APPENDIX A

Chairman's Draft Proposal

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
	)	
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
	)	
Numbering Resource Optimization	)	CC Docket No. 99-200

ORDER ON REMAND AND REPORT AND ORDER
AND FURTHER NOTICE OF PROPOSED RULEMAKING

Adopted: "Insert Adopted Date" **Released: "Insert Release Date"**

Comment Date: [XX days after date of publication in the Federal Register]
Reply Comment Date: [XX days after date of publication in the Federal Register]

TABLE OF CONTENTS

Heading Paragraph #

I. INTRODUCTION

1. In enacting the Telecommunications Act of 1996 (1996 Act),[1] Congress sought to introduce competition into local telephone service, which traditionally was provided through regulated monopolies. Recognizing that in introducing such competition, it was threatening the implicit subsidy system that had traditionally supported universal service, it directed the Commission to reform its universal service program to make support explicit and sustainable in the face of developing competition.

2. For the most part, Congress's vision has been realized. Competition in local telephone markets has thrived. At the same time, the communications landscape has undergone many fundamental changes that were scarcely anticipated when the 1996 Act was adopted. The Internet was only briefly mentioned in the 1996 Act,[2] but now has come into widespread use, with broadband Internet access service increasingly viewed as a necessity. Consistent with this trend, carriers are converting from circuit-switched networks to Internet Protocol (IP)-based networks. These changes have benefited consumers and should be encouraged. Competition has resulted in dramatically lower prices for telephone service, and the introduction of innovative broadband products and services has fundamentally changed the way we communicate, work, and obtain our education, news, and entertainment. At the same time, however, these developments have challenged the outdated regulatory assumptions underlying our universal service and intercarrier compensation regimes, forcing us to reassess our existing approaches. We have seen unprecedented growth in the universal service fund, driven in significant part by increased support for competitive eligible telecommunications carriers (ETCs). The growth of competition also has eroded the universal service contribution base as the prices for interstate and international services have dropped. Finally, we have seen numerous competitors exploit arbitrage opportunities created by a patchwork of above-cost intercarrier compensation rates. Although the Commission has attempted to address many of these issues on a case-by-case basis, it has become increasingly clear that piecemeal efforts to respond to these developments are inadequate—only comprehensive reform can address the

[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act).

[2] *See* 47 U.S.C. § 230; 47 U.S.C. § 157 nt.

fundamental challenges that they present.[3]

3. Today we adopt a comprehensive approach to addressing these difficult, but critical issues. First, we spur widespread deployment of broadband by ensuring that carriers receiving universal service high-cost support offer broadband throughout their service areas. Second, we help Lifeline/Link Up customers participate in this new broadband world by creating a pilot program to provide discounted access to broadband services. Third, we broaden and stabilize our universal service contribution base through equitable and non-discriminatory contributions. Fourth, having placed our universal service fund on solid footing, we now take the long-overdue step of moving toward uniform intercarrier compensation rates that provide efficient incentives for the investment in and use of broadband networks. Finally, our approach minimizes disruptions to carriers and safeguards universal service for consumers by adopting sensible transition plans and ensuring that universal service is used to support service in high-cost areas, not carriers' dividends.

II. REFORM OF HIGH-COST UNIVERSAL SERVICE SUPPORT

4. Today we take a monumental step toward our goal of ensuring that broadband is available to all Americans. We do this by requiring that all recipients of high-cost support offer broadband Internet access service to all customers within their supported areas as a condition of receiving future support. Taking this action will promote the deployment of broadband Internet access service to all areas of the nation, including high-cost, rural, and insular areas where customers may not currently have access to such services. In particular, as a condition of receiving continued high-cost support, we will require all incumbent local exchange carriers (LECs) to commit to offer broadband Internet access service within five years to all customers in study areas where the incumbent LECs receive high-cost support. Competitive eligible telecommunications carriers (ETCs) likewise will be required to commit to offer broadband Internet access services to all customers in their service areas within five years to continue to receive high-cost support, which will be distributed based on the competitive ETCs' own costs. Competitive ETCs that do not make this commitment will not be eligible to receive high-cost support; incumbent LECs that do not make this commitment will gradually lose their high-cost support, as this support will be awarded via reverse auction to an ETC who will meet carrier of last resort obligations and will commit to offering broadband Internet access to all customers in the entire study area within ten years. With these reforms, we take great strides toward ensuring that all Americans, regardless of where they live, will have broadband Internet access service available to them, without increasing the size of the high-cost fund.

A. Background

5. The 1996 Act amended the Communications Act of 1934 (the Act) with respect to the provision of universal service.[4] Congress sought to preserve and advance universal service, while at the

[3] We thus conclude that there is a compelling need to proceed with comprehensive reform at this time, as we describe below. *See, e.g.*, *infra* Parts II.A, III.A, IV.A, and V.B. Given that we have notice and an extensive record, going back in some cases seven years, we are unpersuaded by commenters proposing that we delay reform to seek further comment, or that we issue a Further Notice of Proposed Rulemaking on questions beyond those raised in Part VI. *See, e.g.*, Letter from Ray Baum, Chairman, NARUC Communications Committee, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 80-286, WC Docket Nos. 08-152, 04-32, 06-122, WT Docket No. 05-194 at 2 (filed Oct. 21, 2008) (NARUC Oct. 21, 2008 *Ex Parte* Letter); Letter from Jeffery S. Lanning, Embarq, to Chairman Kevin J. Martin, et al., FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 04-36 at 2 (filed Oct. 28, 2008) (Embarq Oct. 28, 2008 *Ex Parte* Letter); Letter from Eric N. Einhorn, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 06-122, 07-135, 08-152 at 1 (filed October 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter).

[4] 47 U.S.C. § 254 (added by the 1996 Act).

same time opening all telecommunications markets to competition.[5] Section 254(b) of the Act directs the Federal-State Joint Board on Universal Service (Joint Board) and the Commission to base policies for the preservation and advancement of universal service on several general principles, plus other principles that the Commission may establish.[6] Among other things, section 254(b) directs that there should be specific, predictable, and sufficient federal and state universal service support mechanisms; quality services should be available at just, reasonable, and affordable rates; and access to advanced telecommunications and information services should be provided in all regions of the nation.[7]

6. The Commission implemented the universal service provisions of the 1996 Act in the 1997 *Universal Service First Report and Order*.[8] In considering methods to determine universal service support in rural, insular, and high-cost areas, the Commission examined the use of competitive bidding, and identified several advantages of competitive bidding as a method for allocating high-cost universal service support.[9] First, the Commission found that "a compelling reason to use competitive bidding is its potential as a market-based approach to determining universal service support, if any, for any given area."[10] Second, "by encouraging more efficient carriers to submit bids reflecting their lower costs, another advantage of a properly structured competitive bidding system would be its ability to reduce the amount of support needed for universal service."[11] Despite these advantages, the Commission determined that the record at the time was insufficient to support adoption of a competitive bidding mechanism.[12] Moreover, the Commission found it unlikely that competitive bidding mechanisms would be useful at that time because there likely would be no competition in a significant number of rural, insular, or high-cost areas in the near future.[13] The Commission, therefore, declined to adopt a competitive bidding mechanism at that time, but found that competitive bidding warranted further consideration as a potential mechanism for determining levels of high-cost support in the future.[14]

7. Pursuant to section 254(e) of the Act, an entity must be designated as an eligible telecommunications carrier (ETC) to receive high-cost universal service support.[15] ETCs may be

---

[5] 47 U.S.C. § 254.

[6] *See* 47 U.S.C. § 254(b).

[7] 47 U.S.C. § 254(b)(1), (2), (5).

[8] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8780–88, paras. 1–20 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

[9] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[10] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 (agreeing with the Joint Board). The Commission also agreed with the Joint Board that "competitive bidding is consistent with section 254, and comports with the intent of the 1996 Act to rely on market forces and to minimize regulation." *Id*. at 8951, para. 325.

[11] *Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320 ("In that regard, the bidding process should also capture the efficiency gains from new technologies or improved productivity, converting them into cost savings for universal service.").

[12] *See Universal Service First Report and Order*, 12 FCC Rcd at 8949–50, paras. 322–23. Only GTE had proposed a detailed competitive bidding plan, which it characterized as an outline rather than a final proposal. *See* GTE's Comments in Response to Questions, CC Docket No. 96-45, Attach. 1 (filed Aug. 2, 1996).

[13] *See Universal Service First Report and Order*, 12 FCC Rcd at 8950, para. 324.

[14] *See Universal Service First Report and Order*, 12 FCC Rcd at 8948, para. 320.

[15] 47 U.S.C. § 254(e). The statutory requirements for ETC designation are set out in section 214(e) of the Communications Act of 1934, as amended (Communications Act or Act). 47 U.S.C. § 214(e).

incumbent LECs, or non-incumbent LECs, which are referred to as "competitive ETCs."[16] Under the existing high-cost support distribution mechanism, incumbent LEC ETCs receive high-cost support for their intrastate services based on their costs.[17] Competitive ETCs, on the other hand, receive support for each of their lines based on the per-line support the incumbent LEC receives in the service area.[18] This support to competitive ETCs is known as "identical support." The Commission's universal service high-cost support rules do not distinguish between primary and secondary lines; therefore, high-cost support may go to a single end user for multiple connections.[19] Further, the Commission's rules may result in multiple competitors in the same high-cost area receiving identical per-line support.

8. High-cost support for competitive ETCs has grown rapidly over the last several years, which has placed extraordinary pressure on the federal universal service fund.[20] In 2001, high-cost universal service support totaled approximately $2.6 billion.[21] By 2007, the amount of high-cost support had grown to approximately $4.3 billion per year.[22] In recent years, this growth has been due mostly to increased support provided to competitive ETCs, which pursuant to the identical support rule receive high-cost support based on the incumbent LEC's per-line support. Competitive ETC support, in the six years from 2001 through 2007, has grown from under $17 million to $1.18 billion—an annual growth rate of over 100 percent.[23] This "funded competition" has grown significantly in a large number of rural, insular, or high-cost areas; in some study areas, more than 20 competitive ETCs currently receive support.[24]

---

[16] *See* 47 C.F.R. § 54.5 ("A 'competitive eligible telecommunications carrier' is a carrier that meets the definition of 'eligible telecommunications carrier' below and does not meet the definition of an 'incumbent local exchange carrier' in § 51.5 of this chapter.").

[17] Non-rural incumbent LEC ETCs receive support for their intrastate supported services based on the forward-looking economic cost of providing the services. 47 C.F.R. § 54.309. Rural incumbent LEC ETCs receive support based on their loop costs, as compared to a national average. 47 C.F.R. Part 36, sbpt. F; 47 C.F.R. § 54.305. Incumbent LEC ETCs that serve study areas with 50,000 or fewer lines receive support based on their local switching costs. 47 C.F.R. § 54.301. Additionally, incumbent LEC ETCs that are subject to price cap or rate-of-return regulation receive interstate access support based on their revenue requirements. 47 C.F.R. Part 54, sbpts. J, K.

[18] 47 C.F.R. § 54.307(a).

[19] *See Universal Service First Report and Order*, 12 FCC Rcd at 8828–30, paras. 94–96.

[20] Support for the fund derives from assessments paid by providers of interstate telecommunications services and certain other providers of interstate telecommunications. *See* 47 C.F.R. § 54.706. Fund contributors are permitted to, and almost always do, pass those assessments though to their end-user customers. *See* 47 C.F.R. § 54.712. Fund assessments paid by contributors are determined by applying the quarterly contribution factor to the contributors' contribution base revenues. In the second quarter of 2007, the contribution factor reached 11.7%, which is the highest level since its inception. *See Proposed Second Quarter 2007 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 22 FCC Rcd 5074, 5077 (OMD 2007). The contribution factor has since declined to 11.4% in the fourth quarter of 2008. *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD 2008).

[21] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 3.2 (2007) (2007 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-279226A1.pdf.

[22] UNIVERSAL SERVICE ADMINISTRATIVE COMPANY, 2007 ANNUAL REPORT 43 (2007) (USAC 2007 ANNUAL REPORT), *available at* http://www.usac.org/_res/documents/about/pdf/usac-annual-report-2007.pdf.

[23] 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 3.2; USAC 2007 ANNUAL REPORT at 45.

[24] *See* USAC Quarterly Administrative Filings for 2008, Fourth Quarter (4Q) Appendices, HC03—Rural Study Areas with Competition—4Q2008, *available at* http://www.usac.org/about/governance/fcc-

(continued….)

9. To address the growth in competitive ETC support, the Joint Board recommended an interim cap on the amount of high-cost support available to competitive ETCs, pending comprehensive high-cost universal service reform. The Commission adopted this recommendation in 2008.[25]

10. For the past several years, the Joint Board and the Commission have been exploring ways to reform the Commission's high-cost program. In the most recent high-cost support comprehensive reform efforts, the Joint Board issued a recommended decision on November 20, 2007.[26] The Joint Board recommended that the Commission address reforms to the high-cost program and make "fundamental revisions in the structure of existing Universal Service mechanisms."[27] Specifically, the Joint Board recommended that the Commission should: (1) deliver high-cost support through a provider of last resort fund, a mobility fund, and a broadband fund[28]; (2) cap the high-cost fund at $4.5 billion, the approximate level of 2007 high-cost support[29]; (3) reduce the existing funding mechanisms during a transition period[30]; (4) add broadband and mobility to the list of services eligible for support under section 254 of the Act[31]; (5) eliminate the identical support rule[32]; and (6) "explore the most appropriate auction mechanisms to determine high-cost universal service support."[33]

11. On January 29, 2008, the Commission released three notices of proposed rulemaking addressing proposals for comprehensive reform of high-cost universal service support.[34] In the *Identical*

(continued from previous page)
filings/2008/Q4/HC03%20-%20Rural%20Study%20Areas%20with%20Competition%20-%204Q2008.xls (showing 24 competitive ETCs in the study area of incumbent LEC Iowa Telecom North (study area code 351167), and 22 competitive ETCs in the study area of incumbent LEC Iowa Telecom Systems (study area code 351170)).

[25] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No.96-45, Recommended Decision, 22 FCC Rcd 8998, 8999–9001, paras. 4–7 (JB 2007) (*Interim Cap Recommended Decision*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service,* WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (2008) (*Interim Cap Order*). As recommended by the Joint Board, the Commission capped competitive ETC support for each state. *Interim Cap Recommended Decision*, 22 FCC Rcd at 9002, para. 9; *Interim Cap Order*, 23 FCC Rcd at 8846, paras. 26–28. The Commission set the cap at the level of support competitive ETCs were eligible to receive during March 2008. *Interim Cap Order*, 23 FCC Rcd at 8850, para. 38.

[26] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Recommended Decision, 22 FCC Rcd 20477 (JB 2007) (*Comprehensive Reform Recommended Decision*).

[27] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 1.

[28] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20480–81, para. 11.

[29] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26.

[30] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 27.

[31] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481–82, paras. 12–18.

[32] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20486, para. 35.

[33] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, paras. 1–6.

[34] *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1467 (2008) (*Identical Support NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1495 (2008) (*Reverse Auctions NPRM*); *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Notice of Proposed Rulemaking, 23 FCC Rcd 1531 (2008) (*Joint Board Comprehensive Reform NPRM*) (collectively the *High-Cost Reform NPRMs*).

Support NPRM, the Commission sought comment on the Commission's rules governing the amount of high-cost universal service support provided to competitive ETCs.[35] It tentatively concluded that the Commission should eliminate the identical support rule.[36] The Commission also tentatively concluded that support to a competitive ETC should be based on the competitive ETC's own costs of providing the supported services, and it sought comment on how the support should be calculated, the reporting obligations to be applied, and whether the Commission should cap such support at the level of the incumbent LEC's support.[37] In the *Reverse Auctions NPRM*, the Commission tentatively concluded that reverse auctions offer several potential advantages over current high-cost mechanisms and sought comment on whether they should be used as the disbursement mechanism to determine the amount of high-cost universal service support for ETCs serving rural, insular, and high-cost areas, and it sought comment on how to implement reverse auctions for this purpose.[38] The Commission also sought comment on a number of specific issues regarding auctions and auction design.[39] The Commission also released the *Joint Board Comprehensive Reform NPRM*, seeking comment on the Joint Board's *Comprehensive Reform Recommended Decision* and incorporating by reference the *Identical Support NPRM* and the *Reverse Auctions NPRM*.[40] The discussion that follows represents our response to the Joint Board's *Comprehensive Reform Recommended Decision*, pursuant to section 254(a)(2).[41]

B. Discussion

12. Today we comprehensively reform the high-cost universal service support mechanism, and take steps to ensure that broadband Internet access service is deployed quickly to all areas of the country, including rural and insular areas. The steps we take today will provide certainty to providers as to the levels of support available to them in providing supported services and broadband Internet access service to all customers within the supported areas. This will assist providers in creating business plans to deploy services in currently unserved areas and will ensure efficiency in the deployment of services to these areas. Specifically, we are defining the level of high-cost support available to providers that commit to offer broadband to all customers within a service area. Support in incumbent LEC service areas will be set at the total amount of high-cost support disbursed to the incumbent LEC ETC in December 2008 on an annualized basis. Incumbent LEC ETCs will continue to receive this level of support if they commit to offer broadband Internet access services to all customers within the service area within five years. If an incumbent LEC does not make this broadband commitment for a particular service area, the support will be transitioned to the winning bidder of a reverse auction that will commit to deploy broadband throughout the service area within ten years, and to take on carrier of last resort obligations. Competitive ETCs will receive high-cost support, based on their own costs as compared to the relevant high-cost support thresholds, so long as they, too, commit to offer broadband Internet access service to all customers in their service areas within five years. While ensuring that broadband Internet access service is made available to customers in rural and high-cost areas, we also cap the overall size of the high-cost mechanism to protect customers in all areas of the nation from increasing universal service contribution

---

[35] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

[36] *Identical Support NPRM*, 23 FCC Rcd at 1468, para. 1.

[37] *Identical Support NPRM*, 23 FCC Rcd at 1473–78, paras. 12–25.

[38] *Reverse Auctions NPRM*, 23 FCC Rcd at 1495, para. 1.

[39] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500–12, paras. 10–50.

[40] *Joint Board Comprehensive Reform NPRM*, 23 FCC Rcd at 1531, para. 1.

[41] 47 U.S.C. § 254(a)(2). Pursuant to that section, the Commission shall complete any proceeding to implement a Joint Board recommendation within one year after receiving it. The Commission has acted on the *Comprehensive Reform Recommended Decision* prior to the November 20, 2008 one-year statutory deadline.

assessments.

13. The requirements that we adopt for disbursement of high-cost universal service support do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions.[42] We find that these areas have very different attributes and related cost issues than do the continental states.[43] For this reason, we are exempting providers in Alaska, Hawaii and U.S. Territories or possessions from the high-cost support requirements and rules adopted herein, and we will address them in a subsequent proceeding.[44]

1. Controlling the Growth of the High-Cost Fund

14. Consistent with the recommendation of the Joint Board, we cap the total amount of high-cost universal service support.[45] As the Joint Board recognized, high-cost support currently accounts for more than half of total federal universal service support.[46] Since 1997, when the Commission implemented the universal service requirements of section 254 of the Act, high-cost support has increased by 240 percent.[47] Although, earlier this year, we took an initial step to address high-cost fund growth by

---

[42] Providers operating in U.S. Territories and possessions, such as Puerto Rico and Guam, are not subject to the high-cost support requirements adopted in this order. *See* Letter from Earl Comstock, Comstock Consulting LLC, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-377 at 1 (dated Oct. 15, 2008) (asking the Commission to recognize the higher costs and lower income levels in Puerto Rico in any reform efforts it may take); Letter from Eric N. Votaw, Vice President-Marketing & Regulatory, GTA Telecom, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-45, WC Docket No. 05-337 at 1–2 (filed Oct. 24, 2008) (asking the Commission to recognize that Guam's costs are higher than the continental United States and that Guam should be treated separately, along with Alaska and Hawaii, for reform purposes).

[43] *E.g., Verizon Commc'ns, Inc., Transferor, and América Móvil, S.A. de C.V., Transferee*, WT Docket No. 06-113, Memorandum Opinion and Order and Declaratory Ruling, 22 FCC Rcd 6195, 6211, para. 36 (2007) (*Verizon/América Móvil Transfer Order*) (describing "difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Integration of Rates and Services for Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands*, CC Docket No. 83-1376, Supplemental Order Inviting Comments, 4 FCC Rcd 395, 396, paras. 7–8 (1989) (*Rates and Services Integration Order*) (describing the unique market conditions and structure in Alaska); Letter from Brita D. Strandberg, Counsel for General Communication, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 05-337 at 2 (Oct. 3, 2008) (discussing Alaska's particular service needs and network architecture).

[44] *Cf. The Establishment of Policies and Service Rules for the Broadcasting-Satellite Service at the 17.3-17.7 GHz Frequency Band and at the 17.7-17.8 GHz Frequency Band Internationally, and at the 24.75-25.25 GHz Frequency Band for Fixed Satellite Services Providing Feeder Links to the Broadcasting-Satellite Service and for the Satellite Services Operating Bi-directionally in the 17.3-17.8 GHz Frequency Band*, IB Docket No. 06-123, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd 8842, 8860, para. 47 (2007) (*Policies and Service Rules for the Broadcasting-Satellite Service Order*) ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[45] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, 20481, 20484, paras. 2, 11, 26.

[46] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20484, para. 26. In 2007, total federal universal service disbursements amounted to approximately $6.95 billion. Of that amount, approximately $4.29 billion, 62%, was disbursed as high-cost support. USAC 2007 ANNUAL REPORT at 51.

[47] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at 3-14, tbl. 3.1 (high-cost support in 1997 was approximately $1.26 billion, compared with approximately $4.29 billion in 2007). Even taking into account the fact that additional interstate support mechanisms, Interstate Access Support (IAS) and Interstate Common Line Support (ICLS), were created in 2000 and 2001, respectively, high-cost support has still increased by more than 45%, from approximately $2.94 billion in 2002 to its current level of approximately $4.29 billion. *Id.*

capping support to competitive ETCs, that cap was an interim, emergency measure, pending a closer examination of the steps necessary to achieve comprehensive reform.[48] Many commenters have urged the Commission to cap the overall amount of high-cost support, rather than limiting the cap only to competitive ETCs.[49] Although other commenters oppose the adoption of a cap on the total amount of high-cost support or on the amount of support available to incumbent LEC ETCs,[50] we find that, to manage the high-cost support mechanism effectively, we must control its growth, and that capping support in the manner discussed below will provide specific, predictable, and sufficient support to preserve and advance universal service.[51]

15. We find it necessary to cap the high-cost mechanism as a first step toward fulfilling our statutory obligation to create specific, predictable and sufficient universal service support mechanisms.[52] As the United States Court of Appeals for the Fifth Circuit held in *Alenco*: "[t]he agency's broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service."[53] The *Alenco* court also found that

---

[48] *See Interim Cap Order*, 23 FCC Rcd at 8834, para. 1.

[49] *See* CenturyTel *High-Cost Reform NPRMs* Comments at 18 (existing high-cost support mechanisms should be frozen at the study area level or on a statewide basis to provide funding certainty and encourage investment); Chinook *High-Cost Reform NPRMs* Comments, Attach. at 5–6 (any cap on universal service support should apply to all ETCs, including incumbent LECs); Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 5 (supporting a cap on high-cost support set at the 2007 level); Florida PSC *High-Cost Reform NPRMs* Comments at 2 (supporting the recommendation to cap the overall size of the high-cost fund); Information Technology Industry Council (ITI) *High-Cost Reform NPRMs* Comments at 7 (an overall cap should be applied to control the size of the high-cost mechanism); NCTA *High-Cost Reform NPRMs* Comments at 19 (the Joint Board's proposal to cap the overall size of the high-cost mechanism is "a welcome dose of fiscal responsibility"); National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2–3 (supporting the Joint Board's proposal to cap the overall high-cost fund); Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 2–3, 6–9 (Commission should cap the overall high-cost fund).

[50] *See* Frontier *High-Cost Reform NPRMs* Comments at 6–7; JSI *High-Cost Reform NPRMs* Comments at 6; Montana Telecommunications Ass'n *High-Cost Reform NPRMs* Comments at 21–22; NECA *High-Cost Reform NPRMs* Comments at 17–20; TCA *High-Cost Reform NPRMs* Comments at 10–11; TDS *High-Cost Reform NPRMs* Comments at 8–9; Missouri Small Telephone Company Group (MSTC) *High-Cost Reform NPRMs* Reply at 5–7; Utah Rural Telecom Ass'n *High-Cost Reform NPRMs* Reply at 5.

[51] 47 U.S.C. § 254(b)(5); *see* CenturyTel *High-Cost Reform NPRMs* Comments at 18; Comcast *High-Cost Reform NPRMs* Comments at 3, 11; Florida PSC *High-Cost Reform NPRMs* Comments at 8–9; National Consumer Law Center *Joint Board Comprehensive Reform NPRM* Comments at 2; NCTA *High-Cost Reform NPRMs* Comments at 4–6; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Comments at 52–54; Oregon PUC *High-Cost Reform NPRMs* Comments at 2–3; Sprint Nextel *High-Cost Reform NPRMs* Comments at 3; USTelecom *High-Cost Reform NPRMs* Comments at 2; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 7; New Jersey Division of Rate Counsel *High-Cost Reform NPRMs* Reply at 64–65; Sprint Nextel *High-Cost Reform NPRMs* Reply at 8–9; State Commissioners *High-Cost Reform NPRMs* Reply at 2; Texas Office of Public Utility Counsel *Joint Board Comprehensive Reform NPRM* Reply at 2; Virgin Mobile *High-Cost Reform NPRMs* Reply at 3–4. The Commission has already implemented caps on the schools and libraries and rural health care universal service mechanisms. *Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704 (establishing a $2.25 billion annual cap for the schools and libraries mechanism and a $400 million annual cap for the rural health care mechanism); *see also* 47 C.F.R. §§ 54.507(a), 54.623(a).

[52] 47 U.S.C. § 254(b)(5); *see also Universal Service First Report and Order*, 12 FCC Rcd at 9054, 9140, paras. 529, 704.

[53] *Alenco Commc'ns, Inc. v. FCC*, 201 F.3d 608, 620–21 (5th Cir. 2000) (*Alenco*).

"excessive funding may itself violate the sufficiency requirements,"[54] and the United States Court of Appeals for the Tenth Circuit has stated that "excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in [section] 254(b)(1)."[55] Given the excessive growth in high-cost support, we find it necessary to cap this mechanism to ensure that unsubsidized users who contribute to the fund are not harmed by excessive subsidization.

16. Therefore, we take several steps to limit the growth of high-cost support. First, we cap the overall high-cost fund at the total amount of high-cost support disbursed by the Universal Service Administrative Company (USAC) for December 2008 on an annualized basis, net of any prior or past period adjustments. Although we agree with the Joint Board's recommendation to cap the high-cost mechanism, rather than set such a cap at the 2007 level of high-cost support as the Joint Board recommended, we find it is more appropriate to set the cap at the level of support disbursed by USAC in December 2008 on an annualized basis. Furthermore, we freeze each incumbent LEC ETC's individual, annual high-cost support at the amount of support, on a lump sum basis, that the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[56]

17. As discussed below, we also eliminate the identical support rule for competitive ETCs. Competitive ETCs' support levels will be based on their costs as compared to the relevant high-cost support mechanism benchmarks, and frozen at the amount of support, on a lump sum basis, that the competitive ETC received in 2008 on a study area basis.[57]

18. Consistent with section 254(b)(5) of the Act, we find that capping high-cost support in this manner will enable ETCs to predict the specific level of support that they will receive should they choose to participate in the program.[58] To the extent that an incumbent LEC ETC determines that it cannot offer broadband Internet access service throughout its service area at the specified level of support, as discussed below, that particular study area will be deemed an "Unserved Study Area," and we will conduct a reverse auction to determine the entity capable of meeting our service requirements and the amount of support to provide for that area. In fact, through the reverse auction process, it will be the bidders, not the Commission, that determine how much support they would need to offer service. Finally, as discussed below, if the reverse auction process does not yield a winning bidder, the Commission will reexamine whether it needs to take further action with regard to this situation, should it arise.

2. Conditioning Support on Offering Broadband Internet Access Service

19. The broadband era is here. Those of us who have broadband Internet access service use it to communicate, to work, to get vital information, to be educated, and to be entertained. Broadband Internet access service—a novelty at the time of the passage of the 1996 Act—is now mainstream. Yet some Americans still lack access to this vital service, and as Commissioner Copps has said, "does

---

[54] *Alenco*, 201 F.3d at 620.

[55] *Qwest Commc'ns Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

[56] Pursuant to section 214(e)(5) of the Act, the term "service area" is used to refer to the geographic area established by a state commission or this Commission for the purpose of determining universal service obligations and support mechanisms. 47 U.S.C. § 214(e)(5). For a rural telephone company, section 214(e)(5) states that "service area" shall mean the rural company's "study area" unless and until the Commission and the states establish a different definition of service area for such company. *Id.* In this order, we use the terms "service area" and "study area" interchangeably. Nothing in this order is meant to change any redefinitions of service area previously established by the Commission and/or the state commissions.

[57] *See infra* paras. 53–56.

[58] 47 U.S.C. § 254(b)(5).

America at the beginning of the 21st century become technologically stagnant or the leader of the Digital Age? For me, the answer to that question depends in some significant measure upon whether we succeed in bringing high-speed, high-value broadband and an open Internet to all Americans . . . rural as well as urban folks . . . ."[59]

20. Today, we modify our high-cost support system fundamentally to spur deployment and ensure that all Americans have access to broadband. Specifically, we make offering broadband Internet access service a condition of being eligible to receive high-cost support. As we explain below, we will require all incumbent LECs to certify whether or not they will commit to offering broadband Internet access throughout their supported study areas in five years.[60] Those who make that commitment will continue to receive their current levels of support. Existing competitive ETCs likewise will have the opportunity to commit to offering broadband Internet access service throughout their supported service areas, and will be eligible to receive high-cost support based on their actual costs. Auction winners, as well, must commit to offering broadband Internet access service throughout their supported areas as a condition of receiving even initial support. In other words, all ETCs are subject to the same basic obligation—to offer broadband Internet access throughout their supported service areas. We also explain the obligations related to this condition, including carrier-of-last-resort-type obligations.

21. We believe that imposing this condition on the receipt of high-cost support is fully consistent with and indeed promotes Congress's overall objectives as stated in section 254 of the Communications Act and section 706 of the 1996 Act.[61] Section 254(b)(2) of the Act instructs the

---

[59] Remarks of Commissioner Michael J. Copps, Pike & Fischer's Broadband Policy Summit IV, Washington, DC (June 12, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-282890A1.pdf.

[60] *See supra* note 56 (explaining use of the terms "study area" and "service area" in this order). We understand the concern of commenters who point out the need for more granular information on broadband availability. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20481, para. 13; *see also* Comcast *High-Cost Reform NPRMs* Comments at 13–16; GCI *High-Cost Reform NPRMs* Comments at 34–36; NCTA *High-Cost Reform NPRMs* Comments at 20; New Jersey Rate Counsel *High-Cost Reform NPRMs* Comments at 21–22; New York State PSC *Joint Board Comprehensive Reform NPRM* Comments at 1, 5–6; TCA *High-Cost Reform NPRMs* Comments at 11–12; USTelecom *High-Cost Reform NPRMs* Comments at 36; Embarq *High-Cost Reform NPRMs* Reply at 8–10. The Commission has recently undertaken a major effort to gather more specific and granular data about broadband subscribership and availability. *See Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 9691, 9708–09, paras. 34–35 (2008) (*Broadband Data Gathering Order*) (seeking comment on, among other things, adopting a national broadband mapping program). We believe our refined broadband data gathering program will help all of us better assess where our broadband availability needs are greatest. For purposes of implementing the broadband deployment program of this order, we ask incumbent LECs to identify where they will and will not commit to broadband availability, thus identifying where we need to proceed to a reverse auction.

[61] 47 U.S.C. §§ 157 nt, 254. Some commenters suggest that adding broadband Internet access service to the list of "supported services" would be inconsistent with section 254(c)(1) of the Act because broadband Internet access service is an information service, not a telecommunications service. *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 30–31; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 31–32; SouthernLINC *High-Cost Reform NPRMs* Reply at 42–43; Sprint Nextel *High-Cost Reform NPRMs* Reply at 16–17. Using the universal service program to ensure universal broadband availability, however, is fully consistent with the statute as explained above. In addition, section 254(c)(2) provides that "[t]he Joint Board may, from time to time, recommend to the Commission modifications in the definition of the services that are supported by Federal universal service support mechanisms." 47 U.S.C. § 254(c)(2). The Joint Board did just that in the *Comprehensive Reform Recommended Decision*, in which it recommended that we add broadband Internet access service to the list of services eligible for support under section 254. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at

(continued….)

Commission to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[62] Similarly, section 254(b)(3) states that "[c]onsumers . . . in rural, insular, and high-cost areas, should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[63] Indeed, Congress even established the definition of universal service as "an *evolving* level of telecommunications services . . . taking into account advances in telecommunications and information technologies and services."[64] We believe that imposing a broadband condition on receipt of high-cost support advances the general purposes of section 254 of the Act as just described and also advances Congress's objective stated in section 706 of the 1996 Act to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans."[65] We also see no reason why conditioning the receipt of high-cost support on offering broadband Internet access service is not permissible under the Commission's authority to promulgate general rules related to universal service.[66]

22. *Broadband Internet Access As a Condition to Receiving High-Cost Support.* Consistent with the objectives of sections 254 and 706 as just described, all ETCs must offer broadband Internet access service to all customers in their supported service areas as a condition of receiving universal service high-cost support. Since the Commission adopted universal service rules in response to the 1996 Act, broadband Internet access service has evolved into a critical service for American consumers. The importance of this evolution is reflected in Congress's recent finding that "[t]he deployment and adoption of broadband technology has resulted in enhanced economic development and public safety for communities across the Nation, improved heath care and education opportunities, and a better quality of life for all Americans, [and] [c]ontinued progress in the deployment and adoption of broadband technology is vital to ensuring that our Nation remains competitive and continues to create business and job growth."[67] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and so many other uses.[68] Broadband Internet access plays a special role in

(continued from previous page)
20491, para. 56. In this order, we achieve the Joint Board's goal by conditioning receipt of federal high-cost support on an ETC's commitment to offer broadband Internet access service throughout its service area, but we do not add broadband Internet access service to the list of universal service supported services.

[62] 47 U.S.C. § 254(b)(2) (emphasis added).

[63] 47 U.S.C. § 254(b)(3) (emphasis added).

[64] 47 U.S.C. § 254(c)(1) (emphasis added).

[65] 47 U.S.C. §§ 157 nt, 254.

[66] The Commission has previously considered imposing conditions on the receipt of high-cost support. *See Universal Service First Report and Order*, 12 FCC Rcd at 8831, para. 98. And of course, today's recipients of high-cost support must comply with many obligations that are not explicitly spelled out in the statute. For example, to be designated as an ETC, an applicant must demonstrate that it has back-up power. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 20 FCC Rcd 6371, 6382, para. 25 (2005) (*ETC Designation Order*).

[67] Broadband Data Improvement Act, Pub. L. No. 100-385, 122 Stat. 4096, § 102(1)–(2) (2008).

[68] A recent survey finds that, compared to Internet users with dial-up service at home, those with broadband service at home are far more likely to engage in 14 different types of Internet-related activities on a typical day. These activities include using an online search engine, checking for weather reports, getting news, visiting a state or local government Web site, obtaining job information, watching a video, and downloading a podcast. The daily use of a search engine, for example, is reported by 57% of the broadband users as compared to only 26% of the dial-up users.
(continued….)

rural areas, reducing the burdens of distance.[69] For example, high-speed connections to the Internet allow children in rural areas to have access to the same information as school children in urban areas. Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare in sparsely populated, rural areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[70] Broadband service also enables the sharing of critical, time-sensitive information with first responders, government officials, and health care providers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis in coordination.[71]

23. Despite the advances in broadband technology and the deployment of infrastructure to accommodate higher bandwidth speeds, ubiquitous broadband availability does not exist throughout the nation—especially for those consumers in rural areas.[72] In March 2008, the Commission's most recent data revealed that more than half of the households in the United States now subscribe to a high-speed service provider and at least one high-speed service provider is providing service in excess of 200 kbps in at least one direction in 99.9 percent of zip codes in the country.[73] The broadband subscription rate is much lower in rural areas, however. A 2008 survey finds that the percentage of rural households subscribing to broadband service is only 38 percent—well below the 57 percent and 60 percent subscription rates found in urban and suburban areas, respectively.[74] This survey concludes that the lack of broadband availability very likely accounts for some of this disparity.[75] Moreover, this conclusion is

(continued from previous page)
See JOHN B. HORRIGAN, PEW INTERNET & AMERICAN LIFE PROJECT, HOME BROADBAND ADOPTION 2008 at 19 (2008) (2008 PEW BROADBAND ADOPTION STUDY), *available at* http://www.pewinternet.org/pdfs/PIP_Broadband_2008.pdf.

[69] For example, the California Broadband Task Force Report finds broadband service critical to expanding job opportunities for rural residents. It observes, for example, that broadband has facilitated the use of "homeshoring," or the use of home-based workers for providing customer service, instead of requiring employees to adhere to a strict work schedule at a centralized location. This report also finds that broadband offers farmers better access to market information and allows them to expand their potential customer base. *See* FINAL REPORT OF THE CALIFORNIA BROADBAND TASK FORCE at 13 (Jan. 2008) (CALIFORNIA 2008 BROADBAND REPORT), *available at* http://www.calink.ca.gov/taskforcereport/.

[70] *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111, 11112, para. 5 (2006); *see also* SUSANNAH FOX, PEW INTERNET & AMERICAN LIFE PROJECT, THE ENGAGED E-PATIENT POPULATION at 1 (2008) (finding that home broadband users are twice as likely as home dial-up users to do health research on a typical day), *available at* http://www.pewinternet.org/pdfs/PIP_Health_Aug08.pdf.

[71] A recent report to Congress concludes that "[m]odern broadband communications networks and applications present an enormous opportunity to radically improve the manner in which emergency information is shared by health officials. Broadband services enable bandwidth intensive information such as video, pictures, and graphics to be transmitted faster and in a more reliable and secure manner." JOINT ADVISORY COMMITTEE ON COMMUNICATIONS CAPABILITIES OF EMERGENCY MEDICAL AND PUBLIC HEALTH CARE FACILITIES, REPORT TO CONGRESS 2 (Feb. 4, 2008), *available at* http://energycommerce.house.gov/Press_110/JAC.Report_FINAL%20Jan.3.2008.pdf.

[72] *See, e.g.*, Cellular South *High-Cost Reform NPRMs* Comments at 10; *see also generally* 2008 PEW BROADBAND ADOPTION STUDY at 11–12.

[73] *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl. 15 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-280906A1.pdf.

[74] *See* 2008 PEW BROADBAND ADOPTION STUDY at 3–4. The survey was conducted by phone from April 8, 2008 to May 11, 2008 among 2,251 American adults, 1,153 of whom were broadband users. *Id.*

consistent with the results of residential surveys in several states.[76] We find that making the offering of broadband Internet access service a condition of receiving universal service high-cost support can bring this critical service to the remainder of Americans who await its deployment.[77] In addition, doing so will further the objective of section 254(b)(3) that consumers in rural, insular, and high-cost areas have access to advanced telecommunications and information services that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas.[78]

a. Definition of Broadband Internet Access Service

24. For purposes of satisfying the condition to receive high-cost support, we adopt a definition of broadband Internet access service that focuses on the end user's experience, without regard to the types of facilities, protocols, or other technologies used to deliver that experience. Broadband Internet access service is therefore defined as an "always on" service that combines computer processing, information provision, and computer interactivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed elsewhere in this order.[79] We refer specifically to broadband Internet access service—an information service—and not to broadband

(continued from previous page)

[75] Pew acknowledges that the participants in its 2008 survey may report incorrectly as to whether broadband service is available where they live. 2008 PEW BROADBAND ADOPTION STUDY at 11. Pew nonetheless concludes that "the fact that rural residents are more likely to report that broadband isn't available where they live indicates that infrastructure availability comes into play in broadband adoption. Some 28% of rural adult Americans without home high-speed say broadband isn't available where they live, in contrast to 22% of non-rural Americans without broadband who say this. Moreover, 24% of dial-up users in rural areas say having the service available where they live would prompt a switch to broadband; this compares to the 14% figure for all respondents." *Id.* at 11–12.

[76] In Ohio, a March 2008 survey of 1,200 residents found broadband service available in 96% of urban homes but in only 79% of rural homes. *See* CONNECT OHIO TECHNOLOGY ASSESSMENT: EXECUTIVE SUMMARY at 2 (June 27, 2008), *available at* http://connectoh.org/_documents/Res_OHExecutiveSummary06252008_FINAL.pdf. In California, a state-commissioned task force recently found that approximately 500,000 California households, or almost 1.4 million California residents, are unable to subscribe to broadband service with a speed of at least 500 kbps. The task force identified 1,975 communities without broadband service and concluded that many California communities do not have access to the higher broadband speeds. *See* CALIFORNIA 2008 BROADBAND REPORT at 33. In Tennessee, a July 2007 survey of 1,787 residents having dial-up service at home found that 36% of them did not subscribe to broadband service because it was unavailable to their homes. *See* CONNECTED TENNESSEE, TENNESSEE RESIDENTIAL CONSUMERS at 22 (2007), *available at* http://www.connectedtn.org/_documents/CTResidentialSurvey100107.FINAL.pdf.

[77] We disagree with commenters who suggest that it is premature or ill-advised to require all ETCs to offer broadband because, as discussed below, we do so in a manner that does not increase the size of the high-cost fund. *See, e.g.*, SouthernLINC *High-Cost Reform NPRMs* Comments at 30; Sprint Nextel *High-Cost Reform NPRMs* Comments at 16–17; USTelecom *High-Cost Reform NPRMs* Comments at 33–34; Western Telecomms. Alliance (WTA) *High-Cost Reform NPRMs* Comments at 73; SouthernLINC *High-Cost Reform NPRMs* Reply at 41. Similarly, we disagree with commenters who argue that government action at the current time would be wasteful as the market is already taking steps to reach currently underserved areas. *See, e.g.*, NCTA *High-Cost Reform NPRMs* Comments at 19–20; SouthernLINC *High-Cost Reform NPRMs* Comments at 30; SouthernLINC *High-Cost Reform NPRMs* Reply at 42. We cannot wait indefinitely for the benefits of broadband to reach all Americans.

[78] See 47 U.S.C. § 254(b)(3).

[79] *See infra* paras. 28, 45, 52*; see also Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14860–61, para. 9 (2005) (*Wireline Broadband Internet Access Order*), *aff'd sub nom. Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

transmission alone because our goal is to ensure that all Americans have access to the Internet.[80]

b. Broadband Internet Access Service Obligations

25. Section 254(b)(1) instructs the Commission to base policies for the advancement of universal service on the principle that quality services should be offered at just, reasonable, and affordable rates.[81] Below we provide requirements for offering broadband Internet access service as a condition of receiving universal service high-cost support. In sum, all ETCs must offer broadband Internet access service, along with all supported services, to all customers throughout their service areas by the end of a five- or ten-year build-out period consistent with the requirements of this order.

26. Except as described just below, an ETC may offer broadband Internet access service using any technology, or combination of technologies, that meets the requirements for speed set forth in this order. An ETC may also combine services provided over its own facilities with those provided over another provider's facilities pursuant to agreement. Indeed, there may be service areas where it is more economic to offer broadband Internet access service via one technology than another and we explicitly provide for even a single provider to take advantage of the inherent benefits of different technologies for different areas.[82] Furthermore, an ETC can combine a common carrier offering of broadband transmission[83] with the information processing capabilities described above,[84] so long as what the end user receives is in fact broadband Internet access service.

27. An ETC cannot use satellite broadband technology to meet its obligations under this order, however, absent a waiver from the Commission. We are concerned that broadband Internet access service provided via satellite differs from broadband Internet access provided over other technologies in two important ways. First, satellite-provided broadband Internet access service is subject to latency due to the amount of time it takes a signal to travel between the satellite and the user.[85] Latency ranges from a quarter of a second to almost a second, making the use of applications that require a very fast response difficult or impossible, and substantially degrading the quality of other applications like voice over Internet protocol.[86] Second, satellite-provided broadband Internet access service is subject to degradation

---

[80] As explained below, nothing in this order changes the choice that providers have today to offer broadband transmission on a common carrier basis. *See infra* para. 26.

[81] 47 U.S.C. § 254(b)(1).

[82] Thus, we are not favoring wireline technology over another. *But see* Virgin Mobile *High-Cost Reform NPRMs* Reply at 5–6.

[83] *See Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14900–01, paras. 89–90 (giving providers of wireline broadband Internet access the choice to offer broadband transmission on a common carrier basis or a non-common carrier basis).

[84] *See supra* para. 24.

[85] *See, e.g.*, COMPUTER SCIENCE AND TELECOMMUNICATIONS BOARD, NATIONAL RESEARCH COUNCIL, BROADBAND: BRINGING HOME THE BITS 145 (2002) (BRINGING HOME THE BITS); BroadbandInfo.com, Inside the World of Satellite Broadband, BroadbandInfo.com, http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last visited Nov. 3, 2008) (stating that because the satellites providing broadband signals orbit the earth approximately 22,300 miles above the surface, there is a lag time between the sending and receiving of the satellite broadband signal).

[86] *See* BRINGING HOME THE BITS 145 (explaining that for Internet telephony, the delay can cause a real degradation in usability); Jon Norwood, Overview of Satellite Internet—Comparing the Main Features of Broadband Satellite (Oct. 17, 2006), *available at* http://www.velocityguide.com/satellite/satellite-internet-comparison.html (last visited Oct. 24, 2008) (stating that signal delay to a satellite ranges from around 500 to 900 milliseconds, and that this latency can render any software that requires real-time user input problematic at best); BroadbandInfo.com, Inside the World of Satellite Broadband, *available at* http://www.broadbandinfo.com/satellite/intro-to-satellite.html (last

(continued….)

due to weather events ("rain fade") to a greater degree than other wireless technologies.[87] For these reasons, we find that satellite-provided broadband Internet access service cannot be the primary means by which we serve rural America. We recognize, however, that for certain customers, satellite-provided broadband may be the only economic means of reaching them. Therefore, ETCs may apply to the Commission for a waiver to be able to meet their commitments under this order by offering broadband Internet access service via satellite to certain customers, based on a specific, detailed showing that there is no other economic option for serving those customers.[88] If the Commission grants such a waiver with regard to particular customers, that waiver may be transferred if a different ETC becomes subject to the obligation to offer broadband to those customers.

3. Incumbent LECs' Commitment to Offer Broadband

28. As discussed above, as a condition of receiving federal high-cost universal service support, all ETCs must offer broadband Internet access service.[89] Therefore, incumbent LECs receiving high-cost support must certify to the Commission, for each study area[90] for which they receive high-cost support, whether or not they will offer broadband Internet access service to all customers within that study area, consistent with the requirements of this order, within five years of the due date of their commitment.[91] This certification must include a commitment to offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[92]

29. Incumbent LECs that file a certification for a particular study area indicating that they will offer broadband Internet access service under the terms specified in this order will continue to receive their current levels of high-cost support for that study area, which will be deemed a "Committed Study Area." We specify the precise benchmarks that the incumbent LEC must meet over the five-year build-out period, and the consequences for failure to do so, below.[93]

(continued from previous page)
visited Oct. 24, 2008) (stating that for certain broadband Internet real-time applications, such as e-gaming, the latency is enough to cause severe interference with the application).

[87] *See, e.g.*, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, Second Report, 15 FCC Rcd 20913, 20938, para. 59 (2000) (explaining that areas subject to extreme rain or snow may have difficulty receiving satellite signals in those conditions, and describing it as a limitation to satellite Internet last-mile facilities); *see also* Howstuffworks.com, How Does Satellite Internet Operate?, http://computer.howstuffworks.com/question606.html (last visited Oct. 24, 2008) (explaining that, as for satellite TV, heavy rains can affect reception of Internet signals); Skycasters, Broadband Satellite Internet: 99.44% System Reliability, http://www.skycasters.com/satellite-internet-service-specs/system-reliability.html (last visited Oct. 31, 2008) (explaining that rain fade is a short duration period during which the loss of satellite service occurs when intense storm cells are located directly between the satellite and the satellite dish).

[88] If the Commission grants a waiver allowing the use of satellite service, the ETC may not charge a higher price to customers served by satellite than it charges to customers served by another broadband technology.

[89] *See supra* paras. 19–27.

[90] *See supra* note 56 (explaining the use of the terms "study area" and "service area" in this order).

[91] The Wireline Competition Bureau (Bureau) will release a public notice at a future date specifying the manner and due date of the certification. Other reporting, monitoring, and milestone requirements are set forth below. *See infra* paras. 57–63.

[92] This tier of broadband is similar to the tier described as "Basic Broadband Tier 1" in our *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700–01, para. 20 & n.66.

[93] *See infra* paras. 57–63.

30. As discussed above, we freeze each incumbent LEC ETC's individual high-cost support at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area or service area basis.[94] Incumbent LEC ETCs committing to offer broadband Internet access service within a study area consistent with the requirements of this order will continue to receive the frozen high-cost support amount for that study area.[95]

31. Study areas for which incumbent LECs either certify that they will not offer broadband in five years as described herein, or for which the incumbent LECs fail to file any certification at all, will be deemed "Unserved Study Areas." For these areas, the Commission will conduct a reverse auction as described below, awarding high-cost support to a bidder that will commit to take on carrier of last resort obligations and to offer broadband Internet access service throughout the study area.

4. Reverse Auctions for Study Areas Unserved by Broadband

32. The Joint Board recommended that the Commission's universal service goals include universal availability of broadband Internet service at affordable and comparable rates for all rural and non-rural areas.[96] While we are not adopting the Joint Board's recommendation to create a separate broadband fund, we agree with the Joint Board's goal that broadband Internet access service should be universally and affordably available. We are therefore allowing incumbent LECs and competitive ETCs receiving high-cost support to continue to receive such support if they commit to offer broadband services throughout their supported service areas by the end of a five-year build-out period. We anticipate, however, that in some study areas, the incumbent LEC may decline to make that commitment. For these Unserved Study Areas, we will conduct a reverse auction for the right to receive high-cost support.[97]

33. We sought comment in our *Reverse Auctions NPRM* on the merits of using reverse

---

[94] *See supra* para. 16.

[95] Some incumbent LECs assert that they will not be able to commit to provide broadband Internet access service to all customers within their study areas at the frozen level of support. *See, e.g.*, Letter from Eric N. Einhorn, V.P. Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 06-122, 08-152, 07-135, at 3 (filed Oct. 27, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket No. 05-337, at 2 (filed Oct. 20, 2008); Letter from Daniel Mitchell, Vice President Legal & Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 04-36, at 1-2 (filed Oct. 28, 2008). First, to the extent incumbent LECs cannot build out their networks to provide broadband to all customers in their study areas, they may seek a waiver to provide service via satellite technology, as discussed above. Second, universal service support is not meant to subsidize high-cost carriers, but rather it is meant to support customers in high-cost areas. *See Alenco*, 201 F.3d at 620 ("The Act only promises universal service, and that is a goal that requires sufficient funding of customers, not providers. So long as there is sufficient and competitively-neutral funding to enable all customers to receive basic telecommunications services, the FCC has satisfied the Act and is not further required to ensure sufficient funding of every local telephone provider as well."). Therefore, if an incumbent LEC cannot provide broadband service at the frozen support levels, support will go to a reverse auction winning bidder who can provide such service at or below that level on a more efficient basis. Finally, as discussed below, to the extent that a reverse auction does not produce a winning bidder, the Commission will reexamine support to that study area.

[96] *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20491–92, paras. 56–62.

[97] Many commenters, in particular those representing rural telephone companies, opposed the use of reverse auctions to award high-cost support to carriers of last resort in rural areas. *See, e.g.*, OPASTCO *Reverse Auctions* Comments at 16–21; NTCA *Reverse Auctions* Comments at 30–46. Under the measures we adopt today, reverse auctions will be conducted only in study areas for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service.

auctions, a form of competitive bidding, to decide how much high-cost support to provide to ETCs serving rural, insular, and high-cost areas.[98] In a reverse auction, support generally would be determined by the lowest bid to serve the auctioned area.[99] We conclude that using a reverse auction method for identifying both the recipient of high-cost support for an Unserved Study Area, as well as the amount of support, is appropriate because the winning bid should approach the minimum level of subsidy required to achieve our universal service goals.[100] In contrast, a support mechanism based on cost or on a cost model provides no incentive for an ETC to provide supported services at the minimum possible cost.[101] In addition, a reverse auction provides a fair and efficient means of eliminating or reducing the subsidization of multiple ETCs in a given region.[102] For these reasons, we find that a reverse auction offers advantages over the current high-cost support distribution mechanisms and we adopt a reverse auction plan, as discussed below.[103]

34. To implement the reverse auctions, there are several issues that must be addressed. We describe in this part: (1) the geographic area to be auctioned; (2) the reserve price for the reverse auction; (3) what a winning bidder will receive; (4) how the winning bidder will be selected; and (5) the qualifications a bidder must demonstrate before it may participate in a reverse auction.

a. Geographic Area

35. In the *Reverse Auctions NPRM*, we sought comment on whether we should use the study area[104] as the geographic area for reverse auctions.[105] We observed that high-cost support today is

---

[98] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 10.

[99] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[100] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Connecticut Dep't of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 7 (supporting reverse auctions as a means of controlling and reducing the size of the universal service fund, while putting the burden on providers to estimate bid amounts); Comcast *High-Cost Reform NPRMs* Comments at 7 (noting that the use of reverse auctions could reduce the size of the high-cost fund significantly).

[101] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11; *see* Letter from Grover Norquist, Americans for Tax Reform, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 1 (filed Apr. 14, 2008) (arguing that reverse auctions will create incentives to invest in rural communities and will not finance and subsidize wasteful carriers).

[102] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500, para. 11.

[103] Although several rural LEC commenters oppose the use of reverse auctions to distribute high-cost support, as discussed above, incumbent LECs will not be required to participate in a reverse auction to receive support, so long as they commit to deploy broadband throughout their study areas. *See, e.g.*, ATA *High-Cost Reform NPRMs* Comments at 13–15 (opposing the use of reverse auctions); Alexicon *Reverse Auctions NPRM* Comments at 2–3 (opposing reverse auctions for rural LECs).

[104] A study area is a geographic segment of an incumbent LEC's telephone operations. Generally, a study area corresponds to an incumbent LEC's entire service territory within a state. *Direct Communications Cedar Valley, LLC and Qwest Corporation Joint Petition for Waiver of the Definition of "Study Area" of the Appendix-Glossary of Part 36 of the Commission's Rules*, *Petition for Waiver of Section 69.2(hh) and 69.605(c) of the Commission's Rules*, CC Docket No. 96-45, Order, 20 FCC Rcd 19180, 19181, para. 2 (WCB 2005). Section 54.207 of the Commission's rules provides that a rural telephone company's service area will be its study area "unless and until the Commission and the states, after taking into account recommendations of a Federal-State Joint Board instituted under section 410(c) of this Act, establish a different definition of service area for such company." 47 C.F.R. § 54.207(b); 47 U.S.C. § 214(e)(5). As discussed above, we use the terms "study area" and "service area" interchangeably in this order. *See supra* note 56.

[105] *See Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20.

generally based on the wireline incumbent LEC's study area.[106] We tentatively concluded that the wireline incumbent LEC's study area would be the appropriate geographic area on which to base reverse auctions.[107] We adopt our tentative conclusion that the study area is the best geographic area to use for several reasons. First, if we allowed bidders to bid to provide service in smaller geographic areas, we would encourage bidders to bid on areas that are easier or cheaper to serve, leaving our most difficult-to-serve populations still without broadband service.[108] Conversely, if we required bidders to bid on even larger geographic areas, we might discourage bidders from entering the auction because of the difficulty in committing to serve an even larger area. Although some commenters oppose using the incumbent LEC's study area,[109] use of the study area is consistent with the area we ask incumbent LECs to consider in making their commitments. Finally, selecting smaller geographic areas for auction would increase the number of auctions to be held, potentially delaying the conduct of the auction and, therefore, the deployment of broadband to unserved areas.[110] For these reasons, we conclude that the study area is the best available geographic area to consider for the auction. We will conduct a reverse auction for each study area for which the incumbent LEC receiving high-cost support has not committed to offer broadband Internet access service pursuant to the requirements explained above (Unserved Study Areas).[111]

b. Reserve Price

36. In the *Reverse Auctions NPRM*, we noted that we should establish a reserve price—a maximum level of high-cost support that participants in the auction would be allowed to place as a bid.[112] We observed that a reserve price that is set too low is likely to discourage bidders from participating, while one that is set too high raises the possibility of providing too much support.[113] We conclude that the reserve price should be the amount of high-cost support that the incumbent LEC would have been entitled to receive had it committed to offer broadband Internet access service within the study area.[114]

37. We set the reserve price in each study area at the incumbent LEC's current level of high-cost support for several reasons. First, we are capping the overall high-cost fund at its current level.

---

106 *Reverse Auctions NPRM*, 23 FCC Rcd at 1503, para. 20

107 *Reverse Auctions NPRM*, 23 FCC Rcd at 1504, para. 21.

108 Thus, we disagree with commenters' arguments that we should hold auctions for small geographic areas, such as counties, census block groups, or zip codes. *See, e.g.,* Comcast *High-Cost Reform NPRMs* Comments at 9; NCTA *High-Cost Reform NPRMs* Comments at 16; SouthernLINC *High-Cost Reform NPRMs* Comments at 24–25; TracFone *High-Cost Reform NPRMs* Comments at 6.

109 *See, e.g.*, Comcast *High-Cost Reform NPRMs* Comments at 8–9; NCTA *High-Cost Reform NPRMs* Comments at 16; SouthernLINC *High-Cost Reform NPRMs* Comments at 25; TracFone *High-Cost Reform NPRMs* Comments at 5.

110 *See* Ohio PUC *Reverse Auctions NPRM* Comments at 6–7 (generally agreeing that the incumbent LEC's study area is the appropriate geographic area on which to base reverse auctions because further disaggregation could add cost and delays, and increase the opportunity for creamskimming).

111 *See supra* paras. 19–31.

112 *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

113 *Reverse Auctions NPRM*, 23 FCC Rcd at 1509, para. 36.

114 *See* SouthernLINC *High-Cost Reform NPRMs* Comments at 22 n.63 ("The Commission would start bidding at current support levels."). As discussed above, each incumbent LEC ETC's individual high-cost support is frozen at the amount of support, on a lump sum basis, the ETC received in December 2008 annualized, net of any prior or past period adjustments, on a study area basis. *See supra* paras. 16, 30.

Setting a reserve price will help ensure that overall high-cost funding remains within this amount, because the high-cost funding for each Unserved Study Area will merely be transferred to another ETC, not increased. In addition, setting a reserve price at this level will ensure that, even in reverse auctions for particular Unserved Study Areas that do not garner many bids, those bids will be made by providers who are confident that they can assume all the obligations of the carrier of last resort,[115] as well as the new broadband service obligations, and provide service more efficiently than the incumbent LEC.[116] Indeed, we expect that bidders frequently will offer to provide service using newer and more efficient technologies than the incumbent LEC uses today. For these reasons, we set the reserve price at the level described above.

c. Auctioned Support

38. For Unserved Study Areas, we will auction the award of high-cost support to provide all supported services to the entire Unserved Study Area, on a carrier of last resort basis, consistent with the requirements of this order. The maximum annual award amount will be equal to the amount of the winning bid (Award Amount), paid out as described in more detail below as certain geographic areas are built out.[117]

39. The Award Amount is conditioned on the winning bidder providing all supported services as a carrier of last resort, as the incumbent LEC does today under state law, and meeting the ETC requirements set forth in the *ETC Designation Order*.[118] Competitive ETCs are currently required to provide supported services throughout their service area, even though they may not be, under state law, the carrier of last resort.[119] In the *ETC Designation Order*, the Commission adopted additional requirements for ETC designation proceedings in which the Commission acts pursuant to section 214(e)(6).[120] The Commission requires that applicants seeking ETC designation from this Commission demonstrate the following: (1) a commitment and ability to provide services, including providing service to all customers within its proposed service area; (2) that it will remain functional in emergency

---

[115] Carrier of last resort obligations for incumbent LECs are a matter of state law. Under section 214(e)(6), when the state lacks jurisdiction, the Commission shall make the public interest determination on whether to designate a carrier an ETC. 47 U.S.C. § 214(e)(6). The ETC requirements include a requirement to provide supported services throughout the service area. 47 U.S.C. § 214(e)(1).

[116] Some commenters oppose setting the reserve price at current incumbent LEC levels, or setting any reserve price. *See* OPASTCO *High-Cost Reform NPRMs* Comments at 19–20; MSTC Group *High-Cost Reform NPRMs* Comments at 17–18; North Dakota PSC *High-Cost Reform NPRMs* Comments at 5. We find that setting the reserve price at the incumbent LEC support level will provide certainty to bidders and enable bidders with more efficient technologies to provide broadband in areas where incumbent LECs do not commit to do so. Furthermore, as discussed below, if a reverse auction provides no winner, the Commission will examine the need for further action. *See infra* para. 47.

[117] A competitive ETC that currently serves all or a portion of an Unserved Study Area will not receive high-cost support for the same service area as both a winning bidder and based upon a showing of its own costs. If a competitive ETC that already receives high-cost support within this study area wins the auction, it will lose its existing high-cost support for particular geographic areas as it begins to receive its Award Amount for those areas.

[118] *ETC Designation Order*, 20 FCC Rcd 6371. Section 214(e)(6) of the Act gives the Commission authority to designate carriers as ETCs when those carriers are not subject to the jurisdiction of a state commission. 47 U.S.C. § 214(e)(6). The requirements in the *ETC Designation Order* currently apply only to Commission-designated ETCs, although the Commission, in that order, encouraged state commissions to adopt similar requirements. *ETC Designation Order*, 20 FCC Rcd at 6372, 6379, paras. 1, 19.

[119] *See* 47 U.S.C. § 214(e)(1).

[120] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20.

situations; (3) that it will satisfy consumer protection and service quality standards; (4) that it offers local usage comparable to that offered by the incumbent LEC; and (5) an understanding that it may be required to provide equal access if all other ETCs in the designated service area relinquish their designations pursuant to section 214(e)(4).[121] We find that the universal service obligations in the *ETC Designation Order* will apply to all competitive ETCs winning reverse auctions; in addition, the auction winner must accept all of the carrier of last resort obligations of the incumbent LEC for that study area, whether such obligations are imposed on the LEC pursuant to state or federal law.

40. In addition to the *ETC Designation Order* requirements, we add two additional requirements to competitive ETCs winning reverse auctions. First, they must, as a condition of receiving the Award Amount, offer broadband Internet access service to all customers within the Unserved Study Area. Second, competitive ETCs winning reverse auctions must offer supported services at a retail price comparable to the retail price charged by the incumbent LEC in that same study area for the same or equivalent service.[122] In this manner, we ensure that competitive ETCs receiving high-cost support will continue to make supported services at least as affordable and available as they are today.

