Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	

REPLY COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.

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Qwest Communications International Inc. ("Qwest") hereby files these reply comments in the above-captioned docket.

I. INTRODUCTION AND SUMMARY.

The comments filed in response to the Federal Communications Commission's ("Commission") *Notice of Proposed Rulemaking* ("*NPRM*") in this docket makes several matters quite clear:[1]

- The "access stimulation" problem is a matter of grave consequence to the nation's telecommunications infrastructure. A small number of rural incumbent local exchange carriers ("ILECs") and their "free service provider" ("FSP") partners are abusing the system to their own profit in a manner that not only violates the Communications Act but could threaten to undercut the universal service/rural service policy goals of the Commission and the Communications Act.
- The vast majority of rural ILECs, including the majority of those commenting in this docket, are not involved in access stimulation schemes and, indeed, recognize the inherent dishonesty that underlies access stimulation partnerships that result in excessive

[1] *In the Matter of Establishing Just and Reasonable Rates for Local Exchange Carriers,* Notice of Proposed Rulemaking, 22 FCC Rcd 17989 (2007).

access earnings. Those ILECs who do favor access stimulation do so based on arguments that are economically and legally wrong.

- The key to access stimulation -- the fact that ILEC costs do not increase proportionately with traffic -- has not been meaningfully contested. Peter B. Copeland's declaration documenting the fact that the incremental costs of processing additional traffic in an ILEC switch are minimal when line growth is not significant has been met with only a single challenge, and that challenge does not really contend that Mr. Copeland's premise or conclusions are wrong, only that short-run incremental costing is not appropriate for ratemaking and that exhaustion and new investment must be taken into account in conducting a proper incremental cost study.[2] Mr. Copeland's essential conclusion, that switching costs do not rise proportionately with traffic volume (a fact reflected in the NECA average schedules), remains unrefuted.
- Solutions to the access stimulation problem must meet two criteria: 1) They must be narrowly focused. Rural ILECs that are not supportive of access stimulation conduct raise legitimate concerns about overly complex and burdensome rules that might sweep honest ILECs into the same basket as those engaged in access stimulation; 2) They must be comprehensive. Many of the solutions proposed by various commentors would not deal with the access stimulation problem because they would leave too many loopholes. This is especially true in the case of solutions that do not address competitive local exchange carrier ("CLEC") access stimulation.

In these reply comments, Qwest addresses five issues raised in the initial comments.

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[2] *See* Comments of the Rural Alliance at 10-18. These Comments are discussed in detail in Section III., *infra*.

First, Qwest submits that the comprehensive solution that Qwest set forth in its initial comments provides a meaningful and non-intrusive solution to the access stimulation problem. Qwest continues to believe that this approach is optimal. Nevertheless, some commentors have expressed concern that solutions that require tariffs to be filed based on specified percentage of traffic increases might be unnecessarily intrusive and impact on rural LECs that are not engaged in access stimulation. In these reply comments, Qwest submits an alternative option for dealing with the access stimulation problem. Qwest is not withdrawing the proposed rule changes made in its initial comments. What we submit here is another way of dealing with the problem that the Commission should consider.

In this alternative, tariffed rates for rural ILECs that are not in the National Exchange Carrier Association ("NECA") pool are either based on projected costs (Section 61.38) or tied to a revised NECA average schedule in a manner that would require rate modifications based on traffic fluctuations. In the case of (47 C.F.R. § 61.38) filing carriers, shared access revenues would not be a legitimate cost to include in such projections. Rural CLECs would be permitted to charge whatever non-discriminatory rate they negotiate with an interexchange carrier ("IXC"), but they would be permitted to tariff only the rate that would be permitted under the NECA schedule for the level of the CLEC's traffic covered or the rate of the nearest non-rural ILEC. This simple and non-intrusive approach should both deal responsibly and completely with the access stimulation problem in a manner that does not harm honest ILECs or CLECs, and presents a viable option for dealing with unlawful rates caused by access stimulation.

Second, Qwest reviews the Rural Alliance's challenge to the validity of Peter Copeland's analysis. Mr. Copeland has demonstrated that, consistent with long-standing Commission analysis, switching costs do not rise proportionately with traffic increases. In an access stimulation situation where there is no significant numbers of additional lines (or where access lines are not being used at all), the incremental cost of adding additional minutes of use ("MOUs") of traffic is negligible. The Rural Alliance asserts that Mr. Copeland's analysis might not be complete if used to set rates (which Qwest had never urged), but really does not seriously challenge Mr. Copeland's analysis itself. We provide further explication of Mr. Copeland's analysis. This is important because it is the mismatch of rates for rural carriers set based on an assumption of low traffic volumes and the profits generated when high volumes of traffic are pumped through their local switches that (or possibly around them) causes the rates of access stimulating LECs to become unlawful.[3]

Third, Qwest briefly analyzes some proposals to deal with the access stimulation problem that do not treat the entire issue. Approaches that do not encompass CLECs will have little long term benefit, because the FSPs will simply choose rural CLECs as partners, rather than rural ILECs. As has been demonstrated on the record, the CLEC access stimulation phenomenon has already begun to manifest itself, and continues to grow. Similarly, approaches that rely on the complaint and tariff processes alone will not solve the access stimulation problem even with respect to ILECs because of the abuse of the "deemed lawful" provisions of Section 204(a)(3) of the Act that has been a hallmark of a successful access stimulation scheme. Finally, simply limiting the ability of a rural ILEC to move in and out of the NECA pool, while obviously helpful in curtailing access stimulation by ILECs, still leaves open access stimulation possibilities for ILECs seeking to manipulate the tariff process and, depending on the extent to which the NECA average schedules are modified, could leave access stimulation opportunities open for pool members.

[3] *See* Supplemental Declaration of Peter B. Copeland, Attachment A, hereto.

