STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

October 28, 2008

VIA ELECTRONIC FILING

The Honorable Kevin Martin, Chairman
The Honorable Deborah Taylor Tate, Commissioner
The Honorable Michael Copps, Commissioner
The Honorable Jonathan Adelstein, Commissioner
The Honorable Robert McDowell, Commissioner
Federal Communications Commission
Ms. Marlene Dortch, Secretary
445 12th Street, SW
Washington, DC 20554

Re: ***Ex Parte*** **communication from the California Public Utilities Commission,** ***In the Matter of Developing a Unified Intercarrier Compensation Regime,*** **CC Docket No. 01-92, In the Matter of High Cost Universal Service Support and Federal-State Joint Board on Universal Service, WC Docket No. 05-337 and CC Docket 96-45;** ***IP Enabled Services,*** **WC Docket No. 04-36.**

Dear Chairman Martin, Commissioners Tate, Copps, Adelstein and McDowell, Ms. Dortch:

We are submitting these comments on what we understand, based on press reports, to be some of the key proposals in the Recommended Decision on Intercarrier Compensation circulated on October 14, 2008, and tentatively set for consideration at the Federal Communications Commission's (Commission) November 4, 2008, public meeting.

Given the circumstances of not having seen the item, we can only provide a rough "guess-estimate" of the impact of the Recommended Decision on California subscribers.

We are sympathetic to the suggestion of other parties, including the National Association of Regulatory Utility Commissioners (NARUC), that more time for review, including possibly a Commission request for public comment on some of the proposals, would result in a clearer view of the impact of the proposals. We realize, however, that most of the issues addressed in the Recommend Decision and many of its actual proposals, have been vetted publically over a period of several years. Indeed a few of these issues -- such as solutions to "Phantom Traffic" – should be addressed as soon as possible. We do however respectfully request the Commission consider California's views prior to adoption of any reform to the intercarrier compensation scheme and the universal service program.

I. UNIVERSAL SERVICE FUND (USF) REFORM PROPOSALS

A. Change USF Contribution Methodology to a Numbering Methodology

It is our understanding that the Recommended Decision proposes to change the federal universal service fund contribution methodology from a revenue–based percentage surcharge to a numbering methodology. At the outset, the methodology would be a $1 dollar contribution per phone number for residential lines – including wireless. However, businesses would continue to contribute to the federal USF based on a percentage of interstate revenues pending a Notice of Public Rulemaking on how to bill businesses using a numbering methodology.

California supports a connection or unit-based contribution methodology in the form of working telephone numbers (numbers that are not unassigned). Such a methodology would be more cost-effective to administer than the current revenue-based methodology, and provide less opportunity for arbitrage. A working telephone number-based collection methodology would be especially helpful now that carriers are offering bundles as it is difficult to determine the breakdown of revenues from "all–in–one" packages. California recommends that all working numbers have a USF fee imposed upon them**.** Any lag time in conforming business contributions to this methodology should be as short as possible.

Furthermore, if the Commission adopts such a federal contribution methodology, states should be permitted to adopt a similar numbering methodology for collection of state universal service funds.

B. Permanent Cap on Federal High Cost Support Funding

The Recommended Decision is said to propose a cap on the USF High Cost Fund as of December 2008. Loop support for all price-capped LECs would be frozen at study area level.

California does not support a permanent across-the-board cap on federal high cost support because it does not appropriately target High Cost Support. Capping all five major high cost support mechanisms across the board may not be the appropriate way to structure a cap, and further comment on alternatives is warranted.

A more effective long-term solution would be to more appropriately target High Cost Support to truly high cost areas. In particular, the current methodologies for High Cost Loop, Local Switching, and Interstate Common Line Support are not well targeted and provide support to companies whose costs are simply above average, not truly high. The concept of a benchmark contemplated in the Recommended Decision is a positive step, but more needs to be done to ensure support only goes to truly high cost areas. A temporary cap on high cost while the Commission determines the appropriate methodologies to better target high cost support may be appropriate, but a permanent cap will simply fix the mistakes in the current system in place and is not a positive step toward a permanent long-term solution.

C. Broadband Deployment Requirement

The Recommended Decision is reported to require that all rural and mid-size carrier high cost recipients commit to deploy broadband (between 768kbps and 1.5Mbps) within the unserved areas of their study areas within 5 years (20% each year). If a carrier cannot make this commitment upfront, it would lose its guaranteed high cost support for the study area and such area would be auctioned off under a reverse auction process.

California supports the goal of universal deployment of broadband services, and urges a more focused national program to this end. However, we are concerned about the impact to our rural rate of return (ROR) carriers of this proposed requirement. A requirement of full deployment of broadband would be very capital intensive for our carriers who serve the unserved and underserved areas in California. While California is fortunate to have good access to broadband in most parts of the state, our unserved areas tend to be very rural and very geographically challenging. We have “middle mile” problems getting Internet access to remote communities. It is unclear if the carriers would be fully reimbursed from federal high cost support funds for the high cost of such a roll-out in these difficult to serve areas. In combination with the proposed reductions in access charges (see below) which will severely impact the rural ROR and mid-sized carriers, the financial blow to our carriers of last resort may be very serious for many of these companies. The current financial crisis is also a factor. At a minimum, the proposals, as a whole, will inappropriately shift the burden of ensuring service to subscribers to the states, while at the same time reducing the tools available to the states. This proposal should not result in a federal unfunded mandate leaving the states scrambling to make the carriers whole. We cannot fully analyze – let alone support -- this proposal without a great deal more information to discern likely impacts on our state’s carriers.

