**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of	)	
	)	
Developing a Unified Intercarrier Compensation Regime	)	CC Docket No. 01-92
	)	
	)	

FURTHER NOTICE OF PROPOSED RULEMAKING

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By the Commission: Chairman Powell, Commissioners Abernathy, Copps, and Adelstein issuing separate statements.

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I. INTRODUCTION

1. With this Further Notice of Proposed Rulemaking (Further Notice), we begin the process of replacing the myriad existing intercarrier compensation regimes with a unified regime designed for a market characterized by increasing competition and new technologies.[1] In the *Intercarrier Compensation NPRM*, the Commission acknowledged a number of problems with the current intercarrier compensation regimes (access charges and reciprocal compensation) and expressed interest in identifying a unified approach to intercarrier compensation.[2] The Commission solicited comment on a bill-and-keep approach to reciprocal compensation payments governed by section 251(b)(5) of the Act.[3] The Commission also sought comment on alternative reform measures that would build upon the current requirements for cost-based intercarrier payments.[4]

2. In response to the *Intercarrier Compensation NPRM*, the Commission received extensive comment from individual carriers and economists, industry groups and associations, consumer advocates, and state regulatory commissions, among others.[5] The Commission also received numerous *ex parte* filings and considered detailed presentations from interested parties. In addition to the record developed in response to the *Intercarrier Compensation NPRM*, various industry groups and interested parties recently submitted comprehensive reform proposals and principles for consideration by the Commission in this proceeding.[6]

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[1]This examination was initiated in April 2001 by a Notice of Proposed Rulemaking. *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[2]*Id.* at 9612, para. 2. As the Commission explained in the *Intercarrier Compensation NPRM*, the existing intercarrier compensation rules may be categorized as follows: access charge rules, which govern the payments that interexchange carriers (IXCs) and Commercial Mobile Radio Service (CMRS) providers make to local exchange carriers (LECs) to originate and terminate long-distance calls; and reciprocal compensation rules, which, generally speaking, govern the compensation between telecommunications carriers for the transport and termination of "local" traffic. *Id.* at 9613, para. 6. Nevertheless, both sets of rules are subject to various exceptions, such as the enhanced service provider (ESP) exemption from the payment of access charges. *Id.*

[3]*Id*. at 9612-13, para. 4.

[4]*Id.*

[5]A complete list of comments and reply comments filed in response to the *Intercarrier Compensation NPRM* can be found in Appendix A. The Commission received 75 comments and 62 reply comments. *See* Appendix A.

[6]*See infra* Section II.C.

3. As a general matter, the record confirms the need to replace the existing patchwork of intercarrier compensation rules with a unified approach. Many commenters observe that the current rules make distinctions based on artificial regulatory classifications that cannot be sustained in today's telecommunications marketplace.[7] Under the current rules, the rate for intercarrier compensation depends on three factors: (1) the type of traffic at issue; (2) the types of carriers involved; and (3) the end points of the communication.[8] These distinctions create both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions. The record in this proceeding makes clear that a regulatory scheme based on these distinctions is increasingly unworkable in the current environment and creates distortions in the marketplace at the expense of healthy competition. Additional problems with the existing intercarrier compensation regimes result from changes in the way network costs are incurred today and how market developments affect carrier incentives. These developments and others discussed herein confirm the urgent need to reform the current intercarrier compensation rules.

4. Since the Commission adopted the *Intercarrier Compensation NPRM* acknowledging the need for reform, several industry groups have developed proposals for comprehensive reform of existing intercarrier compensation regimes and submitted those proposals to the Commission. In this *Further Notice*, we solicit comment on these proposals, including the legal and economic bases for these proposals, as well as the end-user effects and universal service issues implicated by them. We also ask parties to comment on whether and how these reform proposals would affect network interconnection and seek comment on the implementation issues associated with any reform measures. In addition to the comprehensive reform proposals submitted in the record, we seek comment on alternative reform measures, including changes to the existing intercarrier compensation regimes and cost standards. Finally, we seek comment on issues relating to the regulation of transit services and additional CMRS compensation issues.

