PAETEC

Intercarrier Compensation Reform

Company Overview

PAETEC is a Leading Communications Solutions Provider

- Headquartered in Rochester, NY
- NASDAQ: PAET
- Approximately 4,000 Employees
- Revenue: $1.6 Billion (1)
- Adjusted EBITDA: $240 Million (2)
- Free Cash Flow: Over $100 million (3)
- Free Cash Flow Positive Since 2002

Notes:

(1) Projected Pro Forma 2008.

(2) Projected Pro Forma 2008.

(3) Projected Pro Forma 2008; Free Cash Flow defined as Adj. EBITDA – Capex.

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Company Overview *(Continued)*

- Serving 82 of the Top 100 MSAs
- 4.4 Million Access Lines Equivalents
- 162,000 T-1s Installed
- 77 Voice Switches
- 39 Soft Switches
- 17,000 Owned Fiber Route Miles
- 24 x 7 x 365 Network Operations Centers:
  Cedar Rapids, IA; Charlotte, NC; Rochester, NY
- 2 Class A Data Centers
- ISO 9001:2000 Certified

Data Center - Conshohocken, PA

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ICC Reform Principles

PAETEC supports:

- A single, integrated intercarrier compensation regime for all types of traffic and carriers, irrespective of technology, distance and jurisdictional category, that should be implemented over a reasonable transition period.
- Applicable to all providers of telecommunication services (ILECs, CLECs, IXCs, cable, ISPs, VoIP, wireless, others) that exchange traffic over the PSTN.
- Economically sound regime that will be resistant to gaming; no differences based on classification of carriers or customers, location of customers, or location of end-users; technologically neutral; based on economic cost; simple and inexpensive to administer.

ICC Reform Principles

- **The intercarrier compensation system should be non-discriminatory, technology-neutral and administratively simple.**
- **The intercarrier compensation system should remove incentives to engage in uneconomic arbitrage.**
    - Eliminating uneconomic arbitrage does require rate uniformity amongst all carriers
- **An intercarrier compensation regime should be cost based.**

ICC Reform – What Reform Should Not Do

- No modification of interconnection architecture rules:
  - Single POI per LATA
  - Carrier's retain responsibility on their side of POI
  - Verizon "Missoula Lite" places unnecessary burden on competitors with no advantage to consumers
  - Increased industry costs for no substantive reason
  - Abrogates competitors' cost-based interconnection rights under Act

Cost Based Rates

- FCC cap on CLEC interstate access rates has forced most CLECs to price interstate access services well below their economic cost, which now benefits their largest competitors, the RBOC and their affiliated IXCs.
  - CLECs do not have the scale and scope of RBOCs, and it is wrong to put CLECs in the same category for rate setting purposes
  - While PAETEC is perhaps the most efficient provider in terms of costs, any of the proposed ending termination rates are still well below PAETEC's forward looking costs.
- If rate uniformity is deemed essential to ICC reform, then peg CLECs to more comparable mid-sized ILECs, not the RBOCs.

Reasonable Transition Period Is Key

- **The transition period should provide all market participants a reasonable opportunity to adjust their business plans**
  - All LECs will have to adjust to declining access revenues. However, any plan must recognize that some LECs require a longer glide path to adjust their business plans due to the nature of their existing customer base.
  - Virtually all facilities-based CLECs primarily provide services to business customers under contractual arrangements.
    - PAETEC has service agreements with virtually 100% of its existing business customers.
    - The average PAETEC service agreement is 4.2 years.
  - CLECs cannot offset declining access revenue by shifting cost recovery to end users as easily as large ILECs.
    - ILECs typically realize a much greater percentage of their revenues under month to month arrangements than CLECs. This enables ILECs to adjust their effective rates much faster.
    - Some CLECs do not have SLCs

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Reasonable Transition Period Is Key

- **Any ICC reform affecting interstate termination rates should have a transition plan should of no shorter than five years.**
- **If the FCC attempts to extend ICC reform to encompass intrastate access, then a seven year transition period is reasonable given the delta between existing intrastate rates and any uniform termination rate adopted by the FCC.**
- **A better approach is to strongly encourage State commissions to develop companion policies based on the facts on the ground in their state.**
  - Many are already taking such steps today.

