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April 24, 2009

VIA COURIER

Mr. Jeff Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
P. O. Box 615
Frankfort, KY 40602

Re: MCI Communications, Services, Inc., Bell Atlantic Communications. Inc., NYNEX Long Distance Company, TTI National, Inc., Teleconnect Long Distance Services & Systems Company and Verizon Select Services, Inc., Complainants v. Windstream Kentucky West, Inc., Windstream Kentucky East, Inc.-Lexington, and Windstream Kentucky East, Inc.-London, Defendants
PSC 2007-00503

Dear Mr. Derouen:

Enclosed for filing in the above-captioned case are the original and six (6) copies of BellSouth Telecommunications, Inc.'s, d/b/a AT&T Kentucky, and AT&T Communications of the South Central States, LLC's, Responses to the Commission Staff's First Information Request dated March 30, 2009.

Sincerely,

Mary K. Keyer

Mary K. Keyer
General Counsel-KY

cc: Parties of Record

Enclosures

734198

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served on the following individuals by mailing a copy thereof, this 24th day of April 2009.

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CERTIFICATION

STATE OF GEORGIA

COUNTY OF GWINNETT

Before me, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Perry M. Eller, who, being by me first duly sworn, deposed and said that:

On behalf of BellSouth Telecommunications, Inc., d/b/a AT&T Kentucky, and AT&T Communications of the South Central States, LLC, he supervised the preparation of Responses to Commission Staff's First Information Request to BellSouth Telecommunications, Inc., d/b/a/ AT&T Kentucky, and AT&T Communications of the South Central States, LLC, dated March 30, 2009, in Kentucky Public Service Commission Case No. 2007-00503, *MCI Communications, Inc., et al., v. Windstream Kentucky West, Inc.; Windstream Kentucky East, Inc. – Lexington; and Windstream Kentucky East, Inc. - London.* He certifies that the Responses are true and accurate to the best of his knowledge, information, and belief formed after a reasonable inquiry.

Perry M Eller

PERRY M. ELLER

SWORN TO AND SUBSCRIBED BEFORE ME
THIS 6th DAY OF April, 2009

Colleen B. Lewis

Notary Public

COLLEEN B. LEWIS
Notary Public, Gwinnett County, Georgia

My Commission Expires: My Commission Expires January 12, 2011

732756

REQUEST: Discuss the impact of the Defendants' current access charges upon AT&T Communications' long-distance Kentucky retail customers. Provide cost comparisons to AT&T Communications' long-distance retail customers in five other AT&T Communications states.

RESPONSE: Intrastate access charges are a wholesale input and constitute a significant portion of the total cost of interexchange carriers' ("IXCs") long distance service. Therefore, the inflated access charges currently paid by AT&T Communications, and other IXCs, to Windstream in Kentucky increase their expenses and affect the long distance prices they charge their customers in Kentucky - causing Kentucky consumers to pay more than they should for intrastate long distance calls. AT&T Communications does not have a cost comparison of its retail customers readily available, as this would require a special study. *See* AT&T Kentucky's response to Data Request No. 2 for a discussion of how lower access expense translates into lower retail prices for consumers.

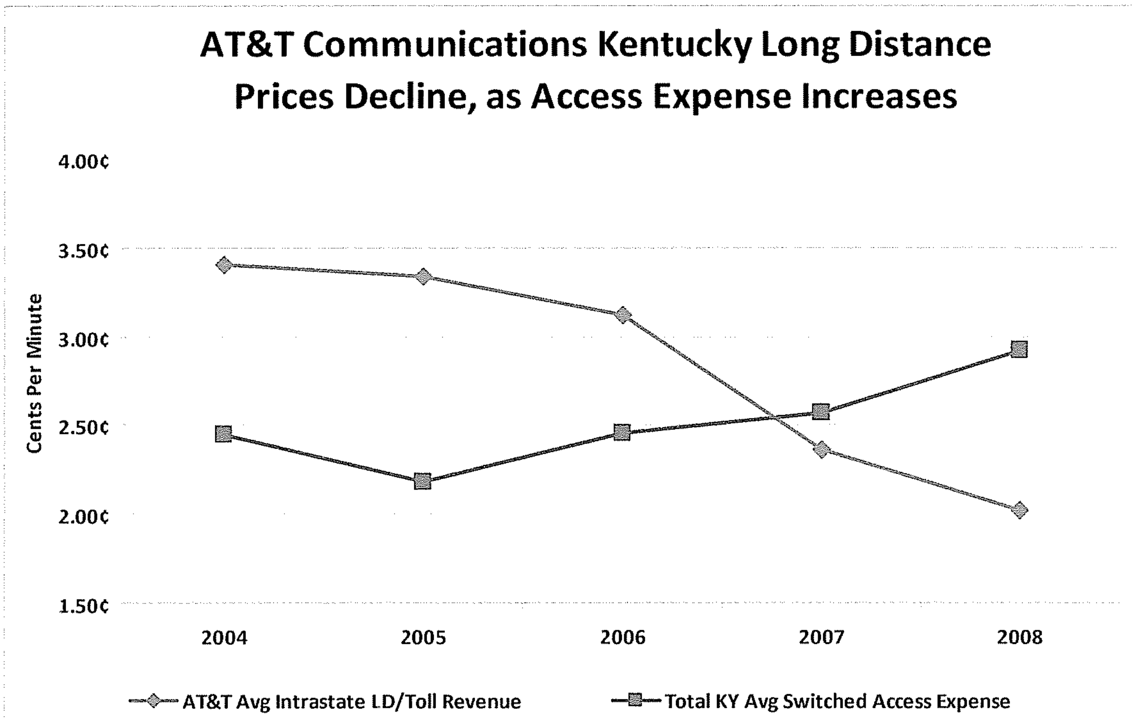
REQUEST: Quantify the effect of AT&T Communications' proposed reduction of access charges on the retail long-distance rates of AT&T Communications and other carriers in the market.

a. Will a reduction of the Defendants' access charges provide a windfall for long-distance providers, including AT&T Communications, instead of resulting in a corresponding reduction in the rates that consumers pay for long distance?

b. Propose the methodology that should be used by the Commission to implement a reduction in the Defendants' access rates to avoid a windfall to long distance providers while simultaneously allowing for reduced long-distance rates for consumers.

RESPONSE: Generally, there is no one-to-one relationship between access charges and AT&T Communications' long-distance service rates. As a result, AT&T Communications cannot postulate, on a carrier-by-carrier basis, the effect of access charge reduction on the long distance prices assessed to end users by AT&T Communications and other IXCs. However, because intrastate access charges are a significant wholesale component of intrastate long distance service, it is rational to expect that a substantial reduction in those wholesale input costs will affect prices in the retail long distance market, especially when traditional long distance companies are under significant pressure from alternative communications providers that do not have to pay those inflated switched access charges because they do not have the same access charge obligations. Historical trends have shown that consumers' long distance or toll prices have consistently declined following decreases in switched access charges. Also, in the past few years AT&T Communications' average price for long distance services in Kentucky has declined dramatically as AT&T Communications has responded to competition; indeed, AT&T Communications' prices declined faster than its access expenses as the following chart reflects:

RESPONSE (cont.):



The chart also highlights the strong urgency for access reform in Kentucky as AT&T Communications continues to be at a competitive disadvantage relative to its competitors who do not pay the same high access charges AT&T Communications currently pays for switched access service. AT&T Communications is doing what it can to stay competitive, but the Kentucky Public Service Commission should move quickly to level the playing field so that AT&T Communications can compete more effectively. As we state herein, concern about flow-through is not warranted and should not be a road block to this urgently needed reform.

Similarly, numerous studies on this issue have reached the same conclusion that reductions in access charges cause retail long distance prices to decline. Examples of such studies are: (1) William E. Taylor and Lester D. Taylor, "Postdivestiture Long-Distance Competition in the United States," American Economic Review 83, no. 2, May 1993; (2) William E. Taylor and J. Douglas Zona, "An Analysis of the State of Competition in Long-Distance Telephone Markets," Journal of Regulatory Economics 11, 1997; (3) Robert W. Crandall and Leonard Waverman, "Talk is

RESPONSE (cont.):

Cheap: The Promise of Regulatory Reform in North American Telecommunications," Washington DC: The Brookings Institution, 1995; and (4) T. Randolph Beard, George S. Ford, R. Carter Hill, and Richard Saba, "The Flow Through Of Cost Changes In Competitive Telecommunications: Theory And Evidence," Empirical Economics 30, 2005.

(a) No. AT&T Communications is not expected to receive any windfall as a result of reductions in Windstream's intrastate access charges. Rather, the expense reduction that AT&T Communications would experience will be passed through to consumers in one way or another. Over many years, as competition has intensified, reductions in long distance prices have not only taken place through tariff changes, but also, carriers in Kentucky and other parts of the country have introduced different lower priced calling plans in the form of bundled packages. Each time a customer selects a lower priced bundled package, that customer receives an effective price reduction. These trends have been observed even when AT&T Communications and other IXCs pay high access charges because they have no choice other than to keep up with the competitive pressures that confront them. AT&T Communications expects this trend will continue because as access charges decline and competition in the long distance and toll market intensifies, IXCs must reduce end user toll rates to avoid further erosion in wireline long distance minutes.

(b) Based on the foregoing responses, AT&T Communications does not believe any methodology mandating a flow-through is necessary. The Commission no longer needs to doubt whether access reductions will pass through to consumers, as the empirical evidence demonstrates that consumers indeed do benefit from decreases in access charges as a result of competitive pressures. The FCC and many state commissions have ordered access reductions in the past without mandating a flow-through or any specific method by which those reductions should pass through to consumers, not because they do not endorse consumer benefits but because they believe these market dynamics are adequate. For example, *see* FCC's CC Docket No. 96-262, 94-1, 91-213, 95-72, *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges* (First Report and Order rel. May 16, 1997). Moreover, evidence from the studies referenced above shows that consumers experience long distance price reduction even in the absence of such mandate.

REQUEST: Provide details about the rate of AT&T Communications' retail subscriber loss in Kentucky attributed directly to the Defendants' access rates for the most recent ten calendar years.

RESPONSE: AT&T Communications does not track retail subscriber losses by carriers. However, AT&T Communications is providing its aggregate decline in intrastate toll revenues for the part of the period requested for which data are available. For the five years from 2004 to 2008, AT&T Communications' Kentucky intrastate toll revenues declined nearly 54%, partly because it cannot compete effectively when burdened with high access charges its competitors are not under the same obligation to pay. The intrastate access charges assessed by Windstream and other local exchange carriers essentially are being imposed *only* on AT&T Communications and other interexchange carriers. Services such as mobile wireless voice, e-mail, instant messaging, VoIP services provided by cable operators, over the top VoIP services (like Vonage and Skype), Internet-based social network services (such as Twitter, MySpace, and Facebook), and communications that take place over the Internet itself all are not subject to the same high intercarrier compensation obligations that apply to circuit switched wireline interexchange carriers like AT&T Communications.

REQUEST: On November 5, 2008, the Federal Communications Commission ("FCC") released a Further Notice of Proposed Rulemaking in *In re: Developing a Unified Intercarrier Compensation,* CC Docket No. 01-92, *et al.,* that, among other things, proposed a reform of inter-carrier compensation including access charges on the intra-state level.

a. Did AT&T Communications provide any comments to the FCC in response to the petition?

b. If so, please provide copies of those comments.

c. Is anything proposed by the FCC contradictory to AT&T Communications' position in this proceeding before the Kentucky Commission?

RESPONSE:

a. AT&T Inc. filed comments to the FCC in response to the petition.

b. AT&T Inc. filed numerous comments and numerous *ex parte* communications in CC Docket No. 01-92. (*See* the FCC Electronic Comment Filing System ("ECFS") website: http://fjallfoss.fcc.gov//prod/ecfs/comsrch_v2.cgi). Attached is a copy of AT&T Inc.'s Comments and Reply Comments filed specifically in response to the FCC's November 5, 2008 Further Notice of Proposed Rulemaking.

c. No. AT&T Inc.'s proposal that Windstream's intrastate switched access charges should mirror the interstate rates is consistent with the FCC's proposal to adopt a unified inter-carrier compensation structure where carriers will charge the same rates regardless of jurisdiction or technology used to provide service.

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

In the Matter of

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

COMMENTS OF AT&T INC.

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November 26, 2008

INTRODUCTION AND SUMMARY

The Commission began its intercarrier compensation reform proceeding in 2001. Since then, AT&T has worked tirelessly with regulators and other industry members to identify issues and find agreement on how to address them. The Commission is now very close to adopting an order that takes definitive steps toward comprehensive reform of both intercarrier compensation and universal service.[1] The steps the Commission proposes will not fully resolve every issue that must eventually be addressed, nor will they completely satisfy every industry segment or interest group. But they are essential to fixing a regulatory status quo that almost everyone concedes is irrational and unsustainable. And they will provide a reasonable and balanced basis upon which the Commission, the industry, and state regulators can build.

In the seven years since the intercarrier compensation reform proceeding was launched, the telecommunications marketplace has changed almost beyond recognition, even as the archaic intercarrier compensation regime has remained essentially unchanged. Circuit-switched networks deployed primarily for voice service are rapidly yielding to optical IP packet-switched networks over which voice is just one of many applications. According to the National Cable Television Association, cable operators already provide VoIP service to over 16 million subscribers, and they offer such service to more than 100 million customers. Over-the-top VoIP providers serve millions of other customers, with Vonage alone serving over 2.6 million.

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1 As discussed below, AT&T supports the reform plan for intercarrier compensation and universal service distribution outlined in the draft order included in Appendix C to the November 5, 2008 Further Notice of Proposed Rulemaking, subject to several modifications. *See* Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *High-Cost Universal Service Support*, WC Docket No. 05-337 (and related proceedings), FCC No. 08-262 (rel. Nov. 5, 2008) ("*Further Notice*"). These comments refer to that draft order as the *Appendix C Draft Order* or simply as the *Draft Order*. For the reasons detailed in its November 21 *ex parte* letter, AT&T supports, with a few modifications, the contribution methodology provisions in the draft order set out in Appendix B to the *Further Notice* (*i.e.*, the "*Appendix B Draft Order*"). *See* Letter from Mary L. Henze, AT&T, to Marlene Dortch, FCC, WC Docket No. 06-122 and CC Docket Nos. 96-45 and 01-92 (filed Nov. 21, 2008) ("*AT&T Nov. 21 Ex Parte*").

Meanwhile, T-Mobile has deployed a service that permits its wireless subscribers to use their home Wi-Fi networks to make unlimited local and long-distance calls for $9.99 a month over broadband connections, while Sprint/Clearwire has begun to deploy a nationwide WiMax network. And both Verizon and AT&T are spending huge sums of money rolling out fiber-based broadband networks that will carry packetized voice communications, along with other services.

This technological revolution has placed the existing intercarrier compensation and universal service systems on a collision course. Access revenues are declining rapidly, as are the implicit subsidies still embedded in them. Carriers that rely on such subsidies to recover the costs of serving rural and other high-cost areas will therefore lose the support on which they and their customers depend. And the effects of this industry transformation are not limited to rural areas and the carriers that serve them. Under today's intercarrier compensation framework, designed for a pre-Internet and pre-competition era, identical functionalities are priced at dramatically different levels depending upon jurisdiction, technology, and regulatory status. Those regulatory disparities distort competition and investment while promoting arbitrage and sometimes outright fraud. These problems are well-known to the Commission, and they consume enormous resources as the Commission and the industry struggle, often unsuccessfully and always belatedly, to address them on a piecemeal basis.

The Commission must act now to overhaul its intercarrier compensation rules in order to ensure adequate funding of service in rural areas and to eliminate the arbitrage and competitive disparities that increasingly undermine the current system. With relatively minor modifications, the *Appendix C Draft Order* would take important steps toward these ends by establishing a unified terminating compensation regime, permitting increases in certain end-user charges and, in some cases, supplemental universal service support. The *Draft Order* would also begin to transform the universal service fund ("USF") into a mechanism for inducing carriers to make the network investments necessary to deploy broadband service to all Americans. This, too, will be a welcome and long-overdue change. American consumers are poorly served by today's universal service system because, among other deficiencies, it does little to support the network investment necessary to deploy broadband services in unserved areas, a key national objective codified in Section 706 of the 1996 Act. Revamping the federal USF mechanism to achieve that objective will help boost the American economy and its global competitiveness and will benefit all American consumers. Over the long term, many questions about the details of this mechanism will need to be answered, and much work will remain, but the Commission must begin taking the necessary steps to make universal broadband availability a reality.

It is no longer responsible to postpone reform in a quest for perfect consensus. No solution could make every party to this proceeding entirely happy. AT&T itself will lose very substantial support under the approach outlined in the *Appendix C Draft Order*. It will lose most of the USF support it now receives as a competitive eligible telecommunications carrier ("CETC"); and, as the largest incumbent local exchange carrier ("ILEC") in the United States, it will lose prodigious access revenues as well. While AT&T may recover some of those access revenue losses by raising its subscriber line charges ("SLCs"), competition will likely constrain AT&T's ability to recover all those losses through SLC increases, and AT&T does not expect to recover them through any additional universal service support. Moreover, although AT&T's long-distance and wireless operations will pay less to other carriers in the form of termination rates, they will not be able to retain those cost savings. Today's indisputably intense competition among providers of long-distance and wireless services will force them to pass through their access charge savings to consumers in the form of still lower retail rates and/or greater investment in service quality and innovation.

AT&T nonetheless supports the basic Appendix C framework because it will remove regulatory impediments to robust industry growth and enhanced consumer welfare and provide a more stable environment in which to achieve the Commission's universal service objectives. By reducing today's excessive termination rates, the framework will eliminate what amounts to a multi-billion-dollar tax on telecommunications usage and thereby increase consumer demand for communications services. By eliminating the many inefficient arbitrage opportunities that arise from today's grab-bag of termination rates, it will allow the market to function more efficiently. And by creating a sustainable basis for universal service support and taking the first critical steps toward promoting broadband deployment to underserved areas, it will benefit consumers in every part of the country. As discussed below, the *Appendix C Draft Order* needs to be refined in several important respects to fill gaps and avoid certain unintended regulatory consequences. But on the whole, it presents a historic opportunity to make the tough but necessary decisions required to adapt intercarrier compensation and universal service rules to today's realities. The Commission should seize that opportunity. Otherwise, this Commission's chief legacy may be inaction in the face of an impending regulatory death spiral.

* * *

AT&T applauds the two basic changes the Commission made to its proposed order in the weeks before the release of the *Further Notice:* the inclusion, in Appendix C, of (i) measures proposed by OPATSCO and WTA to protect rural rate-of-return carriers (*see Draft Order* ¶¶ 27, 30) and (ii) the five-year phase-down for CETC funding proposed by CTIA (*see id.* ¶ 52).

AT&T also agrees with the *Draft Order*'s approach to each of the two issues on which the Commission "seek[s] particular comment" (*Further Notice* ¶ 41). First, for the reasons explained in the *Draft Order,* the Commission should adopt the proposed "incremental cost" standard rather than TELRIC for call-termination purposes. That standard will move the industry in the right direction by compelling most carriers to look primarily to their end users for recovery of their network costs, rather than other carriers and *their* end users, as TELRIC permits. This methodological shift will thus make each carrier more accountable to its subscribers for any inefficiencies in its network and will let consumers, rather than intercarrier compensation rules, pick winners and losers in the marketplace. The Commission should likewise adopt the *Draft Order*'s decision to maintain a "single, statewide rate" for termination rather than "a single rate per operating company" (*Further Notice* ¶ 41). As the European experience has shown, experimentation with rates that vary by carrier or carrier type would produce inefficient, competitively biased cross-subsidies and regulatory uncertainty.

AT&T thus encourages the Commission to adopt the *Appendix C Draft Order* with several discrete modifications, including the following four. *First*, as CTIA and others have proposed, the Commission should shorten the proposed transition period over which the revised intercarrier compensation rules will take effect. The *Draft Order* would establish a three-step transition to take place in years 2, 4, and 10. That should be shortened to a transition that takes place over the course of five years, beginning in mid-2009 in concert with annual ILEC access filings. (Individual states should also be free to streamline the transition by using the two-step approach described below.) A ten-year transition is far too long, given the accelerating erosion of the POTS business model, on which today's implicit support relies.

Second, the Commission should resolve pending disputes about the treatment of IP/PSTN traffic during the transition to a unified termination rate. The *Draft Order* is right to classify VoIP as an "information service." It also correctly observes that, at the end of the transition period, IP/PSTN traffic will be assigned the same termination rate as any other traffic, so the current disputes about compensation for that traffic will become moot. But the *Draft Order* leaves unanswered basic questions about termination rates for IP/PSTN traffic *during* the transition. As AT&T has explained, such traffic is not exempt from the access charge regime under the current compensation rules, even though the service purchased by VoIP subscribers on the non-PSTN side of the call is an information service. All "interexchange" IP/PSTN traffic (as identified by the calling party's number or applicable factors) should thus be treated as access traffic during the transition. In particular, while that transition is in progress, the Commission should treat all terminating interexchange VoIP traffic as interstate access traffic for billing purposes and should subject it to the same phase-down as other interstate access traffic—first to the interim reciprocal compensation levels contemplated in Step 2 of the proposed transition, and then down to the uniform reciprocal compensation rates under the Commission's new methodology. Similarly, "local" IP/PSTN traffic should immediately be treated the same as local PSTN traffic for billing purposes and should be subject to the same transition rules as that traffic. The Commission can and should adopt these compensation rules without affecting any other rights VoIP providers or their CLEC partners may have and without imposing any additional obligations on them.

Third, the Commission should put an immediate stop to "traffic-pumping" schemes, which, at the expense of ordinary consumers, churn out windfall profits for unscrupulous LECs with grossly inflated access charges. Specifically, the Commission should conclude that it is per se unjust and unreasonable for any LEC to assess access charges for calls to end users with whom the LEC has entered into a "revenue sharing" arrangement—*i.e.*, an arrangement that will produce net payments from the LEC to the calling provider over the life of the arrangement. Indeed, the Commission should take that step no matter what other measures it implements for broader intercarrier compensation reform.

Fourth, the Commission should adopt the universal service contribution regime proposed in Appendix B to the *Further Notice* (with the modifications detailed in the *AT&T Nov. 21 Ex*

Parte and summarized in Section III.B below) rather than the regime proposed in Appendix C. The two proposals are very similar, in that each would assess contribution obligations on the basis of North American Numbering Plan ("NANP") numbers and business-line connections. The Appendix B approach, however, would extend the numbers-based contribution obligation to all NANP numbers, whether "business" or "residential," whereas the Appendix C approach would limit that obligation to "residential" numbers. This latter approach would be problematic because there is often and increasingly no workable distinction between "residential" and "business" telephone numbers, and the proposal would thus be nearly impossible to implement. The alternative approach proposed in Appendix B would not only avoid this basic concern, but also benefit ordinary consumers by enlarging the universe of numbers subject to a contribution obligation and thereby (all else held equal) reducing the fee assessed on any given number.