41. We recognize that a transition mechanism is needed to shift high-cost support from the incumbent LEC currently receiving it to another ETC that wins an Award Amount. A flash cut would be harmful in at least two ways. First, the incumbent LEC would immediately lose support upon which it may rely to maintain supported services as a carrier of last resort to consumers today. It is possible that removing support from the incumbent LEC would, in some cases, jeopardize its provision of services to some users. In addition, granting a full Award Amount immediately to a winning ETC would provide little incentive for the competitive ETC to build out new facilities to difficult-to-serve areas until the last possible moment, as in many cases those areas will be the most expensive to serve. As a result, we conclude that, prior to the initiation of an auction, the incumbent LEC for the Unserved Study Area will be required to identify the distribution of support by geographic area for purposes of the auction and the transfer of support to the winning bidder. As the winning ETC builds out to those geographic areas and certifies that it complies with all its obligations under this order for that area, it will receive high-cost support for that portion of the Unserved Study Area, and the incumbent LEC will no longer receive such support for that area.[123] As the winning bidder takes on carrier of last resort obligations and obtains high-cost support for an area, the incumbent LEC will no longer receive high-cost support for that area and will be relieved of its carrier of last resort obligations at both the state and federal levels. We require winning auction bidders to comply fully with all the requirements of this order by the end of a ten-year build-out period.

42. Finally, we address the question of transferability of the Award Amount. We conclude that auction winners may transfer their right to the Award Amount. This transfer could take one of several forms—an auction winner could be purchased by another entity, the winner could sell assets used to provide the supported services, or the auction winner could transfer just the right to the Award Amount itself. The transferee will, in all events, step into the shoes of the auction winner and will be responsible

---

[121] *ETC Designation Order*, 20 FCC Rcd at 6380, para. 20; 47 U.S.C. § 214(e)(4).

[122] In adopting this requirement, we are not setting any specific rates, nor does this requirement conflict with the states' jurisdiction over intrastate rates. Instead, we are conditioning the receipt of federal universal service support on an ETC's provision, on a voluntary basis, of rates comparable to the incumbent LEC's for equivalent services.

[123] The amount of support to be awarded to the winning bidder could be less than the amount of support received by the incumbent LEC for that same area. The transfer of support will be based on the amount of support, relative to support for the entire study area, received by the incumbent LEC for the area to be transferred; that same relative percentage will be used to calculate the amount of award support the auction winner should receive for the same area. In no event will an incumbent LEC who is not an auction winner continue to receive support for an area once an auction winner begins to receive support for that same area.

for meeting all obligations as if it had been the original auction winner. Any such transfer, however, must be authorized by the Commission before it is consummated.

d. Selecting a Winning Bid

43. In the *Reverse Auctions NPRM*, we sought comment on whether the reverse auction should award high-cost support to a single winner or to multiple winners.[124] We observed that if only one winner receives support, this could provide a fair and efficient means of eliminating the subsidization of multiple ETCs in a region, particularly in areas in which costs are prohibitive.[125] We tentatively concluded that universal service support auctions should award high-cost support to a single winner.[126] We now conclude that the single winner format will provide the most effective mechanism for determining the support amount sufficient to meet the universal service goals in any given area.[127] We therefore adopt our tentative conclusion to select one winner in each reverse auction.

44. As we have explained above, in requiring the offering of broadband Internet access service as a condition of receiving high-cost support, one of our main goals is to ensure that all Americans have access to affordable, quality broadband services.[128] Achieving this goal will require careful selection of the winning bidder for a particular Unserved Study Area. As explained in more detail below, the winning bidder will be the one who commits to offer the highest speed of broadband service—throughout the entire Unserved Study Area—at a bid amount that is equal to or less than the reserve price (the incumbent LEC's current high-cost support amount). In so doing, we work towards making quality, technologically advanced broadband services available to all Americans, including those in difficult- or expensive-to-serve areas, rather than settling for lesser broadband service for those Americans who live in high-cost areas. We acknowledge that, in many cases, the winning bid will not be the cheapest one. But we believe that encouraging bidders to offer better broadband services at or below a set reserve price will help us achieve our broadband goals, while keeping an appropriate limit on the amount of high-cost support disbursed to achieve that goal.

45. For purposes of our reverse auction, we establish three tiers of broadband service. We will use the term "Basic Broadband Tier 1" to refer to service with download speeds equal to or greater than 768 kbps but less than 1.5 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 2" to refer to service with download speeds equal to or greater than 1.5 mbps and less than 3 mbps, and upload speeds greater than 200 kbps. We will use the term "Broadband Tier 3" to refer to service with download speeds equal to or greater than 3 mbps, and upload speeds greater than 200 kbps.[129]

---

[124] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 13.

[125] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14.

[126] *Reverse Auctions NPRM*, 23 FCC Rcd at 1501, para. 14

[127] *See, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 4–5; New York PSC *Identical Support and Reverse Auctions NPRMs* Comments at 2–3; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments at 21–22, App. at 12. We disagree with commenters who support multiple winner auctions. *See, e.g.*, Alltel *High-Cost Reform NPRMs* Comments at 40–41; Atlantic Tele-Network *Identical Support and Reverse Auctions NPRMs* Comments at 13. We find that supporting a single auction winner is a more efficient means of ensuring the provision of broadband Internet access in areas where the incumbent LEC has determined that the costs of serving all customers in the area is prohibitive.

[128] *See supra* paras. 19–23.

[129] These terms are similar, but not identical, to terms used in our latest *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700–01, para. 20 & n.66.

46. We will evaluate bids as follows: for any Unserved Study Area, a bidder will submit a bid to commit to offering a service falling within Basic Broadband Tier 1, Broadband Tier 2, or Broadband Tier 3 to all customers in the Unserved Study Area. To qualify for an award, the bid must be equal to or less than the reserve price—that is, equal to or less than the amount of high-cost support received by the incumbent LEC for that Unserved Study Area.[130] The bidder need not specify a specific speed to which it will commit in any of the three tiers, but it must disclose in which tier its proposed service will fall. The bid amount will be an amount of high-cost support to provide all supported services in the Unserved Study Area as carrier of last resort, subject to all the requirements of this order, including the condition to offer broadband throughout the Unserved Study Area. The winning bid will be selected through a two-step process. First, we will identify the highest speed tier for which there is a valid bid. If there is only one bid for that tier, then that is the winning bid. If there are multiple bids within that tier, then the winning bid will be the lowest price bid within that tier.[131]

47. If a particular reverse auction produces no winner, the study area will be identified as a truly high-cost study area. The fact that there is no winning bidder may indicate that the reserve price was set at too low an amount of support. The Commission will reexamine any such study area to determine whether the frozen high-cost support amount is sufficient, and, if it is not, the Commission will determine what further actions should be taken to ensure that the study area is served by a provider that will meet the broadband commitment and carrier of last resort requirements. For example, the Commission may consider disaggregating the study area on a wire center basis for reverse auction purposes, or increasing the amount of high-cost support set as the reserve price for the study area.[132] To ensure continued service to customers during the limited period of time in which the Commission examines these issues, the existing incumbent LEC will continue to have all carrier of last resort and ETC obligations, and will continue to receive high-cost support frozen at its current level pending transfer of such support to the winning bidder of the reverse auction.

e. Bidder Qualifications

48. We adopt a number of conditions that bidders must meet before they can participate in any auction. We adopt these requirements to help ensure that any bidder who wins an auction will be capable of meeting the commitments that flow from being a winning bidder.

49. First, we require that a bidder be an ETC, certified by the Commission or by a state. In the *Reverse Auctions NPRM*, we tentatively concluded that an auction bidder must be an ETC covering the relevant geographic area prior to participating in the auction.[133] We hereby adopt that tentative conclusion. Winning bidders must be designated as ETCs before receiving high-cost support pursuant to sections 214 and 254 of the Act; therefore, requiring bidders to receive this designation prior to participating in an auction entails only a small additional burden. This burden is offset by the potential delay in deploying broadband Internet access service that would result while a non-ETC winning bidder

---

[130] *See supra* paras. 16–36.

[131] For example, assume the Commission conducted a reverse auction for an Unserved Study Area with a reserve price of $5 and received four bids: $1 to offer Basic Broadband Tier 1, $2 to offer Broadband Tier 2, $3 to offer Broadband Tier 3, and $4 to offer Broadband Tier 3. In that scenario, the winning bid amount would be $3 to offer Broadband Tier 3.

[132] *See* Free Press Oct. 24, 2008 *Ex Parte* Letter at 12 (arguing that, if a study area receives no winning bidder in a reverse auction, then the study area should be disaggregated).

[133] *Reverse Auctions NPRM*, 23 FCC Rcd at 1500–01, para. 12; *see also, e.g.*, Florida PSC *High-Cost Reform NPRMs* Comments at 5; Indiana Util. Reg. Comm'n *High-Cost Reform NPRMs* Comments at 12; MSTC Group *High-Cost Reform NPRMs* Comments at 12; Verizon/Verizon Wireless *High-Cost Reform NPRMs* Comments, App. at 8.

seeks and obtains ETC designation.[134] We note that ETCs are not required to provide all supported services with their own facilities.[135] ETCs may enter into contracts with other entities to provide some supported services in part or all of the study area.

50. As a general matter, in our spectrum auctions we require an upfront payment to deter frivolous or insincere bidding.[136] In the reverse auctions we adopt today, we are not requiring an upfront payment. Instead, we are requiring participants to demonstrate to the Commission a capability to meet the milestone requirements. This showing will include, for example, evidence of financial resources with which to undertake the construction or upgrading of facilities necessary to offer broadband Internet access service. In addition, in areas where the bidder does not currently offer telecommunications services, we will require the bidder to submit a plan demonstrating the timetable for building the necessary facilities and obtaining any required permits.

5. Competitive Eligible Telecommunications Carriers

a. Background

51. In the *Identical Support NPRM*, the Commission tentatively concluded that it should eliminate the current identical support rule for competitive ETCs, because the rule bears no relationship to the amount of money competitive ETCs have invested in rural and other high-cost areas of the country.[137] In that notice, the Commission tentatively concluded that a competitive ETC should receive high-cost support based on its own costs, which better reflect real investment in rural and other high-cost areas of the country, and which create greater incentives for investment in those areas.[138] Because a competitive ETC's per-line support is based solely on the per-line support received by the incumbent LEC, rather than its own network investments in an area, the competitive ETC has little incentive to invest in, or expand, its own facilities in areas with low population densities, thereby contravening the Act's universal service goal of improving the access to telecommunications services in rural, insular and high-cost areas.[139] Instead, competitive ETCs have a greater incentive to expand the number of subscribers, particularly those located in the lower-cost parts of high-cost areas, rather than to expand the geographic scope of

---

[134] For this reason, we disagree with commenters who argue that we should not require bidders to be ETCs. *See* GCI *High-Cost Reform NPRMs* Comments at 89; Consumers Union (CU) et al. *High-Cost Reform NPRMs* Reply at 17.

[135] Pursuant to section 214(e)(1)(A) of the Act, a common carrier designated as an ETC must offer the services supported by the federal universal service mechanisms throughout the designated service area either by using its own facilities or by using a combination of its own facilities and resale of another carrier's services (including the services offered by another ETC). 47 U.S.C. § 214(e)(1)(A).

[136] *See, e.g., Auction of LPTV and TV Translator Digital Companion Channels Scheduled for November 5, 2008*, AU Docket No. 08-22, Public Notice, DA 08-1944, para. 53 (WTB 2008).

[137] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5; *see, e.g.*, Embarq *High-Cost Reform NPRMs* Comments at 10 ("It is logically inconsistent to compensate a carrier for serving 'high-cost' areas when there is no evidence–in the form of cost studies, filings, or model results—that the areas being supported are indeed 'high-cost' for that carrier."); Frontier *High-Cost Reform NPRMs* Comments at 4 (asserting that identical support is merely a subsidy to competitive ETCs, "and there is no basis to tell whether consumers are getting any [u]niversal [s]ervice benefits whatsoever" from subsidizing competitive ETCs in this manner).

[138] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5.

[139] *See* 47 U.S.C. § 254(b)(3); Alabama PSC *High-Cost Reform NPRMs* Comments at 3 ("The identical support rule provides little incentive for ETCs to invest in building their own facilities in rural areas with low population densities because their support currently is based solely on the per-line support received by the incumbent, instead of investment in the network.").

their networks. As discussed above, the Joint Board recommended elimination of the identical support rule; we agree with the Joint Board and adopt this recommendation and our tentative conclusion.[140] Under the new high-cost support mechanism that we adopt today, competitive ETCs will be eligible to receive support based on their own costs as compared to the relevant support benchmarks, contingent upon a commitment to offer broadband Internet access service to all customers in a service area within five years.[141]

b. Certification by Existing Competitive ETCs

52. As discussed above, as a condition of continuing to receive federal high-cost universal service support, incumbent LEC ETCs must offer broadband Internet access service to all customers in their service areas within five years.[142] Similarly, to be eligible to receive high-cost support on a going-forward basis, competitive ETCs must also certify that they will offer broadband Internet access service to all customers within a supported service area, consistent with the requirements of this order, within five years of the due date of their commitment.[143] Consistent with the certification required of incumbent LEC ETCs, competitive ETC certifications must include a commitment to offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[144] Failure to make this commitment or to meet the milestones and requirements established herein shall result in loss of ETC status for the service area.

c. Calculation of Support

53. We adopt our tentative conclusion in the *Identical Support NPRM* that competitive ETCs should receive high-cost support based on their own costs.[145] We are not persuaded by arguments that, by requiring competitive ETCs to demonstrate that their own costs exceed a high-cost threshold as a condition of receiving universal service support, we will be placing undue administrative burdens on the competitive ETCs and providing incentives for them to maximize their costs.[146] Instead, we find that competitive ETCs should demonstrate eligibility for high-cost support in the same manner as incumbent LEC ETCs, based on their costs, as this will better reflect competitive ETCs' investment in their service areas.[147] Specifically, we require competitive ETCs to file cost information for the total costs of a service

---

[140] *Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 5 (recommending elimination of the identical support rule, which "bears little or no relationship to the amount of money competitive ETCs have invested in rural and other high-cost areas of the country").

[141] The calculation of support provisions in this Part apply to competitive ETCs that do not receive high-cost support as the result of winning a reverse auction. Support for winning auction bidders, including competitive ETCs, will be based on the bid amount, as discussed above. *See supra* paras 43–47.

[142] *See supra* para. 28.

[143] The Bureau will release a public notice at a future date specifying the manner and due date of the certification. Other reporting, monitoring, and benchmark requirements are set forth below. *See infra* paras. 57–63.

[144] This tier of broadband is similar to the tier described as "Basic Broadband Tier 1" in our *Broadband Data Gathering Order*. *See Broadband Data Gathering Order*, 23 FCC Rcd at 9700–01, para. 20 & n.66.

[145] *Identical Support NPRM*, 23 FCC Rcd at 1470, para. 5.

[146] *See* GCI *High-Cost Reform NPRMs* Comments at 5, 40, 65–67; Oregon PUC *High-Cost Reform NPRMs* Comments at 5; Rural Cellular Ass'n (Rural Cellular) *Identical Support and Reverse Auctions NPRMs* Comments at 2; USCellular *High-Cost Reform NPRMs* Comments at 7, 38–40; USTelecom *High-Cost Reform NPRMs* Comments at 16; Wyoming Office of Consumer Advocate (Wyoming OCA) *Identical Support NPRM* Comments at 2; SouthernLINC *High-Cost Reform NPRMs* Reply at 13.

[147] Many commenters favor basing competitive ETCs' support on their own costs. *See* ATA *High-Cost Reform NPRMs* Comments at 3; Alexicon *Identical Support NPRM* Comments at 3–4; CenturyTel *High-Cost Reform*

(continued….)

area, from which will be developed a cost per line. Spectrum costs are not included for purposes of calculating a cost per line.[148] We will then apply the same benchmarks that are applied to incumbent LECs' costs to determine whether the competitive ETCs qualify to receive high-cost support. In the case of a competitive ETC providing service in a non-rural service area, the cost per line would be compared to the benchmark threshold for support calculated by the High-Cost Proxy Model.[149] For a competitive ETC providing service in a rural service area, support will be determined by comparing the competitive ETC's cost per loop incurred to provide the supported services to the same national average cost per loop used to determine incumbent LEC support for the same service area.[150]

54. Because a competitive ETC may have few or no lines when it first receives its ETC designation, performing a calculation of per-line costs at the initial time of market entry likely would result in a considerable upward bias in the resulting amount. Similarly, a competitive ETC that has not gained customers in high-cost areas would have low line counts, skewing upward its costs per line. Conversely, a competitive ETC that has successfully gained customers will have lower costs per line due to the larger number of lines over which to spread its costs. To correct this issue, rather than relying on the competitive ETCs' line counts to determine per-line costs, we will use the same line counts used to determine the incumbent LEC cost per line for the same service area.

55. Consistent with the freeze on incumbent LEC high-cost support based on December 2008 support levels, we will use December 2008 as the base period for both the incumbent LEC lines used to determine the competitive ETCs' per-line costs, and for the benchmarks against which the competitive ETCs' costs will be compared for high-cost support purposes. Once the competitive ETC has demonstrated that its costs exceed the relevant benchmark, that competitive ETC will be entitled to continue to receive support for the relevant service area, frozen at the amount of support, on a lump sum basis, that the competitive ETC received in 2008. If a competitive ETC does not commit to the broadband build-out requirements set forth herein, or does not demonstrate that its costs exceed the relevant benchmark, it shall no longer be entitled to receive support.

56. If no competitive ETC elects to show its own costs in a particular study area, we will conduct a reverse auction to award support to a broadband mobility provider. The reserve price for such auction shall be the largest amount of high-cost support received by a competitive ETC in the study area

(continued from previous page)
NPRMs Comments at 21–22; Connecticut Dept. of Pub. Util. Control *High-Cost Reform NPRMs* Comments at 2–3; Embarq *High-Cost Reform NPRMs* Comments at 10; Iowa Telecomm. Ass'n (ITA) *Identical Support NPRM* Comments at 3–4; Independent Tel. and Telecomms. Alliance (ITTA) *Identical Support NPRM* Comments at 23–24; John Staurulakis, Inc. (JSI) *High-Cost Reform NPRMs* Comments at 3; Kansas Rural Indep. Tel. Companies *Identical Support NPRM* Comments at 4; Missouri PSC *Identical Support NPRM* Comments at 5; Montana Telecomms. Ass'n *High-Cost Reform NPRMs* Comments at 12; NECA *High-Cost Reform NPRMs* Comments at 22–26; NTCA *High-Cost Reform NPRMs* Comments at 19–23; OPASTCO *High-Cost Reform NPRMs* Comments at 12–13; PetroCom License Corp. *Identical Support NPRM* Comments at 2–3; Qwest *High-Cost Reform NPRMs* Comments at 7; Rural Indep. Competitive Alliance (RICA) *High-Cost Reform NPRMs* Comments at 13–15; Rural Iowa Independent Tel. Ass'n (RIITA) *High-Cost Reform NPRMs* Comments at 2–3; Telcom Consulting Assoc., Inc. (TCA) *High-Cost Reform NPRMs* Comments at 13–15; Texas Statewide Tel. Coop., Inc. (Texas Statewide) *High-Cost Reform NPRMs* Comments at 10; Utah Rural Telecom Ass'n (URTA) *High-Cost Reform NPRMs* Comments at 8; WTA *High-Cost Reform NPRMs* Comments at 22–26.

[148] We agree with ITA that such costs do not represent a direct investment in facilities and infrastructure for purposes of providing supported services in high-cost areas. *See* ITA *Identical Support NPRM* Comments at 3 (spectrum costs represent investment in an intangible asset with an indefinite life rather than a direct investment in facilities with a limited useful life).

[149] *See* 47 C.F.R. § 54.309.

[150] *See* 47 C.F.R. §§ 36.613, 36.622(c).

in 2008. There shall be no interim support in such study area to an existing competitive ETC that does not commit to the broadband requirements pending the completion of the reverse auction.[151]

6. Build-Out Milestones and Monitoring, Compliance, and Enforcement

57. We find that a rigorous monitoring, compliance and enforcement program is necessary to ensure that all ETCs receiving high-cost support adhere to their obligation to offer broadband Internet access service throughout their supported service areas by the end of their respective build-out periods. We therefore establish build-out requirements to monitor providers' progress toward their build-out commitment. Specifically, and as described in detail below, we require each provider receiving high-cost support to meet specific milestones with regard to broadband deployment in the years preceding completion.

58. *Applicability of Requirements*. As an initial matter, we find that the monitoring, compliance and enforcement requirements we adopt today will apply equally to all recipients of high-cost support that commit to offer broadband Internet access service as a condition of receiving support. Consumers should expect to receive the benefits of today's order, irrespective of whether an incumbent LEC, competitive ETC, or winning auction bidder receives high-cost support in their area. We find that the milestone obligations we impose today will not unduly burden any company; rather, they represent efforts we believe carriers would undertake in the normal course of constructing a broadband network. We therefore apply the monitoring, compliance, and enforcement requirements below to all recipients of high-cost support.

59. *Milestones for Committed Incumbent LECs and Existing Competitive ETCs.* To ensure that incumbent LECs that commit to offering broadband and competitive ETCs other than auction winners make steady progress towards offering broadband Internet access service throughout their entire service areas as required in this order, we adopt milestones based on customer locations where the incumbent LEC or competitive ETC is not yet offering broadband Internet access service (Unserved Customers).[152] Specifically, we require incumbent LECs and competitive ETCs to be capable of providing broadband Internet access service to an additional 20 percent of their Unserved Customers by the end of each year of the five-year build-out period. This requirement means that, of the total number of Unserved Customers in the service area, these carriers must offer broadband to 20 percent by the end of year one, 40 percent by the end of year two, 60 percent by the end of year three, 80 percent by the end of year four, and 100 percent by the end of year five. This five-year period starts from the due date of the incumbent LEC or competitive ETC commitment.

60. *Milestones for Auction Winners.* To ensure that auction winners make good progress toward meeting their obligation to become fully compliant with the requirements of this order, we require every auction winner to be capable of serving 10 percent of the potential customers in the service area by the end of year two, 25 percent by the end of year three, 50 percent by the end of year four, 65 percent by the end of year five, 75 percent by the end of year six, 85 percent by the end of year seven, 90 percent by the end of year eight, 95 percent by the end of year nine, 100 percent by the end of year ten. The absence of a milestone at the end of year one is intended to allow new service providers sufficient time to plan their network and to start deploying and marketing it within some parts of the service area. Similarly, the ascending milestones in the remaining years are intended to permit the auction winner a reasonable time in which to build its network and services while ensuring that it does not delay in reaching customers who need this vital service. The ten-year build-out period starts on the date on which that carrier wins the

[151] We also note that, consistent with our capping the high-cost fund and the provisions herein freezing both incumbent LEC and competitive ETC support at the study area level, we keep in place the interim cap on competitive ETC support adopted in the *Interim Cap Order*.

[152] Customer locations include both residential and business locations within the ETC's service area.

auction.

61. *Consequences of Not Meeting Milestones.* For all ETCs receiving high-cost support, failure to achieve any milestone will result in loss of eligibility for support (and, where this Commission has jurisdiction over the designation of ETC status, loss of ETC status) for that service area. If the ETC that loses its eligibility for support is an incumbent LEC or an auction winner, the study area will be subject to re-auction. If at the end of the build-out period, the ETC is not fully compliant with all its obligations under this order, including its obligation to offer broadband Internet service throughout the service area, the ETC will forfeit its eligibility for support and, if its ETC designation was made by this Commission, lose its ETC status.

62. *Milestone Audits*. All milestone data will be subject to audit by the Commission's Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the build-out requirements, the Act, and Commission rules and orders.[153] Service providers will be required to comply fully with the Office of Inspector General's audit requirements, including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of the service providers and their employees, contractors, and other agents, in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this program.[154] Such audits or investigations may provide information showing that a service provider failed to comply with the Act or the Commission's rules, and thus may reveal instances in which universal service support was improperly distributed or used.

63. We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the high-cost program and to determine on a case-by-case basis whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[155]

III. BROADBAND FOR LIFELINE/LINK UP CUSTOMERS

64. In this Part, pursuant to section 254(b) of the Act, we establish a Broadband Lifeline/Link Up Pilot Program (Pilot Program) to examine how the Lifeline and Link Up universal service support mechanism can be used to enhance access to broadband Internet access services for low-income Americans.[156] Specifically, we conclude that we will make available $300 million each year for the next

---

[153] *See Comprehensive Review of the Universal Service Fund Management, Administration, and Oversight, Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-Up, Changes to the Board of Directors for the National Exchange Carrier Association, Inc.*, WC Docket No. 03-109, Report and Order, 22 FCC Rcd 16372, 16383–84, para. 24 (*Comprehensive Review Report and Order*) (requiring "recipients of universal service support for high-cost providers to retain all records that they may require to demonstrate to auditors that the support they received was consistent with the Act and the Commission's rules, assuming that the audits are conducted within five years of disbursement of such support."). The term "service provider" includes any participating subcontractors.

[154] This includes presenting personnel to testify, under oath, at a deposition if requested by of the Office of Inspector General.

[155] *See, e.g.*, 41 U.S.C. §§ 51–58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

[156] The Commission has established a similar universal service pilot program under the Rural Health Care support mechanism. *See Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111(2006) (*2006 Rural Health Care Pilot Program Order*) (establishing a Rural Health Care pilot program to examine how the Rural Health Care funding mechanism can be used to enhance public and non-profit health care providers' access to

(continued….)

three years to enable ETCs to support broadband Internet access service and the necessary access devices. In particular, if an ETC provides Lifeline service to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access installation, including a broadband Internet access device, up to a total amount of $100. In addition, if an ETC provides Lifeline service to an eligible household, the Pilot Program will double, up to an additional $10, the household's current monthly subsidy to offset the cost of broadband Internet access service.

A. Background

65. Since 1985, the Commission, pursuant to its general authority under sections 1, 4(i), 201, and 205 of the Act and in cooperation with state regulators and local telephone companies, has administered two programs designed to increase subscribership by reducing charges to low-income consumers.[157] The Commission's Lifeline program reduces qualifying consumers' monthly charges, and Link Up provides federal support to reduce eligible consumers' initial connection charges by up to one half.[158]

66. Under the Commission's current rules, states and territories have the authority to establish their own Lifeline/Link Up programs that provide additional support to low-income consumers that incorporate the unique characteristics of each state or territory.[159] For example, in establishing eligibility criteria, states have the flexibility to consider federal and state-specific public assistance programs with high rates of participation among low-income consumers in the state. State certification procedures and outreach efforts can also take into account existing state laws and budgetary limits. Some states and territories, however, have elected to use the federal criteria as their default standard. These "federal default states" include not only states and territories with their own Lifeline/Link Up programs that have adopted the federal default criteria, but also states and territories that have not adopted their own Lifeline/Link Up program. In April 2004, the Commission released an order expanding the federal default eligibility criteria to include an income-based criterion and additional means-tested programs.[160]

67. *Eligibility for Lifeline and Link Up.* In states that provide state Lifeline and Link Up

(continued from previous page)
advanced telecommunications and information services); *Rural Heath Care Support Mechanism*, WC Docket No. 02-60, Order, 22 FCC Rcd 20,360 (2007) (selecting Rural Health Care pilot program participants eligible to receive up to 85% of the costs associated with the construction of state or regional broadband health care networks and with the advanced telecommunications and information services provided over those networks).

[157] 47 U.S.C. §§ 151, 154(i), 201, 205.

[158] Lifeline currently provides low-income consumers with discounts of up to $10.00 off of the monthly cost of telephone service for a single telephone line in their principal residence, though this amount adjusts, in part, to reflect the carrier's tariffed federal subscriber line charge. *See* 47 C.F.R. § 54.403. Link Up provides low-income consumers with discounts of up to $30.00 off of the initial costs of installing telephone service. *See* 47 C.F.R. § 54.411(a). Under the Commission's rules, there are four tiers of federal Lifeline support. All eligible subscribers receive Tier 1 support which provides a discount equal to the ETC's subscriber line charge. Tier 2 support provides an additional $1.75 per month in federal support, available if all relevant state regulatory authorities approve such a reduction. (All fifty states have approved this reduction.) Tier 3 of federal support provides one half of the subscriber's state Lifeline support, up to a maximum of $1.75. Only subscribers residing in a state that has established its own Lifeline/Link Up program may receive Tier 3 support, assuming that the ETC has all necessary approvals to pass on the full amount of this total support in discounts to subscribers. Tier 4 support provides eligible subscribers living on tribal lands up to an additional $25 per month towards reducing basic local service rates, but this discount cannot bring the subscriber's cost for basic local service to less than $1. *See* 47 C.F.R. § 54.403.

[159] *See* 47 C.F.R. §§ 54.409(a), 54.415(a).

[160] *See Lifeline and Link Up*, WC Docket No. 03-109, Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd 8302 (2004).

support, Lifeline and Link Up are available to all subscribers who meet state eligibility requirements. Although states have some latitude in selecting means tests, state commissions must establish narrowly targeted qualification criteria that are based solely on income or factors directly related to income for low-income residents to be eligible for Lifeline and Link Up. In addition, states with eligible residents of tribal lands must ensure that their qualification criteria are reasonably designed to apply to residents of tribal lands, if applicable.[161] To receive Lifeline and Link Up in a state that does not mandate state Lifeline support, consumers must certify that their household income is at or below 135 percent of the Federal Poverty Guidelines, or that they participate in one of the following seven federal programs: Medicaid, Food Stamps, Supplemental Security Income (SSI), Federal Public Housing Assistance (Section 8), the Low-Income Home Energy Assistance Program (LIHEAP), the National School Lunch Program's free lunch program, or Temporary Assistance for Needy Families (TANF).[162] Subscribers living on tribal lands qualify to receive federal Lifeline support if: (1) they qualify under state criteria in a state that provides Lifeline support; (2) they certify that their household income is at or below 135 percent of the Federal Poverty Guidelines; (3) they certify that they receive benefits from one of the seven federal programs listed above; or (4) they certify that they participate in one of the following additional federal assistance programs: Bureau of Indian Affairs General Assistance (GA), Tribally administered Temporary Assistance for Needy Families (Tribal TANF), or Head Start (meeting the income-qualifying standard).[163]

68. *TracFone and Computer and Communications Industry Association Petitions.* On October 9, 2008, TracFone Wireless, Inc. (TracFone) submitted a petition requesting that the Commission establish a trial basis program to support broadband Internet access service and the devices that support this service.[164] Citing data demonstrating that a significant amount of low-income families are unable to afford broadband Internet access, TracFone proposes that the Commission, on a temporary basis, provide affordable access to low-income consumers by supporting broadband Internet access service and the devices used to access these services.[165] TracFone proposes limiting the program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee, and the District of Columbia.[166] Doing so, according to TracFone, will enable to the Commission to examine how to better make available broadband Internet access service to low-income consumers throughout the Nation.[167]

69. On October 7, 2008, the Computer and Communications Industry Association (CCIA) filed a petition requesting the Commission revise the definition of universal service supported services to allow low-income consumers receive support for broadband Internet access services.[168] CCIA states that, despite a critical need for broadband Internet access service, low-income consumers still have a considerably low broadband Internet access deployment rate. Accordingly, CCIA argues the definition of supported services for purposes of universal service should be revised to provide support for broadband

---

161 47 C.F.R. § 54.409(a).

162 47 C.F.R. § 54.409(b).

163 47 C.F.R. § 54.409(a)–(d).

164 *See Lifeline and Link Up, Federal-State Joint Board on Universal Service*, WC Docket No. 03-109, CC Docket No. 96-45, Petition to Establish A Trial Broadband Lifeline/Link Up Program (filed Oct. 9, 2008) (*TracFone Petition*).

165 *See TracFone Petition* at 3–4.

166 *See TracFone Petition* at 3.

167 *See TracFone Petition* at 5.

168 *See* Petition for Rulemaking to Enable Low-Income Consumers to Access Broadband Through the Universal Service Lifeline and Link Up Programs, WC Docket No. 03-109 (filed Oct. 7, 2008) (*CCIA Petition*).

Internet access service to low-income consumers.[169]

70. In recent proceedings, other parties have also urged the Commission to provide low-income consumers with support for broadband services. For example, Windstream argues that the Commission should direct broadband support to low-income consumers where such support is most needed.[170] AARP also concludes that the Commission should provide Lifeline/Link Up support for broadband services and urges the Commission to conduct a proceeding to examine the matter.[171] AARP proposes that in addition to examining supporting broadband services, the Commission should also examine how to increase low-income consumers' access to devices that support broadband services and education on how to use such devices.[172] Many consumer groups and service providers have also commented in support of TracFone and CCIA's proposals to support the provision to low-income consumers of broadband Internet access service and the devices used to access these services.[173]

B. Discussion

71. Consistent with the Commission's authority under sections 1, 4(i), 201, 205, and 254 of the Act, we establish a Lifeline and Link Up pilot program to support the provision of broadband Internet access service and the devices used to access this service to low-income consumers.[174] In doing so, we

---

[169] *See CCIA Petition* at 7.

[170] *See* Letter from Eric Einhorn, Vice President Governmental Affairs, Windstream Communications Inc., to Marlene Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 99-68, 08-122, 05-337, 08-152 (Sept. 24, 2008) (Windstream Sept. 24, 2008 *Ex Parte* Letter).

[171] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

[172] AARP *Joint Board Comprehensive Reform NPRM* Comments at 55.

[173] *See, e.g.*, Letter from Dale R. Schmick, CEO, YourTel America, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 03-109, 05-337, at 2 (filed Oct. 21, 2008) (YourTel Oct. 21, 2008 *Ex Parte* Letter); Letter from Thomas J. Sugrue, Vice President Government Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket Nos. 04-356, 07-195 at 3 (filed Oct. 17, 2008) (urging the Commission to adopt quickly TracFone's and CCIA's proposals); Letter from Karyne Jones, President & CEO, National Caucus and Center on Black Aged, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 at 1 (filed Oct. 29, 2008) (NCBA Oct. 29, 2008 *Ex Parte* Letter); Letter from Donnie Ruby, Staff Associate, Telecommunications Research and Action Center, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008); Letter from Bill Newton, Executive Director, Florida Consumer Action Network, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 27, 2008); Letter from Robert D. Atkinson, Chair Public Policy Committee, Alliance for Public Technology, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 24, 2008) (APT Oct. 24, 2008 *Ex Parte* Letter); Letter from John Breyault, Vice President of Public Policy Telecommunications and Fraud, National Consumers League, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 23, 2008) (NCL Oct. 23, 2008 *Ex Parte* Letter); Letter from Mark Richert, Director, Public Policy, American Foundation for the Blind, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 03-109 (filed Oct. 28, 2008) (AFB Oct. 28, 2008 *Ex Parte* Letter).

[174] To the extent that our adoption of the Pilot Program adds broadband to the list of universal service supported services, we clarify that this inclusion is limited only to the Pilot Program—broadband is not a supported service for other low-income or high-cost support purposes. Pursuant to section 254(c)(1) of the Act, the Joint Board has recommended adding broadband as a supported service, and we do so for the limited purpose of the Pilot Program. *See Comprehensive Reform Recommended Decision*, 22 FCC Rcd at 20478, para. 4 ("The Joint Board now recommends that the nation's communications goals include achieving . . . universal availability of broadband Internet services"). Furthermore, the Commission's authority to provide universal service support to low-income consumers pre-dates the adoption in 1996 of section 254 of the Act, and arises out of sections 1, 4(i), 201, and 205 of the Act. 47 U.S.C. §§ 151, 154, 201, 205; *Universal Service First Report and Order*, 12 FCC Rcd at 8956–57,

(continued….)

explain the justification for establishing this program and provide criteria and obligations applicants must satisfy for selection to participate in this program. Further, we establish requirements for oversight and administration of the Pilot Program.

72. *Broadband Internet Access Service and Devices Eligible for Low Income Support.* In the *Universal Service First Report and Order,* consistent with its statutory obligations, the Commission maintained the authority to adopt changes to the Lifeline program to make it more consistent with Congress's mandates in the 1996 Act if such changes would serve the public interest.[175] We believe that a Lifeline and Link Up pilot program comports with the goals of universal service, and advances the public interest by providing new technologies and services to low-income consumers. Section 254(b)(2) of the Act instructs the Commission to base policies for the advancement of universal service on the principle that "[a]ccess to *advanced* telecommunications *and information services* should be provided in all regions of the Nation."[176] Similarly, section 254(b)(3) states that "low-income consumers . . . should have access to . . . *advanced* telecommunications and *information services*, that are reasonably comparable to those services provided in urban areas and that are available at rates charged for similar services in urban areas."[177]

73. Since the Commission first adopted its universal service rules in response to the 1996 Act, broadband Internet access service has evolved into a critical service for American consumers.[178] The majority of consumers who use broadband Internet access service today rely on it for telework, access to banking services, interaction with government, entertainment, shopping, access to news and other information, and many other uses. Access to broadband Internet access service is especially important to low-income consumers for purposes of education, public health and public safety.[179] High-speed connections to the Internet allow children in low-income families access to distance learning and research.[180] Telemedicine networks made possible by broadband Internet access service also save lives and improve the standard of healthcare to low-income families living in areas that may lack access to the breadth of medical expertise and advanced medical technologies available in other areas.[181] Broadband Internet access service also enables the sharing of critical, time-sensitive information with first

(continued from previous page)

paras. 338–40. Pursuant to our authority to regulate low-income support under these sections, as well as under section 254, we provide universal service support for broadband Internet access services through the Pilot Program.

[175] *Universal Service First Report and Order*, 12 FCC Rcd at 8956, para. 339.

[176] 47 U.S.C. § 254(b)(2) (emphasis added).

[177] *See* 47 U.S.C. § 254(b)(3) (emphasis added).

[178] *See* APT Oct. 24, 2008 *Ex Parte* Letter at 2; NCBA Oct. 29, 2008 *Ex Parte* Letter at 1; NCL Oct. 23, 2008 *Ex Parte* Letter at 1.

[179] According to the National Caucus and Center on Black Aged, older low-income Americans have difficulty affording broadband services and many do not have Internet access. NCBA Oct. 29, 2008 *Ex Parte* Letter at 1 (citing Older Americans, Broadband and the Future of the Net, SeniorNet, 2008). Commenters also assert that broadband connections are particularly necessary for consumers who are blind, visually impaired, deaf or hard of hearing. *See* APT Oct. 24, 2008 *Ex Parte* Letter at 1 (citing ALLIANCE FOR PUBLIC TECHNOLOGY, ACHIEVING UNIVERSAL BROADBAND: POLICIES FOR STIMULATING DEPLOYMENT AND DEMAND 27 (2007)); AFB Oct. 28, 2008 *Ex Parte* Letter.

[180] *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, GN Docket No. 07-45, Notice of Inquiry, 22 FCC Rcd 7816, 7817, para. 3 (2007) (*706 Fifth NOI*).

[181] *See 2006 Rural Health Care Pilot Program Order*, 21 FCC Rcd at 11112, para. 5; *706 Fifth NOI*, 22 FCC Rcd at 7817, para. 4.

responders, government officials, and health care providers, thereby improving the government's ability to provide a comprehensive and cohesive response to a public health crisis.

74. Despite the advances in broadband technology, broadband availability still lags for low-income consumers.[182] The Commission's most recent data reveal that where the median income is under $21,000, approximately 99.5 percent of households have high-speed service available with speeds in excess of 200 kbps in at least one direction.[183] Yet, according to the Pew Internet & American Life Project, only 25 percent of households with annual incomes below $20,000 have broadband service.[184] In contrast, among those living in households with annual incomes in excess of $100,000, broadband adoption is approximately 85 percent.[185]

75. According to the Commission's data, there are approximately 6.9 million consumers participating in the Lifeline universal service program.[186] Providing an additional $300 million in annual support through the low-income universal service support mechanisms over a three-year period should increase the broadband subscribership for low-income customers to over fifty percent.[187]

76. We therefore find that this Pilot Program furthers the universal service objectives of section 254 of the Act and serves the public interest by making this critical service available to the low-income Americans who cannot otherwise afford it. In addition, the Pilot Program will provide the Commission with a more complete and practical understanding of how to ensure the best use of Lifeline and Link Up universal service support to deploy advanced services to low-income consumers.[188]

1. Available Funding

77. We establish a maximum annual funding level for this broadband Lifeline and Link Up Pilot Program at $300 million for each of the next three years. In its petition, TracFone proposes that a pilot program should fund up to either $180 million or $360 million per year for Lifeline broadband

---

182 *See* Cellular South *High-Cost Reform NPRMs* Comments at 10.

183 *See* FCC, HIGH-SPEED SERVICES FOR INTERNET ACCESS: STATUS AS OF DECEMBER 31, 2006, tbl. 19 (2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-277784A1.pdf.

184 *See* 2008 PEW BROADBAND ADOPTION STUDY ii.

185 *See* 2008 PEW BROADBAND ADOPTION STUDY at 2.

186 *See* 2007 UNIVERSAL SERVICE MONITORING REPORT.

187 Desktop computers can be purchased for as low as $200. *See* Walmart Consumer Products, http://www.walmart.com/catalog/catalog.gsp?cat=3951&fromPageCatId=14503 (last visited Oct. 24, 2008). For $267, a consumer can purchase a new ASUS Eee PC 2G Surf laptop. *See* Amazon ASUS Eee PC 2G Surf Product Page, http://www.amazon.com/gp/product/B00114T9WY/ref=noref?ie=UTF8&s=pc (last visited Oct. 24, 2008). Personal computers and wireless devices will continue to become available at even lower rates. Throughout the world, there are $100 laptops and wireless devices. *See* Michael Trucano, InfoDev.org, Quick guide: Low-cost computing devices and initiatives for developing world (Apr. 2008), http://www.infodev.org/en/Publication.107.html (last visited Oct. 25, 2008). For example, Candlebox, being developed for use in India by Qualcom, is a low-cost, low-power device that uses mobile technology to provide wireless Internet access and supports e-mail, social networking, e-commerce and distance learning applications. RICHARD P. ADLER & MAHESH UPPAL, ASPEN INSTITUTE INDIA, M-POWERING INDIA: MOBILE COMMUNICATIONS FOR INCLUSIVE GROWTH at 21 (2008), *available at* http://www.aspeninstitute.org/atf/cf/%7Bdeb6f227-659b-4ec8-8f84-8df23ca704f5%7D/2008INDIA.pdf.

188 *See* NCBA Oct. 29, 2008 *Ex Parte* Letter at 2 (suggesting that the Pilot Program should be modeled after the existing Lifeline program and can be studied and evaluated to develop future broadband Lifeline/Link Up support programs).

Internet access service support, and up to $125 million or $250 million for the Link Up portion of the program, for a total of either $305 million or $610 million, depending on whether the program would support 500,000 participants or one million participants.[189]

78. While we recognize the importance of making sufficient funds available for this Pilot Program to enable us to determine whether and, if so, how to make broadband Internet access service funding a permanent part of the Lifeline and Link Up programs, we find that the levels of funding proposed by TracFone are not sufficiently tied to a specific improvement in the adoption of broadband by Lifeline subscribers, as discussed above. In 2007, the overall size of the universal service fund's disbursement mechanisms was approximately $7.0 billion.[190] Of that amount, approximately $823 million went to fund the universal service low-income program.[191] TracFone's proposal represents a potential 74 percent increase over existing low-income program disbursements, and would be limited to targeting low-income consumers in only three states and the District of Columbia.[192] We are concerned that such a large funding commitment for a limited geographic area would not provide the Commission with sufficient information to assess the benefits of expanding the low-income support mechanisms upon the conclusion of the Pilot Program. When extrapolated to all states and territories, the low-income pilot program proposed by TracFone could potentially double the size of the $7 billion universal service fund.[193] We find it more appropriate to fund a pilot program that better correlates with providing broadband Internet access service to all eligible low-income support recipients as this provides better information regarding the permanent adoption of such support.

79. Instead, we set the size of the Lifeline and Link Up Pilot Program at up to $300 million per year over the next three years. We find that this amount provides benefits to low-income consumers while not overly increasing the amount of low-income support disbursed from the universal service fund. Specifically, this level of funding should enable the program to increase the broadband subscribership for these customers to over fifty percent.[194]

2. Eligible Services and Equipment

80. For the broadband Lifeline/Link Up Pilot Program we adopt today, we limit support to one subsidy per household. For purposes of this order, we define "household" as one adult and his/her dependants, living together in the same residence.[195] Participating households who remain eligible for the program will be entitled to remain in the program beyond the first year, subject to the requirement that participating ETCs verify their customers' continued eligibility under the applicable income-based or program-based criteria, as they are required to do for their current voice Lifeline customers. We do not require state or carrier matching requirements. The Pilot Program is exempt from fees and taxes to the same degree as the current Lifeline programs.

---

[189] *See TracFone Petition* at 5.

[190] *See* USAC 2007 ANNUAL REPORT at 51. USAC's administrative expenses for 2007 were $104,073,000. *Id.* at 3.

[191] USAC 2007 ANNUAL REPORT at 3.

[192] *See TracFone Petition* at 3.

[193] Assuming $250 is provided to each consumer, the total cost of the TracFone proposal could reach almost $7 billion.

[194] *See supra* para. 75.

[195] *Federal-State Joint Board on Universal Service, Schools and Libraries Universal Service Support Mechanism, Rural Health Care Support Mechanism, Lifeline and Link-up*, CC Docket Nos. 96-45, 02-6 and WC Docket Nos. 02-60, 03-109, Order, 20 FCC Rcd 16883, 16890, para. 12 (2005) (*Hurricane Katrina Order*). Also, service agreements of longer than the lesser of one year or the remaining Pilot Program funding period are prohibited.

81. Under the Link Up portion of the Pilot Program we adopt today, we seek to overcome barriers that low-income households might face in subscribing to broadband services, such as lacking the equipment necessary to connect to broadband services. Therefore, if an ETC currently provides or seeks to provide Lifeline voice service to an eligible customer, the Pilot Program will support 50 percent of the cost of broadband Internet access service installation, including a broadband Internet access device, up to a total amount of $100. The device can be a laptop computer, a desktop computer, or a handheld device, so long as the equipment has the capability to access the Internet at the speeds established per this order, and the equipment carries at least a warranty.[196] The device subsidy is a one-time subsidy and is limited to one unit per qualified household.[197] The subsidy amount will be paid by USAC to the participating ETC that provides the device and the service to the customer, utilizing the same process that USAC uses for the current Link Up program.[198]

82. Once low-income households have the ability to connect to the Internet, we seek to ensure that they can afford to subscribe to broadband Internet access service. Under the Lifeline portion of the program, if an ETC currently provides or seeks to provide Lifeline voice service to an eligible household, and that ETC provides broadband Internet access service, the Pilot Program will double the current monthly subsidy for the Lifeline subscriber up to $10 per month to offset the cost of broadband Internet access service.[199] As defined in this order, broadband Internet access service is an "always on" service that combines computer processing, information provision, and computer interactivity with data transport, enabling end users to access the Internet and use a variety of applications, at speeds discussed below.[200] This monthly support provided to participating customers under the Pilot Program is separate from and in addition to their monthly Lifeline support for voice telephone service.[201]

83. All ETCs participating in the existing low-income programs are eligible to participate, provided that they notify the Commission and USAC of their election to participate at least a month in advance and certify that they will comply with all program requirements, including those set forth herein. Such certification must identify the service area in which the ETC plans to offer such Lifeline/Link Up broadband services, the costs of such service and broadband device, and all costs, both recurring and nonrecurring, to the customer participating in the program. The ETC must offer the services supported in the Pilot Program throughout the entire service area. The Wireline Competition Bureau will release a public notice establishing a deadline by which ETCs must notify the Commission of their intention to participate.

84. The program we adopt today is technologically and competitively neutral; however, we establish minimum speeds at which participating ETCs must be able to provide broadband service. ETCs

---

[196] Where such device costs $100 or less, the Pilot Program will support 90% of the cost of the broadband Internet access device.

[197] 47 C.F.R. § 54.411(b).

[198] *See* USAC, Low Income: Overview of the Process, http://www.universalservice.org/li/about/overview-process.aspx (last visited Oct. 11, 2008).

[199] Because $10 is the maximum federal support under Tier 1 to Tier 3 of the existing Lifeline program, we find this to be the appropriate support amount for purposes of the Pilot Program. *See* 2007 UNIVERSAL SERVICE MONITORING REPORT, tbl. 2.3. Ten dollars is also above the average Lifeline support amount of $8.46, which includes both tribal and non-tribal recipients. *See id.*, tbl. 2.12.

[200] *See infra* para. 84.

[201] Pilot Program participants may not receive support for the same services from both the Pilot Program and the existing universal service programs—which consist of the rural health care, E-rate, high-cost, and low-income programs.

participating in the Pilot Program must offer broadband Internet access service with download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps.[202]

3. Selection Criteria

85. TracFone suggests that all ETCs notifying the Commission of their intent to participate in the Pilot Program should be allowed to provide the broadband Internet access service and devices under the Pilot Program.[203] TracFone also argues that the Commission should limit the Pilot Program to 500,000 to 100,000 low-income households in Florida, Virginia, Tennessee and the District of Columbia.[204] We agree with TracFone that all ETCs should be allowed to provide services under the Pilot Program, but we disagree that the consumers who are eligible to participate should be limited to three states and the District of Columbia.[205] Instead, it is consistent with the public interest to allow all ETCs and consumers that meet the criteria discussed in this order to participate in the Pilot Program, limited only by the availability of funds. Support will be disbursed on a "first come, first served basis" where priority is established according to ETCs' submission of reimbursement requests to USAC and compliance with program eligibility.

86. *Consumer Qualifications*. To receive reimbursement under the Pilot Program, an ETC must provide support to a consumer eligible for support under the current Lifeline and Link Up programs. Specifically, the consumer must meet the eligibility criteria specified in section 54.409 of the Commission's rules.[206] We agree with TracFone that only one connection and device per household should be funded. Accordingly, we limit Pilot Program support to one new connection and device per household. Lifeline consumers who currently have a broadband connection and related Internet device are excluded from participation in this Pilot Program. In addition to their obligations under section 54.409 of our rules, consumers must demonstrate that they do not currently have a broadband Internet access service subscription or broadband Internet access device.[207]

87. *ETC Obligation to Offer Pilot Program Services*. Prior to participation, ETCs must notify the Commission and USAC of their intention to participate. A participating ETC must offer the services and supported devices to all qualifying low-income consumers throughout its service areas. It must also follow the carrier obligations identified in section 54.405, as applicable, of the Commission's rules.[208] Consumers and ETCs must follow the framework and requirements of the existing Lifeline and Link Up program.[209]

4. Implementation and Reporting Requirements

88. To be eligible for support, ETCs must submit a reimbursement request to USAC 30 days

---

[202] *See supra* para. 52.

[203] *TracFone Petition* at 4.

[204] *TracFone Petition* at 3.

[205] *See, e.g.*, YourTel Oct. 21, 2008 *Ex Parte* Letter at 2 (urging the Commission to allow low-income consumers living in Missouri to be eligible for Pilot Program support).

[206] *See* 47 C.F.R. § 54.409.

[207] As discussed above, for purposes of this Pilot Program we define "household" as one adult and his/her dependants living together in the same residence. *See supra* paras 80–84; *Hurricane Katrina Order*, 20 FCC Rcd at 16890, para. 12.

[208] *See* 47 C.F.R. § 54.405.

[209] 47 C.F.R. § 54.400–.417.

from the date a customer subscribes to service or purchases a device. We require participating each ETC to file with USAC on a monthly basis the number of Pilot Program consumers it is serving, the types and prices of devices offered, the type of technology used (including make and model of equipment used) and the speeds at which it is providing service to each of those consumers. ETCs in their monthly submission must also report the number of subscribers served for the past month and projections for the number of subscribers for the next 2 months. Such monthly reporting is required to allow USAC to monitor availability of funds under the Pilot Program and notify participating ETCs when funds may no longer be available for additional customers. In determining and/or projecting funds availability, USAC should consider the recurring costs of existing customers; we decline to specifically allocate the available funding between Lifeline and Link Up, relying instead on the certification and reporting requirements herein to enable USAC to properly administer the Pilot Program.

89. Similar to current recordkeeping requirements, we also require ETCs to maintain records to document compliance with all Commission requirements governing this Pilot Program for the three full preceding calendar years and provide that documentation to the Commission or USAC upon request.[210] Additionally, ETCs must maintain documentation for as long as the consumer is receiving broadband Lifeline service from that ETC pursuant to the Pilot Program, and for three additional years after the consumer stops receiving service pursuant to the Pilot Program.

90. ETCs may receive reimbursement for the revenue they forego in reducing the price of any qualified consumers' broadband Internet access service and related device. As a condition of participation, it is the ETC's responsibility to make available a wide array of cost efficient broadband Internet access devices capable of providing the speeds described above to qualified consumers under this program. ETCs must also comply with the self-certification procedures, and submit certifications with their monthly submissions, consistent with sections 54.410 and 54.416 of the Commission's rules.[211] Any services or equipment supported under this order are non-transferable and the devices must be returned to the ETC if they are not used in compliance with the terms of this order or other applicable laws or regulations. We delegate to the Wireline Competition Bureau the authority to disqualify an ETC or consumer from the Pilot Program and seek recovery of support not used in a manner consistent with this order.

5. Program Oversight

91. We are committed to guarding against waste, fraud, and abuse, and ensuring that funds disbursed through the Pilot Program are used for appropriate purposes. In particular, each Pilot Program participant shall be subject to audit by the Office of Inspector General and, if necessary, investigated by the Office of Inspector General, to determine compliance with the Pilot Program, Commission rules and orders, as well as section 254 of the Act.[212] The Pilot Program participant will be required to comply fully with the Office of Inspector General's audit requirements including, but not limited to, providing full access to all accounting systems, records, reports, and source documents of itself and its employees, contractors, and other agents in addition to all other internal and external audit reports that are involved, in whole or in part, in the administration of this Pilot Program.[213] Such audits or investigations may provide information showing that a Pilot Program participant or vendor failed to comply with the Act or the Commission rules, and thus may reveal instances in which Pilot Program awards were improperly

[210] *See* 47 C.F.R. § 54.417(a).

[211] *See* 47 C.F.R. §§ 54.410, 54.416.

[212] *See* 47 C.F.R. § 54.619; *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 26.

[213] This includes presenting personnel to testify, under oath, at a deposition if requested by the Office of Inspector General.

distributed or used. To the extent the Commission finds that funds were distributed and/or used improperly, the Commission will require USAC to recover such funds though its normal processes, including adjustment of support amounts in other universal service programs from which Pilot Program participants receive support.[214] If any participant fails to comply with Commission rules or orders, or fails to timely submit filings required by such rules or orders, the Commission also has the authority to assess forfeitures for violations of such Commission rules and orders. In addition, any participant or service provider that willfully makes a false statement can be punished by fine or forfeiture under sections 502 and 503 of the Act,[215] or by fine or imprisonment under Title 18 of the United States Code (U.S.C.) including, but not limited to, criminal prosecution pursuant to section 1001 of Title 18 of the U.S.C.[216] We emphasize that we retain the discretion to evaluate the uses of monies disbursed through the Pilot Program and to determine on a case-by-case basis whether waste, fraud, or abuse of program funds occurred and whether recovery is warranted. We remain committed to ensuring the integrity of the universal service program and will aggressively pursue instances of waste, fraud, and abuse under the Commission's procedures and in cooperation with law enforcement agencies. In doing so, we intend to use any and all enforcement measures, including criminal and civil statutory remedies, available under law.[217] The Commission will also monitor the use of awarded monies and develop rules and processes as necessary to ensure that funds are used in a manner consistent with the goals of this Pilot Program. Finally, we remind participants that nothing in this order relieves them of their obligations to comply with other applicable federal laws and regulations.

IV. REFORM OF UNIVERSAL SERVICE CONTRIBUTIONS

92. In this Part, we adopt a telephone numbers-based methodology under which contributors will pay a constant, flat-rate assessment based on the number of telephone numbers they have assigned to residential end users. We set this per-number assessment at the fixed rate of $1.00 per residential number per month. We conclude that providers of business services should contribute to the universal service fund on a connection basis, and we seek comment on implementation of that methodology. In the interim, providers of business services will continue to contribute based on interstate and international revenues for these services. The separate contribution methodologies for residential and business services will be implemented beginning on January 1, 2010.

A. Background

93. In implementing the universal service requirements of the 1996 Act, the Commission established a method for collecting funds to be disbursed through the various universal service support mechanisms. Specifically, the Commission determined that contributions to the universal service fund would be assessed on telecommunications providers based on their interstate and international end-user

[214] We intend that funds disbursed in violation of a Commission rule that implements section 254 or a substantive program goal will be recovered. Sanctions, including enforcement action, are appropriate in cases of waste, fraud, and abuse, but not in cases of clerical or ministerial errors. *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16388–89, para. 30.

[215] 47 U.S.C. §§ 502, 503(b).

[216] 18 U.S.C. § 1001. Further, the Commission has found that "debarment of applicants, service providers, consultants, or others who have defrauded the USF is necessary to protect the integrity of the universal service programs." *Comprehensive Review Report and Order*, 22 FCC at 16390, para. 32. Therefore, the Commission intends to suspend and debar parties from the Pilot Program who are convicted of or held civilly liable for the commission or attempted commission of fraud and similar offenses arising out of their participation in the Pilot Program or other universal service programs. *See id.* paras. 31–32.

[217] *See, e.g.*, 41 U.S.C. §§ 51–58 (Anti-Kickback Act of 1986); 31 U.S.C. § 3729 (False Claims Act).

telecommunications revenues.[218] The Commission concluded that basing providers' universal service contributions on their revenues would be competitively neutral, easy to administer, and explicit.[219]

94. When the Commission adopted the revenue-based contribution system, assessable interstate revenues were growing. The total assessable revenue base has declined in recent years, however, from about $79.0 billion in 2000 to about $74.5 billion in 2006,[220] while universal service disbursements grew over that same time period from approximately $4.5 billion in 2000 to over $6.6 billion in 2006.[221] Declines in assessable contribution revenues combined with growth in universal service disbursements have increased the contribution factor applied to determine universal service contribution amounts.[222] This upward pressure jeopardizes the stability and sustainability of the support mechanisms, demonstrating the need for long-term fundamental reform of the contribution methodology.[223]

95. In addition, interstate end-user telecommunications service revenues are becoming increasingly difficult to identify as customers migrate to bundled packages of interstate and intrastate telecommunications and non-telecommunications products and services.[224] The integration of local and long-distance wireline services into packages that allow customers to purchase buckets of long distance minutes and local service for a single price blurs the distinction between revenue derived from intrastate

---

[218] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206–07, paras. 843–44; *Federal-State Joint Board on Universal Service; Access Charge Reform*, Sixteenth Order on Reconsideration and Eighth Report and Order in CC Docket No. 96-45 and Sixth Report and Order in CC Docket No. 96-262, 15 FCC Rcd 1679, 1685, para. 15 (1999) (*Fifth Circuit Remand Order*) (establishing a single contribution for all universal service support mechanisms based on interstate and international revenues).

[219] *Universal Service First Report and Order*, 12 FCC Rcd at 9206–08, 9211, paras. 843, 845–48, 854.

[220] *Compare* JIM LANDE & KENNETH LYNCH, FCC, 2000 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2002), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/telrev00.pdf *with* JIM LANDE & KENNETH LYNCH, FCC, 2006 TELECOMMUNICATIONS INDUSTRY REVENUES, tbl. 4 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284929A1.pdf. *But see* Letter from David C. Bergmann, Chair, NASUCA Telecommunications Committee, to Chairman Kevin Martin et al., FCC, WC Docket Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Docket Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286, at 7 (filed Sept. 30, 2008) (NASUCA Sept. 30, 2008 *Ex Parte* Letter) (arguing that the growth in the contribution factor is "almost entirely" due to the growth in universal service disbursement requirements).

[221] *See* FCC, UNIVERSAL SERVICE MONITORING REPORT, tbl. 1.2a (2001) (2001 UNIVERSAL SERVICE MONITORING REPORT), *available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/Monitor/mrs01-0.pdf; 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.11; *see also* USAC 2007 ANNUAL REPORT at 3, 51 (detailing universal service disbursements for 2007 at approximately $6.9 billion).

[222] The contribution factor grew from 5.9% in the first quarter of 2000 to 11.3% for the fourth quarter of 2008. *See Proposed First Quarter 2000 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 15 FCC Rcd 3660 (WCB 1999); *Proposed Fourth Quarter 2008 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 08-2091 (OMD Sept. 12, 2008) (*Fourth Quarter 2008 Contribution Factor Public Notice*).

[223] *See* 47 U.S.C. §§ 254(b), (d).

[224] Although the Commission has established safe harbors for the reporting of interstate telecommunications revenues derived from interstate telecommunications services bundled with customer premises equipment (CPE) or information services, it has not established guidelines for reporting interstate telecommunications service revenues for flat-rated bundles of wireline interstate and intrastate services. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review—Review of Customer Premises Equipment and Enhanced Local Exchange Markets*, CC Docket Nos. 96-61, 98-183, Report and Order, 16 FCC Rcd 7418, 7446–48, paras. 47–54 (2001) (*CPE Bundling Order*).

telecommunications service and interstate telecommunications service. Similarly, the availability of mobile wireless calling plans that allow customers to purchase buckets of minutes on a nationwide network without incurring roaming or long-distance charges also makes it difficult for providers and the Commission to identify the amount of revenue derived from interstate telecommunications service.[225] Further, migration to interconnected VoIP services complicates the distinctions that serve as the basis for current contribution obligations.[226]

96. In 2001 and 2002, the Commission sought comment on modifications to the existing revenue-based contribution methodology, and on replacing that methodology with one that assesses contributions on the basis of a flat-fee charge, such as a per-line charge.[227] The Commission also sought comment on other universal service contribution methodologies, including moving to a numbers-based methodology.[228] Finally, in May 2008, the Commission encouraged commenters to refresh the record in several pending intercarrier compensation and universal service reform proceedings, including the contribution methodology proceeding.[229]

B. Discussion

97. The system of contributions to the universal service fund is broken. The Commission has repeatedly patched the current system to accommodate decreasing interstate revenues, a trend toward "all-you-can-eat" services that make distinguishing interstate from other revenues difficult if not impossible and changes in technology. While the service developments that precipitated these changes have enormous consumer benefits, they have also severely strained the contributions system.[230] We therefore

---

[225] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 21252, 21258–59, paras. 13–15 (1998) (*First Wireless Safe Harbor Order*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, 24965–67, paras. 21–25 (2002) (*Second Wireless Safe Harbor Order*).

[226] *See Universal Service Contribution Methodology*, WC Docket Nos. 06-122, 04-36, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518 (2006) (*2006 Interim Contribution Methodology Order*); *aff'd in part, vacated in part sub nom. Vonage Holdings Corp. v. FCC*, 489 F.3d 1232 (D.C. Cir. 2007).

[227] *See Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001) (*2001 Contribution NPRM*); *see also Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Further Notice of Proposed Rulemaking and Report and Order, 17 FCC Rcd 3752, 3765, para. 31, 3766–89, paras. 34–83 (2002) (*Contribution First FNPRM*).

