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Federal Communications Commission
Office of the Secretary

July 17, 2008

Chairman Kevin Martin
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: ***Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Intercarrier Compensation for ISP-Bound Traffic*, WC Docket No. 99-68; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135**

Dear Chairman Martin:

As the Commission repeatedly has acknowledged for well over a decade, the nation's intercarrier compensation regime is badly broken and desperately in need of a comprehensive overhaul.[1] There is no serious disagreement on this point because policy makers, service providers and other stakeholders all recognize that the pre-Internet era assumptions around which federal and state regulators designed this regime are no longer valid. The Commission's current rules focus entirely on a rapidly obsolescing POTS network architecture and business model and, in so doing, retard the inevitable transition from a narrow-band, voice-centric infrastructure to the broadband, any-application infrastructure of the 21st century. Deployment of this 21st century broadband infrastructure to rural areas depends on refocusing subsidy mechanisms on broadband network expansion and away from the PSTN business model of the past. Reforming intercarrier compensation and universal service rules[2] are thus necessary elements to any policy maker's broadband agenda.

[1] *Access Charge Reform*, 12 FCC Rcd 15982, ¶¶ 31-32 (1997) (the existing system is "sustainable only in a monopoly environment" and the "new competitive environment envisioned by the 1996 Act threatens to undermine this structure over the long run"); *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd 9610, ¶¶ 11-18 (2001) (describing flaws in existing intercarrier compensation regime, including numerous "opportunities for regulatory arbitrage created by the existing patchwork of intercarrier compensation rules"); *Developing a Unified Intercarrier Compensation Regime*, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, ¶ 3 (2005) (observing that the current system "create[s] both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions" and explaining the "urgent need to reform the current intercarrier compensation rules").

[2] *See* AT&T Comments, WC Docket No. 05-337, CC Docket No. 96-45 (filed April 17, 2008) (AT&T USF Comments) (proposing a framework to reform the Commission's high-cost support mechanisms in order to speed deployment of broadband service to unserved areas).

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AT&T is, therefore, very encouraged by the Commission's renewed commitment to intercarrier compensation reform[3] and we are prepared to work constructively with the Commission and the industry to reach a comprehensive solution. We continue to believe that the Missoula Plan provides a solid blueprint for action: the Plan has broad industry support and carefully addresses each interrelated component of intercarrier compensation reform.[4] But if the Commission is unprepared to adopt the Missoula Plan itself, it should use the core element of that Plan – unifying terminating intercarrier compensation regimes and charges – as its goal for comprehensive reform. Moreover, AT&T believes that a benchmark-based framework for rate rebalancing and targeted universal service support can appropriately balance the impact of the resulting access revenue reduction. We propose such a framework for reform based on this goal in Section II, below.

If the Commission does not tackle comprehensive reform this year, it will have no choice but to keep applying regulatory band-aids as each new intercarrier compensation problem arises or, more realistically, long after each problem has arisen and has caused significant damage. At a minimum, one such band-aid *must* be a Commission response to the D.C. Circuit's decision directing it to explain the legal basis for its ISP-bound compensation rules in a final, appealable order by November 5, 2008.[5] And as discussed below in Section III, there is a litany of other pressing intercarrier compensation issues that also demand a timely Commission response. As experience illustrates, however, this game of regulatory "whack-a-mole" is grossly inefficient because it addresses only the symptoms of the underlying regulatory problem, but not the problem itself: an unsustainable intercarrier compensation system designed long ago for a vastly different communications marketplace. So long as that underlying problem persists, the symptoms will worsen and multiply, and addressing them as they arise and in an ad-hoc fashion will only delay, not prevent, the collapse of the current system. Comprehensive reform is by far the healthier and more rational solution and it is the only solution that serves the long-term interests of America's consumers.