Finally, the Commission should reject Free Press's proposal (attached to the *Further Notice*) to impose new limitations on an ILEC's ability to raise its SLC to compensate for a loss of access revenues if it has long-distance or wireless affiliates that will pay reduced access charges under the new regime. To begin with, this so-called "fairness" proposal is in fact unfair. Wireless and long-distance competition, which is indisputably fierce, will force wireless and long-distance carriers to pass through the lion's share of their access charge savings to consumers through rate reductions, improved service quality, and/or investment in new broadband infrastructure. Thus, far from maintaining neutrality or "fairness," the Free Press proposal would substantially harm ILECs with long-distance affiliates, wireless affiliates, or both. In any event, it would make no economic sense to impose different rules on carriers offering the same services depending on their corporate relationships with other carriers offering other services. Free Press's proposal would merely give some companies artificial regulatory advantages over others and create perverse marginal incentives for corporate fragmentation.

ARGUMENT

These comments are divided into three major sections: Section I explains why the proposed reform of intercarrier compensation rules is fundamentally sound—and why Free Press's proposal to treat incumbent LECs with long-distance or wireless affiliates differently from other LECs is fundamentally *unsound*. Section II proposes several modifications to that reform plan. Finally, Section III addresses issues relating to universal service reform. These comments are not meant to be comprehensive. The *Draft Order* set forth in Appendix C is, in most critical respects, simply a variation on industry proposals that have been before the Commission for years, and AT&T has already filed voluminous comments on them. AT&T respectfully refers the Commission to its prior submissions in this docket to the extent these comments do not revisit issues that AT&T has previously discussed.[2]

I. THE INTERCARRIER COMPENSATION REFORMS SET FORTH IN APPENDIX C ARE NECESSARY AND FUNDAMENTALLY SOUND

A. The Commission Should Require Uniform Termination Rates Within Each State Based On Its Proposed Incremental Cost Standard

The *Further Notice* "seek[s] particular comment on two questions" (¶ 42): First, should the Commission adopt an "incremental cost" approach to termination rates, as the *Appendix C*

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2 *See, e.g.*, Ex Parte Brief of the Intercarrier Compensation Forum in Support of the Intercarrier Compensation and Universal Service Reform Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (filed Oct. 5, 2004) (attaching Ex. B, Summary of the ICF Plan); Reply Comments of AT&T Corp., *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (filed July 20, 2005) (supporting ICF Plan); Letter from NARUC Task Force on Intercarrier Compensation to Kevin Martin, Chairman, FCC, attaching Missoula Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (filed July 24, 2006) ("*Missoula Plan*"); Comments of the Supporters of the Missoula Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (filed Oct. 25. 2006); Reply Comments of AT&T Inc. on the Missoula Plan for Intercarrier Compensation Reform, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (filed Feb. 1, 2007) ("*AT&T Missoula Reply Comments*").

Draft Order proposes? Second, should each state establish a uniform terminating rate for all carriers on a statewide basis, as the *Draft Order* also proposes? In each case, the answer is yes.

1. The Commission Should Adopt The Proposed Incremental Cost Standard Rather Than TELRIC

For the reasons identified in the *Appendix C Draft Order*, the proposed "incremental cost" standard is far superior to TELRIC as a means of setting intercarrier compensation rates, both because it will dramatically reduce the competitive distortions that can arise from any regulatory rate-setting regime and because it will make each carrier more accountable to its own end users for the efficiency of its operations.

As an initial matter, this incremental cost standard is plainly lawful; indeed, it is more consistent than TELRIC with the governing statutory language. Section 252(d)(2)(A)(ii) provides that reciprocal compensation rates should reflect "a reasonable approximation of the *additional costs* of terminating" the calls at issue. (Emphasis added.) As the *Draft Order* explains (at ¶ 259), the term "additional costs" appears in only one other place in the Communications Act—in Section 224, which caps the price charged for attaching a device to a utility pole. And in that context the Commission has long construed this term to signify the same type of incremental cost methodology proposed here: "those costs which would not be incurred 'but for' the CATV pole attachment."[3] The Commission derived this standard in part from the underlying Senate Report, which states that "'additional costs' are generally equivalent to what is referred to as incremental cost[.]"[4] Because terms used in different parts of the same statute

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3 Notice of Proposed Rulemaking, *Adoption of Rules for the Regulation of Cable Television Pole Attachments*, 68 F.C.C. 2d 3, ¶ 23 (1978) ("*Pole Attachment NPRM*"); *see also* Memorandum Opinion and Second Report and Order, *Adoption of Rules for the Regulation of Cable Television Pole Attachments*, 72 F.C.C. 2d 59, 72 (1979).

4 *Pole Attachment NPRM*, 68 F.C.C. 2d at ¶ 14 n.1 (1978).

are ordinarily presumed to have the same meaning,[5] the term "additional costs" as it appears in Section 252(d)(2) should likewise be construed to mean "those costs which would not be incurred 'but for'" the termination of traffic.

As the *Draft Order* further explains, that standard and TELRIC prescribe very different approaches to cost recovery. TELRIC is a form of average-cost pricing. As applied to reciprocal compensation, it forces a sending carrier to contribute to the total costs, including joint and common costs, of shared facilities in a terminating carrier's network (tandem and end office switching and shared transport) in direct relation to the portion of shared capacity the sending carrier "uses" when it delivers calls to the terminating carrier.[6] In that respect, TELRIC does not differentiate between capacity consumed by a carrier's own customers and capacity consumed by interconnecting carriers. In contrast, the "incremental cost" standard proposed in the *Draft Order* begins by asking how much capacity a hypothetical ILEC would need to build into these shared facilities but for the need to perform the designated call-termination functions, and it makes sending carriers responsible only for the additional costs that this ILEC would incur once it takes those functions into account. That standard thus forces each terminating carrier to *look first to its own end users* for recovery of joint and common network costs.

As the Commission observes, "the incremental cost of call termination under the traditional economic definition should be significantly lower than that calculated under a

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5 The "normal rule of statutory construction" is that "identical words used in different parts of the same act are intended to have the same meaning." *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (quoting *Department of Revenue of Ore. v. ACF Industries, Inc.*, 510 U.S. 332, 342 (1994)).

6 *See Appendix C Draft Order* ¶ 245 (explaining that TELRIC "permit[s] average-cost pricing using a forward-looking cost methodology" in that, with some exceptions, "the Commission's TELRIC rules permitted the full forward-looking cost of the local switch, tandem switch, and shared interoffice transmission facilities, including a reasonable allocation of common costs, to be recovered through usage-based charges").

TELRIC methodology." *Appendix C Draft Order* ¶ 246. Indeed, "the incremental costs of terminating traffic, as determined using this methodology, are likely to be extremely close to zero." *Id.* ¶ 268. That is as it should be. By setting termination rates at low levels, the proposed standard will move the industry in the right direction by compelling most carriers to rely primarily on their own end users for recovery of their network costs rather than on other carriers and, ultimately, *their* end users. This methodological shift will reward efficient carriers and punish inefficient ones, forcing carriers either to reduce their costs to the prescribed compensation level or incorporate those costs in their own retail rates—which, unlike intercarrier compensation, are subject to competition. The proposed approach will thus make each carrier more accountable to consumers and will let consumers, rather than intercarrier compensation rules, pick winners and losers in the marketplace.[7]

The proposed approach also avoids the danger that termination rates set according to an average-cost methodology such as TELRIC will create perverse arbitrage opportunities, inefficient cross-subsidies, and other market distortions. Using TELRIC for reciprocal compensation purposes creates intractable problems of both rate *structure* and rate *level.* First, as to rate structure, TELRIC irrationally permits terminating carriers to recover their average network costs, many of which are non-traffic-sensitive, from other carriers through purely traffic-sensitive usage charges. The result is a mismatch between the way costs are incurred and the way they are recovered, with predictably inefficient consequences. In particular, the per-minute recovery of average costs under TELRIC gives each carrier artificial incentives to terminate as many minutes as possible, because by hypothesis the average network costs on which per-minute revenues are based always exceed the incremental costs to the carrier of using its network for each additional minute. Second, even apart from this problem of rate structure,

7 *See AT&T Missoula Reply Comments* at 3, 8-9.

no regulator, no matter how omniscient and dedicated, can be expected to set rates at levels that, even in the aggregate, perfectly reflect the underlying costs of shared network facilities.[8]

These inevitable distortions in both rate structure and rate level create not just destabilizing regulatory uncertainty, but also a range of wasteful arbitrage schemes, as carriers hunt down and exploit the implicit subsidies included in inflated termination rates. The classic example of this problem was the ISP reciprocal compensation controversy that the Commission ultimately resolved by adopting termination rates far below the levels prescribed in TELRIC proceedings. That approach eliminated any risk of inefficient cross-subsidies for ISP-serving CLECs. But it fixed the problem of implicit cross-subsidies only with respect to this single type of traffic. And if the D.C. Circuit rejects the Commission's most recent legal justification for this fix, massive arbitrage is likely to resume unless the Commission adopts a new cost methodology for all traffic subject to Section 251(b)(5).

To be sure, determining the "incremental cost" of terminating traffic will itself be an inexact science. But an incremental cost approach will correct TELRIC's inherent rate-structure problem by confining traffic-sensitive intercarrier compensation to the recovery of truly traffic-sensitive costs—namely, the incremental costs a carrier actually incurs when it terminates each additional minute of traffic. Moreover, by dramatically lowering the total amount of intercarrier compensation, and by requiring carriers to look mostly to their own end users for network cost-recovery, the Commission will greatly reduce the practical significance of regulatory errors and will all but eliminate the risk that such errors could create incentives for arbitrageurs to specialize in terminating traffic solely to extract excessive termination rates from other carriers.

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8 Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151, 9185-86 ¶ 76 (2001) ("*ISP Remand Order*"), *remanded on other grounds*, *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

If all intercarrier compensation rates had been based on incremental cost from the beginning, no one would have had artificial regulatory incentives to specialize in terminating traffic to ISPs in the 1990s, nor would carriers have artificial incentives, as they do today, to pump up incoming traffic volumes to inefficiently high levels by hosting free chat lines, teleconferencing services, and the like.[9]

Finally, the Commission should clarify a minor methodological point raised by footnote 708 of the *Appendix C Draft Order*. That footnote observes that "the incremental cost of terminating traffic may include certain non-traffic-sensitive costs, such as the cost of a trunk port," and it suggests that ILECs should recover such costs from interconnecting carriers through flat-rated charges outside the scope of Section 251(b)(5) rather than through per-minute charges within the scope of that provision. We agree, with the following caveat. The costs of "trunk ports" on the *interconnection* side of a tandem switch or end office switch should be recovered outside the scope of Section 251(b)(5). As footnote 708 suggests, when these trunk ports are associated with interconnection trunk groups dedicated to individual interconnecting carriers, these trunk ports should be recovered through flat-rated mechanisms. Conversely, when these trunk ports are associated with interconnection trunk groups associated with another carrier's transit tandem service, these trunk ports are shared by multiple carriers and should be recovered through usage-based mechanisms. In addition, the separate trunk ports that connect a carrier's tandem switch to its end office switches via shared transport facilities on the terminating carrier's network are also used to handle traffic sent by multiple carriers. The costs of these components are rightly considered traffic-sensitive in this context because increased traffic volumes

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9 *See, e.g., Appendix C Draft Order* ¶¶ 173-76 & n.467, ¶ 180, ¶ 234; *ISP Remand Order*, 16 FCC Rcd at 9184-86 ¶¶ 73-76; Comments of AT&T Inc., *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, at 12 (filed Dec. 17, 2007) ("*AT&T Traffic-Pumping Comments*").

associated with terminating traffic during the busy hour may require a carrier to install additional trunks and trunk ports to support multiple carriers' traffic. These costs, like the incremental costs of any other shared resource involved in transport and termination, should thus be subject to reciprocal compensation rates.

2. The Commission Should Mandate A Single Statewide Rate Rather Than Rates That Differ From Carrier To Carrier

The Commission should adopt the *Appendix C Draft Order*'s proposal to mandate a "single, statewide rate" rather than "a single rate per operating company" (*Further Notice* ¶ 41). As the Commission notes, U.S. regulators typically have imposed a uniform local termination rate on all carriers operating within a given geographic region. *Appendix C Draft Order* ¶ 275. When European regulators adopted rates that varied from carrier to carrier, the result was "distortions among markets," "higher retail rates for customers," and "reduce[d] consumer welfare." *Id.* ¶¶ 275-76. That is reason enough to adhere to the consistent American practice of ensuring rate uniformity for all carriers within a given geographic area—and to extend that practice to all traffic, not just traffic that has always been exchanged pursuant to Section 251(b)(5).

Even apart from that experience, there are compelling reasons to ensure uniform rates for all carriers within a state. First, the Commission has rightly proposed to base its cost methodology on the incremental costs of soft-switches, and the unit costs of soft-switches do not vary from carrier to carrier.[10] Proposals to vary termination charges from carrier to carrier may thus lack any empirical foundation in modern technology.

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[10] Letter from Henry Hultquist, AT&T, to Marlene H. Dortch, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 07-135 (filed Oct. 14, 2008); Letter from Henry Hultquist, AT&T, to Marlene H. Dortch, FCC, CC Docket Nos. 96-45, 99-68, 01-92 and WC Docket Nos. 05-337, 07-135 (filed Oct. 28, 2008).

Just as important, there is no competitively neutral way to assign different forward-looking incremental costs to different carriers. Under the Commission's approach since 1996, forward-looking costs are the costs incurred by an objectively efficient carrier.[11] Thus, a carrier claiming that its forward-looking costs are greater than an ILEC's is arguing not only that its chosen network architecture is inherently costlier than the ILEC's, but also that its network architecture is, in some highly subjective sense, *worth the extra cost.* In other words, one carrier's network could be said to have "higher" forward-looking costs than the ILEC's network only to the extent that consumers might value any additional functionality it offers that the ILEC's network does not.[12] In a free market, however, any determination of *what* consumers value and *how much* they value it should be left to consumers themselves. Shifting that inherently subjective inquiry to the regulatory process would add a chaotic new dimension to the regulatory uncertainty that has beset intercarrier compensation disputes since 1996.

More generally, allowing two carriers to charge each other asymmetric rates for call termination when they exchange traffic would force some carriers (and their consumers) to cross-subsidize other carriers (and their consumers) in competitively skewed ways that are essentially invisible to the consuming public. Indeed, European regulators originally adopted asymmetric termination rates precisely *because* they wished to create non-neutral subsidies for

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11 *See, e.g., Appendix C Draft Order* ¶ 267 (any forward-looking incremental cost study "must use the least cost, most efficient network technology"); *see also* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15848-49 ¶ 685 (1996) ("*Local Competition Order*") (adopting, as part of TELRIC, "a forward-looking economic cost methodology based on the most efficient technology," taking locations of existing wire centers as given).

12 *See generally* Arbitration Order, *Petition of Sprint Spectrum L.P. d/b/a Sprint PCS, Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Intercarrier Agreement with Verizon New York Inc.*, Case 01-C-0767, slip op., 2002 WL 31505732 (N.Y. P.S.C. 2002).

one group of carriers (wireless providers) at the expense of others (wireline providers).[13] Any proposal to adopt a similar scheme in this country would fly in the face of modern American telecommunications policy, which recognizes that implicit cross-subsidies—particularly those designed to give one group of competitors an artificial advantage over others—are anathema to efficient competitive entry.[14] Nor could the Commission mitigate these concerns by permitting disparate carrier-specific rates but imposing a "symmetry" rule that would require any two carriers with different rates to default to the higher rate when they exchange traffic with each other. Any such approach would produce the same types of arbitrage opportunities (such as traffic pumping or routing traffic through other carriers for reasons other than network efficiency) that have distorted the telecommunications marketplace under the existing regime.[15]

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13 *See, e.g.*, Press Release, *Lower charges, greater consistency, more competition: Commission consults on bringing down mobile phone tariffs in Europe*, IP/08/1016 (June 26, 2008); Commission of the European Communities, *Draft Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU*, at 2-3 (2008). As noted, European regulators have recognized that these policies led to unexpected consumer harms. *See Appendix C Draft Order* ¶ 275 (asymmetric rates favoring mobile telephony discouraged efficiency to reduce costs and led to "higher retail rates for customers and lower usage of [mobile] technology").

14 *See, e.g.*, *Local Competition Order*, 11 FCC Rcd at 15506-07 ¶ 5 (such subsidies deter and distort competition by placing some carriers at an artificial competitive disadvantage); Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685, 4702 ¶ 33 (2005) ("*2005 Intercarrier Compensation FNPRM*") ("[A]ny new intercarrier compensation approach must be competitively and technologically neutral. Given the rapid changes in telecommunications technology, it is imperative that new rules accommodate continuing change in the marketplace and do not distort the opportunity for carriers using different and novel technologies to compete for customers.").

15 An example illustrates the problem. Suppose that LEC 1 and LEC 2 have different termination rates: one has a rate of $0.0007, and the other a rate of $0.05. When these two carriers exchange traffic with each other, the symmetry rule would require them to default to the higher rate: each would charge the other $0.05. But LEC 2 could try to avoid paying that higher rate to LEC 1 by, for example, routing traffic to LEC 1's customers through a CLEC or other intermediary that had the same low termination rate as LEC 1 and that agreed with LEC 2 to present the traffic to LEC 1 as its own. In that scenario, LEC 1 would bill only $0.0007 from the intermediary for traffic originated by LEC 2, even though it would pay the higher termination rate for all traffic bound for LEC 2.

The only way to establish a stable long-term solution for the industry—and to avoid playing regulatory whack-a-mole as each new arbitrage opportunity arises—is to ensure a uniform termination rate for *all traffic for all carriers* within each state.

Finally, as a legal matter, nothing in the statutory language entitles any given carrier to recover its "own" incremental costs of termination if, under some proposed analysis, those costs might be higher than the forward-looking incremental costs of an efficient ILEC. In 1996, although the Commission authorized state commissions to recognize narrow exceptions to the symmetry rule, the Commission indicated that nothing in the statute requires such exceptions and that the statutory language, if anything, points in the opposite direction:

> [U]sing the incumbent LEC's forward-looking costs for transport and termination of traffic as a proxy for the costs incurred by interconnecting carriers satisfies the requirement of section 252(d)(2) that costs be determined "on the basis of a reasonable approximation of the additional costs of terminating such calls." Using the incumbent LEC's cost studies as proxies for reciprocal compensation is consistent with section 252(d)(2)(B)(ii), *which prohibits "establishing with particularity the additional costs of transporting or terminating calls."*[16]

Section 252(d)(2)(B)(ii) further prohibits the Commission or any state commission from "requir[ing] carriers to maintain records with respect to the additional costs of such calls." That clause, too, indicates that Congress wished to avoid carrier-specific calculations of "additional costs." More generally, Section 252(d)(2)(A)(i) provides only for "mutual and reciprocal recovery by each carrier *of costs* associated with . . . transport and termination." (Emphasis added.) If Congress had meant to provide for carrier-specific calculations of termination costs, it would have entitled each carrier to the recovery of "its" costs, not simply to the recovery of "costs" in the abstract.

Indeed, any contrary interpretation would be not just wrong, but at odds with the favored construction of this provision offered by the CLEC community since the 1990s. As the

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16 *Local Competition Order*, 11 FCC Rcd at 16040 ¶ 1085 (emphasis added).

Commission noted in the *Local Competition Order*, "[m]any state commissions and potential new entrants contend that symmetrical rates should be based on the incumbent LEC's costs."[17] That contention was correct then, and it remains correct today.

B. The Commission Should Reject Free Press's Proposal To Penalize ILECs With Long-Distance Or Wireless Affiliates

In an *ex parte* letter attached to the *Further Notice*, Free Press encourages the Commission to impose new limitations on an ILEC's ability to raise its SLC to compensate for a loss of access revenues if it has "long-distance and wireless" affiliates that enjoy a cost savings from comprehensive access charge reform. Free Press claims that this proposal "is based upon the principle of fairness." *Further Notice*, Appx. D, at 8. But the proposal would be neither fair nor economically sensible.

The principal flaw in Free Press's proposal is that it assumes that any wireless or long-distance company will "keep" the cost savings attributable to access charge reductions and use them to increase its profits. That is incorrect. Long distance and wireless are among the most fiercely competitive services in this industry. Under elementary principles of economics, companies offering those services will thus be forced to pass through much, if not all, of their intercarrier compensation savings to consumers, whether in the form of lower retail rates, accelerated investment in improved service quality, and/or wider deployment of innovative technology used to provide, for example, next-generation broadband services.[18] As a result, Free Press's proposal to bar an ILEC from raising its SLCs because of the passed-through "savings" of its affiliates would leave the ILEC and its affiliates *much worse off* in the aggregate than

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17 *Id.* at 16035 ¶ 1076.

18 *See, e.g.*, Richard N. Clarke & Thomas J. Makarewicz, *Economic Benefits from Missoula Plan Reform of Intercarrier Compensation*, at 18-19 (Feb. 1, 2007), attached as Exhibit 1 to *AT&T Missoula Reply Comments* (explaining why access charge reductions will be passed on to customers).

before the transition, and also much worse off than stand-alone companies competing in the same markets.

Free Press and similar groups express skepticism about the otherwise uncontroversial economic principle that industry-wide cost savings are passed through to consumers in any highly competitive market, and Free Press might thus argue for some new regulatory mechanism to determine the precise extent of any pass-through. But there could be no such mechanism unless, at a minimum, the Commission is prepared to inspect the books of each affected wireless and long-distance company. That is the hallmark of rate-of-return regulation, and the Commission could not rationally conclude, after years of deregulated pricing that has spawned record-low rates, that these markets are now in need of rate regulation. Moreover, a carrier's cost reductions can be "passed on" to consumers in a variety of ways that are not readily susceptible to quantification, such as improved service quality or innovative new services.[19] Any proposal for a pass-through mechanism would therefore require the Commission to substitute its own judgments in place of market forces to decide exactly how carriers should use the cost savings from intercarrier compensation reforms to balance the diverse and complex needs of consumers. And it would have to exercise such unprecedented and intrusive scrutiny in exceptionally competitive markets that were deregulated many years ago. That would be a fool's errand.

Moreover, quite apart from this pass-through consideration, it would make no sense to subject ILECs to differing regulatory treatment depending on their corporate relationships with

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19 *See* Twelfth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993: Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, 23 FCC Rcd 2241, 2297 ¶ 124 (2008) ("Service providers in the mobile telecommunications market also compete on many more dimensions other than price, including non-price characteristics such as coverage, call quality, data speeds, and mobile data content.").

non-dominant wireless and long-distance affiliates. To the contrary, such an approach could create perverse incentives for ILECs to structure their operations so as to avoid Free Press's "affiliate penalty." That makes no sense. Consumer welfare is maximized when ILECs structure their operations in the most efficient manner possible.[20] Free Press would discourage efficiency, to the detriment of consumers, by imposing competitive burdens on ILECs and wireless carriers that elect to consolidate and by conferring competitive benefits on companies that choose to splinter into unrelated ILEC and wireless (or long-distance) entities.