[228] *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24983–97, paras. 66–100 (seeking comment on capacity-based proposals that had been developed in the record and on telephone-number proposals advocated by certain parties); *Commission Seeks Comment on Staff Study Regarding Alternative Contribution Methodologies*, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Public Notice, 18 FCC Rcd 3006 (2003) (*Contribution Staff Study*) (seeking comment on a Commission staff study that estimated potential contribution assessment levels under the then-newly modified revenue-based method and the three connection-based proposals in the further notice portion of the *Second Wireless Safe Harbor Order*).

[229] *Interim Cap Clears Path for Comprehensive Reform: Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

[230] We agree with commenters who argue that the contribution methodology requires a comprehensive overhaul. *See, e.g.*, Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. 1 at 1 (filed Sept. 11, 2008) (AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter); Letter from Roger C. Sherman, Director, Government Affairs—Wireless

(continued….)

adopt today a system of contributions that will assess a $1.00 contribution per residential telephone number per month, and we will move to a connections-based system for business services. In this part, we explain our legal authority to move to these new methodologies, why we have decided to move to these methodologies, and how the residential numbers-based system will work.

1. Legal Authority

98. The Commission has ample authority to require contributions from the variety of providers discussed below. The Commission's authority derives from several sections of the Act: section 254(d), Title I, and section 251(e). These sections of the statute provide us authority to require contributions from the kinds of service providers we address below in our discussions of the new numbers-based approach for residential services and the connections-based approach for business services.

99. Section 254 is the cornerstone of the Commission's universal service program. Section 254(d) first provides that "[e]very telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, to the specific, predictable, and sufficient mechanisms established by the Commission to preserve and advance universal service."[231] Under this "mandatory contribution" provision, every provider of telecommunications services[232] must contribute, although the Commission has authority to exempt a carrier or class of carriers if their contributions would be *de minimis*.[233]

100. Section 254(d) also provides that the Commission may require "[a]ny other provider of interstate telecommunications . . . to contribute to the preservation and advancement of universal service if the public interest so requires."[234] The Commission has relied on this "permissive authority" to require various providers of telecommunications,[235] but not necessarily telecommunications *services*,[236] to contribute. For example, the Commission has required entities that provide interstate telecommunications to others on a private contractual basis to contribute to the universal service fund,[237] as well as payphone

(continued from previous page)

Regulatory, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 04-36 at 1 (filed June 14, 2006) (Sprint Nextel June 14, 2006 *Ex Parte* Letter); Letter from Susanne A. Guyer, Senior Vice President Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 06-122 at 2 (filed Oct. 28, 2008) (Verizon Oct. 29, 2008 *Ex Parte* Letter); Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 1 (filed Oct. 20, 2008) (AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter).

[231] 47 U.S.C. § 254(d).

[232] Section 254(d) refers to "telecommunications carriers," which are defined as "any provider of telecommunications services." 47 U.S.C. § 153(44).

[233] 47 U.S.C. § 254(d).

[234] 47 U.S.C. § 254(d).

[235] "Telecommunications" is defined as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43).

[236] "Telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46).

[237] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9183–84, paras. 794–95. We note that private service providers that provide interstate connections solely to meet their internal needs (i.e., self-providers) will not be required to contribute under the new methodology. This is consistent with our current

(continued….)

aggregators.[238] Most recently, we required interconnected VoIP providers to contribute even though the Commission has not determined that they are telecommunications carriers. Specifically, in the *2006 Interim Contribution Methodology Order*, we used our permissive authority under section 254(d) to require interconnected VoIP providers to contribute, and we noted that they "provide" telecommunications to their end users.[239] We also noted that in some cases, the interconnected VoIP provider may be "providing" telecommunications even if it arranges for the end user to have PSTN access through a third party.[240]

101. The Commission also has authority under Title I to require other service providers to contribute. In general, the Commission can rely on its ancillary jurisdiction under Title I when the Commission has subject matter jurisdiction over the service to be regulated, and the assertion of jurisdiction is "reasonably ancillary to the effective performance of [its] various responsibilities."[241] The Commission relied on this authority before section 254 was added by the 1996 Act to establish a high-cost support fund,[242] which the U.S. Court of Appeals for the D.C. Circuit found to be a permissive exercise of Title I authority.[243] And more recently in the *2006 Interim Contribution Methodology Order*, the Commission relied on its ancillary jurisdiction under Title I as an additional source of authority to require contributions from interconnected VoIP providers.[244] In that order, the Commission noted that the Act grants subject matter jurisdiction over interconnected VoIP because it involves "transmission" of voice by wire or radio,[245] and that imposing contribution obligations on interconnected VoIP providers was "reasonably ancillary" to the effective performance of the Commission's responsibilities to establish "specific, predictable, and sufficient mechanisms . . . to preserve and advance universal service."[246] In particular, the Commission noted that interconnected VoIP providers "benefit from their interconnection

(continued from previous page)
policy. In the *Universal Service First Report and Order*, the Commission reasoned that, for self-providers of interstate telecommunications, the telecommunications is incidental to their primary non-telecommunications business. *See Universal Service First Report and Order*, 12 FCC Rcd at 9185, para. 799.

[238] *See* 47 C.F.R. § 54.706(a); *Universal Service First Report and Order*, 12 FCC Rcd at 9184–85, paras. 796–98. *But see* Letter from Robert F. Aldrich, Counsel for the American Public Communications Council (APCC), to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 01-92, Attach. (filed Oct. 23, 2008).

[239] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7538–40, paras. 39–41; 47 C.F.R. § 54.706(a).

[240] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41 ("To provide this capability [telecommunications], interconnected VoIP providers may rely on their own facilities or provide access to the PSTN through others.").

[241] *See United States v. Southwestern Cable Co.*, 392 U.S. 157, 177–78 (1968); *United States v. Midwest Video Corp.*, 406 U.S. 649, 667–68 (1972); *FCC v. Midwest Video Corp.*, 440 U.S. 689, 700 (1979); *see also American Library Ass'n v. FCC*, 406 F.3d 689 (D.C. Cir. 2005).

[242] *See Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Decision and Order, 96 F.C.C.2d 781, (1984), *aff'd sub nom. Rural Tel. Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988).

[243] *Rural Tel. Coalition*, 838 F.2d at 1315.

[244] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7541–43, paras. 46–49.

[245] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 47 & n.160 (citing *IP-Enabled* Services, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245 (2005) (*VoIP 911 Order*), *aff'd sub nom. Nuvio Corp. v. FCC*, 473 F.3d 302 (D.C. Cir. 2006); 47 U.S.C. § 152(a)).

[246] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48 (quoting 47 U.S.C. § 254(d)).

to the PSTN."[247]

102. In addition, Congress provided the Commission with "plenary authority" over numbering in section 251(e). Specifically, the Commission has "exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States."[248] The Commission relied on its authority under section 251(e) to support its action to require interconnected VoIP providers to provide E911 services.[249] The Commission noted that it exercised its authority under section 251(e) because, among other reasons, "interconnected VoIP providers use NANP numbers to provide their services."[250]

103. These sections of the Act provide the Commission ample authority to require contributions from all providers subject to the new numbers-based and connections-based approaches described in more detail below. These methodologies may require some providers to contribute directly to universal service when in the past they may have been contributing only indirectly or not at all. For example, under the numbers-based approach, any provider who assigns an "Assessable Number" to a residential user must contribute $1.00 per number per month.[251] Providers such as VoIP providers who are not "interconnected VoIP" providers, electronic facsimile service providers, Internet-based TRS providers, one-way and two-way paging service providers, and telematics providers may assign Assessable Numbers to residential users and maintain the retail relationship with the end users.[252] Not all of these providers are "telecommunications carriers" subject to the mandatory contribution obligation of section 254(d). Nonetheless, we have authority to require them to contribute. First, all of these providers provide—directly or indirectly—some amount of interconnection to the public switched telephone network (PSTN), the network that universal service supports. Interconnection to the PSTN benefits the consumers of each of these types of services, facilitating communication (even if just one-way communication) between the end user and PSTN users. As we noted in the *2006 Interim Contribution Methodology Order*, interconnected VoIP providers often provide access to the PSTN via third parties[253] and this is sufficient to permit the Commission to rely on its authority to require contributions from "other provider[s] of interstate telecommunications."[254] And as we explain below, it is in the public interest (as required by section 254(d)) that these providers contribute. Furthermore, the prerequisites for the use of our Title I ancillary jurisdiction are unquestionably met here. All the services that rely on assignment of an Assessable Number to a residential end user come within the Commission's broad subject matter jurisdiction because they involve in some manner "interstate . . . communication by wire or radio."[255] And similar to our explanation in the *2006 Interim Contribution Methodology Order*, requiring contributions from providers who take advantage of PSTN connectivity whether directly or indirectly makes sense because their end users benefit from the ubiquity of that network and from being somehow

[247] *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7542, para. 48.

[248] 47 U.S.C. § 251(e)(1).

[249] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

[250] *See VoIP 911 Order*, 20 FCC Rcd at 10265, para. 33.

[251] The term Assessable Number is defined below. *See infra* paras. 115–129.

[252] This list is meant to be illustrative, not exhaustive. Other providers may also have to contribute to the universal service fund based on the criteria described in this order.

[253] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7539, para. 41.

[254] 47 U.S.C. § 254(d).

[255] 47 U.S.C. § 152(a); *see also VoIP 911 Order*, 20 FCC Rcd 10261–62, para. 28 (providing detailed explanation of why interconnected VoIP falls within the Commission's subject matter jurisdiction).

interconnected with it.[256] Finally, our plenary authority over numbering supports our actions here with regard to a numbers-based methodology for residential services. The purpose of a uniform system of numbering is to facilitate communication on interconnected networks based on a standardized system of identifiers—telephone numbers.[257] Those customers who are assigned telephone numbers, whether for plain old telephone service (POTS) or for any other service, are using the numbers to take advantage of some feature of the PSTN, whether it is the capability to be called, to have their locations automatically relayed to emergency call handlers, to be faxed from anywhere, or for some other reason. Because customers are receiving this benefit, it is appropriate that their service providers (and ultimately, likely, the customers themselves) contribute to the ubiquity and support of the network from which they are benefiting.

104. We reject suggestions that we do not have authority to require contributions based on numbers or connections because we lack authority over intrastate services.[258] The same number or connection typically is used for both interstate and intrastate services. The Commission and courts have rejected the assertion that simply because a single facility has the capacity to provide both interstate and intrastate services, the Commission lacks authority to regulate any aspect of the facility.[259] In fact, the subscriber line charge (SLC) that the Commission established is intended to capture the *interstate* cost of the *local* loop.[260] The contribution methodologies we adopt are thus limited to assessments on services that can provide interstate service. We will only require providers to contribute to universal service based on the Assessable Numbers or connections that are capable of originating or terminating interstate or international communications.[261]

2. The New Numbers-Based Assessment Methodology for Residential Services

105. As discussed above, we adopt a new contribution methodology for residential services based on assessing telephone numbers, rather than interstate and international services revenue. We find that this change will benefit contributors and end users by simplifying the contribution process and providing predictability as to the amount of universal service contributions and pass-through charges for residential services. For residential services, we set the contribution amount at a flat $1.00 per month

---

[256] *Compare 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7540, para. 43.

[257] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No. 96-98, Second Report and Order and Memorandum Opinion and Order, 11 FCC Rcd 19392, 19404, 19407, paras. 19, 25 (1996) (noting that numbering administration ensures the creation of a nationwide, uniform system of numbering essential to the efficient delivery of interstate and international telecommunications services and the development of a competitive telecommunications services market) (subsequent history omitted); *see also Administration of the North American Numbering Plan*, CC Docket No. 95-283, Report and Order, 11 FCC Rcd 2588, 2591, para. 4 (1995) ("Adequate telephone numbers, available through a uniform numbering plan, are essential to provide consumers efficient access to new telecommunications services and technologies and to support continued growth of an economy increasingly dependent upon those services and technologies."); *Administration of the North American Numbering Plan*, CC Docket No. 92-237, Notice of Proposed Rulemaking, 11 FCC Rcd 2068, para. 2 (1994).

[258] *See, e.g.*, American Association of Paging Carriers (AAPC) *Contribution First FNPRM* Comments at 7; Alaska Communication Systems (ACS) *Contribution First FNPRM* Reply at 6–7; Allied Personal Communications Industry Association of California (Allied) *Contribution First FNPRM* Comments at 6–7; National ALEC Association/Prepaid Communications Association (NALA/PCA) *Contribution First FNPRM* Reply at 3.

[259] *See, e.g*., *NARUC v. FCC*, 737 F.2d 1095, 1113 (D.C. Cir. 1984) ("The same loop that connects a telephone subscriber to the local exchange necessarily connects that subscriber into the interstate network as well.").

[260] *NARUC v. FCC*, 737 F.2d at 1113–14.

[261] Services that provide only intrastate communications and do not traverse a public interstate network will not be required to contribute under the new assessment methodology.

charge for each number associated with residential services.

a. Benefits of a Numbers-Based Contribution Methodology

106. We find that adoption of a telephone number-based methodology for residential services will help preserve and advance universal service by ensuring a specific, predictable, and sufficient funding source, consistent with the universal service principles of section 254(b) of the Act.[262] Changes in technology and services have made the revenue-based contribution mechanism difficult to administer. As commenters have noted, the distinction between intrastate and interstate revenues is blurring as providers move from their traditional roles as pure LECs or interexchange carriers (IXCs) to businesses that offer consumers the choice of purchasing their telecommunications needs from a single source.[263] Additionally, these providers are offering consumers greater flexibility, such as bundling of local and long distance service at a flat rate.[264] Moreover, technologies such as wireless and interconnected VoIP have emerged that provide voice and data services that know no jurisdictional boundaries.[265] Consumers benefit from the opportunity to obtain bundled services, and the universal service contribution mechanism should reflect and complement those marketplace and technological developments as much as possible. Our decision to use numbers as the basis for assessing contributions for residential services will enhance the specificity and predictability of entities' contributions.

107. Our adoption of a numbers-based contribution methodology will benefit both residential consumers and contributors by simplifying the basis for assessments and stabilizing assessments at a set amount of $1.00 per month per residential telephone number.[266] Contributors are allowed, and in most cases do, recover their universal service contribution costs from fees assessed on their end-user customers.[267] Under the revenue-based contribution mechanism, a provider's contribution costs fluctuated from quarter to quarter, causing consumers' universal service fees to fluctuate as well. These fluctuations did not allow customers to anticipate changes to their fees. A set $1.00-per-number contribution assessment is simple and predictable for both contributors and for consumers. To the extent a contributor elects to recover its contribution costs through end-user fees, its residential customers will pay the same $1.00 fee per number each month, making the assessment simple and predictable.[268]

108. A numbers-based contribution methodology also benefits residential end users because it

[262] 47 U.S.C. § 254(b)(5).

[263] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1.

[264] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Nov. 19, 2007) (Ad Hoc Nov. 19, 2007 *Ex Parte* Letter) (discussing the convergence of different applications for business and residential customers onto a single integrated network with bundled pricing).

[265] *See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, 22412–14, paras. 16–18 (2004) (*Vonage Order*), *aff'd sub nom. Minnesota Pub. Utils. Comm'n v. FCC*, 483 F.3d 570 (8th Cir. 2007).

[266] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2.

[267] Contributors are prohibited from passing through to subscribers more than their contribution cost. 47 C.F.R. § 54.712.

[268] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also* Information Technology Industry Council (ITI) *2006 Contribution FNPRM* Comments at 6; NCTA *2006 Contribution FNPRM* Comments at 5; Small Business Administration Office of Advocacy (SBA) *2006 Contribution FNPRM* Comments at 8; Vonage *2006 Contribution FNPRM* Comments at 7–8; Letter from Gregory V. Haledjian, Regulatory and Governmental Relations, Counsel to IDT Corporation and USF By the Numbers Coalition, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, Attach. at 3–4 (filed Jan. 30, 2007).

is technologically and competitively neutral. A consumer will pay the same universal service charge regardless of whether the consumer receives residential service from a cable provider, an interconnected VoIP provider, a wireless provider, or a wireline provider. This will enable residential consumers to choose the providers and provider types they want without regard to any artificial distortions that would otherwise be caused by differing contribution charges.[269] In a marketplace characterized by increased competition within and between different technology platforms, residential consumers will receive the same universal service charge regardless of the type of service the customer chooses.

109. Similarly, by subjecting contributors to the same regulatory framework for assessments on residential services regardless of technology, the numbers-based methodology will eliminate incentives under the current revenue-based system for providers to migrate to services and technologies that are either exempt from contribution obligations or are subject to safe harbors.[270] The elimination of such incentives will result in a more competitively and technologically neutral marketplace and a more predictable source of funding for the universal service mechanisms.

110. The adoption of a fixed $1.00 per residential number per month contribution assessment is specific and predictable and will simplify the administration of universal service contributions.[271] Interstate end-user telecommunications revenues have become increasingly difficult to identify, particularly for residential services, due to increased bundling of local and long distance service and the growth of consumer interconnected VoIP offerings.[272] In contrast, telephone numbers provide an easily identifiable basis for contribution.[273] The amount of North American Numbering Plan (NANP) telephone numbers in use has shown steady, stable growth, providing a fairly constant basis for estimating universal service support amounts.[274] The new methodology, based on a flat $1.00 per residential number per month, will be easier to administer, facilitating greater regulatory compliance. A numbers-based contribution methodology will also be readily applicable to emerging service offerings. The new methodology minimizes the potential for providers to avoid contributions by bundling intrastate revenues

---

[269] *See, e.g.*, NCTA *2006 Contribution FNPRM* Comments at 5; Vonage *2006 Contribution FNPRM* Comments at 6; Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, 01-92, CC Docket Nos. 96-45, 99-68, 96-262 at 2 (filed July 15, 2008).

[270] *See* AT&T *2006 Contribution FNPRM* Comments at 4.

[271] In addition to being easily administrable, the record supports adoption of $1.00 per month as the residential per-number assessment amount. *See, e.g.*, Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, Attach. at 3 (filed Oct. 25, 2005); *See* Letter from Mary L. Henze, AT&T Services, and Kathleen Grillo, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 3 (filed Sept. 23, 2008) (AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter) (estimating a $1.01 per-number per-month assessment under a numbers-based contribution methodology); *see also* Letter from Paul Garnett, Assistant Vice President, CTIA–The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45 at 1 (filed Oct. 2, 2008) (CTIA Oct. 2, 2008 *Ex Parte* Letter), Attach. at 5 (supporting the AT&T and Verizon proposal); Letter from David B. Cohen, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, Attach. at 1 (filed Sept. 25, 2008).

[272] *See* 2007 UNIVERSAL SERVICE MONITORING REPORT at tbl. 1.1.

[273] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 1; *see also* ALEXANDER BELINFANTE, FCC, TELEPHONE SUBSCRIBERSHIP IN THE UNITED STATES, tbl. 1 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284923A1.pdf.

[274] *See* CRAIG STROUP AND JOHN VU, FCC, NUMBERING RESOURCE UTILIZATION IN THE UNITED STATES, tbl. 12 (2008) (showing number utilization from December 2000 to December 2007), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284926A1.pdf.

with interstate revenues or engaging in other bypass activities.[275]

111. Further, assessing universal service contributions based on residential telephone numbers will promote number conservation.[276] Telephone numbers are a finite, public resource. If contributors are assessed based on the residential telephone numbers assigned to them, they will have an incentive to efficiently manage their numbering resources in a manner that minimizes their costs. We expect that this will result in the need for fewer area code splits or overlays due to number exhaust.[277]

112. Our adoption of a numbers-based contribution methodology for residential services is consistent with the goal of ensuring just, reasonable, and affordable rates.[278] The per-number assessment of $1.00 per number per month will represent a reduction in pass-through charges for many residential customers.[279] Although the $1.00 per number per month assessment may represent an increase in universal service charges for residential customers that make few or no long distance calls, this increase should be slight. Under the current revenue-based contribution mechanism, providers may assess a federal universal service fee on the basis of the customer's SLC. The residential SLC may be as high as $6.50 per month.[280] Based on the most recent contribution factor of 11.4 percent, even a customer who made no long distance calls could thus be assessed $0.74 per month in universal service charges under the existing revenue-based methodology.[281] Thus, the potential increase for a customer who makes no long distance calls could be as little as $0.26 per month under the $1.00 per number methodology. In addition, we have separate protections to ensure that telephone service remains affordable for low-income subscribers.[282]

---

[275] *See* Ad Hoc *Contribution First FNPRM* Comments at 6–7; Coalition for Sustainable Universal Service (CoSUS) *Contribution First FNPRM* Comments at 38; Sprint *Contribution First FNPRM* Comments at 8–9. Because residential services will no longer be assessed based on revenues, contributors may not mark-up or otherwise adjust the $1.00 per Assessable Number per month residential contribution assessment in response to uncollectible revenues.

[276] *See, e.g.*, ITI *2006 Contribution FNPRM* Comments at 6; Vonage *2006 Contribution FNPRM* Comments at 7.

[277] *See Numbering Resource Optimization*, CC Docket No. 99-200, Report and Order and Further Notice of Proposed Rulemaking, 15 FCC Rcd 7574, 7625, para. 122 (2000) (*NRO I Order*) (determining that implementation of thousands-block number pooling is essential to extending the life of the NANP by making the assignment and use of NXX codes more efficient); *see also Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Fourth Report and Order, 18 FCC Rcd 12472, 12474, para. 5 (2003) (*NRO IV Order*) (explaining further that thousands-block number pooling is a numbering resource optimization measure in which 10,000 numbers in an NXX are divided into ten sequential blocks of 1,000 numbers and allocated to different service providers (or different switches) within a rate center).

[278] 47 U.S.C. § 254(b)(1).

[279] *See* Letter from Jean L. Kiddoo and Tamar E. Finn, Counsel to IDT Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 5 (filed Aug. 2, 2007) (IDT Aug. 2, 2007 *Ex Parte* Letter) (showing that the average residential household paid about $1.37 in universal service fees in 2006). IDT claims the data show that the lowest-income consumers paid an average of $1.09 in universal service fees for wireline telephone bills. *Id*. at 6.

[280] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1). The SLC is referred to as the End User Common Line Charge in the Commission's rules.

[281] The revenue from the $6.50 SLC would be multiplied by the 11.4% contribution factor, resulting in a contribution amount and corresponding assessment of $0.74. *See Fourth Quarter 2008 Contribution Factor Public Notice* at 1; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 3.

[282] *See* 47 C.F.R. § 54.400 *et seq.*; *infra* para. 141 (describing contribution exemptions for services to low-income consumers).

113. Some commenters assert that assessing a flat universal service charge is inherently unfair because it does not take into account the fact that some people make many interstate and international calls, while others make few if any such calls in a given month.[283] We disagree. We find that imposition of a flat charge is warranted because all contributors and their subscribers receive a benefit from being connected to the public network, enabling them to make and receive interstate calls.[284] The *ability* to make or receive interstate calls over a public network is a significant benefit and it is reasonable to assess universal service contributions for residential customers based on access to the network. Customers who do not make any interstate calls still receive the benefit of accessing the network to *receive* interstate calls. The $1.00 per month per number assessment reflects our finding that it is equitable for providers to contribute a fixed amount based on the ability to access and utilize a ubiquitous public network.

114. Some commenters allege that changing from the current revenue-based methodology to a new mechanism based on telephone numbers would not be equitable because it could reduce contributions from certain industry segments and increase them for others.[285] Although the change to a numbers-based contribution methodology for residential services will result in changes in the relative contribution obligations of industry segments, the new contribution methodology is not inequitable or discriminatory. The evolving nature of the telecommunications marketplace and of its participants requires the Commission to periodically review and revise the contribution methodology to ensure that providers continue to be assessed on an equitable and non-discriminatory basis. We find that, given the difficulties in continuing to assess contributions entirely on a revenue-based methodology and the benefit to residential consumers of access to the public network, it is equitable to adopt a numbers-based contribution methodology that assesses a $1.00 per month per number fee for residential services.

b. Assessable Numbers

115. Below, we describe the telephone numbers for which service providers are obligated to contribute to the universal service fund. We call these "Assessable Numbers." The Commission has addressed certain reporting based on telephone numbers in other contexts. In the number utilization context, the Commission requires that each telecommunications carrier that receives numbering resources from the North American Numbering Plan Administrator (NANPA), the Pooling Administrator, or another telecommunications carrier report its numbering resources in each of six defined categories of numbers set forth in section 52.15(f) of our rules.[286] In the regulatory fee context, the Commission used

---

[283] *See, e.g.*, Letter from Maureen A. Thompson, Executive Director, Keep USF Fair Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 5–7 (filed Mar. 27, 2006) (Keep USF Fair Mar. 27, 2006 *Ex Parte* Letter); *see also* NASUCA Sept. 30, 2008 *Ex Parte* Letter at 9.

[284] *Universal Service First Report and Order*, 12 FCC Rcd at 8783, para. 8

[285] *See, e.g.*, FW&A *Contribution First FNPRM* Comments at 13–15; NRTA and OPASTCO *Contribution First FNPRM* Comments at 7–11; SBC *Contribution First FNPRM* Comments at 18; Verizon *Contribution First FNPRM* Reply at 6; Verizon Wireless *Contribution First FNPRM* Comments at 5–6.

[286] These six categories of numbers are defined as follows:

> (i) Administrative numbers are numbers used by telecommunications carriers to perform internal administrative or operational functions necessary to maintain reasonable quality of service standards.
>
> (ii) Aging numbers are disconnected numbers that are not available for assignment to another end user or customer for a specified period of time. Numbers previously assigned to residential customers may be aged for no more than 90 days. Numbers previously assigned to business customers may be aged for no more than 365 days.
>
> (iii) Assigned numbers are numbers working in the Public Switched Telephone Network under an agreement such as a contract or tariff at the request of specific end users or customers for their use, or

(continued….)

the category of "assigned numbers" as the starting point for determining how to assess fees on certain providers, but found it necessary to modify that definition to account for the different regulatory contexts. Specifically, in assessing regulatory fees for commercial mobile radio service (CMRS) providers that report number utilization to NANPA based on the reported assigned number count in their Numbering Resource Utilization and Forecast (NRUF) data, the Commission requires these providers to adjust their assigned number count to account for number porting. The Commission found that adjusting the NRUF data to account for porting was necessary for the data to be sufficiently accurate and reliable for purposes of regulatory fee assessment.[287]

116. We adopt a new term based on the category of assigned numbers to represent the numbers being assessed for universal service contribution purposes—"Assessable Numbers." The definition of Assessable Numbers that we adopt focuses on those numbers that are actually in use by end users for services that traverse a public interstate network. Specifically, we define an Assessable Number as a NANP telephone number or functional equivalent identifier[288] in a public or private network that is in use by a residential end user and that enables the residential end user to receive communications from or terminate communications to (1) an interstate public telecommunications network or (2) a network that traverses (in any manner) an interstate public telecommunications network.[289] Assessable Numbers include geographic as well as non-geographic telephone numbers (such as toll-free numbers and 500-NXX numbers) so long as they meet the other criteria described in this part for Assessable Numbers.

117. The provider with the retail relationship to the residential end user is the entity responsible for contributing.[290] We impose the contribution obligation on the provider with the retail

(continued from previous page)

numbers not yet working but having a customer service order pending. Numbers that are not yet working and have a service order pending for more than five days shall not be classified as assigned numbers.

(iv) Available numbers are numbers that are available for assignment to subscriber access lines, or their equivalents, within a switching entity or point of interconnection and are not classified as assigned, intermediate, administrative, aging, or reserved.

(v) Intermediate numbers are numbers that are made available for use by another telecommunications carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer. Numbers ported for the purpose of transferring an established customer's service to another service provider shall not be classified as intermediate numbers.

(vi) Reserved numbers are numbers that are held by service providers at the request of specific end users or customers for their future use. Numbers held for specific end users or customers for more than 180 days shall not be classified as reserved numbers.

47 C.F.R. § 52.15(f)

[287] *See Assessment and Collection of Regulatory Fees for Fiscal Year 2005, Assessment and Collection of Regulatory Fees for Fiscal Year 2004*, MD Dockets No. 05-59, 04-73, Report and Order and Order on Reconsideration, 20 FCC Rcd 12259, 12271, paras. 39–40 (2005).

[288] "Functional equivalent identifier" means an identifier used in place of and with the same PSTN access capability as a NANP number; it is not intended to capture identifiers used in conjunction with NANP numbers, such as internal extensions that cannot be directly dialed from the PSTN. Nor is "functional equivalent identifier" intended to capture routing identifiers used for routing of Internet traffic, unless such identifiers are used in place of a NANP number to provide the ability to make or receive calls on the PSTN.

[289] For purposes of the definition of Assessable Numbers, we include only the NANP telephone numbers used in the United States and its Territories and possessions.

[290] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844; *see also, e.g.*, Letter from Melissa E. Newman, Vice President-Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, at 7 (filed Sept. 24, 2008) (Qwest Sept. 24, 2008 *Ex Parte* Letter); AT&T and Verizon Sept. 11, 2008, *Ex Parte*

(continued….)

relationship to the end user for several reasons. First, this provider will have the most accurate and up-to-date information about how many Assessable Numbers it currently has assigned to end users. Second, this provider is also in the best position to distinguish residential users from business users, and thus to determine how many of its telephone numbers in use are Assessable Numbers. Finally, this provider, and its users, are benefiting from a supported PSTN, and thus it is sound policy to require them to contribute to its support.[291] We note that today, providers are permitted to pass through their contribution assessments to end users, and we understand that they typically do so.[292] Under the new methodologies, they may continue to do so, subject to the same requirement that they will not pass through more than their contribution amount.[293]

118. Next, we specify whether certain types of numbers are included in the definition of Assessable Numbers. First, numbers used for intermittent or cyclical purposes are included in the definition of Assessable Numbers. Numbers used for cyclical purposes are numbers designated for use that are typically "working" or in use by the end user for regular intervals of time. These numbers include, for example, an end user's summer home telephone number that is in service for six months out of the year.[294] In the *NRO III Order*, the Commission clarified that these types of numbers should generally be categorized as "assigned" numbers if they meet certain thresholds and that, if they do not meet these thresholds, they "must be made available for use by other customers" (i.e., they are "available" numbers).[295] Because these numbers are assigned to end users, we find they should be included in the definition of Assessable Numbers we adopt today.

119. We exclude from our definition of Assessable Numbers those telephone numbers that satisfy the section 52.15 definition of "assigned numbers" solely because the "numbers [are] not yet working but hav[e] a customer service order pending" for five days or less.[296] Providers generally do not bill for services that have yet to be provisioned and therefore are not compensated for services during the pendency of the service order. Moreover, such numbers are not yet operational to send or receive calls.

(continued from previous page)
Letter, Attach. 1 at 1–2; Letter from Brad E. Mutschelknaus, Counsel for XO Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket No. 04-36, Attach. at 9 (filed Oct. 3, 2008); Letter from Donna N. Lampert, Counsel for Google, to Marlene H. Dortch, Secretary, FCC (filed Oct. 3, 2008) (Google Oct. 3, 2008 *Ex Parte* Letter); *see also* 47 C.F.R. § 54.5 (defining "contributor" as "an entity required to contribute to the universal service support mechanism pursuant to § 54.706 [of the Commission's rules]").

[291] *See supra* para. 103 (discussing the public interest in requiring these entities to support the network).

[292] *See, e.g.*, AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 2 at 2; *see also Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24978, para. 50.

[293] 47 C.F.R. § 54.712.

[294] *See Numbering Resource Optimization*, CC Docket Nos. 99-200, 96-98, 95-116, Third Report and Order and Second Order on Reconsideration in CC Docket No. 96-98 and CC Docket No. 99-200, 17 FCC Rcd 252, 303, para. 119 (2001) (*NRO III Order*).

[295] *NRO III Order*, 17 FCC Rcd at 304, para. 122 ("With this requirement, we seek to limit the amount of numbers that are set aside for use by a particular customer, but are not being used to provide service on a regular basis. Thus, in order to categorize such blocks of numbers as assigned numbers, carriers may have to decrease the amount [of] numbers set aside for a particular customer. We also clarify that numbers 'working' periodically for regular intervals of time, such as numbers assigned to summer homes or student residences, may be categorized as assigned numbers, to the extent that they are 'working' for a minimum of 90 days during each calendar year in which they are assigned to a particular customer. Any numbers used for intermittent or cyclical purposes that do not meet these requirements may not be categorized as assigned numbers, and must be made available for use by other customers.").

[296] *See* 47 C.F.R. § 52.15(f)(iii).

Thus, under the existing contribution methodology, providers would not contribute for services they are about to provide (but have not yet provided) under a pending service order. We continue to find it appropriate for contributors not to be required to contribute to the universal service fund for pending service orders.

120. We exclude from the definition of Assessable Numbers those telephone numbers that telecommunications providers have transferred or ported to a carrier using resale or the unbundled network element platform. Under prior numbering orders, such telephone numbers would still be included in the NRUF assigned number count of the transferring-out carrier.[297] Consistent with our definition of Assessable Numbers, because the underlying provider no longer maintains the retail relationship with the end user, the provider should not include these numbers in its Assessable Number count. Conversely, the receiving provider of such transferred customers would include the associated telephone numbers in their count of Assessable Numbers.

121. We exclude from the definition of Assessable Numbers those numbers that meet the definition of an Available Number, an Administrative Number, an Aging Number, or an Intermediate Number as those terms are defined in section 52.15(f) of the Commission's rules.[298] For a particular carrier, the carrier will not have an end user associated with a number in any of these categories of numbers. For example, an intermediate number is a number that is "made available for use by another telecommunications carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer."[299] The receiving provider will be responsible for including the number as an Assessable Number once it provides the number to an end user.[300]

122. We exclude non-working telephone numbers from the definition of Assessable Number. Carriers report as assigned numbers for NRUF purposes entire codes or blocks of numbers dedicated to specific end-user customers if at least fifty percent of the numbers in the code or block are working in the PSTN.[301] Consistent with our definition of Assessable Numbers, carriers should not include the non-working numbers in these blocks in their Assessable Number counts, because the non-working numbers portion of these blocks are not providing service to the end user.

123. We exclude from the definition of Assessable Number those numbers that are used merely for routing purposes in a network, so long as such numbers are always—without exception—provided without charge to the end user, are used for routing only to Assessable Numbers for which a universal service contribution has been paid, and the ratio of such routing numbers to Assessable Numbers is no greater than 1:1. For example, a NANP number used solely to route or forward calls to a residential number, office number, and/or mobile number would be excluded from our definition of

---

[297] *NRO I Order*, 15 FCC Rcd at 7586–87, para. 18. Ported-out numbers, a subcategory of assigned numbers, are not reported to NANPA although NRUF reporting carriers are required to maintain internal records associated with these numbers for five years. *Id*. at 7592, 7601, paras. 36, 62.

[298] *See* 47 C.F.R. § 52.15(f); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 7 (arguing, among other things, that numbers used for administrative purposes and numbers that are not "actively" working, such as aging, unassigned, reserved numbers, and numbers donated back to the industry pool should be excluded from the contributor's base).

[299] *See* 47 C.F.R. § 52.15(f)(v).

[300] *See NRO I Order*, 15 FCC Rcd at 7587, para. 21 (2000) ("We agree with commenters who opine that [intermediate] numbers should not be categorized as *assigned* numbers because they have not been assigned to an end user. . . . We therefore conclude that numbers that are made available for use by another carrier or non-carrier entity for the purpose of providing telecommunications service to an end user or customer should be categorized as *intermediate* [numbers].").

[301] *NRO III Order*, 17 FCC Rcd at 304, para. 122.

Assessable Number if such routing number were provided for free, and such number routes calls only to Assessable Numbers. If, however, such routing or forwarding is provided for a fee, such as with remote call forward service or foreign exchange service, both the routing number and the end user number to which calls are routed or forwarded would be considered Assessable Numbers.

124. In addition, incumbent LECs need not include numbers assigned to wireless providers that interconnect at the end office of an incumbent LEC and have obtained numbers directly from the incumbent LEC.[302] Because the incumbent LEC does not have the retail relationship with the end user, it should not include these numbers in its Assessable Number count. The wireless carriers that have the retail relationship with the end users must include these telephone numbers in their Assessable Number count.

125. Finally, we exclude from the definition of Assessable Numbers those numbers associated with Lifeline services for the reasons described below.[303]

126. We do not restrict our definition to numbers that exclusively use the PSTN.[304] As noted above, evolution in communications technology away from the PSTN to alternative networks that may only partially (if at all) traverse the PSTN is one of the causes in the erosion of the contribution base under the current revenue-based methodology. As more service providers migrate to alternative networks that partially access the PSTN, continuing to assess universal service contributions based only on traffic that exclusively traverses the PSTN will not account for this migration; nor will it allow us to meet our principle of competitive neutrality.[305] Moreover, if a service provider connects a private network to a public network, the service provider and its customers benefit from the connection to the PSTN. Because universal service supports the PSTN and these parties connect to the PSTN, they benefit from universal service.[306] Thus, it is increasingly important that we conform our regulatory definitions to recognize this reality. Indeed, the Commission has already begun to recognize the need to create a level regulatory playing field. For example, calls to end users that utilize interconnected VoIP service are not wholly within the PSTN. Indeed, calls between two interconnected VoIP users may not touch the PSTN at all. Yet we found in 2006 that interconnected VoIP providers must contribute to the universal service fund.[307] For these reasons, we conclude that our definition must account for public or private interstate networks, regardless of the technology of the network (e.g., circuit-switched, packet-switched) or the transmission medium of the network (e.g., wireline, wireless).

127. Finally, we recognize that, by declining to adopt for contribution purposes verbatim the

---

[302] When a wireless carrier interconnects at an incumbent LEC end office it is known as a Type 1 interconnection. *See Federal Communications Commission Seeks Comment on Initial Regulatory Flexibility Analysis in Telephone Number Portability Proceeding*, CC Docket No. 95-116, Public Notice, 20 FCC Rcd 8616, 8632, App. B at para. 19 n.53 (2005) ("Type 1 numbers reside in an end office of a LEC and are assigned to a Type 1 interconnection group, which connects the wireless carrier's switch and the LEC's end office switch.").

[303] *See infra* paras. 140–46.

[304] The record is split over whether the definition of an assessable number should be restricted to the PSTN. AT&T and Verizon, for example, do not include such a requirement in their proposed definitions. *See* AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter, Attach. 1. Other commenters, however, argue for such a requirement. *See* Google Oct. 3, 2008 *Ex Parte* Letter at 1 (the definition of an assessable number should be "premised on a telephone number acting as a proxy for an underlying two-way PSTN connection"). As we explain herein, such a restriction is not warranted.

[305] *Universal Service First Report and Order*, 12 FCC Rcd at 9207, paras. 845–46.

[306] *Universal Service First Report and Order,* 12 FCC Rcd at 9184 para. 796.

[307] *See 2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7536–37, paras. 33-34.

definition of “assigned numbers” in section 52.15(f) of our rules, which is used by carriers to file NRUF reports,[308] we may nominally increase some of the administrative burden associated with universal service contribution filings. We find, however, that any minor administrative cost increases arising from not using the pre-existing definition are outweighed by the benefits of modifying the definition to achieve sound universal service policy. For example, as stated above, the existing definition of assigned numbers would not enable us to meet our universal service contribution goal of ensuring that the provider with the retail relationship to the end user be the one responsible for contributing.[309]

128. Under our numbers-based approach, certain providers will be required to contribute to the universal service fund based on Assessable Numbers even though they are not today required to submit NRUF data. Section 52.15(f) of the Commission’s rules requires only “reporting carriers” to submit NRUF data to the NANPA.[310] A “reporting carrier” is defined as a telecommunications carrier that receives numbering resources from the NANPA, the Pooling Administrator, or another telecommunications carrier.[311] In the case of numbers provided by a telecommunications carrier to a non-carrier entity, the carrier providing the numbers to such entities must report NRUF data to the NANPA for those numbers. Thus, non-carrier entities that use telephone numbers in a manner that meets our definition of Assessable Numbers do not report NRUF data yet must contribute.[312] For example, interconnected VoIP providers may use telephone numbers that meet our definition of Assessable Numbers even though these providers do not report NRUF data.[313] These non-carrier entities that use numbers in a manner that meets our definition of Assessable Number will be required to determine their Assessable Number count based on their internal records (e.g., billing system records) and will be required to report such numbers to USAC.[314]

129. We are mindful that our move to a numbers-based contribution methodology may encourage entities to try to avoid their contribution obligations by developing ways to bypass the use of NANPA-issued numbers.[315] To the extent, however, these alternative methods are the functional equivalent of numbers and otherwise meet our definition of Assessable Numbers, such entities must report these functional equivalents as Assessable Numbers to the universal service fund administrator.

3. Contribution Assessment Methodology for Business Services

130. Although we find that a numbers-based contribution mechanism is superior to the existing revenue-based mechanism for residential services, applying a numbers-based approach to

---

[308] *See* 47 C.F.R. § 52.15(f)(iii).

[309] *See Universal Service First Report and Order*, 12 FCC Rcd at 9206, para. 844.

[310] 47 C.F.R. § 52.15(f).

[311] 47 C.F.R. § 52.15(f)(2).

[312] *NRO I Order*, 15 FCC Rcd at 7587, para. 21.

[313] S*ee Administration of the North American Numbering Plan*, Order, 20 FCC Rcd 2957, 2961–62, para. 9 (2005) (*SBCIS Waiver Order*) (noting that most VoIP providers’ numbering utilization data are embedded in the NRUF data of the LEC). In the *SBCIS Waiver Order*, the Commission granted SBCIS, an Internet service provider, permission to obtain numbering resources directly from the NANPA and/or Pooling Administrator, conditioned on, among other things, SBCIS reporting NRUF data. *Id*. at 2959, para. 4.

[314] *See infra* paras. 147–53.

[315] *See* Letter from Jeanine Poltronieri, Vice President, Federal Regulatory, BellSouth D.C., Inc, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed July 6, 2005) (“If voice service is provided without using telephone numbers, but with IP address or other identifier, FCC will need to establish a ‘functional equivalency’ test.”).

business services would result in inequitable contribution obligations. Specifically, certain business services that do not utilize numbers, or that utilize them to a lesser extent, would not be contributing to the universal service fund on an equitable basis.[316] Section 254(d) of the Act requires "every carrier" that provides interstate telecommunications services to contribute to the universal service fund.[317] Thus, providers of business services, including non-numbers based services, must continue to contribute. We conclude that these services should be assessed based on their connection to the public network.

131. A number of commenters supported moving to a methodology that would assess telephone numbers for those services that are associated with a telephone number and assess based on capacity of the connection to the public switched network those services not associated with a telephone number.[318] Other commenters supported retaining a revenue-based methodology for these services.[319] As discussed above, a revenue-based contribution methodology is no longer sustainable in today's telecommunications marketplace.[320] Additionally, a connections-based contribution methodology will provide a basis for assessing services not associated with telephone numbers, and will recognize the greater utility derived by business end users from these high capacity business service offerings.[321] Further, in contrast to the revenues on which contributions are currently based, the number and capacity of connections continues to grow over time, providing a contribution base that is more stable than the current revenue-based methodology. Moreover, a connections-based mechanism can be easily applied to all business services. We, therefore, conclude that a connections-based contribution mechanism is the better option for business services. We seek comment below on the implementation of the connections-based contribution mechanism for business services.[322]

132. We find that it is equitable and nondiscriminatory, consistent with the requirements of

---

[316] Business services such as private line and special access services do not typically utilize telephone numbers in the same manner as residential services, and would not contribute equitably to the universal service fund under a numbers-based approach. *See, e.g.*, Letter from James S. Blaszak, Counsel to Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 3 (filed Oct. 9, 2002); Letter from Robert Quinn, Vice President Federal Government Affairs, AT&T, to Marlene Dortch, Secretary, FCC, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, NSD File No. L-00-72, at 2 (filed Oct. 22, 2002). Moreover, unlike residential services, which usually have one telephone number assigned per access line, business services do not usually have a number of telephone numbers assigned that aligns with the number of access lines utilized.

[317] 47 U.S.C. § 254(d). Therefore, we disagree with those parties that continue to support a numbers-only based approach because we find such an approach would be inconsistent with the statutory requirement that every telecommunications carrier must contribute to the universal service fund. *See, e.g.*, Letter from James S. Blaszak, Counsel for Ad Hoc, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, WC Docket Nos. 05-337, 07-135, Attach. at 5 (filed Oct. 14, 2008).

[318] *See Staff Study*; *see also* Ad Hoc Telecommunications Users Committee 2003 Staff Study Reply; Letter from John Nakahata, Counsel for the Coalition for Sustainable Universal Service, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Oct. 31, 2002).

[319] *See* Letter from Melissa E. Newman, Vice President-Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 6 (filed Mar. 21, 2006) (Qwest Mar. 21, 2006 *Ex Parte* Letter); *see also* Qwest Sept. 24, 2008 *Ex Parte* Letter at 2.

[320] *See supra* para. 97.

[321] Time Warner *2006 Contribution FNPRM* Comments at 2.

[322] We decline at this time to adopt AT&T and Verizon's proposal for assessing contributions on connections based on flat rate charges that would differ based on the speed of the connection. AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 2. Instead, we seek further comment on implementing assessments based on connections.

section 254(d) of the Act, to establish different contribution methodologies for residential and business services.[323] Although the statute states that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service," it does not require that all contributors or all services be assessed in the same manner.[324] Under the current revenue-based mechanism, the Commission has established different contribution methodologies through the use of proxies for wireless and interconnected VoIP services.[325] As noted above, continuing to use a revenues-based contribution methodology has become increasingly complex, and a numbers-based system would avoid many of those complexities.[326] At the same time, however, if we relied exclusively on a numbers-based contribution methodology, there are some business services—such as private line and special access—that would escape contribution requirements entirely. That result would be inconsistent with the obligation that all providers of interstate telecommunications services contribute to universal service, and would impose an unfair burden on providers that contribute on the basis of numbers.[327] We therefore conclude that adopting different contribution assessment methodologies for residential and business services will result in equitable and nondiscriminatory contribution obligations.

133. On an interim basis, while we conduct a proceeding to implement the connections-based contribution methodology, we continue to require providers to contribute to the universal service fund using the current revenue-based methodology for their business services.[328] We find that providers of business services should continue to bear their portion of the universal service contribution obligation to ensure the sufficiency of the fund while the connections-based contribution mechanism is being implemented.[329]

---

[323] 47 U.S.C. § 254(d).

[324] 47 U.S.C. § 254(b)(4).

[325] The proxies offer an alternative to contributions assessed on actual interstate revenues; they are intended to approximate the portion of revenues derived from the provision of interstate telecommunications services. *First Wireless Safe Harbor Order*, 13 FCC Rcd at 21258–60, paras. 13–15 (establishing safe harbors for wireless service providers); *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 14954, para. 1 (modifying the wireless safe harbors); *2006 Interim Contribution Methodology Order*, 21 FCC Rcd at 7532, 7545, paras. 23, 53 (revising the wireless safe harbor and establishing a safe harbor for interconnected VoIP providers).

[326] *See supra* para. 95.

[327] 47 U.S.C. §§ 254(b)(4), (d).

[328] Contributors will base their contributions on business service revenues in the same manner as they do currently. We make no change to the *de minimis* exemption or to the Limited International Revenue Exception (LIRE) for business contributions based on revenues. 47 U.S.C. § 254(d); 47 C.F.R. § 54.708; *Fifth Circuit Remand Order*, 15 FCC Rcd at 1687–88, para. 19; *Contribution First FNPRM*, 17 FCC Rcd at 3806–07, paras. 125–28. These exceptions do not apply to residential contributions based on numbers.

[329] *See* 47 U.S.C. § 254(d). Prepaid calling card providers, as well as any other current contributors who provide services to residential consumers but do not assign Assessable Numbers, shall continue to contribute based on their revenues during the interim period until these business services are assessed on the basis of connections and/or numbers. Despite IDT's recent request that its prepaid calling card services be treated as residential for purposes of universal service contribution assessments, we find that, consistent with arguments made over the years by such providers, these calling card services are provided to businesses. *See* Request for Review of Decision of the Universal Service Administrator by IDT Corporation and IDT Telecom, CC Docket No. 96-45 at 3 (filed June 30, 2008) ("The vast majority of [prepaid calling card sales] are completed through a network of distributors and resellers before being purchased by the ultimate end user consumer."). *But see* Letter from Tamar E. Finn, Counsel, IDT Corporation, to Marlene Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 (filed Oct. 28,

(continued….)

134. During the interim period in which the revenue-based contribution assessment for business services remains in place, the contribution factor for providers of business services will be determined based on the funding requirements not covered by the $1.00 assessment on Assessable Numbers. We will hold constant the contribution assessment on Assessable Numbers and determine the revenue contribution factor based on the quarterly projected demand of the universal service mechanisms divided by the quarterly projected-collected interstate and international end user telecommunications revenues from business services in the same manner in which the current contribution factor is calculated.[330] This approach will ensure a specific, predictable, and sufficient funding source for the Commission's universal service mechanisms.

4. Wireless Prepaid Plans

135. We adopt an alternative methodology for telephone numbers assigned to handsets under a wireless prepaid plan. Some commenters assess prepaid wireless services on a per-minute-of-use basis.[331] For example, prepaid wireless providers argue that their customers are typically low-income or low-volume consumers and, as such, should be subject to a lesser assessment.[332] Verizon and TracFone further assert that prepaid wireless providers may have difficulty administering a per-number assessment.[333] Verizon, therefore, recommends that any new contribution methodology accommodate prepaid wireless service providers by adopting a per-number assessment that "reflects the unique characteristics of [the] service," and TracFone similarly agrees.[334] Finally, CTIA essentially argues that the sheer number of prepaid wireless end users—over 44 million—combined with the likelihood that most of these end users would see a rise in their pass-through assessments warrants an exception.[335]

136. To accommodate the unique situation of prepaid wireless service providers, we find it appropriate to create a limited modification in contribution assessments for providers of prepaid wireless services and their end users.[336] We agree with commenters that it is considerably more difficult for wireless prepaid providers to pass-through their contribution assessments in light of their "pay-as-you-go"

(continued from previous page)
2008) (asking the Commission to treat prepaid calling cards as residential services if the Commission adopts a numbers-based methodology limited to residential numbers).

[330] The Commission may revise the specific per-number residential assessment amount in the future, if market conditions warrant.

[331] AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 4.

[332] Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 2 (filed Sept. 17, 2008) (TracFone Sept. 17, 2008 *Ex Parte* Letter); CTIA *2006 Contribution FNPRM* Comments at 6; Leap Wireless *2006 Contribution FNPRM* Comments at 2–3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 3–4; Letter from John M. Beahn and Malcolm Tuesley, Counsel to Virgin Mobile USA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 4–7 (filed June 12, 2006) (Virgin Mobile June 12, 2006 *Ex Parte* Letter).

[333] *See, e.g.*, Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 2; Virgin Mobile June 12, 2006 *Ex Parte* Letter, Attach. at 7.

[334] *See* Verizon Mar. 28, 2006 *Ex Parte* Letter, Attach. at 3; TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach.; *see also* Letter from Antoinette Bush, Counsel for Virgin Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 11 (filed Mar. 18, 2005) (Virgin Mobile Mar. 18, 2005 *Ex Parte* Letter); AT&T and Verizon Sept. 23, 2008 *Ex Parte* Letter at 6.

[335] *See* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1 (raising a concern that current proposals could harm the large number of prepaid wireless customers).

[336] As discussed below, Lifeline customers are exempt from contribution assessments. *See infra* para. 141.

service offerings.[337] Because of this significant practical issue, we will modify the numbers-based assessment for prepaid wireless providers with regard to their offering of these services. Further, we note that, just as with Lifeline customers, many prepaid wireless end users are low income consumers. For example, TracFone states that about half of its customers have incomes of $25,000 or less.[338]

137. We find that TracFone's "USF by the Minute" proposal best addresses the concerns of prepaid wireless providers within the context of the new numbers-based contribution methodology we adopt today.[339] TracFone's proposed USF by the Minute Plan would calculate universal service contribution assessments on prepaid wireless services by dividing the residential per-number assessment (the $1.00 flat fee adopted above) by the number of minutes used by the average postpaid wireless customer in a month. This per-minute number would then be multiplied by the number of monthly prepaid minutes generated by the provider. This amount would be the provider's monthly universal service contribution obligation. The per-minute assessment, however, would be capped at an amount equal to the current per month contribution per Assessable Number, the per-number assessment amount adopted above.[340] We illustrate the proposal below.

138. According to CTIA data submitted by TracFone, the average wireless postpaid customer used 826 minutes per month for the period ending December 2007.[341] The residential per-number assessment of $1.00 would be divided by 826 minutes to calculate a per-minute assessment of $0.001210654. The wireless prepaid provider's contribution obligation would be calculated by multiplying the per-minute assessment by the number of prepaid minutes generated for the month. If the wireless prepaid provider generated a billion prepaid minutes in a month, its contribution for that month would be $1,210,654.[342] If the prepaid provider had 10 million prepaid customers that month, the average contribution per customer would be $0.12 and its contribution obligation would remain at $1,210,654. If, on the other hand, it had only 1 million customers, the average contribution per-customer would be $1.20, which exceeds the residential per-number assessment of $1.00. In this case, because the per-customer contribution amount under the calculation would exceed the residential per-number assessment established by the Commission, the prepaid provider's contribution obligation would be capped at $1,000,000, which is the residential per-number assessment of $1.00 multiplied by the 1 million monthly prepaid customers. Under this scenario, the average per-customer contribution for the prepaid wireless provider would be equal to the per-number contribution of $1.00 for non-prepaid residential numbers.

---

[337] *See* Letter from Mitchell F. Brecher, Counsel for TracFone, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 3 (filed June 15, 2007) (TracFone June 15 *Ex Parte* Letter).

[338] TracFone June 15, 2007 *Ex Parte* Letter at 3. TracFone also asserts that an exception is warranted because it provides service to low volume end users (i.e., end users that do make a small amount of calls, measured in minutes). *Id*. However, as explained below, we decline to provide a contribution exception for low-volume users. *See infra* para. 143.

[339] AT&T and Verizon support the TracFone discount approach for prepaid wireless providers. AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 3; *see also* Letter from David L. Sieradzki, Counsel to OnStar Corp., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (dated Oct. 28, 2008) (OnStar "strongly supports" the TracFone per-minute of use proposal for prepaid wireless services) (OnStar Oct. 28, 2008 *Ex Parte* Letter).

[340] TracFone Sept. 17, 2008 *Ex Parte* Letter, Attach. at 4–5.

[341] *See* TracFone Sept. 17, 2008 *Ex Parte* Letter at 5. We use these data because they are the most recent publicly available data.

[342] To the extent that the prepaid wireless subscriber is a Lifeline customer for the prepaid service, the prepaid provider should exclude prepaid minutes associated with the qualifying Lifeline customer. *See infra* para. 141.

139. We find the TracFone discount approach superior to other forms of a discount proposed by parties. For example, CTIA proposed a fifty percent discount for prepaid wireless providers.[343] The TracFone approach is based on actual wireless calling data, whereas the CTIA approach represents a more arbitrary half-off discount. Moreover, the CTIA proposal makes no allowance for the type of end user that is using the prepaid wireless service. This contrasts with the TracFone proposal, which would not provide any discount to those end users that use more than the average monthly post-paid number of minutes. As explained above, for those customers whose usage would result in more than the $1.00 pass-through, the assessment on the provider and the pass-through would be capped at $1.00 per month per Assessable Number. Thus, high volume users would neither benefit from, nor be penalized by, the discount mechanism. Finally, we make clear that if the prepaid provider is an ETC and is providing service to qualifying Lifeline customers, the provider is exempt from contribution assessments on the qualifying Lifeline customers and we prohibit the provider from assessing any universal service pass-through charges on their Lifeline customers.

5. Exceptions to Contribution Obligations

140. A number of parties have asked for exceptions from the contribution obligation. We find that, in general, providing an exception or exemption to a particular provider or to a particular category of end users would complicate the administration of the numbers-based methodology we adopt today. The result would unfairly favor certain groups by reducing or eliminating their contribution obligations, while increasing the contribution obligations on providers that are not exempted from contributing. Therefore, we conclude that grant of an exemption from the contribution obligations is only warranted for those who are truly unable to bear the burden of contributing to the universal service fund—low-income consumers. As discussed below, we exempt providers from contribution assessments on their qualifying Lifeline program customers and prohibit contributors from assessing any universal service pass-through charges on their Lifeline customers. Similarly, we exempt providers of stand-alone voice mail services, which are provided to low-income "phoneless" people, from contribution obligations. As explained below, an exception for low-income consumers is consistent with the Commission's policies underlying the low-income universal service program and targets universal service benefits to those consumers most in need of those benefits.[344]

141. We conclude that telephone numbers assigned to Lifeline customers should be excluded from the universal service contribution base and providers of Lifeline service may not pass-through contribution assessments to Lifeline customers.[345] The Lifeline program provides an opportunity for the Commission to ensure that low-income families are not denied access to telephone service. We find that an exception for Lifeline customers satisfies the high threshold necessary to justify an exception to the new numbers-based contribution methodology we adopt today. Lifeline customers are, by definition, among the poorest individuals in the country. As such, they are in the greatest need of relief from regulatory assessments. Prohibiting recovery of universal service contributions from Lifeline customers helps to increase subscribership by reducing qualifying low-income consumers' monthly basic local service charges.[346] The record, moreover, overwhelmingly supports the creation of an exception for Lifeline customers. Consumer groups, large telecommunications customers, LECs, and wireless providers all support creating an exemption for Lifeline customers, and no commenter opposes an

[343] CTIA Oct. 2, 2008 *Ex Parte* Letter at 5.

[344] *Alenco v. FCC*, 201 F.3d at 621.

[345] *See, e.g.*, AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 4 (proposing that numbers assigned to Lifeline customers be excluded from the monthly number count for contribution purposes).

[346] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24982, para. 62.

exemption for Lifeline customers.[347] We therefore adopt an exemption to our numbers-based contribution methodology for Lifeline customers.

142. Similarly, we find that stand-alone voice mail service providers are exempt from direct contribution obligations of the new methodology we adopt today. Community Voice Mail National (CVM) argues that stand-alone voice mail services consist of free voice mail access to "phoneless" people.[348] As in the exemption for Lifeline customers, we find that stand-alone voice mail service of the type provided by CVM benefits low-income consumers who are most in need of access to such services. We therefore exempt providers of this type of stand-alone voice mail service from universal service contribution assessments on numbers associated with stand-alone voice mail services, and we prohibit providers of these services from assessing any universal service contribution pass-through charges on customers of these services.[349]

143. Although commenters have sought contribution exceptions for other groups of consumers or service providers, we decline to adopt any further exceptions.[350] Some parties argue that consumers who make few or no calls, i.e., low-volume users, should be exempt from the numbers-based residential contribution assessment mechanism.[351] As discussed above, all users of the network, even those who make few or no calls, receive a benefit by being able to receive calls, and therefore it is appropriate for these consumers to contribute to universal service.[352] Also as discussed above, to the extent low-volume consumers may see an increase in the amount of their universal service contribution pass-through fee,[353] any such increase should be slight.[354]

144. We also decline to exempt telematics providers,[355] one-way service providers,[356] and two-

---

[347] *See, e.g.*, CTIA *2006 Contribution FNPRM* Comments at 5; CU et al. *High-Cost Reform NPRMs* Reply at 58; Ad Hoc Nov. 19, 2007 *Ex Parte* Letter at 4; AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 5.

[348] Letter from Jennifer D. Brandon, Executive Director, Community Voice Mail National, to Tom Navin, Wireline Competition Bureau, FCC, CC Docket No. 96-45 at 1 (filed May 30, 2006) (Community Voice Mail May 30, 2006 *Ex Parte* Letter) (CVM provides "free, personalized voicemail access to people in crisis and transition (homeless, victims of domestic violence, and other 'phoneless' people")).

[349] We decline to adopt a reimbursement method, in which contributors would pay the full amount of their contribution assessments and then seek refunds from USAC for any exempted numbers, as recommended by AT&T and Verizon. AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 4. We find that adopting such a reimbursement requirements would create a significant administrative burden on contributors that would outweigh any potential benefits. Letter from Matthew A. Brill, Counsel for USA Mobility, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 2 (filed Oct. 24, 2008).

[350] We do not prejudge whether additional exceptions should apply if the Commission were to assess contributions based on numbers for business services. We note that certain businesses, such as non-profit health care providers, libraries, and colleges and universities, support such exemptions. We do not address those exemptions at this time.

[351] *See, e.g.*, CU et al. *Contribution First FNPRM* Comments at 12; NASUCA *Contribution First FNPRM* Comments at 14; Keep USF Fair Mar. 27, 2006 *Ex Parte* Letter, Attach. at 1.

[352] *See supra* para. 113; *see also* Sprint *Contribution First FNPRM* Comments at 7.

[353] *But see* IDT Aug. 2, 2007 *Ex Parte* Letter at 6–7 (arguing that low-volume consumers who make no long distance calls pay about $1.40 in universal service contribution assessments).

[354] *See supra* para. 112.

[355] Telematics is a service that is provided through a transceiver, which is usually built into a vehicle but can also be a handheld device, that provides public safety information to public safety answering points (PSAPs) using global positioning satellite data to provide location information regarding accidents, airbag deployments, and other emergencies in real time. *See, e.g.*, Letter from David L Sieradzki, Counsel for OnStar, to Marlene H. Dortch, FCC,

(continued….)

way paging services[357] from contributing based on numbers. We disagree with commenters arguing for special treatment for these services.[358] Granting exceptions for these services would provide them with an advantage over other services that are required to contribute based on residential telephone numbers. These services are receiving the benefit of accessing the public network and therefore assessing universal service contributions on these entities is appropriate.[359] These service providers have not shown that grant of a contribution exception is warranted.[360] Accordingly, providers of these services will be assessed the full per-number charge. Some one-way service providers argue that their services are

(continued from previous page)
CC Docket No. 96-45, Attach. at 1 (filed Mar. 2, 2006); *Revision of the Commission's Rules To Ensure Compatibility with Enhanced 911 Emergency Systems*, CC Docket No. 94-102, Order, 18 FCC Rcd 21531, 21531–33, paras. 2, 8 (2003).

[356] One-way services include, but are not limited to, one-way paging, electronic facsimile (e-fax), and voicemail services (other than stand-alone voicemail services, as discussed above).

[357] *See, e.g.*, Letter from Matthew Brill, Counsel for USA Mobility, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 2 (filed Oct. 24, 2008) (opposing the assessment of a numbers-based fee on paging carriers and their customers); Letter from Kenneth Hardman, representing the American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at Attach. (filed Oct. 22, 2008).

[358] *See* Letter from Ari Q. Fitzgerald, Counsel, Mercedes-Benz USA, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Apr. 12, 2006) (Mercedes-Benz Apr. 12, 2006 *Ex Parte* Letter); *see also* Letter from John E. Logan, ATX Group, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 2 (filed Mar. 16, 2006) (ATX Mar. 16, 2006 *Ex Parte* Letter); Letter from David M. Don, Counsel for j2 Global Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, at 1 (filed Nov. 18, 2005) (j2 Global Nov. 18, 2005 *Ex Parte* Letter); Letter from William B. Wilhelm, Jr., Counsel for Bonfire Holdings, to Tom Navin, Chief, Wireline Competition Bureau, CC Docket No. 96-45 (filed Feb. 13, 2006) (Bonfire Feb. 13, 2006 *Ex Parte* Letter); j2 Global *Contribution Second FNPRM* Comments at 2; Letter from Kenneth E. Hardman, Counsel for American Association of Paging Carriers, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1 (filed Oct. 6, 2005) (AAPC Oct. 6, 2005 *Ex Parte* Letter); Letter from Frederick M. Joyce, Counsel for USA Mobility, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, Attach. at 1–3 (filed Mar. 22, 2006) (USA Mobility Mar. 22, 2006 *Ex Parte* Letter).

