete FCC preemption of authority over ICC rates, both interstate and intrastate. There is no basis in law for such an arrogation of power. Section 152 of the Telecom Act specifically reserves to the States authority over in-state rates.

In short, the Commission should reject the Missoula Plan *in toto*. Consumers are far better off under the status quo than they will ever be under the Missoula Plan. If the Commission wishes to address ICC reform, NASUCA recommends a more gradual

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[10] The average Track 2 target rate of $0.01 per MOU is twenty (20) times higher than the Track 1 target rate of $0.0005 per MOU. The Track 3 average target rate of $0.017 per MOU is forty (40) times higher than the Track 1 target rate and includes a different target rate for each rural company. These rates can range from $0.003 per MOU to $0.089 per MOU.

[11] There are over 1100 Track 3 rural carriers. Although ICC rates are unified at the study area level for each carrier, as a practical matter, there will not be 1100 different rates. Because most Track 3 carriers participate in the National Exchange Carrier Association ("NECA") access pool, there should be approximately 28 different termination rates within Track 3 at the end of the phase-in period: the 8 rate bands of the NECA pool, plus different rates for the approximately 20 Track 3 carriers that are not part of the NECA pool.

approach as outlined in its previous comments and *ex partes* in this proceeding. Such an approach will allow movement towards the goal of unitary ICC rates without imposing unacceptable burdens on end user rates and the USF.[12]

II. THE CLAIMED BENEFITS OF THE MISSOULA PLAN ARE ILLUSORY.

A. THE SKY IS NOT FALLING AS CLAIMED BY PROPONENTS OF THE MISSOULA PLAN.

In order to push approval of the Plan, the proponents of the Missoula Plan have tried to create a sense of urgency and crisis surrounding the issue of ICC. With statements like "The ICC system is broken!" the proponents urge scant review and quick approval of the Missoula Plan. The claims that there is a crisis in ICC do not hold up. In fact, the environment within which this proceeding was initiated by the FCC in 2001 has completely changed.

Data available to the Commission and the industry in 2001 did in fact reveal a network and a system of intercarrier payments under great stress. The advent of the Internet and development of the Internet Service Provider ("ISP") industry caused fundamental changes in the engineering assumptions that were the basis of the United States telecommunications network. Call-hold times had averaged 3 minutes per call for decades; average daily usage per access line averaged around 30 minutes.

Telecommunications facilities were designed and installed to meet these seemingly enduring assumptions. With the growth of the Internet and the explosion in dial-up access by end users to ISPs to reach the Internet, however, lines, MOU, number

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[12] See NASUCA Initial Comments, CC Docket No. 01-92 (May 23, 2005); NASUCA Reply Comments, CC Docket No. 01-92 (July 20, 2005); NASUCA *ex parte* Filing (December 16, 2004).

of calls, average length of calls, and average daily usage all skyrocketed.

As shown on the table below, from 1995 (the approximate first year of widespread Internet availability) through 2000, average daily usage per access line soared 50%, from 38 minutes per line to 57 minutes per line. Moreover, this increase in average usage occurred in spite of an 18% increase in the number of access lines during the same period.

CHANGE IN LOCAL USAGE
1990-2000

Year	Lines	Annual % Change	Local Calls (000)	Annual % Change	Local DEM	Annual % Change	Daily Local Call MOU	Annual % Change
1990	136,114,201		402,292,293		1,846		37	
1991	139,412,884	2.4%	416,213,954	3.5%	1,860	1%	37	-2%
1992	143,341,581	2.8%	434,175,743	4.3%	1,926	4%	37	0%
1993	148,106,159	3.3%	447,473,714	3.1%	2,027	5%	37	2%
1994	153,447,946	3.6%	465,207,539	4.0%	2,126	5%	38	1%
1995	159,658,662	4.0%	484,195,345	4.1%	2,224	5%	38	1%
1996	166,445,580	4.3%	504,131,507	4.1%	2,389	7%	39	3%
1997	173,866,799	4.5%	522,025,261	3.5%	2,694	13%	42	8%
1998	179,849,045	3.4%	544,288,934	4.3%	2,992	11%	46	7%
1999	185,002,992	2.9%	553,853,237	1.8%	3,378	13%	50	10%
2000	188,499,959	1.9%	536,523,081	-3.1%	3,909	16%	57	13%

Source: USF Monitoring Reports, Section 8
NECA USF Filings
Growth rates derived
Dial Equipment Minutes ("DEM") in billions of minutes
Local call usage in minutes

Likewise, similar changes occurred in interexchange usage:

CHANGE IN INTEREXCHANGE USAGE 1990 - 2000						
Year	**Interstate MOU (billions)**	**Annual % Change**	**Intrastate MOU (billions)**	**Annual % Change**	**Total MOU (billions)**	**Annual % Change**
1990	307.4		99.7		407.1	
1991	328.0	6.7%	104.5	4.8%	432.5	6.2%
1992	349.7	6.6%	114.2	9.3%	463.9	7.3%
1993	371.2	6.1%	125.3	9.7%	496.5	7.0%
1994	401.4	8.1%	144.4	15.2%	545.8	9.9%
1995	431.9	7.6%	159.8	10.7%	591.7	8.4%
1996	468.1	8.4%	178.2	11.5%	646.3	9.2%
1997	497.3	6.2%	193.4	8.5%	690.7	6.9%
1998	518.8	4.3%	219.8	13.7%	738.6	6.9%
1999	552.3	6.5%	257.3	17.1%	809.6	9.6%
2000	566.9	2.6%	241.7	-6.1%	808.6	-0.1%

Source: FCC Trends in Telephone Service, June 2005
Tables 10-1 and 10-2

This dramatic increase in lines and minutes of use had a number of impacts. First, ILECs were forced to install additional circuit-switching capacity. Existing switches designed for lower call hold times and lower average daily use per line could not keep up with the increasing demand for the limited resources of circuit switches. Second, a huge imbalance in traffic going to ISPs spawned a new industry model as competitive local exchange carriers ("CLECs") made profits terminating traffic coming from the ILEC's end users and going to ISPs.[13] Protests from the ILECs led to the FCC's ISP Remand Traffic Order in 2001,[14] which established an arbitrary ICC rate of $0.0007 per MOU for

[13] It should be recalled that it had been the ILECs that had insisted on substantial reciprocal compensation rates, because they had assumed that most CLEC traffic would be terminating on the ILECs' networks.

[14] *In the Matter of Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*"), remanded *WorldCom v. FCC*, 288 F.3d 429 (DC Cir. 2002), cert. denied, 538 U.S. 1012 (2003).

traffic terminated to an ISP,[15] and an assumption that all traffic out of balance beyond a 3:1 ratio was ISP-bound.

The surging usage of the network, the wide disparity of rates (some of which was created by the FCC itself), and the arbitrage opportunities presented by this environment led the FCC to open this proceeding in 2001, on the same day that it issued its *ISP Remand Order*. In the Notice of Proposed Rulemaking ("*Intercarrier Compensation NPRM*") the FCC listed the shortcomings of the existing intercarrier compensation system and indicated that it was not sustainable.[16] Indeed, it was not. Fortunately, the operating environment of the telecommunications industry has fundamentally changed since 2001.

Unbeknownst to the FCC or any party at the time, 2001 represented the "high water mark" for usage on the old circuit-switched network. The tables below are continuations of the tables previously discussed, including data for the years subsequent to 2000.

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[15] This rate remains one of the lowest ICC rates. As discussed below, the termination rate for Track 1 in the Missoula Plan is improperly and arbitrarily set below the ISP Bound Traffic rate.

[16] *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) at ¶¶ 7-9.

CHANGE IN LOCAL USAGE 1990-2005								
Year	**Lines**	**Annual % Change**	**Local Calls (000)**	**Annual % Change**	**Local DEM**	**Annual % Change**	**Daily Local Call MOU**	**Annual % Change**
1990	136,114,201		402,292,293		1,846		37	
1991	139,412,884	2.4%	416,213,954	3.5%	1,860	1%	37	-2%
1992	143,341,581	2.8%	434,175,743	4.3%	1,926	4%	37	0%
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1998	179,849,045	3.4%	544,288,934	4.3%	2,992	11%	46	7%
1999	185,002,992	2.9%	553,853,237	1.8%	3,378	13%	50	10%
2000	188,499,959	1.9%	536,523,081	-3.1%	3,909	16%	57	13%
2001	185,588,578	-1.5%	515,335,676	-3.9%	3,784	-3%	56	-1%
2002	180,098,691	-3.0%	459,302,668	-10.9%	*		*	
2003	173,136,837	-3.9%	424,617,408	-7.6%	*		*	
2004	165,236,182	-4.6%	381,069,716	-10.3%	*		*	
2005	156,313,074	-5.4%						

Source:
USF Monitoring Reports, Section 8
NECA USF Filings
Growth rates derived
DEM in billions of minutes
Local call usage in minutes
* Beginning in 2001 filing of DEM data became voluntary. Most carriers did not file after 2001.

Likewise, interexchange usage also declined:

CHANGE IN INTEREXCHANGE USAGE 1990 - 2000						
Year	Interstate MOU (billions)	Annual % Change	Intrastate MOU (billions)	Annual % Change	Total MOU (billions)	Annual % Change
1990	307.4		99.7		407.1	
1991	328.0	6.7%	104.5	4.8%	432.5	6.2%
1992	349.7	6.6%	114.2	9.3%	463.9	7.3%
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1994	401.4	8.1%	144.4	15.2%	545.8	9.9%
1995	431.9	7.6%	159.8	10.7%	591.7	8.4%
1996	468.1	8.4%	178.2	11.5%	646.3	9.2%
1997	497.3	6.2%	193.4	8.5%	690.7	6.9%
1998	518.8	4.3%	219.8	13.7%	738.6	6.9%
1999	552.3	6.5%	257.3	17.1%	809.6	9.6%
2000	566.9	2.6%	241.7	-6.1%	808.6	-0.1%
2001	539.7	-4.8%	216.5	-10.4%	756.2	-6.5%
2002	486.7	-9.8%	198.1	-8.5%	684.8	-9.4%
2003	444.0	-8.8%	na		na	
2004	422.4	-4.9%	na		na	
2005	400.9	-5.1%	na		na	

Source: FCC Trends in Telephone Service, June 2005
Tables 10-1 and 10-2

As can be seen, all indicia of usage of the circuit-switched network declined precipitously after 2000. What happened? Broadband happened. Wireless happened. Voice over Internet Protocol ("VoIP") happened. Beginning in 2000-2001 cable modems began to be widely available to American consumers. Availability of broadband through digital subscriber line ("DSL") followed shortly thereafter.[17] The rollout of broadband had two effects. One, consumers began removing second lines which they had installed for dial-up Internet access. Thus access line counts dropped. Second, minutes previously spent surfing the net and tying up circuit-switching capacity were moved to the packet-switched world of broadband. Thus MOU dropped, local calls dropped, average hold times dropped and average daily usage dropped. The latest FCC Advanced Services

[17] See, FCC Advanced Services Reports, 2000-2005.

Report shows that almost 60% of on-line households now access the Internet by broadband. Dial-up Internet access and usage is shrinking by the day.[18]

During the period 2000-2005 wireless phone subscriptions more than doubled and wireless connections now outnumber landlines. The advent of all-distance wireless plans moved MOU off the interexchange carriers' networks, as consumers substituted wireless usage for landline long distance usage. In addition, some consumers, especially younger persons, have "cut the cord," eliminating their landline phone altogether and using wireless service exclusively. The more recent advent of VoIP, a packet-switched voice application that rides over broadband, has not only contributed to the continuing decline in MOU on the circuit-switched network, but has also resulted in some consumers forgoing traditional telephone service.

These trends mean that the absolute size of the problem with disparate ICC rates has diminished over time, and will continue to diminish even if nothing is done. The old thorn in the sides of the ILECs – dial-up calls to ISPs – is a dying industry, with ever-declining impact on ILEC expenses. The "crisis" for ILECs, if there is one, stems from declining traditional revenue streams, like access and local service, which reflect the decline in usage of the circuit-switched network resulting from consumer movement to other services. However, these revenues are largely being replaced by broadband revenues and wireless revenues.[19]

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[18] See, e.g., "At AOL, A Plan for a Clean Break," New York Times (July 10, 2006), at http://www.nytimes.com/2006/07/10/technology/10aol.html?ei=5090&en=2333d859742c5a2f&ex=1310184000&partner=; "AOL's Subscriber Base Shrinks," TechWeb (April 3, 2003), at http://www.techweb.com/wire/26801212.

[19] See, e.g., AT&T's most recent financial reports, at http://att.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=22969.

The radical revamping of rates and interconnection rules called for by the Missoula Plan amount to nothing more than a desperate attempt to insulate a large portion of current ICC revenues from the inexorable trends away from the circuit-switched network. Unfortunately, the wide disparity in rates remaining under the Missoula Plan will still leave ample opportunities for arbitrage, another of the elements of the "crisis" claimed by the proponents of the Missoula Plan.[20] These arbitrage opportunities, the massive changes required, and the extreme complexity of the Missoula Plan make litigation a virtual certainty. The costs of this litigation will be enormous, certainly greater than litigation costs in the current environment.[21]

The solution proposed by the Missoula Plan for the ILEC's "crisis" is to impose at least $6.9 billion in additional charges on end-users. These costs of the Missoula Plan are real, while its purported benefits are entirely speculative. It should be pointed out that from a consumer's viewpoint; there is no crisis in telecommunications. Under the current rules, overall prices have declined,[22] while services, calling plans and new features have all increased. **In short, consumers are much better off under the status quo than they would ever be under the Missoula Plan.** As imperfect as the current ICC regime is, it constitutes a known quantity which can be modified to eliminate the worst abuses without imposing undue costs on end users. Moreover, under the existing ICC system the transition is being made from the old circuit-switched world to the new IP-based world, and that transition is being driven by consumer choice. The substantial disruptions,

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[20] Missoula Plan Supporters *ex parte* (July 25, 2006) at 1.

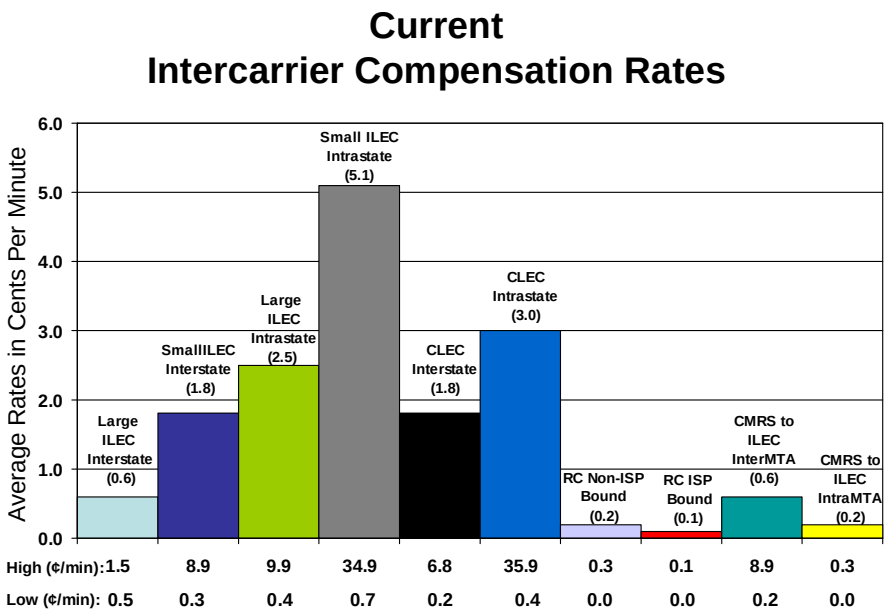
[21] *Id*.

[22] Despite the overall trends, there have been increases for local and long distance service in many areas.

consumer costs and litigation risk that will be imposed by the Missoula Plan will constitute nothing more than expensive and confusing static in this transition, and should be rejected by the Commission.