Finally, even apart from the conceptual arbitrariness of imposing different SLC caps on different ILECs depending on their affiliations with other wireless or long-distance companies, Free Press's proposal would raise thorny implementation problems in practice. ILECs provide wireless and long-distance services through a variety of corporate structures and business arrangements. For example, Qwest resells other carriers' wireless services to its wireline customers, while Verizon owns only a 55% share of its wireless affiliate. If Qwest derives a benefit, even indirectly, from lower access charges paid by wireless carriers, would that benefit offset its access revenue reductions under the Free Press proposal? If not, why not? Would Verizon be penalized to the full extent of its affiliate's "savings" in access charges or simply in an amount equal to 55% of those "savings?" Would Verizon still be penalized if it owned only 25%? 10%? 1%? Would its penalty fluctuate with every decision to increase or decrease its investment in its affiliate? If so, what possible economic justification could there be for that?

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20 *See, e.g.*, Memorandum Opinion and Order, *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent to Transfer Control of Licenses and Authorizations*, 19 FCC Rcd 21522, 21599-611 ¶¶ 201-36 (2004) (discussing potential public-interest benefits from merger of AT&T with Cingular); *see generally* R.H. Coase, THE FIRM, THE MARKET, AND THE LAW (Univ. of Chicago Press 1990); Oliver E. Williamson, THE MECHANICS OF GOVERNANCE (Oxford Univ. Press 1996).

Free Press offers no answers to these questions, and there are none. In sum, its proposal is arbitrary and economically irrational and should be rejected.

II. THE COMMISSION SHOULD MODIFY ITS PROPOSED INTERCARRIER COMPENSATION RULES IN SEVERAL RESPECTS

The proposed intercarrier compensation reforms set forth in Appendix C are fundamentally sound and are a credit to the expertise and thoroughness of the Commission's Staff. AT&T nonetheless proposes the following modifications to make the *Draft Order* stronger still, to fill in some important gaps in the rules governing the transition to the new regime, and to foreclose certain anomalies that could arise if the current draft were adopted as written.

A. The Commission Should Adopt A Five-Year Transition Timetable

The *Appendix C Draft Order* establishes a three-stage transition that would consume ten years and thus would not conclude until 2019. In the first stage, which would conclude two years after the order's effective date, carriers would incrementally lower their terminating switched intrastate access charges to interstate levels (to the extent they are higher); in the second stage, which would conclude in year four, carriers would incrementally reduce all of their terminating rates to a uniform transitional rate set by the states (again, to the extent they are higher); and finally, in the third stage, carriers would spend the ensuing six years lowering all their termination rates to low, "incremental cost" levels, as set by the states. *See Appendix C Draft Order* ¶¶ 188-92.

This ten-year transition period is an eternity by the standards of the modern telecommunications marketplace, and reform would proceed at too glacial a pace to avoid substantial industry dislocations, particularly given the accelerating erosion of the POTS business model. Like competitive bypass more generally, VoIP substitution is robust and accelerating; indeed, as discussed below, VoIP providers are projected to claim more than 45 million subscribers by the end of 2011 alone. These competitive pressures are rapidly siphoning off the per-minute revenues that support low-cost telephone service to millions of American consumers. The fault lies not with VoIP substitution, but with the antiquated regulatory regime that is collapsing under the weight of market forces, and that regime must be replaced sooner rather than later. Moreover, in the absence of prompt reform, arbitrage schemes will only multiply and intensify—as carriers seek both to *avoid paying* the subsidy-laden compensation that supports universal service today (through, for example, phantom traffic or fraudulently disguised traffic) and to *receive* more in the way of inflated compensation (through, for example, traffic-pumping schemes, to the extent the Commission does not otherwise prohibit them). The result in each case would be yet further destabilization of the industry.

In short, neither the industry nor consumers can wait until 2019 for a complete transition to a rational and sustainable regime. AT&T thus proposes to compress the three phases of the transition period, such that the first phase would end in July 2010 (and would occur in two steps, with the first step occurring in July 2009, in concert with annual ILEC access filings), the second phase would end in July 2012, and the third would conclude in July 2014. Moreover, given the limited resources of state commissions, individual states should be free to skip the second phase and proceed immediately to setting the final incremental-cost-based rate applicable to all carriers. If a state chooses this option, it would complete its rate proceeding in year three. The state would then establish a glide-path toward that final rate, which would end no later than in year five. Finally, even if the Commission chooses a ten-year transition, it should clarify that individual states may skip the second phase and establish the final incremental cost rate in year three (with the ensuing glide-path not to exceed seven years).

B. The Commission Should Clarify Its Regulatory Treatment Of IP/PSTN Traffic

1. The Commission Should Classify All VoIP Services As "Information Services" But Preclude Any Suggestion That They Are Therefore Subject to the Computer Inquiry Rules

The Commission should adopt the *Appendix C Draft Order*'s conclusion that all fixed or nomadic VoIP services capable of interconnection with the PSTN are "information services" and are thus exempt from "traditional 'telephone company' regulations" (¶ 206). That finding will resolve the many disputes about this issue that have proliferated in regulatory and judicial proceedings throughout the country. Indeed, because certainty on this issue is so important, the Commission should adopt that finding whether or not it adopts the remainder of the *Draft Order*.

This finding is also plainly correct on the merits. As the *Draft Order* recognizes, traffic that originates on an IP network and terminates on a circuit-switched network (or vice versa) is subject to net protocol conversion, either through software and hardware at the customer premises or through "gateways" that transform a circuit-switched voice signal into IP packets (or IP packets into a circuit-switched voice signal).[21] And the Commission has long concluded that a conversion that "enables an end-user to send information into a network in one protocol and have it exit the network in a different protocol clearly 'transforms' user information" so as to render the service an information service.[22]

In addressing this issue, moreover, the Commission should go one step further. As the *Draft Order* recognizes (at ¶ 204 n.520), protocol conversion is but one basis for characterizing a service as an information service. The 1996 Act defines "information services" as those that

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21 *Appendix C Draft Order* ¶ 204 n.520.

22 First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, 11 FCC Rcd 21905, 21956 ¶ 104 (1996) ("*Non-Accounting Safeguards Order*").

offer the "capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."[23] Following that definition, the Commission rightly classified the VoIP service at issue in the *Pulver Declaratory Ruling* as an information service because it offered various "computing" capabilities, even though the Commission made no findings about whether that service (which did not itself have a "telecommunications" component) generally involved protocol conversion.[24]

The Commission should now conclude that *all* VoIP services are information services as a categorical matter. As AT&T and many other parties have explained,[25] these services increasingly include Internet-enhanced features such as integration with instant messaging, sophisticated "talking" email in place of traditional voicemail, call- and contact-management features, and the ability to access online applications during any call. A VoIP service is not simply another means of providing traditional circuit-switched voice service, but an entirely new service made possible only "through use of an advanced IP communications network."[26] Clarifying that such services are information services *whether or not* they involve "protocol

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23 47 U.S.C. § 153(20). Likewise, the Commission's traditional definition of "enhanced services"—which the agency deemed synonymous with "information services" in the *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21955-56 ¶ 102—includes not only a service that acts on the protocol of the subscriber's submitted information, but any service that "provide[s] the subscriber additional, different, or restructured information; or involve[s] subscriber interaction with stored information," 47 C.F.R. § 64.702(a).

24 Memorandum Opinion and Order, *Petition for Declaratory Ruling that Pulver.com's Free World Dialup Is Neither Telecommunications Nor a Telecommunications Service*, 19 FCC Rcd 3307, 3313-14 ¶ 11-12 (2004).

25 *See, e.g., Appendix C Draft Order* ¶ 205 n.525 (citing materials).

26 Comments of the Voice on the Net (VON) Coalition, *IP-Enabled Services*, WC Docket No. 04-36, at 4 (filed May 28, 2004); *accord Appendix C Draft Order* ¶ 205 ("IP/PSTN services are not mere changes to the underlying technology used for 'existing' basic services, but are entirely new services with characteristics in many ways distinct from pre-existing telephone services.").

conversion" will help eliminate any lingering uncertainty about the regulatory status of future IP applications as they arise.

Significantly, classifying all VoIP services as "information services" should have no impact on the interconnection rules applicable to VoIP services. Section 251(a) entitles all telecommunications carriers to interconnect with other telecommunications carriers, regardless of the traffic they exchange. And that entitlement extends to carriers, such as CLECs, that serve VoIP providers.[27] To be sure, some VoIP providers and their CLEC partners may need to adjust their relationships to ensure that the entity interconnecting with the PSTN qualifies as a CLEC providing *telecommunications services*. But as long as it is the CLEC that seeks such interconnection, the ILEC's interconnection obligations and any additional obligations under Section 251(b) will apply to the same extent as they do today with respect to any other interconnecting carrier.

Finally, the Commission should confirm that classifying VoIP services as information services does not somehow subject those services to the *Computer Inquiry* rules. Those rules (among other things) required any common carrier to "unbundle" each of its information services—that is, to strip out the underlying telecommunications component, tariff it, and offer it for sale on a common carrier basis to other would-be providers of information services.[28] The Commission adopted these rules in the pre-Internet era of the 1980s, when, with few exceptions, incumbent telephone companies owned the only transmission facilities over which information

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

28 *See* Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd 14853, 14867-71 ¶¶ 23-28 (2005) ("*Wireline Broadband Order*") (summarizing rules), *aff'd*, *Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

services could be run. Today, because information services and their underlying telecommunications components are subject to vigorous competition, and because regulation would thus do more harm than good, the Commission has eliminated the application of the *Computer Inquiry* rules for a wide range of services, including all broadband Internet access services and many enterprise broadband services.[29]

Given this backdrop, it would be nonsensical to begin applying these monopoly-era rules to VoIP services, which are even more phenomenally competitive than the information services the Commission has already exempted from those rules. As noted, cable operators already *provide* VoIP service to more than 16 million subscribers, and they *offer* such service to more than 100 million customers.[30] Over-the-top VoIP providers such as Vonage, Skype, and Packet8 serve many millions of additional customers—indeed, Vonage alone serves 2.6 million.[31] All of these providers won this business without once relying on the *Computer Inquiry* rules. In short, there can be no credible argument for applying those rules to VoIP services for the first time, whether such services are offered over the public Internet (as Vonage and other over-the-top services are) or over IP-based transmission paths (as the VoIP services of cable companies and some telcos are). To avoid any prospect for regulatory confusion, however, the Commission

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29 *Wireline Broadband Order*, 20 FCC Rcd at 14875-77 ¶¶ 41-42; Memorandum Opinion and Order, *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, 22 FCC Rcd 18705, 18733-35 ¶¶ 53-58 (2007).

30 *See* NCTA Broadband Deployment Statistics, *available at* http://www.ncta.com/Statistic/Statistic/Statistics.aspx (noting that, as of March 2008, there were more than 16.5 million cable voice/phone customers); United States Department of Justice, *Voice, Video and Broadband: The Changing Competitive Landscape and Its Impact on Consumers*, at i, 33 (Nov. 2008), *available at* http://www.usdoj.gov/atr/public/reports/239284.pdf ("Cable companies today offer telephone services to more than 100 million U.S. households (or over 80 percent of households)").

31 Vonage Holdings Corp., Form 10-Q, at 13 (Nov. 10, 2008).

should confirm the inapplicability of those rules to VoIP at the same time it declares VoIP an "information service."

2. The Commission Should Adopt Transitional Compensation Rules For The Exchange Of IP/PSTN Traffic

Under the *Appendix C Draft Order*, all IP-PSTN traffic will eventually be subject to uniform reciprocal compensation rates at the conclusion of the multi-year transition. But the *Draft Order* proposes to "maintain the status quo for this traffic during the transition" (¶ 213 n.555)—which, if not compressed (as it should be), could last as long as ten years. That approach is untenable, because there is no agreed-upon "status quo" to "maintain."

As the Commission knows, providers have disagreed for many years about whether and when VoIP traffic—which LECs terminate over the PSTN in exactly the same way they terminate all other traffic—should be subject to access charges under existing rules. Even worse, some CLECs that serve VoIP providers try to game the system by imposing access charges on the PSTN/IP traffic they *terminate* to their VoIP provider customers while insisting that they should pay only reciprocal compensation charges on the IP-to-PSTN traffic that *originates* from their VoIP providers. The result of this confusion is a spate of resource-consuming arbitration and litigation in many forums, divergent state-commission decisions,[32] and at least three different regulatory proceedings now pending before the Commission, including two forbearance matters.[33]

32 *See* Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers *Regarding Access Charges and the "ESP Exemption*," WC Docket No. 08-152, at 19 (filed July 23, 2008) ("*AT&T Declaratory Ruling Petition*") (describing Arkansas and Wisconsin decisions).

33 *Petition of the Embarq Local Operating Companies for Limited Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Rule 69.5(a), 47 U.S.C. § 251(b), and Commission Orders on the ESP Exemption*, WC Docket No. 08-8 (filed Jan. 11, 2008); *Petition of Feature Group IP for Forbearance Pursuant to 47 U.S.C. § 160(c) from Enforcement of 47 U.S.C. § 251(g), Rule 51.70(a)(1), and Rule 69.5(b)*, WC Docket No. 07-256 (filed Oct. 23, 2007).

These problems can only multiply as IP-based services continue their explosive growth trend. As AT&T has previously explained, the number of VoIP subscribers served by just three of the leading cable voice providers grew by more than *80 percent* in 2007, from 4.9 million subscribers at the end of 2006 to approximately 8.9 million subscribers at the end of 2007, and IDC estimates that the number of *total* VoIP subscribers will expand from the 16 million that were served in 2007 to *more than 45 million* by the end of 2011.[34] As this traffic expands, vastly increasing amounts of IP-originated traffic will be terminated on the PSTN and vice-versa. The financial consequences for the affected carriers could not be starker. In the absence of Commission guidance, carriers would have no choice but to engage in whatever self-help the law permits, subject, as always, to litigation and regulatory uncertainty.

In short, maintaining the status quo for even another year would destabilize the entire industry. And the consequences would be even more severe if these issues remain unresolved for longer, as would likely be the case if the Commission were to pass now on the opportunity to act. The Commission should therefore adopt a clear transitional regime for IP/PSTN traffic, just as it has for ISP-bound traffic, and thereby ensure that adoption of the *Draft Order* will create immediate certainty for *all* traffic and *all* players throughout the industry. Indeed, as AT&T has proposed in a pending petition for declaratory ruling, the Commission should adopt rules for IP/PSTN traffic even *apart* from what it does for other traffic, given the rapid industry transition to VoIP.[35]

If the Commission adopts the Appendix C framework, it should immediately impose the following transitional rules for IP/PSTN traffic:

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34 *See AT&T Declaratory Ruling Petition* at 21 (citing various sources, including IDC reports).

35 *See generally id.*

- *All* "interexchange" IP/PSTN traffic (including both interstate and intrastate interexchange traffic) should be subject to interstate access charges.[36]

- All "local" IP/PSTN traffic should be subject to reciprocal compensation.

- Once the states set the interim reciprocal compensation levels, all IP/PSTN traffic will be subject either to those interim rates or to the existing rates (whichever are lower), and such traffic will ultimately transition to the state uniform reciprocal compensation rate along with all other traffic.

This framework generally accords with the compromise approach proposed in AT&T's petition for interim declaratory ruling on VoIP access charges.[37]

As AT&T demonstrated there and in other filings,[38] this framework is fully consistent with all applicable law, and the Commission's proposed finding that any VoIP service is an "information service" would not alter that conclusion. In a nutshell, access charges properly apply today to interexchange traffic that is delivered to the PSTN, regardless of its classification,

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[36] Given the nomadic characteristics of certain VoIP services, as well as the non-geographic assignment of telephone numbers by some VoIP providers, call-detail records (*e.g.*, calling and called party numbers) may not be a perfect mechanism for determining whether a particular call is "interexchange" for intercarrier compensation purposes. *See 2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4696-97 ¶ 22. Existing LEC tariffs and interconnection agreements already address this issue, however, because they contain certain mechanisms, which have been approved by state commissions and/or this Commission, to rate traffic for intercarrier compensation purposes where call-detail records are incomplete or inaccurate (for example, through factors such as percent interstate use (PIU) and percent local use (PLU)). *See AT&T Declaratory Ruling Petition* at 33-35. These types of mechanisms could be used to identify "intrastate" interexchange IP/PSTN traffic separately from all other intrastate interexchange traffic in order to apply interstate access charges to such IP/PSTN traffic during the transition.

[37] *Id.* In that petition, AT&T advocated a slightly different result: a ruling that the application of intrastate access charges to IP/PSTN traffic does not conflict with federal policy if such charges are set at or below interstate access charge levels.

[38] *See, e.g.*, AT&T Comments, *Level Three Communications, LLC, Petition for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of 47 U.S.C. § 251(g), Rule 51.701(b)(1), and Rule 69.5*, WC Docket No. 03-266 (filed Mar. 1, 2004); Comments of AT&T Corp., *IP-Enabled Services*, WC Docket No. 04-36 (May 28, 2004); AT&T Comments, *Feature Group IP Petition for Forbearance Pursuant to 47 U.S.C. §160(c) from Enforcement of 47 U.S.C. §251(g),Rule 51.701(b)(1), and Rule 69.5.5(b)*, WC Docket No. 07-256, and *Embarq Local Operating Companies Petition for Limited Forbearance Under 47 U.S.C. §160(c) from Enforcement of Rule 69.5(a), 47 U.S.C. § 251(b), and Commission Orders on the ESP Exemption*, WC Docket No. 08-8 (Filed Feb. 19, 2008).

and there is no merit to arguments that the "ESP exemption" somehow prescribes a different outcome. That exemption was adopted to enable enhanced service providers to purchase local business lines out of state tariffs in order to communicate *with their own customers.* It was never intended to exempt any entity from paying access charges to an ILEC for terminating a call to the *ILEC's* customers on the PSTN in exactly the same way the ILEC terminates calls delivered by conventional circuit-switched interexchange carriers.[39] That conclusion is particularly compelling where the entity delivering the IP traffic to the ILEC is not itself acting as an information services provider purchasing local business lines for its own use, but as a wholesale provider of *telecommunications services* (such as a CLEC that partners with a VoIP provider) and is delivering traffic to the ILEC over a local interconnection facility.[40] Those carriers have been guaranteed interconnection rights under Section 251 precisely because they are "telecommunications carriers," not information service providers. It is irrelevant that the traffic these CLECs deliver is an information service from the perspective of the VoIP subscriber that originates the call; as the Bureau has found, those CLECs' status is unaffected by the "statutory classification of a third-party provider's VoIP services."[41]

In sum, interexchange VoIP calls terminated on the PSTN are access calls and should be treated as such during the transition to a unified termination rate. Specifically, they should be

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39 First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd 15982, 16132-33 ¶ 343 (1997) ("*Access Charge Reform Order*") (explaining that the ESPs for whom the exemption was devised "use incumbent LEC networks to receive calls from their customers") (emphasis added), *pets. for rev. denied*, *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998).

40 *See* Memorandum Opinion and Order, *Northwestern Bell Telephone Company Petition for Declaratory Ruling*, 2 FCC Rcd 5986, 5988 ¶ 21 (1987) (ESPs purchasing transmission services from carriers to be used as inputs into the ESPs' services do "not thereby create an access charge exemption for those carriers"), *vacated on other grounds*, 7 FCC Rcd 5644 (1992).

41 *Time Warner Order*, 22 FCC Rcd. at 3520-21 ¶ 15.

treated as *interstate* access traffic as opposed to some combination of interstate and intrastate traffic. In many states, intrastate access charges have not been subject to the same reform as their interstate counterparts and remain replete with implicit subsidies. Moreover, since the Commission's transition plan already will rapidly move intrastate rates to interstate levels as well, it makes sense to move IP/PSTN traffic directly to interstate levels, which would immediately reduce arbitrage opportunities for this important class of traffic. Until interstate and intrastate rates are unified, carriers could use factors to identify the percentage of their intrastate interexchange traffic that should be subject to the IP/PSTN intercarrier compensation rules (*see* note 36, *supra*). And this interim plan would not necessarily require any change to carriers' interconnection facilities for VoIP traffic: CLECs could continue to use interconnection trunks to terminate their IP/PSTN traffic (or vice versa), even though the traffic would be subject to interstate access rates.[42]

Finally, at a bare minimum, the Commission should prohibit providers from insisting on asymmetrical compensation schemes for IP/PSTN traffic, under which they would *pay* reciprocal compensation rates for interexchange IP/PSTN traffic they originate but *receive* access charges for interexchange PSTN/IP traffic they terminate. In particular, the Commission should make clear that providers can charge no more for terminating a PSTN-to-IP call than they agree to *pay* when they originate an IP-to-PSTN call that is rated similarly. The Commission should declare

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[42] At the same time, the Commission should ensure that IP/PSTN traffic that is currently rated as "local" traffic—which is true of a large degree of "fixed VoIP" traffic provided by cable companies—is not subjected to a sudden increase from local reciprocal compensation rates to access rates. As the Commission has found, it may subject any traffic within its jurisdiction to the state arbitration framework under Sections 251(b)(5) and 252(d)(2). Doing so here will ensure that IP/PSTN traffic, like all other traffic subject to the new regime outlined by the *Draft Order*, will not be subject to rate *increases* as a result of the new transitional plan. *See, e.g.*, *Appendix C Draft Order* ¶ 187-92 & n.492 (explaining that carriers whose rates are below the interim rates may not increase their rates).

that the alternative "heads I win, tails you lose" approach some CLECs advocate is an unjust and unreasonable practice that violates Section 201 of the Act.[43]

C. The Commission Should Put An Immediate End To Traffic-Pumping Schemes

Another intercarrier compensation problem that requires a prompt and comprehensive solution is the recent proliferation of "traffic-pumping" schemes. The carriers involved in such schemes are unscrupulous ILECs and CLECs in mostly rural areas whose access charges were set at very high levels on the assumption that traffic volumes in those areas would be low and the carriers' average costs would therefore be high. In the typical scheme, a LEC artificially inflates the volume of its access traffic by establishing revenue-sharing arrangements with, for example, chat-line and conference-call companies that locate their facilities in its serving area. In turn, these companies typically give away their services for free in order to maximize the access minutes they generate and thus the resulting access revenues they share with the LEC. This flood of access calls defeats the low-traffic-volume assumption underlying the LEC's high access charges, and it thus supplies the LEC with windfall profits in the form of radically above-cost intercarrier compensation. These windfall profits are financed by AT&T and other interexchange carriers—and ultimately by the customers of those carriers. The net result is a massive wealth transfer from ordinary Americans to these arbitrageurs.

Both the number and the magnitude of traffic-pumping schemes have mushroomed over the past two years. Lawsuits, investigations, and case-by-case tariff suspensions have been inadequate to remedy the problem. The traffic-pumping arbitrageurs have adapted quite nimbly to regulatory intervention; as the Commission shuts down one scheme, others pop up in different places or between different entities. It is particularly difficult to combat schemes operated by

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43 *See AT&T Declaratory Ruling Petition* at 7.

