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March 19, 2007

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

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

Dear Ms. Dortch:

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

Very truly yours,

William Irby

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

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

COMMENTS OF THE VIRGINIA STATE CORPORATION COMMISSION STAFF

INTRODUCTION

The Division of Communications of the Virginia State Corporation Commission ("VSCC Staff") respectfully submits these comments on the amendments to the intercarrier compensation reform plan ("Missoula Plan" or "Plan") described in an *ex parte* letter filed on January 30, 2007, and corrected by another filing on February 5, 2007. The *ex parte* letter was submitted by the Missoula Plan proponents,[1] the Chairman of the Wyoming Public Service Commission, and staff members from four other state commissions (Vermont, Maine, Nebraska, and Indiana).

The proposed amendments to the Missoula Plan are referred to as the Federal Benchmark Mechanism ("FBM"), which is intended to address "various issues that 'early adopter' states, i.e. states that have substantially lowered intrastate access charges, would otherwise face under the Missoula Plan."[2]

[1] The proponents refer to themselves as "Supporters of the Missoula Plan."

[2] Supporting Comparability Through a Federal Benchmark Mechanism, attached to the *ex parte* letter of the Supporters of the Missoula Plan filed on January 31, 2007, and amended on February 5, 2007, p. 2 ("Missoula Amendment").

BACKGROUND

The VSCC Staff submitted comments previously that opposed the Missoula Plan.[3] In those comments, we raised several areas of concern as follows:[4]

- The substantial and disparate increases in residential subscriber line charges (SLCs").
- A 32% increase ($2.225B) in funding to the federal universal service fund ("USF").
- The proposal for federal preemption of longstanding state jurisdiction over intrastate access charges and reciprocal compensation.
- Establishing a $1.5B Restructure Mechanism ("RM").
- The inequity and lack of detail associated with the Early Adopter Fund ("EAF").
- The "bully" approach to co-opt state commissions' participation.

The amendments to the Missoula Plan have not mitigated any of our concerns. In fact, the FBM would exacerbate funding requirements of the federal USF and inequity among states. It is time to stop trying to make the Missoula Plan workable and instead allow the FCC, industry, and state commissions to focus their efforts on more equitable and achievable intercarrier compensation reform goals.

THE FEDERAL BENCHMARK MECHANISM

The initial and undefined EAF was so egregious to so many parties that apparently the Supporters of the Missoula Plan ("Supporters") were compelled to try again. Unfortunately, their second attempt at creating an EAF is even more troubling. Assuming one could get past all the other flaws in the Missoula Plan (which is doubtful);

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[3] See VSCC Staff Comments submitted in this proceeding on October 25, 2006 (VSCC Comments").

[4] VSCC Comments, pp. 3-4.

the newly proposed FBM makes a bad situation worse. On its face, it raises the earlier estimate of $200M to fund the EAF to a new estimate of approximately $805M under the FBM. This only reinforces the previously stated concerns of many parties and state commissions that the Missoula Plan would further strain the resources of the federal USF. It is apparent that the strain will be even greater as the revised estimated impact on the federal USF from the Missoula Plan now stands at over $2.7B.[5]

Moreover, the FBM does not live up to the Supporters' claims with respect to their three "guiding principles."[6] Those stated principles are as follows:

1. Create a fair and balanced approach among states.
2. Manage the political feasibility of establishing a new federal mechanism that provides for access recovery at a national level.
3. Address concerns of all early adopter states, not just a handful.

Unfortunately, the Supporters miss on all three points. The FBM is neither fair nor balanced. It rewards some states and penalizes others based on unsubstantiated assumptions about the efforts of various state commissions to reduce intrastate access charges. It was created with the involvement of only a handful of state commissions so it is inherently unable to address all states' concerns.[7] Furthermore, it intentionally harms consumers in certain states "by shifting more revenue recovery … to end users in states that have retained low-end user rates."[8] It insults the efforts of the many state commissions that are promoting competitive choices while also attempting to protect and

[5] Missoula Amendment, Attachment p. 5 of 6.

[6] Missoula Amendment, p. 3

[7] Requesting information from state commissions does not equate to involving all state commissions in determining whether the FBM addresses their concerns.

[8] Missoula Amendment, p. 1.

maintain the affordability of basic telephone services for consumers. Nor is the FBM politically feasible as it is needlessly complex and inappropriately requires federal preemption over intrastate access charges and reciprocal compensation.

The Missoula Plan's Approach to Replace Intrastate Revenues from Interstate Funding Sources is Inequitable, Unworkable, and Convoluted.

