

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

In the Matter of)	
)	
Connect America Fund)	WC Docket No. 10-90
)	
A National Broadband Plan for Our Future)	GN Docket No. 09-51
)	
Establishing Just and Reasonable Rates for Local Exchange Carriers)	WC Docket No. 07-135
)	
High-Cost Universal Service Support)	WC Docket No. 05-337
)	
Developing an Unified Intercarrier Compensation Regime)	CC Docket No. 01-92
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	
Lifeline and Link-Up)	WC Docket No. 03-109

COMMENTS OF VERIZON AND VERIZON WIRELESS

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I. INTRODUCTION AND SUMMARY.

Verizon urges the Commission to follow through on its commitment to reform the antiquated intercarrier compensation and universal service systems this summer. The backwards-looking intercarrier compensation and universal service programs are relics from a bygone era; the FCC must replace this apparatus with a system that provides rational market-based incentives to deploy new technologies and services and to move to a more stable, sustainable regime for all concerned.

There is overwhelming consensus that the current systems must change to reflect the modern communications marketplace and to accommodate the steady transition to IP-based

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

networks and the Administration's goal of ubiquitous broadband access and adoption. The Commission has correctly recognized that the existing scheme has the perverse effect of paying some carriers more when they operate inefficiently, and, taken as a whole, the system discourages carriers from updating their business models for the broadband era in order to hold on to legacy universal service and access subsidies. Under the current intercarrier regime carriers charge a wide range of rates to terminate traffic, depending on factors that are irrelevant in an IP world—such as whether a call crosses state, MTA or LATA boundaries. At the same time, the Universal Service Fund (USF or “fund”) is set up to subsidize traditional wireline voice service over copper networks, the cost of which is increasing as carriers lose lines and traditional voice traffic migrates to other platforms.

This serves no one's interest. The affected carriers are frozen in place; they are unable to forgo the legacy subsidies inherent in the existing system and move forward without any certainty as to the regime that will replace it. In the meantime, consumers suffer, whether because they lose out on access to advanced services, or because they ultimately pay for the legacy subsidies. This proceeding represents the best chance finally to break the deadlock that has persisted for more than a decade.

The Commission has an opportunity to adopt a reasonable, balanced approach; one that moves quickly to a single, low default rate for all intercarrier compensation, that repurposes universal service for the broadband era, and that provides affected carriers with a certain and short transition in which to update their business plans to more sustainable models. This balanced approach will promote innovation and deployment of advanced technologies and services, limit the costs imposed on consumers and put the industry as a whole

on a sounder, more sustainable footing. There are several key components to such a balanced approach as it relates to intercarrier compensation and universal service respectively.

Inter-carrier Compensation

First, as we explained in our recent separate filings on the issue, in order to prevent the current situation with intercarrier compensation from getting worse and enlarging the problem the Commission must solve, the Commission should immediately establish a single low rate of \$0.0007 for all VoIP traffic that connects with the PSTN. Like wireless a decade ago, VoIP is still a relatively small component of all traffic, but it will grow efficiently over time if VoIP remains unfettered by the archaic tariffed access charge regime. And as was the case with wireless, allowing VoIP to grow free of the cost burden of the legacy subsidy schemes will produce enormous benefits for consumers.

Second, the Commission should begin rapidly transitioning all intercarrier compensation rates down to the VoIP rate—a default rate of \$0.0007 per minute for all carriers and all traffic that terminates to the PSTN regardless of the terminating carrier’s legacy regulatory status or the jurisdictional end points of the call. This transition should be completed promptly, and could, for example, reduce rates in three steps over three years, with the final default rate set at \$0.0007. A low, uniform default rate such as \$0.0007 parallels many negotiated interconnection agreements in the marketplace and is the same as the Commission-set rate cap for dial-up ISP traffic and most wireless traffic because of the related “mirroring rule.” A low (but positive) national default rate is the only way to prevent uneconomic arbitrage. At the same time, the Commission should encourage negotiated arrangements, and the default rate should be just that—a rate that applies only in the absence of a commercial agreement.

Third, a short and certain transition mechanism could be established to allow affected carriers time to transition to a new system. For example, one form such a mechanism might take is to partially offset forgone access revenues through universal service support. Any such mechanism must be truly transitional, with both a certain end date and a certain schedule to be phased down. And funding from such a mechanism should only be available to carriers whose own end-user rates are set at rational levels based on a national benchmark, or that have such a rate imputed to them. Support should reflect the fact that carrier access charge revenues are shrinking today and that this decline will accelerate over time as companies continue to lose lines and voice minutes.

Universal Service

First, in order to fund near-term broadband priorities through the proposed Connect America Fund and to start all parties off in the same position, the Commission should begin eliminating remaining CETC support as soon as possible. The Commission already has begun to transition down support for some CETCs and should do likewise for the remainder.

Second, the Commission has correctly recognized that as it transitions universal service to broadband, it again must strike a balance. Because the cost of universal service is borne by consumers, any reform must both limit and target the resulting program to prevent it from reeling out of control and over-burdening consumers. To begin with, in order to satisfy the Commission's own objective not to grow the fund—and ultimately to shrink it over time—the Commission should cap high cost support at 2010 levels and set an expectation that funding levels will decrease as broadband is deployed in additional areas.

Third, the Commission also has correctly recognized that additional measures are needed to target any broadband support to where it is truly needed and to limit the cost to consumers. To

that end, the Commission should adopt several of its well-reasoned tentative conclusions, which include (i) using market-based competitive bidding in both the short-term and long-term phases of the Connect America Fund to distribute broadband support in a balanced, targeted manner in areas that are unserved today or that demonstrably would not be served without subsidies; (ii) funding only one universal service provider in an area, and allowing all potential providers to compete for that funding on a technology-neutral basis; and (iii) extending USF support only to areas where there is no unsubsidized provider. Each of these measures is critical to limit the cost to consumers while still accomplishing the Commission's universal broadband objective.

We encourage the Commission to move forward promptly with its plans to adopt historic reforms consistent with these basic principles.

II. COMPREHENSIVE INTERCARRIER COMPENSATION REFORM IS CRUCIAL FOR THE FUTURE OF THE COMMUNICATIONS INDUSTRY.

The Commission should rationally sequence intercarrier compensation reforms as follows: (1) end the chaos and establish forward-looking rules for VoIP compensation. The default rate for VoIP traffic that connects with the PSTN should mirror the effective rate for most wireless traffic that terminates to the PSTN—\$0.0007 per minute; (2) begin rapidly transitioning all intercarrier compensation rates down to the VoIP rate. A default rate of \$0.0007 reflects many interconnection agreements in the marketplace and is identical to the Commission-set rate cap for dial-up ISP traffic. Moreover, a low (but positive) national rate is the only way to prevent uneconomic arbitrage—even though the Commission should at the same time encourage negotiated arrangements; and (3) if the Commission establishes a transition mechanism through the USF to allow carriers time to update their business plans, funding from that mechanism should phase out quickly and only be available to carriers that first rebalance their own end-user rates.

A. The Notice Correctly Concludes that the National Interest Requires Unifying and Reducing All Intercarrier Compensation Rates.

There is no serious debate about the paramount importance of replacing the existing intercarrier compensation regime with a rational system that promotes investment in next-generation technology and eliminates the uneconomic arbitrage problems that currently plague the industry. The Commission and virtually every section of the industry have documented that the existing system “has fundamental problems that create inefficient incentives.”² Carriers impose a wide range of charges for the traffic they handle, depending on arbitrary factors such as which provider terminates the traffic and whether a call crosses state, MTA, or local calling area boundaries before reaching the terminating provider. Many terminating providers charge as little as \$0.0007 per minute for a “local” call rated under the “mirroring rule”—while rural carriers’ rates can be as much as *175 times more* to terminate an intrastate long distance call.³

As the Commission aptly observes, “[t]he wildly varying and disparate rates within the intercarrier compensation system create arbitrage opportunities and introduce layers of regulatory complexity and associated costs, which hinder deployment of IP networks.”⁴ Although the Commission is taking expedited action to curb the most pressing distortions and arbitrage problems created by the existing system, it is clear that only comprehensive reform of the entire system will create a sustainable long-term solution. *Id.* ¶ 603.⁵ As long as regulators permit communications companies to charge different rates for the same services, or authorize

² *Connecting America: The National Broadband Plan*, <http://download.broadband.gov/plan/national-broadband-plan.pdf>, at 142 (2010) (“NBP”).

³ South Dakota Local Exchange Carrier Association, Inc. S.D. P.U.C. Tariff No.1 at 17-1.

⁴ See *Connect America Fund*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, WC Docket No. 10-90, et al., ¶ 5 (Feb. 9, 2011) (“NPRM”).

⁵ While the Commission proposes to address interstate traffic pumping in the near term, intrastate access rate levels, if left unchecked, will continue to encourage this practice until total reform is achieved.

some companies under some circumstances to charge rates that wildly exceed their costs, the system will continue to create inefficiencies, distortions, and arbitrage activity. As the Commission correctly concludes, “wasteful attempts to game the system will likely persist as long as ICC rates remain disparate and well above carriers’ incremental costs of terminating a call.” *Id.* ¶ 40.

Accordingly, the Commission has long sought to “replac[e] the myriad existing intercarrier compensation regimes with a unified regime designed for a market characterized by increasing competition and new technologies.”⁶ The *NPRM* reaffirms that imperative, and appropriately contemplates reducing all per-minute charges and eliminating disparate rates. *NPRM* ¶ 40.

B. The Commission Should Establish a Low But Positive Default Rate for All Voice Traffic that Terminates to the PSTN.

1. The New Framework Should Encourage Negotiated Intercarrier Compensation Arrangements.

Any new rate regime established by the Commission should be a default regime only. Carriers should be free to negotiate commercial agreements that may depart from the default regime. This approach ensures that the industry continues to move toward market-based rates, and provides carriers the flexibility to adapt their agreements in response to changing business needs and evolving technologies.

Permitting and encouraging negotiated commercial agreements is consistent with the spirit and letter of the Act, which sought to create a pro-competitive, deregulatory framework for the provision of local telephone service that reflects the “virtues of negotiated competition.”

⁶ *Developing a Unified Intercarrier Compensation Regime*, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685, ¶ 1 (2005) (“2005 FNPRM”).

Verizon North Inc. v. Strand, 367 F.3d 577, 585 (6th Cir. 2004). Indeed, one of the key purposes of the Act was to “replace the comprehensive state and federal regulatory scheme with a more market-driven system that is self-regulated through negotiated interconnection agreements.” *Pacific Bell v. Pac West Telecomms., Inc.*, 325 F.3d 1114, 1127 (9th Cir. 2003); *see also MCI Telecomms. Corp. v. Bell Atlantic-Pennsylvania*, 271 F.3d 491, 500 (3d Cir. 2001) (noting the Act’s “clear preference” for “negotiated agreements”).

In the context of intercarrier compensation, the Commission has confirmed that commercial solutions are superior to regulatory prescriptions, finding that “negotiated agreements between carriers are more consistent with the pro-competitive process and policies reflected in the 1996 Act.”⁷ Indeed, the Commission has routinely recognized that “the best way to achieve reliable, ubiquitous service . . . is to encourage further reliance on negotiation and market-based solutions to the fullest extent possible.”⁸ Accordingly, the rules should make clear that any new rate is a default rate only—and that carriers may opt out of that default rate through bilateral or multilateral agreements.

Today’s marketplace provides many examples of different networks interconnecting on commercially negotiated terms in the absence not only of rate regulation, but also in the absence of any regulatory mandate to negotiate or interconnect in the first place. For example, what is commonly referred to as “the Internet” is actually a series of individual networks, owned and

⁷ *Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855, ¶ 14 (2005).

⁸ *Cellular Service and Other Commercial Mobile Radio Services in the Gulf of Mexico*, Report and Order, 17 FCC Rcd 1209, ¶ 27 (2002).

operated by many different entities that have entered into purely voluntary interconnection agreements.⁹

The current regime of market-based arrangements for interconnection and exchange of Internet traffic has been a resounding success, creating incentives that thus far have ensured that the capacity and reach of the Internet has generally kept pace with the fast-growing demand. For example, TeleGeography recently noted that “International Internet traffic and network capacity have grown rapidly throughout the deep recession and low economic recovery of the past few years,” with Internet backbone providers “deploying vast amounts of new capacity” to keep pace with growing demand.¹⁰ In fact, even in the relatively mature U.S. and Canadian markets, capacity has increased at a “compound annual rate of 54 percent” between 2006 and 2010. *Id.* at 2. At the same time, the prices for paid IP transit have been dropping at “approximately 25 percent compounded annually over the past three years,” and the transit rates in major U.S. cities are among the lowest in the world. *Id.* at 5-6.

In addition, the huge and varied number of arrangements for interconnection and exchange of Internet traffic further evidences the success of the current regime of voluntary commercial arrangements. Large Internet providers typically interconnect with hundreds, if not thousands, of other networks. For example, one recent report indicated that Level 3 now connects with 2,767 “autonomous systems” around the world, making it the third most connected Internet provider by this measure. *Id.* at 7. This reflects a significant increase from Level 3’s 1,909 connections in 2005. *Id.* And even the 50th largest Internet provider connected with more than 200 other autonomous systems. *Id.* at 8. Moreover, in order to facilitate these market-based

⁹ See Comments of Verizon, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at Exhibit A, Declaration of Lyman Chapin ¶¶ 5-8 (May 23, 2005).

¹⁰ TeleGeography Research, “Global Internet Geography,” Market Structure at 1 (Dec. 2010) (“TeleGeography Report”).

arrangements, providers typically post the terms on which they will entertain settlement-free arrangements with other networks.¹¹ These data all demonstrate a functioning, competitive marketplace that is responding well to rapidly increasing demand for Internet capacity. Importantly, the tens of thousands of interconnection arrangements—whether paid, settlement-free, or some variation—that enable the Internet were the result of the process of commercial negotiation to achieve mutually beneficial outcomes, not of regulatory intervention.

