Pennsylvania
Public Utility Commission

Missoula Plan Workshop and Facilitated Discussion
Docket No. M-00061972
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Overview

- Overall, the Missoula Plan (the “Plan”) undermines and sabotages the goals set forth in the FCC’s *Unified Intercarrier Compensation Proceeding.*

- The Plan is bad for consumers.

- The Plan is fundamentally anti-competitive.

The FCC’s Goal: Unified Intercarrier Compensation

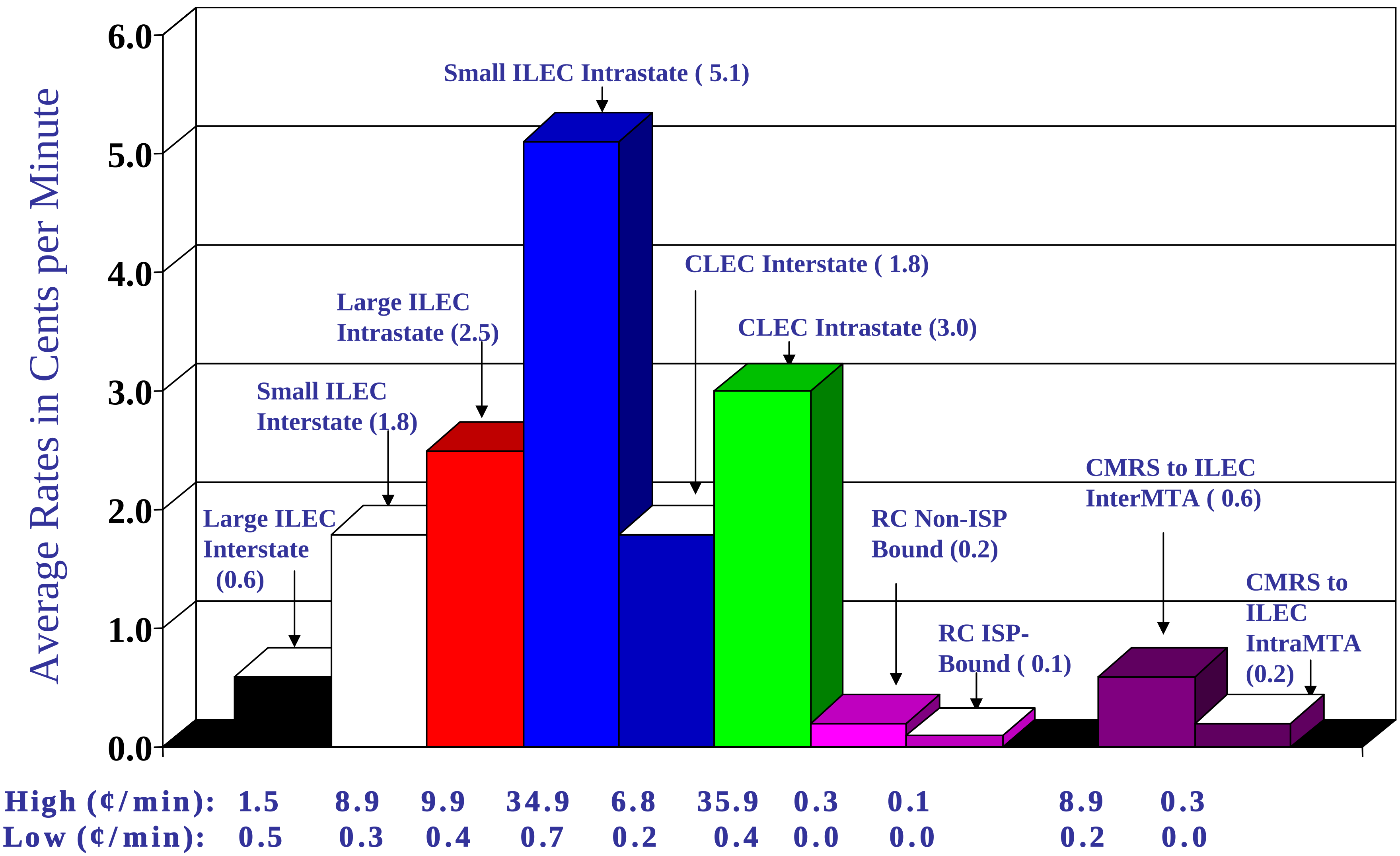
- The goal of the FCC’s *Unified Intercarrier Compensation Proceeding* is clear and simple: a unified intercarrier compensation regime.

  – The FCC stated in its March, 2005 *FNPRM*: “Similar types of traffic should be subject to similar rules. Similar types of functions should be subject to similar cost recovery mechanisms. We are interested in not only similar rates for similar functions, but also in a regime that would apply these rates in a uniform manner for all traffic.” *FNPRM*, at para. 33.