I. The Existing Intercarrier Compensation Regime Is Deteriorating Rapidly, and Comprehensive Reform Is Urgently Needed.

Federal and state regulators designed the current intercarrier compensation regime in large measure to encourage deployment of telecommunications infrastructure across the country and ensure that all Americans have access to affordable local telecommunications services. These twin goals were accomplished, in part, by requiring carriers offering those services to recover a significant portion of their costs through access charges assessed on interconnecting

[3] *See Interim Cap Clears Path for Comprehensive Reform, Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release, May 2, 2008.

[4] *See Comment Sought on Missoula Intercarrier Compensation Reform Plan*, Public Notice, DA 06-1510 (released July, 25, 2006) (noting that the Missoula Plan was the product of a 3-year process of industry negotiations led by NARUC and its supporters include, among others, AT&T, Global Crossing, Level 3 Communications, and 336 members of the Rural Alliance).

[5] *In re: Core Communications, Inc.*, No. 07-1446, 2008 WL 2649636 (D.C. Cir. July 8, 2008).

interexchange carriers, thereby providing local exchange carriers an implicit subsidy to keep rates for local services low. While that regime proved workable in a monopoly environment in which access minutes remained stable, or increased, year-over-year, it could no longer provide the support necessary to sustain the underlying network infrastructure in telecommunications markets opened to competition, as Congress anticipated. For that reason, Congress directed the Commission and the states in 1996 to undertake comprehensive universal service reform to replace implicit subsidy mechanisms (including those contained in intercarrier payments – such as access charges) with explicit support mechanisms that will achieve universal service objectives in a competitive environment.

While some progress has been made to rebalance rates and replace implicit subsidies with explicit support mechanisms, far more work needs to be done to complete comprehensive intercarrier compensation and universal service reform. In the meantime, the circuit-switched networks and their monopoly market structure on which the existing intercarrier compensation regime was based have been replaced by today's robustly competitive environment in which a multitude of providers offer a vast array of "any-distance" communications services over a variety of more technically efficient or customer-desired wireline, wireless and broadband platforms. And while those platforms continue to rely heavily on certain pieces of the old PSTN for critical infrastructure (e.g., copper loop distribution cables), in many cases, they bypass the access charges that regulators require local exchange carriers to collect in order to maintain that infrastructure. Indeed, between 2000 and 2006 incumbent carriers lost more than 249 *billion* access minutes, which represents nearly one-third of their total access minutes.[6]

The root problem with the existing intercarrier compensation system is twofold. First, it forces carriers to recover a substantial portion of their costs through usage-based revenue streams from other carriers. Second, it establishes radically different intercarrier compensation rates for a given call based on outmoded regulatory distinctions relating to the supposed endpoints of the call (e.g., intrastate vs. interstate, local vs. interexchange, intraLATA vs. interLATA, and intra-MTA vs. inter-MTA), or the type of communications provider originating or terminating the call (e.g., wireline vs. mobile wireless). These distinctions reflect defunct industry business models in which (1) different carriers provided different services based on geographic boundaries; and (2) different providers offered entirely distinct and non-competing services using different technologies. But, in a world in which competing service providers offer distance-agnostic bundles of communications services over competing platforms, such distinctions no longer make any sense, and the cross-subsidy mechanisms those distinctions were intended to facilitate can no longer work. For example, technological advances over the past decade have allowed consumers to migrate from traditional wireline long distance services, whose rates recovered the underlying access charges assessed by local exchange carriers, to VoIP and wireless services, as well as instant messaging, social networking sites, and simple email, which typically do not pay such access charges. Yet, even as access minutes, and the implicit support they generate, evaporate from incumbent carrier networks, the intercarrier compensation system remains rooted in the assumption that access charges will remain a viable means to maintain local telephone infrastructure in perpetuity.

[6] Universal Service Monitoring Report, CC Docket No. 98-202, Table 8.3 (2007).