Given the success of commercial negotiations with the Internet model—characterized by peering arrangements and other approaches—there is every reason to believe that the same approach can work well for intercarrier compensation with respect to voice traffic. Even the much publicized Level 3-Comcast dispute at the end of last year is ultimately an example of the success of the commercial negotiation approach to interconnection policy.¹² In that situation Level 3 complained to the Commission that it was forced to enter into a new arrangement with Comcast for the exchange of Internet traffic when the balance of traffic between the providers shifted. Nonetheless, the parties managed to reach a deal, consumers did not lose service, and no traffic was blocked. The experience of the Internet demonstrates that—because carriers have strong incentives to interconnect their networks in an economically efficient manner—negotiated agreements are the most effective way of ensuring efficient interconnection arrangements and efficient network development.

¹¹ See, e.g., <http://www.verizonbusiness.com/terms/peering/>.

¹² See, e.g., Letter from John Ryan, Level 3 to Marlene Dortch, FCC, *Preserving the Open Internet; Broadband Industry Practices; Framework for Broadband Internet Service*, GN Docket No. 09-191; WC Docket Nos. 07-52 & 10-127 (Dec. 14, 2010); Letter from John Ryan, Level 3, to Marlene Dortch, FCC, *Preserving the Open Internet; Broadband Industry Practices; Framework for Broadband Internet Service*, GN Docket No. 09-191; WC Docket Nos. 07-52 & 10-127 (Nov. 30, 2010).

2. A Default Rate of \$0.0007 Would Remove Distortions and Render Many Arbitrage Schemes Uneconomic.

All traffic that connects with the PSTN and is not covered by voluntary commercial agreements—regardless of carrier or of the distance it travels—should be subject to a default terminating rate of \$0.0007 per minute for traffic delivered to the terminating carrier’s serving end office. Establishing such a low, uniform rate will ensure competitive and technological neutrality and help eliminate the fraud, arbitrage and economic distortions caused by today’s disparate intercarrier compensation rates.

The rate of \$0.0007 is low enough to make it uneconomical for arbitrageurs to exploit a difference between their costs and their authorized terminating compensation.¹³ The Commission first employed the \$0.0007 per-minute rate a decade ago for the purpose of “limiting regulatory arbitrage” in the context of ISP-bound traffic.¹⁴ Not only is \$0.0007 appropriate for curbing the arbitrage that was the subject of that order, but it would also make other arbitrage schemes based on aggregating large amounts of traffic, such as many traffic pumping schemes, unprofitable. For example, to generate \$1 million in revenues in a month at a rate of \$0.0007 per minute, a company would need more than 1.4 *billion* minutes of calls—or more than 33,000 lines filled with calls 24 hours a day, every day, for a full month. In comparison, at one of the highest intrastate access charge rates that exists today—\$0.125 per

¹³ Other low rates, such as \$0.0004, would achieve the same result. Verizon proposes \$0.0007 because, as discussed below, it is already widely used both for regulatory and commercial purposes.

¹⁴ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, Order on Remand and Report and Order*, 16 FCC Rcd 9151, ¶ 83 (2001) (“*ISP Remand Order*”).

minute—a company seeking to take advantage of arbitrage opportunities could generate \$1 million in a month with only 8 million minutes of calls—or about 185 lines filled 24 hours a day.

When establishing the \$0.0007 rate for ISP-bound traffic a decade ago, the Commission drew upon then-recent evidence that commercially negotiated agreements showed a “downward trend in intercarrier compensation rates.” *ISP Remand Order* ¶ 85.¹⁵ A decade later, \$0.0007 remains a common rate in negotiated commercial agreements among various industry participants.¹⁶ It is also consistent with commercial agreements that parties may enter into for the exchange of next-generation IP-enabled traffic.¹⁷ And as a result of the Commission’s “mirroring rule,” most intraMTA wireless traffic is also exchanged at the same \$0.0007 rate. *ISP Remand Order* ¶ 85.

In other words, \$0.0007 is already the rate at which a substantial amount of traffic is currently exchanged—either because of market outcomes or because of regulation. As the Commission has recognized, evidence that “carriers have agreed to rates” for intercarrier compensation—through voluntary, arms-length negotiations—constitutes substantial evidence

¹⁵ As the Commission explained at the time, to the extent that all of a carrier’s costs are not recovered through the \$0.0007 per minute rate, the carrier may recover them from its own end users. *Id.* ¶¶ 71, 83-85.

¹⁶ As Verizon described in its comments in the expedited portion of this proceeding, both Verizon and Verizon Wireless have entered into numerous commercially negotiated agreements with various types of companies that establish terminating rate of \$0.0007 or below. *See* Comments of Verizon, *Connect America Fund*, WC Docket No. 10-90, et al., at 15-16 (April 1, 2011) (“Verizon April 1 Comments”). *See also* Ex Parte Letter from Level 3 to Marlene Dortch, FCC, *Intercarrier Compensation for ISP-Bound Traffic; Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 99-68, WC Docket No. 01-92, at 5-6 (Aug. 18, 2008) (Level 3 providing examples of negotiated agreements at or below the \$0.0007 per minute rate).

¹⁷ For example, earlier this year Verizon signed a commercial agreement with Bandwidth.com under which the parties agreed to exchange VoIP traffic at a rate of \$0.0007 per minute. *See* <http://bandwidth.com/about/read/verizonAgreement.html>.

that those rates are just and reasonable. *Id.*¹⁸ The Supreme Court has similarly held that an agency must “presume that the rate set out in a freely negotiated . . . contract meets the ‘just and reasonable’ requirement imposed by law.” *Morgan Stanley Capital Group Inc. v. Public Util. Dist. No. 1 of Snohomish County*, 128 S. Ct. 2733, 2737 (2008).¹⁹ The proven reasonableness of \$0.0007 in both market and regulatory contexts confirms that it is an appropriate default rate for a unified intercarrier compensation regime.

3. Mandating Bill-and-Keep as a Default Would Risk Creating Future Distortions and Arbitrage Opportunities.

Although a low uniform default rate is necessary to remove existing economic distortions and arbitrage incentives, mandating a default “rate” of zero (as a bill-and-keep regime requires) would not be appropriate at this time. Requiring some level of terminating compensation will deter other carriers from “dumping” potentially large amounts of traffic onto the networks of Verizon and other carriers without a corresponding flow of traffic in the other direction—a result which would cause the receiving carriers to incur significant costs simply from the large volume of one-way traffic. The increase of traffic on the receiving party’s network could also cause congestion and negatively impact the quality of the services provided by the terminating carrier to its customers. History and economics teach that any regulatory regime that places unbalanced

¹⁸ See also *Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, Memorandum Opinion and Order, 22 FCC Rcd 1958, ¶ 39 & ¶ 40 n.136 (2007) (finding that “commercially negotiated rates” provide “just and reasonable prices”); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 664 (2003).

¹⁹ See also *Illinois Public Telecomms. Ass’n v. FCC*, 117 F.3d 555, 562 (D.C. Cir. 1997) (Commission may “conclude that market forces generally will keep prices at a reasonable level”); *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993) (holding that an agency “may rely upon market-based prices . . . to assure a ‘just and reasonable’ result”).

regulatory burdens on different parties can create economic distortions and incentives to engage in arbitrage.

Mandating that a service with a cost, albeit a low cost, be provided for free would invite carriers to figure out how to abuse the system in creative ways. Indeed, a bill-and-keep system would make it free for other carriers to use networks, thereby removing incentives for other carriers to manage the flow of traffic efficiently and inviting potential abuse. If the Commission were to mandate bill-and-keep as the default system, new arbitrage schemes would be expected to emerge because a single party would have the ability to send large amounts of traffic to another party—thereby causing the receiving party to incur costs and obligations for which the sending party bears no responsibility. And there will always be ways to abuse a free service.

Bill-and-keep arrangements, of course, are economically rational under certain circumstances—including interconnection arrangements for the exchange of Internet traffic. Carriers can still negotiate for bill-and-keep where it makes sense.²⁰ In the Internet space, for example, a number of factors are considered as providers decide whether to enter into a settlement-free or paid arrangement with another provider's network. One of the principal factors that has long been central to determining the type of arrangement parties employ is the relative traffic flow between their respective networks.²¹

All else being equal, networks generally enter into settlement-free arrangements for Internet traffic only where the traffic flows between the networks are roughly in balance. Where the traffic ratios are significantly asymmetrical, it is common for one provider to pay for the exchange of traffic, either through paid peering or transit, or some other exchange of value.

²⁰ What is important in the near-term is to get to uniform, low rate. From there, the Commission and the industry can evaluate how the market is responding.

²¹ See, e.g., Faratin, Clark, et al, "The Growing Complexity of Internet Interconnection," 72 *Communications & Strategies* 51, 56 (2008).

There is good reason for this, and such arrangements have been crucial to the development and continuing expansion of the Internet. By ensuring that providers are compensated in some form for their greater relative costs when they receive disproportionately larger volumes of traffic from other parties, these voluntary arrangements have allowed providers to continue to expand capacity as traffic volumes increase.

If, on the other hand, Internet operators were not permitted to take relative traffic flows and other relevant factors into consideration to determine whether some form of compensation is warranted, then parties would have an incentive to profit by dumping their traffic onto someone else's network to avoid the bulk of the costs associated with carrying that traffic, rather than investing to expand the reach and capacity of their own networks. Likewise, if receiving networks were not compensated in some form to carry disproportionately larger volumes of traffic for others, it would undermine continued investment by those networks to enhance their capacity to handle the growing traffic volumes that would result. The result would be less overall investment and lower quality service for all Internet users as networks became more congested and capacity expansion failed to keep pace with demand.

In all events—with respect to intercarrier compensation for voice traffic, Internet peering, or otherwise—commercial agreements should, of course, be permitted and encouraged. However, although the costs associated with terminating another company's voice traffic are low, they are not zero. Accordingly, many commercial agreements for the exchange of voice traffic, instead of establishing bill-and-keep arrangements, require each party to pay a low rate (*e.g.*, \$0.0007 or \$0.0004) to the recipient of the traffic (*see* above). The fact that sophisticated economic actors routinely negotiate arms-length commercial agreements that require some (low)

level of compensation for the mutual exchange of voice traffic constitutes strong evidence that an across-the-board bill-and-keep mandate would not be grounded in sound economic principles.

4. The Commission Should Facilitate the Transition to IP Networks but Should Not Impose Rules for IP-to-IP Interconnection.

The transition to IP networks should be governed by the competitive market. When the business case dictates a transition to IP interconnection, providers will move in that direction and will develop the standards that govern interconnections. Although the majority of voice traffic exchanged between carriers continues to be circuit-switched, over time, networks will evolve and providers will have an interest in transitioning to alternative arrangements. That is already happening in some cases. However, industry standards for interconnection for the exchange of voice traffic in IP format are still evolving. The efficient way to allow IP interconnection arrangements to develop would be to follow, as discussed above, the tremendously successful example of the Internet, which relies upon voluntarily negotiated commercial agreements developed over time and fueled by providers' strong incentives to interconnect their networks.²²

In contrast, government-imposed rules regarding IP-to-IP interconnection would lead to arrangements that are economically and technically suboptimal, or even unviable. Indeed, the transition to IP interconnection is a textbook example where government should avoid prescribing the terms that will govern complex and evolving relationships among private sector

²² See Verizon April 1 Comments at 12-13. In the Internet area, neither standards-setting bodies nor governments have attempted to mandate prescriptive interconnection rules. As the Telecommunication Standardization Sector of the International Telecommunication Union (ITU-T) recently observed, "international Internet connection is typically determined by negotiations between the concerned parties." ITU-T, Supplement to Recommendation ITU-T D.50, "General Considerations for traffic measurement and options for International Internet Connectivity," at 1-2 (Geneva, Mar. 28, 2011). The ITU-T provided an overview of "possible approaches for measuring IP traffic flow between networks," *id.* at 1, and emphasized that the overview simply provided "general considerations...to be referred to in bilateral negotiations." *Id.* ITU-T noted that "[a]s technologies and networks evolve, new methods could be developed for measuring traffic flow." *Id.* at 2.

actors. Regulatory history amply demonstrates that, especially in industries marked by rapid technological change, rules based on static assumptions about technology and markets quickly become obsolete—and worse, can lead to unintended negative consequences such as stifling investment and innovation. Policymakers “are often wrong both in their predictions of how the market will develop and in their judgments of what regulatory measures will best promote consumer welfare.”²³ Guessing wrong about the “right” IP interconnection standards at this early stage in the industry’s transition to IP could profoundly retard the industry’s future development and slow the speed at which consumers receive the benefits of next-generation technologies.²⁴ And any regulatory mandate requiring carriers to divert funds prematurely to establish brand new interconnection arrangements for IP voice traffic would reduce the funds available to deploy broadband more widely.

Rather than mandate the terms of IP interconnection or the conditions under which it must occur, the Commission should take steps to remove anticompetitive roadblocks to the market forces that otherwise will promote IP network utilization. For example, as further discussed below, continuing USF subsidies for traditional voice services only encourages carriers to continue to use circuit-switched networks, rather than transition to IP network technology. Likewise, high intercarrier compensation rates are diverting dollars away from and thereby “hindering investment and the introduction of new IP-based services and products.” NBP at 142.

²³ Jonathan E. Neuchterlein & Philip J. Weiser, *Digital Crossroads: American Telecommunications Policy in the Internet Age* (2005), at 428.

²⁴ Economic literature is replete with findings that inappropriate regulation can substantially reduce consumer welfare by harming innovation and delaying the expansion of output. For example, one study concluded that delays in the introduction of voice messaging services due to line-of-business restrictions and delays in the introduction of cellular telephone service each imposed multi-billion dollar losses in consumer welfare. See Jerry Hausman, *Valuing the Effect of Regulation on New Services in Telecommunications*, in *Brookings Papers on Economic Activity, Microeconomics* (Martha V. Gottron & Anne Lesser, eds. 1997).

Accordingly, the most important action this Commission can take to facilitate an all-IP future is prompt implementation of the comprehensive intercarrier compensation and USF reforms discussed herein.