B. THE MISSOULA PLAN DOES NOT ELIMINATE THE DISPARITY IN INTERCARRIER RATES.

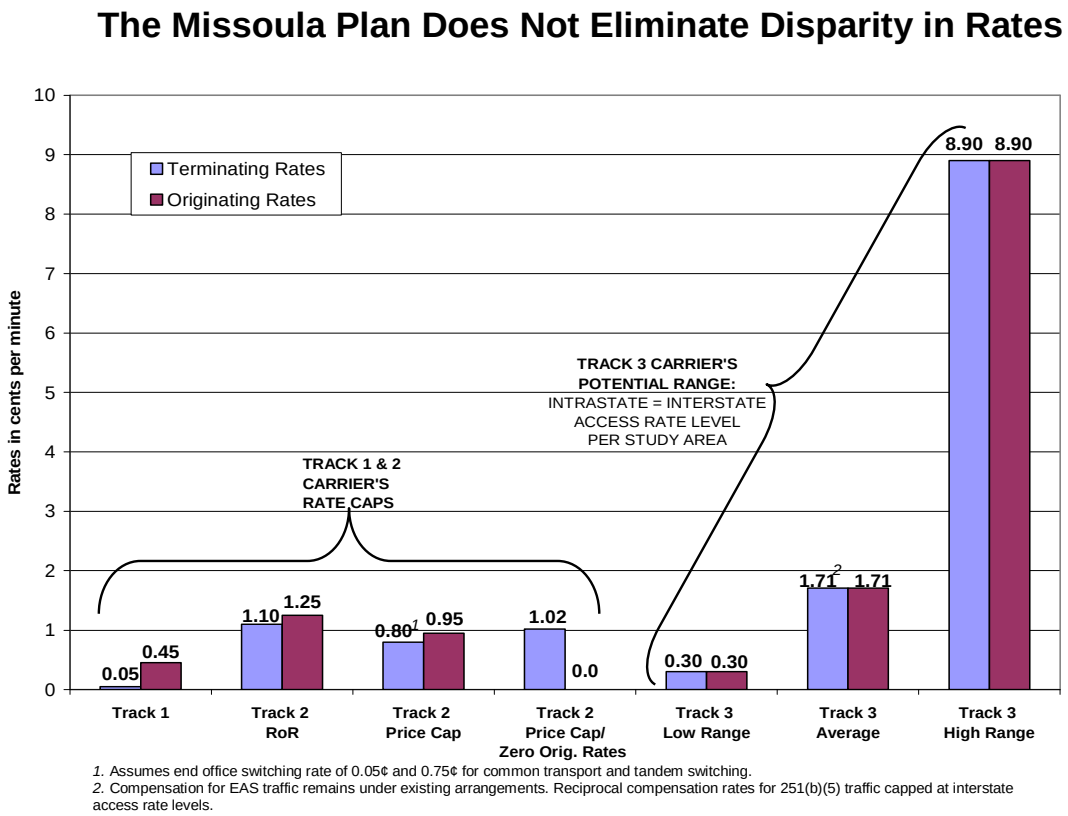
There is no question that a substantial disparity exists in current ICC rates. The Missoula Plan supporters frequently use the following diagram to depict the ICC rates under current rules:[23]



As previously noted, FCC Chairman Martin stated that any reform of intercarrier compensation should result in unitary rates for all types of traffic. Even though the Missoula Plan reduces the absolute level of ICC rates, it does not eliminate disparity in rates. At the end of the phase-in of the Missoula Plan, the following disparity in rates

[23] This is the same chart previously submitted by the Intercarrier Compensation Forum ("ICF").

will remain:



Under the Missoula Plan the termination rate for Tracks 1 and 2 is $0.0005 per MOU.[24] However, interconnecting carriers are required to go much deeper into Track 2 carrier's network to interconnect,[25] and must therefore pay additional common transport and tandem switching, unless the interconnecting carrier chooses to build its own facilities. As a result, the effective termination rate for Track 2 carriers is approximately $0.01 per MOU, or 20 times higher than Track 1.

Track 3 carriers are not even required to achieve a uniform target rate amongst

[24] The Missoula Plan is set forth in a more than 100-page document, in outline form, with four Appendices. Hereafter, references to specific provisions are cited as, Missoula Plan, II-B-1 and 2.

[25] The interconnection point for Track 1 carriers is the tandem switch. For Track 2 carriers, the interconnection point is the end office switch. Missoula Plan, III-B-2-d and e.

themselves. Track 3 carriers only have to move intrastate ICC rates to interstate levels for each study area.[26] Thus, the termination rate for Track 3 carriers could vary by study area for each of the over 1100 Track 3 carriers. As a practical matter, because of the NECA access pool, there will be approximately 28 different termination rates for Track 3 carriers – 8 different rates for the 8 NECA pricing zones, and a different individual study area rate for the approximately 20 Track 3 carriers that are not part of the NECA pool. The 28 different termination rates for Track 3 rates will range from a low of $0.003 per MOU to a high of $0.089 per MOU, over 170 times higher than the Track 1 termination rate.

Finally, wireless carriers, cable operators, and CLECs that provide service in Track 3 ILEC territory are treated as Track 1 carriers by the Missoula Plan.[27] This means that carriers exchanging traffic within the same area will be pay widely divergent rates to each other for performing the same function.

Far from solving the problem of disparate ICC rates, the widely varying rates that will exist at the end of the Missoula Plan will continue to invite arbitrage and abuse as carriers attempt to exploit differing rates. In short, while the Missoula Plan imposes very real and very substantial costs on consumers and other non-ILEC carriers, it does not solve the most basic problem posed by the current regime of divergent ICC rates.

C. THE MISSOULA PLAN CREATES NEW OPPORTUNITIES FOR ARBITRAGE.

The remaining disparity among rates under the Missoula Plan does not eliminate the incentive for carriers to seek to evade higher ICC charges. As discussed above, great

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[26] Missoula Plan, II-B-3.

[27] Missoula Plan, II-A.

differences in rates will exist between carriers in different Tracks, and within Track 3. The Missoula Plan may even allow some intrastate Track 3 ICC rates to increase to match higher interstate levels, which will exacerbate those incentives for arbitrage. Any rational carrier, including VoIP providers, newly subject to ICC charges under the Missoula Plan,[28] will seek to evade these higher costs. A specific example is that 8YY calls can be turned into local calls based on routing.

It should also be recalled that any massive change in a system -- like that embodied in the Missoula Plan -- creates uncertainty and increases the incentive to seek advantage from the change. Incremental changes to the current system, such as those proposed by NASUCA, are much more likely to obtain a satisfactory result without imposing new, unintended consequences.

D. THE TARGET TERMINATION RATE FOR TRACKS 1 AND 2 IS ARBITRARY AND CAPRICIOUS AND RESULTS IN AN EXCESSIVE BURDEN ON END USERS.

As previously discussed, the target termination rate for Tracks 1 and 2 is $0.0005 per MOU. It is unclear how this particular termination rate was decided upon. Its derivation is not explained in the Plan. However, what is clear is that the termination rate of $0.0005 per MOU is below the existing rate for ISP-bound traffic of $0.0007 per MOU, currently the lowest ICC rate. The fact that the Missoula proponents chose a final target termination rate below the lowest existing termination rate shows that there was another agenda at work besides achieving a unitary ICC rate. It must be remembered that the driving force behind the Missoula Plan -- at&t -- was the principal proponent of the ICF's prior bill-and-keep proposal for ICC reform. It appears that the termination rate of

[28] Missoula Plan, III-D-3-i and ii.

$0.0005 per MOU included in the Missoula Plan was chosen because it was close to the ICF's bill-and-keep rate of zero.

The lower the target rate chosen, the more revenue is squeezed out of existing ICC rates and transferred to end users through SLC and USF increases. By choosing a target termination rate below the lowest existing termination rate, the Missoula Plan proponents have made a conscious choice to maximize the burden of the Plan on end users, but have provided no explanation for this choice.

It is obvious that a unitary ICC rate could have been achieved at a higher level which would have reduced the impact on end users. For example, a unitary ICC rate could be achieved by simply establishing the weighted average of all existing ICC rates. Based on 2003 minutes of use, this unitary rate would be approximately $0.014 per MOU. During a transition period, carriers receiving increased revenues under the new unitary rate would make payments to carriers that received less revenue. After a reasonable transition, the Commission could determine what if any of these transfer payments should be moved to the USF. There would be no impact on end user rates under this hypothetical.

NASUCA is not recommending this approach, however. NASUCA's position continues to be that moderate reforms and gradual movement toward unitary rates is the preferred route.[29] However, the example discussed above shows that a unitary ICC rate

[29] See Section VIII. below.

can be achieved with minimal impact on the USF and end user rates.[30] The question then is why didn't the Missoula Plan proponents propose such a unitary rate? The answer is simple: ILECs are still net payers under reciprocal compensation arrangements, including ISP-bound dial-up traffic. Increasing reciprocal compensation rates to a unitary ICC rate higher than current reciprocal compensation rates would result in greater expense for the ILECs. Since the Missoula Plan is an ILEC-centric plan, this outcome was unacceptable to the Missoula Plan proponents. Those proponents, however, obviously have no problem supporting a plan which raises costs for competitors and end users. The Commission should scrap the Missoula Plan and embark on a course of more moderate and more equitable ICC reform that benefits all parties.

E. THE MISSOULA PLAN AMOUNTS TO A REVENUE PRESERVATION FUND WHICH IMPROPERLY FAVORS INCUMBENT CARRIERS.

The Missoula Plan reduces ICC rates for ILECs by $6 billion, and replaces these revenues with $6.9 billion in increased end user charges.[31] SLCs are increased by $4.7 billion and USF charges are increased by $2.225 billion.[32] The "Access Shift per Line," which is the basis of the SLC increases and the Restructure Mechanism increases to the USF, is established at the first step of the Missoula Plan, based on the previous year's

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[30] If there are concerns about new arbitrage opportunities caused by traffic imbalances priced at the higher national average rate, the Commission could establish a lower unitary rate, perhaps at the existing target rate of $0.0055 per MOU. See Section VII.A.1. below.

[31] As discussed in Section VI. below, the $6.9 billion price tag for the Missoula Plan is understated.

[32] Although not included in the estimated increase in the SLC, CLECs can and do charge SLCs on their customers. As shown in the NASUCA Comments filed May 23, 2005 in this proceeding, most CLECs mirror ILEC SLCs, although a few have recently imposed even higher SLCs to recover a variety of costs. If ILEC SLCs increase as a result of the Missoula Plan, it is an absolute certainty that CLEC SLCs will increase as well, resulting in an even higher net impact on end users.

ICC revenues.[33] This Access Shift per Line does not change in subsequent years for Track 1 and 2 carriers, even if lines and MOU continue to decline. Moreover, Track 3 carriers are protected from any loss in revenue occasioned by loss of customers through a recalculation of the carrier's revenue requirement at each step.[34] In other words, while Track 1 and 2 ILECs are well- protected from ICC revenue erosion by the Missoula Plan, Track 3 carriers are made immune to competitive losses.

The method of determining lost revenues to be included in the "Access Shift per Line" for different tracks also favors the incumbents in each of those tracks. Track 1 carriers have their "Access Shift" calculated based on: (1) originating access revenues; (2) terminating access revenues; (3) additional expenses for dedicated transport; (4) ICC revenues lost or additional ICC revenues paid as a result of changes in rules for terminating and transporting Extended Area Service ("EAS") traffic.[35] Track 2 carriers are allowed to include: (1) originating access revenues; (2) terminating access revenues; (3) ICC revenues lost or additional ICC revenues paid as a result of changes in rules for terminating and transporting EAS traffic; (4) ICC revenues lost or additional ICC revenues paid as a result of changes in rules for reciprocal compensation; and (5) ICC revenues lost or additional ICC revenues paid as a result of changes in rules for traffic currently subject to settlements.[36] Rate of return carriers (primarily Track 3) will have their lost revenue calculated based on: (1) intrastate switched access revenues; (2) net

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[33] Missoula Plan, VI-A-1-b-iii.

[34] Missoula Plan, VI-A-1-e.

[35] Missoula Plan, VI-A-1-b-ii-1 through 4.

[36] Missoula Plan, VI-A-1-c-ii- 1 through 3.

reciprocal compensation revenues; and (3) interstate switched access revenues.[37]

Briefly stated, the major difference between the Tracks is that lost revenues of Track 1 carriers do not include reciprocal compensation. This is because large Track 1 carriers are net payers of reciprocal compensation. Thus, exclusion of net reciprocal compensation revenues in the calculation actually increases the amount of lost revenue that Track 1 carriers can recover. On the other hand, smaller Track 2 and 3 carriers are generally net recipients of reciprocal compensation revenues. For these carriers, inclusion of net reciprocal compensation revenues increases the amount of lost revenue that can be recovered. The entire Missoula Plan is unfairly skewed to guarantee the largest amount of revenue recovery possible for incumbent carriers.

The USF portions of the Missoula Plan also favor the incumbents. The Restructure Mechanism is explicitly available only to the incumbents.[38] Both the Restructure Mechanism and the increase in the Low Income Fund are established specifically to preserve the current revenues of the ILECs. Finally, the Early Adopter Fund and increases in the High Cost Loop Fund ensure that ILECs will actually recover more in increased revenues from end users than they lose in reductions in ICC rates.[39] The Missoula Plan acts as a revenue preservation and enhancement mechanism which insulates large portions of ILECs ICC revenues from the effects of competition. While a revenue preservation mechanism may be appropriate as part of a short-term transition vehicle, to permanently enshrine ICC revenues in higher SLCs and USF charges as called

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[37] Missoula Plan, VI-A-1-e-ii-1. and 2.

[38] Missoula Plan, VI-A-2.

[39] As discussed in Section II.G. below, there is absolutely no requirement or commitment in the Missoula Plan that the $6 billion in ICC reductions will be passed through to end users.

for in the Missoula Plan is improper and should be rejected.

F. THE MISSOULA PLAN IMPROPERLY IGNORES CONTINUING DECLINES IN INTERCARRIER REVENUES FOR INCUMBENT CARRIERS.

One of the more galling aspects of the Missoula Plan as a revenue preservation mechanism for ILECs is the fact that it not only replaces ILECs' lost ICC revenues, but replaces an obsolete level of ICC revenue that is excessive. ICC minutes of use and revenues have been declining about 5% per annum since 2000, as demonstrated by the following table:

DECLINE IN ICC MOU AND REVENUES 2000 - 2005

Year	Billion MOU	Rate per KMOU	Revenue $Million
2000	848.4	$13.70	$11,627.1
2001	804.8	$13.82	$11,121.9
2002	728.3	$14.04	$10,228.3
2003	668.6	$14.33	$9,579.4
2004	632.0	$14.37	$9,082.6
*2005	607.9	$14.55	$8,842.2
*2006	580.5	$14.67	$8,518.5

Source: FCC Trends in Telephone Service, June 2005
*MOU estimated
Rates based on NASUCA Estimates[40]

These ICC MOU and revenue declines are continuing. In spite of this -- or perhaps because of this -- the Missoula Plan establishes the revenue to be recovered by

[40] The decline in ICC revenue shown on the above table is based entirely on decline in MOU. The ICC rates for each year are from a base year of 2003 and incorporate rate reductions caused by previous regulatory mandates in the CALLS and MAG proceedings. See *In the Matter of Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, FCC 00-193 (rel. May 2000) ("CALLS Order"); *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 No. 00-256, *Second Report and Order*, FCC 01-304 (rel. November 2001) ("MAG Order"). Changes in the weighted average rate per KMOU each year are caused by different proportions of rate of return, price cap, interstate and intrastate minutes. Since lower-priced price cap MOU are declining at the fastest rate, the weighted average KMOU has generally risen over time.

incumbent carriers at the levels of the year immediately preceding implementation of the Missoula Plan.[41] Given that ICC revenues are continually declining, the Missoula Plan guarantees recovery an amount of ICC revenues that is greater than the revenues that will actually be lost whenever the Missoula Plan is implemented. Under the Missoula Plan the "access shift per line" is frozen in the first step and continues as the target revenue level throughout the future steps of the Missoula Plan, even though ICC revenues under the existing system would have been lower with each succeeding year.

