Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of:	)	
	)	
High Cost Universal Service Support	)	**WC Docket No. 05-337**
	)	
Federal-State Joint Board on Universal	)	
Service	)	**CC Docket No. 96-45**
	)	
Lifeline and Link Up	)	**WC Docket No. 03-109**
	)	
Universal Service Contribution	)	
Methodology	)	**WC Docket No. 06-122**
	)	
Numbering Resource Optimization	)	**CC Docket No 99-200**
	)	
Implementation of the Local Competition	)	
Provisions in the Telecommunications	)	**CC Docket No. 96-98**
Act of 1996	)	
	)	
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**

REPLY COMMENTS OF EMBARQ

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COMMENTS OF EMBARQ

I. INTRODUCTION AND SUMMARY

Working within the short time period that was allotted by the Commission, more than 100 parties filed comments -- often substantive and extensive comments -- on the *Order on Remand and Report and Order and Further Notice of Proposed Rulemaking*

("FNPRM"),[1] totaling more than 3,000 pages. The record shows that a wide range of parties agree that the FNPRM's intercarrier compensation and universal service proposals are unrealistic and unworkable without significant modification. They also show, however, that relatively modest and easily implementable changes along the lines proposed by the United States Telecom Association ("USTelecom") and the Independent Telephone and Telecommunications Alliance ("ITTA") would enjoy broad support and substantially advance the public interest.[2]

Parties largely agree that intercarrier compensation and universal service regimes need reform, but the majority have serious concerns about the direction on these issues proposed in the appendices. A wide range of parties agrees with Embarq that the FNPRM's proposals would be ultimately harmful to consumers and damage the public interest, particularly in rural America. The draconian reductions in intercarrier compensation, without offsetting increases in explicit USF support, would impose unfunded carrier of last resort ("COLR") service mandates on incumbent local exchange carriers ("ILECs") serving rural subscribers -- mandates that would prove crippling on all

[1] Public Notice, DA 08-2486 (rel. Nov. 12, 2008); *Order on Remand and Report and Order and Further Notice of Proposed Rulemaking,* FCC 08-262 (rel. Nov. 5, 2008) ("FNPRM"). Comments were filed on November 26, 2008. *See 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 03-109); *Universal Service Contribution Methodology* (WC Docket No. 06-122); *Number Resource Optimization* (CC Docket 99-200); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996* (CC Docket 96-98); *Developing a Unified Intercarrier Compensation Regime* (CC Docket No. 01-92); *Intercarrier Compensation for IP-Enabled Services* (CC Docket No. 99-68); *IP-Enabled Services* (Docket No. 04-36).

[2] *See* Comments of the United States Telecom Association; Comments of the Independent Telephone & Telecommunications Alliance.

but the largest integrated carriers. State commissions also clearly stated their opposition to the FNPRM's ill-advised proposals and challenged the Commission's legal authority to usurp state power over intrastate services.

At the same time, comments suggest a broad range of support for the principles outlined in the compromise proposals of USTelecom and/or ITTA.[3] Although they may be imperfect, the USTelecom and ITTA proposals recognize the critical importance of voice parity. They recognize that a default intercarrier compensation rate of $0.0007 per minute of use ("MOU") is unreasonable, as it fails to approach a reasonable approximation of the costs of transporting and terminating traffic, especially in rural areas. Both proposals recognize that COLR obligations are the central problem for reform of both intercarrier compensation and high cost universal service support. And they address these issues in a way that advances the goals of intercarrier compensation reform and universal service reform, while promoting investment in the networks on which Americans, particularly rural consumers, depend.

When the Commission reviews the recently-filed comments in these dockets, it should reach the following conclusions about intercarrier compensation and universal services reform:

A. The Commission Should Adopt Either the USTelecom or the ITTA Proposal.

USTelecom and ITTA offer similar, effective answers to the biggest problems with the proposals in the FNPRM. Both recognize the need for prompt Commission

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[3] Some commenters anticipated the USTelecom or ITTA filings, and encouraged the Commission to adopt them. *See* CenturyTel at 22-24; Embarq at 5-8; Frontier at 4-6; Iowa Telecom at 5; Windstream at 14.

action given the growing pressure on the implicit support in access charges, which often remain the principal means by which the Commission has relied to ensure that telecommunications services are available in rural areas at rates that are affordable and comparable to those in urban areas.[4] If anyone doubted that the current regulatory paradigm is broken, the recent bankruptcy of Hawaiian Telcom has made it clear.[5] One key point in both proposals is to avoid an unreasonably short transition to a unified, state-wide, carrier specific rate. Given the extent to which intercarrier compensation remains inextricably linked to ongoing state and federal COLR mandates.[6]

B. The Commission Should Not Reinterpret the Additional Cost Standard.

The Commission's original and now relatively long-standing interpretation of additional cost has worked well. Accordingly, there is no need to move to an incremental cost standard as suggested in the FNPRM proposals. Moreover, an incremental cost standard is inappropriate and must be rejected for the transport component of reciprocal compensation. Accordingly, incremental cost must be rejected for transport under Section 252(d)(2).[7] That means it is utterly inappropriate for intercarrier compensation

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[4] Affordability and comparability are the central statutory goals of universal service, and are mandated by section 254 of the Act. 47 U.S.C. § 254(g).

[5] Hawaiian Telcom filed for bankruptcy under Chapter 11 on December 1, 2008. Associated Press, "Hawaiian Telcom Files For Bankruptcy Protection," (Dec. 1, 2008).

[6] The federal COLR mandate comes from both historical universal service principles, codified in section 254, and the fact that at least 25% of the cost of complying with COLR mandates imposed by states is assigned to the federal jurisdiction, making the Commission a partner in the COLR mandate.

[7] 47 U.S.C. § 252(d)(2).

overall. The statute does not allow different standards for origination and termination, which logically precludes using incremental cost. In any event, should an incremental cost standard be adopted, it would be utterly inappropriate for the Commission to assume that carriers will automatically deploy the latest technological improvements, particularly in the absence of any meaningful opportunity to recover the cost of such investments, as would be the case in the case of radically reduced intercarrier compensation without offsetting revenue opportunities. In fact, an assumption that carriers will use forward looking technology is inherently inappropriate for any incremental cost standard.

C. The Commission Should Not Impose a Uniform Rate for All Carriers.

Contrary to the claims of some parties, the Commission should not impose a single uniform rate for all carriers. In particular, the additional costs of terminating a call vary substantially depending on population density and carrier size, making a statewide rate for all carriers inconsistent with rational economic principles. Moreover, to the extent the Commission chooses an incremental cost standard, the methodology must inherently be carrier-specific. Moreover, a statewide rate inherently imposes rate averaging on carriers, which leads to market distortions, such as above-cost rates in urban areas and below-cost rates for rural areas and smaller carriers. Therefore, a statewide rate requirement would be arbitrary and discriminatory.

D. The Commission Should Ensure that All Voice Traffic is Treated the Same.

The FNPRM's proposal to declare IP/PSTN traffic[8] to be "information services" cannot be rationally sustained. Instead, the Commission should reiterate that IP-originated or -terminated traffic is no different than other traffic. It uses the public switched telephone network in the same way and, indeed, it is indistinguishable from other traffic on the PSTN, making it impossible administratively to afford such traffic different preferential treatment as proposed. The Commission, therefore, must also reject calls to misapply the ESP Exemption to IP/PSTN traffic, and Verizon's call to arbitrarily declare IP-originated traffic jurisdictionally "interstate" for compensation purposes. Voice parity is also essential to avoid distorting competition and undermining universal service.

