Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Lifeline and Link Up	)	WC Docket No. 03-109
	)	
Universal Service Contribution Methodology	)	WC Docket No. 06-122
	)	
Numbering Resource Optimization	)	CC Docket No. 99-200
	)	
Implementation of the Local Competition	)	
Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
Developing a Unified Intercarrier Compensation	)	
Regime	)	CC Docket No. 01-92
	)	
Intercarrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68
	)	
IP-Enabled Services	)	WC Docket No. 04-36

COMMENTS OF VERIZON AND VERIZON WIRELESS

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COMMENTS OF VERIZON[1] AND VERIZON WIRELESS

The first priority for the Commission in this proceeding is to get the rules right for the services of the future: broadband and IP-based services. Consumers and businesses are eagerly embracing innovative packages of data and any-distance voice services like Voice over Internet Protocol ("VoIP"). As the industry moves away from circuit switched telephony and towards an infrastructure based on broadband, wireless, and IP, the Commission should make sure that the regulatory structure keeps up with the

[1] In addition to Verizon Wireless, the Verizon companies participating in this filing ("Verizon") are the regulated, wholly owned subsidiaries of Verizon Communications Inc.

marketplace by providing certainty for consumers, providers, and investors in these new technologies. Above all, the Commission should ensure that outdated rules designed for old-world services in a different era do not hinder the development of these services.

The Commission has an opportunity to accomplish this goal this year. Verizon strongly supports adopting sensible intercarrier compensation and universal service reform, and has urged the Commission to act on these issues comprehensively. The *Further Notice of Proposed Rulemaking* asks for comments on two draft orders that tackle this complex task.[2] In prior filings in these proceedings, Verizon has provided its views on these comprehensive issues. For present purposes, therefore, we will focus on several key areas the Commission must address now to encourage the growth of broadband and advanced IP-enabled services and to position the federal Universal Service Fund ("USF") for the future.

First, the Commission should make clear once and for all that all VoIP and IP-enabled services are subject to the Commission's exclusive jurisdiction – *not* to more than 50 different sets of economic regulation. VoIP and IP-enabled services are multi-faceted, any-distance services that cannot practicably be separated into intrastate and interstate parts. These services are being deployed nationally, using national systems and platforms. A single federal regime will produce efficiencies that would be lost if these services were subjected to more than 50 different sets of rules. Indeed, states today

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[2] *High-Cost Universal Service Support; Universal Service Contribution Methodology; Developing a Unified Intercarrier Compensation Regime, et al.*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, ("*2008 FNPRM*"); also Chairman's Draft Proposal ("*Appendix A*") and Alternative Proposal ("*Appendix C*"); in addition to these two comprehensive proposals, the 2008 FNPRM seeks comment on a Narrow Universal Service Reform Proposal ("*Appendix B*"); WC Docket Nos. 05-337, 03-109, 06-122, 04-36; CC Docket Nos. 96-45, 99-200, 96-98, 01-92, 99-68; FCC 08-262 (Nov. 5, 2008).

generally are not regulating these advanced services – and 13 states plus the District of Columbia have adopted legislation precluding their state commissions from regulating VoIP.

Second, the Commission should decide the appropriate regulatory classification of VoIP and finally resolve a question that has long been the source of numerous disputes within the industry, diverting attention and resources from providing these advanced services to consumers. If the Commission decides to classify VoIP as an information service, it should also make clear that these services are not subject to the Commission's outdated *Computer Inquiry* rules. The Commission has already found that these rules should not apply to broadband services generally – including services offered by both cable providers and wireline companies. The Commission should confirm the same conclusion with respect to all VoIP and IP-enabled services. In addition, the Commission should make clear that its information services classification does not alter carriers' existing abilities to interconnect under the Act or to use the state arbitration process as provided in the Act to resolve interconnection disputes.

Third, the Commission should eliminate the "identical support" rule, which provides high cost universal service support to competitive eligible telecommunications carriers ("ETCs") based on the incumbent's costs. In its place, the Commission should adopt a phase-down of all USF support to competitive ETCs over a five-year period, beginning with a 20 percent reduction in funding the year following the effective date of the order. If the Commission decides to adopt some form of the cost showing provided for in the proposed order, competitive ETCs could be allowed to retain support in a particular area by demonstrating their own high costs in that area. The phase-down of existing support to competitive ETCs is critical to create a level playing field among all competing providers in light of the conditions recently adopted in the Sprint-Clearwire and Verizon Wireless-Alltel transfer of control proceedings. At the same time the Commission authorizes a phase-down of all competitive ETC funding, the Commission should initiate a rulemaking to examine whether and how some of the savings could be devoted to a new infrastructure fund for one-time grants, not ongoing subsidies, to encourage network build-out of both wireless and broadband facilities into unserved areas.

Fourth, the Commission should adopt a workable universal service contribution system based on telephone numbers. The current interstate revenue-based contribution system is not sustainable. Traditional long distance revenues, which once paid for the majority of the fund, are evaporating, and it is becoming increasingly difficult for providers to make distinctions between interstate and intrastate services in today's bundled environment, and between telecommunications and information services as converged products replace traditional services.

Finally, as we have addressed at length previously, if the Commission is prepared to address comprehensive intercarrier compensation reform, it should ensure that reform provides a reasonably prompt and simultaneous transition to a uniform default terminating rate for all carriers and all traffic. Although the two draft orders are a substantial step toward rationalizing the current terminating compensation regime, they must be modified, as described further below, if they are to provide meaningful and timely relief from the market distortions caused by today's disparate intercarrier compensation rates. The Commission also could and should respond to carrier complaints about "phantom traffic" by adopting either the USTelecom phantom traffic proposal or the draft orders' phantom traffic solution. And the Commission should act immediately to put an end to the traffic pumping arbitrage schemes that have plagued the industry in recent years.

I. The Commission Should Act Immediately To Encourage The Deployment Of Broadband And IP-Enabled Services.

A. The Commission Should Reaffirm That VoIP And IP-Enabled Services Are Interstate And Subject To Its Exclusive Jurisdiction.

The most important task before the Commission is to reaffirm explicitly that all VoIP and IP-enabled services, regardless of provider or technology, are interstate services[3] subject to the Commission's exclusive jurisdiction – *not* to more than 50 different sets of economic regulation. This critical step will provide certainty to the marketplace and allow providers to deploy these services efficiently, using nationwide systems and processes.

As a threshold matter, therefore, the Commission should both confirm that all VoIP and IP-enabled services are interstate in nature, and set out its rationale supporting that decision. And it should do so regardless of the decision it reaches on the classification of VoIP, which is addressed below. If, for example, the Commission adopts the draft decision to classify VoIP and IP-enabled services as information services, it should explain that these services (1) offer integrated capabilities and features

[3] In the *Vonage Order*, the Commission found that Vonage's Digital Voice service is jurisdictionally mixed but practically inseverable, and therefore subject to the Commission's exclusive jurisdiction. *Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, Memorandum Opinion and Order, 19 FCC Rcd 22404, ¶¶ 18, 31-32 (2004) ("*Vonage Order*"), *petitions for review denied*, *Minnesota Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir. 2007). For ease of writing, we refer to such services as "interstate."

that operate without regard to geography and cannot practically be broken apart into their component pieces, such as any-distance calling and on-line account and voicemail management; and (2) provide customers the inherent capability to use multiple service features that access different websites or IP addresses during the same communication session and to perform different types of communications simultaneously. If, on the other hand, the Commission were instead to conclude that some or all of these services are telecommunications services, it likewise should explain that these services are inherently integrated, any distance, geography-agnostic services that cannot readily, and should not have to be, segregated into their component parts solely for regulatory purposes.

1. The *Vonage Order* Confirms The Commission's Exclusive Authority Over VoIP And IP-Based Services.

The Commission has already found that VoIP services are subject to its exclusive federal jurisdiction,[4] and it should explicitly reaffirm (as the draft orders do[5]) that that finding applies to *all* VoIP and IP-enabled services, regardless of provider or technology. Specifically, in the *Vonage Order*, the Commission made five key findings that are relevant here. *First*, the Commission recognized that Vonage "has no means of directly or indirectly identifying the geographic location" of its customers when they place or receive calls. *Vonage Order* ¶ 23; *see also id.* ¶¶ 26-27. That is a function of two different features of Vonage's service that each independently results in that geographic indeterminacy and, therefore, independently warrants preemption. One is that the service "is fully portable," so that "customers may use the service anywhere in the world where

[4] *Vonage Order* ¶¶ 15-37.

[5] *Appendix A* ¶¶ 208-211; *Appendix C* ¶¶ 203-206.

they can find a broadband connection." *Id.* ¶ 5. The other is that, "in marked contrast to traditional circuit-switched telephony," Vonage assigns telephone numbers to customers that are "not necessarily tied to" the user's usual or "home" location. *Id.* ¶ 9. Because a customer may have a telephone number associated with one state, but actually be located in a different state, permitting states to regulate calls that appear intrastate based on the telephone numbers involved means that states would, in fact, impermissibly regulate interstate communications. The Commission found that this fact, by itself, is sufficient to justify preemption of state regulation. *See id.* ¶ 26.

Second, the Commission relied on the integrated nature of Vonage's service, which is integrated in two respects. First, it offers consumers any-distance calling without distinguishing "local" and "long-distance" minutes of use. *Id.* ¶ 27. Second, Vonage's service offers a "suite of integrated capabilities and features" with that any-distance calling, including the "multidirectional voice functionality" and "online account and voicemail management" that allows customers to access their accounts from an Internet web page to configure service features, play voicemails back through a computer, or receive or forward them in e-mails with the actual message attached as a sound file. *Id.* ¶ 7. "These functionalities in all their combinations," the Commission stressed, "form an integrated communications service designed to overcome geography, not track it." *Id.* ¶ 25. As a result, the Commission found that its end-to-end analysis does not readily apply to communications sessions using integrated IP-based services. Because those services have the "inherent capability . . . to enable subscribers to utilize multiple service features that access different websites or IP addresses during the same communication session and to perform different types of communications simultaneously," they cannot be meaningfully sliced up into individual components and the end points cannot all be separately tracked or recorded. *Id.*

Therefore, "[e]ven . . . if" information "identifying the geographic location of a [Vonage] subscriber" were "reliably obtainable," that is far from the only information that would matter under the end-to-end analysis; one would also need to know the location of the myriad databases, servers, and websites utilized during the communication session. *Id.* ¶ 23. As the Commission found, these integrated services and functionalities render Vonage's service "too multifaceted for simple identification of the user's location to indicate jurisdiction." *Id.*

Third, the Commission recognized that, whether or not it is technologically possible to carve out a purely intrastate service is not the standard for determining jurisdiction. Instead, the question is whether a "practical means to separate the service" exists and whether compelling providers to do so would conflict with federal policy. *Id.*; *see also id.* ¶ 37. The Commission found that such separation is not practical, because it would require the substantial redesign of Vonage's service at significant cost to try to disaggregate and track all of the individual components of Vonage's service. Vonage would have to change multiple aspects of its service operations to track, record, and process geographic location information, including "modifications to systems that track and identify subscribers' communications activity and facilitate billing; the development of new rate and service structures; and sales and marketing efforts." *Id.* ¶ 29. As the Commission recognized, it has "declined to require" providers to bear the costs of such separation in the past where the provider has "no service-driven reason" to do so, because such a requirement "would impose substantial costs . . . for the sole purpose" of enabling state regulation. *Id.*

Fourth, mandating that Vonage undertake such changes and bear such costs would conflict with the Commission's policies in favor of promoting innovative services in general, and the development and deployment of broadband in particular. As the Commission put it, VoIP "facilitates additional consumer choice, 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. *Id.* ¶ 37. Forcing VoIP providers to incur the substantial costs and operational complexity of separating their integrated, any-distance services would substantially reduce the benefits of IP-based technologies and would discourage the development and deployment of innovative services by increasing the cost and risk of rolling out those new services, contrary to the Commission's policies.

Fifth, the Commission recognized that its conclusions were not limited to Vonage's service, but applied to other VoIP services as well. As the Commission explained, the "integrated capabilities and features" characteristic of VoIP "are not unique to [Vonage's service], but are inherent features of most, if not all, IP-based services." *Id.* ¶ 25 n.93. Therefore, the Commission's conclusions about Vonage's service apply as well to "other types of IP-enabled services having basic characteristics similar to" that service – a class the FCC expressly recognized included "cable companies" and other "facilities-based providers" – and would "preclude state regulation to the same extent." *Id.*; *see also id*. ¶ 32. And the Commission emphasized that a key characteristic warranting the same conclusion is a service offering with "a suite of integrated capabilities" that enables consumers to "originate and receive voice communications and access other features and capabilities." *Id.* ¶ 32. Tellingly absent from that list of "basic characteristics" is any suggestion that a service must be portable in order for state regulation to be preempted. Because the Commission did not have any services other than Vonage's before it, the Commission did not rule directly on those facilities-based services, but made clear that, as to any such services, it "would preempt state regulation" to the same extent. *Id.*[6]

2. The Eighth Circuit Confirmed The Preemptive Scope Of The *Vonage Order*.

In affirming the *Vonage Order*, the Eighth Circuit rejected a variety of challenges and addressed each of the key factual findings discussed above:

First, with regard to the geographic indeterminacy of VoIP services, the Eighth Circuit upheld both of the bases underlying the Commission's finding. The court recognized "the practical difficulties of determining the geographic location of nomadic VoIP phone calls." *Minnesota Pub. Utils. Comm'n*, 483 F.3d at 579. And it also recognized "the practical difficulties" of using the assigned telephone number for "accurately determining the geographic location of VoIP customers when they place a phone call," as the number may not match "the physical location at which they would first utilize [the] VoIP service." *Id.*

Second, the court rejected challenges to the Commission's determinations about the integrated nature of VoIP service. The court specifically upheld the Commission's finding that "communications over the Internet [are] very different from traditional

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[6] *See also id.* ¶ 1 (stating that it is "highly unlikely that the Commission would fail to preempt state regulation of [facilities-based] services to the same extent").

landline-to-landline telephone calls because of the multiple service features which might come into play during a VoIP call, *i.e.*, 'access[ing] different websites or IP addresses during the same communication and [ ] perform[ing] different types of communications simultaneously, none of which the provider has a means to separately track or record [by geographic location].'" *Id.* at 578 (quoting *Vonage Order* ¶ 25) (alterations in original).

