

Intercarrier Compensation – A plea for rationality

By Gregory J. Vogt

Pleas for reform by the Federal Communications Commission (“FCC”) of intercarrier compensation rules are again being pressed publicly. The most recent event sparking the outcry for reform is the so-called “Missoula Plan.” Filed in July 2006, the Missoula Plan proposes to reform intercarrier compensation rules. The Plan resulted from a National Association of Regulatory Utility Commissioners (“NARUC”) task force effort to achieve an industry consensus. The Missoula Plan has been placed on public notice by the FCC in its *ICP*, but the FCC has taken no position one way or another on whether the plan should be adopted. Multiple rounds of comments have been filed both supporting and criticizing the Plan.

Background

Intercarrier compensation in the telecommunications industry has arisen largely through historical accident. The scheme has become incrementally more complicated as technology has increased the number and types of telecommunications industry players, each operating under their own intercarrier compensation scheme imposed to meet the initial requirements of those players’ particular circumstances. For instance, the unified AT&T, dubbed “Ma Bell” separated costs and revenues among its local exchange and long distance operations through a complex scheme of jurisdictional separations.¹ AT&T compensated independent local exchange carriers through privately negotiated intercarrier agreements.²

When Ma Bell was split up by the courts at the insistence of the Department of Justice, the FCC instituted a new access charge scheme that required local exchange companies to file tariffed charges levied on long distance and other users. The Bell Operating Companies (“BOCs”) and other large companies’ access rates were eventually regulated under a price cap system, while most of the independents continue to be regulated under rate of return methodologies. BOC rates have come down substantially over time, but smaller ILEC rates continue to be fairly significant.

When cellular companies began operating, the FCC mandated that they pay access charges for interstate calling, but mandated intercarrier negotiated rates for local

¹ Jurisdictional separation was maintained as a system even after AT&T was split up to ensure that any carriers’ costs were properly separated between the federal and state jurisdictions, since all carriers provided both local services and federal services. The current version of separations is located in Part 36 of the FCC’s rules. 47 C.F.R. Part 36. This system became somewhat more complex when two or more local exchange carriers jointly provided the access service. The FCC did impose a system of “meet point billing” on these arrangements in order to cut down on some controversy associated with this type of pricing as competition grew in the long distance business. *See generally* Access Billing Requirements for Joint Service Provision, 65 RR 2d 650 (1988).

² These intercarrier agreements continue to be valid with minimal federal or state regulation. Many of these agreement resulted in the equivalent of “bill and keep” rates.

traffic.³ These rates were eventually replaced in 1996 with a system of intercarrier compensation contained in Section 251 and 252 of the Communications Act. Since the Act required compensation to be set at “additional costs”,⁴ these rates were routinely far lower than the methodologies used to compute access rates.⁵

Internet-service providers were exempt from most access rates pursuant to an FCC policy that was designed to promote the growing industry.⁶ The FCC eventually adopted an ISP-bound rate that was substantially lower than those applicable even for reciprocal compensation situations.⁷

Intrastate long distance access charge rates, on the other hand, were not regulated by the FCC, and state commissions allowed or mandated that they be kept at extraordinarily high rates in order to keep local rates low. Very few states are politically motivated to change this anomalous situation, because raising local rates is perceived to be a political problem.

These widely varying rates had been of concern to the industry because a number of carriers, both upstanding and unscrupulous ones alike, had been engaged in arbitrage. This meant that these carriers would attempt to classify particular traffic as a certain type in order to minimize the charges associated with the call. Thus, long distance carriers would classify intrastate toll traffic as interstate, and long distance traffic as local traffic, in a never-ending scheme to minimize their costs. Although carriers, mostly local exchange carriers, constantly sought to enforce proper classification of traffic, these enforcement efforts were only marginally effective and led to a plethora of proceedings seeking official designations of traffic.⁸

In an effort to end this seemingly endless bickering, the FCC launched the *ICP* in 2001, proposing to mandate that all telecommunications carriers move to a “bill and keep” regime.⁹ The FCC reached no tentative conclusions as to a solution, but did

³ *The Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services*, 59 RR 2d 1275 (1986).

⁴ 47 U.S.C. §252(d)(2)(A).

⁵ Although states were responsible for arbitrating and determining actual reciprocal compensation rates, the FCC established national standards based on a forward-looking cost methodology. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 15499, ¶¶ 616, *et seq.* (1996).

⁶ *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd 2631 (1988).