E. The Commission Must Not Impose Unfunded Mandates on ILECs.

Intrastate access revenues remain the principal source of funding for universal service support for the majority of supported consumers. Intercarrier compensation reform involves reducing implicit support for the COLR obligation that remains at the heart of federal universal service policy. Accordingly, section 254[9] requires the Commission to offset intercarrier compensation reductions with corresponding explicit support for ILECs' government-imposed universal service obligation. To do otherwise

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[8] IP/PSTN services here refers to traffic that originates with a service provider that utilizes Internet protocol ("IP") and terminates on the public switched telephone network ("PSTN"), or that originates on the public switched telephone network and terminates with a service provider that utilizes Internet protocol. FNPRM at App. A ¶ 209, App. C. ¶ 204.

[9] 47 U.S.C. § 254.

would convert the COLR obligation into an unfunded mandate, which is both misguided public policy and inconsistent with federal law. The FNPRM also proposes a second potential unfunded mandate, by making federal Universal Service Fund ("USF") high cost support contingent on 100% broadband deployment. Such a requirement is unrealistic economically. In fact, current USF high cost support is inadequate to support the ongoing voice service COLR mandates. It is far from sufficient to justify additional broadband deployment. If the Commission wants to promote deployment in uneconomic areas, it should provide greater support targeted to areas of highest cost, not adopt policies that diminish support that is already insufficient.

F. The Commission Should Reject Calls to Regulate Transit Traffic.

Tandem owners have no obligation to provide transit services. Accordingly, transit is not properly subject to Commission regulation, and ILEC transit is provided solely by commercial agreement. In any event, markets for interoffice transport are quite competitive. Indeed, competition for competitive interoffice services first emerged decades ago. Today, competitive transit services are available from many providers, including large local and long distance carriers and competitive local exchange carriers. Nonetheless, the Commission is confronted with calls for extensive regulation of transit services, including below-cost pricing along the lines of the incremental cost proposed for terminating traffic over dedicated loops. Transport networks are constructed equally for all traffic, and the cost of such networks is inherently traffic sensitive. Accordingly, it would make no sense to require .

II. THE COMMISSION SHOULD ADOPT THE REFORM PROPOSALS OF USTELECOM OR ITTA.

USTelecom and ITTA were among the large majority of commenters pointing to serious policy and legal flaws in the FNPRM's proposals. In their filings, the two associations outlined alternative reform proposals, based on modifications to the FNPRM's proposed intercarrier compensation order, as reflected in Appendix C. Either of the USTelecom or ITTA proposals would address the most significant flaws in the FNPRM, while preserving most of the benefits. The Commission should, therefore, adopt an order incorporating either the USTelecom or ITTA proposals.

The two associations reached similar conclusions, and their respective proposals are similar in content. The two proposals address intercarrier compensation and universal service reform in a reasonable way, and are consistent with the four commissioners' Joint Statement, which they attached to the FNPRM. The two proposals share seven common elements, which the Commission should adopt as modifications to the FNPRM's proposed order. They include:

(1) reducing intrastate access rates to company-specific interstate rate levels over a three year period;

(2) allowing ILECs to increase residential subscriber line charges ("SLCs") by $1.50 and business SLCs by $2.30 over that period;

(3) allowing ILECs to recover access reductions (after SLC increases) through increased Interstate Access Support ("IAS") or Interstate Common Line Support ("ICLS") support;

(4) commencing a further rulemaking and referral to the Federal-State Joint Board on Universal Service to determine next steps toward unifying rates for all terminating traffic, and providing adequate replacement mechanisms to offset reductions in access revenue);

(5) ensuring parity in treatment of voice traffic for access rate and jurisdiction, including IP/PSTN traffic;

(6) establishing clear signaling obligations and other measures to reduce phantom traffic, as proposed by USTelecom; and

(7) making high-cost USF distribution more granular, so support is targeted to truly high-cost areas, instead of requiring customers in low-cost areas to subsidize customers in high-cost areas.

The associations' compromise reform proposals were vetted by their memberships, representing perhaps the broadest cross-section available for the ILEC industry. In addition to enjoying support among from their memberships, and, based on the Embarq's review of comments submitted in these dockets, should have fairly broad support even outside the ILEC industry. Notably, they are also consistent with the Joint Statement issued by the four Commissioners with the FNPRM.[10]

For both intercarrier compensation and high-cost universal service support reform, the USTelecom and ITTA proposals solve the chief problems in a reasonable way, resolving the arbitrage problem in a measured way that protects consumers and avoids undermining the industry's health and investment incentives. At the same time, they avoid most of the disruptions and problems posed by the FNPRM's approach. The Commission's proposals, in contrast, are misguided and unrealistic. Indeed, a consensus of support has developed for either the USTelecom or ITTA proposal.

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[10] Joint Statement of Commissioners Michael J. Copps, Jonathan S. Adelstein, FCC 08-262 (rel. Nov. 5, 2008).

III. REFORM OF HIGH COST UNIVERSAL SERVICE.

A. The FNPRM's High Cost Proposals Are Bad Policy and Legally Deficient.

Comments filed show remarkably wide agreement that the proposals outlined in the FNPRM represent bad policy and legally fail to meet the Commissions obligations under the Act. The Wyoming PSC was particularly blunt about the FNPRM's serious deficiencies.[11] The Oklahoma, Washington, Oregon, and Pennsylvania commissions and the Texas Office of Public Utility Counsel all joined Embarq in challenging the FNPRM's high cost USF support proposals.[12]

Several commenters pointed out that the FNPRM misreads the 10th Circuit's ruling in *Qwest II*.[13] The court objected to "gratuitous subsidies," but it did not suggest affordability that section 254's[14] mandate of "sufficient" support can be balanced by the Commission's notions of affordability. "Section 254(d) and (e) obligate the Commission to provide sufficient support," the Wyoming commission explained, "and no concept of 'excessive subsidization' can undermine that statutory duty."[15]

Indeed, many commenters commenting agreed that the existing universal service high-cost support system already provides *insufficient support* to price cap carriers

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[11] Wyoming PSC at 1-3.

[12] *E.g.,* Oklahoma CC at 15; Washington UTC at 9; Pennsylvania PUC at 29-30; Texas Public Counsel at 5.

[13] *Qwest Communications Intl. v. FCC,* 398 F.3d 1222 (10th Cir. 2005) ("*Qwest II*").

[14] 47 U.S.C. § 254(g).

[15] Wyoming PSC at 2. *See* 47 U.S.C. § 254(d), (e).

serving rural areas.[16] They receive comparatively little high cost USF support, despite having mostly rural service territories. Hawaiian Telcom's financial problems were doubtless exacerbated by the costs of providing service in high costs areas without sufficient USF support.

The 10th Circuit certainly was not convinced that the Commission had demonstrated that its existing high cost USF system is adequate to meet statutory requirements. That makes it all the more doubtful that the FNPRM's proposal -- which imposes costly broadband buildout mandates but provides no increase in support -- could ever pass judicial review. And wireless carriers acknowledged that any mandatory broadband requirement for ETCs would be unlawful unless funded by increased USF support.[17] The same is doubly true for price cap ILECs serving high cost areas.

B. The FNPRM's Rationale for USF Reverse Auctions is Flawed.

Commenters showed little support for the FNPRM's proposal for reverse auctions for high cost USF support.[18] State commissions generally opposed the FNPRM on this issue, as did NASUCA and state utility consumer advocates. CLECs offered no support for the proposal. Wireless carriers were generally opposed. Virgin Mobile supported the concept, but Verizon called for fundamental changes in the FNPRM's reverse auction

[16] The Oklahoma Corporation Commission, for example, opposes any "freeze" of USF support. It noted that the FNPRM's proposed cap wrongly targets rural ILECs, "even though the FCC acknowledges that rural ILECs have not contributed to the recent growth in the USF. Rural ILECs should be able to seek necessary funding as appropriate." Oklahoma CC at 9.

[17] CTIA at 12 (noting also that carriers would need time for transition).