C. The Rules Should Require a Swift Transition to the Unified Regime With Minimal Economic Distortions.

1. The Glide Path Should Be No More than Three Years and Should Be Evenly Applied to All Carriers.

The Commission should require all providers to transition simultaneously to the low default rate over a period of no more than three years. During the transition, the Commission should consider stepping down rates by using rates in existence today. The first step-down should require all intrastate switched access rates to mirror interstate switched access levels; the second step-down could move all interstate switched access rates to existing reciprocal compensation levels (if lower than interstate rates); then all reciprocal compensation rates could be reduced to \$0.0007. A transition that relies on existing rates, rather than on creating wholly new rates, will avoid disputes about whether a provider has appropriately calculated its rate.

No intercarrier compensation rates should *increase* during this interim transition period. Existing rates that are already at the target of \$0.0007—such as VoIP rates (*see* above and Verizon’s April 1 Comments and April 18 Reply Comments in this proceeding)—must remain in place during any transition. In addition, most intraMTA termination rates for wireless traffic are already at or below the target rate of \$0.0007 and should not be “stepped *up*” during the transition. Authorizing intercarrier compensation rate increases would create new inefficiencies and harm consumers by substantially increasing the costs carriers incur in exchanging traffic, thereby diverting funds from investment in next generation networks.

Also, it is important that the stepping down be simultaneous for all providers. If different carriers—or different jurisdictions—are permitted to transition over different time periods, the transition itself would create *new* rate disparities which would result in economic distortions and abuse. It is only through simultaneous, evenly-applied rate reductions that the Commission can eliminate, rather than exacerbate, the existing rate disparities that have led to arbitrage and fraud.

2. Any Transitional Revenue Recovery Mechanism Should Be Structured to Reduce Carriers' Dependence on Uneconomic Subsidy Streams.

To the extent some carriers continue to substantially rely on intercarrier compensation revenues to provide services to their customers, they should already be in the process of restructuring their operations so they can compete without transfer payments from their competitors. Carriers have been on notice for years that intercarrier compensation reform is on the horizon, and should have prepared for the transition—such as by developing innovative services and collecting a greater share of their revenue from end user customers. But recognizing the continued apparent dependence of some segments of the industry on switched access and other intercarrier revenue, the *NPRM* contemplates establishing a USF “recovery” mechanism as part of comprehensive ICC reform. *NPRM* ¶¶ 559-72. Appropriately, the Commission seeks comment on how to structure such a mechanism in ways that both control the size of the new fund and provide appropriate incentives for firms to “accelerate the migration to all IP networks.” *Id.* ¶¶ 559.

The purpose of a transition recovery fund should be to provide carriers with some time to adjust their operations in the face of long-overdue regulatory changes. As such, any transition fund must avoid perpetuating unsustainable dependencies created by the legacy intercarrier compensation regime. To promote that goal, it should remove existing incentives to continue

“business as usual,” such as incentives to defer upgrading to IP networks and to subsidize below-market prices for retail telephone service. That objective—and the equally important objective of controlling the size of the fund—can be achieved by embracing three principles.

First, any fund should be structured to bring equity to the retail rates that consumers pay for voice services throughout the nation. Companies that do not charge their end users retail rates in line with a reasonable nationwide benchmark should not be permitted to recover from the fund any of the revenue that could be recovered by charging the benchmark rate. By creating incentives for companies to rebalance rates, the Commission would both limit the size of the universal service fund and ensure that any new funding does not result in disparate treatment of consumers.

Second, given that the goal of the transition is to remove uneconomic subsidies, carriers should not be permitted to offset existing intercarrier compensation revenues on a dollar-for-dollar basis. It would be counterproductive to authorize carriers simply to shift their declining intercarrier compensation revenues into stable revenue streams from the transitional fund. Authorizing 100 percent revenue recovery would frustrate the transition to a more rational system because it would discourage carriers from taking steps to structure their operations more efficiently, such as deploying IP technologies. Also, disbursements from the fund should take into account the overall declining nature of switched access revenues. Any recovery mechanism that allows carriers to “lock in” guaranteed revenue flows equivalent to their current intercarrier compensation revenue would have the perverse effect of increasing dependence on the very subsidies that are to be phased out. Accordingly, any transitional mechanism should disburse less than 100 percent of the intercarrier compensation revenue a carrier loses (properly accounting for end-user rate rebalancing) as a result of intercarrier compensation reform—and

that initial disbursement level should be further reduced during each transition year by an amount that exceeds the carrier’s historical annual decline in intercarrier compensation revenue (also accounting for annual line loss).

Finally—and perhaps most important—the transition fund should sunset after a reasonable amount of time (*see* discussion below regarding a common schedule to phase out all universal service “access replacement” funding). Three years from inception is a reasonable amount of time for carriers to adjust their business plans. Setting a date certain after which no further disbursements will be made would make clear that companies cannot continue to depend on legacy subsidy streams, and would thereby provide an incentive for carriers to restructure their operations so they can compete in a modern communications marketplace.

3. Expecting or “Incentivizing” States to Implement Reform Would Jeopardize the Transition to a Unified National Regime.

The Commission requests comment on the appropriate state role in comprehensive intercarrier compensation reform, including the possibility of “incentivizing” states to participate in the reform process. *NPRM* ¶ 544-49. It would not be productive to attempt comprehensive national reform via a framework that relies on a patchwork of more than 50 different, individual state regulatory efforts. As discussed above, the national interest requires a prompt, harmonized transition to a single, unified rate for all traffic. Perpetuating and relying on existing artificial jurisdictional silos could jeopardize each element of that imperative: it would risk slowing the transition, raise implementation costs, call into doubt the chances of ending up with a single rate at the end of the process, and create new economic distortions and inefficiencies as different states move at different paces and/or employ different approaches to reform.

As discussed above, the problems with the existing system largely derive *from* existing jurisdictional and distance-based classifications that are arbitrary and anachronistic. Indeed, they

make no sense in today's world. Relying on those same legacy classifications to attempt to fix the system is all but certain to fail. The history of state efforts to reform intrastate switched access rates confirms the uncertainty and inconsistency to be expected under any plan that relies on 50-plus jurisdictions to accomplish national objectives. States have understood for many years the urgent need to reform intrastate switched access rates—and that reform would benefit consumers—but few have taken meaningful action.²⁵ Given that the states have historically had difficulty taking action to reform intrastate switched access rates, the Commission simply cannot rely on them to implement a smooth transition to a single national rate.

Moreover, the Commission should not expend federal resources or distort other regulatory regimes in order to create “incentives” to convince state regulators to take actions that plainly need to be taken to protect and promote consumers' interests. The need for a prompt, harmonized transition to a single, unified rate for all traffic is sufficiently great that the Commission should not place its hope in some combination of carrots and sticks to achieve indirectly in more than 50 different jurisdictions what the Commission can, and should, do directly—just once. Indeed, the availability of “incentives” could simply encourage states to hold out for greater benefits as a reward for aligning their state regimes with the national policy, while penalizing those states that have already acted—without the need for such incentives—to take steps to reform their state regimes.

²⁵ Some states have required the largest ILECs in the state to charge intrastate rates that mirror interstate rates, but very few have similarly reformed the intrastate rates charged by midsized or smaller ILECs. So not only has state regulation left in place substantial disparities between interstate and intrastate switched access rates, but the great majority of states have failed to create internally-rational intrastate regimes under which all carriers are treated equally. *See, e.g.,* Ex Parte Letter from Brian Benison, AT&T, to Marlene Dortch, FCC, *Developing a Unified Intercarrier Compensation Regime; High-Cost Universal Service Support; A National Broadband Plan for Our Future*, CC Docket No. 01-92, WC Docket No. 05-337; GN Docket No. 09-51 (Oct. 25, 2010).

In sum, the Commission should avoid any framework under which a state could act as a bottleneck to much-needed reform by failing to act in a timely manner, or by not acting in unison with other jurisdictions. The Commission should therefore directly establish an orderly transition to a unified national rate—and to the extent states are to play a role in such transition (such as enforcement of Commission rate formulas), the framework should ensure that there is no room for them to slow or otherwise frustrate it.

D. The Commission Has Legal Authority To Establish a Single Default Rate of \$0.0007 per Minute for All Traffic Routed over the PSTN.

As explained above and in Verizon’s prior filings, the Commission should adopt a uniform default terminating rate of \$0.0007 per minute for all traffic delivered to the terminating carrier’s end office. That rate should apply regardless of provider, jurisdiction, or technology, unless the parties reach a voluntary commercial agreement for a different arrangement.

In the *NPRM*, the Commission identified two different potential sources of legal authority for achieving comprehensive intercarrier compensation reform: (1) the “carrot and stick” approach involving state commission action as discussed above; or (2) “use the tools provided by sections 251 and 252 in the 1996 Act to unify all intercarrier rates, including those for intrastate calls, under the framework for reciprocal compensation.” *NPRM* ¶ 534. But, as Verizon has explained before,²⁶ there is a *third* option, which is superior to either of the two alternatives proposed in the *NPRM*. Namely, the Commission should find that *all* traffic routed over the PSTN is inseverable and, therefore, interstate for jurisdictional purposes, so that the Commission can use its authority under sections 201 and 332 to establish a uniform default rate for all of that traffic. That is the surest way to achieve the Commission’s longstanding goal of creating a

²⁶ See Ex Parte Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, WC Docket Nos. 04-36 & 06-122 (Sept. 19, 2008).

uniform intercarrier compensation regime for all traffic—with any variations resulting only from mutually beneficial, negotiated, commercial agreements—thereby dramatically simplifying billing practices and substantially eliminating arbitrage opportunities.

Though not the best option for reasons explained below, if the Commission elects not to pursue that path, the section 251(b)(5) approach (option No. 2 in the *NPRM*) is far superior to the “carrot and stick” approach involving state commission action (option No. 1 in the *NPRM*). Nonetheless, the Commission probably could not use section 251(b)(5), alone, to replace the existing regime of disparate state rates with a single, uniform default rate. Given that limitation, and in order to realize the benefits of a low, uniform terminating rate, therefore, even under section 251(b)(5) the Commission would still have to set a default rate, again drawing on its clear authority over interstate traffic and the practical inseverability of other traffic. It thus makes most sense for the Commission to employ its preemption authority and rely on the inseverability of all PSTN traffic in order to set a national default rate in the first instance.

1. The Commission Has Legal Authority Under Sections 201 and 332 To Adopt a Uniform Default Rate for All Types of Traffic.

The Commission can adopt a single, default rate for all traffic routed on the PSTN without relying on section 251(b)(5). For interstate TDM traffic, wireless traffic, and VoIP traffic, the Commission’s authority is beyond dispute, and exists irrespective of whether that traffic is also encompassed within section 251(b)(5). *See* 47 U.S.C. §§ 201, 332(c)(1); *NPRM* ¶ 511; *Core Commc’ns, Inc. v. FCC*, 592 F.3d 139, 143-46 (D.C. Cir. 2010), *cert. denied*, 131 S. Ct. 597, 626 (2010).

The Commission can also assert authority over intrastate TDM traffic routed on the PSTN (whether local or non-local) by relying on the dramatic technological and marketplace changes that are making it increasingly difficult reliably to jurisdictionalize TDM traffic and

making such distinctions increasingly meaningless. As consumers migrate in ever greater numbers to flat-rated, any-distance plans that include location-independent features (such as number-assignment, multi-phone call-answering options, and mobility), carriers find it ever more difficult reliably to identify different types of traffic, let alone to jurisdictionalize the traffic for billing purposes. Moreover, these any-distance, any-phone plans are intended to *transcend* legacy geographic and service distinctions, so their providers have no business reason to invest in the capabilities to align these new services with those old distinctions. Preserving state regimes alongside a uniform federal regime, therefore, poses an obstacle to, and would frustrate, the important federal policy goal of comprehensively reforming the intercarrier compensation system to promote the development of new technologies. The Commission need not leave a hole in an otherwise-uniform system that would perpetuate arbitrage opportunities and, thereby, thoroughly undermine federal policies.

i. The Commission Has Authority Under Sections 201 and 332 Over Interstate TDM, VoIP, and Wireless Traffic.

The Commission has authority to establish a uniform default rate for VoIP, wireless, and interstate TDM traffic. Congress has explicitly given the Commission authority to ensure that rates for “interstate” communications services are “just and reasonable.” 47 U.S.C. § 201. The D.C. Circuit recently upheld the Commission’s authority under section 201 to enact compensation rules regarding interstate traffic, regardless of whether such traffic is also encompassed within section 251(b)(5). *See Core*, 592 F.3d at 143-46.²⁷ The Commission, too, has noted that “no one has questioned (or plausibly could question)” that section 201(b) provides

²⁷ The Commission has long found that all dial-up ISP traffic is interstate and, therefore, subject to the Commission’s jurisdiction under section 201. *See ISP Remand Order* ¶ 1; *see also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd 3689 (1999).

the Commission with “authority over interstate access charges.”²⁸ The FCC’s exclusive authority over interstate communications services also extends to *all* VoIP services, regardless of provider or technology. As Verizon has explained, the *Vonage Order*²⁹ makes clear that all of those services are inseverable and, therefore, interstate for jurisdictional purposes.³⁰

Congress has also extended the Commission’s authority under section 201 to *all* wireless traffic. *See* 47 U.S.C. § 332(c)(1).³¹ Indeed, because Congress has expressly preempted state “regulat[ion] [of] . . . the rates charges by any commercial mobile service,” the Commission has *exclusive* authority to regulate intercarrier compensation for wireless traffic.³²

ii. The Commission Can Rely on the Inseverability Doctrine To Assert Authority Under Section 201 Over All TDM Traffic.

The Commission can, and should, find that dramatic technological and marketplace changes in recent years have rendered *all* traffic inseverable and, therefore, interstate for jurisdictional purposes. Increasingly, carriers can neither reliably identify different types of

²⁸ *Access Charge Reform*, First Report and Order, 12 FCC Rcd 10175, ¶ 7 (1997); *see also NPRM* ¶ 510 (noting that “reducing interstate access charges falls well within our general authority to regulate interstate access under sections 201 and 251(g)”); *Access Charge Reform*, Seventh Report and Order and Notice of Proposed Rulemaking, 16 FCC Rcd 9923, ¶ 21 (2001) (§ 201(b) provides Commission with authority over CLEC interstate access charges).

²⁹ *See Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, Memorandum Opinion and Order, 19 FCC Rcd 22404 (2004) (“*Vonage Order*”).

³⁰ *See* Verizon April 1 Comments at 19-31.

