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 economies do not significantly affect the cost of traffic termination."[659] 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.[660] 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.

250. 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.[661] The economists contend that modern circuit switches are to a large extent non-traffic sensitive.[662] 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.[663] 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."[664] 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.

251. 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.

252. AT&T submitted evidence that attempts to estimate the incremental cost of a modern

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659 Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter, Attach. at 3–4.

660 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.

661 Richard N. Clarke et al., *Economic Benefits from Reform of Intercarrier Compensation (ICF Economists), attached to* ICF *ICC FNPRM* Reply, Errata, App. A.

662 *ICF Economists* at 22.

663 *ICF Economists* at 20–21.

664 *ICF Economists* at 21.

softswitch.[665] 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 investment that is traffic-sensitive.[666] 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.[667] 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.[668] 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.[669] 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.[670] 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.

253. Windstream Communications, Inc. and NuVox subsequently filed ex parte letters criticizing AT&T's analysis of the traffic sensitive costs of a softswitch,[671] and AT&T filed a response.[672] 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

[665] 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).

[666] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2.

[667] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3.

[668] AT&T Oct. 4, 2008 *Ex Parte* Letter at 2–3.

[669] AT&T Oct. 4, 2008 *Ex Parte* Letter at 3–4.

[670] AT&T Oct. 4, 2008 *Ex Parte* Letter at 4.

[671] 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).

[672] *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).

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.

254. 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 LEC to replace all its existing circuit switches with softswitches.[673] 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.[674] 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.[675] 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.[676] As explained above, we conclude that common costs should no longer be included in calculating the incremental cost of call termination.

255. 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.

256. 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

[673] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2.

[674] *See* Windstream Oct. 27, 2008 *Ex Parte* Letter at 2–3; NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 8–9.

[675] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 14–15.

[676] *See* NuVox Oct. 24, 2008 *Ex Parte* Letter, Attach. at 18 & n.40.

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,[677] we assume that the single call per hour requires a network capacity of 100 kbps. This capacity requirement translates to 12,800 bytes per second, or 0.0000128 Gigabytes to be available for the duration of the call.[678] 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.[679] 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.[680] 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.[681] Under these conservative assumptions the cost, on a per-minute basis, would be 0.00001 *cents* per minute.[682] 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.[683] Although we are not directing the states to consider the incremental cost of terminating voice telecommunications on such next generation networks,[684] 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

[677] *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).

[678] 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.

[679] 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.

[680] 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.

[681] 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.

[682] 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.

[683] 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.

[684] *See infra* section V.C.1.

257. 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.[615] The Supreme Court has made clear that an "'initial agency interpretation is not 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."[616] 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.[617] In response, several commenters supported such a proposal noting that the additional incremental cost of terminating traffic is de minimis.[618] 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.[619]

258. As an initial matter, the Commission plainly has the authority to revise its interpretation of "additional costs."[690] Indeed, the Supreme Court has recognized that the phrase "additional costs" is ambiguous.[691] Words like additional cost "give ratesetting commissions broad methodological

[615] 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).

[616] *Brand X*, 545 U.S. at 981 (quoting *Chevron U.S.A. Inc. v Nat'l Res. Def. Council* (*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)).

[617] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4719, para. 71.

[618] *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.").

[619] 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."

[690] 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").

[691] *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).

leeway,"[692] and courts owe "substantial deference to the interpretation the Commission accords them."[693] 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."[694]

259. Revising our interpretation of "additional costs" to follow the traditional economic 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,[695] and that the legislative history for section 224 makes clear that Congress intended such a result.[696] 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."[697]

260. 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").[698] 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."[699] 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.[700]

[692] *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)).

[693] *Capital Network System, Inc. v. FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994).

[694] *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)).

[695] *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*).

[696] *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)).

[697] *See, e.g., Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932).

[698] *Compare* 47 U.S.C. § 252(d)(1) *with* 47 U.S.C. § 252(d)(2).