The current intercarrier compensation regime – and the Commission's failure to resolve fundamental questions about its applicability to certain types of traffic (e.g., VoIP) – has encouraged rampant, competition-distorting arbitrage of intrastate and interstate access charge revenues that support universal service policy objectives. In particular, the disparate charges that may apply to traffic depending on how a provider purports to self-classify that traffic sends artificial price signals to the market. This system has created entire sub-industries – such as traffic-pumpers or CLECs specializing in IP-originated and/or ISP-bound traffic – which rise and fall solely as a result of regulatory uncertainty or loopholes that are exploited for as long as possible. Because such providers benefit so heavily from gaming the system, at least in the intermediate term, they have little incentive to focus on creating genuine consumer value. Likewise, providers disadvantaged by such gamesmanship must devote their own time and resources to expensive litigation. The resulting controversies produce huge transaction costs and investment uncertainty throughout the industry.

II. Benchmark-based Framework for Comprehensive Reform

To achieve comprehensive reform, the Commission must facilitate industry-wide rate rebalancing to substantially eliminate today's arbitrary regulatory disparities in terminating intercarrier charges. To do this, the Commission should adopt a framework that begins by establishing a national comparability benchmark, which will promote the reasonable comparability of end-user rates in accordance with section 254(b)(3) of the Act, and then by adjusting a number of variables in a systematic fashion. The simplest way to conceptualize the variables at play here (terminating intercarrier charges, SLCs, and federal universal service support) is to view them as interdependent "dials" that can each be turned to adjust a flow of revenue or to achieve a specific policy outcome. Optimally, the Commission should set these reform dials so that they collectively minimize arbitrage and promote the transition to broadband, thus furthering the goals of section 706. We introduce the critical "dials" and their purpose below, and then discuss both the national comparability benchmark and the reform dials in more detail in the following sections.

- <u>Terminating intercarrier rates</u>: terminating intercarrier rates for intrastate, interstate, and local calls should be transitioned to a uniform structure and unified at relatively low reciprocal compensation levels (i.e., below existing interstate access rate levels).[7] Absent such reform, incentives to engage in arbitrage will remain.

- <u>Federal subscriber line charges</u>: carriers with relatively low end-user rates should be given at least the *opportunity* to recover directly from their subscribers a greater percentage of their costs of providing service. To that end, the Commission should increase the federal cap on SLC charges of such carriers, as discussed further below, to give those carriers the regulatory freedom – but not necessarily the mandate – to increase end-user rates to mitigate any reduction in access revenues.

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[7] *See, e.g., The Missoula Plan: Policy and Legal Overview* and Attachment A (included in the July 24, 2006 Missoula Plan filing made by NARUC in WC Docket No. 01-92) (providing the legal authority for Commission-ordered reductions in intrastate access charges).

- Universal service: the Commission should provide targeted supplemental federal universal service support to offset a portion of some carriers' reduced access revenues. Although the size of the fund must be controlled, such support is an essential backstop to ensure that end-user rates remain reasonably comparable during the transition from the narrow-band business model and universal service paradigm to the broadband world.

A. National comparability benchmark.

In order to achieve unified terminating intercarrier rates for interstate, intrastate and local traffic, the Commission will need to reduce existing access charge rates below current levels and, in the course of doing so, it will need to determine how much of these access revenue reductions any particular carrier should be permitted to recover through end-user charges and federal universal service support. To accomplish that task, we propose the use of a national comparability benchmark similar in concept to the benchmark proposed by supporters of the Missoula Plan and several state commissions.[8] That mechanism, among other things, was designed to ensure rate comparability among the states so that the customers of carriers operating in states that have acted to lower intrastate access charges, establish state universal service high-cost funds, and/or increase local rates do not shoulder the cost of the access shift for carriers in other states that have taken none of these steps. AT&T proposed a similar benchmark in its USF Comments.[9] AT&T believes that such a benchmark should serve as the foundation of any comprehensive intercarrier compensation reform framework. The basic attributes of a benchmark system are simple and straightforward as we outline below.

The Commission should establish a national comparability benchmark that is a fixed dollar amount (e.g., $XX dollars) reflecting what consumers generally pay for basic telephone service. In determining the appropriate dollar amount, the Commission should pay particular attention to the end-user rates[10] in states that already have taken significant steps, described above, to reform intercarrier compensation, and not the end-user rates in states that have kept such rates artificially low by avoiding reform.