⁷ *Intercarrier Compensation for ISP-Bound Traffic*, 14 FCC Recd 3689 (1999). Although the courts twice remanded this proceeding to the FCC because of the legal theory it used to adopt the lower prices, the pricing rules remain in effect today. *See, e.g., WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 .S. 1012 (2003).

⁸ *See, e.g., Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, 21 FCC Rcd 7290 (2006).

⁹ *Developing a Unified Intercarrier Compensation Regime*, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001)(“*Intercarrier Compensation NPRM*”).

identify two different FCC staff plans that essentially would produce the same result: carriers would not bill each other for interconnection, but would bill their own end users for these costs instead. Carriers would pay for transport to the last interconnection carrier that served the terminating end user. The FCC indicated that a bill and keep proposal could make some end user rates go up significantly, which could create concerns about whether universal service could be maintained.¹⁰ Many have suggested that this concern could be dealt with by placing some limit on an increase in end user charges, and establishing a new universal service mechanism to compensate those carriers that could not adequately recover costs under this proposal.¹¹

The FCC was responding to pleas from various industry members that the existing system of intercarrier compensation was broken. It indicated that reforming intercarrier compensation, which included interstate and intrastate access charges, reciprocal compensation payments, and other intercarrier payments needed to be applied consistently to all communication types, including wireline, wireless, voice over internet, ISP-bound traffic, etc. It found that reform was critical to (1) eliminate arbitrage among various types of interconnection regimes; (2) rationalize pricing for essentially the same type of physical interconnection; and (3) ensure that regulations did not impede fair competition.¹²

Industry response was predictably mixed. Although many industry members applauded the need for and concept of “bill and keep,” various industry segments disagreed on the way in which reform should be accomplished. Initial rounds of comments created no workable consensus on how to accomplish the reform. In the end, the FCC was faced with a proposal that was roundly criticized, did not clearly achieve a workable solution, and resulted in consumer price increases that had no ready base of political support.

In light of these problems, the FCC, under a Republican FCC chairman, informally encouraged the industry to achieve consensus on a plan to reform intercarrier compensation. Industry members worked hard for over two years to hammer out such an approach, resulting in the creation of the Intercarrier Compensation Forum (“ICF”) proposal that was filed with the Commission back in 2004.¹³ ICF limited its members to those participants that agreed to put forward a “bill and keep” proposal. Despite significant input from a number of industry members, the final ICF proposal was agreed to by only a handful of participants.¹⁴

The FCC put the ICF proposal out for public comment, and again the reviews were mixed. Trade associations for all major competitors to the incumbent local

¹⁰ *Id.* at ¶¶ 123-24.

¹¹ *See*, Letter from Gary Epstein, Counsel for Intercarrier Compensation Forum to FCC, Appendix A, *Intercarrier Compensation and Universal Service Reform Plan*, at 60-75 (filed in CC Docket No. 01-92, Oct. 5, 2004)(“*ICF Plan*”).

¹² *Intercarrier Compensation NPRM* at ¶¶ 11-18.

¹³ *ICF Plan*.

¹⁴ ICF members were AT&T, Global Crossing, General Communications, Iowa Telecom, Level 3, MCI, SBC, Sprint and Valor Telecom

exchange carriers (“ILECs”) vigorously opposed the plan. And not even all ILECs supported the proposal, with Verizon, Qwest, BellSouth, several mid-size carriers, and almost all the small rural ILECs opposing the plan as filed. From this response, one could only conclude that the Herculean ICF proposal was a bomb. The FCC, although it continued to extol the need for reform as crucial, rightfully walked away from the proposal as unworkable either practically or politically.

The current Republican Chairman and FCC Commissioners of both parties, informally asked the NARUC task force on intercarrier compensation to see if it could obtain an industry consensus on reform. After over a year’s effort, the task force filed with the Commission the *Missoula Plan* on July 25 2006.¹⁵

Missoula Plan Proposal

The Missoula Plan significantly abandons the Intercarrier Compensation Forum’s insistence to go to full bill and keep. Rather, it proposes to move to a system where an equal charge for an equivalent volume of traffic be instituted instead, on the theory that the price tag could be more palatable to both consumers and carriers alike. Other technical details of the Plan also differ, particularly its attempt to provide more compensation for rural ILECs.¹⁶

The proposal is enormously more complicated than the following description, but these general points give the reader a rough idea of its provisions. The Missoula Plan established a glide path for intercarrier rates based on the type of carrier involved, creating three “tracks.” Although oversimplified, large ILECs, CLECs and CMRS carriers were track 1, mid-size carriers were track 2, and smaller ILECs were track 3. Each track moved rates over a four year transition period to a target level, each target level being different, depending on the track of the carrier (although all rates of a certain carrier would move to an equal rate). Track 3 carriers would move rates to their interstate access level.