Third, the court upheld the Commission's finding that state regulation of VoIP should be preempted even assuming it were technically possible to carve out a separate, intrastate service, and that providers of any-distance VoIP services should not be required to disaggregate their services into separate interstate and intrastate pieces. The court found that it was "proper" for the Commission to consider "the economic burden" that would be imposed on VoIP providers if they were required "to separate the[ir] service into . . . interstate and intrastate components." *Id.* And the court recognized 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." *Id.*

Fourth, the court upheld the Commission's determination that state regulation of VoIP would conflict with federal policies favoring the introduction of innovative services and the deployment and development of broadband. Indeed, the court had no difficulty affirming the Commission's finding that "state regulation of VoIP service would interfere with valid federal rules or policies," expressly finding that "[c]ompetition and deregulation are valid federal interests the FCC may protect through preemption of state regulation." *Id.* at 580. The court specifically upheld the Commission's determinations that state regulation may "*harm consumers by impeding the development of vigorous competition*" and that it "conflicts with the federal policy of nonregulation" of broadband and information services, which permits those services to "flourish in an environment of free give-and-take of the market place." *Id.* (internal quotation marks omitted and emphasis in original).

Fifth, the court recognized that the Commission, in the *Vonage Order*, found that, "if faced with the precise issue" of state attempts to regulate facilities-based VoIP services, the Commission "would preempt" state regulation of such "fixed VoIP services." *Id.* at 582. But, because the Commission was not faced with that precise issue in the *Vonage Order,* the court found no need to reach claims that states can regulate the so-called "intrastate portion" of facilities-based VoIP services. *See id.* at 583.

3. The *Vonage Order* Is Consistent With Numerous Other Commission Decisions Asserting Exclusive Jurisdiction Over Interstate Services.

The Commission has in numerous cases preempted state regulation where it was not possible to enforce the regulation without negating federal policy, even where it might have been *technically* possible to distinguish between intrastate and interstate communications.

One closely analogous example is the Commission's preemption of state regulation of information services under its *Computer Inquiry* orders. The Ninth Circuit upheld the Commission's preemption 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 v. FCC*, 39 F.3d 919, 932 (9th Cir. 1994). As a result, the "BOCs would be forced to comply with the state's more stringent requirements, or choose not to offer certain enhanced services," thereby "essentially negating the FCC's goal of allowing integrated provision" of those services. *Id.* at 932-933. The Ninth Circuit, moreover, had recognized that the Commission's preemption authority does not require the actual impossibility of separating out an intrastate service. The court explained that, even if it were technically "possible to comply with both the states' and the FCC's regulations," preemption was appropriate based on the Commission's finding that it is "highly unlikely, due to practical and economic considerations," that consumer reaction would enable such jurisdictional division to succeed. *Id.* at 933. Thus, in that case, state regulation presented the same conflict with the same federal policies – increasing costs and burdens on providers, thereby deterring the development and deployment of innovative services the FCC wanted to encourage – as is presented by allowing states to regulate VoIP services.

Another closely analogous example is the Commission's preemption of state regulation of customer premises equipment ("CPE"), where the Commission similarly found that federal policies of promoting competition and innovation – the same policies at issue here – supported the preemption of state regulation that would frustrate those objectives. The D.C. Circuit upheld the Commission's finding that consumers' preference for "using CPE jointly for interstate and intrastate communication" would "unavoidably affect . . . federal policy adversely." *Computer and Commc'ns. Indus. Ass'n v. FCC*, 693 F.2d 198, 216 (D.C. Cir. 1982). As the court explained, because "consumers use the same CPE in both interstate and intrastate communications and generally wish to purchase both interstate and intrastate transmission services," if "charges for intrastate transmission service" included CPE charges, that would "certainly influence the consumer's choice of CPE" in conflict with federal policy. *Id.* at 215.

The D.C. Circuit also affirmed the Commission's assertion of jurisdiction over the marketing of CPE, concluding that even though certain marketing requirements would "surely 'affect' charges for" and regulate "intrastate communications services," preemption was appropriate. *Illinois Bell Tel. Co. v. FCC*, 883 F.2d 104, 112-113 (D.C. Cir. 1989). The court specifically recognized that the Commission would have authority to preempt the marketing of a purely intrastate service "if – as would appear here – it was typically sold in a package with interstate services. Marketing realities might themselves create inseparability." *Id.* at 113 n.7. Of course, the VoIP services at issue here are marketed as a single package of any-distance communications, and any attempt to separate out intrastate communications for purposes of regulating them would fly in the face of these "marketing realities."[7]

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,

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[7] In defending its preemption of state regulation of BellSouth's voice mail service, the Commission explained that "absolute impossibility" is not the standard for justifying federal preemption, but instead that it was sufficient to preempt state regulation where "marketing realities effectively preclude[] the separate offering of interstate" and intrastate voice mail services." *See also* Brief of the FCC and the United States, *Georgia Pub. Serv. Comm'n v. FCC*, No. 92-8257, at 29-34 (11th Cir. filed Feb. 8, 1993). The Eleventh Circuit agreed, finding the Commission's defense of its preemption decision so obviously correct that it affirmed the Commission's order in a one-word, unpublished ruling. *See Georgia Pub. Serv. Comm'n v. FCC,* 5 F.3d 1499 (Table) (11th Cir. Sept. 22, 1993).

despite the fact that the CPE in question was used 97-98 percent of the time for intrastate calls.[8]

All of these holdings apply here. Forcing facilities-based VoIP providers artificially to break apart their any-distance, integrated offerings solely to provide states with an intrastate communications component they can regulate would require VoIP providers to change multiple aspects of their service operations to comply with such a requirement. This includes creation of systems that track and identify the many types of communications activity that the integrated features make possible; modifications to billing systems; the development of new services structures and associated rates; and new sales and marketing efforts for these new, artificial offerings, all of which would be done "just for regulatory purposes." *Vonage Order* ¶ 29.

Imposing even one state's regulation – much less 50 or more different sets of regulations – on facilities-based, any-distance, multi-function VoIP services would thus conflict with federal policies favoring the introduction of innovative services and the deployment of broadband, as set forth in Section 706 of the Act and in Commission decisions informed by that section that federal courts have upheld.[9] The Commission has recognized the "nexus between VoIP services and accomplishing [those policy] goals," finding that VoIP "driv[es] consumer demand for broadband connections, and consequently encourag[es] more broadband investment and deployment." *Vonage Order* ¶ 36. Because facilities-based VoIP providers are also the ones investing in the

[8] *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787, 791 (4th Cir. 1976) (emphasis added); *see also North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036, 1044, 1046 (4th Cir. 1977).

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

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, applying state regulations to those providers would harm consumers by "discourag[ing] the . . . building [of] next generation networks in the first place."[10]

For all these reasons, state attempts to regulate the so-called "intrastate" portion of such VoIP services are precisely the types of "costly and inefficient burdens on interstate communications which are sometimes imposed by state regulation" that the Commission is "free to strike down."[11]

4. This Analysis Is Consistent With The Commission's ISP-Bound Traffic Orders.

Relying on an end-to-end analysis to confirm that all VoIP traffic is subject to the Commission's exclusive jurisdiction is consistent with the Commission's recent order "reaffirm[ing]" its consistent "findings concerning the interstate nature of ISP-bound traffic." *2008 FNPRM* ¶ 21; *see also id.* ¶¶ 2-3 & n.9 (explaining that the Commission reached that same jurisdictional conclusion in 1999 and "affirmed its prior finding" in the *ISP Remand Order*[12] in 2001). Indeed, as the Commission noted, it has "consistently found that ISP-bound traffic" – as well as other "services that offer access to the Internet," such as wireline, cable modem, wireless, and powerline broadband Internet

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

[11] *National Ass'n of Regulatory Utils. Comm'rs v. FCC*, 746 F.2d 1492, 1501 (D.C. Cir. 1984).

[12] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*").

access services – are “jurisdictionally interstate.” *2008 FNPRM* ¶ 21 n.69 (citing orders). The D.C. Circuit, moreover, found that there is “no dispute” that the Commission was “justified in relying” on its end-to-end analysis in concluding that ISP-bound traffic is jurisdictionally interstate. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 5 (D.C. Cir. 2000).

But the D.C. Circuit also held that the jurisdictional status of ISP-bound traffic did not necessarily answer the question whether ISP-bound traffic is subject to compensation under Section 251(b)(5). *See id.*; *see also 2008 FNPRM* ¶ 22 (“D.C. Circuit . . . concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under Section 251(b)(5).”). In the context of Section 251(b)(5), the Commission has adopted a functional definition of the statutory term “termination,” defining it as the act of “switching . . . traffic at the terminating carrier’s end office switch . . . and deliver[ing] [that] traffic to the called party’s premises.” 47 C.F.R. § 51.701(d). Therefore, consistent with the D.C. Circuit’s 2000 decision in *Bell Atlantic* and the Commission’s own regulation, the Commission’s finding in its recent order that a CLEC delivering ISP-bound traffic performs the function of termination for purposes of <u>compensation</u> under the unique terms in Section 251(b)(5) and its own rules in no way undermines its oft-repeated holding that the ISP is not an “end point” of the communication for purposes of the Commission’s <u>jurisdiction</u> under Section 201. *See 2008 FNPRM* ¶ 13 & n.47 (finding that a CLEC with an ISP customer “terminates” ISP-bound traffic when it delivers the traffic to its customer pursuant to Section 251(b)(5) and Section 51.701(d)); *2008 FNPRM* ¶ 17 (explaining that the Commission’s “section 251(b)(5) finding . . . does not end [its] legal analysis”).

Moreover, as the Commission found, such an interpretation of Section 251(b)(5) is consistent with Section 251(i), in which Congress expressly provided that "[n]othing in [Section 251] shall be construed to limit or otherwise affect the Commission's authority under section 201." 47 U.S.C. § 251(i); *see also 2008 FNPRM* ¶ 18. Therefore, the word "termination" in Section 251(b)(5) cannot – consistent with Congress's savings clause – be interpreted to remove from the Commission's Section 201 jurisdiction traffic that meets that definition. Instead, as the Commission found, jurisdictionally interstate traffic remains *within* the Commission's Section 201 jurisdiction, even if such traffic satisfies the terms of Section 251(b)(5).

In addition, while the draft orders at issue here recognize[13] – and the Commission in its *2008 FNPRM* held – that Section 201 provides the Commission with authority to "maintain the $.0007 cap and the mirroring rule," *2008 FNPRM* ¶ 29, the draft orders also correctly recognize that is not the only available justification for maintaining those rules. *First*, the draft orders recognize that the Commission retains authority to establish rules to implement the pricing standard in Section 252(d)(2) regardless of the nature of the traffic. *See Appendix A* ¶ 233; *Appendix C* ¶ 228. Indeed, the Commission's authority to adopt rules to implement the pricing standards in the 1996 Act is beyond question.[14]

Here, the rules the Commission adopted in 2001 and maintained in 2008 are unquestionably justified by what the Commission itself has recognized is the unique technical nature of ISP-bound traffic – namely that, once the ISP and its customer lock up what is, in essence, a temporary dedicated connection, virtually all of the communication

[13] *See Appendix* A ¶ 234; *Appendix C* ¶ 229.

[14] *See AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 377-378 (1999).

transmitted over that connection flows from the ISP to the customer – and the arbitrage opportunities that traffic creates. In the context of this technologically unique category of traffic, which "generate[s] extremely high traffic volumes that are entirely one-directional," *ISP Remand Order* ¶ 5, those rules are consistent with the notion reflected both in Section 251(b)(5) and the pricing standard in Section 252(d)(2) that compensation should be "mutual and reciprocal." 47 U.S.C. § 252(d)(2)(A)(i).[15]

Furthermore, the rules the Commission maintained in its recent order are consistent with the "additional costs" language in Section 252(d)(2)(A)(ii) in the context of this unique category of traffic given the ability of "CLECs . . . to recover more of their costs from their ISP customers." *ISP Remand Order* ¶¶ 76, 87. And, because those rules set only a "rate cap" based on rates in "negotiated interconnection agreements," *id.* ¶ 85, those rules (including the mirroring rule) are consistent with the requirement that rates set under Section 252(d)(2) reflect a "reasonable approximation" of the additional costs incurred, without "establish[ing] with particularity th[ose] additional costs." 47 U.S.C. § 252(d)(2)(A)(ii), (d)(2)(B)(ii).

Finally, even aside from the Commission's authority to implement Section 252(d)(2), the Commission could exercise – and can find that, in the unusual

[15] Although the Commission found that the unique technical nature of ISP-bound traffic was not a basis for excluding such traffic from the scope of Section 251(b)(5), *see 2008 FNPRM* ¶ 13 & n.49, the Commission did not dispute that, from a technical standpoint, ISP-bound traffic is unique. Moreover, the Commission found that Section 252(d)(2) "deals with the mechanics of who owes what to whom" and "does not define the scope of traffic to which section 251(b)(5) applies." *Id.* ¶ 12. Therefore, it is consistent with the *2008 FNPRM* for the Commission to rely on the technically unique attributes of ISP-bound traffic in promulgating rules implementing the "mechanics of who owes what to whom."

circumstances here it would have exercised[16] – its forbearance authority under Section 10. Forbearing from Section 251(b)(5) insofar as it applies to ISP-bound traffic would leave compensation arrangements for such jurisdictionally interstate traffic subject to the Commission's Section 201 authority, which is the authority the Commission relied on in the *ISP Remand Order* and in the *2008 FNPRM* for all of the ISP payment rules it adopted in 2001 and maintained in 2008. Findings in the *ISP Remand Order*, moreover, demonstrate that all of the forbearance criteria were satisfied in 2001. First, enforcement of Section 251(b)(5) is not "necessary to ensure" that rates "are just and reasonable," 47 U.S.C. § 160(a)(1)); on the contrary, the record evidence strongly suggested that rates that states had applied to this traffic up to that point (often under color of Section 251(b)(5)) were unjust and unreasonable and had resulted in uneconomic arbitrage. *ISP Remand Order* ¶¶ 5, 70, 87. Second, because requiring payment of reciprocal compensation for ISP-bound traffic results in "a subsidy running from all users of basic telephone service to those end-users who employ dial-up Internet access," *id.* ¶ 87, that deterred companies from offering consumers "viable local telephone competition," *id.* ¶ 21, enforcement of Section 251(b)(5) is not "necessary for the protection of consumers." 47 U.S.C. § 160(a)(2). Finally, the Commission's findings about the anti-competitive effects and regulatory arbitrage from subjecting ISP-bound traffic to reciprocal

[16] By doing so under the unique circumstances here, the Commission would not be forbearing retroactively. That is because the D.C. Circuit in this case has directed the Commission to explain the legal authority it could have relied on in 2001 in lieu of the rationale that the court rejected. Accordingly, the Commission would merely be responding to the court's direction to identify an alternative source of authority for the actions it already has taken. *Cf. Atlantic City Elec. Co. v. FERC*, 329 F.3d 856, 858 (D.C. Cir. 2003) (explaining that, where the court "remand[s] the proceedings for further explanation," but does not vacate, the agency has "authority to provide further explanation on remand, supporting the original result").

compensation, *see, e.g.*, *ISP Remand Order* ¶ 21, demonstrates that forbearance is "consistent with the public interest" and will "promote competitive market conditions." 47 U.S.C. § 160(a)(3), (b).[17] Indeed, the Commission reiterated these findings in the *2008 FNPRM*, and rejected claims that it is required to revisit them, noting that the D.C. Circuit had upheld the Commission's policy justifications. *See 2008 FNPRM* ¶¶ 24-27.