Once established, the national comparability benchmark would be used as follows. For the applicable geographic area, the Commission would compare the national benchmark to each carrier's own calculation of the following components: its rate for basic local telephone service, SLCs (including state SLCs, if applicable) and the amount of any end-user charge attributable to the state's high-cost universal service fund.[11] If the sum of these components is below the

[8] Letter from State Commissions and Missoula Plan Supporters to Marlene Dortch, Federal Communications Commission, CC Docket No. 01-92 (filed Jan. 30, 2007).

[9] AT&T USF Comments at 27-29.

[10] As used here, the term "end-user rates" would include the rate for local telephone service, any federal and state SLC, and any end-user charge attributable to a state high-cost fund.

[11] AT&T does not propose including existing end-user line-item charges attributable to the *federal* high-cost support mechanisms because such contributions are already essentially comparable in the sense that all providers of interstate telecommunications are subject to the same federal contribution factor and most, if not all, such providers flow those contributions through to their end-user customers.

national comparability benchmark, the carrier would be expected to recover access reductions through federal SLC increases until it reaches the lower of the applicable SLC cap or the comparability benchmark. The benchmark thus acts as a ceiling on federal SLC increases. Access reductions in excess of the federal SLC increases allowed under the comparability benchmark could be recovered from targeted universal service support.

Thus, the purpose of the national comparability benchmark is to equitably apportion responsibility for the rate rebalancing needed to achieve unified terminating intercarrier rates among end users, carriers, states, and this Commission. It also is intended to ensure fairness to states that already have taken significant steps to reduce intrastate access charges, increase end-user rates, or provide explicit universal service funding.

B. The reform dials and the impact of different settings.

Once the Commission sets the national comparability benchmark, it can turn the various intercarrier compensation/universal service reform dials to a variety of different settings based on its policy objectives. But because these variables are mutually interdependent, each twist of a dial results in trade-offs. For example, if the Commission does not turn the SLC dial up to the levels proposed in the Missoula Plan (e.g., $10 for certain residential lines), it will need to compensate by turning up one of the other dials, such as federal universal service funding. Below, AT&T offers its views on the impact of different dial settings in achieving reform.

1. *Terminating intercarrier charges.*

Terminating intercarrier charges (i.e., access charges and reciprocal compensation) constitute by far the most important variable for purposes of intercarrier compensation reform. Of all the intercarrier charges, terminating compensation has been the greatest source of uncertainty and disputes, and its erosion in the face of technological advancements, arbitrage and outright fraud is perhaps the most destabilizing factor affecting the industry. Moreover, the continuing uncertainty relating to the applicability of such charges to certain types of traffic threatens to undermine further broadband deployment, as well as development of the innovative service offerings made possible by such deployment, by encouraging business plans based not on customer needs or desires but on the exploitation of obsolete rules and efforts to counter such exploitation. The Commission should act decisively to require each carrier to apply a single low rate for all call terminations. For example, the Commission could turn the terminating access dial to set unified rates no higher than reciprocal compensation rates (or even a zero setting – bill and keep – across the board).

The precise rate levels would depend on the Commission's decisions concerning the size of the universal service fund and end-user rates. As we have noted, moving to a unified terminating rate will result in access revenue reductions that should be offset by these other revenue sources. The further the Commission turns the terminating rate dial, the more effective its reform of intercarrier compensation will be. Unified and low terminating rates will eliminate the incentive carriers currently have to disguise their traffic to take advantage of rate disparities and would result in fewer fights about whether particular traffic should be classified as local, intrastate, or interstate. Thus, rather than focusing their attention and resources on exploiting or closing regulatory loopholes, carriers will devote more attention to making their services more valuable to customers. This will seriously reduce, if not eliminate, the controversy over intercarrier compensation for VoIP and the problem of phantom traffic. *See* Section III, *infra.*

2. *Subscriber line charges.*

As terminating access charges are reduced, SLC caps should be subject to moderate increases for carriers below the comparability benchmark so that those carriers look first, though not necessarily entirely, to their own end users for recovery of their network costs. At least in places where end-user rates are artificially low today, effective reform of the intercarrier compensation regime cannot be achieved without turning up this dial. However, the extent to which this dial is turned will be governed by the comparability benchmark. And the Commission should set an absolute cap on the amount of the SLC increase.