[699] *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.

[700] 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

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261. 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 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[701] and is decreasing even further as carriers transition to softswitches[702] 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."[703] 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.

262. 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.[704] In our Implementation section below, we provide specific guidance to the states

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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.").

701 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.

702 *See* T-Mobile *ICC FNPRM* Comments at 29–30.

703 *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

704 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
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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.[705]

263. 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.[706] 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.[707]

C. Implementation

264. 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

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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.

[705] 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 & 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).

[706] *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 . . . .").

[707] *FPC v. Hope Natural Gas Co.*, 320 U.S. at 605.

be replaced through end-user charges or new universal service support, where needed.

1. Direction to the States

265. 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

266. 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 traffic.[708] 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.[709]

267. 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.[710] We further find that the least cost, most efficient technology for transport is fiber optic cable.[711] We observe that, when carriers deploy fiber, they typically deploy capacity significantly in excess of current needs.[712]

268. Second, consistent with the traditional economic definition of the incremental cost of a service,[713] the cost studies must exclude all common costs, including overhead costs. Third, all non-

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[708] 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.

[709] *See supra* section V.B.4.c.

[710] *See supra* section V.B.4.c.

[711] *See supra* section V.B.4.c.

[712] *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").

[713] *See supra* section V.B.4.c.

traffic-sensitive costs must be excluded from the cost studies.[714] 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.[715] Available evidence suggests that the incremental costs of terminating traffic, as determined using this methodology, are likely to be extremely close to zero.

269. 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 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.

270. Following the transition, once carriers are charging the final uniform reciprocal compensation rate, we establish the following default rules regarding the network "edge."[716] These default rules would not require changes to physical points of interconnection, but would simply define functions governed by a uniform terminating rate.[717]

- 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

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[714] 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.

[715] *See, e.g., supra* section V.B.4.c.

[716] *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); Letter from John N. Rose, President, OPASTCO, and Kelly Worthingon, Executive Vice President, WTA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 96-45, 01-92, WC Docket No. 05-337, Attach. at 2 (filed Oct. 29, 2008) (Corrected OPASTCO/WTA Oct. 29, 2008 *Ex Parte* Letter) (discussing a "rural transport rule" for rural rate-of-return incumbent LECs). 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.

[717] 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.

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.

- 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.

- Notwithstanding the forgoing, for local and extended area service (EAS) calls made by a rural rate-of-return incumbent LEC's customer to a non-rural carrier's customer, the rural rate-of-return incumbent LEC will be responsible for transport to a non-rural terminating carrier's point of presence (POP) when it is located within the rural rate-of-return incumbent LEC's service area. When the non-rural terminating carrier's POP is located outside the rural rate-of-return incumbent LEC's service area, the rural rate-of-return incumbent LEC's transport and provisioning obligation stops at its meet point and the non-rural terminating carrier is responsible for the remaining transport to its POP.

b. Symmetry

271. We conclude that final uniform reciprocal compensation rates should be symmetrical.[718] 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.

[718] "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.

272. *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."[719] 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."[720] 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.[721] 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.[722] A presumption of symmetric 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.[723]

273. 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.[724] 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.[725]

274. *Discussion.* We now require symmetric rates and conclude that the exception that

[719] *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.

[720] *See Local Competition First Report and Order*, 11 FCC Rcd at 16040, para. 1085.

[721] *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.").

[722] *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).

[723] *See Local Competition First Report and Order*, 11 FCC Rcd at 16041–42, para. 1088.

[724] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

[725] *See Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1089.

permitted asymmetric rates under certain circumstances is no longer warranted.[726] 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.[727] 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.

275. 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.[728] 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.[729] 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.[730] As the European experience 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.

276. We conclude that requiring symmetrical compensation arrangements without any exceptions is proper under section 252(d)(2)(A)(ii) of the Act.[731] We also confirm that this mandatory

[726] 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).

