June 12, 2008

**<u>VIA ECFS</u>**

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Portals
Washington, DC 20554

**Re: *Ex Parte*, WC Docket No. 07-135**

Dear Secretary Dortch:

PAETEC Communications Inc., McLeodUSA Telecommunications Services, Inc., and the common carrier operating subsidiaries of US LEC Corp. (jointly "PAETEC"), through undersigned counsel, submits this ex parte to respond to various new rules proposed by Qwest Corporation ("Qwest"), AT&T, Verizon and Sprint/NexTel regarding purported "traffic stimulation" by competitive local exchange carriers ("CLECs").[1] If the goal is to thwart schemes that drastically increase *terminating* access traffic to take advantage of high access rates as suggested by the Commission in the NPRM, then the rules adopted by the Commission, if any, should be narrowly tailored to address those wrongs, and those wrongs alone. Unfortunately, several proposals submitted in this docket go well beyond addressing that legitimate goal. Many of these proposals, if adopted, would improperly impede competition by unfairly limiting the ability of CLECs to compete for enterprise customers using the full arsenal of marketing tools that large ILECs could use for their own competitive advantage.

It is important to note that the record contains no justification for modifying rules for competitive LECs that do not avail themselves of the rural LEC rate exemption. The proponents of new rules acknowledge that the "problem" of traffic stimulation is attributable to rural ILECs or CLECs that benchmark to rural ILEC rates. For instance, Sprint's June 9, 2008, *ex parte* notes that the problem is being perpetrated primarily by "certain competitive local exchange carriers," many of which are affiliates of ILECs. Indeed, none of the reported complaints highlighted in the NPRM or Omnitel highlighted in Sprint's *ex parte* involve competitive LECs that benchmark rates to non-rural LEC rates. Thus, although it does not fully agree with the proposed solution, PAETEC applauds Qwest's ex parte filed May 21, 2008, that targets the rates of CLECs benchmarked to rural ILEC access rates when those carriers partner with third parties to drastically increase terminating volumes. PAETEC agrees that Qwest's proposed "minimally invasive solution" related to those limited situations should be the one an

[1] *Establishing Just and Reasonable Rates for Local Exchange Carriers*, Notice of Proposed Rulemaking, WC Docket No. 07-145, FCC 07-176, released October 2, 2007 ("*NPRM*").

only justifiable focus of this docket with respect to CLEC access charges.[2] In that same vein, while McLeodUSA concurs with the Sprint's characterization that something may need to be done to address these schemes, the remedy must address only those players engaged in the schemes, which are those entities taking advantage of the higher rural LEC access rates.

**Revenue Sharing *Per Se* is Harmless and Pro-Competitive**

"Revenue sharing" is a common business practice in telecommunications that has been upheld by the Commission numerous times against challenge. IXCs themselves have been known to share end user revenue with marketing agents, sometimes only retaining a token fee as the service provider; international carriers share settlement revenue to increase traffic on their networks; payphone providers share revenue with premises owners; operator service providers pay commissions to traffic aggregators. In fact, every discount off of standard pricing offered by a communications provider to an end user is, in effect, a form of "revenue sharing" to that end user for stimulating traffic growth.

Because CLECs are capped at the same rate level as the competing ILEC, access charge revenue sharing that merely incents a customer to move from one LEC to another within the same territory is harmless to IXCs and end users, and a legitimate means of promoting competition between LECs. Access charge revenue sharing alone is therefore not the root cause of the problem the Commission is seeking to address in this proceeding. That problem only arises under circumstances where revenue sharing becomes an incentive for portable, high-volume customers to locate in areas with extraordinarily high access charge rates based directly or indirectly on assumed higher costs and lower volumes. Any solution adopted by the Commission should target only the problem scenario and not revenue sharing in general.

**Net Payor Type Tests Are Unworkable**

The net payor test offered by AT&T is not a reliable indicator of unreasonable traffic stimulation. For example, the willingness of a LEC to share revenues with a hotel, university, or other aggregator, does not provide any incentive to the end user customer to place additional calls since those end users are not actually placing all the calls in that type of environment.[3] Whether or not a particular revenue sharing arrangement is likely

[2] In this ex parte, PAETEC focuses on the proposed rules that would impact CLECs. If the Commission adopts new rules to curtail traffic stimulation, however, those rules should not target the competitive sector and should be applied in a non-discriminatory manner to incumbents and competitors alike.

[3] *Access Charge Reform*, CC Docket No. 96-262, Eighth Report and Order, FCC 04-110, ¶70 ( May 18, 2004) ("*Eighth Report and Order*" ("The IXCs have failed to demonstrate that

to cause unreasonable traffic-volume spikes in high-access-rate areas is primarily a function of the portability of the traffic, not of the amount and direction of net payments between the "business partner" and the LEC. Because it targets the wrong factor, the "net payor" test is both under- and over-inclusive. It is therefore unreasonable and ineffective.

In addition, the use of vague or ill-defined terms makes the various "net payor" tests unworkable. A "communications service provider" is not a defined term in the Act or FCC rules. Absent a reasonable definition, a LEC would be unable to certify compliance. Such a test is particularly unworkable if it applies to other carriers. In an industry where two carriers typically interact as both purchaser and seller, with interactions amongst a variety of affiliates, for a variety of services, in different geographic markets or regions, a net payment test would provide little utility in accurately and efficiently detecting unreasonable traffic stimulation.

Likewise, the "life of the arrangement" is similarly vague and will not fix the actual problem but only encourage creations of new means around any new limitations. For example, if a LEC signs a contract for one year with three optional one-year extensions, is the "life of the arrangement" one year or four? If a contract provides credits in years two, three and four that result in the customer paying less than 50% of the original one-year service price over the four-year term, does this violate the net payment test? In fact, adopting regulations outlawing particular practices is bound to fail. It would result in the FCC, at best, temporarily picking marketing scheme winners and losers.