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For all these reasons, the Commission should reaffirm its exclusive jurisdiction over economic regulation for VoIP services. Doing so will promote new entry, facilitate competition and technological innovation, and encourage the deployment of broadband infrastructure.

B. The Commission Should Determine The Classification Of VoIP.

1. The Commission also should resolve the long-running question of the appropriate regulatory classification of VoIP. The draft orders classify VoIP as an information service,[18] and the Commission should adopt that decision with the clarifications discussed below.

In doing so, the Commission also should explain its legal rationale for the classification of VoIP fully in its final order. The Commission previously held that VoIP services that do *not* connect to the PSTN are information services.[19] Here, the draft

[17] *See generally Developing a Unified Intercarrier Compensation Regime, et al.*, Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Dockets 01-92, 96-98, 99-68, at 41-46 (Oct. 2, 2008).

[18] *Appendix A* ¶¶ 209-210; *Appendix C* ¶¶ 204-205

[19] *Petition for Declaratory Ruling that pulver.com's Free World Dialup is Neither Telecommunications Nor a Telecommunications Service*, Memorandum Opinion and Order, 19 FCC Rcd 3307, ¶ 14 n.54 (2004).

orders explain that VoIP services that *do* connect to the PSTN involve a net protocol conversion between end users, and thus also constitute an "enhanced" or "information" services. *Appendix A* ¶ 209; *Appendix C* ¶ 204. The draft orders note that there are certain limited exceptions to the net protocol conversion rule, but correctly find them inapplicable in the context of VoIP, because "IP/PSTN services are not mere changes to the underlying technology used for 'existing' basic services, but are entirely new services with characteristics in many ways distinct from pre-existing telephone services." *Appendix A* ¶ 210; *Appendix C* ¶ 205. The draft orders also note that the presence of a net protocol conversion is not the only basis for classifying a service as an information service. *Appendix A* ¶ 209 n.529; *Appendix C* ¶ 204 n.520. There is abundant support in the record and in the Commission's prior orders explaining that IP-enabled services meet the statutory definition of an information service for other reasons, including the fact that the voice calling capabilities of these services are inherently tightly integrated with a host of other features and functions that themselves are information services. *Vonage Order* ¶ 32. For example, SBC (now AT&T) explained that IP-enabled services allow end users to connect to the Internet (a functionality that the Commission has long deemed an information service), and provide users with the ability to access stored files (such as voicemail or directory information), engage in customized call management and screening, and route communications in a manner customized to the end user's preferences.[20]

Similarly, Comcast explained that VoIP services include "[m]essaging functions [that] can be integrated across platforms – so that voice mail can be accessed via

[20] *IP-Enabled Services*, Comments of SBC Communications Inc., WC Docket No. 04-36, at 34 (May 28, 2004) ("SBC Comments").

computer, text messages can be accessed as if they were voice messages, and video messages can be viewed on a television set or personal computer."[21] According to Comcast, this will enable users to manage the calls they receive in real-time, by the user (*e.g.*, no calls to be accepted from a particular number, or no calls to be delivered during a particular period, or calls from specified numbers to be forwarded to another device). Comcast also described a video "soft client" on a television set or personal computer that would enable video images to be transmitted, stored, retrieved, and displayed on the display device of the called party's choice. This integration of platforms provides users with the capability for "generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information."[22]

Other commenters note that, as the Commission found, VoIP service includes a net protocol conversion. For example, SBC noted that "[m]any IP-enabled services also include a net protocol conversion that allows customers to interface with the PSTN, traditionally a hallmark of information services under the Commission's precedent."[23] Similarly, Vonage explained that its "business *is* protocol conversion. . . . Vonage receives a series of digitized IP packets from its customers. Vonage receives the call in one protocol and converts it to another."[24] According to Vonage, this "content-neutral

[21] *IP-Enabled Services*, Comments of Comcast Corp., WC Docket No. 04-36, at 12-13 (May 28, 2004).

[22] *Id.* (citing 47 U.S.C. § 153(20)).

[23] SBC Comments at 34.

[24] *IP-Enabled Services*, Comments of Vonage Holdings Corp., WC Docket No. 04-36, at 25 (May 28, 2004) (emphasis in original).

protocol processing" falls within the Commission's definition of "enhanced" or "information service."[25]

Determining the appropriate regulatory classification for VoIP will not impair the Commission's ability to address public interest issues as they relate to VoIP services. Indeed, as the draft orders note,[26] the Commission has already addressed universal service,[27] E911, Customer Proprietary Network Information ("CPNI"), the Communications Assistance to Law Enforcement Act ("CALEA"), disability access, and local number portability ("LNP") requirements as they apply to VoIP services. The

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[25] *Id*. at 25-26 (citing *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act, as Amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996)). *See also IP-Enabled Services*, Comments of (pre-merger) AT&T Communications, WC Docket No. 04-36, at 15-16 (May 28, 2004).

[26] *Appendix A* ¶ 208 & n.527.

[27] The Commission has already determined that interconnected VoIP providers must contribute to the federal USF. *See Universal Service Contribution Methodology*, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518, ¶ 35 (2006) ("*VoIP Contribution Order*") (requiring interconnected VoIP providers to contribute to the fund under the Commission's permissive authority pursuant to 47 U.S.C. § 254(d) without deciding whether VoIP is a telecommunications or an information service). Subsequently, the Commission clarified that audio conferencing providers also must contribute to the fund. *See Request for Review by InterCall, Inc. of Decision of Universal Service Administrator*, Order, 23 FCC Rcd 10731 (2008) ("*InterCall Order*"). The Commission should now further clarify in this order whether audio conferencing products that utilize IP, such as those services that include a VoIP-enabled audio conferencing bridge, must contribute to the USF. The *VoIP Contribution Order* did not specifically address IP audio conferencing products, and the *InterCall Order* did not explicitly state that IP audio conferencing services must also contribute to the fund. At the same time the Commission clarifies other regulatory issues related to VoIP services, the industry would benefit from clear guidance as to whether contributions to the USF are required on audio conferencing services that utilize IP technology. The current uncertainty is becoming more problematic as IP audio conferencing products increasingly replace traditional conferencing services, and providers that do contribute on IP audio conferencing products face an unfair competitive disadvantage vis-à-vis those that do not contribute.

Commission has determined that these requirements apply whether VoIP is classified as an information service or a telecommunications service.[28]

2. In deciding that VoIP should be classified as an information service, the Commission should also confirm that these services are not subject to archaic rules designed for a different world, including in particular the Commission's *Computer Inquiry* rules. VoIP services generally are delivered to customers over facilities that provide broadband internet access, sometimes by the broadband provider and sometimes by a competing VoIP provider. These VoIP services may be either an application used in conjunction with an Internet access service or be virtual private network services simply delivered over the same facility as an Internet access service. The Commission already has determined that the physical wireline broadband transmission facilities over which customers obtain access to VoIP are not subject to the *Computer Inquiry* rules when those facilities are used to deliver broadband Internet access services, and it would make no

[28] *See, e.g.*, *IP-Enabled Services*; *E911 Requirements for IP-Enabled Service Providers*, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, ¶ 26 (2005) ("*VoIP 911 Order*"); *VoIP Contribution Order* ¶ 35; *IP-Enabled Services*; *Implementation of Sections 255 and 251(a)(2) of The Communications Act of 1934, as Enacted by The Telecommunications Act of 1996: Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities; et al*., Report and Order, 22 FCC Rcd 11275, ¶ 24 n.99 (2007) ("*VoIP Disability Access Order*"); *Communications Assistance for Law Enforcement Act and Broadband Access and Services*, First Report and Order and Further Notice of Proposed Rulemaking, 20 FCC Rcd 14989, ¶ 8 (2005), *aff'd*, *Am. Council on Educ. v. FCC*, 451 F.3d 226 (D.C. Cir. 2006); *Telephone Number Requirements for IP-Enabled Services Providers, et al.*, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, ¶¶ 30-38 (2007); *Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information, et al.*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 6927, ¶¶ 54-59 (2007).

sense for the Commission now to reimpose on these same facilities the very same regulation when they are used to provide VoIP services.

In the *Broadband Title I Order*, the Commission determined that the *Computer Inquiry* obligations impeded efficient and innovative technological developments, and that eliminating the requirements was warranted, among other reasons, by the growth and development of new competing broadband platforms and the need for parity among them, as well as the public interest in allowing providers the flexibility to respond more rapidly and effectively to new consumer demands.[29] The Commission therefore relieved all wireline broadband providers of the *Computer Inquiry* requirements. The Third Circuit affirmed the Commission's determination, based on its predictive judgment, that continued application of the *Computer Inquiry* rules to wireline broadband providers would harm consumers by "imped[ing] the development and deployment of innovative wireline broadband Internet access technologies and services." *Time Warner Telecom v. FCC*, 507 F.3d 205, 222 (3d. Cir. 2007). The United States Supreme Court similarly affirmed the Commission's decision not to subject cable companies to these rules when they provide cable modem service. *NCTA v. Brand X*, 545 U.S. 967, 996 (2005); s*ee also Earthlink, Inc. v. FCC*, 462 F.3d 1 (D.C. Cir. 2006) (affirming Commission's determination that forbearance from requiring Bell companies to provide unbundled access to fiber network facilities was in the public interest).

In sum, the Commission has already removed the *Computer Inquiry* rules from the facilities used to provide wireline broadband services. At a minimum, therefore, any

[29] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ("*Broadband Title I Order*").

application-based or over-the-top VoIP services, which ride on the connections already freed from regulation, are not themselves subject to these requirements. But the Commission's rationale clearly applies to any VoIP services, regardless of technology or provider. Accordingly, the Commission should ensure there is no ambiguities and provide for a level playing field by confirming that all VoIP services are free from these archaic rules.

3. The Commission also should clarify that its decision on the regulatory classification of VoIP services will not interfere with the existing rights of competitive carriers to interconnect and to use the state arbitration process as provided in the Act. The Commission should state that VoIP providers that operate as a carrier and connect directly with an ILEC as well as to those who use the services of an affiliated or unaffiliated wholesale telecommunications carrier may continue to obtain interconnection as provided in the Act. Likewise, the Commission should clarify that it is not changing carriers' abilities to interconnect to an incumbent carrier's network at "any technically feasible point" as provided in the Act, nor is it altering carriers' ability to use the state arbitration process to resolve interconnection disputes under the Act. 47 U.S.C. §§ 251(c)(2), 252(b)(1).

4. Finally, starting four years ago and continuing to the present day, the Commission has expressly declined to classify VoIP as an information service or a telecommunications service on at least four different occasions.[30] As a result, there has

[30] *See, e.g.*, *Vonage Order* ¶ 14 ("We reach this decision irrespective of the definitional classification of DigitalVoice under the Act, *i.e.*, telecommunications or information service, a determination we do not reach in this Order."); *VoIP 911 Order* ¶ 26 ("This Order, however, in no way prejudges how the Commission might ultimately classify these services."); *VoIP Contribution Order* ¶ 35 ("The Commission has not yet

been significant uncertainty in the industry over how to deal with this issue, and parties have adopted divergent approaches. The Commission should make clear that, to the extent its classification of interconnected VoIP service as an information service impacts intercarrier compensation that is due, any modification to the amount due is prospective only. For prior periods, parties should be allowed to rely on the terms of effective agreements entered into in the face of the Commission's studied silence.

II. Sensible Universal Service Distribution And Contribution Reform Should Proceed.

A. The Commission Should Phase Down All Competitive ETC High Cost USF Funding Over Five Years And Initiate A Rulemaking To Examine Broadband And Wireless Infrastructure Funding.

There is widespread agreement that the Commission should eliminate the "identical support rule," which provides high cost support to competitive ETCs based on the incumbent's costs. 47 C.F.R. § 54.307. The most reasonable alternative to equal support for competitive ETCs is to phase down all such support over a five-year period.[31] This is similar to the approach taken in *Appendix C*.[32] *Appendix C* ¶¶ 51-52. This

classified interconnected VoIP services as 'telecommunications services' or 'information services' under the definitions of the Act. Again here, we do not classify these services."); *VoIP Disability Access Order* ¶ 24 n.99 ("We will address the regulatory classification of IP-enabled services, including VoIP services, in a separate rulemaking proceeding and we make no findings here regarding the appropriate regulatory classification of interconnected VoIP services.").

[31] *See, e.g.*, Letter from Paul Garnett, CTIA, to Marlene Dortch, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, 06-122 (Oct. 27, 2008) (proposing a phase-down of competitive ETC funding over five years).

[32] Another common theme in all three of the reform proposals is also an overall cap on the high cost fund. *Appendix A* ¶ 14; *Appendix B* ¶ 14; *Appendix C* ¶ 14. Such a cap is appropriate. Consumers ultimately pay for the fund through charges on their bills, and an overall cap would ensure that consumers' funds are used efficiently and wisely. Indeed, this is why the Joint Board itself proposed an overall high cost cap. *See High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, Recommended Decision, 22 FCC Rcd 20477, ¶ 26 (2007). Under the Act, the

approach is much simpler and more workable than allowing competitive ETCs to "receive support based on their own costs as compared to the relevant support benchmarks" as proposed in *Appendix A*. *Appendix A* ¶ 51. Extending a cost-based approach to competitive ETCs, which primarily are wireless carriers, will not make the system more rational, more efficient, or more effective; in fact, the opposite is true. The Commission and the industry would incur significant expense and burden in trying to create and administer such a system, without providing any tangible benefits to consumers. If the Commission decides to retain some form of an option for wireless carriers to submit their own, actual costs, such as the draft orders propose, competitive ETCs could be allowed to retain support in an individual study area where they can demonstrate that their per-line costs meet or exceed an appropriate threshold in that particular area.[33]

The phase-down of existing support to competitive ETCs also is critical to ensure a level playing field among all competing providers in light of the conditions recently adopted in the Sprint-Clearwire and Verizon Wireless-Alltel transfer of control proceedings. In those proceedings, Verizon Wireless and Sprint must phase-down

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Commission's "broad discretion to provide sufficient universal service funding includes the decision to adopt cost controls to avoid excessive expenditures that will detract from universal service." *Alenco Commc'ns, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000).

