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Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

October 13, 2008

Re: Notice of *Ex Parte* Presentation (WC Docket 05-337; CC Docket 96-45; WC Docket 06-122; CC Docket 01-92)

Dear Ms. Dortch,

Free Press submits this *ex parte* filing to update the record on particular issues in the Commission's open dockets on Developing a Unified Intercarrier Compensation Regime (CC Docket No. 01-92), and related Universal Service Fund (USF) dockets (WC Docket No. 05-337 and CC Docket No. 96-45). In this *ex parte* we outline a comprehensive policy framework that will reform the systems of intercarrier compensation (ICC) and universal service in a manner that is fair, efficient, reasonable, and consumer friendly.

We understand that the Commission is currently working with speed to draft a comprehensive ICC and USF reform Order -- action that the Commission indicated this past May would be expeditiously forthcoming.[1] All of the ICC reform plans recently filed by industry groups have one element in common: consumers end up footing the bill for changes in the terminating access payment system.[2] While we discuss this aspect in detail below, it seems that whatever changes are made, millions of consumers will see increases in their monthly telephone bills, especially rural consumers.

These increases may be inevitable—though the burden rests on the agency to demonstrate how changes to ICC policy leave consumers better off than the status quo. Having made this case, the Commission must treat this need to reform ICC as an opportunity to modernize the outdated universal service system. The Commission must ensure that as a result of the changes to ICC, that the short-term "pain" of reform will be followed by long-term consumer benefits in the form of universal affordable broadband. The Commission's job is not done if it merely brings down access charges, increases Subscriber Line Charges (SLCs) and allows rural carriers to draw more money from the USF in order to be "made whole."

The Commission must declare that broadband is *the* supported service, and that the transition to a broadband-only USF is coming. The Commission must make clear that any changes made now to ICC, SLCs and the USF are just temporary steps on the path of this transition.

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[1] "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", FCC News Release, May 2nd 2008.

[2] See for example proposals filed by AT&T (July 17, 2008); Verizon (September 12, 2008); OPASTCO (September 16, 2008); Independent Telephone & Telecommunications Alliance (September 19, 2008).

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Introduction

When Congress enacted the Telecommunications Act of 1996 ("The Act"), the Internet was merely an emerging technology – one that relied on the infrastructure of the Public Switched Telephone Network (PSTN) to reach most end-users. At the time, Congress saw change on the horizon, and tried to build flexibility into the law. But even Congress couldn't anticipate just how rapid the pace of technological development would be, and how quickly this development would render some of the legal constructs of the Act artificial and outdated. For example, as Congress held hearings on the Act during 1995, the first consumer technology for engaging in a computer-to-computer voice "call" was brought to market. But one month after the Act's passage technological progress was already poking holes in the regulatory framework. The same company that had brought IP-to-IP voice technology to the market a year earlier unveiled an IP-to-PSTN product, opening one of the many doors to arbitrage that would emerge over the next decade.[3]

There appears to be consensus in the record that the regulatory framework put in place by the Commission to implement the interconnection and universal service provisions of the Act is being overtaken by innovation, progress, and arbitrage. On the issue of intercarrier compensation (ICC) reform, the debate centers on the appropriate policies to bring the rules back in line with reality. And on this, there is little agreement among interested parties on the details. The fact that there's consensus that something needs to be done, but nothing has been done in the seven years since this proceeding was initiated,[4] illustrates the need for bold Commission action to cut through the self-interested rhetoric of varied industry proposals.

As consumer advocates and advocates of universal affordable broadband, we support regulatory policies that encourage competition, efficiency and modernization, for these are attributes that lead to the best outcomes for consumers. As we have discussed in recent comments, the current Universal Service Fund (USF) is in dire need of modernization in order to fulfill the central goals of the Act.[5] We also agree that the current system of Intercarrier Compensation (ICC) is inefficient and completely divorced from reality. It makes little sense for the same function (e.g. call termination) to have wildly different prices based solely on a call's geographic origin or the legacy classification of the originating or terminating carrier.