Adding insult to injury, there is no consideration in the Missoula Plan of the additional revenues that ILECs gain from serving new broadband lines which are outside of the current ICC system. In other words, ILECs are losing lines and MOU as consumers drop traditional landlines and add broadband lines to access the Internet. However, the revenue gains from broadband line additions are totally out of the picture as far as the Missoula Plan is concerned.

The current system is providing its own transition from the old circuit-switched world to the IP-based world as consumers individually make choices to drop ILEC circuit-switched lines and migrate to broadband lines; or substitute wireless service for wireline long distance; or drop landlines for wireless or VoIP service. The Missoula Plan would preserve yesterday's ICC revenues in increased end user rates and increased USF assessments. The desire of the Missoula Plan proponents to preserve past revenues is entirely understandable, but should not be part of any telecommunications policy decision made in the public interest.

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[41] Missoula Plan VI-A-1-b-ii-1-a. At these revenue levels, many ILECs earned supracompetitive returns on their interstate services. See NASUCA Reply Comments (July 20, 2005) at 41-46.

G. THERE IS NO ASSURANCE THAT ICC REDUCTIONS CALLED FOR IN THE MISSOULA PLAN WILL BE FLOWED THROUGH TO CUSTOMERS.

As previously discussed, the Missoula Plan calls for reductions in ICC payments made to ILECs. The payments come from providers of interexchange services, primarily interexchange carriers ("IXCs"). Under the Plan ILECs are made whole for these lost revenues through increases in SLCs and USF payments.[42] These increased SLC and USF payments will come from end users. In order for end users to be made whole, the reductions in ICC payments to ILECs will have to be flowed through to end users by the entities that received the benefit of the reductions, namely the IXCs and other long-distance carriers. **Unfortunately, there is not one word in the Missoula Plan that guarantees, requires or assures that these reductions in payments will be flowed through to end users**. Without such a requirement, there is absolutely no assurance that end users will see any savings in toll rates at all.

Both the customer impact scenarios and the economic benefit study presented by the proponents of the Missoula Plan assume 100% flow-through of the ICC reductions to end users in the form of lower long distance rates. The Assumptions page for the customer impact scenarios states: "It is also assumed that by the end of the Plan's transition, all carriers will flow through 100% of their realized access savings into lower Toll charges."[43] The Economic Benefit study attached to the Plan is based on the assumption that "the plan's switched access reductions … will be phased in evenly over

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[42] See, for example, Missoula Plan VI-A-1-b-iv: "At Step 4 of the Plan, the carrier may recover -- through SLC increases and the Restructure Mechanism -- 100 percent of its Access Shift per Line, multiplied by its number of lines at Step 4."

[43] Missoula Plan, Exhibit 1.

four years and be flowed through to retail toll rates."[44]

The assumption that 100% of the access reductions called for in the Missoula Plan will be flowed through to customers is erroneous for several reasons. First, the proponents argue that competitive market forces will compel IXCs to flow through access reductions. The problem with this argument is that the stand alone IXC industry has virtually ceased to exist. In the past two years, the two largest ILECs -- SBC and Verizon -- have acquired the two largest long distance providers - AT&T and MCI. As a result, the new at&t and Verizon now control almost 60% of the residential long distance market within their ILEC territories.[45] The pending acquisition of BellSouth by at&t will only increase this dominance.

Second, because of these acquisitions, many existing ICC payments are merely intra-company transfers: payments by one subsidiary are booked as revenues by another subsidiary. It is likely that holding companies will engage in rational revenue maximization behavior by not flowing through expense reductions, not flowing through all such reductions, or delaying such flow through. A recent example of such behavior came in the elimination of the USF assessment on DSL service. Both Verizon and BellSouth responded to the elimination of this USF expense by replacing the USF surcharge with a different surcharge of roughly the same size, effectively increasing bottom-line revenues by the amount of the former USF surcharge. Although political pressure from the Commission forced these companies to rescind these surcharges, the

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[44] Missoula Plan, Exhibit 2, *Economic Benefits from Missoula Plan Reform of Intercarrier Compensation*, Richard N. Clarke and Thomas J. Makarewicz (July 2006) ("Clarke Paper"), p. 2.

[45] *Local Telephone Competition: Status as of December 31, 2005*, FCC IATD (July 2006), Table 6. The timing of this report probably does not fully capture the integration of MCI's lines into Verizon's operations.

inability of the market alone to discipline this revenue-maximizing behavior is obvious.

Third, any long distance competition provided by wireless and VoIP carriers will not be effective in forcing flow through of access reductions. Since wireless and VoIP carriers currently pay few if any access charges, the impact on these carriers from the Missoula Plan access reductions will likewise be small.[46] As result, even if effective long distance competition is present, it is not likely that IXCs will have to flow through their larger access reductions in order to match any rate reductions by wireless and VoIP carriers.

As a fundamental principle of fairness, if customers are expected to pay end user rates that will be $6.9 billion higher as a result of the Missoula Plan, they should be given a guarantee that the $6 billion in access reductions will actually be flowed through to their rates as well. Without such a guarantee, the Plan should be given no consideration at all. However, even with such a guarantee, the manifold flaws in the Plan discussed herein would still require its rejection.

A partial, but insufficient solution would be for the ILEC recipients of the increased SLC to reduce the price of their local and long distance calling packages by the same amount. If SLC increases are intended to offset reduced intercarrier compensation paid by carriers on a revenue neutral basis, it is reasonable that carriers would commit to reduce such flat rate packages at least by an equal amount. Such a commitment would help achieve the goal of flow through that the Missoula Plan promises to achieve.

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[46] In fact, some wireless and VoIP carriers complain that the Missoula Plan will raise their ICC payments.

H. THE CONSUMER SAVINGS CLAIMED BY PROPONENTS OF THE MISSOULA PLAN ARE DECEPTIVE AND MISLEADING.

One of the main selling points for the Missoula Plan pushed by its proponents is its purported consumer savings.[47] According to "Consumer Impact Charts" attached to the Missoula Plan as Exhibit 1, most individual consumers would be better off economically as a result of the Missoula Plan.[48] Low-volume users would see cost increases.[49]

Yet upon closer examination all of the claimed consumer savings evaporate. In the first place, all cases presented in the "Consumer Impact Charts" assume 100% flow-through of access reductions to end-users. As discussed above, **the Missoula Plan does not include one word guaranteeing or committing to flow-through of any reductions by any carrier**.[50] To base heralded savings on factors that are entirely absent from the plan is misleading at best, deceptive at worst.

In addition to overstating hypothetical savings, the Consumer Impact Charts understate real costs. All of the consumer scenarios assume that the ultimate SLC will be $8.75 per month. While it is correct that SLCs for customers of Track 2 and 3 carriers will rise to $8.75 per month, these carriers serve only 12% of the access lines in the United States. Under the Missoula Plan, the SLC cap for Tier 1 carriers -- 88% of the Nation's access lines -- will rise to $10 by the fourth step and then increase by the rate of

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[47] Missoula Plan Supporters *ex parte* (July 25, 2006) at 3.

[48] Missoula Plan, Exhibit 1.

[49] *Id*.

[50] The assumption of flowthrough presumes a level of competition in the long-distance market that no longer exists. Because of recent acquisitions of major interexchange carriers by large Regional Bell Operating Companies, the stand-alone long distance industry has virtually ceased to exist.

inflation thereafter. Thus, the $8.75 SLCs shown for "urban" consumers in the Consumer Impact Charts are understated.

And finally -- and most outrageously -- the model assumes a radical change in the USF assessment mechanism which will magically result in lower USF assessments for most customers in spite of a 32% increase in the overall size of the USF.[51] The USF assessment system used in the Consumer Impact Charts apparently replaces the current revenue-based mechanism with an assessment system based on telephone numbers and connections. As stated in a footnote to the "Summary Matrix" in Exhibit 1, this hypothetical assessment system "is not part of the Plan."[52] This is an understatement. While the Missoula Plan proponents agree that the USF contribution base should be broadened, there is no agreement in the Missoula Plan to adopt any particular type of assessment mechanism. In spite of this, the Plan's proponents once again base their alleged consumer savings on factors that are not in the Plan.

As discussed in detail below, the Missoula Plan will result in a 32% increase -- and more -- in the overall USF. This dramatic increase will undoubtedly cause an increase in USF costs for virtually all Americans. Applying this 32% increase to the current assessment system will result in an increase in the USF assessment factor from 10.5% to 13.9%. For the Missoula proponents to instead present Consumer Impact Charts which allege that almost all consumers will pay less for USF under the Missoula

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[51] If virtually all residential customers would pay less under the hypothetical USF assessment system proposed by the Missoula Plan proponents, this means that someone else or some other group of customers must be paying more. This means that business, institutional and governmental customers would actually pay more in USF assessments under this system, although the impact on these customers is never discussed in the Missoula Plan.

[52] Missoula Plan, Exhibit 1, Summary Matrix, footnote.

Plan is misleading at best, deceptive at worst.

If one takes the Missoula Plan exactly as written -- no flow through of access reductions, increases in the SLC for all customers, and a 32% increase in the size of the USF -- **all consumers are worse off under the Missoula Plan.** The table below uses the same scenarios presented in Exhibit 1 to the Missoula Plan and summarizes the real impact of the Plan on consumers:

COMPARISON OF CONSUMER IMPACTS FROM MISSOULA PLAN

	Customer Type	Net Change in Customer Bills Calculated by NASUCA			Net Change Claimed by Missoula Proponents	Difference
		Current Rules Federal USF @ 10.5%	Missoula Plan Federal USF @ 13.9%	Net Change		
1	DSL with VoIP & Wireless	$107.65	$108.81	$1.16	-$1.11	$2.27
2	Cable Modem with VoIP	$66.70	$67.24	$0.54	-$0.43	$0.97
3	DSL with VoIP	$55.70	$56.24	$0.54	-$0.43	$0.97
4	Wireline-Urban-Medium with DSL	$69.36	$74.78	$5.42	-$0.34	$5.76
5	Wireline-Urban-Low	$32.85	$38.10	$5.25	$2.05	$3.20
6	Wireline-Urban-Medium	$40.36	$45.78	$5.42	-$0.34	$5.76
7	Wireline-Urban-High	$83.30	$89.66	$6.36	-$14.00	$20.36
8	Wireline-Rural-Low	$29.72	$32.68	$2.96	$1.50	$1.46
9	Wireline-Rural-Medium	$40.45	$43.65	$3.20	-$1.91	$5.11
11	Wireline-Lifeline-Medium	$15.65	$15.77	$0.12	-$1.71	$1.83
12	Wireline-Lifeline-High	$42.49	$43.20	$0.71	-$10.25	$10.96
13	Wireless-Low	$31.17	$31.54	$0.37	$0.10	$0.27
14	Wireless-Medium	$51.95	$52.57	$0.62	-$0.68	$1.30
15	Wireless-High	$103.89	$105.14	$1.25	-$2.63	$3.88

USF: Assumes the $2.225 billion increase in the USF included in the Missoula Plan ($1.5 billion Restructure Mechanism; $0.3 billion increase in High Cost Loop Fund; $0.2 billion Early Adopter Fund; and $0.225 billion for Lifeline). This increases the current fund by 32%. Accordingly, the customer bill scenarios assume a 32% increase in the current assessment factor, from 10.5% to 13.9%.
Access Reductions: The Missoula Plan does not call for, require or mention flow through of access reductions to customer bills. Accordingly, the customer bill scenarios assume that 0% of access reductions will be flowed through to customer bills.
Service price includes monthly service charges, increased subscriber line charge per Missoula Plan, and Federal USF surcharges; does not include taxes, fees, or other surcharges.

As can be seen, every type of customer will experience an increase in monthly rates under the exact terms of the Missoula Plan. The details of each consumer scenario are presented in Attachment A. If for no other reason than the unreasonable costs which are imposed on end-users, the Commission should reject the Missoula Plan.

I. THE CLAIMED ECONOMIC BENEFITS OF THE MISSOULA PLAN ARE BASED ON ERRONEOUS ASSUMPTIONS.

Richard N. Clarke and Thomas J. Makarewicz filed a paper on behalf of AT&T called the "Economic Benefits from the Missoula Plan Reform of Intercarrier Compensation" ("Clarke Paper"). The Clarke Paper attempts to demonstrate the economic welfare increase associated with the access reform. The measure of economic welfare used is the change in the consumer surplus due to a change in the access prices.[53] Consumer surplus measures the difference between the price a consumer is willing to pay for a service and the price that the consumer actually pays for the service. The amount that consumers are willing to pay for a service is the area under the demand curve. The amount that consumers pay for the product is the price times the quantity purchased. When the price decreases, consumer surplus increases.

The Clarke Paper provides a graphic display of the increase in consumer surplus in its Figure 1. In Figure 1, the increase in consumer surplus is divided into two shaded areas: the toll price reduction and toll demand stimulation. The toll price reduction area is equal to a decrease in producer surplus because it measures the lost revenue to the producer, in this case the telecommunication carriers. This portion of the consumer surplus gain is not a gain to society. Rather it is just an income distribution between consumers and producers. The toll demand stimulation is known as a dead-weight gain

[53] Clarke Paper, Section 2.1.

(loss) if price decreases (increases). This is the part of the consumer surplus that measures the economic benefit to society, rather than the benefit to one segment of the consumers.

The Clarke Paper only shows the demand curves in markets where price is decreasing. There is a similar curve in the SLC market, however, where the price is increasing, which generates a dead-weight loss. The true measure of the economic benefit is the difference between the dead-weight gain in the toll market and the dead-weight loss in the SLC market.[54] It should not include the offsetting increases and decreases of consumer and producer surplus. Thus, the first error in the Clarke Paper is incorrect definition of the economic benefit.

By not showing the SLC market, the Clarke paper is implicitly assuming that increases in the SLC will not affect that demand for wireline telephone service. Traditionally, economists have believed that the effect on the demand for wireline service associated with a change in price is extremely small. More formally, the change in demand related to the change in price is measured by the elasticity of demand, which is defined as the percentage change in the quantity demanded divided by the percentage change in the price. While the elasticity of the price for wireline telephone service may be low, it is not zero, as the Clarke Paper assumes. Although historically the elasticity of demand for wireline service was relatively low, it is possible that the elasticity has increased recently due to the fact that some customers may "cut the cord" and switch to only wireless service when the SLC increases. Wireless-only service was not available or was not viewed as a choice when many of the elasticity studies were performed. Thus,

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[54] F.M. Scherr and David Ross, *Industrial Market Structure and Economic Performance*, 3rd Edition, Pages 21-29.

those old studies should not be used in the current environment. Therefore, the second error in the Clarke Paper is the over-estimation of the surplus due to the failure to evaluate the impact of price change on the demand for wireline telephone service.

The third major error in the analysis is the elasticity of demand estimate used for toll service. For many customers toll service is no longer an independent commodity. Instead, it is purchased as part of a bundle of services that may include vertical features, local service, data and video. As with the elasticity estimates discussed under the second error, given the change in purchasing practices, old elasticity studies no longer define the current demand for toll service. In addition, many telecom bundles are sold on a flat-rate basis, which means that the customer pays the same amount regardless of usage. Thus, there is no incremental cost to the customer for additional minutes of use. In this situation, decreases in access charges, even with a 100 percent pass-through of access reductions as assumed by the Clarke Paper, cannot stimulate the demand for toll service. Without demand stimulation, there is no dead-weight consumer surplus gain associated with the access rate reduction, and thus, there is no societal benefit associated with the access reduction.

The fourth major error of the Clarke Paper is the assumption that 100 percent of the access reduction will be immediately passed through to consumers. This assumption is driven by the abstract assumptions of extreme competition in the market place. However, as Shapiro and Varian point out in their practical guide to pricing, the best strategies for producers of goods and services are strategies that allow price and cost to separate.[55] Firms will follow this strategic guide rather than abstract assumptions. Those

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[55] Carl Shapiro and Hal Varian, *Information Rules: A Strategic Guide to the Network Economy*, 1999.

strategies may include increases to monthly charges or long term contracts with penalty clauses, or delay in the pass through of access reductions. The result of those strategies would lead to minimal, or certainly less than 100 percent pass-through of the access reduction.