[18] *E.g.,* FNPRM at App. A ¶ 33, App. B ¶ 19, App. C ¶ 33.

model, calling for an inquiry into a wireless build-out program based on one-time grants per reverse auction winner.[19] Smaller wireless carriers also worried that single-winner auctions are inconsistent with the Act's deregulatory and pro-competitive goals.

Mid-sized ILECs consistently opposed the reverse auction concept, and for good reasons. The proposed order argues that a support mechanism based on cost or a cost model provides no incentive for an eligible telecommunications carrier ("ETC") to provide the supported services at the minimum possible cost.[20] The proposed order argues also claims that an auction mechanism is appropriate because the winning bid should approach the minimum level of support required "to achieve our universal service goals." But as Embarq explained in its comments, the FNPRM is based on flawed assumptions. The proposed broadband obligation has the effect of increasing those USF goals to include previously unsupported services, while establishing a reserve price at current funding levels, which are woefully deficient in many study areas for providing even the current list of supported services, prevents the amount of available support from expanding to cover the costs of providing this additional service.

As rural carriers sought to explain, there are three false assumptions underlying the FNPRM's approach to reverse auctions.[21] First, it is wrong to presume that a reverse auction will reveal there is some other provider that is capable of offering ubiquitous broadband in the most rural, high cost regions of the country, for less support than an

[19] Virgin Mobile at 9; Verizon at 31.

[20] FNPRM at App. A ¶ 31, App. C ¶ 31.

[21] CenturyTel, Windstream, and Frontier each emphasized these points.

ILEC needs to provide ubiquitous voice service. Many parties agreed that the FNPRM is unrealistic on this score.

Second, the FNPRM is also wrong to assume that the current high cost support mechanisms do not provide adequate incentives for carriers to operate efficiently, and that an auction mechanism would provide that incentive. The comments of price cap carriers, including Embarq, show that, regardless of how federal USF is structured, price cap carriers have every incentive to operate as efficiently as possible, since it is only through their increased efficiency that they are able to earn an economic return. That difference is reflected in Embarq's BCS plan proposal, which the comments of Frontier, Qwest, and ITTA generally endorsed.[22]

Third, the FNPRM is wrong to assume that the winning bidder would take on the COLR obligations imposed at the state and federal levels, and that an ILEC that lost a reverse auction would be relieved of its COLR obligations. Some state commissions pointed out that the Commission may lack authority to relieve a carrier from state COLR obligations. And it is unreasonable to assume that, after having been legally compelled to invest billions of dollars over a period of many decades building and operating ubiquitous networks, that ILECs could just walk away -- uncompensated -- from their stranded investment.

[22] *See* Letter from David Bartlett (Embarq) to Marlene Dortch (FCC), *High Cost Universal Service Support*, WC Docket No. 05-337, *Federal State Joint Board on Universal Service*, CC Docket No. 96-98 (filed Sept. 18, 2008).

C. The FNPRM's 100% Broadband Mandate is Unrealistic.

A wide range of commenters agree that a ubiquitous broadband build-out mandate for recipients of high cost USF support is unrealistic. Several parties noted that the FNPRM proposes to compel universal broadband coverage in areas where it is simply uneconomic to provide. Indeed, it is uneconomic even to provide even voice services to many high-cost rural customers.

State commissions, for example, all support expanded broadband deployment, and recognize the importance of supporting additional investment in unserved areas. But with few exceptions, they all recognized that it would be impractical and unreasonable -- even unlawful -- to impose an unfunded mandate, without additional high cost USF support funding.[23] Several state commissions are concerned about price cap ILECs, like Embarq, that serve rural areas but receive little high cost support today. The New Jersey Department of Rate Counsel has long supported expanding broadband deployment, yet it criticizes the FNPRM's broadband condition proposal for being insufficiently, or ineffectively, targeted.[24] It also concludes the FNPRM fails to address broadband deployment in any coherent way.

In its comments, Embarq pointed out that its BCS proposal would resolve many of the universal service problems that the FNPRM purports to target, while encouraging expanded broadband investment.[25] Embarq's BCS proposal would create a new high-cost support mechanism for non-rural ILECs, funded by $1 billion from their current high

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[23] *E.g.,* Ohio PUC at 14; Washington UTC at 5; Oklahoma CC at 15.

[24] NJ Division of Rate Counsel at 53.

[25] *See* Embarq at 8-9, 13-14, 63.

cost support and savings from eliminating access replacement for CETCs. It would be targeted, by distributing support to wire centers based on relative costs. It would be split equally with a single CETC if that CETC also committed to rate comparability and service conditions.

Again, other commenters supported Embarq's proposal. Frontier voiced its enthusiastic support, and Qwest and ITTA both endorsed it with only limited modifications. It offers a more realistic compromise approach toward these policy goals.

D. FNPRM Suggestion that Dividend-Paying Carriers Warrant Less USF Support is Unreasonable.

Mid-sized ILECs were appalled by the FNPRM's bizarre suggestion that dividend-paying ILECs should have any access replacement support reduced. As Windstream pointed out, mid-sized ILECs receive relatively little USF support. Federal high-cost USF support accounts for less than 3% of its total revenues.[26] USF support from all sources, state and federal, accounts for less than 2% of Embarq's regulated revenues.[27] Yet all price cap carriers pay dividends to ensure they attract necessary investment capital.

As CenturyTel explained, "[p]ayment of dividends is crucial to attracting investment in telecommunications companies." It is "no exaggeration that carriers would not have equity investors without paying dividends."[28] Companies' dividends are set at market levels depending on what shareholders may demand to be willing to invest in a

[26] Windstream at 44.

[27] Embarq at 15 & n.22.

[28] CenturyTel at 18.

company. They are commonly paid by other regulated entities, including electric, water, and gas companies. Dividends are part of the "cost of equity capital" that regulators have used for years in evaluating a company's return.[29] They are a legitimate business cost, and no commenter offered anything to suggest that mid-sized ILECs' dividend levels are unreasonable for the industry.

Commission precedent has always recognized dividends as a necessary and legitimate practice for regulated carriers. Dividend levels have always been irrelevant to Tariff Review Plans or Cost Filings submitted to the Commission. They are irrelevant to any price cap calculation or showing. They have never been considered by the Commission in any regulatory proceedings, except as a very general matter. They have never been used in setting jurisdictional allocations, or in setting USF payments. Given this history "it would be unprecedented for the FCC to suddenly refused to permit a company to recover a portion of its revenues from an ARM based in part on whether it pays dividends"[30] CenturyTel also noted the irony of the FNPRM's proposal to deny access replacement to dividend-paying ILECs. After all, the chief beneficiaries of access reductions are themselves dividend paying carriers.[31]

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29 Windstream at 44.

30 CenturyTel at 20.

31 Embarq's dividend yield is similar to that of AT&T or Verizon, despite the fact that most of their revenues are no longer generated by their ILEC operations. Embarq, in contrast, has no significant facilities-based long distance or wireless operations.

Windstream also points out that limiting access recovery for dividend paying ILECs would be counterproductive.[32] It would obviously be extremely damaging to ILEC investment, especially in rural areas.

IV. REFORM OF INTERCARRIER COMPENSATION.

A. Mandating a Single, State-Wide Rate for All ILECs is Unreasonable.

Both AT&T and Verizon advocate that the Commission mandate a single statewide rate, rather than rates that are carrier-specific.[33] AT&T attempts to justify this position by offering a series of misleading, incomplete, and economically incorrect arguments. The first such argument is that under the Commission's approach, "forward-looking costs are the costs incurred by an objectively efficient carrier" and somehow this fact supports the notion of a one-size-fits-all approach to call termination rates.[34] What AT&T and others conveniently ignore are the following facts, all based on Commission precedent:

Fact 1: Forward-looking costs include the costs of inputs to production (i.e. the purchase price of inputs).