II. FURTHER NOTICE OF PROPOSED RULEMAKING

A. The Need For Reform

1. Introduction

5. As the Commission explained in the *Intercarrier Compensation NPRM*, interconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation mechanisms that distinguish among different types of carriers and different types of services based on regulatory classifications.[9] Federal and state access charge rules govern the payments that interexchange carriers (IXCs) and commercial mobile radio service (CMRS) providers make to local exchange carriers (LECs) that originate and terminate long-distance calls, while the reciprocal compensation rules established under section 251(b)(5) of the Act generally govern the compensation between

[7] *See, e.g.,* Allegiance Comments at 7, 11-12; ALLTEL Comments at 6-7; Cable & Wireless Comments at 8; CompTel Comments at 8; Global NAPs Comments at 7; AT&T Reply at 1, 5-6.

[8] For instance, a long-distance call carried by an IXC is subject to a different regime than a local call carried by two LECs. Moreover, CMRS providers and LECs are subject to different intercarrier compensation rules, and ISP-bound calls are subject to yet another regime.

[9] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9613, para. 5.

telecommunications carriers for the transport and termination of calls not subject to access charges.[10] These rules apply different cost methodologies to similar services based on traditional regulatory distinctions that may have no bearing on the cost of providing service and many of which are increasingly difficult to maintain. In this section, we briefly describe the existing intercarrier compensation mechanisms and then explain why these mechanisms are difficult to sustain in the current marketplace.

a. Access Charges

6. Prior to the AT&T divestiture in 1984, most telephone subscribers obtained local services from the Bell Operating Companies (BOCs) and long-distance services from AT&T Long Lines, both of which were owned and operated by AT&T.[11] In preparation for divestiture, the Commission in 1983 established a formal system of tariffed access charges.[12] These rules apportioned charges for common line costs between a monthly flat-rated subscriber line charge (SLC) assessed on end users and a per-minute carrier common line (CCL) charge assessed on the IXCs, which ultimately was recovered from end users through long-distance charges.[13] The SLC for residential users was capped at $3.50 and any remaining common line costs were recovered through the CCL charge.[14] Switching costs were recovered through per-minute charges assessed on IXCs.[15] The Commission required that these access charges be

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[10] *See* 47 C.F.R. § 51.701. Intrastate access charges, and intrastate calling generally, are governed by state public utility commissions. Thus, different intercarrier compensation regimes apply to a call originating in New York City depending on, for example, whether it terminates in New York City, elsewhere in the state of New York, or in another state. Different rules also apply depending on whether the calling and called parties are using wireline or wireless services.

[11] *MTS and WATS Market Structure*, CC Docket No. 78-72, Third Report and Order, Phase 1, 93 FCC 2d 241 (*1983 Access Charge Order*), *recon., MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682 (1983) (*First Reconsideration of 1983 Access Charge Order*), *second recon., MTS and WATS Market Structure*, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 834 (1984) (*Second Reconsideration of 1983 Access Charge Order)*.

[12] *1983 Access Charge Order*, 93 FCC 2d at 245-54, paras. 9-35.

[13] Although the access charge regime adopted in 1983 and contained in the Commission's Part 69 access charge rules includes charges that LECs impose on their subscribers, in this item we generally use the term "access charges" to mean charges imposed by a LEC on another carrier.

[14] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982, 15999, para. 37 (1997) (*Access Charge Reform Order*) (subsequent history omitted). The Commission emphasized that its long range goal was for LECs to recover a large share of their non-traffic sensitive common line costs on a flat-rated basis from end users instead of from carriers. *1983 Access Charge Order*, 93 FCC 2d at 264-65. The Commission found that a subscriber who does not use the subscriber line to place or receive interstate calls imposes the same non-traffic sensitive costs as a subscriber who does use the line. Thus, simply by requesting telephone service, the subscriber causes the carrier to incur local loop costs whether he or she uses the service for intrastate or interstate calls or not at all. *Id.* at 278. Initially, the residential SLC was capped at $1.00. The cap was raised to $3.50 on April 1, 1989. *See Federal Communications Commission Releases Study on Telephone Trends*, Industry Analysis and Technology Division, Wireline Competition Bureau, at Tab 1.1 (rel. May 6, 2004) (*Telephone Trends Report*).