Companies operating in good faith that seek to comply with any test and make accurate certifications will be required to review existing customer contracts and trying to fit round pegs into square holes. That would be an especially an unfair result for those companies such as PAETEC that has not had any of its operating subsidiaries accused of unreasonably stimulating traffic. LECs would also have to create elaborate tracking tools, none of which exists today, to monitor arrangements the LEC and potentially various affiliates might have with each of their customers (and potentially various affiliates of each customer), so that each time that a particular customer wanted to order a new service from the LEC, that the LEC could then reasonably ascertain whether the new incremental business opportunity with that customer would cross the "net payor" threshold. Equally troubling is that bad actors would likely be willing to certify compliance without any due diligence given that auditing of such certifications would be difficult. In fact, none of the proposals explain how certifications could be audited.

As a practical matter, enforcement will rely on the same processes used today. An IXC would likely complain when it sees increased traffic volumes to a particular LEC or, perhaps engage in self help by withholding payments, either of which will trigger a request for FCC enforcement action or a Section 208 complaint, or a collection action.

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commission payments to 8YY generators such as universities or hotels translate effectively into incentives for individuals who actually use those facilities to place excessive or fraudulent 8YY calls.").

Even if a LEC fails the net payor test that will not prevent the IXC from having to file a complaint about the LEC's switched access rates. In short, the net payor test will lead the FCC right back to where it started, investigating and adjudicating individual complaints. Except that LECs that are legitimately growing access minutes could be swept up into unwarranted disputes resulting from application of a net payor test.

The Net Payor proposal could also place a LEC in the unenviable position of effectively having to police its customers' use of services. Policing could be required because not all "free services" are necessarily part and parcel of an illicit traffic pumping scheme. For example, presumably a LEC should not be penalized for providing free service that is in the public interest (*e.g.*, suicide prevention or missing persons hotlines; poison control centers). However, a LEC would have to complete due diligence on each customer to know whether the customer's business meets some legitimate public interest criteria. The FCC has long recognized that creating barriers for customers to switch to a different LEC improperly favors the ILEC since they continue to be the dominant provider in their respective local markets. The net payor test would create unnecessary barriers to competition without necessarily solving the problem.

Similarly, Qwest's proposed "business partner" definition is overbroad and could unfairly limit competition. For example, is a BOC wireless affiliate a "business partner?" If not, it appears that Qwest's test would permit BOCs to share revenue with their CMRS affiliates but prohibit CLECs from sharing revenue with unaffiliated CMRS carriers. Such a discriminatory result would disadvantage LECs without a wireless affiliate. If a wireless affiliate would be considered a "business partner," then potentially a BOC would be prohibited from charging tandem switched access for carrying traffic between the IXC and the BOC's CMRS affiliate.

In summary, a "net payor" and "business partner" test are potentially problematic in their current forms because both are overbroad and underinclusive. The Commission should therefore not adopt any such test, but if it does, at a minimum, the terms used in the test should be defined and limited.

**The Underlying Premise that Revenue Sharing Indicates a CLEC is Over-earning on Access Services has been Shown to be Fundamentally Flawed**

A key premise underlying the FCC's willingness to consider further regulation of CLEC access rates was the belief that CLECs are earning a reasonable rate of return on interstate access services under normal traffic volumes, and that increasing traffic volumes leads to excessive returns. The affidavit of Dr. Ankum and Mr. Morrison provided with McLeodUSA's earlier filed comments, which to date remains unrebutted, fully debunked those notions. As explained in that affidavit, the notion that a significant increase in traffic will result in over-recovery of costs for CLECs is simply not supported by the facts.

Assuming *arguendo* that switched access rates generate an unreasonable rate of return, the fact that a LEC charging a price cap rate generates more minutes of use than its competitor is not justification in and of itself to reduce the high-volume LEC's access rate. If the FCC wishes to reverse course and apply rate-of-return regulation to price cap ILECs and CLECs, it must give them the opportunity to justify their rates. However, if the FCC wants to pursue that approach, then it cannot do so in a discriminatory fashion. The BOC returns on switched access must concurrently be examined.

**The Solution Should Focus on the Narrow Problem**

As previously noted, PAETEC commends Qwest's recognition that "innocent CLECs" are not the cause of the problem that the Commission is attempting to solve, and that they, therefore, should not be penalized by any solution. PAETEC could support Qwest's solution with minor modifications to redress the real, limited problem: revenue sharing arrangements with non-carrier end users with highly portable service requirements (such as chat lines and conference call providers that do not require a significant physical presence in the terminating local exchange) that enable significant amounts of switched access traffic to easily shift to high-cost rural ILEC or CLEC served territories from other areas. In order to limit further the test proposed by Qwest, the Commission should make clear that it only applies to a CLEC that elects the rural exemption, and further makes clear that the following scenarios or applications are not part of any such test:

- Revenue sharing arrangements with Internet Service Providers (ISPs) or other Enhanced Service Providers (ESPs) whose traffic is not subject to switched access charges;

- Revenue sharing arrangements with hotels, universities, call centers or other entities with a "brick-and-mortar" physical location in the terminating local exchange, who will not thereby be incented to move into higher cost areas;

- Revenue sharing arrangements with CMRS providers, which the Commission has already addressed and resolved in the 8th Report and Order.

Finally, the FCC should clarify that a CLEC that does not tariff access rates using the rural exemption is not required to provide any type of certification with respect to "business partners" and a CLEC's non-rural access rates are not subject to challenge based on any rules adopted in this proceeding.

Sincerely,

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