The Problem

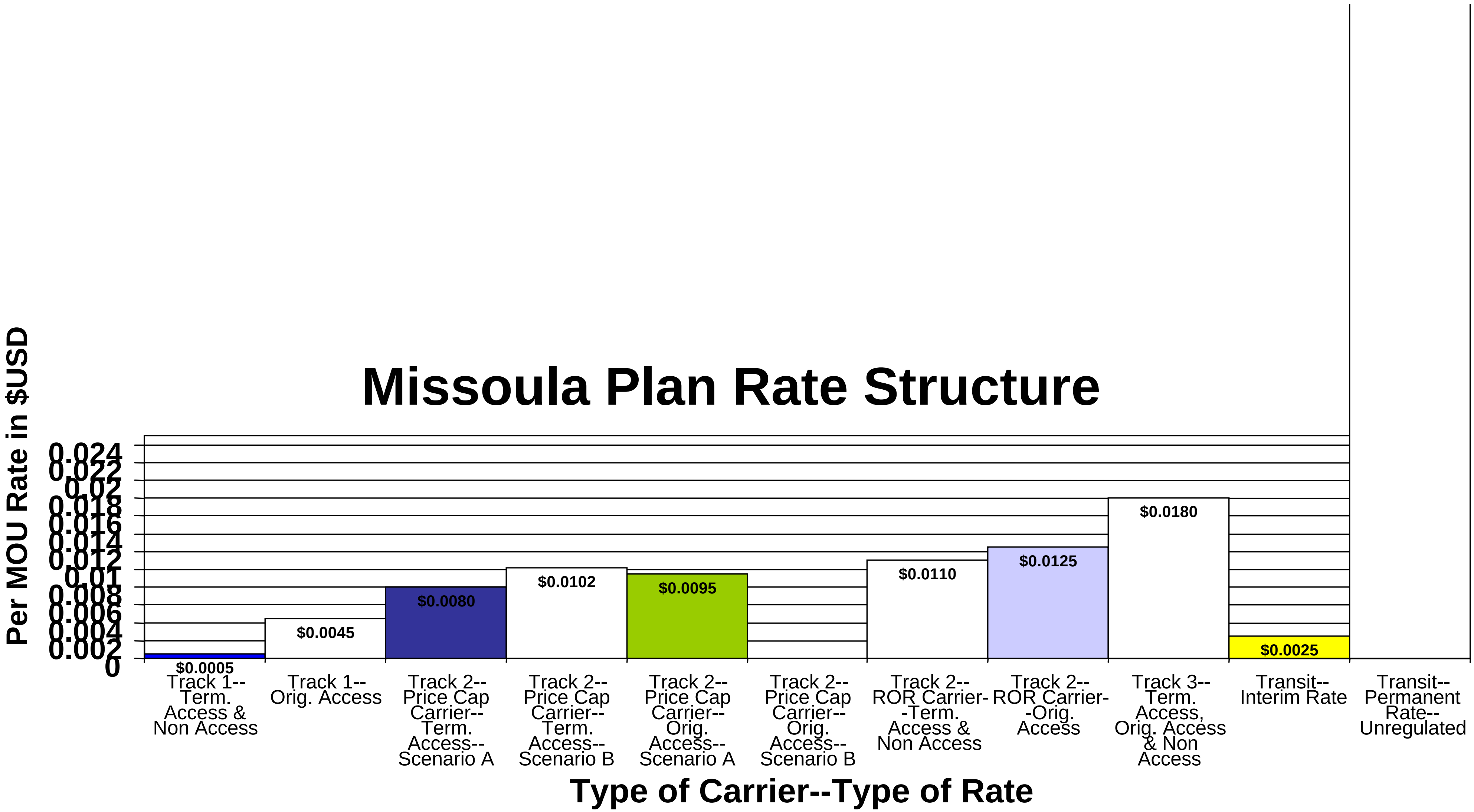
- In the *FNPRM*, the FCC identified the problem with intercarrier compensation today:
  - Many commenters observe that the current rules make distinctions based on ***artificial regulatory classifications*** that cannot be sustained in today's telecommunications marketplace. Under the current rules, 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. These distinctions create both opportunities for regulatory arbitrage and incentives for inefficient investment and deployment decisions." *FNPRM*, at para. 3. (Emphasis added).
- The following chart, filed with the FCC by a group of carrier commenters called the Intercarrier Compensation Forum ("ICF") illustrates the problem, by highlighting the disparity between the various per-MOU rates currently applicable the same function: the origination/termination of telecommunications traffic.