For carriers below the comparability benchmark, raising SLC caps is more appropriate than passing costs on to other carriers – and, ultimately, to those other carriers' end users – in the form of higher federal universal service charges. While competition may constrain carriers from raising the SLC to the maximum permitted level, for purposes of determining the appropriate amount of additional federal universal service support, any reform plan should impute to each carrier the maximum SLC increase allowed for that carrier up to the national comparability benchmark.

3. *Federal universal service support.*

The Commission should set the dial for federal universal service support at a level sufficient to ensure that the rates charged to end users in rural and high cost areas are reasonably comparable to rates charged in urban areas. The appropriate balance will depend on where the Commission sets the other intercarrier compensation dials. On the one hand, the size of the federal universal service fund cannot be allowed to expand without limit because end users overall must foot the bill for that fund. On the other hand, increasing universal service funding to cover some of the costs that are now recovered through intercarrier charges will likely be unavoidable if the Commission wishes to stay faithful to its other stated objectives and to the basic notion in section 254(b)(5) of the Act that funding must be "sufficient," all of which is consistent with Congress's mandate to make explicit all implicit subsidies.

III. If the Commission Cannot Achieve Comprehensive Intercarrier Compensation Reform, It Must Take Immediate Action to Address the Most Urgent Problems with the Current Regime.

For all of the reasons discussed above, there is no long-term alternative to comprehensive reform. Nonetheless, if the Commission is unable to implement such reform this year, the Commission will need to take immediate action to remedy the most pressing problems plaguing the existing regime. If the Commission continues to let these problems fester, the consequences could be catastrophic both for the existing system and for any hope of future comprehensive reform.

A. ISP-bound traffic.

Under the Commission's existing rules, carriers that terminate ISP-bound traffic may no longer collect the TELRIC-based "reciprocal compensation" rates they recovered before 2001. In a 2001 order, the Commission determined that receipt of such rates generated economically irrational windfalls for CLECs that specialized in terminating ISP-bound traffic (and sometimes paid ISPs for the privilege of doing so).[12] The Commission remedied that arbitrage crisis by adopting a transition to bill-and-keep for this traffic, with the current termination rate set at $0.0007. In 2002, the D.C. Circuit rejected the particular legal rationale the Commission chose for its rules on this subject but left the rules themselves intact because it concluded that, on remand, the Commission might well succeed in justifying the same rules under a different legal rationale.[13] In response to a petition for mandamus, the Commission recently promised the D.C. Circuit that it would take prompt action to address that legal question, either as part of comprehensive intercarrier compensation reform or separately.[14] The D.C. Circuit now has ruled that, unless the Commission keeps that promise, the Commission's rules regarding reciprocal compensation for ISP-bound traffic will be vacated, which would throw open the door to renewed regulatory arbitrage by CLECs. Consequently, irrespective of whether the Commission undertakes comprehensive intercarrier compensation reform (as it should), at a minimum, it must finally complete action on D.C. Circuit's remand.

As AT&T explained in a recent ex parte,[15] the Commission has ample authority to maintain its current rules under several independent legal theories. Each of these legal rationales is independent of the others, and each supports adopting bill-and-keep as the ultimate rule for ISP-bound traffic, subject to the Commission's discretion to maintain positive rates for a transitional period. To create greater industry certainty by minimizing the possibility of another judicial remand, the Commission should consider adopting a belt-and-suspenders approach under which it relies on each of these rationales in the alternative.