Fourth, Qwest briefly addresses those commentors who claim that access stimulation is an acceptable type of marketing, a viable economic tool or is pro-competitive. Qwest submitted the declaration of Dr. Timothy J. Tardiff as part of its opening comments. In these reply comments, Dr. Tardiff further analyzes the positions taken by those supporting the legitimacy of access stimulation from an economic perspective. Dr. Tardiff reaffirms his earlier conclusions and responds directly to those commentors claiming that access stimulation arrangements are akin to normal marketing activities -- they are not, and indeed are almost the direct opposite of the function of marketing a service to a willing purchaser.

Fifth, Qwest directs the Commission's attention to evidence regarding the nature of the relationship between FSPs and their LEC partners. As is obvious on this record, access stimulation partners are extremely reluctant to disclose the workings of their partnerships to the public or to anyone else. Most information that Qwest has obtained in various litigation involving access stimulation has been marked as confidential by those providing the information.[4] However, an extremely telling deposition of Greg Lorenzetti, who served as a consultant to Free Conferencing Corporation, a major FSP (freeconferencecall.com) describes that company's relationships with its rural ILEC partners. As can be seen from the deposition, any claim that the relationship between access stimulating rural LECs and their FSP partners is one of carrier and customer would simply not be accurate, at least as it applies to freeconferencecall.com. In addition, statements in this deposition, in a letter from counsel to an FSP to counsel to Qwest, and in an affidavit submitted in the same proceeding document that some access stimulation business arrangements have been marked by back-dating and altering

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[4] Discovery is ongoing in the case of *Qwest Communications Corporation v. Superior Telephone Cooperative, et al.*, Docket No. FCU-07-2, State of Iowa, Department of Commerce Utilities Board.

documents after litigation has been commenced. As the access stimulating partners have been so reluctant to come forward with their own information on the record, Qwest submits that it is reasonable to generalize and conclude, in the absence of additional evidence, that the practices testified to by Mr. Lorenzetti are typical in the access stimulation industry.

II. A NARROWLY-TAILORED APPROACH TO ACCESS STIMULATION IS FEASIBLE.

The overwhelming majority of small ILECs and associations representing them agree that access stimulation that generates unlawful profit levels is not a bona fide or legitimate activity.[5] However, a number of these same commentors express concern that a remedy to access stimulation must not undercut the ability of rural carriers to continue to fulfill their role in the provision of universal service.[6] These concerns are not without merit. Access stimulation itself poses a serious threat to rural telecommunications, and care must be taken to ensure that the solution to this threat does not unduly impact those rural ILECs who are not engaged in the practice. While Qwest does not believe that the solution it submitted in its initial comments (basically tied to ILEC certifications that they were not planning to engage in access stimulation and mandatory tariff revisions based on percentage volume increases) is unduly burdensome, it does recognize that there are other approaches that might achieve the same publicly beneficial result and be more acceptable to the large number of rural LECs that are not planning on engaging in access stimulation.

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[5] CenturyTel, Inc. at 3; Independent Telephone & Telecommunications Alliance ("ITTA") at 4-5; United States Telecom Association ("USTA") at 1-2; Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO") at 10-11; John Staurulakis, Inc. ("Staurulakis") at 22-23.

[6] *See, e.g.,* OPASTCO at 4-5; ITTA at 2. *See also*, Rural Iowa Independent Telephone Association at 5; Western Telecommunications Alliance at 14-17.

With this in mind, solving the interstate portion of the access stimulation problem can be keyed to application of revised and extended NECA average schedules to the rates of average schedule (Section 61.39) companies that leave the NECA pool and file their own tariffs.[7] If Section 61.39 carriers not in the NECA pool were required to adhere to the NECA schedules and to adjust their rates, including a true-up if the rate were too high,[8] every 90 days if necessary to reflect the proper schedule for the amount of traffic carried, much if not all of the incentive for access stimulation would disappear (if no change were to be made to the rates, no tariff filing would be necessary). A Section 61.39 carrier that preferred not to use the NECA schedules to set its tariff rates would need to file based on projected costs under Section 61.38. The Section 61.39 option to file based on historical costs would be eliminated.

Although Qwest's proposals here would modify the Section 61.39 regime, they would not undermine that Section's goals. Cost carriers currently eligible for streamlined tariffing would have the option of either (1) remaining in the NECA pool and thus receiving cost-based compensation through the pool or (2) exiting the pool and receiving compensation based on projected costs. These options will provide cost companies with all of the advantages now contemplated by Section 61.39.[9] Similarly, average-schedule companies would have the option

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[7] It is important that NECA be directed to extend its schedules across a full range of access demand, ultimately reaching at their lowest level a switched access rate comparable to those of non-rural ILECs.

[8] The Commission's authority to order a true-up for excessive earnings is well established. For example, the Commission's "sharing" mechanism under price caps was upheld on appellate review, *Bell Atlantic Telephone Companies v. FCC*, 79 F.3d 1195 (D.C. Cir. 1996), as was the Commission's "add-back" requirement. *Verizon Telephone Companies v. FCC*, 453 F.3d 487 (D.C. Cir. 2006). The rate would be adjusted prospectively, and the adjustment would not amount to unlawful retroactive ratemaking.

[9] Notably, the *Small-Carrier Tariff Order* cited no specific reason why a cost company might want to exit the pool but still avoid making the projections contemplated by Section 61.38. *See In the Matter of Regulation of Small Telephone Companies*, Report and Order, 2 FCC Rcd 3811 (1987) ("*Small-Carrier Tariff Order*"). Nor did the associated Notice of Proposed Rulemaking

of either (1) staying in the pool, charging the NECA access rates, and receiving compensation based on application of the average schedule formulas to their specific circumstances, or (2) leaving the pool, charging rates based on their expected settlements, and then keeping those payments (subject to true-ups). Here, too, the regime preserves the benefits of Section 61.39 – namely, the ability to operate outside the pool while still basing compensation on the average schedules[10] – while minimizing the risk of unlawful rates caused by access stimulation activities without concomitant price reductions.