Fact 2: The purchase price of inputs does vary depending on the size and scale of the provider that is doing the purchasing.

Fact 3: These variations in price do NOT reflect differences in the *efficiency* of the provider. Rather, they reflect bargaining power and things such as volume purchase discounts that are different for larger providers than for smaller providers.

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[32] Windstream Att.1 at 2.

[33] Verizon at 43; AT&T at 14.

[34] AT&T at 15.

Fact 4: The Commission itself has made reference to "greater bargaining power" associated with larger providers.

Fact 5: This means an efficient carrier serving 500,000 end-users will have different costs than an efficient carrier serving 5 million end-users. Both are efficient, yet their costs cannot be expected to be the same.

These legitimate cost differences must be reflected in the rates that carriers are allowed to charge for terminating traffic. Accordingly, a carrier-specific rate is both appropriate and economically justified, and a single, statewide rate is neither appropriate nor justified. AT&T continues to gloss over these pertinent facts when it attempts to argue -- erroneously -- hat cost differences are somehow interconnected to a network's "worth" as measured by what customers do or do not value, and that a carrier arguing for a carrier-specific cost is arguing "not only that its chosen network architecture is inherently costlier than the ILEC's, but also that its network architecture is, in some highly subjective sense, *worth the extra cost*."[35]

That line of argument is flawed in three specific ways. First, the phrase "costlier than the ILEC's" ignores the fundamental question raised above, costlier than *which* ILECs? Is the standard supposed to be an ILEC serving 25 million customers, or one serving 50,000 customers? Second, the phrase "chosen" architecture is incorrect when forward-looking costs are used, because the network architecture -- by definition -- is not the ILEC's "chosen" architecture but rather the most efficient architecture available for an ILEC of a specific size. Third, the phrase "worth the extra cost" is both misleading and meaningless. A properly-calculated forward-looking cost for a smaller carrier -- one

[35] AT&T at 15 (emphasis in original).

that does not have the purchasing power of an AT&T or Verizon -- may indeed be higher than a larger carrier's costs.

And contrary to such arguments, a terminating rate that reflects this smaller carrier's higher cost has nothing do with different functionality, or whether customers value or do not value a service differently. It simply reflects the fact that efficient costs differ with size and scale. And terminating rates that reflect those differences are appropriate. Any suggestion otherwise -- that rates should be based on a one-size-fits-all approach -- is contrary to real-world, real-market practices. It is akin to suggesting that every small retailer that competes with Wal-Mart should charge prices that reflect Wal-Mart's volume purchase discounts from its suppliers, despite the fact that the small retailer does not receive such discounts.

B. The FNPRM's Incremental Costs Standard is Unreasonable.

AT&T is also among the minority of commenters that contend the proposed additional cost standard -- based on an approach by Faulhaber -- is superior to TELRIC as a means of setting Intercarrier compensation rates. As in the case of a single statewide rate, AT&T's arguments are flawed in this area.

A key difference between the "Faulhaber" approach and the existing use of "economic cost based on TELRIC" is the treatment of joint and common costs. Economic costs based on TELRIC, as noted in the FNPRM,[36] include a contribution to shared and common costs; the "Faulhaber" approach does not. AT&T argues that the Faulhaber approach is superior because, in its words, it "forces each terminating carrier to

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[36] FNPRM at App. A ¶ 251; App. C ¶ 247.

look first to its own end users for recovery of joint and common costs."[37] What AT&T fails to provide is any logical economic argument as to why this is a preferred outcome.

In multi-product firms, joint and common costs are recovered across of portfolio of services. Such a portfolio of services can include both retail and wholesale services. Neither AT&T nor any other commenter has presented any economic evidence that it is preferable or efficient to recover joint and common costs solely from retail services -- and for good reason, because *no such evidence exists*. Market-based rates, which are generally perceived to be efficient, include contributions to joint and common costs. Neither AT&T nor any other commenter has provided any argument, any data, and any reason as to why the rates for terminating traffic should be lower than market-based rates. Nor has AT&T or any other commenter provided any argument as to why it is preferable that rates for retail services should be higher -- which they would have to be if they are forced to bear a disproportionate share of joint and common costs.

AT&T's comments suggest that shifting the entirety of joint and common costs to end-users, and allowing connecting carriers to avoid these costs altogether, will "reward efficient carriers and punish inefficient ones."[38] From an economic standpoint this argument is incorrect. Carriers have a motivation to operate efficiently for numerous reasons, and the incentive to reduce joint and/or common costs exists regardless of how those costs are distributed over a portfolio of products.

Most commenters were highly critical of the FNPRM's proposed new additional cost standard. CLECs supported TELRIC, and noted that the FNRPM's proposed

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[37] AT&T at 10 (emphasis in original).

[38] AT&T at 11.

additional cost approach lacked a rational foundation.[39] State commissions joined ILECs in voicing concerns that rural carriers, particularly mid-size price cap carriers, would be unable to recover their costs under the FNPRM's additional cost approach.[40] Hawaiian Telcom's bankruptcy will have only reinforced those concerns. And the New York Public Service Commission pointed out that, even if the FNPRM's additional cost standard were sound, it is certainly impractical and unworkable.

C. The FNPRM's Proposed Rate is Unreasonable.

1. <u>The Proposed $0.0007/MOU Rate is Unrealistically Low</u>.

Although states are concerned by Commission efforts to intrude on their authority, commenters generally recognize the benefits of moving ultimately to a unified rate for interstate and intrastate access traffic. A unified interstate/intrastate rate has benefits; Embarq itself had requested waivers to allow it to unify its interstate and intrastate access rates by study area. But many parties joined Embarq in pointing out that the FNPRM is clearly unrealistic and unlawful in proposing a low $0.0007/MOU rate on all carriers, in all states -- and that is leaving aside the FNPRM's failure to provide an access recovery mechanism for lost intrastate revenues.

Some commenters, of course, want a low rate -- ideally a uniform low rate -- for all traffic. Like Global Crossing, they press for rates as close as possible to zero (i.e., bill

[39] Pac West at 3; Broadview, *et al.* at 3; tw telecom, *et al.* at 5.

[40] California, Tennessee, and Oklahoma commissions, among others, voiced these concerns.

and keep). They want a cap at $0.0007/MOU during the initial 4-year transition, consistent with the rate applicable to ISP-bound traffic.[41]

It makes no sense, however, to insist that, because ISP-bound traffic warrants the Commission applying a low $0.0007/MOU rate, then *all* intercarrier compensation warrants at least that low a rate. ISP-bound traffic is highly out-of-balance, and the Commission deliberately sought to promote the ISP industry by adopting a low default rate for ISP-bound traffic. The Commission also recognized that ISPs do not use the PSTN in the same way that carriers do,[42] a fact that justified the Commission's lower default ISP-bound traffic rate and, indeed, the creation of the ESP exemption in the first place. Furthermore, there is no sustainable rationale for dictating that interconnected VoIP traffic should receive the same intercarrier compensation rate as ISP-bound traffic, or that interconnected voice over Internet protocol ("VoIP") traffic should receive a different intercarrier compensation rate than any other voice traffic.

As for the FNPRM's proposed $0.0007/MOU default rate for intercarrier compensation, even its supporters could offer no support for this plainly arbitrary rate. Verizon actually admitted that the Commission cannot rely honestly on "*any* theoretical cost model ... including the new additional cost standard" to justify its $0.0007/MOU rate.[43] Instead of the Commission pretending that it is justified by a cost model, Verizon

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[41] Global Crossing at 9-10.

[42] *See, e.g., Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982 at ¶¶ 343, 345 (1997), *pet. for rev. denied*, *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) ("*Access Charge Reform Order*"). See also *Southwestern Bell*, 153 F.3d at 542.