Intercarrier Compensation Rates



The Plan Perpetuates Artificial Regulatory Distinctions

- The Plan contemplates no less than nine (9) separate per-MOU rates for the origination/termination of traffic plus an additional rate for tandem transit—no improvement whatever on the current rate structure.
- The Plan sets a very low, unified rate for termination provided by so-called Track 1 carriers (RBOCs, CLECs, Cablecos and Wireless Carriers), as well as higher rate for origination by Track 1 carriers.
- The Plan sets very high, un-unified rates for functions provided by Track 2 and 3 carriers (medium sized and small rural LECs).
- The Plan establishes rates based on artificial regulatory distinctions including type of carrier (rural LEC or non-rural LEC), type of regulation (price cap v. ROR), and direction of traffic (originating v. terminating)
- Much like the current rate structure, there is no cost or policy justification offered for any of the Plan's rate distinctions.



Note 1: **The rates depicted herein are taken from the Plan Summary, at pp. 4-6 and 11.**

Note 2: **Where the Plan establishes separate rates for (1) tandem switching and common transport; and (2) end office switching functions, the rate depicted herein represents the sum of the rates for both functions, i.e., the total rate for applicable to tandem-level interconnection.**

Note 3: **The rate depicted for Track 3—Term. Access, etc. is taken from the ICF chart's rate for "Small ILEC Interstate" access.**

New Opportunities for Regulatory Arbitrage

- Regulatory arbitrage is the ability for a carrier to charge a high rate for the functions it provides to other carriers, while paying a low rate for the same or similar functions it purchases from other carriers.

- The Plan clearly provides regulatory arbitrage opportunity for rural LECs, since the rates they may charge for the origination/termination of traffic are ***orders of magnitude greater*** than the rates they would pay Track 1 carriers.

- In addition, rural LECs may in many cases pick and choose the rate structure that suits their business plan.

  – For example, a Price-Cap rural LEC may choose (1) to charge $0.0095 for originating access and $0.0080 for terminating access; <u>or</u> (2) charge nothing for originating access and $0.0102 for terminating access. A rational rural LEC would make its choice based on the specific traffic flows inherent to its current situation, i.e., whether it is a net recipient, or a net sender, of traffic.

New Opportunities for Regulatory Arbitrage (cont'd)

- As with the current regime, the Plan establishes different rates for the same function with no apparent basis in cost or policy.

  – For example, there is no valid reason why the interim rate for tandem transit ($0.0025) should be five times higher than the unified rate for Track 1 termination ($0.0005), especially since tandem transit is a lesser set of functions (i.e., tandem switching and common transport) than termination (i.e., tandem switching, common transport, and end office switching).

  – As an additional example, there is no valid reason why the rates for rural LEC termination should be orders of magnitude higher then the rates for Track 1 termination. Although ***loop costs*** may be higher in rural areas than in non-rural areas, there is no reason why ***switching costs*** should be higher in rural areas. Termination encompasses tandem and end office switching costs, not loop costs.

The Plan is Bad for Consumers

- The Plan is clearly designed to guarantee revenue neutrality for incumbent carriers, especially rural LECs.
  - "The Plan provides for a Restructure Mechanism designed to replace the revenues that are eliminated in connection with the Track 1, Track 2, and Track 3 transitions, to the extent such revenues are not recovered through restructured intercarrier charges or increased SLCs." Plan Summary, at 12.
- Incumbents may offset access charge reductions with:
  - An increase of the SLC to $10.
  - A new "Restructure Mechansim" charge on end users.
  - A new "State Early Adopter Fund" charge on end users.
- The Plan separately calls for a $300,000,000 increase in funding for the High Cost Loop Fund ("HCLF") portion of USF. Plan Summary, at pp.12-13 and note 12.

No Cost Analysis

- The problem with revenue neutrality is the complete lack of hard evidence that incumbents' current access charge revenues reflect their actual costs or any valid public policy goal.
- The Plan presumes that incumbents—not consumers—are entitled to each and every access revenue dollar the incumbents currently collect.
- The Plan simply replaces access dollars lost from one set of consumers with SLC and other dollars gained from another set of consumers.
- The Plan's revenue recovery mechanisms are permanent and will artificially perpetuate current access charge revenue levels far into the future.
- Given the recent and forecasted declines in access revenues, incumbents' willingness to forego these revenues should rightly be viewed as an empty "sleeves off the vest" gesture.