For Section 61.38 carriers, the solution is even simpler. So long as a Section 61.38 carrier files accurate projections of traffic volumes and costs, and so long as revenue shared with an FSP is not counted as a cost of providing service in determining the proper rate, access stimulation by Section 61.38 carriers should not present a problem. Thus, the Commission should simply require that Section 61.38 carriers exclude shared revenues from expenses in calculating their costs for tariff purposes.

For CLECs, a CLEC could (as is the case today) charge whatever access rates it could negotiate with IXCs. To the extent that a CLEC desired to tariff its access charges, it could

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describe any such reason. *See In the Matter of Regulation of Small Telephone Companies*, Notice of Proposed Rulemaking, 2 FCC Rcd 1010 (1986). The most significant benefit one might imagine would be the carrier's entitlement to base rates on historical figures without providing updated cost data either to NECA or to the Commission. That entitlement, however, should raise significant concerns, given the likelihood that the provider's costs will change – perhaps significantly – over time. Moreover, to the extent the carrier has a legitimate reason for wanting to avoid the burdens associated with making a cost showing, such a carrier can always choose to participate in the pool as an average-schedule provider.

[10] The basis for the Commission's finding that small carriers should be permitted to leave the pool and charge rates based on their hypothetical average-schedule settlements was that "[a]n average schedule company may have valid reasons for wishing to charge not [the NECA] pooled rates, but rates based on [its] own costs as now computed according[] to average schedule formulas." *Small-Carrier Tariff Order*, 2 FCC Rcd at 3814 ¶ 25. Adherence to the modifications imposed by the schedules would better achieve this purpose than the current regulatory structure.

either benchmark its rates to the rates of the nearest non-rural ILEC (*e.g.,* the "rural exemption" would be modified) or to the NECA schedule for the appropriate traffic level. A CLEC that desired to assess higher access charges and was unable to negotiate what it believed was a reasonable rate with IXCs could petition for a waiver from the Commission.[11] But for the most part CLEC rates should be detariffed and subject to market forces except to the limited extent that their tariff rates are consistent with the revised NECA schedule or the rates of the nearest non-rural ILEC.

In suggesting this approach, Qwest does not mean to diminish or downplay the solutions proposed in its own earlier comments and those of other filing parties.[12] Clearly access stimulation is a serious problem that is, as a creature of regulation,[13] susceptible to a variety of regulatory solutions. There is consensus among those commentors who agree that access stimulation presents a problem that a key to the threat (and to the solution) is the fact that the rates of access stimulating LECs are, on that account, unjust, unreasonable and unlawful.[14] Indeed, the Commission has already so found in the *Farmers and Merchants* case.[15] If a

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[11] As has been pointed out on the record, so-called "rural" CLECs do not share the same social obligations or cost characteristics of rural ILECs. Qwest Comments at 10-14, 24-25; Tardiff Declaration ¶¶ 2, 6-7, 10-15. There is no reason for them to be able to charge the extremely high access rates that allow honest rural ILECs to serve their customer base. Qwest Comments at 14-15, 18-23. In fact, as pointed out by Verizon, numerous rural CLECs seem to have been created entirely for the purpose of establishing access stimulation schemes. Verizon at 24. *See* Section IV.A., *infra*.

[12] AT&T Inc. ("AT&T") at 19-32; Verizon at 23-28; Sprint Nextel Corporation ("Sprint") at 17-19.

[13] Mercatus Center, George Mason University ("Mercatus") in its comments suggests that the Commission can eliminate the access stimulation problem by allowing the market to function -- giving IXCs the ability to decline to do business with access stimulating ILECs or by passing the access stimulating costs on to those customers who are calling the FSPs. Mercatus at 9-10.

[14] *See*, *e.g*., Verizon at 6-21; AT&T at 32-40; Embarq Corporation ("Embarq") at 7-8.

[15] *See In the Matter of Qwest Communications Corporation, Complainant, v. Farmers and Merchants Mutual Telephone Company, Defendant*., File No. EB-07-MD-001, Memorandum

mechanism can be devised that ensures that LEC rates remain just and reasonable even if demand increases dramatically, then the interstate access stimulation problem can be eliminated, or at least greatly diminished. Qwest submits that the alternative approach discussed herein (as well as Qwest's original proposal) can achieve that result.

III. SWITCHING COSTS DO NOT INCREASE PROPORTIONATELY AS ACCESS TRAFFIC INCREASES.

In the *Farmers and Merchants* complaint proceeding, Qwest submitted a declaration prepared by Peter Copeland, an expert in development of forward-looking cost studies.[16] This declaration was made a part of the record in this proceeding.[17]

In Mr. Copeland's declaration, he analyzed Farmers and Merchants' increases in traffic and line counts, and demonstrated that the revenue that Farmers would have billed would have recovered far more than the additional cost of processing the traffic that Farmers had stimulated. He concluded that Farmers had incurred no line side cost increases, trunk side increases only to the extent that new trunks were added. Tandem costs did increase somewhat, but increased efficiencies occasioned by the additional traffic (including what Mr. Copeland described as the "Poisson Traffic Model") dramatically reduced the cost per MOU at the tandem switch as well.[18] Ultimately Mr. Copeland estimated that Farmers and Merchants billed "end office switching charges … more than 35 *times* the typical BOC's additional cost.[19]

Opinion and Order, 22 FCC Rcd 17973, 17976-77 ¶ 13, 17979-80 ¶¶ 19-20, 17983 ¶ 25, 17988 ¶ 40 (2007), *partial reconsideration petition pending* (Qwest, Nov. 1, 2007).

[16] Declaration of Peter B. Copeland, attached to Formal Complaint of Qwest Communications Corp., *In the Matter of Qwest Communications Corporation, Complainant, v. Farmers and Merchants Mutual Telephone Company, Defendant*., File No. EB-07-MD-001, May 2, 2007.