[33] *See, e.g., Sprint Nextel Corporation and Clearwire Corporation Applications for Consent to Transfer of Control of Licenses, Leases, and Authorizations*, Memorandum Opinion and Order, WT Docket No. 08-94, FCC 08-259, ¶ 108 (Nov. 7, 2008) ("*Sprint Merger Order*") ("[W]e condition our approval of the transaction on Sprint Nextel's compliance with its voluntary commitment to phase out its pursuit of universal service high cost support over the next five years, unless specifically supported by an actual cost analysis.")

competitive ETC high cost support by 20 percent per year over the next several years.[34] Requiring only two providers to reduce USF funding through merger conditions is not competitively neutral or sustainable in the long run. An industry-wide phase-down would ensure that all competitive ETCs are affected equally and, more important, would free up necessary funding to pay for other, more targeted subsidies – such as one-time construction grants for broadband and wireless infrastructure in unserved areas and any new revenue replacement program resulting from access charge reforms.

The phase-down of competitive ETC support should begin with a 20 percent reduction in funding the year following the effective date of the order. The draft order, however, proposes an immediate flash cut of 20 percent of competitive ETC funding, which would effectively convert a five-year transition for wireless carriers into a four-year transition. *Appendix C* ¶ 52. The Commission, as it did with the interim cap on competitive ETC support earlier this year, should also make clear that the phase-down of funding adopted here "supersedes" the similar Verizon Wireless and Sprint merger conditions.[35] This approach allows the Commission to eliminate the identical support

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[34] *Id.*, ¶¶ 106-108; *see also Applications of Cellco Partnership d/b/a Verizon Wireless and Atlantis Holdings LLC For Consent to Transfer Control of Licenses, Authorizations, and Spectrum Manager and De Facto Transfer Leasing Arrangements and Petition for Declaratory Ruling that the Transaction is Consistent with Section 310(b)(4) of the Communications Act*, Memorandum Opinion and Order and Declaratory Ruling, WT Docket No. 08-95, FCC 08-258, ¶¶ 192-197 (Nov. 10, 2008) ("*Verizon Merger Order*").

[35] *See High Cost Universal Service Support, et al.*, Order, 23 FCC Rcd 8834, ¶ 5 n.21 (2008) (providing that the new interim cap on competitive ETC support replaces similar merger condition caps on high cost support to AT&T and Alltel). Here, the phase-down of Verizon Wireless and Sprint's high cost support happens by the express terms of the merger orders, which adopt the companies' commitments to accept the reductions as conditions of approval. *Verizon Merger Order* ¶ 197; *Sprint Merger Order* ¶ 108. Those commitments expressly provide that any action the Commission takes in this proceeding will supersede the competitive ETC merger conditions. *See* Letter from

rule, to realize savings from funding reductions, and to maintain funding over a transition period for those carriers that currently rely on high cost support to build out their networks into unserved areas.

At the same time the Commission authorizes a phase-down of all competitive ETC funding, the Commission should initiate a rulemaking to examine whether and how it could use some of the savings for a new infrastructure fund for one-time grants, not ongoing subsidies, to encourage network build-out of both wireless and broadband facilities into unserved areas. Targeting funds to areas where broadband or wireless services are not yet available could further the universal service goals of the Act. 47 U.S.C. § 254(b). And by focusing on infrastructure deployment, an infrastructure program could be better targeted to bring broadband into unserved areas than the proposal in the draft orders to condition continued receipt of all high cost support on broadband deployment throughout an ETC's service area. *Appendix A* ¶¶ 19-48; *Appendix C* ¶¶ 19-48. Any new infrastructure fund itself should be time-limited, and grants should be awarded by reverse auction or competitive bidding.[36] Reverse auctions are the best way to determine the amount of subsidy necessary for a provider to deploy broadband or wireless infrastructure into an unserved area. With their auction bids, providers would determine what amount of support would be sufficient to take on the

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John Scott, Verizon Wireless, to Marlene Dortch, FCC, WT Docket No. 08-95 (Nov. 3, 2008) ("In the event that the Commission adopts a different transition mechanism or a successor mechanism to the currently capped equal support rule in a rulemaking of general applicability, however, then that rule of general applicability would apply instead."); *see also* Letter from Lawrence Krevor, Sprint, to Marlene Dortch, FCC, WT Docket No. 08-94 (Nov. 3, 2008) (same).

[36] In addition to Verizon, other commenters have endorsed the use of one-time construction grants to fund broadband and wireless deployment. *See, e.g.,* Ex Parte Letter from Free Press to Marlene Dortch, FCC, CC Docket Nos. 96-45, 01-92; WC Docket Nos. 05-337, 06-122, at 12-13 (Oct. 24, 2008).

obligation to deploy infrastructure. In this way, the amount paid to the auction winner would be as efficient as possible without undermining program objectives.

The complicated details of whether and how such an infrastructure fund could be created and operated in an efficient and effective manner, however, require further comment. If the Commission also determines to authorize a pilot program for broadband support for Lifeline and Link-Up customers, the details of that program should be examined in the same rulemaking. As proposed in the draft orders, the Lifeline and Link-Up broadband program is impractical[37] and places all of the administrative burden on carriers, which provides a disincentive for ETCs to participate. *See Appendix A* ¶ 64; *Appendix C* ¶ 60.

B. The Commission Should Adopt A *Workable* Numbers-Based USF Contribution Methodology.

As the draft orders recognize, the current universal service contribution methodology, which assesses interstate and international telecommunication service revenues, "is broken." *Appendix A* ¶ 97; *Appendix B* ¶ 44. The draft orders correctly observe that interstate revenues continue to decline, which "jeopardizes the stability and sustainability of the support mechanisms," and it has become increasingly "difficult if not

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[37] For example, under this proposal, limited funds would be made available on a "first come, first served basis." *Appendix A* ¶ 85. As a result, when a Lifeline customer places an order, neither the customer nor his or her chosen provider will know for certain whether the service will be subsidized. The draft orders also propose that the low income program subsidize installation charges for a new broadband connection and/or the purchase of an "Internet access device," which could be a computer. *Appendix A* ¶ 81. If the Commission adopts this proposal, a reimbursement method similar to the Billed Entity Applicant Reimbursement ("BEAR") process used for the Schools and Libraries program would be much more workable than filtering computer purchases through service providers. Under the BEAR process, the customer is billed for and pays the full installation charge, but then may request that the Universal Service Administrative Company ("USAC") reimburse a certain portion of the paid charges.

impossible" to distinguish interstate revenues from other revenues as customers migrate to bundled packages and take advantage of new technologies. *See, e.g.*, *Appendix A* ¶¶ 94-95, 97. It is also increasingly difficult to distinguish between telecommunications and information services as providers roll out converged services over multiple network platforms. To fix this "broken" contribution system, AT&T and Verizon jointly proposed a workable numbers-based methodology to replace the current system.[38] The AT&T and Verizon proposal is broadly supported across the industry, and the Commission should adopt it.

A "pure numbers" system with limited, narrowly tailored exclusions as AT&T and Verizon proposed would put all carriers on a single system and would avoid the complexities for contributors and USAC that a dual system would require.[39] A pure numbers system would also be easiest for customers to understand. Those opposed to a pure numbers system primarily raise concerns regarding the size of the per-number charge and the impact on certain classes of customers that may see an increase in their

[38] *See* Ex Parte Letter from AT&T and Verizon to Marlene Dortch, FCC, WC Docket No. 06-122, CC Docket No. 96-45 (Sept. 11, 2008) ("*September 11 Ex Parte*"); *see also* Ex Parte Letter from AT&T and Verizon to Marlene Dortch, FCC, WC Docket No. 06-122, CC Docket No. 96-45 (Oct. 20, 2008) ("*October 20 Ex Parte*"). AT&T and Verizon also urged the Commission to adopt a transition for contributions on non-primary wireless family plan lines. *See September 11 Ex Parte,* Attachment at 4. A transition, during which non-primary family lines would be assessed half of the monthly per-number USF charge, is appropriate because family plan lines help families stay connected to each other and to elderly relatives, and it would have a minimal impact on the per-number charge. *Id*.

[39] The Commission has statutory authority to adopt a pure-numbers USF contribution system. The Act requires only that providers of interstate telecommunications services contribute on an equitable and non-discriminatory basis, not that such providers contribute on every interstate service. 47 U.S.C. § 254(d). Moreover, the Act expressly authorizes the Commission to exempt both individual carriers and even classes of carriers from contributions if "the level of such carrier's contribution to the preservation and advancement of universal service would be de minimis." *Id.*; *see also* 47 C.F.R. § 54.708.

USF contributions. As AT&T and Verizon have demonstrated, however, the per-number charge would likely be slightly more than $1.00, which for many if not most consumers represents an overall decrease in USF contributions.[40] AT&T and Verizon also proposed that if the Commission is concerned about the impact of numbers-based contributions on particular customers, such as colleges and universities, the Commission could allow those customers to seek refunds from USAC for a portion of their contributions. *October 20 Ex Parte* at 5 n.5.

In reforming the current contribution system, the Commission should be careful to avoid adding unnecessary complexity, which harms consumers and providers alike by increasing administrative and compliance costs. For example, the proposed definition of "Assessable Numbers," which represent the numbers being assessed for universal service contribution purposes, in the draft orders is extremely problematic. This definition includes not only a North American Number Plan ("NANP") telephone number, which has a well-understood meaning in the industry, but also a "functional equivalent identifier," a concept that is ill-defined and that appears to lack any basis in the record. *Appendix A* ¶ 116; *Appendix B* ¶ 63.[41] The draft orders' proposed definition of the term "functional equivalent identifier" also contains so many provisos and exceptions that its use would significantly undermine the Commission's goal to "simplify the administration

[40] *See*, *e.g.*, Ex Parte Letter from AT&T and Verizon, to Marlene Dortch, FCC, WC Docket No. 06-122, CC Docket No. 96-45 (Sept. 23, 2008) ("*September 23 Ex Parte*").

[41] Equally problematic is the part of the definition of an "Assessable Number" that references "a public or private network," "an interstate public telecommunications network," and "a network that traverses (in any manner) an interstate public telecommunications network." *Appendix A* ¶ 116; *Appendix B* ¶ 63. These terms do not have an accepted meaning in the industry (and are not well-defined in the order), creating more opportunities for mischief.

of universal service contributions." *See, e.g.*, *Appendix A* ¶ 116 n.288. Consumers and providers would have to grapple with the inherent uncertainty surrounding what constitutes a "functional equivalent identifier" for contribution purposes. For instance, this draft definition might encompass some new, alternative communication services such as the "Private Chat" service associated with the Xbox Live gaming system and the Yahoo Messenger computer-to-computer "Voice Chat" service.[42] If such services begin to significantly displace numbers-based services the Commission may need to reexamine the USF contribution system in the future. But the record on any potential "e-number" USF charges is not sufficiently developed to move forward at this time, and there is no need to delay a numbers-based USF contribution system to examine that issue because the base of NANP numbers remains strong and is increasing. *See*, *e.g.*, *September 23 Ex Parte*.

The draft orders' proposal to exclude broad categories of telephone numbers from the definition of an Assessable Number would also increase the complexity of a numbers-based system. *Appendix A* ¶¶ 119-125; *Appendix B* ¶¶ 67-73. Several proposed exclusions – such as for numbers "used merely for routing purposes in a network" – contain multi-part tests that will be difficult to adopt in practice. Others employ terms – such as the proposed exclusion for numbers that meet the definitions of an "Available Number," an "Administrative Number," an "Aging Number," or an "Intermediate

[42] *See* XBOX, *Voice Communication with Xbox 360*, http://support.xbox.com/support/en/us/xbox360/xboxlive/xboxlivecommunity/chat/chat.aspx; and Yahoo Messenger Voice, *Save money and talk for hours!*, http://messenger.yahoo.com/features/voice/.

Number" in the Commission's numbering rules – that presuppose a clear understanding and consistent application of those terms, which is not the case.

Each category of telephone numbers excluded from the contribution obligation raises compliance and administrative costs for the industry, creates incentives for gaming and evading contribution obligations, and complicates rather than simplifies the USF contribution system. The better approach would be to define an "Assessable Number" as a NANP telephone number that enables consumers to make or receive calls as proposed by AT&T and Verizon. *October 20 Ex Parte* at 3. This definition would be simple to administer and less costly to monitor and audit. It also would obviate the need to confront other administrative challenges raised by the draft orders – such as requiring certain providers to make USF contributions based on Assessable Numbers even though they are not otherwise required to submit numbering resource data. *See, e.g., Appendix A* ¶ 128.[43]

Hybrid universal service contribution systems are less desirable than a pure numbers system. In particular, the dual numbers and revenues system contribution system in *Appendices* A and C would benefit no one. This proposal would require providers to contribute based on telephone numbers for residential services, but continue to contribute to the USF on revenues from business services. *Appendix A* ¶ 133; *Appendix C* ¶ 129. This approach would be even worse than the status quo. It would perpetuate the problems with the current revenue-based contribution methodology.

[43] The proposal in the draft orders to move, exclusively, to a connections-based system for business contributions at some point in the future is also not workable. *Appendix A* ¶ 343; *Appendix C* ¶ 340. If the Commission determines not to adopt a pure numbers contribution system, flat-rate contributions based on business connections make sense only as a supplement to contributions on all telephone numbers, residential and business.