³¹ *See also Petition of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, Declaratory Ruling, 17 FCC Rcd 13192, ¶¶ 8-12 (2002); *Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Services*, Second Report and Order, 9 FCC Rcd 1411, ¶ 179 (1994).

³² *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (subsequent history omitted); *see also NPRM* ¶ 511 (noting that “there is support for the proposition that section 332 of the Act also gives the Commission authority to regulate the intercarrier compensation rates paid by wireless carriers for intrastate traffic—including charges that would otherwise be subject to intrastate access charges”).

traffic nor reliably separate all of the various types of traffic they receive in order to treat the traffic differently for billing purposes based on archaic jurisdictional distinctions. Nor should they have to increase the cost to track, bill, and identify traffic solely for regulatory purposes. The Commission, therefore, may use its section 201 authority to extend the uniform default rate for interstate TDM, wireless, and VoIP traffic to intrastate TDM traffic and, in turn, preempt any state regimes that would permit higher rates, because they are inconsistent with the federal regime.³³ Preserving state regimes alongside a uniform federal regime poses an obstacle to, and would frustrate, the important federal policy goal of comprehensively reforming the intercarrier compensation system to promote the development of new technologies.³⁴

a. The communications landscape has changed dramatically in the past decade and now bears little resemblance to the world Congress faced when it enacted the 1996 Act. It bears even less resemblance to the communications landscape of 1983 when, following the break-up of AT&T, the Commission and the states created access charge regimes.

Today, an ever-greater proportion of calls are in IP format, as millions of consumers and businesses opt for IP-based offerings.³⁵ These offerings upend traditional conceptions of location-based and device-based phone numbers, including by enabling customers to have a

³³ Regardless of whether any of this traffic also falls within section 251(b)(5), the D.C. Circuit's recent *Core* decision makes clear that section 251 does *not* trump the Commission's general authority over rates for interstate traffic under section 201. *Core*, 592 F.3d at 143-44.

³⁴ See NBP at 142 (noting that the non-uniformity of rates leads to "fundamental problems that create inefficient incentives," and that "[t]he current per-minute ICC system was never designed to promote deployment of broadband networks"); see also *NPRM*, ¶ 40 (noting that "wasteful attempts to game the system will likely persist as long as ICC rates remain disparate and well above carriers' incremental costs of terminating a call"); 2005 *FNPRM* ¶ 1 (emphasizing the need to "replac[e] the myriad existing intercarrier compensation regimes with a unified regime designed for a market characterized by increasing competition and new technologies").

³⁵ See Verizon April 1 Comments at 7-8 (citing statistics about the tremendous growth of both interconnected and over-the-top VoIP services).

single number—one of their choice and that may have no connection to their residence or billing address—that reaches them, no matter where they are and what phone (or computer) they are using. These services also offer integrated packages of features and capabilities, allowing customers to perform multiple communications simultaneously, accessing information and reaching individuals located in numerous places.³⁶ These integrated features eliminate the historical understanding that a “call” is a direct linear path between two identifiable end points.

In addition, consumers continue to flock to wireless services. As of December 2010, 96 percent of U.S. consumers had a wireless phone, and more than 26 percent of households have completely “cut the cord.”³⁷ Consumers now use 2.2 trillion minutes per year on their wireless phones, which far exceeds the number of wireline minutes.³⁸ Like VoIP services, wireless services break the connection between telephone numbers and geography, through the mobility inherent in such services. Wireless providers are also deploying third- and fourth-generation wireless networks, which give consumers the ability—much like IP-based wireline services—to engage in simultaneous voice and data communications. Indeed, the next generation of wireless services will utilize VoIP and other IP-based technologies to integrate further the suite of communications services available to consumers.

³⁶ See *Vonage Order* ¶ 25 n.93 (noting that “integrated capabilities and features” are “inherent features of most, if not all, IP-based services”); *id.* ¶ 32; see also Verizon April 1 Comments at 33.

³⁷ See CTIA, Wireless Quick Facts, <http://www.ctia.org/advocacy/research/index.cfm/aid/10323>.

³⁸ See *id.*; see also Robert Roche and Lesley O’Neill, *CTIA’s Wireless Industry Indices, Semi-Annual Data Survey Results*, Chart 58 and Chart 59 (May 2009).

Unsurprisingly, the flip side of this massive growth in intermodal services is a comparably large decline in traditional wireline services.³⁹ Between 2000 and 2008, the number of ILEC end-user switched access lines fell by 34 percent, and total ILEC interstate switched access minutes declined by a staggering 44 percent.⁴⁰ Traditional wireline carriers are also responding to competition from wireless and VoIP providers by offering their own geography-independent services, including any-distance, unlimited calling plans and find-me/follow-me services that—like current offerings using VoIP technology—enable a call to single number to ring in multiple locations. Wireline carriers are also introducing their own facilities-based VoIP services, which likewise will offer customers an integrated, any-distance communications service, lacking readily ascertainable jurisdictional end points.⁴¹

b. As consumers increasingly adopt these any-distance, jurisdiction-independent services, it will become even more difficult for carriers to separate traffic into legacy intrastate and interstate categories for intercarrier compensation purposes. All of these services make telephone numbers an increasingly poor “proxy for . . . subscribers’ geographic locations when making or receiving calls”—that is, for the end-points of a standard voice communication.

³⁹ See generally Comments of AT&T, NBP PN #25, *A National Broadband Plan for Our Future*, GN Docket No. 09-51 *et al.*, at 8-13 (Dec. 22, 2009) (explaining that “[i]n view of the range of alternatives for voice service — many of which offer distinct advantages over traditional landline service — it is not surprising that the POTS business model is in a precipitous decline”); see also *NPRM* ¶ 503 (noting the decline in ILEC switched access minutes as a result of “competition and technological advances and the proliferation of alternate means of communicating”).

⁴⁰ See FCC Industry Analysis and Technology Division, *Trends in Telephone Service*, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-301823A1.pdf, at Table 10.1 (showing 315.7 billion ILEC interstate switched access minutes in 2008 and 566.9 billion minutes in 2000); and Table 8.1 (showing 179.6 million ILEC end-user switched access lines in June 2000 and 118.5 million lines in December 2008) (Sept. 2010),.

⁴¹ See FiOS Digital Voice, <http://www22.verizon.com/residential/homephone/fiosdigitalvoice> (offering VoIP service that has “brilliant clarity” and is “completely integrated” with Verizon’s FiOS service).

Vonage Order ¶ 26. And—even if it were technologically feasible—there is often no *service-driven* reason (regulatory requirements aside) for providers of these new any-distance, geography-independent services to attempt to separate their traffic into “interstate” and “intrastate” components.

Carriers historically relied on telephone numbers to determine the jurisdiction of wireline calls, not because telephone numbers determine jurisdiction—a proposition the Commission has long rejected⁴²—but because telephone numbers were an easily ascertained and reliable proxy for the end-points of a call, which do determine jurisdiction. Customers had little, if any, choice over the area code and first three digits of their telephone numbers (the “NPA-NXX”), and carriers routinely assigned customers telephone numbers with NPA-NXXs associated with a nearby switch that provided dial-tone service to those customers at a particular location. Those numbers, therefore, provided other carriers with a reliable geographic indicator. Telephone numbers were never a perfect proxy for geography,⁴³ but only minor tweaks to federal and state access charge regimes were required to account for any discrepancies.

The advent of location-independent services poses far more significant difficulties for the continued use of telephone numbers as a proxy for geography. These location-independent services include mobile services—both wireless service and nomadic VoIP—that allow customers to make calls from the same telephone number from any place in the nation (and,

⁴² See, e.g., *AT&T Corp. v. Bell Atlantic-Pennsylvania*, Memorandum Opinion and Order, 14 FCC Rcd 556, ¶¶ 71, 80 (1998), *recon. denied*, 15 FCC Rcd 7467 (2000).

⁴³ See, e.g., *Access Billing Requirements for Joint Service Provision*, Memorandum Opinion and Order, 4 FCC Rcd 7183, ¶¶ 21-26 (1989); *Amendment of Part 69 of the Commission’s Rules*, Memorandum Opinion and Order, 102 F.C.C.2d 1243, ¶ 28 (1985) (“clarification” to “provide sufficient guidance . . . to permit the proper billing and collection of access charges”); *MTS and WATS Market Structure*, Memorandum Opinion and Order, 97 F.C.C.2d 834, ¶ 108 (1984).

indeed, the world). The availability of “pick-your-own-area-code” services—which may, or may not, also provide mobility—further divorces a customer’s assigned telephone number from her physical location. Moreover, “find-me/follow-me” services—like current offerings using VoIP technology—enable a call to single number to ring (and be answered) in multiple locations. And the intermodal porting of telephone numbers that were previously associated with a traditional wireline service adds another layer of complexity, as some of the numbers in a block of 1,000 or 10,000 numbers can now make or receive calls from anywhere, not just from the wire center where those numbers are traditionally homed. All of these wildly popular services are *intended* to break—and have succeeded in breaking—the connection between the assigned telephone number and the geographic endpoints of a call.⁴⁴ Therefore, telephone numbers are no longer the reliable proxy for the geographic location of the calling and called party that they once were, and are becoming less and less so.

Moreover, consumers are now using new and innovative IP-based services—including wireless IP services—that offer a “suite of integrated capabilities and features” that allows them “to perform different types of communications simultaneously,” which has demolished the traditional notion that a communication has only two end-points. *Vonage Order* ¶¶ 7, 25; *see id.* ¶ 23 (finding that integrated, any-distance VoIP services are “too multifaceted for simple identification of the user’s location to indicate jurisdiction”); *see also* Verizon April 1 Comments at 21. Therefore, even if telephone numbers were still a meaningful proxy for geography, they would not provide a complete picture of the geography of an IP-based communication for jurisdictional purposes.

⁴⁴ *See, e.g., Vonage Order* ¶¶ 18, 23 (noting that there is no “practical means” or “plausible approach to separating” VoIP calls “into interstate and intrastate components for purposes of enabling dual federal and state regulations to coexist”).

Similarly, wireless providers have been providing mobile services pursuant to national licenses to consumers for many years. An intrinsic feature of mobility is that mobile customers may use their cell phones from any geographic region in the country to place “local” or “long distance” calls to other locations in the country. Recognizing this aspect of mobility, the Commission relied on “its exclusive authority to define the authorized license areas of wireless carriers... to define the local service area for calls to and from CMRS networks for the purposes of applying reciprocal compensation obligations under section 251(b)(5).”⁴⁵ The geographic area the Commission chose to define the “local” rating area for traffic which is exchanged with a CMRS network, was the largest of these licensed service areas, or the “MTA.” See 47 C.F.R. § 51.701(b)(2) (this rule is commonly referred to as the “MTA rule”). In order to implement the reciprocal compensation requirements of the MTA rule, the Commission wisely chose to rely on the *location* of the wireless subscriber at the beginning of the call rather than the telephone number. See *Local Competition Order* ¶ 1044 (“For administrative convenience the location of the initial cell site when a call begins shall be used as the determinant of the geographic location of the mobile customer.”) The Commission endorsed the use of factors, which could be based on traffic studies, to assist carriers with the difficulties of determining the geographic location of wireless callers for the purposes of assessing reciprocal compensation. *Id.* Since 1996, CMRS providers and LECs have successfully relied on the Commission’s guidance and negotiated factors to determine the rating of traffic exchanged between their networks. The widespread use of factors demonstrates that billing systems need not rely on telephone numbers to determine the geographic rating of calls exchanged between carriers.

⁴⁵ *Implementation of the Local Competition Provisions in the Telecommunications Act; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, First Report and Order, 11 FCC Rcd 15499, ¶ 1036 (1996) (“*Local Competition Order*”).

Despite the diminishing correlation between geography and telephone numbers, many carriers still use automated billing systems that rate all traffic, at least in the first instance, based on the telephone numbers that are signaled with the call (and that, absent manipulation, should be the telephone numbers of the calling and called party), even though those numbers are increasingly unreliable proxies for customers' locations. With respect to circuit-switched exchanges of CMRS-LEC traffic, many carriers attempt to bill CMRS providers access charges for traffic which is properly subject to reciprocal compensation pursuant to the FCC's MTA rule. The effect on IP traffic is that carriers, which use these automated systems, inevitably and routinely bill intrastate access charges or reciprocal compensation charges for calls that are jurisdictionally interstate. This improper rating of VoIP and other IP-based calls occurs because the telephone numbers provide an inaccurate proxy for the geographic location of the parties to the call. As VoIP and other IP-based calls—including wireless calls using next-generation IP-based services—constitute an ever-increasing portion of the total volume of traffic routed on the PSTN, an increasing portion of the calls for which carriers bill *intrastate* access charges will actually be jurisdictionally mixed, but inseverable and, therefore, *interstate* IP-based calls.

Finally, providers of these new any-distance, location-independent services often have no *service-driven* reason (again, regulatory obligations aside) to fit these new services into legacy regulatory classifications. And no company should have to incur costs to track, bill, and otherwise comply with regulatory requirements for varying rates and charges based on the identity of traffic that to customers and carriers increasingly looks the same. Other than regulatory purposes, providers have no reason to develop technologies to distinguish and identify calls that are increasingly just packetized bits of information. Nor do VoIP providers or wireless

carriers have any service-driven reason to incorporate such identifying characteristics into their services. Likewise, circuit-switched providers offering any-distance service packages to their customers have no service-driven reason to distinguish among the jurisdiction of the calls their customers originate; they do so only pursuant to legacy regulatory distinctions.

c. These practical and economic impediments to ensuring that a carrier applies its intrastate charges only to intrastate traffic provides the Commission with ample grounds for finding that *all* traffic routed over the PSTN is inseverable as a practical and operational matter, and, therefore, is interstate for jurisdictional purposes. The Commission, therefore, can adopt a single, default rate for *all* traffic routed on the PSTN.