[17] *Id.*, as filed in WC Docket No. 07-135 (Nov. 30, 2007).

[18] *Id.* ¶¶ 10-14.

[19] *Id.* ¶ 9 (emphasis in original).

Mr. Copeland then tied this analysis to the NECA average schedule settlement formulae to demonstrate -- the formulae that dictated the amount of money that Farmers would have received in settlements had it remained in the NECA pool. Based upon this analysis, Mr. Copeland demonstrated that the rate per MOU that Farmers would have received had it remained in the NECA pool would have declined from $0.078/per MOU in June of 2005 (before its access stimulation scheme had been set in motion), to $0.017 in August of 2005, and further to $0.011 in December of 2006.[20] Mr. Copeland concluded:

> The NECA settlement formulae, approved by the Commission, reflect the principles discussed above: When a carrier such as Farmers experiences a substantial increase in access traffic volumes, but that increase is not accompanied by a similar rise in access line counts, its costs rise at a much slower pace than its receipts.[21]

Mr. Copeland's basic conclusions are inescapable and not surprising: once a switch, lines and trunks are in place, the cost of processing additional MOUs is negligible. The basic conclusion is supported by a variety of other commentors in this docket.[22]

Only one commentor commented negatively on the Copeland declaration: The Rural Alliance.[23] The Rural Alliance claims that short-run incremental costs are not a valid basis for ratemaking, and are "not relevant to long run incremental cost used by the Commission to price UNEs and transport and termination under the TELRIC PLUS standard."[24] The Rural Alliance notes that incremental cost analysis at some point must recognize that switch and line capacity

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[20] *Id.* ¶ 22 and Table 1.

[21] *Id.* ¶ 24.

[22] *See, e.g.*, AT&T at 12; Embarq at 5-7; National Cable & Telecommunications Association ("NCTA") at 2-3.

[23] Rural Alliance at 14-17.

[24] *Id.* at 13.

are finite, and that proper incremental costs for ratemaking purposes must recognize this point.[25] The Rural Alliance claims that it "has historically disputed the argument that there are no traffic sensitive costs associated with the provision of end-office switching,"[26] and cites a BellSouth filing claiming that 70 percent of the switching costs are traffic sensitive."[27] The Rural Alliance concludes that "without a clear explanation of the methodology used to calculate the costs of switching and transport presented in the *Qwest Declaration*, the Rural Alliance believes that such cost data is of no value in this proceeding or any other proceeding, . . ."[28]

Despite this rhetoric and some odd cost analysis, the Rural Alliance does not actually dispute what the Copeland declaration actually documented. The Copeland declaration demonstrated that, in situations where line counts do not grow, and where new switches are not added, the cost per MOU of processing additional traffic is minimal. This is the situation that marks access stimulating LECs. If their costs increased proportionately with their additional revenue, they would not be able to pay the costs of providing free services to their FSP partners. It is the situation that is explicitly recognized by the operation of the NECA average schedule formulae. And, ultimately, this basic conclusion is not challenged by the Rural Alliance.[29]

The Copeland declaration is not otherwise challenged on this record. Given the paltry (and ultimately misdirected) nature of the criticisms by the Rural Alliance, Qwest submits that the analysis provided by Mr. Copeland must be recognized as accurate and complete.[30]

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[25] *Id.* at 11-12.

[26] *Id.* at 13.

[27] *Id.* at 14.

[28] *Id.* at 15.

[29] *Id.* at 17.

[30] Note, Mr. Copeland's declaration was not submitted as a proposal for ratemaking methodology. It was submitted as a method of demonstrating that Farmers and Merchants' rates

IV. AN ACCESS STIMULATION SOLUTION MUST BE COMPREHENSIVE.

Despite the general consensus that access stimulation without proper access rates is unlawful, a number of commentors suggest solutions that, because they are partial in nature, would not actually deal with the problem in a meaningful way. Many commentors suggest that the current tariff/complaint system can prevent unlawful access stimulation,[31] while others contend that the problem can be dealt with entirely through preventing manipulation of participation in the NECA pool.[32] While many commentors simply ignore the independent problem posed by CLEC access stimulation, several commentors actually affirmatively claim that CLEC access stimulation is not a problem and need not be dealt with at all.[33]

A. CLEC Access Stimulation Must Be Encompassed In Any Solution.

It is first important to recognize that no access stimulation solution can be meaningful unless it deals decisively with CLECs. Despite protestations by some commentors to the effect that CLEC access stimulation is not a problem,[34] the CLEC access stimulation problem is not a future speculative threat, but a current reality. As Qwest noted in its initial comments, especially after the Commission commenced investigating ILEC access stimulation, a number of CLECs (often created for the sole purpose of engaging in access stimulation) began or dramatically increased access stimulation activities.[35] Verizon reports experiencing similar CLEC access

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were too high. Its methodology applies to any other access stimulating LEC. It is not a substitute for a TELRIC or other incremental analysis used for ratemaking.

[31] *See*, *e.g.*, CBeyond, Inc. and Integra Telecom, Inc. ("Cbeyond") at 6-7; OPASTCO at iii, 9; Hypercube, LLC and MCLeodUSA Telecommunications Services, Inc. ("Hypercube") at 10-11.

[32] Embarq at 3-4; ITTA at 5-7; OPASTCO at iii, 10-14; Staurulakis at iv-vi, 13-15.

[33] All American Telephone Co. Inc., *et al.* ("All American") at i, 4-5.

[34] *Id.* at i, 4-5; Texaltel at third and last pages (pages not numbered); Trans National Communications International, Inc. ("Trans National") at 3-5.