The fifth major error of the Clarke Paper involves a misunderstanding of the way in which consumers use their wireless telephones. Many consumers use their phones to make long distance calls during off-peak hours. These calls have a zero price. Changes in the average price paid per wireless minute will have no impact on the amount of usage of these types of wireless calls. This is another reason why decreases in access charges prices may not encourage additional wireless usage.

The sixth major error of the Clarke Paper is that it does not include any secular decline in wireline minutes of use per customer or number of customers. These declines are not related to wireline prices. They have been associated with the transfer of toll minutes to wireless service and wireline lines to DSL and special access services. Failure to incorporate these changes overstates the alleged consumer benefits associated with the Missoula Plan. On the other hand, the Clarke Paper does incorporate the secular trend in the growth in the number of wireless lines. This asymmetric assumption set skews the results to show a higher level of benefit than actual future consumer action will cause.

The seventh major error in the Clarke Paper is that it assumes a significant difference between the incremental step one end user increase and the incremental step one toll price reduction.[56] The step one end user increase is the access shift per-line pro-rated to the first period. It is the change in access rates in the first period times the

[56] Clarke Paper Figure two, step one toll rate reduction (Area A) is reported at $2,100,703,141, while the Incremental End User increase is $1,523,106,000.

quantity sold. The toll reduction is the change in toll rates in the first period times the quantity sold. However, given the 100 pass-through assumption, retail toll rates would change by exactly the same amount as access rates. The quantities are the same in the base period. Thus the toll revenue reduction should equal the access shift increase in the first step. The reported difference implies that the Clarke Paper starting assumptions are incorrect. The fact that these two numbers are substantially different in the Clarke Paper is major driver of the Clarke Paper toll market benefits. Therefore, the resultant benefit calculation based on incorrect inputs must also be incorrect.

The cumulative effect of all the errors included in the Clarke analysis make it worthless for use in evaluating the effect of the Missoula Plan. Accordingly, it should not be relied upon by the Commission in any part of its consideration of the Missoula Plan.

III. THE REAL COSTS OF THE PLAN FAR OUTWEIGH ANY PURPORTED BENEFITS.

A. THE MISSOULA PLAN REQUIRES END USER RATES TO INCREASE $6.9 BILLION TO PAY FOR $6 BILLION IN INTERCARRIER COMPENSATION RATE REDUCTIONS.

As previously stated, there is a substantial asymmetry in the reductions in access rates and the increases in end user rates set forth in the Missoula Plan. Under the explicit terms of the Plan, access rates are to be reduced by "nearly $6 billion" by the end of the fourth step of the Plan.[57] To pay for these reductions the Missoula Plan calls for end user rates to increase by $6.9 billion, as set forth below:

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[57] *Id*.

$4.700 billion increase in SLCs
$1.500 billion for "Restructure Mechanism"
$0.300 billion increase in the High Cost Loop Fund
$0.225 billion increase in the Low Income Fund
$0.200 billion for an "Early Adopter Fund"
$6.925 billion TOTAL

While paying $6.9 billion for $6 billion in access reductions is bad enough, the Missoula Plan compounds this injustice by containing no commitment or requirement that the reductions in access charges will be passed through to end users. On its face, the Missoula Plan is nothing less than a blatant rip-off of breathtaking proportions. The inherent inequity of the Missoula Plan in its most basic structure requires its absolute rejection by the Commission.

B. THERE IS NO SHARING OF THE BURDEN OF REDUCING INTERCARRIER RATES.

Even if one assumes that there is a problem with the current disparity in ICC rates,[58] the problem is principally one for the ILECs, who are continuing to experience declining ICC revenues. On the other hand, consumers are experiencing no such problem, being presented with new calling plans, new services and lower prices under current ICC rules. Since the Missoula Plan was devised principally by a group of ILECs, it is not surprising that there is no sharing of the burden of reforming ICC rates between carriers and consumers. It is not even surprising that as a result of the Plan, the ILECs are attempting to impose **almost a billion dollars more** on customers than the purported reduction in ICC rates. What is surprising is that the proponents of the Missoula Plan expect anyone else to take their attempt to insulate ICC revenues from competition seriously. The Commission should reject this attempt to detour the progress being made

[58] As previously discussed, the absolute size of this issue is declining with each passing year.

toward the IP-based telecommunications world and totally reject the Missoula Plan.

IV. THE MISSOULA PLAN IMPROPERLY PREEMPTS STATE AUTHORITY.

Although the Missoula Plan is cast as having optional elements, it explicitly includes complete FCC preemption of authority over ICC rates, both interstate and intrastate.[59] There is no basis in law for such an arrogation of authority by the Commission. The proponents of the Plan concede this when they assert: "The FCC will need to adopt *assertive new legal strategies* to implement those provisions and, in particular, to establish uniform rates for all traffic terminated by carriers in those Tracks, including traffic traditionally characterized as 'local' and 'intrastate access.'"[60]

The proponents' declaration of a "need to adopt assertive new legal strategies to implement" the Plan is driven by their knowledge that the applicable law has not changed. Sections 152(b) and 251(d)(3) of the Act still govern jurisdiction and expressly reserve to the states authority over intrastate rates.

Since *Smith v. Illinois Bell*, jurisdictional separations have been recognized as essential to the proper operation of the parallel federal and state regulation of interstate and intrastate telecommunications required by law: "[P]roper regulation of rates can only be had by maintaining the limits of state and federal jurisdiction."[61] In the Communications Act of 1934, Congress expressly denied the FCC "jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or

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[59] Missoula Plan, Attachment A.

[60] Missoula Plan Supporters *ex parte* (July 25, 2006) at 5 (emphasis added).

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

in connection with intrastate communication service by wire or radio of any carrier ....”[62] The broad language of Section 152(b) “contains not only a substantive jurisdictional limitation on the FCC’s power, but also a rule of statutory construction (‘[N]othing in this *chapter* shall be construed to apply or give the Commission jurisdiction with respect to ... intrastate communication service…’).”[63]

The access charge regime, designed to permit local exchange carriers to recover costs caused by an interexchange carrier’s origination and termination of long distance calls on the local carriers’ network, has been in place since the early 1980s. The 1996 Act added exceptions for the establishment of local competition to the general “command of § 152(b) that ‘*nothing* in this chapter shall be construed to apply or give the Commission jurisdiction’ over intrastate service.”[64] However, the 1996 Act **did not** eliminate the preservation of state jurisdiction over intrastate access charges so clearly expressed in Section 152(b).

The 1996 Act granted jurisdiction to the FCC relating to intrastate communication service, but limited that jurisdiction to authority necessary to facilitate the development of competition in telecommunications local exchange service markets, and to preserve the competition which had developed in telecommunications toll service markets.[65] The 1996 Act, however, clearly did not transfer jurisdiction of switched access service for intrastate toll service, or the regulation of prices for such service, from the states to the

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[62] 47 U.S.C. 152(b).

[63] *Louisiana PSC v. FCC*, 476 U.S. 355, 373 (1986) (“*Louisiana PSC*”) (emphasis supplied).

[64] *Id*., 476 U.S. at 377 (emphasis in original).

[65] 47 U.S.C. 251 *et seq.; see, e.g., A.T.&T. Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378-82 and n.8 (1999).

FCC. In fact, the FCC's attempt in the 1996 *First Report and Order* to assert regulatory jurisdiction over intrastate access charges was vacated on appeal as "an assertion of regulatory power ... beyond the scope of the FCC's jurisdiction" as limited by § 152(b).[66]

The Missoula Plan proponents also contend the FCC can preempt state authority over intrastate access under the "impossibility" exception to jurisdictional separation referred to in footnote 4 in *Louisiana PSC*.[67] The proponents argue the FCC "cannot achieve the critical federal goal of effective intercarrier compensation reform if the States substantially deviate from the national plan for intrastate access charges."[68] The proponents characterize their argument as "**an appropriately robust** reading of the footnote 4 exception to *Louisiana PSC*."[69] The Missoula Plan proponents' interpretation of the "footnote 4 exception" may be "robust," but the interpretation is absolutely circular. In reality, the proponents simply argue the FCC must preempt state jurisdiction of intrastate intercarrier compensation because it is impossible to exercise exclusive FCC jurisdiction over both interstate and intrastate intercarrier compensation if the federal statute prescribes FCC jurisdiction of interstate ICC and state jurisdiction of intrastate ICC.

Though suggesting their circular reasoning is sufficient, the proponents also espouse the "inseverability" justification for FCC preemption.[70] They assert that it is

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

[67] Missoula Plan Supporters *ex parte* (July 25, 2006) at 5, and Attachment A at 4-6, citing *Louisiana PSC*, 476 U.S. 355, 376 n.4 (1986).

[68] Missoula Plan Supporters *ex parte* (July 25, 2006), Attachment A at 5.

[69] *Id.* at 6 (emphasis added).

[70] *Id.*

increasingly difficult, and often impossible, to identify wireless and VoIP traffic as interstate or intrastate, and such traffic is a growing share of all traffic.[71] The "inseverability" justification of preemption does not apply, however, where it remains both entirely possible and practical to identify and separate long distance calls that begin and end within a single state.[72] The fact is that end-points are easily verifiable for the vast majority of calls; some wireless and some VoIP traffic remain minor exceptions.[73] Local exchange carriers continue to have and to exercise the ability to separate wireline traffic into interstate and intrastate components – such traffic remains severable.

The proponents characterize their Plan as "a cooperative effort between the FCC and the States."[74] As filed, the Plan is an attempt to abrogate state authority prescribed in the federal statute, and should be rejected.

V. THE MISSOULA PLAN'S PROPOSED CHANGES TO THE SUBSCRIBER LINE CHARGE ARE IRRATIONAL AND UNDULY DISCRIMINATORY.

The Missoula Plan supporters say that the Missoula Plan results in "modestly higher" SLCs.[75] This is a blatant understatement: The overall SLC caps for Track 1

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[71] *Id.*

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

[73] *In the Matter of AT&T Corp. Petition for Declaratory Ruling Regarding Enhanced Prepaid Calling Card Services*, WC Docket No. 03-133; *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Order and Notice of Proposed Rulemaking, FCC 05-41 (rel. February 23, 2005), ¶¶ 22-29.

[74] Missoula Plan Supporters *ex parte* (July 25, 2006) at 4.

[75] *Id*. at 1.

carriers rise from $6.50 to $10.00, an increase of 54%. Under the terms of the Missoula Plan, SLCs in Washington, D.C. would rise from $3.85 to $10.00 and beyond, an increase of two-and-a-half times; in California, the non-rural companies' SLCs would increase from $4.38 to $10.00 and beyond; and in states like Ohio the non-rural companies' SLCs would go from $5.39 to $10.00 and beyond, almost doubling. If those increases are "modest," it would be interesting to see what the Missoula Plan supporters would consider a substantial increase. The Missoula Plan's treatment of the SLC is one of the main reason the Plan must be rejected.

A. THERE IS NO BASIS FOR THE DIFFERING SLC CAPS BETWEEN TRACKS.

Under the Missoula Plan Track 1 carriers are the largest carriers in the nation, serving 88% of access lines and the largest urban areas. These Track 1 carriers have a SLC cap of $10.00 at the fourth step of the Plan. These carriers generally have lower overall costs, have lower current SLC rates and require less USF support.[76] Track 2 and Track 3 carriers are smaller carriers serving 12% of the access lines and typically serve more rural areas. These carriers have a SLC cap of only $8.75. These Track 2 and 3 carriers have higher costs, have higher current SLC rates, and require more USF support.[77] The differential in SLC caps provided for in the Missoula Plan makes no sense and runs counter to costs.

In essence, the SLC caps contained in the Missoula Plan amount to a return to old "value of service" ratemaking, whereby high-cost rural customers paid lower rates than

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[76] See, Universal Service Administrative Company ("USAC"), *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2006* (Aug. 2, 2006), Appendix HC01; Billy Jack Gregg, *Survey of Unbundled Network Elements in the United States* (March 2006), Appendix 2.

[77] *Id.*

low-cost urban customers. Moreover, since Track 1 carriers serve rural populations in addition to their urban bases, the SLC differential between tracks can result in similarly situated and geographically close rural customers of different carriers having substantially different SLC rates. This difference will only increase as the Track 1 SLC rises with inflation after the fourth step.

The proponents of the Missoula Plan have presented no justification for the differing SLCs among different Tracks. Without such a justification, the different SLC levels specified in the Missoula Plan can only be considered arbitrary and capricious.

B. THERE IS NO BASIS FOR ALLOWING THE SLC CAP TO RISE WITH INFLATION.

Under the Missoula Plan the $10.00 SLC cap for Track 1 carriers is not the end point. Beginning in Step 5, the SLC cap for Track 1 carriers rises at the annual rate of inflation. This means at an annual rate of inflation of 5%, the SLC for customers of Track 1 carriers could rise to $10.50, $11.03, $11.58 and so on, *ad infinitum*. There is no limit in the Missoula Plan on the ability of carriers to increase the SLC by the rate of inflation after the fourth step of the Plan. This ability to increase the SLC by inflation applies only to Track 1 carriers. The SLCs for Track 2 and 3 carriers are capped at $8.75. Once again, there is no basis presented in the Missoula Plan for this disparate treatment of similarly situated customers.

Supporters of the Missoula Plan have suggested that the increase in the SLCs by the rate of inflation will decrease the size of the Restructure Mechanism over time. Even if this is true, it is scant comfort. At a 5% inflation rate it would take twenty years to eliminate Restructure Mechanism support for Track 1 carriers; at a 3% inflation rate, 33 years. The inflation adjustment to the SLC for Track 1 carriers amounts to nothing more

than backdoor deregulation of local rates, and should be rejected by the Commission.

C. THE MISSOULA PLAN ALLOWS CARRIERS TO ENGAGE IN UNDUE PRICING DISCRIMINATION IN AREAS WITH LITTLE OR NO COMPETITION (RAMSEY PRICING OF THE SLC).

The Missoula Plan allows carriers to recover most of their lost revenue through increases in SLCs. However, there are many issues associated with the SLC increase that are extremely complicated in the Missoula Plan. To understand these issues, it is necessary to define a number of terms and review how the Plan allows carriers to adjust SLCs over time.

First, there is a need to clarify the difference between allowed SLC increases and allowed increases in SLC caps. For example, the current residential SLC cap is $6.50. Over a four-step process, the Missoula Plan increases this cap to $10.00. In Step 5 the cap is $10.00 plus inflation.

The Plan establishes rules for SLC increases that are separate from the rules for SLC cap increases. It is, however, necessary to juxtapose the SLC increase rules and SLC cap increase rules and the pricing flexibility rules in order to get a clear understanding of how the SLC can increase. A carrier that strategically applies the rules will be able to increase the SLC to $10.00 plus inflation for at least one group of customers, minimize the SLC increase for other customer groups and still recover all of its allowed revenue increase. These strategic actions will discourage competition and extort revenues from the least elastic, most vulnerable customers. In short, the SLC pricing scheme set forth in the Missoula Plan amounts to classic Ramsay pricing -- the practice in a monopoly environment of placing price increases on the customer or group of customers with the least elastic demand.

1. SLC Caps under the Missoula Plan

There are three types of SLC caps included in the Missoula Plan. The first type is a **nationwide cap**. As discussed above, the current cap is $6.50. The nationwide cap for Track 1 carriers (88% of access lines) is allowed to increase to $10.00 during the first four steps of the plan and then increase with inflation in Step 5 and succeeding years.[78] The second cap restrains increases on **individual SLCs**.[79] It allows for increases of 95 cents in the first two steps, $1.20 in Steps 3 and 4. This individual SLC cap is eliminated after Step 4.[80] The third cap is related to the **average SLC within a defined market category.** The Plan defines two market categories. There is a Mass-Market category that includes primary residential lines, non-primary residential lines and single-line business. The second category is the multi-line business market defined as the Enterprise Service category. Within each market category, a carrier can de-average rates. The third cap is associated with the de-averaging process.[81]

The table below shows the impact of these caps on Verizon DC with an assumed

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[78] Missoula Plan, II-C-1.