B. Intercarrier compensation for VoIP traffic.

One of the most destabilizing disputes in the telecommunications industry today concerns the appropriate treatment of VoIP traffic (*i.e.*, calls that take the form of VoIP on one end and ordinary PSTN traffic on the other). As AT&T explains in a petition it is filing contemporaneously with this letter,[16] the Commission should take immediate steps to resolve this set of issues before further damage is done.

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[12] Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 16 FCC Rcd 9151 (2001).

[13] *WorldCom, Inc. v. FCC*, 288 F.3d 429, 434 (D.C. Cir. 2002).

[14] Oral Arg. at 22-26, *In Re: Core Communications, Inc.* (D.C. Cir. May 5, 2008) (No. 07-1446).

[15] *See* Letter from Gary L. Phillips to Marlene Dortch, Federal Communications Commission, CC Docket No. 01-92 et al. (May 9, 2008).

[16] Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers, WC Docket No. ___ (filed July 17, 2008) ("*AT&T Petition*").

Many VoIP providers contend that the Commission's "ESP exemption" excuses them from paying access charges for interconnection with the PSTN. Most ILECs reject that position, observing, among other things, that the ESP exemption applies only to PSTN connections between enhanced service providers and *their own* subscribers rather than, as here, PSTN connectivity with *other* carriers' subscribers. The Commission's failure to resolve this issue has allowed innumerable disputes to rage before state commissions, courts and this agency.[17] Those disputes consume substantial resources and create significant regulatory uncertainty.

The Commission's failure to clarify the application of intercarrier charges to VoIP traffic has disserved both customers and the public interest, and it is long past time for the Commission to act. Accordingly, in a separate petition filed today, AT&T requests that, if the Commission does not adopt comprehensive reform, it declare on an interim basis that interstate terminating access charges apply to interstate interexchange VoIP traffic, intrastate terminating access charges applied to intrastate interexchange VoIP traffic that are equal to or less than interstate terminating access rates do not conflict with federal policy, and reciprocal compensation rates apply to the transport and termination of VoIP traffic that is not access traffic.

C. Traffic pumping.

As AT&T has previously explained in greater detail,[18] "traffic pumping" is a form of arbitrage in which an ILEC or CLEC artificially inflates the volume of its traffic in a rural area in order to reap windfall profits from high access charges. That result undermines the regulatory premise of setting those access charges at such high levels. The ILECs and CLECs that engage in these schemes use a variety of techniques to increase traffic volumes, including offers of free or very low cost chat lines, conferencing services, voicemail, and international calling. These offers entice callers across the country and around the world to place millions of long-distance calls to telephone numbers assigned to rural ILECs or CLECs. Those carriers, in turn, impose millions of dollars in access charges on AT&T and other IXCs, which the LECs then share with the third parties who help them execute their traffic-pumping schemes.

Although traffic pumping was once confined to a handful of carriers, the number and magnitude of such schemes have mushroomed over the past two years. Lawsuits, investigations, and case-by-case tariff suspensions have been inadequate to remedy the problem. The providers that benefit from these traffic-pumping schemes have proven quite adaptive; as the Commission puts an end to one scheme, others pop up in different places or between different entities. It is particularly difficult to combat CLEC schemes, which account for more than 75% of the traffic-

[17] *See, e.g.*, Petition of Feature Group IP for Forbearance from Section 251(g) of the Communications Act and Sections 51.701(b)(1) and 69.5(b) of the Commission's Rules, WC Docket No. 07-256 (filed Oct. 23, 2007); Petition of the Embarq Local Operating Companies for Forbearance from Enforcement of Section 69.5(a) of the Commission's Rules, Section 251(b) of the Communications Act and Commission Orders on the ESP Exemption, WC Docket No. 08-8 (filed Jan. 11, 2008).