[35] Qwest Comments at 8-10.

stimulation growth, observing that over 90% of its traffic to "rural CLECs" was to numbers associated with access stimulation partnerships.[36] Some CLECs are actually bragging about their access stimulation plans.[37] In fact, some access stimulating CLECs seem to have been created by ILECs as a vehicle to bypass any Commission access stimulation rules.[38]

Since the filing of Qwest's initial comments, additional CLEC information has come to light (and continues to come to light). For example, Farmers of Riceville is associated with a CLEC, Omnitel Communications, Inc. In May, 2007, Qwest-carried traffic terminating to Omnitel totaled 19,000 minutes. For the first week of July 2007, there were 91,000 minutes, with 99% of Qwest's terminating traffic associated with known FSPs. Other examples are Coon Creek CLEC which is associated with Coon Creek Rural ILEC, with 97% of Qwest's terminating traffic associated with FSPs; BTC INC, which appears to be associated with Breda Telephone Corp. Prairie Tel, and Westside Independent, with 93% of Qwest's terminating traffic terminating at known FSPs; and Premier Communications, which appears to be associated with Northern IA, Mutual Telephone, and Webb-Dickens, with 97% of Qwest's terminating traffic associated with known FSPs. The interstate cost per minute for these CLECs ranges from 0.0178 to 0.0719 cents per minute.

Qwest submits that, if the Commission devises a solution that deals only with ILECs, it will not be successful. The FSPs will simply partner with CLECs rather than ILECs. There is no conceivable public benefit to be gleaned by transferring the access stimulation windfall from rural ILECs to rural CLECs.

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[36] Verizon at 1.

[37] *See*, *e.g.*, All American at i, 5-8; TC3 Telecom at third page (pages not numbered).

[38] Qwest Comments at 7-8.

Rural ILEC interstate access rates are considerably higher than those of non-rural ILECs because it is assumed that the low volumes of traffic they carry would not provide sufficient revenue to enable them to play their vital role in universal service, and they generally are in the position of a "carrier of last resort," upon which all customers within their service area can rely for service when the CLECs choose not to extend their own networks. A rural ILEC's cost structure will reflect these obligations -- and, indeed, the high access rates that rural ILECs are allowed to charge reflect the Commission's determination that they are necessary to permit rural ILECs to operate in this manner. A "rural CLEC," on the other hand, has no similar universal service or carrier of last resort obligations. Indeed, as noted by Qwest in its initial comments, some "rural CLECs" serve no one but their own access stimulating FSP partners, thus incurring only a small fraction of the costs incurred by a rural ILEC.[39] There is absolutely no evidence that indicates that there is any justification for rural CLEC access rates being tariffed above the rate of the nearest non-rural ILEC.[40] CLEC access rates are almost entirely deregulated, and if a "rural CLEC" can negotiate a deal with IXCs based on superior service or other market factors, so much the better. But the basis for allowing "rural CLECs" to tariff interstate access charges as if they had the same cost structures and service obligations as rural ILECs is based on nothing more than conjecture -- conjecture that is more and more proving false in the realization.

In fact, current efforts to reform the universal service regime are based in part on the Commission's recognition that competitive providers' costs do *not* match the costs of the rural incumbents against whom they compete. This is true not only because rural CLECs do not share the universal service obligations assumed by rural ILECs, but because competitors often use

[39] Qwest Comments at 8, 25.

[40] Verizon notes that the highest non-rural ILEC rate is $0.0095 per MOU. Verizon at 4, 5-6. Qwest submits that, while this might present a reasonable approach, it is better to target for tariff purposes either the lowest NECA schedule rate or the rate of the nearest non-rural ILEC.

newer and less costly equipment than do ILECs and often rely on more efficient network configurations than do ILECs. Thus, for example, the Federal-State Joint Board on Universal Service recently recognized (with the support of Chairman Martin and Commissioners Tate and Copps) that the revenue requirements of a rural ILEC relying on a legacy network "bears little or no relationship to the amount of money competitive [providers] have invested in rural and other high-cost areas of the country."[41]

In all events, it is impossible to deal with access stimulation if CLECs are not included in the solution.

B. Solutions That Focus On Use Of Existing Rules Are Not Adequate.

A number of commentors agree that access stimulation often results in unreasonable and unlawful rates, but, citing the *Farmers and Merchants* case (in which Farmers and Merchants' rates during an access stimulation scheme were declared to be unlawful) and the recent tariff activity (in which at least six rural ILECs were prevented from launching access stimulation schemes when their tariffs were suspended subject to an accounting order and investigation) contend that existing complaint and tariff processes, with some modifications, can deal with ILEC access stimulation.[42] Others suggest that access stimulation be dealt with by preventing Section 61.39 ILECs exiting the NECA pool from returning to the NECA pool for a designated

[41] *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service,* Recommended Decision, WC Docket No. 05-337; CC Docket No. 96-45 ¶ 5 (Jt. Bd. rel. Nov. 20, 2007) (recommending abolition of rule whereby competitive providers' high-cost universal service fund distributions match per-line amounts received by incumbent LEC in same service area). *See also, id.* ¶ 35; *In the Matter of High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, Recommended Decision, 22 FCC Rcd 8998, 9001 ¶ 6 (Jt. Bd. 2007) ("[U]nder the identical support rule, both incumbent rural LECs and competitive ETCs receive support based on the incumbent rural LECs' costs. Therefore, incumbent rural LECs' support is cost-based, while competitive ETCs' support is not.").

[42] *See* note 31, *supra*.

amount of time.[43] Both of these approaches have merit. However, they also raise some difficulties.

First, simply relying on the existing complaint and tariff mechanisms does not provide protection against CLEC access stimulation. CLECs are not subject to rate-of-return regulation and are not required to file tariffs on a regular basis. Additional rules need to be promulgated in any event in order to prevent the access stimulation problem from simply becoming one involving CLECs rather than ILECs.

Second, as is evident from the *Farmers and Merchants* case, the complaint procedure can be extremely cumbersome and time consuming, more so if damages are allowed. The record in the *Farmers and Merchants* case is massive, and creation of numerous similar massive records to deal with access stimulation on a case-by-case basis would clearly be inefficient.