End user rates would gradually increase, with different price points for different tracks. However, basically large carrier end user rates could rise \$4.50 and mid-size and smaller carrier rates could rise by \$2.25, more for second lines and multi-line business lines.

The Plan adopts a new network architecture. Each carrier would establish an “edge”, the point at which other carriers would terminate traffic on the receiving carrier’s networks. In general, carriers would have to pay the cost of transporting a call originating from its end user to the edge of the terminating carrier. For smaller ILECs, the non-rural carrier would pay the cost of transport in both directions, either in whole or in part. A carrier can pay another carrier to transport traffic if it cannot do so over its own network. Transport rates of larger ILECs will continue to be regulated for a period of time.

¹⁵ Letter from NARUC Task Force on Intercarrier Compensation to FCC, CC Docket No. 01-92 (filed July 24, 2006 (“*Missoula Plan*”).

¹⁶ The Missoula Plan is an extremely complex document, with the executive summary alone running 14 pages.

If a carrier cannot make up the difference between its intercarrier rates and what it is currently receiving, it is entitled to recover at least a portion of the difference in the Restructure Mechanism, a universal service-like fund, estimated to be about \$1.5 billion by the end of the four-year transition. The signatories could not agree whether this new mechanism would be portable to competitors as are universal service funds. The Plan also proposed an approximately \$200 million early adopter fund supplement designed to repay states for money spent in early attempts to rebalance rates under the current rules.

Although the proposal does include members from the large, mid-sized, and small ILEC, CLEC, and wireless industries,¹⁷ the filing led to resounding claims that it too was deficient and was the creature of a largely ILEC-oriented consensus, particularly favorable to small rural ILECs. Trade associations for the CLEC, wireless, and consumer advocates again quickly condemned the NARUC proposal as unworkable and inconsistent with the FCC's stated goals. Verizon and Qwest did not in the end join the NARUC effort. And even NARUC task force chair Ray Baum quickly emphasized that no state commissioner endorsed the plan; rather the task force sought to achieve an industry consensus.

I will not attempt to summarize all the comments, but non-ILECs in general trashed the plan as too rich for ILECs. NASUCA, the state ratepayer consumer advocate panned the proposal. And the states were seriously split on the wisdom of the plan. Rural ILECs were uniformly in favor of the proposal. Verizon and Qwest opposed the plan, instead putting forth their own solutions to the issues.

In order to shore up support, the Missoula Plan supporters submitted a revision in November.¹⁸ On January 30, 2007, they also filed an amendment to the Plan called the Federal Benchmark Mechanism.¹⁹ The plan added \$806 million and details to a state support mechanism designed to compensate funds in state for attempts to rebalance rates in the past. The Supporters also urged the Commission separately to address the phantom traffic issues that have plagued the industry.²⁰

Does the Country Need Intercarrier Compensation Reform?

I predict that the FCC will be unwilling to move forward with the Missoula Plan, mainly because it does not reflect industry consensus. Understandably, the FCC needs a solid plan that has sufficient proponents to withstand the inevitable political attack that follows increased end-user charges. Even if overall consumer prices do not rise because carriers pass on their intercarrier compensation cost savings on to consumers, the specter

¹⁷ Missoula Plan Supporters include AT&T, BellSouth, Cingular Wireless, Commonwealth Telephone, Consolidated Communications, Epic touch, Global Crossing, Iowa Telecom, Level 3, Madison River, and the Rural Alliance, made up of 336 small, rural independent telephone companies.

¹⁸ Comments of Missoula Plan Supporters, Docket 01-92, Appendix A (filed October 26, 2006).

¹⁹ Letter from Supporters of the Missoula Plan and Five State Public Utility Commissions to FCC, CC Docket No. 01-92 (filed Jan. 30, 2007).

²⁰ *See* Letter from Supporters of the Missoula Plan to FCC, CC Docket No. 01-92 (filed Nov. 6, 2006).

of a possible rise in consumer prices will create controversy.²¹ Although the FCC could adjust the Missoula Plan proposals, it is doubtful that it will do so given the broad criticism of its previous attempts at fashioning a solution.²²

After this third problematic attempt to craft a comprehensive solution to the intercarrier compensation issue, it is time to take a step back and evaluate what this effort is all about and determine whether it is worth continuing to try to reform intercarrier compensation holistically. There are certain basic principles upon which most participants agree.