The standard for preemption on inseverability grounds is not whether it is *technically* impossible to single out intrastate communications. *See Vonage Order* ¶¶ 23, 29, 37. The dispositive question, instead, is whether it is “economically feasible,” in light of “practical and economic considerations,” to separate interstate traffic from intrastate traffic.⁴⁶ That focus on economic and practical considerations reflects the long-standing rule that carriers are not required to expend resources or modify their services “merely to provide state commissions with an intrastate communication they can then regulate.”⁴⁷

The Commission has in numerous cases preempted state regulation where—as here—it was not practical, in light of economic and operational considerations, to separate the interstate and intrastate services, even though it might have been *technically* possible to distinguish between intra- and interstate communications. For example, the Ninth Circuit upheld the

⁴⁶ *California v. FCC*, 39 F.3d 919, 932-33 (9th Cir. 1994).

⁴⁷ *Minnesota Pub. Utils. Comm’n v. FCC*, 483 F.3d 570, 578 (8th Cir. 2007); *see also Vonage Order* ¶ 25 (holding that “to require Vonage to attempt to incorporate geographic ‘end-point’ identification capabilities into its service solely to facilitate the use of an end-to-end approach would serve no legitimate policy purpose” and would unreasonably “mold[] this new service into the same old familiar shape”).

Commission's preemption in its *Computer Inquiry* orders of state regulation of information services (or enhanced services, as they were called at the time) that included integrated interstate and intrastate capabilities, based on the Commission's determination "that it would not be economically feasible for the BOCs to offer the interstate portion of such services on an integrated basis while maintaining separate facilities and personnel for the intrastate portion." *California v. FCC*, 39 F.3d 919, 932 (9th Cir. 1994). Even if it were technically "possible to comply with both the states' and the [Commission]'s regulations," the court found that preemption was appropriate based on the Commission's finding that it is "highly unlikely, due to practical and economic considerations," that such jurisdictional division would succeed. *Id.* at 933. Similarly, the Fourth Circuit upheld the Commission's preemption of state regulation of CPE on the ground that it was "not feasible, *as a matter of economics and practicality of operation*," to have separate state and federal regulation of the CPE, despite the fact that the CPE in question was used 97 to 98 percent of the time for intrastate calls.⁴⁸

Here, in light of the technological changes in the marketplace set forth above, service providers have no *business* need to separate the various types of traffic for which they bill other providers. For example, to prevent carriers from assessing intrastate charges on interstate calls, service providers would be forced to "incorporate . . . identification capabilities into [their] service[s] solely to facilitate the use of an end-to-end approach" and to "mak[e] it easier to apply traditional voice regulations" to the ever-shrinking proportion of traffic that is carried entirely across circuit-switched wireline networks. *Vonage Order* ¶¶ 25, 29.

⁴⁸ *North Carolina Utils. Comm'n v. FCC*, 537 F.2d 787, 791 (4th Cir. 1976) (emphasis added); *see id.* at 796 (Widener, J., dissenting); *North Carolina Utils. Comm'n v. FCC*, 552 F.2d 1036, 1044, 1046 (4th Cir. 1977).

As the Commission has properly found in an analogous context, it would “serve no legitimate policy purpose” to “impose substantial costs” on service providers to make these changes simply “for certain regulatory purposes,” where—as here—they have “*no service-driven reason to incorporate such capabilit[ies] into [their] operations.*” *Id.* ¶¶ 25, 29 (emphasis added). The Eighth Circuit agreed, holding that it was “proper” for the Commission to consider these “economic burden[s]” and recognizing the long-standing rule—set out in precedents dating back at least to the 1970s—that service providers are not required to bear those costs and “develop a mechanism for distinguishing between interstate and intrastate communications merely to provide state commissions with an intrastate communication they can then regulate.” *Minnesota Pub. Utils. Comm’n*, 483 F.3d at 578.

Indeed, as Verizon has explained in its prior comments,⁴⁹ IP traffic provides a particularly clear example of traffic that is jurisdictionally mixed, but inseverable for jurisdictional purposes, and for which the Commission must establish a uniform federal regime. As the Commission recognized, the “integrated capabilities and features” that “are inherent features of most, if not all, IP-based services”—including those of “facilities-based providers”—“form an integrated communications service designed to overcome geography, not track it,” and that are “too multifaceted for simple identification of the user’s location to indicate jurisdiction.” *Vonage Order* ¶¶ 23, 25 & n.93, 32. The Commission, therefore, concluded that it “would preempt state regulation” of the rates, terms, and conditions on which providers offer those IP-based services, recognizing the disastrous policy consequences of permitting the “imposition of

⁴⁹ See Verizon April 1 Comments at 5-31.

50 or more additional sets of different economic regulations” on VoIP service, which would “risk eliminating or hampering this innovative advanced service.” *Id.* ¶¶ 32, 37.⁵⁰

In today’s world, all of this is true not just of IP-based traffic, but also of *all* traffic that is routed over the PSTN, as explained above, and will only become increasingly more so over time.

d. The Commission has clear authority over the vast majority of traffic routed over the PSTN—interstate TDM, wireless, and VoIP traffic. *See* 47 U.S.C. §§ 201, 332(c)(1). In the exercise of that federal-law authority, the Commission has long had a “goal” of “develop[ing] a uniform regime for all forms of intercarrier compensation.”⁵¹ As the Commission explained, such uniformity is “competitively and technologically neutral” and “is consistent with the pro-competitive de-regulatory environment envisioned by the 1996 Act,” as such a regime requires “minimal regulatory intervention and enforcement.” *2005 FNPRM* ¶ 33. The D.C. Circuit, moreover, has upheld a Commission decision that was based on these “policies favoring a unified compensation regime,” explaining further that it is “not for th[e] court[s] to second-guess the conclusion reached by the agency that Congress has entrusted with balancing those policies.”⁵²

⁵⁰ The Commission has similarly recognized that applying 50 or more sets of state regulations to facilities-based providers of VoIP and other IP-enabled services would harm consumers by “discourag[ing] the . . . building [of] next generation networks in the first place.” *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c)*, Memorandum Opinion and Order, 19 FCC Rcd 21496, ¶ 27 (2004) (“*271 Broadband Forbearance Order*”), *aff’d*, *EarthLink, Inc. v. FCC*, 462 F.3d 1 (D.C. Cir. 2006).

⁵¹ *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd 9610, ¶ 97 (2001) (“*2001 Intercarrier Compensation NPRM*”); *see also 2005 FNPRM* ¶ 33 (expressing the Commission’s goal of “a regime that would apply [intercarrier compensation] rates in a uniform manner for all traffic”); *NPRM* ¶ 495 (noting that a “fundamental problem” with the current ICC regime is that “rates vary based on the type of provider and where the call originated, even though the function of originating or terminating the call does not change”).

⁵² *In re Core Communications, Inc.*, 455 F.3d 267, 283 (D.C. Cir. 2006) (internal quotation marks omitted).

The Commission has also recognized the importance of ensuring that “carriers have [the] incentive to compete . . . on [the] basis of quality and efficiency,” rather than “on the basis of their ability to shift costs to other carriers,” which the Commission recognized creates “troubling distortion[s] that prevent[] market forces from distributing limited investment resources to their most efficient uses.” *ISP Remand Order* ¶ 4. These distortions “create[] incentives for inefficient entry” by carriers intent on taking advantage of “opportunit[ies] for regulatory arbitrage,” rather than engaging in the kind of “telephone competition[] [that] Congress had intended to facilitate with the 1996 Act.” *Id.* ¶ 21. And the Commission, applying Section 706, has recognized the importance of “provid[ing] incentives for all carriers . . . to invest in broadband facilities” and to “promote the timely and comprehensive deployment of [such] facilities.”⁵³

Non-uniform intercarrier compensation rates—such as rates for intrastate TDM traffic that differ from an otherwise-uniform federal default rate for all other traffic—pose a significant obstacle to those federal policies. The Commission has emphasized that the current “patchwork of rates and regulations is inefficient, wasteful, and slowing the evolution to IP networks.”⁵⁴ That is because, where “opportunities for regulatory arbitrage” exist, “parties will revise or rearrange their transactions to exploit a more advantageous regulatory treatment, even though such actions, in the absence of regulation, would be viewed as costly or inefficient.”⁵⁵ In other

⁵³ *271 Broadband Forbearance Order* ¶¶ 6, 34; see also NBP at 142 (noting that “[t]he current per-minute ICC system was never designed to promote deployment of broadband networks”).

⁵⁴ *NPRM* ¶ 502; see also *2005 FNPRM* ¶ 3 (noting that the availability of different rates for different types of traffic “create[s] both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions”).

⁵⁵ *2001 Intercarrier Compensation NPRM*, ¶ 12; see also NBP at 142 (noting that, as a result of ICC-related “arbitrage opportunit[ies],” “investment is directed to free conference

words, investment decisions—including decisions about investment in broadband facilities and IP-based services—will be distorted by the availability of arbitrage opportunities, as well as by uncertainty and disagreement about which of the multiple rates will apply to new services.⁵⁶ In addition, the need to devote funds to increasingly futile efforts to identify, track, and bill differently for different types of traffic further distorts investment decisions.

Indeed, if existing regimes for intrastate TDM traffic were to remain alongside a new federal compensation regime, carriers would have the same incentives as today to engage in traffic pumping schemes to charge higher intrastate rates, rather than the new, lower federal default rate. And carriers would continue to have the incentive both to disguise traffic that remains subject to charges for intrastate TDM traffic in an effort to pay only the lower federal default rate, and to claim an entitlement to payment at higher intrastate rates for traffic that is legitimately subject to the new federal default rate. Such arbitrage efforts and outright fraud—designed to exploit the distinctions in the federal and state regimes—would necessarily undermine the uniform federal intercarrier compensation regime and the federal policies favoring efficiency, economic competition, and broadband deployment that a uniform intercarrier compensation regime furthers.

e. For all of these reasons, the Commission can find that state regimes that differ from its single, federal default rate pose an obstacle to the accomplishment of federal goals and policies and are thus preempted. Under the Supremacy Clause of the Constitution, state law is preempted where, as here, it “stands as an obstacle to the accomplishment and execution of the

(Continued . . .)

calling and similar schemes for adult entertainment that ultimately cost consumers money, rather than to other, more productive endeavors” such as broadband deployment.).

⁵⁶ See NBP at 142 (noting that “regulatory uncertainty about whether or what intercarrier compensation payments are required for VoIP traffic, as well as a lack of uniform rates, may be hindering investment and the introduction of new IP-based services and products”).

full purposes and objectives of Congress” or a federal agency exercising delegated authority. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941); *United States v. Locke*, 529 U.S. 89, 109-10 (2000) (“In this context, [federal agency] regulations are to be given pre-emptive effect over conflicting state laws.”). Indeed, the Supreme Court has expressly found, in the context of this Commission’s regulations, that “[t]he statutorily authorized regulations of an agency will preempt any state or local law that conflicts with such regulations or frustrates the purposes thereof.” *City of New York v. FCC*, 486 U.S. 57, 64 (1988).

Moreover, the Commission’s determination that state regimes pose an obstacle to federal intercarrier compensation policies and the new federal default rate is entitled, at a minimum, to “some weight.” *Geier v. American Honda Motor Co.*, 529 U.S. 861, 883 (2000). Where Congress has delegated to an agency the “authority to implement the statute; the subject matter is technical; and the relevant history and background are complex and extensive”—all factors present in the context of intercarrier compensation—the agency’s view that state law would “stan[d] as an obstacle to the accomplishment and execution” of the agency’s “own regulation and its objectives” “make[s] a difference,” as the agency is “uniquely qualified to comprehend the likely impact of state requirements.” *Id.* (citation omitted).

In an analogous situation, the D.C. Circuit recognized the Commission’s authority to preempt state laws that — as here — pose an obstacle to federal policies or, in that court’s words, “when the state’s exercise of that authority negates the exercise by the [Commission] of its own lawful authority over interstate communication.” *NARUC v. FCC*, 880 F.2d 422, 429 (D.C. Cir. 1989). In that case, the Commission had adopted the policy of “encourag[ing] competition in the provision, installation, and maintenance of inside wiring,” which the court found to be “consistent with the goals of the Act.” *Id.* The court recognized further that “certain

otherwise legitimate state actions regulating intrastate telephone service could interfere with the Commission’s achievement of its valid goal of providing interstate telephone users with the benefits of a free market and free choice in the installation and maintenance of inside wiring.” *Id.* at 430. The Commission thus had authority to “take appropriate measures in pursuit of that goal,” including issuance of a “valid . . . preemption order” with respect to state regulation that—there, as here—“would necessarily thwart or impede the operation of a free market.” *Id.*⁵⁷

Nothing in section 2(b) of the Act, *see* 47 U.S.C. § 152(b)(1), prevents the Commission from preempting state regimes where the Commission finds that the “state’s exercise of [such] authority” would “negate[] the exercise by the [Commission] of its own lawful authority” over intercarrier compensation for “interstate communication[s]” and wireless communications, and would frustrate important federal policy objective in competition and efficient investment in new technologies and services.⁵⁸ More generally, because conflict preemption “turns on the identification of [an] ‘actual conflict,’” it operates even in the face of a savings provision, such as § 2(b), because courts “can assume that Congress or an agency ordinarily would not intend to permit a significant conflict.” *Geier*, 529 U.S. at 884-85; *see also Crosby v. National Foreign Trade Council*, 530 U.S. 363, 387-388 (2000) (“[T]he existence of conflict cognizable under the Supremacy Clause does not depend on express congressional recognition that federal and state law may conflict.”).

⁵⁷ Although the D.C. Circuit found that the Commission had not fully explained the basis for its preemption decision, *see NARUC*, 880 F.2d at 431, the Commission did so soon thereafter, and no party sought review of the Commission’s more detailed explanation of its decision to preempt state regulation regarding inside wiring. *See Detariffing the Installation and Maintenance of Inside Wiring*, Third Report and Order, 7 FCC Rcd 1334 (1992).

⁵⁸ *NARUC*, 880 F.2d at 429; *see Public Serv. Comm’n of Md. v. FCC*, 909 F.2d 1510, 1514-15 (D.C. Cir. 1990) (rejecting similar argument based on § 2(b)); *see also* above discussion of other cases in which courts have upheld Commission preemption of state regulation, including of information services and CPE.