[359] We similarly decline to adopt an exemption from the numbers-based contribution assessment method for services provided by alarm companies. *See* Letter from Donald J. Evans, Counsel for Corr Wireless Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 06-122, WT Docket No. 05-194, at 2 (filed Oct. 23, 2008). These services are receiving the benefit of having access to the PSTN and should therefore contribute to universal service.

[360] Telematics providers argue against imposition of a $1.00 per number per month contribution assessment on telematics numbers due to the service's critical role in advancing public safety, and because the $1.00 assessment would be prohibitively expensive. *See, e.g.*, Letter from Gary Wallace, Vice President Corporate Relations, ATX Group, Inc., to Kevin Martin, Chairman, FCC, CC Docket No. 96-45, WC Docket No. 06-122 at 1–2 (filed Oct. 28, 2008); OnStar Oct. 28, 2008 *Ex Parte* Letter at 3–4; Letter from Matthew Brill, Counsel for Toyota Motor Sales USA, Inc., to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1–2 (filed Oct. 24, 2008). We find, however, that treating these services differently than other residential services would not be equitable, given their use of the PSTN and the ability of telematics providers to recover the assessment from their end users. Given the public safety benefit to consumers, we find unpersuasive the telematics' providers assertions that consumers will discontinue use of the service based on an assessment of only $1.00 per number. Furthermore, we disagree with commenters who argue that telematics service should be treated as a business service, and conclude that telematics service is a residential service that should be assessed under the $1.00 per number per month residential contribution methodology. *See* OnStar Oct. 28, 2008 *Ex Parte* Letter at 2; Letter from Tamara Preiss, Legal and External Affairs, Verizon Wireless, to Marlene Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45 at 1 (filed Oct. 29, 2008).

currently offered on a free, or nearly-free basis, and if these services are assessed on a per telephone number basis, providers will no longer be able to offer them.[361] We disagree that our change in contribution policy necessitates this result. Although these services may be marketed as "free" to the end user, these services are not truly free. Commercial providers of free or nearly-free services generate revenue in other ways, such as advertising or through more sophisticated paid service offerings or product offerings, and, therefore, whether they continue to offer free services would be a business decision based upon the circumstances of the particular business.[362] Indeed, we find that assessing a per-number contribution obligation on these services is consistent with our determination that services that benefit from a ubiquitous public network are fairly charged with supporting the network.

145. We also decline to adopt an exception from the residential numbers-based contribution mechanism for additional handsets provided through a wireless family plan. We do not agree with commenters who argue that telephone numbers assigned to the additional handsets in family wireless plans should be assessed at a reduced rate, either permanently or for a transitional period.[363] These commenters assert that assessing contributions at the full per-number rate would cause family plan customers to experience "rate shock."[364] Although family plan customers may see an increase in universal service contribution pass-through charges on their monthly bills, we are not persuaded that the fear of "rate shock" justifies special treatment. We find that each number associated with a family plan obtains the full benefits of accessing the public network, and thus it is fair to assess each number with a separate contribution obligation. We also note that wireless service is one of the fastest-growing sectors of the industry and the record does not include persuasive data showing that a move to a numbers-based contribution methodology would have a significant, detrimental impact on wireless subscribership.[365] We agree with Qwest that an exception for additional family plan handsets would not be competitively neutral and would advantage approximately 70 million wireless family plan consumers over other residential service consumers.[366] Multiple wireline lines in a household are not given a discounted contribution assessment rate. We therefore decline to adopt a reduced assessment for wireless family plan numbers.

146. Some parties seek an exception to the contribution methodology we adopt today to exclude Internet-based telecommunications relay services (TRS), including video relay services (VRS)

---

[361] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 7 (arguing that a connections-based universal service methodology would force many heavily used one-way communications services out of existence).

[362] *See, e.g.*, j2 Global *Contribution Second FNPRM* Comments at 8 (describing a "free" service supported by advertising revenue).

[363] *See, e.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter at 4; CTIA *2006 Contribution FNPRM* Comments at 5–6; Leap Wireless *2006 Contribution FNPRM* Comments at 2–3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2.

[364] *E.g.*, AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 2 at 4; CTIA *2006 Contribution FNPRM* Comments at 5–6; Leap Wireless *2006 Contribution FNPRM* Comments at 2–3; T-Mobile Apr. 4, 2006 *Ex Parte* Letter at 2–3. *But see* AAPC Oct. 9, 2008 *Ex Parte* Letter at 2.

[365] There are, as of December 2007, 249,235,715 mobile wireless subscribers, a more than 9% increase from the previous year. *See* FCC, LOCAL TELEPHONE COMPETITION: STATUS AS OF DECEMBER 31, 2007, tbl. 14 at 18 (2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-285509A1.pdf. Moreover, where a wireless provider is eligible to receive universal service support, it receives the same level of support for each handset. *See* WTA/OPASTCO/ITTA Oct. 10, 2008 *Ex Parte* Letter at 2.

[366] Qwest Sept. 24, 2008 *Ex Parte* Letter, Attach. at 7; Qwest May 4, 2006 *Ex Parte* Letter, Attach. at 9; *see also* CTIA Oct. 2, 2008 *Ex Parte* Letter at 1.

and IP Relay services.[367] We decline to adopt an exception for such providers at this time. The Commission has an open proceeding on a number of issues related to these providers, including whether certain costs to these providers related to the acquisition of ten-digit numbers by their customers should be reimbursed by the TRS fund.[368] We defer to that proceeding consideration of whether to adopt an exception to the contribution methodology we adopt today for numbers assigned to Internet-based TRS users.[369]

6. Reporting Requirements and Recordkeeping

147. Under the existing revenue-based contribution methodology, contributors report their historical gross-billed, projected gross-billed, and projected collected end-user interstate and international revenues quarterly on the FCC Form 499-Q and their gross-billed and actual collected end-user interstate and international revenues annually on the FCC Form 499-A.[370] Contributors are billed for their universal service contribution obligations on a monthly basis based on their quarterly projected collected revenue.[371] Actual revenues reported on the FCC Form 499-A are used to perform true-ups to the quarterly projected revenue data.[372]

148. We will develop a new and unified reporting system to accommodate our new universal service contribution methodology.[373] Contributors will report their Assessable Number counts on a

---

[367] *See* Letter from Deb MacLean, Communication Access Center for the Deaf and Hard of Hearing, et al. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-122, CC Docket No. 96-45, at 1–2 (filed Sept. 29, 2008) (CSDVRS Sept. 29, 2008 *Ex Parte* Letter).

[368] *See Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, CG Docket No. 03-123, WC Docket No. 05-196, Report and Order and Further Notice of Proposed Rulemaking, 23 FCC Rcd 11591, 11646, para. 149 (2008) ("We . . . seek comment on whether, and to what extent, the costs of acquiring numbers, including porting fees, should be passed on to the Internet-based TRS users, and not paid for by the [TRS] Fund. . . . We also seek comment on whether there are other specific costs that result from the requirements adopted in the *Order* that, mirroring voice telephone consumers, should be passed on to consumers, including, for example, E911 charges.").

[369] To the extent that Internet-based TRS users utilize a proxy number or identifier other than an assigned ten-digit number during/pending the transition to ten-digit numbering for Internet-based TRS services, we make clear that those numbers or identifiers are NOT subject to universal service contribution at this time. This treatment is necessary to ensure the smooth transition to ten-digit numbering for these services, and to prevent duplicative charges for end users of these services.

[370] *See, e.g.*, *Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969, para. 29. Filers are required to file revisions to FCC Form 499-Q within 45 calendar days of the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499-Q, at 10 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-Q/499q.pdf. Filers are required to file revisions to FCC Form 499-A by March 31 of the year after the original filing date. *See* FCC, INSTRUCTIONS TO THE TELECOMMUNICATIONS REPORTING WORKSHEET, FCC Form 499-A, at 11–12 (Feb. 2008), *available at* http://www.fcc.gov/Forms/Form499-A/499a-2008.pdf.

[371] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 35.

[372] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24972, para. 36.

[373] We decline to adopt the suggestion by AT&T and Verizon to transition the Telecommunications Relay Services Fund, local number portability cost recovery, and numbering administration to a numbers/connections-based assessment methodology. *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter at 6. Although these programs rely on the revenue information reported in the current FCC Form 499-A, they do not rely on many of the revenue distinctions, such as interstate and intrastate, that necessitate the change from a revenue-based assessment for the universal service fund.

monthly basis. Contributors must report as an Assessable Number any such number that is in use by an end user during any point in the relevant month. The Commission will develop an additional version of the FCC Form 499 for use in reporting Assessable Numbers. Under the interim business revenue-based reporting component, contributors will report their revenue information on the modified FCC Forms 499-A and 499-Q.

149. Under the new numbers-based system we adopt today, contributors will report historical Assessable Numbers monthly. Contributors will then be invoiced and required to contribute the following month. By reporting actual, historical numbers, the numbers-based component of our contribution methodology remains simple and straightforward. As explained above, a key reason to move to a primarily numbers-based approach is its simplicity. Indeed, several commenters propose monthly reporting of historical number counts.[374] We find that reporting Assessable Numbers on a projected collected basis would unnecessarily complicate the numbers-reporting system. Although we are mindful of the issues inherent in historical reporting,[375] we find that a one month lag between the reported Assessable Numbers and the contribution based on those numbers is minimal and will not unfairly disadvantage any provider, even those with a declining base.

150. We allow contributors to self-certify which telephone numbers are, consistent with this order, considered "residential." Contributors will be subject to audit, however, and their method for distinguishing residential from other numbers must be reasonable and supportable. For example, in the Commission's *Broadband Data Gathering Order* released earlier this year, the Commission directed mobile wireless service providers "to report as residential subscriptions those subscriptions that are not billed to a corporate account, to a non-corporate business customer account, or to a government or institutional account."[376] We added that "[f]or purposes of Form 477, subscriptions billed to a federal government department or agency, for example, will not be 'residential' subscriptions, while subscriptions to a service plan offered to all federal government employees will be considered to be residential subscriptions."[377] For purposes of identifying numbers associated with business services (which are not Assessable Numbers), contributors may rely on the fact that the line associated with that number is assessed a *multi-line* end user common line charge (i.e., SLC); provided, however, that the SLC must be a mandatory charge, rather than a discretionary charge.[378] For determining residential numbers (which are Assessable Numbers), however, a contributor may not rely on the assessment of a residential SLC, because SLC rates are the same for residential and single-line business end users. Therefore, the fact that a contributor charges the single-line business/residential SLC may not accurately indicate whether the service provided is a business or residential service.[379]

---

[374] *See* AT&T and Verizon Sept. 11, 2008 *Ex Parte* Letter, Attach. 1 at 2-3; CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 5; USF by the Numbers Oct. 3, 2008 *Ex Parte* Letter.

[375] *See Second Wireless Safe Harbor Order*, 17 FCC Rcd at 24969–70, paras. 29–32.

[376] *Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership*, WC Docket No. 07-38, 23 FCC Rcd 9691, 9704, para. 24 (2008) (*Broadband Data Gathering Order*), Order on Reconsideration, 23 FCC Rcd 9800 (2008).

[377] *Broadband Data Gathering Order* at para. 24 n.91.

[378] In other words, the SLC type and rate must be established pursuant to the Commission's rules. 47 C.F.R. §§ 69.104(o)(1), 69.152(k)(1). To the extent that the contributor is not required to charge a SLC (e.g., is not rate-regulated by the Commission), a voluntary business choice to include a "subscriber line charge" on a customer's bill may not be dispositive of the type of service, residential or business, being provided.

[379] 47 C.F.R. §§ 69.104(n)(1), 69.152(d)(1).

151. Each contributor must maintain the necessary internal records to justify, in response to an audit or otherwise, its reported Assessable Number counts and the data reported on the Commission's contribution forms.[380] Contributors are responsible for accurately including all Assessable Numbers associated with residential services in their Assessable Number counts and revenues from all business services in the interim business services revenue component of the methodology. Failure to file the required form by the applicable deadline, or failure to file accurate information on the form, could subject a contributor to enforcement action.[381] In addition, as with the current FCC Forms 499-A and 499-Q, we will require that an officer of the filer certify to the truthfulness and accuracy of the forms submitted to the administrator.

152. To ensure that filers report correct information, we continue to require all reporting entities to maintain records and documentation to justify the information reported in these forms, and to provide such records and documentation to the Commission and to USAC upon request.[382] All universal service fund contributors are required to retain their records for five years.[383] Specifically, contributors to the universal service fund must retain all documents and records that they may require to demonstrate to auditors that their contributions were made in compliance with the program rules, assuming that the audits are conducted within five years of such contribution. Contributors further must make available all documents and records that pertain to them, including those of contractors and consultants working on their behalf, to the Office of Inspector General, to USAC, and to their respective auditors. These documents and records should include without limitation the following: financial statements and supporting documentation; accounting records; historical customer records; general ledgers; and any other relevant documentation.[384]

153. Further, we make clear that for purposes of the interim business revenue component, we retain all existing reporting requirements associated with the filing of the FCC Forms 499-A and 499-Q for business service revenue. Finally, we direct the Bureau, and delegate to the Bureau the authority, to develop or modify the necessary forms to ensure proper contribution reporting occurs, consistent with this order.

7. Transition to New Methodology

154. The new reporting procedures discussed above will require reporting entities to adjust their record-keeping and reporting systems in order to provide reports to USAC regarding the number of Assessable Numbers and to adjust their revenue information to include only business service revenue. Accordingly, we implement a 12-month transition period for the new contribution mechanisms.[385] This transition period will give contributors ample time to adjust their record-keeping and reporting systems so that they may comply with modified reporting procedures. As explained below, a 12-month transition

---

[380] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, para. 27.

[381] Pursuant to section 1.80 of the Commission's rules, failure to file required forms or information carries a base forfeiture amount of $3,000 per instance and is subject to adjustment criteria. *See* 47 C.F.R. § 1.80.

[382] *Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; *see also* 47 C.F.R. §§ 54.706(e), 54.711(a).

[383] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16372, para. 27; 47 C.F.R. § 54.706(e).

[384] *See Comprehensive Review Report and Order*, 22 FCC Rcd at 16387, paras. 27–28. We note that contributors who also report NRUF data to the NANPA are currently required to maintain internal records of their numbering resources for audit purposes. *NRO I Order*, 15 FCC Rcd at 7601, para. 62.

[385] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (proposing a 12-month transition to the new mechanism taking effect).

period will also allow reporting entities to submit several reports for informational purposes before being assessed on the basis of projected Assessable Numbers for residential services.[386] We find, therefore, that a 12-month transition period balances administrative burdens on contributors with the need to implement the new contribution methodologies in a balanced and equitable manner.

155. During 2009, filers will continue reporting their interstate telecommunications revenue on a quarterly basis and USAC will continue assessing contributions to the federal universal service mechanisms based on those quarterly reports. This one-year period and, in particular, the first six months of that period, should be used by contributors to adjust their internal and reporting systems to prepare for the reporting of Assessable Numbers and business revenues.

156. Beginning in July 2009, contributors will continue to report and contribute based on their quarterly reported interstate and international revenues for the last two quarters of the year, but they will also begin filing with USAC monthly reports of their Assessable Numbers and quarterly reports of their business revenues. USAC will thus collect data under the old revenue-based methodology, while collecting and reviewing data under the new Assessable Number and business revenues methodologies for the last six months of 2009. We find that this six-month period of double-reporting is necessary to help reporting entities, Commission staff, and USAC identify implementation issues that may arise under this new methodology prior to it taking effect.[387] Although only the December 2009 Assessable Numbers and the fourth quarter 2009 business revenue data will be used to compute contributors' January 2010 and first quarter 2010 assessments, we find it is reasonable to require contributors to begin filing under the new methodologies prior to these periods to ensure that there is adequate time for all affected parties to address any implementation issues that may arise. Moreover, we conclude that the short overlap of reporting under both the old and new methodologies will not be unduly burdensome for contributors given the limited duration of the dual reporting.

V. REFORM OF INTERCARRIER COMPENSATION

157. Since Congress first passed the Communications Act in 1934, the Commission has sought "to make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges."[388] To promote universal service, regulators have long relied on a complex array of intercarrier compensation mechanisms, which generally have included implicit subsidies. Through the years, the introduction of competition into first long-distance and then local markets, as well as the development and deployment of new technologies, have eroded the fundamental economic underpinnings of the current intercarrier compensation regimes. The reforms we adopt in this order are designed to unify and simplify the myriad intercarrier compensation systems in existence today. This unification and simplification will encourage the efficient use of, and investment in, advanced telecommunications and broadband networks, spur intermodal competition throughout the United States, and minimize the need for future regulatory intervention.

---

[386] *See* CTIA *2006 Contribution FNPRM* Comments at 7; *see also* Verizon and AT&T Sept. 11, 2008 *Ex Parte* Letter, Attach. at 2 (advocating a 12-month implementation period followed by a 6-month transition period). Some parties advocated for a transition period as short as possible. *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, Attach. at 2 (filed Sept. 19 2008) (CenturyTel Sept. 19, 2008 *Ex Parte* Letter); Sprint Nextel June 14, 2006 *Ex Parte* Letter. Others advocated for a longer transition period. *See, e.g.*, Qwest Mar. 21, 2006 *Ex Parte* Letter, Attach. at 3 (advocating 18 months); XO Communications Oct. 3, 2008 *Ex Parte* Letter, Attach. at 11 (advocating at least 18 months).

[387] *See* AT&T and Verizon Oct. 20, 2008 *Ex Parte* Letter, Attach. at 3 (recommending a six-month transition period for filers and USAC to test and calibrate the new system prior to its taking effect).

[388] 47 U.S.C. § 151.

158. Today, we adopt a new approach to intercarrier compensation and establish the blueprint for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we recognize, as the Commission has in the past, that we need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan, with separate stages, designed to reduce rates over a sufficient period to minimize market disruptions and to cushion the impact of our reform on both customers and carriers. At the end of the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

A. A Brief History of Intercarrier Compensation

159. This section provides an overview of the development of intercarrier compensation regulation in the United States. Although not comprehensive, it highlights several important goals that have emerged in Commission precedent, which are relevant to intercarrier compensation reform.

- *Promoting universal service.* The Commission has sought to promote universal service, and, in furtherance of that objective, an intricate web of implicit subsidies evolved that were intended to keep the price of residential local telephone service affordable, even if that price was below cost. With the introduction of competition for long-distance telephone service, regulators sought to maintain implicit subsidies of local service when they created regulated intercarrier compensation charges, known as "access charges," that long-distance service providers paid local telephone companies to originate and terminate long-distance calls.

- *Encouraging efficient use of the network.* The Commission has long recognized that requiring end-users to bear a greater proportion of the cost of the local network encourages them to make rational choices in their use of telephone service. The Commission nevertheless has declined to shift a significant percentage of the cost of the network to those end users in light of universal service concerns.

- *Realigning cost recovery in response to competition.* For much of the twentieth century, telephone service was viewed as a natural monopoly. The emergence of competition for long-distance services in the 1970s and for local services, particularly after the 1996 Act, has placed pressure on above-cost intercarrier compensation charges. Although the Commission, in response to competitive entry, sought to develop intercarrier compensation rules that align more closely with the economic principle that costs should be recovered in the way they are incurred, marketplace developments confirm that those efforts were incomplete. As new competitors entered, a series of regulatory arbitrage strategies developed, some of which the Commission has attempted to address on a case-by-case basis.

- *Technological advancements.* As carriers shift from circuit-switched telephone-only networks to packet-switched broadband networks supporting numerous services and applications, it is important that intercarrier compensation rules create the proper incentives for carriers to invest in new broadband technology and that consumers have the opportunity to take full advantage of the new capabilities of this broadband world.

1. Intercarrier Compensation Regulation Before the Telecommunications Act of 1996

160. When AT&T began offering telephone service in 1877,[389] it held all the essential patents and effectively operated as a legal monopoly. When the original patents expired in 1894, however, thousands of independent telephone companies began offering competing local telephone service.[390] This new competition led to lower rates,[391] and reduced AT&T's average return on investments by over 80 percent.[392] AT&T responded by refusing to interconnect with any independent telephone company to exchange long-distance or local traffic.[393] Without interconnection, independent telephone companies could not offer a viable service unless such entities duplicated the AT&T system, which was not economically feasible. As a result, independent telephone companies began to go out of business or were acquired by AT&T.[394]

161. AT&T's predatory strategy led the Department of Justice to file an antitrust suit against AT&T in 1913. The government alleged that AT&T's interconnection and acquisition policies violated Section 2 of the Sherman Act.[395] The case was eventually dropped after AT&T committed to abide by certain principles in what became known as the Kingsbury Commitment of 1913. Under the Kingsbury Commitment, AT&T agreed to: (i) allow independent telephone companies to interconnect with AT&T's long-distance network; and (ii) not acquire any additional independent telephone companies absent regulatory approval.[396] In exchange, the government sanctioned AT&T's monopoly control over markets

---

[389] The company that became AT&T was originally called the Bell Telephone Company. *See* AT&T, A Brief History: Origins, http://www.corp.att.com/history/history1.html (last visited Sept. 11, 2008) (AT&T Brief History). For simplicity, we use the term "AT&T" to include all predecessor companies.

[390] Between 1894 and 1904, "over six thousand independent telephone companies went into business in the United States, and the number of telephones boomed from 285,000 to 3,317,000." *See* AT&T Brief History. By 1900, independent telephone companies controlled "38 percent of the phones installed in the United States." GERALD W. BROCK, THE TELECOMMUNICATIONS INDUSTRY, THE DYNAMICS OF MARKET STRUCTURE 148 (1981) (THE TELECOMMUNICATIONS INDUSTRY). And, by 1902, 451 out of 1002 cities with telephone service had two or more competing providers. *See* MICHAEL K. KELLOGG ET AL. FEDERAL TELECOMMUNICATIONS LAW 11 (1992) (FEDERAL TELECOMMUNICATIONS LAW).

[391] THE TELECOMMUNICATIONS INDUSTRY at 116.

[392] FEDERAL TELECOMMUNICATIONS LAW at 11; *see also* Adam D. Thierer, *Unnatural Monopoly: Critical Moments In The Development Of The Bell System Monopoly*, 14 CATO J. 2 (1994), *available at* http://www.cato.org/pubs/journal/cjv14n2-6.html (*Unnatural Monopoly*). Although independent companies competed with AT&T for local service, AT&T had the only long-distance network operating at the time and possessed important long-distance technology patents. *See* THE TELECOMMUNICATIONS INDUSTRY at 148. According to Brock, there is some evidence that the independent companies had planned on starting a separate long-distance network until AT&T refused interconnection. GERALD W. BROCK, THE SECOND INFORMATION REVOLUTION 30–32 (2003) (SECOND INFORMATION REVOLUTION).

[393] FEDERAL TELECOMMUNICATIONS LAW at 11–12; THE TELECOMMUNICATIONS INDUSTRY at 148; David F. Weiman & Richard C. Levin, *Preying for Monopoly? The Case of Southern Bell Telephone Company, 1894–1912*, 102 J. POL. ECON. 103, 103–26 (1994).

[394] FEDERAL TELECOMMUNICATIONS LAW at 11. In 1912 alone, AT&T purchased 136,000 telephone companies and sold 43,000. *See* THE TELECOMMUNICATIONS INDUSTRY at 156.

[395] Original Petition, *United States v. AT&T*, No. 6082 (D. Or. 1913); *United States v. AT&T*, No. 6082, 1 DECREES AND JUDGMENT IN CIVIL ACTION CASES 483 (D. Or. 1914); *see also* PETER TEMIN, THE FALL OF THE BELL SYSTEM: A STUDY IN PRICES AND POLITICS 9–10 (1987); ROBERT W. GARNET, THE TELEPHONE ENTERPRISE: THE EVOLUTION OF THE BELL SYSTEM'S HORIZONTAL STRUCTURE, 1876–1909 152–53 (1985).

[396] The Kingsbury Commitment was a "unilateral letter rather than an actual consent decree." *See* THE TELECOMMUNICATIONS INDUSTRY at 155. The Kingsbury Commitment was republished in AT&T's 1913 Annual Report at 24–26, *available at* http://www.porticus.org/bell/pdf/1913ATTar_Complete.pdf. AT&T also agreed to

(continued….)

where it already offered service.

162. In essence, the Kingsbury Commitment and subsequent regulation assumed that both the local and long-distance telephone businesses were natural monopolies.[397] Policymakers embraced the view that, because of economies of scale, a natural monopoly could provide service more efficiently than would occur in a competitive market.[398] Rates for these natural monopolies were subject to rate-of-return regulation.[399] In setting regulated rates, a primary policy objective of regulators was to promote universal service to all consumers through affordable local telephone rates for residential customers. To accomplish this objective, however, regulators created a patchwork of what has become known as implicit subsidies. Thus, for example, regulators permitted higher rates to business customers so that residential rates could be lower, and they frequently required similar rates to urban and rural customers, even though the cost of serving rural customers was higher.[400] Similarly, AT&T was permitted to charge artificially high long-distance toll rates, and its interstate toll revenues were placed into an interstate "settlements" pool.[401] AT&T then shared a portion of these interstate revenues with independent telephone companies and AT&T's affiliated Bell Operating Companies (BOCs).[402] These high long-distance rates enabled

(continued from previous page)
sell off its Western Union stock, a large independent telephone company that AT&T had recently acquired. *See id*. at 24. *See* FEDERAL TELECOMMUNICATIONS LAW at 11–12; *see also Unnatural Monopoly*.

[397] *See*, *e.g.*, *Unnatural Monopoly* (noting that a Senate Commerce Committee hearing in 1921 stating that "telephoning is a natural monopoly" and a House of Representative committee report stated that "[t]here is nothing to be gained by local competition in the telephone business.") (quoting G. H. Loeb, *The Communications Act Policy Toward Competition: A Failure to Communicate*, 1 DUKE LAW J. 14 (1978)); *see also id.* (explaining that many state regulatory agencies began refusing requests by telephone companies to construct new lines in areas already served by another carrier and continued to encourage monopoly swapping and consolidation in the name of "efficient service") (citing Warren G. Lavey, *The Public Policies That Changed the Telephone Industry Into Regulated Monopolies: Lessons From Around 1915*, 39 FED. COMM. L.J. 171, 184–85 (1987)); FEDERAL TELECOMMUNICATIONS LAW at 17.

[398] A natural monopoly arises "when a single firm can efficiently serve the entire market because average costs are lower with one firm than with two firms." R. PRESTON MCAFEE, INTRODUCTION TO ECONOMIC ANALYSIS 6–241 (2006), *available at* http://www.mcafee.cc/Introecon/IEA.pdf; *see also* DANIEL F. SPULBER, REGULATION AND MARKETS 3–4 (1989) ("Natural monopoly generally refers to a property of productive technology, often in conjunction with market demand, such that a single firm is able to serve the market at less cost than two or more firms. Natural monopoly is due to economies of scale or economies of multiple-output production.").

[399] For discussions of rate of return regulation, see, *e.g.*, JAMES C. BONBRIGHT ET AL., PRINCIPLES OF PUBLIC UTILITY RATES 197–376 (1988); CHARLES F. PHILLIPS, JR., THE ECONOMICS OF REGULATION: THEORY AND PRACTICE IN THE TRANSPORTATION AND PUBLIC UTILITY INDUSTRIES 260–302 (1969) (PHILLIPS, THE ECONOMICS OF REGULATION); 1 ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS 20–58 (1970) (THE ECONOMICS OF REGULATION).

[400] *See*, *e.g.*, JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS: AMERICAN TELECOMMUNICATIONS POLICY IN THE INTERNET AGE 10–15 (2007) (DIGITAL CROSSROADS).

[401] *See Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer Information, Jurisdictional Separations and Rate Structures*, Docket No. 20003, First Report, 61 FCC 2d 766, 796–97, paras. 81–82 (1976).

[402] Under the settlements process, the local exchange companies were allowed to recover the portion of their costs allocated to the interstate jurisdiction from the interstate toll revenues. The process for affiliated companies was a process of intracorporate accounting known as "division of revenues," while the process for unaffiliated companies represented real payments from AT&T to the independent companies. *See* THE SECOND INFORMATION REVOLUTION at 188. According to Brock, the revenue sharing settlements process was a major source of support for small rural companies, which often could recover a large share of their costs from the interstate toll revenue pool (in some cases as much as 85 % of their non-traffic sensitive costs). *See id.*

regulators to set lower local rates for the BOCs and independent local telephone companies.

163. The use of microwave technology by Microwave Communications, Inc. (MCI), to offer a competitive alternative to AT&T's switched long-distance service beginning in the 1970s cast into doubt the assumption that long-distance telecommunications was a natural monopoly.[403] MCI focused initially on private line service, where AT&T's rates were above cost. MCI's service offerings grew after a series of Commission and court decisions rejected AT&T's objections to MCI's entry.[404] Despite these victories, MCI was not entitled to equal access to local exchange service,[405] and MCI and other IXCs were dependent on the BOCs and independent local telephone companies to complete long-distance calls to the end users.[406]

164. For a number of reasons, including AT&T's resistance to the introduction of competition in the long-distance market, the Department of Justice in 1974 filed an antitrust suit alleging that AT&T had engaged in unlawful monopolization in the local, long-distance, and equipment manufacturing markets.[407] After eight years of litigation, AT&T and the Department of Justice entered into a consent decree, which federal District Court Judge Greene approved in 1982.[408] Under the Modification of Final Judgment (MFJ), AT&T agreed to divest its affiliated BOCs from AT&T long distance, and the BOCs were required to provide equal access and dialing parity.[409] In addition, the MFJ barred the BOCs from entering the long-distance, information services, equipment manufacturing, or other competitive markets to prevent predatory cross subsidization by their regulated monopoly local telephone service.[410] Although

---

[403] *See* DIGITAL CROSSROADS at 60–64.

[404] AT&T argued that MCI would cherry pick the most profitable customers (those paying above-cost rates) and force AT&T to increase local rates thereby undermining the goal of universal service. AT&T opposed the entry of MCI before the Commission and the courts. *See* FEDERAL TELECOMMUNICATIONS LAW at 602–14; *Bell System Tariff Offerings of Local Distribution Facilities for Use by Other Common Carriers*, Docket No. 19896, Decision, 46 FCC 2d 413 (1974), *aff'd Bell Tel. Co. of Pa. v. FCC*, 503 F.2d 1250 (3d Cir. 1974); *see also* DIGITAL CROSSROADS at 60–64 (noting that AT&T fought "tooth and nail" to deprive MCI of effective access and even unplugged certain MCI lines from AT&T's network).

[405] Equal access requires that all long-distance carriers be accessible by dialing a 1 and not a string of long-distance codes before dialing the called party's telephone number. *See, e.g.*, HARRY NEWTON, NEWTON'S TELECOM DICTIONARY 326 (16th ed. 2000).

[406] During much of the 1970s, AT&T and MCI debated before the Commission and courts about the charges that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. In December 1978, under the Commission's supervision, AT&T, MCI, and other IXCs entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), which set the rates that AT&T's affiliated BOCs would charge IXCs for originating and terminating access to local exchange networks. *See Exchange Network Facilities for Interstate Access (ENFIA)*, CC Docket No. 78-371, Memorandum Opinion and Order, 71 FCC 2d 440 (1979) (subsequent history omitted).

[407] *See United States v. AT&T*, 524 F. Supp. 1336, 1346 (D.D.C. 1981).

[408] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983). The 1982 consent decree, as entered by the court, was called the Modification of Final Judgment because it modified a 1956 Final Judgment against AT&T stemming from a 1949 antitrust lawsuit. *See* THE TELECOMMUNICATIONS INDUSTRY at 116–20.

[409] The Act defines "dialing parity" to mean that a "person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier)." 47 U.S.C. § 153(15).

[410] *See United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982).

the MFJ applied only to the BOCs, the Commission subsequently extended interconnection and nondiscriminatory equal access obligations to all incumbent LECs.[411] As a result of the MFJ, MCI, and other competitors were able to compete directly with AT&T to provide long-distance or interstate service, and all IXCs paid interstate access charges to the BOCs and other incumbent LECs to originate and terminate service to end users.

165. While the AT&T antitrust suit was pending, the Commission began to take the first steps toward reforming intercarrier compensation. In 1978, the Commission commenced a review of intercarrier compensation for originating and terminating access.[412] In 1983, following the MFJ, the Commission eliminated the "existing potpourri of [compensation] mechanisms,"[413] and replaced it "with a single uniform mechanism . . . through which local carriers [could] recover the cost of providing access services needed to complete interstate and foreign telecommunications."[414] The access charge rules adopted by the Commission provided for the recovery of incumbent LECs' costs assigned to the interstate jurisdiction and detailed "the precise manner in which [incumbent LECs] may assess charges on IXCs and end users."[415] In designing the interstate access charge rules, the Commission sought to balance a number of competing objectives.[416] For one, the Commission recognized that "[a]rtificial pricing structures, while perhaps appropriate for use in achieving social objectives under the right conditions, cannot withstand the pressures of a competitive marketplace."[417] Consequently, the Commission sought to follow more closely the principle that costs should be recovered in the way they are incurred, consistent with principles of cost-causation.[418] Under this rate structure principle, the cost of facilities that do not vary based on the amount of traffic carried over those facilities (i.e., non-traffic-sensitive costs) should be recovered through fixed, flat-rated charges, while only costs that vary with usage of facilities (i.e., traffic-sensitive costs) should be recovered through corresponding per-minute rates.[419]

166. Despite these rate structure principles, the Commission concluded that a sudden

---

[411] *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241 (1983) (*1983 Access Charge Order*), *modified on recon.*, 97 FCC 2d 682 (1983), *modified on further recon.*, 97 FCC 2d 834 (1983), *aff'd in part and remanded in part, Nat'l Ass'n of Regulatory Util. Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984).

[412] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Notice of Inquiry and Proposed Rulemaking, 73 FCC 2d 222 (1979); Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980); Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980); and Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, 90 FCC 2d 135 (1982).

[413] *See MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 683, para. 2 (1983) (*First Reconsideration of 1983 Access Charge Order*).

[414] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682.

[415] *See Access Charge Reform Order*, 12 FCC Rcd at 15991–92, para. 22.

[416] *See, e.g., First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 683, para. 3 (identifying the four primary objectives of: (1) elimination of unreasonable discrimination and undue preferences among rates for interstate services; (2) efficient use of the local network; (3) prevention of uneconomic bypass; and (4) preservation of universal service).

[417] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 686, para. 7.

[418] *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d. at 688–89, para. 10; *see also Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 24 ("The Commission has recognized in prior rulemaking proceedings that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred, consistent with principles of cost-causation.").

[419] *Access Charge Reform Order*, 12 FCC Rcd at 15992, para. 23.

introduction of large flat-rated charges on end-users could have "adverse effects" on subscribership. It therefore adopted a "plan [that] provides for the gradual introduction of these end-user charges."[420] Thus, the Commission limited the amount of the interstate loop costs assessed to residential and business customers as a flat-rated monthly charge, and it recovered the remaining interstate loop costs through a per-minute charge imposed on IXCs.[421] Moreover, the Commission continued to apply traditional rate-of-return regulation based on carriers' embedded, fully distributed costs, including common costs and overhead.[422]

167. In 1991, the Commission took another step toward intercarrier compensation reform by replacing rate-of-return regulation with an incentive-based system of regulation for the BOCs and GTE.[423] This new regulatory regime, known as price cap regulation, was designed to replicate some of the efficiency incentives found in competitive markets. In particular, price caps were designed to encourage companies to: (1) improve their efficiency by creating incentives to reduce costs; (2) invest efficiently in new plant and facilities; and (3) develop and deploy innovative service offerings.[424] Although many

---

[420] *1983 Access Charge Order*, 93 FCC 2d at 253, para. 35; *see also id.* at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act."). As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[421] This per-minute charge was called the carrier common line charge. *See Access Charge Reform Orde*r, 12 FCC Rcd at 15992, para. 24. Additional charges were imposed on IXCs to recover the interstate portion of the costs of other parts of a local exchange carrier's network, such as local switches and transport. *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 735–40, paras. 129–34, 137–43.

[422] *See* 47 C.F.R. §§ 69.301–.502; *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6787, para. 1 (1990) (*LEC Price Cap Order*). The rate-of-return regulations are set forth in Part 69 of our rules. *See generally* 47 C.F.R. §§ 69.1–701.

[423] Price cap regulation was mandatory for the BOCs and GTE and optional for other incumbent local exchange carriers. *See LEC Price Cap Order*, 5 FCC Rcd at 6818–20, paras. 257–79; *see also Access Charge Reform; Price Cap Performance Review for Local Exchanges Carriers; Interexchange Carrier Purchases of Switch Access Services Offered by Competitive Local Exchange Carriers; Petition of U.S. West Commc'ns, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14224 n.1 (1999) (*Pricing Flexibility Order*).

[424] *LEC Price Cap Order*, 5 FCC Rcd at 6789–91, paras. 21–37; *Special Access Rates for Price Cap Carriers*, WC Docket No. 05-25, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, 1998–99, para. 11 (2005); *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, CC Docket Nos. 96-149, 98-141, 96-149, 01-337, Report and Order, Memorandum Opinion and Order, 19 FCC Rcd 5102, 5115, para. 22 (2004); *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Order on Remand, 18 FCC Rcd 14976, 14979, para. 4 (2003); *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10873, para. 9 (2002). *See also Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order, 23 FCC Rcd 5294 (2008); *Petition of Puerto Rico Telephone Company, Inc, for Election of Price Cap Regulation and Limited Waiver of Pricing and Universal Service Rules; Consolidated Communications Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief; Frontier Petition for Limited Waiver Relief upon Conversion of Global Valley Networks, Inc., to Price Cap Regulation*, WC Docket Nos. 07-291, 07-292, 08-18, Order, 23 FCC Rcd 7353 (2008).

smaller and rural incumbent LECs remain subject to the Part 69 rate-of-return rules, most of the larger incumbent LECs are now subject to price cap regulation.[425]

168. The Commission's reforms during the 1980s and early 1990s yielded many public interest benefits. For example, economists have estimated that above-cost access charges reduced U.S. economic welfare by an estimated $10–17 billion annually during the late 1980s, but that the annual welfare loss declined substantially to between $2.5 billion and $7 billion following the Commission's access charge reforms in the 1980s and early 1990s.[426] Despite these reforms, however, per-minute access rates remained high.[427] These high switched access rates created an opportunity for competitive access providers (CAPs) to begin offering facilities-based competition. CAPs could offer carriers a competitive alternative to the BOCs, often with lower rates and higher quality.[428] The entry of CAPs and the potential entry of cable companies into local residential telephone markets created pressure toward opening the local telephone markets to competition, which ultimately resulted in the passage of the 1996 Act.

2. Intercarrier Compensation Regulation Since the 1996 Act

169. Recognizing these fundamental market changes, Congress's goals in passing the 1996 Act were to: (1) open local exchange and exchange access markets to competition; (2) promote increased competition in telecommunications markets that were already open to competition; and (3) reform the existing universal service system to be consistent with competitive markets.[429] With respect to the last goal, Congress recognized that implicit subsidies, which were implemented when the industry was considered a natural monopoly, were neither consistent with, nor sustainable in, a competitive market, and that they should be replaced with explicit support where necessary.[430] It also recognized, however, that conversion of the existing web of implicit subsidies to a system of explicit support would be a difficult task that could not be accomplished immediately.[431] Accordingly, when Congress established the statutory scheme to open local markets to competition,[432] it included a transitional mechanism in section

[425] *See generally* 47 C.F.R. §§ 61.1–.193, 69.1–.701.

[426] *See* Letter from Jerry Ellig, Senior Research Fellow, Mercatus Center, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 08-183, 07-135, 05-337, 99-68 at 2 (filed Sept. 22, 2008) (Mercatus Center Sept. 22, 2008 *Ex Parte* Letter) (citing ROBERT W. CRANDALL, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA 141 (1991) and ROBERT W. CRANDALL & LEONARD WAVERMAN, WHO PAYS FOR UNIVERSAL SERVICE? 120 (2000)).

[427] Among the reasons that switched access rates remained high were that they were based on fully distributed costs and included a large allocation of common and overhead network costs. *See supra* note 422.

[428] *See, e.g.*, *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Memorandum Opinion and Order, 9 FCC Rcd 5154, 5158, para. 8 (1994) (recognizing that local competition should lead to more efficient operations, the deployment of "new technologies facilitating innovative service offerings, increase the choices available to access customers, and reduce the prices of services subject to competition").

[429] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15505, para. 3 (1996) (subsequent history omitted) (*Local Competition First Report and Order*).

[430] Specifically, Congress directed that universal service support "should be explicit and sufficient to achieve the purposes" of section 254. 47 U.S.C. § 254(e); *see also* S. REP. NO. 104-230, at 131 (1996) (Conf. Rep) (stating that, "[t]o the extent possible, . . . any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today").

[431] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[432] *See* 47 U.S.C. §§ 251–52; *Local Competition First Report and Order*, 11 FCC Rcd at 15505, para. 3.

251(g) providing for the continued enforcement of certain pre-Act obligations.[433] Notably, section 251(g) provides for the continued enforcement of exchange access and interconnection obligations only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after the date of such enactment," suggesting that such obligations would be re-evaluated based on the requirements imposed by the 1996 Act.[434]

170. Congress also recognized the need to impose new obligations on carriers to open local telephone markets to competition, and directed the Commission to adopt implementing rules. Specifically, section 251(b) imposed certain obligations on all LECs, while section 251(c) imposed additional obligations on incumbent LECs, including the obligation to provide access to network elements on an unbundled basis.[435] Of relevance here, section 251(b)(5) of the 1996 Act imposed on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[436]

171. In requiring LECs to enter into reciprocal compensation agreements with requesting carriers, Congress introduced another mechanism through which carriers compensate each other for the exchange of traffic besides the access charge regime preserved under section 251(g). Although Congress expressed a preference for negotiated interconnection agreements to implement the requirements of section 251, section 252 provided procedures for the resolution of interconnection disputes involving incumbent LECs, including standards governing arbitration of such disputes by state regulatory commissions.[437] For such state arbitrations, section 252(d) also established general pricing guidelines for incumbent LECs, including guidelines for setting the price of unbundled network elements (UNEs)[438] and reciprocal compensation rates.[439]

172. In the *Local Competition First Report and Order*, the Commission adopted pricing rules for states to use in setting the price of interconnection and UNEs when arbitrating interconnection disputes.[440] In particular, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, which it called "Total Element Long-Run Incremental Cost" or "TELRIC."[441] The Commission found that TELRIC prices should include a reasonable allocation of

---

[433] *See* 47 U.S.C. § 251(g); *WorldCom, Inc. v. FCC*, 288 F.3d 429, 432 (D.C. Cir. 2002) (*WorldCom*) (subsequent history omitted) (holding that section 251(g) appears to provide for the continued enforcement "of certain pre-Act regulatory 'interconnection restrictions and obligations'"); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) (finding that section 251(g) preserves certain rate regimes already in place and "leaves the door open for the promulgation of new rates at some future date").

[434] 47 U.S.C. § 251(g).

[435] *See* 47 U.S.C. §§ 251(b)–(c). Certain rural carriers were exempt from section 251(c) until such time as a requesting carrier met the statutory test for removing the so-called "rural exemption." *See* 47 U.S.C. § 251(f)(1).

[436] 47 U.S.C. § 251(b)(5).

[437] 47 U.S.C. § 252.

[438] 47 U.S.C. § 252(d)(1).

[439] See 47 U.S.C. § 252(d)(2).

[440] *See Local Competition First Report and Order*, 11 FCC Rcd at 15812–929, paras. 618–862 (implementing the pricing principles contained in sections 251(c)(2) and (c)(3) and section 252(d)(1) of the 1996 Act); *see also* 47 U.S.C. §§ 251(c)(2)–(3), 252(d)(1). Among other things, the 1996 Act required incumbent LECs to make portions of their networks (the physical facilities and features, functions, and capabilities associated with those facilities) available to requesting competitive carriers on an unbundled basis. *See Local Competition First Report and Order*, 11 FCC Rcd at 15624, 15631, paras. 241, 258.

[441] *See Local Competition First Report and Order*, 11 FCC Rcd at 15844–56, paras. 672–703.

forward-looking common costs, including overheads.[442] Although the Commission recognized that peak-load pricing was the most efficient way to recover the cost of traffic-sensitive facilities, it did not require states to adopt peak-load pricing because of the administrative difficulties associated with such an approach.[443] In interpreting the statutory pricing rules for reciprocal compensation contained in section 252(d)(2)(A) of the 1996 Act,[444] the Commission found that costs for transport and termination should "be recovered in a cost-causative manner and that usage based charges should be limited to situations where costs are usage sensitive."[445] In particular, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching" and that non traffic-sensitive costs, such as the costs of local loops and line ports, should not be considered "additional costs."[446] The Commission further found that the "additional costs" standard of section 252(d)(2) permits the use of the same TELRIC standard that it

---

[442] *See Local Competition First Report and Order*, 11 FCC Rcd at 15851–54, paras. 694–98; 47 C.F.R. §§ 51.503, 51.505. The term "common costs" refers to "costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies." *Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676. In its rules, the Commission defines forward-looking common costs as "economic costs efficiently incurred in providing a group of elements or services . . . that cannot be attributed directly to individual elements or services." 47 C.F.R. § 51.505(c)(1). The term "overhead costs" refers to common costs incurred by the firm's operations as a whole, such as the salaries of executives. *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 694.

[443] The Commission recognized that, "[b]ecause the cost of capacity is determined by the volume of traffic that the facilities are able to handle during peak load periods, we believe, as a matter of economic theory, that if usage-sensitive rates are used, then somewhat higher rates should apply to peak period traffic, with lower rates for non-peak usage." *Local Competition First Report and Order*, 11 FCC Rcd at 15878, para. 755. The Commission recognized that higher costs are incurred to carry additional traffic at peak volumes, because additional capacity is required to carry that traffic. *Id.* at 15878, para. 755. In contrast, "off-peak traffic imposes relatively little additional cost because it does not require any incremental capacity to be added to base plant." *Id.* at 15878, para. 755. The Commission found that there would be administrative difficulties with establishing peak-load prices, however, and did not require or forbid states from adopting that approach. *Id.* at 15878–79, paras. 756–57.

[444] *See generally Local Competition First Report and Order*, 11 FCC Rcd at 16008–58, paras. 1027–118 (implementing the reciprocal compensation obligations contained in section 251(b)(5) of the 1996 Act). The reciprocal compensation rules currently require the calling party's LEC to compensate the called party's LEC for the additional costs associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office, and for the additional costs of terminating the call to the called party. Section 51.701(c) of the Commission's rules defines transport as "the transmission and any necessary tandem switching of telecommunications traffic subject to section 251(b)(5) of the Act from the interconnection point between the two carriers to the terminating carrier's end office switch that directly serves the called party, or equivalent facility provided by a carrier other than an incumbent LEC." 47 C.F.R. § 51.701(c). Section 51.701(d) of the Commission's rules defines termination as "the switching of telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises." 47 C.F.R. § 51.701(d). In the *Local Competition First Report and Order*, the Commission also concluded that "the new transport and termination rules should be applied to LECs and CMRS providers." 11 FCC Rcd at 16016–17, para. 1043.

[445] *Local Competition First Report and Order*, 11 FCC Rcd at 16028, para. 1063. This determination led to per-minute pricing for transport and termination, except in the case of dedicated facilities, which may be flat-rated. *Id.* at 16028, para. 1063. Specifically, the Commission required that all interconnecting parties be offered the option of purchasing dedicated facilities on a flat-rated basis. *Id.* at 16028, para. 1063.

[446] *Local Competition First Report and Order*, 11 FCC Rcd at 16024–25, para. 1057. Although the Commission concluded that "non-traffic sensitive costs should not be considered 'additional costs,'" the only non-traffic sensitive costs specifically identified and required to be removed were the costs of local loops and line ports. *Id.* at 16025, para. 1057.

established for interconnection and unbundled elements.[447] The pricing rules governing reciprocal compensation that the Commission adopted in the *Local Competition First Report and Order* remain in effect today.[448]

173. Following passage of the 1996 Act, the Commission also began reforming both interstate access charges and federal universal service support mechanisms by moving the implicit subsidies contained in interstate access charges into explicit universal service support, consistent with the 1996 Act's directives. In particular, in the 1997 *Access Charge Reform Order*, the Commission modified the price cap rules for larger incumbent LECs by aligning the price cap LECs' rate structure more closely with the manner in which costs are incurred.[449] Recognizing Congress's direction that universal service support should be "explicit," the Commission adopted rules to "reduce usage-sensitive interstate access charges by phasing out local loop and other non-traffic sensitive costs from those charges and directing incumbent LECs to recover those NTS [non-traffic sensitive] costs through more economically efficient, flat-rated charges."[450]

174. The Commission acknowledged, however, that the measures it adopted in the *Access Charge Reform Order* would not "remove all implicit support from all access charges immediately."[451] Rejecting suggestions that all implicit subsidies be eliminated from access charges immediately, the Commission noted that it did not have the tools to identify the existing subsidies precisely, and it expressed concern that eliminating all implicit subsidies at once might have an "inequitable impact on the incumbent LECs."[452] Moreover, while stating its desire to rely on competition to drive access charges toward cost,[453] the Commission recognized that "some services may prove resistant to competition," and

---

[447] *Local Competition First Report and Order*, 11 FCC Rcd at 16023–25, paras. 1054–58. As with its pricing rules for UNEs, the Commission determined that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of forward-looking common costs. *Id.* at 16025, para. 1058. Similarly, the Commission again noted that the costs of transporting and terminating traffic during peak and off-peak hours may not be the same. *Id.* at 16028–29, para. 1064. In light of administrability concerns, the Commission once again neither required nor forbid states from adopting rates that reflected peak and off-peak costs, but expressed hope that some states or negotiating parties would consider peak-load pricing. *Id.* at 16028–29, para. 1064.

[448] A number of parties appealed the Commission's *Local Competition First Report and Order*, including the rules it adopted governing the setting of rates for unbundled network elements and reciprocal compensation. In *AT&T v. Iowa Utilities Board*, the Supreme Court upheld the Commission's jurisdiction to "design a pricing methodology" to govern state rate setting under section 252 of the Act. *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999) (*AT&T v. Iowa Utils. Bd*.). Subsequently, in *Verizon Commc'ns, Inc. v. FCC*, the Supreme Court affirmed the Commission's choice of TELRIC as a permissible methodology for states to use in ratemaking proceedings. *Verizon Commc'ns, Inc. v. FCC*, 535 U.S. 467, 497–529 (2002) (*Verizon v. FCC*). The court held that the Commission's decision to adopt a forward-looking cost methodology was a reasonable interpretation of the statute and that the Commission did not err in rejecting alternative methodologies advocated by the incumbent LECs. *Verizon v. FCC*, 535 U.S. at 507–08. The Court also rejected arguments that various aspects of the TELRIC methodology were unlawful. *Verizon v. FCC*, 535 U.S. at 523.

[449] *See Access Charge Reform Order*, 12 FCC Rcd at 16004–07, paras. 54–66 (summarizing the rate structure changes).

[450] *Access Charge Reform Order*, 12 FCC Rcd at 15986, para. 6.

[451] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[452] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9; *see also id.* at 16002–03, paras. 45–47.

[453] Explaining its reliance on a "market-based" approach to access reform, it stated its belief that emerging competition in the local exchange markets would provide a more accurate means of identifying implicit subsidies and moving access rates to economically sustainable levels. *Access Charge Reform Order*, 12 FCC Rcd at 16001–02, para. 44.

it reserved the right to "adjust rates in the future to bring them into line with forward-looking costs."[454]

175. To limit possible rate shock to retail customers, the Commission also limited the amount of allocated interstate cost of a local loop that could be assessed directly on residential and business customers as a flat-rated monthly charge.[455] Although the *Access Charge Reform Order* started the process toward establishing explicit subsidies, the Commission concluded that "a process that eliminates implicit subsidies from access charges over time [was] warranted."[456]

176. In the 2000 *CALLS Order*,[457] the Commission continued its effort to remove implicit subsidies and replace them with explicit universal service support for price cap LECs by, among other things, reducing per-minute intercarrier charges, raising the SLC cap, phasing out the Presubscribed Interexchange Carrier Charge (PICC),[458] and permitting price-cap LECs to deaverage the SLC once the affected carrier charges were eliminated.[459] The Commission also created a new universal service fund to compensate price-cap incumbent LECs, in part, for lost interstate access revenues.[460]

177. In the *MAG Order*, the Commission extended similar reforms to incumbent LECs subject to rate-of-return regulation.[461] As with the *CALLS Order*, these reforms were designed to rationalize the

---

[454] *Access Charge Reform Order*, 12 FCC Rcd at 16003, para. 48. The Commission also applied its market-based approach to the terminating access rates charged by competitive LECs and declined to adopt any regulations governing competitive LEC access charges. *Id.* at 16141, para. 363. It reasoned that "the possibility of competitive responses by IXCs will have a constraining effect on non-incumbent LEC pricing." *Id.* at 16141, para. 362. This reliance on a market-based approach proved misplaced. In subsequent years, competitive LECs, instead of reducing access charges, frequently raised them above the regulated rates of incumbent LECs. As a result, the Commission was forced to regulate competitive LEC access charges. *See* 47 C.F.R. § 61.26; *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order, 16 FCC Rcd 9923, 9924, paras. 1–3 (2001) (*CLEC Access Charge Order*) (establishing benchmark rates for competitive LEC access charges), *recon.*, *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers, Petition of Z-Tel Commc'ns Inc. For Temporary Waiver of Commission Rule 61.26(d) to Facilitate Deployment of Competitive Service in Certain Metropolitan Statistical Areas*, CC Docket No. 96-262, CCB/CPD File No. 01-19, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108 (2004) (*CLEC Access Charge Recon. Order*).

[455] *See*, *e.g.*, *Access Charge Reform Order*, 12 FCC Rcd at 16010–11, para 73. To reduce per-minute carrier common line (CCL) charges, the Commission created the presubscribed interexchange carrier charge (PICC), a flat-rated, monthly charge imposed on IXCs on a per-line basis. *Id.* at 15998–16000, paras. 37–40. The Commission also shifted the cost of line ports from per-minute local switching charges to the common line category and established a mechanism to phase out the per-minute Transport Interconnection Charge (TIC). *Id.* at 16035–40, 16073–86, paras. 125–34, 210–43.

[456] *Access Charge Reform Order*, 12 FCC Rcd at 15987, para. 9.

[457] *See CALLS Order*, 15 FCC Rcd 12962.

[458] *See supra* note 455 (discussing the PICC).

[459] *See generally CALLS Order*, 15 FCC Rcd at 13025–28, paras. 151–59 (reducing interstate switched access rates); *id.* at 12991–13007, paras. 76–112 (raising SLC caps and eliminating PICCs); *id.* at 13007–14, paras. 113–28 (deaveraging SLCs).

[460] *See CALLS Order*, 15 FCC Rcd at 13046–49, paras. 201–05 (establishing a "$650 million interstate access universal service support mechanism").

[461] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return From Interstate*

(continued….)

interstate access rate structure by aligning it more closely with the manner in which costs are incurred.[462] Among other things, the *MAG Order* increased the SLC caps for rate-of-return carriers and phased out the per-minute CCL charge from the common line rate structure.[463] The Commission also created a universal service support mechanism to replace implicit support with explicit support, in order to foster competition and more efficient pricing.[464] Many, but not all, states have also addressed intercarrier compensation regulation. In addition to setting rates for reciprocal compensation, many states have revised their rules governing intrastate access charges. Although some states have chosen to mirror interstate access charges,[465] others continue to maintain intrastate access charges that far exceed interstate charges.[466]

3. Problems Associated With the Existing Intercarrier Compensation Regimes

178. The introduction of competition into local telephone markets revealed weaknesses in the existing intercarrier compensation regimes that remained notwithstanding the efforts of the Commission and certain states to reform interstate and intrastate access charges. As the Commission observed in 2001, "[i]nterconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation regulations . . . [that] treat different types of carriers and different types of services disparately, even though there may be no significant differences in the costs among carriers or

(continued from previous page)
Services of Local Exchange Carriers, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613 (2001) (*MAG Order*), *recon. in part*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon.*, *Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003); *see also Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service*, CC Docket Nos. 00-256, 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004).

[462] *MAG Order*, 16 FCC Rcd at 19617, para. 3.

[463] *MAG Order*, 16 FCC Rcd at 19621, para. 15.

[464] *MAG Order*, 16 FCC Rcd at 19617, para. 3. A new universal service support mechanism, Interstate Common Line Support (ICLS), was implemented to replace the CCL charge beginning July 1, 2002. *Id.* at 19621, para. 15. This mechanism recovers any shortfall between the allowed common line revenue requirement of rate-of-return carriers and their SLC and other end-user revenues, thereby ensuring that changes in the rate structure did not affect the overall recovery of interstate access costs by rate-of-return carriers serving high-cost areas. *Id.* at 19642, 19667–73, paras. 61, 128–41. To reform the local switching and transport rate structure of rate-of-return carriers, the Commission shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the TIC to other access rate elements, thus reducing per-minute switched access charges. *Id.* at 19649–61, paras. 76–111.

[465] *See, e.g.*, *BA-WV's Intrastate Access Charges*, Case No. 00-0318-T-GI, Commission Order, 2001 WL 935643 (West Virginia PSC June 1, 2001) (ordering that "the traffic-sensitive intrastate access charges of Verizon-WV shall be modified to mirror the interstate rate structure and rate elements"); *Tariff Filing of BellSouth Telecommunications, Inc to Mirror Interstate Rates*, Case No. 98-065, Order (Kentucky PSC Mar. 31, 1999) (requiring BellSouth "to eliminate the state-specific Non-Traffic Sensitive Revenue Requirement . . . , thus moving its aggregate intrastate switched access rate to the FCC's 'CALLS' interstate rate"); *Establishment of Carrier-to-Carrier Rules*, Case No. 06-1344-TP-ORD, Order, 2007 WL 3023991 (Ohio PUC Oct. 17, 2007) ("[T]his Commission requires ILECs to mirror their interstate switched access rate on the intrastate side . . . .").

[466] *See, e.g.*, Letter from David C. Bartlett, Vice President of Federal Government Affairs, Embarq, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Exh. C (filed Aug. 1, 2008) (noting intrastate terminating switched access rates five to ten times higher than interstate rates in Missouri, Washington, Virginia, and several other States).

services."[467] We have seen numerous examples of regulatory arbitrage in the marketplace both because of the different rates for similar functions under different intercarrier compensation regimes and because none of these regimes currently set rate levels in an economically efficient manner.[468]

179. One example of regulatory arbitrage involves traffic to dial-up ISPs. Following adoption of the *Local Competition First Report and Order*, state commissions set reciprocal compensation rates for the exchange of local traffic. These reciprocal compensation rates were sufficiently high that many competitive LECs found it profitable to target and serve ISP customers who were large recipients of local traffic, since dial-up Internet customers would call their ISP and then stay on the line for hours. This practice led to significant traffic imbalances, with competitive LECs seeking billions of dollars in reciprocal compensation payments from other LECs.[469] The Commission responded by adopting a separate interim intercarrier compensation regime for this traffic.

180. On February 26, 1999, the Commission issued a Declaratory Ruling and Notice of Proposed Rulemaking in which it held that ISP-bound traffic is jurisdictionally interstate because end users access websites across state lines. Because the *Local Competition First Report and Order* concluded that the reciprocal compensation obligation in section 251(b)(5) applied to only local traffic, the Commission found in the *Declaratory Ruling* that ISP-bound traffic is not subject to section 251(b)(5).[470] On March 24, 2000, in the *Bell Atlantic* decision, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) vacated certain provisions of the *Declaratory Ruling*.[471] The court did not question the Commission's finding that ISP-bound traffic is interstate. Rather, the court held that the Commission had not adequately explained how its end-to-end jurisdictional analysis was relevant to determining whether a call to an ISP is subject to reciprocal compensation under section 251(b)(5).[472] In particular, the court noted that a LEC serving an ISP appears to perform the function of "termination" because the LEC delivers traffic from the calling party through its end office switch to the called party, the ISP.[473]

181. On April 27, 2001, the Commission released the *ISP Remand Order*, which concluded that section 251(g) excludes ISP-bound traffic from the scope of section 251(b)(5).[474] The Commission explained that section 251(g) maintains the pre-1996 Act compensation requirements for "exchange access, information access, and exchange services for such access," thereby excluding such traffic from the reciprocal compensation requirements that the 1996 Act imposed. The Commission concluded that

---

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

[468] The phrase "regulatory arbitrage" refers to profit-seeking behavior that can arise when a regulated firm is required to set difference prices for products or services with a similar cost structure. *See, e.g.*, PATRICK DEGRABA, BILL AND KEEP AT THE CENTRAL OFFICE AS THE EFFICIENT INTERCONNECTION REGIME 1, para. 2 n.3 (Federal Communications Commission, OPP Working Paper No. 33, 2000), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp33.pdf.

[469] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9183, para. 70 (2001) (subsequent history omitted) (*ISP Remand Order*).

[470] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Declaratory Ruling and Notice of Proposed Rulemaking, 14 FCC Rcd 3689, 3703–06, paras. 21–27 (1999) (*Declaratory Ruling*), *vacated and remanded*, *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

[471] *Bell Atlantic*, 206 F.3d at 1.

[472] *See Bell Atlantic*, 206 F.3d at 5.

[473] *Bell Atlantic*, 206 F.3d at 6.

[474] *See ISP Remand Order*, 16 FCC Rcd at 9171–72, para. 44.

ISP-bound traffic is "information access" and, therefore, is subject instead to the Commission's section 201 jurisdiction over interstate communications.[475] The Commission concluded that a bill-and-keep regime might eliminate incentives for arbitrage and force carriers to look to their own customers for cost recovery.[476] To avoid a flash cut to bill-and-keep, however, the Commission adopted an interim compensation regime pending completion of the *Intercarrier Compensation* proceeding.[477]

182. On May 3, 2002, the D.C. Circuit found that the Commission had not provided an adequate legal basis for the rules it adopted in the *ISP Remand Order*.[478] Once again, the court did not question the Commission's finding that ISP-bound traffic is jurisdictionally interstate. Rather, the court held that section 251(g) of the Act did not provide a basis for the Commission's decision. The court held that section 251(g) is simply a transitional device that preserved obligations that predated the 1996 Act until the Commission adopts superseding rules, and there was no pre-1996 Act obligation with respect to intercarrier compensation for ISP-bound traffic.[479] Although the court rejected the legal rationale for the interim compensation rules, the court remanded, but did not vacate, the *ISP Remand Order* to the Commission, and it observed that "there is plainly a non-trivial likelihood that the Commission has authority" to adopt the rules.[480] Accordingly, the interim rules adopted in the *ISP Remand Order* have remained in effect.