Providers would continue to face the challenge of having to classify business offerings that frequently include a bundle of information and telecommunications services and interstate and intrastate services. And it would create additional burdens with no corresponding benefits. For example, it would require that contributors adopt processes to distinguish residential services from business services – a distinction that is not always clear, particularly for wireless services – for the sole purpose of universal service contributions.[44]

It is possible to devise a hybrid contribution methodology that is an improvement over the current interstate revenue system, but any such system is decidedly a second best solution to a pure numbers methodology. One such alternative is a system based on numbers with supplemental, flat-rate contributions based on business network connections. AT&T and Verizon also jointly proposed such an alternative system, s*ee October 20 Ex Parte* at 2-3, and the draft order in *Appendix B* embraces this alternative structure. *Appendix B* ¶¶ 52-82. If the Commission moves forward with this approach, as AT&T and Verizon jointly observed,[45] it is critical to make clear that connections-based contributions will not be assessed on those business broadband services that are equivalent to residential broadband products (*e.g.*, DSL, cable modem, and FTTP). As *Appendix B* is drafted, it appears that the proposed $35 connection charge would apply to these mass market broadband services. This charge would be wildly out of proportion to the monthly cost of such services, which is often less than $60 per month, in many cases

[44] Such distinctions for wireless services would not be an issue with a numbers and connections approach because, as parties have proposed, like wireline residential broadband services, wireless broadband services would pay on the telephone numbers associated with that service and would not be assessed a separate connection charge.

[45] *See* Letter from Mary Henze, AT&T, and Kathleen Grillo, Verizon, to Marlene Dortch, FCC, WC Docket No. 06-122, CC Docket No. 96-45 (Oct. 24, 2008).

much less. As a result, such a charge would discourage providers from rolling out innovative, high speed products offered at a reasonable price.

To address this issue, AT&T separately suggested three tiers of flat-rate connection charges – $2 for connections up to and including 25 mbps; $15 for connections from 25 mbps up to and including 100 mbps; and $250 for connections over 100 mbps.[46] It is not clear from AT&T's filing whether business broadband services that are equivalent to residential broadband products would still be assessed a connection charge. But under this approach or any hybrid contribution system that includes connection-based assessments, these services should not be charged. Connection charges on mass market services that vary by speed discourage innovation to increase speeds and deter market adoption by increasing costs.

Moreover, some of these mass market business broadband services already exceed 25 mbps (more such services will exceed this threshold in the future), and a $15 connection charge under the AT&T alternative would be disproportional to the total cost of the service. For example, Verizon's business FiOS service, a "fiber-to-the-premises" or "FTTP" product, offers speeds greater than 25 mbps,[47] and some of the pricing plans for business FiOS services can start as low as $44.99 per month.[48] The day is also

[46] *See* Letter from Mary Henze, AT&T, to Marlene Dortch, FCC, WC Docket No. 06-122, CC Docket No. 96-45 (Oct. 29, 2008).

[47] *See* Verizon, News-At-A-Glance, *Verizon Extends Groundbreaking 50/20 Mbps FiOS Internet Service to Entire FiOS Footprint*, http://investor.verizon.com/news/view.aspx?NewsID=925 (June 18, 2008) ["Beginning next week, Verizon will make available to more than 10 million homes and businesses the nation's fastest consumer broadband connections, with download speeds up to 50 megabits per second (Mbps) and upload speeds up to 20 Mbps."].

[48] *See* Verizon, Verizon FiOS for Business, http://smallbiz.verizonmarketing.com/products/internet/fios/default.aspx?link=topnav.

approaching when mass market broadband services that are 100 mbps, or faster, may be readily available at attractive prices.[49] The Commission's USF policies should not discourage providers from deploying the faster and faster services that customers demand. Whatever necessary USF contribution reforms the Commission adopts must not artificially increase the costs of desirable high speed broadband services and discourage adoption of those services. Finally, subjecting business broadband services that are equivalent to residential products to connections charges would create arbitrage opportunities and would require providers to police whether a broadband service is truly being used for "business" rather than "residential" purposes.

In addition, in order to achieve the efficiencies of a new USF contribution methodology, the Commission should adopt the same methodology for contributions to other Commission programs including NANP administration, LNP, the Telecommunications Relay Service ("TRS"), as well as to assess regulatory fees. The Commission has broad authority to determine how to assess and collect contributions for NANP, LNP, TRS, and regulatory fee purposes, and the Commission's analysis of its legal authority to adopt a numbers-based and connections-based approach to USF contributions applies equally to other contribution obligations.[50]

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[49] *See* Verizon, News-At-A-Glance, *Verizon Provides New Financial and Operational Details on its Fiber Network as Deployment Gains Momentum*, http://investor.verizon.com/news/view.aspx?NewsID=773 (Sept. 27, 2006) ["FiOS already offers customers unsurpassed Internet-access speeds. . .with plans to offer downstream (download) speeds of up to 100 Mbps[] for interactive gaming, educational, telemedicine, security and other applications."].

[50] *See, e.g.*, 47 U.S.C. § 251(e)(2) ("The cost of establishing telecommunications numbering administration arrangements and number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission"); 47 U.S.C. § 225(d)(3)(B) ("regulations shall generally provide that costs

The Commission also has provided sufficient notice under the Administrative Procedure Act to move to a new contribution methodology for the NANP, LNP, and TRS programs as well as regulatory fees. In 2002, the Commission issued a broad NPRM regarding the contribution methodologies for universal service, NANP, LNP, TRS, and wireline regulatory fees.[51] Earlier this year, the Commission also released a broad NPRM regarding its collection of regulatory fees, including from Interstate Telecommunications Service Providers.[52]

Moreover, as a practical matter, moving to telephone numbers for contributions to these other Commission programs makes sense because, like universal service, they are all currently funded through revenue-based contributions using FCC Form 499 – a funding system that, in the draft orders' words, is "broken." *Appendix A* ¶ 97; *Appendix B* ¶ 44. In adopting the streamlined Form 499 and eliminating separate contribution

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caused by interstate telecommunications relay service shall be recovered from all subscribers for every interstate service"); 47 U.S.C. §§ 159(a)(1), (f)(1) (the Commission "shall assess and collect regulatory fees to recover the costs of [the Commission's activities]" and "shall prescribe appropriate rules and regulations to carry out the provisions of this section").

[51] *See Federal-State Joint Board on Universal Service; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms; Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990; Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size Format,* Notice of Proposed Rulemaking, 17 FCC Rcd 24952, ¶ 74 (2002) (seeking comment on universal service contributions and "comment on whether to continue basing contributions to the Telecommunications Relay Service, Numbering Administration, Local Number Portability and wireline regulatory fees programs on annual revenue data, or whether contributions to these mechanisms also should be based on connections and/or numbers").

[52] *See Assessment and Collection of Regulatory Fees for Fiscal Year 2008*, Report and Order and Further Notice of Proposed Rulemaking, MD Docket No. 08-65, RM-11312, ¶¶ 38-41 (Aug. 8, 2008).

worksheets for the FCC's various programs, the Commission found that there were numerous benefits to administering all programs from the same funding base. *See 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Services, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, Report and Order, 14 FCC Rcd 16602, ¶¶ 10, 66 (1999) ("We expect that using the same funding basis for all of these purposes would reduce confusion and minimize the amount of information we need to collect from contributors. . . Indeed, using the same revenue basis for all four funds furthers the deregulatory, burden-reducing objectives that we seek to achieve by creating a unified contributor collection worksheet. . . We also conclude that adopting one worksheet to satisfy these obligations will reduce confusion for carriers and should increase compliance, particularly by smaller carriers.") All of these benefits and administrative efficiencies from a new numbers-based USF contribution system would be lost if the Commission, as the draft orders propose, steps back in time and maintains different reporting and contribution systems for its various programs. *Appendix A* ¶ 148 n.373; *Appendix B* ¶ 96 n.239; *Appendix C* ¶ 143 n.364.

III. The Commission Should Adopt Comprehensive Intercarrier Compensation Reform That Provides A Prompt Transition To A Uniform Terminating Default Rate.

Verizon and numerous other carriers agree that the time has come for comprehensive reform of the current intercarrier compensation system. As we have explained at length in our prior submissions, it is only through a uniform rate – applied equally to all carriers and all traffic – that the Commission can level the playing field for all carriers and all technologies and can eliminate the fraud and arbitrage that plague today's intercarrier compensation regime. Although the draft orders take substantial steps in this direction, absent the modifications described here, as currently drafted they do not fix the distortions caused by today's disparate rates. Specifically, as discussed below, the Commission should:

(1) close the loophole that could permit some carriers to retain their artificially high access rates for *ten years*;

(2) confirm that the new terminating rate regime is a default regime only;

(3) rely on market-based agreements to establish a uniform terminating rate cap of $0.0007 per minute or, at a minimum, give states the option of doing so in lieu of conducting cost proceedings;

(4) reject suggestions that different carriers should receive different compensation for terminating traffic, either by expressly establishing different terminating rates or by imposing disparate rights and obligations that effectively establish different compensation for some carriers; and

(5) clarify that intercarrier compensation reforms do not open the door for parties to existing interconnection agreements to renegotiate aspects of their agreements that are not affected by the new terminating rate regime.

To provide meaningful relief, any intercarrier compensation reform plan must include a prompt transition to uniform rates. Although the draft orders achieve a uniform terminating rate in the end, the loophole in the draft orders allows for a lengthy and unstructured transition that allows states to postpone uniformity and to permit some carriers to retain their artificially high access rates for *ten years*. This substantially undermines the goals of reform. As discussed below, the Commission should:

(1) adopt a transition period of no more than three to five years;

(2) provide sufficient guidance to ensure that states craft transition plans that provide meaningful rate reductions and increasingly unified rates throughout the transition period;

(3) ensure that rural suspensions and modifications do not undermine the goals of increasing uniformity throughout the transition period;

(4) implement the proposed uniform set of “network edge” rules at the same time that state-set “interim” rates go into effect; and

(5) enable wireless carriers to begin collecting the final uniform terminating rate on access traffic at the same time that state-set “interim” rates go into effect.

Finally, regardless of whether the Commission does or does not adopt comprehensive reform at this time, it should immediately and directly address the most pressing problems under today’s intercarrier compensation scheme. In particular, the commission should adopt either the USTelecom consensus proposal on phantom traffic or the phantom traffic solution proposed in the draft orders. The Commission should also act immediately to put an end to the traffic pumping arbitrage schemes that have plagued the industry in recent years.

A. Any Attempt At Comprehensive Intercarrier Compensation Reform Should Include A Uniform Terminating Rate.

A uniform terminating rate – for all carriers and all traffic – is the only way that the Commission can ensure competitive and technological neutrality and eliminate the fraud and arbitrage that are caused by today’s disparate intercarrier compensation rates.[53] As the Commission has recognized, under the existing regime, “regulatory arbitrage arises from [the] different rates that different types of providers must pay for essentially the same functions” of delivering calls to customers. *2005 FNPRM* ¶ 15.[54] Arbitrage has taken many forms, from competing LECs’ decisions to sign up “ISPs exclusively” as

[53] *See* Letter from Susanne Guyer, Verizon, to Chairman Kevin Martin, et al., FCC, CC Docket Nos. 01-92, 96-45 (Sept. 12, 2008) (“*Verizon September 12 Letter*”); Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 06-122, attaching *The Commission Has Legal Authority to Adopt a Single, Default Rate for All Traffic Routed On The PSTN*, at 1-19 (Sept. 19, 2008).

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

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 rural incumbents' and allegedly rural competitors' efforts to pump up access traffic by paying "free" conference call and chat line providers to be their "customers."[55] Carriers also attempt to disguise traffic subject to high intrastate access charges and to pass it off as subject instead to lower interstate access charges or even lower reciprocal compensation rates, or attempt to bill access rates on calls, such as intraMTA wireless calls, that are actually subject to lower reciprocal compensation rates. Such arbitrage – although beneficial to the arbitrageurs for as long as their scams can last – harms competition and consumers by diverting resources from investments in newer and better network technologies and services to detecting the scams and litigating against the scammers.

The solution to this arbitrage and fraud is a unified intercarrier compensation system with a uniform default termination rate that applies to all traffic and all carriers. Indeed, 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." *2005 FNPRM* ¶ 1. Such a "unified approach" would "replace the existing patchwork of intercarrier compensation rules," where the amount owed for a call depends upon which boundaries – local calling area,

[55] *See* Letter from Donna Epps, Verizon, to Thomas Navin, FCC, WC Docket No. 07-135 (June 8, 2007) ("*June 8 Traffic Pumping Letter*"); Letter from Donna Epps, Verizon, to Thomas Navin, FCC, WC Docket No. 07-135 (June 9, 2007) ("*June 9 Traffic Pumping Letter*"); *Establishing Just and Reasonable Rates for Local Exchange Carriers*, Comments of Verizon, WC Docket No. 07-135 (Dec. 14, 2007) ("Verizon Traffic Pumping Comments"); *Establishing Just and Reasonable Rates for Local Exchange Carriers*, Reply Comments of Verizon, WC Docket No. 07-135 (Jan. 16, 2008) ("Verizon Traffic Pumping Reply Comments"); Ex Parte Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, WC Docket No. 07-135 (Mar. 14, 2008) ("*March 14 Traffic Pumping Ex Parte*").

MTA, or state – a call crosses, and what kind of carrier – incumbent LEC, competing LEC, rural LEC, or wireless carrier – receives it. *Id.* ¶ 3. A system based on a uniform rate will be straightforward, easy to implement, and competitively and technologically neutral. At the same time, a uniform rate will eliminate the rate disparities and arbitrary distinctions that have given rise to arbitrage and fraud in the current system.

The draft orders ultimately reach a uniform terminating rate for all carriers and all traffic, and therefore take substantial strides toward these goals. As written, however, the draft orders do not provide the reform that the industry so sorely needs. If the Commission determines to adopt comprehensive reform, it should modify those drafts to ensure that consumers and the industry receive the full benefits of this reform. The Commission should also reject the changes to the draft orders suggested in the *2008 FNPRM* that would allow rate disparities to continue, and allow some carriers to retain their inflated rates for up to ten years, thereby perpetuating the market distortions caused by today's intercarrier compensation regime.

First, the Commission should close the loophole in the draft orders that would allow carriers to charge their own high interstate access rates, or other high rates, for close to a decade. This loophole denies the industry any real promise of uniformity for ten years. Under the proposal, much of the transition is driven by an "interim uniform reciprocal compensation" rate to be set by the states.[56] After carriers reduce their intrastate access rates to their own interstate levels (which for many carriers will be high interstate rates) at the end of Year Two, the drafts provide for carriers to reduce their access rates to a state-set "interim" rate over two years. At each step of the transition,

[56] *See Appendix A* ¶¶ 194-197; *Appendix C* ¶¶ 189-192.

carriers with rates above the interim rate must lower those rates to the interim cap, but carriers with rates below the interim rate may not raise them. How quickly a state's rates are truly unified therefore depends on how high the "interim" rate is set and how steeply the glide path declines toward the final rate.