CLECs, which account for more than 75% of the traffic-pumping minutes billed to AT&T, in part because the access charges of CLECs are less closely regulated than those of ILECs.[44] In addition, perpetrators of traffic-pumping schemes can easily start new CLECs to replace those whose activities the government has halted. And because CLEC rates are set out in tariffs filed on a streamlined basis, CLECs engaged in traffic pumping argue that, even after their conduct and rates have been found unlawful, they should be shielded from paying refunds by the "deemed lawful" status of their tariffs under Section 204(a)(3).[45]

As AT&T has explained,[46] the Commission can effectively resolve the traffic-pumping problem only through preemptive measures that target the perverse economic incentives that give rise to such schemes. At a minimum, the Commission should adopt the joint proposal filed by the Rural Independent Competitive Alliance and AT&T on November 25th, 2008. The proposal outlines general rules to address the problem of traffic pumping, including the following proposed declaratory ruling governing revenue sharing:

> It shall be an unjust and unreasonable practice for any LEC to assess terminating interstate switched access charges on traffic that is subject to a revenue sharing arrangement. A "revenue sharing arrangement" is any arrangement between a LEC and a calling provider whereby (i) the LEC compensates a calling provider to direct calls to or through a LEC's local exchange and (ii) the arrangement can be expected over its term to produce net payments from the LEC to the calling provider. "Calling provider" means any entity, including any affiliate of a LEC, that promotes or advertises to end users telecommunications services or information services and that provides or uses a LEC's telephone numbers for such services to be routed to or through a LEC's local exchange.[47]

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44 *See AT&T Traffic-Pumping Comments* at 3, 11-12; Letter from Brian Benison, AT&T, to Marlene H. Dortch, FCC, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, at 3-4 (Apr. 25, 2008).

45 *See AT&T Traffic-Pumping Comments* at 8-10 (discussing arguments).

46 *See, e.g., id.* at 2-3.

47 *See* Letter from Brian Benison, AT&T, and Steve Kraskin, RICA, to Marlene Dortch, FCC, *Developing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135 and CC Docket No. 01-92, Attachment at 2 (filed Nov. 25, 2008).

Indeed, the Commission already has tentatively concluded that the sharing of access revenue is an unjust and unreasonable practice for rate-of-return carriers,[48] and it should adopt that ruling for all carriers no matter what other steps it takes in pursuit of broader intercarrier compensation reform.

D. The Commission Should Confirm That The "Mirroring Rule" Does Not Apply To Access Traffic

Under the "mirroring rule" established in 2001 and affirmed in the *Draft Order*, an ILEC may avail itself of the $0.0007 termination rate for ISP-bound traffic "only if it offers to exchange all traffic subject to Section 251(b)(5) at the same rate." *Appendix C Draft Order* ¶ 193; *see id.* ¶ 198. In 2001, the Commission defined the "traffic subject to Section 251(b)(5)" for purposes of this mirroring rule to exclude an ILEC's access traffic.[49] The *Draft Order* now concludes—properly, in AT&T's view—that Section 251(b)(5) "is broad enough to cover access traffic" as well as the "local" traffic to which the Section 251(b)(5) rules were traditionally confined.[50] The scope of Section 251(b)(5) is subject to Section 251(g), which "preserve[s] the pre-1996 Act regulatory regime that applies to access traffic" until the Commission affirmatively acts to bring such traffic within the scope of Section 251(b). *Appendix C Draft Order* ¶ 215.

The *Draft Order* indicates in one passage that preservation of the mirroring rule is intended solely to foreclose increases to "reciprocal compensation rates for traffic currently subject to the mirroring rule." *Appendix C Draft Order* ¶ 198. To avoid ambiguity, the Commission should confirm that, during the transition, ILECs need not flash-cut all of their

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48 Notice of Proposed Rulemaking, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, 22 FCC Rcd 17989, 17997 ¶ 19 (2007).

49 *ISP Remand Order*, 16 FCC Rcd at 9193-94 ¶¶ 89-90.

50 *Appendix C Draft Order* ¶¶ 221-22 (access traffic); *id.* ¶¶ 212-15 (not limited to local traffic).

access charges to $0.0007 in order to take advantage of that rate for ISP-bound traffic. By concluding that the Commission will exercise its authority under Section 251(g) to bring access traffic within the scope of Section 251(b)(5), the *Draft Order*, as currently written, might be misconstrued as extending the mirroring rule—which covers "all traffic subject to Section 251(b)(5)"—to apply to such traffic as well. Of course, if the mirroring rule *were* extended to access traffic, ILECs either would confront an immediate loss of billions of dollars in access revenues or would be forced to abandon reliance on the $0.0007 rate that has governed ISP-bound traffic for many years. Neither result would make sense, and presumably neither is intended. The Commission should obviate any destabilizing regulatory uncertainty on this point by making clear that it wishes merely to preserve the regulatory status quo, not to take the additional radical step of extending the mirroring rule to access traffic.

E. The Commission Should Modify Its Proposed "Measures To Ensure Proper Billing"

As AT&T has previously explained, phantom traffic—traffic for which a carrier cannot accurately bill—is endemic to today's intercarrier compensation regime because (among other considerations) artificial disparities in termination rates give each originating carrier incentives to game the system by disguising the nature of its traffic.[51] Phantom traffic will be less of a problem once a uniform termination rate is in place, but it will remain a problem during much of the transition and to some extent thereafter. By requiring the transmission of specified signaling information to the terminating carrier, the *Draft Order* takes a number of the steps needed to fix the problem.

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[51] *See, e.g.*, Reply Comments of the Supporters of the Missoula Plan on Their Phantom Traffic Proposal, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at 1-4 (Jan. 5, 2007); *Missoula Plan*, Section V, at 56.

The *Draft Order* appropriately adopts signaling requirements that accord with standard industry practice concerning call-signaling content. Consistent with this approach, the Commission has recognized that carriers must be free to depart from the call-signaling content rules in certain limited circumstances.[52] And the Missoula Plan identified several specific situations in which "standard industry practice" involves a departure from the typical content guidelines.[53] The Commission should clarify that its understanding of the "limited exception[s] . . . needed . . . where industry standards permit" includes those laid out in the Missoula Plan—and not just the lone example offered by Verizon and cited in the *Draft Order*.[54] For example, literally construed, the *Draft Order* would entitle a terminating carrier to bill calls at the highest terminating rate whenever it lacks some of the required signaling information.[55] But it would be unfair to apply that rule to calls originated abroad, since carriers have no control over call-signaling content for such calls. In sum, the Commission should incorporate the discussion in the Missoula Plan in order to avoid disputes about the reach of "standard industry practice."

To avoid creating a new set of regulatory anomalies in the context of "transit" traffic, the Commission should also modify the related rules the *Draft Order* proposes for carriers' financial responsibility.[56] Specifically, the Commission should make clear that terminating carriers may not elect, on a call-by-call basis, which carrier to charge for the costs of termination; if they charge transit providers for *some* calls, they must charge them for *all* calls.

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52 *Appendix C Draft Order* ¶¶ 326-31.

53 *Missoula Plan*, Section V.B, at 57.

54 *Appendix C Draft Order* ¶ 331.

55 *Id.* ¶ 322.

56 In a transit arrangement, an intermediate local provider (the transit carrier) routes calls that it receives from another carrier (an originating or interexchange carrier) through its network and delivers those calls to the terminating carrier serving the called party.

There are two plausible ways to structure intercarrier compensation in the transit context. First, the Commission could adopt the compensation structure now used in the access context when two carriers cooperate to terminate an access call—*e.g.*, when an ILEC switches and transports a call received from an interexchange carrier to a point on the network of a terminating LEC. In that context, the ILEC and the terminating LEC independently collect their respective shares of the compensation *directly from the interexchange carrier*. Second, the Commission could adopt the different compensation structure sometimes used today for "local" traffic. Under that structure, the terminating carrier recovers its costs from the transit provider, and the transit provider in turn collects the full price of its service (which includes the call-termination functions performed by the terminating carrier as a wholesale input) from the carrier that hired it to deliver calls to the terminating carrier.

AT&T does not object to the adoption of the latter compensation structure as a default rule for all traffic so long as the Commission removes any vestige of the *other* compensation structure, under which the terminating carrier may sometimes recover directly from the carrier responsible for payment (the carrier delivering the call to the transit provider). In other words, if the Commission permits a terminating carrier to recover from a transit provider (which in turn recovers from the carriers that deliver traffic to it), the Commission should make clear that the terminating carrier must *always* recover from the transit provider for *all calls* (unless the parties reach a different, negotiated agreement). The Commission should also make clear that the terminating carrier may not vary that compensation structure on a call-by-call basis, charging the ultimately responsible carrier directly for some calls and the transit carrier for other calls, such as those that lack the signaling information the terminating carrier needs for direct billing of the carrier with ultimate financial responsibility.

Any such hybrid, call-by-call scheme would be wasteful and ultimately unworkable. If an intermediate carrier is to offer transit services at all, it must have the same freedom as any common carrier to sell a well-defined service on clear terms to any willing purchaser. The purchaser (*i.e.*, the originating or interexchange carrier) must have certainty about what it is buying and from whom. And the transit provider must have certainty about what charges it is collecting and what charges it is paying for any wholesale inputs (such as the call-termination function provided by the called party's LEC). The Commission would destroy any prospect of such certainty, dramatically increase administrative costs, and ultimately undermine transit arrangements if it suggested that terminating carriers may sometimes be entitled to demand payment from originating or interexchange carriers and sometimes from transit providers.

The Commission should thus amend the language in paragraphs 333 through 337 of the *Appendix C Draft Order* to make clear that, as a default rule, termination charges for all transit traffic will be paid by transit providers, who, in turn, will recover their various costs from the carriers delivering the traffic to them. Transit carriers could set their rates to cover not only the transit function itself, but also the costs (plus a reasonable profit) of their billing and collection services and the various termination charges applicable to the traffic they carry. This arrangement would eliminate the substantial administrative burdens and disputes associated with indirect interconnection arrangements today. For example, carriers choosing indirect interconnection no longer would be required to engage in the expensive and time-consuming process of negotiating and managing a multitude of traffic-termination agreements with terminating carriers.

Under AT&T's proposal, this transit traffic compensation structure would be implemented in two steps. First, within twelve months of the effective date of the order, transit providers would implement it for all non-access traffic, including ISP-bound traffic.[57] For all other traffic, the structure would be implemented in the fifth year of AT&T's proposed five-year transition, when all terminating compensation charges are unified.

F. The Commission Should Clarify An Ambiguity In Its Discussion Of Constraints On Federal SLC Increases

In paragraph 294 of the *Appendix C Draft Order*, the Commission proposes that an ILEC recover its net loss in intrastate access revenues by looking first to its state retail rates and any intrastate SLCs. Under this approach, an ILEC could not increase its federal SLC up to the relevant caps to recover its intrastate access revenue shift unless and until it first increases its intrastate retail rates or intrastate SLC to the extent permitted under state law. Once it has done so, any remaining loss could be recovered in any remaining permitted federal SLC increase.

If the Commission adopts this proposal, it should clarify (or, to the extent necessary, modify) it in certain important respects to avoid unintended anomalies in application. In its current form, the *Draft Order* does not make clear how an ILEC's increase in state-level retail rates, on the one hand, and restrictions on its ability to increase the federal SLC, on the other hand, correlate with each other across customers or groups of customers. The current language thus could be construed in such a way as to seriously distort competition and require some groups of customers to bear a disproportionate share of the burden of rebalancing state rates, just as the Commission takes decisive steps to rationalize universal service across the board.

The following examples illustrate the ambiguity:

Example 1:

- Assume $2 in average intrastate access revenue loss per line
- Assume that the ILEC's residential rates in the state are fully constrained

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57 During the transition to unification of terminating rates, all traffic currently subject to the jointly provided access records exchange process would remain subject to that process.

- Assume that business rates are fully deregulated
- Assume that business lines make up 20% of the lines in the state

Would the ILEC be required to raise the rates for every business customer line by $10 (in order to produce the equivalent of a $2 increase for every line) in lieu of recovering its intrastate access shift from federal SLC increases—thereby forcing business customers to bear the entire burden of the access shift?

Example 2:

- Assume $2 in average intrastate access revenue loss per line
- Assume that the rates for 50% of the residential consumers in the state are fully constrained
- Assume that the rates for the remaining 50% of consumers are unconstrained to a degree and would allow a price hike of up to $4

Would the ILEC have to raise the rates for the second group of consumers by $4 (rather than looking to the federal SLC after a $2 increase)—forcing one group of consumers to bear the entire burden of the access shift and subsidize all the consumers in the state?

In both cases, the outcome could be inefficient and unfair: one group of customers could be asked to bear the entire intrastate access shift and to subsidize other customers that are shielded from that burden. The Commission accordingly should clarify that resort to the federal SLC increase is available with respect to any lines for which the ILEC has no intrastate pricing flexibility, without regard to potential increases that might be applied to lines with *unconstrained* pricing flexibility;[58] increases on the rates for the latter lines are required only to make up for the average access revenue loss per line on *those* lines.

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[58] In some cases, a state may have provided pricing flexibility for a specific purpose (*e.g.*, to compensate for a reduction in the state's universal service funding mechanism outside the *Draft Order*'s framework). If an ILEC in such a state increases its rates in an exercise of that targeted

The Commission also should clarify a point that is now implicit in the relevant language in the *Draft Order*—that under the rule, the maximum required increase in intrastate rates per line would be the lesser of the average intrastate access revenue loss per line and the difference between the existing interstate SLC and the new SLC cap. Plainly, by limiting the amount by which the federal SLC must rise before an ILEC is entitled to federal USF support to offset lost intrastate access revenues, the Commission has sought to limit increases to end-user prices, pending resolution of the items it referred to the separations joint board. Consistent with that view, the Commission likewise should limit the amount by which intrastate rates must increase before an ILEC may look to the federal SLC to offset lost intrastate access revenues.

III. UNIVERSAL SERVICE

A. The Commission Should Adopt A Forward-Looking High-Cost Fund That Supports Deployment Of Broadband Facilities

As Congress recognized in 1996, rational, predictable, and appropriately targeted universal service funding is critical to supporting the public telecommunications network and to ensuring that all Americans share in the technological innovations that are changing the face of the communications industry. The *Draft Order* adopts several key reforms that will help advance these goals and eliminate some of the problems that have plagued the universal service system for years. As discussed below, it caps the fund and eliminates duplicate CETCs, thereby ensuring that the fund is "specific and predictable" and capable of supporting the high-quality network and affordable rates Congress envisioned.[59] And it re-focuses the high-cost fund to encourage the deployment of the network infrastructure necessary for the provision of broadband

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pricing flexibility, that rate increase should *not* be counted toward recovering the intrastate access loss resulting from the Commission's reform of intercarrier compensation.

59 47 U.S.C. §§ 254(b)(5), (1); *see also* Comments of AT&T, Inc., *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45, at 23-24, 40 (filed Apr. 17, 2008) ("*AT&T USF NPRMs Comments*").

Internet access services, thus putting in place a framework that can help to improve "[a]ccess to advanced telecommunications and information services" in many high-cost areas.[60]

As a preliminary matter, the *Appendix C Draft Order* would halt the rapid growth of the high-cost fund. The identical support rule and the proliferation of CETCs have dramatically expanded the fund and have diverted universal service funding from one of its core purposes: ensuring that all Americans have access to rapid, efficient communications service at reasonable charges.[61] Indeed, as the Tenth Circuit recognized and the *Draft Order* reiterates here, "excessive subsidization" is ultimately financed by end users and may impair "the affordability of telecommunications services, thus violating the principle in [Section] 254(b)(1)."[62] The *Draft Order* addresses this concern by capping the total amount of high-cost support (except for rural rate-of-return carriers) and eliminating support for CETCs. AT&T further supports the *Draft Order*'s recognition that CETC support should be phased out gradually, rather than on a flash-cut basis.[63] As AT&T has previously explained, this gradual approach will best achieve Congress's mandate for *predictable* universal service support.[64] AT&T therefore urges the Commission to adopt the five-year transition to the elimination of CETC funding that was proposed in the CTIA

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60 47 U.S.C. § 254(b)(2). As discussed below, the *Draft Order* conditions existing high-cost funding on broadband deployment but is silent on whether and how the Commission would target support for broadband deployment in high-cost and rural areas served by "non-rural" carriers that do not currently receive high-cost support (due to the Commission's flawed high-cost model mechanism). Consequently, adopting the *Draft Order*'s broadband-related high-cost provisions is just the first of several steps that the Commission would have to take to ensure ubiquitous broadband Internet access service throughout America.

61 47 U.S.C. § 151.

62 *Appendix C Draft Order* ¶ 15 (citing *Qwest Commc'ns Int'l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005) ("*Qwest II*")).

63 *See Appendix C Draft Order* ¶ 52.

64 47 U.S.C. § 254(b)(5); *see AT&T USF NPRMs Comments* at 23-24, 40.

October 22, 2008 *ex parte*, attached in Appendix D and incorporated into the *Appendix C Draft Order*.

As the *Draft Order* notes, elimination of current CETC support—much of which has supported the provision of wireless services—leaves open the question of what mechanism may best encourage deployment and maintenance of the facilities necessary for the provision of advanced mobile services in high-cost and rural areas.[65] As explained in AT&T's April 17, 2008 Comments on the USF NPRMs, the Commission should transition legacy CETC funding (as it is eliminated over the five-year phase-down) to a new Advanced Mobility Fund designed to support mobile wireless broadband deployment in unserved areas.[66] Under this approach, providers of mobile wireless broadband Internet access would apply for funding to support the provision, maintenance, and upgrade of facilities for the provision of advanced mobile services to Commission-identified unserved areas. Initially, all legacy CETC funding transitioned to the new mechanism would be earmarked to support advanced mobile service projects in the state where support previously was provided. When consumers in all areas of that state have access to such services, support would be released to fund the provision, maintenance, and upgrade of facilities that provide advanced mobile services in the unserved areas of other states. AT&T's proposal offers the Commission a clear and administratively simple roadmap for transitioning and targeting legacy CETC funding to areas that currently lack advanced mobile services.

Moreover, AT&T supports the Commission's efforts to reform existing high-cost support mechanisms to encourage and support the universal deployment of facilities necessary to provide *wireline* broadband Internet access services. As AT&T has previously noted, that reform is necessary to ensure that all Americans, including those in high-cost areas, share the benefits of

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65 *Appendix C Draft Order* ¶ 339.

66 *AT&T USF NPRMs Comments* at 3, 5, 40-41.

high-speed Internet access and related services, as Congress envisioned in Sections 254 and 706.[67] In its April 17 USF Comments, AT&T also recommended that the Commission implement this new approach by adopting a competitive application process, under which interested fixed-location broadband Internet access service providers would apply to provide broadband and voice services to Commission-identified unserved areas. In its *Appendix C Draft Order*, the Commission instead proposed a variation on this proposal: a reverse-auction approach under which each ILEC must declare whether it will offer broadband Internet access service at a minimum speed (in addition to the services included in the existing universal service definition) throughout its study area. Under the Commission's proposal, if an ILEC is unwilling or unable to make this commitment, the Commission will conduct a reverse auction to see if any other provider is willing to replace the existing ILEC as the carrier of last resort (COLR) *and* commit to provide broadband Internet access service throughout the existing ILEC's study area with universal service support capped at the amount currently provided to the existing ILEC. The winning bidder must assume all of the losing ILEC's COLR obligations and commit to offer broadband service throughout the ILEC's study area within ten years.[68]

If the Commission adopts this proposal, it must ensure that any ILEC that loses its federal high-cost support through a reverse auction is relieved of its state-imposed COLR obligations.[69] No other approach makes sense, since the ILEC will no longer be receiving the critical federal support it needs to provide universal service in the relevant areas. The Commission proposes to

67 *See generally AT&T USF NPRMs Comments*; Comments of AT&T Inc., *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45 (filed May 31, 2007).

68 *Appendix C Draft Order* ¶¶ 4, 12.

69 *See AT&T USF NPRMs Comments* at 34-35; Reply Comments of AT&T, Inc., *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45, at 18 (filed June 2, 2008) ("*AT&T USF NPRMs Reply Comments*").

address this issue by requiring winning bidders to assume "all of the [COLR] obligations of the incumbent LEC for [the ILEC's] study area, whether such obligations are imposed on the LEC pursuant to state or federal law."[70] But the Commission is silent about *how* it proposes to ensure that such state-law obligations will shift to winning bidders and (more importantly) how incumbents will be relieved of those obligations. Accordingly, to remove any uncertainty about this aspect of the Commission's proposal, the Commission should be explicit about how it will accomplish this transfer of state-imposed requirements.

Finally, the Commission should address how its *Appendix C Draft Order* relates to the issues raised by the Tenth Circuit in its *Qwest II* decision and quickly issue a separate order resolving any such issues that may remain following adoption of the *Draft Order*. Auctioning high-cost support may well be an effective means to spur broadband network deployment in those ten states where so-called "non-rural" carriers receive high-cost model support, but it does nothing to address the inadequate—or nonexistent—high-cost funding provided to non-rural carriers to serve rural and other high-cost areas in most states. Indeed, if the Commission takes no action on the Tenth Circuit's remand but caps the high-cost fund and limits high-cost dollars to those states where carriers receive them today (as proposed by the *Draft Order*), it will only perpetuate the flaws of the non-rural carrier funding mechanism and undermine the ability of non-rural carriers to offer broadband service in their high-cost and unserved areas. AT&T urges the Commission to act promptly on this remand, which has been pending at the Commission for over three and a half years.

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70 *Appendix C Draft Order* ¶ 39.

B. The Contribution Methodology In The *Appendix B Draft Order* Should Be Adopted With Certain Modifications

With just a few modifications, the contribution methodology proposed in the *Appendix B Draft Order* will provide long-overdue stability to the universal service fund, clarity to consumers, and certainty to providers, the Commission, and the Universal Service Administrative Company ("USAC"). Under this proposal, the Commission would assess contributors based on all of their NANP telephone numbers—residential and business telephone numbers alike—and their interstate dedicated business connections. In an *ex parte* letter filed on November 21, 2008, AT&T detailed a few improvements that the Commission should make to this proposal.[71] Specifically, AT&T recommended that the Commission modify the capacity/assessment tiers for the business connection assessment, adopt AT&T's and Verizon's proposed definition of "Assessable Number," modify the implementation period, and apply the new methodology to certain other fees. AT&T also explained that if the Commission decides that any special treatment is warranted with respect to how certain classes of end users (*e.g.*, public universities) are assessed USF fees, such special treatment should be implemented differently from the special treatment afforded to certain types of *services* (*e.g.*, Lifeline service). And AT&T also explained why the proposal contained in Appendices A and C to the *Further Notice* would be nearly impossible for contributors to implement and for the Commission and USAC to audit—which is why the proposal in the *Appendix B Draft Order* is preferable with respect to contribution methodology. We summarize all these points below.

First, the Commission should amend the capacity/assessment tiers in the *Appendix B Draft Order*. Although AT&T recognizes that the *Appendix B Draft Order* proposes tiers that

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71 *See AT&T Nov. 21 Ex Parte.*

were originally suggested by AT&T and Verizon,[72] the revised tiers set forth in AT&T's filing from October 28, 2008 are more appropriate.[73] The original tier proposal could cause certain customers, particularly small-business customers, to pay considerably more in USF fees than they do today. In addition, the revised tiers should minimize the possibility that the USF fee associated with a particular connection would distort the market by giving customers incentives to purchase different services simply because of the differences in regulatory fees.