Moreover, the Commission did not, at least in the initial *Farmers and Merchants* decision, allow damages. Instead, the Commission found that, notwithstanding the deliberate violation of law that Farmers and Merchants was found to have committed, Farmers and Merchants was protected from damages by virtue of the "deemed lawful" language of Section 204(a)(3) of the Act.[44] This means that, at least as interpreted to date by the Commission on the facts of the *Farmers* case, Farmers would appear to be allowed to retain the fruits of its unlawful conduct. This is clearly not an acceptable or reasonable long-term solution.

Qwest agrees that, if the decision in *Farmers and Merchants* that damages not be awarded is affirmed on reconsideration, the Commission can remedy the protection against damages by means of a requirement that Section 61.39 carriers certify, as part of their tariffs, that they are not parties to any access stimulation scheme and are aware of no reason why access

[43] Embarq at 13-14; ITTA at 6-7; OPASTCO at 10-14; Staurulakis at 21-22.

[44] *Farmers & Merchants*, 22 FCC Rcd at 17983-84 ¶¶ 26-27.

traffic would increase by a certain percentage (or, as some have suggested, to a certain number of minutes per line). The Commission should make it clear that the filing of a false certification in support of a tariff would deprive the tariff of any semblance of "deemed lawful" protection, and damages could be awarded after an appropriate proceeding.[45]

In any event, the "deemed lawful" rules are one of the regulatory lynchpins of successful ILEC access stimulation, because ILECs routinely claim that their unlawful tariff rates are protected by the statute. An approach under which refunds or damages are available if an ILEC tariff is found to be unlawful because an access stimulation scheme resulted in a deliberate violation of the rate-of-return prescription applicable to the tariff would protect against the implementation of future access stimulation and similar ruses designed to collect unlawful tariff charges with impunity. Accordingly, should the Commission ensure that tariffs filed by access stimulating ILECs are not protected by Section 204(a)(3)'s "deemed lawful" language, this action will help reduce, but will not eliminate, unlawful access stimulation.

Third, the use of the tariff filing process in 2007 proved successful in preventing some new prospective access stimulating ILECs from implementing their own schemes.[46] To the extent that similar plans in the future can be discovered prior to tariff implementation, Qwest agrees that the existing rules and processes can prove effective in dealing with ILEC access stimulation. However, the key to what has happened in creating the current crisis is that rural ILECs and their FSP partners were able to file tariffs that appeared on the surface to be lawful --

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[45] *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 411-13 (D.C. Cir.), *reh'g denied*, 2002 U.S. App. Lexis 16616 (D.C. Cir. Aug. 12, 2002), *reh'g, en banc, denied*, 2002 U.S. App. Lexis 16617 (D.C. Cir. Aug. 12, 2002).

[46] AT&T at 2; *and see* Western Telecommunications Alliance at 8; *In the Matter of July 1, 2007 Annual Access Charge Tariff Filings*, Order, 22 FCC Rcd 11619 (2007); *In the Matter of Investigation of Certain 2007 Annual Access Tariffs*, Order Designating Issues for Investigation, 22 FCC Rcd 16109 (2007).

successfully concealing or omitting to reveal their plans to violate the Commission's rate-of-return prescription. Qwest submits that, when a carrier that deliberately earns an unlawful rate-of-return in part by concealing vital information in its tariff filings, the success or failure of the scheme should not depend upon the ability of the customers of that carrier to unearth the scheme in advance. The tariff filing structure is an important part of the Commission's regulatory oversight. In access stimulation, in the words of the Commission, relative to Qwest's formal complaint, "Farmers manipulated the Commission's rules to achieve a result unintended by the rules."[47] The "deemed lawful" language of the Act should not be interpreted to allow such manipulation.

Finally, adoption of rules limiting the ability of Section 61.39 ILECs to reenter the NECA pool, while not impacting the CLEC problem, would reduce the ability of rural ILECs to engage in access stimulation by forcing them ultimately to file rates in their biennial tariff filings that reflected their actual demand for the preceding two years. Manipulation of the NECA pool has been a key element in the ability of rural ILECs to engage in access stimulation -- average schedule ILECs could (and did) leave the pool and file tariffs reflecting historical settlements, engage in access stimulation for two years, and then avoid the consequences of that activity by rejoining the pool. Thus, preventing ILECs from rejoining the pool, or from doing so for a number of tariff periods, is a sound idea.[48] But it is by itself not a sufficient protection against the unlawful rates that result in an access stimulation scheme.

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[47] *Farmers & Merchants*, 22 FCC Rcd at 17984 ¶ 27.

[48] This approach, if relied on as the sole mechanism for preventing unlawful access stimulation, would seem to leave itself open to manipulation by unscrupulous ILECs. If an ILEC were to leave the NECA pool, engage in access stimulation for two years, discontinue the access pumping activity, and then file tariffs based on projected traffic without access stimulation, it would seem that simply limiting its ability to return to the NECA pool would not prove particularly effective.

V. ACCESS STIMULATION IS NOT PRO-COMPETITIVE AND IS NOT A LEGITIMATE FORM OF "MARKETING."

Those commentors who support access stimulation claim that it is really pro-competitive, simply a normal marketing activity, and that the opposition of IXCs to access stimulation schemes is simply an anti-competitive response to threats to the IXCs' own business operations.[49] The claim is even made that, if IXCs priced their own products correctly (*i.e.*, if they eliminated their flat rate long distance plans), the access stimulation problem would go away.[50] The claim is made that access stimulation is simply a normal market response to business opportunities caused by the operation of the free market.[51] One commentor goes so far as to claim that access stimulating LECs and their FSP partners are really pioneers on the road to competition, not unlike the situation that MCI was in several decades ago when the AT&T monopoly was just beginning to open up.[52]

These claims are simply not accurate. Any scheme that depends on the ability to force an unwilling "customer" to "purchase" services that it does not want at prices that are grossly inflated and is prohibited from passing the cost of those purchasers on to those of its own customers who are causing the increased costs cannot possibly be said to reflect in any way on the operation of the free market.