The FMB is flawed from the start. Its deficiencies begin with the foundation and incredible complexity of the Missoula Plan. The Plan demands that consumers pay more for intrastate local exchange service through interstate SLC increases to offset federally mandated decreases in intrastate access charges and reciprocal compensation.[9] Moreover, state commissions are expected to agree to this approach; otherwise their intrastate jurisdiction will be preempted by the FCC.

Next the Supporters create the RM to reimburse those incumbent local exchange carriers ("ILECs") whose revenue losses for reducing intrastate access charges would not be fully recovered by increasing their interstate SLCs to their intrastate local exchange customers. The funding needed to recover these intrastate revenue losses would apparently be obtained through increasing the federal USF by at least $1.25B.[10] This would result in interstate carriers paying a greater percentage of their interstate revenues to the USF to fund intrastate access reductions. Accordingly, those interstate carriers would likely pass along those USF increases required to pay for intrastate access charge reductions to their interstate customers.

[9] That is not the result in all states because the FBM exempts certain "early adopter states" from having to implement part or all of the SLC increases.

[10] Missoula Amendment, Attachment p. 2 of 6.

The FBM is Needlessly Complicated and Designed to Bribe as Many States as Possible and Penalize States Challenging the Plan.

The Missoula Plan's complex web becomes even more tangled. Next, it introduces an additional mechanism (FBM) to increase (or decrease) the amount of the new interstate support going to ILECs in states which have previously taken action to reduce intrastate access charges substantially (i.e. the so called "early adopter states"). This additional federal support is what makes up the estimated $805M cost of the FBM. The Supporters (who of course created the RM) claim the FBM is necessary so that "early adopter states" will not be "unfairly burdened by the RM."[11] This statement is incredulous as the Supporters have apparently no concern for consumers in other states (i.e. particularly those in net payer states) that will be unfairly burdened by the creation of both the RM and FBM as they increase the funding needs of the federal USF by over $2.7B.

The FMB consists of four categories of funding seemingly to represent different state commission actions in lowering intrastate access charges. Category A Funding would replace revenues from some or all the SLC increases permitted under the Missoula Plan when an ILEC's residential local revenues per line ("RLRL") (which equals the sum of basic flat rate service, EAS,[12] interstate SLC, and any state SLC or USF fees) in a given state exceeds the high benchmark rate of $25.00. Either all or a portion of the SLC increases would not be implemented in those instances. Category A Funding would replace that portion of the SLC increase that would cause the RLRL to exceed the $25.00 high benchmark target.

[11] Missoula Amendment, p. 2.

[12] Extended Area Service.

Category B Funding provides a further subsidy in those states where the RLRL are greater than the high benchmark rate before adding the SLC increases. It calculates this additional funding by taking 75% of the difference between RLRL and the $25.00 benchmark rate. Since the RLRL would already be higher than the benchmark rate, the SLC increases would not be implemented (and the state would receive funding under Category A). The additional Category B Funding would be used to reduce or eliminate contributions to an intrastate USF and/or reduce current interstate residential SLCs.

Category C Funding is "designed to provide an additional level of FBM relief for early adopter states that might otherwise receive little or no FBM funding."[13] Apparently this comes into play for states with eligible intrastate USFs that didn't get enough dollars (or weren't eligible) under Category B because those "states have not raised rates substantially to replace intrastate access charges."[14] The FBM allows a state to combine Category B and C funding up to $10M. Category C funding must be used to reduce contributions to the intrastate USF.

The Low Rate Adjustment is the final funding category. This category kicks in when RLRL plus the SLC increases do not meet a low benchmark target of $20.00 and the ILEC draws RM dollars. The Low Rate Adjustment would require that a state (ILEC) implement an additional interstate SLC increase of up to $2.00 and the ILEC's draw from the RM would be correspondingly reduced. However, it would not apply "where a state

[13] Missoula Amendment, p. 5.

[14] Ibid.

has taken significant action to implement Access Parity by reducing intrastate switched access charges to interstate levels."[15]

The use of four categories appears to have two purposes. First it allows states to have multiple bites at the apple while also penalizing states where the Supporters don't think local rates are high enough. The multiple RBM categories allow certain states to obtain funding well beyond offsetting the potential SLC increases by double and triple dipping. Many states would receive funding in at least two categories and at least 15 states would be eligible for funding in Categories A, B, and C.[16] In fact, not only would a number of states apparently receive enough funding to avoid any interstate residential SLC increases; some would get considerably more funding than necessary to accomplish that goal. At least one state would receive additional FBM funding of over **$**10.00 per line to offset its existing local rates or USF contributions at the direct expense of residential customers in other states.[17]

Moreover, since most states would also be eligible for RM funding, the total per line amounts become even more substantial in many states. For example, five states would be eligible for combined RM and FBM funding of over $10.00 per line with two of those over $16.00 per line.[18] The actual results of the RM and the FBM appear to be

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[15] Ibid, p. 6.