Second, AT&T urges the Commission to adopt AT&T's and Verizon's proposed definition of "Assessable Number" and reject the proposed definition contained in the draft orders. AT&T and Verizon proposed a clear and simple definition of Assessable Number: "An Assessable Number is a North American Numbering Plan (NANP) telephone number that enables a Final Consumer to make or receive calls."[74] By contrast, the definition proposed in the drafts is confusing; it introduces—without explanation—new concepts and terminology not previously used by Congress or by the Commission; and it is unnecessarily overbroad. In particular, although the Commission's draft orders would treat "functional equivalent identifiers" such as IP addresses as "Assessable Numbers," they do not explain how such a proposal could

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72 *Appendix B Draft Order* ¶ 81 (an assessable connection up to 64 kbps will be assessed $5/month; an assessable connection over 64 kbps will be assessed $35/month).

73 *See id.* ¶ 3. The revised tiers are as follows: interstate dedicated business connections with capacity up to and including 25 mbps should be assessed $2/month; connections that are over 25 mbps and up to and including 100 mbps should be assessed $15/month; and connections over 100 mbps should be assessed $250/month.

74 Letter from Mary L. Henze, AT&T, and Kathleen Grillo, Verizon, to Marlene Dortch, FCC, *Universal Service Contribution Methodology*, WC Docket No. 06-122; *Federal State Joint Board on Universal Service*, CC Docket No. 96-45, Attachment at 1 (filed October 20, 2008). AT&T and Verizon obviously agree that for purposes of this definition, only NANP telephone numbers used in the United States and its territories and possessions should be included. *See, e.g., Appendix B Draft Order* ¶ 63 n.162.

practically be implemented.[75] Instead of creating confusion by including functionally equivalent identifiers in the definition of "Assessable Number" now, the Commission should seek further comment on whether and how to define an "identifier" that is functionally equivalent to a NANP telephone number.

Third, the Commission should give contributors one full year—not a mere six months, as the current drafts propose—in which to modify their billing systems to implement a numbers- and connections-based contribution methodology. Indeed, AT&T and Verizon have requested one year to make such changes and an additional six months *beyond* the twelve-month implementation period during which providers would report numbers while continuing to contribute based on revenues.[76] While AT&T would like to move to a numbers- and connections-based methodology as quickly as possible, it will have to make significant and complex modifications to its numerous billing systems in order to begin tracking telephone numbers and connections. Unfortunately, such fundamental changes cannot be implemented overnight and will require at least a full year to be implemented properly.

Fourth, the Commission should reconsider its proposed decision to maintain a revenues-based contribution methodology for the Telecommunications Relay Services ("TRS"), local number portability, and NANP funds. Requiring contributors to maintain dual contribution methodologies (numbers and connections for USF; revenues for the other funds) would serve no policy goal, and the Commission has identified none. Moreover, that approach would unnecessarily complicate providers' compliance efforts. Indeed, perpetuating the revenues-

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75 *See AT&T Nov. 21 Ex Parte* at 4 (explaining how broadband Internet access service providers (not application providers) typically assign consumers dynamic, not static, IP addresses for a given session and how the application provider (*e.g.*, Skype) thus has no control over the assignment of its customers' IP addresses and would seemingly have no ability to assess them).

76 *Id.* at 6.

based assessment for these funds would contradict the Commission's previous determination that using the same funding basis and reporting worksheet for all of these funds (USF included) "would reduce confusion and minimize the amount of information we need to collect from contributors."[77]

Fifth, should the Commission determine that exceptions to its contribution methodology are warranted based on the class or identity of certain customers (versus the type of service, such as Lifeline service), it should implement such exceptions in a manner that ensures the targeted customers will actually realize the intended benefit. For example, a rule requiring carriers to distinguish a public university or a non-profit hospital from other business customers would be costly to implement and prone to error. Indeed, because carriers have no means to make that distinction today, it could add months to the amount of time required by a provider to implement the new methodology. In their October 20 *ex parte* letter, AT&T and Verizon recommended that the Commission instead adopt a Billed Entity Applicant Reimbursement (BEAR) process similar to the approach used in the E-Rate program for years. Under this proposal, end users that are entitled to discounts or special treatment because of their status (*e.g.*, public universities) are billed and pay in full but then obtain reimbursement directly from USAC for whatever discount the Commission has approved. By self-identifying, the users that the Commission designates for special treatment can ensure that they receive the discounts to which they are entitled.[78]

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77 Report and Order, *1998 Biennial Regulatory Review—Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Services, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, CC Docket No. 98-171, FCC 99-175, 1999 WL 492955, ¶ 65 (rel. Jul. 14, 1999) ("[U]sing the same [] basis for all four funds furthers the deregulatory, burden-reducing objectives that we seek to achieve by creating a unified contributor collection worksheet").

78 *AT&T Nov. 21 Ex Parte* at 8-9 (also suggesting that the Commission request further comment on which class(es) of end users should be granted discounts or exemptions from USF fees and how any such exception should be implemented).

Sixth, in the *AT&T Nov. 21 Ex Parte*, AT&T urged the Commission to reject the proposal—set forth in Appendices A and C to the *Further Notice*—to require contributors to distinguish residential from business telephone numbers. This arbitrary and increasingly obsolete distinction would risk creating an uneven playing field among competitors. Different providers are likely to undertake very different levels of oversight with respect to this distinction, which would create a new opportunity for unscrupulous competitors to game the system. More generally, any distinction between residential and business telephone numbers would not reflect current marketplace realities, and it would be difficult and expensive for contributors to implement and for the Commission and USAC to audit. The proposed business/residential split would thus negate one of the principal benefits of moving away from a revenues-based contribution methodology: a clear, transparent process free of difficult decisions about what should be included in the assessable base.[79]

Finally, the Commission should address one more source of regulatory uncertainty. In the Commission's discussion classifying "IP/PSTN" services as information services, the *Appendix C Draft Order* notes that while it is preempting any state efforts to impose traditional "telephone company" regulations as they relate to IP/PSTN information services, "states are free to require contributions to state universal service or telecommunications relay service funds through methodologies that are consistent with federal policy."[80] As the Commission is aware, it preempted Minnesota's state universal service statute, among other state statutes, in its *Vonage*

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[79] *Id.* at 9-11.

[80] *Appendix C Draft Order* ¶ 206 & n.527 (*citing* Letter from Robert W. Quinn, Jr., AT&T, to Chairman Kevin J. Martin, FCC, *IP-Enabled Services*, WC Docket Nos. 04-36, 06-122 and CC Docket No. 96-45, at 11-16 (filed July 23, 2008)).

Order.[81] AT&T supports the limited reversal of the *Vonage Order* as it relates to universal service and TRS contributions but requests that the Commission make that reversal explicit to avoid continued confusion on the issue. Recently, for example, a federal magistrate judge rejected arguments by a state commission that the Commission's amicus briefs on this subject could supersede the broad and controlling text of the *Vonage Order* itself.[82] To remove any doubt, AT&T recommends that the Commission expressly reverse the state USF/TRS contribution portion of the *Vonage Order* in the contribution methodology section of its order in this proceeding.

C. The Commission Should Modify The *Draft Order*'s Lifeline Broadband Pilot Proposal To Increase Participation In The Pilot

In the *Draft Order,* the Commission proposes a three-year Broadband Lifeline/Link Up Pilot Program (pilot program) to examine how its low-income support mechanisms could be used to expand access to broadband Internet access services for low-income Americans.[83] Specifically, the Commission proposes to make available $300 million per year for each of the next three years to enable ETCs to provide discounted broadband Internet access services and access devices (such as a laptop or desktop computer, or a handheld device) to eligible low-income consumers.[84]

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81 Memorandum Opinion and Order, *Vonage Holdings Corp.*, 19 FCC Rcd 22404, 22408 ¶ 10 & n.28 (2004) (identifying Minn. Stat. § 237.16, subdivision 9 of which directs the Minnesota state commission to establish and require contributions to a state universal service and TRS fund, as among the state regulations at issue).

82 Magistrate Judge's Proposed Findings and Recommended Disposition, *New Mexico Public Reg. Comm'n v. Vonage Holdings Corp.*, Civ. No. 6:08-cv-00607-WJ-WDS, at 4-5 (D.N.M Nov. 12, 2008) (noting that "the filing of a brief in a separate lawsuit does not change the legal effect of the *Vonage Preemption Order* and is not persuasive," and suggesting that "the proper approach is to have the FCC reevaluate the issue or make the FCC a party and litigate the current validity of their order").

83 *See Appendix C Draft Order* ¶¶ 60-87; *see also Further Notice*, Appx. A, ¶¶ 64-91.

84 *Appendix C Draft Order* ¶¶ 60-87.

AT&T agrees with the Commission that consumers with low incomes should enjoy the well-documented benefits of Internet access services to ensure that they are not left behind in today's information-based economy.[85] Supporting access to such *services* would have a ready and well-proven parallel in the legacy Lifeline and Link Up programs. Supporting Internet access *devices,* on the other hand, would raise complex administrative and other questions that are better addressed in a further notice at the completion of the pilot program. Non-CMRS broadband Internet access providers are not in the business of providing Internet access devices to their customers,[86] and thus lack the systems, procedures, and expertise to distribute, track, maintain, and—if necessary—repossess such devices. The Commission's proposal would effectively require carriers that wish to participate in the pilot program to act as computer resellers and re-possessors if their subscribers are no longer eligible. Any such requirement would raise a host of implementation concerns and would also make participation in the pilot program less likely.[87] The Commission should limit support under the pilot program so that it is

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[85] *Id.* ¶¶ 68-69; *see also* Connected Nation, Inc., *The Economic Impact of Stimulating Broadband Nationally*, at 1, 17-20 (Feb. 21, 2008), *available at* http://connectednation.com/publications/Connected%20Nation%20Broadband%20Economic%20Impact%20Full%20Report_2008%2002%2021_web%20version.pdf (finding that accelerated broadband deployment results in increased employment, saved mileage costs, lower environmental pollution, saved healthcare costs, saved time, improved education, more efficient government services, and a more technologically literate workforce).

[86] Based on the examples provided in the *Draft Order* (laptop and desktop computers, and handheld devices), AT&T does not believe the Commission intended this term to include modems and routers. *See, e.g.*, *Appendix C Draft Order* ¶ 77.

[87] Under the Commission's proposal, ETCs would have to repossess devices if the subscriber does not use the device "in compliance with the terms of this order or other applicable laws or regulations." *See, e.g.*, *id.* ¶ 86. The Commission does not explain how this would be determined or regulated. Since the proposed program would provide only up to $100 toward the purchase of a device, it is unclear what ability or right an ETC would have to repossess that device (given that the subscriber will have spent his or her own money to purchase it). And even assuming *arguendo* that the $100 dollars covered the entire cost of a device, it is not clear what an ETC is to do with a reclaimed device. Must it be re-used or recycled for the pilot program? May it be resold (in the unlikely event that the device has any value)? Does the ETC have any

available only for connection to networks offering broadband Internet access service and should defer to further proceedings any consideration of the need for and the costs of funding *devices*.

To enable broad participation in the pilot program, the Commission should also establish a Lifeline-only designation that is independent from (and not subject to all the requirements of) the traditional ETC designation established under Section 214. AT&T has previously recommended the establishment of such a Lifeline Service Provider (LSP) designation for the existing (voice) Lifeline program as well.[88] As AT&T has explained, this new LSP designation could be awarded to non-telecommunications carriers, such as interconnected VoIP providers. Such a designation would allow interconnected VoIP providers to participate in the existing Lifeline program and would also permit broadband Internet access providers that do not qualify as "telecommunications carriers" to participate in the proposed Broadband Lifeline pilot.

The Commission has ample authority to establish such a designation under Title I. Indeed, the Commission relied on its Title I authority in 1985 to establish the Lifeline program.[89] Moreover, the Commission already has approved at least one ETC application for the sole purpose of providing Lifeline service.[90] In so doing, the Commission has tacitly (if not explicitly) recognized that: (1) it may, through forbearance of certain requirements, authorize ETCs to participate in the low-income program without subjecting them to the full panoply of

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obligations with respect to the data stored on a repossessed computer (is the ETC obligated to protect such data, erase it, or store it on behalf of its former customer), and is the ETC liable for any breach of such obligations? What happens if the ETC is unable to reclaim the device? The Commission would have to address these and other details before requiring service providers to subsidize devices, so that providers may evaluate the benefits and risks of participating.

88 *AT&T USF NPRMs Comments* at 25-27.

89 *Appendix C Draft Order* ¶ 61; *AT&T USF NPRMs Comments* at 26-27.

90 *See, e.g.*, Order, *Federal-State Joint Board on Universal Service, Tracfone Wireless, Inc.*, CC Docket No. 96-45, FCC 08-100 (rel. April 11, 2008).

obligations associated with the high-cost program; and (2) there are significant consumer benefits in having additional ETCs participate in the Lifeline program.

Establishing a LSP designation pursuant to Title I rather than Title II would offer several benefits. As a preliminary matter, this approach would allow the Commission to invite information service providers to participate in the pilot program. Since these entities are not "telecommunications carriers," they cannot participate in the regular high-cost fund under Section 254. But they *should* be eligible to participate, because expanding the provider pool in this way will help achieve the pilot's goal of increased broadband Internet access penetration among eligible consumers. Relying on Title I also makes sense to the extent the LSP designation is connected to the pilot program, which is supporting a service that is not (currently) included in the universal service definition.

In addition, the current language requiring "download speeds equal to or greater than 768 kbps and upload speeds greater than 200 kbps" could imply that providers would be required to guarantee that customers would always have service at these minimum speeds. Instead, AT&T recommends that participating wireline broadband Internet access service providers offer broadband Internet access service with *advertised* download speeds equal to or greater than 768 kbps and *advertised* upload speeds greater than 200 kbps, and mobile wireless broadband Internet access service providers offer *advertised* download speeds of at least 600 kbps and *advertised* upload speeds of at least 500 kbps. Separate minimum advertised speeds for wireline and mobile wireless broadband services are appropriate for this pilot because of the differing transmission speed capabilities of the existing wireline and mobile wireless broadband technologies. AT&T also believes that it is appropriate to incorporate "advertised," and not "guaranteed," minimum speeds into the pilot program. As the California Public Utilities Commission found in specifying that advertised speeds should be used for the California

Advanced Services Fund (a fund designed to encourage broadband deployment in unserved and underserved areas):

> [T]he Commission believes that the advertised speed is a reasonable indicator of the actual speed. While not exactly the same definition used by the FCC in Form 477, it is consistent with how broadband services are purchased and understood by consumers. In advertising for broadband service, broadband providers regularly include legal caveats related to speed and the Commission fully expects that those same caveats would be included in CASF applications. A number of state and federal statutes and regulations of general applicability relate to ensuring commercial advertisements contain accurate information. It is reasonable for the Commission to rely on those rules and their enforcement by appropriate state and federal enforcement entities. This Commission does not need to use its scarce resources to engage in speed monitoring exercises absent evidence of actual instances of alleged fraud relating to broadband service funded under this program. Thus reliance on advertised speeds provides the best measure of reporting and comparing applications. [91]

Finally, AT&T recommends that the Commission consider the following tweaks to its proposal. As drafted, the Commission would exclude from the pilot consumers who already have broadband Internet access service. But if a consumer meets the Lifeline eligibility requirements, there is no policy justification for penalizing him or her for already having made the difficult decision to invest in broadband Internet access services; the expenditure may still pose a significant hardship for that household. Moreover, as a practical matter, AT&T does not know how a potential pilot participant would "demonstrate" to the provider that he or she does not currently have a computer or obtain broadband Internet access service from another service

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91 *See* Resolution T-17143, *Approval of CA Advanced Services Fund (CASF) Application Requirements and Scoring Criteria for Awarding CASF Funds*, Docket R-06-06-028, 4-5 (Cal. PUC filed June 12, 2008). In determining that *advertised* speeds should be used, the California Commission acknowledged comments by parties observing that many factors may cause variances to occur, such as the time of day, distance from the central office or remote terminal, number of customers using the network at the same time, etc. AT&T also noted that with Digital Subscriber Line (DSL) service, speeds are faster nearer the central office and slower farther from the central office. *See id.* at 3-4.

provider.[92] The Commission also should clarify that a participating LSP can designate an area that is smaller than its entire ETC service area/study area for the pilot. AT&T believes that this was the Commission's intent, but there are several inconsistent statements in the *Draft Order* on this point.[93]

92 *Appendix C Draft Order* ¶ 82. Even if the provider required a self-certification from the potential participant, AT&T does not know how the provider or a USAC/Commission auditor could ever verify that participant's assertions.

93 *Compare id.* ¶ 79 ("Such certification must identify the service area in which the ETC plans to offer such Lifeline/Link Up broadband services. . . .") *with id.* ¶ 83 ("A participating ETC must offer the services and supported devices to all qualifying low-income consumers throughout its service areas.").

CONCLUSION

With the modifications discussed above, the Commission should adopt the reform plan for intercarrier compensation and universal service distribution outlined in the *Appendix C Draft Order* and the contribution methodology reforms outlined in the *Appendix B Draft Order*.

Respectfully submitted,

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November 26, 2008

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

In the Matter of

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

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December 22, 2008

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INTRODUCTION AND SUMMARY

Commenters from all corners of this industry have joined AT&T in supporting the key elements of the framework proposed in the November 5, 2008 *Further Notice*[1] for reform of the existing intercarrier compensation and universal service regimes. These commenters include wireless carriers such as Sprint Nextel, cable companies such as Comcast, independent transport providers such as Global Crossing, and the hundreds of rural telephone companies represented here by OPASTCO and WTA. Indeed, there is remarkable consensus even among the *opponents* of the Commission's reform proposals that today's regulatory mechanisms are broken. The vast majority of commenters agree that the current rules arbitrarily impose different rates for identical functions and invite market-distorting arbitrage schemes such as phantom traffic and traffic pumping; that such schemes are severe problems that cry out for immediate solutions; that the implicit subsidies embedded in today's bloated intercarrier compensation rates cannot withstand the industry's accelerating transition to broadband IP-based technologies; and that the ultimate victims of continued regulatory inertia would be millions of American consumers.

As Free Press recognizes, "we no longer live in the 20th century POTS world; we are in the converged broadband era. With this recognition comes the responsibility to launch a complete overhaul of the old regulatory model, which was built for carriers whose main income streams were earned in monopoly markets from price-regulated services."[2] There is no other

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1 Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *High-Cost Universal Service Support*, WC Docket No. 05-337 (and related proceedings), FCC No. 08-262 (rel. Nov. 5, 2008) ("*Further Notice*").

2 Free Press Comments at 5.

option. In this environment, "it is almost certain that rural Americans will not benefit from merely letting present trends continue."[3]

A number of commenters nonetheless quarrel with the details of the proposed transition to a more rational regime. It is no surprise that this proposal is controversial. Any effective reform plan will necessarily require everyone to make some sacrifices, and many stakeholders will predictably argue that the sacrifices should be borne exclusively by others. That is why this set of proceedings has been one prolonged stalemate for many years. As noted in our opening comments, AT&T—the nation's largest ILEC—itself stands to lose hundreds of millions of dollars per year in forgone access charges and CETC funding, and it cannot hope to be "made whole" through increases in end-user rates and access-charge savings.[4] Nor does it expect to receive any supplemental universal service funding designed to facilitate the transition. But AT&T supports the Commission's reform proposals nonetheless because it has a long-term interest in stable, rational, and equitable intercarrier compensation mechanisms and, more broadly, in the health and efficiency of the telecommunications marketplace as a whole.

The Commission cannot responsibly delay reform still longer in a vain hope for perfect consensus. There will *never be* a perfect consensus, and there is no time left to wait for one. Nor would it be appropriate for the Commission to punt this set of issues into the indefinite future on the theory, raised by some commenters, that stakeholders have had too little time to consider the current proposals.[5] Although the details differ, these proposals are derivations of industry plans that have been pending before the Commission for years, such as the Missoula

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3 *Id.* at 10.

4 AT&T Comments at 3, 18-19, 42-44.

5 *See, e.g.*, Initial Comments of the National Ass'n of Regulatory Utility Commissioners at 3-4 ("NARUC Comments"); Comments of the Rural Telecommunications Group, Inc. at 2-4.

Plan submitted in 2006 and the Intercarrier Compensation Forum (ICF) plan submitted in 2004. The current proposals share many of the same basic reform elements as those previous proposals, including (i) phased-in reductions to (and substantial unification of) termination charges for all traffic;[6] (ii) opportunities (not guarantees) for ILECs to try to recover higher end-user charges, subject to caps and competitive pressures, to replace funds formerly provided by access charges;[7] and (iii) new explicit support mechanisms for rural carriers to compensate for the elimination of implicit cross-subsidies.[8] Indeed, as AT&T has previously explained, these are the likely elements of *any* effective reform proposal; the question for the Commission is how best to balance the trade-offs presented as the Commission fine-tunes these elements.[9] That core question has now been teed up for several years, and interested parties have had abundant opportunities for debate. Further delay would be as pointless as it would be irresponsible.

Many of the most fervent opponents of regulatory reform are ILECs and CLECs that warn of dire financial consequences if they lose their streams of above-cost access charges. But the prospect of lost access charges is an argument for, not against, the Commission's reform plan. With the explosive proliferation of VoIP and other bypass technologies, access charges will all but disappear within several years *no matter what the Commission does in this*

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6 Letter from NARUC Task Force on Intercarrier Compensation to Chairman Kevin Martin, FCC, attaching Missoula Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Section II.B at 7-19 (filed July 24, 2006) ("*Missoula Plan*"); Ex Parte Brief of the Intercarrier Compensation Forum in Support of the Intercarrier Compensation and Universal Service Reform Plan, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Appx. A, Section III.A through Section III.E at 31-48 (filed Oct. 5, 2004) ("*ICF Plan*").

7 *Missoula Plan*, Section II.C at 19-24; *ICF Plan*, Section III.G through Section III.J at 60-68.

8 *Missoula Plan*, Section VI at 63-79; *ICF Plan*, Section III.F at 48-60, Section IV at 69-75.

9 *See* Letter from Robert W. Quinn, Jr., AT&T, to Chairman Kevin Martin, FCC, CC Dkt. No. 01-92 *et al.* (filed July 17, 2008) ("*AT&T July 17, 2008 Letter*").

proceeding. The LECs advocating against the reforms proposed here would score a truly pyrrhic victory if they managed to retain high access *charges* but thereby accelerated the erosion of their access *minutes* until they approach zero. Indeed, this concern holds true not just for access charges, but for all termination rates that exceed incremental cost. In the next several years, most voice calls will become mere applications that ride on top of broadband and/or wireless platforms from end to end, and voice providers will seek to avoid above-cost termination fees simply by bypassing circuit-switched wireline networks altogether. In this environment, traditional LECs should welcome an orderly phase-down of all termination rates to incremental cost as part of a plan that affords them an opportunity to recover at least some of the funds formerly provided by intercarrier charges through higher end-user rates and (in the case of smaller carriers) new universal service mechanisms. That proposal offers the only means of stabilizing the industry and giving today's LECs an opportunity to play a role in tomorrow's marketplace. The LECs opposing the Commission's reform plan are not merely rearranging deck chairs on the Titanic; they are torching their own lifeboats as well.