First, intercarrier compensation prices are widely divergent under existing regulations, which leads to regulatorily encouraged arbitrage. Intercarrier compensation prices vary from between zero and over nine cents per minute, despite the fact that the interconnecting carriers are paying for basically the same physical facilities: interconnection, transport, and switching. It is a widely held view that “a minute is a minute”, a view that has been espoused for over ten years by both Democratic and Republican FCC Chairmen and commissioners.²³

Second, some intercarrier compensation prices are too high. Almost all participants agree that some rates, particularly access rates, are too high. Even those carriers who charge these high rates would support decreases, but state that they cannot do so because the revenues generated by the traffic support low basic telephone rates, and can be achieved only by rebalancing, which is politically difficult.²⁴ Everyone but state commissioners agree that local regulators do not have the political will to fix their own

²¹ Consumer advocates argue that the FCC should mandate such cost saving pass through; carriers, however, do not believe a federal mandate is necessary. This debate is essentially between those who do not trust market forces and those who do.

²² Even Ray Baum publicly stated that the FCC is unlikely to fashion its own solution. *See* Comments of Ray Baum, Federal Communications Bar Association, Forum on Intercarrier Compensation (Sept. 27, 2006).

²³ Chairman Reed Hundt drew this conclusion as early as 1996. Speech of Reed Hundt, Chairman, FCC, to National Association of Regulatory Utility Commissioners, Los Angeles, California (July 23, 1996).

²⁴ It is a widely held view among the rural ILEC community that rural ILECs cannot raise local exchange rates because state politicians would prevent the adjustment. Although this theory is not often tested, many in the industry know that this statement is true as a practical matter, even though there are few empirical studies that support the belief. What is known is that there are noted examples where rate increases are actively opposed that clearly undermine rate rebalancing efforts. *See, e.g., Crist v. Jaber*, 908 So. 2d 426 (Fl. 2005). This successful Florida rate increase has been met by continual attempts at reversal by Florida politicians. *See, e.g., Communications Daily*, Nov. 28, 2005 (Attorney General, in his efforts to undermine the PUC decision to allow rate increases, proposes commissioners be elected rather than be appointed). And the FCC has stated that rebalancing of state rates is not required by the federal Communications Act, *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, ¶ 26 (2003), although rebalancing federal rates is required by the Act. 47 C.F.R. § 254(e). This is not to say that there have been no rebalancing efforts, there have been. For instance, Montana has raised local rates by fairly large margins, while imposing a state universal service fund. These efforts nationwide, however, are mixed and there is no consensus about whether the rebalancing has completely set rates based on costs. Indeed there does not seem to be agreement even on what costs should be covered.

issue by allowing or forcing a rise in low basic rates which do not even cover carrier costs.

Third, regulatory asymmetry fails to achieve competitive neutrality. Various industry segments have advantages created by asymmetrical regulation, although it is impossible to get the various industries to agree on which industry has greater advantages or whether such advantages are unreasonable. At a base, everyone agrees however that competitive neutrality has not been achieved by the present rules.

Fourth, there is a need to reform intercarrier compensation. All industry segments agree that there is a need for reform. The FCC has often stated that this need is critical. Although some groups in the context of the “Missoula Plan” are for the first time raising doubts about how serious the issues are, I view these as arguments designed to support their positions on the Missoula Plan rather than serious factual conclusions.

Examining all four of these basic principles, it would appear that there is indeed still a reason to move forward with reform. The only serious disputes go to which rules should be adopted and when. Although these remaining differences are crucial and difficult, they do not undermine the basic conclusion that reform is needed. Given this conclusion, it is useful to analyze current positions and arguments to determine the real needs of the regulators and the industry participants. This effort leads to some basic conclusions about what elements are necessary to achieve a successful plan in the future.

What does the FCC need to proceed?

Although determining FCC needs is difficult without a published final conclusion on a subject, there are some conclusions that can be drawn.

First, the FCC needs to work with a reasonable plan that accomplishes the stated goals. This is necessary in order to protect any FCC decision from Administrative Procedures Act attack, and is the only thing that will help it to meet its public interest goals. In evaluating any plan, the FCC will need to be able to describe why it is consistent with the public interest and why the arguments of any detractor are erroneous.