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Mandatory Bill-and-Keep Is Not A Viable or Fair Solution

- **Neither viable or fair**
  - Does not satisfy Section 201 or Section 252
    - Section 252 requires the “mutual recovery of costs” between carriers terminating each other’s traffic. When traffic is out of balance, bill-and-keep does not provide for the mutual recovery of costs.
    - Bill-and-keep also fails the standard of section 252 because it would not provide recovery of the “additional costs of terminating such calls.”
    - A terminating compensation rate of zero under bill-and-keep arrangements, without the consent of the terminating carrier, is not “just and reasonable,” and therefore would violate Section 201.

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Mandatory Bill-and-Keep Is Not A Viable or Fair Solution

- If a zero rate of compensation can satisfy a "just and reasonable" standard for terminating access service, then the same could be said of rates for transit or unbundled network elements.
  - If a LEC is not entitled to compensation from another carrier for providing transport and termination, there is no reason to expect that it is entitled to compensation when it is providing other services or functions of its network.
  - The 96 Act recognizes that carriers may wish to adopt bill-and-keep arrangements by identifying "arrangements that waive mutual recovery" of costs as acceptable alternatives to reciprocal compensation.
    - The word "waive," however, requires some affirmative, voluntary, and intentional action on the part of a carrier.
    - The FCC cannot order a carrier to "waive" its rights under the Act.

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Phantom Traffic

- Call signaling rules should apply to all traffic that originates on or terminates to the PSTN.
- Carriers should pass all call detail information, without alteration.
  - Technical exceptions may be appropriate but must be enumerated in the rules.
- Rules should not dictate what number carrier may signal in the Charge Number field for certain types of customers.
  - Traffic classification disputes should not be determined by call signaling requirements.
  - End users have control over signaling via customer-owned CPE
- The FCC should not define any call routing practices as *per se* unreasonable but should use existing complaint procedures to evaluate specific practices on a case-by-case basis.

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Phantom Traffic

- ILECs do not have the right to demand interconnection negotiations or direct interconnection with CLECs.
- Clarifying that LECs may tariff 251(b)(5) terminating compensation the state approved reciprocal compensation rate that applies in the absence of negotiated agreements will provide carriers incentives to negotiate agreements to fulfill their 251(b)(5) compensation duties.

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Traffic Stimulation

- **The unrebutted Ankum/Morrison declaration shows that high traffic volumes do not indicate a CLEC is over earning.**
- **If necessary, narrowly target rules to the alleged harm: high rural access rates AND exorbitant traffic volumes.**
- **Limits on "revenue sharing" should not be a part of any solution.**
  - Revenue sharing is a common business practice that the FCC has upheld numerous times against various challenges, e.g., payphone commissions, 8YY.
  - Revenue sharing is a legitimate means of incenting customers to switch service providers and gain market share.
  - Net payor tests are unworkable and inherently favor large, integrated BOCs.

Universal Service Reform

- **Universal service reform should be based solely on universal service considerations.**
- **PAETEC does not support a USF recovery mechanism.**
  - ALL LECs will lose revenue if terminating charges are lowered, current USF mechanism available only to ETCs.
  - Only competitively neutral way for carriers to recover such lost revenue is in retail prices.
  - No evidence that access revenue continues to support universal service by price cap carriers.
- **PAETEC opposes a hybrid USF contribution mechanism.**
  - Adopting numbers plus revenue/connections hybrid methodology would make reporting and assessment more difficult and cumbersome.
  - During the transition period to numbers, the FCC should set up an expedited process, subject to notice and comment, to clarify implementation questions raised by contributors.

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personalizing business communications

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