The coming months may present the last clear chance for the Commission to implement comprehensive reform while there is still time to avoid massive industry dislocations. Reform on this scale is necessarily painful in some respects and controversial in others. But the Commission exists because someone needs to make the hard regulatory choices needed to promote the long-term interests of American consumers. Further delay would be an abdication of that basic responsibility.

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These reply comments are divided into several sections. Section I addresses jurisdictional challenges to the Commission's authority to reform intercarrier compensation for all categories of traffic. Section II addresses various issues relating to the Commission's proposed reduction of intercarrier compensation levels to incremental cost and the corresponding SLC-cap increases. Section III rebuts various CLEC arguments against the proposed "network edge" default rules and for new regulation of transit services. Section IV addresses three urgent intercarrier compensation problems that demand an immediate solution no matter what other reforms the Commission may undertake in this proceeding: the issues of VoIP access charges, traffic pumping, and phantom traffic. Finally, Section V addresses the universal service dimensions of the Commission's proposed reform plan.

ARGUMENT

I. THE 1996 ACT GRANTS THE COMMISSION PLENARY JURISDICTION TO REFORM INTERCARRIER COMPENSATION

As in prior comment rounds, several parties continue to challenge the Commission's authority to bring national uniformity to a field that badly needs it. They claim that although the Commission may reform intercarrier compensation for (i) all traffic that terminates to a wireless carrier, and for all wireline-terminated traffic that is either (ii) "interstate" or (iii) both "intrastate" and "local," it may not reform intercarrier compensation for wireline-terminated traffic that is (iv) "intrastate" but *not* "local" under some definition of that term. As the *Appendix C Draft Order*[10] rightly concludes (at ¶¶ 210-24), nothing in the statute holds the Commission's reform plans hostage to these anachronistic and arbitrary jurisdictional distinctions.

Some of the commenters who attack the Commission's jurisdiction appear oblivious to Congress's fundamental decision in the Telecommunications Act of 1996 to erase legacy

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[10] Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *High-Cost Universal Service Support*, WC Docket No. 05-337 (and related proceedings), FCC No. 08-262, at Appx. C (rel. Nov. 5, 2008) ("*Appendix C Draft Order*" or "*Draft Order*").

jurisdictional distinctions in the regulation of carrier-to-carrier relationships and to grant the Commission plenary authority to reform telecommunications regulation in an age of increasing convergence.[11] For example, one set of commenters trumpets the Eighth Circuit's 1997 conclusion that, despite the 1996 Act, Section 2(b) of the Communications Act operates as a "'hog tight, horse high, and bull strong' jurisdictional fence" that generally bars the Commission from addressing carrier-to-carrier transactions that could be characterized as "intrastate."[12] But their reliance on this familiar passage is perplexing because, in *AT&T Corp. v. Iowa Utilities Board*, the Supreme Court reversed the Eighth Circuit's holding on this very point and confirmed that, "[w]ith regard to the matters addressed by the 1996 Act," including those with "intrastate" components, the Commission "unquestionably" may "draw the lines to which [the state commissions] must hew."[13]

The field of intercarrier compensation is a "matter[] addressed by the 1996 Act." As the *Appendix C Draft Order* explains, Section 251(b)(5) applies to, and thus authorizes the Commission to bring national consistency to, intercarrier compensation for any exchange of telecommunications traffic. By its terms, that provision extends to all compensation issues relating to the transport and termination of "telecommunications" involving at least one local exchange carrier. Section 251(b)(5) makes no distinctions among traffic on the basis of jurisdiction ("local," "toll," "intrastate," or "interstate") or service definition (*e.g.*, "exchange

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11 *See, e.g.*, Joint Comments of Citynet, LLC, Granite Telecommunications, Inc., PAETEC Communications, Inc., RCN Telecom Services, Inc., and U.S. TelePacific Corp. at 4 ("Citynet Comments"); Initial Comments of the National Telecommunications Cooperative Ass'n at 32-37 ("NTCA Comments").

12 Citynet Comments at 4; *see also* Comments of Broadview Networks, Inc., Cavalier Telephone, NuVox, and XO Communications, LLC at 19-24 ("Broadview Comments") (emphasizing importance of Section 2(b)).

13 525 U.S. 366, 378 n.6 (1999).

access," "information access," or "exchange service"). All such traffic is plainly "telecommunications." If it had wished, Congress could have limited the scope of this provision to "local telecommunications," to "telecommunications that originate and terminate within the same local calling area," or to "telecommunications handed off from one LEC directly to another LEC." But Congress included no such limitations on the scope of Section 251(b)(5). Instead, it drafted Section 251(b)(5) broadly to address *all* "telecommunications," the most expansive of the statute's defined terms.[14]

As the *Appendix C Draft Order* further explains, the Commission has always construed Section 251(b)(5) to reach the exchange of any traffic involving at least one LEC, not (as some commenters here submit) just traffic between two LECs.[15] Although the *obligation* to establish reciprocal compensation arrangements for the transport and termination of telecommunications falls on LECs, Congress did not limit the class of potential *beneficiaries* of that obligation to other LECs. Some commenters nonetheless contend that inclusion of the word "reciprocal" in Section 251(b)(5) somehow confines the scope of that provision to exchanges of "local" traffic between two LECs, because "[i]nterexchange carriers and local exchange carriers do not exchange traffic in any way . . . that would cause an IXC and a LEC to compensate the other

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14 *See* 47 U.S.C. § 153(43); *see generally United States Telecom Ass'n v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) (rejecting Commission's efforts to narrow the definition of "telecommunications services" for purposes of Section 251(d)(2) and holding that "[e]ven under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term").

15 *See Appendix C Draft Order* ¶ 217; *see also* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16016 ¶ 1041 (1996) ("*Local Competition Order*") ("Although section 251(b)(5) does not explicitly state to whom the LEC's obligation runs, we find that LECs have a duty to establish reciprocal compensation arrangements with respect to local traffic originated by or terminating to *any* telecommunications carriers," including non-LEC CMRS providers) (emphasis added).

reciprocally."[16] But this argument makes no sense in the modern telecommunications marketplace, where increasingly every LEC is an IXC and vice versa. It also proves far too much. Even in the context of "local" calls, intermediate transit providers routinely hand off traffic to LECs, and no one has suggested that Section 251(b)(5) suddenly becomes inapplicable to that traffic simply because a transit provider sits between the originating and terminating providers. In sum, the term "reciprocal" appears in Section 251(b)(5) simply to confirm that compensation arrangements must be reciprocal whenever two LECs do exchange traffic bound for each other's customers, but it does not otherwise restrict the unambiguously broad scope of Section 251(b)(5).

The effort to carve up the Commission's rulemaking authority on the basis of legacy jurisdictional categories is strikingly similar to the state commissions' unavailing attacks in the 1990s on the Commission's jurisdiction to implement Sections 251 and 252 more generally. Here, as in that context, the attempt to "produce[] a most chopped-up statute" along jurisdictional lines is flawed both because it violates the statutory text and because, to borrow the Supreme Court's words, it is "most unlikely that Congress created such a strange hodgepodge."[17]
It would have been especially perverse for Congress to have authorized the Commission to reform intercarrier compensation rules relating to "local" and "interstate" traffic but not the rules applicable to the one class of traffic—intrastate access—that is subject to the *highest* above-cost charges and that is generally thought to be most laden with unsustainable implicit support. Indeed, no commenter seriously opposes reducing current levels of intrastate access charges to interstate access levels or below. At the same time, no opponent of the Commission's reform plan explains how that will happen unless the Commission acts to lower them. NTCA suggests

16 Broadview Comments at 28.

17 *Iowa Utils. Bd.*, 525 U.S. at 381 n.8.

that the Commission "[a]llow state commissions to reduce voluntarily, on a company-by-company basis, intrastate . . . access rates to interstate . . . levels over a reasonable period of time."[18] But of course state commissions have always been "allowed" to lower their intrastate access charges, and yet intrastate access levels remain grossly inflated in many (though not all) states.[19] If the Commission lacked authority to establish a national solution for this national problem, the problem would never get fixed.

In a separate attack on the Commission's jurisdiction, Broadview claims that, because the Section 251(g) "grandfathering" provision extends to preexisting intrastate access charges, it somehow carves out intrastate access traffic from the scope of Section 251(b)(5).[20] In fact, Section 251(g) supports exactly the opposite conclusion. Section 251(g) *temporarily* grandfathers the pre-1996 rules applicable to access traffic, including rules governing "receipt of compensation," until the Commission exercises its discretion to "supersede[]" these legacy rules with generally applicable rules promulgated under Section 251(b)(5).[21] There would have been little need for Congress to preserve those legacy rules against the effects of Section 251 if

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18 NTCA Comments at 3. NTCA does propose that the Commission "freeze interstate originating and terminating access rates in order to keep interstate access rates from increasing." *Id.* That proposal, while obviously sound on the merits, logically contradicts NTCA's separate insistence that access charges are somehow cost-based and should therefore increase if costs increase.

19 The Nebraska Public Service Commission urges the Commission to adopt a "benchmark" mechanism that would avoid placing consumers in states that have already implemented substantial reforms "at a disadvantage in comparison to other states which have not rebalanced local rates, lowered access charges or adopted state universal service programs." Comments of the Nebraska Public Service Commission at 6 ("Nebraska PSC Comments"). Others similarly endorse a benchmark to avoid extreme rate increases. *See, e.g.*, Comments of the United States Telecom Ass'n at 7-8 ("USTelecom Comments"). AT&T has endorsed this benchmark concept in the past, *see AT&T July 17, 2008 Letter* at 5-6, and recommends that the Commission consider adding it to its overall reform plan.

20 *E.g.*, Broadview Comments at 26-28.

21 47 U.S.C. § 251(g).

Section 251(b)(5) did not in fact address the "receipt of compensation" for the traffic covered by Section 251(g)—*i.e.*, all access traffic, including all intrastate access traffic.[22]

Because Congress is presumed not to have filled this statute with pointless surplusage, the only sensible interpretation of Section 251(g) confirms what Section 251(b)(5) already makes clear on its face: intercarrier compensation for all access traffic falls within the broad scope of the Commission's jurisdiction to implement Section 251, subject only to the temporary grandfathering provisions of Section 251(g). Moreover, the Commission's authority to issue rules "supersed[ing]" the preexisting access regime for purposes of Section 251(g) is plenary: it is not, as Broadview suggests, confined to preexisting rules for *interstate* access traffic. Once the Commission removes any class of traffic from the scope of Section 251(g), that traffic becomes subject to Section 251(b)(5) as it would have been all along if Congress had not temporarily grandfathered such traffic from the effects of Section 251 in the first place.

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22 As the Commission has long recognized, the "section 251(g) carve-out includes intrastate access services." Further Notice of Proposed Rulemaking, *Developing a Unified Intercarrier Compensation Regime*, 20 FCC Rcd 4685, 4722 ¶ 79 (2005) ("*2005 Intercarrier Compensation FNPRM*"). This conclusion, which Broadview endorses (Comments at 27), is correct. No less than its interstate counterpart, the intrastate access charge regime falls within the temporary grandfathering mechanism set forth in 47 U.S.C. § 251(g) for "equal access and nondiscriminatory interconnection . . . obligations (including receipt of compensation) . . . under any court order, consent decree," or FCC order. Before 1982, compensation for interexchange access was generally derived through an AT&T-administered system of settlements and division of revenues. *See* Second Supplemental Notice of Inquiry and Proposed Rulemaking, *MTS and WATS Market Structure*, 77 F.C.C.2d 224, 227-28, 234 ¶¶ 15-19, 47 (1980). The AT&T consent decree replaced that system with a regime of federal *and* intrastate access charges. *See United States v. AT&T Co.*, 552 F. Supp. 131, 227, 232-33 (D.D.C. 1982); Third Report and Order, *MTS and WATS Market Structure*, 93 F.C.C.2d 241, 246 ¶ 11 (1983). The court order accompanying the consent decree made clear that the decree required access charges to be used in both the interstate and intrastate jurisdictions: "Under the proposed decree, state regulators will set access charges for intrastate interexchange service and the FCC will set access charges for interstate interexchange service." *AT&T*, 552 F. Supp. at 169 n.161. Thus, both interstate and intrastate access charges were born of the same "consent decree," and both are preserved under Section 251(g) until superseded by new Commission regulations.

Of course, these statutory provisions are hardly pellucid; as the Supreme Court has observed, the 1996 Act "is in many important respects a model of ambiguity or indeed even self-contradiction."[23] But the Commission receives the greatest judicial deference when construing provisions like these, because "Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency."[24] Here, the Commission should exercise its interpretive discretion by making sense of this statutory scheme as a whole, and that means bringing genuine intercarrier compensation reform to all classes of telecommunications traffic, not just arbitrarily defined subsets of that traffic.[25]

II. THE *APPENDIX C DRAFT ORDER* PRESCRIBES A REASONABLE AND MUCH-NEEDED PLAN FOR WEANING LECS FROM UNSUSTAINABLE RELIANCE ON INTERCARRIER COMPENSATION

A. The Challenges To The Proposed Incremental-Cost Methodology Are Misplaced

A wide range of commenters support the Commission's proposed "incremental cost" methodology, including not just AT&T and other ILECs, but also, for example, Sprint Nextel, Comcast, and Global Crossing. As explained in our opening comments, that methodology is, if anything, more faithful than TELRIC to the "additional cost" standard of Section

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23 *Iowa Utils. Bd.*, 525 U.S. at 397.

24 *Id.*

25 As AT&T has previously explained, the Commission could alternatively justify rules governing all intercarrier compensation by invoking its authority under footnote 4 of *Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986), to exercise preemptive federal authority under Section 201 where it is "*not* possible to separate the interstate and the intrastate components" of the regulated field, *id.* at 375 n.4. *See* Reply Comments of AT&T Inc. on the Missoula Plan for Intercarrier Compensation Reform, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at 41-47 (filed Feb. 1, 2007) ("AT&T Missoula Reply Comments"); *see also* Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC, CC Docket No. 01-92 and WC Docket Nos. 04-36 and 06-122 (filed September 19, 2008) (invoking conflict preemption principles). The Commission should consider adopting that rationale as an alternative, belt-and-suspenders justification for the intercarrier compensation reforms contained in the *Appendix C Draft Order*.

252(d)(2)(A)(ii). AT&T Comments at 9-10. And as we further explained, the incremental-cost methodology is far preferable to TELRIC's average-cost approach as a mechanism for setting termination rates. *Id.* at 9-13. By reducing intercarrier compensation levels, the incremental-cost methodology will force most carriers to rely primarily on their own end users for recovery of their network costs rather than on other carriers and, ultimately, *their* end users. Because retail rates are subject to competition and intercarrier compensation rates are not, this shift in cost-recovery mechanisms will reward efficient carriers, punish inefficient ones, and make each carrier more accountable to its own end users.

Moreover, because per-minute rates based on incremental cost actually track the manner in which carriers incur termination costs, the incremental-cost approach will avoid the rate-structure anomalies caused by TELRIC. As we have explained (AT&T Comments at 11), TELRIC, as an average-cost methodology, unavoidably gives each carrier perverse incentives to terminate as many minutes as possible to recover the inevitable margin between average and incremental costs. Although ITTA implausibly contends that TELRIC has stood the test of time because it has "produced reasonable rates,"[26] TELRIC is in fact responsible for one of the most destabilizing episodes in post-1996 telecommunications history: the rise and collapse of an entire generation of carriers that specialized in serving dial-up ISPs simply to avail themselves of inflated TELRIC-based termination rates. The Commission did not fix that problem by reforming TELRIC; instead, it fixed the problem by reducing termination rates for ISP-bound traffic to $0.0007 per minute, which—because of the mirroring rule (*see* AT&T Comments at 34-35)—is the effective termination rate for much PSTN-based traffic today.

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26 Comments of the Independent Telephone and Telecommunications Alliance at 12 ("ITTA Comments").

The opponents of the proposed incremental-cost standard simply miss these points. In a nutshell, they contend that the incremental-cost standard is methodologically "absurd" because, by design, it would not enable them to recover their average costs *if they relied solely on intercarrier compensation for cost recovery*.[27] These opponents appear to forget that each carrier also has wholesale and retail *customers* who pay fees in exchange for the carrier's services. In the aggregate, the fees that the nation's carriers charge their customers finance—directly or indirectly—essentially all of the costs of the national telecommunications infrastructure. The main question in this proceeding is the extent to which each carrier will recover *its own* network costs from *its own* customers, as opposed to recovering those costs from interconnecting carriers and ultimately *their* customers. As AT&T has long argued, the telecommunications marketplace will become more efficient, and customers as a whole will pay less for better services, if each carrier is required to rely increasingly on end-user charges for the recovery of its own network costs—and certainly for recovery of its joint and common costs. Of course, that end-user-focused cost recovery regime should be supplemented, as appropriate, by explicit universal service support for carriers operating in rural and other high-cost areas.[28]

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27 Broadview Comments at 34 (summarizing views of Lee Selwyn); *see also* Embarq Comments at 45-46; GVNW Consulting Comments at 5-6; Iowa Telecommunications Ass'n Comments at 14-15.

28 *See, e.g.*, AT&T Comments at 4-7, 12-13; AT&T Missoula Reply Comments at 3-4, 8-14; Comments of SBC Communications Inc., *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, at 1-3, 9-13 (filed May 23, 2005). ITTA argues that since rural carriers "have fewer customers over which to distribute local exchange costs, as compared to the Nation's largest carriers, [they] must rely upon access compensation as a mechanism for cost recovery." ITTA Comments at 6. This is a non-sequitur. Of course rural carriers often lack the economies of density enjoyed by more urban carriers, and their costs per subscriber are to that extent higher. But that is a reason to give them adequate access to explicit USF support mechanisms, not to impose a disproportionate burden on *interexchange carriers* to subsidize high-cost rural operations. NTCA separately argues that relieving interexchange carriers of that disproportionate burden would somehow grant them "an annual multi-billion dollar access savings windfall." NTCA Comments at 7. This is untenable—not just because it makes no

At bottom, the opponents of an incremental-cost regime simply assume that the regulatory status quo—under which each LEC looks to other carriers for the recovery of many of its own network costs—should be preserved simply because that is the way business has always been done in this industry. Again, that regulatory status quo is unsustainable, and it should be phased out now, while there is still time for an orderly transition. Significantly, there is nothing untested or hypothetical about cost-recovery regimes that require carriers to recover most of their costs from their own end users. For example, as Sprint Nextel points out, wireless carriers have long recovered costs from their own end users because they have had no regulatory entitlement to collect any compensation for terminating access traffic.[29] As the spectacular success of the wireless marketplace has demonstrated, a regime heavily weighted towards recovering network costs from one's own subscribers has worked well for wireless carriers and their customers, and it would work equally well for other carriers and their customers too.

It is also instructive to compare the proposed incremental-cost approach to a bill-and-keep methodology, under which each terminating carrier receives *no* intercarrier compensation—and looks *entirely* to its own end users—for the recovery of all costs it incurs in transporting and terminating traffic that it receives at defined points of interconnection. Section 252(d)(2) specifically preserves the Commission's authority to impose "bill-and-keep arrangements";[30] the D.C. Circuit suggested in 2002 that the Commission could appropriately impose bill and keep

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sense to characterize relief from an unjustified burden as a "windfall," but also because, as NTCA acknowledges one page later (with no apparent awareness of the contradiction), "IXCs pass on access costs in their retail long-distance rates." *Id.* at 8; *see also* AT&T Comments at 3, 7, 18-19 (discussing pass-through of access savings).

29 *See* Comments of Sprint Nextel Corporation at 15-16 ("Sprint Nextel Comments").

30 47 U.S.C. § 252(d)(2)(B)(i).

even for radically unbalanced traffic;[31] and the Commission's Staff concluded in 2005 that bill and keep may well be theoretically superior to conventional intercarrier compensation regimes for all classes of traffic.[32] If, as these sources indicate, bill and keep would afford all carriers adequate opportunities to recover their network costs even though it prescribes a uniform termination rate of *zero*, it follows *a fortiori* that the Commission's proposed incremental-cost methodology would do so as well.

Finally, some commenters object on various empirical grounds to the Commission's conclusion that the incremental costs of transport and termination functions in today's forward-looking networks are likely to be very low.[33] The short answer is that the Commission need not resolve these empirical quibbles now, and it is uncertain whether the Commission will ever need to resolve them. As the *Appendix C Draft Order* makes clear, individual state commissions will arbitrate factual disputes about particular cost inputs within an incremental-cost model, just as they arbitrate factual disputes today about cost inputs in TELRIC proceedings. If the Commission decides that further methodological refinements are warranted, there will be ample opportunities to make them after the Commission has set the wheels of reform in motion. In all events, the Commission should not let the perfect become the enemy of the good, and it therefore should not delay adoption of the basic regulatory choices embodied in the *Appendix C Draft Order*.

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31 *WorldCom, Inc. v. FCC*, 288 F.3d 429, 434 (D.C. Cir. 2002) (encouraging the Commission to consider invoking Section 252(d)(2)(B)(i) as a basis for ordering bill and keep for ISP-bound traffic).

32 *2005 Intercarrier Compensation FNPRM*, at Appx. C, *A Bill-and-Keep Approach to Intercarrier Compensation Reform: An Analysis of Pleadings in CC Docket No. 01-92 by the Staff of the Wireline Competition Bureau.*

33 *See, e.g.*, ITTA Comments at 12; Broadview Comments at 31; Citynet Comments at 19-20; Comments of Windstream Communications, Inc. at 29 n.65 ("Windstream Comments").

B. The Commission Should Phase In Its Increases To The SLC Cap

Free Press and other commenters argue that, if the Commission adopts the proposed reforms, increases in SLC caps should "be phased-in in parity with the phase-down of access charges."[34] As Free Press observes, the Commission phased in the SLC cap increases that accompanied the access charge reductions in the *CALLS Order*. AT&T agrees that such phased-in increases would be appropriate, and therefore recommends that the Commission make the proposed $1.50 residential SLC-cap increase in two equal steps of $0.75, coinciding with the two-step reduction in intrastate access charges to interstate levels.[35] Finally, as AT&T requested in its opening comments, the Commission should provide further guidance—and flexibility—concerning the relationship between intrastate retail rate increases and the SLC increases permitted under the Commission's proposed plan.[36]

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[34] Free Press Comments at 13; *see also* ITTA Comments at 9; Comments of the Organization for the Promotion and Advancement of Small Telecommunications Companies and the Western Telecommunications Alliance at 3 ("OPASTCO Comments"); USTelecom Comments at 7.

[35] Although some commenters appear to assume otherwise, the *Appendix C Draft Order* would not guarantee that LECs could successfully implement the permitted SLC increases necessary to make them "whole" for losses in access charges and other intercarrier compensation. Instead, the *Draft Order* would give LECs an *opportunity* to recover those losses by modestly increasing current regulatory *caps* on the SLC. But competition will prevent LECs in many areas from increasing their SLCs up to the new caps. The hypothetical Oregon resident described on pages 6-7 of Free Press's comments illustrates that competitive dynamic. After consulting with her daughter, she discovers that she has a broad range of choices for voice service, including not just conventional landline service from Qwest, but wireless service from various providers, cable VoIP service from Comcast, and over-the-top VoIP service from providers such as Skype. These alternatives allow her and millions of other end users to reject any service, whether provided by an ILEC or any other company with high monthly fees. To keep her business, therefore, her ILEC may have to charge less than the maximum permitted levels.