[43] Verizon at 48 (emphasis added).

suggests it try to justify the rate by citing the rates in voluntary interconnection agreements. Verizon then claims that Verizon Wireless has interconnection agreements with some twenty-five CLECs that reflect the $0.0007/MOU rate. In Verizon's view, those CLECs would not have entered those agreements unless they were compensatory under a TELRIC standard. Consequently, it argues, the existence of so many agreements at $0.0007/MOU must mean it is a reasonable rate for all carriers.

Verizon, however, fails to point out that all of the ICAs it cites are with CLECs, not ILECs, and none of them are rural carriers. Moreover, 22 of those 25 are actually bill-and-keep arrangements,[44] which by definition do not have a compensable rate and which properly can apply only where traffic is in balance. Plainly, Verizon's simple rationale is not a legitimate basis for making a "national" uniform rate decision, imposing the same rate on different carriers.

This underscores how the FNPRM itself relied on bad evidence to support its feeble rationale. The FNPRM, App A at 254 points to what it claims is evidence of what the current TELRIC cost of termination rates are. It cites a Sprint Nextel filing that claims the national weighted average UNE rate for unbundled local switching is $0.00058 (ranging as low as $0.00004 to a high of $0.0057). It suggests an average for transport at $0.00057. The data, bad though they are, comes from a Sprint Nextel ex parte filing submitted September 26, 2008. Sprint Nextel, however, pulled that data from a supposed survey of unbundled network elements last updated in March 2006, prepared by Billy Jack Gregg. The survey includes only BOCs, ATU and ACS in Alaska, and Hawaiian Telcom, omitting mid-size and smaller rural ILECs. Even assuming the data

[44] Verizon at n.65.

were otherwise fairly presented, those carriers cannot be justified as a reasonable, reliable "nationwide weighted average" reflecting mid-sized or rural LECs with highly different cost structures.

Indeed, many ILECs, including Embarq local operating companies, have rates above what Sprint Nextel's data conveniently supposes is the high end of the range. This simply underscores the fact that, to the extent the FNPRM claims any rationale for its arbitrary $0.0007/MOU default rate, it is based on biased and incomplete data that ignores industry realities, especially for mid-size and rural LECs.

2. <u>There Are No "De Facto" Bill-and-Keep Arrangements</u>

MetroPCS argues that any "de facto bill-and-keep arrangements" must be subject to the FNPRM's proposed prohibition on rate increases.[45] In making this argument, MetroPCS inadvertently highlighted one of the causes of phantom traffic. Many CMRS carriers "hide" behind a tandem owner and route traffic to RLEC networks *indirectly* for termination. Then, in dealing with the rural LEC, they insist they are entitled to "de facto" bill and keep arrangements with the rural LEC. That conveniently saves the CMRS carrier significant reciprocal compensation expenses.

Of course, in most cases, the terminating rural LEC does not agree that a bill and keep arrangement applies. In many cases, the rural LEC is not even aware of the identity of the originating carriers. The Commission cannot rationally implement new phantom traffic rules meant to help facilitate intercarrier compensation billing and, at the same time, accept MetroPCS's argument. It would unfairly prevent rural LECs from billing CMRS carriers for indirect traffic under such ostensible "bill and keep" arrangements.

[45] MetroPCS at 11-14, 16.

Ironically, MetroPCS claims any move away from its self-declared bill and keep arrangement would allow rural LECs to "exploit loopholes that will allow them to game the system."[46] On the contrary, the Commission should put an end to this form of intercarrier compensation abuse. The Commission should help rural LECs collect terminating intercarrier compensation that they have been rightfully due for years. If MetroPCS is uneasy about this issue, it is because it fears having to start paying for reciprocal compensation expenses with rural LECs that it should have been paying all along.

At the same time, MetroPCS also argues that the Commission should "clarify" that intraMTA, "1+" wireline-to-wireless traffic that is handed off to an IXC and terminated to a CMRS carrier is subject to reciprocal compensation.[47] Embarq disagrees. In that instance, it is the effectively the IXC that has the retail relationship with the end user. It is the IXC that is collecting toll revenue. Appropriately, the IXC should be paying terminating compensation, not the originating ILEC. On the other hand, where the originating ILEC is also providing the toll service to the end user, then Embarq agrees that the originating ILEC would be the parties responsible to pay the terminating reciprocal compensation.

3. <u>The Commission Cannot Compel "Free" Transit</u>.

In its comments, Sprint Nextel argues that transit across ILEC networks should effectively be free for transiting carriers. It claims that is logical because, in its view, the

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[46] MetroPCS at 11.

[47] MetroPCS at 22.

FNPRM suggests the Commission is finding that long distance traffic should enjoy free transport. AT&T and Verizon also endorse free, or effectively free, transit. Their rationale, however, makes no sense. A low terminating access rate -- indeed, a bill and keep arrangement -- is based on the assumptions that (1) the benefit is mutual to both parties, and that (2) the facilities are already in place for other purposes.

Neither is true for transit. First, there is no benefit to the transit provider, at least if it is not paid for the use of its network. Second, access necessarily has transport and switching elements. The transport network, however, is not already there for some other purpose, unlike local loop. Accordingly, there can be no logic in arguing that transit should not be paying transport. A call for free transit shows, instead, that long distance should also be paying transport. The Commission should reject such calls for free ILEC transit and make clear that everyone that transits a carrier's network must help pay for it.

MetroPCS argues for setting transit rates based on TELRIC (not market-based rates) at the beginning of the transition, and then reducing them over time to "unify transit services in accordance with [the Commission's] overall unified intercarrier compensation plan.[48]" But that cannot happen under the FNRPM's proposal. The FNPRM attempts to justify lowering the ultimate unified rate by raising SLCs to the carrier's end user. Transit providers' end users are not involved in a transit call, and the artificially lowered transit rates cannot reasonably be offset by increases to end users who, by definition, are not even involved in the call. It is unreasonable to presume that transit rates can be swept in with a regime for unified terminating rates. MetroPCS's argument just shows how interested parties are using intercarrier compensation reform as

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[48] MetroPCS at 27.

a money grab, as an attempt to get rules that let them use ILEC networks at artificially low rates dictated by the Commission.

As Embarq explained in its comments, providing transit services is not a statutory obligation. Buyers of transit services today have real and growing alternatives for transit services. Today, where mid-sized or rural ILECs are one of the indirectly interconnected carriers, in most cases a competitive carrier -- a CLEC or CMRS carrier -- has made a business decision not to interconnect directly with the ILEC network. That indirectly interconnected carrier is properly liable for the transit charges for traffic exchanged in both directions with a rural carrier, and the transit arrangements are appropriately governed by commercial agreements.

4. <u>Other Rate Opportunism</u>.

The Commission should ensure that any intercarrier compensation reform does not give one group of service provider an artificial commercial advantage in the marketplace by undermining existing interconnection agreements.

For example, T-Mobile wants the Commission to "reiterate that classification of VoIP or IP service as an information service does not affect the Section 251(a) interconnection rights of carriers providing VoIP or IP-based services through the same interconnections as their telecommunications services."[49] T-Mobile apparently wants the ability to use their existing interconnections -- established for the exchange of wireless traffic -- to route other traffic, including IP traffic, over the same interconnections. T-Mobile fails to acknowledge out, however, that CMRS traffic enjoys a much larger MTA

[49] T-Mobile at 10.

rule for defining traffic subject to reciprocal compensation, as compared to access charges.

Granting T-Mobile's request would result in all traffic riding those trunks to receive lower termination rates than otherwise allowed if routed over wireline trunks, absent a negotiated factor to identify the non-wireless traffic. That would give wireless traffic, and wireless carriers, a purely artificial cost advantage over wireline competitors. The Commission has found that ISP-bound traffic warrants different treatment than voice traffic, but any intercarrier compensation rules must ensure that all voice traffic has parity. T-Mobile's request should be denied.