Second, the plan must lead to predictable results. Not only is this necessary to ensure that the plan is reasonable as stated above, it is also a statutory requirement for any universal service support mechanism adopted pursuant to Section 254 of the Communications Act. Predictability, it seems, also means that the plan must be simple enough that the outcome can be determined by non mathematicians and non lawyers. Although “simplicity” sometimes becomes an almost meaningless talisman, in this case it is a real live need in a field that is overly complicated to begin with.²⁵ It could help to achieve political consensus as well.

Third, a broad industry consensus is critical to achieving reform of intercarrier compensation. Any proposal that involves increases to subscriber rates requires political support to achieve. One need only look to 1984, the first time subscriber line charges were imposed, which were only one to two dollars at the time, to understand how quickly

²⁵ The calls for simplicity tend to be overstated. If there is an agreement on the result, even very complicated plans can gain approval. See *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd 12962 (2000) (“*CALLS Order*”).

Congress would move to overturn an FCC initiative that involves increases to subscriber rates. In contrast, in 2000, when the CALLS plan increased SLCs for the largest carriers by over \$3, there was not a peep out of Congress in large part because almost all of the affected industry supported the proposal, except for consumer advocates.²⁶ Industry consensus also tells a regulator that a true compromise has been reached, one where no individual participant gets everything, but each gets something.

What does the industry need?

Industry needs are sometimes elusive when evaluated against public statements. However, in this case the fundamental needs are pretty obvious. The “industry” has a variety of needs, depending on the individual circumstances of a particular company. However, some fundamental goals can be discerned by industry segment.

ILECs. The ILECs need to ensure that they have a fair competitive posture with intercarrier compensation reform. ILECs face a variety of regulatory requirements that others do not face, including regulated pricing and practices, and the obligation to serve high cost areas under the carrier of last resort principle. They also need to ensure that they receive fair compensation for the services or network they provide. Part of the cost issue for ILECs is the undepreciated portion of their legacy networks that cannot simply be eliminated all at once without causing financial damage.

However, different sized ILECs appear to have separate problems. AT&T’s ILEC, SBC, is concerned that the only way to avoid arbitrage is to reform intercarrier compensation. Conjoining AT&T’s long distance business to this issue, adds the concern that access rates be reduced all over the country. Small carriers, on the other hand, face much less competition than does AT&T, and are still focused on maintaining the revenue stream that they currently receive from access charges and universal service, which can be as high as 60 percent for some carriers, but is more typically about 30 percent. Mid-size carriers, such as Windstream and Iowa Telecom, have a mix of needs, some of which resemble the small carriers’ problems. In addition, they see that there is a market transition in their territories that requires an AT&T-like solution, but probably a couple of years after AT&T, and possibly at a different pace for their numerous varied markets.

CLECs. The CLECs need to ensure that they have fair competition, but are nervous about losing the natural advantages that they possess, such as the freedom not to charge SLCs. Preserving access charges also entitles them to maintain terminating rates that are pegged to the ILEC rate in-region. CLECs that rely on ISP-bound traffic do not want all intercarrier compensation to go away, but their advantages in this area have already been substantially eliminated by FCC rulings. CLECS also are adamant that

²⁶ I do not mean to imply that consumer advocate opposition is unimportant, it is. Rather, consumer advocates tend to be somewhat discounted by regulators because they cannot speak directly for the public, but rather take positions that their representatives decide they should take based on limited data and their own viewpoints. And their positions tend to be on behalf of only a certain type of consumer, even though different consumers are likely to have different opinions about a particular regulatory policy. Regulators and politicians must thus take a hard look at consumer advocate positions, determine for themselves what benefits and detriments accrue to consumers from a plan, and evaluate any grass roots support for or against such a proposal.

ILECs not be guaranteed their current income levels because to do so allows them to perpetuate their monopoly advantages. They also plead for simplicity in the rules.

Cable and VoIP. These industry segments are grouped together since their interests are largely aligned, and often the same companies are utilize both technologies. VoIP providers do not want to lose their inherent advantages as new entrants.²⁷ Both benefit from the lack of regulation and the fact that neither pays access charges. At a base, they need to maintain a neutral competitive posture to survive. Cable is not nearly as vulnerable since they have substantial sunk investment in last mile facilities. However, they still seek to benefit from the new entrant advantages of pricing flexibility and less regulatorily imposed legacy rate elements. Cable states that it thinks that the Commission should promote facilities-based competition. Both Cable and VoIP plead for simplicity in the rules.