[36] *See* AT&T Comments at 39-41; *see also* Qwest Comments at 5-9. The Commission also should make clear that the states have flexibility to accelerate the transition to the final incremental-cost-based termination rates by, for example, skipping the intermediate step of setting an *interim* uniform termination rate. *See* AT&T Comments at 22. At the same time, the Commission should make clear that states do *not* have the flexibility to *delay* the benefits of

III. THE *APPENDIX C DRAFT ORDER* IMPOSES REASONABLE "EDGE" DEFAULT RULES AND PROPERLY REFRAINS FROM IMPOSING NEW REGULATIONS ON TRANSIT SERVICES

A. Opponents Of The Draft Order's Approach Misconstrue The Proposed Edge Rules, Which Are A Fundamental Component Of Intercarrier Compensation Reform

The *Appendix C Draft Order* proposes default "edge" rules that are indispensable because they define the scope of the new intercarrier compensation regime for "transport" and "termination" under Section 251(b)(5). These rules provide that unified intercarrier rates under the new regime will apply to the transport and termination of traffic *from* the relevant "edge" of the provider serving the called party *to* the called party. The calling party's LEC or IXC will be separately and additionally responsible for the costs of transporting the call *to* the network edge of the called party's service provider using whatever arrangement or facilities it chooses to deliver the call to that edge.[37] The proposed rules further require each provider *either* to permit interconnection at its own edge *or* to arrange for transport (at no charge to the other carrier) from some other point of interconnection in the LATA to that edge.[38] The *Draft Order* also proposes a rural exception to this rule, which would shift some of the cost of transporting a call to the terminating carrier's edge to the terminating carrier and away from the originating rural carrier.[39]

A number of CLECs attack this proposal on the mistaken premise that it would somehow violate CLEC physical interconnection rights under Section 251(c)(2)(B). For example, Comptel suggests that the rules "requir[e] CLECs to interconnect at the called party service provider's network edge[s]" in violation of the CLEC's putative right to "request a single point of

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reform by setting excessively high "interim" rates: any Phase Two interim rates must be set at a level that involves meaningful reductions in terminating rates from the Phase One interstate access rate.

37 *Appendix C Draft Order* ¶ 270.

38 *Id.*

39 *Id.*

interconnection in a LATA."[40] Citynet likewise insists that the rule "is inconsistent with the plain text of the Act [which] requires ILECs to provide interconnection at any technically feasible point requested by CLECs."[41] And Broadview argues that the rule "displace[s] . . . longstanding interconnection rules, state commission arbitrations implementing those rules, and voluntarily agreed-upon arrangements contained in interconnection agreements."[42]

In fact, the proposed framework would neither limit the points at which CLECs could choose to interconnect nor interfere with their existing physical interconnection arrangements. The *Draft Order* makes clear that the default edges need *not* be the point at which carriers physically interconnect. The originating carrier may choose to interconnect at any other point permitted under existing law or an interconnection arrangement—which is all that Section 251(c)(2)(B) requires. Even the *terminating* carrier need not physically interconnect at its edge so long as it arranges in some other manner to transport traffic to its edge.[43] As Verizon explains, "these 'network edge' rules . . . . do not alter any obligations of incumbent carriers to interconnect at any technically feasible point, nor do they alter carriers' ability to request interconnection and seek arbitration of interconnection disputes."[44] Instead, the edge rules merely specify the default point at which the terminating carrier picks up the financial responsibility for transport and termination of a call under the unified rates adopted under the Section 251(b)(5) termination charge framework. As Verizon, CTIA, Embarq, and others

40 Comptel Comments at 20-21.

41 Citynet Comments at 13; *see also* Comments of tw telecom inc., One Communications Corp., and Cbeyond Inc. at 19 ("tw telecom Comments").

42 Broadview Comments at 46-47.

43 *See Appendix C Draft Order* ¶ 270.

44 Comments of Verizon and Verizon Wireless at 54 ("Verizon Comments").

understand, these rules "merely define the services that are 'included' in the terminating rate, and allocate financial responsibility for getting traffic to and from the network edge."[45]

Broadview insists that, by making the originating carrier financially responsible for transporting its customers' calls to the relevant default edge, the proposed rules will radically shift costs from ILECs to CLECs, forcing the latter to "pay to transport traffic beyond an established point of interconnection all the way to the network's (inner) edge."[46] In fact, however, the *Draft Order* does not prescribe any particular arrangement or pricing regime for transport to the relevant edge, which would normally take the form of dedicated transport pipes (and in many cases would be the same dedicated transport pipes in use today). The terms of such dedicated transport fall outside the scope of any usage-sensitive termination rate prescribed by Section 251(b)(5)—and thus outside the proposed reform framework altogether. In proposing default edge rules, the *Appendix C Draft Order* simply clarifies the scope of the "transport and termination" to which the 251(b)(5) rate applies. And for that limited purpose it prescribes, as the "edge," the most efficient point from which calls can be terminated to a given customer.

Although some parties contend otherwise,[47] these default rules are a critical component of any comprehensive reform plan. In the absence of such rules, disputes would continue to arise about which network functions are included within the Section 251(b)(5) transport and termination rate. Indeed, for this reason, AT&T agrees with Verizon that the Commission

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45 *See id.*; *see also* CTIA Comments at 29; Embarq Comments at 51.

46 Broadview Comments at 46.

47 *See, e.g.*, Comptel Comments at 9; Comments of the National Cable & Telecommunications Ass'n at 22-23 ("NCTA Comments").

should make these rules effective as soon as the interim reciprocal compensation rates are set—namely, in Phase 2 of the proposed rate reform framework.[48]

Finally, there is no basis for the argument that the edge rules are somehow deficient because they "do not make any provision for the *exchange* of IP-based traffic."[49] That argument reflects, once more, the basic misconception that the edge rules are physical "network architecture" rules.[50] These rules merely assign *financial* responsibility for the exchange of traffic on the PSTN. If and when traffic is no longer exchanged over the PSTN and carriers interconnect solely for the exchange of IP traffic, these rules will no longer be applicable. And since carriers remain free, even while the edge rules continue to apply, to *physically* interconnect at any technically feasible point, the rules have no effect on the transition to IP-to-IP network interconnection or traffic exchanges.

B. The Commission Should Reject Calls For Regulation Of Transit Rates

Although a few commenters ask the Commission to regulate transit services for the first time, those proposals have no place in this proceeding. The purpose of this proceeding is to reform the rules that remedy the "terminating access monopoly"—that is, the rules that restrict how much each carrier may charge others for *terminating their calls* in a network environment characterized by government-imposed interconnection obligations, tariffs, and, in most cases, only one pipe leading to any given called party.[51] By definition, transit providers do not terminate traffic, and they therefore have no terminating access monopoly. Any arguments about

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48 Verizon Comments at 60.

49 NARUC Comments at 23. *See also* Broadview Comments at 47; tw telecom Comments at 19.

50 Comptel Comments at 20.

51 For a general discussion of the terminating access monopoly, see Seventh Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, 16 FCC Rcd 9923 (2001).

the degree of competition for the provision of transit services raise entirely distinct issues and are thus appropriately addressed, if at all, in other proceedings.

In any event, there is no basis for regulating transit services in the first place. First, as a legal matter, transit services cannot be subject to any form of rate regulation under Sections 251(b)(5) and 252(d)(2) for the simple reason that they do not involve "termination" of traffic, as Qwest explains and as the Commission itself has previously indicated.[52] Commission precedent further establishes that transit falls outside the scope of rate-regulated direct interconnection obligations under Section 252(d)(1).[53] Second, as a policy matter, transit does not need to be tightly regulated, because it has become a competitive service. While ILECs are the traditional providers of that service, competitors are increasingly entering the field. Neutral Tandem, for example, recently reported that it was operating in 91 markets, carried 15.9 billion minutes of traffic in the third quarter of 2008, and could connect calls to an estimated 372 million telephone numbers assigned to carriers.[54] Another competitive transit provider is HyperCube, LLC, which describes itself as a "premiere provider of local and national tandem services to other carriers throughout the United States via interconnected tandem switches."[55] Indeed, even some proponents of regulating transit grudgingly acknowledge the emerging "market for competitive

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52 *See* Qwest Comments at 24 (citing, *inter alia*, *2005 Intercarrier Compensation FNPRM* at 4737-38 ¶ 120, and *Atlas Tel. Co. v. Oklahoma Corp. Comm'n*, 400 F.3d 1256 (10th Cir. 2005)).

53 *See, e.g.*, *id.* (citing *AT&T v. FCC*, 317 F.3d 227, 234-35 (D.C. Cir. 2003)). *See also Appendix C Draft Order* ¶ 344 (noting that transit involves *indirect* interconnection between two networks).

54 Neutral Tandem, Form 10-Q (Nov. 12, 2008), *available at* http://biz.yahoo.com/e/081112/tndm10-q.html.

55 HyperCube, LLC corporate web site, *available at* http://www.hypercube-llc.com/corporate/network.html.

tandem switching" in at least some areas.[56] Finally, the Commission retains the authority to address any unique concerns about individual transit rates pursuant to Section 201 of the Act.

IV. THE COMMISSION SHOULD RESOLVE OUTSTANDING ISSUES RELATING TO IP/PSTN TRAFFIC, TRAFFIC PUMPING, AND PHANTOM TRAFFIC WHETHER OR NOT IT IMPLEMENTS COMPREHENSIVE REFORM

As discussed, there is no long-term alternative to comprehensive intercarrier compensation reform. But if the Commission is unable to implement such reform in the immediate future, it should promptly remedy the most pressing problems plaguing the existing regime. These include issues relating to IP/PSTN traffic, traffic pumping, and phantom traffic.[57]

A. The Commission Should Resolve Long-Pending Issues Relating To VoIP Traffic

1. The Record Demonstrates An Obvious Need For An Explicit Transitional Compensation Framework For IP/PSTN Traffic

In our opening comments, we urged the Commission to immediately clarify the intercarrier compensation rules that will apply to IP/PSTN traffic during the transition, rather than perpetuating uncertainty, inconsistency, and confusion under the guise of maintaining the "status quo." Any question about the urgent need for Commission guidance has been settled by commenters' divergent descriptions of that "status quo." Sprint Nextel, for example, argues that "until the end-state unified rate is achieved, IP/PSTN traffic should remain subject to Section 251(b)(5)/252(d)(2) compensation."[58] Broadview similarly reads the *Draft Order* to "find that IP-PSTN traffic *currently* qualifies for the ESP Exemption from the application of switched access charges."[59] On the other hand, Embarq argues that "IP/PSTN voice calls have always

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56 Comments of the Coalition for Rational Universal Service and Intercarrier Reform at 6.

57 *See generally AT&T July 17, 2008 Letter* at 7-10.

58 Sprint Nextel Comments at 10.

59 Broadview Comments at 10 (emphasis added).

been subject to access charges."[60] Qwest likewise explains—consistent with AT&T's own comments—that even though the ESP exemption clearly does not apply to such traffic, the current regime is rife with disputes, with "a number of VoIP providers . . . tak[ing] some very strange positions to avoid paying for services purchased from LECs."[61] Against this backdrop of conflicting opinions, Comptel quips: "Does the Commission intend to maintain the 'status quo' of regulatory uncertainty[?]"[62] It is a reasonable question, and one the Commission should answer in the negative by ending that regulatory uncertainty.

As explained in AT&T's opening comments (at 27-32), interexchange VoIP traffic (intrastate and interstate) during the transition should be subject to interstate access charges until those charges are phased down to reciprocal compensation levels, while "local" VoIP traffic should be subject to reciprocal compensation rates from the outset. This solution is the most appropriate compromise between (i) proposals to subject all IP/PSTN traffic, including interexchange traffic, to reciprocal compensation rates and (ii) proposals (supported by some ILECs and even some CLECs) to subject all IP/PSTN traffic, including "local" traffic, to access charges.[63] AT&T's middle-ground proposal will also come closest to preserving an equitable status quo pending comprehensive reform, given that access charges today are already paid on at least certain VoIP traffic, as the nation's largest VoIP provider and its trade association acknowledge.[64] Finally, as explained in AT&T's previous filings, the Commission can and

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60 Embarq Comments at 38.

61 Qwest Comments at 17; *see also id.* at 14-17.

62 Comptel Comments at 3.

63 *See, e.g.*, Broadview Comments at 12 (generically referring to the application of "access charges," without specifying intrastate versus interstate access); tw telecom Comments at 16-18 (same).

64 *See* Comcast Comments at 20; NCTA Comments at 24.

should promptly resolve this compensation issue whether or not it implements broader reform.[65] The last thing this industry needs is further uncertainty on this critical issue.

2. The Commission Should Confirm That All VoIP Services Are Indivisibly Interstate Information Services

Several commenters argue that the Commission need not determine the regulatory classification of VoIP services in this proceeding. They observe that, no matter how the Commission characterizes those services, it is fully authorized to determine the intercarrier compensation rules for such traffic insofar as its broader jurisdictional analysis under Section 251(b)(5) is valid.[66] Although that observation is true, the Commission *should* nonetheless resolve the proper characterization of all VoIP services, because continued uncertainty on that long-disputed issue distorts the market and impedes the deployment of advanced services.

The Commission was correct to recognize that the protocol conversion inherent in any IP/PSTN service renders it an information service under existing precedent. Several commenters argue that the type of protocol conversion at issue falls within a definitional exception for "transmission technologies used to route traffic."[67] As the Commission has explained, however, this exception applies only to the extent that there is no *net* protocol conversion between end users.[68] As Comcast points out, where this type of complete "transformation" takes place, a service easily meets the definition of an enhanced or information service under Commission

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65 *See, e.g.*, Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers Regarding Access Charges and the "ESP Exemption," WC Docket No. 08-152, at 3-4 (filed July 23, 2008) ("*AT&T Declaratory Ruling Petition*").

66 *See, e.g.*, Windstream Comments at 26; NCTA Comments at 7; Comptel Comments at 10.

67 *See, e.g.*, Comptel Comments at 11.

68 *Appendix C Draft Order* ¶ 205 n.522.

precedent.[69] And as one court has held, "[a] net-protocol conversion occurs when an 'end user [can] send information into a network in one protocol and have it exit the network in a different protocol.' That conversion 'transforms' information, and therefore provides an 'enhanced' and an 'information' service."[70] Moreover, the conversion at issue here is far more transformative than the type of conversion that occurs when, for example, a CDMA wireless call is transferred onto a TDM-based wireline network. When a standard POTS call is converted to IP and sent via a VoIP provider to a VoIP customer, the message has not simply changed transmission technologies; it has become susceptible to an entirely new set of functions and capabilities that are integrated into the VoIP customer's service.

There is thus no merit to the "quacks like a duck" argument that Comptel and others make when they suggest that VoIP is essentially "the same service as the customer [gets when] purchasing voice service delivered over [the] circuit-switched network."[71] As Comcast, Verizon, and AT&T have explained, VoIP is a transformative service, "with characteristics in many ways distinct from pre-existing telephone services."[72] For example, Verizon notes that the "voice calling capabilities of these services are inherently tightly integrated with a host of other features and functions that themselves are information services," including access to stored files, voicemail, directory information, and the like.[73] Comcast adds that its VoIP services include functions such as online account management, email forwarding of voicemails, and other integrated capabilities that involve "generating, acquiring, storing, transforming, processing,

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69 Comcast Comments at 19.

70 *Southwestern Bell Tel., L./P. v. Missouri Pub. Serv. Comm'n*, 461 F. Supp. 2d 1055, 1081-82 (E.D. Mo. 2006) (citations omitted).

71 Comptel Comments at 14-16; tw telecom Comments at 12

72 *Appendix C Draft Order* ¶ 205.

73 Verizon Comments at 22-23.

retrieving, utilizing, or making available information."[74] Thus, wholly apart from the net protocol conversion that takes place on an IP/PSTN call, the other unique attributes of VoIP establish it firmly within the "information services" framework, and the Commission should so conclude.

In addition to classifying VoIP as an "information service," the Commission should not only affirm but expand on its prior finding in the *Vonage Order* that VoIP services are indivisibly *interstate* in character and that core federal objectives justify insulating these services from traditional state telecommunications regulation. As Verizon explains in detail, VoIP services—whether fixed or nomadic—are "any-distance, integrated offerings" that do not break down into neat jurisdictional categories.[75] The Commission should make this finding explicit here. The same features that make VoIP an information service make it inherently interstate—or at minimum, make it insusceptible to any traditional jurisdictional analysis.[76] Moreover, as the courts have found, even if there are some aspects of VoIP services that can be jurisdictionalized for some limited purposes without negating federal policy, it would be nonsensical to require providers to divide all VoIP services into separate interstate and intrastate components merely to provide a jurisdictional basis for applying the full panoply of state regulation. *Minn. PUC*, 483 F.3d at 578. In sum, for all of the reasons explained in the *Vonage Order*, state regulation of VoIP services—whether nomadic or fixed—should be preempted because it would inevitably

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74 Comcast Comments at 19 (quoting 47 U.S.C. § 153(20)); *see also* AT&T Comments at 23-25; *AT&T Declaratory Ruling Petition* at 32-33; 47 U.S.C. § 153(20).

75 *See* Verizon Comments at 5-27.

76 Memorandum Opinion and Order, *Vonage Holdings Corp.*, 19 FCC Rcd 22404, 22419-21 ¶ 25 (2004) ("*Vonage Order*") (noting VoIP's "inherent capability . . . to enable subscribers to utilize multiple service features that access different websites or IP addresses during the same communication session and to perform different types of communications simultaneously"); *see also Minnesota Pub Utils. Comm'n v. FCC*, 483 F.3d 570, 578 (8th Cir. 2007).

reach some interstate components of those services and thereby interfere with a distinct federal interest in keeping these services *unregulated*.[77]

Commission clarification of these questions will allow all providers to deploy VoIP services with a clear understanding of the applicable rules. As Comcast notes, such clarification will "promote the goals of section 706 by encouraging increased investment in and deployment of the infrastructure necessary to support broadband services."[78] The only competing concern some commenters raise is the fear that the Commission's classification of VoIP as an information service—and its preemption of state regulation—will somehow deprive VoIP providers or their CLEC partners of existing interconnection or related rights.[79] But as AT&T and Verizon have made clear, these determinations "will not interfere with the existing rights of competitive carriers to interconnect and to use the state arbitration process as provided in the Act."[80] Any certificated telecommunications carrier will continue to have whatever rights it has today under the Act and state law. To remove any possible doubt on this point, the Commission should expressly ratify the Wireline Competition Bureau's *Time Warner* decision, which held that CLECs who choose to serve VoIP providers (including those providers' own CLEC

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77 *See Vonage Order* at 22424 ¶ 32 (noting that other IP-enabled services like the Vonage VoIP service at issue, which included broadband, IP-compatible CPE, a suite of integrated capabilities and features that could be involved sequentially or simultaneously and that allowed dynamic management of personal communications, including voice and video, were "practical[ly] inseverab[le]" and "would likewise preclude state regulation to the same extent"). As AT&T has explained, the conflict inherent in having fifty states regulate such services as Title II telecommunications services need *not* foreclose states from imposing state USF and TRS contribution obligations on VoIP providers. The Commission can and should make clear that such regulation does not conflict with federal policy, which similarly imposes the same type of obligations. *See* AT&T Comments at 50-51.

78 Comcast Comments at 20-21.

79 *See e.g.*, Time Warner Cable Comments at 3-7; *see generally* NCTA Comments.

80 Verizon Comments at 27; *see also* AT&T Comments 25, 31 & n.42.

affiliates) still have statutory interconnection rights, regardless of how VoIP providers' retail VoIP service is ultimately classified.[81]

B. The Commission Should Promptly Ban Traffic-Pumping And Phantom-Traffic Schemes

AT&T's opening comments addressed two particularly pernicious types of arbitrage schemes: *traffic pumping*, in which LECs in rural areas with high access rates enter into revenue-sharing arrangements with third parties in order to artificially inflate traffic volumes and generate windfall profits; and *phantom traffic*, in which carriers avoid appropriate access charges by disguising the source or jurisdictional nature of their traffic. There is broad consensus that both traffic pumping and phantom traffic are serious problems and that the Commission should remedy them immediately.

Although the Commission did not propose a specific solution to traffic pumping in any of the draft orders, commenters from every segment of the industry have called on the Commission to take quick and decisive action to ban such schemes.[82] Those commenters explain that traffic pumping severely distorts competition, bilks ordinary end users to enrich unscrupulous arbitrageurs, and should be curtailed now, regardless of when the Commission adopts

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

[82] *See, e.g.*, Free Press Comments at 6 ("[T]he Commission should be concerned with such arbitrage, because it distorts investment incentives and leads to inefficient investment," with "subsequent welfare impacts . . . on consumers."); Verizon Comments at 67-70 ("The Commission should put an end to the traffic pumping arbitrage scheme, once and for all, regardless of whether it adopts comprehensive reform."); Sprint Nextel Comments at 8 ("[I]t is critical that the Commission act immediately to curtail the deleterious effects of traffic pumping."); Broadview Comments at 9 (noting that the record on traffic pumping "is complete, and the Commission can now act in WC Docket No. 07-135 to select the solution that it deems most appropriate . . ."); Nebraska PSC Comments at 2, 5, 21 (noting that "access stimulation issues definitely should be addressed by the Commission in the short-term").

comprehensive intercarrier compensation reform. The Commission should heed that nearly universal call for action.

Similarly, a broad range of commenters agree that phantom traffic is a serious problem that likewise requires an immediate solution.[83] Although some commenters raise concerns that the proposed solution in the *Appendix C Draft Order* might penalize carriers that should not be held responsible for the "phantom" nature of the traffic they transmit,[84] the Commission can and should eliminate those concerns by adopting the exceptions set out in the Missoula Plan.[85] As AT&T explained in its opening comments, the Missoula Plan identifies several specific situations in which standard industry practice allows departure from call-signaling content rules.[86] In its phantom-traffic rules, the Commission should accordingly identify those situations as included within the "limited exception[s]" to the general rules.[87]

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83 *See, e.g.*, Nebraska PSC Comments at 2, 5, 21-22 (a requirement that carriers properly label traffic "should be implemented as soon as practicable"); Broadview Comments at 6-9 (calling the phantom-traffic problem a "discrete intercarrier compensation issue[] [that] can and should be resolved immediately" (capitalization altered)); Verizon Comments at 63-67 (noting that "[t]he phantom traffic solution contained in the draft orders . . . represents a balanced approach to phantom traffic and could be adopted on a standalone basis, even if the Commission does not adopt all parts of the draft orders"); Windstream Comments at 24-26 ("Windstream largely supports the phantom traffic reform measures proposed by the Commission."); NCTA Comments at 5 (supporting the approach to phantom traffic set out in the *Draft Order*); GVNW Consulting Comments at 10.