2. The Commission Likely Has Authority To Achieve Some Meaningful Reforms Through Section 251(b)(5).

As explained above, the most straightforward way for the Commission to establish a uniform default rate for all traffic routed on the PSTN is to rely on its section 201 and 332 authority over VoIP, wireless traffic, and interstate TDM, while finding that intrastate TDM traffic is inseverable from that other traffic and, therefore, is also jurisdictionally interstate and subject to the Commission's authority under section 201. If the Commission chooses instead to rely on section 251(b)(5), *see NPRM* ¶ 550-555, it has authority to do so, although its authority remains unclear in certain respects. Moreover, even under section 251(b)(5) the Commission would still have to set a national default terminating rate in order to achieve meaningful intercarrier compensation reform. Yet, as explained below, some limitations on the Commission's authority to implement section 251(b)(5) may mean that the Commission could have certain obstacles to implementing a single, uniform default rate to replace the existing system of disparate state rates. Instead, in order to set a default rate for all traffic, the Commission will likely still need to draw on its clear authority over interstate traffic and the practical inseverability of other traffic. It thus makes most sense for the Commission to employ its preemption authority and rely on the inseverability of all PSTN traffic in order to set a national default rate in the first instance independent of section 251(b)(5).

The Commission has previously interpreted section 251(b)(5) as broad enough to cover all telecommunications traffic exchanged with LECs, although it has not yet subjected all such traffic to section 251(b)(5) because some traffic remains exempted under section 251(g).⁵⁹ The

⁵⁹ *See Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6475, ¶ 15 (2008) (finding that “the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2)”); *id.* ¶ 16 (noting that

Commission can promulgate rules to eliminate that exemption and bring that traffic into the section 251(b)(5) regime. *See* 47 U.S.C. § 251(g) (pre-existing access regimes apply “until such . . . obligations are explicitly superseded by regulations prescribed by the Commission”).

As explained above, the Commission plainly has authority over that traffic pursuant to sections 201 and 332. Both the D.C. Circuit and the Eighth Circuit have made clear that the Commission retains this authority, even for traffic that falls within section 251(b)(5).⁶⁰ Section 251(b)(5)—and, in turn, section 252(d)(2)—thus pose no limitations on the Commission’s rate-setting authority for these types of traffic.

With respect to intrastate TDM traffic, although section 251(b)(5) applies to all LECs, Congress only established a pricing standard for the rates charged by ILECs. *See* 47 U.S.C. § 252(d)(2) (“For purposes of compliance by an incumbent local exchange carrier with section 251(b)(5) . . .”). There is accordingly a significant amount of traffic that, on the Commission’s interpretation, is covered by section 251(b)(5) but not section 252(d)(2)—*i.e.*, any traffic exchanged without involvement of an ILEC, and rates charged by non-ILECs even if an ILEC is involved. The Commission can thus set rates for all of this traffic by exercising its section 201(b) rulemaking authority to establish rules implementing section 251(b)(5). Section 252(d)(2)—and state authority to set rates under section 252(c)(2)—clearly poses no obstacle to the exercise of that authority because it simply does not apply to those categories of traffic.⁶¹

(Continued . . .)

“traffic encompassed by section 251(g) is excluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope”).

⁶⁰ *See Core*, 592 F.3d at 143-44; *Iowa Utils. Bd.*, 120 F.3d at 800 n.21 (preserving Commission’s reciprocal compensation rules for wireless services under section 332 even as the court held (erroneously) that the Commission lacked authority to set pricing rules pursuant to section 251(b)(5)).

⁶¹ Indeed, where no ILEC is involved, the section 252 regime for the creation of interconnection agreements—and state authority as part of that regime—does not apply at all.

With respect to ILEC rates for intrastate TDM traffic, section 252(d)(2) *does* apply, and state commissions have authority over rates for that traffic pursuant to section 252(c)(2), absent a voluntary agreement by the incumbent LEC and other carriers regarding the exchange of that traffic. *See* 47 U.S.C. § 252(a)(1) (permitting negotiated agreements “without regard” to the requirements of section 251(b) and (c)). In *Iowa Utilities Board*, the Supreme Court found that “the Commission has jurisdiction to design a pricing methodology” in implementing the pricing standards in section 252(d). *AT&T v Iowa Utils. Bd.*, 525 U.S. 366, 385 (1999). The Eighth Circuit, interpreting *Iowa Utilities Board*, has held that the Supreme Court’s holding means that the “FCC does not have jurisdiction to set the actual prices for state commissions to use.” *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000).⁶² Accordingly, under the Eighth Circuit’s reading of *Iowa Utilities Board*, the Commission may be constrained in setting a default rate for ILECs to charge for intrastate TDM traffic—potentially limited instead to establishing a pricing methodology for incumbent LECs’ rates for that traffic. The Commission could still adopt a methodology that caps those rates at \$0.0007 per minute and instruct incumbent LECs (like all other carriers and providers) to look to their customers to recover any additional compensation for the work they perform.

That kind of hybrid pricing methodology is consistent with the text of section 252(d)(2), which requires only that reciprocal compensation arrangements provide for “the mutual and reciprocal recovery” of a “reasonable approximation” of the costs involved in carrying the traffic that is subject to section 251(b)(5). 47 U.S.C. § 252(d)(2)(A). That section expressly precludes both the Commission and state commissions from determining carriers’ costs “with

⁶² The Supreme Court did not itself hold that the authority to design a pricing methodology represents the outer limits of the Commission’s authority to promulgate rules implementing section 252(d). However, a court of appeals reviewing the Commission’s order may well follow the Eighth Circuit’s reading of the Supreme Court’s decision.

particularity.” *Id.* § 252(d)(2)(B)(ii). Section 252(d)(2), moreover, does not require that a carrier recover *all* of its costs of delivering traffic to its customers from the originating carrier, rather than from its customers. In fact, the statute expressly provides that “arrangements that afford the mutual recovery of costs” for purposes of § 252(d)(2) include “bill-and-keep arrangements,” *id.* § 252(d)(2)(B)(i), under which “each carrier recovers its costs from its own end-users” rather than from the other carrier, *WorldCom, Inc. v. FCC*, 288 F.3d 429, 431 (D.C. Cir. 2002). Because an arrangement in which a carrier recovers *all* of its costs from its customers and *none* from other carriers thus satisfies section 252(d)(2), it follows that section 252(d)(2) can be satisfied through an arrangement where a carrier recovers *some* costs from the originating carriers and some from its customers.

Moreover, the Commission has explained that section 252(d)(2)(A), by its terms, references only “[s]tate commission” review of “compliance by an *incumbent* local exchange carrier,” 47 U.S.C. § 252(d)(2)(A) (emphasis added), without purporting to limit the Commission’s authority over rates, unlike the following subsection, which limits both “the Commission [and] any state commission,” *id.* § 252(d)(2)(B).⁶³ Therefore, the Commission could conclude that section 252(d)(2)(A) does not constrain its rulemaking authority even with respect to rates incumbent LECs charge for intrastate TDM traffic subject to section 251(b)(5).

In sum, for the reasons set forth above, it is likely that the FCC has legal authority to implement comprehensive intercarrier compensation reform pursuant to section 251(b)(5). Nonetheless, because the FCC has never before set a pricing methodology for traffic that is subject only to section 251(b)(5) and not also to section 201 or 332—other than its original

⁶³ FCC Brief at 33-34, *Core Commc’ns, Inc. v. FCC*, Nos. 08-1365, 09-1046, 08-1393, 09-1044 (D.C. Cir. filed Jun. 19, 2009).

decision to apply its TELRIC methodology to section 251(b)(5) traffic⁶⁴—the Commission’s legal authority to set a pricing methodology to cap ILEC rates for intrastate TDM traffic at \$0.0007 per minute could be subject to challenge. If those challenges were to succeed, states could be free to set rates for intrastate TDM traffic above the \$0.0007 per minute default rate that applies to all other traffic routed on the PSTN. Such disparate rate regimes would preserve the same kinds of arbitrage opportunities and inefficiencies that exist today. Moreover, even if the challenges were to fail and the Commission’s authority to set a default rate cap under section 251(b)(5) were upheld, states would still have room to set rates below that cap, which could again invite arbitrage. At a minimum, the potential for further state action under section 251(b)(5) would likely take time to definitively resolve.

Therefore, reliance on sections 201 and 332, and the inseparability of traffic in light of recent (and continuing) technological and marketplace developments, is the more straightforward path to achieving the comprehensive intercarrier compensation reform that the national interest requires.

III. THE COMMISSION SHOULD REPURPOSE THE USF PROGRAM FOR BROADBAND.

The Commission should rely on the following anchors in approaching comprehensive universal service reform: (1) in order to fund new broadband priorities through the proposed Connect America Fund and to start all parties off in the same position the Commission must begin eliminating remaining CETC support as soon as possible; (2) to satisfy the Commission’s own objective not to grow the fund—and ultimately to shrink it over time—the Commission should cap high cost support at 2010 levels; and (3) to accomplish the Commission’s new USF broadband priorities within the current size of the fund and to reduce the USF over time the

⁶⁴ See *Local Competition Order* ¶¶ 1054-1058.

Commission should adopt several of its tentative conclusions, which include (i) using competitive bidding to distribute broadband support in a balanced, targeted manner in areas that are unserved today or that would not be served without subsidies; (ii) funding only one universal service provider in an area on a technology-neutral basis; and (iii) extending USF support only to areas where there is no unsubsidized provider.

A. Reductions in Legacy Voice Support Should Happen Quickly and Treat All Similarly Situated Providers the Same.

1. All Remaining CETC Support Should Be Eliminated Soon, Beginning with Duplicative Family Plan Support.

In the short term, as a first step the only way to free up sufficient USF support for the Commission's USF and intercarrier compensation reform objectives in this proceeding is to make good on the National Broadband Plan recommendation and Commission proposal to eliminate remaining CETC support in addition to the Verizon Wireless and Sprint funding. *NPRM* ¶¶ 248-58.⁶⁵ There is no cause for delay. Indeed, the intercarrier compensation proposal in the *NPRM* to establish a new universal service mechanism for carrier recovery of some portion of access revenues lost as part of comprehensive reform heightens the urgency to eliminate remaining CETC support now. *NPRM* ¶¶ 559-602. The Commission should include final rules for this necessary step in its next universal service and/or intercarrier compensation reform item.

⁶⁵ See also NBP at 147-48; *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*, Notice of Inquiry and Proposed Rulemaking, 25 FCC Rcd 6657, ¶¶ 59-62 (2010) (“*Connect America Fund NPRM*”); See also *High-Cost Universal Service Support; Federal-State Joint Board on Universal Service; Request for Review of Decision of Universal Service Administrator by Corr Wireless Communications, LLC*, Order and Notice of Proposed Rulemaking, 25 FCC Rcd 12854 (2010), *reconsideration pending* (“*Corr Order*”).

All the pieces are in place, and there are no impediments to begin eliminating this legacy voice support immediately. The National Broadband Plan recommendations to free up broadband funding by first repurposing CETC support were issued in March of last year. NBP at 147-48. In the *Connect America Fund NPRM* (issued in April of last year), the Commission then provided notice of and sought comment on how to implement these reductions. *Connect America Fund NPRM* ¶¶ 59-62. Interested parties commented extensively on the proposed reductions in current high cost universal service support teed up in the National Broadband Plan and in the initial Connect America Fund proceeding.⁶⁶ Even outside of the formal *Connect America Fund NPRM* comment cycle, universal service funding reduction issues have been subject to extensive discussion in the industry and in *ex parte* filings with the Commission.⁶⁷

Further, in the *Corr Order* (issued in September of last year), following extensive comment from all interested parties, the Commission adopted detailed, workable procedures to phase out Verizon Wireless and Sprint support pursuant to merger conditions, which can now be applied industry-wide. *Corr Order* ¶¶ 14-17. At the same time the Commission provided explicit, detailed instructions to the Universal Service Administrative Company to administer these support reductions. *Id.* ¶¶ 18-22. Finally, just before the new year the Commission cleared the last operational hurdle, changing the interim CETC cap procedures so that when a carrier

⁶⁶ See, e.g., Comments of the USA Coalition, *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*, WC Docket Nos. 10-90 & 05-337; GN Docket No. 09-51, at 41-54 (July 12, 2010) (“Connect America Fund NPRM Comments”); CTIA Connect America Fund NPRM Comments at 5-12; Qwest Connect America Fund NPRM Comments at 20-24; NECA, NTCA, OPASTCO, WTA and Rural Alliance Connect America Fund NPRM Joint Comments at 34-45.

⁶⁷ See, e.g., Letter from Grant Spellmeyer, US Cellular, to Marlene Dortch, FCC, *A National Broadband Plan for Our Future, et al.*, GN Docket No. 09-51, PS Docket No. 06-229, WC Docket No. 05-25, RM-11592, WT Docket No. 05-265 (Dec. 9, 2010); Letter from Rebecca Murphy Thompson, Rural Cellular Association, to Marlene Dortch, FCC, *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*, WC Docket Nos. 10-90 & 05-337; GN Docket No. 09-51 (Dec. 8, 2010).

relinquishes its ETC status in particular states—which may happen as support is eliminated—funding will now be freed up for new USF priorities instead of being redistributed under existing voice support programs to other CETCs in the state.⁶⁸ With the right mechanisms now in place and procedural issues out of the way the Commission should adopt final rules and begin eliminating the remaining CETC support as soon as possible.

Specifically, the Commission can, and should, act now to eliminate CETC support this year for multiple wireless handsets in the same household. *NPRM* ¶ 257. The National Broadband Plan recognized that “[i]n order to accelerate the phase-down of legacy support, the FCC could *immediately adopt a rule* that any wireless family plan should be treated as a single line for purposes of universal service funding.” NBP at 148 (emphasis added). In 2010 dollars, over the next decade this approach could free up nearly \$6 billion for new USF priorities. *Id.* Since these family plans are billed to a single account and share capacity (minutes) it is reasonable that they not receive duplicative support. The Commission provided for notice and comment on eliminating duplicative family plan subsidies as an initial step (*i.e.*, in 2011) toward eliminating legacy CETC support last July. *Connect America Fund NPRM* ¶ 60 (citing to National Broadband Plan recommendations to eliminate legacy CETC support, including an initial reduction to duplicative family plan support).