Yet, the draft orders appear to provide states no guidance about setting the interim rate or determining the glide path. Indeed, the orders explicitly state that they "do not set forth a methodology that states must use in setting the interim, uniform reciprocal compensation rates" and note that states may set an interim rate that "may be higher . . . than some existing incumbent LEC rates today."[57] Given the lack of standards regarding the transition in the draft orders, it appears that nothing would prevent a state from setting an "interim" rate above the access rates of most carriers in the state and maintaining a high, relatively flat "glide path" until the end of the transition period – thus preserving the patchwork of many different rates below the "glide path" (possibly including different rates for a single terminating carrier) – for another ten years.[58] This would allow carriers with very high interstate access rates to maintain their existing inflated rates.

As discussed above, as long as carriers continue charging different rates, arbitrage opportunities will abound. Carriers will continue to manipulate traffic in an attempt to collect higher rates and pay lower ones. Thus, as described more below, much as the Commission should not adopt a reform plan that imposes different "uniform" rates for each carrier, the Commission should not adopt a "transition" plan that allows the current

[57] *See Appendix A* ¶ 195; *Appendix C* ¶ 190.

[58] The unfettered discretion the draft orders grant to the states with respect to rates also raises a legal concern about compliance with the statutory standards governing rates for traffic subject to Section 251(b)(5), *see* Section 252(d)(2), particularly in light of such a lengthy transition period.

patchwork of different rates to continue, virtually unchecked, for ten years into the future. As long as carriers continue to charge a variety of different rates to terminate traffic, the industry will continue to struggle with the problems caused by today's disparate rates – including phantom traffic, traffic pumping, and other arbitrage and fraud schemes. Despite supposed reform, the industry – and the Commission – would continue to struggle with these problems in a piecemeal manner over the next decade.

Second, any new terminating rate regime established by the Commission should be a default regime only – carriers should be free to negotiate commercial agreements that may depart from the default regime. This approach ensures that the industry continues to move toward market-based rates, and provides carriers the flexibility to adapt their agreements in response to changing business needs and evolving technologies. Permitting negotiated agreements also reduces the regulatory burden on state commissions by eliminating the need for regulatory involvement where the parties are able to reach mutually beneficial agreements on their own.

Third, the Commission should reject the suggestion in the *2008 FNPRM* that states should use the TELRIC ("total element long run incremental cost") methodology to set the final uniform terminating rate.[59] As the Commission itself has recognized, "[s]tate pricing proceedings under the TELRIC regime have been extremely complicated and often last for two or three years at a time. . . . The drain on resources for the state commissions and interested parties can be tremendous."[60] Those state proceedings

[59] *2008 FNPRM* ¶ 41.

[60] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945, ¶ 6 (2003) ("*2003 TELRIC NPRM*").

produced disparate and unintended results, with TELRIC rates that varied widely from state to state – a result that the Commission concluded "may not reflect genuine cost differences but instead may be a product of the complexity of the issues." *Id.* Nor is there any reason to believe that a new round of TELRIC proceedings – this time conducted to determine a single TELRIC rate to apply to all carriers in a state – will proceed any more smoothly or quickly, or produce results that are any more reliable, than earlier TELRIC proceedings. For all of these reasons, the Commission should not direct the states to rely on a TELRIC model in setting the final uniform terminating rate.

Indeed, the Commission should not rely on *any* theoretical cost model to determine the final uniform default terminating rate. As the Commission has recognized, many of the difficulties associated with applying TELRIC were the result of "the excessively hypothetical nature of the TELRIC inquiry," *2003 TELRIC NPRM* ¶ 7 – a problem inherent in *any* theoretical cost model, including the new additional cost standard proposed in the draft orders.[61] As with the TELRIC proceedings, the state proceedings to apply the new additional cost standard will likely be costly, complex, burdensome, and protracted, and will "divert scarce resources from carriers" that would otherwise be used to spur competition and bring new products and new technologies to consumers.[62] Nor, given the imprecision inherent in ratemaking,[63] is there any reason to believe that the additional cost proceedings will produce a rate that is a more reliable "reasonable approximation of the additional costs" of terminating traffic than the rates

[61] *Appendix A* ¶¶ 236-274; *Appendix C* ¶¶ 231-269.

[62] *2003 TELRIC NPRM* ¶ 7.

[63] *See, e.g., United States v. FCC,* 707 F.2d 610, 618 (D.C. Cir. 1983) (ratemaking is not an exact science).

that parties have already negotiated in the marketplace. Finally, individual state rate determinations will likely spawn court challenges that will further delay implementation of a new intercarrier compensation regime.

Instead, the more sensible and efficient approach would be for the Commission to rely on evidence of negotiated, market outcomes to conclude that $0.0007 per minute is a "reasonable approximation of the additional costs" of terminating calls and to cap the final uniform default terminating rate that can be set by the states at that level. *See* 47 U.S.C. § 252(d)(2)(A)(ii). The Commission first adopted the $0.0007 per minute rate in crafting the current rules governing ISP-bound traffic and the mirroring rule, drawing upon then-"recently negotiated interconnection agreements," which showed a "downward trend in intercarrier compensation rates." *ISP Remand Order* ¶ 85. As the Commission explained at that time, to the extent that all of a carrier's costs are not recovered through the $0.0007 per minute rate, the carrier may recover them from its own end users. *Id.* ¶¶ 71, 83-85. Seven years later, the $0.0007 per minute rate is still consistent with market outcomes. Verizon has entered into, 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, demonstrating that the "trend toward substantially lower [intercarrier compensation] rates," *ISP Remand Order* ¶ 83, has continued.[64]

Notably, the widespread use of rates at or below $0.0007 per minute is not limited to carriers exchanging traffic subject to the ISP-bound traffic rule or mirroring rule. For

[64] *See also* Ex Parte Letter from Level 3 Communications to Marlene Dortch, FCC, CC Docket No. 99-68, WC Docket No. 01-92, at 5-6 (Aug. 18, 2008) ("*Level 3 Ex Parte*") (Level 3 providing examples of negotiated agreements at or below the $0.0007 per minute rate).

example, traffic exchanged between CMRS providers and CLECs is not subject to either the ISP-bound traffic regime or the mirroring rule, yet Verizon Wireless has entered into commercially negotiated agreements with at least 25 CLECs, including Comcast, to exchange traffic at or below the $0.0007 per minute rate.[65] The Commission can reasonably conclude that carriers would not agree to terminate traffic at rates or below $0.0007 per minute – whether in the context of ISP-bound traffic, the mirroring rule, or in other agreements – unless such a rate, together with end user recoveries, provided a "reasonable approximation of the additional costs" of terminating that traffic.[66] And, as the draft orders themselves note, the Commission has recognized that the "just and reasonable" standard of Sections 201 and 202 does *not* require cost-based rates.[67] Indeed, the Commission and courts have long recognized that rates set through market-based negotiations are instructive in determining appropriate – and "just and reasonable" – compensation rates. *See, e.g., ISP Remand Order* ¶ 85.[68] The Commission can therefore

[65] Verizon Wireless has negotiated agreements with at least three different CLECs in five states in which the parties voluntarily agreed to the $0.0007 per minute rate. Verizon Wireless has also negotiated at least 22 bill-and-keep agreements with CLECs, including Comcast. Verizon Wireless' bill and keep agreement with Comcast was filed in 29 states.

[66] *See Level 3 Ex Parte* at 12-13.

[67] *See Appendix* A ¶ 300, *Appendix C* ¶ 295 (recognizing that "the Commission has, in fact, adopted regulatory approaches that deviated from cost-based ratemaking" and citing examples).

[68] *See also 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*, Memorandum Opinion and Order, 22 FCC Rcd 1958, ¶ 39, ¶ 40 n.136 (2007) (finding that "commercially negotiated rates" provide "just and reasonable prices"), *petitions for review dismissed, Covad Commc'ns. Group, Inc. v. FCC*, Nos. 07-70898 et al. (9th Cir. June 14, 2007); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 664 (2003) (finding that "arms-length agreements . . . to provide [an] element at [a] rate"

rely on evidence of negotiated, market outcomes to conclude that \$0.0007 per minute is a "reasonable approximation of the additional costs" of terminating calls and to cap the final uniform default terminating rate that can be set by the states can set under Section 252(d)(2) at \$0.0007 per minute.

Indeed, relying on market outcomes in this manner would be consistent with the deregulatory goals of the Act. In Section 252(d)(2)(B), Congress provided that neither the Commission nor the states were to conduct "rate regulation proceeding[s] to establish with particularity the additional costs of transporting and terminating calls," indicating a clear preference that detailed cost proceedings not be used in determining a "reasonable approximation of [] additional costs." This provision of the statute further supports relying on the market evidence supporting a terminating rate of \$0.0007 per minute, rather than a theoretical cost model.

Neither does the Eighth Circuit's opinion regarding "proxy" rates in *Iowa Utilities Board* stand as an obstacle to this market-based approach.[69] The Eighth Circuit invalidated the proxy rules based on concerns of judicial estoppel and because the proxies themselves were based on a cost model (TELRIC) that the Eighth Circuit had deemed

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"demonstrate[s]" that the rate is "just and reasonable"), *aff'd in pertinent part*, *USTA v. FCC*, 359 F.3d 554 (D.C. Cir.), *cert. denied*, 543 U.S. 925 (2004); *Illinois Pub. Telecomms. Ass'n v. FCC*, 117 F.3d 555, 562 (D.C. Cir. 1997) (in competitive markets, the Commission may "conclude that market forces generally will keep prices at a reasonable level"). *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"); *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733, 2737 (2008) (reaffirming that the Mobile-Sierra doctrine requires an agency to "presume that the rate set out in a freely negotiated . . . contract meets the 'just and reasonable' requirement imposed by law").

[69] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *rev'd in part*, *Verizon Commc'ns. Corp. v. FCC*, 535 U.S. 467 (2002).

unlawful. Here, the Commission is merely adopting default caps, not rates, and carriers are free to negotiate different rates that are either higher or lower than the default. The Commission has consistently supported the $0.0007 per minute rate, which it based on market evidence of commercially negotiated agreements and which applies to a substantial portion of traffic exchanged today. Moreover, the continued precedential value of the Eighth Circuit's discussion of the proxy rates is unclear at best following the Supreme Court's two reversals of the Eighth Circuit's decisions on the Commission's authority to establish rules to implement the 1996 Act and its TELRIC pricing rules.[70]

At the very least, the Commission should modify the draft orders to give states the option of selecting $0.0007 per minute as the final uniform default terminating rate. As discussed above, cost proceedings are burdensome and expensive for *all* parties involved – including both state commissions and carriers. The Commission should not require states to bear the burden of conducting arduous and expensive cost proceedings without providing an alternative. Instead, states should be given the discretion to conclude that, in light of the abundant market evidence supporting a $0.0007 per minute rate and the burden of conducting lengthy proceedings to apply the additional cost model in the draft orders, the $0.0007 per minute rate constitutes a "reasonable approximation of the additional costs" of terminating traffic.

Fourth, the Commission should reject the suggestion in the *2008 FNPRM* to set a single rate per operating company.[71] A "uniform" rate per carrier is not "uniform" at all and will not stop the arbitrage that plagues the industry today. As long as some carriers

[70] *See Verizon Commc'ns. Corp. v. FCC*, 535 U.S. 467 (2002); *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

[71] *2008 FNPRM* ¶ 41.

are permitted to charge higher rates than others, there will be a financial incentive for terminating carriers to manipulate traffic to route it to, and through, those carriers that are permitted to charge the higher rates. The recent explosion in "traffic pumping" provides just one example of such a scheme. Carriers with some of the highest access rates today increase the number of calls that appear to terminate on their networks (and that are therefore charged the high access rate) by enticing conference and chat-line providers to become their "customers" by agreeing to illegal kickbacks of a portion of their access revenues. The conference and chat-line providers in turn advertise and market their services to the public as "free" in order to drive up demand, which in turn drives up their kickbacks from the carrier's revenues. The scheme creates a windfall for both sets of entities – providing excess access revenues to the carriers, while sustaining an artificial business model for the conference and chat-line providers.[72] Adopting a "reform" plan that allows different carriers to charge different rates will only allow these and other similar schemes to continue.

For the same reason, the Commission should reject "rural exceptions" to the "network edge" rules proposed in the draft orders. The draft orders correctly recognize that, in order for a uniform terminating rate regime to have meaning, there must be a clear, uniform delineation of which services will be included in that rate, and which services will not.[73] The draft orders therefore provide that the calling party's service provider is financially responsible for transporting the call to the terminating carrier's

[72] *See June 8 Traffic Pumping Letter*; *see also March 14 Traffic Pumping Ex Parte*.

[73] *See Appendix A* ¶ 275; *Appendix C* ¶ 270; *see also* Ex Parte Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, CC Docket No. 01-92, WC Docket No. 04-36 (Oct. 3, 2008) ("*October 3 Interconnection Ex Parte*").

"network edge." The Commission should make clear that these "network edge" rules merely define the services that are "included" in the terminating rate, and allocate financial responsibility for getting traffic to and from the network edge – they do not alter any obligations of incumbent carriers to interconnect at any technically feasible point, nor do they alter carriers' ability to request interconnection and seek arbitration of interconnection disputes.[74]

Some commenters in this proceeding have urged the Commission to modify its proposed network edge rules to adopt a "rural transport exception," such as the one contained in *Appendix C*, that would allow rural incumbent carriers to shift to the terminating carrier the financial responsibility for transporting traffic that the rural carrier originates.[75] These "rural transport exceptions" effectively set different rates for different carriers, perpetuating the rate disparities that have distorted today's intercarrier compensation regime and undermining the Commission's stated goals of uniformity, symmetry, and competitive neutrality.

As such, a rural transport exception would undermine competition, unfairly advantage certain industry segments, and result in evasion of regulatory obligations. A

[74] *See Appendix A* ¶ 275; *Appendix C* ¶ 270; *see also October 3 Interconnection Ex Parte*. A footnote in the draft orders provides that the "network edge" rules do not alter any obligations of incumbent carriers to interconnect at any technically feasible point, nor do they alter carriers' ability to request interconnection and seek arbitration of interconnection disputes. *Appendix A* ¶ 275 n.726; *Appendix C* ¶ 270 n. 717. The Commission should clarify, however, that its network edge rules also do not alter carriers' ability to use the state arbitration process to resolve interconnection disputes under the Act. Likewise, the Commission should clarify that the ability to interconnect and to use the state arbitration process applies to VoIP providers that operate as a carrier and connect directly with an ILEC as well as to those who use the services of an affiliated or unaffiliated wholesale telecommunications carrier to obtain interconnection.