[727] 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).

[728] *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).

[729] *See* EUROPEAN COMMUNITIES at 2, para. 2.

[730] *See* EUROPEAN COMMUNITIES at 3, para. 3.

[731] 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

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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,[732] 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)

277. 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)."[733] 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."[734] 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."[735] The Supreme Court subsequently confirmed that the Commission has the authority to interpret section 251(f).[736] The only existing Commission guideline regarding section 251(f)(2) provides that the burden of proof is on the LEC seeking suspension or modification of particular requirements.[737]

278. As an initial matter, we conclude that any suspension or modification granted pursuant to

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quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies").

[732] *See supra* section V.B.4.c.

[733] 47 U.S.C. § 251(f)(2).

[734] 47 U.S.C. § 251(f)(2).

[735] *Local Competition First Report and Order*, 11 FCC Rcd at 16118, para. 1263; 47 U.S.C. § 251(f)(2).

[736] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

[737] *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).

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"[738] 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.[739] 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.[740] 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.

279. 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."[741] 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."[742] 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 telecommunications services *generally*."[743] 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.

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[738] 47 U.S.C. § 251(f)(2) (emphasis added).

[739] 47 U.S.C. § 251(f)(1).

[740] 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.

[741] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

[742] WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 1096 (1991).

[743] 47 U.S.C. § 251(f)(2)(A)(i) (emphasis added).

280. 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."[744] The Eighth Circuit has interpreted the phase "unduly economically burdensome" to require a state to examine "the full economic burden on the ILEC."[745] 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.

281. 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."[746] 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.

282. 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."[747] In light of the compelling need to adopt comprehensive reform of existing intercarrier compensation regimes as described above,[748] 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, 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.

283. 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),[749] we therefore adopt rules specifically addressing

[744] *See* 47 U.S.C. § 251(f)(2)(A)(ii).

[745] *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.

[746] 47 U.S.C. § 251(f)(2)(A)(iii).

[747] 47 U.S.C. § 251(f)(2)(B).

[748] *See supra* section V.A.3.

[749] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 385.

certain of the implications of a suspension or modification of our intercarrier compensation rules.[750]

284. 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.

285. 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 such a fresh look within the 180 days for new petitions set forth in section 251(f)(2).[751]

d. Existing Agreements

286. Below we discuss the effect of our intercarrier compensation reforms on certain types of existing agreements.

287. *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

[750] 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.").

[751] 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.").

compensation changes as directed by section 252 of the Act.[752] 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.[753] 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."[754] 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.[755]

288. *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.[756] As the Commission has recognized, for example, early termination 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.[757] 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.[758] Rather than adopt a rule that

[752] *See* 47 U.S.C. § 252.

[753] *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.

[754] *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").

[755] 47 U.S.C. § 251(a)(1).

[756] 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).

[757] *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.

[758] *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

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.[759]

2. Revenue Recovery Opportunities

289. 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.[760] 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.[761] 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.

290. 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. 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

291. 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.[762] 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."[763] Importantly, however, the Commission also has maintained "safeguards that ensure that the rates consumers pay . . .

[759] 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").

[760] *See supra* paras. 186–268.

[761] *See supra* paras. 159–185.

[762] *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.

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

remain well within a zone of reasonableness."[764] 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.

292. 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.[765] 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.[766] Other parties contend that most or all of a carrier's replacement of lost intercarrier compensation revenues should come from increased SLCs.[767] On the other hand, some consumer groups assert that no increase in SLC caps is warranted in response to reductions in intercarrier compensation rates.[768]

(i) Current Availability of End-User Charges for Revenue Recovery

293. As an initial matter, we permit incumbent LECs to increase their SLCs up to new caps to

[764] *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").

[765] 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).

[766] *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).

[767] *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.

