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The Honorable Kevin J. Martin
Chairman
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Dear Chairman Martin:

I write to bring to your attention a rapidly proliferating scam that demands immediate Commission action. I am referring to "traffic pumping" schemes involving unscrupulous LECs that: (i) establish grossly excessive access charges under false pretenses; (ii) offer kickbacks to operators of pornographic chat lines and other calling services that agree to advertise their services (typically for "free") to anyone who dials telephone numbers assigned by the LECs; and (iii) bill "terminating" access charges for the millions of calls, involving communications between non-residents of the small communities the LECs serve, that are generated by the advertising. These schemes are transparently designed to evade core Communications Act protections against unjust and unreasonable rates and practices, as well as protections against the exposure of children to pornographic content. They also make a mockery of the universal service system given that these very same LECs are receiving federal universal service subsidies even as they earn staggering returns from their scams. About a dozen LECs are engaged in these swindles today, but many more, apparently drawn by the lure of illicit windfalls, plan to exit the NECA pool in July. AT&T and others have sued the current LEC wrongdoers for their violations of existing law, but given the ease with which these schemes are implemented and shifted rapidly to other locations, it is clear that after-the-fact, case-by-case litigation could never fully protect the public interest. The Commission must act now to discourage these schemes before they are initiated.

The traffic-pumping arrangements I have described are scams, pure and simple. They are designed to take advantage of the high access charges that law-abiding ILECs and CLECs are able to charge in extremely rural areas, which are intended to reflect the high unit costs of serving end-users in these communities. The vast majority of rate of return LECs cover their costs by participating in the NECA pool tariff, which establishes access rates averaging about two cents per minute, far higher than the prevailing rates in non-rural areas. A rural ILEC seeking traffic-pumping windfalls, however, exits the NECA pool and files its own tariff, claiming the right to much higher rates (as much as 13 cents per minute or more) based upon the very low call volume associated with the actual residents of the small community it serves. "CLECs" – some formed solely to

engage in traffic-pumping schemes – parasitically “enter” these rural markets as well, so that they can charge the ILEC rate under the Commission’s “benchmark” rule. The LEC (whether ILEC or CLEC) enters “revenue sharing” contracts with entities that offer some sort of calling service that is guaranteed to generate huge amounts of incoming traffic that far exceed the call volumes upon which the LEC based its rates – typically, the calling services are offered for “free” in order to maximize traffic and, hence, the access revenues the LEC and the calling service provider share. Many of the calling service providers use “free” pornographic chat lines to generate traffic, but there is no limit to their ingenuity. Some offer “free” international calls to China, “free” conferencing services, “free” voicemail services, and other inducements, all of which have a single purpose: to artificially stimulate massive increases in traffic by promising consumers the communications (or pornographic) equivalent of a free lunch.

The calling service providers who partner with rural LECs in this scam become “customers” of the rural LEC and obtain phone numbers from the LEC, which are then advertised worldwide on Internet websites. The end result is millions of calls to the advertised phone numbers, millions of dollars in monthly access charge billings, and enormous windfalls both to the rate of return LEC and the calling service provider, all funded by IXCs and their customers, the vast majority of whom never call and want nothing to do with these services. Yet when their tariff periods expire, these ILECs do not recalculate their access rates based on the vastly increased demand from their traffic pumping schemes, which would result in massive rate decreases; they simply hop back into the NECA pool, and the calling service providers find new LEC partners and begin the scams anew.

These scams work only because the LECs have deceived government authorities, and, specifically, the FCC. They know that their tariffed terminating access rates are set at very high levels that are based on very low historical demand in their sparsely populated areas. Yet they fully expect their traffic levels to dwarf historical demand as a result of their traffic pumping schemes. Superior Telephone Company’s traffic-pumping arrangement in Iowa is illustrative. Even though Superior has one of the highest access rates in the country, it has historically billed AT&T only about two thousand dollars per month, because the population of Superior, Iowa is so small (about 250). Beginning in mid-2006, only months after Superior revised its tariff, however, Superior’s access bills to AT&T suddenly skyrocketed as the millions of calls associated with Superior’s traffic-pumping schemes – including an arrangement with the operator of a service called Hot Live Sex Chat – began pouring in. Indeed, Superior billed AT&T more than two million dollars for a single month, far more than Superior could have billed AT&T if every resident of Superior, Iowa was the recipient of calls from AT&T long distance customers 24 hours a day. To place this in perspective, in only one month, Superior Telephone Company billed AT&T alone the equivalent of \$8000 for every man, woman, and child in Superior, Iowa. And this does not count Superior Telephone’s billings to other interexchange carriers. This helps explain, not only the relative scale of the scam in which Superior Telephone is engaged, but the tremendous lure of this scam to Superior and other carriers unless the Commission acts promptly.

Although these traffic-pumping LECs have quite plainly employed false pretenses to implement their unlawful schemes, they are remarkably brazen in their contempt for the Commission and its processes, publicly proclaiming in court documents and in the press that there is nothing that the Commission can do to curb their misbehavior under existing rules. The LECs' calling service partners are equally dismissive of the Commission's ability to protect the public interest. One provider unabashedly includes on its website a link to a report that proclaims: "Just a note to those who have figured out freeconference.com's business plan, and how it actually does make money on those 'free' calls. You might think that current regulatory trends could hurt Freeconference.com's business plan. Just remember how slow the regulatory process is and how full of holes it is, before you conclude that I'm wrong." See freeconferencecalls.com/PressRel20050117.aspx (visited March 30, 2007).