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[3] Israeli-based VocalTec released "Internet Phone" in the spring of 1995. It transmitted highly compressed low-quality voice signals over IP, requiring only 28.8 kilobit per second (kbps) modems. At the CT Expo in Los Angles in March of 1996 they demonstrated the first ever IP-to-PSTN gateway.

[4] *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[5] *See e.g.*, Reply Comments of Consumers Union, Consumer Federation of America, Free Press and New America Foundation, *In the Matter of High-Cost Universal Service Support and the Federal-State Joint Board on Universal Service*, Notices of Proposed Rulemakings (*USF NPRMs*), WC Docket No. 05-337, CC Docket No. 96-45, FCC 08-4 (*Identical Support Rule NPRM*), FCC 08-5 (*Reverse Auctions NPRM*), and FCC 08-22 (*Federal-State Joint Board NPRM*)(submitted June 2, 2008) (*June 2008 Reply Comments*).

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But consumers are not responsible for the creation of this mess of inefficiency and regulatory arbitrage, and they deserve to be treated fairly in the solution process. In fact, the cost-based, explicit pricing that the act promised consumers was never delivered. In most segments of today's residential telecom market nothing is at priced at economic cost simply because the type of competition the act envisioned was not allowed to grow strong enough to allow market forces to take over. Because of the lack of meaningful competition and the lack of proper cost-based pricing and cost allocation, consumers have been overpaying for telecommunications services for years.

We are not suggesting that consumers be completely shielded from any "pains" of transition – only that their burden not be unduly high. The basic principle of fairness requires that those companies that have profited tremendously from the current inefficiencies, and those companies who will profit tremendously from the "solution", also bear their fair share of the burden of this transition. If the burden is not shared, we do not see how the proposed changes could leave consumers in a better position than retaining the status quo.

ICC Reform is Needed. But the Commission Should Protect Consumers And Establish a Regulatory Policy For the Broadband World

The Need For ICC Reform

The regulatory arbitrage created by the current ICC system is well documented and is reason enough alone for the Commission to enact reforms.[6] But technological progress is also forcing the Commission's hand. Consumers are increasingly relying on mobile wireless and Voice-over-IP (VoIP) as their sole means of voice communications, and both largely bypass the legacy access regime. And other IP-based technologies like email, Instant Messaging (IM), and mirco-blogging offer consumers avenues for communication that bypass voice altogether. This move away from a reliance on the Plain-Old-Telephone-Service (POTS) functionality of the PSTN has a direct consequence on the old business models that relied on per-minute access revenues. Access is in decline, thus access revenues are in decline.

Declining access minutes have a direct impact on the bottom line of those who receive these revenues – Local Exchange Carriers (LECs). It has an even larger impact on rural LECs (RLECs), who have been largely shielded from some of the past efforts to bring down access charges, and who claim to rely on above-cost access charges as an implicit universal service subsidy.

While rural carriers may be right to dispute the appropriateness of a single $0.0007 per minute access rate, they may just be putting off the inevitable. In an all-IP world the rate for access will be zero, because the entire concept of access minutes will cease to exist. In the post-1984 POTS

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[6] *See, e.g.*, Patrick DeGraba, *Bill and Keep at the Central Office as the Efficient Interconnection Regime*, Federal Communications Commission, OPP Working Paper No. 33, Dec. 2000.

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world of regulated local exchanges with terminating access monopolies and interexchange long-distance carriers (IXCs), access charges were necessary. This is because the calling-party-pays principle was reasonable and fair, and customers had specific financial relationships with the IXCs that carried voice calls from a calling- to a called-party. But in the IP-world customers pay for access to an interconnected, always-on network. This is a system in which the old POTS calling-party-pays principle has less relevance than considerations of network effects. In the IP-world customers pay a last-mile Internet Service Provider (ISP) for access to the network, and that ISP makes financial arrangements with transport carriers to send and receive data onto and from the "network of networks." There is no long-distance provider to pay access, because an unknown number of providers in the middle of an end-to-end IP transaction may carry the data of that communication. End-users simply have no financial relationships with any carrier other than their own last-mile ISP.

