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September 19, 2008

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Ex Parte

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

Re: **Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92; IP-Enabled Services, WC Docket No. 04-36; Universal Service Contribution Methodology, WC Docket No. 06-122.**

Dear Ms. Dortch:

Yesterday, Scott Angstreich, Amy Rosenthal, Karen Zacharia, Tamara Preiss and the undersigned representing Verizon and Verizon Wireless met with Matthew Berry, Ajit Pai, Paula Silberthau and Christopher Killion of the FCC's Office of General Counsel to discuss the FCC's legal authority to adopt the comprehensive intercarrier compensation reform plan Verizon and Verizon Wireless filed on September 12, 2008. The discussion was consistent with the attached White Paper.

Sincerely,

Donna Epps

cc Matthew Berry
Ajit Pai
Christopher Killion
Paula Silberthau
Don Stockdale
Marcus Maher

Attachment

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20544

In the Matter of	
Developing a Unified Intercarrier Compensation Regime	CC Docket No. 01-92
IP-Enabled Services	WC Docket No. 04-36
Federal-State Joint Board on Universal Service	CC Docket No. 96-45

THE COMMISSION HAS LEGAL AUTHORITY TO ADOPT A SINGLE, DEFAULT RATE FOR ALL TRAFFIC ROUTED ON THE PSTN

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BACKGROUND

A coalition of providers from all corners of the communications industry, including Verizon, has urged the Commission to adopt comprehensive intercarrier compensation reform in the immediate term.[1] Verizon has also recently put forward its own, comprehensive proposal for intercarrier compensation reform, which builds upon the "dial" framework AT&T introduced in July and the coalition's proposal, as well as other plans already filed with the Commission.[2] Specifically, Verizon proposes that the Commission transition to a uniform, default rate of $0.0007 per minute of use to terminate traffic on the PSTN (as well as ISP-bound traffic), which is the rate that already applies to a significant portion of wireline and wireless terminating traffic as a result of the mirroring rule adopted in the *ISP Remand Order*.[3] This rate would apply equally to all terminating traffic and all providers, regardless of jurisdiction or technology, unless the parties reach a voluntary commercial agreement for a different arrangement. And the Commission, as shown below, has the legal authority to adopt this single, default rate for all traffic routed on the PSTN.

[1] *See* Letter from AT&T, CompTIA, CTIA, Global Crossing, ITIC, NAM, New Global Telecom, PointOne, Sprint Nextel Corp., TIA, T-Mobile, Verizon, and the VON Coalition to Chairman Martin, Commissioner Copps, Commissioner McDowell, Commissioner Adelstein, and Commissioner Tate, CC Docket No. 01-92 (FCC filed Aug. 6, 2008).

[2] *See* Letter from Susanne Guyer, Verizon, to Chairman Kevin Martin *et al.*, CC Docket Nos. 01-92 & 96-45 (FCC filed Sept. 12, 2008).

[3] Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*"), *remanded, WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002). As Verizon has explained elsewhere, it is essential that the Commission respond to the D.C. Circuit's remand in *WorldCom* by issuing — no later than November 5, 2008 — "a final, appealable order that explains the legal authority" for the Commission's reaffirmation of earlier rulings that "exclude ISP-bound traffic from the reciprocal compensation requirement of § 251(b)(5)," regardless of any steps it takes to reform intercarrier compensation on or before that date. *In re: Core Communications, Inc.*, 531 F.3d 849, 862 (D.C. Cir. 2008).

The existing system of widely varying intercarrier compensation rates based on arbitrary jurisdictional and technological distinctions is fundamentally unworkable in today's new world of communications. Consumers and businesses are rapidly embracing Internet-protocol ("IP") and wireless services that up-end traditional assumptions about location-based and device-based telephone numbers. IP services offer customers the ability to pick their own area code and number, which can bear no relationship to the location(s) from which they make or receive calls. And mobility is an inherent feature of wireless services, which allow customers to make and receive calls from the same telephone number anywhere in the nation (or the world). Moreover, these new services offer integrated packages of features and capabilities that allow customers to access information and reach individuals located in numerous places simultaneously, undermining the historical understanding that a "call" has only two end points.

As a result of these technological and marketplace changes, carriers can no longer reliably determine whether a call is local or long distance, intrastate, or interstate in order to apply different rates to each type of traffic; nor can they determine whether incoming calls were originated in IP format, or outgoing calls are bound for an IP customer. Because of providers' inability to distinguish between intra- and interstate traffic — and between purely circuit switched and IP traffic — all traffic that is routed on the PSTN can no longer be reliably separated and treated differently and is therefore inseverable for jurisdictional purposes.

The increasing difficulty of properly categorizing traffic also serves as an invitation to fraud and arbitrage, as some providers attempt to manipulate and disguise traffic to obtain illegal profits or deprive other providers of lawful revenues. The traffic pumping arbitrage schemes that have proliferated in the past few years are just the latest examples of such uneconomic behavior. Additionally, some service providers manipulate call-signaling information and engage in circuitous routing of their customers' calls in order to disguise the jurisdiction of the traffic, in an attempt to reduce the amount they pay for those calls and to deprive terminating carriers of lawful revenues. Although immensely profitable to those engaged in such schemes, arbitrage and fraud undermine competition and harm consumers: resources that could be spent serving consumers and investing in new technologies are instead devoted to fraud detection efforts and litigation.

Moreover, even if there were a ready solution to these issues with the legacy regimes for circuit-switched wireline and wireless traffic, providers also face growing disputes about which (if any) of the myriad existing rates applies to the growing — but not readily identifiable — category of IP traffic. Such uncertainty about the compensation rules for IP traffic creates significant disincentives to further investment in the very next-generation services that consumers seek most. And the disputes divert resources away from investments in those services, contrary to federal policies — particularly, in Section 706 — promoting broadband investment and deployment.

All of these facts *both* demonstrate that comprehensive reform of the existing regime is essential *and* provide the Commission with ample authority to adopt a uniform default rate for all traffic routed on the PSTN, including the authority to preempt states from setting divergent rates for intrastate access traffic. First, for many of the same reasons that the Commission found in the *Vonage Order*[4] that all Voice over Internet Protocol ("VoIP") traffic is inseverable and, therefore, interstate for jurisdictional purposes — providers have neither a practical means for assembling all the clues necessary to determine the jurisdiction of particular communications nor

[4] Memorandum Opinion and Order, *Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minn. Pub. Utils. Comm'n*, 19 FCC Rcd 22404 (2004) ("*Vonage Order*"), *petitions for review denied*, *Minnesota Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir. 2007).

any service-driven reason to develop such means — the Commission can find that, today, *all* traffic routed over the PSTN is inseverable for jurisdictional purposes and, therefore, that the Commission has authority to establish a uniform compensation rate that applies to all traffic.

Second, the Commission can find that the arbitrage and fraud — and wasteful (but necessary) expenditures to combat such schemes — that would necessarily result from any *non*-uniform intercarrier compensation regime, means that the maintenance of state access charge regimes alongside the federal regime poses an obstacle not only to federal intercarrier compensation policies, but also to federal policies favoring economically rational competition and investment and deployment of new technologies and services. As set forth in more detail below, and as the Commission has found in analogous contexts, such arbitrage opportunities distort competitive markets, send false price signals, and lead to uneconomic investment decisions, as service providers try to garner regulatory advantages rather than to offer the services most likely to succeed in the marketplace. A uniform intercarrier compensation regime provides the only way to ensure that the Commission's judgments with respect to intercarrier compensation for interstate traffic (including VoIP and other IP-based traffic) and wireless traffic are given effect. The Commission need not leave a hole in an otherwise-uniform system that would perpetuate arbitrage opportunities and, thereby, thoroughly undermine federal policies. The Supremacy Clause of the Constitution preempts state laws that conflict with federal law in this manner.