[18] Comments of AT&T Inc., WC Docket No. 07-135 (filed Dec. 17, 2007) (AT&T Traffic Pumping Comments).

pumping minutes billed to AT&T, because the access charges of CLECs are not as closely regulated as those of ILECs, and parties who engage in traffic-pumping schemes can easily start new CLECs to replace those whose activities have been halted. And because CLEC rates are set out in tariffs filed on a streamlined basis, CLECs engaged in traffic pumping argue that, even after their conduct and rates have been found unlawful, they should be shielded from paying refunds by the "deemed lawful" status of their tariffs under section 204(a)(3).[19] If left unchecked, these schemes will inevitably result in higher long-distance rates for consumers throughout the country.[20]

As AT&T explained late last year, the Commission can address this problem only through preemptive measures, including modest rule changes designed to close the loopholes that allow traffic-pumping schemes to flourish.[21]

D. Inconsistent application of compensation regimes for the same type of traffic depending upon its direction (i.e., asymmetrical compensation).

Many CLECs that serve VoIP providers and deliver interexchange IP-to-PSTN calls to a LEC for termination on the PSTN route such traffic to avoid access charges and to instead pay reciprocal compensation.[22] But when that same interexchange call flows in the opposite direction (PSTN-to-IP), the same CLEC serving the same VoIP provider may assess access charges on the IXC that delivers the call to the CLEC. Thus, the CLEC pays reciprocal compensation on IP-to-PSTN traffic, but imposes access charges on PSTN-to-IP traffic. This arbitrage scheme imperils the universal availability of affordable telephone service and broadband deployment, as ILECs continue to lose more and more of the intercarrier compensation revenue on which they depend to maintain their networks. If the Commission adopts comprehensive reform, this issue is moot. However, considering the harm and absurdity of this scheme, there is simply no reason to delay a Commission declaration that asymmetrical compensation for IP-to-PSTN and PSTN-to-IP traffic described herein is unjust and unreasonable. Thus, while AT&T discusses this issue at length in the *AT&T Petition* (described above in Section III.B.), the Commission should address this issue expeditiously, regardless of how and when it rules on the other issues raised in that petition. The Commission can accomplish this without having to address the more general treatment of VoIP traffic discussed in the *AT&T Petition.*

[19] 47 U.S.C. § 204(a)(3).

[20] *See* 47 U.S.C. § 254(g).

[21] *See* AT&T Traffic Pumping Comments for greater detail on the proposed rule changes.

[22] Typically, an IP-to-PSTN call is transported in IP format over the interexchange portion of the call and then converted to TDM format in the terminating LATA and delivered to the terminating LEC over local interconnection trunk groups as if it were a local call.

E. IP-in-the-middle.

Despite the Commission's findings in its *IP-in-the-Middle Order*,[23] AT&T and other ILECs continue to be the victims of access arbitrage due to some IXCs' practice of converting long distance PSTN-to-PSTN calls to IP at some point in the call chain and then, using third party carriers, reconverting those long distance calls for delivery to the LEC disguised as *local* calls, which are not subject to access charges. These access avoiding IXCs have apparently justified their unlawful scheme by arranging to have their long distance traffic delivered to LECs by third parties. These IXCs then disclaim any obligation to pay terminating access charges because another carrier is delivering this traffic to the LECs. While their assertions have no merit under Commission precedent, AT&T has had to resort to litigation against these IXCs. In February 2006, a federal district court in Missouri stayed AT&T's lawsuit against Global Crossing and others and referred the matter to the Commission under the primary jurisdiction doctrine. Later that month, AT&T brought this referral to the Commission's attention, where it has now sat for nearly three years.[24] Based on AT&T's latest information, several IXCs continue to employ this scheme, which has cost AT&T alone tens of millions of dollars. Further Commission delay in ending this insidious and unlawful practice only prolongs pending litigation and encourages additional carriers to flaunt the Commission's rules.

F. Interconnection point manipulation.

The Commission should declare as an unjust and unreasonable practice under section 201(b) the increasingly common small LEC scheme of inflating access charges by designating an interconnection point with a centralized equal access provider that is scores or hundreds of miles away from the LEC's actual physical interconnection with that centralized provider. In its traffic pumping comments, AT&T has detailed a number of variations of this scheme, each as unlawful as the next.[25] For example, some small LECs select centralized access providers located in a *different state* in order to maximize their access charge revenues despite the existence of a centralized access provider that is located much closer to where the LEC has its switches. In addition, other LECs designate an interconnection point on the centralized provider's transport ring as their "official" interconnection point that is the furthest from their actual physical interconnection point in order to charge IXCs hundreds of miles of unnecessary transport and, of course, inflated terminating access charges. The cottage industry around these various schemes is only growing and, thus, the Commission should immediately declare these practices to be unjust and unreasonable under section 201(b).