[79] Missoula Plan, II-C-2.

[80] Missoula Plan, II-C-2-b.

[81] Missoula Plan, II-C-3.

Access Shift per Line of $1.71.[82]

	Verizon DC Residential SLC Caps		
Steps	National Cap	Individual Rate Cap	Average Rate Cap
1	$7.25	$4.80	$4.60
2	$8.00	$5.75	$5.35
3	$9.00	$6.95	$6.35
4	$10.00	$8.15	$7.35
5	increases with inflation	no longer binding	no longer binding

The current Verizon DC residential SLC is constrained to no more than $3.85 because the line "cost" is less than the current cap of $6.50.[83] In Step 1, Verizon DC's individual rate cap would increase to $4.80. Thus, even though the nationwide cap would be $7.25, no individual customer in D.C. would pay more than $4.80 during Step 1.

The average rate cap affects rate de-averaging. If Verizon DC chooses to set rates for half its residential customers at the $4.80 cap, then the cap for the other half of its customers would have to be $4.40, allowing the average rate to be $4.60. On the other

[82] The derivation of the $1.71 Access Shift per Line is shown in Attachment B. The Verizon DC study area is used as an example in this discussion because it does not have state toll service. Due to this unique situation, the access shift revenue and access shift per-line can be estimated from public data. For all other study areas the estimates of access shift revenue and access shift per-line are dependent on state access rates and state access minutes. Such data are not available publicly. Appendix D of the Missoula Plan suggests that state access minutes can be obtained from the Automated Reporting Management Information System ("ARMIS") 43-08 report. However, that report only requires carriers to report intrastate interLATA minutes. Thus, it under-reports state minutes to the extent that there are intrastate intraLATA minutes. The Appendix also calculates the state rate as revenue divided by minutes. If the revenue includes both inter- and intraLATA revenue and the minutes are only interLATA, then the rate is over-stated. Finally, some filers with only one LATA in the state have reported state interLATA minutes, and thus, it is not clear whether the report is accurate.

[83] The Verizon DC "CMT" per-line cost, which constrains the current SLC, is $3.85. This value is equal to the sum of common line cost, marketing expenses, and transport cost that the FCC allows to be recovered through the SLC.

hand, if Verizon DC chooses to retain study area average rates, then the highest rate cap for any residential customer would be the average rate of $4.60, even though the individual SLC cap is $4.80.

These principles work in the same way through Step 2, 3, and 4. In Step 4, the nationwide rate cap is still higher than the individual rate cap. Thus, the residential SLC cap for Verizon DC would be the lower individual rate cap of $8.15. Since the average SLC cap is lower still at $7.35, if Verizon DC divides the Mass Market into two equal sub-groups, the higher priced sub-group would be limited to a $8.15 rate cap and the lower priced sub-group would be limited to a $6.55 rate cap. Finally, if Verizon DC chooses to retain study area average rates, then the highest rate cap for any residential customer in DC would be $7.35.

In Step 5, however, the individual and average rate caps are eliminated. The only remaining cap is the national cap, and this cap is allowed to increase with inflation. In DC, the SLC cap would thus be $10.00 and up. These changes will allow the Residential SLC to continue to increase, leading to an excessively high Residential SLC for some customers.

2. SLC Increases Allowed Under the Plan.

The Plan appears to allow a maximum SLC increase that can be less than the caps. The maximum is a function of the "Access Shift Per-Line" for each carrier. If the carrier determines that its Access Shift Per-Line is greater than the maximum allowed SLC increase, then it can recover the excess from the Restructure Mechanism.

The Access Shift Per-Line is defined as the "Access Shift" divided by the number

of lines in the base period.[84] The Access Shift is defined as the loss in revenue that the carrier expects to lose over the course of the plan. For example, if the carrier has 3,000,000 terminating minutes in the base period and the terminating charge decreases from 0.55 cents to 0.05 cents, then the revenue loss associated with terminating charges would be $15,000. If the carrier has 10,000 lines in the base period, then the Access Shift per line is $1.50.

The Plan lists the type of revenues that each carrier would include in its Access shift estimate. They include originating access, terminating access, dedicated transport, and extended area service revenue.[85]

Conspicuously absent from the list is reciprocal compensation revenue. Given the typical assumption that large ILECs have a negative net reciprocal compensation revenue (that is, more traffic flows from ILECs to CLECs than from CLECs to ILECs), the failure to include reciprocal compensation in the Access Shift calculation increases the Access Shift levels. Higher Access Shift estimates increase SLCs. The Track One ILECs will receive the benefit of both the increase in SLCs and the reduction in reciprocal compensation payments.

The Access Shift is calculated as if the Plan's total rate reduction occurs instantaneously. It is based on the difference between the current rate and the step four rates. However, during Steps 1 through 3, the access rate reductions are lower than the final reduction. The Access Shift Per-Line is pro-rated to follow the rate decreases in the

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[84] The "base period" is defined in the Plan as the "the 12 month period ending six months prior to the effective date of annual price cap tariffs." Missoula Plan, VI-A-1-b-ii-1-a. This base period would typically be the previous calendar year.

[85] Missoula Plan VI-A-1-b-ii.

first three steps.[86] In Step 4, following the completion of rate reduction, the recoverable revenue equals the Access Shift Per-Line multiplied by the current lines. In each of the first three steps, the recoverable revenue equals the Access Shift Per-Line multiplied by the appropriate pro-rate multiplied by the current lines.

The Plan appears to be revenue neutral only if the current year line count equals the base year line count. If lines decline, the carrier's revenue declines. If lines increase, the carrier's revenue increases. However, given that the reciprocal compensation revenue is not included in the Access Shift estimate, it is still possible for the lines to decline and revenue to increase.

The Plan also does not specify the maximum recoverable revenue in Step 5, when the nationwide SLC cap begins to escalate by the rate of inflation. It is unclear whether the Access Shift Per-Line ever increases after Step 4 or for any other reason. An explicit statement that there can be no additional revenue shifts would be beneficial to clear up this ambiguity.

Another reason for requiring an explicit statement regarding this issue is that the Plan states: "[I]n the absence of deaveraging, a carrier's total recovery at a particular Step of the Plan -- from SLC increases and the Restructure Mechanism -- will equal the portion of Access Shift Per Line recoverable at that Step multiplied by the carrier's number of lines at that Step."[87] The phrase "in absence of deaveraging" requires further explanation. It is unclear whether the phrase implies that when a carrier deaverages its SLCs, it can recover in excess of an amount equal to the Access Shift Per-Line multiplied

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[86] Missoula Plan VI-A-1-b-iv.

[87] Missoula Plan VI-A-1-b-vi.

by the number of lines.

As noted above, the Verizon DC Access Shift Per-Line is approximately $1.71. This calculation is based on Verizon's current average traffic sensitive rate of $0.0067185 per MOU, the Plan's required terminating rate of $0.0005 per MOU and an originating rate of $0.02 cents per MOU. Appendix D of the Missoula Plan assumes that 60% of minutes are terminating and 40% are originating;[88] given the special nature of D.C., NASUCA has assumed that ARMIS reported interstate minutes are allocated 30 percent to originating minutes and 70 percent to terminating minutes. Finally, the net revenue loss associated with the reduction in access rates is divided by the total base period line count.[89] The implications of this calculation are discussed below.

3. The relationship between Enterprise and Mass Market SLCs

Currently, if the residential SLC is less than the residential SLC cap, the residential SLC and the multi-line business SLC are equal. For example, for Verizon DC both SLCs are $3.85. If the residential SLC equals the residential SLC cap, however, the multi-line SLC cap can be higher than the residential SLC but no higher than the multi-line business SLC cap of $9.20.

The Missoula Plan states that SLC price reduction for one market cannot be offset by SLC price increases in the other market.[90] This constraint places a limit on only one type of price discrimination. Current FCC rules prohibit carriers from setting the multi-

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[88] Missoula Plan, Appendix D, p. 101.

[89] The Verizon July 3, 2006 tariff filing is the source of the average traffic sensitive rate and the total base period line count.

[90] Missoula Plan II-C-5-b.

line business SLC lower than the residential SLC in a geographic market.[91] However, the Plan does not indicate if the current FCC rule will be maintained. Without the current rule, Verizon would be able to increase the residential SLCs and retain the current multi-line business SLC. Thus, the Plan does not prohibit carriers from increasing residential rates to recover Access Shift revenue associated with multi-line business customers.

An additional constraint is required to prevent carriers from increasing residential SLCs for the purpose of recovering Access Shift revenue associated with multi-line business customers. The additional constraint would be to set the allowed step 4 revenue recoverable from each market equal to the Access Shift per-line multiplied by the current period lines **in that market**.

4. SLC Pricing Flexibility Within a Market.

Under the Missoula Plan, price cap carriers will be allowed to vary their prices in many ways. During the first three steps of the plan, there will be some constraints placed on the pricing flexibility. For example, each carrier will be limited to four pricing zones. However, these constraints will be removed in Step 4.[92]

During the first four steps, when a carrier de-averages, the carrier is limited to the extent that there are caps on individual SLC increases. After Step 4, this limitation is no longer binding.[93] Moreover, there is nothing that prevents a carrier from reducing the SLC in one pricing zone and increasing the SLC in another zone as long no SLC exceeds the nationwide cap.

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[91] 47 C.F.R.§69.152(q)(3).

[92] Missoula Plan II-C-7-b.

[93] Missoula Plan II-C-2-b and II-C-3-d.

5. The Interaction of the Pricing Flexibility Rules

The following scenario illustrates how a carrier can use the pricing flexibility rules under the Missoula Plan to increase SLC rates to more than $10.00 for its most vulnerable residential customers, those with few or no competitive choices. Under the Missoula Plan these customers will be required to pay an extremely large and disproportionate share of Access Shift Per-Line revenue.

The scenario uses the data from Verizon DC. As calculated above, the Verizon DC Access Shift Per-Line is approximately $1.71. Verizon DC serves approximately 700,000 lines, of which 400,000 are multi-line business and 300,000 are residential. In this scenario, Verizon DC could divide the 300,000 residential customers into 200,000 preferred customers and 100,000 residual customers. The preferred customers are the customers that Verizon wishes to give discounts to and may have trouble retaining. These customers purchase large bundles of basic, vertical, video and long distance services. The residual customers purchase basic telephone service and maybe a vertical service.[94] They make minimal use of long distance service. Verizon would include its Lifeline customers in the residual category.

The strategy that places the burden of the Access Shift revenue recovery on residual residential customers would work as follows: In Steps 1 to 4, set the rate for the residual customers at the maximum cap for an individual residential rate. Next set the rate for the preferred residential customers such the average residential rate equals the average residential rate cap. If there is remaining Access Shift revenue that not can be

[94] The allocation of customers to preferred and residual groups could also be based geographically, so that urban and suburban customers are in the preferred class and rural customers are in the residual class. A carrier could also determine the geographic boundaries of the classes based on where a cable company is making a strong bid to enter the telephone market.

recovered from residential customers, then increase the multi-line business SLC to recover the remaining revenue. In Step 5, set the rate for the residual customers at $10.00 plus inflation, and reduce the preferred residential rate so that the total additional revenue equals Access Shift Per-Line multiplied by the number of lines.[95]

The following table illustrates the results of adopting the above strategy. The rate for the residual residential customers increases by $6.45 from $3.85 to $10.30.[96] The residual class contains only 14 percent of the lines but pays 54 percent of the revenue shift. The multi-line business SLC increase is $0.37. Multi-line business customers represent 57 percent of lines but are responsible for only 12 percent of the revenue shift. Finally, the preferred residential customer SLC increase by $2.03. The preferred residential customers represent 29 percent of the total lines and pay 34 percent of the revenue shift.

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[95] This last strategy assumes that any Step 1 to 4 increases in the multi-line business SLC cannot be reversed by raising a residential rate. If such action is permissible, then Step 5 could include a reduction in the multi-line business rate. In addition, the strategy is not dependent on the total number of lines. Thus, if the carrier losses lines, it will lose revenue but it still will be able to recover the majority of that reduced revenue from its residual class of customers by raising the SLC for the residual class to the maximum allowable cap.

[96] The $10.30 rate is based on a three percent inflation based adjustment to the SLC cap in Step 5.

	Verizon DC SLC Changes and Access Shift Revenue			
	Multiline business	Preferred residential	Residual residential	Total
number of lines	400,000	200,000	100,000	700,000
Step 1 SLCs	$4.04	$4.50	$4.80	
Step 1 access shift revenue	$891,000	$1,560,000	$1,140,000	$3,591,000
Step 2 SLCs	$4.22	$5.15	$5.75	
Step 2 access shift revenue	$1,782,000	$3,120,000	$2,280,000	$7,182,000
Step 3 SLCs	$4.22	$6.05	$6.95	
Step 3 access shift revenue	$1,773,000	$5,280,000	$3,720,000	$10,773,000
Step 4 SLCs	$4.22	$6.95	$8.15	
Step 4 access shift revenue	$1,764,000	$7,440,000	$5,160,000	$14,364,000
Step 5 SLCs	$4.22	$5.88	$10.30	
Step 5 access shift revenue	$1,764,000	$4,860,000	$7,740,000	$14,364,000
Percent of Lines	57%	29%	14%	
Percent of Access Shift Revenue	12%	34%	54%	

6. Additional SLC Price Flexibility Issues.

There are also some unusual statements in the pricing flexibility section of the Missoula Plan that require further explanation. For example, the SLC revenues generated by contract tariffs are not included in the price-cap basket.[97] There is no explanation for why this item is included in the Missoula Plan. Moreover, the Missoula Plan does not explain whether or how removing a SLC from the price cap baskets may affect the calculation of allowed SLCs for all remaining customers. The Missoula Plan also allows carriers to sell bundles where the bundled price includes all or part of the SLC.[98] This possibility will make it very difficult for regulators to verify if the carriers are charging the allowed SLCs and recovering only the allowed revenue and revenue increases.

[97] Missoula Plan II-C-7-a-v-1.

[98] Missoula Plan II-C-7-a-vi-1.

D. SLC INCREASES AND LIFELINE RECOVERY

The Missoula Plan estimates that Lifeline support will increase by approximately $225 million.[99] This amount represents the SLC increases that otherwise would be imposed on Lifeline customers. The Missoula Plan sponsors, however, provide no back-up material that allows that number to be verified.

Returning to the Verizon DC example, the average SLC increase would have been $1.71 if the Verizon does not engage in any price flexibility tactics. If Verizon adopts a strategic plan, then the average SLC could increase to $7.35, a SLC increase of $3.50, and the SLC for one class of customers could increase to $10.30, a SLC increase of $6.45. The Missoula Plan does not provide any guidance regarding which SLC increase should be applied to Lifeline customers. The Missoula Plan's sponsors provide no indication of whether they incorporated the pricing flexibility rules into their estimate of the new Lifeline support requirement. If many carriers adopt price flexibility plans, the result could be that the Plan's Lifeline support requirement would be significantly higher than the current $225 million estimate.[100]

E. SLC CAPS AND THE RESTRUCTURE MECHANISM.

The SLC caps divide the Access Shift Revenue Per-Line recovery between recovery from SLC increases and recovery from the Restructure Mechanism. For example, if a carrier currently has a $6.50 SLC and an ultimate Access Shift Per-Line of $3.60, its Access Shift Revenue increases by ninety cents per step. In Step 4 and beyond

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[99] See Missoula Plan Supporters *ex parte* (August 17, 2006).