[15] *Access Charge Reform Order*, 12 FCC Rcd at 16006, para. 61.

calculated based on the average embedded cost of providing such services.[16]

7. At that time, the Commission acknowledged that enhanced service providers (ESPs) were among a variety of users of LEC interstate access services.[17] Since 1983, however, the Commission has exempted ESPs, now known as information service providers (ISPs), including those that provide service related to the Internet, from the payment of certain interstate access charges.[18] Rather, ISPs are treated as end users for the purpose of applying access charges and are entitled to pay local business rates for their connections to LEC central offices.[19]

8. In the 1996 Act, Congress sought to foster competition in the local telephone market, while at the same time ensuring the continued provision of affordable service to all Americans.[20] Following its passage, the Commission commenced reform of both interstate access charges and federal universal service support mechanisms in accordance with directives of the Act. In its 1997 *Access*

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[16]*See generally 1983 Access Charge Order*, 93 FCC 2d at 241; *First Reconsideration of 1983 Access Charge Order,* 97 FCC 2d at 682; *Second Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 834.

[17]*First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 711 (ESPs are "[a]mong the variety of users of access service" and "obtain[ ] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit [their] location and, commonly, another location."). The Commission defines "enhanced services" as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a). The 1996 Act describes these services as "information services." *See* 47 U.S.C. § 153(20) ("information service" refers to the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."). *See also Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11516 (1998) (*Universal Service Report to Congress*) (the "1996 Act's definitions of telecommunications service and information service essentially correspond to the pre-existing categories of basic and enhanced services").

[18]This policy, known as the "ESP exemption," has been reviewed by the Commission on a number of occasions and retained each time. *See First Reconsideration of 1983 Access Charge Order*, 97 FCC 2d at 715 (ESPs have been paying local business service rates for their interstate access and would experience rate shock that could affect their viability if full access charges were instead applied); *see also Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2633 (1988) (*ESP Exemption Order*) ("the imposition of access charges at this time is not appropriate and could cause such disruption in this industry segment that provision of enhanced services to the public might be impaired"); *Access Charge Reform Order*, 12 FCC Rcd at 16133-35, paras. 344-48 ("[m]aintaining the existing pricing structure … avoids disrupting the still-evolving information services industry").

[19]*ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. *See also Access Charge Reform Order*, 12 FCC Rcd at 16133-35, paras. 344-48.

[20]47 U.S.C. §§ 217, 254. Traditionally, rates for local telephone service in rural and high cost areas had been implicitly subsidized by charging high-volume long-distance callers and urban residents artificially higher rates. The 1996 Act recognized, however, that these implicit subsidies could not continue in a competitive marketplace and directed the Commission to create explicit universal service support mechanisms that are specific, predictable and sufficient. *See* 47 U.S.C. § 254(e); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

Charge Reform Order, the Commission reformed the manner in which price cap LECs recover access costs by aligning the rate structure more closely with the manner in which costs are incurred.[21] Accordingly, the Commission began phasing out per-minute charges for loop and other non-traffic sensitive costs, and providing for recovery of such costs through flat monthly charges.[22]

9. The *CALLS Order* continued the process of access charge and universal service reform for these carriers through a more straightforward, economically rational common line rate structure.[23] These reforms advanced the goals of requiring price cap LECs to recover their non-traffic sensitive common line costs from end users, instead of carriers, and of recovering these costs on a flat-rated, rather than a per-minute, basis.[24] In addition, the Commission approved an immediate $2.1 billion reduction in per-minute switched access charges, which the CALLS interexchange carrier members committed to pass through to their customers.[25] To offset these reductions in per-minute switched access charges, the Commission established a new explicit, portable universal service support mechanism, targeted at $650 million per year for five years.[26]

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[21] *See Access Charge Reform Order*, 12 FCC Rcd at 16007-33, paras. 67-120. In particular, the Commission decided that loop costs should be recovered entirely through flat rates rather than per-minute rates. *Id*. at 16004, para. 54.

[22] *Id.* at 15998, para. 35. In order to reduce per-minute CCL charges, the Commission created the presubscribed interexchange carrier charge (PICC), a flat, monthly charge imposed on IXCs on a per-line basis. *Id*. at 15998-16000, paras. 37-40. The Commission also shifted the cost of line ports from per-minute local switching charges to the common line category and established a mechanism to phase out the per-minute Transport Interconnection Charge (TIC). *Id*. at 16035-40, 16073-86, paras. 125-34, 210-43. Line ports connect subscriber lines to the switch in the LEC central office. *See id.* at 16034-35, para. 123.