183. On November 5, 2007, Core filed a petition for writ of mandamus with the D.C. Circuit seeking to compel the Commission to enter an order resolving the court's remand in the *WorldCom* decision.[481] On July 8, 2008, the court granted a writ of mandamus and directed the Commission to respond to the *WorldCom* remand in the form of a final, appealable order that "explains the legal authority for the Commission's interim intercarrier compensation rules that exclude ISP-bound traffic from the reciprocal compensation requirement . . . ."[482] The court directed the Commission to respond to the writ

[475] *See ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. Thus, the Commission affirmed its prior finding in the *Declaratory Ruling* that ISP-bound traffic is jurisdictionally interstate. *See id*; *see also Declaratory Ruling*, 14 FCC Rcd at 3701–03, paras. 18–20.

[476] *ISP Remand Order*, 16 FCC Rcd at 9184–85, paras. 74–75. The Commission discussed at length the market distortions and regulatory arbitrage opportunities created by the application of per-minute reciprocal compensation rates to ISP-bound traffic. In particular, the Commission found that requiring compensation for this type of traffic at existing reciprocal compensation rates undermined the operation of competitive markets because competitive LECs were able to recover a disproportionate share of their costs from other carriers, thereby distorting the price signals sent to their ISP customers. *See id*. at 9181–86, paras. 67–76.

[477] *See ISP Remand Order*, 16 FCC Rcd at 9155–57, paras. 7–8. The interim regime adopted by the Commission consisted of: (1) a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use; (2) a growth cap on total ISP-bound minutes for which a LEC may receive this compensation; (3) a "new markets rule" requiring bill-and-keep for the exchange of this traffic if two carriers were not exchanging traffic pursuant to an interconnection agreement prior to the adoption of the interim regime; and (4) a "mirroring rule" that gave incumbent LECs the benefit of the rate cap only if they offered to exchange all traffic subject to section 251(b)(5) at the same rates. *Id*. at 9187–89, 9193–94, paras. 78, 80, 89. In a subsequent order, the Commission granted forbearance to all telecommunications carriers with respect to the growth caps and the new markets rule. *See Petition of Core Commc'ns Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, Order, 19 FCC Rcd 20179 (2004) (*Core Forbearance Order*). Thus, only the rate caps and mirroring rule remain in effect today.

[478] *See WorldCom*, 288 F.3d at 429.

[479] *See WorldCom*, 288 F.3d at 433.

[480] *See WorldCom*, 288 F.3d at 434.

[481] Pet. for Writ of Mandamus, In re Core Communications Inc., No. 07-1446 (D.C. Cir. Nov. 5, 2007).

[482] *In re Core Commc'ns Inc*., 531 F.3d 849, at 861–62 (D.C. Cir. 2008) (*Core Decision*).

of mandamus by November 5, 2008.[483]

184. Another regulatory arbitrage opportunity arose as a result of the Commission's 1997 decision not to regulate the interstate access charges of competitive LECs. As a result, many competitive LECs filed tariffs with access charges that were well above the rates charged by incumbent LECs for similar services.[484] In response, the Commission adopted new rules that effectively capped the interstate access charges that competitive LECs could tariff.[485]

185. Two more recent examples of regulatory arbitrage involve billing problems and the "Access Stimulation" problem. Commenters describe problems billing for traffic when it arrives for termination with insufficient identifying information.[486] Because the existing intercarrier compensation mechanisms have vastly disparate rates that apply to different types of traffic, carriers have both the opportunity and incentive to disguise the nature, or conceal the source, of the traffic being sent in order to avoid or reduce payments to other carriers.[487] "Access Stimulation" refers to allegations that certain LECs may have entered into agreements with providers of services that generate large volumes of incoming calls to substantially increase the number of calls sent to the LEC.[488] It has been alleged that this significantly increased "growth in terminating access traffic may be causing carriers' rates to become unjust or unreasonable" in violation of section 201 of the Act.[489] In the *Access Stimulation NPRM*, the Commission has sought information about the extent of this practice, its potential impact on the rates of price cap, rate-of-return, and competitive LECs, and how this practice should be addressed.[490]

B. Comprehensive Reform

---

[483] *See Core Decision*, 531 F.3d at 861–62. If the Commission fails to comply with the writ by the November 5th deadline, the interim rules will be vacated on November 6, 2008. *See id*. at 862.

[484] *See CLEC Access Charge Order*, 16 FCC Rcd at 9931, para. 22. For instance, the Commission found that certain competitive LECs charged $0.09 per minute and that the weighted average of competitive LEC access rates was above $0.04 per minute. *Id.* In contrast, the same underlying data showed a composite incumbent LEC rate of $0.0056 for that same traffic. *See* AT&T Additional Comments, CC Docket Nos. 96-262, 97-146, CCB/CPD File No. 98-63, App. A. (Jan. 11, 2001). The Commission found that competitive LECs could impose excessive charges due to two factors. First, the Commission observed that access charges are paid by the IXC rather than the end-user customer. Because the IXC has no ability to affect the calling or called party's choice of service providers, it cannot avoid carriers with high access charges. *CLEC Access Charge Order*, 16 FCC Rcd at 9935, para. 31. Second, the Commission found that the rate averaging requirements in section 254(g) of the Act precluded IXCs from passing through particular competitive LECs' excessive access charges to the end user customers of those competitive LECs. *Id*. As a result, the Commission found the existing regulatory regime did not effectively create the incentives for the end users to select a lower-priced access provider. *Id*.

[485] *See* 47 C.F.R. § 61.26 (containing rules governing the tariffing of competitive LEC interstate switched exchange access services). As a general matter, the Commission's rules governing competitive LEC access charges limit these rates to those charged by the competing incumbent LEC. *Id*.

[486] *See infra* Part V.D.

[487] *See infra* para. 326.

[488] *See, e.g.*, *Qwest Commc'ns Corp. v. Farmers and Merchs. Mut. Tel. Co.*, File No. EB-07-MD-001, Memorandum Opinion and Order, 22 FCC Rcd 17973, para. 1 (2007) (addressing Qwest's allegations that Farmers deliberately planned to "increase dramatically the amount of terminating access traffic delivered to its exchange, via agreements with conference calling companies").

[489] *See Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 17989, para. 1 (2007) (*Access Stimulation NPRM*).

[490] *Access Stimulation NPRM*, 22 FCC Rcd 17989.

1. Introduction

186. Evidence of increasing regulatory arbitrage, as well as increased competition and changes in technology, has led the Commission to consider comprehensive reform of intercarrier compensation. In 2001, the Commission adopted a Notice of Proposed Rulemaking to examine possible alternatives to existing intercarrier regimes with the intent of moving toward a more unified system.[491] The notice generated extensive comments that generally confirmed the need for comprehensive intercarrier compensation reform, including a number of competing proposals.[492] In 2005, the Commission adopted a Further Notice of Proposed Rulemaking seeking comment on the various industry proposals.[493] In 2006, another industry coalition submitted an alternative comprehensive intercarrier compensation reform proposal, known as the Missoula Plan.[494] The Commission separately requested and received comments on the Missoula Plan proposal.[495] Finally, in 2008, the Commission stabilized the universal service fund by adopting an interim cap on payments to competitive ETCs, helping pave the way for comprehensive intercarrier compensation and universal service reform, and leading to a number of new reform

---

[491] *See Intercarrier Compensation NPRM*, 16 FCC Rcd 9610. The Commission acknowledged a number of problems with the existing regimes, including inefficient rates and different rates for the same types of calls. *Id.* at 9616–18, paras. 11–18. The Commission thus sought comment on alternative approaches to reforming intercarrier compensation, including moving to a bill-and-keep approach to intercarrier compensation. *Id.* at 9611–13, paras. 2–4.

[492] *See, e.g.,* Regulatory Reform Proposal of the Intercarrier Compensation Forum (ICF Proposal), *attached to* Letter from Gary M. Epstein and Richard R. Cameron, Counsel for the Intercarrier Compensation Forum, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, App. A (filed Oct. 5, 2004) (ICF Oct. 5, 2004 *Ex Parte* Letter); Comprehensive Plan For Intercarrier Compensation Reform of Expanded Portland Group (EPG Proposal), *attached to* Letter from Glenn H. Brown, EPG Facilitator, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); Intercarrier Compensation Reform Plan of Alliance for Rational Intercarrier Compensation (ARIC Plan), *attached to* Letter from Wendy Thompson Fast, President, Consolidated Companies, and Ken Pfister, Vice President—Strategic Policy, Great Plains Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, 99-68, 96-98, WC Docket No. 04-36 (filed Oct. 25, 2004); Cost-Based Intercarrier Compensation Coalition (CBICC Proposal), *attached to* Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 2, 2004); Updated Ex Parte of Home Telephone Company, Inc. and PBT Telecom (Home/PBT Proposal), *attached to* Letter from Keith Oliver, Vice President, Finance, Home Telephone Company, and Ben Spearman, Vice President, Chief Regulatory Officer, PBT Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 2, 2004); NASUCA Intercarrier Compensation Proposal at 1 (NASUCA Proposal), *attached to* Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 14, 2004); Western Wireless Intercarrier Compensation Reform Plan at 9 (Western Wireless Proposal), *attached to* Letter from David L. Sieradzki, Counsel for Western Wireless Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 1, 2004).

[493] *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, 4687, para. 4 (2005) (*Intercarrier Compensation FNPRM*).

[494] *See* Missoula Plan for Intercarrier Compensation Reform (Missoula Plan), *attached to* Letter from Tony Clark, Commissioner and Chair, NARUC Committee on Telecommunications, Ray Baum, Commissioner and Chair, NARUC Task Force, and Larry Landis, Commissioner and Vice-Chair, NARUC Task Force, to Hon. Kevin Martin, Chmn., FCC, CC Docket No. 01-92 (filed July 24, 2006) (NARUC Task Force July 24, 2006 *Ex Parte* Letter).

[495] *Comment Sought on Missoula Intercarrier Compensation Reform Plan*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 8524 (2006). Subsequently, the Missoula Plan supporters filed additional details concerning specific aspects of the plan, on which the Commission continued to seek comment. *See Comment Sought on Missoula Plan Phantom Traffic Interim Process and Call Detail Records Proposal*, CC Docket No. 01-92, Public Notice, 21 FCC Rcd 13179 (2006); *Comment Sought on Amendments to the Missoula Plan Intercarrier Compensation Proposal to Incorporate a Federal Benchmark Mechanism*, CC Docket No. 01-92, Public Notice, 22 FCC Rcd 3362 (2007).

proposals.[496]

187. As a result of the *Intercarrier Compensation NPRM*, the *Intercarrier Compensation FNPRM*, the filing of the Missoula Plan, and the more recent proposals that have been filed, the Commission has compiled an extensive record over the past seven years. The Commission has received comments or proposals from a wide variety of interested parties, including, states, incumbent LECs, competitive LECs, rural companies, IXCs, new technology companies, consumer advocates, business customers, and industry associations. As demonstrated throughout this order, the Commission has thoroughly reviewed and analyzed the voluminous record, has considered the evidence submitted by the parties supporting the alternatives, and has carefully evaluated each of the proposals that have been presented. Based on this examination of the options, we find that the approach we describe below and adopt in this order best achieves the goals of promoting universal service, encouraging the efficient use of, and investment in, broadband technologies, spurring competition, and ultimately, further reducing the need for regulation.

2. A New Approach to Intercarrier Compensation

188. Since the introduction of competition into long-distance telephone service, the Commission has moved toward eliminating implicit subsidies from intercarrier charges. At every stage, however, the Commission has had to balance the desire to establish more efficient intercarrier charges against the potential adverse effects on consumers (in the form of higher flat-rated charges) and carriers (in the form of reduced intercarrier revenues). The introduction of competition into local telephone markets accelerated the need for reform. As discussed above, since the implementation of the 1996 Act, not only has local competition increased, but so has the incidence and severity of regulatory arbitrage.

189. We conclude today that, with the universal service fund now stabilized, we can wait no longer to begin the process of comprehensive intercarrier compensation reform. The differences in existing intercarrier compensation regimes impose significant inefficiencies on users and distort carriers' investment incentives, which can result in losses of billions of dollars in consumers and producers surplus. Possibly more important, these legacy regulatory regimes pose an obstacle to the transition to an all-IP broadband world. Because carriers currently can receive significant revenues from charging above-cost rates to terminate telecommunications traffic, they have a reduced incentive to upgrade their networks to the most efficient technology or to negotiate interconnection agreements that are designed to accommodate the efficient exchange of IP traffic, as both actions would likely lead to reduced intercarrier payments.[497]

190. In this order, we therefore adopt a new approach to intercarrier compensation and establish the blueprint for moving to new uniform termination rates that are economically efficient and sustainable in our increasingly competitive telecommunications markets. At the same time, we recognize, as the Commission has in the past, the need to be cognizant of market disruptions and potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes to our new uniform approach to intercarrier compensation. Accordingly, we adopt here a gradual ten-year transition plan with separate stages, designed to reduce rates over a sufficient period to minimize market disruptions and to cushion the impact of our reform on both customers and carriers. At the end of

---

[496] The Commission invited parties to refresh the record in these and other relevant dockets. *Interim Cap Clears Path for Comprehensive Reform: Commission Poised to Move Forward on Difficult Decisions Necessary to Promote and Advance Affordable Telecommunications for All Americans*, News Release (May 2, 2008), *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-281939A1.pdf.

[497] *See, e.g.,* T. RANDOLPH BEARD & GEORGE S. FORD, DO HIGH CALL TERMINATION RATES DETER BROADBAND DEPLOYMENT? (Phoenix Center Policy Bulletin No. 22, Oct. 2008), *available at* http://www.phoenix-center.org/PolicyBulletin/PCPB22Final.pdf.

the transition period, all telecommunications traffic will be treated as falling within the reciprocal compensation provisions of section 251(b)(5), and states will set default reciprocal compensation rates pursuant to the new methodology we adopt herein.

191. The requirements that we adopt for intercarrier compensation do not apply to providers operating in Alaska, Hawaii, or any U.S. Territories and possessions. We find that these areas have very different attributes and related cost issues than the continental states.[498] For this reason, we are exempting providers in Alaska, Hawaii and U.S. Territories and possessions from the requirements and rules adopted herein, and we will address them in a subsequent proceeding.[499]

192. *Transition Plan*. As described below, we adopt a ten-year transition plan.[500] In the first stage, intrastate access rates are reduced to the levels of interstate rates. During stage two, carriers will reduce their rates to an interim uniform termination rate, set by the state. Carriers whose current rates are below the interim uniform rate set by the state, however, may not increase their rates. During stage three, the rates carriers charge at the end of stage two (either the interim uniform rates or their prior rates, whichever are lower) will be gradually reduced to the rates that will apply at the end of the transition. This transition will be designed by the state so as to minimize market disruptions and adverse economic effects. This transition is described in more detail below.

193. *Intrastate Rate Reductions*. One year from the effective date of this order, we require that all LECs reduce their terminating *intrastate* switched access rates by 50 percent of the difference between their intrastate switched access rates and their *interstate* switched access rates.[501] Two years from the effective date of this order, we require that all LECs reduce their terminating intrastate switched access rates by the remaining 50 percent of the difference between their intrastate switched access rates and their interstate switched access rates so that their intrastate rates equal their interstate rates. Carriers will comply with state tariffing requirements or other applicable state law in effectuating those changes in intrastate terminating access rates.

194. *State Establishment of Interim, Uniform Reciprocal Compensation Rates.* Within two years from the effective date of this order, states must adopt a state-wide interim, uniform reciprocal compensation rate applicable to all carriers (except carriers whose rates are below the interim, uniform

---

[498] *See, e.g.*, *Verizon/América Móvil Transfer* Order, 22 FCC Rcd at 6211, para. 36 (describing "difficult to serve terrain and dramatic urban/rural differences" in Puerto Rico); *Rates and Services Integration Order*, 4 FCC Rcd at 396, paras. 7–8 (describing the unique market conditions and structure in Alaska); GCI Oct. 3, 2008 *Ex Parte* Letter (citing cost distinctions between Alaska and the continental United States).

[499] *Cf. Policies and Service Rules for the Broadcasting-Satellite Service Order*, 22 FCC Rcd at 8860, para. 47 ("The Commission is committed to establishing policies and rules that will promote service to all regions in the United States, particularly to traditionally underserved areas, such as Alaska and Hawaii, and other remote areas.").

[500] A number of parties argue for a shorter transition period than that provided here. *See, e.g.*, Letter from Robert W. Quinn, Senior Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Oct. 23, 2008) (AT&T Oct. 23, 2008 *Ex Parte* Letter); Letter from Kyle McSlarrow, President and CEO, NCTA, to Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed Oct. 28, 2008) (NCTA Oct. 28, 2008 *Ex Parte* Letter); Letter from Paul W. Garnett, Assistant Vice-President, CTIA—The Wireless Association, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed October 27, 2008) (CTIA October 27, 2008 *Ex Parte* Letter); Small Business Administration Office of Advocacy (SBA) *ICC FNPRM* Comments at 5–7. We note that the reforms adopted today do not preclude carriers from entering into agreements that would reduce intercarrier charges more quickly, (*See, e.g*., Letter from Susanne A. Guyer, Senior Vice-President, Verizon, to Kevin J. Martin, Chairman, FCC, CC Docket No. 01-92 (filed October 28, 2008) at 6.) nor do they prevent state commissions from accelerating the glide path toward the final reciprocal compensation rate if they deem it appropriate.

[501] To the extent that a carrier's intrastate terminating access rate already is below its interstate terminating access rate, it will not change that rate.

rate, in which case, those carriers' rates shall be capped at those lower, existing rates). Three years from the effective date of this order, we require that all LECs reduce their terminating rates by 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state. Four years from the effective date of this order we require that all LECs reduce their terminating rates by the remaining 50 percent of the difference between their current terminating rate and the interim, uniform reciprocal compensation rate established by the state so that their terminating rates equal the state-set interim, uniform reciprocal compensation rate. This rate will become the starting point for stage three—a six-year gradual downward transition to the final uniform reciprocal compensation rate, which the states will also set, consistent with the methodology we adopt in this order. The states will have discretion to determine the glide path, which begins four years from the effective date of this order and ends ten years from the effective date of this order. This glide path will determine the trajectory of the interim reciprocal compensation rate as it trends down to the final reciprocal compensation rate. All carriers are subject to this glide path. However, if a carrier's rate is below the rate specified in the glide path, such carrier cannot raise its rates, but is subject to the trajectory when the interim rate equals that carrier's rate. At the end of ten years (i.e., at the end of stage two), all the terminating rates of all carriers in each state will be reduced to the new final, uniform reciprocal compensation rate established by each state. We believe that, by establishing this ten-year, multiple-stage transition to a state-set final uniform reciprocal compensation rate, we will provide a sufficiently smooth and gradual glide path so that carriers will be able to adjust their other rates and revenues in a measured way over time, as allowed by the reforms adopted in this order, without creating unacceptable rate or revenue effects.

195. Although we permit the states to establish the particular interim, uniform reciprocal compensation rate for each step of the final six years of the transition, we establish certain conditions on the interim, uniform reciprocal compensation rate and on the terminating intercarrier rates that carriers may charge. First, although we do not set forth a methodology that states must use in setting the interim, uniform reciprocal compensation rates, we do require that, within each state, there must be a single, state-wide interim, uniform reciprocal compensation rate during each year and at each stage of the transition.[502] Therefore, in establishing interim, uniform reciprocal compensation rates, a state may wish to consider the impact of those rates on all the carriers in the state. States are permitted to adopt an interim, uniform reciprocal compensation rate that may be higher at the beginning of the transition than some existing incumbent LEC rates today. If they do so, however, carriers with lower termination rates may not raise them to the interim uniform rate. Second, states may determine the glide path for moving from the interim, uniform reciprocal compensation rate to the final, uniform reciprocal compensation rate, subject to the requirement that the interim uniform rate be identical for all carriers at each step in the transition. By the end of the transition period, the interim, uniform reciprocal compensation rates must decrease to a single final, uniform reciprocal compensation rate for all carriers established pursuant to the Commission's new "additional costs" methodology.

196. *Transition of Rates During Stage Three.* Beginning four years from the effective date of this order, and through the remainder of the transition, each carrier must set each of its terminating rates at the lower of: (i) its current rate; or (ii) the state-set interim, uniform reciprocal compensation rate applicable at that stage of the transition. Thus, for example, if a carrier has an interstate terminating access rate above the interim, uniform reciprocal compensation rate applicable at that stage of the transition, but a current reciprocal compensation rate below the interim, uniform reciprocal compensation rate, the carrier will reduce its interstate rate to the interim rate but leave its current reciprocal compensation rate unchanged. That carrier will continue to have two separate termination rates until such time as the applicable interim, uniform reciprocal compensation rate is adjusted lower and becomes less

[502] We recognize that the state-wide interim, uniform reciprocal compensation rates may vary state-by-state as state commissions consider the best means of transitioning to a final, uniform reciprocal compensation rate.

than its current reciprocal compensation rate. At that time, all the carrier's rates will be set at the level of the interim, uniform reciprocal compensation rate for that state.

197. We emphasize that under no circumstances shall a carrier be permitted to increase its current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates. In this respect, the applicable interim, uniform reciprocal compensation rate set by the states will act as a ceiling or cap on such rates. We do not permit a carrier to charge a rate for terminating interstate or intrastate access, reciprocal compensation, or ISP-bound traffic that is higher than the interim, uniform reciprocal compensation rate, but we will permit a carrier to continue to charge a rate that is lower than the interim, uniform reciprocal compensation rate. We note that because CMRS providers may not tariff terminating access today,[503] and we do not permit a carrier to increase rates during the transition, CMRS providers therefore will not be permitted to charge for terminating access until the end of the transition period.[504]

198. We note that we already have an interim intercarrier compensation regime for ISP-bound traffic, and to avoid disruption in the marketplace, we will apply on a transitional basis the pricing standards we adopted for ISP-bound traffic in the *ISP Remand Order*,[505] as modified by the *Core Forbearance Order*.[506] Currently, two rules remain in effect: (1) ISP-bound traffic is currently subject to a reciprocal compensation rate cap of $.0007 per minute-of-use; and (2) under the mirroring rule, the $.0007 cap applies to traffic exchanged with an incumbent LEC only if it offers to exchange all traffic subject to section 251(b)(5) at the same rate. As explained below, we conclude that it is appropriate to retain these rules, but only on a transitional basis until a state commission, applying the "additional costs" standards adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

199. In the *ISP Remand Order* in 2001, based on "convincing evidence in the record" that carriers had "targeted ISPs as customers merely to take advantage of . . . intercarrier payments"—offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud—the Commission adopted an interim ISP payment regime to "limit, if not end, the opportunity for regulatory arbitrage."[507] The Commission adopted a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use.[508] These

[503] Although CMRS providers may not tariff access charges, they are not prohibited from entering into contracts with interexchange carriers that provide for the payment of such charges. *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges,* WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192 (2002) (*CMRS Access Charges Declaratory Ruling*).

[504] Consistent with our conclusion that CMRS providers are unable to assess access charges during the transition, we make clear that our symmetry rule, set forth in Part V.C.1.b, will not apply until the transition is over. Even so, we clarify that, to the extent that any carrier has a terminating rate above the permissible rate, such carrier must reduce the rate to the permissible level. Specifically, in the first year of the transition, all carriers with intrastate access charges higher than their interstate access charges must reduce such charges by 50 percent of the difference between its interstate switched access rate and its intrastate switched access rate. Similarly, once the state-set interim, uniform rate is in effect, all carriers must reduce terminating rates, whether interstate access, reciprocal compensation, or ISP-bound traffic, by 50 percent of the difference between the current terminating switched access rate and the interim, uniform rate (as it is reduced over time). Even though rates during the transition will not reflect true symmetry, rates for most carriers should be symmetric before the transition is over as all carriers reduce charges to the final, uniform rate.

[505] *See ISP Remand Order*, 16 FCC Rcd at 9153, 9186–93, paras. 21, 77–88.

[506] *See Core Forbearance Order*, 19 FCC Rcd at 20184–89, paras. 16–26.

[507] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 77.

[508] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

rate caps reflected the downward trend in intercarrier compensation rates contained in then-recently negotiated interconnection agreements.[509] We have previously recognized that evidence that "carriers have agreed to rates"—through voluntary, arms-length negotiations—constitutes substantial evidence that rates are just and reasonable.[510]

200. Most commenters urge the Commission to maintain the interim compensation rules governing ISP-bound traffic until the Commission is able to transition to comprehensive intercarrier compensation reform.[511] These parties contend that a higher compensation rate would create new opportunities for arbitrage[512] and impose substantial financial burdens on wireless companies, incumbent LECs and state public utility commissions.[513] They further claim that the existing regime has simplified

---

[509] *ISP Remand Order*, 16 FCC Rcd at 9190–91, para. 85.

[510] *ISP Remand Order*, 16 FCC Rcd at 9190–91, para. 85; *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*, WC Docket No. 05-281, 22 FCC Rcd 1958, 1984–85, paras. 39, 40 n.136 (2007) (finding that "commercially negotiated rates" provide "just and reasonable prices"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 98-147, 96-98, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17389, para. 664 (2003) (subsequent history omitted) (*Triennial Review Order*) (finding that "arms-length agreements . . . to provide [an] element at [a] rate" "demonstrate[s]" that the rate is "just and reasonable").

[511] *See*, *e.g*., Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 10 (filed July 8, 2008) (asking the Commission to maintain the existing compromises reached with respect to ISP-bound traffic); Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68 at 8 (filed May 9, 2008) (asserting that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform); Letter from L. Charles Keller, Counsel for Sage Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 99-68, 01-92, Attach. at 6 (Sage Telecom May 9, 2008 *Ex Parte* Letter) (stating that retaining the ISP rate serves broad policy goals); Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 1 (filed May 7, 2008) (supporting continuation of the interim compensation rules); Letter from Joshua Seidmann, Vice President of Regulatory Affairs, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 2 (filed Apr. 28, 2008) (ITTA Apr. 28, 2008 *Ex Parte* Letter) (asking the Commission to retain the current $0.0007 rate for ISP-bound traffic); Letter from Donna Epps, Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 at 1 (filed Apr. 7, 2008) (urging the Commission to support its earlier finding that $0.0007 is appropriate compensation for dial-up ISP traffic); Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, Attach. (filed May 1, 2008) (describing how elimination of the existing ISP rate would create substantial burdens on a number of carriers and state commissions) (Verizon Wireless May 1, 2008 *Ex Parte* Letter); Letter from Glenn Reynolds, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-262, WC Docket No. 07-135 at 2 (filed Apr. 29, 2008) (noting that the Commission's existing rules have "largely mitigated the debate around compensation for ISP-bound traffic, but there is every reason to believe the same problems would arise if the Commission were to reverse direction on this issue") (USTelecom Apr. 29, 2008 *Ex Parte* Letter).

[512] *See, e.g*., USTelecom Apr. 29, 2008 *Ex Parte* Letter at 2; Letter from Melissa E. Newman, Vice President, Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, WC Docket No. 07-135, Attach. at 3–5 (filed Apr. 25, 2008) (Qwest April 25, 2008 *Ex Parte* Letter); Verizon and BellSouth, Further Supplemental White Paper on ISP Reciprocal Compensation at 20 (Verizon/BellSouth Further Supp. ISP White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004).

[513] *See*, *e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter, Attach.

interconnection negotiations.[514]

201. We share these commenters' concerns. The record also suggests that eliminating the $.0007 cap and instead applying higher reciprocal compensation rates that may be set by the states during the transition period to the adoption of our new methodology would have a significant negative impact on carriers serving rural markets and broadband deployment.[515] The record demonstrates that dial-up minutes remain at high levels in rural areas and that the application of reciprocal compensation to these minutes would generate significant costs to carriers serving these rural areas.[516] Thus, it remains the case that the "rate caps help avoid arbitrage and market distortions that otherwise would result from the availability of reciprocal compensation for ISP-bound traffic."[517] We further believe that maintaining the cap on a transitional basis will minimize the disruptive effects and regulatory uncertainty that otherwise would result from the abrupt elimination of clear compensation rules for ISP-bound traffic.

202. We expect that state commissions, applying the new "additional costs" standard adopted in this order, will set final reciprocal compensation rates at or below $.0007 per minute-of-use. As noted below, the evidence in the record suggests that the incremental cost of call termination on modern switches is de minimis.[518] We have given state commissions up to ten years to transition to new rates based on the "additional costs" standard. Accordingly, the rate cap will only have an impact in a particular state on a transitional basis until that state sets rates at or below $.0007.

203. The mirroring rule has also succeeded in promoting the Commission's "goal of a more unified intercarrier compensation regime by requiring LECs to offer similar rates for like traffic."[519] Most intraMTA traffic is now exchanged pursuant to the rate caps, and a substantial portion of wireline intraexchange traffic is being exchanged at rates at or below the rate caps as well.[520] Eliminating the mirroring rule and allowing carriers to charge higher transitional reciprocal compensation rates for traffic

---

[514] *See*, *e.g*., Verizon Wireless May 1, 2008 *Ex Parte* Letter (stating that "the [m]irroring [r]ule simplified wireless-ILEC interconnection negotiations tremendously."); Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Docket Nos. 01-92, 96-98, 99-68 at 38–40 (filed Oct. 2, 2008) (Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments) (indicating that Verizon entered into multiple agreements using the $.0007 rate cap established in the *ISP Remand Order*).

[515] *See*, *e.g*., ITTA April 28, 2008 *Ex Parte* Letter, Attach. at 3, 5; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 2, 5–7.

[516] *See*, *e.g*., Letter from Tamar E. Finn, Counsel for Earthlink, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at iii, 11–12 (filed Aug. 14, 2008) (estimating that 24% of dial-up users in rural America say that broadband service is not available where they live); Sage Telecom May 9, 2008 *Ex Parte* Letter at 3–4; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 6 (calculating its cost to be $100 million if all ISP-bound minutes were subject to TELRIC-based rates under section 251(b)(5)); ITTA Apr. 28, 2008 *Ex Parte* Letter (noting that dial-up usage remains strong in rural areas); USTelecom Apr. 29, 2008 *Ex Parte* Letter (noting a "recent study from the Pew Internet & American Life Project that indicated that while the number of dial-up subscribers had dropped 63% since 2001, the number of minutes spent online by each dial-up subscriber had increased approximately 70%. As a result, some USTelecom member companies are actually seeing an *increase* in dial-up minutes.") (emphasis in original); Letter from Bennett L. Ross, General Counsel—D.C., BellSouth D.C., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 03-171 (filed Aug. 29, 2005) (attaching a chart showing that "dial-up subscribers would continue to generate substantial minutes of dial-up ISP calls, notwithstanding projections of a continued decline in the number of dial-up subscribers.").

[517] *Core Forbearance Order*, 19 FCC Rcd at 20815–16, para. 18.

[518] *See supra* para. 255.

[519] *Core Forbearance Order*, 19 FCC Rcd at 20816, para. 19.

[520] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

currently subject to the mirroring rule would significantly increase the cost carriers incur in exchanging that traffic. Those increased costs would divert funds from investment in next generation wireless networks and likely would be borne by consumers, through increases in the costs of wireless offerings.[521]

204. We reject arguments that the Commission unlawfully delegated its authority in the *ISP Remand Order* and arguments that the Commission addressed previously in the *Core Forbearance Order*.[522] We also disagree with parties who suggest that the Commission, in responding to the D.C. Circuit's remand in *WorldCom*, must offer detailed new justifications for each of the four features of the ISP intercarrier payment regime: the rate caps, the mirroring rule, the growth cap, and the new markets rule.[523] The prior policy justifications offered for those rules by the Commission have not been overturned by any court, and our current policy justification for retaining these rules is simply to maintain the status quo in this area on a transitional basis until our new "additional costs" methodology has been fully implemented. Indeed, pursuant to our new "additional costs" methodology, we believe that the rate caps set forth in 2001 may well be higher than the final, uniform reciprocal compensation rates set by the states. However, discarding these rules during the transition to our new methodology would be unwise and unwarranted because the "rate caps are necessary to prevent discrimination *between* dial-up Internet access customers and basic telephone service customers," those caps "protect consumers of basic telephone service" from being forced to subsidize dial-up Internet access service, and the rate caps minimize the "classic regulatory arbitrage" that reciprocal compensation for ISP-bound traffic had made possible.[524]

205. In sum, we maintain the \$.0007 cap and the mirroring rule, on a transitional basis, pursuant to our section 201 authority. These interim rules shall remain in place in a state until the state commission, applying the "additional costs" standard adopted in this order, has established reciprocal compensation rates that are at or below \$.0007 per minute-of-use.

206. We find that our transition plan is necessary and appropriate to prevent undue economic hardships to carriers caused by a too-rapid reduction in intercarrier compensation rates. If there is evidence that carriers are attempting to abuse the interim, uniform reciprocal compensation rate and/or transition process to create arbitrage opportunities, we encourage carriers to bring such evidence to our attention or that of the state commission so such claims can be investigated and, if appropriate, action taken.

3. Legal Authority

a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g)

207. The history of intercarrier compensation reveals many policy reasons for

---

[521] Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments. at 40.

[522] *See* Letter from Michael B. Hazzard, Counsel for Core Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at 18 & n.8 (filed May 14, 2008) (Core May 14, 2008 *Ex Parte* Letter). We also reject Core's argument that the *ISP Remand Order* unlawfully delegates to incumbent LECs the decision of whether the *ISP Remand Order* applies. *See id*. at 19–20. The Commission did not delegate its authority in the *ISP Remand Order* but rather provided options that were not mandatory. *See, e.g.*, *ISP Remand Order*, 16 FCC Rcd at 9193, para. 89. Additionally, Core argues that the Commission provided no reasoned explanation for the growth cap and new market rules adopted in the *ISP Remand Order* and never provided notice or an opportunity for comment on those specific rules. These rules, as applicable to all carriers, were forborne from in the *Core Forbearance Order*. *See Core Forbearance Order*, 19 FCC Rcd at 20186–87, paras. 20–21. As such, this argument is moot.

[523] *See* Core May 14, 2008 *Ex Parte* Letter, Attach. at 20–26.

[524] *In re Core Commc'ns* 455 F.3d at 277–80 (internal quotation marks omitted).

comprehensively reforming intercarrier compensation rates, including reducing arbitrage, promoting competition, facilitating the introduction of new technologies, and benefiting consumers. The dual structure of separate federal and state jurisdiction over communications has made accomplishing such reforms more complex, however. Although our reform does not disturb those fundamental jurisdictional distinctions, we find that, through the tools made available by the 1996 Act, we have the means to accomplish this reform by electing to partner with the states.

208. The Commission unquestionably has authority to reform intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and IP/PSTN traffic. Section 2(a) of the Act establishes the Commission's jurisdiction over interstate services, for which the Commission ensures just, reasonable, and not unjustly and unreasonably discriminatory rates under section 201 and 202.[525] Likewise, the Commission has authority over the rates of CMRS providers pursuant to section 332 of the Act.[526] We also make clear that authority to impose economic regulation with respect to IP/PSTN traffic rests exclusively with this Commission. The Commission has adopted a number of regulatory requirements applicable to interconnected VoIP services and providers.[527] With respect to the statutory classification of IP-enabled services, however, the Commission only has addressed two situations.[528]

209. We now classify as "information services" those services that originate calls on IP networks and terminate them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks (collectively "IP/PSTN" services).[529] Such traffic

---

[525] 47 U.S.C. §§ 152(a), 201, 202.

[526] 47 U.S.C. § 332.

[527] *See, e.g., Telephone Number Requirements for IP-Enabled Services Providers; Local Number Portability Porting Interval and Validation Requirements; IP-Enabled Services; CTIA Petitions for Declaratory Ruling on Wireline-Wireless Porting Issues*, CC Docket Nos. 99-200, 95-116, WC Docket Nos. 07-243, 07-244, 04-36, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, 19538–40, paras. 14, 16 (2008) (*LNP Order*) (imposing LNP requirements, and noting that the Commission previously imposed the requirement to provide 911 service, to contribute to universal service, to protect the privacy of customers, to comply with disability access and telecommunications relay service requirements, and to satisfy certain CALEA obligations).

[528] On one hand, the Commission classified as an "information service" Pulver.com's free service that did not provide transmission and offers a number of computing capabilities. *Petition for Declaratory Ruling that Pulver.com's Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, WC Docket No. 03-45, Memorandum Order and Opinion, 19 FCC Rcd 3307 (2004) (*Pulver.com Order*). On the other hand, the Commission found that certain "IP-in-the-middle" services were "telecommunications services" where they: : (1) use ordinary customer premises equipment (CPE) with no enhanced functionality; (2) originate and terminate on the public switched telephone network (PSTN); and (3) undergo no net protocol conversion and provide no enhanced functionality to end users due to the provider's use of IP technology. *See, e.g., Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 (2004) (*IP-in-the-Middle Order*). *See also, e.g., Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290 (2006) (*Prepaid Calling Card Order*).

[529] We use the term "IP/PSTN" as a shorthand, without reaching any universal conclusions regarding the technology underlying the PSTN. Today the PSTN continues to rely primarily on circuit-switched technology to connect to end-user customers, although we recognize that carriers increasingly are converting portions of their networks to IP technology. *See, e.g., IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers*, WC Docket Nos. 04-36, 05-196, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, 10258, para. 24 & n.77 (2005) (distinguishing the "specialized" CPE required for interconnected VoIP services from the standard CPE used for typical telephone calls); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11532, para. 84 (1998) ("'IP telephony' services enable real-time voice transmission

(continued….)

today involves a net protocol conversion between end-users, and thus constitutes an "enhanced" or "information service."[530]

210. Although there are certain exceptions to this treatment, we do not find them applicable.[531] In particular, we do not find this to be "protocol conversion in connection with the introduction of new technology to implement existing services" that would be treated as a "basic," rather than "enhanced" service.[532] That exception was designed to address situations "involving no change in an existing service, but merely a change in electrical interface characteristics to facilitate transitional introduction of new technology."[533] By contrast, we find that 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.[534]

(continued from previous page)
using Internet protocols. The services can be provided in two basic ways: through software and hardware at customer premises, or through 'gateways' that enable applications originating and/or terminating on the PSTN. Gateways are computers that transform the circuit-switched voice signal into IP packets, and vice versa, and perform associated signaling, control, and address translation functions."). Insofar as a service allows a customer to originate a communication on an IP network and terminate it on a circuit-switched network, or vice versa, it involves a net protocol conversion, and we classify it as an "information service" today. Insofar as that service allows communications with no net protocol conversion, it is not subject to our "information service" classification here. We note that the presence of a net protocol conversion is not the only basis for classifying a service as an "enhanced" or "information service." *See, e.g.*, 47 C.F.R. § 64.702(a); *Computer II Final Decision*, 77 FCC 2d at 420–21, para. 97. We do not reach those issues at this time, however.

[530] *See, e.g.*, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21957–58, para. 106 (1996) (*Non-Accounting Safeguards Order*). Interpreting the 1996 Act's definition of "information services," the Commission held that "all of the services that the Commission has previously considered to be 'enhanced services' are 'information services.'" *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21956, para. 103. For the all reasons discussed in Part V.B.2, we decline to defer the classification of IP/PSTN services, as requested by some parties, instead finding it appropriate to address this issue as part of our comprehensive reforms. *See*, *e.g.*, Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, CC Docket Nos. 96-45, 01-92 at 15 (filed Oct. 24, 2008) (Free Press Oct. 24, 2008 *Ex Parte* Letter); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Broadview Networks, et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008).

[531] Two of the exceptions are: (1) protocol processing involving communications between an end user and the network itself (e.g., for initiation, routing, and termination of calls) rather than between or among users; and (2) protocol conversion to facilitate the interconnection of networks. *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957–58, para. 106. These categories of protocol processing services may involve protocol conversions, but they result in no net protocol conversion between the end users. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, Order on Reconsideration, 12 FCC Rcd 2297, 2297–99, para. 2 (1997). Thus, they are not relevant here.

[532] *Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Phase II Carrier Service and Facilities Authorization Thereof; Communications Protocols Under Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 85-229, Report and Order, 2 FCC Rcd 3072, 3081, para. 65 (1987) (*Computer III Phase II Order*). *See also Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957–58, para. 106.

[533] *Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, GN Docket No. 80-756, Memorandum Opinion, Order, and Statement Of Principles, 95 FCC 2d 584, para. 16 (1983) (*Protocols Order*).

[534] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 9–11 (filed Sept. 19, 2008); Letter from Susanne A. Guyer, Senior Vice President, Federal Regulatory Affairs, Verizon, to Chairman Kevin J. Martin, FCC,
(continued….)

211. Consistent with the *Pulver.com Order* and the *Vonage Order*, we preempt any state efforts to impose "traditional 'telephone company' regulations" as they relate to IP/PSTN information services as inconsistent with our generally unregulated treatment of information services.[535] Of course, neither the *Vonage Order*, the *Pulver.com Order*, nor our actions here preempt state actions that are consistent with federal policy.[536] Moreover, as we describe below, we allow states to establish reciprocal compensation rates, pursuant to our methodology, including for IP/PSTN traffic.

212. Our classification of IP/PSTN traffic as "information service" traffic warrants clarification of the so-called "ESP exemption," subject to which enhanced service providers are relieved of certain access-charge obligations but are required to purchase necessary telecommunications inputs under applicable business-service tariffs. Parties have disputed the proper application of this exemption in the context of IP/PSTN traffic, with some arguing that any intercarrier compensation for such traffic should be based only on the TDM portion of the call (and that the point of presence at which the call is converted between IP and TDM format is therefore one "end point" of the call for jurisdictional purposes), others arguing that the ESP exemption simply does not apply to such traffic (and that the actual point of origination and point of termination are all that matter for compensation purposes, irrespective of where the call is converted between IP and TDM), and still others arguing that the ESP exemption removes all IP/PSTN traffic from the intercarrier compensation regime.

213. We hereby clarify that the ESP exemption does not apply to IP/PSTN traffic, and that such traffic is properly treated like other traffic for intercarrier compensation purposes. Adopted in 1983, the ESP exemption was based in significant part on the belief that ESPs – which generally relied on third-party private lines – would purchase necessary services directly from carriers under applicable business tariffs, eliminating the carriers' need to seek additional compensation via access charges.[537] The Commission reaffirmed this policy decision in 1997's *Access Charge Reform Order*.[538] There, the

(continued from previous page)

WC Docket No. 04-36, at 10–11 (filed Aug. 6, 2007); Letter from AT&T et al., to Chairman Kevin J. Martin, FCC, et al., WC Docket No. 04-36, CC Docket No. 01-92 at 2–3 (filed Aug. 6, 2008); VON Coalition *IP-Enabled Services NPRM* Comments at 3–16; AT&T *IP-Enabled Services NPRM* Comments at 13–17. We thus disagree with parties who suggest, in essence, that IP/PSTN services are no different than "basic" services. *See, e.g.*, Letter from Thomas Jones and Jonathan Lechter, Counsel for tw telecom et al., to Marlene H Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 99-68, 04-36, Attach. at 2 (filed Oct. 28, 2008) (tw telecom *et. al* Oct. 28, 2008 *Ex Parte* Letter). We note that whether a service is viewed by consumers as a possible substitute for a "basic" service is a distinct question from whether, as a matter of technology and the nature of the service offering, the service simply replaces the technology underlying a pre-existing basic service. Thus, our conclusion here is not inconsistent with the Commission's recognition that interconnected VoIP services increasingly are viewed by consumers as a substitute for traditional telephone services. *See, e.g.*, *LNP Order*, 22 FCC Rcd at 19547, para. 28.

[535] *Vonage Order*, 19 FCC Rcd at 22404; *see also Pulver.com Order*, 19 FCC Rcd at 3316, para. 15 ("We determine, consistent with our precedent regarding information services, that FWD is an unregulated information service and any state regulations that seek to treat FWD as a telecommunications service or otherwise subject it to public-utility type regulation would almost certainly pose a conflict with our policy of nonregulation.").

[536] For example, states are free to require contributions to state universal service or telecommunications relay service funds through methodologies that are consistent with federal policy. *See, e.g.*, Letter from Robert W. Quinn, Jr. Senior Vice President, Federal Regulatory, AT&T, to Chairman Kevin J. Martin, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 96-45 at 11–16 (filed July 23, 2008) (describing ways that states could require contributions to state universal service or telecommunications relay service funds in a manner that is consistent with federal policy).

[537] *See MTS and WATS Market Structure*, 97 F.C.C. 2d 682, 715 ¶ 83 (1983); *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 2 FCC Rcd 4305,4305 ¶ 3 (1987); *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd 2631, 2631 ¶ 2 n.8 (1988).

[538] *Access Charge Reform* et al., 12 FCC Rcd 15982, 16133 ¶ 345 (1997).

Commission restated its view that LECs were adequately compensated for the traffic they delivered to ESPs by virtue of the local exchange charges assessed on the ESPs and other local exchange customers.[539] This rationale, however, has no application in the IP/PSTN traffic context. In most cases, the ESP involved in an IP/PSTN communication is the facilities-based provider itself (e.g., a cable provider, wireline carrier, wireless broadband provider, or broadband-over-powerline provider). Moreover, in the context of IP-PSTN communications, the ESP is using the network not as an "end user" of some sort, but as just another communications carrier interconnecting with the PSTN. Under these circumstances, there is no basis for singling out IP-based providers for special treatment in the context of intercarrier charges. We therefore make clear that IP/PSTN is subject to intercarrier payments.[540]

214. Likewise, we do not believe there is any reason to adopt an IP-specific regime for identifying which intercarrier charges should apply to a given call during the transition period discussed herein. As with other forms of traffic, whether IP/PSTN traffic is properly characterized as "local," "intrastate toll," or "interstate toll" for compensation purposes depends on the actual origination and termination points of the communication (and not, for example, on the telephone numbers of the parties to a call where those numbers do not reflect the call's endpoints). This approach will ensure that carriers do not design their networks in a manner meant to game our interconnection rules by placing gateway facilities in locations that capitalize on differences in the applicable intercarrier payment obligations/entitlements rather than on principles sound network engineering. In any event, we emphasize that IP/PSTN traffic will be subject to the same transition plan applied herein to other traffic, such that the distinction between intra- and inter-state access will be eliminated by the close of Phase I, and all rates will be unified within each state will be unified by the close of Phase II.[541]

215. In sections 251 and 252 of the Act, Congress altered the traditional regulatory framework based on jurisdiction by expanding the applicability of national rules to historically intrastate issues and state rules to historically interstate issues.[542] In the *Local Competition First Report and Order*, the Commission found that the 1996 Act created parallel jurisdiction for the Commission and the states over interstate and intrastate matters under sections 251 and 252.[543] The Commission and the states "are to address the same matters through their parallel jurisdiction over both interstate and intrastate matters under sections 251 and 252."[544] Moreover, section 251(i) provides that "[n]othing in this section shall be

---

539 *See id.* at 363-64 ¶ 346.

540 As a consequence of these holdings, ISPs involved in the provision of IP/PSTN traffic will be precluded from purchasing telecommunications as local end users. Rather, these providers will continue to obtain interconnection with the PSTN via agreements with competitive LECs or IXCs, as they currently do. The the extent an IXC delivers the traffic to a terminating provider on the PSTN, it would be subject to access charges, as with other traffic delivered from an IXC to a terminating carrier. To the extent a competitive LEC delivered the traffic, the terminating carrier could bill the competitive LEC for access in the case of toll traffic or for reciprocal compensation in the case of local traffic.

541 Although we effectuate our decisions here via rule changes where necessary, we note that even if such rule changes were for some reason impermissible, we would forbear from the ESP exemption as necessary to put in place the regime described above. For the reasons described in the text, any application of the ESP exemption to the intercarrier compensation framework that treated some steams of traffic differently than others based merely on the fact that they began (or terminated) in IP format, or on the location at which the conversion between IP and TDM format took place would not be necessary to ensure that rates and terms remain just and reasonable, to protect consumers, or to further the public interest. *See* 47 U.S.C. § 160.

542 *See Local Competition First Report and Order*, 11 FCC Rcd at 15544, para. 83.

543 *Local Competition First Report and Order*, 11 FCC Rcd at 15544–45, para. 85.

544 *Local Competition First Report and Order*, 11 FCC Rcd at 15546–47, para. 91.

construed to limit or otherwise affect the Commission's authority under section 201."[545] The Commission concluded that section 251(i) "affirms that the Commission's preexisting authority under section 201 continues to apply for purely interstate activities."[546]

216. In implementing sections 251 and 252 in the *Local Competition First Report and Order*, the Commission's treatment of LEC-CMRS traffic provides an instructive approach. Prior to the 1996 Act, the Commission expressly preempted "state and local regulations of the kind of interconnection to which CMRS providers are entitled" based on its authority under section 201 and 332 of the Act.[547] Nevertheless, in the *Local Competition First Report and Order*, the Commission brought LEC-CMRS interconnection within the section 251 framework as it relates to intraMTA (including interstate intraMTA) traffic.[548] The Commission recognized, however, that it continued to retain separate authority over CMRS traffic.[549]

217. Courts confirmed that, in permitting LEC-CMRS interconnection to be addressed through the section 251 framework, the Commission did not in any way lose its independent jurisdiction or authority to regulate that traffic under other provisions of the Act. Thus, although the Eighth Circuit invalidated the Commission's TELRIC pricing rules in general,[550] it recognized that "because section 332(c)(1)(B) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers, [including the reciprocal compensation rules] but only as these provisions apply to CMRS providers. Thus, [the pricing] rules . . . remain in full force and effect with respect to the CMRS providers, and our order of vacation does not apply to them in the CMRS context."[551] Subsequently, the D.C. Circuit held that CMRS providers were entitled to pursue formal complaints under section 208 of the Act for violations of the Commission's reciprocal compensation rules.[552]

218. We build upon our actions in the *Local Competition First Report and Order*, and now permit states to establish a uniform reciprocal compensation rate, in accordance with the new methodology we establish in this order, pursuant to the section 251(b)(5) and 252(d)(2) framework. In particular, section 251(b)(5) imposes on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[553] Section 252(d)(2)(A) sets forth an "additional costs" standard that state commissions, in arbitrating interconnection disputes involving incumbent LECs, should apply in setting the "charges for transport and termination of

[545] 47 U.S.C. § 251(i).

[546] *Local Competition First Report and Order*, 11 FCC Rcd at 15546–47, para. 91.

[547] *Implementation of Sections 3(n) and 332*, Second Report and Order, 9 FCC Rcd 1411, 1498, para. 230 (1994).

[548] *See Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023.

[549] *Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023 ("By opting to proceed under sections 251 and 252, we are not finding that section 332 jurisdiction over interconnection has been repealed by implication, or rejecting it as an alternative basis for jurisdiction.").

[550] We note that the Supreme Court later reversed this decision and affirmed the TELRIC methodology. *See Verizon v. FCC*, 535 U.S. at 467.

[551] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (*Iowa Utils. I*), *rev'd in part and remanded on other grounds*, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366.

[552] *Qwest Corp. v. FCC*, 252 F.3d 462, 465–66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. I* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion).

[553] 47 U.S.C. § 251(b)(5).

traffic."[554] Although we allow states to set new uniform termination rates under this framework, pursuant to our methodology, we retain our authority under section 201 to find that reciprocal compensation charges are unjust and unreasonable as they relate to interstate, CMRS, and IP/PSTN traffic within our jurisdiction.[555] We expect that states will faithfully implement the pricing standards adopted in this order, and thus it will not be necessary for us to exercise that authority.[556]

219. The Commission unquestionably has authority to interpret and adopt rules implementing sections 251(b)(5) and 252(d)(2). Congress delegated to the Commission the task of administering the Communications Act. Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[557] "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'"[558] The Commission's rulemaking authority is not limited to interstate matters; it extends to all provisions of the Communications Act.[559]

220. In addition, we find that the section 251(b)(5) and 252(d)(2) framework is broad enough to facilitate our intercarrier compensation reform. We acknowledge that, in the *Local Competition First Report and Order*, the Commission found that section 251(b)(5) applies only to local traffic,"[560] and some commenters continue to press for such an interpretation.[561] As other commenters recognize, however, the Commission, in the *ISP Remand Order*, reconsidered that judgment and concluded that it was a mistake

---

[554] 47 U.S.C. § 252(d)(2)(A).

[555] *See supra* paras. 208–14. *See also, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92 at 9–11 (filed on Aug. 18, 2008) (Level 3 Aug. 18, 2008 *Ex Parte* Letter). Contrary to Verizon's claims, we thus find no tension between permitting states to set reciprocal compensation rates for interstate traffic under the section 251 and 252 framework and the Commission's continuing authority over traffic subject to its jurisdiction, including section 201 authority expressly preserved under section 251(i).

[556] We recognize that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking." *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and *Order*, 12 FCC Rcd 16606, 16619–20, para. 44 (*Access Charge Reform Second Order*) (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)). In this order, we adopt an incremental cost methodology for setting termination rates. We find that the proper application of that methodology produces rates that are "just and reasonable" under section 201. As discussed below, we find it appropriate to adopt a transition before carriers begin charging rates set pursuant to our incremental cost methodology.

[557] 47 U.S.C. § 201(b) ("The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.").

[558] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378.

[559] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

[560] *Local Competition First Report and Order*, 11 FCC Rcd at 16012–13, para. 1033.

[561] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24–32; Letter from Daniel Mitchell, Vice President, Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9 (filed Sept. 30, 2008) (NCTA Sept. 30, 2008 *Ex Parte* Letter); Verizon *ICC FNPRM* Comments at 38–42; NARUC *ICC FNPRM* Comments at 6–7; Rural Alliance *ICC FNPRM* Comments at 144–49; Cincinnati Bell *ICC FNPRM* Comments at 5–11; Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7; New York State PSC *ICC FNPRM* Comments at 7; Verizon and BellSouth, Supplemental White Paper on ISP Reciprocal Compensation, CC Docket No. 96-98, 99-68 at 16–20 (filed July 20, 2004) (Verizon/BellSouth Supp. ISP White Paper); NARUC's Initial Comments at 7 n.13 (May 23, 2004). *But see, e.g.*, ICF *ICC FNPRM* Comments at 39.

to read section 251(b)(5) as limited to local traffic, given that "local" is not a term used in section 251(b)(5).[562] We recognize, as the Supreme Court noted in *AT&T Corp. v. Iowa Utilities Board*, that "[i]t would be a gross understatement to say that the 1996 Act is not a model of clarity."[563] Nevertheless, we find that the better view is that section 251(b)(5) is not limited to local traffic.

221. We begin by looking at the text of the statute. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[564] The Act broadly defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[565] Its scope is not limited geographically ("local," "intrastate," or "interstate") or to particular services ("telephone exchange service,"[566] telephone toll service,"[567] or "exchange access"[568]). We find that the traffic we elect to bring within this framework fits squarely within the meaning of "telecommunications."[569] Had Congress intended to preclude the Commission from bringing certain types of telecommunications traffic within the section 251(b)(5) framework, it could have easily done so by incorporating restrictive terms in section 251(b)(5). Because Congress used the term "telecommunications," the broadest of the statute's defined terms, we conclude that section 251(b)(5) is not limited only to the transport and termination of certain types of telecommunications traffic, such as local traffic.

222. In the *Local Competition First Report and Order* the Commission concluded that section 251(b)(5) applies only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge."[570] In the *ISP Remand Order*, the Commission reversed course on the scope of section 251(b)(5), finding that "the phrase 'local traffic' created unnecessary ambiguities, and we

[562] *ISP Remand Order*, 16 FCC Rcd at 9166–67, para. 35. *See also, e.g.*, Qwest, Legal Authority for Comprehensive Intercarrier Compensation Reform at 2–4, *attached to* Letter from Melissa Newman, Counsel for Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 06-45, 99-68, WC Docket Nos. 04-36, 05-337, 05-195, 06-122 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Counsel for T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9–10 (filed Oct. 3, 2008); Level 3 Aug. 18, 2008 *Ex Parte* Letter at 2, 15–18; AT&T *Missoula Phantom Traffic* Reply at 35–41; Brief from Gary M. Epstein, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 29–35 (filed Oct. 5, 2004)

[563] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 397.

[564] 47 U.S.C. § 251(b)(5).

[565] 47 U.S.C. § 153(43).

[566] *Id.* at § 153(47).

[567] *Id.* at § 153(48).

[568] *Id.* at § 153(16).

[569] As discussed above, we classify IP/PSTN services as "information services." We note, however, that information services, by definition, are provided "via telecommunications," enabling us to bring IP/PSTN traffic within the section 251(b)(5) framework. 47 U.S.C. § 153(20). Moreover, given that we retain independent authority under section 201, we find it reasonably ancillary to that authority to regulate IP/PSTN services in this regard, consistent with our efforts to ensure uniform treatment of all traffic on the PSTN for intercarrier compensation purposes. Thus, ~~IP/PSTN traffic ultimately will be subject to the final uniform reciprocal compensation rates established pursuant to the methodology adopted in this order. We maintain the status quo for this traffic during the transition, however~~we clarify here that during the transition period, IP/PSTN traffic will be subject to the same intercarrier compensation requirements that apply to other traffic traversing the PSTN. We discuss these issues at greater length above.

[570] *Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033.

correct that mistake here."[571] The *ISP Remand Order* noted that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)."[572] The Commission found that the scope of section 251(b)(5) is limited only by section 251(g), which temporarily grandfathered the pre-1996 Act rules governing "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers until "explicitly superseded by regulations prescribed by the Commission."[573] On appeal, the D.C. Circuit left intact the Commission's findings concerning the scope of section 251(b)(5), although it took issue with other aspects of the *ISP Remand Order*.[574]

223. We agree with the finding in the *ISP Remand Order* that traffic encompassed by section 251(g) is excluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope. Section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation."[575] There would have been no need for Congress to have preserved these compensation rules against the effects of section 251 if the scope of section 251(b)(5) was not broad enough for the Commission to bring within its scope the traffic covered by section 251(g), i.e., access traffic. Because Congress is presumed not to have wasted its breath, particularly with a provision as lengthy and detailed as section 251(g), we find that section 251(g) confirms that section 251(b)(5) applies to the transport and termination of all telecommunications traffic exchanged with LECs, including ISP-bound traffic. And because section 251(g) "is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act,"[576] we clearly have authority under the Act to adopt regulations superseding that regime. We exercise that authority today.[577]

224. By placing all traffic under the umbrella of one compensation scheme, we eliminate jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions.[578] Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis. These artificial distinctions distort the telecommunications markets at the expense of healthy competition. Similar types of traffic should be subject to similar rules. Similar types of functions should be subject to similar cost recovery mechanisms. We achieve that result by moving away from the regime preserved by section 251(g) and bringing that traffic within the section 251(b)(5) framework.

225. We disagree with commenters who argue that section 251(b)(5) only can be applied to

---

[571] *ISP Remand Order*, 16 FCC Rcd at 9173, para. 46.

[572] *ISP Remand Order*, 16 FCC Rcd at 9167, para. 34.

[573] 47 U.S.C. § 251(g).

[574] *See WorldCom*, 288 F.3d at 429.

[575] 47 U.S.C. 251(g).

[576] *WorldCom*, 288 F.3d at 430.

[577] Verizon notes that although the Commission in the *ISP Remand* Order deleted the word "local" from its regulations governing reciprocal compensation, the regulations continued to exclude access services from the scope of section 251(b)(5). *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24–32; 47 C.F.R. § 51.701(b)(1). At that time, it made sense to retain the access exemption because the Commission had not issued rules superseding the access regime preserved by section 251(g). We supersede the grandfathered access regime in this order, at least in part.

[578] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 12.

traffic exchanged between LECs, and not traffic exchanged between a LEC and another carrier.[579] The Commission rejected that argument in the *Local Competition Order*, finding that section 251(b)(5) applies to traffic exchanged by a LEC and any other telecommunications carrier, and adopted rules implementing that finding.[580] In a specific application of that principle, the Commission concluded that "CMRS providers will not be classified as LECs,"[581] but nevertheless found that "LECs are obligated, pursuant to section 251(b)(5) (and the corresponding pricing standards of section 252(d)(2)), to enter into reciprocal compensation agreements with all CMRS providers."[582] No one challenged that finding on appeal, and it has been settled law for the past 12 years. We see no reason to revisit that conclusion now. Although section 251(b)(5) indisputably imposes the duty to establish reciprocal compensation arrangements on LECs alone, Congress did not limit the class of potential beneficiaries of that obligation to LECs.[583]

226. We also disagree with commenters who argue that section 252(d)(2)(A)(i) limits the scope of section 251(b)(5).[584] Section 252(d)(2)(A)(i) provides that a state commission "shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless "such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[585] Verizon and others argue that this provision necessarily

---

[579] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments ("The best interpretation of § 251(b)(5) – read in light of the text, structure, and history of the 1996 Act – is that the reciprocal compensation obligation applies only to intraexchange (or 'local') voice calls that originate on the network of one LEC (or wireless provider) and terminate on the network of another LEC (or wireless provider) operating in the same exchange (or, in the case of wireless providers, the same MTA."); Verizon and BellSouth, Internet-Bound Traffic is Not Compensable Under Sections 251(b)(5) and 252(d)(2) at 26 (Verizon/BellSouth ISP White Paper) ("By its nature, 'reciprocal compensation' must . . . apply to 'telecommunications' exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs."), *attached to* Letter from Ann D. Berkowitz, Associate Director, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 (filed May 17, 2004).

[580] *See Local Competition First Report and Order*, 11 FCC Rcd at 16013–16, paras. 1034–41. *See also* 47 C.F.R. 51.703(a) ("Each LEC shall establish reciprocal compensation arrangements for transport and termination of telecommunications traffic with any requesting telecommunications carrier."); *ISP Remand Order*, 16 FCC Rcd at 9193–94, para. 89 n.177 ("Section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier . . . .").

[581] *Local Competition First Report and Order*, 11 FCC Rcd at 15996, para. 1005. In this regard, we note that, absent a determination that CMRS providers are LECs, IXC-CMRS traffic would not be encompassed by section 251(b)(5), since neither are LECs. Nevertheless, it is our intention that, at the end of the transition, CMRS providers be entitled to reciprocal compensation for all the traffic they terminate. As the Commission has observed, "[t]here are three ways in which a carrier seeking to impose charges on another carrier can establish a duty to pay such charges: pursuant to (1) Commission rule; (2) tariff; or (3) contract." *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges, Declaratory Ruling*, 17 FCC Rcd 13192, 13196, para. 8 (2002).

[582] *Local Competition First Report and Order*, 11 FCC Rcd at 15997, para. 1008.

[583] If Congress had intended to limit the class of potential beneficiaries of LECs' duty to establish reciprocal obligation arrangements, it would have said so explicitly. *See* 47 U.S.C. § 251(b)(3) (describing the "duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service").

[584] *See, e.g.*, Verizon/BellSouth ISP White Paper at 41–43; New York State PSC *ICC FNPRM* Comments at 8–9; TDS *ICC FNPRM* Comments at 19 n.27; Qwest *ICC FNPRM* Comments at 39; NASUCA *ICC FNPRM* Reply at 17–18.

[585] 47 U.S.C. § 252(d)(2)(A)(i).

excludes interexchange traffic from the scope of section 251(b)(5) because at the time the 1996 Act was passed, calls neither originated nor terminated on an IXC's network.[586] We reject this reasoning because it erroneously assumes that Congress intended the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5). We do not believe that Congress intended the tail to wag the dog.