This changing market structure does not mean that a pure bill-and-keep interconnection system should replace the old per-minute access regime. Nor does it mean that regulators should cease to be concerned about terminating access monopoly power. It simply means that the old regulatory and pricing models are no longer workable.

The changing market structure also does not mean we need to abandon our commitment to universal service. If above-cost access revenues were a means of implicit universal service support in the POTS world, we should ensure that carriers are supported in an efficient manner to the extent needed to ensure that "advanced telecommunications and information services [are] provided in all regions of the Nation."[7]

Indeed, as rural carriers move away from the POTS world to the IP world, they replace an incoming revenue stream (access minutes) with an outgoing cost (transport). For many of these carriers, the transport market they face is essentially an unregulated originating access monopoly. Thus we urge the Commission to place just as much emphasis on correcting this market failure as they do on reforming the failed access market. Getting both right is critically important. This approach also sends clear signals to the market that agency rules will be fair and equitable across the marketplace for all parties.

ICC Policy Changes: Terminating Access Rates

We agree that the current system of artificial distinctions that result in wildly different terminating access rates based not on cost, but on regulatory labels, is in need of reform. We also agree that the declining cost of technology likely means that many of today's terminating rates are probably well above cost and should be priced significantly lower. And as stated above, the concept of a unified rate of zero is likely inevitable on the path to the all IP-world.

But the Commission is bound by the framework established in the Act. Specifically, Section 251 of the Act puts much of the authority on where to land on rates in the hands of state authorities.

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[7] 47 U.S.C. §254 (b) (2).

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Also, perhaps most importantly, the Act directs that interconnection pricing standards be cost-based. Section 252's emphasis is on the actual "additional costs of terminating" calls ("determined without reference to a rate-of-return or other rate-based proceeding"). We feel that this is a sensible standard, one that should be carefully considered in any attempt to mandate a single rate for all carriers.

It may be the case that from a pure cost perspective, that a small rural carrier serving a sparse area might require a higher terminating access rate than a large urban ILEC. In such a situation, a "multi-track" approach like that of the Missoula plan may be appropriate (though the rates for the tracks in that plan may themselves have little relationship to actual costs). In this light it may be appropriate to distinguish the cost of termination from the cost of transport, as the former does not have as large a variation among carriers as the latter. In the end, if the Commission chooses to deviate from cost-based principles and establish a single uniform rate, it should justify how this particular deviation is in the public interest (i.e. the benefits of a uniform rate may outweigh the costs, but this should be demonstrated and not merely assumed).

First and foremost we urge the Commission to adhere to the Act's cost-based principles. If the Commission does mandate a single unifying rate, or provides a narrow framework for individual states to bring down access charges to a low unified rate, we hope that such action adheres to cost-based principles, and does not land on a rate that is either below cost (thus unfairly increasing the burden on rural ratepayers and potentially increasing the demands on the USF) or above cost (thus perpetuating the current system's inefficiencies and providing an incentive to maintain reliance on the dying POTS access market).

This latter point illustrates why *sensible* cost-based access charge reform is needed. At a time when our national leaders are calling for the deployment of universal affordable broadband, rural carriers are reliant on explicit support that excludes broadband as a supported service, and partially reliant on implicit subsidies from telephone access charges. Thus, if the Commission simply implements an access revenue offset system of increased SLCs and higher payments from the USF, it leaves in place the strong incentive for rural carriers to delay the full transition to the broadband world. Thus we strongly recommend that the changes to the access payment system be one part of a comprehensive plan to transition the Universal Service Fund to a broadband support system for rural America.