[23] *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962, 12991-93, paras. 76-79 (2000) (increasing SLC caps and phasing out the residential and single-line business PICC) (*CALLS Order*), *aff'd in part, rev'd in part, and remanded in part*, *Texas Office of Public Util. Counsel et al. v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied*, *National Association of State Utility Consumer Advocates v. FCC*, 535 U.S. 986 (2002); *on remand*, *Access Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 and 96-45, Order on Remand, 18 FCC Rcd 14976 (2003) (*CALLS Order on Remand*). To compensate for the loss of revenues from the elimination of the PICC, the Commission raised the SLC cap for primary residential and single-line business lines from $3.50 to $6.50 over a period of several years. *See CALLS Order*, 15 FCC Rcd at 12974-5, 12991-93, 13004-7, paras. 30, 76-79, 105-112. As promised in the *CALLS Order*, the Commission reviewed the network costs of price cap carriers and determined that the SLC increases should proceed as scheduled. *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Order, 17 FCC Rcd 10868 (2002), *aff'd Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 372 F.3d 454 (D.C. Cir. 2004).

[24] *See 1983 Access Charge Order*, 93 FCC 2d at 264-65, 278; *see also Access Charge Reform Order*, 12 FCC Rcd at 16007, para. 67.

[25] *CALLS Order*, 15 FCC Rcd at 13025, paras. 151-52.

[26] *Id.* at 13039, paras. 185-86.

10. In the *MAG Order*, the Commission reformed the interstate access charge and universal service support system for incumbent LECs subject to rate-of-return regulation.[27] As with the *CALLS Order*, these reforms were designed to rationalize the interstate access rate structure by aligning it more closely with the manner in which costs are incurred. The *MAG Order* increased the SLC caps for rate-of-return carriers to the levels established for price cap carriers[28] and eliminated the CCL charge from the common line rate structure as of July 1, 2003, when SLC caps reached their maximum levels.[29]

11. In addition, a new universal service support mechanism, Interstate Common Line Support (ICLS), was implemented to replace the CCL charge beginning July 1, 2002.[30] This mechanism recovers any shortfall between the allowed common line revenue requirement of rate-of-return carriers and their SLC and other end-user revenues, thereby ensuring that changes in the rate structure did not affect the overall recovery of interstate access costs by rate-of-return carriers serving high-cost areas.[31] To reform the local switching and transport rate structure of rate-of-return carriers, the Commission shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the Transport Interconnection Charge (TIC) to other access rate elements, thus reducing per-minute switched access charges.[32]

b. Reciprocal Compensation

12. Reciprocal compensation for the transport and termination of telecommunications traffic

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[27] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, Report and Order, *Prescribing the Authorized Rate of Return From Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613 (2001) (*MAG Order*), *recon. in part, Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, First Order on Reconsideration, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Twenty-Fourth Order on Reconsideration, 17 FCC Rcd 5635 (2002), *amended on recon., Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Third Order on Reconsideration, 18 FCC Rcd 10284 (2003). *See also Multi-Association Group (MAG) Plan for Regulation of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004).

[28] *MAG Order*, 16 FCC Rcd at 19621, para. 15. The *MAG Order* increased the residential and single-line business SLC cap to $5.00 on January 1, 2002, to $6.00 on July 1, 2002, and to $6.50 on July 1, 2003. The multi-line business SLC cap increased to $9.20 on January 1, 2002. *Id.* at 19634, 19638, paras. 42, 51.

[29] *Id*. at 19642, para. 61.

[30] *Id*.

[31] *Id*. at 19642, 19667-73, paras. 61, 128-41.