227. Section 251(b)(5) defines the scope of traffic that is subject to reciprocal compensation. Section 252(d)(2)(A)(i), in turn, deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies. Section 252(d)(2)(A)(i) provides that, at a minimum, a reciprocal compensation arrangement must provide for the recovery by each carrier of costs associated with the transport and termination on each carrier's network of calls that originate on the network of the other carrier.[587] Section 252(d)(2)(A)(i) does not address what happens when carriers exchange traffic that originates or terminates on a third carrier's network. This does not mean, as Verizon suggests, that section 251(b)(5) must be read as limited to traffic involving only two carriers. Rather, it means that there is a gap in the pricing rules in section 252(d)(2), and the Commission has authority under section 201(b) to adopt rules to fill that gap.

228. We reject Verizon's argument that a telecommunications carrier that delivers traffic to an ISP is not eligible for reciprocal compensation because the carrier does not "terminate" telecommunications traffic at the ISP.[588] In the *Local Competition Order*, the Commission defined "termination" as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises."[589] As the D.C. Circuit suggested in the *Bell Atlantic* decision, "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"[590] We agree.[591] Consequently, ISP-bound traffic is subject to our new intercarrier compensation framework.[592]

---

[586] *See, e.g.*, Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7–8; New York State PSC *ICC FNPRM* Comments at 7–10; Verizon/BellSouth Supp. ISP White Paper at 16–20; NARUC *ICC FNPRM* Comments at 7 n.13.

[587] 47 U.S.C. § 252(d)(2)(A)(i).

[588] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 33–34; Verizon/BellSouth ISP White Paper at 31–32.

[589] *Local Competition First Report and Order*, 11 FCC Rcd at 16015, para. 1040. *See also* 47 C.F.R. § 51.701(d).

[590] 206 F.3d at 6.

[591] Because ISP-bound traffic did not fall within the section 251(g) carve out from section 251(b)(5) as "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic," *WorldCom*, 288 F.3d at 433, ISP-bound traffic is, and always has been, subject to section 251(b)(5), although clearly interstate in nature and subject to our section 201 authority.

[592] We reject Verizon's argument against the application of section 251(b)(5) to ISP-bound traffic because this traffic is one-way traffic and as such is not reciprocal. *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 41–43. As Level 3 points out, these arguments have been rejected by the Commission and the U.S. Court of Appeals for the Ninth Circuit. *See* Level 3 Aug. 18, 2008 *Ex Parte* Letter at 18; *Pacific Bell v. Cook Telecom, Inc.*, 197 F.3d 1236, 1242–44 (9th Cir. 1999) (reciprocal compensation applies to paging traffic); *TSR Wireless, LLC v. U.S. West Commc'ns, Inc.*, 15 FCC Rcd 11166, 11178, para. 21 (2000) (the Commission's reciprocal compensation rules draw "no distinction between one-way and two-way carriers"). Because our conclusion in this order concerning the scope of section 251(b)(5) is no longer tied to whether this traffic is local or long distance, we need not address arguments made by the parties as to whether ISP-bound traffic constitutes "telephone exchange service" under the Act. *See, e.g.*, Letter from John T. Nakahata, Counsel for Level

(continued….)

229. We reject opponents' other arguments that the context and history of the 1996 Act compel a finding that section 251(b)(5) could not be applied to access traffic. Verizon argues, for example, that section 251(g) demonstrates that Congress did not intend to displace the existing access pricing regime.[593] This argument ignores that Congress preserved the access regime only "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[594] As noted above, we find that section 251(g) actually supports a finding that section 251(b)(5) is broad enough to cover access traffic. Verizon also argues that the reference to reciprocal compensation in the competitive checklist in section 271,[595] which was designed to ensure that local markets are open to competition, somehow shows that Congress intended to limit the scope of section 251(b)(5) to local traffic.[596] We do not see how this argument sheds any light on the scope of section 251(b)(5). Congress no doubt included the reference to reciprocal compensation in section 271 because section 251(b)(5) applies to local traffic, a point that no one disputes. That does not suggest, however, that section 251(b)(5) applies *only* to local traffic.

230. We need not respond to every other variation of the argument that the history and structure of the Act somehow demonstrate that section 251(b)(5) does not apply to access traffic. At best, these arguments show that one plausible interpretation of the statute is that section 251(b)(5) applies only to local traffic, a view that the Commission embraced in the *Local Competition First Report and Order*. These arguments do not persuade us, however, that this is the only plausible reading of the statute. Moreover, many of the same arguments based on the history and context of the adoption of section 251 to limit its scope to local traffic were rejected by the D.C. Circuit in the context of section 251(c).[597] We find that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2).

231. The approach we adopt here provides a sound basis for comprehensive reform, and we thus decline to adopt alternative proposals. On one hand, we note that some commenters advocate that the Commission adopt an intercarrier compensation rate or cap of $0.0007 per minute of use for all traffic.[598] To implement this reform proposal, parties have suggested that it would likely be necessary for

(continued from previous page)
3 Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 1 (filed Sept. 24, 2004). We note, however, that we retain our interim ISP-bound traffic rules. *See supra* paras. 198–205.

[593] *See* Verizon *ICC FNPRM* Comments at 41.

[594] 47 U.S.C. § 251(g).

[595] *See* 47 U.S.C. § 271(c)(2)(B)(xiii).

[596] *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 9.

[597] *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) (*USTA II*) ("Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not 'telecommunications services' has no support."). In *USTA II*, the D.C. Circuit was addressing whether the term "telecommunications services" was limited to local telecommunications services under section 251(c), while here we consider the analogous question of whether "telecommunications" is limited to local telecommunications under section 251(b).

[598] *See, e.g.*, Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. A at 1 (filed Oct. 6, 2008); Letter from Teresa D. Bauer and Richard R. Cameron, Counsel for Global Crossing North America, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 18, 2008); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Kevin Martin et al., Commissioners, FCC, CC Docket. 01-92 at 4 (filed Sept. 12, 2008) (Verizon Sept. 12, 2008 *Ex Parte* Letter). *But see, e.g.*, Letter from Richard A. Askoff, Executive Director—Regulatory, NECA, to Marlene

(continued….)

the Commission to preempt state regulation of intrastate access charges.[599] We believe that such a significant step is not currently warranted, and elect instead to allow states to continue setting rates for intrastate traffic, as well as permitting them to set rates for traffic subject to federal jurisdiction, pursuant to our methodology. We fully expect the new pricing methodology to achieve the goals of our continuing intercarrier compensation reform. On the other hand, some parties contend that the Commission should leave matters of intrastate intercarrier compensation reform entirely to the states.[600] These proposals evidence a pre-1996 Act worldview, however. Given the tools that the 1996 Act put at our disposal, we find it possible to move forward with truly comprehensive intercarrier compensation reform under an approach which still provides for a state role.

232. We note that, in the *Local Competition First Report and Order*, the Commission observed that section 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such charges were prohibited under that provision of the Act.[601] Because we elect to have the states set rates under section 251(b)(5), pursuant to our methodology, we find that retention of originating charges would be inconsistent with that statutory scheme and our new regulatory approach. Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated at the conclusion of the transition to the new regime. We recognize, however, that changes to originating access charge rates may raise issues distinct from terminating charges. Moreover, several parties urge the Commission to delay any changes to originating charges.[602] For these reasons, we ask parties to comment on the appropriate transition for eliminating originating access charges in the accompanying Further Notice.[603] Although we

(continued from previous page)
H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Oct. 7, 2008) ("Prescription of a nationwide uniform default rate of $0.0007 is unnecessary to solve the rate arbitrage problems identified by Verizon. It would also represent bad policy."); Letter from Lawrence Zawalick, Senior Vice President, Rural Telephone Finance Cooperative, to Kevin Martin et al., Commissioners, FCC, CC Docket 01-92 at 1 (filed Sept. 30, 2008) ("The Rural Telephone Finance Cooperative (RTFC) strongly opposes [the $0.0007] proposal.").

[599] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 14–25 (filed Sept. 19, 2008) (Verizon Sept. 19, 2008 *Ex Parte* Letter).

[600] In some cases, parties propose that the Commission make available universal service support as an "enticement" for states to reform intrastate rates, but ultimately the decisions would be left to the individual states. *See* Letter from Tom Karalis, Counsel for Rural Alliance, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Sept. 26, 2008).

[601] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042. *See also* 47 C.F.R. § 51.703(b) (stating that a "LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network").

[602] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter at 5 (asking the Commission to defer reform of originating access); Letter from Grace E. Kohl, Policy Counsel, Cox, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, CC Docket Nos. 96-45, 01-92, 99-68, 96-262 at 2 (filed Oct. 6, 2008) (supporting proposals to delay reform of originating access) (Cox Oct. 6, 2008 *Ex Parte* Letter); Letter from Brian Benison, Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 05-337, 07-135, Attach. at 3 (filed Oct. 7, 2008) (describing model with "No Change to Current Structure and Rates" for originating access); Letter from Kathleen O'Brien Ham, Federal Regulatory Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 5 (filed Oct. 3, 2008); *cf.* Letter from Mary C. Albert, Assistant General Counsel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, Attach. at 1 (filed Oct. 2, 2008) (urging the Commission to delay any changes to intercarrier compensation). *But see* Letter from Anna M. Gomez, Vice President, Government Affairs, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 7 (filed Oct. 1, 2008) (urging the Commission to reform originating access immediately) (Sprint Oct. 1, 2008 *Ex Parte* Letter).

[603] *See infra* para 346.

ask parties to comment on the appropriate transition for eliminating originating access charges, we clarify that, under the transitional mechanism we adopt today, carriers are not permitted to increase any of their current rates, including their originating access rates.[604] Thus, both interstate and intrastate originating switched access rates will remain capped at current levels until further action by the Commission addressing the appropriate transition for this traffic. This approach is consistent with our transition of terminating rates[605] and with our goal of eliminating originating access charges at the conclusion of the transition to the new regime. Nevertheless, we also emphasize that originating access rates are a valid and lawful feature of the current interconnection framework, and will remain so until the end of the transition period contemplated herein. Consistent with the appended Further Notice, we intend to scrutinize closely the difficult issues surrounding the elimination of originating access charges. While we do not prejudge any of those issues, we recognize that the elimination of such charges might raise questions concerning the recovery of lost revenues and could necessitate the simultaneous implementation of other requirements to minimize harm to consumers.

b. Legal Authority for the Transition

233. Although we comprehensively reform intercarrier compensation, we do not flash cut to our new regime, but provide for a measured transition.[606] The goal of this transition is to avoid overly rapid rate changes for consumers while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.[607] For many of the same reasons that we have authority to adopt comprehensive reform, we find that the Commission has clear authority to establish such a transitional structure to serve as a glide path to the new methodology we have developed in this order.

234. We find it reasonable to adopt a transition plan under these circumstances. As the D.C. Circuit has recognized, avoiding "market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule,"[608] and here temporary rules setting forth a glide path are needed to mitigate potentially adverse rate or revenue effects that may be caused by our comprehensive intercarrier compensation reform, including the elimination of implicit universal service subsidies in those rates. Therefore, the Commission's exercise of its authority to create a transition plan is especially appropriate here, where the Commission is acting to reconcile the Act's "implicit tension between . . . moving toward cost-based rates and protecting universal service."[609] Not surprisingly, most commenters

---

[604] This prohibition on increasing access rates also applies to the Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, and the per-minute Residual Interconnection Charge in section 69.155 of the Commission's rules. 47 C.F.R. §§ 69.153, 69.154, 69.155.

[605] *See supra* paras. 194–95 (prohibiting carriers from increasing their current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates).

[606] *See supra* section V.B.2.

[607] This approach is consistent with Commission precedent set forth in Part V.A, which started reforming intercarrier compensation in the 1980s. There the Commission found that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end-user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act." *1983 Access Charge Order*, 93 FCC 2d at 243, para. 4. As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[608] *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002).

[609] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

have affirmatively recognized the need for a transitional regime.[610] Indeed, every major plan submitted to us in this proceeding, whether the Missoula plan,[611] the ICF plan,[612] Verizon's plan,[613] AT&T's plan,[614] or the plan from CBICC,[615] ARIC,[616] NARUC,[617] or NASUCA,[618] has called for the Commission to establish an orderly transition period. We take heed of these commenters and of our statutory responsibilities to ensure a smooth transition to the new regime by setting forth a multi-stage transition plan as part of our comprehensive reform of intercarrier compensation.

235. Moreover, we have several independent sources of legal authority to adopt the transition plan established in this order. For one, section 251 explicitly contemplates our authority to adopt a transitional scheme with regard to access charges. We agree with the United States Court of Appeals for the District of Columbia Circuit that section 251(g) created a "transitional enforcement mechanism"[619] preserving the access charge regimes that pre-dated the 1996 Act "until . . . explicitly superseded by regulations *prescribed by the Commission*."[620] Thus, section 251(g), by its terms, anticipates that the

---

[610] *See, e.g.*, BellSouth *ICC FNPRM* Comments at 17 ("In order to avoid the market disruption and dislocation that would be associated with instantaneous implementation of a unified plan, BellSouth proposes a two-phase transition plan."); CCG *ICC FNPRM* Comments at 2 ("Any plan that reduces access rates should be phased-in over as long a period as possible, at least for rural carriers, so these companies have time to prepare for and adjust to the economic impact."); Cincinnati Bell *ICC FNPRM* Comments at 12 ("The Commission must allow carriers the opportunity to earn this lost access revenue in the transition to a new compensation regime in order to make any regime change revenue neutral to the affected carriers."); CCAP *ICC FNPRM* Comments at 23 ("The CCAP believes that any reform of the existing intercarrier compensation regimes should take place over a three-to-five-year period . . . .").

[611] Missoula Plan, Executive Summary at 3 ("Recognizing the vast differences among carriers, the Plan creates three different transition schedules for intercarrier compensation rates.").

[612] Letter from Gary M. Epstein and Richard R. Cameron, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 2 at 3 (filed Aug. 16, 2004).

[613] Verizon Sept. 12, 2008 *Ex Parte* Letter at 9–10.

[614] Letter from Henry Hultquist, Federal Regulatory Vice-President, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach 1 at 4 (filed July 17, 2008).

[615] Letter from Richard M. Rindler, Counsel for CBICC, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 2.

[616] ARIC *ICC FNPRM* Comments, Attach. 1 at 33.

[617] NARUC *ICC FNPRM* Comments, Attach. C at 6.

[618] Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 1 (filed Dec. 14, 2004).

[619] *WorldCom*, 288 F.3d at 433.

[620] 47 U.S.C. § 251(g) (emphasis added). At the least, section 251(g) preserved the interstate access regime the Commission had prescribed for all carriers (*see id.* (preserving "obligations (including receipt of compensation) . . . under any . . . regulation, order, or policy of the Commission . . . .")) and the intrastate access regime the Bell Operating Companies had agreed to in the Modified Final Judgment. *See United States v. AT&T*, 552 F. Supp. at 169. Recognizing, however, that it would be "'incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms,'" the Commission has consistently interpreted section 251(g) to preserve the intrastate access regime pre-dating the Act for all carriers. *ISP Remand Order*, 16 FCC Rcd at 9168 n.66 (quoting *Local Competition First Report and Order*, 11 FCC Rcd at 15869, para. 732); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) ("[I]t is clear from the Act that Congress did not intend all access charges to move to cost-based pricing, at least not immediately. The Act plainly preserves certain rate regimes already in place.").

Commission may take action to end the regimes grandfathered by section 251(g), and inherent within the power to supersede the grandfathered access regime is the lesser power to prescribe regulations that determine *how* to transition to a cost-based pricing mechanism—a power that we have twice employed in the past to reduce access charges without explicitly superseding that regime.[621]

236. In addition, as the Supreme Court has further held, the Commission has authority to prescribe the requisite pricing methodology that the States will apply in setting rates under section 252(d)(2).[622] Consistent with our authority, the Commission here is providing for a transitional regime in the public interest to smooth the transition to the new pricing standard adopted by this order. The goal of this transition is to allow gradual changes to consumer rates while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.

237. Significantly, as discussed in greater detail above, although we elect to rely on the sections 251(b)(5) and 252(d)(2) framework for reform, that does not affect the Commission's jurisdiction over traffic or services otherwise subject to federal authority.[623] With respect to interstate services, the Act has long provided us with the authority to establish just and reasonable "charges, practices, classifications, and regulations."[624] The Commission also has authority over the rates of CMRS providers pursuant to section 332 of the Act.[625] The Commission thus retains full authority to adopt transition plans for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework. Because we re-affirm our findings concerning the interstate nature of ISP-bound traffic, it follows that such traffic falls under the Commission's section 201 authority preserved by the Act.[626] This conclusion is reinforced by section 251(i) of the Act. As the Commission explained in the

---

[621] *See MAG Order*, 16 FCC Rcd 19613 (reducing interstate access charges for rate-of-return carriers); *CALLS Order*, 15 FCC Rcd 12962 (reducing interstate access charges for price-cap carriers), *aff'd in relevant part by Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d at 324 (reasoning that because the Commission had not yet superseded the pre-Act interstate access regime, it retained authority under section 201(b) to set just and reasonable rates for interstate access); *see also WorldCom*, 288 F.3d at 433 ("We will assume without deciding that under § 251(g) the Commission might modify LECs' pre-Act 'restrictions' or 'obligations,' pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption . . . .").

[622] *AT&T v. Iowa Utils. Bd*., 525 U.S. at 384; *see also id*. at 378 ("The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252, added by the Telecommunications Act of 1996.")

[623] *See supra* section V.B.3.

[624] 47 U.S.C. § 201(b).

[625] 47 U.S.C. § 332.

[626] We have consistently found that ISP-bound traffic is jurisdictionally interstate. ISP-bound traffic melds a traditional circuit-switched local telephone call over the PSTN to packet switched IP-based Internet communication to Web sites. *Declaratory Ruling*, 14 FCC Rcd at 3702, para. 18; *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. This conclusion has not been questioned by the D.C. Circuit. *See WorldCom*, 288 F.3d at 431; *Bell Atlantic v. FCC*, 206 F.3d at 5 ("There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate"). In other contexts, the Commission has likewise found that services that offer access to the Internet are jurisdictionally interstate services. In 1998, for example, the Commission found that ADSL service is jurisdictionally interstate. *See GTE Tel. Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22481, para. 28 (1998) ("finding that GTE's ADSL service is subject to federal jurisdiction" and is "an interstate service"). More recently, the Commission has confirmed this ruling for a variety of broadband Internet access services. *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4832, para. 59 (2002) (finding that, "on an end-to-end analysis," "cable modem service is an interstate information service"); *Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14914, para. 110, *aff'd by Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs.* (*Brand X*), 545 U.S. 967 (2005); *Appropriate Regulatory Treatment for Broadband Access*

(continued….)

ISP Remand Order, section 251(i) "expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[627] It concluded that section 251(i), together with section 201, equips the Commission with the tools necessary to keep pace with regulatory developments and new technologies.[628] When read together, these statutory sections preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic. Consequently, in the *ISP Remand Order*, the Commission properly exercised its authority under section 201(b) to issue interim pricing rules governing the payment of compensation between carriers for ISP-bound traffic.[629]

238. This result is consistent with the D.C. Circuit's opinion in *Bell Atlantic*, which concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under section 251(b)(5).[630] It is also consistent with the court's *WorldCom* decision, in which the court rejected the Commission's view that section 251(g) excluded ISP-bound traffic from the scope of section 251(b)(5), but made no other findings.[631] Finally, this result does not run afoul of the Eighth Circuit's decision on remand from the Supreme Court in the *Iowa Utilities Board* litigation, which held that "the FCC does not have the authority to set the actual prices for the state commissions to use" under section 251(b)(5).[632] At the time of that decision, under the *Local Competition First Report and Order*, section 251(b)(5) applied only to local traffic. Thus, the Eighth Circuit merely held that the Commission could not set reciprocal compensation rates for local traffic. The court did not address the Commission's authority to set reciprocal compensation rates for interstate traffic.[633] In sum, the Commission plainly has authority to establish pricing rules for interstate traffic, including ISP-bound traffic, under section 201(b), and that authority was preserved by section 251(i).

4. Additional Costs Standard

239. We now turn to reconsideration of our "additional costs" standard for implementing

(continued from previous page)
to the Internet Over Wireless Networks, WT 07-53, Declaratory Ruling, 22 FCC Rcd 5901, 5911, para. 28 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, WC 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281, 13288, para. 11 (2006). In the *Vonage Order*, the Commission likewise found that VoIP services are jurisdictionally interstate, employing the same end-to-end analysis reflected in those other orders. *Vonage Order*, 19 FCC Rcd at 22413–14, paras. 17–18.

[627] *ISP Remand Order*, 16 FCC Rcd at 9174, para. 50.

[628] *See ISP Remand Order*, at 9175, para. 51.

[629] We thus respond to the D.C. Circuit's remand order in *WorldCom*, 288 F.3d at 434, and the court's writ of mandamus in *Core Communications*, 531 F.3d at 861–62, which directed the Commission to explain its legal authority to issue the interim pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*. Specifically, we find, for the reasons set forth above and in Part V.B.3, that the Commission had the authority to adopt the interim pricing regime pursuant to our broad authority under section 201(b) to issue rules governing interstate traffic.

[630] *See Bell Atlantic*, 206 F.3d at 5.

[631] *See WorldCom*, 288 F.3d at 434.

[632] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000) (*Iowa Utils. II*), *rev'd in part sub nom. Verizon v. FCC*, 535 U.S. 467.

[633] Indeed, as discussed above, the court expressly confirmed the Commission's independent authority to set rates for CMRS traffic pursuant to section 332 and declined to vacate the Commission's pricing rules as they applied in the context of CMRS service. *See supra* para. 214; *Iowa Utils. I*, 120 F.3d at 800 n.21.

section 252(d)(2). Before describing our new standard, we briefly review the relevant statutory language and the Commission's implementation of the "additional costs" standard in the *Local Competition First Report and Order*. We then explain the importance of incremental cost in regulated pricing. Next we examine the incremental cost of call termination on modern networks. Finally we describe in detail the "additional costs" standard we adopt in this order.

a. Background

240. Section 252(d)(2)(A) sets forth the standard that state commissions, in arbitrating interconnection disputes, should apply in setting the "charges for transport and termination of traffic." That section states that "[f]or the purposes of compliance … with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."[634] Section 252(d)(2)(B) provides that the preceding standard "shall not be construed (i) to preclude arrangements that afford the mutual recovery of costs through offsetting of reciprocal obligations, including arrangements that waive mutual recover (such as bill and keep arrangements); or (ii) to authorize the Commission or any State commission to engage in any rate regulation proceedings to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls."[635]

241. In the *Local Competition First Report and Order*, the Commission adopted implementing rules interpreting section 252's pricing standards for interconnection and UNEs (section 252(d)(1)), and for reciprocal compensation (section 252(d)(2)). In setting the pricing methodology for interconnection and UNEs, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, known as TELRIC.[636] The TELRIC methodology assumes that the relevant increment of output is all current and reasonably projected future demand, (i.e., it is designed to calculate the total cost of building a new, efficient network).[637] The Commission found that TELRIC rates should also include a reasonable allocation of forward-looking common costs, including overhead costs. Thus, TELRIC calculates the long-run average incremental cost of a network element. In setting the pricing methodology for reciprocal compensation, the Commission concluded that the statutory pricing standards for interconnection and UNEs (section 252(d)(1)), and for transport and termination of traffic (section 252(d)(2)), were "sufficiently similar" to permit the use of the same TELRIC methodology for establishing rates under both statutory provisions.[638]

---

[634] 47 U.S.C. § 252(d)(2)(A).

[635] 47 U.S.C. § 252(d)(2)(B).

[636] *Local Competition First Report and Order*, 11 FCC Rcd at 15515, 15844–96, paras. 29, 672–732.

[637] *Local Competition First Report and Order*, 11 FCC Rcd at 15850–57, paras. 690–703, *see also* 47 C.F.R. § 51.505.

[638] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054. In applying the TELRIC methodology to reciprocal compensation, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching." For purposes of setting rates, the Commission concluded that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on a usage-sensitive basis constitutes an 'additional cost' to be recovered through termination charges." *Id.* at 16024–25, para. 1057. The Commission excluded non-traffic sensitive costs, such as the costs of local loops and line ports. *Id.* Further, the Commission concluded that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of

(continued….)

242. Market developments since the adoption of the *Local Competition First Report and Order* demonstrate that application of the TELRIC methodology to reciprocal compensation has led to "excessively high reciprocal compensation rates."[639] More specifically, following the Commission's order, certain carriers began designing business plans to take advantage of above-cost reciprocal compensation payments by becoming a net recipient of local traffic. The most prevalent example of regulatory arbitrage for reciprocal compensation is ISP-bound traffic where the Commission found evidence that "CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients" of reciprocal compensation payments.[640] As a result, the Commission has found that reciprocal compensation rates "do not simply compensate the terminating network, but also appear to generate profits for each minute that is terminated, thus creating a potential windfall."[641] In short, the evidence indicates that application of the TELRIC methodology to reciprocal compensation has not led to rates that accurately reflect a carrier's "additional costs" as the Commission initially envisioned and Congress intended. Rather, the Commission's existing pricing standard has led to rates that not only vary significantly among states,[642] but are generally too high, and which ultimately create regulatory arbitrage opportunities. Based on this evidence, and as detailed further below, we therefore conclude that we need to revise the current reciprocal compensation pricing methodology to align our standard more closely with the statutory text and with economic theory to eliminate, as far as possible, opportunities for regulatory arbitrage.

b. The Importance of Incremental Cost In Regulated Pricing

243. To provide a framework for our reconsideration of the proper "additional costs" methodology, we begin with a brief overview of long-standing principles for public utility pricing. As explained below, we believe the traditional economic definition of incremental cost, as applied to multiproduct firms, is most appropriate for setting intercarrier compensation rates. The Commission's existing TELRIC standard governing reciprocal compensation deviates from this more efficient version of incremental cost, and is likely to lead to rates that significantly exceed efficient levels. We also consider evidence in the record concerning costs of switches and fiber.

(continued from previous page)

forward-looking common costs because, the Commission reasoned, a rate equal to incremental costs may not compensate carriers fully when common costs are present. *Id.* at 16025, para. 1058. For transport, the Commission required the calling party's LEC to compensate the called party's LEC for the "additional costs" associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office and for the additional costs of terminating the call to the called party. *Id.* at 16008–58, paras. 1027–118; see also 47 C.F.R. §§ 51.701(c), (d).

[639] *ISP* Remand Order, 16 FCC Rcd at 9185, para. 75); see also Letter from Norina Moy, Director, Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36 (filed Sept. 26, 2008) (Sprint Nextel Sept. 26, 2008 Ex Parte Letter).

[640] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11.

[641] *See, e.g., Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11; *see also Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4698 n.67 ("[R]eciprocal compensation rates often substantially exceed the per-minute incremental cost of terminating a call and therefore create a potential windfall for carriers that serve customers that primarily or exclusively receive traffic."); *ISP Remand Order*, 16 FCC Rcd at 9192, para. 87 ("[T]here may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination."); BellSouth *ICC* NPRM Comments at 9 ("[R]eciprocal compensation payments enabled carriers to offer services to their customers at rates that bore little relationship to actual costs and provided the recipients of reciprocal compensation an advantage over their competitors."); Verizon *2000 Remand of ISP Declaratory Ruling Public Notice* Comments at 11–12 (noting that competitive LECs with ISP customers reap a "windfall profit" because of high reciprocal compensation rates).

[642] *See, e.g.,* Eastern Rural Telecom Ass'n *ICC FNPRM* Comments at 2–3 ("Depending on the assumptions used to develop a company's TELRIC study, the results can vary significantly and be open to challenge.").

244. In economic theory generally and in its application to regulation, the relationship of price and marginal cost is of fundamental importance. Marginal cost can be simply defined as the rate of change in total cost when output changes by an infinitesimal unit. In economics, the term incremental cost refers to a discrete change in total cost when output changes by any non-infinitesimal amount, which might range from a single unit to a large increment representing a firm's entire output.[643] The terms additional costs and avoidable costs are commonly used to refer to incremental costs resulting from an increase or a decrease in output respectively.[644]

245. In a competitive market, it is assumed that both consumers and producers independently will choose outputs to purchase or to supply on the basis of a market price. In standard economic analysis, this price is determined by the intersection of a downward sloping demand function, which represents consumer valuations for additional units of consumption, and an upward sloping supply function, which represents the marginal cost of supplying an additional unit. The competitive price is efficient in the following sense. At any other price, consumer demands would no longer be equal to producer supply, and market transactions would be limited to the smaller of the two terms.[645] At this level of output, consumers would value an additional unit of output more than the cost of producing it as determined by the marginal cost function. Hence both consumers and producers could be made better off by increasing output by a small amount.[646] When price is equal to the competitive price, no alternative price can be found such that both consumer and producers are better off.

246. *Forward-looking versus Historical Cost:* When prices are determined in a regulated market, similar reasoning applies. In this context, there is a large amount of literature on practical rules and procedures that must be considered to achieve an outcome that is as close as possible to a fully efficient one.[647] The cost of any economic resource is equal to its value in the best alternative use. The cost which a regulated firm incurs in producing a particular output is therefore equal to the value of the economic resources that are used to produce it, and which are therefore no longer available for the production of alternative goods and services. It follows that from the standpoint of economic efficiency, the only costs that are relevant in pricing decisions of a regulated firm are current or future costs, and that

---

[643] If $C(q)$ represents the cost of producing an output q and Δq represents an increment of output, then incremental cost is equal to $C(q+\Delta q) - C(q)$. If incremental cost is used as a guide to pricing, then price should be set equal to the average incremental cost $\frac{C(q+\Delta q)-C(q)}{\Delta q}$. If there are no fixed costs and initial output $q = 0$, then incremental cost pricing is equivalent to average cost pricing. If Δq is small, then incremental cost pricing approximates marginal cost pricing. *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15844, para. 675.

[644] 1 KAHN, THE ECONOMICS OF REGULATION at 65–66. *See also* PRINCIPLES OF PUBLIC UTILITY RATES at 393.

[645] If price is greater than the competitive level, consumer demand is less than supply, and demand would determine market volume. If price is less than the competitive level, then producers voluntarily would supply no more than the amount at which marginal cost is equal to price.

[646] Where the market price exceeds marginal cost, there will be an associated deadweight loss in social welfare. The deadweight loss represents the loss in consumer plus producer surplus caused by a deviation from the competitive equilibrium. *See, e.g.,* DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 84 (1990); KENNETH E. TRAIN, OPTIMAL REGULATION 185 (1992) (OPTIMAL REGULATION).

[647] *See, e.g.*, Ronald. H. Coase, *The Theory of Public Utility Pricing and Its Applications*, 1 BELL J. ECON. 113, 113–128 (1970) (*Theory of Public Utility Pricing*); 1 KAHN, THE ECONOMICS OF REGULATION at 63–86.

historical costs can be ignored.[648] We acknowledge that economists and industry experts have often debated the relative merits of forward-looking (or reproduction) cost versus historical (or original) capital cost in administering rate-of-return regulation,[649] and that regulators, including state regulators and this Commission, have continued to use historical cost in rate setting for smaller, primarily rural telephone companies. Nevertheless, since the adoption of the *Local Competition First Report and Order,* the Commission has consistently concluded that it believes that forward-looking costs are the most appropriate measure of cost.[650] In this order, we reaffirm our conclusion that forward-looking costs should form the basis for regulation in a uniform intercarrier compensation regime.

247. *Short-Run versus Long-Run Incremental Cost:* Economists have also debated whether it is appropriate to use short-run or long-run incremental cost as a guide for regulatory pricing.[651] Short-run incremental cost refers to the cost of an increment of demand when some inputs to production are in fixed supply. Long-run incremental cost refers to the cost of an increment when all inputs are variable. In order to set prices so as to maximize economic efficiency at any particular point in time, it is clear that short-run incremental cost is the appropriate concept.[652] For example, if an airline carrier has empty seats for a particular scheduled flight, then it would make sense to sell capacity for those seats at any price that would recover the small additional costs of fuel and amenities for an additional passenger. Pricing based on short-run incremental cost, however, necessarily implies that prices can be adjusted freely and perhaps continuously during the day.[653] Moreover, in a regulatory context, such flexibility is likely infeasible.

248. Short- or intermediate-run costs might also be advocated on practical grounds, since some productive inputs (e.g., poles and conduits) can have extremely long lives. Nevertheless, regulators have traditionally relied on long-run incremental costs rather than short-run incremental costs in setting regulated prices. First, setting prices on the basis of short-run incremental cost may mean that a carrier would not recover its average total cost of investment over the life of the asset.[654] Second, to the extent that forward-looking costs are used, long-run incremental costs are more naturally and easily accommodated, since a forward looking cost study can legitimately assume that all inputs are variable. In the *Local Competition First Report and Order*, the Commission, in adopting its TELRIC methodology, explained that "[t]his 'long run' approach ensures that rates recover not only the operating costs that vary in the short run, but also the fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element."[655] We reaffirm here the Commission's decision in the *Local Competition First Report and Order* that long-run incremental cost rather than short-run incremental cost is the appropriate cost concept.[656]

---

[648] *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 122; Alexander C. Larson, *An Economic Guide to Competitive Standards in Telecommunications Regulation*, 1 COMMLAW CONSPECTUS 31, 47 n.100 (1993) (quoting *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 121–22).

[649] *See, e.g.,* 1 KAHN, THE ECONOMICS OF REGULATION at 109–16.

[650] *Local Competition First Report and Order*, 11 FCC Rcd at 15813, 15846, paras. 620, 679.

[651] *See* 1 KAHN, THE ECONOMICS OF REGULATION at 70–75, 83–103; *see also* PHILLIPS, THE ECONOMICS OF REGULATION at 390–91 (rev. ed. 1969); PRINCIPLES OF PUBLIC UTILITY RATES at 417–25.

[652] 1 KAHN, THE ECONOMICS OF REGULATION at 71; DANIEL F. SPULBER, REGULATION AND MARKETS 234 (1989) (REGULATION AND MARKETS).

[653] 1 KAHN, THE ECONOMICS OF REGULATION at 84.

[654] 1 KAHN, THE ECONOMICS OF REGULATION at 88.

[655] *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 692.

[656] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054.

249. *Peak Load Pricing*: Closely related to the question of short-run versus long-run costing is the issue of peak load pricing. When demand varies systematically by time of day, day of the week, or over longer periods, there may be periods of time when there is significant excess capacity, since productive inputs clearly cannot vary with such frequency. In such cases, economic efficiency might require that prices should vary by time or day or over longer periods even in the long run.[657] For example, many wireless telephone carriers offer free minutes of usage during weekends or evenings. Although these arguments are indisputable, it has proven difficult in practice to incorporate peak load pricing principles into regulated rate proceedings.[658] Accordingly, we conclude, as the Commission did in the *Local Competition First Report and Order*, that we should not require peak-load pricing as part of an intercarrier compensation regime, although we affirm that carriers should be free to voluntarily negotiate agreements including peak pricing principles.

250. *Common Costs*: Telecommunications carriers are multiproduct firms which provide a large array of services to different groups of consumers. Within the category of traditional telephony, these services include call origination, call termination, local transport, and either access to long distance transport or long distance service through an affiliated carrier. As networks evolve, the number of services that a telecommunications network can provide is rapidly expanding to include Internet access and other data services and, in some cases, video distribution. Many of these services share common facilities.[659] For example, a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services. The incremental cost of voice service, assuming that DSL is already provided, therefore does not include any of the long run incremental cost of the loop itself. Similarly, the incremental cost of DSL, assuming voice is already provided, includes only that portion of the loop cost that may be required to condition the loop to meet the higher quality standards that may be required for data transmission.

251. *Methodology for Computing Incremental Cost in Multiproduct Firms:* Common cost and its relationship to incremental cost in multiproduct firms can be more precisely defined as follows using an analysis developed by Faulhaber, Baumol, and others.[660] Under this approach, one imagines a multiproduct firm in which a forward looking cost function is known, which allows one to compute the "stand alone cost" of any possible subset of products. For example, if the set of products is indexed by the set $N = \{1, \ldots, n\}$, then the stand alone cost of the entire firm can be represented by the value $C(N)$. The incremental cost of any individual product j contained in N can then be represented by the value $IC(j) = C(N) – C(N – j)$, where $C(N – j)$ represents the stand alone cost of producing every product in the set N except product j. Under this definition, the incremental cost may be viewed as the *additional costs* of adding product j to a firm currently producing products $(N – j)$. Alternatively, it may be viewed as the cost that may be *avoided* if the firm, currently producing products 1 through n, decides not to produce

[657] 1 KAHN, THE ECONOMICS OF REGULATION at 89.

[658] *See Local Competition First Report and Order* at 15878, paras. 755–57. *See also* 1 KAHN, THE ECONOMICS OF REGULATION at 91–93.

[659] *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676 ("The term 'common costs' refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers).").

[660] *See, e.g.*, Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966, 966–77 (1975). Faulhaber's objective in the paper was to define a test for cross subsidy, which could precisely define the maximum and minimum prices that a regulated firm should be allowed to charge to any subset of customers; WILLIAM J. BAUMOL ET AL., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 351–56 (1982); William J. Baumol, *Minimum and Maximum Pricing Principles for Residual Regulation, in Current Issues in* PUBLIC UTILITY ECONOMICS (A. Danielson & D. Kamerschen eds., 1983).

product j. The common cost for the firm as a whole is then equal to $C(N) - \sum_{j \in N} IC(j)$. When there is significant sharing of facilities used in providing groups of services to customers, common costs are typically positive, and may be a significant portion of the firm's total cost.

252. *Multiproduct Incremental Cost versus TELRIC:* In the *Local Competition First Report and Order*, the Commission adopted a pricing methodology, which it called Total Element Long Run Incremental Cost or TELRIC. Under the TELRIC methodology, prices for UNEs and interconnection would be determined by estimating the forward-looking cost of individual network elements, which the Commission defined as "physical facilities of the network, together with the features, functions, and capabilities associated with those facilities."[661] In adopting the TELRIC methodology, the Commission determined that forward-looking costs should be "based on the least cost, most efficient network . . . technology," assuming current wire center locations.[662] It further determined that the relevant increment should "be the entire quantity of the network element provided."[663] The Commission concluded that "forward-looking common costs shall be allocated among elements and services in a reasonable manner … . "[664] In choosing to estimate the forward-looking cost of the entire network element, the Commission acknowledged that, when a requesting carrier leased access to that element, it would have exclusive control over that element.[665]

253. With respect to reciprocal compensation, the Commission determined that "the 'additional cost' of terminating a call . . . primarily consists of the traffic-sensitive component of local switching."[666] Nevertheless, the only non traffic-sensitive cost of the local switch that the Commission required states to exclude was the cost of line ports.[667] Similarly, in the rules that the Commission adopted regarding "shared transmission facilities between tandem switches and end offices," the Commission allowed the full forward-looking cost of those facilities to be recovered through usage sensitive charges.[668] Thus, with the exception of requiring recovery of the cost of line ports through flat-rated charges, the Commission's TELRIC rules permitted the full forward-looking cost of the local switch, tandem switch, and shared interoffice transmission facilities, including a reasonable allocation of common costs, to be recovered through usage-based charges. In effect, the Commission's TELRIC methodology permitted average-cost pricing using a forward-looking cost methodology.

254. The TELRIC methodology thus differs significantly from the definition of incremental cost for multiproduct firms proposed by Faulhaber and others. First, unlike TELRIC, the traditional economic approach for determining the incremental cost of a single service excludes all common costs. Second, although the TELRIC methodology is essentially an average cost methodology, the traditional economic approach focuses on identifying the additional forward-looking cost that a network would incur if it provided an additional service—in this case call termination. Under the traditional economic

---

[661] *Local Competition First Report and Order*, 11 FCC Rcd at 15631, para. 258.

[662] *Local Competition First Report and Order*, 11 FCC Rcd at 15848–49, paras. 683–85.

[663] *Local Competition First Report and Order*, 11 FCC Rcd at 15850, para. 690.

[664] *Local Competition First Report and Order*, 11 FCC Rcd at 15852–53, para. 696.

[665] *Local Competition First Report and Order*, 11 FCC Rcd at 15693, para. 385.

[666] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[667] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057. *Cf.* 47 U.S.C. § 51.509(b) (requiring only that line port costs of the unbundled local switching element be recovered through a flat-rated charge).

[668] 47 U.S.C. § 51.509(d).

definition, the incremental cost of call termination would be determined by estimating the stand alone cost of a network which incorporates all existing services except call termination (including call origination, switching, etc.) and then subtracting this amount from a comparable estimate of the total cost of providing all the same existing services, including call termination. As should be obvious, the incremental cost of call termination under the traditional economic definition should be significantly lower than that calculated under a TELRIC methodology.

255. *The Relevance of Multi-part Pricing:* One common criticism of incremental cost pricing is that it may not permit a firm to recover its total costs, particularly if there are significant common costs.[669] Economists have pointed out, however, that multi-part pricing regimes can potentially lead to more efficient outcomes than uniform prices set equal to either marginal cost or average cost.[670] For example, if the firm is able to charge a fixed monthly fee and a variable usage charge, then it is possible for the firm to set the usage charge at or close to marginal cost and recover any residual costs through the fixed charge. In this case, the regulator must take account of both subscription and usage elasticities in order to minimize the possibility that higher fixed fees will cause some subscribers to drop off the network.[671] We note that, in the access charge regime, the Commission recognized the efficiencies associated with multi-part pricing, even if it failed to reduce usage-based charges to marginal or incremental cost.

c. The Incremental Cost of Call Termination on Modern Networks

256. We now consider the evidence in the record concerning the incremental cost of terminating calls on modern telecommunications networks. We note at the outset that there appear to be no cost studies or analyses in the record that attempt to estimate the termination costs using Faulhaber's definition of incremental cost. Thus, we would expect the cost estimates in the record to be significantly lower if they had been calculated using Faulhaber's definition.

257. We consider first evidence concerning the cost of termination on modern circuit switches. We note that, in 1996, when the Commission adopted the TELRIC methodology, circuit switches and fiber optic transmission facilities were generally considered the "least-cost, most efficient" currently available technology. And it appears that state commissions in interconnection arbitrations analyzed the forward-looking costs of circuit switches and fiber optic transmission facilities in developing TELRIC rates. Sprint Nextel filed an *ex parte* in which it analyzed state UNE rates for unbundled switching and common transport.[672] Sprint Nextel reports that the national weighted average price per minute for unbundled local switching was $0.00058 (with individual rates ranging from a low of $0.00004 to a high of $0.0061). Similarly the national weighted average price per minute for common transport was $0.00057 (with individual rates ranging from a low of $0.00010 to a high of $0.00727). Sprint Nextel further observes that "the rates for companies in the survey with a relatively small number of lines were often lower than the rates for companies with a large number of lines, indicating scale and scope

---

[669] *See, e.g.*, REGULATION AND MARKETS at 122–23.

[670] *See, e.g.*, *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 117–20; OPTIMAL REGULATION at 191–213.

[671] Demand for subscription is generally estimated to be significantly less elastic than demand for usage. *See* Mercatus Center Sept. 22, 2008 *Ex Parte* Letter at 3 n.15; Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 39 (1999) (estimating elasticity of demand for subscription to be -.005, whereas elasticity of demand for long-distance service is closer to -0.7); *Effects of Breakup of AT&T*, 83 AM. ECON. REV. at 182 (estimating elasticity of demand for basic access at -0.005 and elasticity of demand for long-distances service between -0.25 and -1.2).

[672] *See* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter. The data used in the analysis were obtained from the March 2006 "Survey of Unbundled Network Element Prices in the United States."

economies do not significantly affect the cost of traffic termination."[673] As Sprint Nextel notes, these rates are all based on the TELRIC methodology and thus represent estimates of average, traffic-sensitive forwarding-looking costs, plus an allocation of common cost and overheads.[674] These estimates, by definition, will significantly exceed incremental cost estimates using the Faulhaber definition; therefore they provide an upper bound on the rates that may result under a Faulhaber approach to incremental cost.

258. Some additional evidence concerning the incremental cost of terminating calls on modern circuit switches can be gleaned from a declaration filed by three economists in support of the Intercarrier Compensation Forum (ICF) plan.[675] The economists contend that modern circuit switches are to a large extent non-traffic sensitive.[676] According to the authors, whereas earlier generations of switching technologies had large shared resources that could be commandeered by any line needing to place or receive a telephone call, most of the resources in a digital switch are dedicated to individual lines through line ports and trunk ports.[677] In addition, according to the authors, because of the "massive increases in computing power offered by modern microchips," modern circuit switches include "call processing capacity . . . [that] is adequate to serve all reasonably offered demand."[678] In other words, modern switches are designed to be non-blocking, which would suggest that the incremental cost of termination is zero. The declaration thus concludes that the incremental cost of call termination on modern circuit switches should be de minimis.

259. The economists' declaration further argues that the incremental costs of adding additional fiber optic transmission capacity similarly are low. They contend that fiber optic technologies have large fixed costs associated with supporting structures (poles, trenches and conduits) and relatively low incremental costs of increasing the capacity of each fiber cable by installing improved laser transmission equipment (which in many cases is based on technological advances made subsequent to the initial fiber deployment). For these reasons, they conclude that "once a fiber cable has been laid on a route, the costs of increasing its transmission capacity are relatively small, so extra minutes of demand result in very little incremental costs. We note that this analysis suggests, at a minimum, that the incremental cost of adding capacity is significantly less—and likely orders of magnitude less—than the forward looking average cost of capacity, as estimated under TELRIC.

260. AT&T submitted evidence that attempts to estimate the incremental cost of a modern softswitch.[679] AT&T maintains that, to estimate the incremental cost of a softswitch, it is necessary to estimate two parameters: the total investment associated with a softswitch, and the percentage of this

---

[673] Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter, Attach. at 3–4.

[674] We note that NuVox disputes some of Sprint Nextel's assumptions. *See, e.g.*, Letter from Brad Mutschelknaus & John J. Heitmann, Counsel to NuVox, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 and WC Docket No. 04-36 (filed Oct. 27, 2008) (NuVox Oct. 27 *Ex Parte* Letter). There is insufficient information in the two *ex parte* submissions for us to resolve this dispute. Carriers remain free to raise issues for consideration in the course of state proceedings.

[675] Richard N. Clarke et al., *Economic Benefits from Reform of Intercarrier Compensation (ICF Economists)*, *attached to* ICF *ICC FNPRM* Reply, Errata, App. A.

[676] *ICF Economists* at 22.

[677] *ICF Economists* at 20–21.

[678] *ICF Economists* at 21.

[679] Letter from Henry Hultquist, Vice President-Regulatory Affairs, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 05-337, 96-45, 99-68, 07-135 (filed Oct. 4, 2008) (AT&T Oct. 4, 2008 *Ex Parte* Letter).

investment that is traffic-sensitive.[680] Using what it claims are "conservative" estimates, AT&T first compares the estimated investment cost per line of a Class 5 circuit switch with the estimated investment cost per line of a modern softswitch and finds that the investment cost per-line of a softswitch is significantly lower.[681] Although it estimates that the investment cost of a Class 5 switch is approximately $100 per line, it finds that the likely investment cost of a softswitch is between $34 and $80 per line.[682] AT&T then considers the likely percentage of the investment costs per line that are traffic-sensitive, and concludes that, depending on the particular softswitch, the traffic-sensitive costs are likely to be between zero and 20 percent of the total investment cost of the switch.[683] Using the higher estimate of 20 percent traffic-sensitive costs, and assuming that each line carries an average of 1400 minutes a month, AT&T derives a traffic sensitive incremental cost per minute of between $0.00010 and $0.00024.[684] For the other softswitch that AT&T considers, however, the traffic-sensitive incremental costs of termination would be zero. Although we do not necessarily accept the precise estimates contained in AT&T's *ex parte* letter, we note that its analysis suggests that the incremental traffic-sensitive costs of modern softswitches are likely to be significantly lower than those of circuit switches and possibly zero, both because the investment cost per line is lower and because the percentage of traffic-sensitive costs to total costs is lower for modern softswitches.

261. Windstream Communications, Inc. and NuVox subsequently filed ex parte letters criticizing AT&T's analysis of the traffic sensitive costs of a softswitch,[685] and AT&T filed a response.[686] Essentially, both Windstream and NuVox criticize specific elements of AT&T's analysis. In addition, Windstream argues that it would be grossly inefficient for a rural carrier to immediately replace circuit switching equipment with softswitch technology, while NuVox contends that even a forward-looking network design would not consist entirely of soft switches. Significantly, NuVox criticizes AT&T for failing to apply the TELRIC methodology, and NuVox recalculates AT&T's estimates using TELRIC. Because we expressly reject use of the TELRIC methodology for purposes of setting reciprocal compensation rates, we conclude that many of the NuVox challenges are moot. To the extent that NuVox and Windstream are challenging cost assumptions that may be applied by states pursuant to our new additional costs methodology, such issues may be raised for consideration by the state commission during the cost proceeding to establish the uniform reciprocal compensation rate. We feel compelled, however, to point out a few of the most critical mistakes and misconceptions contained in the Windstream and NuVox ex parte letters.

262. First, Windstream argues that it is somehow inappropriate to consider the additional costs of softswitches in setting termination rates because it would be economically infeasible for an incumbent

---

[680] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2.

[681] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3.

[682] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2–3.

[683] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3–4.

[684] AT&T Oct. 4, 2008 *Ex Parte* Letter at 4.

[685] Letter from Eric N. Einhorn, Vice President, Federal Government Affairs, Windstream Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 06-122, 07-135, 08-152 (filed Oct. 27, 2008) (Windstream Oct. 27, 2008 *Ex Parte* Letter); Letter from John J. Heitmann, Counsel for NuVox, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Oct. 24, 2008) (NuVox Oct. 24, 2008 *Ex Parte* Letter).

[686] *See* Letter from Henry Hultquist, Vice President Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 07-135 (Oct. 28, 2008) (AT&T's response appears specific to the NuVox Oct. 24, 2008 *Ex Parte* Letter).

LEC to replace all its existing circuit switches with softswitches.[687] This argument fundamentally misconstrues the purpose of a forward-looking cost methodology. The adoption of a forward-looking cost standard does not imply in any way that existing carriers should replace fully functional plant and equipment simply because a more recent vintage of replacement equipment is available. Forward-looking costs are simply a measure of the economic value of future investments, and in a competitive marketplace, these values should determine the appropriate investment decisions regarding replacement of existing plant. More importantly, these values should be used as an appropriate guide in setting efficient prices for the utilization of existing plant and equipment. Second, although both Windstream and NuVox raise objections to AT&T's cost analysis, neither they nor AT&T actually attempt to estimate the incremental cost of call termination. For example, both Windstream and NuVox argue that AT&T's estimates of the cost of investment in forward-looking softswitch technologies are flawed because of the assumptions made about the number of lines served per switch.[688] Although this is may be a valid issue, as it relates to the extent to which softswitch technologies are scalable for deployment in wire centers with different numbers of final customers, the dispute does not really address the issue of the incremental cost of call termination. Third, NuVox claims that the absence of line cards in softswitches is evidence that all switch costs are traffic sensitive.[689] This analysis ignores the potentially large fixed costs associated with a softswitch that are not related to line ports. Since softswitches resemble small computers, the appropriate analogy for estimating incremental cost would be the cost of additional memory cards, which could be inserted into the CPU. Fourth, NuVox maintains that both common costs to the firm as a whole and land and building costs associated with switching equipment should be included in any traffic sensitive cost computed for purposes of reciprocal compensation.[690] As explained above, we conclude that common costs should no longer be included in calculating the incremental cost of call termination.

263. Another approach to estimating the incremental cost of call termination is to examine the technology of next generation networks in which voice calls are carried on the same network platform as data and video services delivered to the same customer. Telecommunications carriers are currently deploying such networks at a rapid pace, although the transition to the new technology is far from complete. Nevertheless, most experts believe that IP technologies will be used to deliver the predominant share of voice and data traffic within a few years. Packet technologies, and the resulting commingling of voice and data traffic, make possible a dramatic reduction in the cost of originating and terminating voice traffic in the network. In addition, although the costs of circuit based switching technologies are difficult to quantify using public data sources, the Internet itself provides a variety of sources which can be used to provide at least a rough estimate of the costs associated with a next generation network.

264. Consider the case of a single customer who subscribes to a next generation network offering a full range of voice, video and data services. Suppose that this customer makes exactly one voice call lasting five minutes during each hour of the busy period (which we will unrealistically assume to last for 16 hours every day of the month). High quality (ISDN level) voice service requires a channel capacity of 64 kbps. Ignoring the possibility of signal compression, and making a conservative allowance for packet header overhead,[691] we assume that the single call per hour requires a network capacity of 100

---

[687] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2.

[688] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2–3; NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 8–9.

[689] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 14–15.

[690] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 18 & n.40.

[691] *See, e.g.*, VoIP-Info.org, Bandwidth Consumption, http://www.voip-info.org/wiki-Bandwidth+consumption (last visited Oct. 25, 2008); Westbay, Voice over IP Bandwidth, http://www.erlang.com/bandwidth.html (last visited Oct. 24, 2008) (investigating bandwidth requirements for the transmission of voice over an IP based network).

kbps. This capacity requirement translates to 12,800 bytes per second, or 0.0000128 Gigabytes to be available for the duration of the call.[692] Publicly available estimates of the cost of serving residential customers on a broadband network range from $0.1 Gigabytes per month to $0.5 Gigabytes per month.[693] These estimates include the cost of the servers, routers and fiber links necessary to provide service to the residential customer, but do not include the substantial cost of the local broadband loop.[694] The hypothetical consumer described above places a demand of 0.000512 Gigabytes per month, and using the upper limit on the estimated cost, we estimate a monthly incremental cost to the consumer of delivering this level of voice service at 0.0256 *cents* per month.[695] Under these conservative assumptions the cost, on a per-minute basis, would be 0.00001 *cents* per minute.[696] Even if the cost estimates used above are wrong by several orders of magnitude, it is clear that the cost of voice traffic on a broadband network is vanishingly small.[697] Although we are not directing the states to consider the incremental cost of terminating voice telecommunications on such next generation networks,[698] we find that, as carriers move to an all IP broadband world, the incremental costs of terminating voice calls should drop dramatically.

d. Reconsideration of Additional Costs Standard

265. We adopt a new "additional costs" methodology using the traditional economic definition of the incremental cost of a service produced by a multiproduct firm, rather than continuing to rely on the TELRIC methodology.[699] The Supreme Court has made clear that an "'initial agency interpretation is not

---

[692] In this analysis, we ignore the additional economies that can result because multiple packet streams for voice traffic can be transmitted simultaneously over the same channel capacity.

[693] The lower estimate is contained in the Wikipedia entry "Broadband Internet Access," http://en.wikipedia.org/wiki/Broadband_Internet_access (last visited Oct. 11, 2008). The higher estimate is contained the trade publication Telephony Online, "OFC: BellSouth Chief Architect warns of HD VOD costs," March 7, 2006, http://telephonyonline.com/iptv/news/BellSouth_VOD_costs_030706 (last visited Oct. 11, 2008). Both estimates are also reported in David Clark, A Simple Cost Model for Broadband Access: What Will Video Cost?, Presentation at the Telecommunications Policy Research Conference (Sept. 28, 2008), *available at* http://tprcweb.com/files/Cost%20analysis%20TPRC.pdf.

[694] The cost of the local loop is clearly a common cost that is shared by all of the voice, video, and data services consumed by the subscriber and should not be included under any reasonable definition of incremental cost.

[695] Broadband Internet service is typically priced on the basis of capacity—either the maximum instantaneous upload and download speed or, as in this example, total monthly traffic. A rigorous application of true incremental cost pricing would require measuring each customer's contribution to system costs, which primarily consists of the delays or packet losses imposed on other users. For this purpose, minutes of use are largely irrelevant.

[696] These estimated costs do not include the costs of billing, advertising, or other customer care expenses. As with the case of the local loop, we believe that such costs should not be included in any measure of long run incremental cost of call termination.

[697] It is very unlikely that the cost estimates are significantly low. Telecommunications carriers continue to upgrade their networks to provide precisely the range of video and data services that the articles in a previous footnote were concerned with. Indeed, the BellSouth estimate was given with concern that such services would not be viable unless that estimate of cost could be reduced in the near future. Very similar arguments were made exactly 20 years ago in ROBERT M. PEPPER, THROUGH THE LOOKING GLASS: INTEGRATED BROADBAND NETWORKS, REGULATORY POLICY, AND INSTITUTIONAL CHANGE (FCC, OPP Working Paper No. 24, Nov. 1988), *available at* http://www.fcc.gov/Bureaus/OPP/working_papers/oppwp24.pdf.

[698] *See infra* section V.C.1.

[699] We find it preferable to shift entirely to an approach based on the traditional economic definition of incremental cost, rather than trying to achieve the same result through extensive revisions to the TELRIC methodology as some commenters suggest. *See, e.g.*, Rural Alliance *ICC FNPRM* Comments at 50–54 (calling for a more precise definition of TELRIC for purposes of reciprocal compensation).

instantly carved in stone. On the contrary, the agency … must consider varying interpretations and the wisdom of its policy on a continuing basis,' for example in response to changed factual circumstance, or a change in administrations."[700] Consistent with this, the Commission, in its 2005 *Intercarrier Compensation FNPRM,* solicited comment on whether the Commission should reinterpret "additional costs" to mean "incremental cost" in light of the need to reform intercarrier compensation due to market distortions.[701] In response, several commenters supported such a proposal noting that the additional incremental cost of terminating traffic is de minimis.[702] Based on the evidence highlighted above and for the reasons set forth below, we revise our interpretation of the "additional costs" language in section 252(d)(2) to mean "incremental costs" as traditionally defined. We believe that this conclusion is supported by the economic theory discussed above, and represents a more appropriate interpretation of the "additional costs" standard than the TELRIC methodology.[703]

266. As an initial matter, the Commission plainly has the authority to revise its interpretation of "additional costs."[704] Indeed, the Supreme Court has recognized that the phrase "additional costs" is ambiguous.[705] Words like additional cost "give ratesetting commissions broad methodological leeway,"[706] and courts owe "substantial deference to the interpretation the Commission accords them."[707] The Commission, consistent with its obligation to "consider varying interpretations and the wisdom of its policy on a continuing basis" now revises its definition of "additional costs."[708]

267. Revising our interpretation of "additional costs" to follow the traditional economic

---

[700] *Brand X*, 545 U.S. at 981 (quoting *Chevron U.S.A. Inc. v. Nat'l Res. Def. Counci*l (*Chevron*), 467 U.S. 837, 863–64 (1984) and citing *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Automobile Ins. Co.* (*State Farm*), 463 U.S. 29, 59 (1983) (Rehnquist, J., concurring in part and dissenting in part)).

[701] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4719, para. 71.

[702] *See, e.g.*, CTIA *ICC FNPRM* Comments at 16 ("Because a call does not impose significant incremental costs on either the calling party's or called party's network, there is no justification for allowing the terminating network to impose any charge on the non-terminating network."); Frontier *ICC FNPRM* Comments at 7 ("However, there is virtually NO additional incremental cost of sending a minute-of-use across [dedicated hardware interfaces]."); Western Wireless *ICC FNPRM* Comments at 16 ("Independent Wireless Carriers urge the Commission to confine its analysis of 'additional cost' only to the incremental traffic-sensitive switching and transport costs actually incurred by the parties exchanging traffic for purposes of intercarrier compensation.").

[703] We reaffirm that the TELRIC methodology is appropriate for setting interconnection and network element rates pursuant to section 252(d)(1), where Congress directed the Commission to consider a "reasonable profit."

[704] The Supreme Court affirmed the Commission's authority to apply a cost methodology for the states to implement. *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. *See also id.* at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has."); 47 U.S.C. § 201(b); *United Telegraph Workers, AFL-CIO v. FCC*, 436 F.2d 920, 923 (D.C. Cir. 1970) (citations and quotations omitted) (finding that section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act").

[705] *See Verizon v. FCC*, 535 U.S. at 499–501 ("[W]ithout any better indication of meaning than the unadorned term, the word 'cost' in section 252(d)(1), as in accounting generally, is 'a chameleon,' a 'virtually meaningless' term . . . .") (citations omitted).

[706] *See Verizon v. FCC*, 535 U.S. at 499–501 (quoting *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 423 (Breyer, J., concurring in part and dissenting in part)).

[707] *Capital Network System, Inc. v. FCC,* 28 F.3d 201, 204 (D.C. Cir. 1994).

[708] *Brand X*, 545 U.S. at 981 (quoting *Chevron*, 467 U.S. at 863–64 and citing *State Farm*, 463 U.S. at 59 (Rehnquist, J., concurring in part and dissenting in part)).

definition of the incremental cost of a service is supported by the Commission's interpretation of the term "additional costs" in section 224 of the Act. Section 224, which addresses the pricing of pole attachments, is the only other place in the Act that uses the term "additional costs." The Commission consistently has found that the term "additional costs" in section 224 means incremental cost,[709] and that the legislative history for section 224 makes clear that Congress intended such a result.[710] Interpreting the term "additional costs" as used in two parts of the Act in the same manner is consistent with the "presumption that identical words used in different parts of the same act are intended to have the same meaning."[711]

268. In contrast, the statutory pricing standard for reciprocal compensation ("additional costs") is not the same as the statutory pricing standard for UNEs ("cost" plus "a reasonable profit").[712] Even though the two statutory provisions may, as the Commission found previously, be "similar," our subsequent experience indicates that TELRIC is not consistent with the "additional costs" standard. First, as discussed above, evidence indicates that reciprocal compensation rates based on TELRIC methodology were "excessive."[713] If reciprocal compensation rates truly reflected the incremental "additional costs," regulatory arbitrage should not occur because a carrier would not make a profit by recovering its incremental cost.[714]

269. Second, TELRIC includes the cost of the "total element" and, as a result, measures the long run incremental average cost of the switch including common costs and overhead, not just the additional costs of using the function to terminate another carrier's traffic. In other words, TELRIC measures the *average* cost of providing a function, which is not necessarily the same as the *additional* costs of providing that function. Because of this, we expect that the TELRIC methodology would

---

[709] *See, e.g., Adoption Of Rules For The Regulation Of Cable Television Pole Attachments,* CC Docket No. 78-144, Memorandum and Opinion and Second Report and Order, 72 FCC 2d 59, 62, para. 8 (1979); *Adoption Of Rules For The Regulation Of Cable Television Pole Attachments*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d 3, 15, App. (1978) (*Cable Television Pole Attachment NPRM*).

[710] *Cable Television Pole Attachment NPRM*, CC Docket No. 78-144, Notice of Proposed Rulemaking, 68 FCC 2d at 15, App. ("'Additional costs' are generally equivalent to what is referred to as incremental cost, and the proportional part of 'Operating expenses and actual capital costs' are generally equivalent to fully allocated costs." (quoting S. Rep. No. 95-580 at 19–21 (1977)).

[711] *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

[712] *Compare* 47 U.S.C. § 252(d)(1) *with* 47 U.S.C. § 252(d)(2).