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[49] Alexicon Telecommunications Consulting at 2; Global Conference Partners at 12-15; Texas Statewide Telephone Cooperative, Inc. at 3-4; Texaltel at second page (pages not numbered); Chase Com, *et al.* ("Chase") at 4-5.

[50] Chase at 4-5; Futurephone.com, LLC ("Futurephone") at 19-20.

[51] *See*, *e.g.*, Consolidated Reply of Jordan-Soldier Valley Telephone Company, *et al.* to the Petitions to Suspend and Investigate filed by Qwest Communications Corporation, AT&T Corp., Sprint Nextel Corporation and Verizon, WCB/Pricing File No. 07-10, *In the Matters of July 2007 Annual Access Charge Tariff Filings, et al.*, June 26, 2007, at v, 9, and Exhibit A, attached thereto, Declaration of Christina Bobbyn ¶¶ 11, 13.

[52] Futurephone at 7-10.

In fact, as has been pointed out, access stimulation is not a market phenomenon, but instead is almost entirely a creature of arbitrage and regulation. Qwest noted in its opening comments that access stimulation was the product of five separate market dysfunctions: 1) the "terminating monopoly" held by LECs; 2) very high rural ILEC access rates predicated on the assumption that traffic would continue to be relatively light; 3) the "no blocking" policy that prohibits IXCs from choosing whether or not to do business with an access stimulating LEC; 4) the "rate averaging" rules that prevent IXCs from charging their own customers for calling access stimulating numbers; and 5) the "deemed lawful" rule that the Commission has held provides at least some protection against damages even when an access stimulating ILEC deliberately violated the Commission's rules and the Communications Act.

The fact that access stimulation is based on bad economics and is anti-competitive and anti-consumer was pointed out at length in the declaration of Dr. Timothy Tardiff, submitted as Exhibit B to Qwest's initial comments. Upon receipt of the latest claims of those commentors supporting access stimulation, Qwest asked for additional analysis by Dr. Tardiff. Attached hereto as Attachment B is a Reply Declaration of Dr. Tardiff addressing some of the comments supporting access stimulation.

Dr. Tardiff examines these comments and furthers his initial analysis. He concludes that access stimulation partnerships "are not examples of competition on the merits in which cost-causing customers pay prices reflective of the costs their calling impose and the firms offering such services can expect to earn normal profits, but rather are schemes that rely on the unwilling shareholders and/or customers of captive IXCs."[53] Observing the regulatory roots of access

[53] Tardiff Reply Declaration ¶ 7.

stimulation, Dr. Tardiff explains how access stimulation is a result of "rural carriers [that] may be able to exploit their market power over terminating access. . . ."[54]

Dr. Tardiff rejects the assertion that sharing revenues with a FSP partner is simply a form of "marketing." In a normal market, the costs of marketing a product are part of the cost of goods sold to the customer. In an access stimulation scheme the revenues are generated on account of a partnership that does not include the IXCs (at least not willingly).[55] Thus:

> [T]hese arrangements are markedly different from ordinary marketing arrangements in that (1) revenue is being generated by payments from IXCs (such as AT&T and Qwest) that are not willing parties to the rural carrier/service provider partnership, (2) unlike large users who receive a discount relative to other users, service providers such as free conference call services receive revenues from (rather than make payments to) the rural carriers, and (3) such arrangements exist primarily because they take advantage of the regulatory arbitrage opportunities arising from high rural interconnection rates.[56]

Analyzing the claim that current access stimulators stand in the shoes of the pre-divestiture MCI,[57] Dr. Tardiff notes that there are no significant economic or policy similarities between the long distance market of the 1970s and today's conferencing, international and similar markets, especially as, unlike the early MCI situation, the current market for these services is competitive, and allowing an arbitrage situation to develop and flourish could destroy the natural (and beneficial) workings of a competitive market.[58]

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[54] *Id.* ¶ 10.

[55] *See, e.g.*, the Commission's discussion of the revenues and compensation at issue within an access stimulation context as it relates to IXCs. *NPRM*, 22 FCC Rcd at 17997-98 ¶¶ 18-20.

[55] Tardiff Reply Declaration ¶ 7.

[56] *Id.* (footnote omitted). This argument was actually advanced by Futurephone. Futurephone at 11-12. Chase goes further and argues that LECs and their FSP partners have a First Amendment right to engage in access stimulation. Chase at 9-11.

[57] Tardiff Reply Declaration ¶ 8.

[58] *Id.*

Dr. Tardiff concludes with the observation -- which really forms the heart of the access stimulation issue from an economic perspective -- that an access stimulation scheme is predicated on the ability of a rural LEC, by manipulating a variety of regulations (plus its own control of the terminating monopoly) to earn "supranormal" profits by divorcing the customers of FSPs from paying the economic costs that they cause. Access stimulation is not a normal or benign market activity. It remains fundamentally anti-competitive and destructive.

VI. EVIDENCE RECEIVED FROM FREECONFERENCECALL.COM DURING DISCOVERY IN QWEST'S COMPLAINT IN IOWA PROVIDES A VITAL INSIGHT INTO THE WORKINGS OF AN ACCESS STIMULATION SCHEME.