[32] *Id.* at 19649-61, paras. 76-111.

is governed by sections 251(b)(5) and 252(d)(2) of the Act.[33] Section 251(b)(5) generally governs the compensation between telecommunications carriers for the transport and termination of calls not subject to access charges.[34] Section 252(d)(2)(A) states that, for the purpose of incumbent LEC compliance with section 251(b)(5), a state commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless such terms and conditions: (i) provide for the "mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier;" and (ii) "determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."[35]

13. Current Commission rules require the calling party's LEC to compensate the called party's LEC for the additional costs associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office, and for the additional costs of terminating the call to the called party.[36] The rules further require that the charges for both transport and termination must be set at forward-looking economic cost.[37] The Commission concluded that the "additional cost" standard of section 252(d)(2) permits the use of the same Total Element Long Run Incremental Cost (TELRIC) standard that it established for interconnection and unbundled elements.[38] The TELRIC cost standard establishes prices based on the average cost of providing a particular

[33]Section 251(b)(5) imposes on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." 47 U.S.C. § 251(b)(5).

[34]*See* 47 C.F.R. § 51.701.

[35]47 U.S.C. § 252(d)(2)(A). Section 252(d)(2)(B) further provides that the language in section 252(d)(2)(A) shall not be construed "to preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)" or to authorize the Commission or any state to "engage in any rate regulation proceeding to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls." 47 U.S.C. § 252(d)(2)(B)(i)-(ii).

[36]47 U.S.C. § 252(d)(2)(A); 47 C.F.R. § 51.701. *See also Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd 15499, 16024-25, paras. 1056-59 (1996) (subsequent history omitted) (*Local Competition First Report and Order*). Section 51.701(c) of our rules defines transport as "the transmission and any necessary tandem switching of telecommunications traffic subject to section 251(b)(5) of the Act from the interconnection point between the two carriers to the terminating carrier's end office switch that directly serves the called party, or equivalent facility provided by a carrier other than an incumbent LEC." 47 C.F.R. § 51.701(c). Section 51.701(d) of our rules defines termination as "the switching of telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises." 47 C.F.R. § 51.701(d). In the *Local Competition First Report and Order*, the Commission also concluded that "the new transport and termination rules should be applied to LECs and CMRS providers." *Local Competition First Report and Order*, 11 FCC Rcd at 16016-17, para. 1043.

[37]47 C.F.R. § 51.705. *See also Local Competition First Report and Order*, 11 FCC Rcd at 16054-58, paras. 1111-18.

[38]*Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054.

function.[39]

14. In the *Local Competition First Report and Order*, the Commission identified the wireline network costs that are recoverable through reciprocal compensation rates.[40] Specifically, the Commission concluded that "[f]or the purposes of setting rates under section 252(d)(2), only that portion of the forward-looking, economic cost of the LEC's end-office switching that [is] usage sensitive constitutes an 'additional cost' to be recovered through termination charges."[41] The Commission also concluded that the "additional costs" incurred when terminating a call were likely to be greater when termination involved the use of an incumbent LEC's tandem switch.[42] The Commission found that the higher rate for tandem switching would be available to carriers other than incumbent LECs if those carriers utilize a switch that serves a geographic area comparable to that served by the incumbent LEC's tandem switch.[43] In the *CMRS Termination Compensation Order*, the Commission affirmed that a carrier is entitled to the tandem interconnection rate under section 51.711(a)(3) of the Commission's rules if it can satisfy a comparable geographic area test and need not also satisfy a functional equivalency test.[44]

2. The Current Intercarrier Compensation Regimes Cannot Be Sustained in the Developing Marketplace

a. Introduction

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[39] *See Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, WC Docket No. 03-173, Notice of Proposed Rulemaking, 18 FCC Rcd 18945, 18953, para. 18 (2003), Erratum, 18 FCC Rcd 20265 (2003) ("*TELRIC NPRM*").

[40] *Local Competition First Report and Order*, 11 FCC Rcd at 16024-25, para. 1057. In the *Local Competition First Report and Order*, the Commission permitted carriers to receive compensation only for "the traffic-sensitive components of local switching," and not for local loop costs, which it concluded were not considered traffic-sensitive. *Id*.