84 *See, e.g.*, ITTA Comments at 14 n.27 (the Commission's plan to allow terminating carriers to charge their highest rate for phantom traffic is "punitive to tandem operators who may be unable through no fault of their own to obtain proper signaling information from the originating carrier"); CenturyTel Comments at 8-9 (suggesting protections for transit carriers).

85 *See Missoula Plan*, Section V.B at 57-58.

86 AT&T Comments at 36.

87 *Appendix C Draft Order* ¶ 331.

V. THE COMMISSION SHOULD MAKE LONG-OVERDUE REFORMS TO THE UNIVERSAL SERVICE SYSTEM

A. The Commission Should Move Swiftly To Implement A Numbers-Based Or Numbers/Connections-Based Contribution Mechanism To Fix Today's Unsustainable Revenues-Based System

The Commission's proposal to replace the outdated and long-broken revenues-based USF contribution system enjoys the dual attributes of almost universal support and relative simplicity. The Commission should heed commenters' calls for reform and act now to replace that existing system with one based on numbers or numbers and connections.

It has been nearly eight years since the 2001 rulemaking in which the Commission first proposed reform of the revenues-based framework. Even then, the Commission found that "the telecommunications marketplace has undergone dramatic changes that may necessitate a reexamination of the way in which we recover universal service contributions."[88] The Commission warned then, and has repeated thereafter,[89] that the contribution base would erode in the face of trends toward bundled, all-distance services and away from traditional technologies. Almost a decade later, those trends all but define the modern telecommunications industry. As a result, the Commission has had to "repeatedly patch[] the current system to accommodate decreasing interstate revenues, a trend toward 'all-you-can-eat' services that make distinguishing interstate from other revenues difficult if not impossible[,] and changes in technology." *Appendix C Draft Order* ¶ 93. These patches have been ineffective or worse. Increasing the contribution factor on covered services to combat decreasing assessable revenues

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88 Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, 16 FCC Rcd 9892, 9899-9000 ¶¶ 12-13 (2001).

89 *See, e.g.*, Report and Order and Second Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, 17 FCC Rcd 24952, 24955 ¶ 3 (2002); Report and Order and Notice of Proposed Rulemaking, *Universal Service Contribution Methodology*, 21 FCC Rcd 7518, 7520, 7527-29 ¶¶ 3, 17-19 (2006).

exacerbates the problem by raising the retail prices of those services and thus encouraging migration away from them in favor of uncovered substitutes or by giving carriers perverse incentives to misallocate their revenues to lessen their contribution obligations. In the Commission's own words, the result is a contributions system that is "severely strained." *Id.*

Yet there has never been a greater need for a robust and stable universal service contribution base. As recognized in the draft orders attached to the *Further Notice*, the United States cannot maintain a leadership role in the world economy without a world-class telecommunications infrastructure. That in turn will require, *at a minimum*, the continued availability of existing support. Thus, wholly apart from whether additional funding is needed, the Commission cannot continue ignoring the increasingly destabilizing effects of today's anachronistic contribution methodology on the universal service system as a whole. To the contrary, contribution reform is an urgent imperative.

The record in this proceeding provides full support for moving forward. The commenters overwhelmingly support replacing the end-user-revenues mechanism with some type of numbers-based mechanism.[90] Indeed, with the exception of the isolated comments discussed

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[90] *See, e.g.*, Sprint Nextel Comments at 39; Verizon Comments at 32-33; CTIA Comments at 19; Qwest Comments at 40-41; Comments of Trilogy International Enterprises, LLC at 2 ("Trilogy Comments"); Comments of the Washington Independent Telecommunications Ass'n and the Oregon Telecommunications Ass'n at 10; Comments of the Michigan Public Service Commission at 5 ("Michigan PSC Comments"); Comments of T-Mobile USA, Inc. at 15; Comments of the Public Utilities Commission of Ohio at 36; ITTA Comments at 27; Comments of the Public Service Commission of the State of Missouri at 13; Comments of Network Enhanced Telecom, LLP at 2, 4 ("NetworkIP Comments"); Comments of the VON Coalition, CCIA, ITI, Net Coalition, Technet, and TIA at 16 ("High Tech Ass'ns Comments"); OPASTCO Comments at 6, 7; Comments of the AdHoc Telecommunications Users Committee at 14-15 ("AdHoc Comments"); Joint Comments of Alpheus Communications, L.P. and Covad Communications at 2-3 ("Covad Comments"); Comments of Global Crossing North America, Inc. at 12 ("Global Crossing Comments"); Comcast Comments at 30; Comments of the California Public Utilities Commission and the People of the State of California at 12 ("California PUC Comments"); Comments of the Public Service Commission of Wisconsin at 3-4; Comments of the Oklahoma

below, the record is almost entirely devoid of opposition to the need for such reform. To the extent there is disagreement, it focuses primarily on the implementation details of the replacement approach. AT&T believes that those details can and should be resolved promptly.

As several commenters observe, and as AT&T previously has suggested, the simplest way to implement this core reform would be to move to a unified contribution mechanism that is based solely on numbers.[91] The numbers-only mechanism described by AT&T and Verizon in their September 11, 2008 ex parte[92] would be straightforward and neutral across technologies and end users. It would also be entirely predictable in application, easy to audit, and readily extendable to new and emerging technologies. These virtues of a numbers-based approach are beyond dispute. Indeed, the Commission itself ascribes these attributes to the numbers-based portion of the hybrid numbers/connections-based mechanism it proposes in the *Appendix B Draft Order*.[93] Conversely, many of the criticisms that commenters raise concerning the Commission's hybrid contribution reform proposal relate specifically to the inclusion of connections as part of the methodology, since—as proposed in the draft orders—a connections component would complicate compliance and raise various questions concerning the appropriate and equitable assessments for connection-based customers.[94] Contrary to the suggestion in the

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Rural Telephone Coalition at 6; CenturyTel Comments at 5, 7; Cincinnati Bell Comments at 18; Qwest Comments at 41; Embarq Comments at 17; Windstream Comments at 60-61.

91 *See, e.g.*, Verizon Comments at 33; Covad Comments at 2-3; Cincinnati Bell Comments at 19-20; Global Crossing Comments at 12-13; AdHoc Comments at 14-20.

92 *See* Letter from Mary L. Henze, AT&T, and Kathleen Grillo, Verizon, to Marlene Dortch, FCC, WC Docket No. 06-122 and CC Docket No. 96-45 (filed Sept. 11, 2008).

93 Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *High-Cost Universal Service Support*, WC Docket No. 05-337 (and related proceedings), FCC No. 08-262, at Appx. B ¶¶ 53-59 (rel. Nov. 5, 2008) ("*Appendix B Draft Order*").

94 *See, e.g.*, Covad Comments at 2-5; Comptel Comments at 23-28; Citynet Comments at 24-26; AdHoc Comments at 19-20.

Appendix B Draft Order (at ¶ 78), moreover, a numbers-only mechanism would fully comport with existing law. As Verizon explains, Section 254(d) requires providers of interstate services to contribute on a non-discriminatory *basis*, but it does *not* require such providers to contribute on every interstate *service*.[95]

If, however, the Commission continues to prefer a dual numbers- and connections-based system, AT&T joins the overwhelming consensus that the proposal in the *Appendix B Draft Order* is, with certain modifications, the appropriate basis for reform, and urges the Commission to adopt it as soon as possible. That proposal would assess all numbers (residential *and* business) one flat amount and adopt an additional assessment for dedicated interstate business connections. Though more complex than a numbers-only plan, this proposal is similarly technology-neutral and easily applied to emerging services. As discussed below, so long as the Commission modifies the tiers for assessing business connections, this approach would be equitable, easily enforceable, and much more straightforward and predictable than today's regime.

In this respect, the proposal set out in the *Appendix B Draft Order* stands in stark contrast to the proposals in the *Appendix A Draft Order*[96] and *Appendix C Draft Order*. First, those proposals, while acknowledging the need to end reliance on a revenues-based contribution system, would perpetuate that very system for businesses for the foreseeable future (*i.e.*, "while we conduct a proceeding to implement the connections-based contribution methodology").[97] By

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95 *See* Verizon Comments at 33 n.39 (citing Section 254(d)); *see also* AdHoc Comments at 20-22 (explaining that Section 254(d) does not require identical contribution methodologies to be used for different services and citing the *de minimus* exemption in Section 254(d)).

96 Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, *High-Cost Universal Service Support*, WC Docket No. 05-337 (and related proceedings), FCC No. 08-262, at Appx. A (rel. Nov. 5, 2008) ("*Appendix A Draft Order*").

97 *Id.* ¶ 133; *Appendix C Draft Order* ¶ 129.

retaining revenues as the basis for contribution on business services—and thereby perpetuating the most unsustainable feature of today's contribution system—these proposals would in fact undermine the transition to a more stable and predictable system.[98] Second, the approach in the *Appendix A Draft Order* or *Appendix C Draft Order* would create regulatory confusion and a new generation of arbitrage opportunities by differentiating between "residential" and "business" customers and imposing a numbers-based contribution obligation only on the former.[99] And even beyond these concerns about regulatory certainty and stability, these proposals would create burdensome record-keeping and other implementation nightmares for providers.[100] Accordingly, the only workable hybrid mechanism on the table is the *Appendix B Draft Order*, which moves immediately away from a revenues-based approach and dispenses with unnecessary complexities and artificial distinctions between residential and business customers.

Nevertheless, certain modifications should be made to the *Appendix B Draft Order* to ensure that it can be implemented equitably, as Section 254 requires.[101] The most important of these is modification of the contribution tiers associated with connections. As Covad and others point out, the tiers set forth in the *Appendix B Draft Order* would disproportionately burden

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98 *See, e.g.*, Verizon Comments at 36-37; AdHoc Comments at 14, 24-25; Windstream Comments at 60-62; Covad Comments at 2-3; NetworkIP Comments at 5-9; Sprint Nextel Comments at 52.

99 AT&T Comments at 50; Letter from Mary L. Henze, AT&T, to Marlene Dortch, FCC, WC Docket No. 06-122 and CC Docket Nos. 96-45 and 01-92, at 9-11 (filed Nov. 21, 2008) ("*AT&T Nov. 21 Ex Parte*"); Verizon Comments at 36-37; Covad Comments at 7 ("[R]equir[ing] carriers to determine how a customer is using a particular service in order to classify it for USF contribution purposes . . . has been a significant problem with the current methodology."); Broadview Comments at 54-56.

100 *See* Verizon Comments at 36-37; Broadview Comments at 54-56; Trilogy Comments at 2; Cincinnati Bell Comments at 19-20; Comments of the USA Coalition & Rural Cellular Ass'n at 27-28 ("USA Coalition Comments").

101 AT&T detailed a number of proposed modifications to the *Appendix B Draft Order* in the *AT&T Nov. 21 Ex Parte*. While AT&T does not repeat all of them here, it continues to urge the Commission to make all of those recommended changes.

small businesses (which use smaller increments of capacity) with excessive contribution obligations.[102] The revised tiers that AT&T proposed in its October 29 ex parte filing were specifically designed to address this unintended consequence of the original tiers previously proposed by AT&T and Verizon.[103] Even commenters most critical of the existing tiers recognize that the revised tiers are an improvement over those in the *Appendix B Draft Order*.[104] In Covad's words, "[t]he AT&T alternative makes great strides in fixing the inequities inherent in Proposal B by creating broadband usage tiers that treat small businesses more fairly and ensure small businesses are not left bearing the brunt of universal service contribution."[105] The Commission accordingly should adopt the revised tiers submitted by AT&T.

The Commission should promptly adopt this modified proposal, while retaining the ability to make additional adjustments to the specific assessment levels as future circumstances may warrant. Once the Commission adopts the tier categories, contributors can begin the work to their systems that will be necessary to record and report Assessable Numbers/Connections.[106] The Commission then can use the period when carriers must "double report" on both their revenues and their Assessable Numbers/Connections to evaluate the sufficiency of the initial assessments, with input from the industry, of course—and can modify them if necessary to

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102 *See, e.g.*, Covad Comments at 3-4; Comptel Comments at 24-28; Broadview Comments at 56.

103 Letter from Mary L. Henze, AT&T, to Marlene Dortch, FCC, WC Docket No. 06-122 and CC Docket No. 96-45 (filed Oct. 29, 2008).

104 *See, e.g.*, Covad Comments at 5; Comments of Megapath Inc. at 2-4.

105 Covad Comments at 5.

106 In fact, if the Commission decides to proceed with one of its other two proposals, and thus seeks further comment on the connections-based approach, it should delay implementation of the numbers-based assessment as well until it finalizes the connections component. It would be burdensome and inefficient for contributors to make some but not all of the changes to their billing systems. Beginning that process but not completing it would likely extend the time for and increase the costs of implementation.

ensure that the right amount of funding is collected, and in an equitable manner. Among other things, the Commission should be careful to ensure that any modification to the connection assessments retain the relative relationships among Assessable Numbers and connections.[107]

Several other modifications to the *Appendix B Draft Order* would also be in order, as several commenters note:

- **The Commission Should Simplify the Definition of "Assessable Number":** The Commission should adopt AT&T's and Verizon's proposed definition of this term, which is preferable to the one the Commission advanced in the draft orders.[108] As several commenters note, the Commission's definition is confusing and laden with provisos and exceptions that should be rejected in favor of the simpler approach that AT&T and Verizon have suggested.[109] And the Commission should in all events reconsider its proposal to include not only NANP numbers but also "functional equivalent identifier[s]" within the definition of "Assessable Numbers."[110] The "functional equivalent" category is highly ambiguous, and it could be read to broadly sweep any number of now-exempt services into the category of USF contributors.[111] For example, as Verizon points out, "Private Chat" services associated with Xbox Live gaming systems or computer-to-computer game systems might have some limited "functional equivalence" to an end-user NANP number, for specific purposes—but no one seriously proposes to subject these services to USF obligations.[112] Nor, as several commenters note, is there any need for the Commission to expand the contribution base so dramatically at this time. The Commission can address the need to assess such "identifiers" if and when there is any evidence that they are displacing NANP numbers—whether in an effort to avoid universal service obligations or simply as a result of technological change.[113]

- **The Commission Should Apply the Same Contribution Methodology Across the Universal Service, TRS, LNP, and NANP Funds.** Commenters broadly agree with AT&T that it would make no sense to apply different contribution methodologies for

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107 *See, e.g.*, Letter from Mary L. Henze, AT&T, and Kathleen Grillo, Verizon, to Marlene Dortch, FCC, WC Docket No. 06-122 and CC Docket No. 96-45, at 2 (filed Oct, 20, 2008) ("*AT&T/Verizon Oct. 20 Ex Parte*").

108 *AT&T/Verizon Oct. 20 Ex Parte*, Attachment at 1; *AT&T Nov. 21 Ex Parte* at 3-5.

109 *See, e.g.*, Verizon Comments at 34-35; Sprint Nextel Comments at 46.

110 *Appendix B Draft Order* ¶ 63.

111 AT&T Comments at 47-48; *AT&T Nov. 21 Ex Parte* at 3-4; Sprint Nextel Comments at 44-45; Verizon Comments at 34-35; High Tech Ass'ns Comments at 18-19.

112 Verizon Comments at 35.

113 Sprint Nextel Comments at 45; Verizon Comments at 35; *AT&T Nov. 21 Ex Parte* at 4.

these various funds. Indeed, doing so would be contrary to Commission precedent and would create an administrative and compliance nightmare.[114]

- **The Commission Should Lengthen the Implementation Period:** As AT&T explains in its opening comments,[115] and as many other commenters argue as well,[116] six months is an inadequate period of time in which to modify carrier systems to enable them to track and report numbers and/or connections. This concern would not be resolved by the additional six-month grace period the Commission has provided before *contribution* obligations begin, since carriers will still face *reporting* obligations during that period. And the short amount of time provided in the *Appendix B Draft Order* is insufficient for modification of carriers' existing systems. The Commission should therefore allow an additional six months for such modifications.[117]

- **The Commission Should Clarify that Assessable Number Counts Should Be Recorded Monthly, Not Daily.** The *Appendix B Draft Order* states that contributors would have to report Assessable Numbers and Connections on a monthly basis, but also notes that the reports must indicate numbers that are in use "during any point in the relevant month."[118] Some commenters read the latter phrase to create confusion about whether providers must keep track of numbers and connections on a daily basis.[119] The Commission should confirm that contributors need only count their Assessable Numbers and Assessable Connections on a *monthly* basis—for example, at the end of the month—not on a daily one.

- **The Commission Should Ensure that the Charges Will Remain Stable and Not Be Subject to Change on a Regular Basis.** At least one commenter raises questions concerning how frequently the Commission might revise the Assessable Number and Assessable Connection charges.[120] When AT&T and Verizon proposed the tier and number charges, they were designed to be fixed, flat-rate amounts that would be

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114 *See AT&T Nov. 21 Ex Parte* at 6-7; AT&T Comments at 48-49; Trilogy Comments at 4; Sprint Nextel Comments at 52-53; Covad Comments at 8-9; Windstream Comments at 60-62; Massachusetts Department of Telecommunications and Cable Comments at 26; Comments of the National Exchange Carrier Ass'n, Inc. at 43 ("NECA Comments"); Verizon Comments at 39; Cincinnati Bell Comments at 19.

115 AT&T Comments at 48.

116 Sprint Nextel Comments at 54; Covad Comments at 9; Cincinnati Bell Comments at 24-25; Qwest Comments at 42-43; Citynet Comments at 28.

117 The implementation period is yet another reason that the Commission should move promptly to adopt contribution reform: even once the Commission has enacted the new mechanism, it will be a year before those reforms are fully in place.

118 *Appendix B Draft Order* ¶ 96.

119 *See, e.g.*, Sprint Nextel Comments at 53; Cincinnati Bell Comments at 20.

120 *See* Sprint Nextel Comments at 53.

> sufficient to cover funding demand for the foreseeable future. The Commission should clarify that it will not modify these charges (up or down) unless absolutely necessary.[121] Given the increased overall stability of a numbers-based system, AT&T believes that the Commission should reduce consumer confusion and costs for both contributors and administrators by eliminating or at least minimizing the regular fluctuations in charges that occur today.

None of these modifications would be difficult to implement, and none should slow the Commission's adoption of a new contribution mechanism to replace the broken revenues-based model. As noted above, the minimal opposition to this long-overdue development is isolated and insubstantial. For example, although Broadview contends that such reform would be too "complex,"[122] AT&T and others have demonstrated that this is simply untrue and is, in reality, nothing more than empty rhetoric in support of the do-nothing approach that has mired the industry in its current problems. And although NTCA and NASUCA express a preference for today's revenues-based approach,[123] NTCA acknowledges that this approach could work, if at all, only if the Commission dramatically broadened the contribution base to include all manner of facilities-based, IP-enabled, "broadband information services,"[124] presumably including content delivery networks such as those owned by Akamai or Google. This "solution" would expand the Commission's authority into uncharted territories, and, to the extent the Commission tries to draw lines to identify those Internet-based companies that are subject to contribution

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121 As AT&T and Verizon proposed in their October 20, 2008 ex parte, USAC should be permitted to collect any overage in an account that could be applied to cover any fluctuations in funding needs year to year. The Commission could then establish upper and lower thresholds for this account that would trigger review of the USF charges, up or down. *AT&T/Verizon Oct. 20 Ex Parte* at 3.

122 Broadview Comments at 54.

123 NTCA Comments at 26-29; Comments of the National Ass'n of State Utility Consumer Advocates, Maine Office of Public Advocate, Maryland Office of Peoples' Counsel, the Utility Reform Network, and the Utility Consumer Action Network at 39 ("NASUCA Comments").

124 NTCA Comments at 27.

obligations and those that are not, it would generate a brand new welter of destabilizing new arbitrage opportunities as well.

In short, contribution reform stands out as a step on which almost the entire industry is in sync. Given the breadth of this support and the pressing need for reform, the Commission should move forward promptly.

B. Proposals For Reform Of USF Distribution

A key component of the Commission's proposals for reforming USF distribution is reduction of CETC funding through elimination of the "identical support rule." If the Commission proceeds with this approach, AT&T urges the Commission, consistent with the views of most commenters, to phase out legacy CETC funding over a five-year transition period, as opposed to a flash-cut to zero.[125] The *Appendix C Draft Order* purports to establish such a transition,[126] but as Verizon and CTIA note, that order, as currently drafted, would actually result in a four-year transition. In particular, because it proposes an *immediate* reduction of 20 percent of CETC funding on the effective date of the order, rather than one year *after* the effective date of the order, it would produce five 20-percent reductions by the end of four years.[127] The Commission should modify the language in the *Appendix C Draft Order* to make clear that the

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125 CenturyTel Comments at 7-8; Verizon Comments at 28-30; CTIA Comments at 17; Michigan PSC Comments at 3-4; Comments of the National Exchange Carrier Ass'n, Inc. at 16-17 ("NECA Comments").

126 *Appendix C Draft Order* ¶¶ 17, 52.

127 Verizon Comments at 30 ("The phase-down of competitive ETC support should begin with a 20 percent reduction in funding the year following the effective date of the order. The draft order, however, proposes an immediate flash cut of 20 percent of competitive ETC funding, which would effectively convert a five-year transition for wireless carriers into a four-year transition."); CTIA Comments at 17 (noting that, under the *Draft Order* as written, "all CETC support would be eliminated at the end of the fourth year following the beginning of the transition."); *see also* Centennial Comments at 3.

transitional phase-down of CETC funding will take place over the full five years it has proposed, and not just four.

Many commenters also have expressed the well-founded concern that none of the proposals attached to the *Further Notice* would address the Tenth Circuit's February 2005 remand in *Qwest Communications International Inc. v. FCC*, 398 F.3d 1222 (10th Cir. 2005).[128] As AT&T has explained, these reforms are necessary to ensure that high-cost funding is sufficient for and appropriately targeted to the highest-cost areas where support of facilities is most critical to ensure affordable services, even in states whose average *statewide* costs are moderate (because they contain a mix of large, densely populated urban areas and remote, high-cost rural areas). High-cost areas that receive no funding under the framework in place today would be left even further behind if the Commission were to adopt the broadband USF proposals without first ensuring that high-cost support is more appropriately targeted.[129] As the Commission crafts its final USF distribution-reform plan, it therefore must include provisions to address these remand issues.

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[128] *See, e.g.*, Qwest Comments at 36-38; USA Coalition Comments at 4-7; Comments of the Washington Utilities and Transportation Commission at 6-7; Comments of the New Jersey Division of Rate Counsel at 43-48.

[129] Indeed, several commenters recommend that the Commission *first* tailor the high-cost mechanism so that support is sufficient for and directed to areas where funding is needed most, and *then* adopt measures to ensure that the funding targeted to those areas supports the deployment of broadband facilities in particular. *See, e.g.*, California PUC Comments at 9; Qwest Comments at 38. As AT&T has explained, the Commission should issue an order addressing the Tenth Circuit's second remand as quickly as possible. AT&T Comments at 45.

CONCLUSION

With the modifications discussed in AT&T's opening comments and above, the Commission should adopt the reform plan for intercarrier compensation outlined in the *Appendix C Draft Order* and the USF reform plan outlined in the *Appendix B Draft Order.*

Respectfully submitted,

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December 22, 2008