ICC Policy Changes: SLC Increases and Access Charge Recovery from the USF

Most of the USF reform plans before the Commission seek to achieve revenue neutrality for LECs. That is, they all assume that carriers are entitled to recover the revenues "lost" from access charge reductions. The reality however, is that access minutes are declining. Yet none of these plans are structured so that the access "recovery" (from increased SLCs and higher USF draws) declines as access minutes decline.

But this assumption of entitlement that has framed ICC reform as a zero-sum-game has no basis in the law. While it is assumed that the current above cost access rates are an implicit but

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necessary subsidy to achieve universal service, no one in this proceeding has offered evidence that the reduction of these rates require a dollar-for-dollar offset in order to ensure that rural rates and services are reasonably comparable to urban rates and services.[8] Contrary to the claims of NTCA, FCC-mandated reductions in access rates do not constitute a *per se* regulatory confiscation, because to make that case a carrier would have to "open its books" and show all costs and revenues (both regulated and unregulated).

The 500 pound gorilla in the room here is the unregulated revenue streams of rate-of-return and price cap Local Exchange Carriers serving in high-cost areas. Many of these carriers have deployed broadband and television services, allowing them to earn substantial unregulated revenues. Yet these revenues are not considered in the discussions of "need" for the purposes of universal service. Indeed, there are many instances where a USF-supported rural LEC provides a triple-play of voice, video and data in direct competition with a non-USF supported cable company. This raises the question of the extent of USF support actually needed in order for a rural LEC to meet its Carrier of Last Resort (COLR) obligations.

These concerns notwithstanding, we expect the Commission will move forward with some level of SLC increases as a part of its ICC reform package. If SLC changes are made in the context of a national benchmark, then these potential increases are reasonable from a fairness standpoint. That is to say – we accept that a national benchmark rate would reveal many lines with below-benchmark prices that could reasonably bear an increase. The Act requires rates for services in rural and high-cost areas to be "reasonably comparable to rates charged for similar services in urban areas."[9] We recognize that comparability runs both ways, and that it is unreasonable for rural rates to be substantially lower than urban rates.

But in today's era of technological progress and declining costs, we should expect SLCs to be *decreasing* in order to avoid over-recovery of costs on access lines nationwide. A national benchmark approach that leads to an average of $2 or less in per month increases to the Federal SLC could arguably be characterized as fair, but not cost-based. Thus we urge the Commission to pay close attention to the level of over-recovery these changes in SLC bring. Also, claims that competition will prevent carriers from increasing SLCs to the new capped level should be met with skepticism. There is absolutely no evidence that the current level of competition has prevented carriers from pricing SLCs at the current cap.

While we'd like the Commission to consider a carrier's entire revenue stream before allowing increased USF support to offset lost access revenues, we recognize that this is politically problematic. Thus, we expect that there will be some increased burden on the Fund as a result of ICC reform. We suggest that such changes be a temporary (perhaps partial) revenue offset during the transition of the USF to a broadband-only support fund. We also suggest that these

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[8] We question whether price-cap carriers should (as a result of this ICC reform effort) be allowed to "offset" their "lost" revenues, as these carriers already operate under incentive-based regulation. Indeed, we question the continued need for these carriers to receive support from the IAS and ICLS funds.

[9] 47 U.S.C. §254 (b) (3).

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access revenue replacements be confined to rate-of-return carriers only. In order to avoid the creation of a new path-dependent sub-USF funding program, we suggest that these new access revenue replacement funds be distributed through the ICLS program.

Since it is apparent that there is no stomach among policymakers for seeing the size of the Fund increase, the Commission may face a challenge in finding a source for the estimated $600 million to $1.8 billion in annual revenue needed for this new access revenue offset fund.[10] One possible source would be money diverted from payments to CETC wireless carriers who no longer qualify for support as a result of the elimination of the identical support rule (see further discussion below).