[100] As discussed in Section V.C.2. above, the Missoula Plan allows a carrier to recover "100% of its Access Shift Per Line multiplied by the number of lines…." Missoula Plan, VI-A-1-b-iv-1. Because the number of lines is not adjusted by the number of Lifeline lines, carriers receive a double revenue for each Lifeline customer: once as part of the Restructure Mechanism and once as part of increased Lifeline support.

it will be entitled to $10.10 per-line. The SLC cap only increases by 75 cents in the first two steps and then by one dollar in the third and fourth step and by inflation in the last step. This carrier would receive 15, 30, 20, and 10 cents per-line from the Restructure Mechanism for Steps 1 to 4 respectively. If inflation increases the SLC cap to $10.30 in Step 5, then the carrier will no longer receive Restructure Mechanism support.[101] The implication of this example is that the purpose of the inflation adjustment is to reduce the burden of the Plan on the Restructure Mechanism and to require carriers to recover their costs from their own customers.

However, the above example may not be typical. Instead, it is more likely that the typical carrier has a current SLC of $5.80 and an ultimate Access Shift Per-Line of $3.00.[102] In this example the Access Shift Revenue increases by seventy-five cents per step. In Step 4 and beyond the carrier will be entitled to $8.80 per-line. Because the SLC cap increases by 75 cents in the first two steps and then by one dollar in the third and four step and by inflation in the last step, this carrier never receives Restructure Mechanism support and recovers its entire Access Shift Per-Line from its customers. For carriers in this position, the increasing caps are simply an invitation to price discriminate in order to discourage competition and extort revenue from vulnerable customers.

Because of the unreasonable impact on end user rates resulting from SLC increases called for in the Missoula Plan, the Commission should reject the Missoula Plan in its entirety. Even if the Plan is approved in part, NASUCA recommends that the

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[101] While carriers are not required to charge the SLC cap, their ability to draw from the Restructure Mechanism is determine as if they are charging the SLC cap. Missoula Plan VI-A-1-b-v-1.

[102] Nation-wide average SLC for the largest carrier in each state is $5.71. See Billy Jack Gregg, *Survey of Unbundled Network Elements in the United States* (March 2006), Appendix 2.

Commission reject the price flexibility and inflation adjustment portions of the Missoula Plan because of the strong likelihood that carriers will use SLC cap increases to engage in price discrimination.

F. THE SLC INCREASES CALLED FOR IN THE MISSOULA PLAN IMPROPERLY SUBSIDIZE HIGH VOLUME USERS.

Discussions of interstate access charges have often alleged that a subsidy flow from high-volume customers to low-volume customers. The per-minute interstate carrier common line charge ("CCLC") was the alleged cause of this subsidy.[103] Customers paid for their interstate loop costs directly through their SLC payments and indirectly through the CCLC. High-volume customers generated more CCLC revenue than low-volume customers and, therefore, it was been asserted that the CCLC was an implicit subsidy.[104] To eliminate the subsidy, the FCC has taken actions to reduce the CCLC and increase the SLC, culminating in the CALLS and MAG Orders. In these Orders, the FCC substantially increased the SLC and virtually eliminated the CCLC. In adopting the MAG Order, the FCC stated:

> The Commission 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**.[105]

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[103] NASUCA has shown that many residential SLCs are greater than the incremental cost of service. Therefore, the evidence supporting a subsidy claim does not exist for most residential customers. *In the Matter of Access Charge Reform, In the Matter of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, NASUCA Comments (January 24, 2002).

[104] MAG Order, ¶15 (emphasis added.)

[105] *Id*., ¶17.

The Missoula Plan, however, contradicts these assumptions and the reasoning used to justify rate changes, because the plan proposes to recover traffic sensitive switching and transport costs through increases in the SLC, a flat non-traffic-sensitive charge. Instead of eliminating subsidies, the Plan creates a new subsidy from low-volume end-users to high-volume end-users by increasing fixed charges to recover traffic sensitive costs.

Moreover, even if the SLCs are not increased, the proposed terminating rate (0.05 cents per minute) is a subsidized rate because it is below the current cost-based reciprocal compensation rate (estimated to be approximately 0.2 cents per-minute). States approve reciprocal compensation rates based on a general outline and rules established by the FCC. These rules require the states to approve rates based on the FCC Total Element Long Run Incremental Cost principles.[106] Thus, approved reciprocal compensation rates are equal to the incremental cost of services.[107] It is generally accepted that a rate below the incremental cost of service is a subsidized rate.[108] Therefore, because the Plan's proposed termination rate is below the incremental cost of service as measured by current reciprocal compensations rates, the rate is a subsidized rate, and should be rejected.

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[106] 47 C.F.R. §51.705.

[107] ILECs have criticized state commissions for interpreting these rules in a manner that sets rates too low (below what they considered to be the incremental cost of service) but have not criticized state commissions for setting rates too high. See e.g., Declaration of Howard Shelanski submitted in support of the comments of the Verizon Telephone Companies, In the Matter of the Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, WC Docket No. 03-173; Declaration of Paul B. Vasington, submitted on behalf of Verizon Maine, Investigation into Line Sharing Pursuant to State Law, Maine Public Utilities Commission Docket No. 2004-809.

[108] Faulhaber, Gerald, 1975, "Cross-Subsidization: Pricing in public enterprise," *American Economic Review*, 65, December, pp. 966-977.

VI. THE MISSOULA PLAN'S IMPACT ON THE UNIVERSAL SERVICE FUND IS UNREASONABLE AND UNSUSTAINABLE.

The Missoula Plan proposes to increase the overall federal universal service fund by $2.25 billion.[109] This increase includes $1.5 billion for the Restructure Mechanism, $200 million for the Early Adopter Fund, $225 million for Lifeline Increases, and $300 million for High Cost Loop Fund adjustments.[110]

These increases are substantial. The overall federal universal service fund would grow by 32 percent, high-cost funding would grow by 48 percent and lifeline funding by 27 percent.[111] The federal contribution factor would increase to 13.9 percent from its current 10.5 percent.[112] Thus, the USF -- which is already burdened with supporting multiple ETCs in high-cost areas -- would be rendered unsustainable by the additional demands imposed by the Missoula Plan. The unreasonably large impact on the USF resulting from the Missoula Plan should be reason enough to reject the Plan. However, as discussed below, as large as these advertised increases are, the estimates of the impact of the USF changes included in the Missoula Plan are too low. Moreover, the various changes proposed for the existing USF High Cost Fund have little if any relationship to intercarrier compensation reform, and amount to nothing less than a grab-bag of goodies for particular carriers or classes of carriers.

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[109] As discussed below, this advertised increase is grossly understated.

[110] The Missoula Plan, Appendix D; see also, Missoula Plan Supporters August 17, 2006 *ex parte*.

[111] The USF currently amounts to approximately $7 billion per year, and would rise to $9.225 billion under the Missoula Plan. The Missoula Plan changes to the USF would increase the High Cost Fund from $4.2 billion to $6.2 billion per year. The Low Income Fund would rise from $820 million to over $1 billion.

[112] The percentages are calculated using third quarter 2006 projected industry requirements. See, Proposed Third Quarter 2006 Universal Service Contribution Factor, CC Docket No. 96-45, DA 06-1252 (rel. June 9, 2006.

A. THE RESTRUCTURE MECHANISM.

The Missoula Plan creates a new $1.5 billion fund called the "Restructure Mechanism," to replace revenues lost by ILECs as a result of access rate reductions and not otherwise recovered through increases to the SLC. Even though the size of the Restructure Fund is formidable, the proponents of the Missoula Plan are deliberately vague as to the basis and nature of the Restructure Mechanism.

The Missoula Plan does not formally include the Restructure Mechanism as part of the universal service fund even though the Mechanism is, in practice, part of the fund. Otherwise, there would be no basis to collect contributions from all other carriers and end users to fund the Restructure Mechanism. The avoidance of a precise definition of the Restructure Mechanism is nothing more than a clumsy attempt by the proponents to exempt the Restructure Mechanism from the FCC's portability rules, and limit Restructure Mechanism funds to incumbents and other carriers currently charging access fees. As the Plan states, "Restructure Mechanism dollars will be available to other carriers in circumstances to be determined in the future."[113]

As discussed below, the proponents of the Missoula Plan cannot agree among themselves on the legal basis for the Restructure Mechanism. If the legal basis for the Restructure Mechanism is found in Section 254 of the Act, the funds must be portable and available to all CETCs. As a result, estimates of the cost of the Restructure Mechanism presented in the Missoula Plan are far too low.

1. The Legal Basis for the Restructure Mechanism Is Unclear.

The proponents of the Missoula Plan are intentionally unclear on the legal basis

[113] Missoula Plan, VI-A-2.

for the Restructure Mechanism, and how funds for the Restructure Mechanism will be collected. This is because there is no agreement among the proponents on what, if any, legal basis there is for this new fund. The $1.5 billion for the Restructure Mechanism has to come from somewhere, but the Missoula Plan is silent on the source of the funding. Apparently, the Track 2 and 3 rural carriers believe that the Restructure Mechanism can be based upon Section 201 of the Act, which provides the Commission authority to establish rates for interconnection in the interstate jurisdiction. According to this argument, because the Restructure Mechanism is based upon Section 201, there is no requirement that funds from the Restructure Mechanism be portable and made available to other CETCs. The problem with this argument is that the Commission's authority under Section 201 is limited to establishing "just and reasonable" charges for interconnection. While the Commission may establish interconnection rate elements, there is no basis under Section 201 for assessing all other carriers (and their customers) to replace access revenues lost as a result of ICC reform.

On the other hand, the Track 1 carriers apparently believe that the Restructure Mechanism should be based upon Section 254 of the Act and considered a part of the universal service fund. This was the same basis used in creating the Interstate Access Support fund and Interstate Common Line Support fund in the CALLS and MAG Orders. These carriers point out that Section 254(d) of the Act explicitly requires every telecommunications carrier to contribute to the universal service mechanisms established by the Commission. Moreover, if the Restructure Mechanism is created under Section 254, then the funds must be portable to competitors. Before any consideration can be given to the operation of the Restructure Mechanism, the Commission must clarify its

legal basis and the source of its funding.

2. The Restructure Mechanism Improperly Excludes Support Payments to CETCs.

There are two estimates of the size of the Restructure Mechanism presented by the proponents of the Missoula Plan. The first is $1.4 billion and the second is $1.6 billion.[114] This $200 million difference is significant. The sponsors of the Missoula Plan should provide the back-up data and spreadsheets that generated these estimates so that state commissions, the FCC, and independent parties can verify the estimates. Individual carriers should provide the state commissions and the FCC with their best estimates of the amount of Restructure Mechanism they would receive under the Missoula Plan so that the state commissions and the FCC will have an alternative estimate of the Missoula Plan's funding requirements.

In spite of the difference in estimates, it is clear both estimates model only the impact on carriers that currently impose access charges. As stated in Appendix D: "Payments from the new Restructure Mechanism (RM) are equal to the total access shift (the reduction in switched access revenue) minus the increase in SLC revenue."[115] Thus, only CLECs that currently charge access and will be affected by reductions in such rates, are included in the calculation of the size of the Restructure Mechanism. Equal support payments from the Restructure Mechanism to other CETCs are apparently not included in the estimates of the size of the fund. As previously noted, the Plan states: "Restructure Mechanism dollars will be available to other carriers in circumstances to be determined

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[114] It should be pointed out that there is a complete lack of back-up data attached to the Missoula Plan. While certain assumptions are stated, there are no workpapers which would show how the amount of the Restructure Mechanism -- or any other aspect of impact on the USF -- is calculated.

[115] Missoula Plan, Appendix. D, p. 102.

in the future."[116]

If the legal basis for the Restructure Mechanism is Section 254 of the Act, support from the Restructure Mechanism must be portable. The basic principle of the Commission's portability rules is that a CETC serving a customer in an ILEC territory receives the same amount of support as the ILEC. Thus, if the Restructure Mechanism is part of the federal universal service fund, CETCs are eligible to receive Restructure Mechanism support. Based on current CETC draw from the High Cost Fund, NASUCA estimates that inclusion of portable support payments to CETCs will increase the $1.4 billion Restructure Mechanism by $37.5 million, to $1.875 billion.[117]

B. INCREASES IN THE LOW INCOME FUND AMOUNT TO A DOUBLE COUNT.

The Missoula Plan exempts Lifeline customers from paying the increases in the SLC resulting from the Plan.[118] The proponents estimate that this exemption will amount to $0.225 billion.[119] Even assuming that the estimate of the impact of the Lifeline exemption is correct, the manner in which the Missoula Plan proponents have included the exemption amounts to an improper double count.

The Missoula Plan estimates that SLCs will increase $4.7 billion and a $1.5

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[116] Missoula Plan, VI-A-2.

[117] In the 4th Quarter of 2006, CETCs were responsible for $261.3 million of the total demand on the High Cost Fund of $1.045 billion, or approximately 25%. *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2006*, USAC (Sept. 1, 2006). Increasing the Restructure Mechanism by 25% to account for equal support payments to CETCs results in a Restructure Mechanism amounting to $1.875 billion.

[118] Missoula Plan, VI-C-6.

[119] Missoula Plan Executive Summary, p. 13, fn. 12. As with other parts of the Missoula Plan, the basis for this Lifeline estimate is not provided.

billion Restructure Mechanism will be created to offset the nearly $6 billion reduction in access rates.[120] As the Missoula Plan states, the total of the SLC increases and the Restructure Mechanism are supposed to equal the reduction in access revenues. Assuming that $4.7 billion is the correct amount of SLC increases, and assuming that $0.225 billion is the correct amount of SLC increases that Lifeline customers will not pay because of their exemption, carriers should only recover a total of $4.475 billion in SLC increases from customers as a result of the Lifeline exemption ($4.7 billion less $0.225 billion Lifeline exemption = $4.475 billion collected). The remaining $0.225 billion that remains uncollected because of the exemption should be paid to carriers from the Low Income Fund. This would result in carriers being made whole for the full $4.7 billion in SLC increases.

Unfortunately, this is not how the Missoula Plan works. In aggregate, carriers are already receiving $6.2 billion from SLC increases and the Restructure Mechanism to offset a $6 billion loss of access revenue. For carriers to receive another $0.225 billion from the Low Income Fund amounts to an improper double recovery or double count of the same revenues. Because of the wording of the Missoula Plan, carriers can recover the full cost of lost ICC revenues from SLCs and the Restructure Mechanism, plus recover from the Low Income Fund an extra $0.225 billion for the SLCs that otherwise would be paid by exempt Lifeline customers.

Currently, the Plan states: "At Step 4 of the Plan, the carrier may recover -- through SLC increases and the Restructure Mechanism -- 100 percent of its Access Shift

[120] Missoula Plan, Appendix D, p. 100.

per Line, multiplied by its number of lines at Step 4."[121] In order to prevent double recovery by carriers, the Plan should be changed to read: "At Step 4 of the Plan, the carrier may recover -- through SLC increases and the Restructure Mechanism -- 100 percent of its Access Shift per Line, multiplied by its number of lines at Step 4 **minus all its Lifeline lines**." In this way, the lost revenue which may be recovered from SLCs and the Restructure Mechanism will be net of the monies received from the Low Income Fund for exempt Lifeline customers. The rules in Missoula Plan VI-A-1-e, dealing with rate of return carriers in Tracks 1 through 3, will also have to be changed to exclude Lifeline lines or funds received for Lifeline customers in order to prevent double recovery.

C. PROPOSED CHANGES TO THE HIGH COST SUPPORT FUND ARE UNSUSTAINABLE AND HAVE NOTHING TO DO WITH INTERCARRIER COMPENSATION REFORM.

The Missoula Plan proposes a number of changes to existing federal universal high-cost support mechanisms. The funding requirements are extremely large and undocumented. A review of these changes shows that the proposals have nothing to do with intercarrier compensation reform and that the Plan proponents have consistently excluded or underestimated the impact of these changes. The cumulative impact of these is so large that by themselves they may destroy the viability of and support for the entire universal service program.

These changes proposed to the existing high cost fund are as follows:

1. Re-indexing of the high cost loop ("HCL") fund;

2. Eliminating differences in the high cost loop support rule based on carrier size;

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[121] Missoula Plan, VI-A-1-b-iv (Track 1 carriers); VI-A-1-c-iv (Track 2 carriers).