The “initial reduction” to CETC support need not be tied to duplicative subsidies for family plan handsets if the Commission prefers a different approach. The Commission could, for example, eliminate 40 percent of the remaining legacy CETC funding before the end of 2011 (and phase out reductions to the remaining 60 percent of this support) over the next few years. This alternative approach would be consistent with the Commission’s implementing procedures

⁶⁸ *High-Cost Universal Service Support; Federal-State Board on Universal Service*, Order, 25 FCC Rcd 18146, ¶ 5 (2010).

for the Verizon Wireless and Sprint reductions. *Corr Order* ¶ 18 (retroactively implementing, in 2010, the 20 percent per-year Verizon Wireless and Sprint 2008 merger condition reductions—effectively reducing these carriers’ high cost USF support by 40 percent initially, followed by a phased reduction of remaining support).

After an initial reduction in legacy CETC funding before the end of 2011, the Commission should eliminate remaining support in equal percentage amounts over the next few years consistent with the procedures laid out in the *Corr Order*. *Id.* ¶¶ 14-17. The National Broadband Plan recommends that the Commission complete the phase-out within five years, by 2016. NBP at 144. As a practical matter, however, if the Commission moves promptly to make a material initial reduction to CETC support in 2011, the Commission would free up more funding more quickly for broadband and/or intercarrier compensation reform.

2. Any “Access Replacement” Support Should Be Eliminated on a Common Schedule.

While the Commission proposes to take five years to phase out CETC support, it proposes to phase-out IAS funding (approximately \$550 million, much of which is disbursed to incumbent price cap LECs) over just two years, beginning in 2012. *NPRM* ¶ 228, Appendix A. Not only does the *NPRM* fail to justify the differential treatment of CETCs and price cap incumbent LECs eligible for IAS, but the *NPRM* backs away from even the modest proposal in the National Broadband Plan to cap ICLS funding (more than \$1 billion total)—the equivalent access revenue replacement mechanism for rate-of-return carriers—on a per-line basis, which would have the effect of reducing this support as rural carriers lose lines. NBP at 147. To complete the picture, as discussed above, the Commission is considering new USF funding to off-set reductions in access charges as part of ICC reform. All of these USF programs, or proposed mechanisms, are designed to do the same thing—to give carriers a soft landing

following reductions in ICC rates. All should be treated alike, and all access replacement funding should be phased out over time according to a common schedule. There is no legitimate policy basis to privilege rate-of-return carriers (who in all events must wean themselves from unsustainable direct and indirect subsidies; *see* below) and burden price cap carriers with a disproportionate obligation to pay for new broadband programs.⁶⁹

Recognizing the need to resolve various “historically vexing” intercarrier compensation issues, the Commission established IAS as an explicit interstate universal service support mechanism to replace implicit support previously collected through access charges.⁷⁰ This allowed the Commission to “provide more equal footing for competitors in both the local and long-distance markets, while still keeping rates in higher cost areas affordable and reasonably comparable with those in lower cost areas.” *Id.* ¶ 3. In its subsequent *MAG Order*, the Commission created ICLS to replace the implicit form of universal service support then being recovered by rate-of-return carriers through carrier common line (CCL) charges.⁷¹ The Commission found that this funding shift was consistent with the Act’s mandate that universal service support be explicit, and would enable rate-of-return carriers serving rural and high cost areas “to continue providing access to quality telecommunications services at rates that are

⁶⁹ At a minimum the Commission should modify rate-of-return regulations to allow ICLS to phase out on a common schedule with other access replacement funding without a corresponding increase in these carriers’ access or other carrier charges.

⁷⁰ *See Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶¶ 2, 201 (2000).

⁷¹ *See Multi-Association (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report & Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report & Order in CC Docket No. 96-45, and Report & Order in CC Docket Nos. 98-77 and 98-166, 16 FCC Rcd 19613, ¶ 128 (2001) (“*MAG Order*”).

affordable and reasonably comparable to those in urban areas.” *Id.* In so doing, the Commission noted that “[t]here are a range of reasonable solutions, and we must select one that strikes a balance among the goals and principles of the Act.” *Id.* ¶ 130. But phasing out subsidies for legacy circuit-switched networks will restore rational economic incentives to upgrade, and repurposing the fund for broadband will provide funding support in areas where there is no business case to launch advanced networks.

At a minimum, the Commission should reduce price cap ILECs’ per-line *ICLS* support (currently received by rate-of-return carriers that converted to price cap regulation; *see below*) on the same schedule as IAS funding is phased out. In granting these price cap conversion applications, the Commission allowed the former rate-of-return carriers to continue participating in the *ICLS* mechanism, but converted the funding to a per-line basis to mirror IAS funding for other price cap carriers.⁷² Once IAS funding reductions are initiated, there is no basis for allowing carriers that have converted from rate-of-return to price cap regulation to continue to draw *ICLS* subsidies based on their former regulatory status.

The Commission should provide incumbent price cap LECs that lose IAS support with the flexibility to adjust subscriber line charges, just as CETCs would have the flexibility to adjust end user charges to offset reductions in IAS support. At the same time, the Commission should amend its price cap rules and prohibit carriers that lose IAS support from increasing carrier access charges. Under current price cap rules, decreases in IAS funding can result in an increase in the maximum permitted level of certain access charges—specifically legacy charges known as (1) the multiline business presubscribed interexchange carrier charge (MLB PICC); and (2) the CCL. 47 CFR §§ 69.153, 69.154. Part of the reason for the CALLS and the MAG plans was to

⁷² *See, e.g., Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief*, Order, 23 FCC Rcd 5294, ¶¶ 20-22 (2008).

eliminate these carrier-to-carrier charges. It would make no sense to phase out access replacement funding only to go backwards and see these charges return—especially in light of the Commission’s other proposals to reduce access charges further.

3. Proposals to Cut Back on Lock-Step Profits for Rate-of-Return Carriers Will Have Only a Modest Impact, and in the Long-Term Rate-of-Return Regulation Must Be Eliminated.

The *NPRM* backs away from the National Broadband Plan recommendation to eliminate rate-of-return regulation in favor of incentive regulation, and instead proposes only a series of small adjustments to rate-of-return USF support. NBP at 147; *NPRM* ¶¶ 157-227. This is a mistake. The proposed rate-of-return funding changes will have, at best, a modest impact on support levels. And in a competitive environment it does not make sense to lock in “a stable 11.25 percent return” for a privileged class of more than 1,000 carriers “regardless of their marketplace performance.” *NPRM* ¶ 165. Such a system rewards inefficiency, insulates carriers from competition, and gives these providers a disincentive to innovate.

Achieving the National Broadband Plan’s goals requires more fundamental changes in the regulatory approach to LECs currently operating under rate-of-return regulation. “Rate-of-return regulation was not designed to promote efficiency or innovation,” and “[i]n an increasingly competitive marketplace with unsubsidized competitors operating in a portion of incumbent’s territories, permitting carriers to be made whole through USF support lessens their incentives to become more efficient and offer innovative new services to retain and attract consumers.” NBP at 147. The suggested model for moving rate-of-return ILECs to incentive regulation—converting them to price cap regulation and shifting to a per-line USF support approach (*see id.*)—has worked previously without harming universal service. *Connect America Fund NPRM* ¶ 55 n.123-24. The Commission approved a number of price cap conversion

petitions over the past two years, in each instance finding that granting the request was in the public interest. *Id.* ¶ 55 n.123. Allowing carriers to convert from rate-of-return regulation to price cap regulation has benefitted consumers through fewer demands on the USF, lower costs of regulatory compliance, increased operational efficiencies and enhanced competition, and offers a path to move all rate-of-return carriers to incentive regulation.

No carrier should be forever insulated from the effects of competition or relieved of the need to pursue innovation in order to remain competitive in the modern communications marketplace. Rate-of-return regulation is a relic of a bygone regulatory era, one in which competition was virtually non-existent. In comparison to the vibrant intermodal competition of today's world, local exchange carriers during that era provided only ordinary telephone service, and more heavy-handed regulation was arguably necessary to protect ratepayers.⁷³ While the USF subsidies that rate-of-return carriers receive are lucrative and attractive to those carriers, the rate-of-return regulatory model is simply no longer sustainable.

Moreover, the several proposed adjustments to rate-of-return funding in the *NPRM* will not likely result in material reductions in USF subsidies for these carriers' legacy voice services. *See NPRM* ¶ 158 (proposing to modify certain funding mechanisms and combine others and impose a cap on total per-line high cost support of \$3,000). And the Commission is already being pressured to back down from these modest proposals in any event. Even the proposed per-line limit on high cost funding would not result in material reductions in USF support and would potentially have the opposite effect. Only a handful of carriers today exceed \$3,000 in funding per line. *NPRM* at Figure 12. Most carriers, even rural carriers serving fewer than 500 lines,

⁷³ *See, e.g.*, NBP at 147 (“Rate-of-return regulation was implemented in the 1960s, when there was a single provider of voice services in a given geographic area that had a legal obligation to serve all customers in the area and when the network only provided voice service.”).

have significant headroom in per-line support below \$3,000. *NPRM* ¶ 210 n.323 (LECs with fewer than 500 lines receive an average of \$1,148 per line each year).

To be sure, even modest reductions in rate-of-return USF support (which is far too high) are worth pursuing if that is as far as the Commission is willing to go. However, in the long-term rate-of-return is simply not consistent with meaningful ICC and USF reforms that should be designed to produce a rational, market-based system.

B. The Commission’s Proposal to Cap the High Cost Fund at 2010 Levels Is the Correct and Essential First Step, and Over Time the Fund Should Shrink—Not Grow.

The Commission proposes to cap all high cost funding at current levels, and asks “whether total disbursements should be lower in the future to minimize the burden on consumers.” *NPRM* ¶ 23. The Commission should adopt its proposal to set an overall budget for high cost funding at 2010 levels (approximately \$4.3 billion) and to establish an expectation that funding will decrease over time as broadband is deployed into unserved areas and technology drives greater efficiencies. *NPRM* ¶ 414. To reduce support in the future the Commission should rely on market-based mechanisms such as a competitive bidding to ensure that the fund benefits from the most efficient providers and technologies.

The Commission has many times extolled the benefits of putting high cost funding on a budget but thus far has failed to draw the line on total spending. “[E]nsur[ing] that the size of the fund remains reasonable” is “an essential first step toward repurposing the universal service fund to support broadband as well as voice service,” since continued growth of the fund will ultimately drive end users off the very networks the USF was created to support.⁷⁴ The Federal-State Joint Board on Universal Service (Joint Board) recognized several years ago that

⁷⁴ See *Connect America Fund NPRM* ¶¶ 51-52.

“unrestrained growth in the universal service fund, regardless of the source, could be, and would likely be catastrophic for universal service,” because it would threaten the affordability of communications services and erode public support for the universal service program.⁷⁵ The Commission echoed these same concerns in the National Broadband Plan. NBP at 149. And for good reason: to finance an \$8-9 billion annual fund the USF contribution factor is already stuck in double digits and setting new records above 15 percent.

In transitioning the fund to support broadband deployment and service, all parties, therefore, must set reasonable expectations about available speeds in remote locations and the costs to deploy broadband to those few remaining areas that still lack access. For example, one estimate of the subsidy required to extend ultra-high speed, 100 Mbps service to all homes using fiber to the premises (FTTP) is \$321.8 billion, which would result in an enormous—and impractical—increase in the contribution factor that could approach 60 percent, assuming the subsidy were spread over 10 years. *Connect America Fund NPRM* at Appendix C (“The Broadband Availability Gap: OBI Technical Paper No. 1,” April 2010).⁷⁶

Courts have also weighed in, concluding across the board that the Commission has an affirmative obligation under the Act to keep the fund from growing too large. In upholding a cap on high cost support for CETCs, the D.C. Circuit concluded last year that the Commission must exercise fiscal responsibility with universal service funding by “balanc[ing] the risks of excessive subsidization with the principles set forth in § 254(b)” and “consider not only the possibility of pricing some customers out of the market altogether, but the need to limit the

⁷⁵ See *Federal-State Joint Board on Universal Service*, Recommended Decision, 22 FCC Rcd 20477, ¶¶ 24-25 (2007) (“*Recommended Decision*”).

⁷⁶ A \$321.8 billion subsidy spread over 10 years would require \$8.045 billion per quarter. Assuming that the contribution base (approximately \$15.3 billion per quarter) and other USF programs’ demand (approximately \$1 billion per quarter) remain unchanged, the contribution factor would be approximately 59 percent.

burden on customers who continue to maintain telephone service.”⁷⁷ The court concluded that it was “entirely reasonable” for the Commission to “consider its interest in avoiding excessive funding from consumers.” *Id.* at 1103. The D.C. Circuit echoed the Fifth Circuit’s earlier findings in its *Alenco* decision.⁷⁸

The Commission must therefore “proceed with measured steps to assure that as it advances the nation’s broadband goals, it does not increase the USF contribution factor, which is already at a public historic high.”⁷⁹ NBP at 150. As a result, a cap on overall high cost funding is the prudent option to protect consumers and keep the size of the fund manageable.⁸⁰

Nonetheless, while acting on longstanding recommendations to cap the fund is good start, the Commission should not stop there. There is no philosophical or practical reason why consumers should not expect that high cost funding will actually decrease over time. As broadband networks are in fact deployed into those few remaining areas that still lack access (*i.e.*, to fewer than 5 percent of Americans according to the National Broadband Plan), and as

⁷⁷ See *Rural Cellular Ass’n, et al. v. FCC*, 588 F.3d 1095, 1102 (D.C. Cir. 2009).

⁷⁸ See *Rural Cellular*, 588 F.3d at 1102. *Alenco* recognized that the Commission’s “broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service.” See *Alenco Comm’ns, Inc. et al. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000). The *Alenco* court also noted that “excessive funding may itself violate” the Act by “detract[ing] from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market.” *Id.* at 620. The Tenth Circuit expressed similar concerns in its *Qwest II* decision, acknowledging that “excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1).” See *Qwest Comm’ns. Int’l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005) (“*Qwest II*”) (citing *Qwest Corp. v. FCC*, 258 F.3d 1191 (10th Cir. 2001)).