As a part of an overall transition of the USF to broadband, all access replacement components of the USF should sunset no more than seven years from the adoption of the forthcoming ICC/USF reform Order. These funds (which currently amount to $2.2 billion per year, and could total as much as $3.5 billion per year after ICC reform) should be transitioned to supporting broadband infrastructure deployment in unserved areas.

Comprehensive USF Reform that Leads to
Universal Affordable Broadband Must Accompany ICC Reform

Depending on where the terminating access rate is set, there will be a wealth transfer from rural ratepayers and USF contributors to the current payers of access charges (primarily long-distance companies) in the amount of $2 to $4 billion dollars per year. This transfer may be needed in the name of preventing regulatory arbitrage, but consumers are not responsible for the creation of this problem and their expected shouldering of the burden of the solution should be accompanied by a meaningful change in policy that will lead to universal affordable broadband.

We have previously outlined our discussion proposal to transition the current POTS-based USF to a broadband-only fund.[11] Our approach is based on the principles of universal service established in the Act, and is a rational, practical and fair approach to universal service in the 21st century communications marketplace. It has elements that will likely seem unworkable to big LECs, rural LECs, CETCs, and even other consumer advocates. This is simply a consequence of the need to move past self-interested politics and towards the common goal of a modernized and efficient fund. But our discussion proposal is by no means the "right" approach or the only approach. We attempted to use data to provide a detailed transition proposal that arrived at universal broadband in a timely fashion using the current level of USF funding. We welcome other such proposals.

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[10] *See* Ex Parte Communication of AT&T, September 12, 2008. In this letter, AT&T estimated that at a level of zero cents per minute and a national benchmark of $25, the increase in the fund would be $1.8 billion annually. If the benchmark were $27 and the rate set to reciprocal compensation, the increase in the fund would be $500 million annually.

[11] *Supra* note 5.

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At the base of our proposal is the central premise that broadband technology is an infrastructure that can support many essential applications, including telephony. If this premise is accepted, then it makes absolutely no sense to follow the approach outlined by the Joint Board and others who simply "bolt" a minimal level of broadband service obligations and support on top of the current system of POTS USF support. That approach merely bloats the fund by ignoring technological realities in the name of maintaining as much of the status quo as possible. This may be necessary in order to foster consensus among the various industry factions, but it is not good public policy.

This is where the FCC can play a leadership role and move this proceeding beyond the current impasse. The Commission should rule that broadband is a supported service, and declare that the USF system will fully transition to a broadband-only fund within no more than ten years. The Commission should initiate a proceeding that solicits detailed transition plans from all interested parties ("Transition NPRM"). These transition plans should be bound by a set of standards and goals for the new broadband USF. For example, the Commission should provide guidelines for adequate broadband capability and define terms such as "reasonably comparable rates and services" and "unserved" and "underserved" areas.

We recommend that in the ICC Reform Order and USF Transition NPRM, the Commission set a high standard for broadband in order to ensure the deployment of future-proof networks whose capabilities are in line with those defined by Congress in Section 706 of the 1996 Act.

We also recommend that the Commission conclude that all future USF support will be based on actual need that considers all costs and revenues. This approach is critical to ensuring that every dollar of USF is put to its most efficient and highest-need use.

As stated above, the starting point of the ICC Reform Order and Transition NPRM should be the ruling that broadband is a supported service. This conclusion not only impacts the structure of the High-Cost fund, but also the Low-Income program. Thus the Transition NPRM must seek detailed input on how to incorporate broadband into the Lifeline and Linkup programs. In fact, as we discuss below, this aspect could be dealt with in an expedited fashion and be resolved far in advance of the High-Cost Fund transition issues.

The Transition NPRM should also solicit input on the impact of the uncompetitive transport market on rural ISPs, and conclude that fair, non-discriminatory cost-based pricing in this market segment is of critical importance for the purposes of achieving universal service.