Wireless. Wireless companies need to maintain a neutral competitive posture and would prefer to keep their competitive advantages that avoid most regulations. However, since cellular must pay intrastate and interstate access charges for some traffic, they need those rates to be as low as possible. Wireless is also adamant that ILECs not be guaranteed existing revenue streams because it would be anticompetitive and harm their own customers, who would have to pay higher universal service pass-throughs. And you've heard it before, they think the rules need to be kept simple.

Consumers. Consumer advocates need end user rates to be as low as possible, and they would prefer that low volume users pay less than high volume users. Consumer advocates would like the government to promote competition so that consumer choices are greater and competition can discipline market prices and practices, although they voice a heavy skepticism that such discipline is achievable from a practical viewpoint. And they want to keep the rules simple.

States. All of the states are nervous about consumer price increases and none of them will accede to the FCC's jurisdiction over intrastate access rates. As to the rest of the issues, states are split. About a third of the states are urban and are thus net payers into the current USF. These states uniformly oppose increases in universal service surcharges and SLC rate increases or any incursion into their own jurisdiction. Another third are rural and thus net recipients of the current USF. They tend to advocate for increased governmental support. The rest just do not actively participate in the FCC's proceedings for various reasons. Because states have more contacts with consumers, their needs are more closely aligned with those of consumers than with those of any particular type of carrier.

Assessment. One has to admit from an examination of these needs that everyone has some legitimate points, and that all their views have to be seriously accommodated. This is what makes the issue of intercarrier compensation so inherently complicated: no one segment's needs can be easily dismissed on the merits. However, there is more to some of these needs than meets the eye.

²⁷ VoIP is slowly losing its initial advantages from recent Commission decisions that impose E-911 obligations, obligations to serve the hearing impaired community, and to pay into the universal service fund. See, e.g., *IP-Enabled Services*, WC Docket No. 04-36, FCC 07-110 (rel. Jun. 15, 2007).

It is true that ILECs have been hamstrung by legacy regulations that regulators are unwilling to eliminate, particularly at the state level. However, ILECs have an inherent advantage because they all have the most customers for regulated voice communications, due in large part to the fact that they once had a monopoly in that market. Customers are voting more and more with their pocketbooks and their legs, but inertia works in the telecommunications field for both residential and business subscribers. Although constitutionally carriers should be able to recover their booked costs, there is a deep-seated mistrust about carrier identification of their costs and many feel that some game the system to inflate booked costs. And yet true costs simply cannot vanish at the whim of regulators because shareholders' value is rooted in carrier financial systems.

All the competitors to ILECs, however, have been advantaged from having almost no pricing or other regulations that are imposed upon the ILECs. Each of them uses these differences to market services to end users. For example, CLECs obtain customers because they do not charge SLCs. Cable companies receive clients because they can price more flexibly and do not have all the regulatory add-ons that burden ILECs. Certain parts of the industry have been getting away with murder by avoiding the payment of access charges, by disguising the true nature of their traffic, by making unreasonable arguments before the FCC,²⁸ or by outright cheating.²⁹

Wireless companies have reason to complain because, unlike other competitors, they are forced to pay access charges, but the FCC has repeatedly thrown roadblocks in the industry's way, keeping them from charging their own access charges. However, wireless companies have also been successful in avoiding paying reciprocal compensation, at least to smaller ILECs, because of their refusal to negotiate interconnection agreements.³⁰

The consumer advocates do not actually poll their constituents (or at least do so infrequently or with questionable accuracy) and do not have members like industry trade associations do. Therefore, regulators do not know what consumers really think about the issue.³¹ Consumer advocates also continue to argue for uneconomic pricing of end user charges, even though low volume and high volume customers may cost the companies the same amount of money.³²

²⁸ See note 8, *supra*.

²⁹ See, e.g., *Verizon Gives FCC Data Allegedly Showing MCI Access Charge Manipulation*, Communications Daily, Aug. 14, 2003.

³⁰ See *T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, 20 FCC Rcd 4855 (2005).

³¹ Of course, the real world is not that simple. Different consumers have different interests based on their volume of use of the network or technical savvy. There are undoubtedly a large number of consumers who still rue the day Ma Bell was broken up by the government in 1984. Others do not like subsidizing low volume users, particularly business consumers.