Finally, the $0.0007 per minute rate that Verizon and others propose as the single, default rate for all traffic that traverses the PSTN is one that the Commission reasonably can select in the exercise of its considerable authority in this area. The Commission initially selected that rate based on negotiated interconnection agreements between incumbents and competitors; Verizon's own experience is that its negotiated interconnection agreements today continue to set rates at or below that level for terminating local traffic and for ISP-bound traffic. As the Commission and courts have recognized, such voluntary, market outcomes provide strong evidence that $0.0007 per minute is a just and reasonable rate. Moreover, as the Commission's experience with ISP-bound traffic has shown, a $0.0007 per minute rate is low enough to remove the financial incentives for arbitrage schemes, such as the traffic pumping schemes that are proliferating today. Finally, to the extent particular carriers' costs exceed the $0.0007 per minute rate, Verizon's proposal provides for further recovery mechanisms, both from end users and from an additional recovery fund.

DISCUSSION

I. The Commission Has Legal Authority To Establish a Single, Default Rate for All Traffic Routed Over the PSTN

A. Changes in Technology and the Communications Marketplace Have Rendered the Existing Intercarrier Compensation Regimes Unworkable

1. The communications landscape has changed dramatically in the past decade and now bears little resemblance to the world Congress faced when it enacted the Telecommunications Act of 1996. It bears even less resemblance to the communications landscape of 1983 when, following the break-up of AT&T, the Commission and the states created access charge regimes. Today, an ever greater proportion of calls are originating in Internet protocol ("IP") format, as consumers and businesses alike opt for IP-based offerings. These offerings up-end traditional conceptions of location-based and device-based phone numbers, including by enabling customers to have a single number — one of their choice and that may have no connection to their residence or billing address — that reaches them, no matter where they are and what phone (or computer) they are using. They also eliminate the historical understanding that a "call" has only two end points. Instead, these services offer integrated packages of features and capabilities, allowing customers to perform multiple communications simultaneously, accessing information and reaching individuals located in numerous places. Analysts report that VoIP providers continue to experience double-digit growth rates, and that they are expected to add more than 4 million customers in 2008, and to have 36 million total customers — or about 31 percent of all United States households — by 2011.[5]

In addition, consumers continue to flock to wireless services, which likewise break the historical connection between telephone numbers and geographic location, both through the mobility inherent in such services and the broad areas that serve as "local" calling areas for wireless providers. Wireless providers are also deploying third- and fourth-generation wireless networks, which give consumers the ability — much like IP-based wireline services — to engage in simultaneous voice and data communications. Indeed, the next generation of wireless services is expected to utilize VoIP and other IP-based technologies to integrate further the suite of communications services available to consumers. During the last three years for which Commission data are available, the number of wireless subscribers has grown by an average of nearly 24 million new subscribers each year, and there were more than 238 million wireless subscribers as of June 2007. *See FCC Local Competition Report*[6] at Table 14. Moreover, government estimates are that 15.8 percent of households have fully "cut the cord" — and use *only* wireless phones — with another 13.1 percent of households that have both wireless and wireline phones using their wireless phones almost exclusively, and those numbers have been

[5] *See* Simon Flannery *et al.*, Morgan Stanley, *Broadband Outlook: Cable Modem Speeds Boosting Market Share* at 11 (Mar. 27, 2008); Frost & Sullivan, *Move Toward Full Convergence – Communication Services Bundling for U.S. Residential Markets*, N020-62 at 1-21 (2007).

[6] Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *Local Telephone Competition: Status as of June 30, 2007* (Mar. 2008) ("*FCC Local Competition Report*").

steadily increasing.[7] Indeed, total wireless usage increased to approximately 2 *trillion* minutes in 2006 from approximately 335 billion in 2000,[8] with "[c]lose to half the minutes of use in the U.S. . . . now wireless."[9] Indeed, analysts estimate that those with wireless and wireline telephones make 68 percent of all their long-distance calls, and 51 percent of all their local calls, on their wireless phones, rather than their wireline phones.[10]

Unsurprisingly, the flip side of this massive growth in intermodal services is a comparably large decline in traditional wireline services. The Commission's most recent data show that end-user switched access lines declined by almost 30 million lines — to less than 163.2 million — from a peak of nearly 192.4 million lines in December 2000. *See id.* Table 1. These declines are not limited to Bell companies and larger incumbent LECs, as rural incumbent LECs have seen significant access line reductions since 2002.[11] Traditional wireline access minutes have also been decreasing significantly: from a high of about 792 billion interLATA minutes in 2000 to less than 544 billion such minutes in 2006.[12] Thus, long-distance calls that customers traditionally made on their wireline telephones — and for which wireline carriers collected access charges — have now shifted overwhelmingly to wireless and IP networks. And

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[7] *See* Stephen J. Blumberg and JulianV. Lake, National Center for Health Statistics, CDC, *Wireless Substitution: Early Release Estimates from the National Health Interview Survey, July-December 2007*, at 1 (May 13, 2008).

[8] *See* CTIA, Background on CTIA's Semi-Annual Wireless Industry Survey, http://files.ctia.org/pdf/CTIA_Survey_Year_End_2007_Graphics.pdf.

[9] Tim Horan and Ned Baramov, Oppenheimer, *Cautious on the RLEC Sector* at 23 (June 18, 2008).

[10] *See* Margo DeBoer, Yankee Group, *One in Seven US Households Say "No Thanks" to Wireline Phone Services in 2010*, at 4, Exhibit 2 (Dec. 2006).

[11] *See* Stifel Nicolaus, *Telecom Services Equity Research: 2008 Outlook and 4Q07 Preview*, at Slide 94 (Jan. 2008).

[12] *See* Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *Trends in Telephone Service*, at Table 10.2 (Aug. 2008).

industry analysts estimate that, by the end of 2008, traditional, wireline telephone companies will provide circuit-switched telephone service to only 64 percent of the more than 108 million households with some form of telephone service.[13] Traditional wireline carriers are responding by offering their own geography-independent services, including any-distance, unlimited calling plans and find-me/follow-me services that — like current offerings using VoIP technology — enable a call to single number to ring in multiple locations. Those wireline carriers are also preparing to introduce their own facilities-based VoIP services, which likewise will offer customers an integrated, any-distance communications service, lacking readily ascertainable jurisdictional end points.

All available evidence suggests that the trends in favor of wireless and IP-based services — and away from traditional wireline services — will continue and that these changes will continue to have significant and ever-increasing effects on the communications marketplace. As the Commission has recognized, such an "emerging and changing" marketplace is best "analyzed in view of larger trends in the marketplace" and not through "snapshot data that may quickly and predictably be rendered obsolete as th[e] market continues to evolve."[14] Moreover, the Commission should regulate in light of — and, indeed, in anticipation of — the further changes that available and emerging technologies portend for the communications marketplace. In other words, the Commission should not wait until change has not only arrive, but has finished — and

[13] *See* Jeff Wlodarczak *et al.*, Wachovia Capital Markets, *Q4 2007 State of Video/Data/Phone Markets* at 8 (Mar. 3, 2008).