3. Change in Safety Valve rules;

4. Institution of a rural price-cap carrier option plan;

5. Change in the "base factor portion" of the SLC; and

6. Expansion of "Incentive Regulation" to Track 3 carriers.

NASUCA has been able to quantify the impact of several of these proposed changes. However, the ultimate impact of a number of these proposals is currently unknown. Moreover, if the Plan's sponsors wish to have these program changes reviewed, then they should have requested the Commission to refer the program changes to the Federal-State Joint Board on Universal Service ("Joint Board"). The Joint Board is the appropriate place for such a review because the Joint Board is responsible for evaluating the universal service program in its entirety.

1. Re-Indexing the High Cost Loop Fund

Re-indexing the HCL fund requires the lifting of the fund cap, providing support as if the fund cap does not exist and then re-instating the fund cap.[122] It is possible to use public data to verify the Plan's $300 million estimated increase to the HCL Fund resulting from re-indexing. The data are included in the annual NECA filing to the FCC.[123] To verify the Plan's estimate, the HCL support adjustment must be calculated using the existing rules and the proposed rules. The difference between the two support

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[122] Missoula Plan VI-C-1.

[123] NECA's Overview of Universal Service Fund, http://www.fcc.gov/wcb/iatd/neca.html, filed September 30, 2005.

estimates is actually $350 million for ILECs, not the Plan's reported $300 million.[124] On top of this, additional HCL support payments to CETCs are not included in the Missoula Proponents' $300 million estimated impact. CETCs would receive additional HCL support of approximately $50 to $70 million.[125] The total increase from rebasing the HCL is, therefore, between $400 and $420 million. This difference between the Plan's estimate and NASUCA's independent estimate raises questions regarding the validity of all USF estimates provided in the Plan. The only way to verify the Plan's estimates is for the sponsors of the Plan to release all of their data and back-up spreadsheets. Such a release will allow all of the estimates to be verified including not only the summary national estimates but also state and carrier estimates.

As discussed above, this proposal will cost the federal universal fund between $400 and $420 million. However, these changes to the HCL have nothing to do with intercarrier compensation reform and are not needed in order to implement any of the access reforms associated with the Plan. The Plan contains two mechanisms that are tied to the access rate changes proposals -- the Restructure Mechanism and the Early Adopter Fund. The re-indexing of the HCL fund solves none of the problems associated with intercarrier compensation, nor is it tied to any intercarrier compensation change included in the Missoula Plan. The only reason to adopt such re-indexing would be if the current

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[124] Forecasted 2006 high cost loop support for carriers that are not subject to Section 54.305 restrictions is $1,037,677,346. High cost loop support for these same carriers determined using a national average cost of $275.76 and eliminating the cap imposed by Section 36.631(d) is $1,391,547,092. The difference between the two estimates is $353,869,746. See NECA's Overview of Universal Service Fund and Study Results filed September 30, 2005, http://www.fcc.gov/wcb/iatd/neca.html.

[125] CLEC line counts by ILEC study area can be found in the quarterly USAC filings. The difference between the two CLEC estimates is that the lower estimate is based on eligible lines and the higher estimate is based on all CLEC lines. A summary of these calculations is Attachment C to these comments. Upon request, NASUCA will provide a copy of the entire spreadsheet to any interested party.

HCL fund was insufficient for the purposes of maintaining universal service. Nowhere in the Plan is there any argument or data that supports a claim that the current USF funding is insufficient.

2. Study Area Size and High Cost Loop Support

Currently, study areas serving 200,000 or fewer lines receive more HCL support than study areas serving more than 200,000 access lines. For example, the smaller study areas receive 75 percent of all loop costs that are greater than 150 percent of the national average loop cost, while the larger study areas do not reach the 75 percent support level until their costs are greater than 250 percent of the national average loop cost.[126] The Missoula Plan proposes to eliminate the rules that reduce support for larger carriers.[127]

As shown on Attachment D, adoption of this rule change will increase HCL funding for five large study areas by $22.5 million a year.[128] As with re-indexing of the HCL fund, eliminating differences in support for large study areas has nothing to do with reform of intercarrier compensation and only serves to unduly increase the size of the USF. The only purpose in this proposed rule change appears to be an attempt to increase the number of carriers that support the Plan.

3. Rural Price Cap Carrier Option

This option allows a rural price cap carrier to choose to participate in the non-rural high cost support mechanism, and is restricted to carriers that do not receive rural high cost loop support as January 2006 and are not part of a holding company that

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[126] 47 C.F.R. §36.631(c) & (d).

[127] Missoula Plan VI-C-2.

[128] It should be noted that the large rural carrier in Texas shown in Attachment D, Windstream, may be subject to restrictions on support under 47 CFR 54.305.

receives such support.[129] These restrictions effectively limit this option to Iowa Telecom, the only Track 2 carrier to sign on to the Missoula Plan. Not coincidentally, this option provides the specific relief that Iowa Telecom has asked for in waiver and forbearance petition currently pending before the Commission.[130] Based on Iowa Telecom's filing in that case, this option will increase Iowa Telecom's USF high cost support by $22 million. Once again, providing this benefit to Iowa Telecom amounts to regulatory arbitrage, has nothing to do with intercarrier compensation and only serves to further inflate the high cost fund.

4. SLC Base Factor Portion Adjustment

The SLC Base Factor Portion adjustment appears in two places in the Missoula Plan. First, in the determination of Track 3 carriers' lost revenue, the SLC offset is the difference between the higher SLC under the Plan ($8.75) and the lower of the SLC caps in place prior to the Plan or the "base factor portion."[131] Thus, the SLC offset is higher for a carrier with a base factor portion of less than $6.50. The higher SLC offset reduces the lost revenue that is recovered through the Restructure Mechanism.[132]

Second, the calculation of interstate common line support ("ICLS") is changed such that the SLC revenue recognized in the ICLS calculation is the lower of the base

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[129] Missoula Plan VI-C-4.

[130] Iowa Telecom Petition for Forbearance under 47 U.S.C. 160(c) from the Universal Service High-Cost Loop Support Mechanism, WC Docket 05-337 (filed May 8, 2006); Iowa Telecom Petition for Interim Waiver of the Commission's Universal Service High-Cost Loop Support Mechanisms, WC Docket 05-337 (filed May 8, 2006).

[131] The definition of the "base factor portion" is found in 47 CFR §69.501(f): "Beginning January 1, 2002, the Common Line element revenue requirement shall be apportioned between End User Common Line and Carrier Common Line pursuant to Sec. 69.502. The Common Line element annual revenue requirement shall be described as the base factor portion for purposes of this subpart."

[132] Missoula Plan VI-C-3.

factor portion or $6.50.[133] The immediate impact of the interplay of these two changes is to move support from the Restructure Mechanism to the ICLS mechanism. However, for carriers with both relatively low base factor portions and relatively high common line revenue requirements, this transfer becomes a windfall.[134]

For example, if a carrier has a base factor portion equal to $6.00 line and a common line revenue requirement equal to $9.00 per line, the current ICLS support would equal $2.50 per line, the difference between the current SLC of $6.50 and the $9.00 revenue requirement. The proposed rule change reduces the SLC revenue counted as an offset to the common line revenue requirement in the ICLS support mechanism, thus, ICLS support would increase to $3.00 per line, the difference between the $9.00 revenue requirement and the $6.00 base factor portion. In the lost revenue calculation, the SLC offset is equal to difference between the new capped SLC of $8.75 and the $6.00 base factor portion. Therefore, the Restructure Mechanism is reduced by $2.75. With ICLS support increased by $3.00 and the Restructure Mechanism decreased by $2.75, the carrier receives a 25 cent per line windfall. The Base Factor Portion adjustment only serves to increase USF high cost funding and should be rejected by the Commission.

5. Safety Valve Changes

The Missoula Plan proposes two changes to the Safety Valve rules. The first change (Safety Valve I) eliminates the index year provision and allows the acquiring

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[133] Missoula Plan VI-A-1-e-ii-2 and VI-A-1-e-iii-2.

[134] The difference between the common line revenue requirement and the base factor portions includes the portion of the switching equipment and the transport interconnection charge assigned to the common line revenue requirement.

carrier to immediately receive support.[135] The index year provision required the acquiring carrier to own the new exchanges for a year and determine its costs at the end of the first year of operations. These first year costs became the index year that is compared to costs in succeeding years to determine whether the carrier is eligible for support. The new rule replaces the index year with the costs of the selling carrier in its last year of operation. Therefore, the main focus of Safety Valve I is to accelerate the time period for receipt of support. However, in year one, the Plan does not specify whether the other constraints associated with Safety Valve support remain in place. These constraints include that the carrier, in the absence of the restrictions of §54.305(a), would qualify for support, and that the safety valve adjustment must be less than the difference between the unconstrained support and the transferred support.[136]

The second change, Safety Valve II, is much more expansive.[137] It provides support for non-loop investment, including switching, transmission, and general support facilities. Safety Valve II is essentially the difference between the non-loop revenue requirement for the acquired exchanges before and after the sale of exchanges. The support mechanism does not contain any provision regarding whether the carrier or the acquired exchanges are high-cost exchanges. Therefore, under Safety Valve II, support may be provided to low cost carriers and exchanges. Moreover, there is no limit on the amount of support provided.[138] The Plan specifically states that "Safety Valve II support

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[135] Missoula Plan VI-C-5-a.

[136] 47 C.F.R.§54.305(b) and (d).

[137] Missoula Plan VI-C-5-b.

[138] Safety Valve I is limited to being no greater than five percent of total rural incumbent local exchange carrier high cost loop support. 47 C.F.R. §54.305(e).

will not be capped."[139] The dollar impact of these changes to the Safety Valve mechanisms is not stated in the Plan. Because Safety Valve II may provide support to low cost carriers and does not have a limit, it should not be adopted.

6. Incentive Regulation

The "incentive regulation plan" will allow carriers to maintain their per-line intra state access revenue and interstate revenue requirement, even if minutes of use and lines are declining.[140] Accordingly, the incentive plan provides a carrier an incentive to do nothing and collect exactly the same revenue. This implies that if minutes and lines are decreasing, rates or Restructure Mechanism payments will increase under Incentive Regulation. The so-called Incentive Regulation included in the Missoula Plan is clearly inferior to the current regulatory mechanism (rate of return regulation) that contains an incentive to invest in new equipment and facilities.

Moreover, the incentive regulation plan has the same fundamental flaws that were in the MAG incentive plan that the Commission refrained from adopting.[141] First, "all of the benefits of the productivity or efficiency improvements would accrue to the carrier in the form of higher returns and none of the benefits accrue to access customers."[142] Second, "as structured [the plan] does not insure that adequate investment or service quality levels will necessarily be maintained." [143]

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[139] Missoula Plan, VI-C-5-b-vii.

[140] Missoula Plan, VII-B-1.

[141] MAG Order, ¶ 217.

[142] Id., ¶ 218.

[143] Id., ¶ 220.

Finally, the cost of the so-called "incentive regulation plan" has not been included in the total support payments advertised by the Plan. The incentive plan contained in the Missoula Plan in reality provides no incentives for efficiency, and only serves to inflate high cost support payments from the USF.

D. THE PURPOSE OF THE EARLY ADOPTER FUND IS DUBIOUS AND ITS SIZE IS LAUGHABLY INADEQUATE FOR ITS STATED PURPOSE.

The Missoula Plan includes $200 million for a so-called "Early Adopter Fund" ("EAF"). The stated purpose of the EAF is to reimburse "States that have reduced intrastate access charges through explicit State funds by the time the Plan is adopted."[144] Although, once again, the source of funding for the EAF is unclear, the EAF "must be used to decrease the size of explicit State funding mechanisms."[145]

There is no doubt that various states have undertaken intrastate access reform over the last 15 to 20 years. Many states have reduced in-state access charges to interstate levels and below by a variety of means. Some have raised local rates to offset access reductions, some have created state universal service funds to replace lost access revenues, and some have required carriers to absorb some or all of the access reductions. However, no matter what the reason and no matter what the means used to achieve intrastate access reductions, the reductions occurred within the respective states and were paid for or accounted for within that particular state. The consumers and carriers in those states presumably enjoyed the benefits of any such access restructuring.

Under the EAF proposed in the Missoula Plan, the costs of past access reform in one state will be unfairly shifted to customers in other states. Many states have been able

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[144] Missoula Plan, VI-Summary.

[145] Missoula Plan, VI-B-1.

to achieve these reductions without raising local rates or imposing state USF charges. However, as a result of the EAF, they will be asked to subsidize past access reform in other states.

Even if the basis of the EAF was reasonable, the estimates of its size are not. A number of states took measures to reform intrastate access charges years ago. To try and estimate the current revenue impact of those changes would be virtually impossible. Many states reformed in-state access by raising basic rates. Under the terms of the Missoula Plan, however, only access reform paid for by a state USF would be eligible for recompense from the EAF.

Yet even if only access replacement payments from state USFs are considered, the amount of dollars at issue dwarfs the proposed $200 million size of the EAF. According to the recent National Regulatory Research Institute ("NRRI") Survey of State USFs, state high cost funds amount to approximately $1.4 billion annually.[146] A large portion of these high cost funds are based on access charge replacement.

If state rate rebalancing to replace access is also included, the figure would swell considerably. Finally, if the EAF is considered a part of the USF, then CETCs would also have access to EAF on an equal basis. Opening just the $200 million proposed for the EAF to portable support for CETCs would add $50 million to the EAF.[147] The proposed EAF is unfair, unworkable and laughably inadequate for its stated purpose.

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[146] *State Universal Service Funding Mechanisms: Results of the NRRI's 2005-2006 Survey*, NRRI (July 2006), Table 21.

[147] Once again using 4th quarter 2006 figure of 25% of high cost support going to CETCs results in an increase in the EAF of $50 million.

E. THE CUMULATIVE IMPACT OF THE MISSOULA PLAN ON THE USF IS DEVASTATING.

As discussed above, the estimates of the impact on the USF published with the Missoula Plan are too low in a number of particulars. The cumulative effect of these underestimates and omissions raises serious questions about the very credibility of the plan itself. Set forth below is NASUCA's best estimate of the impact of each of the new funds created by the Missoula Plan as well as modifications of existing rules:

Stated Impact of Restructure Mechanism	$1,500 million
Additional RM Payments to CETCs	$ 375 million
Stated Impact of Lifeline Exemption	$ 225 million
Stated Impact of HCL Changes	$ 300 million
Additional HCL Payments to ILECs	$ 50 million
Additional HCL Payments to CETCs	$ 75 million
Impact of Change of % of Support	$ 22 million
Impact of Option to Use Non-rural	$ 22 million
Stated Impact of Early Adopter Fund	$ 200 million
Additional EAF Payments to CETCs	$ 50 million
TOTAL KNOWN USF INCREASES	**$2,819 million**

It appears that the known increases to the USF resulting from the Missoula Plan will be almost 25% higher than advertised by the proponents of the Plan. In addition to these known increases, there will be additional impacts from the changes to rules for Safety Valve support, SLC base factor portion, incentive regulation, and any further changes to the EAF. It is clear that the current USF is already growing at an unsustainable pace because of support rules already in place. To propose that the USF be saddled with another $2 to $3 billion is in the words of FCC Chairman Martin "not politically viable." The changes in the USF included in the Missoula Plan should be rejected in their entirety.

VII. THERE ARE FAR BETTER WAYS TO REFORM INTERCARRIER COMPENSATION THAN THE MISSOULA PLAN

As is obvious from the above comments, NASUCA adamantly opposes the Missoula Plan and believes there are far better ways to reform intercarrier compensation. Although proponents claim that the Missoula Plan is the only comprehensive plan of ICC reform before the Commission, the fact is that there have been numerous industry and consumer plans presented to the FCC over the past few years. The Missoula Plan is simply the latest -- and most self-serving -- of those plans.