[16] All these states receive RM funding as well.

[17] That state is Wyoming. Information obtained from February 20, 2007, *ex-parte* presentation to the FCC by representatives of the Supporters of the Missoula Plan and six state Commissions, p. 12.

[18] Ibid. pp. 10-12. Wyoming and South Dakota would receive over $16.00 per line. Arkansas, North Dakota, and Nebraska would receive over $10.00 per line.

contradictory in light of their respective purposes. It is neither conceivable nor reasonable that a state should be viewed as both an early adopter state (by receiving FBM funding) and also a state that has not significantly lowered intrastate access charges as evidenced by receiving RM funding. This could result in quadruple dipping.

The second purpose for this convoluted scheme allows the Supporters to make their claim that the "FBM proposal provides a net positive support for 39 states."[19] The absurdity of this statement can't be overlooked. It is just not possible for residential consumers in 39 states to be better off under the Missoula Plan. Many residential customers in numerous states will still face very significant interstate SLC increases and consumers in all states will be required to pay higher rates to fund the over $2.7B cost of the RM, FBM, and other USF changes.

The Underlying Assumptions in the FBM are Unsubstantiated.

The FBM assumes that high local exchange service rates and/or an existing explicit intrastate USF are sufficient proof that a state has significantly reduced intrastate access charges. The Supporters allege that "such states have allowed carriers to raise end user rates to recover costs that previously were recovered through intrastate access charges."[20] However, the Supporters provide no evidence to prove this contention. In fact, they contradict this in their January 30, 2007 cover letter which states that the FBM "targets new federal support to states that have the highest end-user rates, many of which are the result of early adopter state initiatives to reduce switched access charges."[21]

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[19] Missoula Amendment, p 7.

[20] Ibid. p. 1.

[21] Ibid. Cover letter, p. 1.

Apparently, they realize that there is not an automatic correlation between high local rates and low intrastate access charges.

The Supporters should have been able easily to obtain information on the actual intrastate access charges of every ILEC in the country without requiring or relying on state commissions to provide such.[22] They did not do so and instead relied on the existence of high local exchange rates (or an intrastate USF) as evidence of low intrastate access charges. That rationale does not hold up under scrutiny. First, high local exchange rates can be the result of many factors unrelated to the level of the ILEC's intrastate access charges. High local rates could be reflective of high loop costs that are already being subsidized through the federal USF. In addition, high local exchange rates could be indicative of large local calling areas, competitive classification, statutory deregulation, or nontraditional regulatory pricing plans. On the other hand, low local exchange rates could be indicative of small local calling areas, noncompetitive classification, statutory mandate, or traditional rate of return regulation.[23]

Furthermore, the Supporters do not define or quantify what constitutes substantially lowered intrastate access charges. Unlike with "high" residential rates, they suggest no threshold intrastate access rate benchmarks to compare the actions of state commissions. For example, some states mirror interstate access charges. A state with an interstate access parity benchmark might be "reasonable" evidence of significant state

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[22] For example, on February 1, 2007, AT&T Communications of Virginia, LLC included information that compared rate levels of intrastate switched access charges of all ILECs in Virginia in comments filed with the VSCC in Case No. PUC-2006-00154.

[23] The Supporters even recognize that some states have reduced intrastate access charges without offsetting rate increases. See FBM Amendment p. 5, which states "… where states have not raised rates substantially to replace intrastate charges, FBM funding … does not provide relief."

action. However, with no information of actual intrastate access charges in any state (or for any ILEC) or no comparison of intrastate access rate levels between various states one cannot (and should not) assume anything. In any event, the Supporters have not even attempted to prove any assumptions underlying the FBM.

The Use of a National Residential Benchmark Rate is Inappropriate and will Lead to Inequitable Results.

The use of benchmark rates as a threshold to qualify for any federal USF support may have considerable merit but it is misguided and inappropriate for use with the FBM. It is particularly troubling when there is absolutely no analysis or rationale provided to support the chosen benchmark rates.

The Supporters have provided no explanation of the derivation of either the low or high benchmark rates, and they appear to be picked at random. Moreover, even more perplexing is that the Supporters believe they are more knowledgeable than individual state commissions about affordable and reasonable rates in a given state.