[768] *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).

recover reductions in interstate intercarrier compensation revenues. 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."[769] 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.[770] Similarly, the non-primary residential line SLC cap is $7.00, but the national average SLC for those lines is $5.81.[771] 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.[772] 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 charge reductions.[773]

294. 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 intercarrier compensation revenues, at least on an interim basis.[774] 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.[775] 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. We 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.[776]

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[769] *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.

[770] 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).

[771] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1.

[772] 2008 TRENDS IN TELEPHONE SERVICE, tbl. 1.1

[773] 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.

[774] 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.

[775] 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.

[776] *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*

(continued....)

295. 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.[777] 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 cost-based ratemaking."[778] In the past, the Commission has, in fact, adopted regulatory approaches that deviated from cost-based ratemaking.[779] We find such an approach warranted here to help mitigate regulatory burdens during the transition, as described above.

296. 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.

297. 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.[780]

(ii) Joint Board Referral of Possible Changes to End-User Charges

298. 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

(continued from previous page)

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.").

[777] *See, e.g., Universal Service Ninth Report and Order*, 14 FCC Rcd 20432 (providing high-cost universal service support for intrastate costs).

[778] *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)).

[779] *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).

[780] *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).

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.

299. 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."[781] 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 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.[782]

300. 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.

301. *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.[783] Under the Missoula Plan's initial proposal, SLC cap increases vary for the three "tracks" or categories of carriers defined in the plan.[784] 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.[785] Other parties, such as CTIA, contend that recovery of lost intercarrier compensation revenues by incumbent LECs

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[781] 47 U.S.C. § 410(c).

[782] 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, 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.").

[783] ICF *ICC FNPRM* Comments, App. C at C-7.

[784] NARUC Task Force July 24, 2006 *Ex Parte* Letter, Attach. 2 at 7.

[785] ITTA Sept. 19, 2008 *Ex Parte* Letter, Attach. at 2–3.

should come solely from end-user charges.[786] In contrast, Free Press, NASUCA, and Ad Hoc propose that SLC caps not be increased at all.[787]

302. 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.[788] 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.[789] 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 approach, it should specify which carrier rates should be included in the relevant benchmark or threshold.

303. Third, the Separations Joint Board could recommend some combination of the first and second options.

304. 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.[790] 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.

305. *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

306. 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

[786] 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).

[787] 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).

[788] Verizon Sept. 12, 2008 *Ex Parte* Letter at 6–7.

[789] Verizon Sept. 12, 2008 *Ex Parte* Letter.

[790] 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.

of those lost revenues through end-user charges.[791] We also acknowledge that, in the past, the Commission has sometimes provided new universal service support to replace reductions in intercarrier compensation revenues.[792] 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." [793] Thus, excessive universal service subsidization could, perversely, cause undesirable increases in consumers' bills.

307. 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."[794] Commenters continue to express concern that existing universal service subsidies too often lead simply to "'high overhead, sumptuous earnings, [and] rich dividends.'"[795] 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.[796] 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."[797] 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."[798] Indeed, commenters note that "some carriers owned by co-ops pay their

[791] 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.

[792] *See, e.g.*, *CALLS Order*, 15 FCC Rcd 12962; *MAG Order*, 16 FCC Rcd 19613; *see also MAG* Second *FNPRM*, 19 FCC Rcd 4122.

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

[794] 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*).

[795] 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).

[796] *A Fair Copper*, FINANCIAL TIMES, Oct. 28, 2008, at 16.

[797] *Universal Service Telephone Subsidies* at 34.

[798] *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.").

members annual dividends that exceed their members' local phone charges."[799] 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.[800]

308. Thus, rather than guaranteeing revenue neutrality, as some commenters propose,[801] 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."[802] "By way of 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."[803] 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."[804] 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

[799] *Universal Service Telephone Subsidies* at 70.

[800] *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").

[801] *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).

[802] NASUCA Sept. 30, 2008 *Ex Parte* Letter at 6.

[803] 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.").

[804] 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.").