[14] Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853, ¶ 50 (2005), *aff'd*, *Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007); Memorandum Opinion and Order, *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*; *Petition of BellSouth Corporation for Forbearance Under Section 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, 22 FCC Rcd 18705, ¶ 20 (2007), *petitions for review pending*, *Ad Hoc Telecomms Users Comm. v. FCC*, No. 07-1426 (D.C. Cir.).

wireless and VoIP and other IP-based subscribership and usage has reached its zenith — before the Commission modifies legacy regulatory regimes not only to accommodate, but also to promote those marketplace changes. That is especially true given that any comprehensive intercarrier reform will necessarily be phased in through a transition, which means that the full benefits of such reform will not be felt until years after the Commission adopts its order, during which time marketplace changes will continue apace.

2. As customers increasingly adopt IP-based and current and next-generation wireless services — and adopt existing and forthcoming wireline services, such as "find-me, follow-me" services, that also provide location independence — it will become even more difficult for carriers to separate traffic into intrastate and interstate categories for intercarrier compensation purposes. All of these services make telephone numbers an increasingly poor "proxy for . . . subscribers' geographic locations when making or receiving calls" — that is, for the end-points of a standard voice communication. *Vonage Order* ¶ 26.

Carriers historically relied on telephone numbers to determine the jurisdiction of wireline calls not because telephone numbers determine jurisdiction — a proposition the Commission has long rejected[15] — but because telephone numbers were an easily ascertained and generally reliable proxy for the end-points of a call, which do determine jurisdiction. Customers had little (if any) choice over the area code and first three digits of their telephone numbers (the "NPA-NXX"), and carriers routinely assigned customers telephone numbers with NPA-NXXs associated with the particular switch that provided dial-tone service to those customers. Those numbers, therefore, provided other carriers with a reliable geographic indicator. Although telephone numbers were never a perfect proxy for geography, as the Commission's decisions on

[15] *See, e.g.*, Memorandum Opinion and Order, *AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, ¶¶ 71, 80 (1998), *recon. denied*, 15 FCC Rcd 7467 (2000).

"leaky" PBXs and Feature Group A service make clear,[16] those services required only minor tweaks to federal and state access charge regimes to account for the false geographic signal telephone numbers gave in those circumstances.

The advent of location-independent services poses far more significant difficulties for the continued use of telephone numbers as a proxy for geography. These location-independent services include mobile services — both wireless service and nomadic VoIP — that allow customers to make calls from the same telephone number from any place in the nation (and, indeed, in the world). In addition, the intermodal porting of telephone numbers that were previously associated with a traditional wireline service adds an additional layer of complexity, as some — but not all — of the numbers in a block of 1,000 or 10,000 numbers can now make or receive calls from anywhere, not just from the wire center where those numbers are homed. The availability of "pick-your-own-area-code" services — which may, or may not, also provide mobility — further divorces a customer's assigned telephone number from her physical location. Indeed, all of these wildly popular services are intended to break — and have succeeded in breaking — the connection between the assigned telephone number and the geographic end-points of a call. Therefore, telephone numbers are no longer a valid proxy for the geographic location of the calling and called party, and service providers cannot rely on numbers to make accurate assessments of the jurisdiction of traffic they exchange.

[16] *See, e.g.*, Memorandum Opinion and Order, *Access Billing Requirements for Joint Service Provision*, 4 FCC Rcd 7183, ¶¶ 21-26 (1989); Memorandum Opinion and Order and Request for Supplemental Comments, *Amendment of Part 69 of the Commission's Rules To Ensure Application of Access Charges to All Interstate Toll Traffic*, 102 F.C.C.2d 1243, ¶ 28 (1985) ("clarification" to "provide sufficient guidance . . . to permit the proper billing and collection of access charges"); Memorandum Opinion and Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 834, ¶ 108 (1984).

Moreover, consumers are now using new and innovative IP-based services, including wireless services, that offer a "suite of integrated capabilities and features" that allows them "to perform different types of communications simultaneously," which has demolished the traditional notion that a communication has only two end-points. *Vonage Order* ¶¶ 7, 25; *see id.* ¶ 23 (finding that integrated, any-distance VoIP services are "too multifaceted for simple identification of the user's location to indicate jurisdiction"). Therefore, even if telephone numbers were still a meaningful proxy for geography, they would not provide a complete picture of the geography of an IP-based communication for jurisdictional purposes.

Carriers, moreover, have no means of distinguishing VoIP and other IP traffic from the circuit-switched-originated calls that they receive and deliver to their customers. By the time an IP-originated call is delivered to a carrier for termination on the PSTN, it is in the same TDM form as circuit-switched-originated calls. There are no distinguishing features that would provide the terminating carrier with an easy means of determining that the call was originated as a VoIP call. Similarly, carriers that originate traffic on the PSTN currently have no means of determining whether the calls they originate are being delivered to a VoIP or other IP-based customer (or to a wireless customer) with a telephone number that bears no relation to that customer's location or to the jurisdiction of the call. As a result, carriers' automated billing systems rate IP traffic based on the telephone numbers that are signaled with the call (and that, absent manipulation, should be the telephone numbers of the calling and called party).

The effect of all of these changes is that carriers inevitably and routinely bill intrastate access charges or reciprocal compensation charges for jurisdictionally interstate calls, because the calls either are IP traffic or the telephone numbers provide a misleading indicator of the geographic location of the parties to the call. As VoIP and other IP-based calls — including wireless calls using next-generation IP-based services — constitute an ever-increasing portion of the total volume of traffic routed on the PSTN, an increasing portion of the calls for which carriers bill *intra*state access charges will actually be jurisdictionally mixed, but inseverable and, therefore, *inter*state IP-based calls.

Finally, carriers have no service-driven reason to develop the capabilities that they currently lack. They have no reason to develop technologies to distinguish IP-based calls from circuit-switched calls, as whether the call was originated (or terminated) in an IP format has nothing to do with the work the carrier performs in terminating (or originating) that call or the service the carrier provides to its own customer. Nor do VoIP providers or wireless carriers have any service-driven reason to incorporate such identifying characteristics into their services. Likewise, circuit-switched providers offering any-distance service packages to their customers have no service-driven reason to distinguish among the jurisdiction of the calls their customers originate; they do so only pursuant to legacy regulatory distinctions. And service providers have no service-driven reason to develop new proxies to replace the role that telephone numbers had historically played in determining jurisdiction, even assuming such proxies could fully reflect all of the information necessary to determine the jurisdiction of an IP-based communication.

3. Despite these intractable difficulties, carriers today must devote considerable resources to attempting to measure, categorize, and bill the calls they deliver to their customers, applying different rates to different types of calls. Those rates vary widely: a terminating carrier, for example, may charge as little as $0.0007 per minute for a “local” call rated under the “mirroring rule,” or more than *175 times* as much for an intrastate long-distance call terminated by a rural carrier: carriers in the South Dakota Local Exchange Carrier Association, for example, charge intrastate access rates of *twelve-and-a-half cents* ($0.125) per minute.[17]

As the Commission has noted, the patchwork nature of the current regime "require[s] carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis." *Intercarrier Compensation FNPRM* ¶ 15. The existence of widely different rates that "usually have no economic or technical basis" is an invitation to fraud and regulatory arbitrage, as some carriers attempt to manipulate and disguise traffic in order to gain illegal profits for themselves or to deprive other carriers of lawful revenues. As the Commission is aware, such arbitrage has taken many forms, from competing LECs' decisions to sign up "ISPs exclusively" as customers and not to "offer[] viable local telephone competition," in an effort to obtain a one-way flow of reciprocal compensation payments, *ISP Remand Order* ¶ 21, to the traffic pumping schemes that have proliferated in recent years, with carriers pumping up access traffic subject to extremely high rates by paying "free" conference call and chat line providers to be their "customers." Such arbitrage also involves carriers attempting to pass off traffic subject to high intrastate access charges as though it were subject instead to lower interstate access charges or to even lower reciprocal compensation rates, as well as to bill access rates on calls, such as intraMTA wireless calls, that are actually subject to lower reciprocal compensation rates.