We recognize that a full transition to a broadband-only USF is complicated by state Carrier of Last Resort obligations. Thus, as a part of the Transition NPRM, the Commission should ask the Federal-State Joint Board to review the continued usefulness of COLR obligations as currently defined, and offer recommendations on how to transition these obligations to be appropriate for an IP-world and a broadband-only FUSF.

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The path to a full transition must be set in place in the upcoming ICC reform order, and be one that must be followed through on by the Commission seated next January. Since consumers will be feeling a substantial amount of immediate "pain" resulting from ICC reform, it is critical that the long-term reward for this pain be more than just a mere promise of universal affordable broadband. This is why the Transition NPRM must be specific and firm in its tentative conclusions. The timeline should be firm. No more than four months for submission of transition plans, and then two additional months for further public comment. A six month window for the move to a final transition order would then follow. Thus, by December 2009 the transition would be fully underway.

Short-Term Issues for the Next 12 Months

We agree with the Commission's tentative conclusions that the identical support rule should be eliminated, and that wireless carriers should not be eligible for support from the IAS, ICLS and LSS programs. As stated above, we expect that the Commission will use some or all of the estimated billion-plus dollars in funds freed up by this move to plug the "hole" created by ICC reform. We again stress that the Commission should avoid guaranteeing revenue neutrality and establish a cost-based standard for need of access revenue offset funds.

If it can keep the amount of the freed-up funds earmarked for access offsets to a minimum, we would urge the Commission to immediately redirect these funds for use in the newly structured broadband Low-Income program (see above), and/or for use in a pilot broadband infrastructure deployment fund for unserved areas. This pilot fund could be established in the ICC Reform Order and Transition NPRM based in part on the parameters established by the Joint Board in its recent recommendations. It is critical to begin funding infrastructure deployment in unserved areas, and the pilot fund would provide a valuable opportunity to learn how to best structure the transition to a broadband-only USF.

In the process of transitioning to a broadband-only support fund, the Commission should solicit guidance from Congress on the issue of voice mobility, which may serve a unique purpose separate from that envisioned by the Act (as written). In the interim, the Commission should cease to fund any mobile carrier in an area where there is service available from one or more unsubsidized mobile voice provider(s).

If the Commission decides to modify the current system of USF contributions, it should take special care to avoid stunting the growth in consumer adoption of broadband by placing a USF assessment on residential broadband connections. As we discussed in our June 2008 Reply Comments, consumers -- especially those in rural areas -- are far more sensitive to increases in the price of broadband than they are to increases in the price of telephone service (wireline or wireless). Assessing broadband for the purposes of funding a broadband-USF program could actually lead to a net loss of rural (and even urban) subscribers, a result that is in direct conflict with the central purposes of Section 254 of the Act.

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Finally, we strongly recommend that in declaring that broadband is a supported service, that the Commission affirm that all recipients of USF that offer Internet services must adhere to the Commission's *Internet Policy Statement*.

Conclusion

Policymaking by *ex parte* is far from ideal, but we recognize that the current hastened schedule presents the opportunity to move issues that have only festered as they lay dormant. Reforming Intercarrier Compensation is something that we as consumer advocates agree is necessary. But we are steadfast in our belief that reforms should be based upon principles contained in the Act -- principles of cost-based compensation, comparability of rates and services, modernization, and promoting consumer welfare and the public interest.

No one is disputing the fact that access charge reform will shift billions of dollars from one segment of the industry to another -- billions that will likely come out of the pockets of consumers. This transfer of wealth may at this point be inevitable, but the Commission has the duty to ensure that the shifting of the burden is conducted in as fair a manner as possible. In the long-term, the burden that ICC reform places on consumers must be offset with commensurate or greater benefits. The Commission must take action to modernize the USF in order to bring rural America the ultimate payoff: universal affordable broadband.

Respectfully submitted,

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