[75] *Appendix C* ¶ 270; *see also* Ex Parte Letter from Stuart Polikoff, OPASTCO and WTA, to Marlene Dortch, FCC, CC Docket Nos. 01-92, 96-45; WC Docket No. 04-36 (Oct. 29, 2008).

rural transport exception would raise the costs for wireless carriers and other competitors to offer service in rural areas and would thus be at odds with the observation, elsewhere in the draft order, that "increased costs would divert funds from investment in next generation wireless networks."[76] It also would be inconsistent with court decisions that have rejected this "terminating carrier pays" approach as contrary to federal law.[77] Most important, a special rule applicable only to traffic originated by certain rural carriers invites the same sorts of arbitrage and evasion schemes that the Commission aims to end; a rural CLEC, for example, might seek to route its traffic through a rural incumbent carrier, in hopes of foisting its transport costs on the terminating carrier.

Moreover, relieving rural incumbent carriers of their transport obligations – particularly on an industry-wide basis – is unwarranted. The transport facilities connecting rural carriers to tandem transit providers are already in place; therefore, subjecting rural incumbent carriers to the same transport obligations as other carriers is not a question of requiring rural carriers to construct new transport facilities. In addition, to the extent that a rural incumbent carrier can show that, in light of the circumstances of that particular carrier, assuming these transport obligations is "unduly economically burdensome," Section 251(f)(2) already provides that the carrier can seek relief at its state

[76] *Appendix A* ¶ 203; *Appendix* C ¶ 198.

[77] *See, e.g., Atlas Tel. Co. v. Oklahoma Corp. Comm'n*, 400 F.3d 1256,1266 (10th Cir. 2005) (rejecting rural LECs' argument that CMRS providers must bear the expense of transporting RLEC-originated traffic); *see also Implementation of the Local Competition Provisions in the Telecommunications Act; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers,* First Report and Order, 11 FCC Rcd 15499, ¶ 1042 (1996) (under Section 251(b)(5), LECs must not charge CMRS providers (or other carriers) for terminating LEC-originated traffic and must provide that traffic to CMRS providers without charge) ("*Local Competition Order*").

commission. 47 U.S.C. § 251(f)(2). There is no need for the Commission to adopt a blanket "rural transport exception" for *all* rural incumbent carriers.

If, however, the Commission is determined to adopt some version of a "rural transport exception" – and it should not – it should, at the very least, narrow the exception to reduce the competitive harm to other carriers. First, the Commission should apply the exception only in those cases when the terminating carrier serves no end users in the rural incumbent carrier's service area, as Verizon previously proposed.[78] Such a limitation is necessary to provide competitive neutrality for carriers that are actively bringing competition to the rural incumbent carrier's service area, by ensuring that those competitors are not forced to bear the rural incumbent's transport obligations, in addition to their own. Second, the terminating carrier that is made financially responsible for transport as a result of a rural transport exception should have the option of choosing either direct or indirect interconnection.[79] Allowing the carrier who must pay for the transport to determine the means of interconnection promotes economic efficiency and reflects basic fairness, as evidenced by the fact that rural incumbent carriers supported such a condition in the Missoula Plan (which contained a "rural transport exception").[80]

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[78] *See Verizon September 12 Letter*, Attachment at 3

[79] Verizon is concerned that rural carriers may attempt to invoke the rural exemption of Section 251(f)(1) to avoid direct interconnection. Section 251(f)(1), however, applies only to obligations under Section 251(c); it does not apply to interconnection obligations under Section 251(a) or to the reciprocal compensation obligations of Section 251(b)(5). 47 U.S.C. § 251(f)(1) ("Subsection (c) of this section shall not apply to a rural telephone company" until certain conditions are met.).

[80] NARUC Task Force on Intercarrier Compensation, Filing of Industry-Sponsored Missoula Plan, WC Docket No. 01-92, Attachment at 33-35 (July 24, 2006) ("*Missoula Plan*").

By the same token, the Commission should clarify that rural carriers cannot evade the network edge rules – and thereby obtain, in effect, a different terminating rate – through joint ownership of tandem facilities. The proposed network edge rules provide that, when the terminating carrier "owns or controls" a tandem, the tandem is the carrier's "network edge" – in other words, the terminating carrier is responsible for all network functions, including transport, from the tandem onward.[81] In some states, however, tandems are jointly owned by groups of rural carriers. The Commission should therefore clarify that for purposes of the network edge rules, a tandem may be "owned or controlled" by more than one carrier, and each carrier with an ownership interest in the tandem must designate the jointly owned tandem as its "network edge" unless the carrier with an ownership interest in the tandem allows direct interconnection as an option. Otherwise, these rural carriers would be able to collect both the uniform terminating rate *and* force interconnecting carriers to pay transit charges, potentially for traffic in both directions, and then share in the proceeds from the tandem transit services.[82]

Finally, the Commission should acknowledge the value of existing interconnection agreements by clarifying the portion of the order addressing existing interconnection agreements. Specifically, the Commission should confirm that the reforms contemplated in the draft orders do not affect those portions of existing agreement that are not affected by the new intercarrier compensation rules. The reforms

[81] *Appendix A* ¶ 275; *Appendix C* ¶ 270.

[82] As Verizon previously suggested, the Commission should address tandem transit services, including the rates charged by these ILEC consortia, in a further notice of proposed rulemaking. *Verizon September 12 Letter*, Attachment at 4.

in the draft orders should not be used as an excuse for parties to relitigate issues on which the new regime has no bearing.[83]

B. The Commission Should Adopt A Transition Plan That Achieves Meaningful Uniformity In Rates In A Timely Manner.

The Commission should ensure that any intercarrier compensation reform plan provides a timely solution to the market distortions that plague the industry today by including a prompt, simultaneous transition to a uniform default terminating rate. Although the draft orders ultimately reach the right result after *a full decade* – a low, uniform terminating rate for all carriers and all traffic – the transition plan proposed in the draft orders inappropriately delays that end result, and could allow some carriers to retain their artificially high rates for ten years. Given the rapid pace of change in the communications industry and the urgent need for reform, the ten-year transition period should be shortened to three to five years.[84] Moreover, the draft orders improperly postpone some key components of the proposal until the end of the transition. The Commission should therefore restructure its transition plan to ensure that rates are unified in a timely and consistent manner.

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[83] *See Appendix A* ¶ 292; *Appendix C* ¶ 287.

[84] *See* Ex Parte Letter from Mary McManus, Comcast, to Marlene Dortch, FCC, CC Docket Nos. 01-92, 99-68; WC Docket Nos. 05-337, 06-122 (Oct. 21, 2008) and Ex Parte Letter from Mary McManus, Comcast, to Marlene Dortch, FCC, CC Docket Nos. 01-92, 99-68; WC Docket Nos. 05-337, 06-122, 04-36 (Oct. 23, 2008) ("*Comcast Ex Partes*") (proposing a three-year transition); Letter from Melissa Newman, Qwest, to Marlene Dortch, FCC, CC Docket Nos. 01-92, 96-45, 99-68; WC Docket Nos. 05-337, 07-135, 04-36 (Oct. 23, 2008) ("*Qwest Letter*") (suggesting a three-year transition); Letter from Susanne Guyer, Verizon, to Chairman Kevin Martin, et al., FCC, CC Docket Nos. 01-92, 96-45; WC Docket Nos. 04-36, 05-337, 06-122 at 5 (Oct. 28, 2008) ("*Verizon October 28 Letter*") (proposing a five-year transition); *see also Verizon September 12 Letter* at 4 (suggesting a three-year transition in the context of Verizon's own reform proposal).

First, the transition itself should be shortened. The transition period should strike a balance between allowing carriers to adjust to the new rates to avoid rate shock and providing a prompt remedy to the market distortions caused by today's disparate rate structure. The draft orders fail to recognize the harms caused by allowing the transition to drag on for ten years before reaching the final result. By contrast, a transition period of three to five years, as Verizon and others have proposed, gives carriers sufficient time to adjust to the new rate structure, particularly in light of the revenue replacement mechanisms also being made available, while still providing a timely solution to the many flaws in the current intercarrier compensation system.[85]

Second, the Commission should take steps to ensure that states adopt "interim" rates and glide paths that provide meaningful rate reductions, and increasingly unified rates, throughout the transition period. The draft orders purport to establish a "measured transition" by providing a "smooth and gradual glide path" that reduces rates in a "measured way over time." *Appendix A* ¶¶ 194, 230; *Appendix C* ¶¶ 189, 225. The transition plan outlined in the draft orders, however, does no such thing. As discussed above, the draft orders provide no guidance as to how interim rates should be set or how glide paths should be structured. As a result, nothing in the draft orders would prevent a state from setting a high "interim" rate and adopting a flat glide path with a flash cut to the final rate at the end of ten years – which is hardly the "smooth and gradual glide path" touted in the draft orders. *Id.*.

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[85] *See Verizon October 28 Letter* at 5; *Comcast Ex Partes* (proposing a three-year transition); *Qwest Letter* at 4-5 (proposing a three-year transition); *see also Verizon September 12 Letter* (suggesting a three-year transition in the context of Verizon's own reform proposal).

The Commission should instead establish standards for states to apply in setting interim rates and designing glide paths that will ensure rates make meaningful steps down toward uniformity each year of the transition. For example, the Commission should set an upper bound on the interim rate that a state could set, such as the lowest interstate access rate in the state, to ensure that implementation of the interim rate – at the very least – unifies all access traffic at a single rate. The Commission should also ensure that terminating rates become progressively lower and more uniform throughout the transition by requiring that each state reduce its interim rate cap by no less than equal steps toward the final rate in each subsequent year of the transition.[86]

Third, the Commission should establish "network edge" rules that take effect at the same time that access traffic transitions to the uniform "interim" rate. The draft orders correctly recognize that, in order for a uniform terminating rate regime to have meaning, there must be a clear, uniform delineation of which services will be included in that rate, and which services will not.[87] Nevertheless, the draft orders attempt to begin

[86] For the same reasons, the draft orders should be clarified to ensure that Section 251(f)(2) is not used as a way for some carriers to undermine the move toward reduced and more unified rates during the transition. The draft orders impose a "symmetry" requirement to ensure that rural suspensions and modifications granted pursuant to Section 251(f)(2) do not undermine the goals of reform: any rural carrier obtaining a higher terminating rate through the Section 251(f)(2) procedures must also pay that higher rate to terminate traffic on other carrier's networks. *See Appendix A* ¶ 289; *Appendix C* ¶ 294. It appears – but is not entirely clear – that this symmetry requirement is intended to apply to any rural carriers that obtain suspensions or modifications *during* the transition period such that they are permitted to charge rates above the state's "glide path." *See Appendix A* ¶ 279 n.735; *Appendix C* ¶ 274 n. 726. The draft orders should therefore be modified to clarify that the symmetry requirement applies to *all* rural suspensions and modifications, whenever granted, to ensure that Section 251(f)(2) is not used as a means to undermine the Commission's reform goals during or after the transition.

[87] *See Appendix A* ¶ 275; *Appendix C* ¶ 270. A footnote in the draft orders provides that the "network edge" rules do not alter any obligations of incumbent carriers

unifying rates at a state-wide "interim" rate without providing guidance as to what services would and would not be included in that rate. To be sure, the draft orders set forth a sensible and uniform set of "network edge" rules that would govern all traffic and allocate financial responsibility among carriers in a call path. But those rules would not become effective until the *end* of the transition period – several years *after* today's separate access regimes are eliminated and the terminating rate for all of that traffic is capped at a single "interim" rate in each state. State and federal access tariffs set forth the rates, terms, and conditions for interconnection; once those tariffs no longer apply, there will be an obvious need for an interconnection framework. It makes no sense, however, for each state, as part of setting its interim rate, to establish its own "network edge" rules to govern during the transition – only to have those rules superseded by the federal network edge rules shortly thereafter at the end of the transition. Instead, the Commission should modify the draft orders so that the network edge rules and the interim rate set by the states take effect at the same time.

Finally, for similar reasons, the Commission should enable CMRS carriers to collect a terminating rate on *all* traffic that they terminate at the same time that all traffic becomes governed by the interim rate.[88] As discussed above, it is at that point in the transition that "access" traffic is no longer subject to a separate "access" regime and

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to interconnect at any technically feasible point, nor do they alter carriers' ability to request interconnection and seek arbitration of interconnection disputes. *Appendix A* ¶ 275 n.726; *Appendix C* ¶ 270 n.717. The Commission should clarify, however, that its network edge rules also do not alter carriers' ability to use the state arbitration process to resolve interconnection disputes under the Act. Likewise, the Commission should clarify that the ability to interconnect and to use the state arbitration process applies to VoIP providers that operate as a carrier and connect directly with an ILEC as well as to those who use the services of an affiliated or unaffiliated wholesale telecommunications carrier to obtain interconnection. *See also October 3 Interconnection Ex Parte*.

[88] *See Appendix A* ¶ 197; *Appendix C* ¶ 192.

instead *all* traffic is grouped into a single category of traffic subject to a single terminating rate cap in each state. As each state's glide path declines toward the final terminating rate and sweeps more and more pre-existing rates into the path, carriers will no longer sort traffic into "access" and "not access" buckets in order to collect terminating charges – except for wireless carriers. Under the draft orders, wireless carriers alone must continue to distinguish access traffic from non-access traffic until the end of the transition – ten years away. Throughout the transition, wireless carriers alone would be required to pay terminating charges on access traffic, while remaining unable to collect them. Such an approach is neither symmetrical nor competitively or technologically neutral. Wireless carriers, like all other carriers, should therefore be empowered to collect a terminating rate on *all* traffic when the separate access regime is eliminated and all rates are capped at the interim levels.[89]

This approach is consistent with the draft orders' limitation that carriers cannot raise existing rates during the transition period. Wireless carriers' access rates are not set or capped at zero today; they are merely detariffed. *See CMRS Second Report and Order* ¶ 179.[90] Indeed, the Commission has explicitly confirmed that wireless carriers are permitted to charge a positive rate for terminating access traffic pursuant to negotiated

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[89] Because under the draft orders, CMRS providers would remain subject to different compensation schemes during the transition, it is imperative that the Commission make clear that the "MTA rule," 47 C.F.R. § 51.701(b)(2), continues to apply until there is no difference in treatment between "access" and "non-access" traffic. This means that, during the transition, traffic exchanged between LECs and CMRS providers that originates and terminates within the same MTA is subject to reciprocal compensation, not access charges, without regard to how the traffic is routed or whether connection is direct or indirect. *Id.*; *see also Atlas Tel. Co. v. Okla. Corp. Comm'n*, 400 F.3d 1256, 1267 (2005).