V. LEGAL AUTHORITY

A. The FNPRM's Proposed Rules Reflect an Unlawful Abdication of the Commission's Statutory Obligations Under Section 254(g).

Many commenters remarked how the FNPRM's proposals fail to comply with the Commission's obligations under section 254(g). Section 254(g) directs the Commission to ensure that the rates charged to subscribers in rural and high cost areas are affordable and comparable to those in low-cost, urban areas. It also directs the Commission to maintain state-wide, geographically averaged rates by service providers.

Several parties noted that the FNPRM's analysis fails to address section 254(g). The Wyoming PSC was particularly blunt. The FNPRM's proposal "fail[s] to fulfill -- or even address -- the promise to rural, high-cost areas of the nation for reasonable rate comparability made by Congress."[50] The FNPRM's determination to increase subscriber line charges and its failure to include a reasonable access replacement mechanism is

[50] Wyoming PSC at 1.

incompatible with the Commission's statutory duty. After all, "[p]rotection of consumer interests and preservation of network cost recovery for rural carriers are at the heart of Section 254's affordability and comparability requirements."[51]

In addressing intercarrier compensation and universal service reform, the Commission needs to improve its compliance with the section 254 mandate, not ignore it. The proposed order fails to meet these requirements, and the FNPRM offers no rational basis for concluding that the Commission is meeting the statutory mandate.

B. The Commission Lacks Jurisdiction Over Intrastate Traffic.

State commissions uniformly rejected the Commission's assertion of section 251 jurisdiction over all traffic.[52] The Commission cannot expect to preempt state authority in this way, and the FNPRM does not begin to provide a sufficient or sustainable preemption analysis. The FNPRM's proposal to rely on "very broad interpretation of Sections 201(a) and (b) and Section 252(d)(2)(A)" lacks "solid reasoning."[53]

State commissions pointed out that the distinctions between interstate and intrastate traffic have been part of the Communications Act since its adoption nearly 75 years ago. Moreover, section 2(b) of the 1996 Act specifically directs the Commission to acknowledge its lack of authority over intrastate services and rates.[54]

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[51] CenturyTel at 10.

[52] 47 U.S.C. § 251. Among state commenters challenging the Commission's jurisdiction were NARUC and the Massachusetts, Ohio, Oklahoma, New York, Pennsylvania, Tennessee, Virginia, Washington, and Wisconsin commissions.

[53] Pennsylvania PUC at 33.

[54] 47 U.S.C. § 152(b).

State concern about Commission over-reaching is not merely a matter of principle. They recognize that the proposals within the FNPRM would be damaging to the public interest. State commenters voice real that rural carriers, particularly mid-size price cap carriers, would be unable to recover their costs under the FNPRM's additional cost approach.[55] Others also voiced concern that the FNPRM's approach would hurt consumers through higher rates, especially in rural areas.[56] And many recognized that the FNPRM would put continued investment at risk.

C. The Commission Cannot Lawfully Conclude that IP/PSTN Traffic Qualifies as an Enhanced Service.

Many parties agree with Embarq that the Commission should not and properly cannot declare IP/PSTN traffic is "information services." Qwest, for example, was one of many commenters pointing out that IP/PSTN traffic cannot rationally or lawfully be found to be "different" from other voice traffic.[57] State commissions around the country also vigorously opposed the FNPRM's proposal to reclassify IP/PSTN traffic as information services.[58] A wide range of ILECs also oppose such reclassification as arbitrary and unlawful.

This is not merely a question of bad commission policy. Many commenters note that the Commission does not have legal authority to classify IP/PSTN traffic as

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[55] *See, e.g.,* Washington UTC at 5-6.

[56] *See, e.g.,* Washington UTC at 1-2.

[57] Qwest at 15.

[58] State critics included NARUC, the Texas Office of Public Utility Counsel, and commissions in Massachusetts, Ohio, Pennsylvania, Texas, and Washington commissions, among others.

"information services."[59] Cable companies worried that such a ruling would render VoIP traffic ineligible for interconnection, because section 251 obligations apply only to carriers' telecommunications tariff.[60] CLECs shared the same concern. If the Commission were to make such a misguided ruling as finding IP/PSTN traffic information services, they asked, then the Commission should reiterate the *Time Warner Declaratory Ruling Order*'s[61] conclusion that CLECs providing service to IP providers are entitled to interconnection as *carriers*.[62]

Curiously, cable companies (and carriers like Sprint Nextel that support them) seem to want to have it both ways, benefiting from the rights while avoiding all of the obligations. They oppose the FNPRM's proposed finding IP/PSTN services information services. Yet for retail purposes, they want to claim that VoIP is an information service, so as to avoid regulatory burdens that their ILEC competitors bear. This just underscores the irrational nature of the FNPRM's proposed approach, and the need to ensure that all traffic is treated the same.

IP-based providers, naturally, supported the FNPRM's proposed designation of IP/PSTN services as information services.[63] But they ignore what other parties

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[59] *See*, *e.g.,* CompTel at 16.

[60] Comcast at 3; Time Warner at 3. NCTA (at 24) also worried about such a finding's potential impact on transit rights.

[61] *Time Warner Cable Request for Declaratory Ruling that Competitive Local Exchange Carriers May Obtain Interconnection Under Section 251 of the Communications Act of 1934, as Amended, to Provide Wholesale Telecommunications Services to VoIP Providers*, Memorandum Opinion and Order, 22 FCC Rcd 3513 (2007).

[62] Alpheus, *et al.* at 11; CityNet, *et al.* at 16; Telecom Investors at 11.

[63] *E.g,* Vonage at 1; High-Tech Associations at 4.

recognize: that such a finding cannot hold up. It would be irrational to treat voice services as information services, simply because of the technology used in originating or terminating the call. It would be inconsistent with Commission precedent and would be anticompetitive. It would be inconsistent with the statute, relying on a selective misreading to achieve an irrational policy result.

D. Implementation -- Revenue Recovery Opportunities

1. USF Reform Must Provide Dollar-for-Dollar Recovery Opportunities for Reductions in Intrastate Access Rates, to Account for the Implicit Universal Service Subsidy.

Predictably, it is not enough for ILECs' competitors to have access rates drastically cut. They also want the Commission to deny ILECs recovery of those revenues and to handicap ILECs in the marketplace, in spite of the obvious harms that would result to rural consumers. They contend ILECs have no right to "revenue neutrality" or "dollar-for-dollar" recovery for the implicit universal service support now provided by intrastate access charges -- support that the FNPRM would wipe out.[64] The Commission must take a stand for rural consumers and provide sufficient funding for the rural carriers that serve them.

AT&T's comments acknowledge that wireless carriers and IXCs will directly benefit from the FNPRM's proposed virtual elimination of ILEC access revenue. These lower rates, it says, will allow wireless carriers and IXCs to "invest" in lower rates, better service quality, new services, and "innovation."[65] The Wyoming PSC, however, points

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[64] CTIA at 35.

[65] AT&T at 3.

out that "the very low proposed price for access appears to give interexchange carriers a *windfall* that would be difficult, if not impossible, to pass on to end user customers."[66]

AT&T It conveniently ignores the fact that such investment comes at the expense of price cap ILECs that would be left without revenue recovery mechanisms, even while they are saddled with increased broadband obligations. AT&T actually supports the FNPRM's protections for rural rate-of-return carriers.[67] Yet it fails to see that those reasons for those protections apply equally to rural price cap carriers. Such a policy result would benefit urban consumers and the rural customers of rural rate-of-return carriers, at the expense of the millions of rural customers served by price cap ILECs.