³² Some companies rightfully argue that high-volume customers actually cost telephone companies less to some than low volume customers because they contribute more to overhead and justify network investment out to the customer's premises. At base, however, a low-volume customer with one loop should pay the same as a high volume customer with one loop because the costs to install the facility are the same. The FCC has repeatedly rejected the consumer advocates' age-old arguments that

States need to ensure that rates remain as low as possible and that competition is not impeded by a system of intercarrier compensation. Although the states abhor losing their jurisdiction over intrastate access charges, the problem cries for a national solution.

Intrastate access legal controversy

States have traditionally regulated intrastate access rates, the rates that long distance and other users pay for the origination and termination of intrastate toll traffic. Section 2(b) of the Communications Act reserves to the states the authority to regulate intrastate communications service rates.³³ The FCC has authority to regulate mixed use facilities, those used to provide both interstate and intrastate services, but may only impose exclusive regulation when the traffic is predominantly interstate and is inseparable.³⁴

Section 252(b) gives the Commission jurisdiction to set the methodology used to compute rates for reciprocal compensation for interconnection traffic.³⁵ The FCC has already arguably stated that this section applies to all traffic, not simply interstate traffic.³⁶ However, many states and some of the other parties in the Intercarrier Compensation proceeding raise doubts about this legal conclusion, in large part because the FCC has never regulated intrastate access rates in the past, even after passage of the 1996 Telecommunications Act.

So what is the solution?

I admit that the assessments section can be viewed as quite harsh to all segments of the industry. With difficult problems, however, it is necessary to bite the bullet and find common ground. Where is the common ground? I submit it is the following:

1. Intercarrier compensation pricing is irrational because “a minute is a minute.” All pricing between carriers should be equalized by type of carrier to reduce regulatory arbitrage. This does not mean that all rates among carriers be equal, only that a single carrier have one rate.
2. Regulations that promote competition among players will benefit consumers.
3. Any change to pricing must be put in place during a transition period to prevent dislocations of carriers and customers.

multiple services should pay for the costs of the loop, since these costs are recovered in local and SLC charges. *See, e.g., Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, 20 FCC Rcd 14853, ¶¶ 139-42 (2005).

³³ 47 U.S.C. § 152(b).

³⁴ *See, e.g., Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404 (2004), *aff'd*, *Minn. PUC v. FCC*, 483 F.3d 570; (D.C. Cir., 2007).

³⁵ 47 U.S.C. § 252(d)(2); *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 377-80 (1999).

³⁶ *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 16 FCC Rcd 9151, 9166-67, 9172-73 ¶¶ 34, 45 (2001), *remanded on other grounds, WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

4. For practical reasons, large ILECs should be forced to continue to be transport providers at a regulated price for a time period.
5. Some rural ILECs should be provided accommodations, at least during a transition period, because of uniquely high costs and regulatory burdens.
6. All originating telephone numbers should be properly identified to the extent it is technically feasible to do so.
7. Intercarrier compensation involves significant dollars that will substantially impact the fabric of the industry.
8. Too much is at stake to achieve a complete and permanent solution at this time, even during a specified transition.

For all the noise surrounding disagreements on proposals to reform intercarrier compensation, by the list provided above, there is an quite a bit that the parties agree on. In fact, the issues agreed upon may outnumber those on which the industry disagrees. However, since enough parties entertain the belief that they will be okay if nothing changes, there is insufficient reason for the parties to engage in a real compromise that will benefit everyone. Although regulatory lawyers and regulators can cheer about their continued employment during this stalemate, maintaining the status quo is not the optimal solution for anyone in the telecommunications business.

From these points of agreement, an immediate, although not permanent, solution is evident:

- ILECs should have to equalize rates by carrier type, but the rates, based on actual prudently incurred costs, can vary between these different categories of carriers through a transition.
- At the end of the transition period, origination rates should be set at zero if possible, or at least lower than or equal to terminating rates.³⁷
- CLECs should be treated as large ILECs because they have no legacy cost structures.
- The originating carrier should pay for termination to the terminating carriers' first switch.
- End user SLC rates should rise to \$10, or embedded loop costs, whichever is lower, over a transition period.
- Mid-size and small ILECs should be able to recover the unrecovered remainder, as if they were charging the average national rate for local service, from a USF mechanism that is not portable to competitors during a transition period.

