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Mr. Thomas Navin
Chief, Wireline Competition Bureau
Federal Communications Commission
445 Twelfth Street S.W.
Washington D.C. 20554

Re: Proposals to Address Traffic-Pumping Schemes

Dear Mr. Navin:

Verizon and other carriers have documented the growing phenomenon of "traffic pumping" and the harm that it is inflicting on the industry and on the public.[1] As Verizon has discussed with staff and with Commissioners' legal advisors, there are several actions that the Commission can and should take now in order to prevent this regulatory arbitrage scheme from growing further, which Verizon summarizes below.

As Verizon and others have explained, these traffic pumping arbitrage schemes involve primarily rural ILECs and CLECs charging excessive access rates while increasing the number of calls that appear to terminate on their networks by enticing conference and chat-line providers into their jurisdictions with free or low-cost service. The conference and chat-line providers in turn advertise and market their services to the public as "free" in order to drive up demand. As a result, Verizon and other carriers are forced to pay excessively high access rates for a hugely increasing volume of traffic terminating to the LECs, which "kickback" a portion of those revenues to the conference and chat-line providers driving the increased demand. This creates a windfall for both sets of entities – providing excess access revenues to the LECs, while sustaining an artificial business model for the conference and chat-line providers.

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1 *See, e.g.*, Letter from U.S. Telecom members to Chairman Martin and Commissioners Copps, Adelstein, Tate, and McDowell (Apr. 30, 2007); Letter from Susanne Guyer (Verizon) to Chairman Martin and Commissioners Copps, Adelstein, Tate, and McDowell (Apr. 19, 2007); Letter from David Zesinger (Embarq) to Chairman Martin and Commissioners Copps, Adelstein, Tate, and McDowell (Apr. 17, 2007); Letter from James Cicconi (AT&T) to Chairman Martin (Apr. 4, 2007); *see also* Letter from CTIA to Marlene Dortch, CC Docket 01-92 (Apr. 24, 2007).

These rural LECs are able to charge excessive rates by exploiting the Commission's tariff filing procedures. Rural ILECs take advantage of rules that permit them to set their rates based on *historical* demand and to adjust their rates only every two years. *See* 47 C.F.R. § 61.39. When the Commission decided to permit small ILECs to rely on historical support data, it did so at a time when demand for these carriers' services was relatively stable, such that historical demand was a reasonable proxy for future demand. The Commission also believed that, to the extent there was some limited change in demand, the tariff process would be "self-correcting and thus rate neutral over time because current actuals would be used in subsequent period to set rates. Carriers using this ratemaking process thus should neither gain nor lose revenues in the long run as a result of using historical data." *Regulation of Small Telephone Companies*, Report and Order, 2 FCC Rcd 3811, ¶ 2 (1987). But in this case, the rural ILECs rely on past demand to tariff high access rates and then enter into kickback arrangements with conference and chat-line providers that they know will render past demand irrelevant. These inflated rates are not self-correcting in future periods, because these rural ILECs are likely to return to the NECA pool and rely on the NECA tariff rather than file new tariffs that reflect current demand. *See* Letter from Susanne Guyer (Verizon) to Chairman Martin and Commissioners Copps, Adelstein, Tate, and McDowell (Apr. 19, 2007).

Rural CLECs also profit from traffic pumping by gaming the Commission's CLEC "benchmarking" rule to mirror the high access rates charged by small ILECs. *See* 47 C.F.R. § 61.26. In some cases, these CLECs are located near, and therefore "benchmark" to, a small ILEC with high tariffed access rates based on the ILEC's low historical demand. Due to the CLEC's traffic pumping activities, however, the CLEC's demand far exceeds that of the ILEC whose rates it mirrors and the CLEC's rate is unreasonable in light of that demand. In other cases, these CLECs take advantage of the rural exemption in § 61.26(e) to "benchmark" to NECA's highest access rate, rather than the lower rate of the competing ILEC. These benchmarking rules were based on the assumption that CLECs operating in rural areas would have cost and demand levels that would justify higher access rates comparable to the rates of rural ILECs. *See Access Charge Reform*, Seventh Report and Order, 16 FCC Rcd 9923, ¶ 51 (2001). The Commission's rationale does not hold true, however, where the CLEC is using traffic pumping schemes to generate artificially high demand that far exceeds the demand underlying the rural ILEC "benchmark" rate.

These traffic pumping schemes provide no public benefit, but instead harm consumers. While some consumers may believe that they are receiving the benefit of "free" conference calling or chat lines, those services are not truly "free." The excessive access charges that Verizon and other carriers are being forced to pay must ultimately be passed on to all consumers. Thus, those consumers who are using "free" conference and chat-line services – as well as other consumers that do not use the "free" services – are harmed by traffic pumping schemes in the end.

The time for the Commission to address these harms is now, before traffic pumping schemes grow larger, become more widespread, and cause even more harm. The fact that 38 additional small ILECs intend to leave the NECA pool with this year's annual filing in order to file their own tariffs – presumably based on historical demand – demonstrates how quickly traffic pumping schemes are growing and why the Commission needs to take action quickly.

To prevent further harm from traffic pumping, the Commission should take action on three fronts: (1) issue a declaratory ruling or letter ruling that traffic pumping kickback arrangements are unlawful; (2) suspend and investigate the tariffs of the 38 ILECs leaving the NECA pool to ensure that these carriers cannot hide behind "deemed lawful" rates that are based on misleading historical demand in order to reap arbitrage profits from traffic pumping throughout the upcoming 2-year tariff period; (3) promulgate modest changes to tariffing rules governing small ILECs and CLECs in order to close the loopholes that carriers have been exploiting with traffic pumping schemes.[2] Notably, none of these steps alone is sufficient to address traffic pumping. Rather, simultaneous action on all three fronts is essential to address traffic pumping in both the short-term and the long-term. Verizon summarizes each of these three proposals, and the need for simultaneous action, on the following pages.

Sincerely,

Donna Epps

cc: Don Stockdale
Al Lewis
Deena Shetler
Pam Arluk

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[2] Shortly before Verizon submitted this letter and the attached outline of its proposals, three ILECs located in Iowa suggested in a letter to the Commission that traffic pumping could be adequately addressed by a declaratory ruling on the appropriate uses of the Commission's existing tariff rules for small ILECs, 47 C.F.R. §§ 61.38, 61.39. *See* Letter to Chairman Martin and Commissioners Copps, Adelstein, Tate, and McDowell from The Farmers' Tel. Co. of Riceville, Superior Tel. Co., and Interstate 35 Tel. Co. (June 4, 2007). As Verizon will explain in more detail in a future submission, the Iowa LECs' proposal is far from sufficient to solve the growing problem of traffic pumping.