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[23] *Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, Order, 19 FCC Rcd 7497 (2004) ("*IP-in-the-Middle Order*).

[24] *See* Letter from Jack Zinman, AT&T Inc., to Marlene Dortch, Federal Communications Commission, WC Docket No. 05-276 (filed May 21, 2008).

[25] *See, e.g.*, AT&T Traffic Pumping Comments at 34-38.

G. Phantom traffic.

Today's intercarrier compensation regime depends heavily on the appropriate characterization of traffic as local, interstate access, or intrastate access. Comprehensive reform should help mitigate the problem of "phantom traffic" – traffic whose origin or appropriate regulatory classification cannot be determined – by reducing the economic significance of traditional regulatory distinctions among types of terminating traffic. But until the Commission unifies or eliminates termination rates, phantom traffic will remain an increasingly urgent problem for the entire telecommunications industry.[26] In particular, so long as each LEC is expected to recover a substantial portion of its network costs from termination charges it assesses against the thousands of carriers that originate calls that are terminated on the LEC's network, each LEC will need to know whom it should bill and in what amount.

Phantom traffic creates profound competitive distortions in the marketplace. Unidentified originators of traffic or carriers that disguise the proper regulatory classification of the traffic they originate can avoid paying their fair share of intercarrier compensation. This, in turn, disadvantages other carriers that play by the rules. Phantom traffic also causes inequities in universal service contributions, which are based on the proper characterization of traffic. The failure to create or exchange call-detail information is particularly problematic when traffic is exchanged between two carriers that do not have an interconnection agreement with each other. When carriers exchange traffic only via third-party transit providers, the absence of either a governing Commission rule or a negotiated agreement concerning phantom traffic leads to pitched battles about which carrier has the obligation to identify or track traffic. These disputes consume considerable resources without producing any tangible benefit. If the Commission does not take action, the industry will continue to suffer the competition-distorting and inefficiency-producing effects of phantom traffic, while at the same time facing increasingly severe litigation expenses.

The Commission cannot simply put this problem on hold while it postpones consideration of comprehensive intercarrier compensation reform. AT&T thus supports the proposal submitted earlier this year by the United States Telecom Association.[27] Adopting USTelecom's proposed rules would eliminate phantom traffic in most circumstances, to the benefit of carriers and consumers alike. The Commission should thus promptly grant USTelecom's proposal.

IV. Conclusion.

In accordance with the principles discussed above, the Commission should promptly implement comprehensive reform of the intercarrier compensation system. In the event the Commission cannot meet that challenge, it should adopt the discrete solutions proposed above to

[26] *See, e.g.*, Letter from Glenn Reynolds, United States Telecom Association, to Marlene Dortch, Federal Communications Commission, CC Docket No. 01-92 (filed May 8, 2008) (USTelecom May *Ex Parte* Letter); Letter from Glenn Reynolds, United States Telecom Association, to Marlene Dortch, Federal Communications Commission, CC Docket No. 01-92 (filed February 12, 2008).

[27] *See, e.g.*, USTelecom May *Ex Parte* Letter at 2-3.

the issues of ISP-bound traffic, VoIP traffic, traffic pumping, asymmetrical traffic, IP-in-the-middle traffic, and phantom traffic.

Sincerely,

Robert W. Quinn, Jr.

cc: Commissioner Michael Copps
Commissioner Jonathan Adelstein
Commissioner Deborah Tate
Commissioner Robert McDowell
Daniel Gonzalez
Amy Bender
Scott Deutchmann
Scott Bergmann
Greg Orlando
John Hunter