The existence of these arbitrage opportunities — although immensely profitable to the arbitrageurs for as long as their scams can last — harms competition and consumers by diverting resources from investment in newer and better network technologies and services to detection of scams and litigation against the scammers. The arbitrage also encourages service providers to

[17] *See* South Dakota Local Exchange Carrier Association, Inc. S.D. P.U.C. Tariff No. 1 at 17-1, *available at* http://puc.sd.gov/commission/tariff/leca/section17.pdf.

make investment decisions for regulatory gain, rather than on the basis of economic efficiency and consumer welfare. And it hides from consumers the true cost of the services they purchase, so they "do not receive accurate price signals." *Id.* ¶ 68. The "resulting market distortions" undermine federal policies. *Id.* ¶ 69.

In addition, the existence of so many different potential rates under the current regime breeds uncertainty about which rates will apply to newer technologies — such as current disputes about which (if any) of the existing rates applies to VoIP traffic — creating further disincentives to investment in new technologies and to the development of new products. Such disincentives undermine Congress's directive to the Commission, in Section 706, to "encourage the deployment . . . of advanced telecommunications capability to all Americans" and to "remove barriers to infrastructure investment." 1996 Act[18] § 706 (codified at 47 U.S.C. § 157 note).

In sum, there is no justification today for maintaining a system that requires or permits carriers to apply different rates to different traffic based on arbitrary distinctions.

B. The Commission Has Authority To Preempt State Access Charge Regimes To Adopt a Uniform Federal Intercarrier Compensation Regime

The Commission has long sought to "replac[e] the myriad existing intercarrier compensation regimes with a unified regime designed for a market characterized by increasing competition and new technologies." *Intercarrier Compensation FNPRM*[19] ¶ 1. The technological and marketplace facts set foth above both demonstrate the need for comprehensive reform of the existing intercarrier compensation regimes *and* provide the Commission with ample authority to adopt a uniform, federal default rate for all traffic routed on the PSTN,

[18] Telecommunications Act of 1996 ("1996 Act"), Pub L 104-104, 110 Stat 56 (1996), codified at 47 U.S.C. § 151 *et seq*.

[19] Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685 (2005) ("*Intercarrier Compensation FNPRM*").

including the authority to preempt states from setting divergent rates for intrastate access traffic. Indeed, as explained below, carriers can neither reliably identify different types of traffic nor reliably separate all of the various types of traffic they receive in order to treat the traffic differently and preserving state regimes alongside a uniform federal regime poses an obstacle to, and would frustrate, important federal policy objectives.

1. In Today's World, Carriers Can No Longer Reliably Identify Or Separate Different Types of Traffic

As described above, technological and marketplace changes mean that, in today's world, there is no "practical means" or "plausible approach to separating" calls "into interstate and intrastate components for purposes of enabling dual federal and state regulations to coexist." *Vonage Order* ¶¶ 18, 23. Those practical and economic impediments to ensuring that a carrier applies its intrastate charges *only* to intrastate traffic provides the Commission with ample grounds for finding that all traffic routed over the PSTN is inseverable as a practical and operational matter, and for adopting a single, default rate for all of this inseverable traffic.

As the Commission correctly recognized in the *Vonage Order*, the standard for preemption on inseverability grounds is not whether it is *technically* impossible to single out intrastate communications. The dispositive question, instead, is whether it is "economically feasible," in light of "practical and economic considerations," to separate interstate traffic from intrastate traffic. *California v. FCC*, 39 F.3d 919, 932-33 (9th Cir. 1994). That focus on economic and practical considerations reflects the long-standing rule that carriers are not required to expend resources and to modify their services "merely to provide state commissions with an intrastate communication they can then regulate." *Minnesota Pub. Utils. Comm'n*, 483 F.3d at 578.

The Commission has in numerous cases preempted state regulation where — as here — it was not practical, in light of economic and operational considerations, to separate the interstate and intrastate services, even though it might have been *technically* possible to distinguish between intra- and interstate communications. For example, the Ninth Circuit upheld the Commission's preemption in its *Computer Inquiry* orders of state regulation of information services (or enhanced services, as they were called at the time) that included integrated interstate and intrastate capabilities, based on the Commission's determination "that it would not be economically feasible for the BOCs to offer the interstate portion of such services on an integrated basis while maintaining separate facilities and personnel for the intrastate portion." *California*, 39 F.3d at 932. The Ninth Circuit, moreover, explained that, even if it were technically "possible to comply with both the states' and the [Commission]'s regulations," preemption was appropriate based on the Commission's finding that it is "highly unlikely, due to practical and economic considerations," that such jurisdictional division would succeed. *Id.* at 933. Similarly, the Fourth Circuit upheld the Commission's preemption of state regulation of CPE on the ground that it was "not feasible, *as a matter of economics and practicality of operation*," to have separate state and federal regulation of the CPE, despite the fact that the CPE in question was used 97 to 98 percent of the time for intrastate calls.[20]

Here, in light of the technological changes in the marketplace set forth above, service providers currently have no reliable and economic means of separating the various types of traffic they handle. They cannot distinguish IP traffic from circuit-switched calls, nor can they reliably determine the jurisdiction of individual types of calls — local, intraMTA, intrastate toll,

[20] *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787, 791 (4th Cir. 1976) (emphasis added); *see id.* at 796 (Widener, J., dissenting); *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036, 1044, 1046 (4th Cir. 1977).

and interstate — because telephone numbers are no longer a valid or reliable proxy for the geographic locations of the parties to a call. To create the capabilities to categorize accurately all of the various types of traffic they handle, service providers would have to modify their services and operations, and to invent new proxies to replace telephone numbers. For example, as the Commission found in the *Vonage Order*, to prevent carriers from assessing intrastate charges on interstate calls, service providers would be forced to "incorporate . . . identification capabilities into [their] service[s] solely to facilitate the use of an end-to-end approach" and to "mak[e] it easier to apply traditional voice regulations" to the ever-shrinking proportion of traffic that is carried entirely across circuit-switched wireline networks. *Vonage Order* ¶¶ 25, 29.

Service providers, moreover, would have to invest resources into new systems and equipment that could ascertain the true geographic location of the *other* party to the call — who might be using a mobile service or have selected a number associated with an area code different from the one normally assigned to her location — as well as to determine whether a circuit-switched call is bound for a customer of a VoIP or other IP-based service. These new systems and equipment, moreover, would need to be able to process all of this information in *real time,* so that carriers' and providers' billing systems could be automated to bill correctly and accurately for traffic.

As the Commission has properly found in an analogous context, it would "serve no legitimate policy purpose" to "impose substantial costs" on service providers to make these changes simply "for certain regulatory purposes," where — as here — they have "*no service-driven reason to incorporate such capabilit[ies] into [their] operations*." *Id.* ¶¶ 25, 29. And the Eighth Circuit agreed, holding that it was "proper" for the Commission to consider these "economic burden[s]" and recognizing the long-standing rule — set out in precedents dating back at least to the 1970s — that service providers are not required to bear those costs and "develop a mechanism for distinguishing between interstate and intrastate communications merely to provide state commissions with an intrastate communication they can then regulate." *Minnesota Pub. Utils. Comm'n*, 483 F.3d at 578.