[41] *Id.* By contrast, the Commission did not address at that time the traffic sensitive costs of wireless network components that are appropriately recovered through reciprocal compensation rates. The Commission recently clarified the application of these rules to CMRS providers, however. *See* Letter from Thomas J. Sugrue, Chief, Wireless Telecommunications Bureau, and Dorothy T. Attwood, Chief, Common Carrier Bureau, to Charles McKee, Senior Attorney, Sprint PCS, CC Docket Nos. 95-185 and 96-98, and WT Docket No. 97-207, 16 FCC Rcd 9597 (2001) ("Joint Letter"), *affirmed, Cost-Based Terminating Compensation for CMRS Providers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Calling Party Pays Service Offering in the Commercial Mobile Radio Services*, CC Docket Nos. 95-185 and 96-98, and WT Docket No. 97-207, Order, 18 FCC Rcd 18441 (2003) ("*CMRS Termination Compensation Order"*), *appeal filed, SBC Communications v. FCC,* Case No. 03-4311 (3d Cir. filed Nov. 3, 2003). It determined that a CMRS carrier is entitled to receive reciprocal compensation for the additional costs of terminating traffic on its network at a rate exceeding the incumbent LEC rate if it can demonstrate that its termination costs exceed those of the incumbent LEC and that those costs are traffic-sensitive. *CMRS Termination Compensation Order*, 18 FCC Rcd at 18445, paras. 8-9; Joint Letter, 16 FCC Rcd at 9598.

[42] *Local Competition First Report and Order*, 11 FCC Rcd at 16042, para. 1090.

[43] *Id.*

[44] *CMRS Termination Compensation Order*, 18 FCC Rcd at 18447-49, paras. 17-21; Joint Letter, 16 FCC Rcd at 9599 (citing *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9648, para. 105).

15. The record in this proceeding shows that the three basic principles underlying our existing intercarrier compensation regimes must be re-examined in light of significant market developments since the adoption of the access charge and reciprocal compensation rules. First, our existing compensation regimes are based on jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions.[45] Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis.[46] These artificial distinctions distort the telecommunications markets at the expense of healthy competition.[47] Moreover, the availability of bundled service offerings and novel services blur the traditional industry and regulatory distinctions that serve as the foundation of the current rules.[48]

16. Second, our existing compensation regimes are predicated on the recovery of average costs on a per-minute basis. Under average cost pricing, a network can invest in facilities to attract subscribers and recover a share of those costs from subscribers choosing competing networks. As competition has increased, the ability to shift costs to competitors through intercarrier charges increasingly distorts the competitive process. In addition, advancements in telecommunications infrastructure affect the way carrier costs are incurred and call into question the use of per-minute pricing.

17. Third, under the existing regimes, the calling party's carrier, whether LEC, IXC, or CMRS provider, compensates the called party's carrier for terminating the call.[49] Thus, as a general matter, our existing regimes are based on a "calling-party-network-pays" (CPNP) approach to compensation. Developments in the ability of consumers to manage their own telecommunications services undermine the premise that the calling party is the sole cost causer and should be responsible for all the costs of a call. As discussed below, we find that all these developments compel the Commission to move toward a new, unified intercarrier compensation regime that is better suited to a market characterized by competition among multiple types of carriers and technologies.

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[45]*Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 12.

[46]*See, e.g.*, AOL Comments at 2-3; Global NAPs Comments at 7; Level 3 Comments at 25-26. For instance, a LEC providing terminating access service may charge an IXC ten or more times the reciprocal compensation rate it charges another LEC to provide the same transport and termination service for similar traffic. AT&T Comments at 12. There is an even greater difference for originating traffic, where not only is the rate different, but the direction of payment is different as well.

[47]As AT&T observes in its comments, "[t]he existing patchwork of rules -- under which a local exchange carrier's charges for use of the same facilities in the same manner can vary by an order of magnitude or more based upon such economically irrelevant considerations as the identity or status of the interconnecting carrier or the called party -- is wholly incompatible with the competitive environment Congress envisioned." AT&T Comments at 1. AT&T goes on to state that inappropriate intercarrier charges create barriers to entry, tilt the competitive playing field, and distort investment and use. *Id.*

[48]For instance, the Commission has struggled to determine the appropriate regulatory regime for Internet traffic. *See ISP Remand Order. Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9161-62, paras. 18-20 (2001) (*ISP Remand Order*), *remanded, WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003). In this proceeding, the Commission hopes to address the compensation regime for all types of traffic, including ISP-bound traffic.

[49]*See Intercarrier Compensation NPRM*, 16 FCC Rcd at 9614-15, para. 9.