NASUCA continues to believe that the plan that it submitted to the FCC in December 2004, and which was put out for comment by the Commission on March 3, 2005,[148] establishes a sound foundation for incremental ICC reform with minimal impact on end user rates and the USF. NASUCA also recommends that the Commission immediately address several transcendent intercarrier issues such as phantom traffic and access obligations rather than wasting time considering the Missoula Plan.

A. THE NASUCA PLAN PROVIDES A REASONABLE PATH TO INTERCARRIER COMPENSATION REFORM.

1. Establishment of Target Rates

As previously outlined in its submissions to the Commission, NASUCA's plan for intercarrier compensation reform would minimize, but not eliminate, the current disparities in ICC rates over an interim 5 year period. Each year a new target ICC rate would be established by the FCC. Interstate ICC rates above this target would step down to the target level; rates below the target level would be maintained. The final target rate

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[148] *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking (March 3, 2005).

for the fifth year for non-rural carriers would be $0.0055 per MOU. The final target rate for rural carriers would be $0.0095 per MOU. These are the same targets currently used for traffic sensitive interstate access rates of price cap carriers under the CALLS plan. Using these same rates as targets for ICC reform means that there will be very little interstate revenue impact for non-rural carriers. Any revenue shifts will be caused by reduced intrastate access rates for all carriers, and reduced interstate access rates for rural carriers.[149] In comparison, the Missoula Plan reduces the final target termination rate for large carriers by 90% from its current interstate level, resulting in excessive revenue shifts.

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

Intercarrier Compensation Target Rates

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

Unlike the Missoula Plan, the NASUCA plan relies on Commission leadership of the states, not Commission preemption of the states. The FCC would establish the policy and rationale for achieving uniform target rates. States would be expected to match the target rates by the end of the five-year phase-down period. However, because many states have procedural barriers to changing ICC rates or changing them in a timely manner, it would not be expected that states would precisely match the ICC rates established for the interim years. Nevertheless, NASUCA's plan provides strong

[149] As explained below, the selection of the target rate results in a revenue shift under the NASUCA plan of $3 billion ($4.9 billion including MOU erosion) compared to $6 billion under the Missoula Plan.

incentives for states to bring intrastate ICC rates to the final target rates as rapidly as possible. As discussed below, a state inducement fund would provide pre-allocated annual amounts of additional support to states that reach the final target rates.

As the disparity among ICC rates is reduced, and as the total revenue at issue declines, carriers will have greater incentive to enter into negotiated agreements, especially bill and keep arrangements. Negotiated bill and keep arrangements between carriers would not result in unavoidable increases in local rates as under the Missoula Plan, which calls for mandated increases in the SLC. Carriers negotiate bill and keep interconnection agreements today with little or no impact on basic rates.

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

2. Network Management Issues

A basic component of any ICC system should be truthful labeling of all calls, whether circuit-switched or packet-switched. Removal of carrier identification headers should be explicitly prohibited and subject to substantial and effective sanctions. In addition, all calls that originate, terminate, or transit the public switched telephone network ("PSTN") should pay the ICC rates applicable, regardless of whether the call originates or terminates through an ISP. In other words, the Commission should eliminate the ISP exemption from ICC rates for calls that originate, terminate or transit

the PSTN. Adoption of such a rule will create a level playing field for all telecommunications providers that access the PSTN, while preserving the ISP exemption where the PSTN is not involved.[150]

3. State Inducements

a. Targets for State ICC Rates.

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

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

b. State Inducement Fund.

NASUCA recommends establishment of a state inducement fund as part of the USF. States reaching target levels of ICC established by FCC could receive funding, which would act as a temporary transitional means of replacing a portion of lost intrastate ICC revenues. For example, a $200 million fund could be established, with each state's share pre-allocated and targeted to companies within that state. The allocation could be based on percentage of access lines within a state compared to the national total, or on the

[150] As this shows, addressing the phantom traffic issue can be accomplished outside the Missoula Plan.

amount of a state's access revenues (interstate and intrastate) compared to the national total.[151] A state's share of the inducement fund would only be available on a going-forward basis once a state certifies that it has reached the final target ICC rate levels. Further, as discussed in subsection 4.b. below, access to the inducement fund would be predicated on a state having a state USF. The inducement fund should not become a permanent entitlement, but should have a predetermined life span. For example, the inducement fund could expire three years after the end of the five-year phase down of ICC rates.

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

Unlike the Early Adopter Fund proposed by the Missoula Plan, the size of the State Inducement Fund is predetermined and the allocated shares for each state are easy to ascertain. The State Inducement Fund would avoid arguments over what steps which states took when in trying to determine eligibility for the Inducement Fund. Eligibility for the State Inducement Fund would be based on achieving the target rates. Moreover, those states that had already taken action in the past to mirror interstate rates would get the advantage of early access to the State Inducement Fund.

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

4. Revenue Impact of the NASUCA Plan.

Intercarrier compensation revenues amounted to approximately $9.6 billion during 2003 and approximately $9 billion in 2004.[152] These ICC revenues are paid from carrier to carrier and constitute a cost of doing business which is currently recovered in revenues received from end-users. ICC revenues represent approximately 4% of total annual end-user telecommunications revenues.[153]

As previously discussed, the level of ICC revenues is declining each year. Considering these trends, NASUCA estimates that access minutes of use for non-rural companies will continue to decline at a rate of 5% per year.[154] As shown below, this means that ICC revenue will likely shrink to $7.7 billion in 2010, even with no change in ICC rates. All of this decline is attributable to reductions in minutes of use for non-rural carriers. Minutes of use for rural companies are expected to remain flat throughout this period.

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

This ongoing nationwide decline in MOU and revenues must be incorporated into whatever revenue estimates are used by the FCC for ICC reform. The Missoula Plan's

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[152] See chart in Section II.F. above.

[153] $9.6 billion intercarrier revenues/$230.7 billion total end user revenues = 4.16%. *Id.*; *Telecommunications Industry Revenues 2003*, Wireline Competition Bureau, Industry Analysis Division (March 2005), Table 1.

[154] This projection is conservative given the fact that access MOU have fallen by 25% in the last four years.

proposal for revenue neutrality based on historical levels of ICC revenue will always overstate current ICC revenue and will cement an obsolete and economically inefficient level of ICC revenue into going-forward rates.

NASUCA estimates the revenue impact of its plan using as the base case the estimated 2010 revenues of $7.7 billion annually. These revenues reflect the continuation of current market evolution. Phasing down to the recommended NASUCA target rate levels by 2010 will remove approximately $3 billion from both interstate and intrastate ICC revenues. As shown below, this will leave $4.7 billion in residual ICC revenues, which represents approximately 2% of total telecommunications revenues.[155]

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

5. Recovery of Lost Revenues

Reduction of ICC rates will necessarily reduce revenues of carriers. Whether any particular loss of revenue should be replaced in whole or in part should always be a question of fact, not of right. Any demonstrated need for additional revenue as a direct result of ICC reform should be recovered first from local rates,[156] next from state universal service funds, and finally from the federal universal service fund.

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[155] $4.7 billion/$230.7 billion = 2.04%. This calculation assumes that overall telecommunications revenues stay flat over the period.

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

a. Recovery from Increases in Local Rates.

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

Any increase in local rates should be based on a demonstration to the state regulatory authority that such increase is necessary to provide quality service and maintain a reasonable return (or such other indicia of sufficiency as are allowed under each state's individual rate regime). Only when local rates have reached the reasonable comparability benchmark[157] should there be recourse to other sources of revenue replacement. The reasonable comparability benchmark represents a level beyond which rates in rural and high-cost areas may not rise without violating the reasonable comparability standard set forth in Section 254(b)(3) of the Act. NASUCA recommends that the rate comparability benchmark and supplemental rate support already established for non-rural carriers be extended to rural carriers.

b. State Universal Service Funds

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

> Congress intended that states, acting pursuant to section 254(f) of

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

> the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. …[A]s states implement their universal service plans, we will be able to assess whether additional federal universal service support is necessary to ensure that quality services remain "available at just, reasonable and affordable rates.[158]

Although the FCC and federal courts have also recognized that attaining universal service goals is a joint effort of both state and federal governments,[159] there has previously been no requirement that states demonstrate that they are contributing any level of state funding to universal service as a prerequisite for receipt of federal universal service.

As a result, carriers in several states currently receive large amounts of federal universal service without any showing that the carriers' rates are not reasonably comparable or not affordable, or that the state has implemented a state universal service fund to assist in provision of service in high-cost and rural areas. For example, Mississippi receives $187 million in annual federal high-cost support ($11.32 per line per month), yet Mississippi does not have a state universal service fund to support high-cost areas within its borders.[160]

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

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

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

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

pursuant to Section 254(f) of the Act to provide support for rural and high-cost areas within that state.

c. Federal Universal Service Fund

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

i. Local Switching Support

Rural carriers currently recover a portion of revenues related to non-traffic sensitive costs through the current ICLS mechanism. However, recovery of traffic-sensitive costs is more problematic. The current LSS mechanism for rural carriers is based on the number of access lines served by a carrier, rather than the carrier's actual switching costs. Only rural carriers serving 50,000 lines or less within a study area are currently eligible for LSS. As a result, small carriers with low switching costs may receive support, while carriers serving over 50,000 lines in a study area do not receive

support, even if they have very high switching costs.[161] This limitation effectively precludes recovery from the federal USF of traffic-sensitive costs which may be lost by some rural carriers, even if such recovery is appropriate. As a result, NASUCA would support modification of the LSS mechanism to a cost basis.

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

An alternative method could be used to estimate the embedded cost of switching.

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

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

The impact of using cost instead of line size in determining switching support cannot be estimated at this time because the data for the small carriers are not available. To perform that analysis USAC would have to release the data it collects on the LSS data collection form. These data are not proprietary. Large carriers already report the information in the ARMIS 43-04 report. Therefore, NASUCA requests the FCC to direct USAC to release this information so that NASUCA and other parties can estimate the cost of local switching for the universe of rural carriers. However, determination of the cost of switching is merely the first step. Only after compiling data on the cost of switching for the universe of carriers can proposals for a revised switching support

mechanism be developed. Because of the great disparity between embedded and forward-looking switching costs discussed in NASUCA's previous comments in this proceeding,[162] it is likely that a cost-based switching support mechanism will likely be substantially different from current embedded support mechanisms for loop support.

ii. Supplemental Rate Support

In the *Tenth Circuit Remand Order*, the Commission established an expanded state certification process which involved rate review, and the opportunity for states to request supplemental support if local rates of non-rural carriers exceeded the FCC's rate benchmark.[163] So far, one state -- Wyoming -- has filed a request for supplemental support under the procedure outlined in the *Tenth Circuit Remand Order*.[164] Although portions of the *Tenth Circuit Remand Order* have been remanded to the Commission again, the expanded state certification and supplemental rate review procedures were upheld.[165] Offsetting the loss of access revenue with increases in local rates and universal service funding may result in rates for some rural carriers that are above the Commission's rate comparability benchmark. In order that states may have an avenue to seek supplemental support for rural carriers with excessive rates, the Commission should extend the supplemental support procedures to rural carriers as part of the reform of ICC rates.

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[162] NASUCA Initial Comments, CC Docket No. 01-92 (May 23, 2005), at pp. 19-20.

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

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

[165] *Qwest II*, 398 F.3d at 1238 (10th Cir. 2005)

d. NASUCA Estimate of Recovery of Lost Revenues.

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

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

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

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

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

The figures above also include the $200 million State Inducement Fund allocated 89% to non-rural carriers and 11% to rural carriers. The actual allocation may vary. At

the end of the phase-down period, NASUCA estimates that $1.4 billion of lost revenue will be recovered by carriers from local rates, state and federal USFs, while $1.6 billion of lost revenue will not otherwise be recovered and will not have to be replaced.

B. CONSISTENCY OF NASUCA'S PLAN WITH FCC GOALS OF ICC REFORM.

NASUCA's plan is consistent with the goals of intercarrier compensation previously identified by the Commission. These goals are promoting economic efficiency, preservation of universal service, and competitive and technological neutrality. NASUCA's proposal meets all three goals, and does not violate any of them.

1. Promotion of Economic Efficiency

Economic efficiency is enhanced by bringing carrier-to-carrier charges closer to cost and requiring carriers that use other carriers' networks to pay charges to recover that cost; in other words, by setting and using a proper price signal. Economic efficiency is **not** enhanced by shifting recovery of costs caused by other telecommunications carriers to end users, as proposed in the Missoula Plan. Nor is economic efficiency enhanced by automatic recovery of carrier revenues lost when the rates are brought closer to cost. Achieving uniformity by dropping ICC rates below cost and near zero creates other incentives which are not economically efficient.[166]

2. Preservation of Universal Service

Addressing the universal service implications of ICC reform, NASUCA's proposal most closely tracks the statutory purpose of ensuring reasonable, affordable and

[166] Specifically, where the rate for origination and termination is set below cost, at or near zero, the economic signal is that there is little cost to using another carrier's network. Accordingly, there will be great incentives for carriers to use the networks of other carriers to provide, for example, unlimited switched access rather than special access.

reasonably comparable rates by not providing assistance to any carrier unless -- absent current intercarrier revenues -- the carrier's basic service rates are no longer reasonable, affordable, or reasonably comparable. The USF should not become a revenue guarantor.

3. Competitive and Technological Neutrality

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

NASUCA's proposal balances these competing concerns by reducing ICC rates over a five year period to lower target rates, but maintaining a higher target rate for smaller rural carriers than for larger non-rural carriers, in recognition of the higher costs of rural carriers. On the other hand, unifying each carrier's terminating charges, so that all carriers terminating traffic on that carrier's network pay the same amount regardless of the type of call, is competitively and technologically neutral.

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

NASUCA's proposal calls for the FCC to establish target rates for interstate ICC rates, and to encourage states to adopt and mirror those same rates. The NASUCA plan recognizes that states retain authority over intrastate ICC rates, and that different states will take different routes to achieving the target rates. Revenue losses caused by ICC reform can be accommodated without major change to the federal USF. As a result, the NASUCA plan lies clearly within the existing authority of the FCC over interstate rates

and the federal USF, and does not alter the roles of the Federal-State Joint Boards on Separations and Universal Service. NASUCA's proposal to lower interstate access rates is similar in nature to the CALLS and MAG plans which have been previously upheld by the courts.[167]

As shown in Section IV., above, the preemptive basis of the Missoula Plan is clearly outside the Commission's existing authority, calling for example, for the complete overturning of separate jurisdiction of state and the federal governments over access services, and the establishment of federal rate elements to recover intrastate revenues. These proposals also ignore the role of the Federal-State Joint Boards on Separations and Universal Service. The NASUCA plan equitably balances numerous competing concerns, and charts a measured pace to fundamental intercarrier compensation reform. NASUCA urges the Commission to adopt the plan described herein and in previous NASUCA submissions in this proceeding.

C. THE COMMISSION SHOULD IMMEDIATELY ADDRESS SEVERAL LONG STANDING INTERCARRIER ISSUES.

As discussed in the preceding section, NASUCA's plan for ICC reform contains proposed solutions to two long-standing intercarrier issues: phantom traffic and the obligations of various carriers to pay access charges. Regardless of whether the Commission adopts a comprehensive plan for intercarrier compensation reform or not, NASUCA believes the Commission address these two issues immediately. Carriers should be required to properly label traffic and sanctions should be imposed for failure to deliver properly labeled traffic. All carriers that originate, transit or terminate traffic on the public switched network -- regardless of the type of technology used -- should be

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

required to pay applicable access charges for origination, transit and termination services provided by other carriers. Imposing these common sense solutions to these long standing problems should go a long way towards inducing the carriers to work out market-based solutions for their intercarrier relationships.

VIII. CONCLUSION

The Commission should reject the Missoula Plan and implement the more gradual approach to intercarrier compensation reform advocated by NASUCA. Even if a comprehensive intercarrier compensation reform plan is not adopted by the Commission, the issues of phantom traffic and carrier obligations for access charges should be immediately addressed by the Commission.

Respectfully submitted,

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