³⁷ This proposal ignores the very real dispute about whether the FCC has jurisdiction to regulate intrastate access as reciprocal compensation rates. If additional authority needs to be granted, then Congress should step up to the plate and enact the necessary legislation. Regardless of who is "right" in this debate, enacting such legislation would reduce any litigation that would naturally ensue from any plan adopted by the FCC based on a contestable legal theory.

- The revenues should be recovered through a USF-like contribution mechanism, AND USF should be reformed, especially as to portability and to using numbers or connections.
- Phantom traffic should be identified to the charging (usually terminating) carrier.
- The transition period should not be a “hard” date: rather, the FCC should commit to evaluate results at the mid-point and at the end of the transition.

At the end of the transition period, the FCC should examine the economic effects of the plan to determine whether additional steps should be taken. If justified by the facts, further issues should be resolved at that time, including (1) whether to eliminate all intercarrier compensation; (2) whether all ILEC rates can be equalized; and (3) what should be done to more permanently reform universal service subsidies. Although there has been a regulatory interest in making hard transition end dates, those regulations make adoption of a solution much more difficult out of fear of being unable to predict the consequences. Therefore, periodic reexaminations prior to pulling the trigger on the end of a transition can alleviate this up-front concern. And the regulator should not be shy about creating a lengthy transition period, even ten years if need be. Slow progress is better than no progress at all.

Granted, the above-described plan glosses over many of the important details that are currently in the plans under discussion. However, I assert that those details can be worked out with proper motivation. While everyone always seeks to achieve some advantage through regulatory design, there is no reason why a regulator should agree to accommodate those wishes if unjustified by the facts. If consumers are going to bear a \$6 billion rate hit, carriers should step up to the plate by making painful changes that will be beneficial to them and to consumers in the long run. Mid-sized and local ILECs should do their part by being required to either increase local service rates to the national average, or forgo universal service-like payments for the difference between the national average and their current lower rates. Any dislocations can be addressed in the waiver process, particular for smaller carriers and those companies with more rural properties, which face unique circumstances.

Although competitors will object to the lack of portability of the new universal service-like fund, avoidance of portability reduces the size of the needed funds, recognizes that only the ILECs have legacy costs that must be recovered, and reinforces the temporary nature of the remedy. Making the fund temporary, subject to the reexamination and extension of transition periods discussed above, will ensure that ILECs recognize that they cannot expect a guaranteed revenue stream forever, but have to take affirmative steps to earn revenues on their own in the long run. On the other hand, providing them relief in the interim will recognize that there is a regulatory and constitutional obligation to help the carrier recover its costs when regulations change the underlying assumptions the carriers and their shareholders have come to rely on. Reexamination of economic consequences and the waiver process can relieve particular situations that arise during the transition. Although there is some dissimilarity of treatment, the ultimate elimination of the subsidy is more important than is the equal

treatment during the interim. As rates come down, the market will encourage efficient entry by competitors, regardless of the lack of equality of treatment.

Instead of relying on a certain existing rate, regulators should establish a definitive price for small ILECs, which could vary by size and circumstance of the carrier just like the current NECA banding price structure for interstate access charges. Only by establishing a reasonably low rate, can the regulator assure competitors that intercarrier compensation is going away and is no more than is necessary to cover carrier costs. Excessively high rates must be a thing of the past for all types of traffic.

Consumers, even low volume consumers, should be able to pay \$10 SLCs by the end of the transition, particularly if the increases are minimal from year to year, such as \$0.50 per line. And telecommunications is still the cheapest utility game in town. Local rates that are too low will rise because only average national rates will support additional USF receipts. Although rural ratepayers may face the largest increases because they likely will see their SLCs and local rates rise at the same time, the overall cost to any individual is not all that great and it will be roughly equal to what urban customers already pay in any event. The other issue facing rural customers, high intrastate toll rates, should be reduced to a large extent because intrastate access rates will decline. Any customer that truly has trouble paying the price can enroll in the FCC's and state Lifeline programs.

Yes, I will admit that there are a lot more problems to solve. At the end of my proposal, there are still chances for arbitrage, particularly between different size ILEC territories. There are still differences between some ILECs and CLECs. There still are concerns that USF is too high. My plan does not address the need to reform universal service in general. However, these seemingly intractable problems will be easier to solve once the initial transition is complete. And the fact that the USF monies are not permanent fixtures prevents small carriers from claiming reliance at the end of the process.

Although some will criticize this proposal for failing to address some of the most knotty problems associated with intercarrier compensation, my plan has the benefit that it will bring the industry at least half the way there. That is certainly twice as far as we've gotten in the last five years.