Those words should be a call to action to the Commission. As Milton Friedman reminded us, there is no such thing as a free lunch – or free telephone calls. If some people are receiving services for "free," someone else is paying for those services -- and, in this case, they are also funding the massive profit margins that attend this scheme. Hence, if the traffic-pumping LECs have their way, the majority of Americans will subsidize the telephone bills of a minority of heavy chat-line, conferencing and international callers and line the pockets of the LEC perpetrators and their "free" calling partners. Indeed, these schemes even force Americans to subsidize foreign callers for international calls that neither originate nor terminate in the United States, but that are merely routed through the traffic-pumping LECs' exchanges.

The cost of these schemes is already massive, and the lure of easy money is causing them to grow exponentially. The estimated 2007 impact on AT&T alone – and, ultimately, AT&T's customers – will be more than \$250 million. Unless these scams are remedied, all U.S. long distance and wireless carriers will have to raise their rates to cover their increasing costs. And the rapid and exponential increases in traffic routed to rural exchanges have already caused serious network congestion that has disrupted ordinary long distance calls that have nothing to do with these schemes.

The Commission should take immediate steps to address this problem. One of the Commission's central mandates is to ensure that rates are just and reasonable, and there is no area in which that mandate compels more immediate action than in putting an end to these burgeoning traffic-pumping schemes. Although the Commission has determined that rate-of-return ILECs should receive an 11.25% annual return, these traffic-pumping schemes, unless remedied, could easily generate returns of 11.25% per day for the LECs that perpetrate them.

To make matters worse, these LECs have the temerity to continue to pocket universal service funding, even as they are billing more in access charges each month than their annual cost of service. Indeed, one traffic-pumping LEC that is billing millions of dollars in access charges monthly – and based its tariff on an annual cost of service of less than half a million dollars – just filed a petition for "eligible telecommunications carrier" status with the Iowa Utilities Board to obtain additional universal service

funding. Monopolizing scarce universal service funding that should be put to much better uses is disgraceful and offensive, and, as more and more LECs enter into these schemes, the drain on the Universal Service Fund and those who must contribute to it will only increase.

These schemes also harm the public interest in other ways. For example, the fact that the “free” pornographic chat-lines and other services offered by the traffic-pumping LECs’ calling service partners can be accessed from any phone with an ordinary 1+ call reflects an effort to evade the important protections Congress and the Commission provided to parents under the Telephone Disclosure and Dispute Resolution Act (TDDRA). 47 U.S.C. § 228. The purpose of TDDRA is to require such services to be offered through 800 or 900 numbers that have certain protections for parents, such as the ability to block the calls. But anyone (including children) can call the rural LEC numbers advertised for these services, with no ability for parents to block the calls and without any of TDDRA’s other protections.

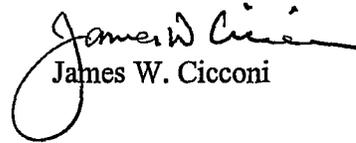
As noted, many of the current LECs engaged in traffic-pumping schemes are violating existing laws. Most of these arrangements violate both the LEC’s tariff and the Act, because they purport to charge IXCs for “terminating” calls that do not actually terminate in that LEC’s service area (or, in many cases, even in this country). And many of these schemes involve sham arrangements that are designed solely to inflate access charges. Indeed, some of the “CLEC” perpetrators are sham carriers that have “entered” the local telephone market in these sparsely populated rural areas not to serve the residents of these communities, but solely to engage in traffic-pumping schemes and to mirror the ILEC’s extremely high terminating access charges for calls to those schemes. AT&T has brought lawsuits against a number of Iowa LECs that are engaged in these schemes, and Qwest has recently filed its own suit against these and other LECs. Although AT&T expects ultimately to prevail in these individual lawsuits, this problem cannot be effectively solved through case-by-case litigation. These LECs and their calling service partners are a constantly moving target, essentially engaging AT&T and other IXCs in a nationwide game of “Whack-a-Mole.” The calling service providers post numbers obtained from their LEC partners on their websites, but they can continuously change those numbers just as they can quickly change their LEC partners. Moreover, new calling service schemes are appearing constantly on the Internet. As soon as AT&T identifies one scam, two more pop up. Moreover, what was once a relatively isolated problem associated with a handful of LECs in rural Iowa is now spreading to South Dakota, Minnesota and other states.

The need for quick action is all the more important given that 29 rural ILECs have indicated their intent to leave the NECA pool on July 1 – far more than the handful that exit NECA in a typical year – and we have reason to believe these LECs intend to initiate yet more of these traffic-pumping schemes. After-the-fact lawsuits simply are not deterring this conduct, which is becoming ever more widespread and serious. Unless the Commission takes immediate action to check the growth of these schemes, it will be faced with an ever-increasing, ever-changing parade of schemes that threaten to raise consumer bills and do serious harm to the public and the entire industry.

Unfortunately, the ease with which the Internet allows anyone to reach a national (indeed, global) audience has emboldened more and more people to try to profit by hijacking the investments, services, and creative works of others. In our view, those offering "free" calling services are engaged in the same practice as those who profit from digital piracy. And in the same way, cleverness in devising the scheme is no excuse for the fundamental dishonesty which underlies the act itself. The Commission should act promptly to stop this unscrupulous free-riding and the increasingly severe negative impact it is having on the entire industry.

We look forward to meeting with you as soon as possible to discuss potential solutions to this urgent problem.

Sincerely,


James W. Cicconi

cc: Commissioner Adelstein
Commissioner Copps
Commissioner McDowell
Commissioner Tate