The Commission, however, cannot reasonably or lawfully take away the universal service support without violating its statutory duty under section 254. Section 254 demands sufficient funding to ensure rate and comparability. ILECs cannot reasonably or lawfully be subjected to continued COLR obligations and denied dollar-for-dollar recovery of those costs. In fact, although parties like Sprint Nextel contend USF should be reduced because of line loss,[68] just maintaining levels of funding would seriously underfund mid-size price cap ILECs. ILECs operate in a high fixed-cost business. They are compelled to provide service at a loss in high cost areas that other competitors do not bother to serve. A lack of recovery could ultimately lead to more ILEC failures like Hawaiian Telcom.

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[66] Wyoming PSC at 1.

[67] AT&T at 4.

[68] *E.g.,* Sprint Nextel at 22.

Sprint Nextel complains that it is unreasonable for just "one class" of carrier, ILECs, to receive a disproportionate amount of USF support.[69] But it ignores the fact that ILECs alone bear COLR obligation. Certainly, it is hypocritical for a cable or wireless company to object to USF support for ILECs, when those competitors simply cherry pick low-cost areas only, driving down prices and eliminating implicit subsidy, then refusing to serve the very high-cost rural customers who rely on that subsidy to receive comparable services and reasonably comparable rates. That is precisely why USF is needed for COLR ILECs. If anything, USF support must increase, not decrease, as competitors gain more lines in areas that are lower cost to serve, and ILECs' burden of high cost lines increases proportionately. ILECs face declining lines, declining minutes of use, and declining revenues. They are being forced to reduce investment and lay off employees, even while the Commission seeks to expand broadband into more rural areas. The FNPRM's proposals would seriously harm price cap ILECs, along with the rural consumers they serve, and would cripple broadband investment in rural areas.

2. Excessive Reliance on Subscriber Line Charges Would Harm Consumers and Inject Competitive Bias in the Marketplace.

As state and consumer commenters recognized, it is unfair and bad policy to force ILECs to maximize SLCs to offset reductions in implicit universal service support. Not only does it raise costs for consumers and put their service at risk, it unfairly handicaps ILECs in the competitive market.[70] In effect, SLCs penalize customers for choosing the ILEC's service, forcing them to pay more for their service than cable and wireless

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[69] Sprint Nextel at 30.

[70] *See, e.g.,* Pennsylvania PUC at 30-31.

competitors who do not bear the SLC burden. Indeed, cable companies routinely advertise that they do not impose such surcharges, and ILECs realistically will be hurt in the marketplace by anything by the most modest SLC increases.

Naturally, cable and wireless competitors support Commission policies that would handicap their ILEC competitors in the marketplace, but the Commission cannot rationally adopt a policy that places the cost of intercarrier compensation and universal service reform onto price cap ILECs and their customers. The Commission has long recognized that its policies must maintain a level competitive playing field, and the FNPRM would fail to do so. SLC increases will have the perverse result of shifting market share to non-ILECs via regulatory fiat. Furthermore, it is disproportionately rural customers who will bear the brunt of increases in SLC rates

Comcast, CTIA, and Sprint Nextel argue that SLCs should be set at the highest possible level before an ILEC can receive any USF support.[71] Free Press worries about the potential for "over-recovery," and notes that SLC increases under the FNPRM could amount to a "$2.8 billion revenue increase."[72] Free That attitude ignores the impact of SLCs in the marketplace. Competitive pressures would preclude ILECs for recovering all of the potential SLCs, and high SLCs would only accelerate ILEC line loss to competitors that lack that regulatory handicap. Far from over-recovering for the lost implicit USF subsidies, the FNPRM would grossly under-compensate ILECs, even while hurting them in the marketplace.

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[71] Comcast at 9; CTIA at 35.

[72] Free Press at 11.

Embarq agrees with Qwest (at 5) that the Commission should eliminate the requirement to maximize SLCs, and should allow ILECs with deregulated rates flexibility in determining whether SLCs should be increased.

3. The Commission Should Not Attempt to Require a Carrier to Subsidize Regulated Services with Non-Regulated Revenues.

It is also unfair, and bad policy, to assume that ILECs must cover reductions in USF by earnings in non-regulated operations. Again, cable and wireless competitors would be happy if the Commission, by regulatory fiat, limited price cap ILECs' high cost support by including non-regulated revenues in assessing whether USF is "needed."

For example, Comcast and CTIA argue that ILECs should qualify from universal service support only if they complete a public cost proceeding that includes revenue for all regulated and *non-regulated* services and can show they cannot earn a sufficient return.[73] These same parties also wants the Commission to deny USF replacement to any ILEC that has deregulated rates, and suggests that ILECs make enough money through their unregulated services that they do not need cost recovery.[74]

Comcast's logic is obviously faulty. If the ILEC's regulated operations lose money, the ILEC is supposed to cover those loses from its non-regulated, competitive operations. But if the non-regulated operations lose money too, USF is certainly not intended to cover that. In reality, non-regulated operations are a matter of shareholder risk; they are outside the scope of the USF debate. Including those revenues in high cost support calculations would only penalize ILECs for investing in those operations, and

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[73] Comcast at ii; CTIA at 35.

[74] CTIA at 35, Sprint Nextel at 24.

would seriously chill any further broadband investment. The Commission is not free to deny USF support simply because it things an ILEC can otherwise earn a sufficient return. The reality, however, is that the FNPRM's proposals would put more ILECs in the same untenable position that led to Hawaiian Telcom's recent bankruptcy.

E. Measures to Ensure Proper Billing

1. Network Architecture Rules

Global Crossing said the Commission should make network architecture rules effective coincident with the initial four-year transition proposed by the FNPRM, rather than wait until the end of the transition. It argues that, "[a]s termination rates become uniform, carriers will be able to begin eliminating redundant trunk groups and achieving other network efficiencies"[75] that Global Crossing believes uniform rates will somehow automatically create.

In reality, however, until *all* traffic is terminated at the same rate, separate trunks will be necessary for billing purposes. Carriers cannot simply begin to take down trunks and route traffic subject to different rates over the same trunks on Day One. Combining trunks simply cannot happen until rate unification is completely in place. Allowing carriers to route all traffic over the same trunks, as Global Crossing is requesting, will only exacerbate the current rate arbitrage problems and create an even bigger phantom traffic problem.

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[75] Global Crossing at 12.

2. Transit Providers Must Not Be "Bankers."

AT&T supports the FNPRM's proposal to force tandem providers to act as "bankers" for transit.[76] AT&T advocated a general rule that allows a terminating carrier to recover its costs from the transit provider, and then the transit provider in turn may attempt to recover the full price of its service, at a reasonable (i.e., market based) rate, the from originating carrier. Embarq agrees that transit services should be priced at market rates,[77] but as Embarq and other carriers noted in their comments, forcing transit providers to serve as a banker between originating and terminating carriers is an unreasonable and unrealistic approach.

AT&T contends that forcing transit providers to be a banker "would eliminate the substantial administrative burdens and disputes associated with indirect interconnection arrangements today. For example, carriers choosing indirect interconnection no longer would be required to engage in the expensive and time-consuming process of negotiating an managing a multitude of traffic-termination agreements with terminating carriers."[78] Unfortunately, however, making the transit provider serve as a banker between the originating and terminating carriers does not eliminate their need to negotiate agreements

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[76] AT&T at 37.

[77] Qwest notes that the plan expressly provides that transit providers may pass along termination charges to the providers that deliver transit traffic to them "in addition to any otherwise-application charge for their services." Qwest at 28. That shows there should "be no doubt whatsoever that transit service providers have pricing flexibility to take advantage of this." Nevertheless, "[t]he Commission should make clear once and for all that transit service providers are not required to provide transit service at TELRIC." *Id.* As Qwest points out, transit service has a distinct regulatory status. The interconnection obligations imposed upon telecommunications carriers generally under sections 251(a)(1) and 251(c)(2) have no application to transiting services. *Id.* at 24.