The access stimulation industry has thus far been marked by a powerful bond of secrecy and, even where documents and information can be obtained in regulatory litigation, the information is generally marked as confidential and cannot be brought to the attention of this Commission.[59] However, three documents have recently been produced on the public record that shed significant light on the theory and practice of access stimulation. These three documents are: 1) a deposition of Greg Lorenzetti, taken on December 19, 2007, in discovery in the case of *Qwest Communications Corporation v. Superior Telephone Cooperative*;[60] 2) an affidavit filed by James Troup, counsel to a number of access stimulating LECs (including Farmers and Merchants in the Commission proceeding), attached to a Motion to Strike and Resistance to a Qwest discovery motion in the same docket; and 3) a letter from counsel to Free Conferencing Corporation to counsel for Qwest stating that Free Conferencing had received a request to

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[59] *See* Qwest Motion to Compel Production of Documents, in *Qwest Communications Corporation v. Farmers and Merchants Mutual Telephone Company*, File No. EB-07-MD-001, Nov. 1, 2007.

[60] Docket No. FCU-07-2, State of Iowa, Department of Commerce Utilities Board, Lorenzetti Deposition, Attachment C, hereto.

backdate bills and contracts with two access stimulating ILECs on May 29, 2007.[61] These documents, while obviously only illustrative, show access stimulating LECs and FSPs engaging in backdating of critical documents, conceding that none of the normal hallmarks of customer/carrier relationships existed in the case of the ILEC/FSP partnerships, agreeing that normal marketing activities were not conducted in return for the putative "marketing fees" used as a ruse for the access stimulating kickbacks, and disclosing plans to not only transfer stimulated access traffic from ILECs to CLECs, but plans for the FSPs to establish their own CLECs.

Turning first to Mr. Lorenzetti, who was employed on a consulting basis by Free Conferencing Corporation, owner of freeconferencecall.com, one of the most notorious FSPs between 2005 and September, 2007. In this capacity he worked extensively with David Erickson, president of Free Conferencing Corporation, on strategic matters. From Mr. Lorenzetti's deposition, the following appears:

- Mr. Erickson and Mr. Lorenzetti had discussions about ILEC-initiated backdating of documents reflecting the relationship between Free Conferencing and access stimulating ILECs on at least "several" occasions, on one of which an attorney was part of the conversation, and at least one of which occurred after the litigation concerning access stimulation had commenced.[62]
- To Mr. Lorenzetti's knowledge, Free Conferencing never performed any normal marketing functions for any of its access stimulating ILEC partners.[63]

[61] Troup Affidavit, Attachment D, hereto.

[62] Lorenzetti Deposition pp. 91-92, 96-100.

[63] *Id.* pp. 79-80.

- To Mr. Lorenzetti's knowledge, Free Conferencing never received any traditional local exchange services from its access stimulating ILEC partners, including: payment of bills or receipt of invoices, payment of universal service charges, listing in telephone directories, listing of telephone numbers or inclusion in the 911 data base.[64]
- Aware of the ultimate tenuousness of the access stimulating scheme, Mr. Lorenzetti and Mr. Erickson discussed the possibility of utilizing CLEC (as opposed to ILEC) partners, as well as Free Conferencing establishing its own CLEC.[65]

Mr. Troup's affidavit is equally revealing. In this affidavit, Mr. Troup conceded that Farmers and Merchants (the defendant in Qwest's Commission complaint proceeding) had back billed its FSP partners (and had backdated contract amendments) and that the decision to send out backdated bills and contracts was made in or around April 2007, after Qwest and other parties had initiated litigation involving access stimulation in federal district court and before the Iowa Utilities Board (and perhaps after Qwest had sent its April 20, 2007 pre-complaint letter in this proceeding). In Mr. Troup's words:

> In its Answer filed on May 29, 2007, Farmers indicted that it had billed conference call companies for local telephone service pursuant to its local exchange tariff filed with the Board. . . . This was an accurate statement because Farmers had back-billed the conference call companies to ensure compliance with its tariff. Both the Board and the FCC have recognized that it is common industry practice to back-bill for up to two years to correct errors in billing. Farmers did not represent that it was billing the conference call companies pursuant to a contract or any amendment to a contract. There were no back-bills, contracts or amendments to contracts attached to Farmer's Answer.[66]

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[64] *Id.* pp. 84-85, 110-112.

[65] *Id.* pp. 103-104.

[66] Troup Affidavit ¶ 8.

Finally, a letter from J. Isaac Himowitz, counsel to Free Conferencing, to Chuck Steese, counsel to Qwest, dated October 30, 2007,[67] contains the following quotation concerning a discovery request from Qwest to Free Conferencing:

> **4. Correspondence with providers of telecommunications services (or their agents) in Iowa: Qwest believes that Farmers & Merchants and I-35 delivered backdated bills and contracts to FCC on May 29, 2007. Qwest is requesting any letters and/or communications included with these documents or discussing the documents.**
>
> > [Free Conferencing] acknowledges that such a package was delivered. [Free Conferencing] responded negatively to the request of Farmers & Merchants and I-35, and will attempt to locate the other relevant contracts and any other relevant communications.

The upshot of the foregoing is that, while obviously it presents only a snapshot of limited dealings between LECs and their FSP partners, because of the reluctance of access stimulating LECs and their FSP partners to allow a full record to be developed before this Commission, it is the only evidence of what is actually happening in this area. Qwest submits that it demolishes contentions that access stimulation schemes have been normal above-board business responses to legitimate market opportunities.

VII. CONCLUSION.

The record in this proceeding demonstrates that access stimulation presents a significant threat to the national telecommunications infrastructure. It is quite simply a deliberate abuse of regulations intended to benefit rural telecommunications and universal service for personal profit in a manner that threatens both of those regulatory goals. Allowing the access stimulation operations to continue to charge excessive rates to IXCs, rates that must be subsidized by the

[67] J. Isaac Himowitz Letter, Attachment E, hereto.

great body of long distance telephone users, would be both anti-competitive and contrary to the public interest.

As Qwest has pointed out in its initial comments and in these reply comments, there are a variety of ways in which the Commission can deal with access stimulation. Qwest has set forth two such solutions. Qwest respectfully requests that immediate action be taken to adopt and implement one of these solutions.

Respectfully submitted,

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