⁷⁹ The National Broadband Plan notes that the USF will have nearly doubled this decade, growing from approximately \$4.5 billion in 2000 to a projected \$8.7 billion in 2010. NBP at 150.

⁸⁰ See *High-Cost Universal Service Support*, Further Notice of Proposed Rulemaking, 24 FCC Rcd 14858, ¶¶ 33-34 (2009) (discussing the Commission’s “responsibility to be a prudent guardian of the public’s resources” and “fairness” to consumers who pay into the fund).

technology makes delivery of advanced services less expensive, consumers should see benefits in the form of reduced USF contributions. Reductions in high cost funding will be possible if the Commission adopts its tentative conclusions discussed below, all of which follow from a sensible and targeted competitive bidding mechanism to distribute new broadband funding. If, for example, the Commission limits funding to those areas where broadband service would otherwise not be available or affordable—as it should—the need will be limited.

C. The Commission Should Distribute High Cost Support Using a Competitive Bidding Mechanism that Limits Funding to the Amount Necessary to Serve those Areas Where Consumers Would Otherwise Be Denied Service.

To accomplish the Commission’s new USF broadband priorities within the current size of the fund and to reduce the USF over time the Commission should adopt several of its tentative conclusions, including use of competitive bidding to distribute broadband support in a balanced, targeted manner in areas that are unserved today or that would not be served without subsidies; funding only one universal service provider in an area on a technology-neutral basis; and extending USF support only to areas where there is no unsubsidized provider. *NPRM* ¶ 268.

The current high cost programs provide “universal service support to both a well-run company operating as efficiently as possible . . . and a company with high costs due to or exacerbated by imprudent investment decisions, bloated corporate overhead, or an inefficient operating structure.” *NPRM* ¶ 171. Indeed, because subsidies have historically been a function of a provider’s costs and cost estimates, subsidized providers have had little incentive to control or reduce costs. In order to achieve meaningful USF reform, the Commission must impose the kind of market discipline on the system that will shrink the fund over time. Competitive bidding will create incentives to contain costs and determine the least amount of funding needed for broadband deployment in high cost areas based on market forces. “By encouraging more

efficient carriers to submit bids reflecting their lower costs . . . a properly structured competitive bidding system would . . . reduce the amount of support needed for universal service.” *NPRM* ¶ 263. Moreover, relying on market forces to determine the proper amount of necessary funding will encourage innovation, efficiency, transparency, and ultimately lower the amount of USF surcharges consumers pay by decreasing the overall size of the fund over time.

Verizon has long supported the use of competitive bidding to distribute universal service funds. Indeed in 2007, Verizon filed its *Reform Plan* to transform the USF into an efficient, market-based system through competitive bidding.⁸¹ The virtues of competitive bidding in the USF context are plain. Such benefits include technology-neutral bidder participation, better knowledge of service costs in discrete areas, and streamlined quality control processes through standard contracts with winning bidders. Importantly, competitive bidding breaks high cost funding from the unsustainable cycle of providing ever-increasing support to make rural carriers whole as their per-line costs increase—a trend that is irreversible as these carriers lose lines. Moreover, many important goods and services, such as critical product development work for military equipment and repair work for bridges and roads, are purchased by government entities based on competitive bid contracts. Competitive bidding is the standard way that government procures goods and services for the best price, and there is no reason a properly structured competitive bidding mechanism cannot work well to produce better results in the universal service context.

In fashioning the right competitive bidding mechanism and considering other market-based reforms, it is important to recognize that the vast majority of Americans today already

⁸¹ See Comments of Verizon and Verizon Wireless, *High Cost Universal Service Support; Federal-State Joint Board on Universal Service*, WC Docket No. 05-337, CC Docket No. 96-45, Attachment - Modernizing Universal Service: Verizon’s Plan for Comprehensive Reform (May 31, 2007).

have access to fixed and/or wireless broadband. NBP at 20-22. As discussed above, at least 95 percent of Americans have access to terrestrial broadband service and, of those, more than 80 percent live in markets with more than one broadband provider. *Id.* The marketplace has indeed driven broadband deployment far and wide even without the benefit of direct USF subsidies for broadband. And unsubsidized broadband expansion will only increase in the coming months and years. For example, the National Broadband Plan anticipates that if the build-out of LTE wireless broadband services occurs as announced, approximately five million of the seven million currently unserved housing units in the United States will have LTE broadband coverage. NBP at 137. In fact, Verizon alone has already announced plans to service at least 147 domestic cities with LTE service by the end of 2011, and will have LTE coverage everywhere that Verizon has 3G coverage by the end of 2013.⁸² Verizon's LTE coverage has download speeds of 5-12 Mbps and upload speeds of 2-5 Mbps, both well in excess of the National Broadband Plan's 4/1 minimum thresholds for broadband. In addition, satellite broadband service can be very effective at reaching remote locations too expensive to serve with either fixed wireline or traditional wireless.⁸³

Nevertheless, there are a few remaining isolated areas where private investment is unlikely to reach in the near-term. The Commission should target those areas that would not

⁸² Bonnie Cha, CNET, "Verizon 4G LTE Network to Cover 147 Cities by End of Year," http://reviews.cnet.com/8301-12261_7-20046102-10356022.html (March 22, 2011); Verizon Wireless 4G LTE website, <http://network4g.verizonwireless.com/#/coverage>.

⁸³ ViaSat intends to launch next generation broadband services in 2011 that will exceed the National Broadband Plan's proposed service requirements (4/1 Mbps), while other satellite providers anticipate that "the satellite industry will be able to serve a significantly large proportion of unserved households." See Letter from John Janka, ViaSat, Inc. and WildBlue Communications, Inc., to Marlene Dortch, FCC, *A National Broadband Plan for Our Future; High-Cost Universal Service Support; Connect America Fund*, GN Docket No. 09-51; WC Docket Nos. 05-337 & 10-90 (Nov. 2, 2010); Letter from L. Charles Keller, DISH Network & EchoStar Satellite Services to Marlene Dortch, FCC, *High-Cost Universal Service Support; Connect America Fund*, WC Docket Nos. 05-337 & 10-90, at 6 (Nov. 12, 2010).

otherwise be served with USF support using the competitive bidding and other market-based approaches discussed in the *NPRM*. For instance, the Commission’s proposal to use one-time grant funding, not ongoing subsidies, to expand broadband infrastructure to areas lacking even basic broadband service makes sense where grant funding is sufficient. *NPRM* ¶ 261. Non-recurring funding for construction of facilities or upgrades to existing infrastructure is projected to fill nearly *half* of the existing broadband availability gap (to the extent such a gap remains following roll-out of new LTE wireless and satellite services) and extend broadband coverage to more than 3.2 million households. NBP at 138.

Indeed, in order to avoid the waste inherent in the current system the Commission must avoid unnecessary and costly ongoing subsidies when ongoing subsidies are not absolutely necessary. *NPRM* ¶ 1. *See also, e.g., Recommended Decision* ¶ 54 (“the Broadband and Mobility Funds should provide operational support only when essential.”). Providing ongoing subsidies in circumstances where a one-time infusion of support is sufficient creates perverse incentives. It places providers that are willing to provide broadband service without USF support at a competitive disadvantage, removes incentives for funding recipients to operate more efficiently, and it creates a potentially addictive revenue stream for subsidized providers.

Likewise, financial support should be made available to only one broadband provider in each unserved area, and must not be used to fund build-out in any area that is already being served by an unsubsidized provider or another subsidized provider. As the Joint Board recognized almost four years ago, it is not “in the public interest to use federal high-cost support to subsidize competition and build duplicative networks” *Recommended Decision* ¶ 35. Indeed, for too long scarce universal service dollars have been used to fund multiple providers in areas that are prohibitively expensive for even one provider to serve, increasing the size of the

fund and the contribution burden to a point that threatens to “undermine the benefits of the program” *NPRM* ¶ 10. Not only is subsidizing multiple overlapping providers an obvious waste of universal service dollars, it does not necessarily enhance consumer choice,⁸⁴ and it discourages independence from subsidies, efficiency and innovation.

Nor does it make sense to subsidize a provider in an area that is already being served by a non-subsidized provider. Indeed, the entire theory underlying the need for high cost funding is that there are areas that would not receive service at reasonably comparable rates without subsidies because there is no business case for a provider to provide such service. Where a provider *is* in fact providing broadband service without USF subsidies, the rationale for government support disappears entirely. Moreover, subsidizing competition in this manner is wholly inconsistent with the Commission’s competitive neutrality principle. 47 U.S.C. § 254(b)(7). Not only does it put the non-subsidized providers at a competitive disadvantage, it discourages market entry by additional providers. Thus, the Commission should adopt the National Broadband Plan’s recommendations to subsidize “at most one [] provider of broadband per geographic area” and should “only provide funding where there is no private sector business case” for broadband service. NBP at 145.

The Commission’s proposal to award funding on a technology-neutral, and a provider-neutral, basis is also the right approach. The existing USF program provides different levels of funding for price cap carriers, price cap converts, rate-of-return carriers, and “rural” and “non-rural” carriers—and also different funding for CETCs, which under the current regime, almost all of which are wireless carriers. According to the 2010 actual disbursements for high cost

⁸⁴ *The Availability of Unsubscribed Wireless and Wireline Competition in Areas Receiving Universal Service Funds*, Criterion Economics, LLC, Nicholas Vantzelfde, at 12, 14 (June 13, 2007).

support, rate-of-return carriers annually received \$348 on average in support per line, while price cap converts received \$85 per line and price cap carriers received only \$6 annually per line.

NPRM ¶ 165. As the Commission has acknowledged, these funding priorities “may no longer make sense in today’s marketplace[.]” *NPRM* ¶ 63. Funding from any new broadband fund should be available to any service provider that is capable of providing the desired broadband capability at the lowest cost. This is consistent with a market-based approach and with the Commission’s obligation to provide funding on a competitively neutral basis.

D. The Commission’s Proposals for New Connect America Fund Broadband Support Are on the Right Track.

1. The Commission’s proposal for an interim grant program to award through competitive bidding up to \$1.5 billion in one-time infrastructure funding in areas that lack broadband service today has some appeal. The interim program may further the National Broadband Plan goal of closing the broadband availability gap quickly (and efficiently) and is consistent with the Plan’s concomitant finding that many unserved areas could become served through non-recurring one-time funding grants. NBP at 144. Using a competitive bidding process to award these one-time grants will also provide the Commission with valuable experience that can and should inform long-term distributions from the all-broadband Connect America Fund. *NPRM* ¶ 261.

The Commission should consider structuring the interim Connect America Fund to be as similar as possible to the process used in awarding grants from the Mobility Fund proposed as a mechanism to bring 3G or better wireless service to those few areas that still lack access. In doing so, the Commission can maximize efficiencies by employing a system with which potential participants and the Commission are familiar. More than anything, successful auctions require a sufficient number of bidders, and utilizing a process that is familiar to at least some of

the potential bidders will encourage participation. Verizon filed detailed comments responding to the proposed structure of the Mobility Fund, most of which is portable to the proposed interim Connect America Fund.⁸⁵

2. For the long-term, the Commission proposes to transition all high cost funding into an all-broadband permanent Connect America Fund. *NPRM* ¶ 398. The Commission should phase out all legacy support for voice services and phase in its new broadband programs—syncing the two so that the fund does not grow as a result of new broadband priorities.

To distribute support from the permanent Connect America Fund the Commission asks about three alternatives: (1) use of competitive bidding and market-based mechanisms for all funding in all areas; (2) a “right of first refusal” approach whereby ILECs would have an opportunity to accept or reject long-term broadband support in specific areas determined by a cost model; or (3) limiting the right of first refusal approach to price cap carriers and allowing rural carriers to stay under rate-of-return regulations with limited changes to their universal service funding streams. *NPRM* ¶¶ 418-56.

As discussed above, competitive bidding and use of market-based mechanisms in all areas is the best approach—in both the short-term and the long-term—to transform the USF into an efficient, narrowly targeted broadband program responsive to the modern communication services consumers actually want. There is no substitute for critical market-based discipline that the USF program lacks today. To survive, the fund simply must be made more efficient. Neither of the two proposed alternatives to competitive bidding is likely to achieve the same result.

⁸⁵ See Comments of Verizon and Verizon Wireless, *Universal Service Reform; Mobility Fund*, WT Docket No. 10-208 (Dec. 16, 2010); see also Reply Comments of Verizon and Verizon Wireless, *Universal Service Reform; Mobility Fund*, WT Docket No. 10-208 (Jan. 18, 2011).

Providing ILECs with a special opportunity to turn down funding, for example, could fail to take into account the potential benefits of new competition from intermodal providers and legitimate consumer preferences for different technologies, particularly in unserved areas.⁸⁶ In addition, there is no reason to use a theoretical cost model when the Commission can rely on providers' own critical evaluations of the amount of support needed to take on a universal service obligation in a particular area. And, for reasons discussed above, there is no legitimate public policy basis to continue to insulate hundreds of rate-of-return carriers from market conditions with USF subsidies that drive artificially high investment returns and do little to promote efficiencies and innovation. Rate-of-return should be eliminated in favor of incentive regulation—not locked into the universal service program indefinitely.

In addition, the Commission should relieve those common carriers that no longer receive support from high cost programs of legacy ETC obligations. In the new broadband high cost USF regime, support will be provided to only a single provider in specific geographic areas. Any new or continuing regulatory obligations should flow only to recipients of new broadband support—which, for the first time, would not include all ETCs under any of the Commission's proposed long-term approaches to Connect America Fund support. It would be inappropriate to impose substantial service, reporting, and other regulatory obligations on carriers that receive no support.

⁸⁶ *See, e.g.*, TR Daily, “Mobility More Important than Ultra-High Speeds” (March 19, 2011) (quoting Consumer Federation of America director Mark Cooper regarding 4G services that “hit the sweet spot” with respect to consumer broadband speeds and concluding that LTE wireless services are better capable of extending broadband coverage into unserved areas).

IV. CONCLUSION.

For these reasons, the Commission should act as soon as possible to step down all intercarrier compensation rates to a single, low terminating rate of \$0.0007 for all traffic and all technologies. At the same time the Commission should repurpose the Universal Service Fund for broadband by first adopting its proposal to cap the fund and as further discussed herein.

Respectfully submitted,

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