The Supporters are apparently unaware that the FCC already provides a nationwide benchmark rate that it adjusts annually for state commissions to use in determining reasonable comparability of urban and rural residential rates for non-rural carriers.[24] Presently, residential customers in urban areas pay on average approximately $24.74 per month for residential flat rate service, including federal and state SLCs and other charges such as taxes and 911 fees.[25] However, the FCC does not interpret residential rates above the $24.74 as unreasonable for comparing urban and rural rates

[24] See 47 U.S.C. § 56.316 (b): Rate comparability review and certification for areas served by non-rural carriers. Safe harbor.

[25]The FCC's Wireline Competition Bureau's 2006 *Reference Book of Rates, Price indices, and Expenditures for Telephone Services* ("2006 Reference Book of Rates"). Table 1.1. Average rate as of October 15, 2005.

nationwide. In fact, because of the great variation in urban rates nationwide the FCC has determined that the nationwide urban benchmark shall equal the average rate plus two weighted standard deviations.[26] The FCC's 2006 Reference Book of Rates shows that the nationwide residential urban benchmark is $34.58.[27]

We are not suggesting using the FCC benchmark would somehow make the FBM acceptable because it would not.[28] However, it does reinforce the obvious assumption fallacies inherent in the FBM. The Supporters have offered no studies comparing the reasonableness of residential rates among states or any other support for the high benchmark rate of $25.00.

The Benchmarks Appear to be Static and Will lead to Further Inequity Among States or Substantially Underestimate the FBM Funding Requirements.

The operational details of the FBM are nonexistent. However, there neither appears to be a mechanism to adjust the benchmark rates going forward (i.e. for annual inflation) nor to recognize that local exchange rates in states may increase over time. Many state commissions permit local rate increases by various means. For example, the VSCC regulates its largest ILEC under a form of alternative regulation that allows basic telephone rates to increase annually by no more than 10 percent up to an annually adjusted price ceiling. Apparently, if an ILEC's rates exceed the benchmark prospectively (or exceed by a greater amount to perhaps otherwise qualify for Category B

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[26] See 47 U.S.C. § 56.316 (b).

[27] 2006 Reference Book of Rates, p. I-4.

[28] We suspect using the FCC nationwide urban benchmark or applying a similar standard deviation calculation to the Missoula Plan benchmark would wipe out much, if not all, of the FBM funding requirements.

Funding), there does not appear to be a procedure to receive additional FBM funding. This could lead to rates in certain states exceeding the high benchmark level at some future date, but those states would not being eligible for FBM funding (or the ability to offset SLC increases) since they are not identified as early adopter states. In fact, it would be very possible (and likely) that the rates in the non early adopter states would soon equal or exceed those in the early adopter states with no ability to be made whole. This will produce even **greater inequity among the states** instead of less as the Supporters contend.

The $805M price tag appears to be based only on current rates in the various states. Therefore, if the FBM contemplates that eligibility for funding is prospective, then its cost is seriously underestimated as local rates increase over time. Further, if national benchmarks are not adjusted over time, the funding deficiency only intensifies. Moreover, even if the FBM does not intend to apply to rates prospectively, the cost will increase up to $25M higher as the Low Rate Adjustment requirements in various states are met.

<u>The FBM does not Enhance Intercarrier Compensation Reform.</u>

It is unfair and irresponsible to expect consumers in certain states to pay more for their services so those in other states can pay less because of some unsupportable assumptions about the actions of certain state commissions. The basic premise of the FBM is inappropriate and misplaced, and if state commissions have taken actions to reduce intrastate access charges substantially and correspondingly raise local rates, they or the Supporters should be able (and required) to provide specific documentation of such action.

There is no doubt that the main purpose of the FBM (and RM) is to increase federal USF support to various ILECs and states as a means to gain support for other provisions of the Missoula Plan. We are not convinced that additional USF funding is necessary or sustainable; however, the Missoula Plan would only make the current situation worse. It would not accomplish the goal of intercarrier compensation reform on either an equitable or sustainable basis. Increasing the federal USF by approximately 35 percent ($2.7B) to implement this seriously flawed Plan is extremely dangerous and shortsighted. Ultimately, the Missoula Plan would put the future existence of the federal USF at even greater risk to the detriment of <u>all</u> consumers in <u>all</u> states.

CONCLUSION

The FBM does nothing to address the multiple problems inherent in the Missoula Plan. It is unquestionably inequitable and would benefit a few states at the expense of others. The Supporters have offered neither rationale nor support for the assumptions used in developing the FBM.

The Missoula Plan, including the FBM should be rejected. It is time to stop this time consuming effort to make the Missoula Plan somehow palatable. The FCC, industry, and state commissions should focus efforts on more manageable and reasonable methods to address intercarrier compensation as well as universal service reform.

Respectfully submitted,
Virginia State Corporation Commission Staff

William Irby

William Irby
Director
Division of Communications

March 19, 2007