Demands for HCLF Increases

- The Plan calls for increases in HCLF funding, which is paid for by consumers and goes primarily to rural LECs.
- These increases are not tied to revenue neutrality under the Plan or any other ostensible policy goal.
- The public policy benefits of HCLF have been called into serious question. (See, study entitled "'Universal Service' Telephone Subsidies: What Does $7 Billion Buy?", attached hereto at **Tab A**).
- Pennsylvania was the sixth greatest net payor state to USF in 2004 (paid out $101,143,000)(Federal State Joint Board on Universal Service, 2005 Monitoring Report, at Table 1.12, Universal Service Support Mechanisms by State: 2004, attached hereto at **Tab B**).
- Increases in the HCLF portion of USF will further increase the total amount of money Pennsylvania consumers pay into USF.

The Plan is Anti-Competitive

- The Plan ignores the increasing use of IP and other new technologies, and instead forces all carriers and all traffic into an expensive and antiquated TDM architecture.

- The Plan clearly favors one set of carriers (rural LECs and to a lesser extent, RBOCs) over the interest of other carriers (CLECs, wireless carriers, and cablecos).

  – The rate structure clearly favors rural LECs at the expense of other carriers.

  – The interconnection rules also favor incumbents, and rural LECs in particular, over CLECs, wireless carriers, and cablecos.

No Accommodation of IP Networks

- The Plan notes the increasing competition felt from IP-based communications and other forms of landline replacement. Plan Policy and Legal Overview, at 1. Yet the Plan assumes and reinforces an intercarrier compensation model and an interconnection architecture model based on TDM switch hierarchy and copper loop technology.

- The Plan provides no real clarification of intercarrier compensation for IP-based traffic origination or termination on the PSTN—which is perhaps the biggest intercarrier compensation issue out there.
  - Since the Plan does not actually eliminate extreme rate disparity between access and non-access traffic origination/termination, the problem of IP-based traffic will continue.

No Accommodation of IP Networks (cont'd)

- The Plan's Interconnection architecture caters to ILECs' view of their own legacy networks, with no accommodation for new competitive networks.
  - Competitors would be forced to purchase inefficient, TDM-based transit and/or transport services from the ILECs at unregulated or lightly regulated special access rates.
  - No thought given to the use of innovative interconnection options, such as neutral tandem providers, or IP-based traffic exchange, in order to reduce interconnection costs for all carriers.

Interconnection Makeover

- The Plan would completely overhaul the existing regime for facilities-based interconnection. (A detailed analysis of the Plan's interconnection rules is attached hereto at **Tab C**).
- All incumbents would benefit from the new "Edge" architecture, which permits a carrier to designate multiple traffic termination points on its own network in each LATA.
  - The Edge concept would permit incumbents to multiply competitors' interconnection costs by designating multiple Edges (i.e., POIs) in each LATA.
- Incumbents would also benefit from the "out-of-balance traffic" rule, which releases them from financial obligation for their own originating traffic.
  - Under the out of balance traffic rule, any competitor that terminates a certain threshold ratio of traffic must pay ***all interconnection transport costs***, including the costs to transport the incumbent's originating traffic to the competitor's network Edge.

Special Rules for Rural LECs

- The Plan affords rural LECs significant additional protections.
- Under the “Modified Rural Transport Rule”, certain rural LECs are financially responsible for ***only half of the costs*** associated with transport of their own originating traffic past a meet point in each rural LEC exchange.
- Under the “Full Rural Transport Rule”, certain other rural LECs are financially responsible for ***none of the costs*** associated with transport of their own originating traffic past a meet point in each rural LEC exchange.
- Rural LECs, not their competitors, unilaterally control whether they will adopt the Modified or the Full Rural Transport Rule

Transit is Deregulated

- The FCC has identified tandem transit as an important bottleneck service that facilitates low-volume connections between multiple carriers.
  - "The record suggests that the availability of transit service is increasingly critical to establishing indirect interconnection—a form of interconnection explicitly recognized in the Act. It is evident that competitive LECs, CMRS carriers, and rural LECs often rely upon transit service from the incumbent LECs to facilitate indirect interconnection with each other. Without the continued availability of transit service, carriers that are indirectly interconnected may have no efficient means by which to route traffic between their respective networks." *FNPRM*, at para. 125.
- Yet the Plan would set an interim cap of $0.0025 per MOU (five times the unified rate for Track 1 transport and termination) and then deregulate pricing altogether.
- The Plan would permit RBOCs to price gouge its competitors for this essential bottleneck service.

Conclusion

- The Commission should reject the Plan as a basis for intercarrier compensation reform.
- Real reform should aim directly at a single unified, cost-based rate for all traffic, with careful consideration given to preserve any universal service needs that are proven and valid.
- Real reform should benefit consumers, not simply move dollars from one basket to another.
- Real reform should come in the form of a carrier-neutral, technology neutral regime, not one that favors certain segments of the industry.