[78] AT&T at 38.

setting the terms and conditions for the exchange of traffic. It just forces transit providers into an awkward, expensive, dispute-prone, and unjustified middleman role. As Qwest explained, "This new obligation would now put transit service providers entirely at the mercy of both originating and terminating carriers and into the middle of their disputes. And it is entirely unnecessary."[79]

It is understandable why AT&T can support the FNPRM's misguided idea here. AT&T's ILEC operations are positioned to provide LATA-wide transit services as a significant new business opportunity. The competitive side of AT&T (including AT&T Wireless) does not want to have to negotiate agreements with smaller ILECs, and wants to use AT&T's ILEC as its own banker. That may be a comfortable arrangement for a huge, integrated carrier like AT&T, but it is unreasonable for virtually everyone else, for the many reasons outlined in Embarq's initial comments. Intercarrier compensation rules should not be designed simply because they are most convenient for AT&T.

Qwest agrees with Embarq, and others, that allowing the transit provider to be default-billed would be inappropriate and would significantly "increase the cost of providing transit service."[80] As it explained, "This new obligation would now put transit service providers entirely at the mercy of both originating and terminating carriers and into the middle of their disputes." And it is entirely unnecessary.[81] Rules allowing the transit provider to be default billed, Qwest recognized, are almost certainly destined to create for trouble. If the "bank" rules are implemented, the Commission must clarify

[79] Qwest at 26-27.

[80] Qwest at 28.

[81] Qwest at 26-27.

with better "precision" what circumstances trigger an intermediate carrier's termination expense transfer obligation in order to avoid the inevitable and costly disputes as originating and terminating carriers "whipsaw" intermediate carriers by maximizing their terminating compensation liability."[82]

As Qwest explained, history shows that whenever there is any room for debate, costly disputes arise and then transit providers would end up "holding the bag."[83] "The Commission should make explicit in any final order precisely what constitutes "information sufficient to identify the provider that delivered the traffic to the intermediate provider."[84]

3. The Commission Should Adopt Signaling Rules.

Virtually all commenters agree that the Commission needs to act to reduce the problem of phantom traffic. Verizon and Qwest are among the wide range of parties supporting the USTelecom proposal for signaling rules, and they encourage the Commission to adopt it so as to substantially reduce the problem of phantom traffic.[85] Embarq agrees that the Commission should adopt the USTelecom proposal;[86] indeed, the industry as a whole is broadly behind that proposal. But the Commission needs to adopt it in its entirety.

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[82] Qwest at 28-29.

[83] Qwest at 30.

[84] Qwest at 30.

[85] Verizon at 64; Qwest at 20.

[86] Embarq at 56-57. *See* Letter from Glenn Reynolds (USTelecom) to Marlene Dortch (FCC) at Att. pp. 9-14, WC Docket No. 01-92 (Feb. 12, 2008).

Verizon also sees this middleman role as "unnecessary," but suggests the FNPRM is not unreasonable because of the limited situations in which the tandem owner can be default-billed. Verizon bases that opinion on the assumption that the FNPRM's draft order does not allow default billing of the tandem provider unless either the signaling information is lacking or the tandem owner does not deliver an industry-standard billing record.[87] The FNPRM's proposal, however, is not so clear. If the Commission were to adopt any default billing rule, it should be "explicit ... what constitutes 'information sufficient to identify the provider that delivered the traffic to the intermediate provider,"[88] and doubly explicit about when such default billing may occur. It is imperative, for example, that the second tandem owner is not default-billed in double-tandem transit scenarios. The second tandem owner cannot fairly be default-billed when it is not the carrier that would create the call detail record, and failing to prevent this would only provide more incentives for such abuses.

Verizon states that "limited clarifications to signaling rules together with enforcement actions against deliberate manipulation of signaling information and misrouting of traffic, are the most appropriate regulatory response to the issue of phantom traffic."[89] Those two measures are important, but of course the Commission should adopt

87 Verizon at 64-67.

88 Qwest at 30.

89 Verizon at 65-66.

the USTelecom phantom traffic proposal in its entirety. That includes, among other things, making sure that the *T-Mobile Order*[90] extends to CLECs.

Qwest suggests that the T-Mobile Order may not need to be extended to all such agreements. While Qwest highlights that all carriers have "the ability and the obligation to enter into agreements,"[91] it is not enough that carriers have the *ability* to enter agreements. Embarq believes the Commission should explicitly allow ILECs to initiate negotiations of an interconnection agreement. Otherwise, some CLECs lack sufficient incentives and will simply never come to the negotiating table. And while Verizon suggests that "most so-called 'phantom traffic' can, in fact, be billed through proper use of cost-effective tools that are available today, such as negotiated agreements setting forth billing factors,"[92] ILECs are too often unable to negotiate interconnection agreements and factors. For example, establishing interMTA factors with wireless carriers tends to be a hotly disputed process that unnecessarily extends negotiations and can result in increased arbitrations to finalize CMRS agreements. The data or "tools" necessary to determine the location of the wireless end user lie with the CMRS carrier, yet most of CMRS carriers unrealistically insist on a 0% interMTA factor.

Qwest uses these comments as a platform to ask the FCC to require originating carriers that use Qwest's transit services to pay Qwest. They state "transit service

90 *Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855 (2005), *appls. pending sub nom. Ronan Telephone Co., et al. v. FCC*, Nos. 05-71995 (9th Cir.) (appeals stayed until Mar. 16, 2009 by 9th Circuit Order, Sept. 12, 2008).

91 Qwest at n.42.

92 Verizon at 64.

providers continue to have difficulty obtaining agreements from carriers that hand them traffic and obtaining payment for their services."[93] They state that "the Commission's historic bedrock policy of intercarrier compensation is that the carriers who are the cost causer for any given traffic should incur the intercarrier compensation liability related to such traffic. Embarq agrees that the transit provider should get paid for the use of its network. Nevertheless, Embarq firmly believes the competitive carrier who chooses to *not* establish a direct connection with a rural ILEC's network and instead rely upon the services of a transit provider is clearly the cost-causer and, therefore, ought to incur the intercarrier compensation liability (i.e., transit charges) for the traffic exchanged in both directions. The RLEC should not have to pay for transit costs that reside outside its service territory simply because a CLEC/CMRS carrier chose to not correctly establish network architecture arrangements to facilitate the proper exchange of traffic with a rural ILEC's network. If the FCC would adopt the rural transport rule and require the competitive carrier to pay for transit costs in both directions, Qwest would not have this issue of not getting paid for its services, and a growing area of disputes would be avoided.

VI. CONCLUSION

From the comments filed, it is obvious that intercarrier compensation reform and universal compensation reform are vitally important issues for the industry and for the public. It is imperative that the Commission not mishandle these critical issues. By reducing implicit support for universal service, while failing to assure the additional

[93] Qwest at 26.

funding required to provide government-mandated, below-cost service in high-cost rural areas, the FNPRM would represent an abdication of the Commission's responsibilities under section 254 of the Communications Act. The FNPRM's proposals would frustrate the expansion of broadband services. They would place existing rural network integrity at risk, and threaten to ultimately cripple or even bankrupt carriers serving rural areas. Clearly, as many commenters pointed out, the FNPRM's proposals are unsustainable as matters of policy or law.

The Commission should instead modify the FNPRM's proposed order to reflect the principles outlined by USTelecom and ITTA in their comments. Their principles are consistent with the Commission's goals for intercarrier compensation reform, universal service reform, and phantom traffic reform. They are consistent with the four commissioners' joint statement that accompanied the FNPRM. They have broad support in the industry, showing them to be reasonable and realistic. Finally, they genuinely represent a huge and positive step forward in intercarrier compensation and universal service policy.

Respectfully submitted,

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