II. INTERCARRIER COMPENSATION REFORM

A. Seven to Ten Year Transition To Unified Terminating Rate .0007 Or Lower and Recovery of Lost Revenues

It is our understanding that the Recommended Decision also proposes to reduce all terminating access charges to between $0 (bill and keep) and $.0007 per minute over a ten-year transition, unifying all terminating rates for all local, toll, VoIP, CMRS and ISP. bound traffic. In Stage 1 of the proposal – a two-year period – all carriers would have to reduce their intrastate switched access charges to the level of their interstate switched access rates.

In Stage 2 of the proposal, all access rates would go to reciprocal compensation rates over a five to eight year period (unclear), resulting in a unified default terminating access rate for all terminating traffic. In this stage, the states would set interim default reciprocal compensation rates using an additional (incremental) cost methodology put together by former FCC Chief Economist and Wharton Prof. Gerald R. Faulhaber.

Carriers would be permitted to recover some of the lost revenue from these reductions by increasing residential and single-line business Subscriber Line Charges by $1.50 /month and multi-line business EUCLs by $2.00/month.

Rural rate-of-return carriers may not be made whole automatically by a federal recovery mechanism for any lost revenue not replaced by end user SLC/EUCL increases or rate increases. It is unclear from what we know of the plan, although some parties are reporting that rural rate-of-return carriers may be made whole through increases in the interstate common line surcharge, but only if they demonstrate that they need a subsidy to have a “reasonable opportunity” to make a reasonable return.

However it is our understanding that interstate price cap carriers would not have an automatic recovery mechanism available and if they wanted further subsidy after raising SLCs and rates, these companies would have to make a showing of need based on both regulated and non-regulated costs/revenues for their entire business.

California supports a transition to a unified terminating rate. However, the proposed transition plan as reported in the press causes us concern. The plan favors the large carriers, but will greatly impact rural carriers and their subscribers, as well as some mid-size companies. The end default terminating rate of 0.0007 per minute of use is far below the current rates of California’s rural carriers. Rough estimates of the possible impact of the plan in California show a total loss of almost $60 million in intrastate access revenues for California incumbent companies at the end of two-year Stage 1. At the end of Stage 2, assuming all the incumbent companies are charging 0.0007 rate for terminating access, the loss of interstate and intrastate access revenues would be close to $160 million for just California’s incumbent local exchange companies. Assuming the incumbent carriers all increase their SLCs/EUCLs up to the new caps, the small rural rate of return carriers would still have a loss deficit of an estimated $32 million, Rates in many of our rural areas would have to be increased substantially to make up the difference.

We believe an approach that uses different transition tracks for carriers based on economic differences, similar to the three track approach in the Missoula Plan, is a better approach. The Commission must take into account the high costs and lack of competition in the study areas of many rural rate-of-return carriers. Federal law requires that rural rates be reasonably comparable to urban rates. Unless the federal government is able to provide full recovery for net losses due to required access charge reductions, the end user customers in the rural high cost areas will see unreasonable rate increases, or alternately, the carriers will have to reduce capital investment and/or cut labor costs, impacting broadband rollout in rural areas and customer service. Given the desire to encourage broadband deployment and the state of national economy, we are concerned about the adverse impacts of such an access charge reduction plan.

California does not support the “revenue neutrality” concept. We believe that recovery of lost revenue should be a net recovery that takes into account such factors as the natural decline in revenue due to competition from other communications technologies such as wireless, VOIP, and CLECs. Interstate access revenue has been declining over the years, and any recovery must take into account the downward trend in ILEC wireline minutes of use and declining line counts. Any federal recovery mechanism should reflect these declining revenue trends.

California also urges the Commission to require interexchange carriers to pass through to their subscribers any savings from the reductions in terminating access charges. If these carriers are not required to pass-through these savings, then the amount saved should at least be deducted from any loss revenue figures.

B. Allocation of SLC/EUCL Revenues

Recovery of lost revenues (both intrastate and interstate) through SLCs/EUCLs presents a problem because such revenue is booked to interstate revenues only. To ensure fairness, an appropriate allocation of these monies should be made to intrastate revenues – otherwise California’s universal service programs would be adversely impacted.

C. Phantom Traffic Solution

The Recommended Decision proposes a solution to the Phantom Traffic problem. The proposed solution would require carriers to begin labeling/identifying all terminating traffic and would make the owner of a tandem switch responsible for collecting and paying for traffic that passes through the tandem switch.

California urges swift action on the phantom traffic issue. The Commission should adopt a Phantom Traffic solution at its November 4, 2008.

We appreciate your consideration of California's views as you deliberate on these important matters.

Sincerely,

/s/ MICHAEL R. PEEVEY

Michael R. Peevey
President

/s/ RACHELLE B. CHONG

Rachelle B. Chong
Commissioner