[713] *See, e.g.*, *Intercarrier Compensation FNPRM,* 20 FCC Rcd at 4694, 4697–98, 4717, 4719, paras. 16, 23–24, 66, 71–72; *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616-18, paras. 11–18; *ISP Remand Order*, 16 FCC Rcd at 9161–62, paras. 18–20.

[714] For the same reasons, we reject suggestions that TELRIC should be used to set a unified rate for intercarrier compensation. *See, e.g.*, Ohio PUC *ICC FNPRM* Comments at 20 ("[T]he Ohio Commission recommends the use of the TELRIC standard for setting intercarrier compensation rates."); Pac West et al. *ICC FNPRM* Comments at 9 ("The 'additional cost' standard should continue to be tied to TELRIC"); Time Warner Telecom et al. *ICC FNPRM* Comments at 1–2 ("[A] central component of reform must be the requirement that, to the extent possible, each carrier charge a single, cost-based rate for the exchange of all types of traffic. . . . [T]he Commission arguably has the authority to mandate that states use a cost-based methodology, in particular TELRIC, as the basis for setting all intercarrier termination rates."); Integra *ICC FNPRM* Comments at 3 ("Integra urges the Commission to . . . [u]nify access and reciprocal compensation rates at TELRIC based levels on a company-by-company basis."); KMC and Xspedius *ICC FNPRM* Reply at 3 ("[T]he Commission should support tariffed-based intercarrier compensation arrangements that: (i) set rates no higher than the comparable TELRIC (or similar cost-based) rates."); XO *ICC FNPRM* Reply at 11 ("[T]he only appropriate intercarrier compensation regime must include TELRIC-based rates.").

continue to produce reciprocal compensation rates above the true "additional costs" of terminating such traffic, in light of evidence that the cost of terminating traffic today is low[715] and is decreasing even further as carriers transition to softswitches[716] and ultimately pure packet switches. Consistent with our change in methodology, we also disavow our finding in the *Local Competition First Report and Order* that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on a usage-sensitive basis constitutes an "additional costs" to be recovered through termination charges."[717] In particular, as explained above, we specifically exclude common costs and overhead allocations from the calculation of what constitutes "additional costs" under our new pricing methodology.

270. We thus end our reliance on the TELRIC methodology for setting reciprocal compensation rates, and instead require that such rates be set pursuant to our new incremental cost methodology.[718] In our Implementation section below, we provide specific guidance to the states regarding how to apply this new methodology. We note that this Commission takes seriously its responsibility to ensure that rates for carriers are just, reasonable, and not confiscatory. In this order, we have set in motion mechanisms to help ensure that the financial viability of carriers will not be undermined. We feel confident that these mechanisms, in combination with the other avenues available for carriers to offset declines in access revenues, will be sufficient to achieve this result.[719]

---

[715] The national average of TELRIC rates for transport and termination of calls was $0.00212 in 2004, which likely overstates the actual incremental costs because, as noted above, TELRIC includes common and overhead costs and examines the average cost of the function, not the additional cost of terminating traffic. Letter from Richard M. Rindler, Counsel for the Cost-Based Intercarrier Compensation Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Sept. 2, 2004) (CBICC Sept. 9 *Ex Parte* Letter); *see also* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter.

[716] *See* T-Mobile *ICC FNPRM* Comments at 29–30.

[717] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[718] A number of parties advocate for or against Commission adoption of bill-and-keep for intercarrier compensation. *See, e.g.*, Letter from Jonathan Askin, Counsel for FeatureGroup IP, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3–4 (filed Oct. 7, 2008); Letter from Paul W. Garnett, Assistant Vice President of Regulatory Affairs, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Oct. 7, 2008); Corr *ICC FNPRM* Comments at 8; Cox *ICC FNPRM* Comments at 8–9; ICF *ICC FNPRM* Comments at 26, 30; Western Wireless et al. *ICC FNPRM* Comments at 6–8. *But see, e.g.*, Letter from Tamar E. Finn, Counsel for PAETEC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 10 (filed Oct. 7, 2008) ("Mandatory Bill-and-Keep Is Not A Viable or Fair Solution"); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Cavalier Telephone et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 3, 2008) ("[T]he adoption of mandatory bill-and-keep arrangements is extremely ill advised as a policy matter."); BellSouth *ICC FNPRM* Comments at 9 ("[A] plan to transition rates ultimately to bill-and-keep would not promote economic efficiency or preserve universal service, nor is bill-and-keep competitively neutral."); CCG Consulting Inc. (CCG) *ICC FNPRM* Comments at 7 ("[A]ccess rates should not be reduced to zero through implementation of a Bill and Keep mechanism."); CenturyTel *ICC FNPRM* Comments at 4 (". . . CenturyTel unequivocally opposes replacing intercarrier compensation with a "bill and keep" regime."); CCAP *ICC FNPRM* Comments at 11 ("The CCAP urges the Commission to avoid implementation of a bill and keep regime . . . ."); Frontier *ICC FNPRM* Comments at 6 (arguing that bill and keep is inappropriate because it does not account for asymmetric traffic patterns); SBA *ICC FNPRM* Comments at 7 (arguing that bill-and-keep is inappropriate between rural and larger LECs due to various asymmetries). We believe the reforms we adopt here are preferable to a pure bill-and-keep requirement and more appropriately balance the interests of consumers and carriers at this time. The approach we adopt in this order avoids the need to resolve disputes in the record regarding bill-and-keep in various circumstances because it allows parties to advocate for such an approach before state commissions and parties may negotiate such arrangements.

[719] Some carriers have suggested that our changes in ratemaking methodology will necessarily produce confiscatory rates and constitute a taking. *See, e.g.*, NTCA, Interim Universal Service & Intercarrier Compensation Reform Proposal (NTCA Interim Proposal) at 19–22, *attached to* Letter from Daniel Mitchell, Vice President, Legal &

(continued….)

271. Moreover our decision to adopt a unified intercarrier compensation methodology is in no way arbitrary or adopted with any confiscatory purpose. In fact, the determinations made in this order reveal just the contrary, our decision to raise the cap on SLCs, our referral to the Federal-State Joint Board on Separations (Separations Joint Board) of the issue of whether to allow additional increases in SLC caps in Part V.C below, and our acknowledgment of the ability of a carrier to establish entitlement to supplemental universal service to help ensure that carriers can maintain their financial integrity.[720] Although in most cases the rates for intrastate and interstate terminating access will drop substantially, that alone is not the test for whether a taking has occurred; rather, a primary consideration for takings claims is whether the rates ultimately adopted will produce a reasonable return sufficient to enable a company to maintain its financial integrity.[721]

C. Implementation

272. In this section, we detail certain implementation items. First, we provide guidance to states with regard to their implementation responsibilities for the intercarrier compensation regime we adopt today. Importantly, this includes setting reciprocal compensation rates using the new incremental cost pricing methodology. We also provide guidelines for the states' application of the modification and suspension provisions of section 251(f)(2) of the Act. We explain the need to require symmetrical compensation arrangements without any exceptions under section 252(d)(2)(A)(ii) of the Act. And we discuss the effect of our intercarrier compensation reforms on existing interconnection and commercial agreements. Finally, we address the extent to which reduced revenue from carrier-to-carrier charges may be replaced through end-user charges or new universal service support, where needed.

1. Direction to the States

273. We set forth the timeline for states to implement our comprehensive reform and adopt an interim, uniform reciprocal compensation rate along with a transition plan in section [III.B.2] above. In this section, we set forth additional parameters for states to follow in implementing the reforms adopted in this order.

a. Setting Final Reciprocal Compensation Rates Based on Incremental Cost

274. Under our new methodology for setting final reciprocal compensation rates, states will need to set prices according to a forward-looking economic cost study or computer cost model using the Faulhaber principles to identify the traffic-sensitive incremental cost of transport and termination of

(continued from previous page)
Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92 (filed Oct. 6, 2008) (NTCA Oct. 6, 2008 *Ex Parte* Letter) (contending that the Commission's current access regime, not to mention any reductions in access rates, threatens rate-of-return carriers with unconstitutional takings). *See also* Cincinnati Bell *ICC FNPRM* 11–12 ("The elimination of interstate switched access charges without an opportunity to earn the revenue in another fashion could be confiscatory . . . ."); GVNW Consulting *ICC FNPRM* Comments at 9 ("The existing system of cost recovery consisting of three equally important components of access charges, universal service support, and local rates is the only approach available to the Commission that will enable it to avoid valid claims of confiscation."). This argument lacks merit. Faced with a similar challenge to the TELRIC methodology previously adopted by the Commission, the Supreme Court stated unequivocally that "this Court has never considered a taking challenge on a ratesetting methodology without being presented with specific rate orders alleged to be confiscatory . . . ." *Verizon v. FCC*, 535 U.S. at 524 (citations omitted).

[720] *See FPC v. Hope Natural Gas Co*., 320 U.S. 591, 605 (1944) ("Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return . . . .").

[721] *FPC v. Hope Natural Gas Co*., 320 U.S. at 605.

traffic.[722] First, states will need to evaluate a forward-looking economic cost analysis of a stand-alone network that performs all functions of a modern telecommunications network, including transport and termination of other carriers' traffic. Second, states will need to evaluate a forward looking economic cost analysis of a stand-alone network that performs all the same functions except for the transport and termination of other carriers' traffic. Third, states must compare the costs of these two networks. The difference between the costs of the two networks is the additional costs of termination of traffic subject to the "additional costs" standard we adopt in this order.[723]

275. We offer further guidance regarding specific aspects of these cost studies. First, these cost studies must use the least cost, most efficient network technology. We find that the least cost, most efficient switch today is a softswitch.[724] We further find that the least cost, most efficient technology for transport is fiber optic cable.[725] We observe that, when carriers deploy fiber, they typically deploy capacity significantly in excess of current needs.[726]

276. Second, consistent with the traditional economic definition of the incremental cost of a service, [727] the cost studies must exclude all common costs, including overhead costs. Third, all non-traffic-sensitive costs must be excluded from the cost studies.[728] Cost studies using the TELRIC methodology do not meet these requirements, given the differences between TELRIC and the traditional economic methodology for determining the incremental cost of a service discussed above.[729] Available evidence suggests that the incremental costs of terminating traffic, as determined using this methodology, are likely to be extremely close to zero.

277. We also require each state to set a single, uniform rate for all carriers in that state through their pricing proceedings. We find this approach warranted for several reasons. First, softswitches are easily scalable, and thus the incremental cost of termination does not vary with the number of lines the switch serves. Second, because carriers tend to deploy significant excess capacity when deploying fiber, the incremental cost of adding traffic is likely to approach, or equal, zero. Third, we find that setting a single uniform rate for all incumbent LECs and interconnecting carriers in a state simplifies the regulatory

[722] We recognize that the incremental cost of terminating traffic may include certain non-traffic-sensitive costs, such as the cost of a trunk port. Consistent with cost-causation principles, however, such non-traffic-sensitive costs may not be recovered through per-minute charges, but must rather be recovered through flat-rated monthly charges associated with interconnection trunks.

[723] *See supra* section V.B.4.c.

[724] *See supra* section V.B.4.c.

[725] *See supra* section V.B.4.c.

[726] *See, e.g., Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156, 20237, para. 186 (1999) (subsequent history and citation omitted) ("As we explained in the *Inputs Further Notice*, in determining appropriate cable sizes, network engineers include a certain amount of spare capacity to accommodate administrative functions, such as testing and repair, and some expected amount of growth."); *Triennial Review Order*, 18 FCC Rcd at 17166, para. 312 n.919 (citing evidence that "the first carrier to lay fiber to a particular location will lay significantly more than it will need because the incremental cost of burying additional fibers is negligible").

[727] *See supra* section V.B.4.c.

[728] We thus go beyond the requirement in the *Local Competition First Report and Order* that only required states to exclude the cost of line ports, *see* 11 FCC Rcd at 16025, para. 1057, and mandate that *all* non-traffic sensitive costs be excluded.

[729] *See, e.g., supra* section V.B.4.c.

process, minimizes arbitrage that could arise, and reduces the likelihood that unidentifiable traffic would remain a problem. Finally, setting rates based on the costs of the current, least cost, most efficient technology creates incentives for carriers with less efficient networks to migrate more quickly to those more efficient technologies.

278. Following the transition, once carriers are charging the final uniform reciprocal compensation rate, we establish the following default rules regarding the network "edge."[730] These default rules would not require changes to physical points of interconnection, but would simply define functions governed by a uniform terminating rate.[731]

- For every call, the calling party service provider (e.g., the calling party's LEC for a local call or the calling party's IXC for a long distance call) is responsible for the transmission and routing of the call to the network edge of the called party service provider.

- The calling party service provider may fulfill its responsibility for the transmission and routing of a call to the called party service provider network edge via its own facilitates and services, the facilities and service of another entity (including the called party's service provider), or any combination.

- The calling party service provider is also responsible for the payment of the uniform terminating rate to the called party service provider. The called party service provider is responsible for performing all network functions to deliver traffic from the network edge to the called party, including dedicated transport, common transport, tandem switching, end office switching, and SS7 messaging.

- The reciprocal compensation regime of section 251(b)(5) will apply to traffic from the called party service provider network edge to the called party.

- The called party service provider's network edge is the location of its end office, MSC, point of presence, or trunking media gateway, which PSTN routing conventions (e.g., NPAC or LERG) associate with the called party telephone number unless that location subtends a tandem switched owned or controlled by the called party service provider, in which case that tandem is the network edge for that call. A service provider that utilizes a tandem as its edge may require, upon reasonable request consistent with standard industry network interconnection principles, that calling party service providers groom their traffic onto segregated trunk groups.

---

[730] *See* Letter from Hank Hultquist, AT&T Services, Inc., and Donna Epps, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1–2 (filed Oct. 14, 2008) (AT&T and Verizon Oct. 14, 2008 *Ex Parte* Letter) (providing seven default rules). We reject PAETEC's assertion that the Commission lacked notice to adopt such rules. *See* Letter from Jonathan S. Frankel and Michael A. Romano, Counsel for PAETEC, CC Docket Nos. 99-68, 01-92 at 2-3 (Oct. 28, 2008) (PAETEC Oct. 28, 2008 *Ex Parte* Letter). The Commission expressly sought comment on this issue in the *Intercarrier Compensation FNPRM*. *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4687, 4702-03, 4712-13, 4727-30, paras. 4, 34, 40-44, 54, 91-97.

[731] Thus, the default "edge" rule we adopt today does not alter any obligations of incumbent LECs' to interconnect at any technically feasible point, nor does the rule alter carriers' ability to request interconnection. *See, e.g.*, Letter from Susanne A. Guyer, Verizon, to Chairman Kevin J. Martin, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 05-337, 06-112 at 5 (filed Oct. 5, 2008). *See also, e.g.*, PAETEC Oct. 28, 2008 *Ex Parte* Letter at 5-6 (expressing concern that the adoption of rules regarding a network "edge" not alter existing rules and obligations regarding physical interconnection). Moreover, the "edge" rules we adopt, which will apply at the end of the transition period, are merely a default, and carriers are free to negotiate alternative arrangements.

- The called party service provider must either permit interconnection at its edge for purposes of exchanging traffic with the calling party service provider or provide transport at no charge to that edge from a location in the same LATA where it does permit such interconnection.

- The calling party service provider may at its sole discretion choose whether to interconnect directly or indirectly with the called party service provider.

b. Symmetry

279. We conclude that final uniform reciprocal compensation rates should be symmetrical.[732] In contrast to the approach taken in the *Local Competition First Report and Order*, we require, for the reasons described below, symmetry in all cases once the final uniform reciprocal compensation rates become effective.

280. *Background*. In the *Local Competition First Report and Order*, the Commission concluded that charges for reciprocal compensation were to be presumptively symmetrical and that it was "reasonable to adopt the incumbent LEC's transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination."[733] The Commission observed that "[b]oth the incumbent LEC and the interconnecting carriers usually will be providing service in the same geographic area, so the forward-looking economic costs should be similar in most cases."[734] Moreover, by using the incumbent LEC's costs of transport and termination, the Commission found that symmetry would provide an incentive for interconnected carriers to minimize costs because if the interconnected carrier could reduce its costs below the costs of the incumbent LEC, then it could realize additional termination revenue.[735] Symmetrical compensation also provided the incumbent LECs an incentive to minimize costs. The Commission further found that symmetry reduced incumbent LECs' bargaining strength because asymmetrical rates could have allowed incumbent LECs to negotiate high charges for traffic terminating on their networks and low charges for traffic originating on their networks, citing as an example incumbent LECs' treatment of CMRS providers.[736] A presumption of symmetric

[732] "Symmetrical compensation arrangements are those in which the rate paid by an incumbent LEC to another telecommunications carrier for transport and termination of traffic originated by the incumbent LEC is the same as the rate the incumbent LEC charges to transport and terminate traffic originated by the other telecommunications carrier." *Local Competition First Report and Order*, 11 FCC Rcd at 16031–32, para. 1069.

[733] *Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085. The Commission provided the following findings supporting its conclusion: (1) "using the incumbent LEC's forward-looking costs for transport and termination of traffic as a proxy for the costs incurred by interconnected carriers satisfies the requirements of section 252(d)(2)" and "is consistent with section 252(d)(2)(B)(ii)"; (2) "[i]f both parties are incumbent LECs, . . . the larger LEC's forward-looking costs should be used to establish the symmetrical rate for transport and termination"; (3) "larger LECs are generally in a better position to conduct a forward-looking economic cost study"; (4) "imposing symmetrical rates based on the incumbent LEC's additional forward-looking costs will not substantially reduce carriers' incentives to minimize those costs"; and (5) "states may establish transport and termination rates in the arbitration process that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch." *Id.* at 16040–42, paras. 1085–86, 1090.

[734] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085.

[735] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1086 ("A symmetric compensation rule gives the competing carriers correct incentives to minimize its own costs of termination because its termination revenues do not vary directly with changes in its own costs.").

[736] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041, para. 1087 (noting that incumbent LECs have used their greater bargaining power to negotiate asymmetrical rates with CMRS providers and to charge CMRS providers origination, as well as termination, charges).

rates was administratively efficient and did not require a competing carrier to conduct a forward-looking cost study to enter the market, lowering the cost of entry and thus increasing competition.[737]

281. The Commission, however, carved out an exception to the presumption of symmetry. In the *Local Competition First Report and Order*, the Commission permitted interconnecting carriers to rebut the presumption of symmetry by submitting a forward-looking cost study to show that their costs of termination were higher than the incumbent LEC's.[738] If the interconnecting carrier established that "the costs of efficiently configured and operated systems [were] not symmetrical," the state commission could adopt a "different compensation rate" for the interconnecting carrier.[739]

282. *Discussion*. We now require symmetric rates and conclude that the exception that permitted asymmetric rates under certain circumstances is no longer warranted.[740] We note that there is scant evidence of any competitive LECs seeking to establish their own, higher, costs during the last 12 years, let alone being successful in doing so.[741] We conclude that asymmetric rates could undermine the comprehensive reform we adopt by permitting different termination rates for traffic in the same geographic area, which could open the door for continued regulatory arbitrage and thwart the intended public interest benefits associated with reforming the patchwork of existing intercarrier compensation payments.

283. As noted above, symmetrical rates promote efficiency. Symmetry will encourage interconnecting carriers to deploy more efficient technology to reduce their costs. Notably, the Commission of the European Communities (European Communities) has also found that divergent regulatory treatment between different technology termination rates, as this rebuttable presumption exception allows, creates distortions among markets.[742] In the context of fixed versus mobile telephony, the European Communities recognized that some European countries have allowed smaller CMRS carriers to charge higher termination rates to compensate for these carriers' lack of economies of scale.[743] The European Communities concluded that these higher termination rates for mobile technology led to higher retail rates for customers and lower usage of this technology.[744] As the European experience

---

[737] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041–42, para. 1088.

[738] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

[739] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

[740] We note that the rates that will apply under our transition plan, discussed *supra* Part V.B.2, will not necessarily be symmetric. For example, we do not permit CMRS providers to assess access charges during the transition. *See supra* para. 197; 47 U.S.C. § 251(f)(2). Our symmetry rules thus apply outside the transition framework, i.e., for carriers exchanging traffic at the final, uniform reciprocal compensation rate, or for carriers that have received a suspension or modification of our intercarrier compensation requirements pursuant to 251(f)(2).

[741] Indeed, we are only aware of one case where a competitive LEC attempted to rebut the presumption and, in that case, the state commission found that the competitive LEC had failed to do so. *See* Petition of Sprint Spectrum L.P. d/b/a Sprint PCS, Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Intercarrier Agreement with Verizon New York Inc., Case 01-C-0767, Arbitration Order, 2002 WL 31505732 (N.Y. P.S.C. 2002) (holding that Sprint did not rebut the presumption that its costs were higher than the incumbent LEC's).

[742] *See* THE COMMISSION OF THE EUROPEAN COMMUNITIES, DRAFT COMMISSION RECOMMENDATION ON THE REGULATORY TREATMENT OF FIXED AND MOBILE TERMINATION RATES IN THE EU 3, para. 3 (2008), *available at* http://ec.europa.eu/information_society/policy/ecomm/doc/library/public_consult/termination_rates/termination.pdf (last visited Oct. 24, 2008) (EUROPEAN COMMUNITIES).

[743] *See* EUROPEAN COMMUNITIES at 2, para. 2.

[744] *See* EUROPEAN COMMUNITIES at 3, para. 3.

shows, allowing the present exception to the symmetry rule could encourage higher termination rates, and asymmetric termination rates—particularly if such termination rates were high for one carrier—could reduce consumer welfare and lead to higher prices.

284. We conclude that requiring symmetrical compensation arrangements without any exceptions is proper under section 252(d)(2)(A)(ii) of the Act.[745] We also confirm that this mandatory symmetry requirement applies without regard to whether traffic exchanged by the interconnected carriers is balanced or not. Given the substantial benefits of symmetrical rates as described above, the likelihood that allowing asymmetrical rates would give carriers an incentive to find ways to arbitrage the higher rates, and the minimal costs associated with terminating calls,[746] we find that an exception to symmetrical rates where traffic is out of balance is not warranted.

c. Modifications and Suspensions under Section 251(f)(2)

285. In light of the importance of bringing uniformity and symmetry to intercarrier compensation, eliminating opportunities for regulatory arbitrage, and providing regulatory certainty to carriers in making investment plans, we find it appropriate to adopt guidelines regarding the application of section 251(f)(2). Section 251(f)(2) of the Act gives state commissions the ability to suspend or modify our intercarrier compensation rules implementing section 251(b) and (c) under certain conditions. Specifically, section 251(f)(2) of the Act permits a "local exchange carrier with fewer than 2 percent of the Nation's subscriber lines installed in the aggregate nationwide" to "petition a State commission for a suspension or modification of the application of a requirement or requirements of [section 251] (b) or (c)."[747] The state commission shall grant such petition "to the extent that, and for such duration as, the State commission determines that such suspension or modification (A) is necessary (i) to avoid a significant adverse economic impact on users of telecommunications services generally; (ii) to avoid imposing a requirement that is unduly economically burdensome; or (iii) to avoid imposing a requirement that is technically infeasible; and (B) is consistent with the public interest, convenience, and necessity."[748] In the *Local Competition First Report and Order*, the Commission "decline[d] . . . to adopt national rules or guidelines" regarding the specific implementation of section 251(f), but explained that the Commission "may offer guidance on these issues at a later date, if we believe it is necessary and appropriate."[749] The Supreme Court subsequently confirmed that the Commission has the authority to interpret section 251(f).[750] The only existing Commission guideline regarding section 251(f)(2) provides that the burden

---

[745] This section requires that, in setting rates under interconnection agreements, states must ensure that reciprocal compensation charges are a "reasonable approximation of the additional costs of terminating such calls." *See* 47 U.S.C. § 252(d)(2)(A)(ii). In the *Local Competition First Report and Order*, the Commission found that the incumbent LEC's costs were a reasonable proxy for other carriers' costs. 11 FCC Rcd at 16040, para. 1085. We reaffirm that finding, especially given that our pricing methodology focuses on the costs of the least cost, most efficient network technology. Moreover, per the express terms of the Act, the "additional costs" standard applies only to the costs of the incumbent LEC, not the competitive LEC. This interpretation of the Act promotes efficiency and therefore bolsters competition, consistent with the goals of the Act. *See* 1996 Act, Preamble (declaring the purpose of the Act to be "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").

[746] *See supra* section V.B.4.c.

[747] 47 U.S.C. § 251(f)(2).

[748] 47 U.S.C. § 251(f)(2).

[749] *Local Competition First Report and Order*, 11 FCC Rcd at 16118, para. 1263; 47 U.S.C. § 251(f)(2).

[750] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

of proof is on the LEC seeking suspension or modification of particular requirements.[751]

286. As an initial matter, we conclude that any suspension or modification granted pursuant to section 251(f)(2) must be for a limited "duration" and cannot be indefinite. This interpretation follows directly from the express language of section 251(f)(2). Specifically, section 251(f)(2) provides that the state should grant a suspension or modification "to the extent that, *and for such duration as,* the State commission determines that such suspension or modification"[752] satisfies the statutory test. Congress thus expected that the conditions warranting suspension or modification of a requirement would not be permanent, and it permitted the states to continue such modifications or suspensions only for a particular "duration," rather than remaining in place indefinitely. In contrast, Congress adopted the opposite approach in section 251(f)(1), where it provided a default exemption for "rural telephone companies" from section 251(c) that continues indefinitely "until" certain statutory criteria are met.[753] Accordingly, we conclude that the LEC requesting the suspension or modification under section 251(f)(2) has the burden of demonstrating the appropriate duration of any suspension or modification. To the extent that a state grants a suspension or modification for a particular duration, the Commission encourages the state to impose a timeline or other requirements on the LEC to ensure that it is taking concrete steps to enable it to comply with the relevant requirements once the suspension or modification ends.[754] If a state finds that a LEC is not taking such steps necessary to ensure compliance on a date certain, we find that such a determination would be sufficient for the state immediately to revoke the suspension or modification as no longer satisfying the "public interest" criteria.

287. We also offer guidance regarding the substantive standards that state commissions must apply when evaluating requests pursuant to section 251(f)(2) for a suspension or modification of section 251(b) or (c). The first prong of section 251(f)(2)(A) directs state commissions to determine whether the LEC establishes that absence of the requested suspension or modification would cause a "*significant* adverse economic impact on users of telecommunications services generally."[755] The term "significant" is ambiguous. According to Webster's Dictionary, "significant" means "having or likely to have influence or effect; of a noticeably or measurably large amount."[756] We find this to be a reasonable definition, and conclude that for an "adverse economic impact" to be "significant" requires that such harm be "measurably large." Moreover, the state commission must evaluate the net impact "on users of

---

[751] *See* 47 C.F.R. § 51.405(b). In the *Local Competition First Report and Order,* the Commission held that, in petitions under section 251(f)(2), "a LEC must offer evidence that application of those requirements would be likely to cause undue economic burdens beyond the economic burdens typically associated with efficient competitive entry." 11 FCC Rcd at 16118, para. 1262. The Commission also placed the burden of proof on the carrier seeking the relief under section 251(f)(2). *Id*. at 16118, para. 1263. Although the Supreme Court ultimately upheld the Commission's authority to interpret section 251(f), *see AT&T v. Iowa Utils. Bd*., 525 U.S. at 385, the Eighth Circuit subsequently vacated the Commission's interpretation of "undue economic burden," finding that the Act requires a state to look at the entire economic burden not just the additional burden of complying with sections 251(b) or 251(c). *See Iowa Utils. II,* 219 F.3d at 759–62. The Eighth Circuit also found that the Commission erred in placing the burden of proof on the rural LEC when a requesting carrier seeks to remove the section 251(f)(1) exemption from section 251(c). The Eighth Circuit therefore vacated sections 51.405(a), (c), and (d) of our rules, *id*. at 762, but did not disturb the allocation of burden of proof under section 251(f)(2) as set forth in 47 C.F.R. § 51.405(b).

[752] 47 U.S.C. § 251(f)(2) (emphasis added).

[753] 47 U.S.C. § 251(f)(1).

[754] Moreover, if, in the future, we have evidence that states are granting arbitrarily long suspensions/modifications to requesting LECs, the Commission will consider imposing a limit on the number of years that a suspension/modification is appropriate.

[755] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[756] WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1096 (1991).

telecommunications services *generally*."[757] We conclude that state commissions must consider users of telecommunications services more broadly, rather than focusing narrowly on impacts on isolated groups of users, such as customers of the LEC requesting the suspension or modification. Further, state commissions must weigh the overall impact on such users, including not only any adverse impacts on particular users, but whether there are other associated benefits of the regulatory requirements to telecommunications users. For example, the reduction in intercarrier compensation payments might lead some carriers to increase some rates, but also should reduce long distance rates, stimulate additional competition in local markets, consistent with the goals of the 1996 Act, and provide additional benefits to end users. We direct states to consider the totality of the circumstances in evaluating the impact on telecommunications users.

288. The second prong of section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that the requested suspension or modification is necessary to "avoid imposing a requirement that is unduly economically burdensome."[758] The Eighth Circuit has interpreted the phase "unduly economically burdensome" to require a state to examine "the full economic burden on the ILEC."[759] Consistent with this interpretation, and our interpretation of section 251(f)(2)(A)(i) above, we conclude that states must evaluate the totality of the circumstances in evaluating the net burden. For example, in evaluating the impact of section 251(b)(5) as we interpret it today, states cannot simply look at the LEC's loss of intercarrier compensation revenues. Rather, the state must consider the full economic impact on the LEC of all the comprehensive reforms we adopt, including the ability of carriers to recover revenues by raising other rates, including the federal SLC, the potential economic savings due to reduced billing costs, fewer disputes and litigation regarding the classification of traffic, and the possibility that a carrier may receive universal service support if its financial integrity is threatened.

289. The third prong under section 251(f)(2)(A) requires a state commission to determine whether the LEC has demonstrated that compliance with section 251(b) or (c) may be "technically infeasible."[760] We do not believe that any carrier will be able to establish that implementation of our intercarrier compensation reforms is "technically infeasible," considering that carriers generally are exchanging and billing for traffic today, and our rules adopted in this order should merely simplify this process. Thus, we recommend that state commissions scrutinize rigorously any claims of technical infeasibility, particularly if the LEC is paying and/or receiving intercarrier compensation today.

290. Even if a state finds that a LEC satisfies the requirements for a temporary suspension or modification under section 251(f)(2)(A), section 251(f)(2)(B) provides that a state commission cannot grant a petition for suspension or modification unless it also finds that granting the requested petition is "consistent with the public interest, convenience, and necessity."[761] In light of the compelling need to adopt comprehensive reform of existing intercarrier compensation regimes as described above,[762] the Commission urges states to use caution and consider carefully the ramifications of granting any suspension or modification, particularly regarding petitions seeking relief from section 251(b)(5). Indeed,

---

[757] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[758] *See* 47 U.S.C. § 251(f)(2)(A)(ii).

[759] *Iowa Utils. II*, 219 F.3d at 761. The Commission initially interpreted undue economic burden to mean the "undue economic burden beyond the economic burden that is typically associated with efficient competitive entry." 47 C.F.R. § 51.405(d). The Eighth Circuit vacated this reading of the statute. *See Iowa Utils. II*, 219 F.3d at 760–61.

[760] 47 U.S.C. § 251(f)(2)(A)(iii).

[761] 47 U.S.C. § 251(f)(2)(B).

[762] *See supra* section V.A.3.

any suspension or modification that continues to treat traffic under different rate structures opens the door for continued regulatory arbitrage and disputes. Such action would undermine the tremendous public interest benefit associated with treating all traffic the same.

291. The Act is silent on what occurs if a state grants a suspension or modification of the section 251(b) or (c) obligations. We find that this silence creates ambiguities and could lead to inconsistent results following a modification or suspension under section 251(f)(2). We are concerned that a suspension or modification of section 251(b)(5) could result in exactly the kind of disparate treatment that we intend to correct with our actions today. Pursuant to our authority under section 201(b), as well as our authority to interpret section 251(f),[763] we therefore adopt rules specifically addressing certain of the implications of a suspension or modification of our intercarrier compensation rules.[764]

292. First, to minimize inconsistency and the possibility that the reforms we adopt today could be undermined, we extend our symmetry requirement for reciprocal compensation rates at the end of the transition period described in Part V.B to any suspension or modification of our section 251(b)(5) reciprocal compensation rules and requirements. If a LEC receives a suspension or modification of our reciprocal compensation pricing methodology, for example, all other LECs and CMRS providers that exchange traffic with the LEC receiving the suspension or modification will likewise be entitled to charge that LEC those same rates that the LEC charges them for the duration of such suspension or modification. We conclude that this symmetry requirement is in the public interest and will reduce disputes, arbitrage, and transaction costs. Indeed, a contrary result that would permit different terminating rates in the same geographic area would not be in the public interest and likely would lead to the same disputes we have today. If a state attempts to avoid this symmetry requirement by granting a LEC a suspension or modification of any section 251(b)(5) reciprocal compensation obligation and the state fails to require symmetric rates, we will invoke our authority under sections 201 and 332 of the Act to ensure that all carriers exchanging traffic with that LEC pay the same rate for terminating all traffic.

293. Second, if a state grants any suspension or modification that is more than 1 year in duration, we require the state to take a fresh look to determine whether such suspension/modification continues to satisfy the statutory test in light of possible changes in circumstances. To this end, 90 days before the 1-year anniversary of the grant of the suspension or modification, the LEC must file a petition demonstrating that the suspension or modification continues to satisfy the statutory criteria. In the intervening time, for example, a state may have rebalanced rates, the LEC may have increased its end-user charges, or other relevant changes may have occurred. Those actions may have obviated the need for the suspension or modification or, at a minimum, could result in the need for changes to the terms and duration of the suspension or modification. In such a review, the LEC continues to have the burden of demonstrating that the section 251(f)(2) criteria remain satisfied. We conclude that states should act upon

[763] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

[764] Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act." 47 U.S.C. § 201(b); *see also* 47 U.S.C. § 154(i) ("The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions."). "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'" *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378. As the Supreme Court has confirmed, this grant of authority necessarily includes section 251(f). *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385 (holding that the Commission has "jurisdiction to promulgate rules . . . regarding rural exemptions"); *see also id.* at 378 n.6 ("[T]he question in theses cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

such a fresh look within the 180 days for new petitions set forth in section 251(f)(2).[765]

d. Existing Agreements

294. Below we discuss the effect of our intercarrier compensation reforms on certain types of existing agreements.

295. *Interconnection agreements*. With respect to interconnection agreements, we do not disturb the processes established by section 252 of the Act. As discussed above, the intercarrier compensation reforms we adopt will necessitate that states implement our new reciprocal compensation methodology. We expect that incumbent LECs and competing carriers will implement the reciprocal compensation changes as directed by section 252 of the Act.[766] We make clear that our actions today constitute a change in law, and we recognize that interconnection agreements may contain change of law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.[767] Verizon raises a concern regarding the impact on contracts in "evergreen" status, which Verizon describes as "contracts that have reached the end of their terms but remain in effect pending entry into new contracts."[768] Given that the comprehensive reforms today are necessary to eliminate arbitrage and reduce disputes, we believe it is appropriate for carriers to take a "fresh look" at their interconnection agreements in "evergreen" status, including agreements that lack a change-of-law provision, and follow the section 252 process of negotiation and arbitration. We also note that, pursuant to section 251(a)(1), carriers remain free to negotiate alternative arrangements.[769]

296. *Commercial arrangements*. As discussed above, the intercarrier compensation reforms will require carriers to make certain changes to their tariffs relating to carrier-to-carrier charges, and potentially also SLCs. We do not, however, abrogate existing contracts or otherwise allow for a "fresh look" in light of our reforms.[770] As the Commission has recognized, for example, early termination

---

[765] 47 U.S.C. § 251(f)(2) ("The State commission shall act upon any petition filed under this paragraph within 180 days after receiving such petition.").

[766] *See* 47 U.S.C. § 252.

[767] *See Triennial Review Order*, 18 FCC Rcd at 17404, para. 700. Although section 252(a)(1) and section 252(b)(1) refer to requests that are made *to* incumbent LECs, we have interpreted that in the interconnection agreement context to mean that either the incumbent or the competitive LEC may make such a request, consistent with the parties' duty to negotiate in good faith pursuant to section 251(c)(1). *See Triennial Review Order*, 18 FCC Rcd at 17405, para. 703 n.2087; *see also* 47 U.S.C. §§ 251(c)(1), 252(a)(1), (b)(1). We believe that this adequately addresses concerns about existing interconnection agreements that do not include express change of law provisions.

[768] *See, e.g.,* Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 5–6 (urging that any new intercarrier compensation regime displace such contracts). By the same token, we decline to insulate existing interconnection agreements from the section 252 processes to the extent that some commenters propose that they remain in effect. *See, e.g.*, Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 04-36, 06-122, 05-195, CC Docket Nos. 01-92, 96-45, 99-68, Attach. at 13 (filed Oct. 7, 2008) (proposing that the Commission "order that those prior arrangements should at least presumptively remain in force after the implementation of a new, unified . . . rate regime").

[769] 47 U.S.C. § 251(a)(1).

[770] Several commenters request that the Commission give them a fresh look at existing contracts. *See, e.g.*, Letter from Richard R. Cameron and Teresa D. Baer, Counsel for Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 08-152; CC Docket Nos. 01-92, 99-68, 96-45 at 2 (filed Sept. 18, 2008) (asking that the Commission "provide an 18-month window within which carriers can reconfigure their interconnection facilities without incurring reconfiguration charges or early termination liabilities under existing transport contracts"); Ad Hoc *ICC FNPRM* Comments at 22–24 (arguing that customers should be allowed to opt out of existing contracts); Earthlink *ICC FNPRM* Reply at 7 (arguing that end users should have the opportunity to negotiate different terms and, if renegotiation is not possible, be permitted to terminate existing contracts without liability).

provisions can be mutually beneficial by giving providers greater assurance of cost recovery, and giving customers (whether wholesale or end-users) discounted and stable prices over the relevant term.[771] Indeed, allowing for a fresh look could result in a windfall for customers that entered long-term arrangements, in exchange for lower prices, as compared to other customers that avoided early termination fees by electing shorter contract periods at higher prices.[772] Rather than adopt a rule that these commercial arrangements must be reopened, we will leave such issues to any change-of-law provisions in these commercial arrangements, or to commercial negotiations among the parties.[773]

2. Revenue Recovery Opportunities

297. In the preceding sections of this order, we adopt fundamental changes to the existing intercarrier compensation regimes. These reforms are designed to unify and simplify these mechanisms, consistent with the framework Congress adopted in the 1996 Act. This new approach will result in overall reductions in interstate and intrastate intercarrier compensation rates.[774] In this section, we address the extent to which revenue reductions from carrier-to-carrier charges may be replaced through end-user charges and new universal service support. In prior intercarrier compensation reforms, the Commission largely replaced reductions in intercarrier compensation revenues through a combination of increased end-user charges and new universal service funding.[775] Our actions here carefully balance the need to ensure reasonable revenue recovery by carriers against the potential adverse impact on consumers of increased end-user charges, and the pressure placed on the universal service program to the extent that new subsidies are made available.

298. As an initial matter, we increase the caps on interstate SLCs, and we permit incumbent LECs to increase their SLCs up to the new caps to recover lost interstate and intrastate intercarrier compensation revenues resulting from reduced switched access and reciprocal compensation rates. We also enlist the aid of the Separations Joint Board to evaluate the need for further increases in interstate end-user charges to recover any net loss in interstate and intrastate intercarrier compensation revenues, and to evaluate the conditions under which carriers may seek additional universal service funding. To limit the increase in the total universal service fund, we establish certain preconditions that carriers must satisfy before they can receive additional universal service funding to compensate for lost intercarrier compensation revenues.

a. End-User Charges

---

[771] *See, e.g., Triennial Review Order*, 18 FCC Rcd at 17400, 17402–03, paras. 692, 697–99; *see also, e.g.*, AT&T *ICC FNPRM* Reply at 17–19 (arguing against giving end users a fresh look at existing contracts). To the extent that there is evidence that particular termination penalties are inappropriate, the Commission can resolve such a matter through an enforcement proceeding. *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 698.

[772] *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

[773] This situation is thus different than cases where the Commission found that certain contract provisions might adversely affect competition or where end-user customers would be denied the benefits of new Commission policy absent a fresh look opportunity. *See, e.g., Local Competition First Report and Order*, 11 FCC Rcd at 16044, para. 1094; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7350, para. 21 (1993) (allowing a fresh look at agreements in "situations where excessive termination liabilities would affect competition for a significant period of time"); *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5907, para. 151 (1991) (giving customers of AT&T 90 days to terminate their contracts without penalty to let them "tak[e] advantage of 800 number portability when it arrives").

[774] *See supra* paras. 186–268.

[775] *See supra* paras. 159–185.

299. In this section, we consider whether revenue reductions from reformed carrier-to-carrier charges should be replaced to any extent by increases in end-user charges, as the Commission has done in some prior intercarrier compensation reform proceedings.[776] The Commission has acknowledged that "[t]he concept that users of the local telephone network should be responsible for the costs they actually cause is sound from a public policy perspective and rings of fundamental fairness," and also helps ensure "that ratepayers will be able to make rational choices in their use of telephone service."[777] Importantly, however, the Commission also has maintained "safeguards that ensure that the rates consumers pay . . . remain well within a zone of reasonableness."[778] To permit carriers to recover at least part of their lost intercarrier compensation revenues, we raise the caps on interstate SLCs as described below, which we find to be within the "zone of reasonableness" and which should not have a significant adverse effect on telephone penetration. We also enlist the help of the Separations Joint Board to consider the need, if any, for further increases in end-user charges and certain other revenue recovery issues.

300. The record reveals a wide variety of proposals for modifying interstate end-user charges in response to reductions in intercarrier compensation rates. The majority of these proposals advocate increasing the caps on the interstate SLCs. The interstate SLC is a flat-rated charge that recovers the interstate portion of local loop costs from an end user. Under our current rules governing incumbent LECs, SLCs are subject to a cap that varies based upon whether the line is: (a) a primary residential or single-line business line; (b) a non-primary residential line; or (c) a multi-line business or Centrex line.[779] Some parties propose specific increases in SLC caps to offset a portion of the revenues lost through mandated reductions in intercarrier compensation–including both reductions in interstate and intrastate revenues.[780] Other parties contend that most or all of a carrier's replacement of lost intercarrier compensation revenues should come from increased SLCs.[781] On the other hand, some consumer groups assert that no increase in SLC caps is warranted in response to reductions in intercarrier compensation

[776] *See, e.g.*, *First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d 682; *Access Charge Reform Order*, 12 FCC Rcd 15982; *CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613.

[777] *First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 686, para. 7.

[778] *CALLS Order*, 15 FCC Rcd at 12976, para. 33; *see also, e.g.*, *1983 Access Charge Order*, 93 FCC 2d at 243, para. 4 (finding that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act").

[779] For price cap and rate-of-return carriers, the current SLC cap for residential and single-line business lines is $6.50, 47 C.F.R. §§ 69.104(n)(1)(ii)(C), 69.152(d)(1)(ii)(D), and the current SLC cap for multi-line business and Centrex lines is $9.20, 47 C.F.R. §§ 69.104(o)(1)(i); 69.152(k)(1)(i). Price cap carriers currently also have a SLC cap of $7.00 for non-primary residential lines. 47 C.F.R. § 69.152(e)(1)(i).

[780] *See, e.g.*, ICF *ICC FNPRM* Comments, App. C at C-7; NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7; Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach at 2–3 (filed Sept. 19, 2008); Verizon Sept. 12, 2008 *Ex Parte* Letter, Attach. at 6–7; Letter from Mary L. Henze, Executive Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket Nos. 05-337, 06-112, 99-68, 07-135, Attach. at 2 (filed Oct. 9, 2008).

[781] *See, e.g.*, Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 5 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Federal Regulatory Affairs, T-Mobile USA, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 8 (filed Oct. 3, 2008); Cox *ICC FNPRM* Comments at 5–6; Eschelon *ICC FNPRM* Comments at 12.

rates.[782]

(i) Current Availability of End-User Charges for Revenue Recovery

301. As an initial matter, we permit incumbent LECs to increase their SLCs up to new caps to recover reductions in ~~interstate~~ intercarrier compensation revenues resulting from reduced switched access and reciprocal compensation rates.[783] In particular, we increase the SLC cap for residential and single-line business lines from $6.50 to $8.00, the non-primary residential line SLC cap from $7.00 to $8.50, and the multi-line business SLC cap from $9.20 to $11.50. We believe that these modest increases in the SLC caps continue to "ensure that the rates consumers pay for the SLC remain well within a zone of reasonableness."[784] Moreover, we believe that these SLC cap increases also address commenters' concerns about the need for some end-user recovery in light of lost intercarrier compensation revenues. Although some commenters argue for more substantial increases in the SLC caps, we note that there is evidence that incumbent LECs charge rates below even the existing caps in a number of instances. For example, the primary residential and single-line business SLC cap is $6.50, but the national average SLC for those lines is $5.93 based on recent Commission data.[785] Similarly, the non-primary residential line SLC cap is $7.00, but the national average SLC for those lines is $5.81.[786] Further, the multi-line business and Centrex line SLC cap is $9.20, but the national average SLC for those lines is $6.30—nearly $3.00 below the cap.[787] We therefore find it reasonable in the first instance to raise the interstate SLC cap and to allow carriers whose current SLCs are below the new caps to increase those SLCs to recover revenues lost from interstate and intrastate ~~access~~ intercarrier ~~charge~~ compensation reductions.[788]

302. To the extent that an incumbent LEC increases its SLCs to recover reductions in its ~~interstate~~ intercarrier compensation revenues and any of its SLCs are still below the relevant caps, we allow those carriers to raise their SLCs further, up to the caps, to recover any net loss in ~~intrastate~~

[782] *See* Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. 2 at 22 (filed Sept. 19, 2008); Letter from David C. Bergmann, Assistant Consumer's Counsel Chair, NASUCA Telecommunications Committee, to Marlene H. Dortch, Secretary, FCC, WC Dockets Nos. 08-152, 07-135, 06-122, 05-337, 05-195, 04-36, 03-109, 02-60, CC Dockets Nos. 02-6, 01-92, 00-256, 99-68, 96-262, 96-45, 80-286 at 10 (filed Sept. 30, 2008); Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

[783] For purposes of the calculations described here, intercarrier compensation revenues will be calculated on a per-SLC-chargeable-line basis, using a 2008 base year. This 2008 intercarrier-revenue-per-SLC-chargeable-line figure will be used throughout the transition period for calculating the revenue shift to the SLC.

[784] *CALLS Order*, 15 FCC Rcd at 12976, para. 33. We note that section 54.403 of the Commission's rules provides for Tier 1 lifeline support to cover the tariffed SLCs established by rate-of-return and price cap carriers pursuant to sections 69.104 and 69.152 of the Commission's rules. 47 C.F.R. § 54.403.

[785] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1 (providing national weighted average SLCs for price cap carriers and all LECs in the NECA pool as of June 30, 2008).

[786] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1.

[787] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1

[788] Should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, the difference between the charges it sets and the maximum charges it is allowed to set may not be recovered through increased SLCs, nor may such carriers seek to obtain supplemental universal service support, as described in Part V.C.2, based on that difference.

intercarrier compensation revenues, at least on an interim basis.[789] In these cases, the appropriate measure of the SLC will equal the relevant CMT revenues, as defined by our rules, plus any lost per-line intercarrier revenues. Carriers are free to calculate SLC increases on a per-study-area basis or an averaged basis, and this decision need not track the manner in which the carrier's existing (CMT-revenues-based) federal SLC is structured. To ensure that incumbent LECs do not double-recover lost intercarrier payments in state rates and federal SLCs, ~~As a prerequisite for incumbent LECs to increase their SLCs in this manner, we require that the LEC's state retail rates and any intrastate SLC be set at the maximum level permitted under state regulations.[790] This will ensure that revenues from interstate end-user charges will not be used to recover intrastate revenue requirements until the carrier has fully availed itself of all available intrastate revenue opportunities under existing law.~~ w~~W~~e ~~also~~ mandate that any increase in interstate SLC revenues that are intended to recover lost ~~intrastate~~ intercarrier compensation revenues be used by the state in ratemaking to reduce costs or revenue requirements to be recovered in the intrastate jurisdiction.[791] We underscore that so long as they remain consistent with the overall caps set forth herein, SLC increases may be effectuated any time an applicable reciprocal compensation or access rate falls during the transition period. Furthermore, so long as the SLC increases meet the requirements set forth herein and are associated with revenue losses attributable to reduced access or reciprocal compensation rates, we impose no other limits or preconditions applicable to requirements on those increases.[792]

303. We find that we have authority to allow recovery of intrastate revenue requirements in this manner. For one, the legacy separations regime does not preclude this action. The Commission historically has provided federal funds to cover at least a portion of costs assigned to the intrastate jurisdiction.[793] Although those decisions relied on the Commission's universal service authority pursuant to section 254, we find that we have authority under section 251(g) to allow recovery of intrastate revenue requirements through interstate SLC rates. Section 251(g) empowers the Commission to subject traffic previously encompassed by section 251(g) to the reciprocal compensation regime of section 251(b)(5), including providing for an orderly transition. Allowing incumbent LECs the option to recover certain lost intrastate intercarrier compensation revenues through increases in the interstate SLC, subject to the new caps, furthers such a transition. In particular, this option helps mitigate any need incumbent LECs might have to seek increases in state rates due to decreases in intrastate intercarrier compensation revenues during the initial stages of the transition, pending the Separations Joint Board referral and subsequent Commission action. We also acknowledge that interstate SLC charges are governed by sections 201 and 202 of the Act, and that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from

[789] As discussed below, we are referring to the Joint Board, among other things, the question of whether, and to what extent, net reductions in intrastate intercarrier compensation revenues should be offset by revenues from interstate end-user charges. *See infra* paras. 303–310.

[790] To the extent that a carrier's state retail rates have been deregulated, that carrier may not increase its SLCs to recover any net loss in intrastate intercarrier compensation revenues.

[791] *Cf. Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20486–87, para. 106 (1999) (*Universal Service Ninth Report and Order*) (specifying that "hold-harmless" universal service support "should continue to operate through the jurisdictional separations process to reduce book costs to be recovered in the intrastate jurisdiction.").

[792] We note that the SLC increases contemplated here could be effectuated in the course of the current annual filing process, such that the new SLCs would become effective each July.

[793] *See, e.g., Universal Service Ninth Report and Order*, 14 FCC Rcd 20432 (providing high-cost universal service support for intrastate costs).

cost-based ratemaking."[794] In the past, the Commission has, in fact, adopted regulatory approaches that deviated from cost-based ratemaking.[795] We find such an approach warranted here to help mitigate regulatory burdens during the transition, as described above.

304. In sum, we adopt increased SLC caps to allow incumbent LECs to recover some or all of their net loss in intercarrier compensation revenues resulting from rate reductions pursuant to this order. In particular, to recover those lost revenues, we permit incumbent LECs to increase each of their SLCs up to the new caps.

305. With respect to non-incumbent LECs, we note that most interstate rates of such providers are not subject to *ex ante* regulation by the Commission. Thus, we allow those carriers to recover any net loss in intercarrier compensation revenues in any lawful manner.[796]

(ii) Joint Board Referral of Possible Changes to End-User Charges

306. We enlist the aid of the Separations Joint Board to evaluate the need for any additional increases in interstate end-user rates for carriers to recover any net loss in interstate and/or intrastate intercarrier compensation revenues as a result of the reform measures we adopt today. There are a range of widely divergent proposals in the record regarding the need for additional changes to the SLC caps adopted above as part of comprehensive intercarrier compensation reform. We believe that the information and analysis developed by the Separations Joint Board will be extremely valuable in evaluating these issues.

307. Our decision to seek input from the Separations Joint Board is consistent with section 410 of the Act. Section 410(c) of the Act requires the Commission to refer to the Separations Joint Board any changes to the separations rules being considered through a rulemaking proceeding. Although no changes to the separations rules are at issue here, section 410(c) also authorizes the Commission to refer matters "relating to common carrier communications of joint Federal-State concern to a Federal-State Joint Board."[797] We believe that recommendations from a Joint Board regarding these issues are important to striking the right balance among the various policy goals at stake, relating to traffic that historically has been regulated, in part, by both federal and state jurisdictions. Moreover, the issue of using revenues from additional interstate end-user charges to recover intrastate revenue requirements is sufficiently related to the underlying separations requirements themselves that we believe the Separations Joint Board possesses highly relevant expertise to provide recommendations on these issues.[798]

---

[794] *Access Charge Reform Second Order*, 12 FCC Rcd at 16619–20, para. 44 (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)).

[795] *See, e.g.*, *LEC Price Cap Order,* 5 FCC Rcd 6786 (adopting price cap regulation, under which rates are not tied directly to cost); *Pricing Flexibility Order*, 14 FCC Rcd 14221, 14307, para. 168 (once price cap carriers are granted pricing flexibility, they lose the option of a low end adjustment, which would permit incumbent LECs earning rates of return less than 10.25% in a given year to increase their price cap indices to a level that would enable them to earn 10.25%.); *MCI Telecomms. Corp. v. U S WEST Commc'ns, Inc*., File Nos. E-97-08, E-97-20 through 24, Memorandum Opinion and Order, 15 FCC Rcd 9328, 9334, para. 14 (2000) (finding that incumbent LECs' non-cost-based PICC did not violate section 201(b) given the Commission's prior establishment of a safe harbor).

[796] *Cf. Telephone Number Portability,* CC Docket No. 95-116, Third Report and Order, 13 FCC Rcd 11701, 11725–26, 11773–80, paras. 39, 135–49 (1998) (carriers other than incumbent LECs permitted to recover such costs in any lawful manner).

[797] 47 U.S.C. § 410(c).

[798] The Commission has referred non-separations issues to the Separations Joint Board previously. *See, e.g.*, *MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules,* CC Docket Nos. 78-72, 80-286,

(continued….)

308. As described in greater detail below, we refer to the Separations Joint Board certain specific issues regarding possible increases in interstate end-user charges: (i) whether SLC caps should be increased by a fixed amount to recover any net loss in intercarrier compensation revenues; (ii) whether a "flexible" SLC cap should be used in conjunction with an overall benchmark or threshold; or (iii) some combination of those options.

309. *Quantifying Any Increase in End-User Charges*. We refer to the Separations Joint Board several possible approaches for establishing any additional permissible increases in interstate end-user charges, to the extent that any are warranted. First, the Separations Joint Board could directly recommend particular further increases in the SLC caps. Parties here have proposed various levels of SLC cap increases, and different ways to distribute those increases across the different SLC caps. For example, the ICF proposal would result in all SLC caps being increased to $10.00 by the end of a transition period.[799] Under the Missoula Plan's initial proposal, SLC cap increases vary for the three "tracks" or categories of carriers defined in the plan.[800] ITTA proposes a $2.25 increase in each SLC cap by the end of a transition period, subject to a benchmark consisting of SLCs, retail rates, and certain other charges.[801] Other parties, such as CTIA, contend that recovery of lost intercarrier compensation revenues by incumbent LECs should come solely from end-user charges.[802] In contrast, Free Press, NASUCA, and Ad Hoc propose that SLC caps not be increased at all.[803]

310. Second, the Separations Joint Board could recommend a "flexible" SLC cap that would vary depending upon a carrier's other end-user rates and an overall benchmark or threshold. For example, under a recent Verizon proposal, the 'default' SLC caps all would increase to $10.00 by the end of a transition period.[804] However, to the extent that a carrier's relevant end-user rates still are below a proposed benchmark, that carrier's SLC cap would increase as much as needed to reach the benchmark.[805] Thus, the Separations Joint Board could determine a particular benchmark or threshold and allow the SLC cap to vary for each carrier, depending upon how much "headroom" that carrier has under the benchmark, in light of the carrier's other rates. To the extent that the Separations Joint Board recommends this

(continued from previous page)
Further Notice of Proposed Rulemaking, 49 Fed. Reg. 18318, 18318, para. 1 (1984) (referring to a Separations Joint Board issues including: (1) the subscriber line charge for residential and single-line business customers; (2) the transition mechanism for implementing subscriber line charges for these customers; (3) an exemption from the subscriber line charge or other assistance for low income households; and (4) additional assistance for small telephone companies.); *MTS and WATS Market Structure and Amendment of Part 67 of the Commission's Rules*, CC Docket Nos. 78-72, 80-286, Recommended Decision, 49 Fed. Reg. 48325, 48327, para. 9 n.20 (1984) (noting that "[s]ince these issues do not involve the allocation of costs between the jurisdictions, preparation of a Joint Board recommendation is not mandatory.").

799 ICF *ICC FNPRM* Comments, App. C at C-7.

800 NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7.

801 ITTA Sept. 19, 2008 *Ex Parte* Letter, Attach. at 2–3.

802 CTIA Oct. 2, 2008 *Ex Parte* Letter, Attach. at 10. *See also, e.g.*, Letter from Norina Moy, Director, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92 at 2 (filed Aug. 7, 2008).

803 Letter from Ben Scott, Policy Director, Free Press, Washington Office, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. 2 at 22 (filed Sept. 19, 2008); NASUCA Sept. 30, 2008 *Ex Parte* Letter at 10; Letter from James S. Blaszak, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 4 (filed Oct. 14, 2008).

804 Verizon Sept. 12, 2008 *Ex Parte* Letter at 6–7.

805 Verizon Sept. 12, 2008 *Ex Parte* Letter.

approach, it should specify which carrier rates should be included in the relevant benchmark or threshold.

311. Third, the Separations Joint Board could recommend some combination of the first and second options.

312. In making recommendations on these issues, the Separations Joint Board will consider the extent to which any recommended increases in interstate end-user charges should be used to offset lost intrastate intercarrier compensation, to the extent that decreases in interstate intercarrier compensation revenues already have been recovered. Most comprehensive reform proposals in the record assume that SLC cap increases will be used to offset at least some intrastate revenues.[806] Logically, however, another alternative is for any increases in the SLC caps to be used only to recover reductions in interstate intercarrier compensation revenues, and to leave it to each state to address lost intrastate intercarrier compensation revenues as appropriate under state law.

313. *Timing*. We direct the Separations Joint Board to issue its recommended decision not later than one year from the effective date of this order. In light of that timetable, we limit the Separations Joint Board to consideration of specific issues we refer in this order.

b. Universal Service Support

(i) Policy Approach

314. We recognize that the actions we take to reform intercarrier compensation will result in reduced revenues for many carriers. As discussed above, carriers have the opportunity to replace certain of those lost revenues through end-user charges.[807] We also acknowledge that, in the past, the Commission has sometimes provided new universal service support to replace reductions in intercarrier compensation revenues.[808] As the Fifth Circuit has recognized, however, "[b]ecause universal service is funded by a general pool subsidized by all telecommunications providers—and thus indirectly by customers - excess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market." [809] Thus, excessive universal service subsidization could, perversely, cause undesirable increases in consumers' bills.

315. We note that many companies—in particular price cap carriers—consistently are paying dividends and are using the same supported network to provide both regulated services and non-regulated services. Throughout the course of our comprehensive reform proceedings, commenters have identified this as a concern to be weighed carefully when evaluating the need for universal service support. For example, following the 2005 intercarrier compensation Further Notice, CTIA contended that some rural incumbent LECs already "are overcompensated by universal service support" based on evidence that their "stocks generate returns, measured by market-to-book ratios, far in excess of, and exhibit significantly lower risk premiums than, the supposedly more secure RBOCs."[810] Commenters continue to express

---

[806] To the extent that interstate end-user charges are used to offset any lost intrastate intercarrier compensation revenues, we mandate that the states take account of those revenues in their state ratemaking by reducing the intrastate costs or revenue requirement to be recovered through intrastate rates.

[807] In this order, we do not decide the maximum amount that incumbent LECs ultimately may charge customers in the form of interstate end-user charges. As discussed above, that will depend upon further Commission action based on recommendations from the Joint Board.

[808] *See, e.g., CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613; *see also MAG* Second *FNPRM*, 19 FCC Rcd 4122.

[809] *Alenco*, 201 F.3d at 620.

[810] CTIA *ICC FNPRM* Comments at 37 citing Western Wireless Reply, CC Docket No. 96-45, Attach. at 2–5 (filed Dec. 14, 2004) (attaching Economics and Technology, Inc., *Reforming Universal Service Funding for Rural ILECs: An Idea Whose Time Has Come*).

concern that existing universal service subsidies too often lead simply to "'high overhead, sumptuous earnings, [and] rich dividends.'"[811] For example, recent news reports indicate that CenturyTel and Embarq still "remain highly profitable – operating margins for both are 27 percent" notwithstanding any competition they face.[812] Parties have argued that there continues to be evidence that "[i]nvestors place a higher value on RLEC earnings than on other ILEC earnings. In today's market, the larger ILECs, which do not generate much of their revenues from federal subsidies, are valued much less highly per dollar of profit."[813] While there are "various factors in play" this suggests that "[m]illions of dollars in extra wealth end up in the hands of private investors" by "transferring income from telephone users to phone company stockholders."[814] Indeed, commenters note that "some carriers owned by co-ops pay their members annual dividends that exceed their members' local phone charges."[815] In light of these concerns and the mandates of section 254, we agree with commenters that it is not appropriate to require all universal service contributors to pay into the fund so that these carriers can continue to pay dividends.[816]

316. Thus, rather than guaranteeing revenue neutrality, as some commenters propose,[817] we take steps here to ensure that any new universal service subsidies are targeted carefully to situations where they are most crucially needed. In particular, far from the regulated monopolies of years past, significant marketplace developments have resulted in additional revenue opportunities for carriers. As NASUCA observes, "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets."[818] "By way of

---

[811] Thomas W. Hazlett, *"Universal Service Telephone Subsidies: What Does $7 Billion Buy?* (*Universal Service Telephone Subsidies*) at 33, *attached to* Core *Missoula Phantom Traffic* Comments, Tab B (quotation omitted).

[812] *A Fair Copper*, FINANCIAL TIMES, Oct. 28, 2008, at 16.

[813] *Universal Service Telephone Subsidies* at 34.

[814] *Universal Service Telephone Subsidies* at 34, 70. *See also* Julie Tanner, General Counsel, Chinook Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10, Attach. 1 at 7 (filed Feb. 22, 2008) (arguing that incumbent LECs receiving universal service support "send a comfortable return on investment to investors (and rural cooperative members) with no accountability"); NTCH, CC Docket No. 96-45, WC Docket Nos. 05-337, 08-10 at 8 (filed Feb. 22, 2008) ("The object of the [universal service] subsidy is not to prop up high cost legacy companies and technologies or assure their profitability, nor to add to the profits of wireless carriers.").

[815] *Universal Service Telephone Subsidies* at 70.

[816] *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 68 ("Even if excessive support does not lead to unaffordable increases in rates for non-subsidized subscribers, requiring those customers to pay more than is necessary in order to excessively subsidize rates for other [services] (or worse yet, to finance high dividend payments to owners of rural ILECs) is not consistent with maintaining just and reasonable rates."); Time Warner Telecom *Missoula Phantom Traffic* Comments at 10 (noting that "RBOCs are already realizing substantial profits from [network] investments, easily compensating for any loss in access payments that they may face" and that "a high [universal service] contribution level may approach the point at which the USF charges imposed upon end-users actually threaten the goal of universal service").