[90] *Implementation of Sections 3(n) and 332 of the Communications Act Regulatory Treatment of Mobile Services*, Second Report and Order, 9 FCC Rcd 1411, ¶ 179 (1994) ("*CMRS Second Report and Order*").

agreements. *See Sprint Declaratory Ruling* ¶ 7.[91] But, as a practical matter, the fact that wireless carriers' access rates are detariffed has prevented wireless carriers from collecting access charges. Nevertheless, in order to strike a balance between the need for competitive neutrality for wireless carriers and the interest in keeping rates low during the transition, Verizon proposes that CMRS carriers' terminating rate for "access" traffic should be capped at the lower, final uniform terminating rate – not the higher interim rate cap that would apply to other carriers.[92] The Commission should make clear that CMRS carriers are able to begin collecting the final uniform terminating rate on what is now known as "access" traffic at the same time that other carriers transition their access rates to the new interim rate. The Commission should also clarify that traffic exchanged between interexchange carriers and CMRS carriers is included within the new uniform terminating rate regime pursuant to the Commission's authority under Sections 201 and 332.[93]

C. The Draft Orders Represent A Reasonable Approach To Addressing Phantom Traffic That Could Be Adopted As Part Of A Broader Order Or On A Standalone Basis.

Over the past several years, various carriers have raised concerns about "phantom traffic." Verizon continues to support the proposal that USTelecom – with the support of

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[91] *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges*, Declaratory Ruling, 17 FCC Rcd 13192, ¶ 7 (2002) ("*Sprint Declaratory Ruling*").

[92] In the event that the state has not yet determined the final uniform terminating rate, the Commission should enable wireless carriers to charge $0.0007 per minute for this traffic, pursuant to the Commission's authority over IXC-CMRS traffic under Sections 201 and 332.

[93] *See Appendix A* ¶ 222 n.576 and *Appendix C* ¶ 217 n. 567, in which the Commission asserts its "intent" that IXC-CMRS traffic be included within the uniform rate regime.

a wide cross-section of the industry – put forward to address phantom traffic by closing loopholes in the Commission's existing signaling standards.[94] USTelecom's proposed solution represents a balanced, consensus approach to phantom traffic, and Verizon urges the Commission to adopt it. The phantom traffic solution contained in the draft orders,[95] however, also represents a balanced approach to phantom traffic and could be adopted on a standalone basis, even if the Commission does not adopt all parts of the draft orders.

The term "phantom traffic" has been used to describe traffic that is difficult for terminating carriers to bill, either because the terminating carrier asserts that it cannot identify the carrier responsible for payment or because the terminating carrier does not know the jurisdiction of the call, and therefore is unsure of what rate to apply. Most so-called "phantom traffic" can, in fact, be billed through proper use of cost-effective tools that are available and widely used throughout the industry today, such as negotiated agreements setting forth billing factors.

There are, however, some carriers that engage in deliberate misconduct to disguise jurisdictional information in an attempt to pay a lower rate or to get paid a higher rate than properly applies to the traffic. Carriers do so by removing, or failing to insert, the calling party number ("CPN") or charge number ("CN") in the SS7 signaling stream; inserting an invalid CPN or CN into the SS7 signaling stream; or altering the CPN or CN to suggest a different calling party location. Although factoring and other industry methods, when properly applied, still enable carriers to bill for this traffic, improved signaling rules, such as those included in USTelecom's proposal and in the draft orders,

[94] *See*, *e.g.*, Letter from Glenn Reynolds, USTelecom, to Marlene Dortch, FCC, CC Docket No. 01-92 (Apr. 4, 2008) (setting out the specific rules that USTelecom proposes).

[95] *Appendix A* ¶¶ 326-342; *Appendix C* ¶¶ 322-338.

will help to combat such misconduct and to ensure that carriers can charge the *correct* rate for traffic that they terminate.

The rules that USTelecom has proposed, as well as the rules embodied in the draft orders, would make clear that originating providers must transmit, in the signaling stream, the actual telephone number that it received from (or assigned to) the calling party. The rules would then require any other provider involved in transporting the call to the terminating provider to transmit without alteration the telephone number that it received from the originating provider (or the immediately prior provider), unless industry standards dictate otherwise.[96] The rules proposed in the draft orders impose the same requirements regarding the calling party's charge number.[97] Because downstream providers depend upon upstream providers for accurate signaling information – a provider cannot pass on information that it does not receive – an enforceable requirement that originating carriers place accurate information in the signaling stream, and that all other providers replicate that information without alteration, should ensure that accurate signaling information is transmitted all the way to the terminating provider.

The wide range of carriers supporting USTelecom's proposal indicates a broad consensus among the industry that limited clarifications to the Commission's existing

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[96] *See* Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, CC Docket No. 01-92, attaching *Verizon's Proposed Regulatory Action to Address Phantom Traffic*___ at 9-10 (Dec. 20, 2005) ("*Verizon Phantom Traffic White Paper*"); *see also Appendix A* ¶ 335 n.872; *Appendix C* ¶ 331 n.867.

[97] The draft orders also require carriers that use Multi Frequency ("MF") trunks to signal the caller's telephone number in the Automatic Number Identification ("ANI") field. *Appendix A* ¶ 332, *Appendix C* ¶ 328. MF trunks are configured to signal ANI only on the originating end of a Feature Group D access call, however. MF trunks do not signal ANI on non-access calls or on the terminating leg of an access call. *See Verizon Phantom Traffic White Paper*, Appendix A**.** If the Commission adopts the phantom traffic solution that is included in the draft orders, it should first modify those rules to recognize this technical limitation.

signaling rules, together with enforcement actions against deliberate manipulation of signaling information and misrouting of traffic, are the most appropriate regulatory response to the issue of phantom traffic.[98] USTelecom's supporters also recognize that such clarification would better enable private agreements between carriers to govern intercarrier payments for the traffic they exchange, which are superior to top-down regulation.

The phantom traffic solution proposed in the draft orders nevertheless goes a step further and establishes financial remedies for terminating carriers that receive unlabeled traffic. Although such remedies are unnecessary – the industry has developed cost-effective tools, such as factoring, to bill for unlabeled traffic – the financial remedies outlined in the draft orders provide a reasonable alternative. Under the proposed remedies, a terminating carrier that does not receive the information reasonably needed for billing would be permitted to bill its highest rate to the carrier that delivered the traffic. The draft orders recognize, however, that terminating carriers may receive the needed billing information from a variety of sources – not just through the signaling stream. A terminating carrier may therefore bill the delivering carrier only when traffic is lacking the required signaling information *and* the delivering carrier does not otherwise provide billing information, such as through industry standard billing records. *See Appendix A* ¶ 337; *Appendix C* ¶ 333. Thus, the draft orders recognize that "intermediate

[98] Letter from Glenn Reynolds, USTelecom to Marlene Dortch, FCC, CC Docket No. 01-92, at 1 (May 8, 2008) ("[A]ll of the following parties (and more) have filed in this docket in support of improved call-signaling rules: USTelecom, NECA, ITTA, CTIA, NCTA, NARUC, NuVox, XO Communications, One Communications, OPASTCO, Western Telecommunications Alliance, Qwest, The Rural Alliance, Alltel, Cavalier Communications, COMPTEL, GCI, iBasis, Pac-West Telecom, RCN Telecom, VON Coalition, Time Warner Telecom, T-Mobile, USA Datanet, Verizon, Alaska Telephone Association, Missoula Plan, Sprint/Nextel and Frontier.").

service providers that provide, to subsequent service providers in a call path, information sufficient to identify the provider that delivered the traffic to the intermediate provider should not be responsible for terminating intercarrier payments for that traffic." *See Appendix A* ¶ 337 n.875; *Appendix C* ¶ 333 n.870. In light of these limitations on the proposed financial remedies, the phantom traffic approach taken in the draft orders is a reasonable one.

D. Regardless Of Whether The Commission Adopts Broad Intercarrier Compensation Reform, The Commission Should Immediately Put An End To The Illegal Arbitrage Scheme Known As "Traffic Pumping."

Numerous carriers and other parties have documented the growing phenomenon of "traffic pumping" and the harm that it is inflicting on the industry and on the public.[99] As Verizon and others have explained, these traffic pumping arbitrage schemes involve primarily rural ILECs and CLECs exploiting the Commission's tariff rules to charge excessive access rates while simultaneously increasing the number of calls that appear to terminate on their networks by enticing conference and chat-line providers into their jurisdictions with free or low-cost service and agreements to share the carrier's access revenues, resulting in net payments to the providers. The conference and chat-line providers in turn advertise and market their services to the public as "free" in order to drive up demand. The result is that other carriers, and ultimately the ordinary consumers

[99] Ex Parte Letter from David Frankel, ZipDX, to Marlene Dortch, FCC, WC Docket No. 07-135 (Apr. 17, 2008); Ex Parte Letter from David Frankel, ZipDX, to Marlene Dortch, FCC, WC Docket No. 07-135 (Oct. 16, 2008); Letter from Norina Moy, Sprint, to Marlene Dortch, FCC, WC Docket No. 07-135 (June 9, 2008); *Investigation of Certain 2007 Annual Access Tariffs,* Order Designating Issues for Investigation, 22 FCC Rcd 16109 (2007) ("*Designation Order*"); *Qwest Communications Corp. v. Farmers and Merchants Mutual Telephone Co.,* Memorandum Opinion and Order, 22 FCC Rcd 17973 (2007); *see also Establishing Just and Reasonable Rates for Local Exchange Carriers,* Notice of Proposed Rulemaking, 22 FCC Rcd 17989 (2007) ("*Access Stimulation NPRM*").

they serve, must subsidize supposedly "free" services that do not benefit them and that they would never voluntarily support.

The Commission has already tentatively concluded that such traffic-pumping practices are unjust and unreasonable as a general matter, and the Wireline Competition Bureau took steps to stop this abuse of the Commission's tariff rules in 2007, suspending certain tariffs and designating issues for investigation. But the Bureau's actions necessarily applied only to the particular carriers with suspended tariffs and, moreover, only to those specific tariffs. And, as Verizon and numerous other carriers have documented, following the Commission's tariff investigation in 2007, much of the traffic pumping arbitrage activity merely shifted to CLECs claiming to serve rural communities.[100] The Commission should put an end to the traffic pumping arbitrage scheme, once and for all, regardless of whether it adopts comprehensive reform. The need to address traffic pumping is even more urgent if the Commission does not adopt comprehensive intercarrier compensation reform in December, or if the Commission adopts reform but does not substantially shorten the proposed transition period.

Specifically, the Commission should either include in any order adopted here or promptly issue a declaratory ruling that when a LEC assesses terminating interstate switched access charges on traffic that is subject to a revenue sharing arrangement, it engages in an unreasonable practice in violation of Section 201(b). In the *Access Stimulation NPRM*, the Commission suggested that a rate-of-return ILEC violates Section 201(b) when it "shares revenue, or provides other compensation to an end user customer .

[100] *See* Ex Parte Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, WC Docket No. 07-135 (June 4, 2008); Ex Parte Letter from Donna Epps, Verizon, to Marlene Dortch, FCC, WC Docket No. 07-135 (Mar. 14, 2008).

. . and bundles those costs with access."[101] Because rate-of-return ILECs' rates are based on their costs, an ILEC that bundles with access the cost of compensating customers is effectively forcing interexchange carriers to pay "for the costs of the stimulating service through the higher access charges assessed by the exchange carrier."[102] This is unreasonable because those costs are "primarily for the benefit of the carrier" rather than providing any "customer benefits."[103] This is particularly true when the scheme involves payments from the LEC to its purported customer – in the form of a revenue-sharing agreement, a commission agreement, or any other arrangement with similar effect – that cause net revenue to flow from the LEC to the customer for each additional minute of traffic generated.

The Bureau made a similar observation in June 2007 when it suspended certain ILECs' switched-access tariffs and concluded that their traffic-pumping practices raised "substantial questions" about whether those ILECs' tariffs were lawful.[104] Subsequently, the Bureau designated specific issues for that investigation, including whether the ILECs could properly include "the costs of any direct payments, sharing of revenues, or other forms of compensation to the provider of an access stimulating service" in their rates.[105] Just as the Commission recognized in the *Access Stimulation NPRM*, the Bureau noted that a carrier's inclusion of these costs in its access charges forces interexchange carriers

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[101] *Access Stimulation NPRM* ¶ 19.

[102] *Id.* ¶ 18.

[103] *Id.* ¶ 19 n.47 (citing orders applying "the 'used and useful' doctrine and its associated prudent expenditure standard" to determine whether costs can permissibly be used to calculate a carrier's rates).

[104] *July 1, 2007 Annual Access Charge Tariff Filings*, Order, 22 FCC Rcd 11619, ¶ 7 (2007).

[105] *Designation Order* ¶ 1; *see also id.* ¶¶ 13-14.

to "pay[ ] for the costs of the access stimulating service through . . . higher access charges."[106]

Traffic pumpers' attempts "inappropriately to shift [costs] onto the long distance market" by charging interstate terminating access charges on traffic that has been artificially stimulated through revenue-sharing arrangements are "inconsistent with the competitive market that [the Commission] seek[s] to encourage for access service."[107] The Commission should therefore issue a declaratory ruling that it is an unjust and unreasonable practice for any LEC to assess terminating interstate switched access charges on traffic that is subject to a revenue sharing arrangement.

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[106] *Id.* ¶ 13. The Commission subsequently terminated the investigation because all of the ILECs involved had either rejoined the National Exchange Carriers Association pool or adopted specific safe-harbor "tariff language that committed them to modify their local switching and transport tariff rates in the event they experience an increase in demand above a threshold level." *Investigation of Certain 2007 Annual Access Tariffs*, Order, 22 FCC Rcd 21261, ¶ 2 (2007).

[107] *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, ¶ 33 (2001).

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For the foregoing reasons, the Commission should adopt an order consistent with the above and Verizon's previous submissions in these proceedings.

Respectfully submitted,

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