Indeed, as Verizon has explained at length elsewhere, IP traffic provides a particularly clear example of traffic that is jurisdictionally mixed, but inseverable for jurisdictional purposes and for which the Commission must establish a uniform federal regime.[21] As the Commission recognized, the "integrated capabilities and features" that "are inherent features of most, if not all, IP-based services" — including those of "facilities-based providers" — "form an integrated communications service designed to overcome geography, not track it," and that are "too multifaceted for simple identification of the user's location to indicate jurisdiction." *Vonage Order* ¶¶ 23, 25 & n.93, 32. The Commission, therefore, concluded that it "would preempt state regulation" of the rates, terms, and conditions on which providers offer those IP-based services, recognizing the disastrous policy consequences of permitting the "imposition of 50 or more additional sets of different economic regulations" on VoIP service, which would "risk eliminating or hampering this innovative advanced service." *Id.* ¶¶ 32, 37.

Subjecting VoIP and other IP-based services to state regulations designed for different services in a different era would thus conflict with Congress's and the Commission's policies to encourage the development and deployment of broadband services, as set forth in Section 706 of the 1996 Act and in Commission decisions informed by that section, which federal courts have

[21] *See* Letter from Kathleen Grillo, Vice President, Federal Regulatory,Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36 (FCC filed Aug. 6, 2007).

upheld.[22] The Commission has recognized the "nexus between VoIP services and accomplishing [those policy] goals," finding that VoIP and IP-based services "driv[e] consumer demand for broadband connections," "spurs technological development and growth of broadband infrastructure, and promotes continued development and use of the Internet" — all of which is in furtherance of federal policy and strongly in the public interest. *Vonage Order* ¶¶ 36-37. That is particularly true with respect to facilities-based providers of VoIP and other IP-based services, as they are also the ones investing in the deployment of next-generation broadband infrastructure — over which VoIP service can be provided by either the facilities-based provider itself or a third-party, "over the top" provider, such as Vonage. As the Commission has recognized in analogous contexts, applying 50 or more sets of state regulations to those facilities-based providers would harm consumers by "discourag[ing] the . . . building [of] next generation networks in the first place."[23]

In today's world, all of this is true not just of IP-based traffic, but also of all traffic that is routed over the PSTN, as explained above.

2. Separate State Access Charge Regimes Pose an Obstacle to the Accomplishment of Important Federal Policy Objectives

The Commission's federal law authority over the vast majority of traffic routed over the PSTN is unquestioned and, indeed, incontrovertible. As the Commission has recognized, it "clearly has authority under section 201 to adopt or modify compensation mechanisms that apply

[22] *See, e.g., EarthLink, Inc. v. FCC,* 462 F.3d 1, 8 (D.C. Cir. 2006); *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 584 (D.C. Cir. 2004).

[23] Memorandum Opinion and Order, *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c)*, 19 FCC Rcd 21496, ¶ 27 (2004) ("*271 Broadband Forbearance Order*"), *aff'd*, *EarthLink, Inc. v. FCC,* 462 F.3d 1 (D.C. Cir. 2006).

to jurisdictionally interstate traffic." *Intercarrier Compensation FNPRM* ¶ 35.[24] That authority extends to jurisdictionally mixed traffic that the Commission has found to be inseverable for jurisdictional purposes, such as VoIP. *See Vonage Order* ¶¶ 23, 25 & n.93, 32. Congress has also expressly extended the Commission's authority under § 201(b) to all wireless traffic, both interstate and intrastate. *See* 47 U.S.C. § 332(c)(1).[25]

In the exercise of that federal-law authority, the Commission has long had a "goal" of "develop[ing] a uniform regime for all forms of intercarrier compensation." *Intercarrier Compensation NPRM*[26] ¶ 97; *see Intercarrier Compensation FNPRM* ¶ 33 (expressing the Commission's goal of "a regime that would apply [intercarrier compensation] rates in a uniform manner for all traffic"). As the Commission explained, such uniformity is "competitively and technological neutral" and "is consistent with the pro-competitive de-regulatory environment envisioned by the 1996 Act," as such a regime requires "minimal regulatory intervention and enforcement." *Intercarrier Compensation FNPRM* ¶ 33. The D.C. Circuit, moreover, has

[24] The Commission long-ago noted that "no one has questioned (or plausibly could question)" that § 201(b) provides the Commission with "authority over interstate access charges." Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd 10175, ¶ 7 (1997); Seventh Report and Order and Notice of Proposed Rulemaking, *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, 16 FCC Rcd 9923, ¶ 21 (2001) (§ 201(b) provides Commission with authority over CLEC interstate access charges).

[25] In particular, because Congress has expressly preempted state "regulat[ion] [of] . . . the rates charged by any commercial mobile service," "[n]otwithstanding section[] 152(b)," the Commission also has sole authority to regulate intercarrier compensation for intrastate wireless traffic. 47 U.S.C. § 332(c)(3)(A); *see Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (subsequent history omitted). *See also* Declaratory Ruling, *Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, 17 FCC Rcd 13192, ¶¶ 8-12 (2002); Second Report and Order, *Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Services*, 9 FCC Rcd 1411, ¶ 179 (1994).

[26] Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd 9610 (2001) ("*Intercarrier Compensation NPRM*").

upheld a Commission decision that was based on these "policies favoring a unified compensation regime," explaining further that it is "not for th[e] court[s] to second-guess the conclusion reached by the agency that Congress has entrusted with balancing those policies."[27]

The Commission has also recognized the importance of ensuring that "carriers have [the] incentive to compete . . . on [the] basis of quality and efficiency," rather than "on the basis of their ability to shift costs to other carriers," which the Commission recognized creates "troubling distortion[s] that prevent[] market forces from distributing limited investment resources to their most efficient uses." *ISP Remand Order* ¶ 4. These distortions "create[] incentives for inefficient entry" by carriers intent on taking advantage of "opportunit[ies] for regulatory arbitrage," rather than engaging in the kind of "telephone competition[] [that] Congress had intended to facilitate with the 1996 Act." *Id.* ¶ 21. And the Commission, applying Section 706, has recognized the importance of "provid[ing] incentives for all carriers . . . to invest in broadband facilities" and to "promote the timely and comprehensive deployment of [such] facilities." *271 Broadband Forbearance Order* ¶¶ 6, 34.

As the Commission has recognized, non-uniform rates for intercarrier compensation for all the traffic that carriers exchange — such as between intrastate access rates and an otherwise-uniform federal default rate for all other traffic — pose a significant obstacle to those federal policies. The availability of different rates for different types of traffic "create[s] both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions." *Intercarrier Compensation FNPRM* ¶ 3. That is because, where such "opportunities for regulatory arbitrage" exist, "parties will revise or rearrange their transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation,

[27] *In re Core Communications, Inc.*, 455 F.3d 267, 283 (D.C. Cir. 2006) (internal quotation marks omitted).

would be viewed as costly or inefficient." *Intercarrier Compensation NPRM* ¶ 12. In other words, investment decisions — including decisions about investment in broadband facilities and services — will be distorted by the availability of arbitrage opportunities, as well as by uncertainty confusion about which of the multiple rates will apply to new services. In addition, the need to devote funds to ultimately futile efforts to identify, track, and bill differently for different types of traffic further distorts investment decisions.

Indeed, if existing intrastate access charges were to remain alongside a new federal compensation regime, terminating carriers would have the same incentives as today to engage in traffic pumping schemes to charge those high intrastate rates, rather than the new, lower federal default rate. And carriers would continue to have the incentive both to disguise traffic that remains subject to intrastate access charges in an effort to pay only the lower federal default rate, and to claim an entitlement to payment at the higher intrastate rate for traffic that is legitimately subject to the new federal default rate. Such arbitrage efforts and outright fraud — designed to exploit the distinctions in the federal and state regimes — would necessarily undermine the uniform federal intercarrier compensation regime and the federal policies favoring efficiency, economic competition, and broadband deployment that a uniform intercarrier compensation regime furthers.

Here, too, IP traffic provides a particularly clear and rapidly growing example (though hardly the sole example) of the obstacles to the achievement of federal policies that arbitrage opportunities present. Because of the impracticability of reliably identifying terminating VoIP traffic and the uncertainties about which (if any) of the existing rates apply to IP traffic, service providers have operated on divergent views of what the law requires — and, in some cases, on their view of what the law will let them get away with. Thus, while in some instances VoIP providers attempt to self-identify their traffic as VoIP and pay at interstate access rates, in other cases, VoIP traffic is delivered intermingled with circuit-switched traffic, and carriers that terminate those calls bill based on the telephone numbers, even though that often results in application of intrastate access charges to these interstate calls. Still others refuse to pay anything for VoIP calls and assert — at times, without substantiation — that the calls they deliver are VoIP calls. The uncertainties and arbitrage opportunities that the availability of multiple carrier compensation rates presents, therefore, distorts competition among IP providers and between IP providers and circuit-switched providers and provides disincentives to investment in broadband services.

For all of these reasons, the Commission can find that state access charge regimes that differ from its single, federal default rate pose an obstacle to the accomplishment of federal goals and policies and are preempted. Under the Supremacy Clause of the Constitution, state law is preempted where, as here, it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" or a federal agency exercising delegated authority. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *United States v. Locke*, 529 U.S. 89, 109-10 (2000) ("In this context, [federal agency] regulations are to be given pre-emptive effect over conflicting state laws."). Indeed, the Supreme Court has expressly found, in the context of this Commission's regulations, that "[t]he statutorily authorized regulations of an agency will pre-empt any state or local law that conflicts with such regulations or frustrates the purposes thereof." *City of New York v. FCC*, 486 U.S. 57, 64 (1988).

Moreover, the Commission's determination that state access charge regimes pose an obstacle to federal intercarrier compensation policies and the new federal default rate is entitled, at a minimum, to "some weight." *Geier v. American Honda Motor Co.*, 529 U.S. 861, 883

(2000). As the Supreme Court has explained, where Congress has delegated to an agency the "authority to implement the statute; the subject matter is technical; and the relevant history and background are complex and extensive" — all factors present in the context of intercarrier compensation — the agency's view that state law would "stan[d] as an obstacle to the accomplishment and execution" of the agency's "own regulation and its objectives" "make[s] a difference," as the agency is "uniquely qualified to comprehend the likely impact of state requirements." *Id.* (internal quotation marks omitted; alteration in original).

In an analogous situation, the D.C. Circuit recognized the Commission's authority to preempt state laws that — as here — pose an obstacle to federal policies or, in that court's words, "when the state's exercise of that authority negates the exercise by the [Commission] of its own lawful authority over interstate communication." *NARUC v. FCC*, 880 F.2d 422, 429 (D.C. Cir. 1989). In that case, the Commission had adopted the policy of "encourag[ing] competition in the provision, installation, and maintenance of inside wiring," which the court found to be "consistent with the goals of the Act." *Id.* The court recognized further that "certain otherwise legitimate state actions regulating intrastate telephone service could interfere with the Commission's achievement of its valid goal of providing interstate telephone users with the benefits of a free market and free choice in the installation and maintenance of inside wiring." *Id.* at 430. Therefore, the court found, the Commission had authority to "take appropriate measures in pursuit of that goal," including to require that "all of the[] [states] unbundle inside wiring from basic telephone services." *Id.* The Commission, therefore, can issue "a valid . . .

preemption order" with respect to state regulation that — there, as here — "would necessarily thwart or impede the operation of a free market." *Id.*[28]

Contrary to the claims of NTCA and others,[29] § 2(b) does not prevent the Commission from preempting state access charge regimes because the "state's exercise of [such] authority" would "negate[] the exercise by the [Commission] of its own lawful authority" over intercarrier compensation for "interstate communication[s]" and wireless communications, and would frustrate important federal policy objective in competition and efficient investment in new technologies and services. *NARUC*, 880 F.2d at 429; *see Public Serv. Comm'n of Md. v. FCC*, 909 F.2d 1510, 1514-15 (D.C. Cir. 1990) (rejecting similar argument based on § 2(b)); *see also supra* pp.15-16 (discussing other cases in which courts have upheld Commission preemption of state regulation, including of information services and CPE). More generally, the Supreme Court has recognized that, because conflict preemption "turns on the identification of [an] 'actual conflict,'" it operates even in the face of a savings provision, such as § 2(b), because courts "can assume that Congress or an agency ordinarily would not intend to permit a significant conflict." *Geier*, 529 U.S. at 884-85; *see also Crosby v. National Foreign Trade Council*, 530 U.S. 363, 387-388 (2000) ("[T]he existence of conflict cognizable under the Supremacy Clause does not depend on express congressional recognition that federal and state law may conflict.").

[28] Although the D.C. Circuit found that the Commission had not fully explained the basis for its preemption decision, *see NARUC*, 880 F.2d at 431, the Commission did so soon thereafter, and no party sought review of the Commission's more detailed explanation of its decision to preempt state regulation, *see* Third Report and Order, *Detariffing the Installation and Maintenance of Inside Wiring*, 7 FCC Rcd 1334 (1992).

[29] *See, e.g.*, Letter from Daniel Mitchell, Vice President – Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-33, at 1, 3 (Aug. 22, 2008) ("*NTCA Aug. 22 Ex Parte*").

C. As Part of a Comprehensive Reform of Intercarrier Compensation Under §§ 201 and 332, the Commission Can Extend a Single, Federal Default Rate to Traffic Subject to § 251(b)(5)

As part of its adoption of a comprehensive reform of intercarrier compensation pursuant to its authority under § 201 and § 332 over interstate and wireless communications, the Commission can extend its single, default rate to traffic that is subject to § 251(b)(5), using its authority to establish rules to implement the reciprocal compensation duty. Alternatively, the Commission can forbear from § 251(b)(5) and regulate such traffic directly, as it is inseverable for jurisdictional purposes, for the reasons set forth above.

1. In the Context of Comprehensive Reform of Intercarrier Compensation Under §§ 201 and 332, the Commission Can Extend Its Single Rate to Traffic Subject to § 251(b)(5)

As the Commission has recognized, it "clearly has authority to modify the pricing methodology that applies to reciprocal compensation under section 252(d)(2)." *Intercarrier Compensation FNPRM* ¶ 35. Indeed, the Commission's authority to adopt rules to implement pricing standards in the 1996 Act is beyond question.[30] Section 252(d)(2) sets a standard for assessing rates for § 251(b)(5) traffic: such rates must reflect a "reasonable approximation of the additional costs of terminating . . . calls" subject to § 251(b)(5). 47 U.S.C. § 252(d)(2)(A)(ii). In this context, exercising its rulemaking authority, the Commission can find that its national default rate — adopted under § 201 and § 332 — is *also* a "reasonable approximation of th[os]e additional costs," 47 U.S.C. § 252(d)(2)(A)(ii), particularly in light of the opportunities that service providers have under Verizon's proposal to recover additional amounts from retail customers and from a Replacement Mechanism. Indeed, in an analogous context in the *ISP Remand Order*, the Commission recognized that, where a carrier's "costs exceed" the $0.0007

[30] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-78 (1999).

per minute rate cap the Commission adopted, carriers can instead “recover those amounts from its own end-users,” which is “fully consistent with the manner in which this Commission has directed ILECs to recover the[ir] costs.” *ISP Remand Order* ¶¶ 80, 87.

In addition, the Commission has already recognized that existing rate disparities “are based on jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services” and, therefore, set “different rates . . . for essentially the same function.” *Intercarrier Compensation FNPRM* ¶ 15. Accordingly, there is no reason to believe there are multiple, reasonable approximations of the additional costs of terminating § 251(b)(5) traffic, that could differ from carrier to carrier, or from state to state. In fact, § 252(d)(2) eschews such a carrier-specific analysis, as it expressly precludes both the Commission and state commissions from engaging in a “proceeding to establish with particularity the additional costs” of individual carriers, as well as from “requir[ing] carriers to maintain records with respect to the[ir] additional costs.” 47 U.S.C. § 252(d)(2)(B)(ii). The Commission, therefore, could set by rule a single rate as *the* reasonable approximation of the additional costs of terminating § 251(b)(5) traffic.

Indeed, although Congress gave state commissions — not this Commission — the statutory authority to “establish . . . rates” for § 251(b)(5) traffic “pursuant to []section [252](d),” 47 U.S.C. § 252(c)(2), (d)(2), the Supreme Court has made clear that the 1996 Act establishes a “new *federal* regime . . . guided by federal-agency regulations” and that a state commission must “regulat[e] in accordance with federal policy,” or a federal court “may bring it to heel.” *Iowa Utils. Bd.*, 525 U.S. at 378 n.6. The Court held further that it is the Commission that will “draw the lines to which the[] [state commissions] must hew.” *Id.* In the context of the Commission’s establishment of a comprehensive, federal reform of intercarrier compensation — based on the

Commission's various statutory grounds of authority over traffic routed on the PSTN and which provides additional opportunities to providers to recover from their retail customers and a Replacement Mechanism, where needed — the Commission's authority to draw a line to which states "must hew" for this single category of traffic is at its zenith.

That is particularly so in light of § 251(i), which provides that "[n]othing in . . . section [251]" — which includes § 251(b)(5) — "shall be construed to limit or otherwise affect the Commission's authority under section 201." 47 U.S.C. § 251(i). If states were permitted, in implementing § 251(b)(5), to set rates different from the single, default rate the Commission established for all other traffic, such different rates *would* "affect the Commission's authority under section 201," contrary to Congress's limitation on the scope of § 251. The different rates would create opportunities for regulatory arbitrage among the different rates, as well as requiring carriers to invest substantial resources in quantifying and separating calls subject to § 251(b)(5) from all other calls, which would remain subject to the federal default rate. Moreover, just as carriers have no practical means of determining whether a call that appears to be an intrastate toll call — based on the telephone numbers — is, in fact, part of an inseverable and, therefore, jurisdictionally interstate IP-based communication or is an interstate wireless call, they similarly have no practical ability to determine whether an apparently local (or intraexchange) call subject to § 251(b)(5) is actually jurisdictionally interstate. For all of these reasons, interpreting the 1996 Act to preclude the Commission from setting a single rate for traffic subject to § 251(b)(5) would conflict with § 251(i), by construing § 251 to "limit or otherwise affect the Commission's authority under section 201." 47 U.S.C. § 251(i).

2. The Commission Can Forbear From § 251(b)(5) and Exercise Its Authority To Adopt a Comprehensive Scheme with a Uniform Rate

Finally, and in the alternative, the Commission could forbear from enforcing § 251(b)(5), insofar as it would require carriers to enter into reciprocal compensation arrangements that are subject to state commission authority. *See* 47 U.S.C. § 160(a). In place of reciprocal compensation arrangements, carriers would be subject to the Commission's single, federal default rate. As explained above, the Commission can rely on the same inseverability analysis that provides one ground for preempting state access charge regimes to find that traffic subject to § 251(b)(5) can be brought under the Commission's § 201 authority over traffic that cannot reliably be separated for jurisdictional purposes.

Once the Commission determines that traffic formerly subject to § 251(b)(5) would instead be subject to the new, single, default rate for all other traffic routed over the PSTN, the Commission can readily find that the each of the forbearance criteria is satisfied.

First, reciprocal compensation arrangements would not be necessary to ensure just and reasonable rates. *See id.* § 160(a)(1). Instead, carriers would remain subject to the federal default rate, which the Commission will have found is just and reasonable. Moreover, to the extent that the federal default rate is $0.0007 per minute — the same rate currently applicable to a significant portion of § 251(b)(5) traffic as a result of the Commission's mirroring rule — forbearance would result in no change in the rate at which carriers exchange such traffic. In addition, following forbearance, carriers would have greater ability to negotiate commercial agreements with other carriers, as such negotiated agreements could encompass *all* of the traffic they exchange, rather than having one agreement (subject to state commission approval) for § 251(b)(5) traffic and another agreement (entirely outside of the §§ 251 and 252 process) for all other traffic.

Second, reciprocal compensation arrangements are not necessary for the protection of consumers. *See id.* § 160(a)(2). On the contrary, a uniform, national default rate benefits consumers by reducing opportunities for regulatory arbitrage. Indeed, the Commission has recognized that "avoid[ing] arbitrage" is relevant to the analysis under § 10(a)(2) in the context of intercarrier compensation. *Core Forbearance Order*[31] ¶ 25. That is because resources devoted to arbitrage opportunities — and to the fight against such arbitrage efforts — are resources diverted from consumer-welfare-enhancing investments in new and innovative services.

Finally, forbearance is in the public interest, *see* 47 U.S.C. § 160(a)(3), (b), for all the reasons set forth above: creation of a single, federal default rate for all traffic would eliminate regulatory arbitrage and promote competitive market conditions. The Commission has already recognized the "public interest in creating a uniform compensation regime." *Core Forbearance Order* ¶ 21.

II. The Commission Can Reasonably Select $0.0007 Per Minute as the Single, Default Rate for All Traffic Routed Over the PSTN

As shown above, the Commission has ample authority to establish a single, national default rate for all traffic routed over the PSTN. In the exercise of that authority, the Commission can reasonably select $0.0007 per minute as that single, default rate. Indeed, $0.0007 per minute is *already* the default rate for a substantial portion of the traffic that wireline and wireless carriers exchange today. Verizon Wireless's experience is that most intraMTA traffic is now exchanged pursuant to the rate caps, and Verizon's experience is that a substantial portion of wireline intraexchange traffic is being terminated at rates at or below the rate caps.

[31] Order, *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, 19 FCC Rcd 20179 (2004) ("*Core Forbearance Order*") (subsequent history omitted).

Extending that rate to the remaining traffic routed over the PSTN provides the most straightforward way for the Commission to reach a single, unified intercarrier compensation regime.

When the Commission adopted the $0.0007 per minute rate, it drew upon then-"recently negotiated interconnection agreements," which showed a "downward trend in intercarrier compensation rates." *ISP Remand Order* ¶ 85. The $0.0007 per minute rate is consistent with Verizon's more recent experience in negotiating agreements with competing LECs. In the past several years, Verizon has entered into negotiated, and publicly filed, interconnection agreements with a number of carriers, including (pre-merger) AT&T and Level 3, that set a rate at *or below* $0.0007 per minute for terminating local traffic and for ISP-bound traffic, showing a continued "trend toward substantially lower [intercarrier compensation] rates." *Id.* ¶ 83.

As the Commission has recognized, evidence that "carriers have agreed to rates" for intercarrier compensation — through voluntary, arms-length negotiations — constitutes substantial evidence that rates are just and reasonable. *Id.* ¶ 85. Indeed, the Commission has recognized generally that rates set through market-based negotiations are just and reasonable rates. *See, e.g., ACS Forbearance Order*[32] ¶ 39 & ¶ 40 n.136 (finding that "commercially negotiated rates" provide "just and reasonable prices"); *Triennial Review Order*[33] ¶ 664 (finding that "arms-length agreements . . . to provide [an] element at [a] rate" "demonstrate[s]" that the

[32] Memorandum Opinion and Order, *Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, 22 FCC Rcd 1958 (2007) ("*ACS Forbearance Order*"), *petitions for review dismissed*, *Covad Communications Group, Inc. v. FCC*, Nos. 07-70898 *et al.* (9th Cir. June 14, 2007).

[33] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978 (2003) ("*Triennial Review Order*"), *aff'd in pertinent part*, *USTA v. FCC*, 359 F.3d 554 (D.C. Cir.), *cert. denied*, 543 U.S. 925 (2004).

rate is "just and reasonable"). Courts have likewise held that, in competitive markets, the Commission may "conclude that market forces generally will keep prices at a reasonable level." *Illinois Public Telecomms. Ass'n v. FCC*, 117 F.3d 555, 562 (D.C. Cir. 1997); *see also Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) (holding, in an analogous context, that an agency "may rely upon market-based prices . . . to assure a 'just and reasonable' result"). The Supreme Court, moreover, has recently reaffirmed that the *Mobile-Sierra* doctrine — initially developed under the Federal Power Act and Natural Gas Act, but also applicable under the Communications Act[34] — requires an agency to "presume that the rate set out in a freely negotiated . . . contract meets the 'just and reasonable' requirement imposed by law." *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733, 2737 (2008).

In addition, applying the $0.0007 per minute rate to all traffic on the PSTN would make the existing arbitrage efforts either impossible or unprofitable. *See ISP Remand Order* ¶ 83 (finding that the $0.0007 rate will "limit[] regulatory arbitrage"). With a single rate applying to all traffic, service providers would no longer have reason to disguise traffic — such as by stripping off calling number information or through circuitous routing arrangements — because such efforts would not change the applicable rate. In addition, arbitrage opportunities that depend upon high, one-way volumes of traffic — such as traffic pumping and serving ISPs exclusively — become uneconomical when the per minute rate for such calls is $0.0007 or less. For example, to generate $1 million in revenues in a month at a rate of $0.0007 per minute, a company would need more than 1.4 *billion* minutes of calls — or more than 33,000 lines filled with calls 24 hours a day, every day, for a full month. In comparison, at one of the highest

[34] *See, e.g., Western Union Telegraph Co. v. FCC*, 815 F.2d 1495, 1501 (D.C. Cir. 1987).

intrastate access charge rates that exists today — $0.125 per minute — a company seeking to take advantage of arbitrage opportunities could generate $1 million in a month with only 8 million minutes of calls — or about 185 lines filled 24 hours a day, each day of the month.

At the same time, Verizon's proposal provides alternative mechanisms for companies to recover a portion of the revenues they previously received through access charges. Those access charges, historically, had been set at a level designed to subsidize other services; to the extent that access charges continue to do so today, the alternative mechanisms that Verizon has proposed provide for an alternative, and more predictable, predictable revenue stream. Specifically, the Commission should establish a universal service "Replacement Mechanism" and, at the same time, should bring equity to the retail rates that consumers pay for voice services throughout the nation. Providers would be able to draw from the Replacement Mechanism to offset some of the revenue reduction from the switch to the single, default rate of $0.0007 per minute. But recovery from the Replacement Mechanism would be limited by companies' ability to recover from their customers what residential end users in today's communications environment can reasonably be expected to pay on a monthly basis for telecommunications service. By creating incentives for companies to look to their own end users, the Commission would both limit the size of the universal service fund and ensure that any new funding does not result in the disparate treatment of consumers. Moreover, it would force carriers to compete "on the basis of the quality and efficiency of the services they provide" their customers, rather than "their ability to shift costs to other carriers" or successfully exploit arbitrage opportunities. *Id.* ¶ 71.

For these reasons, there is no merit to NTCA's claims that the Takings Clause in the Fifth Amendment to the Constitution prevents the Commission from establishing a $0.0007 per minute rate for all traffic that is routed on the PSTN.[35] NTCA makes no argument that such a default rate "is so unjust as to be confiscatory, that is, . . . threatening [the] financial integrity" of any particular carrier.[36] Moreover, whether a rate is confiscatory cannot be determined by reference to the rate in isolation, but rather must be judged in light of the "total effect of the rate order."[37] Therefore, the mere fact that a federal default rate would reduce NTCA's members' intercarrier compensation rates for some kinds of traffic does not come close to making out a takings claim, without (at a minimum) reference to those members' overall sources of revenue — which include recovery from the Replacement Mechanism and the ability to raise subscriber line charges. Indeed, the Commission has previously rejected takings claims where, as here, carriers have revenues source other than intercarrier payments.[38]

And Verizon's plan specifically addresses those carriers, particularly in rural areas, that depend on access charges to maintain their infrastructure. Yet, today, those carriers' access revenues face very real threats on several fronts. First, access revenues are shrinking as carriers of all sizes continue to lose access minutes, year over year, as consumers continue to flock to wireless and IP-based services. Second, existing arbitrage schemes and fraud prevent carriers from realizing the full access revenue on their remaining access minutes. In the face of these pressures on access revenues, Verizon's proposed Replacement Mechanism will provide carriers

[35] *See NTCA Aug. 22 Ex Parte* at 2, 3-4.

[36] *Verizon Communications, Inc. v FCC*, 535 U.S. 467, 524 (2002) (internal quotation marks omitted); *see FPC v. Texaco Inc.*, 417 U.S. 380, 391-92 (1974) ("All that is protected against, in a constitutional sense, is that rates fixed by the Commission be higher than a confiscatory level.").

[37] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

[38] *See* Memorandum Opinion and Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, *Rules and Policies Regarding Calling Number Identification Service – Caller ID*, 10 FCC Rcd 11700, ¶ 42 (1995) ("Because the IXCs are recovering the costs associated with their deployment of SS7 through rates for long distance services . . . . [t]he CPN rule does not effect an unlawful taking of carrier property.").

with a more predictable and reliable source of revenue support. Under Verizon's proposal, federal rate-of-return and price-cap carriers would recover the full amount their access reduction due to the change to the single, national default rate, after imputing additional revenues available through rate rebalancing. In five years, the Commission would open a rulemaking to determine whether and how to transition from the Replacement Mechanism to a new model, such as a fund to support broadband capital or facilities.

CONCLUSION

For the foregoing reasons, the Commission has ample authority to adopt a single, default rate of $0.0007 per minute for all traffic routed on the PSTN.