[817] *See, e.g.*, CenturyTel Sept. 19, 2008 *Ex Parte* Letter, Attach. at 5 (arguing that revenue neutrality should be a fundamental goal of comprehensive intercarrier compensation reform); Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92, WC Docket Nos. 04-36, 05-337, 06-122, Attach. at 3 (filed Sept. 16, 2008) (arguing that, if the Commission does not adopt the Missoula Plan, it should establish a mechanism for "rural RoR ILECs that allows for full recovery of the revenues lost as a result of the change in intrastate access rates and structure, on a revenue neutral basis."). *See also* Rural Alliance *ICC FNPRM* Comments at 21 (arguing that decreases in intercarrier compensation rate levels should be offset from the USF or another revenue replacement mechanism).

[818] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

illustration," NASUCA points out that "using their common local loop platform, carriers are now generating billions of dollars in digital subscriber line ("DSL") revenues that they did not generate five or ten years ago."[819] Indeed, Time Warner Telecom has pointed to evidence that, for some carriers, "revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services."[820] Thus, Free Press observes that "the unregulated revenue streams of rate-of-return and price cap Local Exchange Carriers serving in high-cost areas" are the "500 pound gorilla in the room," and it contends that "these revenues" should be "considered in the discussions of 'need' for the purposes of universal service."[821] We agree that such "new and growing source[s] of revenues should mitigate the impact of intercarrier compensation reform for rural and other carriers."[822]

317. We are concerned that universal service support be targeted to those companies whose reduced intercarrier compensation revenues truly are needed to continue providing quality service at affordable rates, and that it should not simply enable the company to pay bigger dividends to shareholders or pad a company's bottom line. Therefore, for price cap carriers, we adopt the proposal of various commenters to consider all a company's costs and revenues—both regulated and non-regulated—before providing new universal service support.[823] Thus, price cap incumbent LEC seeking universal service funding to replace lost intercarrier compensation revenues must make such a showing to the Commission when petitioning for such support. We recognize that rate-of-return carriers present a special situation, because under our rules they must be provided an opportunity to earn the rate of return established by our orders.[824] As a result, we do not impose a similar condition before rate-of-return carriers can recover

---

[819] Comments of the National Association of State Utility Consumer Advocates to Refresh the Record, CC Docket Nos. 96-45, 02-6, 01-92, 00-256, 96-262, 99-68, 80-256, WC Docket Nos. 05-337, 07-135, 06-122, 05-195, 03-109, 02-60 at 6 (filed July 7, 2008) (NASUCA July 7, 2008 Supp. Comments). *See also id*. at 10 ("Adding insult to injury, there is no consideration in the Missoula Plan of the additional revenues that ILECs gain from serving new broadband lines which are outside of the current ICC system. In other words, ILECs are losing lines and MOU as consumers drop traditional landlines and add broadband lines to access the Internet. However, the revenue gains from broadband line additions are totally out of the picture as far as the Missoula Plan is concerned.").

[820] Time Warner Telecom *Missoula Phantom Traffic* Comments at 10 ("According to AT&T, the revenue derived from the ILECs' advanced services more than doubles the revenue from switched access services. As AT&T stated in its Annual Report, '[w]e have found that when customers add broadband to a basic package, they are 40 percent less likely to switch to another provider, and average revenue per customer jumps nearly 120 percent.' It would make little sense for the ratepayers to subsidize the ILECs' already profitable business decisions.").

[821] Free Press Oct. 13, 2008 *Ex Parte* Letter at 6. *See also id*. at 6–7 ("While we'd like the Commission to consider a carrier's entire revenue stream before allowing increased USF support to offset lost access revenues" to the extent that there is such support it "should be confined to rate-of-return carriers only.").

[822] NASUCA July 7, 2008 Supp. Comments at 6. Indeed, there is some indication that carriers may be earning excessive returns even with respect to their regulated services. *See, e.g.*, GCI *Missoula Phantom Traffic* Comments at 66–67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25% rate of return on its regulated interstate switched access services, including 32.12% for 1997–98, 30.26% for 1999–2000; 35.29% for 2001–02; and 15.01% for 2003–04).

[823] *See*, *e.g.*, Letter from Mary C. Albert, Assistant General Counsel, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 05-337, 04-36 at 1 (filed Oct. 2, 2008); NASUCA July 7, 2008 Supp. Comments at 32–34; Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1–2 (filed Oct. 7, 2008).

[824] *See, e.g.*, Free Press Oct. 13, 2008 *Ex Parte* Letter at 6–7 (noting that, to the extent that there is universal service support to address any net loss in intercarrier compensation revenues, it "should be confined to rate-of-return carriers only."). *But see, e.g.*, GCI *Missoula Phantom Traffic* Comments at 66–67 (asserting that ACS of Anchorage has regularly earned returns in excess of an 11.25% rate of return on its regulated interstate switched access services).

universal service support.

318. We also agree with proposals that carriers fully avail themselves of existing opportunities for end-user recovery before collecting new universal service subsidies.[825] To the extent that regulators have determined that rates at a particular level are reasonable, we find it appropriate for carriers to charge those rates in the first instance, rather than pricing below those levels in order to foist recovery of the additional revenues on universal service contributors. Consequently, as additional preconditions for receiving new universal service support, any carrier—whether price cap or rate-of-return—must show that its federal SLC, state SLC (if any), and state retail local service rates are at the maximum levels permitted under existing applicable law.[826]

319. In conjunction, we conclude that the conditions we adopt as prerequisites for obtaining new universal service support adequately target that support to carriers with a genuine need without unduly burdening consumers with excessive new universal service contribution burdens.[827]

(ii) Legal Authority

320. Consistent with our mandate to "ensure that universal service is available at rates that are just, reasonable, and affordable," we establish a new supplement to IAS and ICLS universal service funding mechanism.[828] As we did recently in two other Commission orders that reformed interstate switched access charges, we include here additional universal service funding to keep retail rates affordable while ensuring that maintaining affordable rates does not unduly threaten the financial viability of rate-regulated incumbent LECs.[829] Our decision to establish a new funding mechanism is also consistent with our general authority under section 4(i) of the Act because it furthers our universal service objectives.[830] Mindful of our obligation to ensure that these new subsidies are made available only where essential, however we make new universal service subsidies available subject to specific conditions that

---

[825] *See, e.g.*, Letter from Donna Epps, Vice President—Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 1–2 (filed Oct. 2, 2008); Letter from Robert W. Quinn, Jr., Senior Vice President—Federal Regulatory, AT&T, to Kevin Martin, Chairman, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 07-135, 05-337 at 5–7 (filed July 17, 2008); Letter from Anthony M. Alessi, Senior Counsel, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, WC Docket No. 05-337 at 3–5 (filed May 23, 2008); Cox *ICC FNPRM* Comments at 12–13.

[826] Although we do not adopt a particular revenue benchmark here, as some commenters propose, the Joint Board may well recommend such an approach. Thus, depending upon the Joint Board's proposal, and the Commission's subsequent action, maximum federal SLCs and/or state retail local rates might be determined, in part, by such a benchmark.

[827] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

[828] 47 U.S.C. § 254(i) (requiring that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."); *see also* 47 U.S.C. §254(b)(1) (stating that "[q]uality services should be available at just, reasonable, and affordable rates").

[829] *See, e.g., CALLS Order*, 15 FCC Rcd at 12971, para. 24; *MAG Order*, 16 FCC Rcd at 19669–70, para. 132.

[830] Section 4(i) provides that the Commission may "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). Prior to the enactment of section 254 (as part of the 1996 Act), sections 1 and 4(i) provided authority for the Commission's adoption of a universal service fund. *See Rural Telephone Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988). *See also New England Telephone and Telegraph Co. v. FCC*, 826 F.2d 1101, 1107 (D.C. Cir. 1987) (describing section 4(i) as a "wide-ranging source of authority"), *cert. denied*, 490 U.S. 1039 (1989).

will target the support to only those carriers whose circumstances merit it.

(iii) Access to Universal Service Support

321. As discussed below, we limit access to universal service support to incumbent LECs that meet certain preconditions. As an initial matter, we find that limiting such support to incumbent LECs is consistent with their position in the marketplace and the resulting regulatory constraints on their pricing behavior. In a series of orders in the Competitive Carrier proceeding, the Commission distinguished two kinds of carriers—those with individual market power (dominant carriers) and those without market power (non-dominant carriers).[831] The Commission found it appropriate to continue to subject dominant carriers to full regulation under Title II of the Communications Act.[832] Incumbent LECs are dominant carriers in their provision of switched access services and, as a result, are subject to rate regulation.[833] This rate regulation comes in two forms—regulation of intercarrier charges and regulation of end user charges. The Commission regulates interstate end-user charges of incumbent LECs, while the states generally regulate those carriers' intrastate end-user rates. Unlike incumbent LECs, competitive carriers (e.g., such as competitive LECs, CMRS providers, and non-dominant IXCs) lack market power and are considered non-dominant. As a result, their end-user charges are not subject to comparable rate regulation by the Commission and the states.[834]

322. Because incumbent LECs, as a result of their classification as dominant carriers, have had their end-user charges regulated (both in terms of rate levels and rate structures), they have less flexibility than other carriers to recover decreased intercarrier revenues through end-user charges. As a result, they are less likely to be able to recover reductions in intercarrier compensation revenues resulting from the actions we take today. Accordingly, we conclude that access to universal service support should be limited to incumbent LECs that meet the necessary preconditions. For this reason, we disagree with parties that advocate making funding available to all carriers, both incumbent and competitive[835] or to all

---

[831] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (*Competitive Carrier First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed. Reg. 17308 (1982); Second Report and Order, 91 FCC 2d 59 (1982) (*Competitive Carrier Second Report and Order*); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28292 (1983); Third Report and Order, 48 Fed. Reg. 46791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (*Competitive Carrier Fourth Report and Order*), *vacated, AT&T v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), Fifth Report and Order, 98 FCC 2d 1191 (1984) (*Competitive Carrier Fifth Report and Order*); Sixth Report and Order, 99 FCC 2d 1020 (1985), *vacated, MCI Telecomms. Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985) (*Competitive Carrier Sixth Report and Order*), *aff'd, MCI v. AT&T*, 512 U.S. 218 (1994) (collectively, the *Competitive Carrier* proceeding); *see* 47 C.F.R. § 61.3(q), (y).

[832] *Competitive Carrier First Report and Order*, 85 FCC 2d at 10–11, para. 26.

[833] *See Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112; CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440, 16484, para. 90 (2007).

[834] For instance, the Commission has declined to regulate the SLCs of competitive LECs. *See Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10870 n.8 (2002) (subsequent history omitted); *see also CLEC Access Charge Order*, 16 FCC Rcd at 9955, para. 81 (stating that competitive LECs competing with CALLS incumbent LECs are free to build into their end-user rates a component equivalent to the incumbent LEC's SLC).

[835] *See*, *e.g.*, T-Mobile Oct. 3, 2008 *Ex Parte* Letter at 9 & n.14 (arguing that "any ICC replacement mechanism be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality.").

(continued….)

carriers that currently receive access charge revenues.[836] As discussed above, competitive carrier end-user charges are not subject to rate regulation, and those carriers have the opportunity to recover lost access revenue through any legally permissible means.[837] We also reject an approach that would limit funding to rural rate-of-return carriers.[838] Incumbent LECs subject to price cap regulation also are subject to regulatory constraints on end-user charges, and we therefore decline to categorically deny universal service funding to particular types of incumbent LECs.[839]

323. Consistent with the policy approach discussed above, we further find it necessary to establish certain requirements that an incumbent LEC must satisfy to receive the new universal service subsidies. Before seeking universal service funding, incumbent LECs must first demonstrate that their

(continued from previous page)
Sprint argues that a fund that compensates only incumbent LECs (and not competitive LECs, wireless carriers, and IXCs) for lost access revenues is "blatantly anti-competitive." Letter from Anna M. Gomez, Vice President of Government Affairs, Sprint Nextel Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket No. 04-36 at 4 (filed Oct. 1, 2008). Many CMRS carriers maintain that any replacement mechanism must be fully portable to competitive carriers in order to fulfill the principles of competitive and technological neutrality. *See, e.g.*, Leap *ICC FNPRM* Reply at 18; Allied National *ICC FNPRM* Comments at 10; CTIA *ICC FNPRM* Comments at 37; SouthernLINC *ICC FNPRM* Reply at 9; RCA *ICC FNPRM* Comments at 4; US Cellular *ICC FNPRM* Comments at 4; T-Mobile *ICC FNPRM* Comments at 26; Dobson and American *ICC FNPRM* Comments at 10.

[836] *See, e.g.*, ICF *ICC FNPRM* Comments at 32–33 (stating that any funding should be temporary and limited to those that lose access revenue because of intercarrier compensation reform); USTA *ICC FNPRM* Comments at 40 (arguing that funding should not compensate wireless carriers and that it should not be portable); CCAP *ICC FNPRM* Reply at 14 (stating that funding "should not be portable to competitive eligible telecommunications carriers."); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, Attach. at 7 (filed Oct. 12, 2008) (asserting that funding should compensate only LECs that have lost revenues because of intercarrier compensation reform); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, Docket Nos. 01-92, 04-36, 96-45, 05-337, Attach. at 9 (filed Oct. 3, 2008) (arguing that the Commission should "limit duplicative networks" by prohibiting wireless carriers and other carriers that do not receive access compensation from benefiting from the fund); Letter from Alex J. Harris, Vice President—Regulatory, Frontier, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 16, 18 (filed May 11, 2005) (proposing that the funding be confined to incumbent LECs in rural study areas but available to all carriers that lost access revenues in non-rural study areas); *see also* Letter from Brad E. Mutschelknaus, Counsel to XO Communications, Kelley Drye & Warren LLP, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 06-122, Attach. at 4 (filed Oct. 3, 2008) (contending that revenue replacement funding should either be "competitively neutral" or limited to only rate-of-return carriers).

[837] Some competitive LECs claim that, in practice, they have little opportunity to recover their costs because the incumbent LEC, whose prices are regulated, effectively sets a ceiling on the prices they charge. *See, e.g.*, COMPTEL *Missoula Phantom Traffic* Comments at 7. Although we acknowledge that, in a homogeneous goods market with a single price, such an argument might be plausible, we do not find such assumptions apply in modern telecommunications markets. In particular, with modern telecommunications technology, carriers are offering an expanding number of new services and marketing them through a variety of bundled service offerings. As a result, telecommunications services are becoming much more of a differentiated product, and competitors have greater opportunity to offer niche services. In light of these developments, we find unpersuasive arguments that competitors are effectively price regulated and thus do not have an opportunity to recover lost access revenues.

[838] *See, e.g.*, NCTA *ICC FNPRM* Comments at 11 (arguing that funding should be limited to "non-Tier 1 rural carrier[s]"); NTCA *ICC FNPRM* Comments at 56 (asserting that funding "should be targeted at rural ILECs exclusively"); Comments of the Rural Alliance, CC Docket No. 01-92 at 4 (filed Jun. 27, 2008) (stating that the fund should only compensate rural rate-of-return carriers that lose access revenues).

[839] For these same reasons, should a carrier agree to (or tariff) intercarrier charges below those that would be required by the reforms adopted in this order, that carrier may not seek to obtain supplemental universal service support based on the difference between the charges it sets and the maximum charges it is allowed to set.

end-user charges are at the maximum allowable rate levels. Thus, incumbent LECs must show that they are charging the maximum interstate SLCs permitted under applicable law, and they must make the same showing with respect to any intrastate SLCs. In addition, incumbent LECs must demonstrate that their retail local rates are at the maximum allowable amount based on applicable state regulation. Incumbent LECs operating in states where retail rates are deregulated are not entitled to the new universal service funding adopted here. In this case, these incumbent LECs will be similarly situated to competitive carriers, because without regulation, they have the opportunity to recover lost access revenues due to intercarrier compensation reform through increased end-user charges.

324. As discussed below, there are additional requirements to qualify for universal funding that vary depending on whether a carrier is subject to price cap or rate-of-return regulation. In either case, the incumbent LEC bears the burden of demonstrating that it is entitled to such funding based on the following criteria.

325. *Rate-of-Return Incumbent LECs*. For incumbent LECs subject to rate-of-return regulation, a carrier may qualify for universal service funding if it can demonstrate that, it will not have a reasonable opportunity to earn its authorized rate of return as a result of its net loss of revenues caused by the changes in intercarrier compensation rates resulting from this order, even after having increased its interstate SLC, state SLC (if any), and state retail local rates to the maximum permitted by applicable law.

326. *Price Cap Incumbent LECs*. For incumbent LECs subject to price cap regulation, a carrier may qualify for universal service funding if it can demonstrate that, as a result of reduced and reformed intercarrier charges, and after accounting for increased end-user charges, it is still unable to earn a "normal profit." In the *Local Competition First Report and Order*, the Commission discussed the concept of normal profit and defined it as the "total revenue required to cover all the costs of a firm, including its opportunity costs."[840]

327. As described above, many companies—in particular, price cap carriers—consistently are paying dividends and are using the same supported network to provide both regulated services and non-regulated services.[841] We do not find it appropriate to require all universal service contributors to pay into the fund to provide for "'high overhead, sumptuous earnings, [and] rich dividends'" on the part of these carriers.[842] Indeed, as discussed above,[843] "[i]ntercarrier compensation, SLCs and the USF are but three of the numerous spigots from which dollars flow to fill up the telephone companies' revenue buckets"[844] in addition to other nonregulated services that use "their common local loop platform."[845] . Therefore, in determining whether this criterion is met, the Commission will evaluate the total costs and total revenues of the company as a whole, including those from both regulated and non-regulated sources.[846] While this is a more stringent showing than that required of rate-of-return carriers, we find such differences warranted by the different rate regulation frameworks. In light of our reforms, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of-return

[840] *Local Competition First Report and Order*, 11 FCC Rcd at 15854, para. 699.

[841] *See supra* para. 312.

[842] *Universal Service Telephone Subsidies* at 33.

[843] *See supra* para. 313.

[844] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[845] NASUCA July 7, 2008 *Ex Parte* Letter at 6.

[846] The non-regulated costs and revenues to be included in this calculation are those associated with non-regulated activities involving the common or joint use of assets or resources in the provision of both regulated and non-regulated products and services.

regulation.[847]

328. We recognize that the conditions by which we would make universal service funding available may not ensure that all carriers recover all reduced intercarrier compensation revenues that result from the reforms we adopt here. We reject the assertion by some carriers that any revenue replacement mechanism adopted by the Commission in the context of intercarrier compensation reform must ensure absolute revenue neutrality.[848] We agree with commenters who maintain that the Commission has no legal obligation to ensure that carriers recover every dollar in access revenues lost as a result of reform, absent a showing of a taking.[849] We conclude that certain increased end-user charges and narrowly targeted supplemental IAS or ICLS universal service support will provide a reasonable opportunity to recover revenues lost as a result of our intercarrier compensation reform, and to earn a reasonable profit. Such recovery, however, is not automatic and whether a particular carrier is entitled to any revenue recovery will be considered on a case-by-case basis based on the criteria outlined here.

D. Measures to Ensure Proper Billing

[QWEST PROPOSES IN THE FIRST INSTANCE THAT THE COMMISSION REMOVE ALL LANGUAGE HIGHLIGHTED IN YELLOW BELOW FROM ANY ORDER ADOPTED IN THIS PROCEEDING. TO THE EXTENT THE COMMISSION IS UNWILLING TO DELETE THIS LANGUAGE, QWEST ASKS IT TO EFFECTUATE THE EDITS TO THAT HIGHLIGHTED LANGUAGE SET FORTH IN REDLINE BELOW.]

1. Introduction

329. As explained in Part V.A., the current disparity of rates under existing intercarrier

[847] Pursuant to section 61.41(d) of the Commission's rules, once a carrier is subject to price cap regulation, it may not "withdraw from such regulation." 47 C.F.R. § 61.41(d); *see also* 47 C.F.R. § 61.41(b), (c) (requiring conversion from rate-of-return to price cap regulation under certain circumstances). Under section 1.3 of the Commission's rules, however, "any provision of the Commission's rules may be waived by the Commission . . . if good cause therefore is shown." 47 C.F.R. § 1.3. As interpreted by the courts, this requires that a petitioner demonstrate that "special circumstances warrant a deviation from the general rule and that such a deviation will serve the public interest." *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164 (D.C. Cir. 1990) (citing *WAIT Radio v. FCC*, 418 F.2d 1153, 1158 (D.C. Cir. 1969)). In other circumstances in the past, the Commission has found good cause to waiver section 61.41(d) and other related provisions of the Commission's rules to enable operations subject to price cap regulation to convert to rate-of-return regulation. *See, e.g., ALLTEL Corp. Petition for Waiver of Section 61.41 of the Commission's Rules and Application for Transfer of Control*, CCB/CPD No. 99-1, Memorandum Opinion and Order, 14 FCC Rcd. 14191 (1999); *CenturyTel of Northwest Arkansas, LLC et al., Joint Petition for Waiver of Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Petition for Waiver of Sections 61.41(c) and 69.3(g)(2) of the Commission's Rules*, CC Docket No. 96-45, Memorandum Opinion and Order, 15 FCC Rcd 25437 (Acc. Pol. Div. 2000); *ALLTEL Service Corporation, Petition for Waiver of Section 61.41 of the Commission's Rules*, Order, 8 FCC Rcd 7054 (Com. Car. Bur. 1993) (granting waiver of sections 61.41(c), (d) of the Commission's rules). Likewise, as noted above, we find it appropriate, upon request, to allow price cap carriers to make a one-way election of rate-of-return regulation.

[848] *See supra* para. 313.

[849] *See*, *e.g*., Ad Hoc *ICC FNPRM* Reply at 10–11 (arguing that the Commission has no legal obligation to allow revenue neutrality); CTIA *ICC FNPRM* Comments at 46; Nextel *ICC FNPRM* Comments at 20; T-Mobile *ICC FNPRM* Comments at 13 (intercarrier compensation was not intended to guarantee an ILEC revenue stream or preserve low local rates for a given industry segment, doing so would perpetuate inefficiencies); NASUCA *ICC FNPRM* Reply at 34–38 (arguing that the Commission is not required to provide for revenue neutrality and that revenue neutrality deviates from the Commission's past policy).

compensation mechanisms presents service providers[850] with the opportunity and the incentive to misidentify or otherwise conceal the source of traffic to avoid or reduce payments to other service providers. In this Part, we amend our rules to help ensure the ability of service providers to receive the appropriate compensation for traffic terminated on their networks.[851] More importantly, we believe that the comprehensive compensation reforms we adopt today should significantly reduce service providers' incentives to mislabel traffic or otherwise to try to avoid their financial obligations.[852] Nonetheless, we balance a desire to facilitate resolution of billing disputes with a reluctance to regulate in areas where industry resolution has, in many cases, proven effective. We find that the requirements we adopt here will facilitate the transfer of information to terminating service providers, and improve their ability to identify providers from whom they receive traffic, without imposing burdensome costs. In the event that ~~traffic does not contain the information required by our rules, or~~ the provider delivering ~~the~~ traffic does not ~~otherwise~~ provide ~~the required~~ call information that is required by our rules and that has been passed on to the transiting provider by the provider that handed it the traffic, either in the signaling stream or otherwise (for example by providing an industry-standard billing record), to the provider receiving it, we allow the terminating service provider to charge its highest terminating rate to the service provider delivering the traffic. To the extent that a provider acting simply as an intermediate provider (such as a transit provider)[853] becomes subject to a charge under this provision, that intermediate provider can charge the rate it was charged to the provider that delivered the improperly labeled traffic to it. This will ensure that providers are paid for terminating traffic in those instances, and gives financial incentives for upstream providers in the call path to ensure that the traffic includes proper information in the first instance.

2. Background

330. Problems related to traffic arriving for termination with insufficient identification information arise from the technical systems and processes used to create, transfer, and gather intercarrier compensation billing information. To bill for termination of traffic, a terminating service provider must be able to identify the appropriate upstream service provider, and the location of the caller (or a proxy for the caller's location) in order to determine jurisdiction, which is necessary to determine the appropriate charge under existing intercarrier compensation rules.[854] Calls frequently traverse several networks to connect the calling and called parties. When the originating and terminating networks are not directly

---

[850] We use the term "service providers" in this section to refer both to carriers that provide telecommunications services and to providers of services that originate calls on IP networks and terminate them on circuit switched networks.

[851] Parties frequently use the term "phantom traffic" in describing this problem. We will not use that term in the regulations we adopt here because there is no consensus as to how it should be defined, nor is such a definition necessary for us to address the underlying issues faced by service providers in billing for traffic they receive.

[852] Similarly, we believe that the transition to a uniform intercarrier compensation rate based on the additional costs methodology described above also will address the access stimulation concerns that have recently been raised. *See supra* para. 185. In the unlikely event that service providers persist in these activities, however, we note that the Commission has an open proceeding in which appropriate responses to such actions may be considered. *See generally Access Stimulation NPRM*, 22 FCC Rcd 17989.

[853] We specify that the discussion herein does not implicate jointly provided switched access ("JPSA") service, in which multiple LECs cooperate to provide originating or terminating access. This service is generally provided pursuant to tariff and has not given rise to the problems detailed below.

[854] This order initiates a process of unifying terminating intercarrier compensation rates, thereby eliminating the rate distinctions between local and long distance calls. Although knowing the origination point of a call remains important, especially during the period of transition to a unified terminating rate, the origination point is less significant for the purpose of determining intercarrier compensation due.

connected, as is the case when calls are delivered via tandem transit service, complications with transmitting and receiving billing information related to a call can arise.[855] Terminating service providers that are not directly connected to originating service providers receive information about calls sent to their networks for termination from two sources: Signaling System 7 (SS7) signaling streams[856] and industry standard billing records,[857] which typically are provided by the intermediate service provider connecting the terminating provider to the originating provider.[858]

331. One significant source of billing problems is traffic routed through an intermediate provider that does not include calling party number (CPN) or other information identifying the calling

---

[855] *See, e.g.*, Letter from Patrick J. Donovan, Counsel for PacWest Telecomm, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3–4 (filed Oct. 14, 2005).

[856] SS7 is an out-of-band signaling system that is separate from, but runs parallel to, the public switched telephone network (PSTN) and is used to set up call paths between calling and called parties. The following steps typically occur when SS7 sets up a call path for a wireline LEC to wireline LEC call originating and terminating on the PSTN. When a wireline LEC customer dials a call destined for an end user served by a different wireline LEC, the calling party's LEC determines, based on the dialed digits, that it cannot terminate the call. The SS7 call signaling system then begins the process of identifying a path that the call will take to reach the called party's network. SS7 identifies each service provider in the call path and provides each with the called party's telephone number and other information related to the call, including message type and nature of connection indicators, forward call indicators, calling party's category, and user service information if that information was correctly populated and not altered during the signaling process. *See* Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Sept. 13, 2005) (Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter). SS7 was designed to facilitate call routing and was not designed to provide billing information to terminating carriers. *See* Verizon, *Verizon's Proposed Regulatory Action to Address Phantom Traffic* at 5–7 (Verizon Phantom Traffic White Paper), attached to Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 20, 2005). Technical content and format of SS7 signaling is governed by industry standards rather than by Commission rules, although Commission rules require carriers using SS7 to transmit calling party number (CPN) to subsequent carriers on interstate calls where it is technically feasibly to do so. 47 C.F.R. § 64.1601.

[857] Industry standard billing records are the other common source of information that terminating service providers not directly connected to originating service providers receive about calls sent to their networks for termination. Billing records are typically created by a tandem switch that receives a call for delivery to a terminating network via tandem transit service. Tandem switches create billing records by combining CPN or Charge Number (CN) information from the SS7 signaling stream with information identifying the originating service provider to provide terminating service providers with information necessary for billing. *See* Verizon Phantom Traffic White Paper at 5–7. The tandem switch creating the billing record identifies service providers from whom it receives traffic using the trunk group number (TGN) of the trunk on which a call arrives. *See* Verizon Phantom Traffic White Paper at 4; *see also* Letter from Glenn T. Reynolds, Vice President—Federal Regulatory, BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92, Attach. at 5 (filed Jan. 12, 2006) (BellSouth Jan. 12, 2006 *Ex Parte* Letter). The tandem switch translates the TGN into one of two codes identifying the originating the service provider: Carrier Identification Code (CIC) if the originating service provider is an IXC, or Operating Company Number (OCN) for non-IXC calls. The appropriate CIC or OCN is then added, by the tandem switch, if it is equipped to record such information, to the billing record for the call, which is then forwarded to the terminating service provider. *See* Verizon Phantom Traffic White Paper at 5–7; *see also* Verizon *ICC FNPRM* Reply at 16. Service providers delivering billing records typically use the Exchange Message Interface (EMI) format created and maintained by the Alliance for Telecommunications Industry Solutions Ordering and Billing Forum (ATIS/OBF), an industry standards setting group. *See* ATIS Exchange Message Interface 22 Revision 2, ATIS Document number 0406000-02200 (July 2005).

[858] *See* Verizon Phantom Traffic White Paper at 5–7.

party.[859] In addition, commenters describe several examples of other situations where traffic arrives for termination with insufficient information to identify the originating service provider.[860] Another source of disputes occurs when terminating service providers find differences when attempting to reconcile SS7 data they record and billing records they receive.[861] Such a reconciliation process will likely be inexact, because SS7 streams were not designed to provide billing information.[862] Similarly, at least one commenter asserts that "problems arise" when terminating service providers "second guess tandem traffic reports and generate their own billing statements for carriers with whom they are indirectly interconnected."[863] In addition to unidentifiable traffic caused by unintended network routing circumstances, as described above, several commenters allege that they receive traffic in which the billing information intentionally has been altered or stripped before the call reaches the terminating service provider.[864] Indeed, numerous parties have described experiencing problems of the sort described above.[865] Several proposals suggesting how the Commission should address this problem have been filed in the record in this proceeding in recent years.[866] Recently, the United States Telecom Association

[859] The Commission recognized that the ability of service providers to identify the provider to bill appropriate intercarrier compensation payments depends, in part, on billing records generated by intermediate service providers. Thus, the Commission sought comment on whether current rules and industry standards create billing records that are sufficiently detailed to permit determinations of the appropriate compensation due. *See Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4743, para. 133.

[860] For example, when a call bound for a number that has been ported to a different service provider is delivered without the responsible service provider performing a local number portability (LNP) query, the call may be delivered to the wrong end office and then may be re-routed to a tandem switch for delivery to the correct end office. *See* Verizon Phantom Traffic White Paper at 18–19. According to Verizon, neither the end office that re-routes the call nor the tandem switch receiving the rerouted call are able to route the call over an access trunk; the call must be sent over a local interconnection trunk. *See id*. In this scenario, the terminating carrier may have difficulty billing the appropriate charges to the IXC that sent the call.

[861] *See* Letter from Stephen T. Perkins, General Counsel, Cavalier Telephone, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 29, 2005). *See also* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 10 (filed Oct. 21, 2005).

[862] *See* Letter from Donna Epps, Vice President—Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 5 (filed Aug. 1, 2005); Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2.

[863] Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 3.

[864] *See, e.g.*, Balhoff and Rowe *ICC FNPRM* Reply at 10; California Small LECs *ICC FNPRM* Comments at 9; ITCI *ICC FNPRM* Reply at 7; Montana Independent Telecommunications Systems (MITS) et al. *ICC FNPRM* Comments at 14, 20; MITS et al. *ICC FNPRM* Reply at 23–24, 33; NECA *ICC FNPRM* Comments at 16; Rural Alliance *ICC FNPRM* Comments at 108; SureWest *ICC FNPRM* Comments at 7; TDS *ICC FNPRM* Comments at 10; BellSouth Jan. 11, 2006 *Ex Parte* Letter at 6.

[865] *See, e.g.*, Letter from Glenn T. Reynolds, Vice President, Policy, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 12, 2008) (USTA Feb. 12, 2008 Proposal). *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, NECA Petition for Interim Order (filed Jan. 22, 2008) (NECA Petition).

[866] *See, e.g.*, NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2; Letter from Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Nov. 6, 2006) (Missoula Plan Supporters Nov. 6 *Ex Parte* Letter or Missoula Plan Call Signaling Proposal); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 4, 2006); Letter from Jeffrey S. Lanning, Associate General Counsel, USTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006) (MCC/USTA Proposal); Letter from Karen Brinkmann, Attorney for the

(continued….)

(USTelecom) filed a proposal that appears to enjoy the broadest industry support of any filed to date.[867] For reasons detailed below, we agree that traffic that lacks sufficient information to enable proper billing of intercarrier compensation charges is a problem. Consequently, we take steps to address the problem and help ensure proper functioning of the intercarrier compensation system.[868]

3. Discussion

332. We amend our rules as described below to facilitate the transfer of necessary information to terminating service providers, particularly in cases where traffic is delivered through indirect interconnection arrangements. These new requirements will assist in determining the appropriate service provider to bill for any call. We note that these new requirements generally reflect standard industry practice, as recommended by several commenters.[869] We also amend our rules to establish payment obligations for service providers under certain circumstances where they fail to comply with the requirements described below. Incorporating these practices into our rules will facilitate resolution of billing disputes, will provide incentives to help prevent manipulation or deletion of information from signaling streams, and will provide incentives for service providers to ensure that traffic traversing their networks is properly labeled and identifiable, in compliance with the rules we adopt in this order.[870]

a. Regulatory Status of Transiting Traffic

333. We clarify that transiting services provided by intermediate carriers are not properly deemed "interconnection" under section 251(a) or section 251(c), nor are they "transport and termination" as we have defined those terms in the context of section 251(b). As such, the rates and terms governing transiting services are governed by sections 201 and 202 of the Act, and not by the rates and terms

(continued from previous page)
MidSize Carrier Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 31, 2006) (supporting MCC/USTA Proposal).

[867] *See* USTA Feb. 12, 2008 Proposal; *see also* Letter from Melissa E. Newman, Vice President—Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Sept. 24, 2008); Letter from Curt Stamp, President, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2, filed Sept. 19, 2008); Letter from Eric Einhorn, Vice president, Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 et al. (filed Sept. 24, 2008); Comments of Windstream, CC Docket Nos. 99-68, 01-92, 96-45, WC Docket Nos. 08-152, 07-135, 04-36, 06-122, 05-337 at 16 (filed Aug. 21, 2008); Letter from Gregory J. Vogt, Counsel for CenturyTel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Aug. 6, 2008); Letter from Henry Hultquist, Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 17, 2008).

[868] The rules we adopt herein reflect the Commission's determinations regarding how to address call signaling problems as they relate to unidentified and unbillable traffic. Therefore, we disagree with commenters requesting that we adopt alternative proposals such as the NECA petition or the Missoula Plan Call Signaling Proposal. *See, e.g.*, Letter from Robert F. Aldrich, Counsel to the American Public Communications Council, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92 (filed Oct. 21, 2008).

[869] *See, e.g.*, Letter from Paul Garnett, Director, Regulatory Policy, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Jan. 3, 2006); Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Mar. 30, 2006).

[870] The rules we amend in this order were adopted in a 1995 order addressing Caller ID services. *See Rules and Policies Regarding Calling Number Identification Service – Caller ID*, CC Docket No. 91-281, Memorandum Opinion and Order on Reconsideration, Second Report and Order and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 11700, 11728, para. 79 (1995) (*Caller ID Order*). In the *Caller ID Order*, the Commission found, inter alia, that the CPN based services to which the rules adopted apply are "jurisdictionally mixed" and the Commission therefore preempted an inconsistent state statute. *Id.* at 11722–23, paras. 62, 85. For these same reasons, to the extent the amendments we make to our call signaling rules in this order conflict with any current or future state statutes, those statutes are preempted. *See id.* at 11728–34, paras. 78–95.

governing these section 251 offerings.[871] Specifically, rates for these transiting services are governed by section 201's "just and reasonable" mandate, not by the TELRIC standard currently applicable to section 251(c) interconnection and section 251(b) transport and termination or the "additional cost" methodology we adopt today. Likewise, access to transiting service is available subject to tariff or contract, not as of right. To the extent a carrier seeks access to another carrier's transiting service, and that transiting service is not available pursuant to tariff, the first carrier must negotiate a contract pursuant to which such service will be provisioned.

b. Signaling Information

334. We agree with the USTelecom Feb. 12, 2008 Proposal concerning the importance of call signaling obligations.[872] CPN is a critical component of call signaling information. When CPN is populated in the SS7 stream by an originating service provider and passed, unaltered, along a call path to a terminating service provider, the terminating provider can use the CPN information to help determine the applicable intercarrier compensation.

335. We agree with commenters[873] that assert that the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call is to require originating providers to populate, and to prohibit all providers ~~them~~ from stripping or altering, CPN information in the SS7 call signaling stream.[874] In an environment where numerous service providers may be involved in the completion of a call, this SS7 signaling information must be passed, unaltered, from one to the next in a call path until it reaches the terminating service provider. We therefore modify our rules to prohibit stripping or altering information in the SS7 call signaling stream. We do not, however, make any changes to the designation of particular fields as mandatory or optional, nor do we otherwise intend to change industry standards that govern the population of the SS7 signaling stream.[875]

[871] Even if there were any question regarding our section 201 authority over transiting services, we note that we also would enjoy jurisdiction over these offerings pursuant to sections 259 and 271 of the Act to the extent they are offered by incumbent LECs or Regional Bell Operating Companies, respectively. *See* 47 U.S.C. §§ 259, 271. Neither of these provisions contemplates application of TELRIC pricing. In fact, section 259(b)(3) expressly exempts section 259 offerings from common-carrier regulation, and the Commission has held that section 271's access requiremenets are governed by the general section 201 "just and reasonable" rate requirement.

[872] *See* USTA Feb. 12, 2008 Proposal.

[873] *See, e.g.*, USTA Feb. 12, 2008 Proposal; NECA Petition.

[874] Because we agree that requiring population of CPN is the best way to ensure that complete and accurate information about a call gets to the terminating service provider for that call, we disagree with proposals to exclude certain types of traffic from this requirement. *See, e.g.*, Letter from Jim Kohlenberger, Executive Director, The VON Coalition, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket 04-36 at 6 (filed Oct. 28, 2008). We note that parties are free to contract with third parties to ensure that these requirements are met. *Cf., e.g.*, *LNP Order*, 22 FCC Rcd 19531 (holding that, where interconnected VoIP providers rely on other carriers for access to numbers, both parties must take the steps needed to comply with the number porting obligations established in that order); *Interconnected VoIP 911 Order*, 20 FCC Rcd 10245 (finding that interconnected VoIP providers might elect to comply with their 911 obligations in party by relying on services provided by third parties).

[875] We take a cautious approach in considering any new or revised signaling requirements. SS7 was designed to facilitate call setup and routing, and action we take here is not intended to interfere with the ability of calls to reach their intended recipient. As Verizon Wireless explains, certain SS7 fields are considered mandatory, while others (including CPN, CN, and JIP) are considered optional. *See* Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter at 2. The distinction is significant, because a call will not be completed if a mandatory field has not been populated. *See* Letter from Thomas Goode, Associate General Counsel, ATIS, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. (filed Feb. 10, 2006). Although CPN is considered optional in the industry standard, our rules, before and after amendment pursuant to this order, require service providers to pass CPN in specified circumstances. *See* 47 C.F.R § 64.1601.

In particular, we do not require intermediate providers to populate signaling fields that are not populated when they receive the traffic at issue.

336. The record also makes clear that we must expand the scope of our existing rule regarding passing CPN,[876] which currently applies only to service providers using SS7 and only to interstate traffic. We therefore extend these requirements to all traffic originating or terminating on the PSTN, including jurisdictionally intrastate traffic.[877] We also amend our rules to require service providers using MF signaling for non-local traffic to pass CPN information, or the charge number (CN) if it differs from the CPN, in the Multi Frequency Automatic Number Identification (MF ANI) field.[878] This rule change will ensure that information identifying the calling party is included in call signaling information for all calls. Here too, however, we make clear that we do not require intermediate carriers to populate information that is not passed to them from the providers who hand them traffic.

337. In addition, we agree with commenters who suggest that our call signaling rules should address CN as well as CPN.[879] Verizon states that, in accordance with industry practice, the CN parameter is not populated in the SS7 stream when it is the same as CPN, but that when the CN parameter is populated, CN is included in billing records in place of CPN.[880] We therefore clarify that populating a CN field with information other than the charge number to be billed for the call, consistent with industry standards, falls within this prohibition. This clarification is not intended to disrupt standard industry practice with regard to using CN in the signaling stream and in billing records. But, we also clarify that the prohibition on altering or stripping signaling information applies to CN as well as CPN. The prohibition on altering or stripping SS7, MF ANI, or CN signaling information obligates intermediate service providers to pass, unaltered, whatever signaling information they receive.

338. The call signaling rules we adopt in this order will help ensure that signaling information is passed completely and accurately to terminating service providers. These rules are not intended to affect existing agreements between service providers regarding how to "jurisdictionalize" traffic when traditional call identifying parameters are missing, as long as such agreements are not inconsistent with the rules adopted in this order.

339. We find that some very limited exceptions to these new rules are needed. We agree with Verizon, for example, that a limited exception is needed in situations where industry standards permit, or even require, some alteration in signaling information by an intermediate service provider.[881] As noted above, we do not intend to change standard industry practice with respect to the content of the signaling stream. Service providers that follow standard industry practice in this way will not be considered in violation of the prohibition on altering signaling information. We also note that the exemptions from our existing call signaling requirements described in section 64.1601(d) remain necessary for their limited purposes, and will continue to apply.[882]

---

[876] *See* 47 C.F.R. § 64.1601.

[877] *See supra* note 862.

[878] *See* Missoula Plan at 56; Letter from Brad E. Mutschelknaus, Counsel for XO, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 11–12 (filed Feb. 14, 2006).

[879] *See, e.g.*, NECA Petition; Letter from Cheryl A. Tritt, Counsel for T-Mobile USA, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 6 (filed Feb. 2, 2006); Verizon Phantom Traffic White Paper at 8–10.

[880] *See* Verizon Phantom Traffic White Paper at 8.

[881] *See* Verizon Phantom Traffic White Paper at 9–10. For example, Verizon states that on a call to a party that has forwarded its number, the called party's service provider will replace the caller's CN with the called party's CN before sending the call to the forward location.

[882] 47 C.F.R. § 64.1601(d).

c. Financial Responsibilities

340. We also impose financial responsibilities that will work in step with our amended signaling rules to give service providers financial incentives to ensure that they, and the providers whose traffic they carry, comply with the signaling obligations. We find that these requirements will significantly reduce any existing incentives to avoid compliance by substantially eliminating any financial benefits of noncompliance.

341. We agree with commenters who propose that we permit service providers that terminate traffic lacking sufficient information to bill the service provider that delivered the traffic to the terminating provider.[883] In particular, we require that a service provider, e.g., transit provider, that (1) alters or strips SS7, MF ANI, or CN signaling information that was passed on to the transit provider~~delivering traffic that lacks any of the signaling information required by our rules as amended herein~~, ~~or that~~ or (2) does not, where the identity of the carrier handing the traffic to the transit provider is not otherwise identifiable, provide in some other form the required call information, for example by providing an industry standard billing record,[884] to the recipient, must pay the terminating service provider's highest termination rate in effect at the time the traffic is delivered to the terminating service provider.[885] By making intermediate service providers financially responsible in these circumstances, we ensure that service providers are compensated for terminating traffic.

342. We also permit those intermediate service providers, in turn, to pass along the termination charges to the provider that delivered the applicable traffic to them, in addition to any otherwise-applicable charge for their services. We agree with commenters that the providers delivering traffic are in a better position than the terminating service provider "to know which carriers are routing improperly or incompletely identified traffic"[886] and to recover the termination charges from them. Moreover, by permitting intermediate service providers to pass along those charges on top of their otherwise-applicable rates, we create disincentives for service providers who might otherwise originate, or act as a "pass through" for mislabeled or unidentifiable traffic. We specify that this paragraph represents a break from prior practice that may trigger an interconnection agreement's change-of-law

---

[883] *See, e.g.*, EPG Proposal at 2 ("All messages that are not properly labeled would be billed at the highest prevailing intercarrier compensation rate to the interconnecting carrier delivering the traffic."); ARIC Plan at 55; CenturyTel *ICC FNRPM* Comments at 6; Hickory *ICC FNPRM* Comments at 2 ; JSI *ICC FNPRM* Comments at 4–6; Colorado Telecom Ass'n et al. *ICC FNPRM* Reply at 13, TDS Telecom *ICC FNPRM* Reply 14, JSI *Missoula Phantom Traffic* Comments at 4–6; RICA *Missoula Phantom Traffic* Comments at 2–3; TexalTel *Missoula Phantom Traffic* Comments at 7–8; Cavalier *Missoula Phantom Traffic* Comments at 2–3; PAPUC *Missoula Phantom Traffic* Reply at 8.

[884] We exempt traffic using MF signaling or intra-company SS7 signaling from this obligation, as we recognize that carriers' current networks are unable to create necessary billing records for this traffic. We thus limit this obligation to service providers that are connected to the service provider through their own facilities and using SS7 signaling.

[885] We agree with commenters who note that intermediate 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, e.g.*, Letter from Susanne A. Guyer, Senior Vice President – Federal Regulatory Affairs, Verizon, to Chairman Kevin Martin et al., FCC, CC Docket Nos. 96-45, 01-92 at 2 (filed Oct. 28, 2008); Letter from Mark D. Schneider, Counsel, Neutral Tandem, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008); Letter from Tamar E. Finn, Counsel, Zayo Group, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 2 (filed Oct. 28, 2008). Thus, an intermediate provider that passes to the terminating carrier information that identifies the OCN of the carrier that handed it the traffic will not be responsible for paying termination charges to the terminating carrier.

[886] ARIC Plan at 55.

provision.

343. We stress that the requirements we adopt here are meant to ensure proper labeling of traffic, and do not supersede otherwise applicable norms governing interconnection. Thus, whether or not an originating network opts to utilize a transiting carrier to move traffic to its destination, nothing in this order curtails that originating provider's obligation to ensure the delivery of its customer's traffic, or to compensate the terminating carrier for transport and termination of calls. We also clarify that all carriers exchanging traffic have the ability and obligation to enter into agreements setting forth the terms of such exchange. We recognize that only some of those agreements will fall under section 252 of the Act, and that others will be governed by section 201 or other statutory provisions.

344. We understand that the rules we adopt herein to ensure proper billing may make it necessary for intermediate carriers to implement systems changes. Accordingly, to avoid a flash cut, the rules we adopt herein with respect to the responsibilities and obligations of intermediate carriers will not become effective until one year after the effective date of this order. This will allow intermediate carriers sufficient time to implement necessary changes to their systems.

345. We are unpersuaded by the objections to imposing such financial obligations on intermediate service providers.[887] For example, one objection is based on the assumption that transit providers will be the only intermediate service providers subject to such liability, and will be unable to pass along those charges.[888] The financial responsibility under this order for traffic that lacks sufficient billing information is not limited to transit service providers, however. Rather, any service provider that passes traffic lacking sufficient billing information becomes responsible for intercarrier payments to the receiving provider. Additionally, we expressly permit service providers subject to this charge to pass it along to the service provider that delivered the applicable traffic to them.

346. Another commenter objects to any proposal that "gives . . . [ILECs] the authority to impose new rates based on their own interpretation of the sufficiency of data received or interpretation of jurisdictional parameters."[889] Under our amended rules, service providers will not be able to impose rates based on their own interpretation of the sufficiency of data received. Instead, our amended rules set the standard for what information must be included and passed. Specifically, the financial obligations discussed herein will apply only where the intermediate carrier fails to pass to the terminating carrier information that identifies the OCN of the carrier that handed it the traffic.

347. We also disagree with commenters who suggest that imposing liability on intermediate service providers implies that the problem is the result of transiting service providers altering call detail information.[890] The financial obligations we impose on intermediate service providers are triggered by passing traffic that does not comply with the call signaling rules, regardless of whether the traffic was originated or altered by the passing service provider. Accordingly, any service provider, not just a provider who stripped or altered traffic signaling, who is not taking steps to ensure that traffic carried on their network is properly labeled and identifiable could be held responsible for payment by the provider to

[887] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed July 7, 2007); Letter from Charles W. McKee, Director—Government Affairs, Federal Regulatory, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Apr. 20, 2007) (Sprint Nextel April 20, 2007 *Ex Parte* Letter); Letter from Charon Phillips, Director—Government Affairs, Federal Regulatory, Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 13, 2007).

[888] *See, e.g.*, Verizon *Missoula Phantom Traffic* Reply at 5–6.

[889] *See* Sprint Nextel April 20, 2007 *Ex Parte* Letter at 2.

[890] *See* Missoula Plan Supporters *Missoula Phantom Traffic* Reply at 11–12.

whom it delivered traffic.

348. In addition to call signaling, the USTelecom Feb. 12, 2008 proposal seeks Commission action related to routing traffic, local number portability queries, and providing incumbent LECs with certain rights with regard to the section 251 and 252 negotiation and arbitration processes.[891] Although a broad cross section of the industry supports the USTelecom Feb. 12, 2008 proposal in its entirety, several commenters objected to the section 251 and 252 negotiation and arbitration provisions.[892] In light of the lack of consensus on some of these issues and the changes to the intercarrier compensation system adopted in this order we are not persuaded that the other specific actions sought in the USTelecom Feb 12, 2008 proposal and not addressed above are necessary at this time.[893]

E. Curbing Access Stimulation

349. As explained above, one form of arbitrage arising from existing above-cost termination rates, known as "access stimulation," arises from agreements whereby LECs with high terminating rates work with providers of "free" or heavily subsidized services (often conference calling, chat-line, or similar offerings) to generate exceedingly high call volumes and to share the substantial resulting profits. As they have been described in our record, these schemes often involve an arrangement in which the LEC earned substantial above-cost payments for every minute of traffic delivered to the business partner, and agrees to share those revenues with the business partner. Ultimately, IXCs and their customers pay not only for the "free" service that generates these high call volumes but also for substantial excess subsidies collected by the LEC and the "free" service provider. We have taken action to curb this abuse, particularly among rural incumbent LECs, but the record shows that rural competitive LECs continue to engage in access stimulation and that the public is harmed by this activity.

350. We believe that adoption of final uniform state-by-state terminating rates based on the "additional cost" standard is likely to eliminate or substantially reduce the prospects for profitable access stimulation: If properly set, rates based on this standard should not allow for the revenue-sharing that permits access-stimulation activities to persist. However, we also recognize that this solution will have no effect in the short term, because rates based on the additional cost methodology may not take effect for ten years in many states. We therefore conclude that action addressing the access stimulation problem is appropriate today.

351. To that end, we find that a LEC's practice of sharing its access revenues with its business partner will be deemed *prima facie* evidence of an unjust and unreasonable behavior, contrary to section 201(b) of the Act. For purposes of this finding, a "business partner" will be defined to mean any entity which receives as much or more compensation from the LEC in connection with the LEC's delivery of

[891] *See* USTA Feb. 12, 2008 Proposal.

[892] *See, e.g.*, Letter from Brad Mutschelknaus, Counsel to Broadview Networks et al. to Kevin J. Martin et al., FCC, CC Docket No. 01-92 (filed Oct. 22, 2008); Letter from Henry T. Kelly, Counsel to Peerless Networks to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92 et al. (filed Sept. 16, 2008); Letter from Charles W. McKee, Director—Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Apr. 16, 2008); Letter from Thomas Cohen, Edward A. Yorkgitis, Jr., Counsel for NuVox Communications et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Mar. 11, 2008); Letter from Daniel L. Brenner, Senior Vice President, Law and Regulatory Policy, NCTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 29, 2008); Letter from Paul Garnett, CTIA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Feb. 25, 2008).

[893] The USTA Feb 12, 2008 Proposal also sought certain enforcement commitments related to our call signaling rules. In this regard, USTA's proposal did not seek anything beyond the ordinary course of business. As with any of our rules, the Commission is committed to resolving complaints expeditiously and will not hesitate to initiate enforcement proceedings against rule violators.

traffic to the entity than the LEC receives in connection with its provision of service to the entity. In the course of any formal complaint arising from such revenue-sharing, the LEC will be entitled to rebut the prima facie showing of a section 201(b) violation by demonstrating that the revenue-sharing was not designed to further an arbitrage scheme but rather served a distinct interest consistent with the public interest.

352. We believe that the action taken here is likely to curb access stimulation but is narrow in scope and unlikely to harm any parties not engaged in access-stimulation behavior. First, to the extent a LEC engages in revenue-sharing for legitimate purposes, it will surely cite these purposes during the mandatory pre-complaint process, likely averting the filing of any formal complaint. Second, to the extent a party does file a formal complaint, the LEC defendant will have ample opportunity to explain (or to deny) the revenue-sharing and to present evidence in its defense. Moreover, we note that because the policy announced here speaks to the reasonableness of revenue-sharing itself rather than to the reasonableness of the LEC's underlying rates, damage awards will not be blocked by the "deemed lawful" language set forth in section 204(a)(3) of the Act.[894]

VI. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Universal Service Contributions

353. As we explain above, an assessment methodology based solely on telephone numbers would not require certain business services to equitably contribute to the universal service fund.[895] We, therefore, determine that universal service contributions for business services will be based on connections as opposed to numbers. We seek comment on how best to implement a connection-based mechanism for business services, and whether that mechanism should be based solely on connections or on a combination of Assessable Numbers and connections.

354. We also seek comment on expanding our NRUF data collection to all providers who are required to contribute to the universal service fund based on Assessable Numbers. At present, our NRUF reporting rules require "reporting carriers" to file reports. A "reporting carrier" is defined as "a telecommunications carrier that receives numbering resources from the NANPA, a Pooling Administrator or another telecommunications carrier."[896] "Reporting carriers" file reports regarding six categories of numbers, the descriptions of some of which refer to "telecommunications carriers" or "telecommunications services."[897] We seek comment on whether we should amend our rules to require all providers who assign numbers or otherwise make numbers available to end users to file NRUF reports. Would such an expansion assist the Commission and the fund administrator with monitoring and enforcing universal service contribution requirements? What modifications would the Commission need to make to its rules to effectuate this kind of policy change?

B. Intercarrier Compensation Further Notice

355. In this Further Notice of Proposed Rulemaking (Further Notice) we seek comment on certain additional issues not resolved in our accompanying order.

---

[894] 47 U.S.C. § 204(a)(3).

[895] *See supra* para. 130.

[896] 47 C.F.R. § 52.12(f)(2).

[897] *E.g.*, 47 C.F.R. § 52.12(e)(i) ("*Administrative numbers* are numbers used by telecommunications carriers . . . ."); *id.* § 52.12(e)(v) ("*Intermediate numbers* are numbers that are made available . . . for the purpose of providing telecommunications service . . . .").

356. *Originating Access.* In this order, we conclude that retention of originating access charges would be inconsistent with our new regulatory approach to intercarrier compensation.[898] Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated by the conclusion of the transition to the new regime. We also recognize, however, that the elimination of such charges might raise questions concering the recovery of lost revenues, and could necessitate the simultaneous implementation of related rules to minimize any harms posed to consumers. We seek comment on issues relating to the transition for the elimination of originating access.

357. *Transit Traffic*. Transiting occurs when two carriers that are not directly interconnected exchange traffic by routing the traffic through an intermediary carrier's network.[899] We request comment on whether the reforms we adopt today necessitate the adoption of any rules or guidelines governing transit service.

358. *Universal Service Rules Applicable to Rate-of-Return Carriers.* In this order, we conclude that under certain circumstances, rate-of-return carriers will be able to receive universal service support to recover net reduced revenues from intercarrier compensation as a result of reforms adopted in this order that they do not otherwise recover through SLC increases or other revenue increases. We seek comment on what rule changes are necessary to allow rate-of-return carriers to receive universal service support in this manner.

359. *Parts 51, 54, 61 and 69.* Part 51 of the Commission's rules contain requirements applicable to interconnection, including reciprocal compensation.[900] Part 54 of the Commission's rules describe universal service programs and administration.[901] Part 61 of the Commission's rules prescribes the framework for the initial establishment of and subsequent revisions to tariff publications.[902] Part 69 of the rules governs the Commission's access charge regulations for interstate or foreign access services.[903] We solicit comment on the need to revise the rules set forth in Parts 51, 54, 61 and/or 69, or any other rules, as a result of the reforms we adopt today.

VII. PROCEDURAL MATTERS

A. *Ex Parte* Presentations

360. The rulemaking this Further Notice initiates shall be treated as a "permit-but-disclose" proceeding in accordance with the Commission's ex parte rules.[904] Persons making oral ex parte presentations are reminded that memoranda summarizing the presentations must contain summaries of the substance of the presentations and not merely a listing of the subjects discussed. More than a one or two sentence description of the views and arguments presented generally is required.[905] Other requirements

---

[898] *See supra* para. 229.

[899] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4737–38, para. 120. Typically, the intermediary carrier is an incumbent LEC and the transited traffic is routed from the originating carrier through the incumbent LEC's tandem switch to the terminating carrier. The intermediary (transiting) carrier then charges a fee for use of its facilities. *See id.* We note that carriers have various agreements governing the provision of transit traffic. *See id.*

[900] *See* 47 C.F.R. Part 51.

[901] *See* 47 C.F.R. Part 54.

[902] *See* 47 C.F.R. Part 61.

[903] *See* 47 C.F.R. Part 69.

[904] 47 C.F.R. § 1.200 *et seq*.

[905] *See* 47 C.F.R. § 1.1206(b)(2).

pertaining to oral and written presentations are set forth in section 1.1206(b) of the Commission's rules.[906]

B. Comment Filing Procedures

361. Pursuant to sections 1.415 and 1.419 of the Commission's rules,[907] interested parties may file comments and reply comments regarding the Further Notice on or before the dates indicated on the first page of this document. **All filings related to the intercarrier compensation Further Notice of Proposed Rulemaking should refer to CC Docket No. 01-92**. **All filings related to the universal service contributions Further Notice of Proposed Rulemaking should refer to WC Docket No. 06-122**. **All filings related to numbering reporting issues of the universal service contributions Further Notice of Proposed Rulemaking should refer to CC Docket No. 99-200.** Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's e-Rulemaking Portal, or (3) by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 FR 24121 (1998).

362. Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs/ or the Federal e-Rulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

363. ECFS filers must transmit one electronic copy of the comments for CC Docket Nos. 01-92, 99-200, or WC Docket No. 06-122, respectively. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

364. Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Marlene H. Dortch, Office of the Secretary, Federal Communications Commission, 445 12th Street, S.W., Washington, D.C. 20554.

365. The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

366. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

367. U.S. Postal Service first-class, Express, and Priority mail should be addressed to 445 12th Street, S.W., Washington D.C. 20554.

368. Parties should send a copy of their filings in CC Docket No. 01-92 to Victoria Goldberg, Pricing Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A266, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

---

[906] 47 C.F.R. § 1.1206(b).

[907] 47 C.F.R. §§ 1.415, 1.419.

369. Parties should send a copy of their filings in WC Docket No. 06-122 to Jennifer McKee, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

370. Parties should send a copy of their filings in WC Docket No. 99-200 to Marilyn Jones, Competition Policy Division, Wireline Competition Bureau, Federal Communications Commission, Room 5-A423, 445 12th Street, S.W., Washington, D.C. 20554, or by e-mail to cpdcopies@fcc.gov. Parties shall also serve one copy with the Commission's copy contractor, Best Copy and Printing, Inc. (BCPI), Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, (202) 488-5300, or via e-mail to fcc@bcpiweb.com.

371. Documents in CC Docket Nos. 01-92, 99-200, and WC Docket No. 06-122 will be available for public inspection and copying during business hours at the FCC Reference Information Center, Portals II, 445 12th Street S.W., Room CY-A257, Washington, D.C. 20554. The documents may also be purchased from BCPI, telephone (202) 488-5300, facsimile (202) 488-5563, TTY (202) 488-5562, e-mail fcc@bcpiweb.com.

C. Initial Regulatory Flexibility Analysis

372. As required by the Regulatory Flexibility Act of 1980,[908] the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the policies and rules addressed in this document. The IRFA is set forth in Appendix E. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice provided on or before the dates indicated on the first page of this Notice.

D. Final Regulatory Flexibility Analysis

373. Pursuant to the Regulatory Flexibility Act (RFA),[909] the Commission has prepared a Final Regulatory Flexibility Analysis (FRFA) for the Report and Order concerning the possible significant economic impact on small entities by the policies and actions considered in the Report and Order.

E. Paperwork Reduction Act

374. This document contains proposed new or modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collection requirements contained in this document, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107-198,[910] we seek specific comment on how we might "further reduce the information collection burden for small business concerns with fewer than 25 employees."

F. Accessible Formats

375. To request materials in accessible formats for people with disabilities (Braille, large print,

---

[908] *See* 5 U.S.C. § 603.

[909] *See* 5 U.S.C. § 603. The RFA, *see* U.S.C. § 601 *et seq*., has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) ("CWAAA"). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 ("Small Business Act").

[910] *See* 44 U.S.C. § 3506(c)(4).

electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice) or 202-418-0432 (TTY). Contact the FCC to request reasonable accommodations for filing comments (accessible format documents, sign language interpreters, CART, etc.) by e-mail: FCC504@fcc.gov; phone: 202-418-0530 or TTY: 202-418-0432.

G. Congressional Review Act

376. The Commission will include a copy of this Order on Remand and Report and Order and Further Notice of Proposed Rulemaking in a report to be sent to Congress and the Government Accountability Office pursuant to the Congressional Review Act. *See* 5 U.S.C. § 801(a)(1)(A).

VIII. ORDERING CLAUSES

377. Accordingly, IT IS ORDERED that, pursuant to Sections 1–4, 201–209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, and 503 of the Communications Act of 1934, as amended, and Sections 601 and 706 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151–154, 157 nt, 201–209, 214, 218-220, 224, 251, 252, 254, 303(r), 332, 403, 502, 503, and sections 1.1, 1.411–1.429, and 1.1200–1.1216 of the Commission's rules, 47 C.F.R. §§ 1.1, 1.411–1.429, 1.1200–1.1216, the ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING ARE ADOPTED.

378. IT IS FURTHER ORDERED that Parts [__] of the Commission's rules, 47 C.F.R. § [__] are AMENDED as set forth in Appendix A hereto.

379. IT IS FURTHER ORDERED, in light of the opinion of the United States Court of Appeals for the District of Columbia Circuit in *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), we consider our obligations met from the writ of mandamus issued in *In re Core Communications, Inc. on Petition for Writ of Mandamus to the Federal Communications Commission*, D.C. Cir. No. 07-1446 (decided July 8, 2008).

380. IT IS FURTHER ORDERED that this ORDER ON REMAND AND REPORT AND ORDER AND FURTHER NOTICE OF PROPOSED RULEMAKING shall become effective 30 days after publication of the text of a summary thereof in the Federal Register, pursuant to 47 C.F.R. §§ 1.4, 1.13, except for the information collections, which require approval by OMB under the PRA and which shall become effective after the Commission publishes a notice in the Federal Register announcing such approval and the relevant effective date(s).

381. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this REPORT AND ORDER AND ORDER ON REMAND, including the Final Regulatory Flexibility Analyses and Final Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

382. IT IS FURTHER ORDERED that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this FURTHER NOTICE OF PROPOSED RULEMAKING, including the Initial Regulatory Flexibility Analyses and Initial Regulatory Flexibility Certifications, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary