clarify that these ten-year record retention requirements apply to all recipients of high-cost and CAF support.[1025] To ensure access to documents and information needed for effective ongoing oversight, we include in new section54.320 a requirement that all documents be made available upon request to the Commission and any of its Bureaus or offices, the Administrator, and their respective auditors.

D. USAC Oversight Process

622. *Background*. In the *USF/ICC Transformation NPRM*, we sought comment on ways to improve USAC's audit process to reduce improper payments and assess risks. We received only one set of comments addressing this issue.[1026]

623. *Discussion.* As noted in the *USF/ICC Transformation NPRM*, audits are an essential tool for the Commission and USAC to ensure program integrity and to detect and deter waste, fraud, and abuse.[1027] In the *USF/ICC Transformation NPRM*, we discussed the concerns expressed by the GAO in 2008 regarding, among other things, the audit process that existed at the time.[1028] The *USF/ICC Transformation NPRM* also acknowledged USAC's December 2010 Final Report,[1029] which detailed the findings of the audits conducted at the direction of the Commission's Office of Inspector General.[1030]

624. As directed by the Commission's Office of the Managing Director, USAC now has two programs in place to safeguard the Universal Service Fund – the Beneficiary/Contributor Compliance Audit Program (BCAP) and Payment Quality Assurance (PQA) program.**[1031]** We created these programs, in conjunction with USAC, in order to address the shortcomings of the audit processes discussed in the GAO High-Cost Report and USAC's December 2010 Final Report. The PQA program was launched in August 2010,[1032] and the first round of BCAP audits were announced on December 1, 2010. OMD oversees USAC's implementation of both programs.[1033]

625. Audits done pursuant to BCAP are intended to: (1) ensure that recipients of USF support are in compliance with the Commission's rules; (2) prevent, detect, and deter waste, fraud, and abuse; (3)

[1025] As noted in Section VII.E.f.iii. above**,** Mobility Fund Phase I recipients will be required to retain documentation for at least ten years after the date on which the company receives its final disbursement of Mobility Fund Phase I support.

[1026] *See* COMPTEL *USF/ICC Transformation NPRM* Comments at 21 ("One critical action that the Commission should take immediately to strengthen its audit processes … is to ensure that the audits are completed on a timely basis and that timely efforts are made to recover improper payments."). We did, however, receive comments supporting our ability to audit recipients. *See, e.g.*, WISPA *USF/ICC Transformation NPRM* Comments at 10-11.

[1027] *USF/ICC Transformation NPRM* at ¶ 471.

[1028] *USF/ICC Transformation NPRM* at ¶ 469. *See* GAO High-Cost Report at 34-36.

[1029] *USF/ICC Transformation NPRM* at ¶¶ 472-73.

[1030] *See Universal Service Administrative Company, Final Report and Statistical Analysis of the 2007-08 Federal Communications Commission Office of Inspector General High-Cost Program Beneficiary Audits* (Dec. 15, 2010), *available at* http://www.fcc.gov/omd/usf-letters2011.html (December 2010 USAC Compliance Report).

[1031] *See* Letter from Steven VanRoekel, FCC, to Scott Barash, USAC (Feb. 12, 2010), *available at* http://www.fcc.gov/omd/usac-letters/2010/021210-ipia.pdf (Feb. 12, 2010 USAC Letter) (directing USAC to separate its two audit objectives into distinct programs – one focused on Improper Payments Information Act (IPIA) assessment and the second on auditing compliance with all four USF programs.)

[1032] *See* USAC 2010 Annual Report at 5. This report may be found at: http://www.usac.org/about/governance/annual-reports/2010.html.

[1033] *See* Feb. 12, 2010 USAC Letter.

recover funds for rule violations; and (4) ensure equitable contributions to the USF. These compliance audits will also verify the accuracy of the underlying data,[1034] thus addressing one of the concerns expressed by the GAO,[1035] the State Members of the Federal-State Joint Board on Universal Service, and Comptel.[1036]

626. Unlike BCAP, the PQA program does not involve audits.[1037] Rather, it provides for reviews specifically designed to assess estimated rates of improper payments, thereby supporting Improper Payments Information Act (IPIA) requirements. The PQA reviews measure the accuracy of USAC payments to applicants, evaluate the eligibility of program applicants, and involve high-level testing of information obtained from program participants. USAC tailors the scope of procedures to ensure reasonable costs while still meeting IPIA requirements. These reviews occur in four-month cycles, with USAC conducting 20-60 assessments of high-cost recipients per cycle.[1038]

627. To assist program participants, USAC has information about BCAP and the PQA program available on its website.[1039] In addition to BCAP and the PQA program, USAC conducts outreach training events as well as individual outreach activities via phone, e-mail, video-conference, or in person.[1040] USAC also has outreach products on its website, including video tutorials.[1041] USAC has also "enhanced internal controls and data gathering to gain greater visibility into payment operations, calibrated audit and audit follow-up activities to gain greater certainty about beneficiary support, and modernized information technology systems to achieve greater efficiencies and improve reporting capabilities."[1042]

628. We direct USAC to review and revise the BCAP and PQA programs to take into account the changes adopted in this Order. We direct USAC to annually assess compliance with the new requirements established for recipients, including for recipients of CAF Phase I and Phase II. For CAF Phase I, we establish above a requirement that companies have completed build-out to two-thirds of the requisite number of locations within two years. We direct USAC to assess compliance with this requirement for each holding company that receives CAF Phase I funds. ETCs that receive CAF Phase I funding should ensure that their underlying books and records support the assertion that assets necessary to offer broadband service have been placed in service in the requisite number of locations. We also direct USAC to test the accuracy of certifications made pursuant to our new reporting requirements. Any oversight program to assess compliance should be designed to ensure that management is reporting accurately to the Commission, USAC, and the relevant state commission, relevant authority in a U.S. Territory, or Tribal government, as appropriate, and should be designed to test some of the underlying

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[1034] *See* http://www.usac.org/hc/about/understanding-audits.aspx.

[1035] GAO High-Cost Report at 37.

[1036] State Members *USF/ICC Transformation NPRM* Comments at 55; COMPTEL *USF/ICC Transformation NPRM* Comments at 20-21. We received no other comments in response to our request for comment on how to improve the data validation process to correct the weakness identified by GAO.

[1037] *See* http://www.usac.org/fund-administration/about/program-integrity/pqa-faqs.aspx.

[1038] *See* http://www.usac.org/fund-administration/about/program-integrity/pqa-faqs.aspx.

[1039] *See* http://www.usac.org/hc/about/understanding-audits.aspx; http://www.usac.org/fund-administration/about/program-integrity/pqa-program.aspx.

[1040] *See* http://www.usac.org/about/resource-room/individual-outreach/.

[1041] *See* http://www.usac.org/hc/tools/video-tutorials.aspx.

[1042] December 2010 USAC Compliance Report.

data that forms the basis for management's certification of compliance with various requirements. This list is not intended to be exhaustive, but rather illustrative of the modifications that USAC should make to its existing oversight activities. We direct USAC to submit a report to WCB, WTB, and OMD within 60 days of release of this Order proposing changes to the BCAP and PQA programs consistent with this Order.

629. To assist USAC's audit and review efforts, we clarify in new section 54.320 that all ETCs that receive high-cost support are subject to random compliance audits and other investigations to ensure compliance with program rules and orders.[1043]

E. Access to Cost and Revenue Data

630. *Background*. Although USAC is the USF Administrator, high-cost universal service data collection responsibilities are divided between USAC and NECA. In the *USF/ICC Transformation NPRM*, we noted that NECA collects data for the high-cost loop support program, while USAC collects data for the remaining components of the high-cost program. As a result of this division, certain information that is relevant to administration of universal service, including validation of universal service payments, is not routinely provided to USAC. For example, because NECA is responsible for Part 36 Subpart F-Universal Service Fund (HCLS) data collection under the Commission's current rules, NECA analyzes the cost data, performs certain calculations, and then transmits that information to USAC for use in determining HCLS payments to rural carriers, but USAC does not have access to the underlying Part 36 data that carriers submit to NECA.

631. Similarly, section 54.901 of the Commission's rules requires USAC to calculate ICLS support as the difference between the common line revenue requirement and the sum of end-user common line charges and certain other revenues.[1044] Yet NECA calculates the common line revenue requirement and submits the results of its analysis to USAC; USAC does not have access to the underlying information that carriers submit to NECA. In order for USAC to validate ICLS payments to rate-of-return carriers, USAC must request from NECA underlying cost study information and supporting documentation for SLC revenues (residence and single line business and multiline business), uncollectibles, end user ISDN port revenue, and special access revenues.

632. Moreover, the Commission does not routinely receive from NECA and USAC all data used to calculate high-cost payments. Accordingly, in the NPRM, we sought comment on ways to increase the flow of information, including to improve the data validation process to ensure that the funds are used "to advance modern networks capable of providing broadband and voice services."[1045]

633. *Discussion*. We take two steps to facilitate the exchange of information needed to administer and oversee universal service programs. First, we modify our rules to clarify that USAC has a right to obtain – at any time and in any unaltered format – all cost and revenue submissions and related information that carriers submit to NECA that is used to calculate payments under any of the existing programs and any new programs, including the new CAF ICC (access replacement) support.

634. Second, we modify our rules to ensure that the Commission has timely access to relevant data. Specifically, we require that USAC (and NECA to the extent USAC does not directly receive such information from carriers) provide to the Commission upon request all underlying data collected from ETCs to calculate payments under current support mechanisms – specifically, HCLS, ICLS, LSS, SNA, SVS, HCMS and IAS – as well as to calculate CAF payments. This includes information or data

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[1043] This includes audits and investigations conducted by the Commission and its Bureaus and Offices.

[1044] *See* 47 C.F.R. § 54.901.

[1045] *USF/ICC Transformation NPRM* at ¶¶ 467, 476.

underlying existing and future analyses that USAC uses to determine the amount of federal universal service support disbursed in the past or the future, including the new CAF.

635. We anticipate that NECA and USAC will submit summary filings to the Commission on a regular basis, and we delegate to the Wireline Competition Bureau authority to determine the format and timing of such summary filings, but we emphasize that USAC and NECA must timely provide any underlying data upon request. We also modify our rules to require rate-of-return carriers to submit to the Commission upon request a copy of all cost and revenue data and related information submitted to NECA for purposes of calculating intercarrier compensation and any new CAF payments resulting from intercarrier compensation reform adopted in this Order.[1046]

IX. ADDITIONAL ISSUES

A. Tribal Engagement

636. The deep digital divide that persists between the Native Nations of the United States and the rest of the country is well-documented.[1047] Many residents of Tribal lands lack not only broadband access, but even basic telephone service.[1048] Throughout this reform proceeding, commenters have repeatedly stressed the essential role that Tribal consultation and engagement play in the successful deployment of service on Tribal lands.[1049] For example, the National Tribal Telecommunications Association, the National Congress of American Indians, and the Affiliated Tribes of Northwest Indians have stressed the importance of measures to "specifically support and enhance tribal sovereignty, with emphasis on consultation with Tribes."[1050]

637. We agree that engagement between Tribal governments and communications providers either currently providing service or contemplating the provision of service on Tribal lands is vitally important to the successful deployment and provision of service. We, therefore, will require that, at a minimum, ETCs to demonstrate on an annual basis that they have meaningfully engaged Tribal governments in their supported areas.[1051] At a minimum, such discussions must include: (1) a needs assessment and deployment planning with a focus on Tribal community anchor institutions; (2) feasibility and sustainability planning; (3) marketing services in a culturally sensitive manner; (4) rights of way processes, land use permitting, facilities siting, environmental and cultural preservation review processes;

[1046] *See* Section XIII.

[1047] *See, e.g., Improving Communications Services for Native Nations,* CG Docket No. 11-41, Notice of Inquiry, 26 FCC Rcd 2672, 2673 (2011) (*Native Nations NOI*); *Improving Communications Services for Native Nations by Promoting Greater Utilization of Spectrum Over Tribal Lands,* WT Docket No. 11-40, Notice of Proposed Rulemaking, 26 FCC Rcd 2623, 2624-25 (2011) (*Spectrum Over Tribal Lands NPRM*); *Connecting America: The National Broadband Plan,* prepared by staff of the Federal Communications Commission, March 10, 2010 (*National Broadband Plan*).

[1048] *Native Nations NOI*, 26 FCC Rcd at 2673. *See also Extending Wireless Telecommunications Services to Tribal Lands,* WT Docket No. 99-266, Report and Order and Further Notice of Rule Making, 15 FCC Rcd 11794, 11798 (2000) By virtually any measure, communities on Tribal lands have historically had less access to telecommunications services than any other segment of the population."); *National Broadband Plan* at 152, Box 8-4.

[1049] See, e.g., NTTA, NCAI, and ATNI Oct. 18, 2011 ex parte letter; Navajo Commission Oct. 24, 2011 ex parte letter; NPM and NCAI Comments at 8-9; Navajo Commission Reply Comments at 4; Twin Houses Public Notice Comments at 1-3, 6; Navajo Nation Telecommunications Regulatory Commission Ex Parte

[1050] NTTA, NCAI, and ATNI Oct. 18, 2011 ex parte letter.

[1051] As discussed, *infra,* we note that additional engagement obligation would apply in the context of bidding for, and receiving, Mobility Fund support.

and (5) compliance with Tribal business and licensing requirements.[1052] In requiring Tribal engagement, we do not seek to supplant the Commission's own ongoing obligation to consult with Tribes on a government-to-government basis, but instead recognize the important role that all parties play in expediting service to Tribal lands. As discussed above, support recipients will be required to submit to the Commission and appropriate Tribal government officials an annual certification and summary of their compliance with this Tribal government engagement obligation.[1053] Carriers failing to satisfy the Tribal government engagement obligation would be subject to financial consequences, including potential reduction in support should they fail to fulfill their engagement obligations.[1054] We envision that the Office of Native Affairs and Policy ("ONAP"), in coordination with the Wireline and Wireless Bureaus, would utilize their delegated authority to develop specific procedures regarding the Tribal engagement process as necessary.

B. Interstate Rate of Return Prescription

638. In the *USF-ICC Transformation Notice*, the Commission sought comment on whether to initiate a proceeding to represcribe the authorized interstate rate of return for rate-of-return carriers if it determines that such carriers should continue to receive high-cost support under a modified rate-of-return system.[1055] The Commission has not revisited the current 11.25 percent rate of return for over 20 years. Several commenters supported our proposal to initiate a represcription proceeding.[1056] Others offered comments on how the Commission should proceed in the event it does initiate such a proceeding.[1057] We, therefore, conclude that the Commission should represcribe the authorized interstate rate of return for rate-of-return carriers, and we initiate that represcription process today. In the FNPRM, we propose that the interstate rate of return should be adjusted to ensure that it more accurately reflects the true cost of capital today. Based on our preliminary analysis and record evidence, we believe the current rate of return of 11.25 percent is no longer consistent with the Act and today's financial conditions. In this Order, we find good cause to waive certain procedural requirements in the Commission's rules relating to rate represcriptions to streamline and modernize this process to align it with the current Commission practice.

[1052] Tribal business and licensing requirements include business practice licenses that Tribal and non-Tribal business entities, whether located on or off Tribal lands, must obtain upon application to the relevant Tribal government office or division to conduct any business or trade, or deliver any goods or services to the Tribes, Tribal members, or Tribal lands. These include certificates of public convenience and necessity, Tribal business licenses, master licenses, and other related forms of Tribal government licensure.

[1053] Appropriate Tribal government officials are elected or duly authorized government officials of federally recognized American Indian Tribes and Alaska Native Villages. In the instance of the Hawaiian Home Lands, this engagement must occur with the State of Hawaii Department of Hawaiian Home Lands and Office of Hawaiian Affairs.

[1054] We direct the Office of Native Affairs and Policy (ONAP), in coordination with the Bureaus, to develop best practices regarding the Tribal engagement process to help facilitate these discussions.

[1055] *USF-ICC Transformation Notice*, 26 FCC Rcd at 4692, para. 456.

[1056] *See*, e.g., April 18 Comments of CTIA at 28 ("And the permitted rate of return unquestionably must be reduced from the current 11.25 percent level.").

[1057] *See*, e.g., Pennsylvania PUC *August 3 PN* Comments at 19; N.E. Colorado Cellular *August 3 PN* Comments at 1, 17-8; Surewest Communications *USF/ICC Transformation NPRM* Comments at 18.

1. Represcription

639. Section 205(a) of the Act authorizes the Commission, on an appropriate record, to prescribe just and reasonable charges of common carriers.[1058] The Commission last adjusted the authorized rate of return in 1990, reducing it from 12 percent to 11.25 percent.[1059] In 1998, the Commission initiated a proceeding to represcribe the authorized rate of return for rate-of-return carriers.[1060] However, in the *MAG Order*, the Commission terminated that prescription proceeding.[1061] Given the time that has elapsed since the authorized rate of return was last prescribed, and the major changes that have occurred in the market since then, we find that the authorized interstate rate of return should be reviewed and begin that process, seeking the information necessary to prescribe a new rate of return.[1062]

640. The Commission's rules provide that the trigger for a new prescription proceeding is satisfied if the monthly average yields on ten-year United States Treasury securities remain, for a consecutive six month period, at least 150 basis points above or below the average of the monthly average yields in effect for the consecutive six month period immediately prior to the effective date of the current prescription.[1063] The monthly average yields for the past six months have been over 450 basis points below the monthly average yields in the six months immediately prior to the last prescription.[1064] Our trigger is easily satisfied, and we initiate the represcription now.

2. Procedural Requirements

641. Section 205(a) requires the Commission to give "full opportunity for hearing" before prescribing a rate.[1065] However, a formal evidentiary hearing is not required under section 205,[1066] and we have on multiple occasions prescribed individual rates in notice and comment rulemaking proceedings.[1067]

[1058] 47 U.S.C. §§ 201(b), 205(a).

[1059] *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990) (*1990 Prescription Order*).

[1060] *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998) (*1998 Prescription Notice*).

[1061] *See MAG Order*, 16 FCC Rcd at 19701, para. 208.

[1062] *See infra* XVII.C.

[1063] 47 CFR § 65.101

[1064] *See* 10-Year Treasury Constant Maturity Rate (GS10), Federal Reserve Bank of St. Louis (*available at* http://research.stlouisfed.org/fred2/series/GS10) (last visited Oct. 21, 2011).

[1065] 47 U.S.C. § 205(a).

[1066] In *AT&T v. FCC,* for example, the Second Circuit made clear that because section 205 does not require a hearing "on the record," the Administrative Procedures Act (APA) does not require a full evidentiary hearing in section 205 prescription proceedings. 572 F.2d 17, 21-23 (2d Cir. 1978). Moreover, the court found that the language of section 205(a) itself did not impose greater hearing requirements than the APA – concluding that AT&T "may not complain that it had anything less than a 'full opportunity' to be heard" after receiving, in the context of the particular proceeding on review, three rounds of comments. 572 F.2d at 22.

[1067] *See*, *e.g.*, *Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982 , paras. 75-87 (1997), *aff'd Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (prescribing new limits on subscriber line charges for non-primary residential and multi-line business lines); *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd 12962, paras. 58, 70-75 (2000), *aff'd in pertinent part, Texas Office of Pub. Util. Counsel*, 265 F.3d 313 (5th Cir. 2001) (prescribing revised ceilings on subscriber line charges).

Although we have found it useful in the past to impose somewhat more detailed requirements in rate of return prescription proceedings, we have expressly rejected the proposition that we could not "lawfully use simple notice and comment procedures to prescribe the rate of return authorized for LEC interstate access services."[1068] Accordingly, in the FNPRM we initiate a new rate of return prescription proceeding using notice and comment procedures, and on our own motion, we waive certain existing procedural rules to facilitate a more efficient process.

642. The Commission's current interstate rate of return represcription rules in Part 65 contemplate a streamlined paper hearing process.[1069] These procedural rules are more specific and detailed than the Commission's rules for filing comments, replies, and written *ex parte* presentations in permit-but-disclose proceedings. The Part 65 rules require that:

- an original and four copies of all submissions must be filed with the Secretary (rule 65.103(d)),
- all participants in the proceeding state in their initial pleading whether they wish to receive service of documents filed in the proceeding (rule 65.100(b)), and filing parties must serve copies of their submissions (other than initial submissions) on all participants who properly so requested (rule 65.103(e)),
- parties may file "direct case submissions, responses, and rebuttals," with direct case submissions due 60 days after the beginning of the proceeding, responses due 60 days thereafter, and rebuttals due 21 days thereafter (rule 65.103(b),
- direct case submissions and responses are subject to a 70-page limit, and rebuttals to a 50-page limit (rule 65.104(a)-(c)),
- parties must file copies of all information (such as financial analysts' reports) that they relied on in preparing their submissions (rule 65.105(a)), and
- parties may file written interrogatories and discovery requests directed at any other party's submissions, and the submitting parties may oppose those requests (rule 65.105(b)-(f)).

643. We find good cause to waive some of these procedural requirements on our own motion.[1070] We find that these procedures would be onerous and are not necessary to ensure adequate public participation. For instance, there is no need for parties to file an original plus four copies of submissions with the Secretary.[1071] The Commission recently revised its rules to encourage electronic filing of comments and replies whenever technically feasible, and to require that *ex parte* submissions be filed electronically unless doing so poses a hardship.[1072] Given the vast improvements to the electronic

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[1068] *Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes*, Report and Order, 10 FCC Rcd 6788, 6814, para. 55 (1995) (*Rate of Return Streamlined Rules R&O*). *See generally id.*, 10 FCC Rcd at 6814-15, paras. 55-57 (citing case law establishing that the "full opportunity for hearing" language of section 205 does not mandate "trial-type procedures in addition to, or instead of, notice and comment procedures").

[1069] 47 C.F.R. Part 65; *Rate of Return Streamlined Rules R&O*, 10 FCC Rcd at 6812-15, paras. 51-57.

[1070] 47 C.F.R. § 1.3; *see also WAIT Radio v. FCC*, 418 F.2d 1153 (D.C. Cir. 1969); *Northeast Cellular Tel. Co. v. FCC*, 897 F.2d 1166 (D.C. Cir. 1990).

[1071] 47 C.F.R. § 65.103(d).

[1072] 47 C.F.R. § 1.1206(b)(2)(i); *Amendment of Certain of the Commission's Part 1 Rules of Practice and Procedure and Part 0 Rules of Commission Organization*, Report and Order, 26 FCC Rcd 1594, 1596 para. 6 (2011) (encouraging the migration to electronic filing).

filing system, and the usual practice now of many parties to file documents electronically rather than on paper, we see no reason to require the submission of paper copies. Rather, parties to this proceeding may comply with our usual procedures in permit-but-disclosure proceedings.[1073] Pleadings other than *ex parte* submissions may be filed electronically or may be filed on paper with the Secretary's office. If they are filed on paper, the original and one copy should be provided.

644. The Part 65 rules also contemplate that all parties to the proceeding will be served with copies of all other parties' submissions.[1074] Again, this is no longer necessary. Before the greater and more accepted use of electronic filing, service may have been a reasonable requirement to assure timely distribution of relevant materials. However, our electronic filing system generally makes filings available within 24 hours, and the vast majority of parties have access to these materials via the Internet. We, therefore, find that service is not required, and we waive the requirement. Any party that wishes to receive an electronic notification when new documents are filed in the proceeding may subscribe to an RSS feed, available from ECFS.

645. In addition, we waive the specific filing schedule contained in section 65.103(b) of the Commission's rules so that comments may be filed pursuant to the pleading cycle adopted for sections XVII.A-K of the FNPRM. We also find the page limits applicable to rate represcription proceedings to be inappropriate here. Lastly, we waive the requirement in section 65.301 that the Commission publish in this notice the cost of debt, cost of preferred stock, and capital structure computed under our rules, because, as detailed in the FNPRM,[1075] the data set necessary to calculate those formulas is no longer collected by the Commission. We seek comment in the FNRPM on those calculations and the related data and methodology issues.

C. Pending Matters

646. We also deny four pending high-cost maters currently pending before the Commission: two petitions for reconsideration of the *Corr Wireless Order*;[1076] Puerto Rico Telephone Company, Inc.'s petition to reconsider our decision declining to adopt a new high-cost support mechanism for non-rural insular carriers;[1077] and Verizon Wireless's Petition for Reconsideration of the Wireline Competition Bureau's letter directing the USAC to implement certain caps on high-cost universal service support for two companies, known as the "company-specific caps."[1078]

D. Deletion of Obsolete Universal Service Rules and Conforming Changes to Existing Rules

647. As part of comprehensive reform, we make conforming changes to delete obsolete rules from the Code of Federal Regulations. Specifically, we eliminate our rules governing Long Term Support, which the Commission eliminated as a discrete support program in the *MAG Order*, and Interim Hold Harmless Support for Non-Rural Carriers, which addressed non-rural carriers' transition from high-cost loop support to high-cost model support.[1079] Because these rules are obsolete, we find good cause to

[1073] Our rules already designate rate prescription proceedings under section 205 as permit-but-disclose for *ex parte* purposes. 47 C.F.R. § 1.1206(a)(10).

[1074] 47 C.F.R. §§ 65.100(b), 65.103(e).

[1075] *See infra.* Section XVII.C.

[1076] *See* Appendix F.

[1077] *See* Appendix D.

[1078] *See* Appendix E.

[1079] 47 C.F.R. §§ 54.303, 311.

delete them without notice and comment.[1080] We also make conforming changes to existing rules to ensure they are consistent with changes made in this Order.[1081]

X. OVERVIEW OF INTERCARRIER COMPENSATION

648. In this section, we comprehensively reform the intercarrier compensation system to bring substantial benefits to consumers, including reduced rates for all wireless and long distance customers, more innovative communications offerings, and improved quality of service for wireless consumers and consumers of long distance services. The reforms also improve the fairness and efficiency of subsidies flowing to high-cost rural areas, and promote innovation by eliminating barriers to the transformation of today's telephone networks into the all-IP broadband networks of the future. The existing intercarrier compensation system—built on geographic and per-minute charges and implicit subsidies—is fundamentally in tension with and a deterrent to deployment of all IP networks. And the system is eroding rapidly as demand for traditional telephone service falls, with consumers increasingly opting for wireless, VoIP, texting, email, and other phone alternatives. Falling demand has led to rising access rates for smaller rural carriers, fueling wasteful arbitrage schemes and prompting costly compensation disputes.

649. To address these issues, we first take immediate action to curtail two of the most prevalent arbitrage activities today, access stimulation and phantom traffic. These schemes involve service providers exploiting loopholes in our rules and ultimately cost consumers hundreds of millions of dollars annually.

650. Next, we launch long-term intercarrier compensation reform by adopting bill-and-keep as the ultimate uniform, national methodology for all telecommunications traffic exchanged with a LEC. We make clear that states will continue to play a vital role within this framework, particularly in the context of negotiated interconnection agreements, arbitrating interconnection disputes under the section 251/252 framework, and defining the network "edge" for bill-and-keep.

651. We begin the transition to bill-and-keep with terminating switched access rates, which are the main source of arbitrage today. We provide for a measured, gradual transition to a bill-and-keep methodology for these rates, and adopt a recovery mechanism that provides carriers with certain and predictable revenue streams. We also begin the process of reforming originating access and other rate elements by capping all interstate rates and most intrastate rates as of the effective date of the rules adopted pursuant to this Order.

652. This Order also makes clear the prospective payment obligations for VoIP traffic and adopts a transitional intercarrier compensation framework for VoIP. In addition, we clarify certain aspects of CMRS-LEC compensation to reduce disputes and address existing ambiguity. We also make clear our expectation that carriers will negotiate in good faith in response to requests for IP-to-IP interconnection for the exchange of voice traffic.

653. Finally, in the Further Notice of Proposed Rulemaking (FNPRM), we seek comment on the transition and recovery mechanism for rate elements not reduced as part of this Order, including originating access and certain common and dedicated transport. We also seek comment on ways to implement our expectation of good faith negotiations for IP-to-IP interconnection for the exchange of voice traffic, ways to promote IP-to-IP interconnection, as well as other implementation issues for the bill-and-keep end state.

654. Our reforms will bring numerous and significant benefits to consumers. As with past intercarrier compensation reforms, we anticipate savings from intercarrier compensation payments will

[1080] 5 U.S.C. 553(b)(3)(B).

[1081] *See* Appendix A.

result in more robust wireless service, more innovative offerings, and cost savings to consumers. Our proposed gradual reduction of intercarrier charges and movement to a bill-and-keep methodology will significantly increase the efficiency of long distance and local calling, and of other services more generally. Indeed, we estimate, based on conservative assumptions, that once our ICC reform is complete, mobile and wireline phone consumers stand to gain benefits worth over $1.5 billion dollars per year.[1082]

655. In addition, our reforms will promote the nation's transition to IP networks, creating long-term benefits for consumers, businesses, and the nation. The convergence of data, voice, video, and text in networks based upon IP supports the Internet as an open platform for innovation, investment, job creation, economic growth, competition, and free expression.

XI. MEASURES TO ADDRESS ARBITRAGE

A. Rules To Reduce Access Stimulation

656. In this section, we adopt revisions to our interstate switched access charge rules to address access stimulation. Access stimulation occurs when a LEC with high switched access rates enters into an arrangement with a provider of high call volume operations such as chat lines, adult entertainment calls, and "free" conference calls. The arrangement inflates or stimulates the access minutes terminated to the LEC, and the LEC then shares a portion of the increased access revenues resulting from the increased demand with the "free" service provider, or offers some other benefit to the "free" service provider. The shared revenues received by the service provider cover its costs, and it therefore may not need to, and typically does not, assess a separate charge for the service it is offering. Meanwhile, the wireless and interexchange carriers (collectively IXCs) paying the increased access charges are forced to recover these costs from all their customers, even though many of those customers do not use the services stimulating the access demand.

657. Access stimulation schemes work because when LECs enter traffic-inflating revenue-sharing agreements, they are currently not required to reduce their access rates to reflect their increased volume of minutes. The combination of significant increases in switched access traffic with unchanged access rates results in a jump in revenues and thus inflated profits that almost uniformly make the LEC's interstate switched access rates unjust and unreasonable under section 201(b) of the Act.[1083] Consistent with the approach proposed in the *USF/ICC Transformation NPRM*, we adopt a definition of access stimulation that includes two conditions. If a LEC meets those conditions, the LEC generally must reduce its interstate switched access tariffed rates to the rates of the price cap LEC in the state with the lowest rates, which are presumptively consistent with the Act.[1084] This will reduce the extent to which IXC customers that do not use the stimulating services are forced to subsidize the customers that do use the services.

658. Based on the record received in response to the single-pronged trigger proposed in the *USF/ICC Transformation NPRM*, we modify our approach from defining an access stimulation trigger to defining access stimulation. The access stimulation definition we adopt now has two conditions: (1) a

[1082] *See infra* Appendix I.

[1083] 47 U.S.C. § 201(b), which provides that "[a]ll charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is declared to be unlawful . . . ." *See Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, 22 FCC Rcd 17989, 17995-96, para. 14 (*Access Stimulation NPRM*).

[1084] *See infra* Appendix A, Section 61.26(g).

revenue sharing condition, revised slightly from the proposal in the *USF/ICC Transformation NPRM*; and (2) an additional traffic volume condition, which is met where the LEC either: (a) has a three-to-one interstate terminating-to-originating traffic ratio in a calendar month; or (b) has had more than a 100 percent growth in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year. If both conditions are satisfied, the LEC generally must file revised tariffs to account for its increased traffic.

659. Adoption of the definition of access stimulation with two conditions will facilitate enforcement of the new access stimulation rules in instances where a LEC meets the conditions for access stimulation but does not file revised tariffs. In particular, IXCs will be permitted to file complaints based on evidence from their traffic records that a LEC has exceeded either of the traffic measurements of the second condition, i.e., that the second condition has been met. If the IXC filing the complaint makes this showing, the burden will shift to the LEC to establish that it has not met the access stimulation definition and therefore that it is not in violation of our rules. This burden-shifting approach will enable IXCs to bring complaints based on their own traffic data, and will help the Commission to identify circumstances where a LEC may be in violation of our rules.

660. We conclude that these revised interstate access rules are narrowly tailored to minimize the costs of the rule revisions on the industry, while reducing the adverse effects of access stimulation and ensuring that interstate access rates are at levels presumptively consistent with section 201(b) of the Act.

1. Background

661. In the *USF/ICC Transformation NPRM*, we proposed that carriers that have entered a revenue sharing arrangement be required to refile their interstate switched access tariffs to reflect a rate more consistent with their volume of traffic. For rate-of-return LECs, the rate would be adjusted to account for new demand and any increase in costs. For competitive LECs, that rate would be benchmarked to that of the BOC in the state, or, if there was no BOC in the state, to the largest incumbent LEC in the state. We also sought comment on alternative approaches.[1085]

2. Discussion

a. Need for Reform to Address Access Stimulation

662. The record confirms the need for prompt Commission action to address the adverse effects of access stimulation and to help ensure that interstate switched access rates remain just and reasonable, as required by section 201(b) of the Act. Commenters agree that the interstate switched access rates being charged by access stimulating LECs do not reflect the volume of traffic associated with access stimulation.[1086] As a result, access stimulating LECs realize significant revenue increases and thus inflated profits that almost uniformly make their interstate switched access rates unjust and unreasonable.

663. Access stimulation imposes undue costs on consumers, inefficiently diverting capital away from more productive uses such as broadband deployment.[1087] When access stimulation occurs in locations that have higher than average access charges, which is the predominant case today, the average per-minute cost of access and thus the average cost of long-distance calling is increased.[1088] Because of the rate integration requirements of section 254(g) of the Act, long-distance carriers are prohibited from

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[1085] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4757-70, paras. 635-670.

[1086] *See, e.g.*, Free Conferencing Corporation Section XV Comments at 26; ZipDX Section XV Comments at 5.

[1087] *See* 47 U.S.C. § 1302.

[1088] *See, e.g.*, AT&T Section XV Comments at 7-8, 11-12.

passing on the higher access costs directly to the customers making the calls to access stimulating entities.[1089] Therefore, all customers of these long-distance providers bear these costs, even though many of them do not use the access stimulator's services, and, in essence, ultimately support businesses designed to take advantage of today's above-cost intercarrier compensation rates.[1090]

664. The record indicates that a significant amount of access traffic is going to LECs engaging in access stimulation. TEOCO estimates that the total cost of access stimulation to IXCs has been more than $2.3 billion over the past five years.[1091] Verizon estimates the overall costs to IXCs to be between $330 and $440 million per year, and states that it expected to be billed between $66 and $88 million by access stimulators for approximately two billion wireline and wireless long-distance minutes in 2010.[1092] Other parties indicate that payment of access charges to access stimulating LECs is the subject of large numbers of disputes in a variety of forums.[1093] When carriers pay more access charges as a result of access stimulation schemes, the amount of capital available to invest in broadband deployment and other network investments that would benefit consumers is substantially reduced.[1094]

665. Access stimulation also harms competition by giving companies that offer a "free" calling service a competitive advantage over companies that charge their customers for the service. For example, conference calling provider ZipDX indicates that, by not engaging in access stimulation, it is at a disadvantage vis-à-vis competitors that engage in access stimulation.[1095] Providers of conferencing services, like ZipDX, are recovering the costs of the service, such as conference bridges, marketing, and billing, from the user of the service rather than, as explained above in the case of access stimulators, spreading those costs across the universe of long-distance subscribers.[1096] As a result, the services offered by "free" conferencing providers that leverage arbitrage opportunities put companies that recover the cost of services from their customers at a distinct competitive disadvantage.

666. Several parties claim that access stimulation offers economic development benefits, including the expansion of broadband services to rural communities and tribal lands.[1097] Although

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[1089] 47 U.S.C. § 254(g). IXCs charge averaged rates for long-distance calls pursuant to the rate integration policy. To the extent that its average access costs are increased, the costs are spread among all customers of the IXC.

[1090] *See*, *e.g.*, AT&T Section XV Comments at 7. Some parties argue that IXCs are profitable overall or they would eliminate their "all you can eat" pricing plans. *See, e.g.*, Bluegrass Section XV Comments at 8-9; Free Conferencing Corporation Section XV Comments at 24-25. Whether the IXC's revenues for a call are more or less than its cost of terminating the call is not at issue. The question is whether just and reasonable rates are being charged for the provision of interstate switched access services. *See* 47 U.S.C. § 201(b).

[1091] *See* TEOCO, ACCESS STIMULATION BLEEDS CSPS OF BILLIONS, at 5 (TEOCO Study), *attached to* Letter from Glenn Reynolds, Vice President – Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135 (filed Oct. 18, 2010).

[1092] *See* Letter from Donna Epps, Vice President-Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, at 1 (filed Oct. 12, 2010).

[1093] *See, e.g.*, Bluegrass Section XV Comments at 28-29.

[1094] *See*, *e.g.*, AT&T Section XV Comments at 3; USTelecom Section XV Comments at 6-8.

[1095] Letter from David Frankel, CEO, ZipDX, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, at 1, 3 (filed Nov. 26, 2010).

[1096] *See* Testimony of David Frankel, Founder, ZipDX, at the April 6, 2011, WCB Workshop at 25 ("[Zip DX] pay[s] interstate compensation charges as part of [our] wholesale arrangements with our underlying service providers"), *available at* http://webapp01.fcc.gov/ecfs/document/view?id=7021340998.

[1097] *See*, *e.g.*, Free Conferencing Corporation Section XV Comments at 6-7 (the revenues that LECs generate from traffic on their networks allow those carriers to invest in building out their networks with no federal financial (continued…)

expanding broadband services in rural and Tribal lands is important, we agree with other commenters that how access revenues are used is not relevant in determining whether switched access rates are just and reasonable in accordance with section 201(b).[1098] In addition, excess revenues that are shared in access stimulation schemes provide additional proof that the LEC's rates are above cost. Moreover, Congress created an explicit universal service fund to spur investment and deployment in rural, high cost, and insular areas, and the Commission is taking action here and in other proceedings to facilitate such deployment.[1099]

(i) Access Stimulation Definition

667. We adopt a definition to identify when an access stimulating LEC must refile its interstate access tariffs at rates that are presumptively consistent with the Act. After reviewing the record, we make a few changes to the *USF/ICC Transformation NPRM* proposal, including defining access stimulation as occurring when two conditions are met. The first condition is that the LEC has entered into an access revenue sharing agreement, and we clarify what types of agreements qualify as "revenue sharing." The second condition is met where the LEC either has had a three-to-one interstate terminating-to-originating traffic ratio in a calendar month, or has had a greater than 100 percent increase in interstate originating and/or terminating switched access MOU in a month compared to the same month in the preceding year. We adopt these changes to ensure that the access stimulation definition is not over-inclusive and to improve its enforceability.

668. *Definition of a Revenue Sharing Agreement.* Many parties agree that the use of the revenue sharing arrangement trigger alone as proposed in the *USF/ICC Transformation NPRM* would be reasonable to reduce access stimulation,[1100] and other parties argue the existence of a revenue sharing arrangement should be used in conjunction with another condition.[1101] However, the use of a revenue sharing approach alone was criticized by some as being ambiguous, circular, or a poor indicator of access stimulation.[1102] Other parties found the definition of revenue sharing to be over-inclusive and/or under-

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support); Global Section XV Comments at 8 (revenues from competitive conferencing services help further investment in rural infrastructure, thereby promoting development).

[1098] *See, e.g.*, NASUCA and NJ Rate Counsel Section XV Comments at 11-12; Sprint Section XV Reply at 1-2; Statement of Iowa Utilities Board Member Krista Tanner at the April 6, 2011 Workshop, at 61 ("[I]t doesn't matter what the traffic is for. It doesn't matter what you do with your reasonable profits."). The Commission is considering a wide range of issues related to improving communications services for Native Nations. *See generally Improving Communications Services for Native Nations*, CG Docket No. 11-41, Notice of Inquiry, 26 FCC Rcd 2672 (2011).

[1099] *See supra* Sections VI and VII; *see also, e.g.*, *Implementation of Section 224 of the Act; A National Broadband Plan For Our Future*, WC Docket No. 07-245, GN Docket No. 09-51, Report and Order and Order on Reconsideration, 26 FCC Rcd 5240 at 5319, para. 178 (2011) (*2011 Pole Attachment Order*).

[1100] *See, e.g.*, CenturyLink Section XV Comments at 39-40; Global Section XV Comments at 12 ("appropriately tailored step that strikes a proper balance between the Commission's policy concerns and the legitimate business practices of carriers"); Omnitel and Tekstar Section XV Comments at 12-13. *But see* Beehive Section XV Comments at 5-7; EarthLink Section XV Comments at 13-16; HyperCube Section XV Comments at 4; Free Conferencing Corporation Section XV Comments at 2-3, 12-13.

[1101] *See, e.g.*, AT&T Section XV Comments at 18-20; Leap Wireless and Cricket Section XV Comments at 6-7.

[1102] *See, e.g.*, ZipDX Section XV Comments at 5; EarthLink Section XV Comments at 13-14; RNK Section XV Comments at 10-11 (will generate more disputes); Letter from Edward A. Yorkgitis, Jr., Counsel to Omnitel Communications, Inc and Tekstar Communications, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, at 2 (filed May 9, 2011) (Omnitel and Tekstar May 9, 2011 *Ex Parte* Letter).

inclusive.[1103] Several commenters offered suggestions on how to revise the definitional language.[1104]

669. After reviewing the record, we clarify the scope of the access revenue sharing agreement condition of the new access stimulation definition. The access revenue sharing condition of the access stimulation definition we adopt herein is met when a rate-of-return LEC or a competitive LEC: "has an access revenue sharing agreement, whether express, implied, written or oral, that, over the course of the agreement, would directly or indirectly result in a net payment to the other party (including affiliates) to the agreement, in which payment by the rate-of-return LEC or competitive LEC is based on the billing or collection of access charges from interexchange carriers or wireless carriers. When determining whether there is a net payment under this rule, all payments, discounts, credits, services, features, functions, and other items of value, regardless of form, provided by the rate-of-return LEC or competitive LEC to the other party to the agreement shall be taken into account."[1105]

670. This rule focuses on revenue sharing that would result in a net payment to the other entity over the course of the agreement[1106] arising from the sharing of access revenues.[1107] We intend the net payment language to limit the revenue sharing definition in a manner that, along with the traffic measurements discussed below, best identifies the revenue sharing agreements likely to be associated with access stimulation and thus those cases in which a LEC must refile its switched access rates. Revenue sharing may include payments characterized as marketing fees or other similar payments that result in a net payment to the access stimulator. However, this rule does not encompass typical, widely available, retail discounts offered by LECs through, for example, bundled service offerings.

671. Some commenters assert that the proposed definition of access revenue sharing arrangements was over-inclusive and/or under-inclusive.[1108] We believe that the net payment language,

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[1103] *See, e.g.*, Rural Associations Section XV Comments at 32-36; PAETEC et al. Section XV Comments at 21.

[1104] *See, e.g.*, ZipDX Section XV Comments at 5 (proposing a revised definition to read: "Access revenue sharing occurs when a rate-of-return ILEC or CLEC enters in an agreement with another party (including an affiliate) that results in the aggregate fees owed to the ILEC or CLEC by the other party decreasing as the volume of access-fee-generating traffic attributable to that other party increases (including to the point that the other party is receiving a net payment from the ILEC or CLEC."); HyperCube Section XV Comments at 10 (proposing to distinguish wholesale sharing agreements from retail agreements and exclude wholesale agreements from the definition of revenue sharing); Omnitel and Tekstar May 9, 2011 *Ex Parte* Letter, Attach. at 1 (proposing a revised definition to read: "Access revenue sharing occurs when a rate-of-return ILEC or a CLEC enters into an agreement that will result in a net payment over the course of the agreement to the other party (including affiliates) to the agreement, in which payment by the rate-of-return ILEC or CLEC is tied to the billing or collection of access charges from interexchange carriers. When determining whether there is a net payment under this rule, all payment, discounts, credits, services, features and functions, and other items of value, regardless of form, given by the rate-of-return ILEC or CLEC to the other party in connection with the shall be taken into account.").

[1105] *See infra* Appendix A.

[1106] The use of "over the course of the agreement" does not preclude an IXC from filing a complaint if the traffic measurement condition is met. The agreement is to be interpreted in terms of what the anticipated net payments would be over the course of the agreement.

[1107] We clarify that patronage dividends paid by cooperatives generally do not constitute revenue sharing as contemplated by this definition. *See* Rural Associations Section XV Comments at 33-34. However, a cooperative, like other LECs, could structure payments in a manner to engage in revenue sharing that would cause it to meet the definition as discussed herein.

[1108] *See, e.g.*, PAETEC et al. Section XV Comments at 21 (claiming that the net payor test is both over- and under-inclusive because it targets the wrong factor—unreasonable traffic spikes in high-access-cost areas is more a function of the portability of the traffic than the direction or amount of net payments); Rural Associations Section XV Comments at 32-36 (claiming that the Commission must distinguish between situations where traffic levels are (continued…)

combined with either the terminating-to-originating traffic ratio or the traffic growth requirement, sufficiently limits the scope of the revenue sharing definition by narrowing the number of carriers that could be subject to the trigger. HyperCube argues that the Commission should exclude wholesale services from the definition of revenue sharing agreements.[1109] We find HyperCube's proposal unpersuasive because the sharing of access revenues is involved and thus should be covered if the second condition of the definition is met.[1110] If a LEC's circumstances change because it terminates the access revenue sharing agreement(s), it may file a tariff to revise its rates under the rules applicable when access stimulation is not occurring.[1111] As part of that tariff filing, an officer of the LEC must certify that it has terminated the revenue sharing agreement(s).

672. Several parties have urged us to declare revenue sharing to be a violation of section 201(b) of the Act.[1112] Other parties argue that the Commission should prohibit the collection of switched access charges for traffic sent to access stimulators.[1113] Many commenters, on the other hand, assert that revenue sharing is a common business practice that has been endorsed in some situations by the Commission.[1114] As proposed in the *USF/ICC Transformation NPRM*, we do not declare revenue sharing to be a *per se* violation of section 201(b) of the Act.[1115] A ban on all revenue sharing arrangements could be overly broad,[1116] and no party has suggested a way to overcome this shortcoming. Nor do we find that parties have demonstrated that traffic directed to access stimulators should not be subject to tariffed access charges in all cases. We note that the access stimulation rules we adopt today are part of our comprehensive intercarrier compensation reform. That reform will, as the transition unfolds, address remaining incentives to engage in access stimulation.

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artificially inflated and situations where traffic increases as a result of legitimate economic activity); HyperCube Section XV Comments at 4 (claiming that the revenue sharing definition is over-inclusive because it would encompass wholesale revenue sharing arrangements that HyperCube believes are in the public interest by promoting a competitive environment, rather than focusing on end-user stimulation).

[1109] HyperCube Section XV Comments at i, 4.

[1110] In all events, HyperCube states that it is already benchmarking to the rates of the BOC in its service areas and thus would likely be unaffected by the rules adopted here, even though we are departing from the BOC rates as the benchmark and using the lowest price cap rate in the state. *Id*. at 3.

[1111] *See* Bluegrass Section XV Comments at 19.

[1112] *See, e.g.*, CenturyLink Section XV Comments at 33-34, 53 (sharing of revenues is unreasonable practice under section 201(b)); XO Section XV Comments at 44; USTelecom Section XV Comments at 10; AT&T Section XV Comments at 12-13.

[1113] *See, e.g.*, AT&T Section XV Comments at 12-15; Sprint Section XV Comments at 20; CenturyLink Section XV Comments at 34-35 (Billing IXC for tariffed access charges for traffic delivered to business partner instead of end user violates most LECs' access tariffs and FCC rules.).

[1114] *See, e.g.*, HyperCube Section XV Comments at 7-8 (Commission should not ban revenue sharing agreements that are invisible to the calling party, such as HyperCube, and therefore do not stimulate the calling party to place additional calls.).

[1115] *See, e.g.*, Cablevision and Charter Section XV Comments at 13-14; Free Conferencing Corporation Section XV Comments at 30; Neutral Tandem Section XV Comments at 5.

[1116] *See, e.g.*, *Access Charge Reform, Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108, 9142-43, para. 70 (2004) (*CLEC Access Charge Reform Reconsideration Order*); *AT&T's Private Payphone Commission Plan*, ENF-87-19, Memorandum Opinion and Order, 7 FCC Rcd 7135 (1992).

673. A few parties argue that the Commission explicitly approved revenue sharing in the *CLEC Access Charge Reconsideration Order* when it found that commission payments from competitive LECs to generators of toll-free traffic, such as hotels and universities, did not create any incentives for the individuals who use those facilities to place excessive or fraudulent calls.[1117] That case is inapposite. The Commission there was responding to IXC assertions in connection with 8YY calling and the Commission noted that it did not appear that the payments would affect calling patterns because the commissions did not create any incentive for those actually placing the calls to artificially inflate their 8YY traffic.[1118] By contrast, when access traffic is being stimulated, the party receiving the shared revenues has an economic incentive to increase call volumes by advertising the stimulating services widely.

674. Several parties ask that we address the potential for LECs to attempt to evade the prohibition on access stimulation by integrating high call volume operations within the same corporate entity as the LEC, rather than providing those services through contracts with third parties or affiliates, so that it is able to characterize this arrangement as something other than a revenue sharing agreement.[1119] In particular, CenturyLink argues that revenue sharing in the access stimulation context, however structured, violates section 254(k) of the Act because terminating switched access is a monopoly service and the conferencing services are competitive.[1120] The rules adopted here pursuant to sections 201 and 202 of the Act address conferencing services being provided by a third party, whether affiliated with the LEC or not.[1121] Section 254(k) would apply to a LEC's operation of an access stimulation plan within its own corporate organization. In that context, as we have found in other proceedings, terminating access is a monopoly service.[1122] The conferencing activity, as portrayed by the parties engaged in access stimulation, would be a competitive service.[1123] Thus, the use of non-competitive terminating access revenues to support competitive conferencing service within the LEC operating entity would violate section 254(k) and appropriate sanctions could be imposed.

675. *Addition of a Traffic Measurement Condition*. After reviewing the record, we agree that it is appropriate to include a traffic measurement condition in the definition of access stimulation.[1124] Accordingly, in addition to requiring the existence of a revenue sharing agreement, we add a second condition to the definition requiring that a LEC: "has either an interstate terminating-to-originating traffic ratio of at least 3:1 in a calendar month, or has had more than a 100 percent growth in interstate originating and/or terminating switched access MOU in a month compared to the same month in the

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[1117] PAETEC et al. Section XV Comments at 27; EarthLink Section XV Comments at 19-20.

[1118] *See CLEC Access Charge Reform Reconsideration Order*, 19 FCC Rcd at 9142-43, para. 70.

[1119] *See*, *e.g.*, Level 3 Section XV Comments at 5; Verizon Section XV Comments at 43-44.

[1120] CenturyLink Section XV Comments at 43-50. In relevant part, section 254(k) provides that "[a] telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition." 47 U.S.C. § 254(k).

[1121] Free Conferencing Corporation, on the other hand, argues that using revenue sharing as a trigger discriminates in favor of vertically integrated companies, such as AT&T and Verizon, where the conference calling provider and the LEC collecting access charges are part of the same overall enterprise. Free Conferencing Corporation Section XV Comments at 26-27; *see also* Global Section XV Comments at 11-12. This argument is unpersuasive for the reasons stated in paragraph 666 *supra*.

[1122] *See CLEC Access Charge Order*, 16 FCC Rcd 9923, 9935, para. 30.

[1123] *See, e.g.*, Free Conferencing Corporation Section XV Comments at 1, 17; Global Section XV Comments at 9.

[1124] *See*, *e.g.*, AT&T Section XV Comments at 18-20; ITTA Section XV Comments at 25; Verizon Section XV Comments at 44.

preceding year."[1125] The addition of a traffic measurement component to the access stimulation definition creates a bright-line rule that responds to record concerns about using access revenue sharing alone. We conclude that these measurements of switched access traffic of all carriers exchanging traffic with the LEC reflect the significant growth in traffic volumes that would generally be observed in cases where access stimulation is occurring and thus should make detection and enforcement easier. Carriers paying switched access charges can observe their own traffic patterns for each of these traffic measurements and file complaints based on their own traffic patterns. Thus, this will not place a burden on LECs to file traffic reports, as some proposals would.[1126]

676. The record offers support for both a terminating-to-originating traffic ratio[1127] and a traffic growth factor.[1128] The Commission adopted a 3:1 ratio in its 2001 *ISP-Remand Order* to address a similar arbitrage scheme based on artificially increasing reciprocal compensation minutes.[1129] Further, the Wireline Competition Bureau employed a 100 percent traffic growth factor as a benchmark in a tariff investigation to address the potential that some rate-of-return LECs might engage in access stimulation after having filed tariffs with high switched access rates.[1130] In each case, the approach was largely successful in identifying and reducing the practice.

677. We conclude that the use of a terminating-to-originating traffic ratio in conjunction with a traffic growth factor as alternative traffic measures addresses the shortcomings of using either component separately. A few parties argue that carriers can game the terminating-to-originating traffic ratio component by simply increasing the number of originating MOU.[1131] The traffic growth component protects against this possibility because increasing the originating access traffic to avoid tripping the 3:1 component would likely mean total access traffic would increase enough to trip the growth component.

[1125] *See infra* Appendix A.

[1126] *See* Letter from Henry Goldberg, Counsel for Free Conferencing Corporation, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, GN Docket No. 09-51, CC Docket No. 01-92, Attach. at 7 (filed July 8, 2011) (Free Conferencing Corporation July 8, 2011 *Ex Parte* Letter).

[1127] *See, e.g.*, CTIA Section XV Comments at 7-9; Sprint Section XV Comments at 8-9, 18-20; Ohio Commission Section XV Comments at 15; Time Warner Cable Section XV Comments at 15-16; Leap Wireless and Cricket Section XV Comments at 6-7.

[1128] *See, e.g.*, XO Section XV Comments at 41-43; RNK Section XV Comments at 11-12; Cox Section XV Comments at 13; NASUCA and NJ Rate Counsel Section XV Comments at 10.

[1129] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151, 9183, para. 70 (2001) (subsequent history omitted) (*ISP Remand Order*). There, as here, reciprocal compensation rates were sufficiently high that many competitive LECs found it profitable to target and serve ISP customers who were large recipients of local traffic, since dial-up Internet customers would place calls to their ISP with lengthy hold times. This practice led to significant traffic imbalances, with competitive LECs seeking substantial amounts in reciprocal compensation payments from other LECs.

[1130] *See Investigation of Certain 2007 Annual Access Tariffs*, WC Docket No. 07-184, WCB/Pricing No. 07-10, Order Designating Issues for Investigation, 22 FCC Rcd 11619 at 16120, para. 28 (WCB 2007) (*Designation Order*). The *Designation Order* identified two safe harbor provisions that would allow the affected carriers to avoid the investigation if the carrier either: (1) elected to return to the NECA pool; or (2) added language to its tariff that would commit to the filing of a revised tariff if the filing carrier experienced a 100 percent increase in monthly demand when compared to the same month in the prior year. *Id*.

[1131] *See, e.g.*, Letter from Henry Goldberg, Counsel for Free Conferencing Corporation, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, GN Docket No. 09-51, CC Docket No. 01-92, Attach. at 8 (filed May 26, 2011); Letter from Norina Moy, Director, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, at 4-7 (filed June 15, 2011).

The terminating-to-originating traffic ratio component will capture those current access stimulation situations that already have very high volumes that could otherwise continue to operate without tripping the growth component. For example, a LEC that has been engaged in access stimulation for a significant period of time would have a high terminating traffic volume that, under a traffic growth factor alone, could continue to expand its operations, possibly avoiding the condition entirely by controlling its terminating traffic. Because these alternative traffic measurements are combined with the requirement that an access revenue sharing agreement exist, we reduce the risk that the terminating-to-originating traffic ratio or traffic growth components of the definition could be met by legitimate changes in a LEC's calling patterns. The combination of these two traffic measurements as alternatives is preferable to either standing alone, as some parties have urged.[1132] A terminating-to-originating traffic ratio or traffic growth condition alone could prove to be overly inclusive by encompassing LECs that had realized access traffic growth through general economic development, unaided by revenue sharing. Such situations could include the location of a customer support center in a new community without any revenue sharing arrangement, or a new competitive LEC that is experiencing substantial growth from a small base.[1133]

678. We decline to adopt a condition based on absolute MOU per line, either on a stand-alone basis or in conjunction with a revenue sharing condition, as suggested by several parties.[1134] Under these proposals, if a LEC's MOUs per line exceeded a specified threshold, the LEC would be required to take some action to reduce its rates. Many LECs could evade a MOU per line condition simply by adding additional lines. Moreover, a MOU per line approach would require self-reporting, because neither an IXC nor the Commission could otherwise readily tell if the condition had been met.

(ii) Remedies

679. If a LEC meets both conditions of the definition, it must file a revised tariff except under certain limited circumstances. As explained in more detail below, a rate-of-return LEC must file its own cost-based tariff under section 61.38 of the Commission's rules and may not file based on historical costs under section 61.39 of the Commission's rules or participate in the NECA traffic-sensitive tariff. If a competitive LEC meets the definition, it must benchmark its tariffed access rates to the rates of the price cap LEC with the lowest interstate switched access rates in the state, rather than to the rates of the BOC or the largest incumbent LEC in the state (as proposed in the *USF/ICC Transformation NPRM*). We conclude, however, that if a LEC has terminated its revenue sharing agreement(s) before the deadline we establish for filing its revised tariff, or if the competitive LEC's rates are already below the benchmark rate, such a LEC does not have to file a revised interstate switched access tariff. However, once a rate-of-return LEC or a competitive LEC has met both conditions of the definition and has filed revised tariffs, when required, it may not file new tariffs at rates other than those required by the revised pricing rules until it terminates its revenue sharing agreement(s), even if the LEC no longer meets the 3:1 terminating-to-originating traffic ratio condition of the definition or traffic growth threshold. As price cap LECs

[1132] *See, e.g.*, XO Section XV Comments at 46; RNK Section XV Comments at 12 (50 percent increase over the previous six months would create a rebuttable presumption of being engaged in access stimulation).

[1133] State Joint Board Members propose a condition for access stimulation based on a terminating ratio one standard deviation above the national average terminating ratio annually. *See* State Members Comments at 156. Under their proposal, a carrier meeting this condition would set new rates so that the terminating revenue for any carrier equals the carrier's initial rate times its originating minutes times the terminating ratio at the one standard deviation point. *Id*. We decline to adopt this proposal because it is unclear that using originating traffic volumes would produce a rate that adequately reflects the increased terminating traffic volumes sufficient to ensure that rates are just and reasonable as required by Section 201(b) of the Act.

[1134] *See, e.g.*, USTelecom Section XV Comments at 9 n.20; Rural Associations Section XV Comments at 33-36; ITTA Section XV Comments at 25; Louisiana Small Company Committee Section XV Comments at 16-17; Toledo Telephone Section XV Comments at 7.

reduce their switched access rates under the ICC reforms we adopt herein, competitive LECs must benchmark to the reduced rates.

680. *Rate-of-Return Carriers Filing Tariffs Based on Historical Costs and Demand: Section 61.39*. We adopt our proposal in the *USF/ICC Transformation NPRM* that a LEC filing access tariffs pursuant to section 61.39 would lose its ability to base its rates on historical costs and demand if it is engaged in access stimulation.[1135] Incumbent LECs filing access tariffs pursuant to section 61.39 of the Commission's rules currently base their rates on historical costs and demand, which, because of their small size, generally results in high switched access rates based on the high costs and low demand of such carriers.[1136] The limited comment in the record was supportive of our proposal for the reasons set forth in the *USF/ICC Transformation NPRM*.[1137] We accordingly revise section 61.39 to bar a carrier otherwise eligible to file tariffs pursuant to section 61.39 from doing so if it meets the access stimulation definition. We also require such a carrier to file a revised interstate switched access tariff pursuant to section 61.38 within 45 days after meeting the definition, or within 45 days after the effective date of this rule in cases where the carrier meets the definition on that date.

681. *Participation in NECA Tariffs.* In the *USF/ICC Transformation NPRM*, the Commission proposed that a carrier engaging in revenue sharing would lose its eligibility to participate in the NECA tariffs 45 days after engaging in access stimulation, or 45 days after the effective date of this rule in cases where it currently engages in access stimulation.[1138] A carrier leaving the NECA tariff thus would have to file its own tariff for interstate switched access, pursuant to section 61.38 of the rules.[1139]

682. The record is generally supportive of this approach for the reasons stated in the *USF/ICC Transformation NPRM*,[1140] and we adopt it, subject to one modification. We clarify that, pursuant to section 69.3(e)(3) of the rules,[1141] a LEC required to leave the NECA interstate tariff (which includes both switched and special access services) because it has met the access stimulation definition must file its own tariff for both interstate switched and special access services.[1142]

683. We also adopt a revision to the proposed rule similar to a suggestion by the Louisiana Small Carrier Committee, which recommends that rate-of-return carriers be given an opportunity to show

[1135] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4767, para. 664.

[1136] 47 C.F.R. § 61.39.

[1137] *See, e.g.*, AT&T Section XV Comments at 17-18; Level 3 Section XV Comments at 3; USTelecom Section XV Comments at 11.

[1138] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4766, para. 662.

[1139] *Id*.

[1140] *See*, *e.g.*, Rural Associations Section XV Comments at 35-36; AT&T Section XV Comments at 17-18; Level 3 Section XV Comments at 3; *but see* USTelecom Section XV Comments at 10-11 (arguing that such a rule is unnecessary).

[1141] 47 C.F.R. § 69.3(e)(3).

[1142] USTelecom suggests that given that shared revenues are not appropriately included in a carrier's revenue requirement, the Commission does not need to address eligibility for participation in NECA tariffs in its access stimulation rules—a carrier would either stop sharing, or file its own tariff without any mandate to do so. USTelecom Section XV Comments at 10-11. We disagree, because current rules only provide for a participating carrier to leave the NECA tariff at the time of the annual tariff filing. A rule prohibiting LECs from further participating in the NECA tariff when the definition is met, and providing for advance notice to NECA, spells out the procedure.

that they are in compliance with the Commission's rules before being required to file a revised tariff.[1143] Accordingly, we conclude that if a carrier sharing access revenues terminates its access revenue sharing agreement before the date on which its revised tariff must be filed, it does not have to file a revised tariff. We believe that when sharing agreements are terminated, in most instances traffic patterns should return to levels that existed prior to the LEC entering into the access revenue sharing agreement. This eliminates a burden on such carriers when there is no ongoing reason for requiring such a filing.

684. *Rate of Return Carriers Filing Tariffs Based On Projected Costs and Demand: Section 61.38.* In the *USF/ICC Transformation NPRM*, we proposed that a carrier filing interstate switched access tariffs based on projected costs and demand pursuant to section 61.38 of the rules be required to file revised access tariffs within 45 days of commencing access revenue sharing, or within 45 days of the effective date of the rule if the LEC on that date is engaged in access revenue sharing,[1144] unless the costs and demand arising from the new revenue sharing arrangement had been reflected in its most recent tariff filing.[1145] We further proposed that payments made by a LEC pursuant to an access revenue sharing arrangement should not be included as costs in the rate-of-return LEC's interstate switched access revenue requirement because such payments have nothing to do with the provision of interstate switched access service and are thus not used and useful in the provision of such service.[1146] Thus, we proposed to clarify prospectively that a rate-of-return carrier that shares access revenue, provides other compensation to an access stimulating entity, or directly provides the stimulating activity, and bundles those costs with access, is engaging in an unreasonable practice that violates section 201(b) and the prudent expenditure standard.[1147]

685. We adopt the approach proposed in the *USF/ICC Transformation NPRM*. Commenters that addressed this issue support the approach.[1148] In particular, we adopt a rule requiring carriers filing interstate switched access tariffs based on projected costs and demand pursuant to section 61.38 of the rules to file revised access tariffs within 45 days of commencing access revenue sharing, or within 45 days of the effective date of the rule if the LEC on that date was engaged in access revenue sharing,[1149] unless the costs and demand arising from the new access revenue sharing agreement were reflected in its most recent tariff filing. This tariff filing requirement provides the carrier with the opportunity to show, and the Commission to review, any projected increase in costs, as well as to consider the higher anticipated demand in setting revised rates. If the access revenue sharing agreement(s) that required the new tariff filing has been terminated by the time the revised tariff is required to be filed, we will not

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[1143] Louisiana Small Company Committee Section XV Comments at 17 (for example, because unexpectedly high levels of traffic have been terminated).

[1144] *USF/ICC Transformation NPRM,* 26 FCC Rcd at 4767, para. 663.

[1145] *Id.*

[1146] *Id.* at 4766, para. 661.

[1147] *Id.* The prudent expenditure standard is associated with the "used and useful" doctrine, which together are employed in evaluating whether a carrier's rates are just and reasonable. *See Access Stimulation NPRM*, 22 FCC Rcd at 17997, para. 19, n.47.

[1148] *See, e.g.*, AT&T Section XV Comments at 17-18; USTelecom Section XV Comments at 11. Sprint is concerned that rates filed under section 61.38 will not be just and reasonable, even if LECs' projections are made in good faith because of the lack of a true-up mechanism. Sprint Section XV Comments at 15. Sprint's concern is unfounded. The revised tariffs filed by a section 61.38 carrier meeting the revenue sharing definition will be subject to the Commission's tariff review processes in which the projected cost and demand data can be reviewed and appropriate action taken if necessary.

[1149] *See USF/ICC Transformation NPRM,* 26 FCC Rcd at 4767, para. 663.

require the filing of a revised tariff, as the proposal would have. A refiling in that instance would be unnecessary because the original rates will now more likely reflect the cost/demand relationship of the carrier. If a LEC, however, subsequently reactivates the same telephone numbers in connection with a new access revenue sharing agreement, we will presumptively treat that action to be furtive concealment resulting in the loss of deemed lawful status for the LEC's tariff, as discussed below in conjunction with the discussion of section 204(a)(3) of the Act.[1150] This will prevent a LEC from entering into a series of access revenue sharing agreements to avoid the 45-day filing requirement, while benefiting from the advertising of those telephone numbers used under previous agreements.

686. We also adopt the proposal that payments made by a LEC pursuant to an access revenue sharing agreement are not properly included as costs in the rate-of-return LEC's interstate switched access revenue requirement. This proposal received broad support in the record.[1151]

687. We decline to adopt either of two suggested alternative pricing proposals for section 61.38 LECs. First, several parties suggested allowing a rate-of-return carrier filing a tariff based on projected costs and demand pursuant to section 61.38 to file a rate of $0.0007, rather than requiring it to make a new cost showing.[1152] Second, other parties proposed that a section 61.38 carrier be allowed to benchmark to the BOC rate in the state since that rate is just and reasonable.[1153] An established ratemaking procedure for section 61.38 LECs already exists. No party has demonstrated why either of the proposed rates would be preferable to the rates developed under existing ratemaking procedures. Thus, the rule we adopt will require section 61.38 carriers to set their rates based on projected costs and demand data.[1154]

688. *Competitive LECs.* In the *USF/ICC Transformation NPRM*, we proposed that when a competitive LEC is engaged in access stimulation, it would be required to benchmark its interstate switched access rates to the rate of the BOC in the state in which the competitive LEC operates, or the independent incumbent LEC with the largest number of access lines in the state if there is no BOC in the state, and if the competitive LEC is not already benchmarking to that carrier's rate.[1155] Under the proposal, a competitive LEC would have to file a revised tariff within 45 days of engaging in access stimulation, or within 45 days of the effective date of the rule if it currently engages in access stimulation.[1156]

689. After reviewing the record, we adopt our proposal with one modification to ensure that the LEC refiles at a rate no higher than the lowest rate of a price cap LEC in the state. In so doing, we conclude that neither the switched access rate of the rate-of-return LEC in whose territory the competitive

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[1150] *See infra* para. 695. As described therein, a carrier may be required to make refunds if its tariff does not have deemed lawful status.

[1151] *See, e.g.*, AT&T Section XV Comments at 12-15; CenturyLink Section XV Comments at 53; Level 3 Section XV Comments at 3; XO Section XV Comments at 44; RNK Section XV Comments at 11.

[1152] *See, e.g.*, AT&T Section XV Comments at 15-17; CTIA Section XV Comments at 7; MetroPCS Section XV Comments at 5; Sprint Section XV Comments at 8-9, 18-20; T-Mobile Section XV Comments at 8-9.

[1153] CenturyLink Section XV Comments at 42; North County Section XV Comments at 2-3 (LECs reduce rates as volumes increase until the BOC rate is reached).

[1154] Beginning July 1, 2012, rate-of-return LECs must comply with the transition procedures described in Section XII.C, *infra*.

[1155] *USF/ICC Transformation NPRM,* 26 FCC Rcd at 4767, para. 665.

[1156] *Id*.

LEC is operating nor the rate used in the rural exemption[1157] is an appropriate benchmark when the competitive LEC meets the access stimulation definition. In those instances, the access stimulator's traffic vastly exceeds the volume of traffic of the incumbent LEC to whom the access stimulator is currently benchmarking.[1158] Thus, the competitive LEC's traffic volumes no longer operationally resemble the carrier's traffic volumes whose rates it had been benchmarking because of the significant increase in interstate switched access traffic associated with access stimulation.[1159] Instead, the access stimulating LEC's traffic volumes are more like those of the price cap LEC in the state,[1160] and it is therefore appropriate and reasonable for the access stimulating LEC to benchmark to the price cap LEC.[1161]

690. Although many parties support using the switched access rates of the BOC in the state, or the rates of the largest independent LEC in the state if there is no BOC,[1162] as we proposed, we conclude that the lowest interstate switched access rate of a price cap LEC in the state is the rate to which a competitive LEC must benchmark if it meets the definition.[1163] Generally, the BOC will have the lowest interstate switched access rates. However, the record reveals that in California, Pacific Bell's interstate switched access rates are higher than those of other price cap LECs in the state, as well as being higher than the interstate switched access rates of price cap LECs in other states. Benchmarking to the lowest price cap LEC interstate switched access rate in the state will reduce rate variance among states and will significantly reduce the rates charged by competitive LECs engaging in access stimulation, even if it does not entirely eliminate the potential for access stimulation.[1164] However, should the traffic

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[1157] *See* 47 C.F.R. § 61.26(e).

[1158] For example, AT&T submitted data showing that the terminating MOU of 12 competitive LECs in Iowa, Minnesota, and South Dakota averaged 750,000,000 compared to 2,028,398 for NECA Band 8 LECs in those states. *See* Letter from Brian J. Benison, Director, Federal Regulatory, AT&T Services Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. at 6 (filed Dec. 3, 2009) (AT&T Dec. 3, 2009 *Ex Parte* Letter). The relationship of those traffic volumes has not changed significantly since 2009. *See* Letter from Brian J. Benison, Director, Federal Regulatory, AT&T Services Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135, Attach. at 4 (filed May 13, 2011).

[1159] *See, e.g.*, AT&T Section XV Comments at 14-17; CenturyLink Section XV Comments at 37-40; T-Mobile Section XV Comments at 7-8.

[1160] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4767, para. 665. AT&T shows that "rural" access stimulating competitive LECs in Iowa, Minnesota and South Dakota collectively are terminating three to five times as many minutes as the largest incumbent LEC operating in the same state. AT&T Dec. 3, 2009 *Ex Parte* Letter, Attach. at 4.

[1161] We reject NASUCA's suggestion that we use the lowest NECA rate as the benchmark. NASUCA and NJ Rate Counsel Section XV Comments at 11. The traffic patterns of those NECA carriers are likely to be even less comparable to the traffic patterns of a competitive LEC engaged in access stimulation.

[1162] *See, e.g.*, CenturyLink Section XV Comments at 38-39; ITTA Section XV Comments at 24-25; Level 3 Section XV Comments at 3; Omnitel and Tekstar Section XV Reply at 4, 17; IUB Section XV Comments at 17-18; Ohio Commission Section XV Comments at 14-15. Several parties argue that a lower rate would be reasonable and should be adopted. *See, e.g.*, AT&T Section XV Comments at 17; CTIA Section XV Comments at 6-7; Sprint Section XV Comments at 2.

[1163] We decline to adopt the Level 3 proposal that we adopt a requirement that a competitive LEC must file a declaration with the Commission attesting to the fact that it entered into an access revenue sharing agreement within 45 days of the effective date of the agreement. *See* Level 3 Section XV Comments at 4. Under the revised rules, competitive LECs are required to file revised tariffs if they engage in access stimulation. The proposed declaration would be duplicative.

[1164] *See, e.g.*, AT&T Section XV Comments at 17; Sprint Section XV Comments at 13.

volumes of a competitive LEC that meets the access stimulation definition substantially exceed the traffic volumes of the price cap LEC to which it benchmarks, we may reevaluate the appropriateness of the competitive LEC's rates and may evaluate whether any further reductions in rates is warranted. In addition, we believe the reforms we adopt elsewhere in this Order will, over time, further reduce intercarrier payments and the incentives for this type of arbitrage.

691. We require a competitive LEC to file a revised interstate switched access tariff within 45 days of meeting the definition, or within 45 days of the effective date of the rule if on that date it meets the definition. A competitive LEC whose rates are already at or below the rate to which they would have to benchmark in the refiled tariff will not be required to make a tariff filing.

692. We will not adopt a benchmarking rate of $0.0007 in instances when the definition is met, as is suggested by a few parties.[1165] The $0.0007 rate originated as a negotiated rate in reciprocal compensation arrangements for ISP-bound traffic, and there is insufficient evidence to justify abandoning competitive LEC benchmarking entirely. Nor will we immediately apply bill-and-keep, as some parties have urged.[1166] We adopt a bill-and-keep methodology for intercarrier compensation below, but decline to mandate a flash cut to bill-and-keep here. Additionally, we reject the suggestion that we detariff competitive LEC access charges if they meet the access stimulation definition.[1167] Our benchmarking approach addresses access stimulation within the parameters of the existing access charge regulatory structure. We expect that the approach we adopt will reduce the effects of access stimulation significantly, and the intercarrier compensation reforms we adopt should resolve remaining concerns.

693. A few parties encourage the Commission to require high volume access tariffs (HVATs) for competitive LECs.[1168] These tariffs reduce rates as volumes increase and, as suggested by some parties, would provide a transition from today's interstate switched access rates to the benchmarked rate over two years.[1169] Under our benchmarking approach, if a competitive LEC meets the definition, its rates must be revised so that such rates are at or below the benchmark rate, unless they are already at those levels. A transitional HVAT that had one or more rates that exceeded the benchmark rate would not be in compliance with the benchmarking requirement adopted herein. Proponents of a transitional HVAT have not established why a transition is required or even appropriate, particularly considering the high traffic volumes associated with access stimulation. A competitive LEC that met the definition could, of course, file an HVAT if all of the rates in the tariff are below the benchmark rate.

694. We also decline to require or allow competitive LECs to use the "settlements specified in the extended average schedules published by NECA"[1170] or the NECA rate band 1 local switching rate,[1171] or to permit a competitive LEC to use section 61.38 procedures to establish its interstate switched access

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[1165] *See, e.g.*, AT&T Section XV Comments at 21; Sprint Section XV Comments at 2, 8-9.

[1166] *See, e.g.*, CTIA Section XV Comments at 7; Leap Wireless and Cricket Section XV Comments at 7; MetroPCS Section XV Comments at 4; T-Mobile Section XV Comments at 2, 8-9.

[1167] *See, e.g.*, AT&T Section XV Comments at 13-17 (the BOC rate would continue to encourage traffic pumping); Sprint Section XV Comments at 20-21.

[1168] *See, e.g.*, Free Conferencing Corporation Section XV Comments at 37-38; *see also* Free Conferencing Corporation July 8, 2011 *Ex Parte* Letter, Attach. at 6 (urging the use of HVAT as a transition to BOC rates in two years).

[1169] *See* Free Conferencing Corporation July 8, 2011 *Ex Parte* Letter, Attach. at 6-8.

[1170] NASUCA Section XV Comments at 11.

[1171] Bluegrass Section XV Comments at 15-16.

rates if the price cap LEC rates would not adequately compensate the competitive LEC.[1172] We maintain the benchmarking approach to the regulation of the rates of competitive LECs. The average schedules published by NECA are inadequate for this purpose. The schedules are constrained by the characteristics of the carriers included in their samples, which likely do not include any rate-of-return LECs engaging in access stimulation. Thus, NASUCA has not shown that the average schedules would be a reasonable approach for establishing a rate to which competitive LECs could benchmark. There is insufficient evidence in the record that abandoning the benchmarking approach for competitive LEC tariffs and compelling competitive LECs to comply with 61.38 rules is necessary to address concerns regarding access stimulation, particularly considering the burden that would be imposed on competitive LECs to start maintaining regulatory accounting records. Instead, we believe it is more appropriate to retain the benchmarking rule but revise it to ensure that the competitive LEC benchmarks to the price cap LEC with the lowest rate in the state, a rate which is likely most consistent with the volume of traffic of an access stimulating LEC.

695. *Section 204(a)(3) ("Deemed Lawful") Considerations*. In the *USF/ICC Transformation NPRM*, we proposed that LECs that meet the revenue sharing definition be required to file revised tariffs on not less than 16 days' notice.[1173] We further proposed that if a LEC failed to comply with the tariffing requirements, we would find such a practice to be an effort to conceal its noncompliance with the substantive rules that would disqualify the tariff from deemed lawful treatment.[1174] Finally, we proposed that rate-of-return LECs would be subject to refund liability for earnings over the maximum allowable rate-of-return,[1175] and competitive LECs would be subject to refund liability for the difference between the rates charged and the rate that would have been charged if the carrier had used the prevailing BOC rate, or the rate of the independent LEC with the largest number of access lines in the state if there is no BOC.[1176]

696. After reviewing the record,[1177] we decline to adopt our proposal. We conclude that the policy objectives of this proceeding can be achieved without creating an exception to the statutory tariffing timelines. LECs that meet the access stimulation trigger are required to refile their interstate switched access tariffs as outlined above. Any issues that arise in these refiled tariffs can be addressed through the suspension and rejection authority of the Commission contained in section 204 of the Act, or through appropriate enforcement action.

697. We conclude that a LEC's failure to comply with the requirement that it file a revised tariff if the trigger is met constitutes a violation of the Commission's rules, which is sanctionable under section 503 of the Act.[1178] We also conclude that such a failure would constitute "furtive concealment" as

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[1172] Bluegrass Section XV Comments at 14-15; *but see* Free Conferencing Corporation Section XV Comments at 35 (opposing requiring a competitive LEC to use section 61.38).

[1173] *USF/ICC Transformation NPRM,* 26 FCC Rcd at 4768, para. 666.

[1174] The carrier would also be subject to sanctions for violating the Commission's tariffing rules.

[1175] 47 C.F.R. § 65.700. An exchange carrier's interstate earnings are measured in accordance with the requirements set forth in 47 C.F.R. § 65.702.

[1176] *USF/ICC Transformation NPRM,* 26 FCC Rcd at 4768, para. 666.

[1177] *See, e.g.,* Level 3 Section XV Comments at 4.

[1178] Section 503(b)(2)(B) of the Act authorizes the Commission to assess a forfeiture of up to $150,000 for each violation, or each day of a continuing violation, up to a statutory maximum of $1,500,000 for a single act or failure to act by common carriers; *see also* 47 C.F.R. § 1.80(b)(2). In 2008, the Commission amended its rules to increase the maximum forfeiture amounts in accordance with the inflation adjustment requirements contained in the Debt Collection Improvement Act of 1996, 28 U.S.C. § 2461. *See Amendment of Section 1.80(b) of the Commission's* (continued…)

described by the D.C. Circuit in *ACS v. FCC*. [1179] We therefore put parties on notice that if we find in a complaint proceeding under sections 206-209 of the Act, that such "furtive concealment" has occurred, that finding will be applicable to the tariff as of the date on which the revised tariff was required to be filed and any refund liability will be applied as of such date. We conclude that this approach will eliminate any incentives that LECs may have to delay or avoid complying with the requirement that they file revised tariffs. Several parties support this approach.[1180]

698. All American Telephone Co. filed a petition for declaratory ruling requesting that the Commission find that commercial agreements involving the sharing of access revenues between LECs and "free" service providers do not violate the Communications Act.[1181] In this Order, we adopt a definition of access revenue sharing agreement and prescribe that a LEC meeting the conditions of that definition must file revised tariffs. Given our findings and the rules adopted today, we decline to address the All American petition and it is dismissed.

(iii) Enforcement

699. The revised interstate access rules adopted in this Order will facilitate enforcement through the Commission's complaint procedures, if necessary.[1182] A complaining carrier may rely on the 3:1 terminating-to-originating traffic ratio and/or the traffic growth factor for the traffic it exchanges with the LEC as the basis for filing a complaint. This will create a rebuttable presumption that revenue sharing is occurring and the LEC has violated the Commission's rules. The LEC then would have the burden of showing that it does not meet both conditions of the definition. We decline to require a particular showing, but, at a minimum, an officer of the LEC must certify that it has not been, or is no longer engaged in access revenue sharing, and the LEC must also provide a certification from an officer of the company with whom the LEC is alleged to have a revenue sharing agreement(s) associated with access stimulation that that entity has not, or is not currently, engaged in access stimulation and related revenue sharing with the LEC.[1183] If the LEC challenges that it has met either of the traffic measurements, it must

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Rules, Adjustment of Forfeiture Maximum to Reflect Inflation, EB File No. EB-06-SE-132, Order, 23 FCC Rcd 9845 at 9847 (2008).

[1179] In 2002, the United States Court of Appeals for the D.C. Circuit, in reversing a Commission decision that had found a tariff filing did not qualify for deemed lawful treatment and was thus subject to possible refund liability, noted that it was not addressing "the case of a carrier that furtively employs improper accounting techniques in a tariff filing, thereby concealing potential rate of return violations." *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 413 (D.C. Cir. 2002) (*ACS v. FCC*).

[1180] *See, e.g.*, PAETEC et al. Section XV Comments at 31; XO Section XV Comments at 46 (adopt a rebuttable presumption that increases in access volumes of more than 100 percent in a six month time period would automatically revoke, for the period contemporaneous with and following the increase, the "deemed lawful" status of a LEC whose interstate tariffed rates are above those of the BOC or largest incumbent LEC in the state until reviewed by the Commission).

[1181] *See* Petition for Declaratory Ruling of All American Telephone Co., Inc., e.Pinnacle Communications, Inc., and ChaseCom to Reconfirm that Local Exchange Carrier Commercial Agreements with Providers of Conferencing, "Chat Line" and Other Services Do Not Violate the Communications Act, WC Docket No. 07-135 (filed May 20, 2009).

[1182] Given the two-year statute of limitations in section 405 of the Act, 47 U.S.C. § 405, a complaining IXC would have two years from the date the cause of action accrued (the date after the tariff should have been filed) to file its complaint. Because the rules we adopt are prospective, they will have no binding effect on pending complaints.

[1183] The Ohio Commission argues that the Commission should not prohibit rebates, credits, discounts, etc. Ohio Commission Section XV Comments at 13-14. Section 203(c)(1) provides that no carrier shall "charge, demand, collect, or receive a greater or less or different compensation for such communication…than the charges specified in

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provide the necessary traffic data to establish its contention. With the guidance in this Order, we believe parties should in good faith be able to determine whether the definition is met without further Commission intervention.

700. *Non-payment Disputes*. Several parties have requested that the Commission address alleged self-help by long distance carriers who they claim are not paying invoices sent for interstate switched access services.[1184] As the Commission has previously stated, "[w]e do not endorse such withholding of payment outside the context of any applicable tariffed dispute resolution provisions."[1185] We otherwise decline to address this issue in this Order, but caution parties of their payment obligations under tariffs and contracts to which they are a party. The new rules we adopt in today's Order will provide clarity to all affected parties, which should reduce disputes and litigation surrounding access stimulation and revenue sharing agreements.

(iv) Conclusion

701. The rules we adopt in this section will require rates associated with access stimulation to be just and reasonable because those rates will more closely reflect the access stimulators' actual traffic volume. Taking this basic step will immediately reduce some of the inefficient incentives enabled by the current intercarrier compensation system, and permit the industry to devote resources to innovation and investment rather than access stimulation and disputes. We have balanced the need for our new rules to address traffic stimulation with the costs that may be imposed on LECs and have concluded that the benefits justify any burdens. Our new rules will work in tandem with the comprehensive intercarrier compensation reforms we adopt below, which will, when fully implemented, eliminate the incentives in the present system that give rise to access stimulation.

B. Phantom Traffic

702. In this portion of the Order, we amend the Commission's rules to address "phantom traffic" by ensuring that terminating service providers receive sufficient information to bill for telecommunications traffic sent to their networks, including interconnected VoIP traffic. The amendments we adopt close loopholes that are being used to manipulate the intercarrier compensation system.

703. "Phantom traffic" refers to traffic that terminating networks receive that lacks certain identifying information. In some cases, service providers in the call path intentionally remove or alter identifying information to avoid paying the terminating rates that would apply if the call were accurately signaled and billed. For example, some parties have sought to avoid payment of relatively high intrastate access charges by making intrastate traffic appear interstate or international in nature.[1186] Parties have also disguised or routed non-local traffic subject to access charges to avoid those charges in favor of lower reciprocal compensation rates.[1187] Collectively, problems involving unidentifiable or misidentified

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the schedule then in effect." 47 U.S.C. § 203(c)(1). A corollary to subparagraph (1), section 203(c)(2) provides that no carrier shall "refund or remit by any means or device any portion of the charges so specified." 47 U.S.C. § 203(c)(2). This prohibition on rebates is intended to preclude discrimination in charges, and the practice may be subject to sanctions under section 503. 47 U.S.C. § 503.

1184 *See, e.g.*, Pac-West Section XV Comments at 17-19 (carriers must dispute and pay for there to be a level playing field for all carriers).

1185 *All American Telephone Co., et al. v. AT&T Corp.*, File EB-10-MD-003, Memorandum Opinion and Order, 26 FCC Rcd 723, 728 (2011).

1186 *See, e.g.*, CenturyLink Section XV Comments at 19.

1187 *See id.; see also* Windstream Section XV Comments at 15-16.

traffic appear to be widespread. Parties have documented that phantom traffic is a sizeable problem, with estimates ranging from 3-20 percent of all traffic on carriers' networks,[1188] which costs carriers—and ultimately consumers—potentially hundreds of millions of dollars annually.[1189] In turn, carriers are diverting resources to investigate and pursue billing disputes, rather than use such resources for more productive purposes such as capital investment.[1190] This sort of gamesmanship distorts the intercarrier compensation system and chokes off revenue that carriers depend on to deliver broadband and other essential services to consumers, particularly in rural and difficult to serve areas of the country.

704. To address the problem, in the *USF/ICC Transformation NPRM*, we proposed to modify our call signaling rules to require originating service providers to provide signaling information that includes calling party number ("CPN") for all voice traffic, regardless of jurisdiction, and to prohibit interconnecting carriers from stripping or altering that call signaling information. Based on the record developed in this proceeding, we now adopt our original proposal with the minor modifications described in further detail below. Service providers that originate interstate or intrastate traffic on the PSTN, or that originate inter- or intrastate interconnected VoIP traffic destined for the PSTN, will now be required to transmit the telephone number associated with the calling party to the next provider in the call path. Intermediate providers must pass calling party number or charge number signaling information they receive from other providers unaltered, to subsequent providers in the call path.[1191] These requirements will assist service providers in appropriately billing for calls traversing their networks.

705. By ensuring that the calling party telephone number information is provided and transmitted for all types of traffic originating or terminating on the PSTN, our revised rules will assist service providers in accurately identifying and billing for traffic terminating on their networks, and help to guard against further arbitrage practices. These measures will work in tandem with the Commission's reforms adopted elsewhere in this Order, which, by minimizing intercarrier compensation rate differences, promise to eliminate the incentive for providers to engage in phantom traffic arbitrage.[1192] Together, these changes will benefit consumers by enabling providers to devote more resources to investment and innovation that would otherwise have been spent resolving billing disputes.

706. Below, we briefly review how service providers exchange necessary billing information and why the current regime of information exchange has proved inadequate to avoid the problems of phantom traffic. We explain how the rules we adopt present an effective, technologically neutral, and forward-looking solution to reduce litigation and disputes over unidentifiable traffic. Finally, we review several proposals received in the record related to our proposed rules.

[1188] *See* TCA Section XV Comments at 5 ("TCA concurs in various estimates indicating that phantom traffic comprises up to 20 percent of all terminating traffic for many rural LECs."); Kansas Commission Section XV Comments at 17; Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier Communications, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 07-135, 05-337, 04-36, CC Docket Nos. 99-68, 01-92 at 1 (filed Dec. 21, 2010); *see also* April 6, 2011 ICC Hearing Transcript at 44-45.

[1189] ITTA Section XV Comments at 4 (citing C. Goldfarb, *"Phantom Traffic" – Problems Billing for the Termination of Telephone Calls*: *Issues for Congress* 1 (Cong Res. Serv., June 27, 2008)).

[1190] *See, e.g.*, CenturyLink Section XV Comments at 19; Louisiana Small Company Committee Section XV Comments at 11 ("Phantom traffic impacts carriers' ability to invest in networks and services, and undermines their ability to ensure adequate facilities are in place to meet consumers' evolving and expanding needs.").

[1191] *See infra* at App. [] .

[1192] *See* Cincinnati Bell *August 3 PN* Comments at 10-11; Charter *August 3 PN* Reply at 6; VON Coalition *August 3 PN* Comments at 7.

1. Background

707. Service providers need to know certain information for each call to bill for and receive intercarrier payments for traffic that terminates on their networks. Specifically, to know what intercarrier compensation charges apply, a terminating provider must be able to identify the appropriate upstream service provider and the geographic location of the caller (or a proxy for the caller's location). For calls directly connected between an originating service provider and a terminating service provider, this information typically is apparent or easily obtained.[1193] However, for calls where the originating and terminating network are not directly connected (i.e., when calls are delivered via tandem transit service or interexchange carrier),[1194] accurate call information may not be available because there may be one or more interconnecting service providers that handle the call before delivering it to the terminating service provider. The terminating carrier may not receive accurate identifying information for a variety of reasons. For instance, signaling for the call may never have been populated with accurate information or the information may have been intentionally stripped.[1195]

708. As described in the *USF/ICC Transformation NPRM*, terminating service providers that are not directly connected to originating providers receive information about calls sent to their networks for termination from a variety of sources. First, terminating service providers may rely on information contained in the Signaling System 7 (SS7) signaling stream. SS7 is a separate or "out of band" network that runs parallel to the PSTN. Commission rules require carriers that use SS7 to convey the calling party number (CPN) to subsequent carriers on interstate calls where it is technically feasible to do so.[1196] Billing records from tandem switch operators are another source of information for terminating service providers about traffic on their networks.[1197] Notably, the CPN or Charge Number (CN) information used in billing records is derived from the SS7 signaling stream.[1198] Finally, service providers may also rely on

[1193] *See* PAETEC et al. Section XV Comments at 3.

[1194] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4752-53, para. 622. Competitive LECs, CMRS carriers, and rural LECs, who would otherwise have no efficient means of connecting their networks, often rely upon transit service from incumbent LECs to facilitate indirect interconnection with each other. *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 at 4740, para. 125 (2005).

[1195] *See infra* para. 709.

[1196] *See* 47 C.F.R. § 64.1601. As we described in the *USF/ICC Transformation NPRM*, the SS7 call signaling system is used to set up a pathway across the PSTN and the system performs the function of identifying a path a call can take after the caller dials the called party's number. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4751-52, para. 621. Although 47 C.F.R. § 64.1601 requires that the CPN be transmitted where technically feasible, the technical content and format of SS7 signaling is governed by industry standards rather than by Commission rules.

[1197] Billing records are typically created by a tandem switch that receives a call for delivery to a terminating network via tandem transit service. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4752-53, para. 622 and n.950. Service providers delivering billing records typically use the Exchange Message Interface (EMI) format created and maintained by the Alliance for Telecommunications Industry Solutions Ordering and Billing Forum (ATIS/OBF), an industry standards setting group. *See* ATIS Exchange Message Interface 22 Revision 2, ATIS Document number 0406000-02200 (July 2005).

[1198] SS7 was designed to facilitate call routing and was not designed for billing purposes. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4751-52, para. 621 (citing Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Sept. 13, 2005) (Verizon Wireless Sept. 13, 2005 *Ex Parte* Letter)).

identifying information contained in Internet protocol sessions or messages (e.g., Session Initiation Protocol (SIP) header fields) for VoIP calls.[1199]

709. The record in this proceeding confirms that numerous service providers have encountered difficulties with traffic arriving for termination with insufficient or inaccurate identifying information.[1200] The record suggests that gamesmanship with regard to calling party information is rife.[1201] Commenters describe a number of phantom traffic tactics used to avoid higher intercarrier charges including masking intrastate traffic to make it appear interstate or international in nature.[1202] One carrier alleges that a common phantom traffic scheme it faces involves carriers that disguise traffic by putting a telephone number into the CN field that is local to the terminating exchange to avoid higher intercarrier compensation rates.[1203]

2. Revised Call Signaling Rules

710. *Intrastate Traffic*. As described below, we expand the scope of our existing call signaling rules to encompass jurisdictionally intrastate traffic. The record reflects broad support for expanding our rules in this manner and no party opposed or questioned the Commission's legal authority to do so.[1204] The Commission has previously recognized, in exercising authority over intrastate call signaling for caller ID purposes, that "CPN-based services are 'jurisdictionally mixed services'" and that it would be "impractical and uneconomic" to require the development and implementation of systems that would permit separate federal and state call signaling rules to operate.[1205] We conclude that, as with call signaling in the caller ID context, it would be impractical to have separate federal and state rules regarding inclusion of CPN in signaling.[1206] And, we agree with comments in the record asserting that

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[1199] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4751-53, paras. 621-22; RFC 3261, SIP: Session Initiation Protocol (2002) *at* www.ietf.org/rfc/rfc3261.txt; Megaco Protocol Version 1.0 (2000) *at* https://datatracker.ietf.org/doc/rfc3015/.

[1200] *See, e.g.*, USTelecom Section XV Comments at 4 ("Many carriers report that the amount of traffic being received by terminating carriers without calling party identifying information has continued to grow.").

[1201] For example, according to Frontier, an investigation found an "incredible amount of traffic from one telephone number" terminating to its network - an average of 43,378 minutes of interstate traffic a day. Frontier Section XV Comments at 11. According to Frontier, this number was being used to make the traffic appear to be interstate so as to mask the true intrastate nature of the calls to avoid paying intrastate access charges. *Id.*; *see also* USTelecom Section XV Comments at 4.

[1202] CenturyLink Section XV Comments at 19.

[1203] Windstream Section XV Comments at 16.

[1204] Numerous parties supported the proposal to expand the scope of the rule to encompass intrastate traffic. *See, e.g.*, California Commission Section XV Comments at 6 ("And we agree that these new rules be extended, as the FCC proposes, 'to all traffic originating or terminating on the PSTN, including but not limited to, jurisdictionally intrastate traffic …' "); Rural Associations Section XV Comments at 17, 25; TCA Section XV Comments at 6.

[1205] *Rules and Policies Regarding Calling Number Identification Service – Caller ID*, CC Docket No. 91-281, Memorandum Opinion and Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking, 10 FCC Rcd 11700, 11723, para. 62 (1995) (*Caller ID Order*).

[1206] In the caller ID context, the Commission found that it would be impractical to require the development and implementation of systems that would permit separate federal and state call signaling rules to operate because such systems would be burdensome, confusing to consumers, and would potentially slow down the call signaling process. *See id*. at 11724-27, paras. 65-74. In the present context of including CPN in signaling, we conclude that separate CPN inclusion requirements for interstate and intrastate traffic are impractical because a call's jurisdiction is typically not determined until after the call signaling process occurs.

extension of the call signaling rules to intrastate traffic is "justified… because maintaining separate mechanisms for passing CPN is infeasible, and passing CPN is necessary to identify and thus facilitate federal regulation of interstate traffic."[1207]

711. *Calling Party Number*. In the *USF/ICC Transformation NPRM*, we sought comment on extending our call signaling rules (which currently require certain common carriers using SS7 to transmit the CPN associated with an interstate call to interstate carriers[1208]) to all traffic originating or terminating on the PSTN, including but not limited to jurisdictionally intrastate traffic[1209] and traffic transmitted using Internet protocols.[1210] The record broadly supports this change to our rules either as proposed, or as a baseline for addressing phantom traffic problems.[1211] We expect that these rule modifications will help reduce regulatory gamesmanship.[1212]

712. *SS7 Charge Number (CN)*. The *USF/ICC Transformation NPRM* also proposed to apply call signaling rules to address CN where carriers use SS7 signaling.[1213] Generally, the CN field is not populated in the SS7 stream when it is the same as CPN.[1214] However, in cases where the CN is different from the CPN (e.g., where a business has a single charge number for multiple end user numbers), the CN parameter is populated and included in billing records in place of CPN.[1215] Consistent with industry practice, the *USF/ICC Transformation NPRM* proposed to clarify that populating the SS7 CN field with information other than the charge number to be billed for a call is prohibited.

713. Windstream maintains that "[i]t is critical that the Commission make clear that scheming carriers cannot disguise jurisdiction on billing records by failing to provide or manipulating the CN," a practice it states is common.[1216] On the other hand, some parties object to any requirement to not alter the

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[1207] AT&T Section XV Comments at 22 ("Extension of the current rules to intrastate calls is justified under these standards because maintaining separate mechanisms for passing CPN is infeasible, and passing CPN is necessary to identify and thus facilitate federal regulation of interstate traffic."). Unlike the caller ID context, in which a California law permitting CPN blocking in certain circumstances was expressly preempted, (*See Caller ID Order*, 10 FCC Rcd at 11730, para. 85) we are not aware of any state laws that conflict with the call signaling rules we adopt. Accordingly, we do not preempt any state laws at this time. If, however, a state law conflicting with our revised call signaling rules were enacted, preemption analysis would be appropriate.

[1208] *See* 47 C.F.R. § 64.1601.

[1209] *See supra* note 1204.

[1210] *See infra* para. 717.

[1211] *See, e.g.,* Missouri Commission Section XV Comments at 7; NASUCA and NJ Rate Counsel Section XV Reply at 8-9; XO Section XV Comments at 37.

[1212] As we stated in the *USF/ICC Transformation NPRM*, our proposed rules are not intended to affect existing agreements between service providers regarding how to jurisdictionalize traffic in the event that traditional call identifying parameters are missing, as long as such agreements are otherwise consistent with Commission rules and other legal requirements. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4756, para. 632. Accordingly, we decline to adopt proposals to use calling party number or originating and terminating numbers as the basis for jurisdictionalizing calls. *See, e.g.*, Rural Associations Section XV Comments at 27-29; Rural Associations Section XV Reply at 12; *but see* CTIA Section XV Comments at 9-10; NASUCA and NJ Rate Counsel Section XV Reply at 11.

[1213] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4756, para. 631.

[1214] *See id*.

[1215] *See* Windstream Section XV Comments at 13.

[1216] *Id*. at 14.

CN field.[1217] According to these parties, the proposed requirement is problematic because intermediate providers may not be able to pass the CN field in some instances,[1218] and the requirement would prevent intermediate providers from modifying the CN for their own purposes.[1219]

714. We adopt the proposal contained in the *USF/ICC Transformation NPRM* to require that the CN be passed unaltered where it is different from the CPN. We believe that this requirement will be an adequate remedy to the problem of CN number substitution that disguises the characteristics of traffic to terminating service providers. Additionally, we note that the CN field may only be used to contain a calling party's charge number, and that it may not contain or be populated with a number associated with an intermediate switch, platform, or gateway, or other number that designates anything other than a calling party's charge number. We are not persuaded by objections to this requirement. First, unsupported objections that there may be "circumstances where a CN may be different from the CPN but cannot be easily transmitted" are unpersuasive without more specific evidence.[1220] Second, we note that the Commission addressed similar circumstances in the 2006 *Prepaid Calling Card Order*, and prohibited carriers that serve prepaid calling card providers from passing the telephone number associated with the platform in the charge number parameter.[1221] In this case, we agree with the analysis of the *Prepaid Calling Card Order* that "[b]ecause industry standards allow for the use of CN to populate carrier billing records … passing the number of the [] platform in the parameters of the SS7 stream to carriers involved in terminating a call may lead to incorrect treatment of the call for billing purposes."[1222] In sum, the record demonstrates that CN substitution is a technique that leads to phantom traffic, and our proposed rules are a necessary and reasonable response.[1223]

715. *Multi-Frequency (MF) Automatic Number Identification (ANI).* As noted in the *USF/ICC Transformation NPRM*, some service providers do not use SS7 signaling, but instead rely on Multi-Frequency (MF) signaling.[1224] The *USF/ICC Transformation NPRM* proposed that service providers using MF Signaling pass the CPN, or the CN if different, in the MF Automatic Number Identification (MF ANI) field.[1225]

716. We amend our rules to require service providers using MF signaling to pass the number of the calling party (or CN, if different) in the MF ANI field. This requirement will provide consistent treatment across signaling systems and will ensure that information identifying the calling party is included in call signaling information for all calls.[1226] Moreover, this requirement responds to the

[1217] *See, e.g.*, PAETEC et al. Section XV Comments at 8-9; PAETEC et al. Section XV Reply at 6-7.

[1218] *See* Verizon Section XV Comments at 49 n. 69; HyperCube Section XV Reply at 12-13.

[1219] PAETEC et al. Section XV Reply at 6-7.

[1220] Verizon Section XV Comments at 49 n.69.

[1221] *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290, 7302-03, para. 34 (2006) (*Prepaid Calling Card Order*).

[1222] *See id*.

[1223] *See, e.g.*, Windstream Section XV Comments at 15-17.

[1224] Some providers also use IP signaling. *See infra* para. 717.

[1225] *See* Core Section XV Comments at 11("Identifying the calling party's number in the SS7 context, and the ANI and/or Caller ID in the MF signaling context, will certainly help carriers reduce and narrow call rating disputes."); *but see* AT&T Section XV Comments at 25.

[1226] As a result, we decline to adopt AT&T's suggestion that we broadly exempt MF signaling. *See* AT&T Section XV Comments at 25.

concerns expressed in the record that MF signaling can be used by "unscrupulous providers" to engage in phantom traffic practices.[1227] The previous record concerning the technical limitations of MF ANI appears to be mixed.[1228] In balancing the need for a rule that covers all traffic with the technical limitations asserted in the record, we conclude that the approach most consistent with our policy objective is not to exclude the entire category of MF traffic. Such a categorical exclusion could create a disincentive to invest in IP technologies and invite additional opportunities for arbitrage. Although our rules will apply to carriers that use or pass MF signaling, we do not mandate any specific method of compliance. Carriers will have flexibility to devise their own means to pass this information in their MF signaling. Nevertheless, to the extent that a party is unable to comply with our rule as a result of technical limitations related to MF signaling in its network, it can seek a waiver for good cause shown, pursuant to section 1.3 of the Commission's rules.[1229]

717. *IP Signaling*. Consistent with the proposal in the *USF/ICC Transformation NPRM*, the rules we adopt today also apply to interconnected VoIP traffic. Failure to include interconnected VoIP traffic in our signaling rules would create a large and growing loophole as the number of interconnected VoIP lines in service continues to grow.[1230] Many commenters supported application of the proposed requirements to VoIP traffic.[1231] Therefore, VoIP service providers will be required to transmit the telephone number of the calling party for all traffic destined for the PSTN that they originate. If they are intermediate providers in a call path, they must pass, unaltered, signaling information they receive indicating the telephone number, or billing number if different, of the calling party. Because IP transmission standards and practices are rapidly changing, we refrain from mandating a specific compliance method and instead leave to service providers using different IP technologies the flexibility to determine how best to comply with this requirement.

718. In extending our call signaling rules to interconnected VoIP service providers, we acknowledge that the Commission has not classified interconnected VoIP services as "telecommunications services" or "information services." We need not resolve this issue here, for we would have authority to impose call signaling on interconnected VoIP providers even under an

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[1227] *See* XO Section XV Comments at 36-37.

[1228] *Compare* AT&T Section XV Comments at 25 ("Multi Frequency signaling was not designed in many instances to forward originating CN or CPN data to a terminating carrier in the MF Automatic Number Identification (ANI) field. Rather, the MF ANI standards and technology were developed to provide IXCs with the data they need to bill end user customers that originate calls."); Verizon *2008 ICC/USF NPRM* Comments at 65 n.97 ("MF trunks are configured to signal ANI only on the originating end of a Feature Group D access call. . . . MF trunks do not signal ANI on non-access calls or on the terminating leg of an access call."); *with* Participating Wyoming Rural Independents Missoula Plan Comments at 17 (an exception for MF signaling relating to non-Feature Group D traffic is unnecessary, because "[c]urrent technology and methods do exist to enable carriers to identify MF signaling protocol. Thus, to allow for an unnecessary exception would exacerbate phantom traffic problems").

[1229] *See infra* para. 723; 47 C.F.R. § 1.3.

[1230] Total business and residential interconnected VoIP service connections have increased from 21.7 million in December 2008 to 31.7 million in December 2010. *See* Industry Analysis and Technology Division, Wireline Competition Bureau, *Local Telephone Competition Report: Status as of December 2010*, at 2 (Oct. 2011). *See also e.g.*, Blooston Section XV Comments at 5; ITTA Section XV Comments at 3; CenturyLink Section XV Comments at 7.

[1231] Frontier Section XV Comments at 12 ("Failure to apply these rules equally to VoIP traffic would leave a gaping hole in the Commission's rules for the fastest-growing segment of traffic"); *see also* Consolidated Section XV Comments at 34-36.

information service classification.[1232] This Order adopts intercarrier compensation requirements for the exchange of VoIP-PSTN traffic between a LEC and another carrier.[1233] Applying our call signaling rules to interconnected VoIP service providers will enable service providers terminating interconnected VoIP traffic to receive signaling information that will help prevent this traffic from terminating without compensation,[1234] contrary to the prospective intercarrier compensation regime we adopt for that traffic under section 251(b)(5). In addition, under the intercarrier compensation reform framework we adopt today, traffic terminating without compensation could create a need for recovery that shifts costs created by phantom traffic to end-user rates or the Connect America Fund, undermining the transitional role for intercarrier compensation charges established as part of that framework. Our new call signaling rules are necessary to address these concerns.

3. Prohibition of Altering or Stripping Call Information

719. In the *USF/ICC Transformation NPRM*, we also sought comment on a proposed rule that would prohibit service providers from altering or stripping relevant call information. More specifically, we proposed to require all telecommunications providers and entities providing interconnected VoIP service to pass the calling party's telephone number (or, if different, the financially responsible party's number), unaltered, to subsequent carriers in the call path.[1235] Commenters overwhelmingly supported this proposal.[1236] We believe that a prohibition on stripping or altering information in the call signaling stream serves the public interest. The prohibition should help ensure that the signaling information required by our rules reaches terminating carriers. Therefore, we adopt our proposal to prohibit stripping or altering call signaling information with the modifications discussed below.

720. In response to comments in the record, we make several clarifying changes to the text of the proposed rules in this section. First, commenters objected to the use of the undefined term "financially responsible party" in the proposed rules.[1237] We agree with the concerns and clarify that providers are required to pass the billing number (e.g., CN in SS7) if different from the calling party's number. For similar reasons, for purposes of this rule, we add the following definition of the term "intermediate provider" to the rules: "any entity that carries or processes traffic that traverses or will traverse the PSTN at any point insofar as that entity neither originates nor terminates that traffic." We

[1232] *See* 47 U.S.C. §§ 151, 152, 154(i); *Comcast Corp. v. FCC*, 600 F.3d 642, 646 (D.C. Cir. 2010) (quoting *Am. Library Ass'n v. FCC*, 406 F.3d 689, 691-692 (D.C. Cir. 2005)) ("The Commission ... may exercise ancillary jurisdiction only when two conditions are satisfied: (1) the Commission's general jurisdictional grant under Title I [of the Communications Act] covers the regulated subject; and (2) the regulations are reasonably ancillary to the Commission's effective performance of its statutorily mandated responsibilities."). Additionally, as the Commission has previously found, section 706 provides authority applicable in this context. *See generally Preserving the Open Internet; Broadband Industry Practices*, GN Docket No. 09-191, WC Docket No. 07-52, Report and Order, 25 FCC Rcd 17905, 17968-72, paras. 117-23 (2010).

[1233] *See infra* Section XIV.

[1234] Carriers are generally prohibited from blocking calls. *See Establishing Just and Reasonable Rates for Local Exchange Carriers; Call Blocking by Carriers*, WC Docket No. 07-135, 22 FCC Rcd 11629 (2007) (*Call Blocking Declaratory Ruling*). Therefore, there may be situations where a carrier is forced to complete a call even though it is unable to bill for that call due to lack of identifying information in its signaling. *See* Core Section XV Reply at 2; *see also infra* para 973.

[1235] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4793, App. B.

[1236] *See, e.g.*, ATA Section XV Comments at 4; Comcast Section XV Comments at 9; Leap Wireless and Cricket Section XV Comments at 8.

[1237] *See* AT&T Section XV Comments 25; Verizon Section XV Comments at 51.

find that adding this definition will eliminate potential ambiguity in the revised rule.[1238] As provided in Appendix A, we also make modest adjustments to the rules proposed in the *USF/ICC Transformation NPRM*. Specifically, we clarify that the obligation to pass signaling information applies to the telephone number or billing number,[1239] and we clarify that the revised rules apply to telecommunications carriers and providers of interconnected VoIP services. Finally, because, as discussed below, our waiver process is available to parties seeking exceptions to the revised rule, we remove the proposed rule language limiting applicability in relation to industry standards.[1240] With these minor changes, we adopt the proposed prohibition on stripping or altering information regarding the calling party number.

4. Exceptions

721. The *USF/ICC Transformation NPRM* sought comment on whether phantom traffic rules should contain limited exceptions, including where it would not be technically feasible to comply with the obligation to transmit the calling party number with the network technology deployed or where industry standards would permit deviation from the duty to pass signaling information unaltered.[1241] Some parties suggested that the Commission should exercise caution before including any exceptions to its rules. For example, the Missouri Small Telephone Company Group stated that it "does not believe it is appropriate for an industry standard to trump a federal rule," and as such "the entire exception [should] be deleted."[1242] Similarly, parties recommended that the Commission eliminate or carefully enumerate the circumstances in which it would be acceptable to deviate from the requirement to pass signaling information unaltered. The Nebraska Rural Independent Companies expressed concern that the technical feasibility exception "leaves room for many providers to use the excuse of 'transmission was not technically feasible'" and therefore posited that there should be "few to no circumstances that the proposed rules will not be followed."[1243]

722. Meanwhile, other parties proposed that technical feasibility and industry standards exceptions be applied to both sections of the proposed signaling rules, §§ 64.1601(a) and (b).[1244] Commenters also suggested that the rules include an exception for all industry standards, whether published or not,[1245] and asked that the Commission clarify that the rules do not require the deployment of new equipment or otherwise add costs for compliance.[1246] Finally, parties asked the Commission to explicitly recognize certain exceptions to the proposed rules.[1247]

723. We agree with the concern expressed by some commenters that any exceptions would have

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[1238] *See*, *e.g*., Verizon Section XV Comments at 50 (noting that the term "intermediate provider" was undefined).

[1239] *See*, *e.g*., *id*. at 50 n. 71 (urging the Commission to delete references to "all" SS7 notation from the final rules).

[1240] *See infra* para. 723.

[1241] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4793, App. B.

[1242] MoSTCG Section XV Comments at 10; *see also* NECA et al. Section XV Comments at 24.

[1243] Nebraska Rural Companies Section XV Comments at 25.

[1244] *See* Verizon Section XV Comments at 49; Level 3 Section XV Reply at 9-10; *see also* AT&T Section XV Comments at 24; Verizon Section XV Reply at 32.

[1245] *See* PAETEC et al. Section XV Comments at 4, 13; Earthlink Section XV Comments at 24.

[1246] *See* AT&T Section XV Comments at 24-25, Reply at 15; CTIA Section XV Comments at 9; Level 3 Section XV Reply at 9. However, some parties have indicated that the revised rules will not incrementally increase the costs to any carrier. *See* ITTA Section XV Comments at 21.

[1247] *See, e.g*., AT&T Section XV Comments at 24-25.

the potential to undermine the rules.[1248] Moreover, we are concerned that disputes concerning the applicability of exceptions could arise and lead to costly disagreements or litigation. Accordingly, we decline to adopt any general exceptions to our new call signaling rules at this time. Parties seeking limited exceptions or relief in connection with the call signaling rules we adopt can avail themselves of established waiver procedures at the Commission. To that end, we delegate authority to the Wireline Competition Bureau to act upon requests for a waiver of the rules adopted herein in accordance with existing Commission rules.[1249]

5. Signaling / Billing Record Requirements

a. Proposals

724. A number of parties commenting on the *USF/ICC Transformation NPRM*[1250] suggest that our signaling rules should address, in addition to CPN and CN information, other call signaling fields including Operating Company Number (OCN),[1251] Carrier Identification Code (CIC),[1252] Jurisdiction Information Parameter (JIP),[1253] and Local Routing Number (LRN).[1254] These parties propose additional

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[1248] *See* MoSTCG Section XV Comments at 10; Nebraska Rural Companies Section XV Comments at 25; Rural Associations Section XV Comments at 22-24.

[1249] 47 C.F.R. § 1.3.

[1250] *See, e.g.*, Frontier Section XV Comments at 13; Rural Associations Section XV Comments at 22, 27, n. 64, Rural Associations Section XV Reply at 9-14; PAETEC et al. Section XV Comments at 4, 6-8, PAETEC et al. Section XV Reply at 3-5.

[1251] Operating Company Numbers (OCNs), also called company codes, are a four digit numerical code used to uniquely identify telecommunications service providers per industry standard ATIS-0300251, *Codes for Identification of Service Providers for Information Exchange*. NECA assigns all company codes. According to NECA, applications of OCNs include, but are not limited to NECA F.C.C. Tariff No. 4, Assignment of OCNs in the Local Exchange Routing Guide (LERG), Access Service Requests (ASRs), Multiple Exchange Carrier Access Billing (MECAB), Small Exchange Carrier Access Billing (SECAB), Exchange Message Interface (EMI), and Exchange Message Records (EMR). *See* https://www.neca.org/cms400min/NECA_Templates/Code_Administration.aspx (last visited May 31, 2011). The Operating Company Number (OCN) is used in billing records to identify a local telecommunications provider. Billing records for calls completed without an IXC identify the originating carrier by an OCN. *See* Verizon, Verizon's Proposed Regulatory Action to Address Phantom Traffic at 4 (Verizon Phantom Traffic White Paper), attached to Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Dec. 20, 2005).

[1252] CICs (Carrier Identification Code) are a numeric code assigned by the North American Numbering Plan Administrator for the provisioning of selected switched services. The numeric code is unique to each entity and is used by the telephone company to route calls to the trunk group designated by the entity to which the code was assigned. *See* ATIS Telecom Glossary http://www.atis.org/glossary/definition.aspx?id=6095 (last visited June 6, 2011). CIC is also defined in the Commission's rules as a code used in tandem switching that can be used to identify an interexchange provider. *See* 47 C.F.R. § 69.2(vv).

[1253] The Jurisdiction Information Parameter (JIP) is defined as an optional parameter in the SS7 Initial Address Message. In the number portability context, the JIP parameter is used to retain, in call signaling, the first six dialed digits of a telephone number that has been ported. *See* TRAVIS RUSSELL, SIGNALING SYSTEM #7 366, 643 (Table 8.35) McGraw-Hill Communications (Fifth Edition 2006); *see also* Frontier Section XV Comments at 13 (JIP "is the NPA-NXX that identifies the originating caller's geographic location and the originating caller's service provider."). The record in this proceeding also indicates that parties are making alternate use of the optional JIP parameter pursuant to agreements. *See* XO Section XV Comments at 33 ("pursuant to agreements already in place, some carriers are currently exchanging VoIP traffic via local interconnection trunks and populating the Jurisdictional Indicator Parameter ("JIP") field on the call record to designate the traffic as VoIP traffic").

signaling requirements that they assert will allow terminating carriers to identify the service provider financially responsible for each call, to jurisdictionalize traffic, and to bill the appropriate parties.[1255] Other parties oppose these proposals.[1256]

b. Discussion

725. After considering the substantial record received in response to the *USF/ICC Transformation NPRM*, we determine that limiting the scope of the rules we adopt to address phantom traffic to CPN and CN signaling is consistent with our goal of helping to ensure complete and accurate passing of call signaling information, while minimizing disruption to industry practices or existing carrier agreements.[1257] Our revised and expanded requirements with regard to CPN and CN will ensure that terminating carriers will receive, via SS7, MF, or IP signaling, information helpful in identifying carriers sending terminating traffic to their networks. This information, in combination with billing records provided to terminating carriers in accordance with industry standards, should significantly reduce the amount of unbillable traffic that terminating carriers receive.

726. As detailed above, several commenters advocate requirements for CIC or OCN to be included in billing records. However, neither our existing nor our proposed rules specify any billing record requirements. Accordingly, we decline, at this time, to disturb the industry billing record processes that have developed independently of Commission regulation.

727. Other commenters want to require CIC or OCN information to be passed in call signaling.[1258] These commenters do not, however, address certain complexities related to such a requirement, such as whether and how the signaling should be required in the SS7 stream, whether equivalent signaling should be required for IP traffic, and if so, what formats and protocols should be required.[1259] These complexities are, in our view, best resolved by industry standard setting bodies so that they can be informed by, and adapt to, changing technology.[1260] Accordingly, unlike calling party

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[1254] The Local Routing Number (LRN) is a telephone number assigned in the local number portability database for the purposes of routing a call to a telephone number that has been ported. When a call is made to a number that has been ported, the routing path for the call is established based on the LRN rather than on the dialed number. *See* TRAVIS RUSSELL, SIGNALING SYSTEM #7 640 McGraw-Hill Communications (Fifth Edition 2006).

[1255] Specifically, parties proposing CIC and OCN signaling requirements would like the Commission to mandate inclusion of CIC or OCN in providers' SS7 call signaling or in billing records, as appropriate. *See* GVNW Section XV Comments at 5-6; PAETEC et al. Section XV Comments at 6-7. Parties proposing JIP and LRN signaling requirements assert that such requirements would help solve phantom traffic problems. *See, e.g.*, Frontier Section XV Comments at 13; Rural Associations Section XV Comments at 21-23.

[1256] *See* AT&T Section XV Reply at 18; Verizon Section XV Reply Comments at 33.

[1257] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4756, para. 632.

[1258] Blooston Section XV Comments at 10; Consolidated Section XV Comments at 37-38.

[1259] For example, as discussed above, commenters request that the Commission require providers to include CIC or OCN codes in signaling information and/or billing records. But, no commenter explains exactly how these proposals would be implemented, given that the CIC field is optional under the current SS7 industry standard. And, the proposals do not provide specific procedures by which IXCs involved in a call path would access the SS7 signaling stream to insert their OCN in the CIC field. Additionally, Sprint commented that if a terminating carrier subtends a tandem, the tandem owner has the responsibility to pass the OCN and CIC to the terminating carrier. Sprint does not offer a legal basis to impose such an obligation on a tandem owner if it is providing transit service. *See* Sprint Section XV Comments at 26.

[1260] *See* ATIS Section XV Comments at 7.

number-based requirements, which have long been at the core of our signaling rules, we decline to include requirements for signaling CIC or OCN in our revised call signaling rules. If the reforms adopted herein prove inadequate to curb problems associated with phantom and unidentifiable traffic, we will revisit measures such as additional signaling mandates at a later date.

728. There is debate in the record about the technical feasibility of proposals relating to JIP. For example, the Nebraska Rural Independent Companies propose that wireless carriers be required to populate the JIP with a two digit state identifier and a two digit MTA code associated with the cell site along with the six-digit NPA-NXX of the originating switch.[1261] But, in reply comments, HyperCube noted that "the JIP can be populated only with the LRN 6-digit NPA-NXX code. There are only six spaces in the field, and therefore wireless carriers cannot be required to populate the field not only with the LRN of the originating switch but also with a two-digit state code and a two-digit MTA code associated with the originating cell site."[1262] Additionally, wireless providers note that JIP does not, in some circumstances, provide accurate information about a call's jurisdiction.[1263] The record pertaining to JIP lacks the specific factual information necessary to resolve conflicting information at this level of detail about the operation, and carrier usage of JIP. Furthermore, as with CIC and OCN signaling, complexities related to JIP signaling are, in our view, best resolved by industry standard setting bodies so that they can be informed by and adapt to changing technology.[1264] Finally, we are reluctant to mandate any particular use of the JIP field as doing so would preclude innovative use of the field for other purposes, such as identification of VoIP traffic, specified in agreements between carriers.[1265]

729. We also note that the OCN and JIP fields provide alternatives to CPN and CN as a means of identifying the originating carrier for a call. We are thus not convinced that signaling requirements related to OCN and JIP will lead to any additional incremental reductions in the phantom traffic problem over our revised rules related to CPN and CN.

c. Enforcement

730. Commenters to the *USF/ICC Transformation NPRM* urged the Commission to consider a number of measures to ensure compliance with our new rules.[1266] As explained below, however, there is

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[1261] *See* Nebraska Rural Companies Section XV Comments at 23-24.

[1262] HyperCube Section XV Reply Comments at 13 n.39.

[1263] *See, e.g.*, AT&T Reply at 19; T-Mobile Section XV Comments at 13.

[1264] Similar conflicting information is present in the record regarding the LRN and its applicability in the call signaling context as well. Several commenters propose requiring the LRN to be included in signaling or in billing records. *See* TDS Section XV Comments at 9; Texas Telephone Section XV Comments at 11-12. Other commenters note that the LRN is not an SS7 parameter and is used primarily for the limited purpose of routing calls to numbers that have been ported to providers other than the carrier to which the number was assigned. *See* AT&T Section XV Reply Comments at 19 n.51. The record before us does not contain sufficiently detailed information to resolve this discrepancy, and, as with other signaling proposals discussed above, we believe these issues are best resolved by industry standards setting bodies.

[1265] *See* XO Section XV Comments at 33.

[1266] *See infra* paras. 731-735, We note that some parties suggested that the Commission expand the scope of the Commission's *T-Mobile Order* to allow all LECs to demand interconnection with all carriers. *See Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855 (2005) (*T-Mobile Order*), *petitions for review pending, Ronan Tel. Co. et al. v. FCC*, No. 05-71995 (9th Cir. filed Apr. 8, 2005); *see also* ITTA Section XV Comments at 22-23; Rural Associations Section XV Comments at (continued…)

no persuasive evidence that existing enforcement mechanisms and complaint processes are inadequate.[1267] We therefore decline to adopt these enforcement proposals. Parties aggrieved by violations of our phantom traffic rules have a number of options, such as filing an informal or formal complaint.[1268] In addition, the Commission has broad authority to initiate proceedings on its own motion to investigate and enforce its phantom traffic rules.[1269]

731. Some commenters suggest that the Commission impose financial responsibility on the last carrier sending traffic with incomplete billing data.[1270] Under this proposal, the terminating carrier would be allowed to charge its highest rate to the service provider delivering the phantom traffic to it. In turn, an intermediate provider would be able to charge that rate to the service provider that preceded it in the call path until ultimately the carrier that improperly labeled the traffic would be penalized.[1271]

732. We decline to adopt additional measures related to enforcement of our phantom traffic rules. Proposals to impose upstream liability or financial responsibility on carriers threaten to unfairly burden tandem transit and other intermediate providers with investigative obligations. Instead, we agree that the "responsibility – and liability – should lie with the party that failed to provide the necessary information, or that stripped the call-identifying information from the traffic before handing it off."[1272] Moreover, the phantom traffic rules we adopt herein are not intended to ensnare providers that happen to receive incomplete signaling information.[1273] Imposing upstream liability on all carriers in a call path would be likely to generate confusion and result in the unintended consequence of yielding additional phantom traffic disputes.

733. Commenters also advocated for imposition of a "penalty rate" for unidentifiable traffic or treble damages for willful and repeated action, suggesting that this approach will provide "strong

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30; USTelecom Section XV Comments at 5-6; Windstream Section XV Comments at 17-19. We address these issues in Sections XII.C.5 and XVII.N.

[1267] In response to suggestions that the Commission encourage use of the complaint process to combat phantom traffic, we reiterate that allegations of violations of our rules will be subject to the Commission's existing enforcement and complaint mechanisms. *See* CenturyLink Section XV Comments at 22; ITTA Section XV Comments at 21-22; Time Warner Cable Section XV Comments at 13-14.

[1268] *See* 47 C.F.R. § 1.711. Parties can file an informal complaint by contacting the Enforcement Bureau, which will seek to facilitate a resolution to the issue. *See* 47 C.F.R. §§ 1.716-18. Additionally, parties can avail themselves of the Commission's formal complaint process, if they were not satisfied with the outcome of their informal complaint. 47 U.S.C. § 208; 47 C.F.R. §§ 1.718, 1.720-36. Formal complaint proceedings are similar to court proceedings and are generally resolved on a written record. *See* 47 C.F.R. § 1.720. We note, under the Act, that section 208 complaints can only be brought against common carriers. *See* 47 U.S.C. § 208(a). Parties seeking relief against an interconnected VoIP provider for alleged violations of our signaling rules could seek relief against that interconnected VoIP provider's partnering or affiliated LEC. If this proves to be insufficient, the Commission could reevaluate whether a different approach is appropriate.

[1269] *See* 47 U.S.C. §§ 403, 503.

[1270] *See* Rural Associations Section XV Comments at 26-27; XO Section XV Comments at 38; NASUCA and NJ Rate Counsel Section XV Reply at 11.

[1271] *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6647-49 App. A, paras 336-42; *id*. at 6846-48 App. C, paras. 332-38.

[1272] Comcast Section XV Comments at 10.

[1273] AT&T Section XV Reply at 16; *see also* Level 3 Section XV Reply at 10; CenturyLink Section XV Reply at 20.

financial incentives to ensure compliance."[1274] We note that commenters advocating for additional enforcement measures such as financial penalties provide no sufficient reason that the Commission's existing enforcement mechanisms are inadequate to address any rule violations.[1275] We also note that a phantom traffic-specific penalty rate or other financial penalty provision would likely divert additional industry and Commission resources to disputes over the applicability and enforcement of the penalty rate. Based on the availability of the Commission's existing enforcement mechanisms, we think it is unlikely that any benefits of an additional phantom-traffic specific enforcement mechanism will outweigh its costs. Therefore, we decline to adopt a "penalty rate" or other financial punishment in connection with phantom traffic.

734. Parties also proposed that the Commission allow selective call blocking, which would permit carriers in the call path to block traffic that is unidentified or for which parties refuse to accept financial responsibility.[1276] We decline to adopt any remedy that would condone, let alone expressly permit, call blocking.[1277] The Commission has a longstanding prohibition on call blocking.[1278] In the *2007 Call Blocking Order*, the Wireline Competition Bureau emphasized that "the ubiquity and reliability of the nation's telecommunications network is of paramount importance to the explicit goals of the Communications Act of 1934, as amended" and that "Commission precedent provides that no carriers, including interexchange carriers, may block, choke, reduce or restrict traffic in any way."[1279] We find no reason to depart from this conclusion. We continue to believe that call blocking has the potential to degrade the reliability of the nation's telecommunications network.[1280] Further, as NASUCA highlights in its reply comments, call blocking ultimately harms the consumer, "whose only error may be relying on an originating carrier that does not fulfill its signaling duties."[1281]

735. *Other Proposals*. Finally, parties proposed that the Commission should impose rules surrounding the proper look-up[1282] and routing for traffic.[1283] Because these proposals are unrelated to the Commission's limited phantom traffic objectives related to signaling, and because we find little evidence

[1274] GVNW Section XV Comments at 6; *see also* Frontier Section XV Comments at 12; WGA Section XV Comments at 5.

[1275] *See supra* note 1267. Although we decline to adopt any specific enforcement mechanism related to phantom traffic and continue to believe our existing enforcement mechanisms are adequate, we will monitor this issue and, if necessary, may determine that additional measures are appropriate.

[1276] *See, e.g.*, Frontier Section XV Reply at 9; Missouri Commission Section XV Comments at 9; RNK Communications Section XV Comments at 9.

[1277] We note that at least two states currently allow for blocking of intrastate traffic in certain circumstances. *See* Missouri Commission Section XV Comments at 9; Ohio Commission Section XV Comments at 11-12.

[1278] *See Call Blocking Declaratory Ruling*, 22 FCC Rcd at 11629, 11631 paras. 1, 6; *see also Blocking Interstate Traffic in Iowa*, Memorandum Opinion and Order, 2 FCC Rcd 2692 (1987) (denying application for review of Bureau order, which required petitioners to interconnect their facilities with those of an interexchange carrier in order to permit the completion of interstate calls over certain facilities).

[1279] *Call Blocking Declaratory Ruling*, 22 FCC Rcd at 11631, para. 6.

[1280] *Id*. at 11631, para. 5 (internal citation omitted).

[1281] NASUCA and NJ Rate Counsel Section XV Reply at 11.

[1282] *See, e.g.*, CenturyLink Section XV Comments at 24.

[1283] *See, e.g.*, Aventure Section XV Comments at 7-9; Rural Associations Section XV Comments at 29-30.

at this time of a need for additional Commission action, we decline to adopt these proposals.[1284] We believe the changes to the call signaling rules adopted in this Order provide a narrowly tailored and straightforward remedy to the problems of unidentifiable traffic.

XII. COMPREHENSIVE INTERCARRIER COMPENSATION REFORM

736. Consistent with the National Broadband Plan's recommendation to phase out regulated per-minute intercarrier compensation charges,[1285] in this section we adopt bill-and-keep as the default methodology for all intercarrier compensation traffic. We believe setting an end state for all traffic will promote the transition to IP networks, provide a more predictable path for the industry and investors, and anchor the reform process that will ultimately free consumers from shouldering the hidden multi-billion dollar subsidies embedded in the current system.

737. Under bill-and-keep arrangements, a carrier generally looks to its end-users—which are the entities and individuals making the choice to subscribe to that network—rather than looking to other carriers and their customers to pay for the costs of its network. To the extent additional subsidies are necessary, such subsidies will come from the Connect America Fund, and/or state universal service funds. Wireless providers have long been operating pursuant to what are essentially bill-and-keep arrangements, and this framework has proven to be successful for that industry.[1286] Bill-and-keep arrangements are also akin to the model generally used to determine who bears the cost for the exchange of IP traffic, where providers bear the cost of getting their traffic to a mutually agreeable exchange point with other providers.

738. Bill-and-keep has significant policy advantages over other proposals in the record.[1287] A bill-and-keep methodology will ensure that consumers pay only for services that they choose and receive, eliminating the existing opaque implicit subsidy system under which consumers pay to support other carriers' network costs. This subsidy system shields subsidy recipients and their customers from price signals associated with network deployment choices. A bill-and-keep methodology also imposes fewer regulatory burdens and reduces arbitrage and competitive distortions inherent in the current system, eliminating carriers' ability to shift network costs to competitors and their customers.[1288] We have legal

[1284] *See* AT&T Section XV Reply at 15 n.39; XO Section XV Comments at 38-39.

[1285] *See* National Broadband Plan at 150 (Recommendation 8.14).

[1286] CMRS providers are prohibited from filing interstate access tariffs, *see* 47 C.F.R. § 20.15(c), but may collect access charges from an IXC if both parties agree pursuant to contract. *See Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13198, para. 12 (2002) (*Sprint/AT&T Declaratory Ruling*), *petitions for review dismissed*, *AT&T Corp. v. FCC*, 349 F.3d 692 (D.C. Cir. 2003). Practically speaking, this means that CMRS providers generally do not collect access charges for calls that originate or terminate on their networks. CMRS providers are, however, able to receive reciprocal compensation for eligible traffic that terminates on their networks, although the record indicates that many of those arrangements are also bill-and-keep. *See, e.g.*, Letter from Tamara Preiss, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135, at 6, 10 (filed June 28, 2010); CTIA *USF/ICC Transformation NPRM* Comments at 36 (explaining that bill-and-keep "is the model that has been successful in the wireless industry"); T-Mobile *USF/ICC Transformation NPRM* Comments at 24 (internal citations omitted) (detailing that "[w]ireless carriers essentially operate now under a bill-and-keep regime, and bill-and-keep, is in large part, the end point of this proposal"); *cf.* ABC Plan, Attach. 5 at 36-37 (commenting that the majority of intraMTA wireless traffic has been, and currently is, exchanged at rates at or below $0.0007 per minute).

[1287] *See infra* Section XII.A.1.

[1288] *See generally*, Letter from Kathleen O'Brien Ham, VP, Federal Regulatory Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 03-109; CC Docket Nos. 01-92, 96-46; GN Docket No. 09-51 (filed Oct. 20, 2011) (T-Mobile Oct. 20, 2011 *Ex Parte* Letter).

authority to adopt a bill-and-keep methodology as the end point for reform pursuant to our rulemaking authority to implement sections 251(b)(5) and 252(d)(2), in addition to authority under other provisions of the Act, including sections 201 and 332.[1289]

739. We also adopt in this section a gradual transition for terminating access, providing price cap carriers, and competitive LECs that benchmark to price cap carrier rates, six years and rate-of-return carriers, and competitive LECs that benchmark to rate-of-return carrier rates, nine years to reach the end state. We believe that initially focusing the bill-and-keep transition on terminating access rates will allow a more manageable process and will focus reform where some of the most pressing problems, such as access charge arbitrage, currently arise. Additionally, we believe that limiting reform to terminating access charges at this time minimizes the burden intercarrier compensation reform will place on consumers and will help manage the size of the access replacement mechanism adopted herein. We recognize, however, that we need to further evaluate the timing, transition, and possible need for a recovery mechanism for those rate elements–including originating access, common transport elements not reduced, and dedicated transport–that are not immediately transitioned; we address those elements in the FNPRM. The transition we adopt sets a default framework, leaving carriers free to enter into negotiated agreements that allow for different terms.[1290]

A. Bill-and-Keep as the End Point for Reform

740. In this section, we first explain the policy reasons for adopting a bill-and-keep methodology. We then explain our legal authority to comprehensively reform intercarrier compensation and adopt a bill-and-keep methodology as the end state for all traffic. Finally, we explain why, on balance, a national, uniform framework best advances our goals and how states will have a critical role in implementing this national framework.

1. Bill-and-Keep Best Advances the Goals of Reform

741. We adopt a bill-and-keep methodology as a default framework and end state for all intercarrier compensation traffic. We find that a bill-and-keep framework for intercarrier compensation best advances the Commission's policy goals and the public interest, driving greater efficiency in the operation of telecommunications networks[1291] and promoting the deployment of IP-based networks.[1292]

742. *Bill-and-Keep Is Market-Based and Less Burdensome than the Proposed Alternatives*. Bill-and-keep brings market discipline to intercarrier compensation because it ensures that the customer

[1289] *See infra* Section XII.A.2.

[1290] We agree with commenters that "[c]arriers should be free to negotiate commercial agreements that may depart from the default regime." Verizon *USF/ICC Transformation NPRM* Comments at 7.

[1291] *See* National Broadband Plan at 142. *See also* T-Mobile *USF/ICC Transformation NPRM* Comments at 17 (explaining that "LEC requirements that packet-based traffic be converted into TDM further deprive consumers of the full benefits that packet-based technologies can offer. This arrangement also stifles investment. . . ."); Global Crossing *USF/ICC Transformation NPRM* Comments at 7 (stating that "Global Crossing has previously noted that it spends approximately 2,290 man-hours per month managing the intercarrier compensation regime, which accounts for time required to address disputes, bill reconciliation, contract negotiation, routing, and other tasks.").

[1292] *See* AT&T *USF/ICC Transformation NPRM* Reply at 3; *see also* CTIA *USF/ICC Transformation NPRM* Comments at 36; Google *USF/ICC Transformation NPRM* Comments at 9; Sprint *USF/ICC Transformation NPRM* Comments, App. B at 4. *See also* Letter from Stuart Polikoff, VP – Regulatory Policy and Business Development, OPASTCO to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 05-337 and 06-122, CC Docket Nos. 96-45 and 01-92, at 2 (filed Oct. 28, 2009) (urging that "[a]ll intercarrier compensation (ICC) rates transition down to zero over seven years").

who chooses a network pays the network for the services the subscriber receives.[1293] Specifically, a bill-and-keep methodology requires carriers to recover the cost of their network through end-user charges,[1294] which are potentially subject to competition. Under the existing approach, carriers recover the cost of their network from competing carriers through intercarrier charges, which may not be subject to competitive discipline. Thus, bill-and-keep gives carriers appropriate incentives to serve their customers efficiently.[1295]

743. Bill-and-keep is also less burdensome than approaches that would require the Commission and/or state regulators to set a uniform positive intercarrier compensation rate, such as $0.0007. In particular, bill-and-keep reduces the significant regulatory costs and uncertainty associated with choosing such a rate, which would require complicated, time consuming regulatory proceedings, based on factors such as demand elasticities for subscription and usage as well as the nature and extent of competition.[1296] As the Commission has recognized with respect to the existing reciprocal compensation rate methodology, "[s]tate pricing proceedings under the TELRIC [Total Element Long Run Incremental Cost] regime have been extremely complicated and often last for two or three years at a time. . . . The drain on resources for the state commissions and interested parties can be tremendous."[1297] Indeed, the cost of implementing such a framework potentially could outweigh the resulting intercarrier compensation revenues for many carriers.[1298] Moreover, in setting any new intercarrier rate, it would be necessary to rely on information from carriers who would have incentives to maximize their own revenues, rather than ensure socially optimal intercarrier compensation charges.[1299] Thus, the costs of

[1293] *See infra* Section XII.A.2.

[1294] In certain areas, we recognize that, in addition to end user charges, explicit universal service support may also be appropriate. *See generally* Section XIII.

[1295] *See, e.g.*, Patrick DeGraba, *Central Office Bill and Keep as a Unified Inter-carrier Compensation Regime*, 19 Yale Journal of Regulation 37 (2002) (DeGraba); AT&T *USF/ICC Transformation NPRM* Reply at 23.

[1296] *See, e.g.*, Body of European Regulators for Electronic Communications, *BEREC Common Statement on Next Generation Networks Future Charging Mechanisms/Long Term Termination Issues*, June 2010, http://erg.eu.int/doc/berec/bor_10_24_ngn.pdf, at 24-26, 51 (BEREC Common Statement); *see also* DeGraba at 26-27; *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4790-92, App. C ("In practice, however, regulators rarely have sufficient information or sufficient resources to establish rates that accurately reflect the cost of providing service. . . . Furthermore, as new technologies and network architectures develop, the challenges associated with setting cost-based rates will only increase.").

[1297] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd 18945 at 18948-49, para. 6 (2003). *See also, e.g.,* Pennsylvania Commission *2008 Order and ICC/USF FNPRM* Comments at 24 (describing the possible adoption of a new incremental cost pricing methodology as imposing an "obligation upon the states to carry out a new series of very complex and expensive proceedings in order to derive cost-based rates"); Verizon *2008 Order and ICC/USF FNPRM* Comments at 47-48 (discussing the burdens associated with the regulatory process of setting reciprocal compensation rates under a new methodology).

[1298] *See, e.g.*, Virginia Commission *August 3 PN* Comments at 6; Vermont Commission *USF/ICC Transformation NPRM* Reply at 6; TCA *2008 Order and ICC/USF FNPRM* Comments at 10; Nebraska PSC *2008 Order and ICC/USF FNPRM* Comments at 7; Leap Wireless *2008 Order and ICC/USF FNPRM* Comments at 10-11.

[1299] *See, e.g.*, BEREC Common Statement at 24; DeGraba at 26-27.

choosing a new positive intercarrier compensation rate would be significant, and a reasonable outcome would be highly uncertain.[1300]

744. *Bill-and-Keep Is Consistent with Cost Causation Principles*. As the *USF/ICC Transformation NPRM* observed, "[u]nderlying historical pricing policies for termination of traffic was the assumption that the calling party was the sole beneficiary and sole cost-causer of a call."[1301] However, as one regulatory group has observed, if the called party did not benefit from incoming calls, "users would either turn off their phone or not pick up calls."[1302] This is particularly true given the prevalence of caller ID, the availability of the national do-not-call registry, and the option of having unlisted telephone numbers.[1303] More recent analyses have recognized that both parties generally benefit from participating in a call, and therefore, that both parties should split the cost of the call. That line of economic research finds that the most efficient termination charge is less than incremental cost, and could be negative.[1304]

[1300] *See, e.g.*, *Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Global Networks Inc., for Authorization to Provide In-Region, Interlata Services in Massachusetts*, CC Docket No. 01-9, 16 FCC Rcd 8988 (2001).

[1301] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4716, para. 525.

[1302] BEREC Common Statement at 28.

[1303] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 15 & n.22.

[1304] *See* Benjamin E. Hermalin and Michael L. Katz, *Network Interconnection with Two-Sided User Benefits*, Walter A. Haas School of Business, University of California, Berkeley (2001); *see also* DeGraba at 37-84; Doh-Shin Jeon, Jean-Jacque Laffont and Jean Tirole, *On the "Receiver Pays" Principle*, 35 RAND J. OF ECON., 85 (2004). *See generally*, Wilko Bolt and Alexander F. Tieman, *Social Welfare and Cost Recovery in Two-Sided Markets*, IMF Working Paper, at 103–117, *www.imf.org/external/pubs/ft/wp/2005/wp05194.pdf* (2005); E. Glen Weyl, *A Price Theory of Multi-Sided Platforms*, 100 AM. ECON. REV., 1642 (2010); Alexander White, and E. Glen Weyl, *Imperfect Platform Competition: A General Framework*, http://alex-white.net/Home/Research_files/WWIPC.pdf (2011). *See also, e.g., USF/ICC Transformation NPRM*, 26 FCC Rcd at 4716, para. 525 (citing relevant sources); *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4782-86, App. C. *See also ISP Remand Order*, 16 FCC Rcd at 9183-85, paras. 71-74; CTIA *USF/ICC Transformation NPRM* Comments at 36 (Bill-and-keep "is also perfectly consistent with the realities of the modern telecommunications network and cost-causation principles. Both the calling and called parties benefit from participating in the call, and a bill-and-keep regime fairly apportions costs premised on that reality – a point the Commission has recognized for a decade.") (internal citations omitted).

Earlier models of interconnection pricing assumed that the calling party was both the cost causer and the sole beneficiary of the call. *See, e.g.*, Jean-Jacques Laffont, Patrick Rey, and Jean Tirole, *Network Competition I: Overview and Non-Discriminatory Pricing*, 29 RAND J. OF ECON., 1 (1998); Jean-Jacques Laffont, Patrick Rey, and Jean Tirole, *Network Competition II: Price Discrimination*, 29 RAND J. OF ECON., 38 (1998); Mark Armstrong, *Network Interconnection in Telecommunications*, 108 THE ECON. J., 545 (1998). Even in this stylized setting a number of results were found that implied that above cost termination charges were inefficient. For example, network providers can tacitly collude through access charges to set monopolistic retail prices, and worse, network providers acting competitively may raise termination charges beyond the monopoly level, harming consumers and themselves. *See, e.g.*, Michael Carter and Julian Wright, *Interconnection in Network Industries*, 14 REV. OF INDUS. ORG., 1 (1999); *see also* Julian Wright, *Access Pricing Under Competition: An Application to Cellular Networks*, 50 J. OF INDUS. ECON., 289 (2002); *see also* Mark Armstrong, *The Theory of Access Pricing and Interconnection*, 1 HANDBOOK OF TELECOMM. ECON., 295 (Cave M. et al., eds. 2002).

In some cases, unregulated networks also wish to mark usage prices up over their incremental costs. *See, e.g.*, Wouter Dessein, *Network Competition in Nonlinear Pricing*, 34 RAND J. OF ECON., 593 (2003); Wouter Dessein, *Network Competition with Heterogeneous Customers and Calling Patterns*, 16 INFO. ECON. AND POLICY, 323 (2004); David Harbord & Marco Pagnozzi, *Network-Based Price Discrimination and "Bill-and-Keep" vs. "Cost-*
(continued…)

745. Moreover, the subscription decisions of the called party play a significant role in determining the cost of terminating calls to that party.[1305] A consequent effect of the existing intercarrier compensation regime is that it allows carriers to shift recovery of the costs of their local networks to other providers because subscribers do not have accurate pricing signals to allow them to identify lower-cost or more efficient providers.[1306] By contrast, a bill-and-keep framework helps reveal the true cost of the network to potential subscribers by limiting carriers' ability to recover their own costs from other carriers and their customers,[1307] even as we retain beneficial policies regarding interconnection, call blocking, and geographic rate averaging.[1308]

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Based" Regulation of Mobile Termination Rates, 10 REV. OF NETWORK ECON. (2010). This means that so long as overall costs can be recovered through other charges, such as a fixed fee, the efficient termination charge is less than the carrier's incremental cost (so that retail prices, after markups, reflect underlying resource costs). *See, e.g.*, Jean-Jacques Laffont & Jean Tirole, COMPETITION IN TELECOMM., Section 2.5 (2000). Similarly, in an analysis of dynamic investment incentives, it was shown that access charges (both origination and termination) should be set below incremental cost. *See* Carlo Cambini and Tommaso Valletti, *Investments and Network Competition*, 36 RAND J. OF ECON., 446 (2005)*; see also* Carlo Cambini and Tommaso Valletti, *Network Competition with Price Discrimination: 'Bill and Keep' Is Not So Bad After All*, 81 ECON. LETTERS 205 (2003).

[1305] It is the called party that chooses the carrier that will be used for originating calls from, and terminating calls to, that user.

[1306] This was made possible by virtue of the interrelationship of the tariffed access charge regime, mandatory interconnection and policies against blocking or refusing to deliver traffic and statutory requirements for nationwide averaging of long distance rates. *See, e.g., CLEC Access Reform Order*, 16 FCC Rcd at 9935–36, para. 31; *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 (*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) (subsequent history omitted).

[1307] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4787-88, App. C. Bill-and-keep "rewards efficient carriers and punishes inefficient ones by forcing carriers to incorporate their costs into their own retail rates – which, unlike regulated intercarrier compensation, are subject to competition." AT&T *USF/ICC Transformation NPRM* Reply at 23.

[1308] Under geographic rate averaging, long-distance providers are precluded from charging customers of an interstate service in one state a rate different from that in another state. *See* 47 U.S.C. § 254(g).

We therefore reject the contentions of some parties that the cost of completing calls to their customers from other providers' networks are being imposed on them by the customers of those other networks. *See, e.g.*, NASUCA *USF/ICC Transformation NPRM* Reply at 125; PAETEC et al. *USF/ICC Transformation NPRM* Reply at 27. To the extent that these commenters in reality are contending that both calling and called parties benefit from a call, but not to an equal degree in all cases, they have not provided evidence demonstrating the relative benefit to each party, how that should be factored in to any intercarrier compensation payment owed, nor how the benefits arising from such an approach outweigh the regulatory costs associated with its implementation. *See, e.g.*, Core *USF/ICC Transformation NPRM* Comments at 13-14; State Members *USF/ICC Transformation NPRM* Comments at 152. Some carriers contending that the calling party is the cost causer have acknowledged that, even in the face of non-payment of intercarrier compensation, "it may be self-defeating to 'turn off' a large IXC and leave one's own customers unable to place *or receive* calls carried via that long distance provider." Rural Associations Section XV Comments at 37 (emphasis added).

746. We reject claims that bill-and-keep does not allow for sufficient cost recovery.[1309] In the past, parties have argued that a bill-and-keep approach somehow results in "free" termination.[1310] But bill-and-keep merely shifts the responsibility for recovery from other carrier's customers to the customers that chose to purchase service from that network plus explicit universal service support where necessary.[1311] Such an approach provides better incentives for carriers to operate efficiently by better reflecting those efficiencies (or inefficiencies) in pricing signals to end-user customers.[1312]

747. To the extent carriers in costly-to-serve areas are unable to recover their costs from their end users while maintaining service and rates that are reasonably comparable to those in urban areas, universal service support, rather than intercarrier compensation should make up the difference. In this respect, bill-and-keep helps fulfill the direction from Congress in the 1996 Act that the Commission should make support explicit rather than implicit.[1313]

748. *Consumer Benefits of Bill-and-Keep.* Economic theory suggests that carriers will reduce consumers' effective price of calling, through reduced charges and/or improved service quality. We predict that reduced quality-adjusted prices will lead to substantial savings on calls made, and to increased calling. Economic theory suggests that quality-adjusted prices will be reduced regardless of the extent of competition in any given market,[1314] but will be reduced most where competition is strongest.[1315] These price reductions will be most significant among carriers who, by and large, incur but do not collect termination charges, notably CMRS and long-distance carriers. The potential for benefits to wireless customers is particularly important, as today there are approximately 300 million wireless devices, compared to approximately 117 million fixed lines, in the United States.[1316] Lower termination charges for wireless carriers could allow lower prepaid calling charges and larger bundles of free calls for the

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[1309] The Commission has cited evidence suggesting that the forward-looking incremental cost of terminating traffic was extremely low, and very near $0—certainly much lower than current switched access charges, and even many reciprocal compensation rates. *See, e.g.*, *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6610-12, 6613-14 App. A, paras. 254-57, 260-61; *id*. at 6808-10, 6811-12, App. C at paras. 249-52, 255-56. *See also* BEREC Common Statement at 48, 51; *see also* Letter from Gary M. Epstein and Richard R. Cameron, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, at Attach. 3, p. 3 (filed Aug. 17, 2004). *But see* CenturyLink *USF/ICC Transformation NPRM* Comments at 62 (noting possible proliferation of arbitrage if there is inadequate cost recovery).

[1310] *See, e.g.*, Core Section XV Reply at 15; Louisiana Small Company Committee Section XV Comments at 9; KMC Telecom and Xspedia *Intercarrier Compensation FNPRM* Reply at 2.

[1311] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Reply at 23 (explaining that bill-and-keep would not limit the *amount* of recovery but merely the *source* of that recovery) (emphasis in original).

[1312] *Id*. at 23-24. *See also supra* paras. 742-743.

[1313] *See, e.g.*, VON Coalition *August 3 PN* Comments at 6-7; Vonage Section XV Reply at iii, 12.

[1314] *See, e.g.*, J. Bulow and P. Pfleiderer, *A Note on the Effect of Cost Changes on Prices*, J. OF POLITICAL ECON., 91 (1983).

[1315] *See id.*; *see also*, J. Hausman and G. Leonard, *Efficiencies from the Consumer Viewpoint*, 7 GEO. MASON LAW REVIEW, 707 (1999).

[1316] *See* CTIA, "U.S. Wireless Quick Facts," http://www.ctia.org/advocacy/research/index.cfm/aid/10323; *see also* FCC, Wireline Competition Bureau, *Local Telephone Competition Status as of Dec. 31, 2010*, http://transition.fcc.gov/Daily_Releases/Daily_Business/2011/db1007/DOC-310264A1.pdf.

same monthly price.[1317] For example, carriers presently offer free "in-network" wireless calls at least in part because they do not have to pay to terminate calls on their own network. Lower termination charges could also enable more investment in wireless networks, resulting in higher quality service—e.g., fewer dropped calls and higher quality calls—as well as accelerated deployment of 4G service.[1318] Similarly, IXCs, calling card providers, and VoIP providers will be able to offer cheaper long-distance rates and unlimited minutes at a lower price.

749. Moreover, as carriers face intercarrier compensation charges that more accurately reflect the incremental cost of making a call, consumers will see at least three mutually reinforcing types of benefits. First, carriers operations will become more efficient as they are able to better allocate resources for delivering and marketing existing communications services. Specifically, as described below, bill-and-keep will over time eliminate wasteful arbitrage schemes and other behaviors designed to take advantage of or avoid above-cost interconnection rates, as well as reducing ongoing call monitoring, intercarrier billing disputes, and contract enforcement efforts. Second, carrier decisions to invest in, develop, and market communications services will increasingly be based on efficient price signals.[1319]

750. Third, and perhaps most importantly, we expect carriers will engage in substantial innovation to attract and retain consumers. New services that are presently offered on a limited basis will be expanded, and innovative services and complementary products will be developed. For example, with the substantial elimination of termination charges under a bill-and-keep methodology, a wide range of IP-calling services are likely to be developed and extended,[1320] a process that may ultimately result in the sale of broadband services that incorporate voice at a zero or nominal charge. All these changes will bring substantial benefits to consumers.

751. The impact of the Commission's last substantial intercarrier compensation reform supports our view that consumers will benefit significantly from today's reforms. In 2000, the *CALLS Order* reduced interstate access charges.[1321] At the same time, in ways similar to the present reforms, we imposed modest increases in the fixed charges faced by end users.[1322] In the *CALLS Order*, the Commission forecasted that reduced interstate access rates would bring a range of efficiency benefits.[1323] Although some of these forecasts were met with initial skepticism,[1324] end-users in fact realized benefits

[1317] Previous ICC reforms have translated into wireless consumer rate reductions and an increase in service offerings, we anticipate a similar outcome as a result of the reform adopted herein. *See, e.g.*, Letter from Scott K. Bergmann, Assistant Vice President, Regulatory Affairs, CTIA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 09-51, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45 at 5 (filed Sept. 29, 2011).

[1318] *See* Letter from Charles McKee,VP, Federal and State Regulatory, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket No. 01-92, 96-45, Attach. at 1 (filed Oct. 3, 2011) ("Sprint will be able to invest such expense savings in enhancing its network and expanding its provision of wireless broadband services, while continuing to provide consumers with industry-leading pricing.").

[1319] *See, e.g.* Steven Landsburg (2011), *Price Theory and Applications,* South-Western Publishers, p. 36.

[1320] For example, bill-and-keep could allow substantial extension and development of services such as GoogleVoice and Skype.

[1321] *See CALLS Order*, 15 FCC Rcd 12962, 12975-76 para. 30.

[1322] *See id*.

[1323] *See generally, CALLS Order*, 15 FCC Rcd 12962-74, paras. 1-28.

[1324] NJ Division of the Ratepayer Advocate *CALLS NPRM* Comments at 8-9 ("Under this proposal, residential customers would see a cost increase of $50 million per month if this proposal is adopted. This cost would increase (continued…)

that exceeded most expectations. In particular, the *CALLS Order* resulted in substantial decreases in calling prices, but in largely unexpected ways. As a result of the *CALLS Order*, retail toll charges fell sharply, bringing average customer expenditures per minute of interstate toll calling down 18 percent during the year 2000.[1325] However, rather than merely reducing per-minute rates, wireless carriers started offering a new form of pricing, a fixed fee for a "bucket" of minutes, and ended distance-based pricing. As a result of these price declines, the gains in consumer surplus for wireless users in the United States from the *CALLS Order* were estimated to be about $115 billion per year.[1326] Competitive pressure from wireless providers brought similar changes to fixed line carriers, who began offering unlimited domestic calls. These price declines and innovations also had important indirect effects, allowing end-users to fundamentally change the way they used telephony services. For example, lower calling charges enabled a substantial and ongoing shift from landlines to wireless. In short, the Commission's prior intercarrier compensation reform led to more convenient access to telecommunication services and substantially lower costs for long-distance calls.

752. *Bill-and-Keep Eliminates Arbitrage and Marketplace Distortions.* Bill-and-keep will address arbitrage and marketplace distortions arising from the current intercarrier compensation regimes, and therefore will promote competition in the telecommunications marketplace. Intercarrier compensation rates above incremental cost have enabled much of the arbitrage that occurs today,[1327] and to the extent that such rates apply differently across providers, have led to significant marketplace distortions. Rates today are determined by looking at the average cost of the entire network, whereas a bill-and-keep approach better reflects the incremental cost of termination,[1328] reducing arbitrage incentives. For example, based on a hypothetical calculation of the cost of voice service on a next generation network providing a full range of voice, video, and data services, one study estimated that the incremental cost of delivering an average customer's total volume of voice service could be as low as $0.000256 per month; on a per minute basis, this incremental cost would translate to a cost of $0.0000001 per minute.[1329] Moreover, non-voice traffic on next generation networks (NGNs) is growing much more

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to $200 million per month if the SLC charge reaches the cap of $7.00 per month. In the short term, there is a huge monthly cost increase to consumers and over the long term, there could be a $2.4 billion dollar increase on an annualized basis to consumers."). *See* NASUCA *CALLS NPRM* Comments at 7-15 (predicting that the CALLS proposal will negatively affect consumers by increasing the rates paid, reducing consumer confidence and negatively impacting low income and low volume end users).

[1325] *See* Federal Communications Commission/WCB (2008), *Reference Book on Rates, Price Indices, and Household Expenditures for Telephone Service,* Table 1.15, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284934A1.pdf. For three years, 1997-1999, average customer expenditures per minute of interstate toll calls held constant at $0.11 per minute. In 2000, average customer expenditures per minute of interstate toll calls fell 18 percent to $0.09 cents per minute. However, this likely understates the full decline in reduction as a result of the Commission's reforms because the access charge reduction occurred in July of 2000. In 2001, the average rate fell to $0.08, or 27 percent from the $0.11 starting point. Rates fell again in 2002, to $0.07 cents per minute, and again in 2003 to $0.06 cents. *See id*.

[1326] *See* ABC Plan, at Attach. 4, para. 11.

[1327] *See supra* paras. 662-666. We therefore reject claims that arbitrage arises solely because of *differences* in rates among jurisdictions of traffic or otherwise regardless of the absolute rate level. *See, e.g.*, CRUSIR *USF/ICC Transformation NPRM* Comments at 11-12; Rural Carriers - State USF *USF/ICC Transformation NPRM* Comments at 2-3; ITTA *USF/ICC Transformation NPRM* Comments at 39-40.

[1328] *See infra note* 1304. *See, e.g.*, *2008 Order and USF/ICC FNPRM,* 24 FCC Rcd at 6610-14 paras. 253-61

[1329] *See* Letter from Henry Hultquist, Vice President – Federal Regulatory, AT&T Services, Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92; WC Docket Nos. 99-68, 05-337, 07-135, at 4 (filed Oct. 13, 2008) (incremental cost of a softswitch is between 0.0010 and 0.00024).

rapidly than voice traffic, and under any reasonable methods of cost allocation, the share of voice cost to total cost will continue to be small in an NGN.[1330] Record evidence indicates that the incremental cost of termination for circuit-switched networks is likewise extremely small.[1331]

753. Our conclusion that the incremental cost of call termination is very nearly zero, coupled with the difficulty of appropriately setting an efficient, positive intercarrier compensation charge, further supports our adoption of bill-and-keep.[1332] Exact identification of efficient termination charges would be extremely complex, and considering the costs of metering, billing, and contract enforcement that come with a non-zero termination charge, we find that the benefits obtained from imposing even a very careful estimate of the efficient interconnection charge would be more than offset by the considerable costs of doing so.[1333]

754. Some parties have expressed concerns that bill-and-keep arrangements will encourage carriers to "dump" traffic on other providers' terminating network, because the cost of termination to the carrier delivering the traffic will be zero.[1334] Such concerns, however, appear to be largely speculative; no commenter has identified a concrete reason why any carrier would engage in such "dumping" or how it would do so. Indeed, there has been no evidence that any such "dumping" has occurred in the wireless industry, which has operated under a similar framework. Even so, if a long distance carrier decided to deliver all of its traffic to a terminating LECs' tandem switch, that practice could result in tandem exhaust, requiring the terminating LEC to invest in additional switching capacity. To help address this concern, we confirm that a LEC may include traffic grooming requirements in its tariffs. These traffic grooming requirements specify when a long distance carrier must purchase dedicated DS1 or DS3 trunks to deliver traffic rather than pay per-minute transport charges, a determination based on the amount of traffic going to a particular end office. We believe this accountability and additional information will deter concerns regarding traffic dumping.[1335]

[1330] *See, e.g., Ref. 2009-70-MR-EC-Future of Interconnection Charging Methods* at 74, Nov. 23, 2010, http://ec.europa.eu/information_society/policy/ecomm/doc/library/ext_studies/2009_70_mr_final_study_report_F_101123.pdf ("In the future, the voice total costs will be much smaller in an 'NGN only' network than in a 'PSTN only' legacy network. The share of the voice total costs in the total costs of the network will be small in an NGN network."); *see also* Letter from Donna N. Lampert, Counsel for Google, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket Nos. 10-90, 05-337; GN Docket No. 09-51, Attach. at 2-7 (filed June 16, 2011) (Google June 16, 2011 *Ex Parte* Letter) (arguing that "standalone voice will represent a vanishingly small segment of overall network traffic" and illustrating "the changing nature of the relationship between traditional voice traffic and modern IP-based communications"). "The move to bill-and-keep would rid the intercarrier compensation system of the inefficiencies and arbitrage opportunities that have plagued it and speed the transition to more efficient feature-rich IP networks. . . ." T-Mobile Oct. 20, 2011 *Ex Parte* Letter at 1.

[1331] *See, e.g.*, *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6610-14, paras. 253-61; 6808-12, paras. 248-56.

[1332] We note that the statutory text of section 252(d)(2) provides that the methodology for reciprocal compensation should allow for the recovery of the "additional costs" of a call which equals incremental cost, not the average or total cost of transporting or terminating a call. *See* 47 U.S.C. § 252(d)(2)(A)(ii) (noting that costs should be approximate "the additional costs of terminating such calls").

[1333] We acknowledge that it is also possible that in some instances, the efficient termination rates of preceding models would not allow overall cost recovery. In that case, while the efficient *cost-covering* termination rate could lie above incremental cost, we also conclude that it is more efficient to ensure cost recovery via direct subsidies, such as the CAF, than by distorting usage prices.

[1334] *See, e.g.,* Verizon *USF/ICC Transformation NPRM* Comments at 13-16.

[1335] We would expect that these handoffs would recognize the same engineering principles that govern current network configurations. To the extent that one party to the interconnection agreement desired to deviate from those (continued…)

755. *Bill-and-Keep Is Appropriate Even If Traffic Is Imbalanced*. The Commission initially permitted states to impose bill-and-keep arrangements on providers, but did so with the caveat that traffic should be roughly in balance.[1336] At the time, the Commission reasoned that carriers incur costs for terminating traffic, and bill-and-keep may not enable the recovery of such costs from other carriers.[1337] The Commission also expressed concern that, in a reciprocal compensation arrangement, bill-and-keep may "distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic."[1338]

756. In light of technological advancements and our rejection of the calling party network pays model in favor of a model that better tracks cost causation principles, we revisit the Commission's prior concerns and conclusions supporting the "balanced traffic limitation."[1339] First, we reject claims that, as a policy matter, bill-and-keep is only appropriate in the case of roughly balanced traffic.[1340] Concerns about the balance of traffic exchanged reflect the view that the calling party's network should bear all the costs of a call. Given the understanding that both the calling and called party benefit from a call, the "direction" of the traffic—i.e., which network is originating or terminating the call—is no longer as relevant.[1341] Under bill-and-keep, "success in the marketplace will reflect a carrier's ability to serve customers efficiently, rather than its ability to extract payments from other carriers."[1342] Additionally, bill-and-keep is most consistent with the models used for wireless and IP networks, models that have flourished and promoted innovation and investment without any symmetry or balanced traffic requirement.[1343]

757. Second, as already explained, we reject the assertion that bill-and-keep does not enable cost recovery. Although a bill-and-keep approach will not provide for the recovery of certain costs via

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standards, the interconnection agreement could establish the amount, if any, the deviating entity should compensate the other carrier. We seek comment on these and other possible issues related to traffic dumping in the attached FNPRM. *See supra* Section XVII.N.

[1336] 47 C.F.R. § 51.713(b) ("A state commission may impose bill-and-keep arrangements if the state commission determines that the amount of telecommunications traffic from one network to the other is roughly balanced with the amount of telecommunications traffic flowing in the opposite direction, and is expected to remain so, and no showing has been made pursuant to § 51.711(b) [permitting asymmetrical rates based on a cost study]").

[1337] *Local Competition First Report and Order*, 11 FCC Rcd at 16055, para. 1112.

[1338] *Id; but see ISP Remand Order*, 16 FCC Rcd at 9183-85, paras. 71-74.

[1339] As such, we revise the relevant rules as described in Appendix A below.

[1340] *See* COMPTEL *USF/ICC Transformation NPRM* Comments at 33-34; Cincinnati Bell *USF/ICC Transformation NPRM* Reply at 11-12; Cbeyond et al. *USF/ICC Transformation NPRM* Comments at 14-15; EarthLink *USF/ICC Transformation NPRM* Reply at 9; PAETEC et al. *USF/ICC Transformation NPRM* Reply at 17; Letter from Jeffrey S. Lanning, Ass't Vice President – Federal Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 06-122, 05-337, 04-36, 03-109, CC Docket Nos. 01-92, 99-200, 99-68, 96-98, 96-45, GN Docket No. 09-45 at 3 (filed Oct. 21, 2011) (CenturyLink Oct. 21, 2011 *Ex Parte* Letter). We also discuss below certain arguments that, in the context of reciprocal compensation under the section 251 and 252 framework, bill-and-keep only may be lawfully imposed in the context of roughly balanced traffic. *See infra* XII.A.2.

[1341] *See supra* paras. 744-747.

[1342] *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4787, App. C.

[1343] For instance, commenters suggest that "eventually most traffic will flow over VoIP" and "the only barriers to such migration are the antiquated ICC regimes." MetroPCS *August 3 PN* Comments at 8.

intercarrier compensation, it will still allow for cost recovery via end-user compensation and, where necessary, explicit universal service support.[1344] We find that although the statute provides that each carrier will have the opportunity to recover its costs, it does not entitle each carrier to recover those costs from another carrier, so long as it can recover those costs from its own end users and explicit universal service support where necessary.

758. As a result, we depart from the Commission's earlier articulated concern that bill-and-keep distorts carriers incentives. To the contrary, we conclude, based on policy and economic theory, that bill-and-keep best addresses the significant arbitrage incentives inherent in today's system.[1345]

759. These conclusions are consistent with the Commission's more recent consideration of bill-and-keep arrangements in the context of ISP-bound traffic. Specifically, in the *ISP Remand Order*, the Commission stated that its initial "concerns about economic inefficiencies associated with bill and keep missed the mark" because they incorrectly assumed that the "calling party was the sole cost causer of the call."[1346] The Commission tentatively concluded that bill-and-keep would provide a viable solution to the market distortions caused by ISP-bound traffic.[1347] Indeed, the Commission's experience with ISP-bound traffic suggests that a bill-and-keep approach may be most efficient where the traffic is not balanced because the obligation to pay reciprocal compensation in such situations may give rise to uneconomic incentives.[1348] We therefore conclude it is appropriate to repeal section 51.713 of our rules.[1349]

2. Legal Authority

760. Our statutory authority to implement bill-and-keep as the default framework for the exchange of traffic with LECs flows directly from sections 251(b)(5) and 201(b) of the Act.[1350] Section 251(b)(5) states that LECs have a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[1351] Section 201(b) grants the Commission authority to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[1352] In *AT&T Corp. v. Iowa Utilities Board*, the Supreme Court held that "the grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,'

[1344] *See infra* Section XIII.

[1345] We find that the adoption of a bill-and-keep methodology will help address long-term arbitrage problems while access stimulation and phantom traffic rules adopted today will address arbitrage in the near term. *See supra* Section XI.

[1346] *See Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 at 9183-83, paras. 71-74 (2001) (*ISP Remand Order*), *remanded but not vacated by WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002).

[1347] *See id*. at 9155, para. 6.

[1348] As discussed above, bill-and-keep avoids the incentives for arbitrage that can arise from excessive intercarrier compensation rates without imposing the regulatory costs of other regimes. *See supra* paras. 752-754.

[1349] *See* 47 C.F.R. § 51.713. *See supra* Appendix A.

[1350] We have additional statutory authority under section 332 to regulate interconnection arrangements involving CMRS providers. *See infra* paras. 834-836.

[1351] 47 U.S.C. § 251(b)(5).

[1352] 47 U.S.C. § 201(b).

which include §§ 251 and 252."[1353] As discussed below, we may exercise this rulemaking authority to define the types of traffic that will be subject to section 251(b)(5)'s reciprocal compensation framework and to adopt a default compensation mechanism that will apply to such traffic in the absence of an agreement between the carriers involved.

761. *The Scope of Section 251(b)(5)*. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." The Commission initially interpreted this provision to "apply only to traffic that originates and terminates within a local area."[1354] In the 2001 *ISP Remand Order*, however, the Commission noted that its initial reading is inconsistent with the statutory terms.[1355] The Commission explained that section 251(b)(5) does not use the term "local,"[1356] but instead speaks more broadly of the transport and termination of "telecommunications."[1357] As defined in the Act, the term "telecommunications" means the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received"[1358] and thus encompasses communications traffic of any geographic scope (e.g., "local," "intrastate," or "interstate") or regulatory classification (e.g., "telephone exchange service,"[1359] "telephone toll service,"[1360] or "exchange access"[1361]). The Commission reiterated this interpretation of section 251(b)(5) in its *2008 Order and ICC/USF FNPRM*,[1362] and we proposed in the *ICC/USF Transformation NPRM* to make clear that section 251(b)(5) applies to "all telecommunications, including access traffic."[1363]

762. After reviewing the record, we adopt our proposal and conclude that section 251(b)(5) applies to traffic that traditionally has been classified as access traffic. Nothing in the record seriously calls into question our conclusion that access traffic is one form of "telecommunications." By the express terms of section 251(b)(5), therefore, when a LEC is a party to the transport and termination of access traffic, the exchange of traffic is subject to regulation under the reciprocal compensation framework.

763. We recognize that the Commission has not previously regulated access traffic under section 251(b)(5). The reason, as the Commission has previously explained,[1364] is section 251(g).[1365]

[1353] *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 378 (1999).

[1354] *Local Competition First Report and Order*, 11 FCC Rcd at 16013 para. 1034.

[1355] *See generally ISP Remand Order*, 16 FCC Rcd 9151 (2001).

[1356] *ISP Remand Order*, 16 FCC Rcd at 9166-67 para. 34.

[1357] *ISP Remand Order*, 16 FCC Rcd at 9165-66 para. 31-32.

[1358] 47 U.S.C. § 153(43).

[1359] *See id.* at § 153(47).

[1360] *See id.* at § 153(48).

[1361] *See id.* at § 153(16).

[1362] *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6479, paras. 7-8.

[1363] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4712-13, para. 514.

[1364] *ISP Remand Order*, 16 FCC Rcd at 9165-66 para. 31; *2008 Order and ICC/USF FNPRM,* 24 FCC Rcd at 6483, para. 16.

[1365] 47 U.S.C. § 251(g).

Section 251(g) is a "transitional device"[1366] that requires LECs to continue "provid[ing] exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation)" previously in effect "until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[1367] Section 251(g) thus preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation," and thereby precluded the application of section 251(b)(5) to such traffic "unless and until the Commission by regulation should determine otherwise."[1368]

764. In this Order, we explicitly supersede the traditional access charge regime and, subject to the transition mechanism we outline below, regulate terminating access traffic in accordance with the section 251(b)(5) framework. Consistent with our approach to comprehensive reform generally and the desire for a more unified approach, we find it appropriate to bring all traffic within the section 251(b)(5) regime at this time, and commenters generally agree.[1369] Doing so is key to advancing our goals of encouraging migration to modern, all IP networks; eliminating arbitrage and competitive distortions; and eliminating the thicket of disparate intercarrier compensation rates and payments that are ultimately borne by consumers. Even though the transition process detailed below is limited to terminating switched access traffic and certain transport traffic, we make clear that the legal authority to adopt the bill-and-keep methodology described herein applies to all intercarrier compensation traffic. As noted below, we seek comment on the transition and recovery for originating access and transport in the accompanying FNPRM.

765. We reject arguments that section 251(b)(5) does not apply to intrastate access traffic. Like other forms of carrier traffic, intrastate access traffic falls within the scope of the broad term "telecommunications" used in section 251(b)(5). "Had Congress intended to exclude certain types of telecommunications traffic," such as "local" or "intrastate" traffic, "from the reciprocal compensation framework, it could have easily done so by using more restrictive terms to define the traffic subject to section 251(b)(5)."[1370] Nor do we believe that section 2(b) of the Act, which generally preserves state authority over intrastate communications, bears on our interpretation of section 251(b)(5).[1371] As the Supreme Court noted, "[s]uch an interpretation [of section 2(b)] would utterly nullify the 1996 amendments, which clearly 'apply' to intrastate services, and clearly confer 'Commission jurisdiction'

[1366] *WorldCom v. FCC*, 288 F.3d 429, 430 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 1012 (2003); *see also Competitive Tel. Ass'n v. FCC*, 309 F.3d 8, 15 (D.C. Cir. 2002).

[1367] 47 U.S.C. § 251(g).

[1368] *ISP Remand Order*, 16 FCC Rcd at 9169, para. 39.

[1369] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4711, para. 512. *See generally id*. at 4710-15, paras. 509-22 (seeking comment on the Commission's legal authority to accomplish comprehensive intercarrier compensation reform). *See* AT&T *USF/ICC Transformation NPRM* Comments at 38-43; CBeyond et al. *USF/ICC Transformation NPRM* Comments at 7-11; Comcast *USF/ICC Transformation NPRM* Comments at 6-8; MetroPCS *USF/ICC Transformation NPRM* Comments at 9-12; Time Warner Cable *USF/ICC Transformation NPRM* Comments at 3-5; *but see* NARUC *USF/ICC Transformation NPRM* Comments at 10-12.

[1370] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4712, para. 513; *see* NARUC *USF/ICC Transformation NPRM* Comments at 10.

[1371] *See* Massachusetts DTC *USF/ICC Transformation NPRM* Comments at 20; New York Commission *USF/ICC Transformation NPRM* Comments at 12; State Members *USF/ICC Transformation NPRM* Comments at 143; NASUCA *August 3 PN* Comments at 30.

over some matters."[1372] Indeed, if section 2(b) limited the scope of section 251(b)(5), we could not apply the reciprocal compensation framework even to local traffic between a CLEC and an ILEC—the type of traffic that has been subject to our reciprocal compensation rules since the Commission implemented the 1996 Act. We see no reason to adopt such an absurd reading of the statute.

766. We also reject arguments that sections 251(g) and 251(d)(3) somehow limit the scope of the "telecommunications" covered by section 251(b)(5).[1373] Whatever protections these provisions provide to state access regulations, it is clear that those protections are not absolute. As noted above, section 251(g) preserves access charge rules only during a transitional period, which ends when we adopt superseding regulations. Accordingly, to the extent section 251(g) has preserved state intrastate access rules against the operation of section 251(b)(5) until now, this rulemaking Order supersedes that provision.[1374]

767. Section 251(d)(3) states that "[i]n prescribing and enforcing regulations to implement the requirements of this section, the Commission shall not preclude the enforcement of any regulation, order, or policy of a State commission that— (A) establishes access and interconnection obligations of local exchange carriers; (B) is consistent with the requirements of this section; and (C) does not substantially prevent implementation of the requirements of this section and the purposes of this part."[1375] As the Commission has previously observed, "section 251(d)(3) of the Act independently establishes a standard

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[1372] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 380.

[1373] *See* Massachusetts DTC *USF/ICC Transformation NPRM* Comments at 20-21; NARUC *USF/ICC Transformation NPRM* Comments at 12; State Members *USF/ICC Transformation NPRM* Comments at 143-144; *see also* Ohio Commission *USF/ICC Transformation NPRM* Comments at 58.

[1374] Commenters have different views on whether section 251(g) preserves the intrastate as well as interstate access regime. *Compare* Massachusetts DTC *USF/ICC Transformation NPRM* Comments at 20-21; Arizona Commission *USF/ICC Transformation NPRM* Reply at 4-5 *with* Nebraska Rural Companies *August 3 PN* Comments at 19. If section 251(g) does not apply to state access regulations, it is unclear what other provision of the Act would prevent section 251(b)(5) from directly applying to intrastate access traffic, given that section 251(d)(3) does not speak to the preemptive effect of the statute. As we noted in the *Local Competition First Report and Order*, "although section 251(g) does not directly refer to intrastate access charge mechanisms, it would be incongruous to conclude that Congress was concerned about the effects of the potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms." *Local Competition First Report and Order*, 11 FCC Rcd at 15869, para. 732. *See also, e.g.*, *Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) (*Competitive Telecomms. Ass'n*) (finding it "clear from the Act that Congress did not intend all access charges to move to cost-based pricing, at least not immediately. The Act plainly preserves certain rate regimes already in place."). Moreover, as we explained in the *USF/ICC Transformation NPRM*, "[t]he court order accompanying the AT&T consent decree made clear that the decree required access charges to be used in both the interstate and intrastate jurisdictions: 'Under the proposed decree, state regulators will set access charges for intrastate interexchange service and the FCC will set access charges for interstate interexchange service.' *AT&T*, 552 F. Supp. at 169 n.161. Because both the interstate and intrastate access charge systems were created by the same consent decree, it is reasonable to conclude that both systems were preserved by section 251(g)." *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4712 n.750. We need not resolve this issue, however, because all traffic terminated on a LEC will, going forward, be governed by section 251(b)(5) regardless of whether section 251(g) previously covered the state intrastate access regime.

[1375] 47 U.S.C. § 251(d)(3). We note that section 261(c) likewise preserves state authority to "impos[e] requirements on a telecommunications carrier for intrastate services that are necessary to further competition in the provision of telephone exchange service or exchange access, *as long as the State's requirements are not inconsistent with this part or the Commission's regulations to implement this part*." 47 U.S.C. § 261(c) (emphasis added).

very similar to the judicial conflict preemption doctrine,"[1376] and "[i]ts protections do *not* apply when the state regulation is inconsistent with the requirements of section 251, *or* when the state regulation substantially prevents implementation of the requirements of section 251 or the purposes of sections 251 through 261 of the Act."[1377] Moreover, "in order to be consistent with the requirements of section 251 and not 'substantially prevent' implementation of section 251 or Part II of Title II, state requirements must be consistent with the FCC's implementing regulations."[1378] In other words, section 251(d)(3) instructs the Commission not to preempt state regulations that are consistent with and promote federal rules and policies, but it does not protect state regulations that frustrate the Act's policies or our implementation of the statute's requirements.[1379] As discussed in this Order, we are bringing all telecommunications traffic terminated on LECs, including intrastate switched access traffic, into the section 251(b)(5) framework to fulfill the objectives of section 251(b)(5) and other provisions of the Act.[1380] Consequently, we find that, to the extent section 251(d)(3) applies in this context, it does not prevent us from adopting rules to implement the provisions of section 251(b)(5) and applying those rules to traffic traditionally classified as intrastate access.[1381]

768. Finally, we reject the view of some commenters that the pricing standard set forth in

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[1376] *BellSouth Telecommunications, Inc. Request for Declaratory Ruling that State Commissions May Not Regulate Broadband Internet Access Services by Requiring BellSouth to Provide Wholesale or Retail Broadband Services to Competitive LEC UNE Voice Customers*, WC Docket No. 03-251, Memorandum Opinion and Order and Notice of Inquiry, 20 FCC Rcd 6830 at 6839, para. 19 (2005) (footnote references omitted).

[1377] *Id.* at 6842, para. 23 (emphasis in original).

[1378] *Local Competition First Report and Order*, 11 FCC Rcd at 15550, para. 103.

[1379] In light of our interpretation of section 251(d)(3), we need not resolve whether "[t]he word 'access' in section 251(d)(3) . . . refers not to access charge obligations, but to unbundled network element requirements." *See* ABC Plan Proponents *August 3 PN* Reply at 22-23.

[1380] *See supra* Section XII.A.

[1381] We also disagree with commenters' claims that the timing requirements of section 251(d)(1) mean that, if the Commission had authority to supersede existing intrastate access regulations, such authority expired "fifteen years ago." *See* State Members *USF/ICC Transformation NPRM* Comments at 144. Section 251(d)(1) provides that "[w]ithin 6 months after [February 8, 1996,] the Commission shall complete all actions necessary to establish regulations to implement the requirements of this section." 47 U.S.C. § 251(d)(1). However, the actions that were "necessary" to implement section 251 at the time of the 1996 Act do not constitute the entire universe of regulations that may be necessary or appropriate to implement those provisions in the future. Thus, although the Commission adopted initial regulations implementing section 251(b)(5) in the *Local Competition First Report and Order*, it has modified them since. *See, e.g., ISP Remand Order*, 16 FCC Rcd 9151 (2001). Our interpretation also is reinforced by the historical relationship between access charges as implicit subsidy mechanisms and the goal of universal service. Although Congress provided a six month deadline for the initial implementation of section 251, it did not provide a similar deadline for implementing the universal service requirements of section 254. As the Eighth Circuit recognized, if access charges moved immediately to the section 251(b)(5) framework, it potentially could threaten universal service given the lack of a six month deadline for the establishment of explicit universal service support mechanisms. *See Competitive Telecomms. Ass'n*, 117 F.3d at 1073-76. We note that the Commission did, in fact, assert authority to address intrastate access charges in the *Local Competition First Report and Order*, 11 FCC Rcd at 15869, paras. 732-33, although that action was reversed by this same *Competitive Telecomms. Ass'n* decision. *See Competitive Telecomms. Ass'n*, 117 F.3d at 1075 n.5. That decision preceded the Supreme Court's holding that the Commission has rulemaking authority under section 201(b) to implement the requirements of section 251 of the Act. *See Iowa Utils. Bd. v. FCC*, 525 U.S. 366, 377-86 (1999).

section 252(d)(2)(A) limits the scope of section 251(b)(5).[1382] As the Commission explained in the *2008 Order and ICC/USF FNPRM*, section 252(d)(2)(A)(i) "deals with the mechanics of who owes what to whom, it does not define the scope of traffic to which section 251(b)(5) applies."[1383] The Commission noted that construing "the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5)"[1384] would nonsensically suggest that "Congress intended the tail to wag the dog."[1385] We reaffirm that conclusion here.

769. *Authority To Adopt Bill-and-Keep as a Default Compensation Standard*. We conclude that we have the statutory authority to establish bill-and-keep as the default compensation arrangement for all traffic subject to section 251(b)(5). That includes traffic that, prior to this Order, was subject to the interstate and intrastate access regimes, as well as traffic exchanged between two LECs or a LEC and a CMRS carrier.

770. Section 201(b) states that "[t]he Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[1386] As the Supreme Court held in *Iowa Utilities Board*, section 201(b) of the Act "means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252."[1387] Moreover, section 251(i) of the Act states that "[n]othing in this section [section 251] shall be construed to limit or otherwise affect the Commission's authority under section 201."[1388] Section 251(i) "fortifies [our] position" that we have authority to regulate the default compensation arrangement applicable to traffic subject to section 251(b)(5).[1389]

771. We conclude that we have statutory authority to establish bill-and-keep as a default compensation mechanism with respect to interstate traffic subject to section 251(b)(5).[1390] Section 201 has long conferred authority on the Commission to regulate interstate communications to ensure that "charges, practices, classifications, and regulations" are "just and reasonable" and not unreasonably discriminatory.[1391] Indeed, the D.C. Circuit recently upheld the Commission's authority under section

[1382] *See* NARUC *USF/ICC Transformation NPRM* Comments at 10-11; New York Commission *USF/ICC Transformation NPRM* Comments at 10-11.

[1383] *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6481, para. 12.

[1384] *Id.* at 6480, para. 11.

[1385] *Id*.

[1386] 47 U.S.C. § 201(b).

[1387] *AT&T v. Iowa Utilities Bd.*, 525 U.S. at 378.

[1388] 47 U.S.C. § 251(i).

[1389] *Core Commc'ns. Inc. v. FCC*, 592 F.3d 139, 143 (D.C. Cir. 2010) (*Core*).

[1390] Some commenters argue that the Commission may prescribe a rate for interstate services only if it undertakes the rate prescription process set forth in Section 205 of the Act. *See* 47 U.S.C. § 205. *See* EarthLink *August 3 PN* Comments at 28 (citing *AT&T Co. v. FCC*, 487 F.2d 865 (2d Cir. 1973) (*AT&T*)); *see also* Core *USF/ICC Transformation NPRM* Comments at 8-9; SureWest *USF/ICC Transformation NPRM* Comments at 14-22. We disagree. In *AT&T*, the Second Circuit held that the Commission may not require a carrier to seek permission to file a tariff effecting a rate increase, but instead must process such a tariff in accordance with the procedures set forth in sections 203 to 205 of the Act. Nothing in that decision calls into question our authority to adopt rules to define what constitutes a just and reasonable rate for purposes of section 201. *See, e.g.*, *Cable & Wireless, PLC v. FCC*, 166 F.3d 1224 (D.C. Cir. 1999).

[1391] 47 U.S.C. § 201; *see also, e.g.*, *NARUC v. FCC*, 746 F.2d 1492, 1498 (D.C. Cir. 1984).

201 to establish interim rates for ISP-bound traffic, which the Commission had found to also be subject to section 251(b)(5).[1392]

772. In any event, we conclude that we have authority, independent of our traditional interstate rate-setting authority in section 201, to establish bill-and-keep as the default compensation arrangement for all traffic subject to section 251(b)(5), including intrastate traffic. Although section 2(b) has traditionally preserved the states' authority to regulate intrastate communications, after the 1996 Act section 2(b) has "less practical effect" because "Congress, by extending the Communications Act into local competition, has removed a significant area from the States' exclusive control."[1393] Thus, "[w]ith regard to the matters addressed by the 1996 Act," Congress "unquestionably" "has taken the regulation of local telecommunications competition away from the States,"[1394] and, as the Supreme Court has held, "the administration of the new *federal* regime is to be guided by federal-agency regulations."[1395] Our rulemaking authority in section 201(b) "*explicitly* gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies"[1396] and thereby authorizes our adoption of rules to implement section 251(b)(5)'s directive that LECs have a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[1397]

773. We reject the argument of some commenters that sections 252(c) and 252(d)(2) limit our authority to adopt bill-and-keep.[1398] Section 252(c) provides that states conducting arbitration proceedings under section 252 shall "establish any rates for interconnection, services, or network elements according to" section 252(d).[1399] Section 252(d)(2), in turn, states in relevant part that "[f]or the purposes of compliance by an *incumbent local exchange carrier* with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless they: (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 through a "reasonable approximation of the additional costs of terminating such calls."[1400] Section 252(d)(2) also states that the pricing standard it sets forth "shall not be construed . . . to preclude arrangements . . . that waive mutual

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[1392] *See Core*, 592 F.3d 139; *see also 2008 Order and USF/ICC FNPRM*, 24 FCC Rcd at 6481, paras. 11-12 (finding that the "Commission has authority under section 201(b) to adopt rules to fill [] gap[s]" in section 252). In the *2008 Order and ICC/USF FNPRM* the Commission observed that sections 201 and 251(i), when read together, "preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic." *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6484-85, para. 21

[1393] *AT&T v. Iowa Utilities Board*, 525 U.S. at 381-82 n.8.

[1394] *Id.* at 378-79 n.6.

[1395] *Id.* (emphasis in original).

[1396] *Id.* at 380.

[1397] 47 U.S.C. § 251(b)(5).

[1398] *See* COMPTEL *USF/ICC Transformation NPRM* Comments at 33-34; NASUCA *USF/ICC Transformation NPRM* Comments at 94, 103-05; Rural Associations *USF/ICC Transformation NPRM* Comments at 22, 26; Pac-West *USF/ICC Transformation NPRM* Comments at 11; CenturyLink Oct. 21, 2011 *Ex Parte* Letter at 2.

[1399] 47 U.S.C. § 252(c)(2).

[1400] 47 U.S.C. § 252(d)(2)(A) (emphasis added).

recovery (such as bill-and-keep arrangements)."[1401] Although the Supreme Court made clear that the Commission may, through rulemaking, establish a "pricing methodology" under section 252(d) for states to apply in arbitration proceedings,[1402] the Eighth Circuit has held that "[s]etting specific [reciprocal compensation] prices goes beyond the FCC's authority to design a pricing methodology and intrudes on the states' right to set the actual rates pursuant to § 252(c)(2)."[1403] Commenters who cite section 252(d) as a limitation on the Commission's authority to adopt bill-and-keep argue that bill-and-keep intrudes on states' rate-setting authority by effectively setting a compensation rate of zero.[1404]

774. We disagree for two reasons. First, the pricing standard in section 252(d) simply does not apply to most of the traffic that is the focus of this Order – traffic exchanged between LECs and IXCs. Section 252(d) applies only to traffic exchanged with an ILEC, so CLEC-IXC traffic is categorically beyond its scope. Even with respect to traffic exchanged with an ILEC, section 252(d) applies only to arrangements between carriers where the traffic "originate[s] on the network facilities of the other carrier," i.e., the carrier sending the traffic for transport and termination. IXCs, however, typically do not originate (or terminate) calls on their own network facilities but instead transmit calls that originate and terminate on distant LECs. Accordingly, to the extent our bill-and-keep rules apply to LEC-IXC traffic, the rules do not implicate any question of the states' authority under section 252(c) or (d) or the Eighth Circuit's interpretation of those provisions.[1405]

775. Second, and in any event, bill-and-keep is consistent with section 252(d)'s pricing standard. Section 252(d)(2)(B) makes clear that "arrangements that waive mutual recovery (such as bill-and-keep arrangements)" are consistent with section 252(d)'s pricing standard.[1406] As explained in the *Local Competition First Report and Order*, this provision precludes any argument that "the Commission and states do not have the authority to mandate bill-and-keep arrangements" or that bill-and-keep is permissible only if it is voluntarily agreed to by the carriers involved.[1407] Bill-and-keep also ensures "recovery of each carrier of costs" associated with transport and termination.[1408] The Act does not specify from whom each carrier may (or must) recover those costs and, under the approach we adopt today, each carrier will "recover" its costs from its own end users or from explicit support mechanisms such as the

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[1401] 47 U.S.C. § 252(d)(2)(B).

[1402] *AT&T v. Iowa Utilities Board*, 525 U.S. at 384.

[1403] *Iowa Utilities Board v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000).

[1404] *See* NASUCA *USF/ICC Transformation NPRM* Reply at 120-23.

[1405] Opponents of bill-and-keep argue that the language in the bill-and-keep "savings clause" in section 252(d)(2)(B)(i) implies the requirement that traffic be roughly in balance for a bill-and-keep arrangement to be appropriate. *See* XO *USF/ICC Transformation NPRM* Comments at 24; EarthLink *USF/ICC Transformation NPRM* Reply at 9. We disagree. Although our rules currently require a rough balance of traffic flows before a state may impose bill-and-keep in an arbitration proceeding, 47 C.F.R. § 51.713, as explained below, we reject that restriction as a matter of policy. *See supra* paras. 755-759. For present purposes, it is sufficient to note that nothing in section 252(d)(2) requires that traffic be balanced before bill-and-keep may be imposed on carriers.

[1406] 47 U.S.C. § 252(d)(2)(B)(i).

[1407] *Local Competition First Report and Order*, 11 FCC Rcd at 16054, para. 1111 (explaining that section 252(d)(2) "would be superfluous if bill-and-keep arrangements were limited to negotiated agreements, because none of the standards in section 252(d) apply to voluntarily-negotiated agreements."); *see also* 47 U.S.C. § 252(a)(1).

[1408] Although bill-and-keep by definition "waive[s] mutual recovery" (47 U.S.C. § 252(d)(2)(B)(i)) in that carriers do not pay each other for transporting and terminating calls, a bill-and-keep framework provides for "reciprocal" recovery because each carrier exchanging traffic is entitled to recover their costs through the same mechanism, i.e., through the rates they charge their own customers.

federal universal service fund.[1409] Thus, bill-and-keep will not limit the amount of a carrier's cost recovery, but instead will alter the source of the cost recovery – network costs would be recovered from carriers' customers supplemented as necessary by explicit universal service support, rather than from other carriers.[1410]

776. Finally, even assuming section 252(d) applies, our adoption of bill-and-keep as a default compensation mechanism would not intrude on the states' role to set rates as interpreted by the Eighth Circuit. To the extent the traffic at issue is intrastate in nature and subject to section 252(d)'s pricing standard, states retain the authority to regulate the rates that the carriers will charge *their end users* to recover the costs of transport and termination to ensure that such rates are "just and reasonable."[1411] Moreover, states will retain important responsibilities in the implementation of a bill-and-keep framework. An inherent part of any rate setting process is not only the establishment of the rate level and rate structure, but the definition of the service or functionality to which the rate will apply.[1412] Under a bill-and-keep framework, the determination of points on a network at which a carrier must deliver terminating traffic to avail itself of bill-and-keep (sometimes known as the "edge") serves this function, and will be addressed by states through the arbitration process where parties cannot agree on a negotiated outcome.[1413] Depending upon how the "edge" is defined in particular circumstances, in conjunction with how the carriers physically interconnect their networks, payments still could change hands as reciprocal compensation even under a bill-and-keep regime where, for instance, an IXC pays a terminating LEC to transport traffic from the IXC to the edge of the LEC's network.[1414] Consistent with their existing role

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[1409] The economic premise of a bill-and-keep regime differs from the calling party network pays (CPNP) philosophy of cost causation. Under CPNP thinking the party that initiated the call is receiving the most benefit from that call. Under the bill-and-keep methodology the economic premise is that both the calling and the called party benefit from the ability to exchange traffic, i.e., being interconnected. This is consistent with policy justifications for bill-and-keep described in the *Intercarrier Compensation NPRM* in which the Commission said "there may be no reason why *both* LECs should not recover the costs of providing these benefits directly from their end users. Bill-and-keep provides a mechanism whereby end users pay for the benefit of making *and* receiving calls." *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9625, para. 37 (emphasis in original).

[1410] "Carriers would need to turn to their own customers (supplemented, in appropriate cases, by explicit universal service support) to recoup their network costs, rather than to other carriers and, ultimately, those carriers' customers." AT&T *USF/ICC Transformation NPRM* Reply at 23.

[1411] 47 U.S.C. § 252(d)(2)(A).

[1412] *See, e.g.*, *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87–313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3051-56, paras. 359-68 (1989) (discussing the need for, and definition of, baskets and bands of services for purposes of price cap regulation of AT&T); *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Thereof Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 85–229, Report and Order, 104 FCC 2d 958, paras. 214-17, 220-22 (1986) (requiring the identification and tariffing of certain Basic Service Elements underlying enhanced services). *See also, e.g.*, 47 C.F.R. § 61.2(a) ("In order to remove all doubt as to their proper application, all tariff publications must contain clear and explicit explanatory statements regarding the rates and regulations."); 47 C.F.R. § 61.54(j) ("The general rules (including definitions), regulations, exceptions, and conditions which govern the tariff must be stated clearly and definitely.").

[1413] In the FNPRM we seek comment on relying on that approach to defining the "edge" for purposes of bill-and-keep more generally, or whether additional Commission guidance or rules would be appropriate. *See infra* Section XVII.N.

[1414] This statement does not suggest any particular outcome with respect to the definition of the "edge," which is an issue we seek comment on below. *See infra* Section XVII.N.

under sections 251 and 252, which we do not expand or contract, states will continue to have the responsibility to address these issues in state arbitration proceedings, which we believe is sufficient to satisfy any statutory role that the states have under section 252(d) to "determin[e] the concrete result in particular circumstances" of the bill-and-keep framework we adopt today.[1415]

777. *Originating Access*. Some parties contend that the Commission lacks authority over originating access charges under section 251(b)(5) because that section refers only to transport and termination.[1416] Other commenters urge the Commission to act swiftly to eliminate originating access charges.[1417] Although we conclude that the originating access regime should be reformed, at this time we establish a transition to bill-and-keep only with respect to terminating access charge rates. The concerns we have with respect to network inefficiencies, arbitrage, and costly litigation are less pressing with respect to originating access, primarily because many carriers now have wholesale partners or have integrated local and long distance operations.

778. As discussed above, section 251(g) provides for the continued enforcement of certain pre-1996 Act obligations pertaining to "exchange access" until "such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[1418] Exchange access is defined to mean "the offering of access to telephone exchange services or facilities for the purpose of the *origination* or termination of telephone toll services."[1419] Thus, section 251(g) continues to preserve originating access until the Commission adopts rules to transition away from that system. At this time, we adopt transition rules only with respect to terminating access and seek comment in the FNPRM on the ultimate transition away from such charges as part of the transition of all access charge rates to bill-and-keep.[1420] In the meantime, we will cap interstate originating access rates at their current level, pending resolution of the issues raised in our FNPRM.[1421]

779. *Section 332 and Wireless Traffic*. With respect to wireless traffic exchanged with a LEC, we have independent authority under section 332 of the Act to establish a default bill-and-keep methodology that will apply in the absence of an interconnection agreement. Although we have not previously exercised our authority under section 332 to reform intercarrier compensation charges paid by or to wireless providers, we have clear authority to do so, and this authority extends to both interstate and intrastate traffic.[1422] The Eighth Circuit has construed the Act to authorize the Commission to set reciprocal compensation rates for CMRS providers.[1423] In reaching that decision, the court relied on:

[1415] *AT&T v. Iowa Utilities Board*, 525 U.S. at 384.

[1416] *Compare* CBeyond et al. *USF/ICC Transformation NPRM* Comments at 10-11 *with* Global Crossing *USF/ICC Transformation NPRM* Comments at 12-13.

[1417] *See* iBasis *August 3 PN* Comments at 1-2.

[1418] 47 U.S.C. § 251(g).

[1419] 47 U.S.C. § 153(16) (emphasis added).

[1420] *See supra* Section XVII.M.

[1421] *See infra* Section XII.C.

[1422] We note that the Commission relied on its section 332 authority to adopt rules prohibiting LECs from imposing compensation obligations on CMRS carriers for non-access traffic pursuant to tariff. *See Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855, 4863-64, para. 14 (2005) (*T-Mobile Order*); *see also infra* Sections XII.C.5 and XV.

[1423] *Iowa Utils. Bd. v. FCC,* 120 F.3d 753, 800 n.21 (8th Cir. 1997), *vacated and remanded in part in other grounds sub nom. AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

(a) section 332(c)(1)(B), which obligates LECs to interconnect with wireless providers "pursuant to the provisions of section 201;"[1424] (b) section 2(b), which provides that the Act should not be construed to apply or to give the Commission jurisdiction with respect to charges in connection with intrastate communication service by radio "[e]xcept as provided in . . . section 332;"[1425] and (c) the preemptive language in section 332(c)(3)(A), which prohibits states from regulating the entry of or the rates charged by CMRS providers.[1426] The D.C. Circuit likewise recently acknowledged the Commission's authority in this regard, observing that the Commission historically had elected to leave intrastate access rates imposed on CMRS providers to state regulation, and recognizing: "That the FCC *can* issue guidance does not mean it must do so."[1427] Accordingly, we conclude that we have separate authority under sections 201 and 332(c) to establish rules governing the exchange of both intrastate and interstate traffic between LECs and CMRS carriers.

780. *Section 254(k)*. We also reject the claims of some commenters that a bill-and-keep approach would violate section 254(k) of the Act.[1428] Section 254(k) of the Act states that a telecommunications carrier "may not use services that are not competitive to subsidize services that are subject to competition," and that the Commission "shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[1429] Some parties express concern that, under a bill-and-keep regime, retail voice telephone services subject to universal service support would bear more than "a reasonable share of the joint and common costs."[1430]

781. The United States Court of Appeals for the Eighth Circuit previously considered and rejected similar arguments concerning the reallocation of loop costs between end users and IXCs.[1431] Specifically, the court considered whether the recovery of joint and common costs must be borne mutually by end-users and by IXCs, and whether a shift in cost recovery from IXCs to end-users violated section 254(k) of the Act.[1432] As to the first provision of section 254(k), the court found that "[s]ection 254(k) was not designed to regulate the apportionment of loop costs between end-users and IXCs because this allocation does not involve improperly shifting costs from a competitive to a non-competitive

[1424] 47 U.S.C. § 332(c)(1)(B).

[1425] *Id.* § 152(b).

[1426] *Id.* § 332(c)(3)(A).

[1427] *MetroPCS California, LLC v. FCC*, 644 F.3d 410, 414 (D.C. Cir. 2011) (*MetroPCS California v. FCC*) (emphasis in original). *See also id*. (noting the Commission's position in the *North County v. MetroPCS* decision "that '[w]hether to depart so substantially from such long-standing and significant Commission precedent [and to proceed to regulate intrastate rates on this basis] is a complex question better suited to a more general rulemaking proceeding'"). We find this rulemaking proceeding the appropriate context to address this issue.

[1428] *See, e.g.,* Nebraska Rural Companies *USF/ICC Transformation NPRM* Comments at 31; State Members *USF/ICC Transformation NPRM* Comments at 150; SureWest *USF/ICC Transformation NPRM* Reply at 8.

[1429] 47 U.S.C. § 254(k).

[1430] For example, commenters contend that "long distance toll carriers and other service providers, along with their end users, benefit from the utilization of expensive RLEC networks to originate, transport and terminate calls" and that bill-and-keep "would prohibit a reasonable allocation of costs to these other carriers that reflects a rational measure of their use of RLEC networks." Rural Associations *USF/ICC Transformation NPRM* Comments at 23-24. *See also* Nebraska Rural Companies *USF/ICC Transformation NPRM* Comments at 31.

[1431] *See Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 559 (8th Cir. 1998).

[1432] *See id*.

service," even if "a LEC allocates all of its local loop costs to the end-user."[1433] Further, the court disagreed that an increase in the SLC price cap violates the second part of 254(k) by causing services included in the definition of universal service to bear more than a reasonable share of the joint and common costs of facilities used to provide those services. The court explained that the "SLC is a method of recovering loop costs, not an allocation of costs between supported and unsupported services"[1434] in violation of section 254(k). We concur with the Eighth Circuit's analysis and conclude that it applies equally in this context. A bill-and-keep framework resolves whether a carrier will recover its costs from its end users or from other carriers; the underlying service whose costs are being recovered is the same, however, so no costs are being improperly shifted between competitive and non-competitive services for purposes of section 254(k).[1435]

3. Other Proposals Considered

a. Low Uniform Per-Minute Rate

782. Several parties have suggested that the Commission adopt a low uniform per-minute access charge rather than a bill-and-keep approach.[1436] For example, some stakeholders propose an end state of \$0.0007 for terminating switched and certain terminating transport elements.[1437] Although we recognize that a low uniform rate would result in substantially reduced intercarrier compensation rates, we find several difficulties with this approach.

[1433] *Id*.

[1434] *Id*.

[1435] We find the bill-and-keep methodology consistent with section 254(k). As to the first provision of section 254(k), we find this approach more consistent with the statute than the previous regime. Access charges were designed to include a subsidy of the local network. *See, e.g., 2008 Order and USF/ICC FNPRM*, 24 FCC Rcd at 6569-70, 6574-75, App. A at paras. 165-66, 173-75; *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4706, 4722, paras. 501, 540. Given the historical under-allocation of costs to non-regulated services that use the local network, the use of access charges—which are not subject to competition—to subsidize the local network would, in effect, subsidize such services, which can be subject to competition. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4573, 4732, paras. 52, 569. *See also, e.g., CALLS Order*, 15 FCC Rcd at 13001, para. 98 ("To date, we are not aware of any incumbent LECs that have allocated any loop costs to ADSL services."). *See Petition of Qwest Corporation For Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, Memorandum Opinion and Order, 25 FCC Rcd 8622, 8664, para. 79 & n.238 (2010). *See, e.g., Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules; Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) with Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services*, WC Docket Nos. 02-112, 06-120, CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440, 16460-61, para. 39 (2007) (finding that AT&T and Verizon lack classical market power with respect to certain mass market services, including bundled local and long distance voice telephone service); *id*. at 16466, para. 49 (concluding the same with respect to certain retail enterprise services). Further, as to the second provision of section 254(k), we explain above why we conclude that bill-and-keep best advances the relevant policy considerations. To the extent that our adoption of bill-and-keep results in an additional allocation of joint and common costs to services supported by universal service, we find that to be reasonable based on those policy considerations. *See* 47 U.S.C. § 254(k) (directing the Commission "to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.").

[1436] *See, e.g.,* Verizon *USF/ICC Transformation NPRM* Comments at 7-13; Level 3 *USF/ICC Transformation NPRM* Comments at 8-9.

[1437] *See* ABC Plan, Attach 1 at 9.

783. *Relationship to All-IP Networks*. We believe that an end point of a low uniform per-minute rate perpetuates the use of TDM networks, whereas our goal is to facilitate the transition to an all-IP network and to promote IP-to-IP interconnection.[1438] Some commenters claim that the existing intercarrier compensation regime is consistent with investment in IP networks, citing LECs' investments in softswitches for example,[1439] but they do not rebut the conclusion that *per minute* charges are inconsistent with the exchange of traffic on an IP-to-IP basis.[1440] Nor do they cite evidence that carriers that historically have relied heavily on per-minute intercarrier compensation charges—typically incumbent LECs—have nonetheless interconnected on an IP-to-IP basis.[1441] The record affirms the *USF/ICC Transformation NPRM*'s suggestion that per-minute intercarrier compensation charges are an impediment to IP-to-IP interconnection.[1442]

784. *Use in Agreements.* Some commenters observe that members of the industry have entered into negotiated agreements for the exchange of traffic at a $0.0007 rate.[1443] But selected parties' use of a rate in interconnection agreements[1444] does not necessarily support enacting that rate for an entire industry.[1445] The Commission has recognized that the reasonableness of a negotiated rate cannot be

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[1438] *See supra* Section XVII.P.

[1439] *See*, *e.g.*, COMPTEL *USF/ICC Transformation NPRM* Comments at 4-5; PAETEC et al. *USF/ICC Transformation NPRM* Comments at 6-7, n. 16.

[1440] *See*, *e.g.*, Letter from Ad Hoc Telecommunications Users Committee et al., to Julius Genachowski, Chairman, FCC, et al., WC Docket Nos. 10-90, 07-135, 05-337, 03-109, 06-122; GN Docket No. 09-51; CC Docket Nos. 01-92, at 9 (filed Aug. 18, 2011) (Ad Hoc et al. Aug. 18, 2011 *Ex Parte* Letter) ("IP-to-IP traffic today is often exchanged based upon capacity or ports, not per-minute as is the case with circuit-switched TDM traffic. IP network charges are generally driven by peak hour network utilization levels, which are poorly reflected by per-minute charges.").

[1441] Rather, the record reveals that incumbent LECs generally have been reluctant to interconnect on an IP-to-IP basis. *See* Global Crossing *USF/ICC Transformation NPRM* Comments at 7; XO *USF/ICC Transformation NPRM* Reply at 12-13.

[1442] *See, e.g.*, XO *USF/ICC Transformation NPRM* Comments at 22.

[1443] "The $0.0007 per minute rate is also consistent with the rates contained in certain recently negotiated agreements between ILECs and CLECs. For example, Verizon recently entered into a commercial agreement with Bandwidth.com for the exchange of VoIP traffic at $0.0007 per minute." *See* ABC Plan, Attach. 5 at pp. 34-35; Verizon *USF/ICC Transformation NPRM* Comments at 12-13.

[1444] Some commenters also question the extent to which the $0.0007 rate actually is employed in voluntarily negotiated agreements. *See*, *e.g.*, Cablevision and Charter Section XV Reply at 8 ("The fact that the market has been almost universally *unwilling* to provide Verizon with agreements at its preferred rate (with the exception of one small provider that serves PBX customers) is the reason it is asking the Commission to impose such a rate, and should readily dispel any contention that $0.0007 represents a rate for the exchange of IP-originated or IP terminated traffic set by the 'market.'") (emphasis in original).

[1445] A number of commenters argue that $0.0007 cannot be enacted for the entire industry because no cost basis has been offered in the record to justify the rate. Rather, some commenters have provided data taking various approaches to estimating cost that yield different rates higher than $0.0007 per minute. *See* Letter from James Bradford Ramsay, Counsel to the State Members of the Federal State Joint Board on Universal Service, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, at 2 (filed July 14, 2011) ("there is NO record evidence – no empirical data – no actual cost studies – to support imposing a single industry-wide $0.0007 rate as compensatory") (emphasis in original). Other commenters believe that the $0.0007 rate is higher than the cost of termination under other measures, especially as more and more providers move to IP technology. *See* Sprint Section XV Comments at 18, n.32 ("The $.0007 rate (continued…)

evaluated in isolation, but must be considered in the context of the agreement as a whole.[1446] The suggestion to take a rate that appears in some interconnection agreements[1447] in isolation from the other rates, terms, and conditions in that agreement and apply it more broadly therefore conflicts with the Commission's policies regarding interconnection agreements.[1448]

785. For these reasons, we decline to adopt a positive per-minute rate as the end point to reform though we implement $0.0007 per-minute as part of the transition to bill-and-keep, as described below.[1449]

b. Flat-Rated Charges

786. The *USF/ICC Transformation NPRM* also sought comment on the use of flat-rated charges as an alternative pricing methodology.[1450] The possible use of flat-rated charges is a hold over suggestion made prior to the explosion of bundled offerings and the decline of per-minute long-distance calling rates. This approach received limited support in the record, and we decline to adopt it.[1451] Flat-rated charges would continue the present opaque system where customers of one network subsidize customers of another,[1452] and would in all likelihood, result in arbitrary prices being assigned to different interconnecting carriers. Considerable questions remain as to how flat-rated charges would be calculated and structured. Given the potential variability of these rates, we believe such charges would fail to

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was computed some 12 years ago, and Sprint believes that the economic cost of terminating a minute today, particularly using current IP technology, is even lower.").

[1446] *See Implementation of Section 224 of the Act; A National Broadband Plan for Our Future*, WC Docket No. 07-245; GN Docket No. 09-51, 26 FCC Rcd at 5336-37 paras. 217-19. The fact that an agreement was negotiated among companies with roughly comparable bargaining power may be a good reason to judge that agreement as establishing just and reasonable rates, terms and conditions between those two parties. *See id.* at 5334-36, paras. 215-16.

[1447] In the *ISP Remand Order*, the $0.0007 rate was selected as a transitional rate on the glide path to the recovery of costs from end-users based on evidence that some carriers had agreed to this rate in interconnection agreement negotiations. *See ISP Remand Order*, 16 FCC Rcd at 9190-91, para. 85. In the *2008 Order and ICC/USF FNPRM*, the Commission decided to "maintain the $.0007 cap and the mirroring rule pursuant to its section 201 authority. These rules shall remain in place until we adopt more comprehensive intercarrier compensation reform." *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6489 para. 29.

[1448] In particular, the Commission replaced its previous "pick and choose" rule that permitted carriers to opt-in to isolated provisions of existing interconnection agreements with the "all or nothing" rule that required carriers to opt-in to interconnection agreements as a whole. *See generally, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Second Report and Order, 19 FCC Rcd 13494 (2004); *see also* Letter from James M. Tobin, Counsel for Pac-West, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 01-92; WC Docket No. 99-68, Attach. at 5 (filed Oct. 6, 2008) ("The $0.0007 rate was just one element in negotiated interconnection agreements that, like any negotiation, necessarily involved various tradeoffs in other areas, and has no precedential effect when taken in isolation."); Letter from Thomas Jones, Counsel for twtelecom inc. and One Communications Corp., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket Nos. 05-337, 99-68, 04-36, Attach., at 3 (filed Oct. 6, 2008).

[1449] *See infra* Section XII.C.

[1450] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4719 para. 531.

[1451] *See, e.g.*, COMPTEL *USF/ICC Transformation NPRM* Comments at 34-35; GVNW *USF/ICC Transformation NPRM* Comments at 24.

[1452] *See supra* para. 657.

address the arbitrage and marketplace distortions described above that arise from the fact that intercarrier rates are currently above incremental cost.[1453] Nor would a transition to such flat-rated charges address the marketplace distortions that arise from the differential application of intercarrier compensation rules to different providers and different types of traffic.[1454] To the extent that flat-rated charges were based on something other than per-minute rates, the regulatory and implementation costs of setting the rates could be significant.[1455] Flat-rated charges applied to TDM traffic could also continue to hinder the transition to all-IP networks. We agree that if some carriers require other carriers to convert their IP traffic to TDM to complete a call, "merely substituting a flat-rated intercarrier compensation regime for a per minute system is not going to accelerate the deployment of IP networks or speed the transition away from the circuit-switched PSTN."[1456] We find such approaches less consistent with cost causation principles and the goal of ensuring more appropriate pricing signals to end users than the bill-and-keep methodology we adopt.

c. More Limited Rate Reductions

787. Other parties advocate that the Commission initiate reforms to only the highest intercarrier charges and then reassess whether further reform is necessary. The Rural Associations, for instance, propose that RLEC intrastate switched access rates be reduced to interstate levels by individual carriers at the direction of state commissions in tandem with the creation of a federal restructure mechanism.[1457] Carriers would have access to the restructure mechanism if they make certain service and rate reduction commitments.[1458] We have several concerns with the RLEC Plan: There is no mandate for action, action to reduce non-intrastate rates would be delayed for three to five years, and the Plan would not result in uniformity of rates. We find that such a conservative approach to reform would do little to address the multitude of issues described in the *USF/ICC Transformation NPRM* that plague the current intercarrier compensation systems. Again, we find bill-and-keep to be the best option to accomplish comprehensive intercarrier compensation reform.

B. Federal/State Roles in Implementing Bill-and-Keep

788. We turn now to the transition and implementation issues surrounding our move to a bill-and-keep framework, beginning in this section with the threshold question of respective federal and state roles. In the *USF/ICC Transformation NPRM*, we outlined two possible approaches for working with the states to advance sustainable intercarrier compensation reform, given a uniform, national methodology as the end point for reform.[1459] Under the first approach, the states would set the transition and recovery mechanism for intrastate access charges, while the Commission would do so for interstate charges, including providing universal service support to offset carriers' reduced interstate revenues, as required.[1460] The Commission also sought comment on providing incentives for states to implement their transitions expeditiously, for example by making limited federal universal service funds available to assist with intrastate recovery, while setting a firm backstop for states that failed to act. Under the second approach, the Commission would set the transition path and recovery mechanism for all traffic, including

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[1453] *See supra* paras. 662-666.

[1454] *See supra id*.

[1455] *See supra 742*-743.

[1456] COMPTEL *USF/ICC Transformation NPRM* Comments at 35.

[1457] *See* RLEC Plan at 12-22.

[1458] *See id*.

[1459] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4721-28, paras. 537-55.

[1460] *See id*.

intrastate calls, while assuming the burden of USF recovery, as necessary, for both interstate and intrastate revenues reduced as a result of reform.[1461]

789. In response, we received proposals supporting both approaches. Some states supported the bifurcated approach in which they would manage the transition and recovery for intrastate rates while the majority of industry stakeholders supported a more predictable, nationally uniform approach.[1462] The State Members of the Federal State Joint Board, meanwhile, submitted an alternative plan under which states would be responsible for reforming intrastate access charges, even as the federal jurisdiction assumed the primary burden for intrastate revenue recovery through SLC increases up to the current SLC caps and explicit support from the federal universal service fund.[1463] In contrast, other stakeholders proposed that the Commission adopt a uniform, national framework for reductions in interstate and intrastate access charges, as well as recovery from the federal jurisdiction.[1464] The *August 3 Public Notice* sought additional comment on these approaches as well as possible modifications.[1465]

790. We now conclude that a uniform, national framework for the transition of intercarrier compensation to bill-and-keep, with an accompanying federal recovery mechanism, best advances our policy goals of accelerating the migration to all IP networks, facilitating IP-to-IP interconnection, and promoting deployment of new broadband networks by providing certainty and predictability to carriers and investors. Although states will not set the transition for intrastate rates under this approach, we do follow the State Member's proposal regarding recovery coming from the federal jurisdiction. Doing so takes a potentially large financial burden away from states. States will also help implement the bill-and-keep methodology: They will continue to oversee the tariffing of intrastate rate reductions during the transition period as well as interconnection negotiations and arbitrations pursuant to sections 251 and 252, and will have responsibility for determining the network "edge" for purposes of bill-and-keep.[1466]

791. Today, intrastate access rates vary widely. In many states, intrastate rates are significantly higher than interstate rates; in others, intrastate and interstate rates are at parity; and in still other states, intrastate access rates are below interstate levels.[1467] The varying rates have created

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[1461] *See id*.

[1462] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 31, 38-43 (urging federal framework); CTIA *USF/ICC Transformation NPRM* Comments at 40-42 (same); California Commission *USF/ICC Transformation NPRM* Comments at 19-20 (urging current jurisdictional roles); New York Commission *USF/ICC Transformation NPRM* at 7-12 (same).

[1463] *See* State Members *USF/ICC Transformation NPRM* Comments at 153-55.

[1464] *See* ABC Plan at 11-13; Joint Letter at 2-3.

[1465] *Further Inquiry Into Certain Issues in the Universal Service-Intercarrier Compensation Transformation Proceeding*, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; CC Docket Nos. 01-92, 96-45; GN Docket No. 09-51, Public Notice, DA 11-1348 at 10-13 (WCB rel. Aug. 3, 2011) (*August 3 PN*). The *August 3 PN* sought comment on the ABC Plan, which proposed for the Commission to unify all rates consistent with the second option from the *USF/ICC Transformation NPRM*. Comment was also sought on an alternative whereby states would act to reform intrastate access during an initial three year period, following which the Commission would bring intrastate traffic under section 251(b)(5), consistent with the first option. *Id*. at 12.

[1466] *See supra* para. 776; *infra* paras. 1321, 1370.

[1467] Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 80-286, Attach. (filed Dec. 29, 2010) (NECA Dec. 29, 2010 *Ex Parte* Letter) (providing a report showing average intrastate access rates per state for NECA common line 2010 pool members from as low as 1.98 cents per minute to as high as 13.5 cents per minute).

incentives for arbitrage and pervasive competitive distortions within the industry.[1468] Equally important, consumers may not receive adequate price signals to make economically efficient choices because local and long-distance rates do not necessarily reflect the underlying costs of their calls. Depending on their regulatory classification, some carriers charge and collect intercarrier compensation charges, while other carriers do not. A bill-and-keep system will ultimately eliminate the competitive distortions and consumer inequities that arise today when different carriers that use differing technologies (wireline, wireless, VoIP) to perform the same function – complete a call – are subject to different regulatory classifications and requirements.

792. Providing a uniform national transition and recovery framework, to be implemented in partnership with the states, will achieve the benefits of a uniform system and realize the goals of reducing arbitrage and promoting investment in IP networks as quickly as possible. By transitioning all traffic in a coordinated manner, we will minimize opportunities for arbitrage that could be presented by disparate intrastate rates.[1469] For example, our approach will reduce the potential for arbitrage that could result from a widening gap between intrastate and interstate rates if the Commission were to initially reduce interstate rates only.[1470] In addition, a coordinated transition involving both intrastate and interstate traffic will help to align principles of cost causation and provide appropriate pricing signals to end users. Whether completing an interstate or intrastate call, consumers will benefit from a unified system in which arbitrage opportunities that inequitably shift costs among consumers are reduced.

793. By moving in a coordinated manner to address the intercarrier compensation system for all traffic, we will also help to ensure that there is no disruption in the transition to more efficient forms of all IP networks. The record suggests that a "federally managed, geographically neutral" intercarrier compensation regime that eliminates incentives for arbitrage will allow service providers to deploy resources in more productive ways.[1471] In addition, a unified approach for all ICC traffic will help remove obstacles to progress toward all-IP networks where jurisdictional boundaries become less relevant.[1472] In sum, our approach helps to ensure that the intercarrier compensation modernization effort will continue apace without unnecessary delays needed to harmonize disparate state actions.

794. Although several states have sought to reform intrastate access rates, significant challenges remain that could impede our comprehensive reform efforts absent a uniform, national transition.[1473] Under the direction of both state commissions and legislatures, states have taken a variety

[1468] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 13; *see also* NASUCA *USF/ICC Transformation NPRM* Comments at 73 (describing a patchwork of rates).

[1469] *See* AT&T *USF/ICC Transformation NPRM* Comments at 13; CBeyond et al. *USF/ICC Transformation NPRM* Comments at 8-9; AT&T et al. *August 3 PN* Reply at 4.

[1470] CBeyond et al. *USF/ICC Transformation NPRM* Comments at 8-9.

[1471] *See* TIA *August 3 PN* Comments at 10; *see also* AT&T *USF/ICC Transformation NPRM* Comments at 14; Google *USF/ICC Transformation NPRM* Comments at 5.

[1472] *See* Google *USF/ICC Transformation NPRM* Comments at 5; Global Crossing *USF/ICC Transformation NPRM* Comments at 6-7; Ad Hoc et al. Aug. 18, 2011 *Ex Parte* Letter, at 2.

[1473] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4723-24, para. 543 (highlighting efforts of states including Nebraska, Iowa, and Maine); s*ee also* Alaska Commission *USF/ICC Transformation NPRM* Comments at 26-27; IUB *USF/ICC Transformation NPRM* Comments at 4-5; Kansas Commission April 18 *USF/ICC Transformation NPRM* Comments at 15; Massachusetts DTC *USF/ICC Transformation NPRM* Comments at 19, Attachs. 1 & 2; Michigan Commission *USF/ICC Transformation NPRM* Comments at 10-13; Missouri Commission *USF/ICC Transformation NPRM* Comments at 17; New Jersey Board *USF/ICC Transformation NPRM* Comments at 5; Ohio Commission *USF/ICC Transformation NPRM* Comments at 55-57; Washington Commission *USF/ICC Transformation NPRM* Comments at 8-11; Letter from James Bradford Ramsay, General Counsel, NARUC, to (continued…)

of approaches to reform.[1474] In some states, these efforts have resulted in intrastate access rate levels coming to parity with interstate levels.[1475] In other states, reform has led to reductions in intrastate rate levels, but rates remain above interstate levels.[1476] Although many states may genuinely desire to advance additional reforms, the challenges posed by a state-by-state process would likely result in significant variability and unpredictability of outcomes.[1477] Moreover, some state commissions lack authority to address intrastate access reform,[1478] and we are concerned that many states will be unable to complete reforms in a timely manner or will otherwise decline to act. Indeed, the Missouri Commission endorsed a section 251(b)(5) approach because "states should not be allowed to delay access reform."[1479] The lack of certainty and predictability for the industry without a uniform framework is a significant concern. Carriers and investors need predictability to make investment and deployment decisions and lack of certainty regarding intrastate access rates or recovery hampers these efforts. In addition some parties warned that it would be "extremely costly" to participate in "the multitude" of state commission proceedings that would follow from an approach relying on dozens of different state transitions and recovery frameworks.[1480]

(Continued from previous page)

Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, Attach. A (filed Sept. 21, 2011); Letter from Brian J. Benison, Director – Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 05-337, GN Docket No. 09-51, Attach. 1, 2 (filed Oct. 25, 2010) (AT&T Oct. 25, 2010 *Ex Parte* Letter); Petition of Sprint to Reduce Intrastate Access Rates of Incumbent Local Exchange Carriers in North Carolina, Interim Report of the Access Charges Working Group, Docket P-100, Sub 167 (filed Oct. 14, 2010), *cited in* NASUCA *USF/ICC Transformation NPRM* Comments at 73 n.214. Since the release of the *USF/ICC Transformation NPRM*, we note that there have been additional intrastate access reform efforts. *See, e.g.*, 2011 Tenn. Pub. Acts 068 (codified at TENN. CODE. ANN. § 65-5-301 et seq.); *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, Opinion and Order, (Pa. PUC rel. July 18, 2011).

[1474] *See, e.g.*, Michigan Commission *USF/ICC Transformation NPRM* Comments at 10; New Jersey Board *USF/ICC Transformation NPRM* Comments at 5; *Board's Investigation and Review of Local Exchange Carrier Intrastate Access Rates*, Docket No. TX08090830, Telecommunications Order, 27 (NJ Bd. of Pub. Utils. Feb. 1, 2010); 2011 Tenn. Pub. Acts 068 (codified at TENN. CODE. ANN. § 65-5-301 et seq.).

[1475] *See, e.g.*, Kansas Commission *USF/ICC Transformation NPRM* Comments at 15; Massachusetts DTC *USF/ICC Transformation NPRM* Comments at 19.

[1476] *See, e.g.*, Missouri Commission *USF/ICC Transformation NPRM* Comments at 17.

[1477] The record indicates that, in some cases, state reform efforts have taken well over a decade, sometimes with little result. *See* Verizon *USF/ICC Transformation NPRM* Reply at 57-66 (describing the length of reform efforts in states including Minnesota and Arizona and noting that South Dakota recently completed a six year proceeding that resulted in a rule capping CLEC rates "at a remarkably high six cents per minute").

[1478] *See* Florida Commission *USF/ICC Transformation NPRM* Comments at 5; Montana Commission *USF/ICC Transformation NPRM* Reply at 5.

[1479] Missouri Commission *USF/ICC Transformation NPRM* Comments at 19 ("One option is for states to remain responsible for reforming intrastate access charges while the second option relies on the FCC to establish a methodology which states would then work with the FCC to implement. The MoPSC prefers the second option. Assuming the FCC's initial goal of intercarrier compensation reform is for parity between intrastate and interstate rates then the FCC should set a schedule for achieving that objective. States should be allowed to accelerate intrastate reform; however, a state should not be allowed to delay access reform."); *see also* Wisconsin Commission *August 3 PN* Comments at 5.

[1480] CBeyond et al. *USF/ICC Transformation NPRM* Comments at 8.

795. In addition, as noted above, adopting a uniform federal transition and recovery mechanism will free states from potentially significant financial burdens. Our recovery mechanism will provide carriers with recovery for reductions to eligible interstate *and* intrastate revenue. As a result, states will not be required to bear the burden of establishing and funding state recovery mechanisms for intrastate access reductions, while states will continue to play a role in implementation. Furthermore, the Residential Rate Ceiling adopted as part of our recovery mechanism will help ensure that consumer telephone rates remain affordable, and will also recognize so-called "early adopter" states that have already undertaken reform of intrastate access charges and rebalanced rates.[1481]

796. Some commenters argued that the uniform approach we take today is inappropriate because states should be allowed to pursue tailored intrastate access reforms.[1482] We appreciate and respect the expertise and on-the-ground knowledge of our state partners concerning intrastate telecommunications. Indeed, as we have said, states will have responsibility for implementing the bill-and-keep methodology adopted herein and will continue to oversee the tariffing of intrastate rates during the transition period and interconnection negotiations and arbitrations pursuant to section 252, as well as determine the network "edge" for purposes of bill-and-keep.[1483] With respect to the ultimate ICC framework and the intervening transition, however, we find that a uniform national approach will best create predictability for carriers and promote efficient pricing and new investment to the benefit of consumers.

797. We also conclude that a uniform transition to bill-and-keep is preferable to the plan of State Members of the Universal Service Joint Board that would set a positive per-minute ICC rate per carrier that could be higher than existing reciprocal compensation rates.[1484] In particular, the State Members suggest that the Commission set a single rate per provider for all purchasers in a single location, and then provide states the option of adopting this proposal or not.[1485] If a state adopts the single rate per provider option it would require "that each telecommunications carrier in the State would establish a maximum intercarrier per-minute termination rate that is no higher than the lower of its own current per-minute interstate termination rate and its average intercarrier compensation terminating rate."[1486] Under this plan, however, states could choose not to adopt the single rate per provider option and therefore could maintain existing intrastate rates in perpetuity, preserving all the associated problems with the current system.

C. Transition

798. In light of our decision to adopt a uniform federal transition to bill-and-keep, in this section we set out a default transition path for terminating end office switching and certain transport rate elements to begin that process. We also begin the process of reforming other rate elements by capping all interstate rate elements as of the effective date of the rules adopted pursuant to this Order,[1487] and capping terminating intrastate rates for all carriers. Doing so ensures that no rates increase during reform, and that

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[1481] *See infra* paras. 913 - 916.

[1482] *See, e.g.,* Kansas Commission *USF/ICC Transformation NPRM* Comments at 36-39; Michigan Commission *USF/ICC Transformation NPRM* Comments at 9.

[1483] *See supra* para. 776; *infra* paras. 1321, 1370.

[1484] *See* State Members *USF/ICC Transformation NPRM* Comments at 153-55.

[1485] *See id*. *See also* Cincinnati Bell *USF/ICC Transformation NPRM* Comments at 15-16 (supporting the State Members' Plan as a possible alternative).

[1486] State Members *USF/ICC Transformation NPRM* Comments at 154.

[1487] The effective date of the rules will be 30 days after the rules are published in the Federal Register.

carriers do not shift costs between or among other rate elements, which would be counter to the principles we adopt today. And, this transition will help minimize disruption to consumers and service providers by giving parties time, certainty, and stability as they adjust to an IP world and a new compensation regime.

799. In the *USF/ICC Transformation NPRM*, we sought comment on the transition away from existing intercarrier compensation rates to facilitate carriers' movement to IP networks, including the sequencing and timing of rate reductions that would allow carriers to plan appropriately.[1488] The record contains a variety of recommendations for the length of the transition period and the rates that would be affected during different phases of the transition.[1489] Some of these proposals would begin the reform process by reducing intrastate switched access rates, and in some cases, reciprocal compensation rates, down to interstate rate levels over three to five years.[1490] Other proposals would reduce both interstate and intrastate rates to bill-and-keep or another end-point in the same amount of time.[1491] Parties also supported different transition periods by carrier type. For example, some parties submit that rate-of-return carriers should be given longer to reduce their rates than price cap carriers because the costs and rates of rate-of-return carriers generally are significantly higher than those of price cap carriers.[1492] Some parties suggest that competitive LECs should be given more time than other carriers to transition their rates.[1493]

800. Balancing these considerations, we set forth our transition path for terminating end office switching and certain transport rate elements and reciprocal compensation charges in Figure 9. In brief, our transition plan first focuses on the transition for terminating traffic, which is where the most acute intercarrier compensation problems, such as arbitrage, currently arise. We believe that limiting reductions at this time to terminating access rates will help address the majority of arbitrage and manage the size of the access replacement mechanism. We also take measures today to start reforming other elements as well by capping all interstate switched access rates in effect as of the effective date of the rules, including originating access and all transport rates. Absent such action, rate-of-return carriers could shift costs between or among other rate elements and rates to interconnecting carriers could continue to increase as they have been in the past years, which is counter to the reform we adopt today. Even so, we do not

[1488] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4720-28, paras. 533-55. This is consistent with the National Broadband Plan, which observed that "[s]udden changes in USF and ICC could have unintended consequences that slow progress" and that "[s]uccess will come from a clear road map for reform, including guidance about the timing and pace of changes to existing regulations, so that the private sector can react and plan appropriately." National Broadband Plan at 141.

[1489] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 30-32; California Commission *USF/ICC Transformation NPRM* Comments at 18-20; CBeyond et al. *USF/ICC Transformation NPRM* Comments at 4-7; Comcast *USF/ICC Transformation NPRM* Comments at 3-6; CTIA *USF/ICC Transformation NPRM* Comments at 37-39; Earthlink *USF/ICC Transformation NPRM* Comments at 11; Frontier *USF/ICC Transformation NPRM* Comments at 5, 7-8; Global Crossing *USF/ICC Transformation NPRM* Comments at 14; Kansas Commission *USF/ICC Transformation NPRM* Comments at 39-41; Level 3 *USF/ICC Transformation NPRM* Comments at 6-8; MetroPCS *USF/ICC Transformation NPRM* Comments at 6-7; MoSTCG *USF/ICC Transformation NPRM* Comments at 10; T-Mobile *USF/ICC Transformation NPRM* Comments at 27-28.

[1490] *See, e.g.*, CBeyond et al. *USF/ICC Transformation NPRM* Comments at 4, Earthlink *USF/ICC Transformation NPRM* Comments at 11, Frontier *USF/ICC Transformation NPRM* Comments at 5, 7-8, Global Crossing *USF/ICC Transformation NPRM* Comments at 14, and Level 3 *USF/ICC Transformation NPRM* Comments at 6-8.

[1491] AT&T *USF/ICC Transformation NPRM* Comments at 30.

[1492] Rural Associations *August 3 PN* Comments at 35-39.

[1493] *See, e.g.*, COMPTEL *August 3 PN* Comments at 20-22.

specify the transition to reduce these rates further at this time. Instead, we seek comment regarding the transition and recovery for such other rate elements in the FNPRM.[1494]

801. Thus, at the outset of the transition, all interstate switched access and reciprocal compensation rates will be capped at rates in effect as of the effective date of the rules.[1495] We cap these rates as of the effective date of the Order, as opposed to a future date such as January 1, 2012,[1496] to ensure that carriers cannot make changes to rates or rate structures to their benefit in light of the reforms adopted in this Order. For price cap carriers, all intrastate rates will also be capped, and, for rate-of-return carriers, all terminating intrastate access rates will also be capped. Consistent with many proposals in the record, our transition plan provides rate-of-return carriers, whose rates typically are higher, additional time to transition as appropriate. Specifically, we conclude that a six-year transition for price cap carriers and competitive LECs that benchmark to price cap carrier rates and a nine-year transition for rate-of-return carriers and competitive LECs that benchmark to rate-of-return carrier rates to transition rates to bill-and-keep strikes an appropriate balance that will moderate potential adverse effects on consumers and carriers of moving too quickly from the existing intercarrier compensation regimes.[1497]

Intercarrier Compensation Reform Timeline		
Effective Date	**For Price Cap Carriers and CLECs that benchmark access rates to price cap carriers**[1498]	**For Rate-of-Return Carriers and CLECs that benchmark access rates to rate-of-return carriers**[1499]
Effective Date of the rules	All intercarrier switched access rate elements, including interstate and intrastate originating and terminating rates and reciprocal compensation rates are capped.	All interstate switched access rate elements, including all originating and terminating rates and reciprocal compensation rates are capped. Intrastate terminating rates are also capped.

[1494] We do, however, cap price cap interstate and intrastate originating access rates to combat potential arbitrage and other efforts designed to increase or otherwise maximize sources of intercarrier revenues during the transition.

[1495] Although the ABC Plan and Joint Letter proposed that rates should be capped on January 1, 2012, ABC Plan at 11, Joint Letter at 3, we cap such rates as of the effective date of the rules. This will ensure that carriers do not seek to inflate their access charges in advance of our reforms. Specifically, we cap all rate elements in the "traffic sensitive basket" and the "trunking basket" as described in 47 C.F.R. §§ 61.42(d)(2)-(3) unless a price cap carrier made a tariff filing increasing any such rate element prior to the effective date of the rules and such change was not yet in effect.

[1496] *See* ABC Plan, Attach. 1 at 11; Joint Letter at 3 & n.1.

[1497] As a baseline, we adopt the transition proposed in the ABC Plan and Joint Letter with the addition of an extra year to allow each set of carriers to complete a transition to bill-and-keep. *See id*.

[1498] ABC Plan, Attach. 1 at 11. We note that CMRS providers are subject to mandatory detariffing. Nonetheless, CMRS providers are included in the transition to the extent their reciprocal compensation rates are inconsistent with the reforms we adopt here.

[1499] Joint Letter at 3 & n.1. We note that carriers remain free to make elections regarding participation in the NECA pool and tariffing processes during the transition. *See* 47 C.F.R. § 69.601 et seq. At the same time, we decline to adopt the Rural Associations' proposal to require carriers that withdraw from NECA association tariffs for switched access elements to continue to contribute to the pool as if they had remained part of the NECA pool. *See* Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos.10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, Attach. at 25 (filed Oct. 17, 2011). Such a requirement would frustrate efficiencies generated by our reforms and could unnecessarily burden carriers with costs that are no longer necessary.

July 1, 2012	Intrastate terminating switched end office[1500] and transport rates,[1501] originating and terminating dedicated transport,[1502] and reciprocal compensation rates, if above the carrier's interstate access rate, are reduced by 50 percent of the differential between the rate and the carrier's interstate access rate.	Intrastate terminating switched end office[1503] and transport rates,[1504] originating and terminating dedicated transport,[1505] and reciprocal compensation rates, if above the carrier's interstate access rate, are reduced by 50 percent of the differential between the rate and the carrier's interstate access rate.
July 1, 2013	Intrastate terminating switched end office and transport rates and reciprocal compensation, if above the carrier's interstate access rate, are reduced to parity with interstate access rate.	Intrastate terminating switched end office and transport rates and reciprocal compensation, if above the carrier's interstate access rate, are reduced to parity with interstate access rate.
July 1, 2014	Terminating switched end office and reciprocal compensation rates are reduced by one-third of the differential between end office rates and $0.0007.[*]	Terminating switched end office and reciprocal compensation rates are reduced by one-third of the differential between end office rates and $0.005. [*]
July 1, 2015	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the original differential to $0.0007.[*]	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the original differential to $0.005.[*]
July 1, 2016	Terminating switched end office and reciprocal compensation rates are reduced to $0.0007.[*]	Terminating switched end office and reciprocal compensation rates are reduced to $0.005.[*]
July 1, 2017	Terminating switched end office and reciprocal compensation rates are reduced to bill-and-keep. Terminating switched end office and transport are reduced to $0.0007 for all terminating traffic within the tandem serving area when the terminating carrier owns the serving tandem switch.	Terminating end office and reciprocal compensation rates are reduced by one-third of the differential between its end office rates ($0.005) and $0.0007.[*]
July 1, 2018	Terminating switched end office and transport are reduced to bill-and-keep for all terminating traffic within the tandem serving area when the terminating carrier owns the serving tandem switch.	Terminating switched end office and reciprocal compensation rates are reduced by an additional one-third of the differential between its end office rates as of July 1, 2016 and $0.0007.[*]
July 1, 2019		Terminating switched end office and reciprocal compensation rates are reduced to $0.0007. [*]
July 1, 2020		Terminating switched end office and reciprocal compensation rates are reduced to bill-and-keep.[*]

[1500] *See* App. A, 47 C.F.R. § 51.903(d).

[1501] *See* App. A, 47 C.F.R. § 51.903(i).

[1502] *See* App. A, 47 C.F.R. § 51.903(c).

[1503] *See* App. A, 47 C.F.R. § 51.903(d).

[1504] *See* App. A, 47 C.F.R. § 51.903(i).

[1505] *See* App. A, 47 C.F.R. § 51.903(c).

[*] Transport rates remain unchanged from the previous step.

Figure 9

802. We believe that these transition periods strike the right balance between our commitment to avoid flash cuts and enabling carriers sufficient time to adjust to marketplace changes and technological advancements, while furthering our overall goal of promoting a migration to modern IP networks.[1506] We find that consumers will benefit from this regulatory transition, which enables their providers to adapt to the changing regulatory and technical landscape and will enable a faster and more efficient introduction of next-generation services.

803. The transition we adopt is partially based on a stakeholder proposal,[1507] with certain modifications, including the adoption of a bill-and-keep methodology as the end state for all traffic. As explained further below, states will play a key role in implementing the framework we adopt today. In particular, states will oversee changes to intrastate access tariffs to ensure that modifications to intrastate tariffs are consistent with the framework and rules we adopt today. For example, states will help guard against carriers improperly moving costs between or among different rate elements to reap a windfall from reform.

804. Since intercarrier compensation charges are constrained by the transition glide path that we adopt, we will be monitoring to ensure that carriers do not shift costs to other rate elements that are not specifically covered, such as special access or common line. We also clarify that, in cases where a provider's interstate terminating access rates are higher than its intrastate terminating access rates, intrastate rate reductions shall begin to occur at the stage of the transition in which interstate rates come to parity with intrastate rate levels.[1508]

805. The transition imposes a cap on originating intrastate access charges for price cap carriers at current rates as of the effective date of the rules. The transition does not cap originating intrastate access charges for rate-of-return carriers. Rate-of-return carriers suggested that it would not be viable for them to reduce terminating switched rates, while at the same time reducing originating rates without overburdening the Universal Service Fund.[1509] In the meantime, rate-of-return carriers indicate that the wholesale long distance market will constrain originating rates.[1510] Given our commitment to control the

[1506] We decline to adopt a "tribal carve-out" for ICC reform as proposed by Gila River. *See* Letter from Tom W. Davidson, Counsel to Gila River Telecommunications, Inc., to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45 at 2 n.2 (filed Oct. 21, 2011). There is insufficient evidence in the record demonstrating that any such carve-out is necessary; nor is there any evidence that the recovery mechanism we adopt below, coupled with the Total Earnings Review process for additional recovery described below, is somehow insufficient for Tribal carriers. Moreover, we are concerned that such a carve-out could invite arbitrage opportunities that we are seeking to curtail in this Order.

[1507] *See* ABC Plan, Attach. 1 at 11; Joint Letter at 3 & n.1.

[1508] *See* App. A, 47 C.F.R. §§ 51.907, 909. As we describe above, in most cases intrastate terminating access rates are higher than intrastate rates (*see supra* para. 791), and we believe that initially focusing our reforms to address this disparity is appropriate. *But see* Letter from Tina Pidgeon et al., General Communication, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 2 (filed Oct. 6, 2011) (proposing that the higher of interstate or intrastate access rates be reduced during the first two years).

[1509] Rural Associations *August 3 PN* Comments at 40.

[1510] *Id*. at 41 ("[I]f originating access rates are not reduced . . . then the interexchange carriers upon which RLECs rely to provide retail toll service will likely increase their wholesale rates . . . . Another likely outcome is that some IXCs may simply exit rural markets and no longer provide wholesale services to RLECs.").

size of the CAF and minimize burdens on consumers, we do not cap intrastate originating access charges for rate-of-return carriers at this time. As noted above, we have placed priority on reform of terminating access charges and we are mindful of the compromises that must be made to accomplish meaningful reform in a measured and timely manner. In the FNPRM, we seek comment on the transition of *all* originating access charges to bill-and-keep, including originating intrastate access charges for rate-of-return carriers.

806. *CMRS Providers*. As noted above, CMRS providers will be subject to the transition applicable to price cap carriers. Although CMRS providers are subject to mandatory detariffing, these providers are included to the extent their reciprocal compensation rates are inconsistent with the reforms we adopt here.[1511] In section XV, we also address compensation for non-access traffic exchanged between LECs and CMRS providers. As we detail in that section, we immediately adopt bill-and-keep as the default compensation methodology for non-access traffic exchanged between LECs and CMRS providers under section 20.11 of our rules and Part 51.

807. *Competitive LECs*. To ensure smooth operation of our transition, we provide competitive LECs that benchmark their rates a limited allowance of additional time to make tariff filings during the transition period. Application of our access reforms will generally apply to competitive LECs via the CLEC benchmarking rule.[1512] For interstate switched access rates, [1513] competitive LECs are permitted to tariff interstate access charges at a level no higher than the tariffed rate for such services offered by the incumbent LEC serving the same geographic area (the benchmarking rule).[1514] There are two exceptions to the general benchmarking rule. First, rural competitive LECs offering service in the same areas as non-rural incumbent LECs are permitted to "benchmark" to the access rates prescribed in the NECA access tariff, assuming the highest rate band for local switching (the rural exemption). Second, as explained in Section XI.A above, competitive LECs meeting the access revenue sharing definition are required to benchmark to the lowest interstate switched access rate of a price cap LEC in the state.[1515] Because we retain the CLEC benchmark rule during the transition, we allow competitive LECs an extra 15 days from the effective date of the tariff to which a competitive LEC is benchmarking to make its filing(s). We emphasize that the rates that are filed by the competitive LEC must comply with the applicable benchmarking rate. As is the case now, we decline to adopt rules governing the rates that competitive LECs may assess on their end users.

[1511] *See supra* note 1498.

[1512] In cases where more than one incumbent LEC operates within a competitive LEC's service area and those incumbent LECs are both price cap and rate-of-return regulated, a question may arise as to the appropriate transition track for the competitive LEC. *See Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108, 9131-32, paras 46-48 (2004). If the competitive LEC tariffs a benchmarked or average rate in such circumstances, that competitive LEC shall adopt the transition path applicable to the majority of lines capable of being served in its territory. For example, if price cap carriers serve 70 percent of a competitive LEC's service territory and rate-of-return carriers serve 30 percent of the service territory, then the competitive LEC using a blended rate should follow the price cap transition.

[1513] References to access services and access rate elements in our rules or otherwise does not presuppose the application of access charge regulation.

[1514] *See* 47 C.F.R. § 61.26; *see also CLEC Access Reform Order*, 16 FCC Rcd at 9925, para. 3.

[1515] *See infra* para. 679.

808. We decline to adopt a separate and longer transition period for competitive LECs, as suggested by some commenters.[1516] For one, competitive LEC rates are already at or near parity for many if not all access rates. Due to the operation of the Commission's CLEC benchmark rules, competitive LEC tariffed access rates are largely already at parity with incumbent LEC rates. And, in a large number of states, competitive LEC intrastate access rates are at or near parity to those of the incumbent LEC, as well.[1517] Thus, we do not find a sufficient basis for creating a separate transition for competitive LECs. Moreover, the transition periods of six and nine years are sufficiently long to permit advance planning and represent a careful balance of the interests of all stakeholders. As a result, we conclude that a uniform approach for all LECs is preferable and do not find compelling evidence to depart from the important policy objectives underlying the CLEC benchmarking rule. Further, new arbitrage opportunities could arise and increased regulatory oversight would be necessary were we to abandon the CLEC benchmarking rule.

1. Authority To Specify the Transition

809. Specifying the timing and steps for the transition to bill-and-keep requires us to make a number of line-drawing decisions. Although we could avoid those decisions by moving to bill-and-keep immediately, such a flash cut would entail significant market disruption to the detriment of consumers and carriers alike. As the D.C. Circuit has recognized, "[w]hen necessary to avoid excessively burdening carriers, the gradual implementation of new rates and policies is a standard tool of the Commission," and the transition "may certainly be accomplished gradually to permit the affected carriers, subscribers and state regulators to adjust to the new pricing system, thus preserving the efficient operation of the interstate telephone network during the interim."[1518] Thus, "[i]t is reasonable for the FCC to take into account the ability of the industry to adjust financially to changing policies," and "[i]nterim solutions may need to consider the past expectations of parties and the unfairness of abruptly shifting policies."[1519] In such circumstances, "the FCC should be given 'substantial deference' when acting to impose interim regulations."[1520]

810. In our judgment, the framework we adopt carefully balances the potential industry disruption for both payers and recipients of intercarrier compensation as we transition to a new intercarrier compensation regime more broadly. It is particularly appropriate for the Commission to exercise its authority to craft a transition plan in this context, where the Commission is acting, as it has in prior orders, to reconcile the "implicit tension between" the Act's goals of "moving toward cost-based

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[1516] *See, e.g.*, COMPTEL *August 3 PN* Comments at 20-22; TDS Metrocom *August 3 PN* Reply at 4-5. *But see* Northern Telephone & Data Corp. Ex Parte Comments at 2-3 (filed Oct. 20, 2011) ("Any plan adopted by the Commission cannot treat ILECs and CLECs differently; and similarly, must recognize than [sic] many rural CLECs, such as NTD, should receive the same treatment as rural ILECs under the transition.").

[1517] *See, e.g.*, Verizon New England, Inc., et al., for Investigation under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers, D.T.C. 07-9, Order, (Mass. D.T.C. June 22, 2009), *aff'd*, Order on Motion for Reconsideration and Clarification (Dec. 7, 2009); DEL. CODE ANN. tit. 26 § 707(e) (2008); MO. ANN. STAT. § 392.370 (2008); 66 PA. CONS. STAT. ANN. § 3017(c) (2004); 20 VA. ADMIN. CODE § 5-417-50(E) (2007); WASH. ADMIN. CODE § 480-120-540(2) (2007).

[1518] *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1135-36 (D.C. Cir. 1984).

[1519] *MCI Telecommc'ns Corp. v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984).

[1520] *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1106 (D.C. Cir. 2009); *see also ACS of Anchorage, Inc. v. FCC,* 290 F.3d 403, 410 (D.C. Cir. 2002); *Competitive Telecommc'ns Ass'n v. FCC,* 117 F.3d 1068, 1073-75 (8th Cir. 1997); *MCI*, 750 F.2d at 141.

rates and protecting universal service."[1521]

2. Implementation Issues

811. We now address a number of ancillary issues surrounding implementation of the transition. First, we describe the continuing role of tariffs during the transition. Next, we discuss price cap conversions and the impact of our reforms on existing agreements. Finally, we address pending petitions that are mooted by the changes adopted as part of the transition.

812. *Role of Tariffs*. Under today's intercarrier compensation system, carriers typically tariff their access charges. To avoid disruption of these well-established relationships,[1522] we preserve a role for tariffing charges for toll traffic during the transition.[1523] Pursuant to the transition set forth above, we permit LECs to tariff the default charges for intrastate toll traffic at the state level, and for interstate toll traffic with the Commission, in accordance with the timetable and rate reductions set forth above.[1524] At the same time, carriers remain free to enter into negotiated agreements that differ from the default rates established above, consistent with the negotiated agreement framework that Congress envisioned for the 251(b)(5) regime to which access traffic is transitioned. As an interim matter, this new regime will facilitate the benefits that can arise from negotiated arrangements, while also allowing for revenue predictability that has been associated with tariffing.[1525] In some respects our allowance of some tariffing may be similar to the wireless termination tariffs for non-access traffic addressed in the Commission's 2005 *T-Mobile Order*.[1526] In that decision, the Commission prohibited the filing of state tariffs governing the compensation for terminating non-access CMRS traffic because they were inconsistent with the negotiated agreement framework contemplated by Commission precedent and by Congress when it enacted section 251.[1527] We do not, however, believe that the policies underlying the prohibition of wireless termination tariffs for non-access traffic in the *T-Mobile Order* precludes our allowance of certain tariffing of intercarrier compensation for toll traffic.[1528] Finally, during the transition, traffic that historically has been addressed through interconnection agreements will continue to be so addressed.

[1521] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

[1522] *See* Letter from Mary McManus, Comcast Corporation, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, at 2 (filed Oct. 5, 2011) (Comcast Oct. 5, 2011 *Ex Parte* Letter).

[1523] In the FNPRM, we seek comment on whether the Commission needs to forbear from tariffing requirements in section 203 of the Act and part 61 of our rules to enable carriers to negotiate alternative arrangements pursuant to this Order. *See infra* para. 1322.

[1524] Although we do not require a "fresh look" to open existing contracts, we recognize that the framework we adopt today encourages carriers to enter into contracts in lieu of the tariffing framework. If two carriers do not have a reciprocal compensation rate today or are otherwise unable to agree to a rate through negotiations, we make clear that state commissions will continue to have a role in establishing rates for non-access traffic where those rates had not been previously established. States may initially establish such rates on the basis of the Commission's existing cost methodology (TELRIC) consistent with section 51.715 or on the basis of the Commission's new cost methodology, i.e., bill-and-keep. After such rates are initially established, they shall be subject to the transition set forth above.

[1525] *See infra* para. 961.

[1526] *T-Mobile Order*, 20 FCC Rcd at 4860, para. 9.

[1527] *See id*. As provided in Section XIV, we do not disrupt the regulatory approach applicable to CMRS providers, which are subject to detariffing.

[1528] *See infra* paras. 964-965.

813. Because carriers will be revising intrastate access tariffs to reduce rates for certain terminating switched access rate elements, and capping other intrastate rates,[1529] states will play a critical role implementing and enforcing intercarrier compensation reforms. In particular, state oversight of the transition process is necessary to ensure that carriers comply with the transition timing and intrastate access charge reductions outlined above. Under our framework, rates for intrastate access traffic will remain in intrastate tariffs.[1530] As a result, to ensure compliance with the framework and to ensure carriers are not taking actions that could enable a windfall and/or double recovery, state commissions should monitor compliance with our rate transition; review how carriers reduce rates to ensure consistency with the uniform framework; and guard against attempts to raise capped intercarrier compensation rates, as well as unanticipated types of gamesmanship. Consistent with states' existing authority, therefore, states could require carriers to provide additional information and/or refile intrastate access tariffs that do not follow the framework or rules adopted in this Order. Moreover, state commissions will continue to review and approve interconnection agreements and associated reciprocal compensation rates to ensure that they are consistent with the new federal framework and transition. Thus, we will be working in partnership with states to monitor carriers' compliance with our rules, thereby ensuring that consumers throughout the country will realize the tremendous benefits of ICC reform.

814. *Price Cap Conversions.* The Commission has regulated the provision of interstate access services by incumbent LECs, pursuant to either rate-of-return regulation or price cap regulation. The Commission has previously described the benefits that flow from the adoption of price cap regulation,[1531] and has allowed carriers to convert from rate-of-return to price cap regulation.[1532] The Commission continues to encourage carriers to undergo such conversions. The application of our reforms to proposed conversions will be addressed in the context of those proceedings based on the individualized situation of the carrier seeking to convert to price cap regulation.[1533]

815. *Existing Agreements*. With respect to the impact of our reforms on existing agreements, we emphasize that our reforms do not abrogate existing commercial contracts or interconnection agreements or otherwise require an automatic "fresh look" at these agreements.[1534] As the Commission

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[1529] We do not cap intrastate originating access for rate-of-return carriers in this Order. We note that states remain free to do so, provided states support any recovery that may be necessary, and such a result would promote the goals of comprehensive reform adopted today.

[1530] As we describe in Section XIII, we require carriers to file with their interstate tariffs all data, including as relevant intrastate rates and MOU, necessary to verify eligibility for ARC replacement funding.

[1531] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6790-91 para. 33 (1990).

[1532] *See, e.g., CenturyTel, Inc. Petition for Conversion to Price Cap Regulation and Limited Waiver Relief*, WC Docket No. 08-191, Order, 24 FCC Rcd 4677 (WCB 2009); *Windstream Petition for Conversion to Price cap Regulation and for Limited Waiver Relief*, WC Docket No. 07-171, Order, 23 FCC Rcd 5294 (2008).

[1533] Similarly, transition issues related to rate-of-return affiliates of price cap holding companies, *see supra* para. 271, will be addressed in the context of such proceedings as well.

[1534] In the past, several commenters have requested that the Commission give them a fresh look at existing contracts in the context of comprehensive reform. *See, e.g.*, Letter from Richard R. Cameron and Teresa D. Baer, Counsel for Global Crossing, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 08-152, 99-68; CC Docket Nos. 01-92, 96-45 at 2 (filed Sept. 18, 2008) (asking that the Commission "provide an 18-month window within which carriers can reconfigure their interconnection facilities without incurring reconfiguration charges or early termination liabilities under existing transport contracts"); Sage Telecom *2008 ICC/USF FNPRM* Comments at 13 ("The Commission should be aware that wholesale agreements for local service (unbundled network element platform replacement agreements) often contain rates for transport and termination of traffic . . . . While these agreements (continued…)

has recognized, both telecommunications carriers and their customers often benefit from long-term contracts—providers gain assurance of cost recovery, and customers (whether wholesale or end-users) may receive discounted and stable prices—and we try to avoid disrupting such contracts.[1535] Indeed, giving carriers or customers an automatic fresh look at existing commercial contracts or interconnection agreements could result in a windfall for entities that entered long-term arrangements in exchange for lower prices, as compared to other entities that avoided the risk of early termination fees by electing shorter contract periods at higher prices.[1536] Accordingly, we decline to require that these existing arrangements be reopened in connection with the reforms in this Order, and leave such issues to any change-of-law provisions in these arrangements and commercial negotiations among the parties.[1537] We do, however, make clear that our actions today constitute a change in law, and we recognize that existing agreements may contain change-of-law provisions that allow for renegotiation and/or may contain some mechanism to resolve disputes about new agreement language implementing new rules.

816. *Dismissal as Moot of Pending Petitions*. The reforms adopted today render moot a petition filed by Embarq in 2008 and a petition filed by Michigan CLECs in 2010.[1538] The Embarq petition sought waivers that would allow it to unify its switched access rates by making reductions to its intrastate rates and offsetting increases to its interstate rates.[1539] The actions taken in this Order, which set forth a comprehensive intercarrier compensation plan, render the Embarq petition moot and, we further note that CenturyLink has subsequently filed a letter seeking to withdraw the petition.[1540] The Michigan CLECs filed a petition asking the Commission to preempt Michigan's 2009 access restructuring law,

(Continued from previous page)

were of course 'negotiated,' they were negotiated under particular assumptions regarding the applicable regulatory defaults, and under circumstances of asymmetrical bargaining power. The Commission should consider whether such provisions will adversely affect competition and thus should be subject to a fresh look.").

[1535] *See, e.g.*, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17400, 17402–03, paras. 692, 697–99 (2003) (*Triennial Review Order*); *see also*, *e.g.*, AT&T 2005 *ICC FNPRM* Reply at 17–20 (arguing against giving end users a fresh look at existing contracts). To the extent that there is evidence that particular termination penalties are inappropriate, the Commission can resolve such a matter through an enforcement proceeding. *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 698.

[1536] *See Triennial Review Order*, 18 FCC Rcd at 17403, para. 699.

[1537] This situation is thus different from cases where the Commission found that certain contract provisions might adversely affect competition or where end-user customers would be denied the benefits of new Commission policy absent a fresh look opportunity. *See, e.g.*, *Local Competition First Report and Order*, 11 FCC Rcd at 16044, para. 1094; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7350, para. 21 (1993) (allowing a fresh look at agreements in "situations where excessive termination liabilities would affect competition for a significant period of time"); *Competition in the Interstate Interexchange Marketplace*, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5906, para. 151 (1991) (giving customers of AT&T 90 days to terminate their contracts without penalty to let them "tak[e] advantage of 800 number portability when it arrives").

[1538] *See* Petition for Waiver of Embarq Pleading Cycle Established, WC Docket No. 08-160, Public Notice, 23 FCC Rcd 11914 (2008); Pleading Cycle Established for Comments on Joint Michigan CLEC Petition for Declaratory Ruling and Motion for Temporary Relief, WC Docket No. 10-45, Public Notice, 25 FCC Rcd 1807 (2010).

[1539] *See* Petition for Waiver of Embarq Local Operating Companies of Sections 61.3 and 61.44-61.48 of the Commission's Rules, and any Associated Rules Necessary to Permit it to Unify Switched Access Charges Between Interstate and Intrastate Jurisdictions, WC Docket No. 08-160 (filed Aug. 1, 2008).

[1540] *See* Letter from Jeffrey Lanning, Assistant Vice President – Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 08-160 (filed June 23, 2011).

which mandated intrastate access rate reductions and created an access restructuring mechanism that was unavailable to CLECs.[1541] Here, again, the actions we take in this Order, which include bringing intrastate access traffic within section 251(b)(5) and subjecting that traffic to the above transition, address many of the access rates elements at issue in the Michigan CLECs' petition.[1542] We therefore dismiss the petition as the reforms in this Order and the accompanying FNPRM will render it moot.

3. Other Rate Elements

817. *Originating Access.* We find that originating charges also should ultimately be subject to the bill-and-keep framework. Some commenters urge that originating charges be retained, at least on an interim basis.[1543] Other parties express concerns with the retention of originating access charges.[1544] The legal framework underpinning our decision today is inconsistent with the permanent retention of originating access charges. In the *Local Competition First Report and Order*, the Commission observed that section 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such charges were prohibited under that provision of the Act.[1545] Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework should ultimately move to bill-and-keep.

818. Notwithstanding this conclusion, we take immediate action to cap all interstate originating access charges and intrastate originating access charges for price cap carriers. Although we do not establish the transition for rate reductions to bill-and-keep in this Order, we seek comment in the FNPRM on the appropriate transition and recovery mechanism for ultimately phasing down originating access charges.[1546] Meanwhile, we prohibit carriers from increasing their originating interstate access rates above those in effect as the effective date of the rules.[1547] A cap on interstate originating access represents a first step as part of our measured transition toward comprehensive reform and helps to ensure that our initial reforms to terminating access are not undermined. Thus, interstate originating switched access rates will remain capped and may not exceed current levels until further action by the Commission addressing the appropriate transition path for this traffic.

[1541] *See* Joint Petition for Expedited Declaratory Ruling that the State of Michigan's Statute 2009 PA 182 is Preempted Under Sections 253 and 254 of the Communications Act, WC Docket No. 10-45 (filed Feb. 12, 2010).

[1542] To the extent that states have established rate reduction transitions for rate elements not reduced in this Order, nothing in this Order impacts such transitions. *See, e.g*., Letter from John R. Liskey, Executive Director, MITA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51 at 2 (filed Oct. 17, 2011). Nor does this Order prevent states from reducing rates on a faster transition provided that states provide any additional recovery support that may be needed as a result of a faster transition.

[1543] *See, e.g.,* ABC Plan, Attach. 1 at 11; Cincinnati Bell *August 3 PN* Comments at 3.

[1544] iBasis Retail, Inc. *August 3 PN* Comments at 2; CRUSIR *August 3 PN* Comments at 11-13; Texas Telephone *August 3 PN* Comments at 7-8.

[1545] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042.

[1546] *See supra* Section XVII.M.

[1547] This prohibition on increasing access rates also applies to any remaining Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, and the per-minute Residual Interconnection Charge in section 69.155 of the Commission's rules. 47 C.F.R. §§ 69.153, 69.154, 69.155. Price cap carriers and CLECs that benchmark to price cap rates are also prohibited from increasing their originating intrastate access rates.

819. *Transport.* Similarly, the transition path set forth above begins the transition for transport elements, including capping such rates, but does not provide the transition for all transport charges for price cap or rate-of-return carriers to bill-and-keep. For price cap carriers, in the final year of the transition, transport and terminating switched access shall go to bill-and-keep levels where the terminating carrier owns the tandem. However, transport charges in other instances, i.e., where the terminating carrier does not own the tandem, are not addressed at this time. Meanwhile, under the transition for rate-of-return carriers, which is consistent with the transition path put forward by the Joint Letter, interstate and intrastate transport charges will be capped at interstate levels in effect as of the effective date of the rules through the transition.[1548]

820. Ultimately, we agree with concerns raised by commenters that the continuation of transport charges in perpetuity would be problematic.[1549] For example, the record contains allegations of "mileage pumping," where service providers designate distant points of interconnection to inflate the mileage used to compute the transport charges.[1550] Further, Sprint alleges that current incumbent LEC tariffed charges for transport are "very high and constitute a sizeable proportion of the total terminating access charges ILECs impose on carriers today."[1551] More fundamentally, if transport rates are allowed to persist, it gives incumbent LECs incentives to retain a TDM network architecture and therefore likely serves as a disincentive for incumbent LECs to establish more efficient interconnection arrangements such as IP.[1552] As a result, commenters suggest that perpetuating high transport rates could undermine the Commission's reform effort and lead to anticompetitive behavior or regulatory arbitrage such as access stimulation.[1553] We therefore seek comment on the appropriate treatment of, and transition for, all tandem switching and transport rates in the FNPRM.[1554]

821. *Other Rate Elements.* Finally, we note that the transition set forth above caps rates but does not provide the transition path for all rate elements or other charges, such as dedicated transport charges.[1555] In our FNPRM, we seek comment on what transition should be set for these other rate elements and charges as part of comprehensive reform, and how we should address those elements.

4. Suspension or Modification Under Section 251(f)(2)

822. Section 251(f)(2) provides that a LEC with fewer than two percent of the country's subscriber lines may petition its state commission for a suspension or modification of the application to it of a requirement or requirements of section 251(b) or (c), and that the state commission shall grant such

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[1548] *See* ABC Plan, Attach. 1 at 11; Joint Letter at 3.

[1549] *See, e.g.*, COMPTEL *August 3 PN* Comments at 14-20; NCTA *August 3 PN* Comments at 19-20; Sprint *August 3 PN* Comments at 11-16; T-Mobile *August 3 PN* Comments at 8.

[1550] *See* AT&T Section XV Comments at 5, 30-37; Letter from John T. Nakahata, Counsel to Level 3, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 10-90, 07-135, 03-109, GN Docket No. 09-51, Attach at 2 (filed Sept. 16, 2011).

[1551] Sprint *August 3 PN* Comments at 13.

[1552] Sprint *August 3 PN* Comments at 15; NCTA *August 3 PN* Comments at 20.

[1553] *See* CBeyond et al. *August 3 PN* Comments at 15-18; NCTA *August 3 PN* Comments at 20; T-Mobile Aug*ust 3 PN* Comments at 7; Time Warner Cable *August 3 PN* Comments at 7; *see also* Section XVII.M.

[1554] *See supra* Section XVII.M.

[1555] *See* Level 3 *August 3 PN* Comments at 11-12; COMPTEL *August 3 PN* Comments at 18-20; Letter from Charles W. McKee, VP, Federal and State Regulatory, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, at 2 (filed Oct. 3, 2011).

petition where it makes certain determinations.[1556] That provision further states that the state commission must act on the petition within 180 days and "may suspend enforcement of the requirement or requirements to which the petition applies" pending action on the petition.[1557] Parties aggrieved by a state commission decision under section 251(f) may seek review of that decision in federal district court – under section 252(e)(6) of the Act, if the decision is rendered in the course of arbitrating an interconnection agreement,[1558] or under general "federal question" jurisdiction if the decision arises outside of the arbitration context.[1559]

823. In *Iowa Utilities Board v. FCC*, the Eighth Circuit held that state commissions had "exclusive authority" to make decisions under section 251(f) and that the FCC lacked authority to prescribe "governing standards for such determinations."[1560] On review, however, the Supreme Court reversed the Eighth Circuit's decision with regard to the Commission's general authority to implement Title II of the Act. The Court stated that "the grant in § 201(b) [of the Act] means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252."[1561] Accordingly, we find that this general grant of rulemaking authority recognized by the Court includes the authority to adopt reasonable rules construing and implementing section 251(f).[1562]

824. In light of the Supreme Court's holding, we may adopt specific, binding prophylactic rules that give content to, among other things, the "public interest, convenience, and necessity" standard that governs states' exercise of section 251(f)(2) authority to act on suspension/modification petitions. We sought comment on specific rules in the *ICC/USF Transformation NPRM* and in the *2008 ICC NPRM*.[1563] However, given the limited record we received in response, we decline to adopt specific rules regarding section 251(f)(2) at this time. Nevertheless, we caution states that suspensions or modifications of the bill-and-keep methodology we adopt today would, among other things, re-introduce regulatory uncertainty, shift the costs of providing service to a LEC's competitors and the competitor's customers, increase transaction costs for terminating calls, and undermine the efficiencies gained from adopting a uniform national framework.[1564] Accordingly, we believe it highly unlikely that any attempt by a state to modify or suspend the federal bill-and-keep regime would be "consistent with the public interest, convenience and necessity" as required under section 251(f)(2)(B), and we urge states not to grant any

[1556] 47 U.S.C. § 251(f)(2)("The State commission shall grant such petition to the extent that, and for such duration as, [it] determines that such suspension or modification -- (A) is necessary – (i) to avoid a significant adverse economic impact on users of telecommunications services generally; (ii) to avoid imposing a requirement that is unduly economically burdensome; or (iii) to avoid imposing a requirement that is technically infeasible; and "(B) is consistent with the public interest, convenience, and necessity.").

[1557] *Id.*

[1558] *See, e.g.*, *New Cingular Wireless PCS, LLC v. Finley*, 2010 WL 3860384 at *1, *11-*14 (E.D. N.C. 2010); *Wireless World, L.L.C. v. Virgin Islands PSC*, 2008 WL 5635107 at *2, *3-*12 (D. VI 2008).

[1559] *See* 47 U.S.C. § 252(e)(6); 28 U.S.C. § 1331. *See also, e.g., Midcontinent Commc'ns v. North Dakota PSC*, 2009 WL 3722898 at *5-*9 (D. ND 2009).

[1560] 120 F.2d 753, 802 (8th Cir. 1997) (subsequent history omitted).

[1561] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378 (1998).

[1562] *Id.* at 385.

[1563] *See ICC/USF Transformation NPRM*, 26 FCC Rcd at 4714, paras. 519–20; *see also 2008 ICC/USF NPRM*, 24 FCC Rcd at 6623–26, App. A, paras. 282–90.

[1564] *See supra* Section XII.A (discussing the justification for adopting a bill-and-keep methodology).

petitions seeking to modify or suspend the bill-and-keep provisions we adopt herein. We will monitor state action regarding the reforms we adopt today, and may provide specific guidance for states' review of section 251(f)(2) petitions in the future.

5. The Duty To Negotiate Interconnection Agreements

825. Because we move traffic from the access charge regime to the section 251(b)(5) framework, where payment terms are agreed to pursuant to an interconnection agreement, incumbent LECs have asked the Commission to make clear that they have the ability to compel other LECs and CMRS providers to negotiate to reach an interconnection agreement. This is a concern for incumbent LECs because under sections 251 and 252 of the Act, although LECs and CMRS providers can compel incumbent LECs to negotiate in good faith and invoke arbitration if negotiations fail, incumbent LECs generally lack the ability to compel other LECs and CMRS providers to negotiate for payment for traffic that is not exchanged pursuant to a tariff. In particular, parties have asked the Commission to expand upon the Commission's findings in the 2005 *T-Mobile Order*, which found that incumbent LECs can compel CMRS providers to negotiate to reach an interconnection agreement.

826. After reviewing the record, we conclude it is appropriate to clarify certain aspects of the obligations the Commission adopted in the 2005 *T-Mobile Order*. As a result, in this section, we reaffirm the findings in the *T-Mobile Order* that incumbent LECs can compel CMRS providers to negotiate in good faith to reach an interconnection agreement, and make clear we have authority to do so pursuant to Sections 332, 201, 251 as well as our ancillary authority under 4(i). We also clarify that this requirement does not impose any section 251(c) obligations on CMRS providers, nor does it extend section 252 of the Act to CMRS providers.

827. We decline, at this time, to extend the obligation to negotiate in good faith and the ability to compel arbitration to other contexts. For example, the *T-Mobile Order* did not address relationships involving competitive LECs or among other interconnecting service providers. Subsequently, competitive LECs have requested that the Commission expand the scope of the *T-Mobile Order* and require CMRS providers to negotiate agreements with competitive LECs under the section 251/252 framework, just as they do with incumbent LECs.[1565] In addition, rural incumbent LECs urged the Commission to "extend the T-Mobile Order to give ILECs the right to demand interconnection negotiations with all carriers."[1566] We do not believe the record is currently sufficient to justify doing so, but ask further questions about the policy implications as well as our legal authority to do so in the FNPRM.[1567]

a. Background

828. Regulated intercarrier compensation payments among carriers have been imposed in two basic ways: through tariffs and through carrier-to-carrier agreements. The comprehensive intercarrier compensation reforms we adopt supersede the preexisting access charge regime, bringing that traffic in to the section 251(b)(5) reciprocal compensation framework subject to a transition to bill-and-keep. Under that transitional framework, however, we permit carriers to negotiate alternative intercarrier compensation

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[1565] *See, e.g.*, Pac-West Comments at 3; PAETEC et al. Section XV Reply at 23-24; Letter from Michael B. Hazzard, counsel for Xspedius, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Aug. 10, 2005); Supra Telecommunications and Information Systems *Ex Parte* Comments and Cross-Petition for Limited Clarification, CC Docket No. 01-92 at 10 (filed July 14, 2005).

[1566] NECA et al. Section XV Comments at 29 n.67, 30.

[1567] *See infra* para. 1324.

arrangements to the default rates specified in the tariffs.[1568] In addition, the FNPRM seeks comment on the appropriate long-term implementation framework, including whether even the transitional role for tariffing should be replaced, with carriers relying solely on interconnection agreements.[1569]

829. Notably, interconnection, and the associated intercarrier compensation, has evolved since the passage of the 1996 Act in a manner different than originally anticipated. The Act contemplated that competitive carriers would obtain reciprocal compensation arrangements with incumbent LECs by request, leading to negotiation and, if necessary, arbitration.[1570] The 1996 Act included an implementation framework in section 252, which "introduced a mechanism by which CMRS providers may compel LECs to enter into bilateral interconnection arrangements."[1571] The Act also provides specific legal standards for reciprocal compensation that states are required to apply in resolving disputes, and these statutory standards help to define the scope of the obligations in question.[1572] Section 252 also provides that parties may enter into arrangements without regard to these standards, but specifically contemplates that such arrangements would be the product of a negotiation process.[1573] Section 252 did not expressly impose the same obligations on CMRS providers, or other non-incumbent LECs, to ensure payment of the associated intercarrier compensation, however. With respect to intercarrier compensation in particular, experience has not borne out prior views presuming a limited need for regulatory protections for incumbent LECs. In particular, given mandatory interconnection and restrictions on blocking traffic, LECs have been unable to avoid terminating traffic delivered to them even absent a compensation agreement, and experience has shown that even incumbent LECs thus can be at a negotiating disadvantage in particular circumstances.

830. Consequently, the Commission found in the *T-Mobile Order*, terminating LECs had difficulty getting other carriers, such as CMRS providers, to enter into agreements for compensation for non-access traffic absent a legal compulsion for those carriers to do so.[1574] Although certain states, in response, allowed the filing of wireless termination tariffs, the Commission prohibited those on a prospective basis as inconsistent with the framework established in sections 251 and 252 of the Act.[1575] That prohibition of tariffs, standing alone, would have left incumbent LECs with no meaningful way to obtain an arrangement for the receipt of compensation from CMRS providers that complied with the relevant default requirements under the Act and Commission rules. Thus, the *T-Mobile Order* adopted section 20.11(e) of the Commission's rules, which authorizes incumbent LECs to request interconnection and requires CMRS providers to comply with "the negotiation and arbitration procedures set forth in section 252 of the Act."[1576] The *T-Mobile Order* also required CMRS providers to "negotiate in good faith" and follow the Commission's interim transport and termination pricing rules once a request for

[1568] *See supra* Section XII.C (discussion of the transition period).

[1569] *See infra* Section XVII.N (seeking comment on interconnection).

[1570] *See* 47 U.S.C. §§ 251(b)(5), 252(a).

[1571] *T-Mobile Order*, 20 FCC Rcd at 4861, para. 11.

[1572] *See* 47 U.S.C. § 251(b)(5), 252(d)(2).

[1573] 47 U.S.C. § 252(a)(1).

[1574] *T-Mobile Order*, 20 FCC Rcd at 4864, para. 15.

[1575] *T-Mobile Order*, 20 FCC Rcd at 4863-64, para. 14.

[1576] *T-Mobile Order*, 20 FCC Rcd at 4863-65, paras. 14-16. *See also* 47 C.F.R. § 20.11(e).

interconnection is made.[1577]

831. Subsequently, the Rural Cellular Association (RCA) and the American Association for Paging Carriers (AAPC) filed petitions asking the Commission to reconsider certain aspects of the *T-Mobile Order*. RCA argues that the Commission exceeded its authority by directly applying sections 251(c) and 252 of the Act to CMRS carriers.[1578] Specifically, it argues that the Commission cannot require CMRS providers to interconnect directly with ILECs pursuant to section 251(c), or submit to compulsory arbitration pursuant to section 252.[1579] Likewise the American Association of Paging Carriers argues that section 20.11(e) of the Commission's rules is contrary to the Administrative Procedures Act because the Commission failed to give notice of the proposed rule, and that section 20.11(e) contravenes Congressional intent by directly applying section 251(c) to CMRS providers.[1580] In addition, the Commission received several petitions seeking clarification regarding the operation of the *T-Mobile Order* and the state of the law that existed prior to that decision.[1581]

b. Petitions for Reconsideration of the *T-Mobile Order*

832. As described below, we resolve the challenges several parties have made to the Commission's authority to adopt sections 20.11(d) and (e). We conclude that the Commission has both direct and ancillary authority to permit incumbent LECs to request interconnection from a CMRS provider and invoke the negotiation and arbitration procedures of section 252 of the Act. Given this clarification of the Commission's exercise of its authority, we find that these requirements, codified in section 20.11(e) of the Commission's rules, are consistent with the Act. We also conclude that the adoption of those requirements in the *T-Mobile Order* was procedurally proper, and we consequently deny requests to reconsider that rule.

(i) Authority To Adopt Section 20.11(e) of the Commission's Rules

833. In its petition for reconsideration, RCA claims that the Commission lacked authority to adopt section 20.11(e) of the Commission's rules arguing that the Commission cannot directly apply section 251(c) of the Act to CMRS providers by requiring them to interconnect directly with ILECs, or submit to compulsory arbitration pursuant to section 252 of the Act.[1582] RCA misinterprets the nature of the Commission's action in the *T-Mobile Order*, however, viewing it as the direct application of sections 251(c) and 252 to CMRS providers.[1583] Properly understood, the Commission did not apply sections

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[1577] 47 C.F.R. § 20.11(e). The applicable rules for interim transport and termination pricing are found in section 51.715 of the Commission's rules.

[1578] RCA Petition for Clarification or, in the Alternative, Reconsideration, CC Docket No. 01-92 at 2-3 (filed Apr. 29, 2005).

[1579] RCA Petition at 6-10.

[1580] AAPC Petition for Reconsideration, CC Docket No. 01-92 at 4-6 (filed Apr. 29, 2005) (AAPC Petition).

[1581] *See, e.g.*, MetroPCS Petition; Missouri Small Telephone Company Group Petition for Reconsideration, CC Docket No. 01-92 (filed Mar. 25, 2005) (MoSTCG Petition) (seeking clarification that small ILECs may opt in to existing traffic termination arrangements that wireless carriers have with other rural ILECs); T-Mobile USA Petition for Clarification or, in the Alternative, Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005) (seeking clarification on the pricing rules that apply during negotiations between wireless carriers and ILECs).

[1582] RCA Petition at 6–10.

[1583] *Id*.

251(c) and 252 in that manner.[1584] Rather, the *T-Mobile Order* obligations imposed on CMRS providers, codified in section 20.11(e) of the Commission's rules, implement the Commission's authority under sections 201 and 332, and are reasonably ancillary to the implementation of our statutorily mandated responsibilities under sections 201, 251(a)(1), 251(b)(5) and 332.

834. *Direct Authority Under Sections 201 and 332.* Sections 201 and 332 of the Act provide a basis for rules allowing an incumbent LEC to request interconnection, including associated compensation, from a CMRS provider and invoke the negotiation and arbitration procedures set forth in section 252 of the Act. Section 332(c)(1)(B) states that "[u]pon reasonable request of any person providing commercial mobile service, the Commission shall order a common carrier to establish physical connections with such service" pursuant to the provisions of section 201 of the Act.[1585] Section 201(a) provides that "every common carrier engaged in interstate or foreign communication by wire or radio" shall: (i) "furnish such communication service upon reasonable request therefore;" and (ii) "in accordance with the orders of the Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes."[1586] We have long relied on these provisions to regulate the terms of LEC-CMRS interconnection, including associated compensation.

835. Historically, interconnection requirements imposed under these provisions were understood to encompass not only the technical linking of networks, but also the associated compensation. For example, intercarrier compensation under the access charge regime had, as its origin, the need to "ensur[e] *interconnection* at reasonable rates, as required under Section 201 of the Act, 47 U.S.C. § 201."[1587] Likewise, the Commission previously has specified not only the intercarrier

[1584] *See infra* Section XII.C.5.b(ii).

[1585] 47 U.S.C. § 332(c)(1)(B).

[1586] 47 U.S.C. § 201(a). Although section 201(a) requires an opportunity for hearing, our previous use of notice and comment procedures to satisfy the section 201 hearing requirement was expressly confirmed by the U.S. Court of Appeals for the Third Circuit. *See Bell Telephone Co. v. FCC,* 503 F.2d 1250, 1265 (3rd Cir. 1974) (holding that section 201(a) permits procedures less formal and adversarial than an evidentiary hearing because, among other things, courts have come to favor rulemaking over adjudication for the formulation of new policy), *cert. denied*, 422 U.S. 1026 (1974). As discussed below, the Commission provided notice and received comment here. *See infra* para. 843. Consequently, we reject arguments that the Commission cannot rely on its section 201(a) authority to require interconnection through a rulemaking proceeding. *See, e.g.,* RCA Reply, CC Docket No. 01-92 at 4-5 (filed July 11, 2005). For further discussion of the Commission's authority under sections 332 and 201 to regulate LEC-CMRS intercarrier compensation, *see* Section XV.

[1587] *American Telephone and Telegraph Company and the Bell System Operating Companies Tariff F.C.C. No. 8 (BSOC 8); Exchange Network Facilities for Interstate Access (ENFIA),* CC Docket No. 78–371, Order on Reconsideration, 93 FCC 2d 739, para. 33 (1983) (emph. added) (adopting certain tariffed charges as "inherently a temporary measure, intended to provide a means of approximating costs that cannot be known with precision until a more permanent access charge system can be put in place"). *See also MTS and WATS Market Structure Inquiry (Phase I)*, 93 FCC 2d 241, paras. 37-39 (1983) (concluding that "[s]ection 201(a) authorizes this Commission to replace the industry-devised contractual arrangement with a Commission-devised formula" and adopting access charge rules); *Investigation of Access and Divestiture Related Tariffs; MTS and WATS Market Structure,* CC Docket No. 83–1145 Phase I, CC Docket No. 78–72 Phase I, Memorandum Opinion and Order, 98 FCC 2d 730 (1984) (holding that "[p]ursuant to 47 U.S.C. §§ 154(i), 201(a), and 205(a), the Commission is authorized to establish charges for carrier interconnections."); *Hawaiian Telephone Company Tariff F.C.C. No. 18, Exchange Network Facilities for Interstate Access Hawaiian Telephone Company Tariff F.C.C. No. 19, Customer Indirect Network Exchange Access Hawaiian Telephone Company Revisions to Tariff F.C.C. No. 11, Foreign Exchange Service*, Memorandum Opinion and Order, 85 FCC 2d 767, para. 6 (Com. Car. Bur. 1981) (observing that "a great deal of (continued…)

compensation required in conjunction with interconnection by, and with, CMRS providers, but also the mechanism for implementing those compensation obligations. Even prior to the adoption of section 332 of the Act, the Commission relied on its section 201 authority to require LECs and CMRS providers to negotiate interconnection agreements in good faith governing the physical interconnections among these carriers, as well as the associated charges.[1588] Following the adoption of section 332, the Commission affirmed that "LECs [must] provide reasonable and fair interconnection for all commercial mobile radio services,"[1589] including "mutual compensation" by each interconnected carrier for "the reasonable costs incurred by such providers in terminating traffic" that originated on the other carrier's facilities.[1590] At that time the Commission retained its then-existing implementation framework, which primarily relied on negotiated agreements with only a limited role expressly identified for tariffing, while observing that this framework would be subject to "review and possible revision."[1591]

836. In the *T-Mobile Order* the Commission built upon the existing rules governing interconnection and compensation for non-access traffic exchanged between LECs and CMRS providers, incorporating the right of incumbent LECs to request interconnection with a CMRS provider, including associated compensation, and adopting an implementation mechanism.[1592] It established obligations surrounding the pre-existing duty both CMRS providers and ILECs have to establish connections between their respective networks, as well as exercising the Commission's authority over the pre-existing tariffing regime. We find, in light of the analysis and precedent above, that these actions are supported by the Commission's authority under sections 201 and 332 of the Act.[1593]

837. *Ancillary Authority*. Ancillary authority also supports the *T-Mobile Order* requirement that CMRS providers comply with the negotiation and arbitration procedures set forth in section 252 of

(Continued from previous page)

attention has been paid to compensation arrangements because of the legal obligation imposed upon local telephone companies under Section 201 of the Communications Act, 47 U.S.C. § 201, to interconnect their local exchange facilities with interstate services . . . . This right to interconnection is limited only by the duty to pay a fair and reasonable sum to the local telephone companies for the service.").

1588 *The Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services*, Declaratory Ruling, 2 FCC Rcd 2910, 2912-13, paras. 17-21 (1987) (*CMRS Interconnection Declaratory Ruling*).

1589 *Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Services*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd 1411, 1497-98, para. 230 (1994) (*CMRS Second Report and Order*).

1590 *CMRS Second Report and Order*, 9 FCC Rcd at 1498, para. 232 ("LECs shall compensate CMRS providers for the reasonable costs incurred by such providers in terminating traffic that originates on LEC facilities. Commercial mobile radio service providers, as well, shall be required to provide such competition to LECs in connection with mobile-originated traffic terminating on LEC facilities.").

1591 *CMRS Second Report and Order*, 9 FCC Rcd at 1497, 1498, paras. 229, 235.

1592 *T-Mobile Order*, 20 FCC Rcd at 4864-65 para. 16; 47 C.F.R. § 20.11(e). *See also T-Mobile Order*, 20 FCC Rcd at 4864, para. 15 n.61 (observing that, "given uncertainty as to the relationship between the arrangements contemplated in section 20.11 and the section 251/252 agreements contained in the Act . . . the rights of LECs to compel negotiations with CMRS providers are not entirely clear" and that "although CMRS providers may indeed haven an existing legal obligation to compensate LECs for the termination of wireless traffic under section 20.11(b)(2) . . . the rules fail to specify the mechanism by which LECs may obtain this compensation").

1593 *See, e.g.*, CenturyTel Opposition, CC Docket No. 01-92 at 7 (filed June 30, 2005) (supporting the Commission's authority to adopt the relevant rules pursuant to sections 201 and 332 of the Act); CTIA Opposition, CC Docket No. 01-92 at 2 (filed June 30, 2005) (same); SBC Opposition, CC Docket No. 01-92 at 5 (filed June 30, 2005) (same).

the Act.[1594] Ancillary jurisdiction may be employed, at the Commission's discretion, when two conditions are satisfied: "(1) the Commission's general jurisdictional grant under Title I of the Act covers the regulated subject and (2) the regulations are reasonably ancillary to the Commission's effective performance of its statutorily mandated responsibilities."[1595] Both incumbent LECs and CMRS providers are telecommunications carriers, over which we have clear jurisdiction. Further, to meaningfully implement intercarrier compensation requirements established pursuant to sections 201, 332, and 251(b)(5) against the backdrop of mandatory interconnection and prohibitions on blocking traffic under sections 201 and 251(a)(1), it was appropriate for the *T-Mobile Order* to impose requirements on CMRS providers beyond those expressly covered by the language of section 252.

838. As discussed above, pursuant to the authority of sections 201 and 332, the Commission required interconnected LECs and CMRS providers to pay mutual compensation for the non-access traffic that they exchange.[1596] Even if sections 201 and 332 were not viewed as providing direct authority to require that CMRS providers negotiate interconnection agreements with incumbents LECs for the exchange of non-access traffic under the section 252 framework, such action clearly is reasonably ancillary to the Commission's authority under those provisions, including the associated requirement to pay mutual compensation. Likewise, although section 251(b)(5) does not itself require CMRS providers to enter reciprocal compensation arrangements, the Commission brought intraMTA LEC-CMRS traffic within that framework.[1597] CMRS providers received certain benefits from this regime,[1598] and the Commission likewise anticipated that they would enter agreements under which they would both "receive reciprocal compensation for terminating certain traffic that originates on the networks of other carriers, and . . . pay such compensation for certain traffic that they transmit and terminate to other carriers."[1599] Further, when carriers are indirectly interconnected pursuant to section 251(a)(1), as is often the case for LECs and CMRS providers, the carriers' interconnection arrangements can be relevant to addressing the appropriate reciprocal compensation, as the Commission recently recognized.[1600]

839. Given that the Commission prohibited tariffing of wireless termination charges for non-access traffic on a prospective basis, LECs needed to enter into agreements with CMRS providers providing for compensation under those regimes. Because LEC-CMRS interconnection is compelled by section 251(a)(1) of the Act, and section 201 of the Act also generally restricts carriers from blocking

[1594] *See, e.g.*, SBC Opposition, CC Docket No. 01-92 (filed June 30, 2005) (citing the Commission's "authority under 47 U.S.C. § 154(i) to 'make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions'").

[1595] *Comcast Corp. v. FCC*, 600 F.3d 642, 646 (D.C. Cir. 2010) quoting *Am. Library Ass'n v. FCC*, 406 F.3d 689, 691-692 (D.C. Cir. 2005).

[1596] *See supra* para. 834.

[1597] *See infra* Section XV.

[1598] *See, e.g.*, *Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042 ("We therefore conclude that section 251(b)(5) prohibits charges such as those some incumbent LECs currently impose on CMRS providers for LEC-originated traffic. As of the effective date of this Order, a LEC must cease charging a CMRS provider or other carrier for terminating LEC-originated traffic and must provide that traffic to the CMRS provider or other carrier without charge.").

[1599] *See, e.g.*, *Local Competition First Report and Order*, 11 FCC Rcd at 16018, para. 1045.

[1600] *Petition of CRC Communications of Maine, Inc. and Time Warner Cable Inc. for Preemption Pursuant to Section 253 of the Communications Act, as Amended, et al.*, WC Docket No. 10-143, CC Docket No. 01-92, GN Docket No. 09-51, Declaratory Ruling, 26 FCC Rcd 8259, 8270, para. 21 (2011) (*Interconnection Clarification Order*).

traffic,[1601] experience revealed that incumbent LECs would have limited practical ability to ensure that CMRS providers negotiated and entered such agreements because they could not avoid terminating the traffic even in the absence of an agreement to pay compensation. To ensure that the balance of regulatory benefits intended for each party under the LEC-CMRS interconnection and compensation regimes was not frustrated, it was necessary for the Commission to establish a mechanism by which incumbent LECs could request interconnection, and associated compensation, from CMRS providers, and ensure that those providers would negotiate those agreements, subject to an appropriate regulatory backstop. Thus, the Commission's section 4(i) authority also supports the *T-Mobile Order* requirement that CMRS providers negotiate interconnection agreements with incumbent LECs in good faith under the section 252 framework.

(ii) Consistency with the Communications Act and the Administrative Procedures Act

840. In response to the concerns of some Petitioners, we clarify that the negotiation and arbitration requirements adopted for CMRS providers in the *T-Mobile Order* did not impose section 251(c) on CMRS providers.[1602] As commenters observe, with one exception, the requirements of section 251(c) expressly apply to incumbent LECs, and nothing in the *T-Mobile Order* attempts to extend those statutory requirements to CMRS providers.[1603] Nor does the reference to "interconnection" in section 20.11(e) of the Commission's rules apply to CMRS providers the statutory interconnection obligations governing incumbent LECs under section 251(c)(2).[1604] As the *T-Mobile Order* makes clear, the primary focus of that rule is to provide a mechanism to implement mutual compensation for non-access traffic between incumbent LECs and CMRS providers.[1605] However, the Commission's mutual compensation rules were adopted in the context of addressing LEC-CMRS interconnection, against a backdrop where "interconnection" regulations were understood to encompass not only the physical connection of networks, but also the associated intercarrier compensation.[1606] In addition, as the Commission recently

[1601] Although the Commission's prohibitions on blocking under section 201 generally apply to interstate traffic, *see, e.g.*, *Call Blocking Declaratory Ruling*, 22 FCC Rcd 11629, given LECs' indirect interconnection with CMRS providers, and the fact that CMRS providers' telephone numbers are not tied to particular geographic locations, it is unclear that a LEC that undertook to block intrastate CMRS traffic could avoid blocking interstate traffic.

[1602] *See generally* AAPC Petition at 4; RCA Petition at 2, 5-6, 8-11. *But see, e.g.*, MetroPCS Communications Petition for Limited Clarification or Partial Reconsideration, CC Docket No. 01-92 at 2 n.8 (filed Apr. 29, 2005) (MetroPCS Petition) ("The *Order* was not intended to impose upon other CMRS carriers the panoply of duties under Section 251(c) of the Act - - e.g., the duty to provide direct interconnection under § 251(c)(2), the duty to provide unbundled access under § 251(c)(3), the duty to offer resale under § 251(c)(4), the duty to provide notice of changes under § 251(c)(4) or the duty to allow collocation under § 251(c)(5)."); T-Mobile Opposition and Comments, CC Docket No. 01-92 at 5 (filed June 30, 2005) ("T-Mobile does not read the *WTT Order* as having imposed interconnection obligations on CMRS providers pursuant to the Commission's authority to implement Section 251(c) of the Communications Act.").

[1603] *See, e.g.*, AllTel Opposition, CC Docket No. 01-92, at 2-3 (filed June 30, 2005); Leap Comments, CC Docket No. 01-92 at 4 (filed June 30, 2005). Section 251(c)(1) also requires "requesting telecommunications carriers . . . to negotiate in good faith the terms and conditions of" interconnection agreements. 47 U.S.C. § 251(c)(1).

[1604] *See, e.g.*, RCA Petition at 3, 5-6, 9.

[1605] *See, e.g.*, *T-Mobile Order*, 20 FCC Rcd at 4864-65, 15-16.

[1606] *See supra* para 835. We thus conclude that the definition of "interconnection" in section 51.5 of the Commission's rules is not dispositive of the interpretation of that term here. *See, e.g.*, RCA Petition at 4 (citing the definition of "interconnection" in 47 C.F.R. § 51.5, which is focused on "the linking of two networks" and excluding "transport and termination of traffic"). This rule was codified in Part 20, not Part 51.

recognized, interconnection arrangements can bear on the resolution of disputes regarding reciprocal compensation under the section 252 framework.[1607] For example, while interconnection for the exchange of access traffic does not currently implicate section 251(b), an interconnection agreement for the exchange of reciprocal compensation traffic may contain terms relevant to determining appropriate rates under the statute and Commission rules.[1608] Moreover, section 20.11(e) of the Commission's rules does not supplant or expand the otherwise-applicable interconnection obligations for CMRS providers, as some contend.[1609] Thus, in response to a request by an incumbent LEC for interconnection under section 20.11(e), CMRS providers are not required to enter into direct interconnection, and may instead satisfy their obligation to interconnect through indirect arrangements.

841. Similarly, the Commission did not interpret section 252 as binding on CMRS providers in the same manner as incumbent LECs.[1610] Rather, the Commission exercised its authority under sections 201, 332, 251 and 4(i) to apply to CMRS providers' duties analogous to the negotiation and arbitration requirements expressly imposed on incumbent LECs under section 252.[1611] Although Congress did not expressly extend these requirements this broadly in section 252 of the Act, our

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[1607] *Petition of CRC Communications of Maine, Inc. and Time Warner Cable Inc. for Preemption Pursuant to Section 253 of the Communications Act, as Amended, et al.*, WC Docket No. 10-143, CC Docket No. 01-92, GN Docket No. 09-51, Declaratory Ruling, 26 FCC Rcd 8259, 8270, para. 21 (2011) (*Interconnection Clarification Order*); *Local Competition First Report and Order*, 11 FCC Rcd at 15991, para. 997 ("we find that indirect connection (e.g., two non-incumbent LECs interconnecting with an incumbent LEC's network) satisfies a telecommunications carrier's duty to interconnect pursuant to 251(a)").

[1608] *See, e.g.*, 47 U.S.C. §§ 251(b)(5), 252(d)(2)(A); 47 C.F.R. § 51.701(b)(1) (specifically excluding "interstate or intrastate exchange access, information access, or exchange services for such access" from the scope of the reciprocal compensation pricing rules); *Local Competition First Report and Order,* 11 FCC Rcd at 16012-25, paras. 1033-59; s*ee also id.*

[1609] *See, e.g.*, RCA Petition at 3, 5-6, 9. *See also, e.g.*, Nextel Partners Comments and Opposition, CC Docket No. 01-92 at (filed June 30, 2005) (arguing that section 20.11(e) of the Commission's rules should not be interpreted to "impose new physical interconnection negotiations on CMRS providers"); Qwest Opposition, CC Docket No. 01-92 at 2 n.4 (filed June 30, 2005) (acknowledging that "ILECs do not have a statutory right to demand Section 251(b) or (c) interconnection with CMRS carriers," but that "they certainly have the right to demand interconnection with CMRS providers pursuant to Sections 201(a) and 251(a) of the Act and to insist that the CMRS provider conduct itself in good faith during the negotiation (and performance) phases of the agreement."); Cingular Wireless Reply, CC Docket No. 01-92 at 2-4 (filed July 11, 2005) (arguing that the *T-Mobile Order* should not be interpreted to impose a new direct interconnection requirement on CMRS providers). For these same reasons, we reject the claim that section 20.11(e) is in conflict with section 20.11(a) of the Commission's rules, which grants CMRS providers certain interconnection rights with respect to incumbent LECs. *See* RCA Petition at 5-6 (citing 47 C.F.R. § 20.11(a)). Nothing in section 20.11(e) of the Commission's rules should be read to eliminate CMRS providers' rights under section 20.11(a).

[1610] *See*, *e.g.*, *T-Mobile Order*, 20 FCC Rcd at 4864, para. 15 (observing that "LECs may not require CMRS providers to negotiate interconnection agreements or submit to arbitration under section 252 of the Act"). As AAPC observes, for example, "the *ILEC's* receipt of a request for interconnection from another telecommunications carrier is an explicit condition precedent" to a petition for arbitration under section 252. AAPC Petition at 4 (citing 47 U.S.C. § 252(b)(1)) (emphasis in original).

[1611] *See, e.g.*, CTIA Opposition, CC Docket No. 01-92 at 6 (filed June 30, 2005) ("Thus, the references to Section 252 in the *Order* and in the amended Section 20.11 were simply a shorthand way of generally describing the procedures that the Commission intended to make available to the requesting ILECs in negotiating reciprocal compensation agreements."); T-Mobile Opposition and Comments, CC Docket No. 01-92 at 6 (filed June 30, 2005) ("The Commission also should clarify that, as discussed above, any reference to negotiation and arbitration procedures under Section 252 is solely a shorthand for procedures similar to those that the Commission has applied under Section 252, rather than reliance upon Section 252 as its jurisdictional authority.").

subsequent experience with interconnection and intercarrier compensation, as described above, demonstrate the need for the duties imposed on CMRS providers in the *T-Mobile Order*.[1612] Thus, the Commission sensibly required CMRS providers to negotiate interconnection agreements with incumbent LECs in good faith, subject to arbitration by the state or, where the state lacks authority[1613] or otherwise fails to act,[1614] by the Commission.[1615] This approach also is supported by the concept of cooperative federalism, which is reasonably contemplated by sections 251 and 252 of the Act.[1616] Because of the cooperative federalism embodied by sections 251 and 252, and the role of the Commission in arbitrating interconnection disputes under the section 252 framework when states lack authority or otherwise fail to act, we also reject claims that the *T-Mobile Order* constituted an unlawful delegation to the states.[1617]

842. We also do not interpret silence in certain provisions of the Act regarding the duties of CMRS providers as precluding the Commission's action in the *T-Mobile Order*. For one, we reject requests that we ignore the Commission's experience with interconnection and intercarrier compensation and treat Congress' silence regarding the rights of incumbent LECs to invoke negotiation and arbitration in section 252 of the Act as equivalent to a statutory prohibition on extending such rights.[1618] Nor are we persuaded that the language of section 332(c)(1)(B) precludes the Commission's extension of section

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[1612] *See supra* paras. 828-836.

[1613] *See, e.g.*, *Petition of WorldCom, Inc. for Preemption of Jurisdiction of the Virginia State Corporation Commission Pursuant to Section 252(e)(5) of the Telecommunications Act of 1996 and for Arbitration of Interconnection Disputes With Verizon-Virginia, Inc.*, CC Docket No. 00-218, Memorandum Opinion and Order, 16 FCC Rcd 6224 (2001).

[1614] *See, e.g.*, *Petition of Northland Networks, Ltd. For Preemption of the Jurisdiction of the New York Public Service Commission Pursuant to Section 252(e)(5) of the Communications Act of 1934, as Amended*, WC Docket No. 03-242, Memorandum Opinion and Order, 19 FCC Rcd 2396 (Wir. Comp. Bur. 2004).

[1615] *See generally* 47 C.F.R. Part 51, Subpart I.

[1616] *See, e.g.*, *Core v. Verizon PA*, 493 F.3d 333 (3d Cir. 2007); *Centennial Puerto Rico License Corp. v. Telecom. Reg. Bd. of Puerto Rico*, 634 F.3d 17, 22 (1st Cir. 2011).

[1617] *See, e.g.*, AAPC Petition at 6; RCA Reply, CC Docket No. 01-92 at 7-9 (filed July 11, 2005). We also disagree with RCA that a role for the states is at odds with the "uniform, national deregulatory environment for CMRS" that "Congress sought to achieve." RCA Reply, CC Docket No. 01-92 at 7-8 (filed July 11, 2005). As the D.C. Circuit recently recognized, a state role in the context of LEC-CMRS interconnection issues can be "consistent with the dual regulatory scheme assumed in the Communications Act" notwithstanding concerns about a resulting "patchwork of regulatory schemes throughout the states [that could] undermine Congress's understanding that 'mobile services ... by their nature, operate without regard to state lines as an integral part of the national telecommunications infrastructure.'" *MetroPCS v. FCC*, 644 F.3d 410, 413-14 (D.C. Cir. 2011). *See also id*. at 414 ("the FCC's reasonable reading of the Communications Act and Rule 20.11(b) is not disturbed by MetroPCS's wish that the FCC do it all, which finds no expression in the statute").

[1618] *Compare, e.g.*, RCA Reply, CC Docket No. 01-92 at 6 (filed July 11, 2005) (arguing that, because section 252 expressly imposes certain obligations on incumbent LECs, it is inconsistent with the Act to impose those requirements on other carriers) *with, e.g.*, SBC Opposition, CC Docket No. 01-92 at 5 (filed June 30, 2005) (arguing that the focus on incumbent LECs in section 252 "by no means prohibits the Commission from adopting a rule allowing ILECs to request negotiations"). RCA further observes that section 251(c)(1) expressly requires incumbent LECs to negotiate interconnection agreements in good faith "in accordance with section 252," while the good faith negotiation requirement for requesting carriers does not specifically reference section 252. RCA Reply, CC Docket No. 01-92 at 6 (filed July 11, 2005). This simply reflects the explicit focus on incumbent LECs in the text of section 252, however. Because we do not interpret the Act's silence in section 252 regarding implementation procedures governing non-incumbent LECs as precluding section 20.11(e) of the Commission's rules, we likewise do not interpret section 251(c)(1) in that manner.

252-type procedures in this manner. RCA observes that section 332(c)(1)(B) only expressly discusses requests *by* CMRS providers for interconnection, and contends that precludes rules that would enable incumbent LECs to request interconnection *from* CMRS providers.[1619] As a threshold matter, we observe that CMRS providers are required to interconnect with other carriers under section 251(a) of the Act, and that section 201 also provides the Commission authority to require CMRS providers to interconnect. We thus disagree with RCA's suggestion that section 332 should be read to preclude CMRS providers from being subject to such requests.[1620] With respect to the procedures for implementing such requests, however, we note that the Commission previously has suggested "that the procedures of section 252 are not applicable in matters involving section 251(a) alone."[1621] We find it appropriate to interpret the obligations imposed on CMRS providers under section 20.11(e) in a manner consistent with the Commission's interpretation of the scope of the comparable requirements of section 252 from which it was derived. We thus make clear that section 20.11(e) does not apply to requests for direct or indirect physical interconnection alone, but only requests that also implicate the rates and terms for exchange of non-access traffic.

843. We further find that the rules adopted in the *T-Mobile Order* were procedurally proper, contrary to the contentions of some petitioners.[1622] The Commission's 2001 *Intercarrier Compensation NPRM* expressly sought "comment on the rules [the Commission] should adopt to govern LEC interconnection arrangements with CMRS providers, whether pursuant to section 332, or other statutory authority,"[1623] and "on the relationship between the CMRS interconnection authority assigned to the Commission under sections 201 and 332, and that granted to the states under sections 251 and 252."[1624] The T-Mobile petition was incorporated into the docket in that proceeding, and in response to the Commission's request for comment on that petition,[1625] the issue of LECs being able to request interconnection negotiations with CMRS carriers was raised in the record.[1626] We thus are not persuaded

[1619] RCA Reply, CC Docket No. 01-92 at 5 (filed July 11, 2005).

[1620] *See, e.g., Policy and Rules Concerning the Interstate Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as Amended; Petitions for Forbearance*, CC Docket No. 96-61, Memorandum Opinion and Order, 14 FCC Rcd 391, 398, para. 15 (1998) ("the interconnection requirements of section 251(a) clearly apply to CMRS providers").

[1621] *Interconnection Clarification Order*, 26 FCC Rcd at 8270, para. 21 & n.76.

[1622] *See, e.g.*, AAPC Petition at 4 (arguing that section 20.11(e) of the Commission's rules "was adopted without providing general notice of 'either the terms or substance of the proposed rule' in apparent disregard of the Administrative Procedures Act") (quoting 4 U.S.C. § 553(b)(3)).

[1623] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9642, para. 90.

[1624] *Id.* at 9641, para. 86.

[1625] *Comment Sought on Petitions for Declaratory Ruling Regarding Intercarrier Compensation for Wireless Traffic*, CC Docket No. 01-92, Public Notice, 17 FCC Rcd 19046 (2002); Intercarrier Compensation for Wireless Traffic, 67 Fed. Reg. 64,120 (Oct. 17, 2002) (publishing the Public Notice in the Federal Register). *See also* T-Mobile Opposition and Comments, CC Docket No. 01-92 at 7 (filed June 30, 2005) ("The Commission fully complied with [notice and comment] requirements by issuing a public notice seeking comment on the reciprocal compensation issues involving CMRS providers and incumbent LECs, as raised in the petition for declaratory ruling filed by T-Mobile and other parties. This public notice was subsequently published in the Federal Register and therefore satisfies the notice-and-comment requirements of the APA.") (footnotes omitted).

[1626] SBC Opposition, CC Docket No. 01-92, at 3 n.7 (filed June 30, 2005). *See also, e.g.*, Alabama Rural Local Exchange Carriers Reply, CC Docket No. 01-92 at 6 (filed Nov. 1, 2002) (The Commission should "revise its existing rules to make it clear that 'that CMRS providers have an affirmative obligation to negotiate and enter into interconnection compensation agreements with independent LECs' prior to terminating traffic to such LECs (continued…)

that parties lacked adequate notice and an opportunity to comment on the requirements ultimately imposed in section 20.11(e) of the Commission's rules.

c. Requests for Clarification

844. A number of petitions seek clarification regarding the operation of the *T-Mobile Order* and/or the state of the law that existed prior to such decision.[1627] Except insofar as discussed above,[1628] or in our actions regarding wireless intercarrier compensation generally,[1629] we decline to provide such clarification here. The Commission has discretion whether to issue a declaratory ruling, and rather than addressing these requests here, we can address issues as they arise.[1630]

d. Extending *T-Mobile* to Other Contexts

845. We decline, at this time, to extend the obligations enumerated in the *T-Mobile Order* to other contexts. As discussed above, the *T-Mobile Order* imposed on CMRS providers the duty to negotiate interconnection agreements with incumbent LECs under the section 252 framework.[1631] However, the *T-Mobile Order* did not address relationships involving competitive LECs or among other interconnecting service providers. Subsequently, competitive LECs have requested that the Commission expand the scope of the *T-Mobile Order* and require CMRS providers to negotiate agreements with competitive LECs under the section 251/252 framework, just as they do with incumbent LECs.[1632] In addition, rural incumbent LECs urged the Commission to "give small carriers some legal authority to demand a negotiated interconnection agreement," and argued that "the Commission should extend the *T-Mobile Order* to give ILECs the right to demand interconnection negotiations with all carriers."[1633] Policy and legal issues surrounding the possible extension of the *T-Mobile Order* are insufficiently addressed in our current record, and as such we seek comment in the accompanying FNPRM on whether to extend *T-Mobile Order* obligations to other contexts.[1634]

846. However, this issue remains highly relevant notwithstanding our adoption of bill-and-keep as the default for reciprocal compensation between LECs and CMRS providers under section

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pursuant to arrangements with an RBOC.") (quoting Frontier and Citizens Comments, CC Docket 01-92, at 8 (filed Oct. 18, 2002).

[1627] *See, e.g.*, MetroPCS Petition; Missouri Small Telephone Company Group Petition for Reconsideration, CC Docket No. 01-92 (filed Mar. 25, 2005) (MoSTCG Petition); T-Mobile USA Petition for Clarification or, in the Alternative, Reconsideration, CC Docket No. 01-92 (filed Apr. 29, 2005).

[1628] *See supra* Section XII.C.5.b.

[1629] *See infra* Section XV.

[1630] *See* 47 C.F.R § 1.2; *Yale Broadcasting Co. v. FCC*, 478 F.2d 594, 602 (D.C. Cir. 1973) (Commission did not abuse its discretion by declining to grant a declaratory ruling).

[1631] *See supra* XII.C.5.

[1632] *See, e.g.*, Pac-West Comments at 3; PAETEC et al. Section XV Reply at 23-24; Letter from Michael B. Hazzard, counsel for Xspedius, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Aug. 10, 2005); Supra Telecommunications and Information Systems *Ex Parte* Comments and Cross-Petition for Limited Clarification, CC Docket No. 01-92 at 10 (filed July 14, 2005).

[1633] NECA et al. Section XV Comments at 29 n.67, 30.

[1634] *See infra* para. 1324

251(b)(5).[1635] Under a bill-and-keep methodology, carriers still will need to address issues such as the "edge" for defining the scope of bill-and-keep, subject to arbitration where they cannot reach agreement.[1636] These issues do not lend themselves well to one-size-fits-all approaches as would be required under a tariffing regime. Imposing a duty to negotiate, subject to arbitration, will negate the need for Commission intervention in this context and will facilitate more market-based solutions.[1637] Because we also maintain our existing requirements regarding interconnection and prohibitions on blocking traffic, our experience suggests that carriers under no legal compulsion to come to the table may have no incentive to do so, thus frustrating the efforts of interconnected carriers to resolve open questions. The section 252 framework—already in place in other contexts under the terms of the Act—may be a reasonable mechanism to use to address these situations.

XIII. RECOVERY MECHANISM

A. Introduction

847. In this section, we adopt a transitional recovery mechanism to facilitate incumbent LECs' gradual transition away from ICC revenues reduced as part of this Order. This mechanism allows LECs to recover ICC revenues reduced as part of our intercarrier compensation reforms, up to a defined baseline, from alternate revenue sources: incremental, and limited increases in end user rates and, where appropriate, universal service support through the Connect America Fund. The recovery mechanism is limited in time and carefully balances the benefits of certainty and a gradual transition with our goal of keeping the federal universal service fund on a budget and minimizing the overall burden on end users.

848. The recovery mechanism is not 100 percent revenue-neutral relative to today's revenues, but it eliminates much of the uncertainty carriers face under the existing ICC system, allowing them to make investment decisions based on a full understanding of their revenues from ICC for the next several years. Absent reform, price cap and rate-of-return carriers alike face an increasingly unpredictable revenue stream from ICC, which will only get worse as demand for traditional telephone service continues to decline. For price cap carriers, under the current system, access rates remain constant as demand declines, so declining MOUs have led to rapid and significant revenue declines. Rate-of-return carriers are experiencing similar declines in intrastate access revenues, because most states do not perform regular true ups of intrastate access rates to reflect declining demand. And while rate-of-return carriers' interstate access rates do increase today as demand declines, in theory holding their interstate access revenues constant, in practice the rapid decline in demand has caused large rate increases that incent other communications providers to develop and use access avoidance schemes.[1638] Such schemes, along with phantom traffic, uncertainty about payment for VoIP, and resulting litigation, have placed significant additional strain on the reliability of intercarrier compensation as a revenue stream for all types

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[1635] *See supra* XV. We hold above that the mutual compensation owed for purposes of section 20.11 of the Commission's rules is coextensive with the reciprocal compensation requirements between LECs and CMRS providers, and we also adopt bill-and-keep as the default reciprocal compensation arrangement in this context. *See supra* XV.C. For convenience, this discussion uses the phrases "mutual compensation" and "reciprocal compensation" interchangeably, without prejudging the appropriate compensation level prior to this Order.

[1636] *See supra* Sections XII.A and XV.

[1637] *See, e.g.*, RNK Communications Section XV Comments at 8 (citing benefits that can arise from a framework that allows parties to negotiate mutually agreeable outcomes, rather than all parties being categorically bound to a single regime); Verizon Section XV Comments at 13-14 (same); Bandwidth.com Reply at 11, 15-17 (same).

[1638] *See, e.g.*, Letter from Jerry Weikle, ERTA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, at 1, 3 (filed July 8, 2011) (ERTA July 8, 2011 *Ex Parte* Letter)(describing arbitrage concerns with respect to Halo Wireless).

of carriers. These trends are only likely to accelerate as communication options for consumers continue to proliferate beyond landline telephone calling.

849. In establishing the framework for recovery, we conclude that carriers should first look to limited recovery from their own end users, consistent with the principle of bill and keep and the model in the wireless industry, and we take measures to ensure that phone rates remain affordable and reasonably comparable among all Americans. Therefore, we adopt several safeguards to protect end users from unreasonable or excessive increases, for example by adopting a Residential Rate Ceiling above which consumer recovery through a federal Access Recovery Charge (ARC) is prohibited, and significantly mitigating ICC recovery from residential consumers by balancing it with recovery from multi-line businesses. We also adopt protections to ensure that multiline businesses do not see any unreasonable increases by adopting a per-line total cap that includes both the federal SLC and the new federal ARC. Additional recovery, when permitted, will be provided from the CAF. We also adopt safeguards to ensure USF stays within our budget and to ensure that CAF ICC support serves to advance our goal of universal voice and broadband, creating significant consumer benefits. We note that, during the transition adopted in this Order, all LECs will continue to collect intercarrier compensation for originating access and dedicated transport, providing continued revenue flows from those sources.

B. Summary

850. Our recovery mechanism has two basic components. First, we define the revenue incumbent LECs are eligible to recover, which we refer to as "Eligible Recovery." Second, we specify how incumbent LECs may recover Eligible Recovery through limited end-user charges and, where eligible and a carrier elects to receive it, CAF support. Competitive LECs are free to recover reduced revenues through end-user charges.

851. *Eligible Recovery.*

- Price cap incumbent LECs' Baseline for recovery will be 90 percent of their Fiscal Year 2011 (FY2011)[1639] interstate and intrastate access revenues for the rates subject to reform and net reciprocal compensation revenues. For price cap carriers' study areas that participated in the Commission's 2000 *CALLS* reforms, and thus have had interstate access rates essentially frozen for almost a decade, Price Cap Eligible Recovery (i.e., revenues subject to our recovery mechanism) will be the difference between: (a) the Price Cap Baseline, subject to 10 percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on estimated MOUs multiplied by the associated default rate for that year. For carriers that have more recently converted to price cap regulation and did not participate in the *CALLS* plan, we phase in the reductions after five years, so that the initial 10 percent reduction occurs in year six. Estimated MOUs will be calculated as FY2011 minutes for all price cap carriers, and will be reduced 10 percent annually for each year of reform to reflect MOU trends over the past several years. Because such demand reductions have applied equally to all price cap carriers, we do not make any distinction among price cap carriers for purposes of this calculation. We adopt this straight line approach to determining MOUs, rather than requiring carriers to report actual minutes each year, because it will be more predictable for carriers and less burdensome to administer.
- Rate-of-return incumbent LECs' Baseline for recovery, which is somewhat more complex, will be based on their 2011 interstate switched access revenue requirement (which is recovered today through interstate access revenues and local switching support (LSS), if

[1639] We define "fiscal year" 2011 for these purposes as October 1, 2010 through September 30, 2011.

applicable), plus FY2011 intrastate terminating switched access revenues and FY2011 net reciprocal compensation revenue. Rate-of-Return Eligible Recovery will be the difference between: (a) the Rate-of-Return Baseline, subject to five percent annual reductions; and (b) the revenues from the reformed intercarrier compensation rates in that year, based on actual MOUs multiplied by the associated default rate for that year. The annual Rate-of-Return Baseline reduction used in the calculation of Rate-of-Return Eligible Recovery revenue reflects two considerations. First, in recent years rate-of-return carriers' interstate switched access revenue requirements have been declining on average at approximately three percent annually due to declining regulated costs, with corresponding declines in interstate access revenues; such declines are projected to continue each year for the next several years.[1640] In addition, rate-of-return carriers' intrastate revenues have been declining on average at 10 percent per year as MOU decline,[1641] with state regulatory systems that typically do not have annual, automatic mechanisms to increase rates to account for declining demand. Weighing these considerations, we find it appropriate to reduce rate-of-return carriers' Eligible Recovery by five percent annually.[1642] This approach to revenue recovery will put most rate-of-return carriers in a better financial position—and will provide substantially more certainty—than the *status quo* path absent reform, where MOU declines would continue to be large and unpredictable and would significantly reduce intrastate revenues. This approach also provides carriers with the benefit of any costs savings and efficiencies they can achieve by enabling carriers to retain revenues even if their switched access costs decline. And it avoids creating misaligned incentives for carriers to inefficiently increase costs to grow their intercarrier compensation revenue requirement and thereby draw more access replacement from the CAF.

852. *Recovery from End Users*. Consistent with past ICC reforms, we permit carriers to recover a limited portion of their Eligible Recovery from their end users through a monthly fixed charge called an ARC. We take measures to ensure that any ARC increase on consumers does not impact affordability of rates, including by limiting the annual increase in consumer ARCs to $0.50. We also make clear that carriers may not charge an ARC on any Lifeline customers.[1643] This charge is calculated independently from, and has no bearing on, existing SLCs, although for administrative and billing efficiencies we do permit carriers to combine the charges as a single line item on a bill.

[1640] *See* Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at Attach. 3 at 1 (filed Sept. 9, 2011) (NTCA Sept. 9, 2011 *Ex Parte* Letter).

[1641] *See generally* Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed April 6, 2011); Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 11, 2011); Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 25, 2011) (collectively *NECA Data Filings*) (based upon aggregation of confidential data).

[1642] We seek comment in the FNPRM asking whether we should change this reduction after five years by either moving to a decline based on MOUs and/or increasing the decline by one percent per year up to a maximum of 10 percent annual baseline decline. *See supra para.* 1329.

[1643] *See, e.g.*, Letter from Chris Riley, Policy Counsel, Free Press, to Marlene H. Dortch, Secretary, FCC, WT Docket No. 11-65, WC Docket Nos. 10-90, 05-337, 03-109, 11-42, GN Docket No. 09-51, CC Docket Nos. 01-92 at 1 (filed Oct. 14, 2011) (urging the Commission to exclude any Lifeline customers from any recovery charge adopted as part of ICC reform).

- *Recovery Fairly Balanced Across All End Users.* We do not, as some commenters urge, put the entire burden of access recovery on consumers. Rather, consistent with the Commission's approach in past reforms, under which business customers also contributed to offset declines in access charges, we balance consumer and single-line business recovery with recovery from multi-line businesses. We also adopt additional measures to protect consumers of incumbent LECs that elect not to receive CAF funding, by limiting the proportion of Eligible Recovery that can come from consumers and single-line businesses based on a weighted share of a carrier's residential versus business lines.[1644]

- *Protections for Consumers Already Paying Rebalanced Rates*. To protect consumers, including in states that have already rebalanced rates through prior state intercarrier compensation reforms, we adopt a Residential Rate Ceiling that prohibits imposing an ARC on any consumer paying an inclusive local monthly phone rate of $30 or more.[1645]

- *Protections for Multi-Line Businesses*. Although we do not adopt a business rate ceiling, nor were there proposals in the record to do so, we do take measures to ensure that multi-line businesses' total SLC plus ARC line items are just and reasonable. The current multi-line business SLC is capped at $9.20. Some carriers, particularly smaller rate of return and mid-size carriers, are at or near the cap, while larger price cap carriers may have business SLCs as low as $5.00. To minimize the burden on multi-line businesses, we do not permit LECs to charge a multi-line business ARC where the SLC plus ARC would exceed $12.20 per line. This limits the ARC for multi-line businesses for entities at the current $9.20 cap to $3.00. We find this limitation for multi-line businesses consistent with the reasons we place an overall limit on the residential ARCs discussed below.

- To recover Eligible Recovery, price cap incumbent LECs are permitted to implement monthly end user ARCs with five annual increases of no more than $0.50 for residential/single-line business consumers, for a total monthly ARC of no more than $2.50 in the fifth year; and $1.00 (per month) per line for multi-line business customers, for a total of $5.00 per line in the fifth year, provided that: (1) any such residential increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20. The monthly ARC that could be charged to any particular consumer cannot increase by more than $0.50 annually, and in fact we estimate that the average increase in the monthly ARC that would be permitted across all consumer lines over the period of reform, based on the amount of eligible recovery, is approximately $0.20 annually.[1646] However, we expect that not all

[1644] This limitation is only necessary for carriers that are not eligible or elect not to receive CAF funding because carriers recovering from CAF will have the full ARC imputed to them.

[1645] The Residential Rate Ceiling is based on the state basic local residential service rate plus the federal SLC and the ARC; the flat rate for residential local service, mandatory extended area service charges, and state subscriber line charges; per-line state high cost and/or access replacement universal service contributions; state E911 charges; and state TRS charges. *See infra* paras. 913-916.

[1646] FCC Staff Analysis. Using incumbent LECs' filings in this docket, staff totaled each LECs' access revenues that are being reduced as a result of this Order, and then converted these aggregate dollar figures into a per line amount by dividing by the carrier's average lines in service for the most recent filing period. *See* Letter from Karen Brinkmann, Counsel to Alaska Communications Systems, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Sept. 7, 2011); Letter from Karen Brinkmann, Counsel to Hawaiian Telecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed June 24, 2011); Letter from Karen Brinkmann, Counsel to Fairpoint, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. (continued…)

carriers will elect or be able to charge the ARC due in part to competitive pressures, and we therefore predict the average actual increase across all consumers to be approximately $0.10-$0.15 each year, peaking at approximately $0.50 to $0.90 after five or six years, and declining thereafter.[1647]

- To recover Eligible Recovery, rate-of-return incumbent LECs are permitted to implement monthly end user ARCs with six annual increases of no more than $0.50 (per month) for

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09-51 at Attach. (filed Apr. 19, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at 2 (filed Apr. 14, 2011); Letter from Christopher Heimann, General Attorney, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Apr. 8, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Ex. 1 (filed Mar. 24, 2011); Letter from Maggie McCready, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Ex. 1 (filed Mar. 14, 2011); Letter from Melissa Newman, Vice President-Federal Relations, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at Attach. (filed Jan. 18, 2011); CenturyLink, Response to FCC Data Request, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 (filed Jan. 13, 2011); Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Dec. 16, 2010); Letter from Malena Barzilai, Regulatory Counsel & Director – Federal Regulatory Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed Oct. 15, 2010) (collectively *ILEC Data Filings*) (collectively, *ILEC Data Filings*); *see also*, Letter from Regina McNeil, Vice President of Legal, General Counsel and Corporate Secretary, NECA, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed May 25, 2011); Letter from Regina McNeil, Vice President of Legal, General Counsel and Corporate Secretary, NECA, to Marlene H. Dortch, Secretary, FCC, and Lynne Hewitt Engledow, Pricing Policy Division, Wireline Competition Bureau, FCC, CC Docket No. 01-92, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51 at Attach. (filed May 11, 2011); Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 80-286 at Attach. (filed Dec. 29, 2010). Staff then trended this value over the period of reform to reflect the excess MOU loss over expected line loss (annual declines of 10 percent and 7.5 percent respectively), and applied the appropriate reduction to eligible recovery. This produced the approximate total recovery need per line for the carrier over the course of reform. Staff then divided this value by the number of ARC increases (5 for price cap, 6 for rate of return) to get an average ARC increase across all lines. Staff then adjusted this average based on each carrier's mix of residential and single line businesses to multiline businesses and the carrier's potential annual ARC increases, factoring in the annual caps of $0.50 and $1.00 on consumers and multiline businesses respectively, the residential ceiling of $30 and the business ARC + SLC limit of $12.20 and the exclusion of Lifeline lines, to estimate the average imputed consumer ARC increase.

[1647] To estimate likely actual consumer ARC increase, staff applied a 25-50 percent reduction factor to the theoretically permitted ARCs to reflect our expectation that competitive pressures will prevent carriers from imposing the full charges on all consumers. Filings in the record support our prediction that carriers will not charge the maximum permitted ARCs on all customers. *See, e.g.*, Reply Comments of AT&T Inc. on the Missoula Plan for Intercarrier Compensation Reform, CC Docket No. 01-92, filed Feb. 1, 2007, Exhibit 1 at n. 11. *See also* http://www.phoenix-center.org/perspectives/Perspective11-06Final.pdf (suggesting carriers would realize as little as 40 percent ARC recovery). We recognize that these estimates are necessarily predictive and imprecise, however, and we believe any burden on consumers will be significantly outweighed by the benefits of reform even if carriers are able to charge the full permitted ARCs.

residential/single-line business consumers, for a total ARC of no more than $3.00 in the sixth year; and $1.00 (per month) per line for multi-line business customers for a total of $6.00 per line in the sixth year, provided that: (1) such increases would not result in regulated residential end-user rates that exceed the $30 Residential Rate Ceiling; and (2) any multi-line business customer's total SLC plus ARC does not exceed $12.20.

- Competitive LECs, which are not subject to the Commission's end-user rate regulations today, may recover reduced intercarrier revenues through end-user charges.

853. *Explicit Support from the Connect America Fund*. The Commission has recognized that some areas are uneconomic to serve absent implicit or explicit support. ICC revenues have traditionally been a means of having other carriers (who are now often competitors) implicitly support the costs of the local network. As we continue the transition from implicit to explicit support that the Commission began in 1997, recovery from the CAF for incumbent LECs will be provided to the extent their Eligible Recovery exceeds their permitted ARCs. For price cap carriers that elect to receive CAF support, such support is transitional, phasing out over three years beginning in 2017. This phase out reflects, in part, the fact that such carriers will be receiving additional universal service support from the CAF that will phase in over time and is designed to reflect the efficient costs of providing service over a voice and broadband network. For rate-of-return carriers, ICC-replacement CAF support will phase down as Eligible Recovery decreases over time, but will not be subject to other reductions.

- All incumbent LECs that elect to receive CAF support as part of this recovery mechanism will be subject to the same accountability and oversight requirements adopted in Section VIII above. For rate-of-return carriers, the obligations for deploying broadband upon reasonable request specified in the CAF section above apply as a condition of receiving ICC-replacement CAF.[1648] For price cap carriers that elect to receive ICC-replacement CAF support, we require such support be used for building and operating broadband-capable networks used to offer their own retail service in areas substantially unserved by an unsubsidized competitor[1649] of fixed voice and broadband services. Thus, all CAF support will directly advance broadband deployment. This approach is consistent with carriers' representations that they currently use ICC revenues for broadband deployment.[1650]
- Competitive LECs, which have greater freedom in setting rates and determining which customers they wish to serve, will not be eligible for CAF support to replace reductions in ICC revenues.[1651]

C. Policy Approach to Recovery

854. As discussed above, our reforms seek to enable more widespread deployment of broadband networks, to foster the transition to IP networks, and to reduce marketplace distortions. We recognize that this transition affects different—but overlapping—segments of consumers in different ways. We therefore seek to adopt a balanced approach to reform that benefits consumers as a whole.

[1648] These are the same obligations, including latency, speed and usage levels, adopted for rate-of-return legacy high-cost funding adopted above. *See supra* Section VI.

[1649] *Supra* para. 103.

[1650] *See, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 50; Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Comments at 25; USTelecom *USF/ICC Transformation NPRM* Comments at 3.

[1651] We are not abrogating agreements in this Order, but observe that agreements may have relevant change of law provisions. *See supra* para. 815.

855. The overall reforms adopted in this Order will enable expanded build-out of broadband and advanced mobile services to millions of consumers in rural America who do not currently have broadband service. Our ICC reforms will fuel new investment by making incumbent LECs' revenue more predictable and certain. Indeed, incumbent LECs receiving CAF support as part of this recovery mechanism will have broadband deployment obligations.

856. In addition, as discussed above, we anticipate that reductions in intercarrier compensation charges will result in reduced prices for network usage, thereby enabling more customers to use unlimited all-distance service plans or plans with a larger volume of long distance minutes, and also leading to increased investment and innovation in communications networks and services.[1652] Moreover, consistent with previous ICC reforms, which gave rise to substantial benefits from lower long distance prices, we expect consumers to realize substantial benefits from this reform. This is especially true for customers of carriers for which intercarrier compensation charges historically have been a significant cost, such as wireless providers and long distance carriers.[1653]

857. Today, carriers receive payments from other carriers for carrying traffic on their networks at rates that are based on recovering the average cost of the network, plus expenses, common costs, overhead, and profits, which together far exceed the incremental costs of carrying such traffic. The excess of the payments over the associated costs constitutes an implicit annual subsidy of local phone networks—a subsidy paid by consumers and businesses everywhere in the country. This distorts competition, placing actual and potential competitors that do not receive these same subsidies at a market disadvantage, and denying customers the benefits of competitive entry.

858. As we pursue the benefits of reforming this system, we also seek to ensure that our transition to a reformed intercarrier compensation and universal service system does not undermine continued network investment—and thus harm consumers. Consequently, our recovery mechanism is designed to provide predictability to incumbent carriers that had been receiving implicit ICC subsidies, to mitigate marketplace disruption during the reform transition, and to ensure our intercarrier compensation reforms do not unintentionally undermine our objectives for universal service reform. As the State Members observe, for example, "[b]ankers and equity investors need to be able to see that both past and future investments will be backed by long-term support programs that are predictable."[1654] Similarly, they

[1652] An example of lower usage prices is lower per-minute prices within a bundle of cell-phone minutes (*e.g.*, through larger numbers of minutes being added to the bundle). *See, e.g.*, *supra* Section XII.A.1.

[1653] *See supra* Section XII.A.1. In addition, economists have estimated that above-cost access charges reduced U.S. economic welfare by an estimated $10–17 billion annually during the late 1980s, but that the annual welfare loss declined substantially to between $2.5 billion and $7 billion following the Commission's access charge reforms in the 1980s and early 1990s. *See* Letter from Jerry Ellig, Senior Research Fellow, Mercatus Center, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 08-183, 07-135, 05-337, 99-68 at 2 (filed Sept. 22, 2008) (citing Robert W. Crandall, AFTER THE BREAKUP: U.S. TELECOMMUNICATIONS IN A MORE COMPETITIVE ERA 141 (1991) and Robert W. Crandall & Leonard Waverman, WHO PAYS FOR UNIVERSAL SERVICE? 120 (2000)).

[1654] State Members *USF/ICC Transformation NPRM* Comments at 5; *see also, e.g.*, Kansas Commission *USF/ICC Transformation NPRM* Comments at 3; Louisiana PSC *August 3 PN* Comments at 4; Verizon Section XV Reply at 19-20 (quoting Rebecca Arbogast et al., Stifel Nicolaus, *FCC Looks To Shift USF-ICC Reform Drive into Overdrive; August Order Eyed*, at 1 (Mar. 15, 2011)); FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 96-97, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop.

note that “abrupt changes in support levels can harm consumers.”[1655] Predictable recovery during the intercarrier compensation reform transition is particularly important to ensure that carriers “can maintain/enhance their networks while still offering service to end-users at reasonable rates.”[1656] Providing this stability does not require revenue neutrality, however.

859. Ultimately, consumers bear the burden of the inefficiencies and misaligned incentives of the current ICC system, and they are the ultimate beneficiaries of ICC reform. In structuring a reasonable transition path for ICC reform, we seek to balance fairly the burdens borne by various categories of end users, including consumers already paying high residential phone rates, consumers paying artificially low residential phone rates, and consumers that contribute to the universal service fund. Given nationwide disparities in local rates, it would be unfair to place the entire burden of the ICC transition on USF contributors. Just as the Commission has undertaken some intercarrier compensation reforms since the 1996 Act, shifting away from implicit intercarrier subsidies to end-user charges and universal service for recovery, some states have done so, as well. For example, Alaska has recently reformed its intrastate access system, establishing a Network Access Fee of $5.75, and increasing the role of the Alaska USF in subsidizing carriers’ intrastate revenues with a state USF surcharge of 9.4 percent.[1657] Similarly, in Wyoming, which has also rebalanced rates, many rural customers face total charges for basic residential phone service in excess of $40 per month.[1658] The Nebraska Companies note total out-of-pocket local residential rates in that state already exceed $30 per month and should not be increased under any federal reforms contemplated by the Commission.[1659] Were we to place the entire burden of ICC recovery on USF contributors, not only would consumers in each of these states be forced to contribute more, but USF, which is also supported through consumer contributions, could not stay within the budget discussed in Section VII.B above. Meanwhile, as discussed above, other states have retained high intrastate intercarrier compensation rates to subsidize artificially low local rates—including some as low as $5 per month—effectively shifting the costs of those local networks to long distance and wireless customers across the country.[1660] In this context, we find it reasonable to allow carriers to seek some recovery from their own customers, subject to protection for consumers already paying rates for local phone service at or near $30 per month. We also prevent carriers from charging an ARC on any Lifeline customers. We also protect consumers by limiting any increases in consumer ARCs based upon actual or imputed increases in ARCs for business customers.

860. Some commenters argue that a variety of other regulatory considerations should alter the Commission’s approach to recovery. For example, some express concerns about the level of existing federal subscriber line charges (SLCs) and special access rates and the extent to which carriers use the ratepayer- and universal service-funded local network to provide unregulated services.[1661] Although we

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[1655] State Members *USF/ICC Transformation NPRM* Comments at 5-6; *see also, e.g.*, Michigan PSC *USF/ICC Transformation NPRM* Comments at 18.

[1656] Michigan PSC *USF/ICC Transformation NPRM* Reply at 10. *See also, e.g.*, Louisiana PSC *August 3 PN* Comments at 3-4.

[1657] Alaska Regulatory Commission *USF/ICC Transformation NPRM* Comments at 26-27.

[1658] Wyoming PSC *USF/ICC Transformation NPRM* Reply at 5.

[1659] Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Comments at 30 n.45 (“with the local rate benchmarks required under the Nebraska USF program along with subscriber line charge and other surcharges, total out-of-pocket local residential rates in the state already exceed $30 per month”).

[1660] *See supra* Section VII.D.5.

[1661] *See, e.g.*, Free Press *August 3 PN* Comments at 10; NASUCA *August 3 PN* Comments at 62-63.

address certain of those issues below, we are not persuaded that we should delay comprehensive intercarrier compensation and universal reform pending resolution of those outstanding questions, given the urgency of advancing the country's broadband goals. Nor do we treat those issues as a static, unchanging backdrop to the reforms we adopt here. In the FNPRM below we reevaluate existing SLCs, including by seeking comment on whether SLCs today are set at an excessive level and should be reduced.[1662] To attempt to account for these concerns through reduced recovery here, particularly given potential changes that the Commission might consider, would unduly complicate—and significantly delay—badly needed reform that we believe will result in significant consumer benefits. Consequently, we believe that the consumer protections incorporated in our recovery mechanism and the transitional nature of the recovery strike the right balance for consumers as a whole.

861. Although the preceding has been focused on the substantial benefits of our reform to consumers, in crafting these reforms we also took account of costs and benefits to industry. Our reforms are minimally burdensome to carriers, imposing only minor incremental costs (i.e., costs that would not be otherwise incurred without our reforms). The incremental costs of reform arise primarily from implementation, meaning that they are one-time costs of the transition that are not incurred on an ongoing basis. Further, these costs are heavily outweighed by efficiency benefits that carriers, as well as other industry participants and consumers, will experience. For carriers as well as end users, these benefits include significantly more efficient interconnection arrangements. Carriers will provide existing services more efficiently, make better pricing decisions for those services, and innovate more efficiently. Carriers' incentives to engage in inefficient arbitrage will also be reduced, and carriers will face lower costs of metering, billing, recovery, and disputes related to intercarrier compensation. Further, carriers, firms more generally, and consumers, facing more efficient prices for voice services, will make more use of voice services to greater effect, and more efficient innovation will result. In contrast to the transitional, one-time costs of reform, these efficiency benefits are ongoing and will compound over time.

D. Carriers Eligible To Participate in the Recovery Mechanism

862. The Commission sought comment in the *USF/ICC Transformation NPRM* on whether recovery should be limited to certain carriers, or whether it should extend more broadly to all LECs.[1663] We extend the recovery mechanisms adopted in this Order to all incumbent LECs because regulatory constraints on their pricing and service requirements otherwise limit their ability to recover their costs.[1664]

[1662] One commenter states that "the Commission concluded that approximately 82 percent of residential and single-line business price-cap lines had forward-looking costs below $6.50." Free Press *USF/ICC Transformation NPRM* Comments at 7. In fact, rather than endorsing that cost estimate, the Commission concluded that "even the most conservative estimate of forward-looking costs" for price cap carriers "shows that [the cost of] a substantial number of lines exceeds both the current $5.00 SLC cap, and the ultimate $6.50 SLC cap." *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, 94-1, Order, 17 FCC Rcd 10868, 10871-72 para. 5 (2002). Notwithstanding that distinction, however, we find it appropriate to take a fresh look not only at whether SLCs are set at appropriate levels under existing regulations, but, longer term, whether such charges should be retained at all. *See infra* Section XVII.O.

[1663] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571. *See also, e.g.*, *2008 USF/ICC FNPRM*, 24 FCC Rcd at 6632, 6637-39 App. A, paras. 302, 318-19; *2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4706, 4709-10, 4732, paras. 43, 50, 51, 104.

[1664] If an incumbent LEC receives recovery of any costs or revenues that are already being recovered as Eligible Recovery through ARCs or the CAF, that LEC's ability to recover reduced switched access revenue from ARCs or the CAF shall be reduced to the extent it receives duplicative recovery. Incumbent LECs seeking revenue recovery will be required to certify as part of their tariff filings to both the FCC and to any state commission exercising jurisdiction over the incumbent LEC's intrastate costs that the incumbent LEC is not seeking duplicative recovery in (continued…)

All incumbent LECs have built out their networks subject to COLR obligations, supported in part by ongoing intercarrier compensation revenues.[1665] Thus, incumbent LECs have limited control over the areas or customers that they serve, having been required to deploy their network in areas where there was no business case to do so absent subsidies, including the implicit subsidies from intercarrier compensation. At the same time, incumbent LECs generally are subject to more statutory and regulatory constraints than other providers in the retail pricing of their local telephone service.[1666] Thus, incumbent LECs are limited in their ability to increase rates to their local telephone service customers as a whole to offset reduced implicit subsidies.

863. Proposals to limit the recovery mechanism to only some classes of incumbent LECs, such as rate-of-return carriers,[1667] neglect these considerations, and in particular ignore that price cap incumbent LECs typically are also subject to regulatory constraints on end-user charges. We do, however, recognize the differences faced by price cap and rate-of-return carriers under the *status quo* absent reform, and therefore adopt different recovery mechanisms for price cap and rate-of-return carriers, as explained below.

864. *Competitive LECs*. We decline to provide an explicit recovery mechanism for competitive LECs.[1668] Unlike incumbent LECs, because competitive carriers have generally been found to lack market power in the provision of telecommunications services,[1669] their end-user charges are not subject to comparable rate regulation,[1670] and therefore those carriers are free to recover reduced access

(Continued from previous page)

the state jurisdiction for any Eligible Recovery subject to the recovery mechanism. To monitor and ensure that this does not occur, we require carriers participating in the recovery mechanism, whether ARC and/or CAF, to file data annually. *See infra* paras. 921-923.

[1665] *See, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 3, 9; SureWest *USF/ICC Transformation NPRM* Comments at 10; Pend Orielle *USF/ICC Transformation NPRM* Comments at 7; Windstream Aug. 21, 2008 Comments, CC Docket Nos. 94-68, 01-92, 96-45; WC Docket Nos. 08-152, 07-135, 04-36, 06-122, 05-337, 99-68 at 7.

[1666] This includes both Commission regulation of the federal SLC and, frequently, state regulation of retail local telephone service rates as well.

[1667] *See, e.g*., NCTA *USF/ICC Transformation NPRM* Reply at 8 (“Any access replacement support should be limited to a very small number of truly rural providers that are subject to rate-of-return regulation, and should not be available to make all incumbent LECs whole for every dollar of access charge revenue that is eliminated”).

[1668] CMRS providers generally do not collect access charges for originating or terminating calls on their networks. As they will generally not be losing access revenue and will see the elimination of most terminating access charges, they are not entitled to recovery from the recovery mechanism. *See generally USF/ICC Transformation NPRM*, 26 FCC Rcd at 4718 n.787.

[1669] *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, at 9926, para. 8 (2001) (*CLEC Access Charge Order*) (“Competitive entrants into the exchange access market have historically been subject to our tariff rules, but have been largely free of the other regulations applicable to incumbent LECs.”) (citations omitted).

[1670] For instance, the Commission has declined to regulate the SLCs of competitive LECs. *See Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps; Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10870 n.8 (2002) (subsequent history omitted); *see also CLEC Access Charge Order*, 16 FCC Rcd at 9955, para. 81 (stating that competitive LECs competing with CALLS incumbent LECs are free to build into their end-user rates a component equivalent to the incumbent LEC’s SLC).

revenue through regular end-user charges.[1671] Some competitive LECs have argued that their rates are constrained by incumbent LEC rates (as supplemented by regulated end-user charges and CAF support);[1672] to the extent this is true, we would expect this competition to constrain incumbent LECs' ability to rely on end-user recovery as well. Moreover, competitive LECs typically have not built out their networks subject to COLR obligations requiring the provision of service when no other provider will do so,[1673] and thus typically can elect whether to enter a service area and/or to serve particular classes of customers (such as residential customers) depending upon whether it is profitable to do so without subsidy.

865. In light of those considerations, we disagree with parties that advocate making the recovery mechanism we adopt today available to all carriers, both incumbent and competitive, or to all carriers that currently receive access charge revenues.[1674] Competitive LECs are free to choose where and how they provide service, and their ability to recover costs from their customers is generally not as limited by statute or regulation as it is for incumbent LECs.[1675]

866. We likewise decline to permit competitive LECs to reduce their access rates over a longer period of time than incumbent LECs. Instead, we believe that the approach adopted in the *CLEC Access Charge Order*, under which competitive LECs benchmark access rates to incumbent LECs' rates, is the better approach.[1676] That benchmarking rule was designed as a tool to constrain competitive LECs' access rates to just and reasonable levels without the need for extensive, ongoing accounting oversight and detailed evaluation of competitive LECs' costs.[1677] Deviating from that framework for purposes of the access reform transition would create new opportunities for arbitrage and require increased regulatory oversight, notwithstanding the fact that competitive LECs' access rates under the *CLEC Access Charge*

[1671] Although some competitive LECs assert that their contracts with business customers would not readily allow them to change intercarrier compensation rates under those contracts in the event of intercarrier compensation reform, *see, e.g.*, TDS Metrocom *August 3 PN* Reply at 6, those contracts reflect decisions made against the backdrop of possible intercarrier compensation reforms being contemplated by the Commission.

[1672] *See e.g.*, EarthLink *USF/ICC Transformation NPRM* Comments at 11 ("Even where EarthLink has the ability to modify rates, it may be prevented from increasing such rates because of competitive constraints (e.g., the incumbent against who EarthLink competes may not raise rates either because it is vertically integrated and its access charge savings offset its loses or it recovers a portion of its lost access revenue from a USF revenue recovery mechanism).").

[1673] See *supra* paras. 82-83.

[1674] *See, e.g.*, XO *USF/ICC Transformation NPRM* Comments at 50; Verizon and Verizon Wireless *USF/ICC Transformation NPRM* Comments at 50 ("All of these . . . proposed mechanisms, are designed to do the same thing—to give carriers a soft landing following reductions in ICC rates. All should be treated alike."); COMPTEL *USF/ICC Transformation NPRM* Comments at 37; PacWest *USF/ICC Transformation NPRM* Comments at 9; SouthEast Telephone *USF/ICC Transformation NPRM* Comments at 5; Letter from Bill Wade, General Manager, Mid-Rivers Communications, to Julius Genachowski, Chairman, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 1-4 (filed Oct. 17, 2011).

[1675] *See, e.g.*, ITTA *USF/ICC Transformation NPRM* Comments at vi ("[C]ompetitors without COLR obligations have defined their own service areas in a manner that allows them to serve only the lowest-cost customers in an area.").

[1676] *See generally CLEC Access Charge Order*; *see, also* Letter from Karen Reidy, COMPTEL, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket No. 01-92, 96-45, GN Docket No. 09-51, at 3 (filed July 27, 2011).

[1677] *CLEC Access Charge Order*, 16 FCC Rcd at 9924, para. 2.

Order were not based on any demonstrated level of need associated with those carriers' networks or operations. Nor has any commenter provided sufficient evidence to warrant departure from the benchmarking approach in this context. We therefore decline to adopt a separate transition path for competitive LECs. Rather, consistent with the general benchmarking rule that had been used for interstate access service, competitive LECs will benchmark to the default rates of the incumbent LEC in the area they serve as specified under this Order.

E. Determining Eligible Recovery

867. The first step in our recovery mechanism is defining the amount, called "Eligible Recovery," that incumbent LECs will be given the opportunity to recover.

1. Establishing the Price Cap Baseline

868. *Costs vs. Revenues.* The *USF/ICC Transformation NPRM* sought comment on whether, in adopting a recovery mechanism, the Commission should base recovery on carrier costs, carrier revenues, or some combination thereof.[1678] For the reasons set forth below, for price cap carriers, we will provide recovery based upon Fiscal Year 2011 ("FY2011" or "Baseline")[1679] access revenues that are reduced as part of the reforms we adopt today, plus FY2011 net reciprocal compensation revenues. Selecting FY2011 ensures that gaming or any disputes or nonpayment that may occur after the release of the Order does not impact carriers' Baseline revenues. For rate-of-return carriers, we adopt a bifurcated approach based on: (1) their 2011 interstate switched access revenue requirement;[1680] and (2) their FY2011 intrastate switched access revenues for services with rates to be reduced as part of the reforms we adopt today, plus FY2011 net reciprocal compensation revenues. Carriers have not demonstrated here that the existing intercarrier compensation revenues that we use as part of our Baseline calculations are

[1678] AT&T *USF/ICC Transformation NPRM* Comments at 4730, para. 564, citing National Broadband Plan at 148.

[1679] We will use Fiscal Year 2011 (i.e., October 1, 2010 through September 30, 2011) data to allow carriers a reasonable amount of time to collect the data necessary for implementation of these reforms. We chose to use a full 12-month period, rather than, for example, annualizing a portion of 2011 data, to ensure that carriers with seasonal calling patterns are not disproportionately affected. *See, e.g.,* Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket Nos. 00-218, 00-251, Memorandum Opinion and Order, 18 FCC Rcd 17722, 17866, para. 366 & n.958 (Wir. Comp. Bur. 2003) (discussing seasonal variation in traffic and noting, for example, that "[r]esort communities typically experience upwards of 60-75 percent of their total annual traffic during a 2 or 3 month vacation period"). We note that, because annual USF funding is not as subject to the same seasonal variance as are calling patterns, we use annualized figures for certain CAF purposes in this Order.

[1680] For a rate-of-return carrier that participated in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement associated with the NECA 2011 annual interstate switched access tariff filing. For a rate-of-return carrier subject to section 61.38 of the Commission's rules that filed its own annual access tariff in 2010 and did not participate in the NECA 2011 annual switched access tariff filing, its 2011 interstate switched access revenue requirement will be its projected interstate switched access revenue requirement in its 2010 annual interstate switched access tariff filing. For a rate-of-return carrier subject to section 61.39 of the Commission's rules that filed its own annual switched access tariff in 2011, its revenue requirement will be its historically-determined annual interstate switched access revenue requirement filed with its 2011 annual interstate switched access tariff filing.

confiscatory or otherwise unjustly or unreasonably low,[1681] and we thus find them to be an appropriate starting point for our calculations under the recovery mechanism.[1682]

869. We conclude that, where the Commission lacks data, it is preferable to rely on revenues for determining recovery, as most commenters suggest.[1683] Defining carriers' costs today would be a burdensome undertaking that could significantly delay implementation of ICC reform. "Cost" would first have to be defined for these purposes, which is a difficult and time-consuming exercise. Indeed, price cap carriers' access charges are not based on current costs,[1684] and reliable cost information is not readily available.[1685] It is not clear that a reliable cost study based on current network configuration could be completed without undue delay,[1686] and doing so could be a complicated, time consuming, and expensive process, nor is it clear that a regulatory proceeding could come up with a definition of "cost" appropriate for recovery that is any better than the revenues approach we adopt today.

870. Moreover, the Commission has long recognized that intercarrier compensation rates include an implicit subsidy because they are set to recover the cost of the entire local network, rather than the actual incremental cost of terminating or originating another call. Given our commitment to a gradual transition with no flash cuts, our focus on revenues is appropriate to ensure carriers have a measured transition away from this implicit support on which they have been permitted to rely for many years.

871. For rate-of-return carriers, however, interstate switched access rates today are determined based on their interstate switched access revenue requirement, which is calculated in a manner that includes their "regulated interstate switched access costs" as the Commission has historically defined them, plus a prescribed rate of return on the net book value of their interstate switched access investment. Although rate-of-return carriers' revenue requirement might not be based on the precise measure of cost

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[1681] Indeed, within the range of just and reasonable rates it is possible that rates could be set at levels lower than those that generated the FY2011 revenues in certain cases, as discussed in greater detail below. *See infra* Section XIII.G.

[1682] To the extent that it subsequently is determined that an incumbent LEC's rates during the Baseline time period were not just and reasonable because they were too low, that carrier may seek additional recovery as needed through the Total Cost and Earnings Review Mechanism. *See infra* Section XIII.G.

[1683] *See, e.g.*, ABC Plan at 9.

[1684] *See, e.g., Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket No. 07-21, pp. 2-3 (filed Jan. 25, 2007) ("Under pure price cap regulation, rates are subject to price ceilings that are determined without reference to costs. Indeed, a key premise of price cap regulation is that consumers will benefit from increased efficiencies that will result from severing the relationship between rates and costs.").

[1685] *See, e.g., Petition of AT&T Inc. for Forbearance under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket Nos. 07-21, 05-342, Memorandum Opinion and Order, 23 FCC Rcd 7302 (2008), *pet. for recon. pending, pet. for review pending, NASUCA v. FCC,* Case No. 08-1226 (D.C. Cir. filed June 23, 2008. In addition, the jurisdictional separations process has been frozen since 2001, and is currently subject to a referral to the Separations Joint Board. *See Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 26 FCC Rcd 7133 (2011); 47 C.F.R. Part 36.

[1686] As the Commission noted in 2009, "Many carriers no longer have the necessary employees and systems in place to comply with the old jurisdictional separations process and likely would have to hire or reassign and train employees and redevelop systems for collecting and analyzing the data necessary to perform separations." *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 24 FCC Rcd 6162, 6166 at para. 12 (2009); *see, e.g.*, Alexicon *USF/ICC Transformation NPRM* Comments at 2-4; TCA *USF/ICC Transformation NPRM* Comments at 4; ITTA *USF/ICC Transformation NPRM* Comments at 5-6.

we might otherwise adopt if we were starting anew, we believe that using those carriers' interstate revenue requirement is sensible for purposes of determining their Eligible Recovery. For one, this information is readily available today.[1687] In addition, use of the revenue requirement avoids implementation issues surrounding disputed or uncollectable interstate access revenues, providing greater predictability and substantially insulating small carriers from the harms of arbitrage schemes such as phantom traffic.[1688] This approach likewise prevents carriers that may have been earning in excess of their permitted rate of return from locking in those revenues and continuing such overearnings in perpetuity.

872. Our approach is also consistent with the reforms to local switching support (LSS) we adopt above. Historically, smaller carriers have received LSS as a subsidy for certain switching costs, effectively satisfying a portion of their interstate switched access revenue requirement.[1689] As discussed above, defining Eligible Recovery based on carrier's interstate switched access requirement allows us to eliminate LSS as a separate universal service support mechanism for rate-of-return carriers. Eligible Recovery will be calculated from carriers' entire interstate switched access revenue requirement—whether it historically was recovered through access charges or LSS. Thus, in essence, carriers receiving LSS today will be eligible to receive support as part of their Eligible Recovery.

873. At the same time, although rate-of-return carriers do track certain costs to establish their interstate revenue requirement for switched access services, the same information is not readily available—or necessarily relevant—for intrastate switched access services or net reciprocal compensation. As a result, their Eligible Recovery will be based on their FY2011 intrastate switched access revenues addressed as part of the reform adopted today plus FY2011 net reciprocal compensation as of April 1, 2012.[1690]

874. The *USF/ICC Transformation NPRM* also sought comment on whether, under a revenues-based approach, to base carriers' recovery on gross intercarrier revenue or alternatively to use net intercarrier compensation, defined as "a company's total intercarrier compensation revenue . . . less its intercarrier compensation expense" including expenses paid by affiliates.[1691] We received a mixed record

[1687] We will carefully monitor material changes in cost allocation to categories where recovery remains based on actual cost to ensure that carriers do not shift costs properly associated with switched access. We rely on the revenue requirement information available at the time of the initial tariff filings required to implement this recovery framework. This not only enables implementation of our recovery mechanism in the specified timeframes, but also addresses possible incentives to engage in gaming if carriers were able to increase the Rate-of-Return Baseline subsequently. If a carrier subsequently can demonstrate that it is materially harmed by the use of the projected, rather than final, 2011 interstate revenue requirement, it may seek a waiver of the rule specifying the Rate-of-Return Baseline to allow it to rely on an increased Rate-of-Return Baseline amount. Any such waiver would be subject to the Commission's traditional "good cause" waiver standard, rather than the Total Cost and Earnings Review specified below. *See* 47 C.F.R. § 1.3.

[1688] *See, e.g.*, ERTA July 8, 2011 *Ex Parte* Letter. For price cap carriers, there is no revenue requirement to use for this purpose. Consequently, we discuss below the extent to which price cap carriers will be able to include currently disputed ICC revenues in their FY2011 baseline. *See infra* para. 880.

[1689] 47 C.F.R. § 69.106(b).

[1690] Rate-of-return carriers may elect to have NECA or another entity perform the annual analysis. The underlying data must be submitted to the relevant state commissions, to the Commission, and, for carriers that are eligible for and elect to receive CAF, to USAC.

[1691] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4731, para. 567.

in response.[1692] For the reasons described below, the approach we adopt is neither a pure net revenue approach nor a pure gross revenue approach.

875. Although we are sympathetic to requests to determine recovery based on net revenues, we decline to do so for several reasons. Most importantly, we are committed to a gradual transition with sufficient predictability to enable continued investment, and a net revenue approach could reduce that predictability,[1693] especially for non-facilities-based providers of long distance service who pay intercarrier compensation expenses indirectly through their purchase of wholesale long distance service from third parties.

876. There also are other difficulties, substantive and administrative, involved in calculating net revenues, which cannot be adequately addressed based on the information in the record. For example, although reductions in an individual incumbent LEC's ICC revenue is tied to a particular study area, its affiliated IXC or wireless carrier may operate across multiple study areas, and the record does not suggest an administrable method for accurately identifying the cost savings associated with a particular incumbent LEC. Moreover, determinations of which affiliates should be counted, whether they are fully owned by the incumbent LEC or not, and to what extent, would be highly company-specific and could lead to inequitable treatment of similarly-situated carriers.

877. Such an approach also could create inefficient incentives during the transition regarding the acquisition of exchanges with ICC revenue reductions. For example, if an incumbent LEC has a large reduction in ICC revenue that is offset by affiliates' ICC cost savings, other carriers that lack affiliates with comparable ICC cost savings will be deterred from acquiring such exchanges if they would not be able to obtain additional recovery once it acquired that exchange. Conversely, if a carrier that lacked affiliates with comparable ICC cost savings *would* be entitled to new recovery if it acquired that exchange, a net revenue recovery approach could create inefficient incentives to acquire such exchanges given the potential for expanded CAF support (and thus also risk unconstrained growth in universal service).

878. Finally, although the record does not enable us to determine the precise extent to which savings will be passed through from IXC to incumbent LEC, competition in the long distance market is likely to lead IXCs to pass on significant savings to incumbent LECs, rendering 100 percent gross revenues likely more generous than necessary for incumbent LECs.[1694] This is further complicated by incumbent LECs with affiliated IXCs that provide wholesale long distance service; counting the cost savings associated with wholesale long distance service against the recovery need for the affiliated

[1692] *Compare, e.g.*, Nebraska Rural Independent Companies' *USF/ICC Transformation NPRM* Comments at 30 (advocating a net approach); NASUCA *USF/ICC Transformation NPRM* Comments at 112-14 (same); COMPTEL *USF/ICC Transformation NPRM* Comments at 36 (same) *with, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 35-37 (arguing against a net approach); ITTA *USF/ICC Transformation NPRM* Comments at 29 (same); Kansas Corporation Commission *USF/ICC Transformation NPRM* Comments at 42 (arguing that a net approach would have a minimal impact for many Kansas incumbent LECs).

[1693] *See supra* Section VII.D.11.

[1694] *See, e.g.*, Testimony of Robert W. Quinn, Senior Vice President—Federal Regulatory, AT&T, at FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 66, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop.; AT&T *USF/ICC Transformation NPRM* Comments at 36; *see also USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571, (*citing* DEBRA J. ARON, *ET AL*., AN EMPIRICAL ANALYSIS OF REGULATOR MANDATES ON THE PASS THROUGH OF SWITCHED ACCESS FEES FOR IN-STATE LONG-DISTANCE TELECOMMUNICATIONS IN THE U.S. at 6-11, 30-31 (Oct. 14, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674082).

incumbent LEC could create disincentives for the IXC to simultaneously pass through those cost savings in lower wholesale long distance rates, thereby reducing the potential for lower retail long distance rates.

2. Calculating Eligible Recovery for Price Cap Incumbent LECs

879. For price cap carriers, the recovery mechanism allows them to determine at the outset exactly how much their Eligible Recovery will be each year. The certainty regarding this recovery will enable price cap carriers to better manage the transition away from intercarrier compensation for recovery. Our recovery approach will use historical trends regarding changes in demand to project future changes in demand (typically MOU), in conjunction with the default rates specified by our reforms, to determine Eligible Recovery.[1695] Specifically, under our mechanism, Price Cap Eligible Recovery will be calculated from a Baseline of 90 percent of relevant FY2011 revenues, reduced on a straight-line basis at a rate of ten percent annually starting in year one (2012). This is consistent with the historical trajectory of decreasing MOU,[1696] with which price cap carriers' intercarrier compensation revenues decline today. We conclude this approach provides the necessary predictability for carriers[1697] without reducing their incentives to seek efficiencies or to maximize use of their network. We will not annually true-up actual MOU for price cap carriers, instead likewise using a straight line decline of 10 percent relative to FY2011 MOU, which is a more predictable and administratively less burdensome approach. If MOU decline is less than 10 percent, carriers will receive the benefit of additional revenues. Conversely, if MOU decline accelerates, the risk of decreased revenues falls on the carriers. This allocation of risk incents carriers to be more efficient and retain customers.

880. Specifically, the Price Cap Baseline for price cap incumbent LECs' recovery will be the total switched access revenues that: (1) are being reduced as part of reform adopted today; (2) are billed for service provided in FY2011; and (3) for which payment has been received by March 31, 2012. In addition, the Baseline will include net reciprocal compensation revenues for FY2011, based on net payments as of March 31, 2012. Carriers will be required to submit to the states data regarding all FY2011 switched access MOU and rates, broken down into categories and subcategories corresponding to the relevant categories of rates being reduced. With this information, states with authority over intrastate access charges will be able to monitor implementation of the recovery mechanism and compliance with our rules, and help guard against cost-shifting or double dipping by carriers.[1698] A price cap incumbent LEC that is eligible to receive CAF shall also file this information with USAC for purposes of implementing CAF ICC support, and we delegate to the Wireline Competition Bureau authority to work with USAC to develop and implement processes for administration of CAF ICC support.[1699] These

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[1695] We recognize that our transitional intercarrier compensation framework sets default rates but leaves carriers free to negotiate alternatives. Our approach to recovery relies on the default rates specified by our transition and will impute those rates for purposes of determining recovery, even if carriers negotiate a lower ICC rate with particular providers.

[1696] *See infra* paras. 885-886.

[1697] *See*, *e.g.*, FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 97, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop. (comments of Paul Gallant, Senior Vice President and Telecom Analyst, MF Global, discussing the importance of certainty of access revenue to continued investor support for broadband build-out).

[1698] *See supra* paras. 812-813. Upon request, carriers will also be required to file these data with the Commission.

[1699] USAC plays a critical role in the day-to-day administration of universal service support mechanisms, *see*, *e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4595, para. 116 n.192, including the ICC-replacement CAF support that is part of our recovery mechanism.

figures will establish the Base Minutes for each relevant category, and shall not include disputed revenues or revenues otherwise not recovered, for whatever reason, or the MOU associated with such revenues. Every carrier, in support of its annual access tariff filing, must also provide data necessary to justify its ability to impose an ARC, including the potential impact of the ARC for residential and multi-line business customers.

881. In determining the recovery mechanism, we decline to provide 100 percent revenue neutrality relative to today's revenues. Rather, we adopt an approach that is informed in part based on the *status quo* path facing price cap carriers today, where intercarrier compensation revenues decline as MOU decline,[1700] but also adopt some additional reductions for carriers that have had the benefit of interstate rates essentially being frozen for almost a decade, rather than being reduced annually as would typically occur under price cap regulation. Thus, for study areas of carriers that participated in the *CALLS* plan, which is approximately 95 percent of all price cap lines, and 90 percent of all lines across the country, we adopt a 10 percent initial reduction in price cap incumbent LECs' Eligible Recovery to reflect the fact that these carriers' productivity gains have generally not been accounted for in their regulated rates for many years. Incentive regulation typically provides a mechanism for sharing the benefits of productivity gains with ratepayers.[1701] Prior to the *CALLS Order* in 2000, the Commission included a productivity adjustment to the price cap indices to ensure that savings would be shared.[1702] The *CALLS Order* did not include a productivity-related adjustment, however, providing instead a transitional "X-factor" designed simply to target the lower rates specified in that reform plan.[1703] After the targeted rates were achieved, which occurred by 2002 for 96 percent of study areas for carriers participating in the *CALLS* plan, the X-factor was set equal to inflation for the carriers originally subject to the *CALLS* plan and provided no additional consumer benefit from any productivity gains.[1704] As a result, study areas of price cap LECs that participated in the *CALLS* plan have had no X-Factor reductions to their price cap indices (PCIs), productivity-related or otherwise, for any PCI at least since 2004, and some price cap carriers' X-Factor reductions to their switched access-related PCIs stopped even earlier than that.[1705]

882. The record supports the use of a productivity factor such as the X-factor previously applied to price-cap carriers to reduce the amount carriers are eligible to recover through a recovery

[1700] *See infra* paras. 885-886. Although we adopt rules to help address concerns about traffic identification and establish a prospective intercarrier compensation framework for VoIP-PSTN traffic, absent our actions in this Order, issues regarding compensation for that traffic would not have been resolved. Because we are considering the *status quo* path absent reform, our recovery framework is based on historical declining demand notwithstanding reforms that potentially could mitigate some of that decline.

[1701] David E.M. Sappington, *Price Regulation*, in Handbook of Telecommunications Economics, Vol. I, 225, 231, 248-53 (Martin E. Cave et al. eds., 2002).

[1702] *See Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, 18 FCC Rcd 14976 at 14997-98, para. 35 (2003) (*CALLS Remand Order*).

[1703] *CALLS Order*, 15 FCC Rcd at 13028-29, paras. 160-63.

[1704] *See id.*, 15 FCC Rcd at 13028-29, paras. 160-63.

[1705] Because price cap carriers reached their target rates at different times, the inflation-only X-factor took effect at different times for different price cap carriers. In the *CALLS Remand Order*, the Commission concluded that price cap carriers serving 36 percent of total nationwide price cap access lines had achieved their target rates by their 2000 annual access filing. *CALLS Remand Order*, 18 FCC Rcd at 15002, para. 43, 15010-13, App. B. By the 2001 annual accessing filings the number grew to carriers serving 75 percent of total access lines, and by the 2002 annual access filings, carriers serving 96 percent of total access lines had achieved their target rates. *Id.*

mechanism.[1706] A productivity factor would require recovery to decrease annually by a predetermined amount designed to capture for consumers the efficiencies found to apply generally to the industry. For example, if we had maintained a five percent annual X-factor, rates for carriers that had reached their target rates would have been subject to caps reduced by five percent each year, so by today those rate caps would have been reduced by approximately 30 percent. Although the record does not contain the detailed analysis required to support a particular productivity factor that would apply on an ongoing basis,[1707] we find this initial 10 percent reduction for study areas of price cap LECs that participated in the *CALLS* Plan to be a conservative approach given the absence of any sharing of productivity or other X-factor reductions for a number of years, particularly when supplemented by other justifications for revenue reductions that we do not otherwise account for in our standard recovery mechanism.[1708]

883. We recognize, however, that the industry has changed significantly since the 2000 *CALLS Orde*r, with some price cap *CALLS* carriers merging with or acquiring carriers that did not participate in the *CALLS* plan and/or newly converted price cap carriers acquiring study areas that did participate in the *CALLS* plan. For this reason, we conclude it is necessary to apply the 10 percent reduction on a study area basis for *CALLS* participants, which we collectively define as "CALLS study areas." Thus, we will apply the 10 percent reduction to all price cap study areas that participated in the *CALLS* plan.[1709]

884. We also recognize, however, some price cap LECs converted to price cap regulation from rate-of-return regulation within the last five years and therefore such carriers did not participate in the *CALLS* plan. Thus, not all price cap carriers have had the benefit of productivity gains associated with reaching their target rates by 2002.[1710] Indeed, there are a few study areas that have converted to price cap regulation in the last two years and are still in the process of reducing their interstate rates to meet their *CALLS* target rate. As a result, for non-price cap study areas that were not part of the *CALLS* plan, we believe a more incremental approach is warranted.[1711] In particular, for non-*CALLS* study areas, we

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[1706] *See generally* CRUSIR *USF/ICC Transformation NPRM* Comments at 8 ("An X-factor should be applied to [price cap] carriers on an ongoing basis. Although productivity is one factor to note, so is the decreasing cost of the optical transmission gear and switching equipment used by these carriers."); Ad Hoc *USF/ICC Transformation NPRM* Comments at 33-38; Free Press *USF/ICC Transformation NPRM* Comments at 8. *But see* AT&T *USF/ICC Transformation NPRM* Reply at 38-39. ("In the 20th century, it was appropriate to impose such a productivity factor on price-cap carriers to reflect the declining per-line costs of providing service, which resulted from both efficiency improvements and steady increases in line counts . . . . Over the past decade, however, ILECs have hemorrhaged access lines, and their per-line costs have—if anything—increased.").

[1707] *See, e.g., USTA v. FCC*, 188 F.3d 521, 525-530 (D.C. Cir. 1999) (reversing and remanding for further explanation the Commission's prescription of a 6.5 percent productivity factor).

[1708] As discussed below, we consider these additional factors more specifically in the context of any Total Cost and Earnings Review requested by an incumbent LEC to justify a greater recovery need. *See infra* Section XIII.G.

[1709] All incumbent LECs subject to price cap regulation at the time of the *CALLS Order* elected to participate in the *CALLS* plan. *See, e.g., Iowa Telecom Forbearance Order*, 17 FCC Rcd 24319 (2002). *See also CALLS Remand Order*, 18 FCC Rcd at 15010-13, App. B (listing carriers subject to the *CALLS Order*).

[1710] *See supra note* 1705.

[1711] The Commission sought comment in the *USF/ICC Transformation NPRM* on whether any intercarrier compensation reform recovery mechanism should differ depending upon the type of carrier. *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732-33, para. 571. Likewise, carriers have advocated in this proceeding that the Commission's intercarrier compensation reforms accommodate the particular needs of carriers that converted to price cap regulation subsequent to *CALLS*. *See, e.g.*, ACS *August 3 PN* Reply at 4 (advocating different treatment under any intercarrier compensation reform given its recent conversion to price cap regulation); (continued…)

will delay the implementation of the 10 percent reduction to Eligible Recovery for five years, which is approximately the difference in time between when 96 percent of study areas of *CALLS* price cap carriers reached their target rates in 2002 and when the non-*CALLS* price cap carriers began converting from rate-of-return in 2007. We believe doing so enables carriers that more recently converted to price cap regulation, carriers which are typically smaller, have additional time to adjust to the intercarrier compensation rate reductions. In year six, the 10 percent reduction to Eligible Recovery will apply equally to all price cap carriers.

885. In addition, as discussed in the *USF/ICC Transformation NPRM*, Commission data and the record confirm that carriers are losing lines and experiencing a significant and ongoing decrease in minutes-of-use.[1712] Incumbent LEC interstate switched access minutes have decreased each year since 2000,[1713] as shown in the chart below.[1714]

(Continued from previous page)

Letter from Russell M. Blau, counsel for Consolidated, to Marlene H. Dorth, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; CC Docket Nos. 01-92, 96-45; GN Docket No. 09-51 at 1 (filed Aug. 22, 2011) (expressing concern with the impact of certain universal service and intercarrier compensation reform proposals "especially those that recently and voluntarily converted to price cap regulation"); Windstream *2008 Order and ICC/USF FNPRM* Comments at 22 & n.49 (advocating intercarrier compensation reform and an accompanying recovery mechanism that accommodates the needs of carriers that recently converted to price cap regulation); Letter from Eric N. Einhorn, V.P. Federal Government Affairs, Windstream, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, 08-152, 07-135; CC Docket Nos. 01-92, 96-45, 99-68 at 5 (filed Oct. 27, 2008) (same).

[1712] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732, para. 570; *Sept. 2010 Trends in Telephone Service*, at Table 7.1, Chart 10.1; 2010 Universal Service Monitoring Report at Table 8.1; Letter from Donna Epps, Vice President – Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135 at 1 (filed Oct. 28, 2010); *see also* PAETEC *USF/ICC Transformation NPRM* Comments at 33-34.

[1713] *2010 Trends in Telephone Service*, Table 10.1.

[1714] Network Usage by Carrier, Annual Submission by NECA of Access Minutes of Use, *available at* http://transition.fcc.gov/wcb/iatd/neca.html (Tier-1 NECA and Non-NECA Companies).

Interstate Switched Access Minutes for Incumbent LECs (In Billions) [1715]

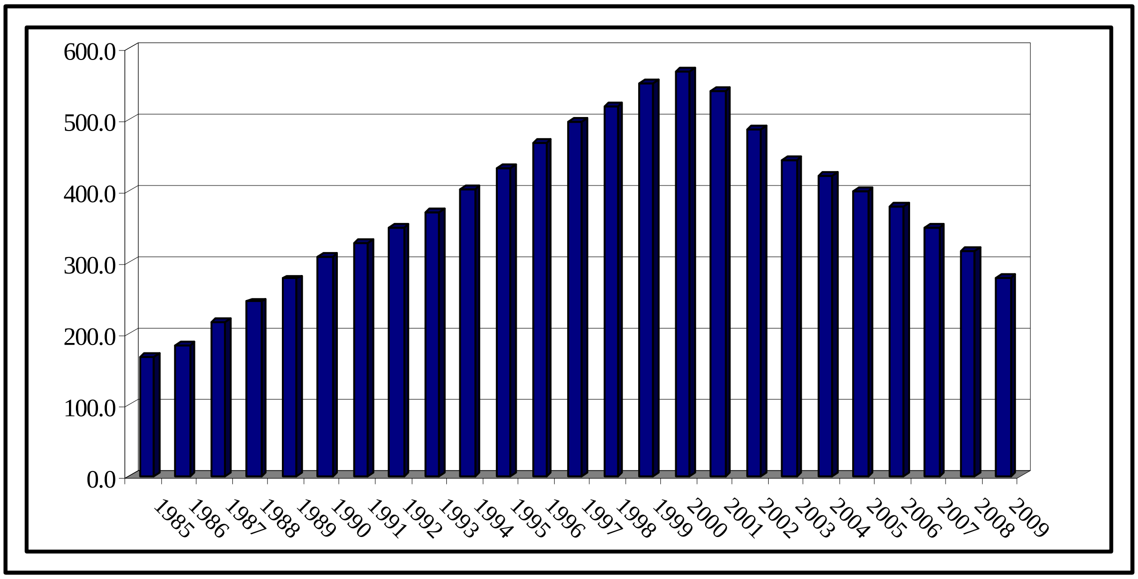

Figure 10

886. This represents an average annual decrease of over 10 percent and a total decrease of over 36 percent since 2006.[1716] Further, the percentage loss of MOU is accelerating—it increased each year between 2006 and 2010, and exceeded 13 percent in 2010.[1717] Based on the record, it is our predictive judgment that significant declines in MOU will continue.[1718] Accordingly, we will reduce Price Cap Eligible Recovery by 10 percent annually for price cap carriers to reflect a conservative prediction regarding the loss of MOU, and associated loss of revenue, that would have occurred absent reform.

887. As a result, for price cap carriers, Base Minutes will be reduced by 10 percent annually beginning in 2012 to reflect decline in MOU. For example, Year One or "Y1" (2012) Intrastate Minutes will be .9 x Intrastate Base Minutes; Y2 (2013) Intrastate Minutes will be .81 x Intrastate Base Minutes (i.e., .9 x .9 x Intrastate Base Minutes); etc.

[1715] *See* IATD, Wir. Comp. Bur., Universal Service Monitoring Report, Chart 8.1 (Dec. 2010).

[1716] Network Usage by Carrier, Annual Submission by NECA of Access Minutes of Use, *available at* http://transition.fcc.gov/wcb/iatd/neca.html (Tier-1 NECA and Non-NECA Companies); *see also* Letter from Stuart Polikoff, Director of Government Relations, OPASTCO, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 01-92, 96-45, Attach. at 12-13 (filed May 27, 2008) (providing a 2008 projection that, over the subsequent three years, "intrastate access revenues will decline by between 5% and 12% per year (with 8% as the most likely annual decline)").

[1717] *Id.*

[1718] *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 54 ("The legacy POTS business model is declining at an astonishing rate. Incumbent carriers are hemorrhaging customers to competitors…."); Verizon and Verizon Wireless *USF/ICC Transformation NPRM* Comments at 20 ("[D]isbursements from the fund should take into account the overall declining nature of switched access revenues.").

888. *Price Cap Eligible Recovery*. Price Cap Eligible Recovery in a given year is the cumulative reduction in a particular intercarrier compensation rate since the base year multiplied by the pre-determined minutes for that rate for that year, as defined above.

Price Cap Example.[1719] A price cap carrier has a 2011 intrastate terminating access rate for transport and switching of $.0028, an interstate terminating access rate for transport and switching of $.0020, and 10,000,000 Intrastate Base Minutes. Its Eligible Recovery for intrastate switched access revenue would be determined as follows:

Year 1. Reduce intrastate terminating access rate for transport and switching, if above the carrier's interstate access rate, by 50 percent of the differential between the rate and the carrier's interstate access rate.

The carrier's Year 1 (Y1) Minutes equal 9,000,000 (10,000,000 x .9). Its intrastate terminating access rate for transport and switching, $.0028 in 2011, is reduced by $.0004 (($.0028-$.0020) x 50 percent)) to $.0024. Its Y1 Eligible Recovery is $3,600 ($.0004 x 9,000,000). For a *CALLS* study areas, Eligible Recovery would be reduced by an additional 10 percent to $3,240 ($3,600 x .9). For a non-*CALLS* study area, such reductions will begin in year six.

Year 2. Reduce intrastate terminating access rate for transport and switching, if above the carrier's interstate access rate, to the carrier's interstate access rate.

The carrier's Year 2 (Y2) Minutes equal 8,100,000 (9,000,000 x .9). Its intrastate terminating access rate for transport and switching is reduced by an additional $.0004 from $.0024 to $.0020, for a cumulative reduction of $.0008. Its Y2 Eligible Recovery is $6,480 ($.0008 x 8,100,000). For a *CALLS* study area, Eligible Recovery would be reduced by an additional 10 percent to $5,832 ($6,480 x .9). For a non-*CALLS* study area, such reductions will begin in year six.

889. *This Approach to Recovery for Price Cap Carriers Provides Certainty and Encourages Efficiency*. Under the Act, the Commission has "broad discretion in selecting regulatory tools, [which] specifically includes 'selecting methods . . . to make and oversee rates,'"[1720] and is not compelled to follow any "particular regulatory model."[1721] Our approach to defining Price Cap Eligible Recovery continues to give those incumbent LECs incentives for efficiency while also providing greater predictability for carriers and consumers. Under price cap regulation, incumbent LECs already have significant incentives to control their costs associated with services provided to end-users, but have not had the same incentives to limit the costs imposed on IXCs for terminating calls on the price cap incumbent LECs' networks. These costs are ultimately borne by the IXCs' customers generally, rather than by the price cap LECs' customers specifically. By phasing out those termination charges and

[1719] This is a simplified example of the calculation of Price Cap Eligible Recovery for a price cap carrier's reduction in intrastate terminating access resulting from the reforms we adopt for illustrative purposes only. It is not intended to encompass all necessary calculations applicable in determining Price Cap Eligible Recovery in the periods discussed in the example for all possible rates addressed by our Order.

[1720] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3297-98, para. 194 (citations omitted) (1988). *See also LEC Price Cap Order* at 6836, paras. 401-03.

[1721] *Id*. Consequently, we disagree with commenters that suggest we lack authority to adopt such an approach. *See, e.g.*, Blooston Rural Carriers *USF/ICC Transformation NPRM* Comments at 23-36. Some of these commenters object to particular ways of implementing recovery that they view as problematic. *See, e.g.,* Alexicon *USF/ICC Transformation NPRM* Comments at 33 & Exh. D. Because the recovery mechanism adopted here differs from those envisioned by those commenters, those filings do not dissuade us from taking this approach.

providing recovery in part through limited end-user charges, our reform will provide price cap LECs incentives to minimize such costs as they transition to broadband networks.

890. We have considered a number of alternative proposals regarding the elimination of intercarrier terminating switched access charges and find that the approach we adopt today constitutes a hybrid of a variety of proposals that best protects consumers while facilitating the reasonable transition to an all-broadband network. Some commenters have argued that no additional recovery should be allowed absent a specific showing that denying recovery would constitute a taking.[1722] Based upon the record in this proceeding, we conclude that such a denial would represent a flash-cut for price cap LECs, which is inconsistent with our commitment to a gradual transition and could threaten their ability to invest in extending broadband networks. We also find that denying any recovery pending the adjudication of a request for an exogenous low-end adjustment under our price cap rules[1723] would be unduly burdensome for carriers and for the Commission because of the number of claims the carriers would be required to file and the Commission would be required to adjudicate.[1724] Our definition of Price Cap Eligible Recovery for both *CALLS* and non-*CALLS* study areas gives predictability not only to price cap carriers, but also to consumers and universal service contributors, given the fluctuations that could result from a true-up approach for these large carriers.[1725]

3. Calculating Eligible Recovery for Rate-of-Return Incumbent LECs

891. For rate-of-return incumbent LECs, we adopt a recovery mechanism that provides more certainty and predictability than exists today, while also rewarding carriers for efficiencies achieved in switching costs. Specifically, the recovery mechanism will allow interstate rate-of-return carriers to determine at the outset of the transition their total ICC and recovery revenues for all transitioned rate elements, for each year of the transition: Eligible Recovery will be adjusted as necessary with annual true ups to ensure that rate-of-return carriers have the opportunity to receive their Baseline Revenue, notwithstanding changes in demand for their intercarrier compensation rates being capped or reduced under our Order. We find that providing this greater degree of certainty for rate-of-return carriers, which are generally smaller and less able to respond to changes in market conditions than are price cap carriers, is necessary to provide a reasonable transition from the existing intercarrier compensation system.[1726]

892. As the starting point for calculating the Rate-of Return-Baseline, we will use a rate of return carrier's 2011 interstate switched access revenue requirement, plus FY2011 intrastate switched access revenues and FY2011 net reciprocal compensation revenues.[1727] We will then adjust this Baseline

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[1722] *See*, e.g., Free Press *USF/ICC Transformation NPRM* Comments at 3, NASUCA *USF/ICC Transformation NPRM* Comments at 20.

[1723] *See* 47 C.F.R. § 69.3(b)

[1724] Unlike some proposals in the record, *see, e.g.*, ABC Plan, Attach. 1 at 11-12, we require carriers to seek recovery first from all their customers—residential and single-line business customers as well as multi-line business customers—rather than from residential customers only. This will reduce the burden on residential customers and the CAF.

[1725] *See, e.g.*, T-Mobile *August 3 PN* Comments at 19-20; Comcast *August 3 PN* Comments at 15.

[1726] *See e.g.*, Letter from Lawrence Zawalick, Senior Vice President, Rural Telephone Finance Cooperative, to Julius Genachowski, Chairman, FCC, WC Docket Nos. 10-90, 07-135, 05-337 and 03-109, GN Docket No. 09-51 and CC Docket Nos. 01-92 and 96-45, Attach. at 10 (noting that, for rate-of-return carriers, the "[c]apital markets and private lenders would react positively to regulatory certainty and cash flow stability").

[1727] Average schedule carriers will use projected settlements associated with 2011 annual interstate switched access tariff filing.

over time to reflect trends in the *status quo* absent reform. Under the interstate regulation that has historically applied to them, rate-of-return carriers were able to increase *interstate* access rates to offset declining MOU, which has averaged 10 percent per year, and consequently had insufficient incentive to reduce costs despite rapidly decreasing demand.[1728] However, the record indicates that, in the aggregate, rate-of-return carriers' interstate switched access revenue requirement has been declining approximately three percent each year, reflecting declines in switching costs.[1729] As a result, interstate switched access revenues have been declining at approximately three percent annually. NECA and a number of rate-of-return carriers project that the revenue requirement will continue to decline at approximately three percent a year over the next five years, because switching costs are declining dramatically given the availability of IP-based softswitches, which are significantly less costly and more efficient than the TDM-based switches they replace.[1730] Similarly, the record reveals that legacy LSS, which is being incorporated in our recovery mechanism for rate-of-return carriers, is projected to decline approximately two percent per year, likewise resulting in reduced interstate revenues for carriers receiving LSS.[1731]

893. In the intrastate jurisdiction, moreover, the majority of states do not have an annual true-up mechanism; intrastate rates generally do not automatically increase as demand declines and as a result, most rate-of-return carriers have been experiencing significant annual declines in intercarrier

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[1728] *See supra* paras. 885-886.

[1729] Letter from Jeffrey E. Dupree, Vice President—Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; CC Docket Nos. 01-92, 96-45; GN Docket No. 09-51, Attach. 2, at 1 (filed Aug. 29, 2011) ("Preliminary RLEC CAF Computations") (NECA et al. Aug. 29, 2011 *Ex Parte* Letter).

[1730] *See supra* para. 752. Softswitches are modular general-purpose hardware programmed to control voice calls across TDM- and IP-based networks. *See* William Stallings, Data and Computer Communications, 8th ed., at 307, Pearson Prentice Hall, Upper Saddle River NJ, 2007. The use of softswitches permits carriers to reduce capital and operating costs for a range of reasons. As a straight replacement for a legacy specialized Class 5 central office switch, a softswitch is said to save 70 percent in space, 60 percent in power, and up to 50 percent operating expenses in certain situations. *See, e.g., id*.; Google *August 3 PN* Comments at 8 n.28; Franklin D. Ohrtman, Jr, Softswitch: Architecture for VoIP, McGraw-Hill, New York, NY, 2003 (Chapter 11 passim, compare with page 57: "A Class 5 switch can cost tens of thousands of dollars and require at least half a city block in real estate."); http://www.genband.com/Home/Solutions/Fixed/Network-Transformation-Large-Office.aspx; and http://www.metaswitch.com/wireline/Local-Exchange-Evolution.aspx and http://www.ericsson.com/res/docs/whitepapers/efficient_softswitching.pdf. Costs are also reduced when softswitches are used to gain the efficiencies of IP technologies. In addition, open softswitch software architectures allow carriers to expand service offerings, spreading fixed costs over more services. *See, e.g*, , Jr., Softswitch: Architecture for VoIP, McGraw-Hill, New York, NY, 2003, especially chapter 11; Florida PSC *USF/ICC Transformation NPRM* Comments at 7-8; *see also* Letter from Jason J. Dandridge, CEO, Palmetto Rural Telephone Cooperative, to Albert M. Lewis, Chief, Pricing Policy Division, Wireline Competition Bureau, at 5 (filed Sept. 9, 2009) ("The new softswitch will help to position the Cooperative to use VoIP if it chooses to do so in the future, which will generate substantial cost savings for Palmetto."). We therefore reject concerns raised by the rate-of-return carriers that the recovery mechanism disincents investment in softswitches. *See*, Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 2 (filed October 17, 2011); Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 5 (filed Oct. 19, 2011). To the contrary, evidence overwhelmingly indicates that such switches are significantly more efficient and carriers that reap the benefits of efficiencies, including for example by sharing a softswitch, will be able to retain additional revenues. *See, e.g.,* Viearo Wireless *August 3 PN* Comments, Exh. 2 at 17, 39-40, 45-46.

[1731] NTCA Sept. 9, 2011 *Ex Parte* Letter, Attach. 3 at 1.

compensation revenue.[1732] In particular, aggregate data from more than 600 rate-of-return carriers reveals an average decline in intrastate MOUs of approximately 11 percent, and an average decline in intrastate access revenues of approximately 10 percent annually.[1733] Our recovery mechanism accounts for this existing revenue loss, which would continue to occur under the *status quo* path absent reform, as illustrated in the figure below.[1734]

[1732] We are aware of only a few states conduct some form of annual review to allow incumbent LECs to modify intrastate intercarrier compensation in response to changes in demand or to otherwise replace those revenues through other processes in whole or in part. *See, e.g.*, *Alaska Exchange Carrier's Ass'n v. Regulatory Comm'n of Alaska*, No. S-13528, 2011 WL 4715209 (Alaska rel. Oct. 7, 2011); *Fourteen Small Incumbent Local Exchange Carriers and the California High Cost Fund-A Administrative Committee Fund*, Resolution T-17298, 2011 WL 660558 (Cal. PUC rel. Jan. 27, 2011); *Implementation of House Bill 168,* Docket No. 32235, Order Implementing House Bill 168, 2010 WL 4925826 (Ga. Pub. Serv. Comm'n rel. Nov. 23, 2010); KAN. STAT. ANN. § 66-2005(c). The record does not indicate that most states have such a process. Rather, in other states, there are not automatic annual true-ups, whether because carriers instead must request permission to increase rates through a formal rate case or a less formal process, because rates are specified by statute, or because interstate rate-of-return carriers are subject to some alternative form of regulation at the state level. *See, e.g.,* ABC Plan Proponents *August 3 PN* Comments at 5; Florida PSC *USF/ICC Transformation NPRM* Comments at 5; Cincinnati Bell *2008 Order and ICC/USF FNPRM* Comments at 15-16; *Investigation Into Streamlining the Procedures and Filing Requirements For Intrastate Access Tariffs that Implement or Maintain Parity with Interstate Tariffs*, Cause No. 44004, Order, 2011 WL 2908623 (Ind. Util. Reg. Comm'n rel. July 13, 2011); *Application of Highland Telephone Cooperative, Inc. for an Adjustment of Rates*, Case No. 2010-00227, Order, 2011 WL 2678154 (Ky. Pub. Serv. Comm'n rel. July 7, 2011); *Intrastate Access Charge Policies*, Application No. C-4145/NUSF-74/PI-147, Order, 2010 WL 2650347 (Ne. Pub. Serv. Comm'n rel. Apr. 20, 2010); *Investigation into the Earnings of Citizens Telephone Company of Higginsville, Missouri*, Case No. IR-2005-0024, Order Approving Stipulation and Agreement, 2004 WL 1855412 (Mo. Pub. Serv. Comm'n rel. Aug. 12, 2004); *Illinois Independent Telephone Association*, Docket 01-0808, Order, 2003 WL 23234577 (Il Commerce Comm'n rel. Nov. 25, 2003); 65-407 ME CODE Ch. 280 § 8; Mich. Comp. Laws ch. 484.2310 § 310(12); 2007 Nevada Laws Ch. 216 (A.B. 518); Tenn. Code Ann. § 65-5-302; Wis. Stat. § 196.212; Wy Stat. § 37-15-203(j); *see also* James C. Bonbright, et al., PRINCIPLES OF PUBLIC UTILITY RATES at 96, 198 (2d ed. 1988) (discussing regulatory lag as a common feature of rate regulation); W. Kip Viscusi, et al., Economics of Regulation and Antitrust at 432-33 (4th ed. 2005) (discussing regulatory lag and its effects).

[1733] Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 25, 2011).

[1734] NECA Dec. 29, 2010 *Ex Parte* Letter; NECA May 25, 2011 *Ex Parte* Letter; NECA Aug. 29, 2011 *Ex Parte* Letter; FCC staff analysis of data *available at* http://www.usac.org/hc/tools/disbursements/default.aspx. For purposes of this chart, trends in reciprocal compensation MOUs are assumed to follow trends for intrastate access MOUs.

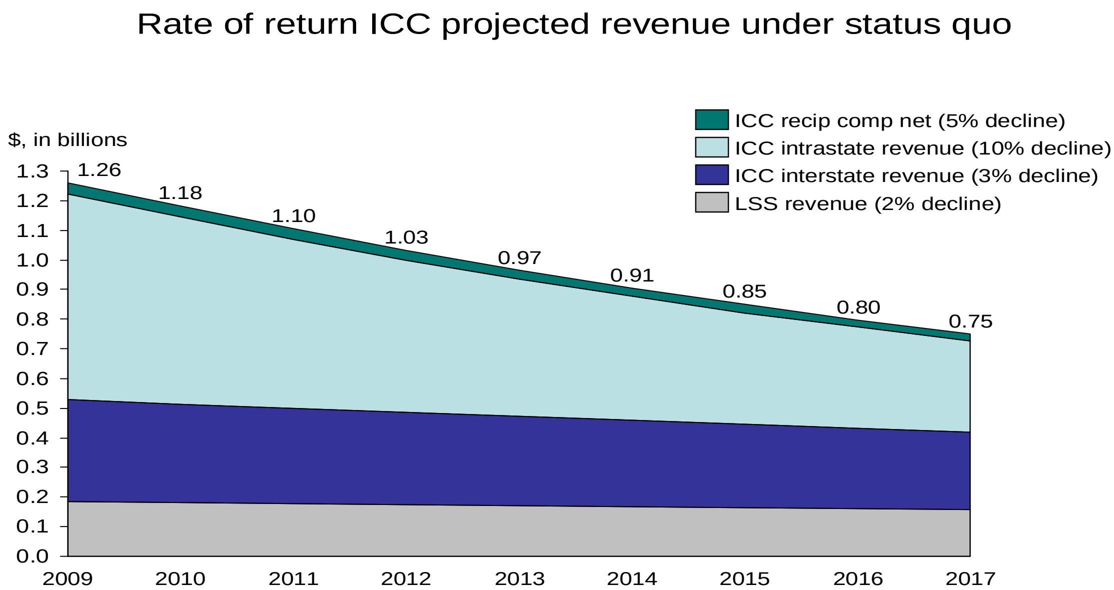

Figure 11[1735]

894. Accounting for both the declining interstate revenue requirement and the ongoing loss of intrastate revenue with declining MOU, the record establishes a range of reasonable potential annual reductions in the Baseline from which Rate-of-Return Eligible Recovery is calculated; within that range we initially adopt a five percent annual decrease. At the lower end of the range, an annual decrease of three percent would represent rate-of-return carriers' approximate annual interstate revenue decline absent reform.[1736] Limiting our Baseline adjustment to three percent would make these carriers substantially better off with respect to their intrastate access revenues, however. As discussed above, carriers in many states do not have annual true-ups under state access rate regulations so as MOU decline, intrastate access revenues decline as well. Data indicate that this intrastate access revenue decline has been approximately 10 percent.[1737] Combining these interstate and intrastate declines weighted by the relative portion of aggregate rate-of-return revenues subject to the mechanism attributable to each category could justify a

[1735] According to NECA, intrastate access is approximately 56 percent of these revenues, interstate access is approximately 28 percent of these revenues, and LSS is approximately 16 percent of these revenues. *See* Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 80-286, GN Docket No. 09-51 at Attach. (filed Dec. 30, 2010) (providing revenue figures); NTCA Sept. 9, 2011 *Ex Parte* Letter Attach. 3 at 1 (providing revenue and LSS change projections). Using a 10 percent annual decline for intrastate access revenues, 3 percent annual decline for the interstate access revenue requirement, and 2 percent annual decline for LSS yields a weighted annual decline of approximately 7 percent.

[1736] *See* NTCA Sept. 9, 2011 *Ex Parte* Letter Attach. 3 at 1. We note that this revenue requirement includes a prescribed rate of return of 11.25 percent. Although the rate-of-return carriers proposed a 10 percent rate of return as part of their reform proposal, rate represcription is addressed in the FNPRM and is not part of this analysis. *See infra* Section XVII.C.

[1737] Letter from Regina McNeil, VP of Legal, General Counsel & Corporate Secretary, NECA to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket No. 01-92 (filed May 25, 2011).

possible Baseline reduction of approximately seven percent annually.[1738] Because we recognize that our approach to recovery may require adjustments by rate-of-return carriers, we initially adopt a conservative approach and limit the decline in the Baseline amount from which Rate-of-Return Eligible Recovery is calculated to five percent annually.[1739]

895. Moreover, we note that the annual five percent decline does not include the proposal in the *USF/ICC Transformation NPRM* and from the Rural Associations to apply the corporate operations expense limitation to LSS.[1740] LSS offsets a portion of rate-of-return carriers' interstate switched access revenue requirement. Applying the corporate operations expense limitations to LSS, or more generally to the entire switched access interstate revenue requirement, would have resulted in one-time reduction of almost three percent.[1741] By foregoing this reduction before setting the Baseline, we ensure that the five percent decline is appropriately conservative, while still consistent with our overall goals to encourage efficiency and cost savings.

896. Rate-of-return carriers will receive each year's Baseline revenue amount from three sources. First, they will continue to have an opportunity to receive intercarrier compensation revenues, pursuant to the rate reforms described above. Second, they will have an opportunity to collect ARC revenue from their customers, subject to the consumer protection limitations set forth below. Third, they will have an opportunity to collect any remaining Baseline revenue from the CAF. Together, the second and third sources comprise the Rate-of-Return Eligible Recovery.

897. Specifically, Rate-of-Return Eligible Recovery will be calculated from the Rate of Return Baseline by subtracting an amount equal to each carrier's opportunity to collect ICC from the rate elements reformed by this Order. In each year, this ICC opportunity will be calculated as actual demand for each reformed rate element times the default intercarrier compensation rate for that element in that year. The intercarrier glide path adopted above sets default transitional ICC rates, and permits carriers to negotiate alternatives.[1742] In computing the opportunity to collect ICC, we will use the default rates rather than any actual rate to prevent carriers from negotiating low rates simply to prematurely shift intercarrier compensation revenues to the CAF. Thus, in the event that a carrier negotiates intercarrier compensation

[1738] *See supra* note 1735.

We note that some commenters have projected an 8 percent decline in intrastate access MOUs. *See* NTCA Sept. 9, 2011 *Ex Parte* Letter, Attach. 4 ("RLEC RM Price-Out by State and Interstate Component") (8 percent estimate). Although we find the trend based on actual historical results more reliable, even if we instead used that lower projected MOU loss as a proxy for associated intratstate revenue loss (i.e., an 8 percent revenue loss), this still would yield a weighted annual decline of approximately 6 percent.

[1739] We seek comment in the FNPRM asking whether we should change this baseline reduction after five years by either moving to a decline based on MOUs or increasing the decline by one percent per year up to a 10 percent decline. *See infra* para. 1329.

[1740] *See USF/ICC Transformation NPRM*, 26FCC Rcd at 4624, para. 198. *See* Letter from Joshua Seidemann, Director of Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90; GN Docket No. 09-51; WC Docket Nos. 07-135, 05-377; CC Docket No. 01-92, Attach. at 1 (filed Aug. 26, 2011).

[1741] Staff analysis of local switching support data provided by NECA (submitted by NECA as confidential). *See, NECA Data Filings.*

[1742] See infra Section XII.C.

rates lower than those specified, we will still impute the full default rates, for the purpose of computing the amount each carrier has an opportunity to collect from ICC.[1743]

898. Carriers will annually estimate their anticipated MOU for each relevant intercarrier compensation rate capped or reduced by this Order. We note that carriers already use forecasts today in their annual access filings to determine interstate switched access charges and we are requiring carriers to use similar methodology to forecast intercarrier compensation for use in determining Rate-of-Return Eligible Recovery. Because estimated minutes likely will differ from actual minutes, there will be a true-up in two years to adjust the carrier's Rate-of-Return Eligible Recovery for that year to account for the difference between forecast MOU and actual MOU in the year being trued-up.[1744] These data on MOU will establish the Base Minutes for each relevant category, and shall not include MOU for which revenues were not recovered, for whatever reason.[1745] Rate-of-return carriers will be required to submit to the states the data used in these calculations,[1746] allowing state regulators to monitor implementation of the recovery mechanism.[1747] A rate-of-return incumbent LEC that is eligible to receive CAF shall also file this information with USAC, and we delegate to the Wireline Competition Bureau authority to work with to USAC to develop and implement processes for administration of CAF ICC support.[1748] In support of the carriers' annual access tariff filing, each carrier will provide the necessary data used to justify any ARC to the Commission.

899. *Rate-of-Return Eligible Recovery*. A rate-of-return carrier's baseline for recovery ("Rate-of-Return Baseline") is its 2011 interstate switched access revenue requirement, plus its FY2011[1749] intrastate switched access intercarrier compensation revenues for rates capped or reduced by this Order, plus its FY2011 net reciprocal compensation revenues. A rate-of-return carrier's Eligible Recovery ("Rate-of-Return Eligible Recovery"), in turn, is: (a) its Rate-of-Return Baseline reduced by five percent each year; less (b) its ICC recovery opportunity for that year, defined as: (i) its estimated MOU for each

[1743] To do so, carriers are required to file data annually to ensure that carriers do not recover more than they are entitled under the recovery mechanism we adopt today.

[1744] In the FNPRM we seek comment on when the true-up process should end, and what the appropriate replacement should be. *See infra* para. 1329.

[1745] Carriers may, however, request a waiver of our rules defining the Baseline to account for revenues billed for terminating switched access service or reciprocal compensation provided in FY2011 but recovered after the March 31, 2012 cut-off as the result of the decision of a court or regulatory agency of competent jurisdiction. The adjusted Baseline will not include settlements regarding charges after the March 31, 2012 cut-off, and any carrier requesting such modification to its Baseline shall, in addition to otherwise satisfying the waiver criteria, have the burden of demonstrating that the revenues are not already included in its Baseline, including providing a certification to the Commission to that effect. Any request for such a waiver also should include a copy of the decision requiring payment of the disputed intercarrier compensation. Any such waiver would be subject to the Commission's traditional "good cause" waiver standard, rather than the Total Cost and Earnings Review specified below. *See* 47 C.F.R. § 1.3.

[1746] *See supra* paras. 812-813. Upon request, carriers will also be required to file this data with the Commission.

[1747] As discussed above, rate-of-return carriers may elect to have NECA or another entity perform and submit the annual analysis. *See supra* note. 1690.

[1748] USAC plays a critical role in the day-to-day administration of universal service support mechanisms, *see, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4595, para. 116 n.192, including the ICC-replacement CAF support that is part of our recovery mechanism.

[1749] I.e., October 1, 2010 through September 30, 2011.

rate element subject to reform times; (ii) the default transition rate for that rate element for that year; plus (3) any necessary true-ups based on the prior year's actual MOUs.

> **Rate of Return Example**.[1750] A rate-of-return carrier has a 2011 interstate switched access revenue requirement of $200,000, FY2011 intrastate switched access revenues of $50,000, and net reciprocal compensation revenues of $5,000. Its Eligible Recovery would be determined as follows:
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> *Year 1*. The carrier is entitled to collect $242,250 ($255,000 x .95). The carrier will subtract from this total its ICC recovery opportunity from switched access charges capped or reduced in this Order (both intrastate and interstate) and net reciprocal compensation, defined as its forecast MOU times the default rates specified by this Order. The remainder is Eligible Recovery.
>
> *Year 2*. Prior to adjustment for any under- or over-estimation of minutes in Year 1, the carrier is entitled to recover $230,137.50 ($242,250 x .95). This figure is adjusted up or down in the annual true-up to reflect any difference between forecast minutes in Year 1 and actual minutes in Year 1. For example, if the carrier had fewer minutes than estimated in Year 1, such that its ICC recovery opportunity was $500 less than forecast, its recovery in Year 2 would be adjusted upward by $500 and it would be permitted to recover $230,637.50 in Year 2 ($230,137.50 + $500). Conversely, if the carrier had a higher number of MOU than had been forecast and provided the carrier an opportunity for $500 more ICC recovery, its recovery in Year 2 would be adjusted downward to $229,637.50 ($230,137.50 - $500). The carrier will then subtract from this total its Year 2 ICC recovery opportunity, based on its Year 2 forecast minutes and the Year 2 default rates specified by this Order. The remainder is Eligible Recovery.

900. *This Approach to Recovery for Interstate Rate-of-Return Carriers Provides Certainty, Minimizes Burdens to Consumers, and Constrains the Size of USF*. Exercising our flexibility under the Act to design specific regulatory tools,[1751] we adopt an approach to Rate-of-Return Eligible Recovery that takes interstate rate-of-return carriers off of rate-of-return based recovery specifically for interstate switched access revenues,[1752] but provides them more predictable recovery than exists under the *status quo*.[1753] Price cap carriers today already the bear the risk that costs increase and have no true up

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[1750] This is a simplified example of the calculation of Rate-of-Return Eligible Recovery for a rate-of-return carrier's reduction in intrastate terminating access resulting from the reforms we adopt for illustrative purposes only. It is not intended to encompass all necessary calculations applicable in determining Rate-of-Return Eligible Recovery in the periods discussed in the example for all possible rates addressed by our Order.

[1751] *See supra* para. 889.

[1752] In addition, to the extent that any interstate rate-of-return carriers also are subject to rate-of-return regulation at the state level, our recovery mechanism for switched access services replaces that, as well. We observe that our recovery mechanism otherwise leaves unaltered the preexisting rate regulations for these carriers' other services, such as common line (as modified by Sections VIII.C and D. of this Order) and special access. Nonetheless, we recognize that this approach represents a potentially significant regulatory change for those carriers and adopt a longer transition for these carriers for this reason. In addition to the benefits of the standard recovery mechanism discussed below, the Total Cost and Earnings Review mechanism we adopt today will ensure that this recovery mechanism will not deprive any carrier of the opportunity to earn a reasonable return.

[1753] *See, e.g.*, Mo STCG *USF/ICC Transformation NPRM* Reply at 10 ("[A]ny changes to small rate-of-return ILEC's revenue streams must be accompanied by a predictable and sufficient replacement mechanism."); FCC Universal Service Fund and Intercarrier Compensation Workshop, April 6, 2011, CC Docket No. 01-92 at 97, transcript *available at* http://www.fcc.gov/events/universal-service-fundintercarrier-compensation-reform-workshop (comments of Paul Gallant, Senior Vice President and Telecom Analyst, MF Global, discussing the importance of certainty of access revenue to allow continued investor support for broadband build-out).

mechanism for declines in demand. For this reason, the recovery mechanism we adopt for rate-of-return carriers is different than the recovery mechanism we adopt for price cap carriers. Although rate-of-return carriers have a true up process to the Eligible Recovery for actual demand, this is akin to how such carriers are regulated today.[1754] At the same time, however, we decline to conduct true-ups with regard to rate-of-return carriers' switched access costs; accordingly, carriers will have incentives to become more efficient and to reduce switching costs, including by investing in more efficient technology and by sharing switches. Carriers that are more efficient will be able to retain the benefits of the cost savings. We believe the rural LEC forecast with regard to reduced switched access costs is conservative, and carriers will have additional opportunities to recognize efficiencies with regard to these costs. We discuss these issues in greater detail below.

901. As discussed above, incumbent LECs are experiencing consistent, substantial, and accelerating declines in demand for switched access services.[1755] The effect of current interstate rate regulation is to insulate rate-of-return carriers from revenue loss due to competitive pressures that result in declining lines and MOU, but rapidly increasing access rates have exacerbated these carriers' risk of revenue uncertainty due to arbitrage,[1756] and carriers themselves project declining costs—and thus declining revenues—under the *status quo*. In the intrastate jurisdiction, as described above, carriers are often unable to automatically increase rates as they experience a decline in demand caused by competition and changing consumer usage, leading to declining intrastate revenues.[1757]

902. Our framework allows rate-of-return carriers to profit from reduced switching costs and increased productivity, ultimately benefitting consumers.[1758] We note in this regard that the transition to broadband networks affords smaller carriers opportunities for efficiencies not previously available. For example, small carriers may be able to realize efficiencies through measures such as sharing switches, measures that preexisting regulations, such as the thresholds for obtaining LSS support, may have deterred.[1759] Under the new recovery framework, carriers that realize these efficiencies will not experience a resulting reduction in support. In addition, our new recovery framework—in conjunction

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[1754] The true-up process also protects carriers resulting from changes with regard to, for example, reforms related to various arbitrage schemes. The record does not allow us to quantify with precision the impact of these arbitrage-related reforms on rate-of-return carriers.

[1755] *See supra* paras. 885-856.

[1756] *See, e.g.*, Letter from Michael R. Romano, Sr. V.P. – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, Docket No. 01-92, Attach. (filed July 18, 2011); Letter from Gregory W. Whiteaker, Herman & Whiteaker, LLC, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, Attach. at 3 (filed Sept. 23, 2011) (NECA et al. Sept. 23, 2011 *Ex Parte* Letter).

[1757] *See supra* para. 893.

[1758] Our analysis is informed by the Commission's prior findings regarding the advantages that can arise from regulatory frameworks that encourage more efficient investment. *See, e.g.*, *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6789, para. 21 (1990) (*LEC Price Cap Order*). "[A] properly-designed system of incentive regulation will be an improved form of regulation, generating greater consumer benefits . . . ." *Id.* at 5 FCC Rcd 6786, para. 1. Not only have carriers been denied the benefits of increased efficiency under the current system, in some instances our rules actively discourage efficiencies. *See, e.g.*, 47 C.F.R. § 36.125(f). Competition is not a precondition for incentive-based regulation; the Commission previously has concluded that where there is limited competition there is "little incentive to become more productive. Applying incentive regulation to LECs is arguably a more significant regulatory reform in terms of its ability to generate consumer benefits than applying incentive regulation to a carrier or industry that faces substantial competition." *LEC Price Cap Order*, 5 FCC Rcd at 6790-91, para. 33.

[1759] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4565, para. 21.

with the overall reforms adopted in this Order—provides revenue certainty, stability, and predictable support,[1760] as well as promoting continued investment,[1761] consistent with advantages some historically have associated with rate-of-return regulation.[1762]

903. Importantly, our approach also avoids the risk of unconstrained escalation in the burden on end-user customers and universal service contributors. We agree with commenters that, absent incentives for efficiency, determining recovery based on the historical approach to these carriers' rate regulation could cause the Connect America Fund to grow significantly and without constraint.[1763] This prediction is consistent with the Commission's past recognition that rate-of-return regulation can create incentives for inefficient investment, which would flow through to our recovery mechanism.[1764] Although some commenters contend that Commission accounting regulations and oversight adequately protect against inefficient investment,[1765] the effectiveness of Commission accounting regulations and oversight is limited in certain respects,[1766] as the Commission itself previously has recognized.[1767] More

[1760] *See supra* para. 858.

[1761] *See supra* Section VI.B.

[1762] *See, e.g.*, *MAG Order*, 16 FCC Rcd at 19705, para. 220; *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, First Order on Reconsideration, CC Docket No. 00-256, Twenty-Fourth Order on Reconsideration, CC Docket No. 96-45, Report and Order, 17 FCC Rcd 5635, 5636, para. 2 (2002). We also observe that carriers will be able to continue to participate in NECA pooling. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4741-42, para. 597 (citing the benefits of NECA pooling as a risk sharing mechanism for rate-of-return carriers).

[1763] *See, e.g.*, Ad Hoc *August 3 PN* Comments at 24 & n.39; CTIA *August 3 PN* Comments at 19 ; XO *August 3 PN* Comments at 15-16; Viaero Wireless *August 3 PN* Comments at 15-17 & Exh. 2. at 10-12, 15-20, 36-40, 43-51; Verizon *USF/ICC Transformation NPRM* Reply at 55; Letter from David L. Sieradzki, counsel for Alltel, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 01-92, 96-45, RM-10822, at 1-2 & Attach. (filed Mar. 6, 2007); Mercatus Center *Intercarrier Compensation FNPRM* Comments at 15, 22-23; Western Wireless Feb. 13, 2004 Comments, CC Docket No. 96-45, RM-10822 at Attach. As the Commission observed in the *USF/ICC Transformation NPRM*, "[o]ver time, aggregate high-cost support for rate-of-return carriers has increased, while such support for carriers that have chosen to move to price cap regulation has declined." *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4611-12, para. 166 & Figure 7.

[1764] The Commission has found, for example, that because both decreases and increases in company costs are passed on to consumers, a rate-of-return regulated carrier has little incentive to manage inputs efficiently. *See, e.g.*, *LEC Price Cap Order*, 5 FCC Rcd at 6789, para. 22; *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87–313, 4 FCC Rcd 2873, 2889-90, para. 30 (1989) (*AT&T Price Cap Order*); *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987); Further Notice of Proposed Rulemaking, CC Docket No. 87–313, 3 FCC Rcd 3195, 3218-19, 3222, paras. 38, 43 (1988) (*Price Cap Further Notice*). The Commission also has observed that if the authorized rate-of-return exceeds the carrier's actual cost of capital, it may have an incentive to expand its rate base uneconomically. *See, e.g.*, *Price Cap Further Notice*, 3 FCC Rcd at 3219-20, paras. 39-40; *AT&T Price Cap Order*, 4 FCC Rcd at 2889-90, para. 30. In addition, as the *USF/ICC Transformation NPRM* observed, other regulators likewise have trended away from rate-of-return regulation in recent years. *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4740, para. 596 & n.888.

[1765] *See, e.g.*, Rural Broadband Alliance *August 3 PN* Comments at 23-24.

[1766] *See, e.g.*, Viaero Wireless *August 3 PN* Comments, Exh. 2. at 15-16 (citing backward-looking nature of regulatory constraints on investment, the relative information disparity between carriers and regulators, and the potential for cost-shifting or other actions that seek to evade constraints on certain costs); *id*., Exh. 2 at 37-38 ("While it is possible to adopt a variety of constraints that would apply to specific expenditures, it is impossible to ascertain the effectiveness of those constraints absent an external benchmark").

broadly, as commenters observe, retaining rate-of-return regulation as historically employed by the Commission risks "perpetuat[ing the] isolated, ILEC-as-an island operation," thus increasing the costs subject to recovery to the extent that, for example, each individual incumbent LEC purchases its own facilities, rather than sharing infrastructure with other carriers where efficient.[1768] Of particular relevance here, as one commenter observes, under the preexisting regulatory framework "there is little evidence of shared investment in local switching, even though such sharing would be engaged in by rational carriers subject to market incentives," while, "[i]n contrast, there is evidence of at least some efforts to engage in joint ventures to invest in transport and tandem switching assets for which there are fewer regulatory incentives for rate-of-return carriers to invest in their own equipment and facilities."[1769] We are committed to constraining the growth of the CAF, and the recovery mechanism we adopt for interstate rate-of-return carriers advances that goal. To this end, states that have jurisdiction over intrastate access rates should monitor intrastate tariffs filed pursuant to the rules and reforms adopted in this Order to ensure carriers do not shift costs from services subject to incentive regulation to services still subject to rate-of-return regulation.

904. We decline to adopt the recovery mechanism proposed by associations of rate-of-return carriers.[1770] Although these carriers contend that their approach would allow intercarrier compensation reform for rate-of-return carriers that would limit the burdens placed on the CAF, we are not persuaded by a number of the assumptions that lead them to this conclusion. The rate-of-return carriers project that their revenue requirement for switched access will decline three percent annually for the next five years.[1771] Our approach locks in this historical trend, adjusted to account for the intrastate *status quo*. In the absence of locking in this historical trend, however, we have concerns about whether such declines in

(Continued from previous page)

[1767] For example, where regulated prices reflect reported costs, a carrier may have an incentive to exaggerate costs to secure higher prices. *See, e.g.*, *LEC Price Cap Order*, 5 FCC Rcd at 6789, para. 22 ("Under rate of return, carriers are allowed to set their rates based on the costs—investment and expense—of providing a service. Carriers are given fairly wide latitude in the costs they can claim as the basis for their rates.") (citation omitted); *see also, e.g.*, *LEC Price Cap Order*, 5 FCC Rcd at 6790, paras. 29-30; *AT&T Price Cap Order*, 4 FCC Rcd at 2889-90, paras. 30-31. Rate-of-return regulation also can enable carriers to shift some of the costs of their non-regulated, competitive services to the customers of their rate-of-return regulated services. *See, e.g.*, *Price Cap Further Notice*, 3 FCC Rcd at 3223-24, para. 48.

[1768] *See, e.g.*, Viaero Wireless *August 3 PN* Comments, Exh. 2. at 18-19; *see also id*., Exh. 2 at 19-20 (discussing discouragement of efficient consolidation among carriers).

[1769] Viaero Wireless *August 3 PN* Comments, Exh. 2. at 17 n.11; *see also id*., Exh. 2 at 39-40, 45-46.

[1770] Letter from Walter B. McCormick, Jr., United States Telecom Ass'n, Robert S. Quinn, Jr., Senior Vice President—Federal Regulatory, AT&T, Melissa Newman, Vice President—Federal Regulatory Affairs, CenturyLink, Michael T. Skrivan, Vice President—Regulatory, FairPoint Communications, Kathleen Q. Abernathy, Chief Legal Officer and Executive Vice President—Regulatory and Government Affairs, Frontier, Kathleen Grillo, Senior Vice President—Federal Regulatory Affairs, Verizon, Michael D. Rhoda, Senior Vice President—Government Affairs, Windstream, Shirley Bloomfield, Chief Executive Officer, National Telecommunications Cooperative Association, John Rose, President, OPASTCO, Kelly Worthington, Executive Vice President, Western Telecommunications Alliance, to Chairman Genachowski, Commissioner Copps, Commissioner McDowell, and Commission Clyburn, at 2 (filed Jul. 29, 2011). (Submitted attached to Letter from Jonathan Banks, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket Nos. 05-337, 07-135, 10-90; GN Docket No. 09-51; CC Docket No. 96-45; WC Docket No. 06-122; CC Docket Nos. 99-200, 96-98, 99-68; WC Docket No. 04-36 (filed July 29, 2011)).

[1771] NECA et al. Aug. 29, 2011 *Ex Parte* Letter), Attach. 2 at 1 (Preliminary RLEC CAF Computations; Assumptions and Computations).

the revenue requirement actually will occur. As commenters observe, because ICC costs will be shifted primarily to the CAF to make rate-of-return carriers whole, carriers would face incentives for inefficient investment, and such incentives could be heightened to the extent that carriers seek to offset the effects of intercarrier compensation rate reductions.[1772] A more realistic view of the assumptions underlying the associations' projections suggests that the financial impact on the CAF of the associations' proposal is likely far greater than they project. Consequently, adopting their proposal appears likely to lead to one of two results—the CAF would grow significantly, or intercarrier compensation reform would stop once CAF demands outstripped the available budget.[1773]

F. Recovering Eligible Recovery

905. We now explain the two-step mechanism by which carriers will be allowed to recover their Eligible Recovery. First, incumbent LECs will be permitted to recover Eligible Recovery through limited end-user charges. If these charges are insufficient, carriers will be entitled to CAF support equal to the remaining Eligible Recovery.[1774] Because we view our recovery mechanism as a transitional tool, we implement several measures to ensure it is truly temporary in nature. First, the Eligible Recovery that incumbent LECs are permitted to recover phases down over time, based on a predetermined glide path for price cap carriers and a more gradual framework for rate-of-return carriers. Second, ICC-replacement CAF support for price cap carriers is subject to a defined sunset date. Finally, in the FNPRM, we seek further comment on the timing for eliminating the recovery mechanism—including end-user recovery—in its entirety. Carriers recovering eligible recovery will be required to certify annually that they are entitled to receive the recovery they are claiming and that they are complying with all rules pertaining to such recovery.

1. End User Recovery

906. The *USF/ICC Transformation NPRM* sought comment on the role that interstate SLCs should play in intercarrier compensation reform and the ongoing relevance of the SLC as the marketplace moves to IP networks.[1775] The subsequent *Public Notice* sought further comment on particular

[1772] *See, e.g.*, CTIA *August 3 PN* Comments at 18; Free State Foundation *August 3 PN* Comments at 4; US Cellular *August 3 PN* Comments at 10-11.

[1773] As stated in the Joint Letter: "To the extent, however, that sufficient funding is not expected for any reason to be available to provide the necessary levels of high-cost support and/or intercarrier compensation restructuring for carriers in any given year, any and all reductions in intercarrier compensation rates shall be deferred until such sufficient funding is confirmed to be available." Joint Letter at 2-3. Similar concerns would arise from other proposals that rely on rate of return-based recovery in conjunction with more limited intercarrier compensation rate reforms. *See, e.g.*, NECA et al. *USF/ICC Transformation NPRM* Comments at 12-27; *see also*, Letter from Colin Sandy, Government Relations Counsel, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 1-2 (filed Oct. 21, 2011).

[1774] Carriers electing to forego recovery from the ARC or the CAF must indicate their intention to do so in their 2012 tariff filing. Carriers may also elect to forgo CAF reform in any subsequent tariff filing. A carrier cannot, however, elect to receive CAF funding after a previous election not to do so. Notwithstanding a carrier's election to forego recovery from the ARC or the CAF, tariff filings may require carriers to provide the information necessary to justify the rates and terms in the tariff.

[1775] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4736, para. 579; *see also, e.g.*, *2008 USF/ICC FNPRM*, 24 FCC Rcd at 6497, App. A, paras. 298-310 (seeking comment on a recovery mechanism that would rely on certain SLC increases); *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4706-4734, paras. 42, 49, 51, 53, 54, 56, 59, 88, 101-02, 106, 108, 111 (seeking comment on recovery alternatives that would rely on SLC increases or other new end-user charges).

alternatives for using SLCs as part of any recovery mechanism.[1776] Although the record reveals a wide variety of proposals, most parties commenting on the matter supported an increase in end-user charges as a necessary part of ICC reform.[1777] In developing the recovery mechanism, we seek to balance the interests of both end-user customers and USF contributors. We thus agree that it is appropriate to first look to customers paying lower rates for some limited, reasonable recovery, and adopt a number of safeguards to ensure that rates remain affordable and that consumers are not required to contribute an inequitable share of lost intercarrier revenues.

907. In addition to balancing the needs of ratepayers and USF contributors, we also account for differences among different ratepayers, adopting particular protections for consumers. For example, some proposals in the record would require that end-user recovery be borne in the first instance by consumers.[1778] Instead, acknowledging that all end users benefit from the network, and consistent with the Commission's approach to end-user recovery in prior intercarrier compensation reform, we conclude that all end users should contribute to reasonable end-user recovery from the beginning of ICC reform.[1779]

908. We adopt a transitional ARC that is subject to three important constraints. First, in no case will the monthly ARC increase more than $0.50 per year for a residential or single-line business customer, or more than $1.00 (per line) per year for a multi-line business customer. Price cap incumbent LECs are allowed to increase ARCs for no more than five years; rate-of-return incumbent LECs for no more than six years.[1780] Second, in no case will the consumer ARC increase if that increase would result in certain residential end-user rates exceeding the Residential Rate Ceiling, which we discuss below. Third, ARCs can only be charged in a particular year to recover an incumbent LEC's Eligible Recovery for that year; total revenue from ARCs cannot exceed Eligible Recovery. Thus if a carrier's Eligible Recovery decreases from one year to the next, the total amount of ARCs it may charge its end users will also decrease. Importantly, carriers also are *not* required to charge the ARC.[1781]

[1776] *August 3 PN* at 10-16.

[1777] *See, e.g.*, Cbeyond et al. *USF/ICC Transformation NPRM* Comments at 15-16; CenturyLink *USF/ICC Transformation NPRM* Comments at 67, 69; Comcast *USF/ICC Transformation NPRM* Comments at 20; COMPTEL *USF/ICC Transformation NPRM* Comments at 36; Cox *USF/ICC Transformation NPRM* Comments at 14-15; Fidelity *USF/ICC Transformation NPRM* Comments at 13; ICore *USF/ICC Transformation NPRM* Comments at 21-22; Madison Telephone *USF/ICC Transformation NPRM* Comments at 14; Michigan PSC *USF/ICC Transformation NPRM* Comments at 18; Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Comments at 41; Sprint *USF/ICC Transformation NPRM* Comments at 13; T-Mobile *USF/ICC Transformation NPRM* Comments at 27; Vitelco *USF/ICC Transformation NPRM* Comments at 17; Wheat State *USF/ICC Transformation NPRM* Comments at 14; XO *USF/ICC Transformation NPRM* Comments at 49. *But see* Ad Hoc *USF/ICC Transformation NPRM* Comments at 56-62.

[1778] *See, e.g.*, ABC Plan Proponents *August 3 PN* Comments at 34-35.

[1779] *See, e.g.*, *Access Charge Reform Order*, 12 FCC Rcd at 16005 para. 58-60; *CALLS Order*, 15 FCC Rcd at 12978, para. 41; *MAG Order*, 16 FCC Rcd at 19634-35, paras. 43-44.

[1780] We believe that the consumer ARC adopted here, which, even if fully imposed, represents a smaller percentage increase than SLC increases adopted by the Commission in prior reforms, strikes the proper balance. *CALLS Order*, 15 FCC Rcd at 12991, 13004, paras. 76, 105-06; *MAG Order*, 16 FCC Rcd at 19634, 19638, paras. 42, 51.

[1781] Incumbent LECs may be unable to charge ARCs in whole or in part based on competitive constraints or other considerations, or may choose not to. *See, e.g.*, Letter from Jonathan Banks, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90; GN Docket No. 09-51; WC Docket No. 07-135; WC Docket No. 05-337; CC Docket No. 01-92; CC Docket No. 96-45; WC Docket No. 04-36 at 1 (filed Oct. 17, 2011). Although we will impute the full permitted ARC revenues to those carriers for purposes of evaluating the need for additional recovery of Eligible Recovery, some commenters have suggested that carriers facing competition may choose to refrain from (continued…)

909. To minimize the consumer burden, we limit increases in the monthly consumer ARC to \$0.50 per year.[1782] Furthermore, while some commenters advocate end-user charges only for residential and single-line business customers, we reject requests to place the entire recovery burden on consumers. We provide for increases in the monthly ARC for multi-line business customers of \$1.00 (per line) per year, and we will require potential revenue from such increases to be imputed to carriers, reducing the total amount of consumer ARCs they may charge. Doing so is consistent with the Commission's prior intercarrier compensation reforms, which recognized that "universal service concerns are not as great for multi-line business lines."[1783] Consequently, in previous reforms, the Commission has adopted higher increases in end-user charges for multi-line business customers than for consumers, and on a more accelerated timeline. For example, in the *Access Charge Reform Order*, the Commission did not raise the SLC cap for primary residential and single-line business users,[1784] but concluded that universal service concerns were not as great for multi-line business users, for example, and raised the SLC caps for such users from \$6.00 to \$9.00 per line.[1785] In the *2008 ICC/USF Order and NPRM*, the Commission proposed increasing the residential and single-line business and the non-primary residential line SLC by \$1.50 and the multi-line business SLC by \$2.30.[1786] In the *USF/ICC Transformation NPRM* the Commission sought comment on those amounts again.[1787] Commenters supported this increase.[1788] In fact, some commenters advocated for a higher SLC increase.[1789] The ARC adopted today, which is lower on an annual basis than the annual SLC increase proposed in 2008, balances the burdens on consumers and businesses. However, we have taken measures to ensure that charges for multi-line businesses remain just and reasonable. In particular, to ensure that multi-line businesses' total SLC plus ARC line items are just and reasonable and to minimize the burden on businesses, we limit the maximum SLC plus ARC fee to \$12.20.[1790] This limits the ARC for multi-line businesses for entities at the current \$9.20 cap to \$3.00, comparable to the overall limit on residential ARCs.

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charging the ARC, and we preserve carriers' flexibility to do so. *See, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 32.

[1782] We also make clear that carriers may not charge any Lifeline customers an ARC. As a result, incumbent LECs' calculation of ARCs for purposes of the recovery mechanism must identify and exclude such customers. Given that our intercarrier compensation reforms also do not alter the operation of the existing SLC, these intercarrier compensation reforms will not affect the Lifeline universal service support mechanism.

[1783] *MAG Order*, 16 FCC Rcd at 19638-39, para. 52.

[1784] *Access Charge Reform Order*, 12 FCC Rcd at 16010-11 para. 73.

[1785] *Access Charge Reform Order*, 12 FCC Rcd at 16005 para. 58-60.

[1786] *See 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6630, para. 298

[1787] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4737, para. 582.

[1788] *See, e.g.*, Frontier *2008 Order and ICC/USF FNPRM* Comments at 6; GVNW *2008 Order and ICC/USF FNPRM* Comments at 9; Cbeyond, et al. *USF/ICC Transformation NPRM* Comments at 15; Frontier *USF/ICC Transformation NPRM* Comments at 10; XO *USF/ICC Transformation NPRM* Comments at 49.

[1789] *See* OPASTCO *2008 Order and ICC/USF FNPRM* Comments at 9-11.

[1790] Several commenters urged the Commission to adopt some sort of cap on the overall multi-line business charges from the existing SLC and any new recovery charge. *See e.g.*, Letter from Henry Hultquist, VP, Federal Regulatory, AT&T Services, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51; CC Docket Nos. 01-92, 96-45 (filed Oct. 21, 2011); Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 4 (filed Oct. 17, 2011).

910. We permit carriers to determine at the holding company level how Eligible Recovery will be allocated among their incumbent LECs' ARCs.[1791] By providing this flexibility, carriers will be able to spread the recovery of Eligible Recovery among a broader set of customers, minimizing the increase experienced by any one customer.[1792] This also will enable carriers to more fully recover Eligible Recovery from end-users with rates below the $30 Residential Rate Ceiling, limiting the potential impact on the CAF.[1793] For carriers that elect to receive CAF support, we will impute to each carrier the full ARC revenues they are permitted to collect, regardless of whether they actually collect any or all such revenues. If the imputed amount is insufficient to cover all their Eligible Recovery, they are permitted to recover the remainder from CAF ICC support.

911. In the event a carrier elects not to receive CAF ICC support,[1794] we take measures to limit the burden on residential and single-line business customers. Absent doing so, carriers potentially could use their holding company-level flexibility to target their ARC recovery primarily or exclusively to residential and single-line business customers, rather than larger multi-line business customers. We therefore require that a carrier allocate its Eligible Recovery by a proportion of a carrier's mix of residential versus business lines. However, because line counts alone would not reflect the fact that there is a lower cap on ARC increases for residential and single-line business lines ($0.50 per line) than for multi-line business lines ($1.00 per line), we adopt a double-weighting of multi-line business lines for purposes of this calculation. The percentage of ARC revenues a carrier is eligible to recover from residential and single-line business customers cannot exceed the percentage of total residential lines assessed a SLC by such customers where multi-line business lines are given double weight.[1795] For example, if a carrier had 1000 residential and single-line business lines and 200 multi-line business lines, and Eligible Recovery of $600 monthly, under our limitation, it would be permitted to collect no more than 71.43 percent of that amount—approximately $429—from residential and single line business

[1791] *See, e.g.*, ABC Plan, Attach. 1 at 12. The ARC's modest and capped size, its interim nature, and the requirement to impute revenue from charging ARCs to multi-line business customers as well as to consumers, together with the $30 Residential Rate Ceiling, will ensure that overall rates remain affordable and set at reasonable levels. Further, while it may be that holding companies will allocate ARC amounts to markets where their incumbent LECs face less competitive pressure, those markets would likely be ones that are relatively costly to serve. *See* Letter from Chris Miller, Assistant General Counsel, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, WC Docket No. 04-36, at 1-2 (filed Oct. 20, 2011).

[1792] In the *USF/ICC Transformation NPRM* we sought comment on allowing carriers to vary the end-user charges based upon network usage, and on further differentiating the magnitude of end-user recovery beyond the categories of customers associated with existing SLC caps. We also sought comment regarding the National Broadband Plan's suggestion that the Commission consider whether to deregulate end user charges in areas where states have deregulated local service rates. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4737, para. 583. There was little support for such changes. Particularly given the minimal record support, as well as the possibility for consumer confusion resulting from too many variations of SLCs and potential burdens on end users, we find our approach to recovery more appropriate.

[1793] We decline to adopt other flexibility proposals in the record. For instance, in the *August 3 Public Notice*, we sought comment on the ABC Plan proposal that price cap carriers be allowed to choose between different SLC options depending on whether or not they choose to take ICC revenue recovery from the CAF in addition to end-user charges. *See August 3 Public Notice* , 26 FCC Rcd at 11124-28. We do not find a basis in the record for such differential treatment of customers, and instead adopt a uniform approach for price cap carriers.

[1794] The decision to elect not to receive ICC replacement CAF support, discussed below, is distinct from the decision to assess the full authorized ARC.

[1795] In addition, this calculation will exclude lines for Lifeline customers because we prevent carriers from assessing an ARC on any Lifeline customer.

customers based on the calculation: 1000 residential and single line business lines/(1000 residential and single-line business lines + 2 x 200 multi-line business lines) = 71.43 percent.

912. We decline to implement end user recovery through increases to the pre-existing SLC, as some commenters suggest.[1796] SLCs today are designed to recover common line revenues as defined by Commission regulation. We are not formally recategorizing any costs or revenues to be included in that regulatory category, and the calculation of Eligible Recovery for purposes of the reforms we adopt today is completely independent of SLC rate calculations. As a result, we leave current SLCs unmodified for now.[1797] Instead, the new ARC will be separately calculated, reduced over time, and separately tariffed and reported to the Commission to enable monitoring to ensure carriers are not assessing ARCs in excess of their Eligible Recovery.[1798] Moreover, we find that it is appropriate to reevaluate our SLC rules, and do so in the attached FNPRM.[1799]

913. *Residential Rate Ceiling.* In the *Public Notice*, we sought comment on the appropriate level and operation of a ceiling to limit rate increases in states that already had undertaken some intercarrier compensation reforms.[1800] To ensure that consumer telephone rates remain affordable and to recognize states that have already undertaken reform, we adopt a Residential Rate Ceiling of $30 per month for all incumbent LECs, both price cap and rate-of-return. Although the Residential Rate Ceiling does not generally limit rates carriers can charge, it prevents carriers from charging an ARC on residential consumers already paying $30 or more.

914. For purposes of comparison with the Residential Rate Ceiling, we consider the rate for basic local service, including additional charges that a consumer actually pays each month in conjunction with that service (referred to collectively as rate ceiling component charges). The rate ceiling component charges consist of the federal SLC and the ARC; the flat rate for residential local service,[1801] mandatory extended area service charges, and state subscriber line charges; per-line state high cost and/or access replacement universal service contributions;[1802] state E911 charges; and state TRS charges. Carriers are not permitted to charge ARCs to the extent that ARCs would result in rate ceiling component charges exceeding the Residential Rate Ceiling for any residential customer. For example, a consumer in Parsons,

[1796] *See, e.g.*, Alexicon *USF/ICC Transformation NPRM* Reply at 8; ABC Plan, Attach. 1 at 11-12. *See also, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 436-38, paras. 579-84

[1797] Carriers whose current SLCs are below the caps are not otherwise permitted to increase their SLCs to recover revenues reduced by interstate and intrastate access charge reforms, i.e., we are not permitting carriers to raise their SLCs beyond the level they are currently authorized to charge, even if that level is below the relevant regulatory SLC cap. We seek comment in the accompanying FNPRM regarding whether existing regulation of SLCs is appropriate, including whether SLCs should be reduced or phased-out over time. *See infra* paras. 1330-1333.

[1798] The ARC can, however, be combined in a single line item with the SLC on the customer's bill.

[1799] *See infra* paras. 1330-1333; NASUCA *USF/ICC Transformation NPRM* Comments at 98; Free Press *August 3 PN* Comments at 12-13.

[1800] *Further Inquiry Into Certain Issues in the Universal Service-Intercarrier Compensation Transformation Proceeding*, 26 FCC Rcd 11112 at 11122-23 (2011) (*August 3 Public Notice*) (discussing proposals ranging from $25-30, and their associated implementation).

[1801] This is sometimes known as the "1FR" or "R1" rate. *See, e.g.*, Letter from the Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. 1 at 3 (filed Jan. 30, 2007) (Missoula Plan Corrected Jan. 30 *Ex Parte* Letter) (referencing "the basic residential local rate (1FR or equivalent)").

[1802] ABC Plan, Attach. 1 at 12 (describing the rates used for the benchmark comparison).

Kansas may have a rate of $13.90,[1803] a SLC of $6.40, a mandatory contribution to the Kansas Universal Service Fund of $6.75, a mandatory EAS charge of $1.70, and a TRS charge of $1.00—his or her aggregate rate ceiling component charges before the ARC would be $29.75. Accordingly, a carrier could only charge this consumer an ARC of $0.25 before reaching the $30 Residential Rate Ceiling.[1804] (The carrier could still charge multi-line business customers a $1.00 per line ARC, provided that any multi-line business customer's total SLC plus ARC does not exceed $12.20). After the ARC, any additional Eligible Recovery would have to be recovered from the CAF rather than from end-users.

915. The Residential Rate Ceiling particularly helps protect consumers in states that have already begun state intercarrier compensation reform.[1805] As part of such reform, some states are rebalancing rates, with local rate increases phasing in over time, including potentially after January 1, 2012.[1806] These local rate increases will be included in the calculation of end-users rates for comparison to the Residential Rate Ceiling. Further, as part of our universal service reforms, we are adopting an intrastate rate minimum benchmark designed to avoid over-subsidizing carriers whose intrastate rates are not minimally reasonable.[1807] To ensure that states are not disincented from rebalancing artificially low local retail rates after January 1, 2012, and to ensure that our Residential Rate Ceiling continues to protect consumers in those states, we will use the *higher of* the relevant rates in effect on January 1, 2012 or of January 1 in the year in which the ARC is to be charged for comparison to the Residential Rate Ceiling, thus accounting for possible increases in consumer rates over time.[1808]

916. We find the $30 Residential Rate Ceiling will help ensure that consumer rates remain affordable and set at reasonable levels by preventing any ARC increases to consumers who already pay $30 or more.[1809] Although some commenters propose using a $25 (or lower) rate,[1810] we note that several

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[1803] *See* U.S. General Accounting Office, *Telecommunications: Federal and State Universal Service Programs and Challenges to Funding*, at 52 (GAO-02-187, Feb. 4, 2002), http://www.gao.gov/new.items/d02187.pdf ("GAO Report").

[1804] Consistent with the goal of the Residential Rate Ceiling, because non-primary residential SLC lines are charged to residential customers we limit carriers' ARC for non-primary residential SLC lines to an amount equal to the ARC charged for such consumers' primary residential lines. Thus, to the extent that the Residential Rate Ceiling limits the ARC that can be assessed on residential customers' primary lines, it effectively will limit the ARC that can be charged on their non-primary lines, as well.

[1805] *See, e.g.*, Letter from Joel Shifman, Maine Public Utilities Commission, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 1 (filed October 14, 2011) (urging the Commission to recognize early adopter states that have already undertaken intrastate access reform and rate rebalancing).

[1806] *See, e.g.*, Pennsylvania PUC *August 3 PN* Comments at 17.

[1807] *See supra* Section VII.

[1808] *See* ABC Plan Proponents *August 3 PN* Comments at 21-22. Because this approach protects consumers in states that are in the process of rebalancing local rates, we believe it is preferable to the "snapshot" approach others have proposed. *See, e.g.,* ABC Plan, Attach. 1 at 12; Joint Letter at n.1. Although states are free to lower intrastate access rates more quickly than specified by our reform, doing so would not increase the ARC or ICC-replacement CAF support available to carriers in such states. If it accomplished that reform by rebalancing local rates, however, those increased local rates would be accounted for in our Residential Rate Ceiling.

[1809] We note that we also adopt a "local rate benchmark" as part of universal service reform of HCLS and HCMS. *See supra* Section VII.D.5. The CAF benchmark serves a different purpose and has a different function from the Residential Rate Ceiling. The CAF benchmark is focused on ensuring that universal service does not overly subsidize carriers with artificially low local rates. As a result, it focuses more narrowly on the specific rates of concern, especially flat-rated local service charges, state SLCs, and state USF contributions and sets a lower bound to encourage carriers to charge reasonably comparable local rates. HCLS and HCMS are federal universal service (continued…)

states that have rebalanced rates already have rates above $30, suggesting that this rate is affordable and set at reasonable levels.[1811] To the extent that prior surveys of urban rates yielded an average of approximately $25, we observe that the surveys encompassed a more limited set of charges than our Residential Rate Ceiling.[1812] As demonstrated by the rates in a number of states that have undertaken significant intercarrier compensation reform—which we find to be a more relevant data set in this context than average urban rates—rates including the full ranges of charges can be close to or more than $30.[1813] We also decline to adopt separate rate ceilings for different carriers, and instead agree with commenters that it would "be inappropriate—and inconsistent with Section 254—for the Commission to adopt different benchmarks for different geographic areas or providers."[1814] Such an approach would mandate rate disparities between geographic areas, contrary to the Commission's goal of promoting reasonably comparable rates throughout the country.[1815] We thus conclude that the $30 Residential Rate Ceiling

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mechanisms that pick up intrastate loop costs, and we will not use limited universal service funding to subsidize artificially low rates. The CAF benchmark therefore serves as a floor.

We do not use the Residential Rate Ceiling for other purposes, such as an imputed level of revenue to limit a carrier's recovery from the CAF, as some commenters suggest. *See, e.g.*, NASUCA *August 3 PN* Comments at 60. The CAF benchmark includes an imputation and imputing those same revenues twice could be problematic. Moreover, the ICC Residential Rate Ceiling acts as a cap on any federal ARC increases resulting from intercarrier compensation reform, ensuring that overall consumer rates remain affordable. The Residential Rate Ceiling thus considers a wider range of end-user charges and is set at a higher level than the CAF benchmark. Although the Residential Rate Ceiling also helps target end-user rate increases for recovering Eligible Recovery to consumers in states with the lowest rates, those increases alone do not ensure that consumers in those states will ultimately pay rates more comparable to other areas. Thus, the HCLS/HCMS rate benchmark plays a complementary role.

1810 *See, e.g.*, NECA et al. *August 3 PN* Comments at 46; Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 4 (filed Oct. 17, 2011).

1811 *See, e.g.*, *supra* para. 859; *see also, e.g.*, Letter from Brian J. Benison, Director-Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket No. 01-92, GN Docket No. 09-51, Attach. 2 (filed Oct. 25, 2010); Missoula Plan Corrected Jan. 30 *Ex Parte* Letter, Attach. 2 at 1-2 (identifying 27 states estimated to receive proposed universal service funding where "Residential Revenues Per Line" already were greater than $25).

1812 For example, it did not include state universal service contributions. *See, e.g.*, IATD, WCB, Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, App. at 1 (rel. Aug. 2008) (describing information collected in 2007 urban rate survey).

1813 *See supra* para. 859.

1814 Time Warner Cable *August 3 PN* Comments at 14, 15.

1815 Nor are we persuaded that other considerations justify such disparate treatment of customers based on whether they obtain service from a price cap carrier or a rate-of-return carrier. For example, some commenters contend that rate-of-return carriers have smaller local calling areas, and therefore fewer of their calls are encompassed by local retail rates. *See, e.g.*, MoSTCG *USF/ICC Transformation NPRM* Comments at 10; North Dakota PSC *USF/ICC Transformation NPRM* Comments at 3. As an initial matter, the record contains no reliable data regarding relative local calling area sizes for rate-of-return and price cap carriers generally. In addition, the retail residential rates encompassed by the Residential Rate Benchmark cover both telephone exchange service (i.e., the ability to make calls within a given local calling area) and exchange access (i.e., the ability to connect to an IXC to make long distance calls).

strikes the right balance between ensuring that consumers pay their fair share of recovery and protecting consumers in states that already have undertaken substantial reforms.[1816]

2. CAF Recovery

917. The Commission has recognized that, as we move away from implicit support, some high cost, rural areas may need new explicit support from the universal service fund. Consequently, in the *USF/ICC Transformation NPRM*, the Commission sought comment on the appropriate role of universal service support to offset some intercarrier revenues lost through reform.[1817] We agree with the many commenters advocating that transitional recovery should, in part, come through the CAF. In particular, the limits on ARCs and the Residential Rate Ceiling we adopt above place important constraints on end user recovery. Consequently, we anticipate that end user recovery alone will not provide the full recovery permitted by our mechanism for many incumbent LECs, particularly rate-of-return carriers. Given our desire to ensure a measured, predictable transition, we thus find it appropriate to supplement end user recovery with transitional ICC-replacement CAF support.

918. To that end, as part of the new CAF universal service mechanism, we permit incumbent LECs to recover Eligible Recovery that they do not have the opportunity to recover through permitted ARCs.[1818] The same oversight and accountability obligations we adopt above apply to CAF support received as part of the recovery mechanism.[1819] In addition, all rate-of-return CAF ICC recipients, whether a current recipient of high cost universal service support or not, must satisfy the same public interest obligations as carriers receiving high-cost universal service support. All price cap CAF ICC recipients must use such support for building and operating broadband-capable networks used to offer

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[1816] Some commenters express concerns that our rate ceiling will not absolutely guarantee that states will not have rates that exceed the $30 Residential Rate Ceiling. To the extent that commenters express concern that states subsequently might increase local rates and/or state universal service fund contributions, *see, e.g.*, Kansas Commission *August 3 PN* Reply at 5-7, we note that our rate ceiling will account for future increases in local rates and per line universal service contributions, counting those higher amounts toward the benchmark. The Kansas Corporation Commission also observes that some states have deregulated basic local phone service rates, and thus "a carrier may face no constraint whatsoever in increasing basic local rates." Kansas Commission *August 3 PN* Reply at 6. If carriers were unconstrained in their ability to increase particular rates, it is not clear why they would not already have set them at the profit-maximizing level, such that further increases would not be profitable. States also remain free to reconsider their regulatory approach if problems arise with respect to particular rates.

[1817] *See, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4738-41, paras. 585-94. *See also, e.g., 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6634-41, App. A, paras. 311-25; *2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4706-4734, paras. 42-44, 51, 53, 55, 58, 59, 101, 104, 109-11.

[1818] The ICC-replacement CAF support for carriers that are eligible and elect to receive it is the remainder of Eligible Recovery not recovered through ARCs. As a result, those same data will enable USAC to calculate CAF support as well. Thus, we direct carriers to file those same data with USAC for purposes of CAF distribution under our recovery mechanism. We note that although incumbent LECs will experience intercarrier compensation reductions on a study area-by-study area basis, they have flexibility at the holding company level to determine where and how to charge ARCs. Thus, USAC needs an approach to attributing those revenues to particular study areas to determine the amount of CAF funding to provide to each such area. In this regard, we note that one benefit of our universal service reform is the greater accountability associated with the CAF support mechanism. Given that, we direct USAC to attribute ARC revenue to all of the holding company's study areas in proportion to the Eligible Recovery associated with that study area. This will ensure that some study areas are not insulated from the CAF accountability measures by having sufficient ARC revenue attributed to meet their entire Eligible Recovery need.

[1819] These obligations are subject to waiver pursuant to the Total Cost and Earnings Review. *See infra* Section XIII.G.

their own retail broadband service in areas substantially unserved by an unsubsidized competitor of fixed voice and broadband services.[1820] We believe it is appropriate to adopt slightly different obligations for receipt of CAF ICC support for price cap and rate-of-return carriers. For one, the price cap CAF support is transitional, and phasing out completely over time as we have adopted a long-term phase II CAF support for areas served by price cap carriers. Thus, we have a mechanism to advance our goal of universal voice and broadband to areas served by price cap carriers that are unserved today. For rate-of-return carriers, however, we have not adopted a different long-term approach for receipt of universal service support. Therefore, we believe it is appropriate to impose the same obligations that such carriers have for receipt of all universal service support that we adopt above, which requires carriers to extend broadband upon reasonable request [1821] Finally, we allow a carrier to elect not to receive ICC replacement CAF support (and therefore to avoid the obligations that accompany support) even if it would otherwise be entitled to do so under the Eligible Recovery calculation.[1822]

919. Providing CAF recovery is consistent with our mandate under section 254[1823] and the Commission's use of universal service funding as a component of prior intercarrier compensation reforms.[1824] In light of the broadband obligations we adopt, our decision to establish this funding mechanism is also consistent with our general authority under section 4(i) of the Act[1825] and section 706 of the 1996 Act,[1826] because it furthers our universal service objectives and promotes the deployment of advanced services. [1827]

[1820] Consistent with our discussion of obligations associated with frozen high-cost support for price cap carriers in Section VII.C.1 above, while we expect CAF ICC recipients to use support in areas without an unsubsidized competitor, to the extent support is used to serve any geographic area that is partially served by an unsubsidized competitor, the recipient must certify that at least 50 percent of the locations served are in census blocks shown as unserved by an unsubsidized competitor, as shown on the National Broadband Map. *See supra note* 168. *See also* Letter from Jonathan Banks, USTelecom, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90; GN Docket No. 09-51; WC Docket No. 07-135; WC Docket No. 05-337; CC Docket No. 01-92; CC Docket No. 96-45; WC Docket No. 04-36 at 1-2 (filed Oct. 21, 2011).

[1821] CAF ICC support must also be used to support the speed, latency and usage levels adopted above. *See supra* Section VII.D.

[1822] The election to decline CAF support will be made in the carrier's July 1, 2012 tariff filing. A carrier that elects not to receive CAF cannot subsequently change this election. A carrier can, however, initially elect to receive CAF support but elect to end that support at any time. Moreover, like forgone ARC recovery, forgone CAF will be imputed to a carrier seeking any additional recovery under the Total Cost and Earnings Review, discussed below. *See infra* Section XIII.G.

[1823] 47 U.S.C. § 254(i) (requiring that "[t]he Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable"); 47 U.S.C. §254(b)(1) (stating that "[q]uality services should be available at just, reasonable, and affordable rates").

[1824] *See, e.g.*, *CALLS Order*, 15 FCC Rcd at 12971, para. 24; *MAG Order*, 16 FCC Rcd at 19669–70, para. 132.

[1825] Section 4(i) provides that the Commission may "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). Prior to the enactment of section 254 (as part of the 1996 Act), sections 1 and 4(i) provided authority for the Commission's adoption of a universal service fund. *See Rural Telephone Coalition v. FCC*, 838 F.2d 1307 (D.C. Cir. 1988). *See also New England Telephone and Telegraph Co. v. FCC*, 826 F.2d 1101, 1107 (D.C. Cir. 1987) (describing section 4(i) as a "wide-ranging source of authority"), *cert. denied*, 490 U.S. 1039 (1989).

[1826] 47 U.S.C. § 1302.

[1827] *See supra* Section V.

920. For price cap carriers that elect to receive ICC-replacement CAF support, such support is transitional and phases out in three years, beginning in 2017.[1828] Although we do not adopt a similar sunset for rate-of-return carriers' ICC-replacement CAF support in this Order, we seek comment on alternatives in this regard in the FNPRM.[1829]

3. Monitoring Compliance with Recovery Mechanism

921. To monitor compliance with this Order, we require all incumbent LECs that participate in the recovery mechanism, including by charging any end user an ARC, to file data on an annual basis regarding their ICC rates, revenues, expenses, and demand for the preceding fiscal year.[1830] All such information may be filed under protective order and will be treated as confidential.

922. These data are necessary to monitor compliance with the provisions of this Order and accompanying rules, including to ensure that carriers are not charging ARCs that exceed their Eligible Recovery and that ARCs are reduced as Eligible Recovery decreases. The data are also needed to monitor the impact of the reforms we adopt today and to enable the Commission to resolve the issues teed up in the FNPRM regarding the appropriate transition to bill-and-keep and, if necessary, the appropriate recovery mechanism for rate elements not reduced in this Order, including originating access and many transport rates. Such data will enable the Commission to determine the impact that any transition would have on a particular carrier or group of carriers, and to evaluate the trend of ICC revenues, expenses, and minutes and compare such data uniformly across all carriers.

923. To minimize any burden, filings will be aggregated at the holding company level, limited to the preceding fiscal year, and will include data carriers must monitor to comply with our recovery mechanism rules. For carriers eligible and electing to receive CAF ICC support, we will ensure that the data filed with USAC is consistent with our request, so that carriers can use the same format for both filings. To ensure consistency and further minimize any burden on carriers, we delegate to the Wireline Competition Bureau the authority to adopt a template for submitting the data, which should be done in conjunction with the development of data necessary to be filed with USAC for receipt of CAF ICC support, which has also been delegated to the Wireline Competition Bureau.[1831] Given that carriers must be monitoring these data to comply with our revised tariff rules, we require incumbent LECs to file electronically annually at the same time as their annual interstate access tariff filings.

G. Requests for Additional Support

924. Although we provide an opportunity for revenue recovery to promote an orderly transition away from terminating access charges, we decline to adopt a revenue-neutral approach as advocated by some commenters.[1832] Rather, we agree with commenters who maintain that the

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[1828] *See, e.g.*, ABC Plan, Attach. 1 at 12-13.

[1829] *See infra* para. 1328.

[1830] We also encourage, but do not require, all competitive LECs and CMRS providers to similarly file such data.

[1831] Although the Commission requested such data in the *USF/ICC Transformation NPRM*, such submission was often incomplete and not filed in the same format by all carriers. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4733, para. 572 and n.853.

[1832] *See, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 63 ("All carriers should have an opportunity to replace all ICC revenue lost as a result of rate reform."); Mississippi Public Commission *USF/ICC Transformation NPRM* Comments at 15 ("[W]ireline carriers, incurring both intrastate and interstate access reductions, should be 'made whole.'"); Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to (continued…)

Commission has no legal obligation to ensure that carriers recover access revenues lost as a result of reform, absent a showing of a taking.[1833] We establish a rebuttable presumption that the reforms adopted in this Order, including the recovery of Eligible Recovery from the ARC and CAF, allow incumbent LECs to earn a reasonable return on their investment. We establish a "Total Cost and Earnings Review," through which a carrier may petition the Commission to rebut this presumption and request additional support.[1834] We identify below certain factors in addition to switched access costs and revenues that *may* affect our analysis of requests for additional support, including: (1) other revenues derived from regulated services provided over the local network, such as special access; (2) productivity gains; (3) incumbent LEC ICC expense reductions and other cost savings, and (4) other services provided over the local network.[1835] Particularly given these factors, it is our predictive judgment that the limited recovery permitted will be more than sufficient to provide carriers reasonable recovery for regulated services, both as a matter of the constitutional obligations underlying our rate regulation and as a policy matter of providing a measured transition away from incumbent LECs' historical reliance on intercarrier compensation revenues to recovery that better reflects today's marketplace.[1836] Nonetheless, we also adopt a Total Cost and Earnings Review to allow individual carriers to demonstrate that this rebuttable presumption is incorrect and that additional recovery is needed to prevent a taking.

925. To show that the standard recovery mechanism is legally insufficient, a carrier would face a "heavy burden,"[1837] and need to demonstrate that the regime "threatens [the carrier's] financial integrity or otherwise impedes [its] ability to attract capital."[1838] As the Supreme Court has long

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Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 3 (filed Oct. 18, 2011).

[1833] Ad Hoc *USF/ICC Transformation NPRM* Comments at 51; AT&T *USF/ICC Transformation NPRM* Comments at 32; NASUCA *USF/ICC Transformation NPRM* Reply at 12; Letter from Scott Bergman, CTIA, to Marlene H. Dortch, Secretary, FCC GN Docket No. 09-51; WC Docket Nos. 96-45, 05-337, 10-90; CC Docket No. 01-92 (filed Sept. 9, 2011).

[1834] We believe the Total Cost and Earnings Review procedure alone is sufficient to meet our legal obligations with regard to recovery.

[1835] *See infra* Section XIII.G. *See also USF/ICC Transformation NPRM*, 26 FCC Rcd at 4729, para. 562 (seeking comment on the extent of the Commission's legal obligation to provide a recovery mechanism); *id*. at 4730, para. 563 (the relationship with jurisdictional separations considerations); *id*. at 4731, para. 567 (the relevant revenues to include for recovery purposes); *id*. at 4731-32, paras. 568-69 (the implications for recovery of other services provided using the same multi-purpose networks); *id*. at 4732, para. 570 (the appropriate baseline, including disputed revenues); *id*. at 4732-33, para. 571 (the role of cost savings); *see also August 3 Public Notice*, 26 FCC Rcd at 11125-26 (seeking comment on an approach that would incorporate specified reductions in the recovery baseline, allowing carriers to realize the benefits of reduced costs and/or greater efficiency); *id*. at 16 (whether carriers seeking recovery should have to demonstrate need based on their operations more broadly); *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6640, App. A, para. 324 (seeking comment on a recovery mechanism that would consider all a carrier's costs and revenues when evaluating the need for recovery); *2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4730-31, paras. 99-100 (seeking comment on the scope of any legal obligation to provide a recovery mechanism, including the relevance of revenues from a carrier's other services and of cost savings).

[1836] See *Time Warner Entertainment Co., L.P. v. F.C.C.*, 240 F.3d 1126, 1133 (D.C. Cir. 2001) ("Substantial evidence does not require a complete factual record-we must give appropriate deference to predictive judgments that necessarily involve the expertise and experience of the agency.") citing *Turner II*, 520 U.S. at 196, *Federal Communications Commission v. National Citizens Comm. for Broadcasting*, 436 U.S. 775 at 814 (1978).

[1837] *Hope Natural Gas*, 320 U.S. at 602.

[1838] *Illinois Bell Telephone Co. v. FCC*, 988 F.2d 1254, 1263 (D.C. Cir. 1993).

recognized, when a regulated entity's rates "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed," the company has no valid claim to compensation under the Takings Clause, even if the current scheme of regulated rates yields "only a meager return" compared to alternative rate-setting approaches.[1839] For the reasons described above, we believe that our recovery mechanisms provide recovery well beyond any constitutionally-required minimum, and we find no convincing evidence in the record here that the standard recovery mechanism will yield confiscatory results.

926. Specifically, a carrier can petition for a Total Cost and Earnings Review to request additional CAF ICC support and/or waiver of CAF ICC support broadband obligations.[1840] In analyzing such petitions, the Commission will consider the totality of the circumstances, to the extent permitted by law.[1841] Our analysis will consider all factors affecting a carrier and its ability to earn a return on its relevant investment, including the factors described below. As a result of this analysis of costs and revenues, the Commission will be able to determine the constitutionally required return and will not be bound by any return historically used in rate-setting nor any specific return resulting from the intercarrier compensation recovery mechanism adopted in this Order,[1842] or possible rate represcription as discussed in the FNPRM.[1843]

927. As we seek to protect consumers from undue rate increases or increases in contributions to USF, we will conduct the most comprehensive review of any requests for additional support allowed by law. Our recovery mechanism goes beyond what might strictly be required by the constitutional takings principles underlying historical Commission regulations. Therefore, although our standard recovery mechanism does not seek to precisely quantify and address all considerations relevant to resolution of a takings claim, carriers will need to address these considerations to the extent that they seek to avail themselves of the Total Cost and Earnings Review procedure based on a claim that recovery is legally insufficient.[1844]

928. *Revenues Derived from Other Regulated Services Provided Over the Local Network*. We agree with those who argue that it is appropriate for the Commission to consider the implications of services other than switched access that are provided using supported facilities,[1845] to the extent

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[1839] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 605 (1944).

[1840] *See supra* para. 918.

[1841] *See, e.g.*, Comcast *August 3 PN* Comments at 16-19 (claiming that "there is no Congressional or FCC prohibition against the Commission's consideration of unregulated revenues when determining the appropriate level of subsidies for regulated services").

[1842] Given the extensive discussion of reform proposals over the years, a carrier could not reasonably "rely indefinitely" on the existing system of intercarrier compensation, "but would simply have to rely on the constitutional bar against confiscatory rates" in the event the Commission revised its compensation rules. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 528 (2002).

[1843] *See infra* Section XVII.C.

[1844] *See infra* Section XIII.G.

[1845] *See, e.g.*, ITTA *USF/ICC Transformation NPRM* Comments of at 38 ("It is, of course, reasonable to require CAF recipients to account for the expected revenues from supported services."); CBeyond et al. *USF/ICC Transformation NPRM* Comments at 16. *But see* NECA et al. *USF/ICC Transformation NPRM* Comments at 18 ("any decision by the Commission to take into consideration the extent to which RLECs or other regulated carriers earn revenues from non-regulated services would appear to represent a dramatic about-face in Commission regulatory policy, which has for more than forty years emphasized the importance of keeping regulated and non-regulated costs and revenues separate. This principle has been one of the cornerstones of the Commission's regulatory policy, on which its Part 64 Joint Cost Rules and numerous orders dealing with activities as diverse as (continued…)

constitutionally permitted.[1846] Notwithstanding our intercarrier compensation reform, carriers will continue to receive revenues from other uses of the local network. For example, although the reforms adopted in this Order will bring many intercarrier compensation rates into a bill-and-keep framework, other intercarrier compensation rates will be subject to minimal—or no—reforms at this time.[1847] Consequently, incumbent LECs will continue to collect intercarrier compensation for originating access and dedicated transport, providing continued revenue flows—including the underlying implicit subsidies—from those sources during the transition outlined in this Order, although we have determined that such rates ultimately will reach bill-and-keep as well. Carriers acknowledge that the subsidies in these remaining intercarrier compensation rates are used for investment in their network to provide regulated services such as special access service. In addition, there was debate in the record regarding whether, and how, to consider special access revenues in this regard.[1848] At this time we do not prescribe general rules considering such revenue, but, as with other services that rely on the local network, we will consider such earnings and may reconsider this decision if warranted upon conclusion of the Commission's ongoing special access proceeding.[1849]

929. *Productivity Gains*. As discussed above, although incentive regulation commonly involves sharing the benefits of productivity gains between carriers and ratepayers, such a mechanism has not been in place for many years.[1850] Our standard recovery mechanism adopts a 10 percent reduction in *CALLs* price cap incumbent LECs' baseline revenues, initially for *CALLS* price cap study areas, and after five years for non-CALLS price cap study areas to reflect this. However, because we believe that is a conservative approach, we find it appropriate to consider efficiency gains for particular price cap carriers on an individual basis in our Total Cost and Earnings Review, as well.

930. *LEC Cost Savings and Increased Revenue*. Currently, carriers are frequently embroiled in costly litigation over payment, jurisdiction, and type of traffic.[1851] The reforms we adopt today should substantially reduce such disputes,[1852] and we anticipate that comprehensive intercarrier compensation

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Yellow Pages advertising to Video Dialtone Services to wireline broadband Internet access services rest." (footnotes omitted)).

[1846] *See*, *e.g.*, *Hope Natural Gas*, 320 U.S. at 602 (when performing a takings analysis, it is necessary to consider "the total effect" of the challenged regulation); *see also, e.g.*, *Baltimore & Ohio Railroad Co. v. United States*, 345 U.S. 146, 148 (1953); *Puget Sound Traction, Light & Power Co. v. Reynolds*, 244 U.S. 574, 579-81 (1917); *Consolidated Edison Co. v. Pataki*, 292 F.3d 338, 351 (2d Cir. 2002).

[1847] *See supra* Section XII.A.

[1848] *Compare, e.g.*, Ad Hoc *USF/ICC Transformation NPRM* Comments at 51-53; NASUCA *August 3 PN* Reply at 151 *with, e.g.*, CenturyLink *USF/ICC Transformation NPRM* Comments at 68; ITTA *August 3 PN* Reply at 11.

[1849] *See generally Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994 (2005).

[1850] *See supra* para. 881.

[1851] *See, e.g.*, Letter from Paul Kouroupas, Vice President, Regulatory Affairs, Global Crossing North America, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Dec. 17, 2010) (Global Crossing Dec. 17, 2010 *Ex Parte* Letter) (estimating that disputes regarding intercarrier compensation may represent $450,000,000 annually).

[1852] *See* Sections XI.A and B, XIV, and XV. *See also USF/ICC Transformation NPRM*, 26 FCC Rcd at 4702, 4710, paras. 493, 507.

reform will further reduce carriers' costs of administering intercarrier compensation.[1853] Likewise, our actions regarding phantom traffic and intercarrier compensation for VoIP traffic may increase the proportion of traffic for which intercarrier compensation can be collected. Finally, we note that our reforms should result in expense savings in other lines of business, such as the provision of long distance services. Although we do not adopt a "net revenues" approach as part of our standard recovery mechanism,[1854] in appropriate circumstances we believe an analysis of intercarrier expenses could be warranted in the examination of an individual carrier's claim under the more fact- and carrier-specific Total Costs and Earnings Review mechanism.[1855] We will consider these factors to the extent legally permissible, including but not limited to the following categories:

- *Revenue for Exchanging VoIP Traffic*. A number of carriers have alleged that they are not receiving compensation for exchanging VoIP traffic.[1856] In this Order we adopt rules clarifying the obligation of VoIP traffic to pay intercarrier compensation charges during the transition to bill and keep.[1857] The decisions we adopt today will provide LECs, including incumbent LECs, with more certain revenue throughout the transition, and will also allow them to avoid the litigation expense associated with attempts to collect access charges for VoIP traffic.[1858]
- *Reduced Phantom Traffic*. Similarly, the rules adopted in this Order will enable carriers to identify and bill for phantom traffic.[1859] These rules thus should enable carriers to collect intercarrier compensation charges throughout the transition that they are not currently able to collect. We also anticipate that incumbent LECs will be able to reduce administrative and litigation costs associated with such traffic.[1860]
- *Other Reduced Litigation Costs and Administrative Expenses*. In addition to reduced litigation costs and administrative expense associated with VoIP and phantom traffic as a result of the reforms we adopt in this Order, the record indicates that carriers will benefit more generally from the clarity and

[1853] *See, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4732, para. 570 (seeking comment on the appropriate baseline, including disputed revenues); *2005 Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4730-31, paras. 99-100 (seeking comment on the scope of any legal obligation to provide a recovery mechanism, including the relevance of revenues from a carrier's other services and of cost savings); *id*. at 4767, para. 193 (discussing benefits to small entities from ICC reform due to reduced administrative expenses and disputes).

[1854] *See supra* paras. 874-878.

[1855] *See, e.g.*, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, WC Docket No. 02-112; CC Docket No. 00-175, Report and Order and Memorandum Opinion and Order, 22 FCC Rcd 16440 (2007) (permitting certain incumbent LECs to integrate their LEC and IXC operations without becoming subject to dominant carrier regulation of those interexchange services); *Petition of AT&T Inc. for Forbearance under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket Nos. 07-21, 05-342, Memorandum Opinion and Order, 23 FCC Rcd 7302, 7312-13, para. 19 n.71 (2008) (quoting AT&T Reply comments stating that "a price cap ILEC raising a confiscation claim may find it more difficult to prove such a claim without separated cost data").

[1856] *See infra* Section XIV.B.

[1857] *See infra* Section XIV.C.

[1858] *See infra* paras. 937-939.

[1859] *See supra* Section XI.B.

[1860] *See supra* paras.705.

relative simplicity of the rules we adopt today. We anticipate that this will be reflected in additional savings in litigation and administration costs.[1861]

- *Other Services Provided Over the Local Network*. In addition to regulated services provided over the local network, many carriers also provide unregulated services, such as broadband and video. Although parties have identified some uncertainty regarding the Commission's ability to consider revenues from such services in calculating a carrier's return on investment in the local network,[1862] the Commission will, at a minimum, carefully scrutinize the allocation of costs associated with such services. As one commenter states, "[i]t simply no longer makes any sense (if it ever did) for the agency to allow rural carriers to spend as much as they can on their networks, earning a rate of return on these historical costs while only considering the small sliver of regulated local telephony revenues earned using these USF subsidized networks."[1863]

931. We note that some carriers argued that the Commission should not rely on revenue from unregulated services to offset a carrier's defined eligible revenue, but that if it did, it should only use net unregulated revenue, considering both the costs and revenues from those services.[1864] In addition, although there are a range of possible approaches for allocating many types of costs, a number of commenters recognized that historical accounting underlying intercarrier compensation rates and other charges fail to reflect the marketplace reality of the number and types of services provided over the local network.[1865] For example, the record revealed concerns about the extent to which loop costs have been allocated to regulated services such as voice telephone service versus services such as broadband Internet access service.[1866] Consequently, we will give appropriate consideration to these services as part of the Total Cost and Earnings Review, including an analysis of both the revenue generated by such other services and whether the cost of such services, both regulated and unregulated, have been properly allocated.

932. *Cost Allocation*. The *USF/ICC Transformation NPRM* sought comment on the implications of the jurisdictional separations process, including ongoing reform efforts, on intercarrier

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[1861] *See* Global Crossing Dec. 17, 2010 *Ex Parte* Letter at 2 (filed Dec. 17, 2010) ("Global Crossing spends approximately 2,290 man hours per month managing the inter-carrier compensation regime. Bill reconciliation and disputes constitutes approximately 750 man-hours per month. Management of the inter-carrier compensation regime through contract negotiation, routing, costing, pricing, and product support constitutes an additional 1,540 man-hours per month. Time and resources devoted to inter-carrier compensation is time and resources that cannot be devoted to customer service and network management.").

[1862] *See, e.g.,* Alexicon *August 3 PN* Comments at 9. *But see* California PUC *USF/ICC Transformation NPRM* Comments at 20.

[1863] Free Press *USF/ICC Transformation NPRM* Comments at 8. *See also, e.g.,* NASUCA *USF/ICC Transformation NPRM* Reply at 154-155 ("[T]argeting the SLC for rate increases is not appropriate, especially if such an increase is pursued outside of a full evaluation of the regulated and non-regulated operations of the LEC.").

[1864] NECA *et al. USF/ICC Transformation NPRM* Comments at 19; CenturyLink *USF/ICC Transformation NPRM* Comments at 68.

[1865] *See, e.g.,* Comcast *USF/ICC Transformation NPRM* Comments at 19 (in assessing the need for high-cost support in the future, the Commission should look at the carriers' regulated and non-regulated revenues as well as technological advances and the efficiencies that companies realize when they provide multiple services over a single network").

[1866] *See, e.g.,* Ad Hoc *USF/ICC Transformation NPRM* Comments at 51-52; Free Press *USF/ICC Transformation NPRM* Comments at 8; NASUCA *August 3 PN* Comments at 70-71.

compensation reforms.[1867] The jurisdictional separations process, which has been frozen for some time, is currently the subject of a referral to the Separations Joint Board.[1868] Any carrier seeking additional recovery will be required to conduct a separations study to demonstrate the current use of its facilities. Although this is a burdensome requirement, it is not unduly so given the importance of protecting consumers and the universal service fund.

XIV. INTERCARRIER COMPENSATION FOR VOIP TRAFFIC

933. Under the new intercarrier compensation regime, all traffic—including VoIP-PSTN traffic—ultimately will be subject to a bill-and-keep framework. As part of our transition to that end point, we adopt a prospective intercarrier compensation framework for VoIP traffic. In particular, we address the prospective treatment of VoIP-PSTN traffic by adopting a transitional compensation framework for such traffic proposed by commenters in the record.[1869] Under this transitional framework:

- We bring all VoIP-PSTN traffic within the section 251(b)(5) framework;
- Default intercarrier compensation rates for toll VoIP-PSTN traffic are equal to interstate access rates;
- Default intercarrier compensation rates for other VoIP-PSTN traffic are the otherwise-applicable reciprocal compensation rates; and
- Carriers may tariff these default charges for toll VoIP-PSTN traffic in the absence of an agreement for different intercarrier compensation.

We also make clear providers' ability to use existing section 251(c)(2) interconnection arrangements to exchange VoIP-PSTN traffic pursuant to compensation addressed in the providers' interconnection agreement, and address the application of Commission policies regarding call blocking in this context.

934. Although we adopt an approach similar to that proposed by some commenters, our approach to adopting and implementing this framework differs in certain respects. For one, we are not persuaded on this record that all VoIP-PSTN traffic must be subject exclusively to federal regulation, and as a result, to adopt this prospective regime we rely on our general authority to specify a transition to bill-and-keep for section 251(b)(5) traffic.[1870] As a result, tariffing of charges for toll VoIP-PSTN traffic can occur through both federal and state tariffs.[1871] In addition, given the recognized concerns with the use of telephone numbers and other call detail information to establish the geographic end-points of a call, we decline to mandate their use in that regard, as proposed by some commenters.[1872] We do, however, recognize concerns regarding providers' ability to distinguish VoIP-PSTN traffic from other traffic, and,

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[1867] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4730, para. 563. *See also, e.g.*, *2008 Order and USF/ICC FNPRM*, 24 FCC Rcd at 6632, App. A, para. 304 (seeking comment on an approach that would refer certain recovery questions to the Separations Joint Board give the cross-jurisdictional implications of the possible approach to recovery).

[1868] *See, e.g.*, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 26 FCC Rcd 7133 (2011)

[1869] ABC Plan, Attach. 1 at 10; Joint Letter at 3; NCTA July 29, 2011 *Ex Parte* Letter at 2; New York PSC *August 3 PN* Comments at 18-19; TCA *August 3 PN* Comments at 10-11.

[1870] *See infra* paras. 954-955.

[1871] *See infra* paras. 961-963.

[1872] *See infra* para. 962.

consistent with the recommendations of a number of commenters, we permit LECs to address this issue through their tariffs, much as they do with jurisdictional issues today.[1873]

935. We believe that this prospective framework best balances the competing policy goals during the transition to the final intercarrier compensation regime. By declining to apply the entire preexisting intercarrier compensation regime to VoIP-PSTN traffic prospectively, we recognize the shortcomings of that regime. At the same time, we are mindful of the need for a measured transition for carriers that receive substantial revenues from intercarrier compensation. Although our action clarifying the prospective intercarrier compensation treatment of VoIP-PSTN traffic does not resolve the numerous existing industry disputes, it should minimize future uncertainty and disputes regarding VoIP compensation, and thereby meaningfully reduce carriers' future costs.[1874]

A. Background

936. Questions regarding the appropriate intercarrier compensation framework for VoIP traffic have been raised in a number of previous rulemaking notices from varying perspectives and in varying levels of detail.[1875] Most recently, in the *USF/ICC Transformation NPRM* the Commission sought "comment on the appropriate treatment of interconnected VoIP traffic for purposes of intercarrier compensation," asking about "a range of approaches, including how to define the precise nature and timing of particular intercarrier compensation payment obligations."[1876] To inform this analysis, the Commission sought comment on how best to balance competing policy concerns, the possible need to clarify or modify any aspects of existing law to enable the adoption of a particular VoIP intercarrier compensation regime, and how any such regime would be administered, including the appropriate scope of traffic that should be addressed by the Commission.[1877] In addition, in the *August 3 PN*, we sought comment on measures to clarify the operation of one proposed approach to intercarrier compensation for VoIP-PSTN traffic.[1878]

B. Widespread Uncertainty and Disagreement Regarding Intercarrier Compensation for VoIP Traffic

937. As the Commission recognized in the *USF/ICC Transformation NPRM*, the lack of clarity regarding the intercarrier compensation obligations for VoIP traffic has led to significant billing

[1873] *See infra* para. 963.

[1874] This Order does not address intercarrier compensation payment obligations for VoIP-PSTN traffic for any prior periods. *See, e.g.*, Letter from Grace Koh, Policy Counsel, Cox, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, Attach. at 1 (filed July 1, 2011) (Cox July 1, 2011 *Ex Parte* Letter).

[1875] *See, e.g.*, *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9613, 9621, 9629, para. 6 n.5, paras. 24, 52 (seeking comment on comprehensive intercarrier compensation reform, including issues presented by "IP telephony"); *IP-Enabled Services NPRM*, 19 FCC Rcd at 4904-05, paras. 61-62 (seeking comment on the application of intercarrier compensation charges to VoIP or other IP-enabled services); *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4710, 4722, 4743-44, 4750, paras. 51, 80, 133 & n. 384, 148; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6589-91, 6594, App. A, paras. 209-11, 218 n.703; *id*. at 6787-89, 6792, App. C, paras. 203-06, 213 n.1844.

[1876] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4745, para. 609.

[1877] *Id*. at 4747-48, paras. 612-13.

[1878] *See August 3 Public Notice*, 26 FCC Rcd at 11128. For instance, we sought comment on mechanisms for distinguishing "toll" VoIP-PSTN traffic from other traffic, including possible alternatives to the use of call detail information as proposed by the ABC Plan and Joint Letter. *Id*. at 11129.

disputes and litigation.[1879] Both state commissions and courts have been called upon to address disputes regarding intercarrier compensation for VoIP traffic in a range of contexts and with a range of outcomes. For example, some states have held that the same intrastate access charges that apply in the context of traditional telephone service also apply to at least some VoIP traffic.[1880] Others have applied lower intercarrier compensation charges in certain circumstances,[1881] and still others have deferred to the Commission.[1882] Courts likewise have addressed disputes about the intercarrier compensation payments associated with VoIP traffic, reaching divergent outcomes.[1883] In a number of cases, the state commission's or court's decision hinged in part on the language of particular tariffs or agreements.[1884] Disputes also remain pending in a number of courts and state commissions.[1885]

[1879] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4745-47, 4748, paras. 610-11, 614.

[1880] *See, e.g.*, *Sprint v. Iowa Telecom*, Docket No. FCU-2010-0001, Order (Ia. Util. Bd. rel. Feb. 4, 2011) (applying intrastate access charges); *Re Southwestern Bell Telephone Company dba AT&T Kansas*, Docket No. 10-SWBT-419-ARB, Order Adopting Arbitrator's Determination of Unresolved Interconnection Agreement Issues Between AT&T and Global Crossing (Kan. Corp. Comm'n rel. Aug. 13, 2010) (same); *Palmerton v. Global NAPS*, Docket No. C-2009-2093336, Motion of Chairman James H. Cawley (Pa. PUC rel. Feb. 11, 2010) (same); *Hollis Telephone, Inc., Kearsarge Telephone Co., Merrimack County Tel. Co., and Wilton Telephone Co*., DT 08-28, Order No. 25,043 (NH PUC Nov. 10, 2009) (same).

[1881] *See, e.g.*, *Petition of UTEX Communications Corporation For Arbitration Pursuant to Section 252(b) of the Federal Telecommunications Act and PURA for Rates, Terms, and Conditions of Interconnection Agreement With Southwestern Bell Telephone Company*, Docket No. 26381, Arbitration Award (Tx. PUC rel. Jan. 27, 2011) (holding that AT&T may not charge for traffic covered by the ESP exemption, and that for other traffic compensation should be paid pursuant to the interconnection agreement's terms, as applicable). Other state commissions have held that reciprocal compensation rates apply, but subsequent legislative actions have raised questions about those decisions. Letter from VON et al, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 06-122, 05-337, 04-36, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51 at 3 n.9 (filed Aug. 3, 2011) (VON et al. Aug. 3, 2011 *Ex Parte* Letter) (discussing circumstances in Missouri and Wisconsin).

[1882] *See, e.g.*, *Re Level 3 Communications*, Docket UT-063006, Order 12 (Wa. UTC rel. June 7, 2007) (deferring to the Commission); *Re Level 3 Communications LLC*, Docket Nos. 70043-TK-05-10, 70000-TK-05-1132, Memorandum Opinion, Findings and Order, Record No. 9891 (Wy. PSC rel. Apr. 30, 2007) (same); *Re Florida Digital Network, Inc. dba FDN Communications*, Docket No. 041464-TP, Order on Arbitration, PSC-06-0027-FOF-TP (Fl. PSC rel. Jan. 10, 2006) (same).

[1883] *See, e.g.*, *Global NAPS California v. Pub. Util. Comm'n of State of Calif.*, 624 F.3d 1225, 1231-32 (9th Cir. 2010) (affirming state commission decision that access charges apply); *Central Tel. Co. of Va. v. Sprint Communications Co. of Va.*, Civil Action No. 3:09cv720, Slip Op., 2011 WL 778402, *8 (E.D. Va. rel. Mar. 2, 2011) (holding that access charges apply); *Manhattan Telecommunications Corp. v. Global NAPS*, No. 08 Civ. 3829(JSR), Slip Op., 2010 WL 1326095, *3-4 (S.D.N.Y. rel. Mar. 31, 2010) (holding that, as a matter of equity, interstate access rates apply); *Global NAPS Ill. v. Il. Commerce Comm'n*, 749 F.Supp.2d 804, 814-16 (N.D. Il. 2010) (upholding state commission decision applying intercarrier compensation charges even if traffic was VoIP); *PAETEC v. CommPartners*, No. 08-0397, slip op., 2010 WL 1767193, *5 (D.D.C. Feb. 18, 2010) (finding that "the access charge regime is inapplicable to VoIP originated traffic").

[1884] *See, e.g.*, *Global NAPS v. Pub. Util. Comm'n of State of Calif.*, 624 F.3d at 1231-32; *Central Tel. Co. of Va. v. Sprint*, 2011 WL 778402, *8; *Global NAPS v. Il. Commerce Comm'n*, 749 F.Supp.2d at 814-16.

[1885] XO Section XV Comments at 9-10 (citing cases and proceedings); Letter from J.G. Harrington, counsel for Cox, to Sharon Gillett, Chief, Wireline Competition Bureau, FCC, CC Docket No. 01-92, Attach. (filed Sept. 29, 2011) (same).

938. In addition to formal litigation, the record reveals numerous informal disputes in this area.[1886] In some cases, carriers may receive some intercarrier compensation payments at something less than the full intercarrier compensation rates charged in the case of traditional telephone service.[1887] In other cases, terminating carriers state that they receive no intercarrier compensation payments at all for traffic that is, or is alleged to be, VoIP traffic.[1888] Further, some providers cite asymmetries in payments, where, for example, some VoIP providers' wholesale carriers charge full access charges while refusing to pay them to the terminating LEC.[1889]

939. Against this backdrop, and the fact that the current uncertainty and associated disputes are likely deterring innovation and introduction of new IP services to consumers, we find it appropriate to address the prospective intercarrier compensation obligations associated with VoIP-PSTN traffic. Indeed, despite the varied opinions in the record regarding the appropriate approach to VoIP-PSTN intercarrier compensation, there is widespread agreement that the Commission needed to act to address that issue now.[1890]

C. Prospective Intercarrier Compensation Obligations for VoIP-PSTN Traffic

1. Scope of VoIP-PSTN Traffic

940. The prospective intercarrier compensation regime we adopt for a LEC's exchange of VoIP traffic with another carrier focuses on what we refer to as "VoIP-PSTN" traffic.[1891] For purposes of

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[1886] In at least some cases, parties have reached negotiated resolutions regarding the intercarrier compensation payments for VoIP traffic. For example, Verizon cites agreements it reached to exchange VoIP traffic at a rate of $0.0007 per minute. Verizon Section XV Comments at 11; Verizon Reply at 10-11; *see also* XO Section XV Comments at 33; Letter from John Nakahata, Counsel for Level 3, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 99-68, CC Docket No. 01-92, Attach. 1, Part B at 2 (filed Aug. 18, 2008) (Level 3 Aug. 18, 2008 *Ex Parte* Letter); *Re Level 3 Communications*, ARB 665, Order No. 07-098 (Or. PUC rel. Mar. 14, 2007).

[1887] *See, e.g.*, Bright House Section XV Comments at 7; Frontier Section XV Comments at 7-8; Nebraska Rural Independent Companies Section XV Comments at 5, 14-15; State Members of the USF Joint Board Comments at 21.

[1888] GVNW Section XV Comments at 4; NECA et al. Section XV Comments at 6; State Members of the USF Joint Board Comments at 21; Letter from Colin Sandy, Government Relations Counsel, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92, at 1 & Attach. (filed Sept. 23, 2009); Letter from Joe A. Douglas, Vice President, Government Relations, NECA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-36, CC Docket No. 01-92, Attach. at 2-4 (filed May 15, 2009).

[1889] *See, e.g.*, AT&T Section XV Comments at 26, 29-30; *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4745-46, para. 610 & n.920.

[1890] "While there are choices that we would prefer, we frankly think that the industry can survive and thrive on any of the likelier outcomes provided the Commission does act expeditiously and thoroughly." TEXALTEL Section XV Comments at 1. *See also, e.g.*, AT&T Section XV Comments at 28-29; Cablevision-Charter Section XV Comments at 3-13; Cbeyond et al. Section XV Comments at 4-16; NECA et al. Section XV Comments at 4-6, 8-13; Sprint Section XV Comments at 2; Washington UTC Section XV Comments at 2-5. We are unpersuaded by commenters expressing concern about the transitional VoIP-PSTN intercarrier compensation framework becoming effective January 1, 2012, when the tariff changes to effectuate the broader intercarrier compensation rate reforms will not take effect until July 1, 2012. *See, e.g.*, EarthLink *August 3 PN* Comments at 14. Given the importance of providing clarity regarding intercarrier compensation for VoIP-PSTN traffic going forward, we do not find it appropriate to delay its effectiveness.

[1891] We use the term "VoIP-PSTN" as shorthand. We recognize that carriers have been converting portions of their networks to IP technology for years. *See, e.g.*, *IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers*, WC Docket Nos. 04-36, 05-196, First Report and Order and Notice of Proposed Rulemaking, 20 FCC (continued…)

this Order, we adopt the definition of traffic proposed in the Joint Letter: "VoIP-PSTN traffic" is "traffic exchanged over PSTN facilities that originates and/or terminates in IP format."[1892] In this regard, we focus specifically on whether the exchange of traffic between a LEC and another carrier occurs in Time-Division Multiplexing (TDM) format (and not in IP format), without specifying the technology used to perform the functions subject to the associated intercarrier compensation charges.[1893]

941. Although the *USF/ICC Transformation NPRM* proposed focusing specifically on interconnected VoIP services, we note that the Commission's existing definition of interconnected VoIP would exclude traffic associated with some VoIP services that are originated or terminated on the PSTN, such as "one-way" services that allow end-users either to place calls to, or receive calls from, the PSTN, but not both.[1894] Although these one-way services do not meet the definition of interconnected VoIP, carriers are likely to be providing origination or termination functions with respect to this traffic comparable to that of "two-way" traffic that meets the existing definition of interconnected VoIP. Moreover, intercarrier compensation disputes have encompassed all forms of what we define as VoIP-PSTN traffic, and addressing this traffic more comprehensively helps guard against new forms of arbitrage. Various commenters recommended including such traffic within the scope of our intercarrier compensation framework for VoIP[1895] or otherwise expressed support for the approach taken in the ABC

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Rcd 10245, 10257-59, para. 24 & n.77 (2005) (*IP-Enabled Services Order*); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11541-43, para. 84 (1998). Nonetheless, many carriers today continue to rely extensively on circuit-switched technology particularly for the exchange of traffic subject to intercarrier compensation rules. *See, e.g.*, Cablevision-Charter Section XV Comments at 4; Cbeyond et al. Section XV Comments at 12 n.35; TCA Section XV Comments at 2; Cox July 21, 2011 *Ex Parte* Letter, Attach. at 1. Likewise the definition of "interconnected VoIP" uses the term "PSTN" as distinct from at least certain types of VoIP services. *See, e.g.*, 47 C.F.R. § 9.3. Thus, in the context of our VoIP-PSTN intercarrier compensation rules, our reference to "PSTN" refers to the exchange of traffic between carriers in (Time Division Multiplexing) TDM format. *See* ABC Plan, Attach. 1 at 10 n.9.

[1892] Joint Letter at 3. *See also* ABC Plan, Attach. 1 at 10. Some commenters question the scope of traffic that "originates and/or terminates in IP format." *See, e.g.*, CRUSIR *August 3 PN* Comments at 20; Level 3 *August 3 PN* Comments at 12-13. Although our prospective VoIP-PSTN intercarrier compensation is not circumscribed by the definition of "interconnected VoIP service" in section 3(25) of the Act (referencing section 9.3 of the Commission's rules) or the definition of "non-interconnected VoIP service" in section 3(36) of the Act, nonetheless, informed by those definitions, we believe it is appropriate to focus on traffic for services that require "Internet protocol-compatible customer premises equipment." *See* 47 U.S.C. § 153(25) (referencing 47 C.F.R. § 9.3); 47 C.F.R. § 9.3 (subpart (3) in the definition of "interconnected VoIP"); 47 U.S.C. § 153(36)(A)(ii) (discussing services that "require[] Internet protocol compatible customer premises equipment"). Sections 3(25) and 3(36) of the Act were adopted in section 101 of the Twenty-First Century Communications and Video Accessibility Act of 2010, Pub. L. No. 111-260, § 103(b), 124 Stat. 2751 (2010).

[1893] *See, e.g.*, NECA et al. *USF/ICC Transformation NPRM* Comments at 24-25 n.54; Letter from Matthew M. Polka, President/CEO, ACA, and Michael K. Powell, President and CEO, NCTA, to Hon. Julius Genachowski, Chairman, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, at 2 (Aug. 23, 2011). We discuss in greater detail below the issues regarding what particular charges competitive LECs can impose in particular circumstances. *See infra* para. 942.

[1894] *See* 47 C.F.R. § 9.3 (defining "interconnected VoIP service"). *See also IP-Enabled Services Order*, 20 FCC Rcd at 10277, para. 58.

[1895] *See, e.g.*, Consolidated Section XV Comments at 10-11; Nebraska Rural Independent Companies Section XV Comments at 3-4; XO Section XV Comments at 13. *See also* Letter from Christopher W. Savage, Counsel for Bright House, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, at 3 (filed May 27, 2011). XO also proposes that the intercarrier compensation framework extend to "IP-enabled services that do not involve two-way voice communications, such (continued…)

Plan and Joint Letter.[1896] Based on the foregoing considerations, we are persuaded to adopt that approach.[1897]

942. We agree with concerns raised by NCTA and find it appropriate to adopt a symmetrical framework for VoIP-PSTN traffic, under which providers that benefit from lower VoIP-PSTN rates when their end-user customers' traffic is terminated to other providers' end-user customers also are restricted to charging the lower VoIP-PSTN rates when other providers' traffic is terminated to their end-user customers. We thus decline to adopt an asymmetric approach that would apply VoIP-specific rates for only IP-originated or only IP-terminated traffic, as some commenters propose.[1898] The Commission has recognized concerns about asymmetric payment associated with VoIP traffic today, including marketplace distortions that give one category of providers an artificial regulatory advantage in costs and revenues relative to other market participants.[1899] An approach that addressed only IP-originated traffic would perpetuate—and expand—such concerns. Commenters advocating a focus solely on IP-originated

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as electronic fax-to-email services and IP-based voicemail services . . . because such traffic is indistinguishable from two-way voice calling." XO Section XV Comments at 13. However, XO does not clarify the precise definition that would be needed to encompass the specific traffic at issue, given the possible breadth of services encompassed by "IP-enabled services." *See, e.g.*, *IP-Enabled Services NPRM*, 19 FCC Rcd at 4869-79, 4886-90, paras. 8-22, 35-37. We believe that our definition, which itself goes beyond the *USF/ICC Transformation NPRM*'s proposed focus on interconnected VoIP, strikes the appropriate balance for purposes of the transitional intercarrier compensation framework.

[1896] *See, e.g.*, ABC Plan, Attach. 1 at 10; Joint Letter at 3; NCTA July 29, 2011 *Ex Parte* Letter at 2; New York PSC *August 3 PN* Comments at 18-19; TCA *August 3 PN* Comments at 10-11.

[1897] We reject claims that applying our prospective VoIP-PSTN intercarrier compensation regime to this scope of traffic is procedurally improper. *See, e.g.*, Letter from Donna N. Lampert, Counsel for Google, et al., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90, 07-135, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, Attach. at 6 (filed Sept. 30, 2011) (Google et al. Sept. 30, 2011 *Ex Parte* Letter). The *USF/ICC Transformation NPRM* specifically sought comment on the scope of any VoIP intercarrier compensation rules, including "whether the proposed focus on interconnection VoIP is too narrow or whether the Commission should consider intercarrier compensation obligations associated with other forms of VoIP traffic, as well." *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4747, para. 612. In response, commenters proposed approaches that would encompass the scope of VoIP traffic covered by our prospective VoIP-PSTN intercarier compensation framework, and the Commission sought comment on how it could implement such an approach. *August 3 Public Notice*, 26 FCC Rcd at 11128 (seeking comment "on the implementation of the ABC Plan's proposal for VoIP intercarrier compensation"); *id*. at 17 n.57 (discussing the scope of VoIP traffic that would be encompassed by the ABC Plan's proposal).

[1898] *See, e.g.*, Letter from Steven F. Morris and Jennifer K. McKee, NCTA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51 Attach. at 4-5 (filed July 29, 2011) (NCTA July 29, 2011 *Ex Parte* Letter); Comcast Section XV Comments at 4-7; ZipDX Section XV Comments at 2. We note that our VoIP-PSTN intercarrier compensation framework only addresses intercarrier compensation traditionally associated with intrastate and interstate traffic (i.e., access charges and reciprocal compensation), and does not address other compensation associated with international calls. *See* Comcast Section XV Comments at 4 n.4. A separate regulatory regime governs how U.S. carriers negotiate with foreign carriers for the exchange of international traffic. *See, e.g.*, *International Settlements Policy Reform, et al.*, IB Docket Nos. 11-80, 05-254, 09-10, RM-11322, Notice of Proposed Rulemaking, 26 FCC Rcd 7233, 7234-41, paras. 3-10 (2011).

[1899] *See supra* note 1889. *See also, e.g.*, NCTA July 29, 2011 *Ex Parte* Letter at 2.

traffic implicitly recognize as much, noting that providers with IP networks could benefit relative to providers with TDM networks under such an intercarrier compensation regime.[1900]

2. Intercarrier Compensation Charges for VoIP-PSTN Traffic

943. We adopt a prospective intercarrier compensation framework that brings all VoIP-PSTN traffic within the section 251(b)(5) framework. As discussed below, the Commission has authority to bring all traffic within the section 251(b)(5) framework for purposes of intercarrier compensation, including traffic that otherwise could be encompassed by the interstate and intrastate access charge regimes,[1901] and we exercise that authority now for all VoIP-PSTN traffic.

944. We adopt transitional rules specifying, prospectively, the default compensation for VoIP-PSTN traffic:

- Default charges for "toll"[1902] VoIP-PSTN traffic will be equal to interstate access rates applicable to non-VoIP traffic, both in terms of the rate level and rate structure;
- Default charges[1903] for other VoIP-PSTN traffic will be the otherwise-applicable reciprocal compensation rates;[1904] and
- LECs are permitted to tariff these default charges for toll VoIP-PSTN traffic in relevant federal and state tariffs in the absence of an agreement for different intercarrier compensation.

945. Our intercarrier compensation framework for VoIP-PSTN traffic will apply prospectively, during the transition between existing intercarrier compensation rules and the new regulatory regime adopted in this Order, and is subject to the reductions in intercarrier compensation rates required as part of that transition. We do not address preexisting law, including whether or how the ESP exemption might have applied previously, and we make clear that, whatever its possible relevance historically, the ESP exemption is not relevant or applicable prospectively in determining the intercarrier

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[1900] *See, e.g.*, Comcast Section XV Comments at 5-6 (arguing that the relative advantages for providers with IP networks would create incentives for providers with TDM networks to convert to IP); Comcast Section XV Reply at 10 (same).

[1901] *See supra* Section XII.A.2. Our transitional intercarrier compensation framework for VoIP-PSTN traffic applies to all LECs, including LECs that are wholesale partners of VoIP providers.

[1902] The Act defines "telephone toll service" as "telephone service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service." 47 U.S.C. § 153(55). The Commission previously has described toll services as "services that enable customers to communicate outside of their local exchange calling areas," and that, for wireless providers, this means outside the customer's plan-defined home calling area. *See, e.g.*, *Universal Service Contribution Methodology*, WC Docket Nos. 06-122, 04-36, CC Docket Nos. 96-45, 98-171, 90-571, 92-237, 99-200, 95-116, 98-170, Report and Order and Notice of Proposed Rulemaking, 21 FCC Rcd 7518 at 7543, para. 29 (*Interim Universal Service Contribution Methodology Order*). Although the Commission has referred to toll services as "telecommunications services" in some other contexts, *see, e.g., id*., our use of the term "toll" VoIP-PSTN traffic here does not prejudge the classification of VoIP services.

[1903] The default rate applicable to all non-toll VoIP-PSTN traffic is whatever rate applies to other section 251(b)(5) traffic exchanged between the carriers.

[1904] In addition to ISP-bound traffic, section 251(b)(5) traffic historically included all local traffic. In the case of traffic both originated and terminated by a LEC, the local area is defined by the state. *Local Competition First Report and Order*, 11 FCC Rcd at 16013-14, para. 1035. In the case of traffic to or from a CMRS network, section 251(b)(5) applies to traffic that originates and terminates in the same Major Trading Area (MTA). *Id*., at 16014, para. 1036.

compensation obligations for VoIP-PSTN traffic.[1905]

a. The Prospective VoIP-PSTN Intercarrier Compensation Framework Best Balances the Relevant Policy Considerations

946. We believe that our prospective, intercarrier compensation regime for VoIP-PSTN traffic best balances the relevant policy considerations of providing certainty regarding the prospective intercarrier compensation obligations for VoIP-PSTN traffic while acknowledging the flaws with preexisting intercarrier compensation regimes, and providing a measured transition to the new intercarrier compensation framework. Our framework for VoIP-PSTN traffic will also reduce disputes and provide greater certainty to the industry regarding intercarrier compensation revenue streams while also reflecting the Commission's move away from the pre-existing, flawed intercarrier compensation regimes that have applied to traditional telephone service.[1906]

947. Although commenters did not all agree on the treatment of VoIP-PSTN traffic, there was widespread consensus among commenters that, whatever the outcome, it was essential that the Commission address that issue now.[1907] Our framework also seeks to facilitate discussions among the providers exchanging VoIP-PSTN traffic, lessening the need for prescriptive Commission regulations. At the same time, the *USF/ICC Transformation NPRM* recognized the disruptive nature of some providers' unilateral actions regarding VoIP intercarrier compensation,[1908] and we seek to prevent such actions here going forward.

948. We are not persuaded by the arguments of some commenters to subject VoIP traffic to the pre-existing intercarrier compensation regime that applies in the context of traditional telephone service, including full interstate and intrastate access charges.[1909] For one, many of the advocates of such

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[1905] *Compare, e.g.*, Letter from Charles McKee, Vice-President, Government Affairs, Sprint, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 4-6 (filed July 29, 2011) (Sprint July 29, 2011 *Ex Parte* Letter) *with, e.g.*, AT&T Section XV Reply at 23-24. Because we are bringing all traffic within section 251(b)(5), the ESP Exemption from interstate access charges does not apply by its terms. Nonetheless, in this Order, we preserve the equivalent of the ESP Exemption outside of the VoIP-PSTN traffic context. In light of the need for clarity on a prospective basis given the ongoing disputes regarding VoIP intercarrier compensation, as well as the other policy considerations discussed below, we disagree that, as a policy matter, we should adopt the equivalent of the ESP Exemption in this context. *See, e.g.*, Google et al. Sept. 30, 2011 *Ex Parte* Letter, Attach. at 8.

[1906] As in prior Orders, we use the term "traditional telephone service" here colloquially as distinct from VoIP service without reaching any conclusions regarding the classification of VoIP services. *See, e.g.*, *Telephone Number Requirements for IP-Enabled Services Providers; et al.*, WC Docket Nos. 07-243, 07-244, 04-36, CC Docket No. 95-116, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, 19547, para. 28 (2007) (recognizing that interconnected VoIP services increasingly are viewed by consumers as a substitute for traditional telephone services).

[1907] *Supra* para. 939 & note 1890.

[1908] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4748, para. 614. *See also, e.g.*, NECA et al. Section XV Comments at 6; Letter from William A. Haas, Vice President of Public Policy and Regulatory, PAETEC et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 (filed Feb. 1, 2011).

[1909] *See generally, e.g.*, Cablevision-Charter Section XV Comments at 3; Cbeyond et al. Section XV Comments at 4-6; Cox Section XV Comments at 8; NECA *et al*. Section XV Comments at 6; AT&T Section XV Reply at 21-22; Consolidated Reply at 10-12.

an approach subsequently endorsed the ABC Plan and Joint Letter.[1910] Further, such an outcome would require the Commission to enunciate a policy rationale for expressly imposing that regime on VoIP-PSTN traffic in the face of the known flaws of existing intercarrier compensation rules and notwithstanding the recognized need to move in a different direction. Moreover, requiring payment of all existing intercarrier compensation rates applicable to traditional telephone service traffic as part of a transitional regime for VoIP-PSTN traffic would, in the aggregate, increase providers' reliance on intercarrier compensation at the same time the Commission's broader reform efforts seek to move providers away from reliance on intercarrier compensation revenues.[1911] Nor are we persuaded that such an outcome is necessary to advance competitive or technological neutrality.[1912] As discussed above, our prospective regime for VoIP-PSTN intercarrier compensation is symmetrical, and thus avoids the marketplace distortions that could arise from an asymmetrical approach to compensation.[1913] In particular, the record does not demonstrate that our approach advantages in the aggregate providers relying on TDM networks relative to VoIP providers or vice versa,[1914] nor that it advantages in the aggregate certain IXCs relative to others.[1915] Further, to the extent that particular carriers historically have relied on access revenues to subsidize local services,[1916] the record is clear that many providers did not pay the same intercarrier compensation rates for VoIP traffic that would have applied to traditional telephone service traffic.[1917] Additionally, our

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[1910] *See, e.g.*, Joint Letter at 4 (indicating support by the USTelecom, AT&T, CenturyLink, Fairpoint, Frontier, Verizon, Windstream, NTCA, OPASTCO, and WTA); NCTA July 29, 2011 *Ex Parte* Letter at 2 (noting NCTA's support for the VoIP proposal).

[1911] *See supra* Section XII.C.

[1912] *See, e.g.*, Bright House Section XV Comments at 4; CenturyLink Section XV Comments at 13; Frontier Section XV Comments at 9; NARUC Section XV Comments at 4-5; Pac-West Section XV Comments at 5; Cbeyond *et al*. Section XV Reply at 4.

[1913] *See supra* para. 942.

[1914] The transitional VoIP-PSTN intercarrier compensation regime we adopt here can reduce both the intercarrier compensation revenues and long distance and wireless costs associated with VoIP-PSTN traffic. The record does not quantify the net effect of the revenue reduction and cost savings either for VoIP providers and their wholesale carrier partners or for traditional LECs and their wholesale carrier partners. Thus, the record does not demonstrate that, by virtue of our transitional VoIP-PSTN intercarrier compensation regime, VoIP or TDM providers or VoIP or TDM technologies would be advantaged in the marketplace relative to one another.

[1915] The record does not indicate that particular IXCs currently carry a disproportionately large or small portion of VoIP-PSTN traffic today, nor that they would be precluded from competing to carry such traffic in the future. The record thus does not demonstrate a disparate financial impact on particular IXCs from the transitional VoIP-PSTN intercarrier compensation regime.

[1916] *See, e.g.*, Nebraska Rural Independent Companies Section XV Reply at 5. To the extent that high access rates historically have been used to subsidize artificially low rates for other services, we thus are not persuaded that, viewed in that light, access charges can be seen as "100 percent profit" as some contend. *See, e.g.*, Sprint July 29, 2011 *Ex Parte* Letter at 2. Given the flexibility the Commission has under section 201(b), *see, e.g.*, *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and *Order*, 12 FCC Rcd 16606, 16619–20, para. 44 (1997) (citing *Competitive Telecomms. Ass'n v. FCC,* 87 F.3d 522, 529 (D.C. Cir. 1996)), we also disagree that transitional rates above incremental cost are inherently unjust and unreasonable under section 201(b), as some contend. *See, e.g.*, Google et al. Sept. 30, 2011 *Ex Parte* Letter, Attach. at 12-14.

[1917] *See supra* paras. 937-938 (discussing current disputes and alleged non-payment or under-payment of intercarrier compensation for VoIP traffic). *See also, e.g.*, XO Section XV Comments at 34; GVNW Section XV Comments at 4; NECA *et al*. Section XV Comments at 6; State Members of the USF Joint Board Comments at 21.

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transitional VoIP-PSTN intercarrier compensation framework provides the opportunity for some revenues in conjunction with other appropriate recovery opportunities adopted as part of comprehensive intercarrier compensation and universal service reform.[1918]

949. Many of these commenters also argue that comparable uses of the network should be subject to comparable intercarrier compensation charges.[1919] We agree with that policy principle, but observe that the intercarrier compensation regime applicable to traditional telephone service—which they seek to apply to VoIP-PSTN traffic—is at odds with that policy. The pre-existing intercarrier compensation regime imposes significantly different charges for the same use of the network depending upon, among other things, the jurisdiction of the traffic at issue.[1920] A more uniform intercarrier compensation framework for all uses of the network will arise from the end-point of reform adopted in this Order. For purposes of the transition, we conclude that our approach best balances the relevant policy considerations.[1921]

950. We also are unpersuaded by concerns that an intercarrier compensation regime for VoIP-PSTN traffic could lead to further arbitrage or undermine the Commission-established transition adopted

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Some VoIP providers state that they believe that full intercarrier compensation rates have applied to IP-originated or terminated traffic, *see, e.g.*, Cablevision-Charter Section XV Comments at 2 n.2; although, depending upon the nature of their wholesale agreements with long distance providers, VoIP providers might have limited direct knowledge of what compensation was paid for their traffic in some cases, *see, e.g.*, *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9644, para. 96 (discussing certain types of wholesale long distance agreements that incorporate flat, negotiated rates that do not vary with the intercarrier compensation charges actually paid by the IXC). Similarly, some LECs contend that full intercarrier compensation rates commonly have been paid for all VoIP traffic, *see, e.g.*, Apr. 6, 2011 Workshop Transcript, CC Docket No. 01-92 at 77-78 (filed Apr. 25, 2011); although many LECs contend that there has been no mechanism by which they could reliably identify which traffic was VoIP, *see, e.g.*, NECA *et al*. Section XV Comments at 5; PAETEC *et al*. Section XV Comments at 31-33; Windstream Section XV Comments at 7.

[1918] "As one investment analyst has recognized, if rural and mid-size LECs 'can achieve adequate new cost recovery,' then intercarrier compensation reform 'could still be helpful by reducing regulatory uncertainties and *ameliorating the downside* caused by already-eroding ICC revenues (principally access charges).'" Verizon Section XV Reply at 19-20 (quoting Rebecca Arbogast *et al*., Stifel Nicolaus, *FCC Looks To Shift USF-ICC Reform Drive into Overdrive; August Order Eyed*, at 1 (Mar. 15, 2011) (emphasis added)).

[1919] *See, e.g.*, Cablevision-Charter Section XV Comments at 12; Missouri Small Telephone Company Group Section XV Comments at 3; Nebraska Rural Independent Companies Section XV Reply at 6-7, 9-10. Some commenters observe that in the *Access Charge Reform Order* the Commission cited ESPs' different usage of the local network than IXCs in supporting continued application of the ESP exemption and contend that, by contrast, VoIP traffic uses the network in a manner as other traffic that historically has been subject to intercarrier compensation charges. *See, e.g.*, Hawaiian Telcom Section XV Comments at 8-9. The framework we adopt for VoIP-PSTN traffic is transitional, however, and such traffic will pay most of the same rates as all other traffic in the second year of reform. *See supra* Section XII.C.

[1920] *See supra* Section X.

[1921] *See, e.g.*, *Southwestern Bell Tel. Co. et al. v. FCC*, 153 F.3d 523 at 542 (8th Cir. 1998) (upholding Commission intercarrier compensation rules and concluding that "the FCC has made a rational choice regarding the treatment of ISPs from a number of alternatives that are each imperfect. When an agency has gone to considerable lengths to amass information, sift through the record for pertinent facts, and reach a temporary conclusion, it has not acted arbitrarily or capriciously.").

for intercarrier compensation reform more broadly.[1922] An underlying assumption of those arguments is that the carriers delivering traffic for termination will be able to unilaterally determine the portion of their traffic to be subject to the VoIP-PSTN regime. As discussed in greater detail below, the implementation mechanisms for our approach protect against that outcome, both through protections that can be implemented in tariffs and through the option of negotiated agreements, subject to arbitration, regarding the portion of traffic subject to the VoIP-PSTN intercarrier compensation regime. We also permit LECs to include language in their tariffs to address the identification of VoIP-PSTN traffic, much as they do to identify the jurisdiction of traffic today.[1923]

951. States continue to play an important role under our prospective intercarrier compensation framework for VoIP-PSTN traffic, including arbitration of disputes between carriers seeking to enter alternative arrangements. However, we are not persuaded to leave regulation of intercarrier compensation for intrastate toll VoIP-PSTN traffic entirely to the states. Our transitional framework for VoIP-PSTN traffic reflects the fact that our comprehensive intercarrier compensation reforms are gradually moving away from jurisdictionalized intercarrier compensation charges that have led to arbitrage and marketplace distortions,[1924] and reflects the importance of a uniform, predictable transition away from historical intercarrier compensation regimes.[1925] At the same time, our universal service reforms continue to provide for an important state role, consistent with the basic underlying objectives of state commenters.[1926]

952. We also reject requests to immediately adopt a bill-and-keep methodology for VoIP traffic.[1927] Although this would clearly facilitate the Commission's transition away from existing intercarrier compensation regimes, we do not believe that the immediate adoption of bill-and-keep for all forms of VoIP-PSTN traffic appropriately balances other competing policy objectives. In particular, our approach to broader reform seeks a more measured transition away from carriers' reliance on intercarrier compensation as a significant revenue source.[1928] The immediate adoption of bill-and-keep for all VoIP-PSTN traffic would appear to be, in the aggregate, a more significant departure from the intercarrier compensation payments for VoIP traffic that have been made in the recent past.[1929] Our approach also

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[1922] *See, e.g.*, Cablevision-Charter Section XV Comments at 5; PAETEC *et al*. Section XV Comments at 31-33; EarthLink Section XV Comments at 3; Bright House Section XV Reply at 5 & n.9; Cox Section XV Reply at 2-4; State Members July 14, 2011 *Ex Parte* Letter at 10.

[1923] *See infra* Section XIV.C.2.c.

[1924] In light of these concerns with intercarrier compensation charges that vary by jurisdiction, we thus disagree that this approach is inherently inconsistent with the Commission's treatment of VoIP in other contexts. *See, e.g.*, State Members July 14, 2011 *Ex Parte* Letter at 10.

[1925] *See supra* Section XII.C.

[1926] *See supra* Sections VII-IX. *See also*, Letter from James Bradford Ramsay, General Counsel, NARUC, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 96-45, 01-92 at 2 (filed Sept. 22, 2011); *see generally* NARUC Legislative Task Force Report on Federalism and Telecom, July 2005, http://www.dps.state.ny.us/federalism_s0705.pdf.

[1927] *See, e.g.*, CTIA Section XV Comments at 11; Google Section XV Comments at 8; MegaPath-Covad Section XV Comments at 5-8; Sprint Section XV Comments at 6-7; T-Mobile Section XV Comments at 9-12; VON Section XV Comments at 3-5; Vonage Section XV Comments at 3-13.

[1928] *See supra* Section XII.C.

[1929] *See supra* note 1917.

helps limit the initial burden that the intercarrier compensation reform recovery mechanism places on the Universal Service Fund.[1930]

953. Similarly, we conclude that other proposed VoIP-specific approaches to intercarrier compensation do not advance the relevant policy objectives as well as our approach. For example, some of the proposed approaches likely would be almost as significant a departure from the intercarrier compensation payments for VoIP traffic that have been made in the recent past as a bill-and-keep approach.[1931] Nor are such approaches compelled by section 706 of the 1996 Act, as some contend.[1932] Although we seek to ensure that our policies do not hinder the ongoing migration to all-IP networks, and take many actions in this Order to advance the goals of section 706, we also weigh the need to transition carriers away from reliance on intercarrier compensation revenues, which potentially help support some providers' deployment of broadband networks today. Other approaches, which would bring VoIP traffic within the intercarrier compensation regime at a future point in the glide path,[1933] would not increase marketplace certainty in the near term to the same extent as our framework. In sum, we believe that our transitional framework for VoIP-PSTN intercarrier compensation strikes the best balance among the relevant policy goals during the reform transition, while accounting for the flaws in the preexisting intercarrier compensation regimes and the overall direction of comprehensive intercarrier compensation reform.

b. Legal Authority

954. *Authority To Address VoIP-PSTN Traffic Under Section 251(b)(5).* Although the Commission has not classified interconnected VoIP services or similar one-way services[1934] as "telecommunications services" or "information services," VoIP-PSTN traffic nevertheless can be encompassed by section 251(b)(5).[1935] As discussed in greater detail above,[1936] section 251(b)(5) includes "the transport and termination of all telecommunications exchanged with LECs" with the exception of "traffic encompassed by section 251(g) . . . except to the extent that the Commission acts to bring that traffic within its scope."[1937] The Commission previously has recognized that interconnected VoIP

[1930] *See supra* Section XIII.

[1931] *See, e.g.*, Verizon Section XV Comments at 15-19. Similarly, approaches that would adopt reciprocal compensation charges for VoIP Traffic, *see, e.g.*, Comcast Section XV Comments at 4, 13-14; XO Section XV Comments at 14, 19, 22-24, effectively could have as significant a result for many carriers, given the number of carriers exchanging reciprocal compensation traffic at $0.0007 today in light of the ISP-bound traffic rules, *see 2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6486-89, paras. 23-29.

[1932] *See*, *e.g.*, Sprint July 29, 2011 *Ex Parte* Letter at 1-3 (arguing that imposing access charges on VoIP traffic would be inconsistent with section 706); Google *et al*. Sept. 30, 2011 *Ex Parte* Letter, Attach. at 9-11 (same). *See also, e.g.*, Letter from Richard S. Whitt, Director and Managing Counsel, Telecom and Media Policy, Google, *et al*., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92 *et al*. at 2-6 (filed Oct. 18, 2011) (Google Oct. 28, 2011 *Ex Parte* Letter) (contending that requiring intercarrier compensation payment for VoIP traffic could negatively impact certain providers' business models).

[1933] Public Knowledge *USF/ICC Transformation NPRM* Comments at 25 n.62.

[1934] *See supra* Section XIV.C.1.

[1935] We thus are not persuaded by claims that the prospective VoIP-PSTN intercarrier compensation regime must categorically exclude traffic from VoIP services that are claimed to be information services. *See, e.g.*., Google Oct. 28, 2011 *Ex Parte* Letter at 6-7.

[1936] *See supra* Section XII.A.2.

[1937] *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6482-83, paras. 15-16.

providers are providers of telecommunications.[1938] Moreover, the Commission has previously concluded that interconnected VoIP services involve "transmission of [voice] by aid of wire, cable, or other like connection" and/or "transmission by radio,"[1939] and went on to conclude that "[t]he telecommunications carriers involved in originating or terminating a [VoIP] communication via the PSTN are by definition offering 'telecommunications.'"[1940] Further, although classification questions remain regarding retail VoIP services, commenters observe that the exchange of VoIP-PSTN traffic that is relevant to our intercarrier compensation regulations typically occurs between two telecommunications carriers, one or both of which are wholesale carrier partners of retail VoIP service providers.[1941] Nor does anything in the record persuade us that a different conclusion is warranted in the context of other VoIP-PSTN traffic.[1942]

955. *Authority To Adopt Transitional Rates for VoIP-PSTN Traffic*. The legal authority that enables us to specify transitional rates for comprehensive intercarrier compensation reform also enables us to adopt our transitional VoIP-PSTN intercarrier compensation framework pending the transition to bill-and-keep.[1943] For one, the Commission's pre-existing regimes for establishing reciprocal compensation rates for section 251(b)(5) traffic have been upheld as lawful,[1944] and can be applied to non-toll VoIP-PSTN traffic as provided by our transitional intercarrier compensation rules. We also have authority to adopt the transitional framework for toll VoIP-PSTN traffic based on our rulemaking authority to implement section 251(b)(5).[1945] As discussed above,[1946] interpreting our rulemaking authority in this manner is consistent with court decisions recognizing that avoiding "market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule."[1947]

[1938] *Interim Universal Service Contribution Methodology Order*, 21 FCC Rcd at 7539-40, para. 41.

[1939] *Id*. (quoting *VoIP 911 Order*, 20 FCC Rcd at 10261-62, para. 28).

[1940] *Id*.

[1941] *See*, *e.g.*, Cablevision-Charter Section XV Comments at 7-8; CenturyLink Section XV Comments at 5-6; PAETEC *et al*. Section XV Comments at 37; Time Warner Cable Section XV Comments at 8; AT&T Section XV Reply at 23; Bright House Section XV Reply at 3 n.6. Whether the service the carrier is providing as an input to the retail VoIP service is an interexchange service or exchange access depends upon the particular facts. *See, e.g.*, *AT&T IP-in-the-Middle Order*, 19 FCC Rcd at 7469-70, para. 19 n.80 ("Depending on the nature of the traffic, carriers such as commercial mobile radio service (CMRS) providers, incumbent LECs, and competitive LECs may qualify as interexchange carriers for purposes of [the access charge] rule.").

[1942] Because our prospective VoIP-PSTN intercarrier compensation rules typically involves traffic exchanged between carriers, and because intercarrier compensation disputes have tended to involve all forms of VoIP traffic, we are not persuaded that the Commission should draw additional distinctions among traffic associated with different types of VoIP services, as some commenters recommend. *See, e.g.*, Google et al. Sept. 30, 2011 *Ex Parte* Letter, Attach. at 4-6 (arguing that there is significant variability among VoIP services' features and functions, and that intercarrier compensation should not apply to traffic associated with such services for example because of historical policies that information services generally should remain unregulated and the provisions of section 230 regarding the preservation of "the Internet and other interactive computer services, unfettered by Federal or State regulation").

[1943] *See supra* Section XII.A.2.

[1944] *See*, *e.g.*, *AT&T v. Iowa Utilities Board*, 525 U.S. 382, 384-85 (1999) (upholding the Commission's authority to adopt a pricing methodology for section 251(b)(5) traffic); *Core Communications, Inc. v. FCC*, 592 F.3d 139 (D.C. Cir. 2010) (upholding the Commission's reciprocal compensation regime for ISP-bound traffic).

[1945] *See supra* Section XII.A.2.

[1946] *Id.*.

[1947] *Rural Cellular Ass'n v. FCC*, 588 F.3d 1095, 1106 (D.C. Cir. 2009) (quoting *Competitive Telecomm's Ass'n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002)).

Sections 201 and 332 provide additional legal authority specifically for interstate traffic and all traffic exchanged with CMRS providers.[1948]

956. *Application of Section 251(g)*. Additionally, as described above,[1949] section 251(g) supports our view that the Commission has authority to adopt transitional intercarrier compensation rules, preserving the access charge regimes that pre-dated the 1996 Act "until [they] are explicitly superseded by regulations *prescribed by the Commission*."[1950] We reject the claims of some commenters that VoIP-PSTN traffic did not exist prior to the 1996 Act, and thus cannot be part of the access charge regimes "grandfathered" by section 251(g).[1951] This argument flows from a mistaken interpretation of section 251(g). The essential question under section 251(g) is not whether a particular service, or traffic involving a particular transmission protocol,[1952] existed prior to the 1996 Act.[1953] Rather, the question is whether there was a "pre-Act obligation relating to intercarrier compensation for" particular traffic exchanged between a LEC and "'interexchange carriers and information service providers.'"[1954]

957. *Pre-1996 Act Obligations*. Regardless of whether particular VoIP services are telecommunications services or information services, there are pre-1996 Act obligations regarding LECs'

[1948] *See supra* Section XII.A.2.

[1949] *See supra* paras. 763-766.

[1950] 47 U.S.C. § 251(g) (emphasis added).

[1951] *See, e.g.*, MegaPath-Covad Section XV Comments at 7; Sprint Section XV Comments at 5-6.

[1952] VoIP traffic existed prior to the 1996 Act, although the record here does not reveal whether LECs were exchanging IP-originated or IP-terminated VoIP traffic at that time. *See, e.g.*, Consolidated Section XV Reply at 9 (noting a 1996 American Carrier's Telecommunication Association ("ACTA") petition seeking Commission classification of VoIP telephony as a telecommunications service, which included a news report dated before the 1996 Act was enacted that "indicat[ed] that VoIP telephony had at that time been available for over a year"). Because we otherwise reject the claim that intercarrier compensation for VoIP-PSTN traffic is categorically excluded from section 251(g), we need not, and do not, consider further the nature and extent of VoIP traffic that existed prior to the 1996 Act.

[1953] Some commenters cite certain federal district court cases that reached a different conclusion than our statutory analysis above. *See, e.g.*, MegaPath-Covad Section XV Comments at 7 n. 15 (citing *PAETEC Commc'ns, Inc. v. CommPartners*, LLC, CIV-A No. 08-0397, 2010 WL 1767193, at *3 (D.D.C. Feb. 18, 2010); *Southwestern Bell Tel., L.P. v. Missouri Pub. Serv. Comm'n*, 461 F. Supp. 2d 1055, 1080 (E.D. Mo. 2006)). However, as other commenters observe, these outcomes conflict with those reached in other decisions. *See, e.g.*, Cablevision-Charter Section XV Reply at 12-13 n.37 (citing state commission decisions). *See also supra* para. 937 (discussing different decisions by state commissions and courts). In any event, we are not bound by those prior decisions, and find our statutory analysis above to be most appropriate.

[1954] *WorldCom v. FCC*, 288 F.3d 429, 433-34 (D.C. Cir. 2002) (citing 47 U.S.C. § 251(g)). Indeed, the contrary interpretation would suggest that a wide range of traffic would have fallen outside the scope of access charges, and have been exclusively subject to section 251(b)(5) today. *See, e.g.*, NATIONAL BROADBAND PLAN at 76 (discussing wireless technologies introduced since 1997); *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, Memorandum Opinion and Order, 22 FCC Rcd 5662, 5698, para. 63 n.180 (2007) (observing that carriers are migrating to Multiprotocol Label Switching (MPLS)). *Cf.* Cablevision-Charter Section XV Reply at 13-14 ("No one could seriously contend, for example, that LECs upgrading their circuit-switches to soft switches subsequent to the 1996 Act somehow lost their right to assess access charges. Indeed, the Commission has made clear that the use of VoIP technology in and of itself does not exempt a service from access charges, concluding that AT&T's IP-in-the-middle service "'is subject to interstate access charges.'"); GCI 2008 Comments at 14 ("GCI has provided telecommunications services under tariff using a combination of its own copper and fiber facilities, UNEs, and resale. More recently, GCI has also started offering the exact same tariffed services over its cable platform.").

compensation for the provision of exchange access to an IXC or an information service provider.[1955] Indeed, the Commission has already found that toll telecommunications services transmitted (although not originated or terminated) in IP were subject to the access charge regime,[1956] and the same would be true to the extent that telecommunications services originated or terminated in IP.[1957] Similarly, to the extent that interexchange VoIP services are transmitted to the LEC directly from an information service provider, such traffic is subject to pre-1996 Act obligations regarding "exchange access," although the access charges imposed on information service providers were different from those paid by IXCs.[1958] Specifically, under the ESP exemption,[1959] rather than paying intercarrier access charges, information service providers were permitted to purchase access to the exchange as end users, either by purchasing special access services or "pay[ing] local business rates and interstate subscriber line charges for their switched access connections to local exchange company central offices."[1960] But although the nature of the charge is different from the access charges paid by IXCs, the Commission has always recognized that information-service providers providing interexchange services were obtaining exchange access from the LECs.[1961] Accordingly, because they were subject to these exchange access charges, interexchange

[1955] Interexchange VoIP-PSTN traffic is subject to the access regime regardless of whether the underlying communication contained information-service elements.

[1956] *Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457, 7466-70, paras. 14-19 (2004) (*IP-in-the-Middle Order*); *Prepaid Calling Card Order*, 21 FCC Rcd at 7300, para. 27.

[1957] As commenters observe, those access charge obligations did not depend upon the transmission protocol associated with the telecommunications service. *See, e.g.*, Cablevision-Charter Section XV Reply at 13-14; ITTA Section XV Reply at 410; GCI 2008 Comments at 13-14. Under Commission precedent, the presence of protocol processing in a service certainly could be relevant to determining whether it is a telecommunications service or an information service. *See, e.g.*, 47 C.F.R. § 64.702(a) (defining enhanced services).

[1958] 47 U.S.C. § 251(g*)*. *See supra* paras. 763-766.

[1959] In developing the access charge regime, the Commission established a so-called "ESP exemption" because it recognized that certain "users who employ exchange service for jurisdictionally interstate communications, including enhanced service providers (ESPs), had "been paying the generally much lower business service rates" and "would experience severe rate impacts were we immediately to assess carrier access charges up on them." *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Memorandum Opinion and Order, 97 FCC 2d 682, 715, para. 83 (1983) (*First Reconsideration of 1983 Access Charge Reform Order*); *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2631, para. 2 n.8 (1988) (*ESP Exemption Order*).

[1960] *ESP Exemption Order*, 3 FCC Rcd at 2631, para. 2 n.8.

[1961] *See, e.g.*, *Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, CC Docket Nos. 96-149, 98-141, 96-149, 01-337, Report and Order, Memorandum Opinion and Order, 19 FCC Rcd 5102, 5111-12, para. 17 (2004); *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Order on Remand, 15 FCC Rcd 385, 406, para. 45 (1999), *aff'd in part and rev'd in part on other grounds. WorldCom v. FCC*, 246 F.3d 690 (D.C. Cir. 2001); *Enhanced Telemanagement, Inc. v. Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company*, File Nos. E-89-183, E-89-184, 11 FCC Rcd 19669, 19670-71, para. 3 (1996). Note that access services include both carrier's carrier access charges and the subscriber line charge. *See, e.g.*, *Petitions of Qwest Corporation for Forbearance Pursuant To 47 U.S.C. § 160(C) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas*, WC Docket No. 07-97, Memorandum Opinion and Order, 23 FCC Rcd 11729, 11747-48, para. 25 (2008). We note that the Commission at times has used the term "access charges" colloquially as synonymous with carrier's carrier access charges, notwithstanding the fact that access charges actually encompass a broader category of charges. *Compare, e.g.*, *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, Third Report and Order, 93 FCC 2d 241, 249-50, para. 23 (1983) ("Terms such as access, access service and access charges will be used in this *Third*
(continued…)

information service traffic was subject to the over-arching Commission rules governing exchange access prior to the 1996 Act, and therefore subject to the grandfathering provision of section 251(g).

958. The D.C. Circuit's *WorldCom* decision, cited by some commenters, does not compel a different result.[1962] In *WorldCom*, the court considered whether dial-up, ISP-bound traffic was covered by section 251(g)'s grandfathering provision. Consistent with the language of section 251(g), the court focused on whether there was a "pre-Act obligation relating to intercarrier compensation for ISP-bound traffic" and found it "uncontested—and the Commission declared in the Initial Order"—that there was not.[1963] Although the court also stated that "[t]he best the Commission can do" in indentifying a pre-1996 Act obligation "is to point to pre-existing LEC obligations to provide interstate access for ISPs,"[1964] the discussion in the initial *ISP-Bound Traffic Order* cited by the court emphasized the uncertainty at that time regarding the regulatory classification of the functions provided by the carrier serving the ISP—i.e., whether it was providing local service, interexchange service, or exchange access.[1965] As the D.C. Circuit ultimately observed, the fact that the carrier serving the ISP was acting as a LEC—rather than an interexchange carrier or information service provider—would be dispositive that compensation for that traffic exchange could not be encompassed by section 251(g).[1966] Here, by contrast, there is no evidence that the exchange of toll VoIP-PSTN traffic inherently involves the exchange of traffic between two LECs. Moreover, we note that to the extent VoIP-PSTN traffic is not "toll" traffic, it is subject to the preexisting reciprocal compensation regime under section 251(b)(5) rather than the transitional framework for toll VoIP-PSTN traffic that we adopt in this Order.

959. *Other Proposed Approaches*. Based on the present record, and given the framework we adopt, we do not rely on the contention that the Commission has legal authority to adopt this regime because all VoIP-PSTN traffic should be treated as interstate.[1967] Some commenters contend that, under the analysis of the *Vonage Order*, VoIP services are subject to exclusive federal jurisdiction.[1968] As a

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Report and Order to encompass both end user and carrier's carrier charges.") *with, e.g., Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4688-89, para. 6 n.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").

[1962] *See*, *e.g.*, Sprint Section XV Comments at 5-6.

[1963] *WorldCom*, 288 F.3d at 433-34.

[1964] *Id*. Despite mentioning the ESP exemption in the *ISP Remand Order*, the Commission did not rely on those exchange access regulations, including compensation obligations, that existed under that pre-1996 Act framework. *ISP Remand Order*, 16 FCC Rcd at 9164, paras. 27-28. Rather, it held that the exchange of such traffic was "information access" and encompassed by section 251(g) on that basis. *ISP Remand Order*, 16 FCC Rcd at 9171, para. 44.

[1965] *Implementation of the Local Compensation Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 14 FCC Rcd 3689 at 3695, para. 9 (1999).

[1966] *WorldCom*, 288 F.3d at 433-34. *See also, e.g.*, Consolidated Section XV Reply at 8.

[1967] *See*, *e.g.*, ABC Plan, Attach. 5 at 18 (proposing that the Commission find that "all VoIP traffic . . . is inseverable and, therefore, interstate for jurisdictional purposes"). We do not prejudge how services might develop in the future, and how this analysis might apply at that time. At the same time, nothing in this Order alters the *status quo* with respect to the jurisdictional treatment of VoIP traffic or services under existing precedent.

[1968] *See*, *e.g.*, XO Section XV Comments at 14-18; Verizon Section XV Comments at 19-31, Verizon Section XV Reply at 21.

threshold matter, the *Vonage Order* addressed a retail VoIP service.[1969] By contrast, VoIP-PSTN intercarrier compensation typically involves the exchange of traffic between two carriers, one (or both) of which are providing wholesale inputs to a retail VoIP service—not the retail VoIP service itself.[1970] In addition, under the framework adopted here, most default rates actually paid for toll VoIP-PSTN traffic—equal to interstate access rates—will be the same regardless of whether the VoIP-PSTN toll traffic were considered to be solely interstate or both interstate and intrastate. Commenters likewise contend that it is possible to make the distinctions necessary to implement such a framework, whether directly in some cases[1971] or through the use of proxies or factors or the like.[1972]

[1969] *Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, WC Docket No. 03-211, Memorandum Opinion and Order, 19 FCC Rcd 22404, 22406-08, paras. 4-9 (2004) (*Vonage Order*). Nothing in this Order impacts the holding of the *Vonage Order*. Nor does anything in this item impact the holding of the *Kansas/Nebraska Contribution Order*. *See Universal Service Contribution Methodology; Petition of Nebraska Public Service Commission and Kansas Corporation Commission for Declaratory Ruling or, in the Alternative, Adoption of Rule Declaring that State Universal Service Funds May Assess Nomadic VoIP Intrastate Revenues*, WC Docket No. 06-122, Declaratory Ruling, 25 FCC Rcd 15651, 15652-53, para. 5 (2010) (*Kansas/Nebraska Contribution Order*). The *Kansas/Nebraska Contribution Order* performed the relevant preemption analysis for the limited purposes of evaluating state universal service contribution obligations for nomadic interconnected VoIP providers and, based on that analysis and considering that the Commission had already adopted a safe harbor assuming [64.9 percent] of VoIP revenues were intrastate for purposes of contributions to the federal universal service fund, concluded that they would not be preempted in certain circumstances. *See generally Kansas/Nebraska Contribution Order*, 25 FCC Rcd 15651.

[1970] *See supra* note 1941. For example, as cable operators explain, their retail VoIP provider partners with a LEC for the exchange of traffic with other carriers. *See, e.g.*, Cablevision-Charter Section XV Comments at 7-8; Time Warner Cable Section XV Comments at 7-8; Bright House Section XV Reply at 3 n.6; Letter from Mary McManus, Senior Director, FCC and Regulatory Policy, Comcast, *et al*., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 07-135, GN Docket No. 09-51 at 2 (filed Oct. 24, 2011) (Comcast *et al*. Oct. 24, 2011 *Ex Parte* Letter).

[1971] Some commenters contend that the challenges in identifying the jurisdiction of VoIP traffic – particularly on a call-by-call basis – arise to a greater extent for nomadic VoIP, while compliance with jurisdictionalized intercarrier compensation charges is comparatively more straightforward for certain facilities-based VoIP services. *See, e.g.*, Cbeyond *et al*. Section XV Reply at 9-10; Rural LEC Section XV Group Section XV Comments at 4-5; Bright House *August 3 PN* Comments at 8.

[1972] There appears to be broad support for the principle that VoIP providers and their wholesale carrier partners can comply with an intercarrier compensation regime with charges that differ at least to some degree based on where the calls originate and terminate. *See, e.g.*, ABC Plan, Attach. 1 at 10 (proposing intercarrier compensation rules for VoIP traffic that impose differing charges depending upon whether the traffic is toll traffic or traditional reciprocal compensation traffic). Even beyond that, a number of commenters contend that factors or traffic studies have proved workable in addressing the jurisdiction of other traffic and similar approaches can be used for VoIP-PSTN traffic as well. *See, e.g.*, AT&T Section XV Reply at 20; Cbeyond *et al*. Reply at 10; Nebraska Rural Independent Companies Section XV Reply at 8; Pennsylvania PUC *August 3 PN* Comments at 22-23. We also note, for example, that "[t]he Commission has long endorsed the use of [percentage of interstate usage (PIU) factors] to determine the jurisdictional nature of traffic for access charge purposes." *Prepaid Calling Card Order*, 21 FCC Rcd at 7302, para. 32. We do not adopt a jurisdictional safe harbor based on the safe harbor for interconnected VoIP providers' universal service contributions, *see, e.g.*, Cbeyond et al. *August 3 PN* Comments at 15, because that is based on a percentage of revenues, rather than a percentage of traffic, and also does not further differentiate between intrastate toll traffic and other intrastate traffic. Nor do we otherwise have data to justify setting an industry-wide jurisdictional safe harbor.

c. Implementation

960. As discussed below, carriers may tariff charges at rates equal to interstate access rates for toll VoIP-PSTN traffic in federal or state tariffs but remain free to negotiate interconnection agreements specifying alternative compensation for that traffic instead.[1973] Other VoIP-PSTN traffic will be subject to otherwise-applicable reciprocal compensation rates. Because telephone numbers and other call detail information do not always reliably establish the geographic end-points of a call, we do not mandate their use. However, to address concerns about identifying VoIP-PSTN traffic, we allow LECs to include tariff language addressing that issue, much as they do to address jurisdiction questions today.

961. *Role of Tariffs*. During the transition, we permit LECs to tariff reciprocal compensation charges for toll VoIP-PSTN traffic equal to the level of interstate access rates.[1974] Although we are addressing intercarrier compensation for all VoIP-PSTN traffic under the section 251(b)(5) framework, we are doing so as part of an overall transition from current intercarrier compensation regimes—which rely extensively on tariffing specifically with respect to access charges—and a new framework more amenable to negotiated intercarrier compensation arrangements. We therefore permit LECs to file tariffs that provide that, in the absence of an interconnection agreement,[1975] toll VoIP-PSTN traffic will be subject to charges not more than originating[1976] and terminating interstate access rates. This prospective regime thus facilitates the benefits that can arise from negotiated arrangements[1977] without sacrificing the

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[1973] Consistent with the ABC Plan's proposal, nothing in our VoIP-PSTN intercarrier compensation framework alters or supersedes the reciprocal compensation rules for CMRS providers, including the intraMTA rule. ABC Plan, Attach. 1 at 10 n.6. *See also* Section XV.D.

[1974] CMRS providers currently are subject to detariffing, and nothing in our intercarrier compensation framework VoIP-PSTN traffic disrupts that regulatory approach. *See Petitions of Sprint PCS and AT&T Corp. for Declaratory Ruling Regarding CMRS Access Charges*, WT Docket No. 01-316, Declaratory Ruling, 17 FCC Rcd 13192, 13198, para. 12 (2002) (*Sprint/AT&T Declaratory Ruling*), *petitions for review dismissed*, *AT&T Corp. v. FCC*, 349 F.3d 692 (D.C. Cir. 2003). Under our permissive tariffing regime, providers likewise are free not to file federal and/or state tariffs for VoIP-PSTN traffic, and instead seek compensation solely through interconnection agreements (or, if they wish, to forgo such compensation).

[1975] We use the term "interconnection agreement" broadly in this context to encompass agreements that might not address all aspect of section 251's requirements beyond intercarrier compensation, and regardless of the terminology that the parties use to describe the arrangement. *See, e.g.*, Texas Statewide Telephone Cooperative Aug. 19, 2002 Reply at 4 (describing a "template Transport and Termination Agreement . . . developed at the direction of the Texas Public Utility Commission" that was an "abbreviated 251(b)(5) transport and termination agreement").

[1976] As the Commission has observed, "section 251(b)(5) refers only to transport and termination of telecommunications, not to origination." *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4713-14, para. 517. The Commission also has held that origination charges are inconsistent with section 251(b)(5). *See, e.g.*, *Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042 ("Section 251(b)(5) specifies that LECs and interconnecting carriers shall compensate one another for termination of traffic on a reciprocal basis. This section does not address charges payable to a carrier that originates traffic. We therefore conclude that section 251(b)(5) prohibits charges such as those some incumbent LECs currently impose on CMRS providers for LEC-originated traffic."). Although we consequently do not believe that a permanent regime for section 251(b)(5) traffic could include origination charges, on a transitional basis we allow the imposition of originating access charges in this context, subject to the phase-down and elimination of those charges pursuant to a transition to be specified in response to the FNPRM. *See infra* Section XVII.M. *See also USF/ICC Transformation NPRM*, 26 FCC Rcd at 4713-14, para. 517.

[1977] Both the Commission and commenters previously have considered deviating from a pure tariffing regime in favor of more expansive use of negotiated arrangements as part of intercarrier compensation reform. *See, e.g.*,
(continued…)

revenue predictability traditionally associated with tariffing regimes.[1978] For interstate toll VoIP-PSTN traffic, the relevant language will be included in a tariff filed with the Commission, and for intrastate toll VoIP-PSTN traffic, the rates may be included in a state tariff.[1979] In this regard, we note that the terms of an applicable tariff would govern the process for disputing charges.[1980]

962. Contrary to some proposals, however, we do not require the use of particular call detail information to dispositively distinguish toll VoIP-PSTN traffic from other VoIP-PSTN traffic, given the recognized limitations of such information.[1981] For example, the Commission has recognized that telephone numbers do not always reflect the actual geographic end points of a call.[1982] Further, although our phantom traffic rules are designed to ensure the transmission of accurate information that can help enable proper billing of intercarrier compensation, standing alone, those rules do not ensure the transmission of sufficient information to determine the jurisdiction of calls in all instances.[1983] Rather, consistent with the tariffing regime for access charges discussed above, carriers today supplement call detail information as appropriate with the use of jurisdictional factors or the like when the jurisdiction of traffic cannot otherwise be determined.[1984] We find this approach appropriate here, as well.

963. We do, however, clarify the approach to identifying VoIP-PSTN traffic for purposes of complying with this transitional intercarrier compensation regime. Although intercarrier compensation rates for VoIP-PSTN traffic during the transition will differ from other rates for only a limited time, we recognize commenters' concerns regarding the mechanism to distinguish VoIP-PSTN traffic, and thus

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Intercarrier Compensation NPRM, 16 FCC Rcd at 9656-57, para. 130. *See also, e.g.*, AT&T *USF/ICC Transformation NPRM* Comments at 30-31 (advocating detariffing of access charges); AT&T Section XV Comments at 13-15; Verizon *Intercarrier Compensation FNPRM* Comments at 6-14.

[1978] *See, e.g.*, XO Section XV Comments at 32 (arguing that the Commission should ensure that terminating carriers have the right to assess intercarrier compensation charges for VoIP-PSTN traffic "even in the absence of an agreement so that VoIP providers cannot refuse to negotiate a reciprocal compensation agreement to avoid paying any rate for termination of their traffic"); NECA *et al*. Section XV Reply at 6 (arguing that small carriers can have difficulty getting larger carriers to come to the negotiating table at all).

[1979] We note that the Commission has, in the past, regulated services that were offered through state tariffs. *See, e.g.*, *Wisconsin Public Service Commission*, 17 FCC Rcd 2051, 2060-71, paras. 31-65 (2002) (regulating BOCs' state-tariffed payphone access line rates); *Open Network Architecture Plans of the Bell Operating Companies*, 4 FCC Rcd 1, 162-71, paras. 309-25 (1988) (regulating state-tariffed ONA services in various respects).

[1980] *See supra* para. 700.

[1981] *See, e.g.*, ABC Plan, Attach. 1 at 10; Joint Letter at 3.

[1982] *See, e.g.*, *Implementation of Sections 255 and 251(a)(2) of the Communications Act of 1934, as Enacted by the Telecommunications Act of 1996: Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities; Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, WC Docket No. 04-36, WT Docket No. 96-198, CG Docket No. 03-123 & CC Docket No. 92-105, Order, 23 FCC Rcd 5707, 5712-13, paras. 9-10 (CGB Oct. 9, 2007); ABC Plan, Attach. 5 at 22. *See also, e.g.*, CRUSIR *August 3 PN* Comments at 20-21; Sprint *August 3 PN* Comments at 17; CenturyLink Section XV Comments at 23; CTIA Section XV Comments at 9-10; TEXALTEL Section XV Comments at 2; Verizon Section XV Comments at 24; ZipDX Section XV Comments at 4.

[1983] *See supra* Section XI.B.

[1984] *See supra* para.959. *See also, e.g.*, Level 3 *August 3 PN* Comments at 25; NECA *et al*. *August 3 PN* Comments at 50; Bright House Section XV Comments at 5 n.7; CenturyLink Section XV Comments at 23; CTIA Section XV Comments at 10; XO Section XV Comments at 33; Letter from Charon Phillips, Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1-2 (filed Mar. 13, 2007).

sought specific comment on that issue.[1985] In response, a number of commenters[1986] argued that the industry should be permitted to "work cooperatively"[1987] to address this issue, recognizing that "[o]ver the years, carriers have developed reasonable methods for distinguishing between calls for billing purposes . . . and can be expected to do so here."[1988] We agree that, "to help manage the transition" LECs should be permitted to incorporate specific tariff provisions in their intrastate tariffs[1989] that "could, for example, require carriers delivering traffic for termination to identify the percentage of traffic that is" subject to the transitional VoIP-PSTN intercarrier compensation regime "and to support those figures with traffic studies or other reasonable analyses that are subject to audit."[1990] Just as such a tariffing framework already is used to address jurisdiction of traffic,[1991] such an approach is a reasonable tool (in addition to information the terminating LEC has about VoIP customers it is serving) to identify the relevant traffic subject to the VoIP-PSTN intercarrier compensation regime. In addition, one commenter noted the potential to rely on interconnected VoIP subscriber and wireline line count data from Form 477 to develop a safe harbor.[1992] Thus, as an alternative, we permit the LEC instead to specify in its intrastate tariff that the default percentage of traffic subject to the VoIP-PSTN framework is equal to the percentage of VoIP subscribers in the state based on the Local Competition Report, as released periodically,[1993]

[1985] *See August 3 PN* at 17.

[1986] *See, e.g.*, AT&T *et al*. *August 3 PN* Comments at 36; Comcast *August 3 PN* Comments at 20; NECA *et al*. *August 3 PN* Comments at 50-51; XO *August 3 PN* Comments at 10.

[1987] AT&T et al. *August 3 PN* Comments at 36.

[1988] NECA et al. *August 3 PN* Comments at 50. *See also* Vonage Section XV Reply at 14 (observing that although "[t]o date, there has not been a business, regulatory or other reason to justify developing a universal method for identifying VoIP traffic," the industry likely will be able to identify "viable solutions that would make the identification of VoIP traffic relatively easy without requiring onerous or costly billing system changes" once it undertakes to do so).

[1989] As Comcast observes, the only context where there is a default VoIP-specific intercarrier compensation rate is with respect to intrastate toll VoIP-PSTN traffic. Comcast *August 3 PN* Comments at 20 n.57.

[1990] AT&T et al. *August 3 PN* Comments at 36. *See also, e.g.*, XO Section XV Comments at 33 (observing that factors could be used to indicate the percentage of terminated traffic that is VoIP, much as is done in the industry for jurisdictional purposes today); Verizon Section XV Reply at 24 (citing "standard and reliable traffic factoring methods already used today for intercarrier compensation billing purposes" as well as "certifications" and "audits"); Comcast Section XV Reply at 11 (providers could certify the percentage of traffic that is VoIP, subject to auditing); XO *August 3 PN* Comments at 10 (asserting that "the Commission must ensure that LECs have the right to audit any factors or percentages that are self-provided by carriers delivering VoIP traffic to ensure they are accurate").

[1991] As the Commission has observed, "in their tariffs, LECs require IXCs to report PIUs to identify the percentage of interstate traffic on interconnection trunks." *Prepaid Calling Card Order*, 21 FCC Rcd at 7306, para. 32; *see also* Comcast *August 3 PN* Comments at 20. To the extent that the approach we adopt would not identify all variations in traffic in real time, *see* Cox Section XV Reply at 3-4, the record does not demonstrate this to be a more significant issue in the case of identification of VoIP-PSTN traffic than it would be with respect to the identification of the jurisdiction of traffic for which such approaches are used today.

[1992] Cox *August 3 PN* Comments at 7 ("Form 477 requires filers to identify their voice service lines by technology, and the proportion of voice service lines served by a particular technology is a good proxy for the proportion of long distance minutes served by that technology.").

[1993] In particular, under this approach, the default percentage of VoIP-PSTN traffic in a state would be the total number of incumbent LEC and non-incumbent LEC VoIP subscriptions in a state divided by the sum of those reported VoIP subscriptions plus incumbent LEC and non-incumbent LEC switched access lines. *See, e.g.*, IATD, Wir. Comp. Bur., *Local Telephone Competition: Status as of December 31, 2010*, Table 8 (rel. Oct. 2011). *See also* (continued…)

unless rebutted by the other carrier.[1994] Further, although we do not mandate other approaches as part of our tariffing regime, individual providers remain free to rely on signaling or call detail information,[1995] or other measures, to the extent that they enter alternative compensation arrangements through interconnection agreements.[1996] In particular, contrary to some suggestions, we do not require filing of certifications with the Commission regarding carriers' reported VoIP-PSTN traffic.[1997] Such certifications would be required from not only IXCs but also originating and terminating providers nationwide, even though these issues may be of little or no practical concern in states with intrastate access rates that already are at or near interstate rates. Given the likely significant overbreadth in the burden that would impose, we decline to adopt such a requirement.

964. Although we will allow tariffs during the transition to bill-and-keep, we reaffirm our decision in the *T-Mobile Order* that good-faith negotiations generally are preferable to tariffing as a means of implementing carriers' compensation obligations.[1998] In the *T-Mobile Order*, we addressed wireless termination tariffs that applied only in the absence of interconnection agreements.[1999] The Commission found that such tariffs were not precluded by the Act or preexisting Commission rules, but prohibited the use of such tariffs on a going-forward basis,[2000] recognizing that the section 251 and 252 framework of the Act, which encompassed the traffic at issue there, reflected a clear preference for negotiated arrangements.[2001] Nonetheless, under the circumstances here, we do not believe that the policies underlying the prohibition of wireless termination tariffs for non-access traffic in the *T-Mobile Order* requires us to prohibit use of tariffs for toll VoIP-PSTN traffic during the transition. Although we likewise are moving to facilitate negotiated arrangements for intercarrier compensation more broadly,

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Cox *August 3 PN* Comments at 7 (noting the availability of state-specific data). In the event that data are not available for the relevant state, the LEC may instead use the nationwide data.

[1994] Although some commenters assert that there is significant variability in the volume of VoIP-PSTN traffic carried provider-to-provider, *see, e.g.*, AT&T *et al. August 3 PN* Comments at 36; XO *August 3 PN* Comments at 10, we observe that this "safe harbor" is optional on the part of the LEC imposing the charges, and also can be rebutted by the other carrier. In addition, the magnitude of the variability could itself make rebuttal easier, at least in some cases. *See, e.g.*, Verizon Section XV Reply at 24 (noting that certain providers exclusively provide service using VoIP).

[1995] We recognize that signaling or call detail information could be a tool for identifying VoIP-PSTN traffic, and that some providers have reached agreements to use it in this way. *See, e.g.*, XO Section XV Comments at 33; Vonage Section XV Comments at 13-14; InCharge Systems *August 3 PN* Comments at 1. Because there currently are no industry standards in this regard, however, we decline to mandate this approach industry-wide. *See, e.g.*, Level 3 *August 3 PN* Comments at 13-14.

[1996] Thus, to the extent that some commenters are concerned about the burden of implementing particular approaches or otherwise view them as undesirable, *see, e.g.*, Time Warner *USF/ICC Transformation NPRM* Comments at 16; Consolidated *August 3 PN* Comments at 22 n.30, EarthLink *August 3 PN* Comments at 15, they are free to negotiate alternatives that they view as less burdensome or more appropriate.

[1997] *See, e.g.*, Verizon Section XV Reply at 24 ("[i]f there are additional concerns, the Commission could address VoIP traffic identification through certifications"); Comcast *August 3 PN* Comments at 20 ("the Commission should require providers to certify to the accuracy of the factors they supply for VoIP-originated traffic").

[1998] See supra Section XII.C.5

[1999] *T-Mobile Order*, 20 FCC Rcd at 4862-63, para. 13.

[2000] *Id.* at 4860-64, paras. 9-14.

[2001] *Id.* at 4863-64, para. 14.

significant portions of the legacy intercarrier compensation regime have traditionally relied on tariffs, and we believe flash cutting the whole industry to a new regime would be unduly disruptive. Further, in place of tariffing, the *T-Mobile Order* required CMRS providers to negotiate interconnection agreements in good faith subject to section 252 negotiation and arbitration processes at the request of incumbent LECs—a set of requirements that we have not extended more broadly.[2002] Thus, maintaining a continuing role for tariffs during the transition to a new intercarrier compensation framework is a reasonable approach. Further, CMRS providers had expressed concerns about potentially excessive rates in wireless termination tariffs.[2003] Here, rates are ultimately subject to Commission oversight, including the mandated reductions in those charges as part of comprehensive intercarrier compensation reform. We thus conclude that this approach strikes the right balance here.

965. *Reliance on Interconnection Agreements and SGATs.* As discussed above, our transitional intercarrier compensation framework permits tariffing of charges for toll VoIP-PSTN traffic, but permits carriers to negotiate agreements that reflect alternative rates.[2004] In this regard, we note that reciprocal compensation charges generally have been imposed through interconnection agreements or state-approved statements of generally available terms and conditions (SGATs),[2005] which carriers may accept in lieu of negotiating individual interconnection agreements.[2006] Various commenters also describe the benefits that can arise from an interconnection and intercarrier compensation framework that allows parties to negotiate mutually agreeable outcomes, rather than all parties being categorically bound to a single regime.[2007] Likewise, the interconnection and intercarrier compensation framework adopted in sections 251 and 252 of the 1996 Act reflect a policy favoring negotiated agreements, where possible.

966. We recognize the concerns of some commenters that instances of disparate negotiating leverage can occur and that, absent an appropriate regulatory backstop, a regime purely relying on commercial negotiations could systematically disadvantage providers with limited negotiating

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[2002] We deny requests to reconsider the *T-Mobile Order* above. *See supra* Section XII.C.5.b. Some commenters also have asked the Commission to extend the *T-Mobile Order* requirement that parties negotiate and arbitrate agreements pursuant to the section 252 framework to additional circumstances, and we seek comment on those requests in the FNPRM. *See supra* para 1323.

[2003] *T-Mobile Order*, 20 FCC Rcd at 4855-56, para. 1. *See also* T-Mobile USA, Inc. *et al*. Petition for Declaratory Ruling: Lawfulness of Incumbent Local Exchange Carrier Wireless Termination Tariffs, CC Docket Nos. 01-92, 95-185, 96-98, at 5-6 (filed Sept. 6, 2002).

[2004] In the case of incumbent LECs, they must negotiate in good faith in response to requests for agreements addressing reciprocal compensation for VoIP-PSTN traffic. *See* 47 U.S.C. § 251(c)(1).

[2005] *See, e.g.*, *Application of Verizon New York Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc., For Authorization to Provide In-Region, InterLATA Services in Connecticut*, CC Docket No. 01-100, Memorandum Opinion and Order, 16 FCC Rcd 14147, 14176, para. 67 (2001) (noting the inclusion of reciprocal compensation in the SGAT); *Application of Bellsouth Corporation, Bellsouth Telecommunications, Inc., and Bellsouth Long Distance, Inc., For Provision of In-Region, InterLATA Services in Louisiana*, CC Docket No. 98-121, Memorandum Opinion and Order, 13 FCC Rcd 20599, para. 300 (1998) (same).

[2006] *See, e.g.*, *Core Communications, Inc. v. Verizon Maryland, Inc.*, Memorandum Opinion and Order, 18 FCC Rcd 7962, 7971, para. 24 (2003) (explaining that Core accepted the terms of Verizon's Maryland SGAT; Core and Verizon signed a schedule to the SGAT entitled "Request for Interconnection;" and, therefore, the Maryland SGAT served as the parties' interconnection agreement).

[2007] *See, e.g.*, RNK Communications Section XV Comments at 8; Verizon Section XV Comments at 13-14; Bandwidth.com *USF/ICC Transformation NPRM* Reply at 11, 15-17. As discussed above, certain state commissions also have relied on negotiated agreements for intercarrier compensation for the exchange of VoIP traffic. *See supra* para. 937.

leverage.[2008] These concerns arise in part based on the variations in size and make-up of the customers of different networks, and in part based on certain underlying legal requirements, including the general policy against blocking traffic and the lack of a statutory compulsion for certain entities to enter interconnection agreements.[2009]

967. Our transitional regime for VoIP-PSTN intercarrier compensation accommodates these disparities in several ways. For one, the ability to tariff these charges ensures that LECs have the opportunity to obtain the intercarrier compensation provided for by our rules. In addition, the section 252 framework applicable to interconnection agreements provides procedural protections. For example, it provides carriers the opportunity, outside the tariffing framework, to specify a mutually-agreeable approach for determining the amount of traffic that is VoIP-PSTN traffic.[2010] To this end, carriers could include an alternative approach in a state-approved SGAT or negotiate such an approach as part of an interconnection agreement. To the extent that the parties pursue a negotiated agreement but cannot agree upon the particular means of determining the amount of traffic that is VoIP-PSTN traffic, this can be subject to arbitration. Although most incumbent LECs are subject to this duty by virtue of the Act, while other carriers, such as competitive LECs, are not,[2011] we note that the Commission's rules already

[2008] *See, e.g.*, Cox Section XV Reply at 5 n.10; Nebraska Rural Independent Companies Section XV Reply at 16-17; PAETEC *et al*. Section XV Reply at 18-19.

[2009] *See, e.g.*, NECA *et al*. Section XV Comments at 30; Cox Section XV Reply at 5 n.10; Nebraska Rural Independent Companies Section XV Reply at 16-17; PAETEC *et al*. Section XV Reply at 18-19; XO *USF/ICC Transformation NPRM* Comments at 27. For example, IXCs, which pay access charges today, are not compelled to negotiate interconnection agreements subject to state arbitration under the terms of section 252 of the Act. *See* 47 U.S.C. § 252.

[2010] The record reveals a variety of alternatives for how providers might identify such traffic, including some in place in arrangements between particular providers today. For example, XO reports that, pursuant to some agreements addressing intercarrier compensation for VoIP traffic, it uses the JIP field on the call record to identify VoIP traffic. XO Section XV Comments at 33. *See also* Vonage Section XV Comments at 13-14 (noting possibility of including an indicator in signaling or billing information to identify VoIP traffic); *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4743-44, para. 133 n.384 (noting Level 3's proposal to use "the Originating Line Information (OLI), also known as ANI II, SS7 call set-up parameter to identify IP-enabled services traffic"). Alternatively, commenters also identify the potential to use factors or ratios—much as is done for jurisdictional purposes today—as a means of identifying the portion of overall traffic that is (or reasonably is considered to be) VoIP-PSTN traffic. *See, e.g.*, XO Section XV Comments at 33 (observing that factors could be used to indicate the percentage of terminated traffic that is VoIP, much as is done in the industry for jurisdictional purposes today); Verizon Section XV Reply at 24 (citing "standard and reliable traffic factoring methods already used today for intercarrier compensation billing purposes" as well as "certifications" and "audits"); Comcast Section XV Reply at 11 (providers could certify the percentage of traffic that is VoIP, subject to auditing). To the extent that these approaches would not identify all variations in traffic in real time, *see* Cox Section XV Reply at 3-4, the record does not demonstrate this to be a more significant issue in the case of identification of VoIP-PSTN traffic than it would be with respect to the identification of the jurisdiction of traffic today. Further, to the extent that some commenters are concerned about the burden of implementing particular approaches, *see, e.g.*, Time Warner Comments at 16, they are free to negotiate alternatives that they view as less burdensome. *See, e.g.*, Vonage Section XV Reply at 14 (observing that although "[t]o date, there has not been a business, regulatory or other reason to justify developing a universal method for identifying VoIP traffic," the industry likely will be able to identify "viable solutions that would make the identification of VoIP traffic relatively easy without requiring onerous or costly billing system changes" once it undertakes to do so).

[2011] *See, e.g.*, *Petition of CRC Communications of Maine, Inc. and Time Warner Cable Inc. for Preemption Pursuant to Section 253 of the Communications Act, as Amended et al.*, WC Docket No. 10-143, GN Docket No. 09-51, CC Docket No. 01-92, Declaratory Ruling, 26 FCC Rcd 8259 (2011); 47 U.S.C. § 252 (expressly addressing only state arbitration of interconnection agreements involving incumbent LECs).

anticipate the possibility that two non-incumbent LECs might elect to bring a reciprocal compensation dispute before a state for arbitration under the section 252 framework.[2012] To the extent that a state fails to arbitrate a dispute regarding VoIP-PSTN intercarrier compensation, it will be subject to Commission arbitration.[2013]

968. *Scope of Charges Imposed by Retail VoIP Providers' LEC Partners.* Some commenters express concern that, absent Commission clarification, certain LECs that provide wholesale inputs to retail VoIP services might not be able to collect all the same intercarrier compensation charges as LECs relying entirely on TDM networks.[2014] In particular, providers cite disputes arising from their use of IP technology as well as the structure of the relationship between retail VoIP service providers and their wholesale carrier partners.[2015] For the reasons described above, we believe a symmetric approach to VoIP-PSTN intercarrier compensation is warranted for all LECs.[2016] One of the goals of our reform is to promote investment in and deployment of IP networks. Although we believe that our comprehensive reforms best advance this goal, during the transition we do not want to disadvantage providers that already have made these investments. Consequently, we allow providers that have undertaken or choose to undertake such deployment the same opportunity, during the transition, to collect intercarrier compensation under our prospective VoIP-PSTN intercarrier compensation regime as those providers that have not yet undertaken that network conversion.[2017] Further, recognizing that these specific questions have given rise to disputes, we believe that addressing this issue under our transitional intercarrier compensation framework will reduce uncertainty and litigation, freeing up resources for investment and innovation.[2018] We therefore adopt rules clarifying LECs' ability to impose charges in such circumstances under our transitional regime, as discussed below.

969. Our transitional VoIP-PSTN intercarrier compensation rules focus specifically on whether the exchange of traffic occurs in TDM format (and not in IP format), without specifying the technology used to perform the functions subject to the associated intercarrier compensation charges. We thus adopt rules making clear that origination and termination charges may be imposed under our transitional intercarrier compensation framework, including when an entity "uses Internet Protocol facilities to transmit such traffic to [or from] the called party's premises."[2019]

[2012] *See, e.g.*, 47 C.F.R. § 51.711(a)(2) ("In cases where both parties are incumbent LECs, *or neither party is an incumbent LEC*, a state commission shall establish the symmetrical rates for transport and termination based on the larger carrier's forward-looking costs.") (emphasis added).

[2013] *See* 47 C.F.R. §§ 51.801, 51.803.

[2014] *See, e.g.*, Comcast *August 3 PN* Comments at 5-8; NCTA *August 3 PN* Comments at 17-19; Time Warner Cable *August 3 PN* Comments at 9-10.

[2015] *See, e.g.*, Comcast *August 3 PN* Comments at 5-8; NCTA *August 3 PN* Comments at 17-19; Time Warner Cable *August 3 PN* Comments at 9-10.

[2016] *See supra* para. 942.

[2017] *See, e.g.*, Level 3 *August 3 PN* Comments at 23; NCTA *August 3 PN* Comments at 17-19; Time Warner Cable *August 3 PN* Comments at 9.

[2018] *See, e.g.*, Comcast *August 3 PN* Comments at 6; NCTA *August 3 PN* Comments at 18-19; Time Warner Cable *August 3 PN* Comments at 9; Letter from Matthew A. Brill, counsel for Time Warner Cable, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92; WC Docket Nos. 10-90, 07-135, 05-337; GN Docket No. 09-51 at 1-2 (filed Sept. 21, 2011) (Time Warner Cable-Cox Sept. 21, 2011 *Ex Parte* Letter).

[2019] Letter from Mary McManus, Comcast, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45; WC Docket Nos. 10-90, 07-135, 05-337, 03-109; GN Docket No. 09-51, Attach. 1 (Proposed Rule Revisions) at 2 (filed Sept. 22, 2011) (Comcast Sept. 22, 2011 *Ex Parte* Letter).

970. With respect to the issue of whether particular functions are performed by the wholesale LEC or its retail VoIP partner, we recognize that under the Commission's historical approach in the access charge context, when relying on tariffs, LECs have been permitted to charge access charges to the extent that they are providing the functions at issue.[2020] When multiple providers jointly provided access, the Commission was concerned that, for example, permitting a single competitive LEC to impose via tariff all the same charges as an incumbent LEC, regardless of the functions that competitive LEC performs, could result in double billing.[2021] In light of the policy considerations implicated here, we adopt a different approach to address concerns about double billing.[2022] As discussed above, we believe that a symmetrical approach to VoIP-PSTN intercarrier compensation is the best policy,[2023] and thus believe that competitive LECs should be entitled to charge the same intercarrier compensation as incumbent LECs do under comparable circumstances. Because the Commission has not broadly addressed the classification of VoIP services, however, retail VoIP providers that take the position that they are offering unregulated services therefore are not carriers that can tariff intercarrier compensation charges. Consequently, just as retail VoIP providers rely on wholesale carrier partners for, among other things, interconnection, access to numbers, and compliance with 911 obligations—a type of arrangement the Commission has endorsed in the past[2024]—so too do they rely on wholesale carrier partners to charge tariffed intercarrier compensation charges. Given these distinct circumstances, we adopt rules that permit a LEC to charge the relevant

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[2020] As the Commission held in the *Eighth Report and Order*, "our long-standing policy with respect to incumbent LECs is that they should charge only for those services that they provide" and "[w]e believe that a similar policy should apply to competitive LECs." *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers; Petition of Z-Tel Communications, Inc. for Temporary Waiver of Commission Rule 61.26(d) To Facilitate Deployment of Competitive Service in Certain Metropolitan Statistical Areas*, CC Docket No. 96-262, CCB/CPD File No. 01-19, Eighth Report and Order and Fifth Order on Reconsideration, 19 FCC Rcd 9108, 9118-19, para. 21 (2004) (*Eighth Report and Order*). Thus, for example, the Commission clarified that "the competing incumbent LEC switching rate is the end office switching rate when a competitive LEC originates or terminates calls to end-users and the tandem switching rate when a competitive LEC passes calls between two other carriers. Competitive LECs also have, and always had, the ability to charge for common transport when they provide it, including when they subtend an incumbent LEC tandem switch. Competitive LECs that impose such charges should calculate the rate in a manner that reasonably approximates the competing incumbent LEC rate." *Id*.

[2021] This is because *each* of the LECs potentially could impose the full transport and termination charges on IXCs—even though each was providing only part of those functions—and because they are tariffed charges, the IXC has no way to avoid them. *Eighth Report and Order*, 19 FCC Rcd at 9118-19, para. 21.

[2022] As discussed above, we bring all access traffic within section 251(b)(5), and the Commission had not previously addressed LECs' rights to tariff such charges in that context. Nonetheless, for convenience, our transitional intercarrier compensation framework builds upon rules, or rule language, from the access charge context in a number of ways, and we therefore modify aspects of that language in the manner discussed above, based on the record received on this issue. *See, e.g.*, *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4747-48, para. 613 (seeking comment on how to administer any approach to VoIP intercarrier compensation, including any aspect of existing law that would need to be addressed); *id*. at 4748-49, para. 616 (seeking comment on how to administer an approach adopting VoIP-specific intercarrier compensation rates).

[2023] *See supra* paras. 942, 967.

[2024] *See, e.g.*, *IP-Enabled Services Order*, 20 FCC Rcd at 10267, para. 38. Given the Commission's endorsement of these arrangements, we find these circumstances distinguishable from those in the CMRS context, where the Commission prohibited CMRS providers from partnering with competitive LECs to collect access charges in the absence of a contract with the IXC. *See, e.g.*, Time Warner Cable-Cox Sept. 21, 2011 *Ex Parte* Letter at 2. We thus reject claims that there is no basis for distinguishing the historical treatment of CMRS providers from our actions in this context. *See, e.g.*, Letter from Robert W. Quinn, Jr., Senior Vice President, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 07-135; CC Docket No. 01-92; GN Docket No. 09-51, at 4-5 (filed Oct. 21, 2011) (AT&T Oct. 21, 2011 *Ex Parte* Letter).

intercarrier compensation for functions performed by it and/or by its retail VoIP partner,[2025] regardless of whether the functions performed or the technology used correspond precisely to those used under a traditional TDM architecture.[2026] However, our rules include measures to protect against double billing,[2027] and we also make clear that our rules do not permit a LEC to charge for functions performed neither by itself or its retail service provider partner.[2028]

971. Our approach is supported by the fact that we are bringing all traffic within section 251(b)(5). Under Commission precedent in that context, to the extent that a competitive LEC's rates were set based on the incumbent LEC's reciprocal compensation charges, the Commission's rules were not as limiting regarding the scope of those reciprocal compensation charges as historically was the case in the access charge context.[2029] Indeed, in addition to tariffing, providers also remain free to negotiate

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[2025] Going back to dial-up ISP traffic, when two telecommunications carriers exchanged traffic subject to section 251(b)(5) this was subject to intercarrier compensation even though it was an input into a connection to the Internet. *See generally ISP Remand Order*, 16 FCC Rcd 9151. Just as that order did not involve imposing intercarrier compensation requirements on the Internet, we likewise reject claims that permitting the LEC partners of a retail VoIP provider to charge the same intercarrier compensation as other LECs would be broadly imposing access charges on the Internet. *See, e.g.*, AT&T Oct. 21, 2011 *Ex Parte* Letter at 5-6.

[2026] We note that, notwithstanding our rules, to the extent that these charges are imposed via tariff, a carrier may not impose charges other than those provided for under the terms of its tariff. *See, e.g., AT&T v. Ymax*, 26 FCC Rcd 5742 (2011).

[2027] *See* Appendix A. *See also, e.g.*, Comcast Sept. 22, 2011 *Ex Parte* Letter, Attach. 1 at 2 (proposing limits to the total charges that a LEC and an affiliated or unaffiliated provider assess for jointly transporting and terminating traffic); *id*. (proposing limitations on when a competitive LEC could charge for certain services, depending on whether it is listed in the Number Portability Administration Center database as providing the calling party or dialed number); Comcast Oct. 5, 2011 *Ex Parte* Letter Attach. at 1 (same); Comcast *et al*. Oct. 24, 2011 *Ex Parte* Letter at 3 (discussing ways to protect against double billing or arbitrage).

[2028] *Cf. AT&T v. Ymax*, 26 FCC Rcd at 5757, 5758-59, paras. 41, 44 & n.120; Level 3 *August 3 PN* Comments at 21 (distinguishing its proposed approach to symmetry for imposing access charges from the *Ymax* decision, which was based on "the specific configuration of YMax's network architecture"); Level 3 *August 3 PN* Comments at 23 (advocating that LECs should be precluded, "for example, from receiving end office compensation for service provided to the calling or called party by another carrier"). Thus, although access services might functionally be accomplished in different ways depending upon the network technology, the right to charge does not extend to functions not performed by the LEC or its retail VoIP service provider partner. We thus reject claims that it is unreasonable for an IXC to pay for the functions that are performed pursuant to the intercarrier compensation framework, including the rate transition, we adopt in this Order. *See, e.g.*, AT&T Oct. 21, 2011 *Ex Parte* Letter.

[2029] *See, e.g.*, *Local Competition First Report and Order*, 11 FCC Rcd at 16040-41, paras. 1085-86 (describing the presumption of symmetry in reciprocal compensation rates); *id*. at 16040, para. 1085 (observing that this approach "is consistent with section 252(d)(2)(B)(ii), which prohibits 'establishing with particularity the additional costs of transporting or terminating calls'"). Although state arbitrations could set reciprocal compensation rates that "that vary according to whether the traffic is routed through a tandem switch or directly to the end-office switch," *id*. at 16042, para. 1090, within that framework, the Commission did not more narrowly limit competitive LECs and CMRS providers to charging only for the functions they provide to the same degree as in the access charge context. *See, e.g.*, *id*. (directing state commission to "consider whether new technologies (e.g., fiber ring or wireless networks) perform functions similar to those performed by an incumbent LEC's tandem switch and thus, whether some or all calls terminating on the new entrant's network should be priced the same as the sum of transport and termination via the incumbent LEC's tandem switch"); *id*. at 16042-43, para. 1091 (recognizing that carriers with different network architectures than the incumbent LEC would charge the same rate as the incumbent LEC absent a showing "that the costs of efficiently configured and operated systems are not symmetrical and justify different compensation rates, instead of being based on competitors' network architectures").

compensation arrangements for this traffic through interconnection agreements, and to define the scope of charges by mutual agreement or, if relevant, arbitration.

d. Other Issues

(i) Interconnection and Traffic Exchange

972. *Use of Section 251(c)(2) Interconnection Arrangements.* Although we bring all VoIP-PSTN traffic within section 251(b)(5), and permit compensation for such arrangements to be addressed through interconnection agreements, we recognize that there is potential ambiguity in existing law regarding carriers' ability to use existing section 251(c)(2) interconnection facilities to exchange VoIP-PSTN traffic, including toll traffic. Consequently, we make clear that a carrier that otherwise has a section 251(c)(2) interconnection arrangement with an incumbent LEC is free to deliver toll VoIP-PSTN traffic through that arrangement, as well, consistent with the provisions of its interconnection agreement. The Commission previously held that section 251(c)(2) interconnection arrangements may not be used solely for the transmission of interexchange traffic because such arrangements are for the exchange of "telephone exchange service" or "exchange access" traffic – and interexchange traffic is neither.[2030] However, as long as an interconnecting carrier is using the section 251(c)(2) interconnection arrangement to exchange some telephone exchange service and/or exchange access traffic, section 251(c)(2) does not preclude that carrier from relying on that same functionality to exchange other traffic with the incumbent LEC, as well. This interpretation of section 251(c)(2) is consistent with the Commission's prior holding that carriers that otherwise have section 251(c)(2) interconnection arrangements are free to use them to deliver information services traffic, as well.[2031] Likewise, it is consistent with the Commission's interpretation of the unbundling obligations of section 251(c)(3), where it held that, as long as a carrier is using an unbundled network element (UNE) for the provision of a telecommunications service for which UNEs are available, it may use that UNE to provide other services, as well.[2032] With respect to the broader use of section 251(c)(2) interconnection arrangements, however, it will be necessary for the interconnection agreement to specifically address such usage to, for example, address the associated compensation.[2033]

973. *No Blocking.* In addition to the protections discussed above to prevent unilateral actions disruptive to the transitional VoIP-PSTN intercarrier compensation regime, we also find that carriers' blocking of VoIP calls is a violation of the Communications Act and, therefore, is prohibited just as with the blocking of other traffic.[2034] As such, it is appropriate to discuss the Commission's general policy

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[2030] *Local Competition First Report and Order*, 11 FCC Rcd at 15598-99, paras. 190-91.

[2031] *Id*. at 15990, para. 995 ("We also conclude that telecommunications carriers that have interconnected or gained access under sections 251(a)(1), 251(c)(2), or 251(c)(3), may offer information services through the same arrangement, so long as they are offering telecommunications services through the same arrangement as well.").

[2032] *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, 20 FCC Rcd 2533, 2550, para. 29 n.83 (2005) (*Triennial Review Remand Order*).

[2033] For example, this would include provisions addressing the intercarrier compensation for any toll VoIP-PSTN traffic delivered via a section 251(c)(2) interconnection arrangement. We note that some carriers appear to have implemented such an approach already. *See, e.g.*, Level 3 Aug. 18, 2008 *Ex Parte* Letter, Attach. 1, Part C at 2 (Level 3-Embarq interconnection agreement providing that: "After the Parties implement interconnection arrangements for the exchange of Local Traffic, ISP-Bound Traffic, interLATA traffic and intraLATA traffic over the same interconnection trunks, Level 3 may also send VOIP Traffic, as defined below, over those trunks").

[2034] *See supra* Section XI.B, para. 734.

against the blocking of such traffic.[2035] As the Commission has long recognized, permitting blocking or the refusal to deliver voice telephone traffic,[2036] whether as a means of "self-help" to address perceived unreasonable intercarrier compensation charges or otherwise, risks "degradation of the country's telecommunications network."[2037] Consequently, "the Commission, except in rare circumstances[,] . . . does not allow carriers to engage in call blocking"[2038] and "previously has found that call blocking is an unjust and unreasonable practice under section 201(b) of the Act."[2039] Although the Commission generally has not classified VoIP services, as discussed above, the exchange of VoIP-PSTN traffic implicating intercarrier compensation rules typically involves two carriers.[2040] As a result, those carriers are directly bound by the Commission's general prohibition on call blocking with respect to VoIP-PSTN traffic, as with other traffic.

974. We recognize, however, that blocking also could be performed by interconnected VoIP providers, or by providers of "one-way" VoIP service that allows customers to receive calls from, or place calls to the PSTN, but not both. Just as call blocking concerns regarding interexchange carriers and wireless providers arose in an effort to avoid high access charges, VoIP providers likewise could have incentives to avoid such rates, which they would pay either directly or through the rates they pay for wholesale long distance service.[2041] If interconnected VoIP services or one-way VoIP services are telecommunications services, they already are subject to restrictions on blocking under the Act. If such services are information services,[2042] we exercise our ancillary authority and prohibit blocking of voice traffic to or from the PSTN by those providers just as we do for carriers.[2043]

[2035] The Commission has sought comment on whether a shift from a tariffing regime to a regime relying on commercial arrangements for intercarrier compensation could create incentives for blocking. *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9656-57, para. 130.

[2036] By this, we mean "block[ing], chok[ing], reduc[ing] or restrict[ing] traffic in any way." *Call Blocking Declaratory Ruling*, 22 FCC Rcd 11629, 11631, para. 6.

[2037] *Access Charge Reform Seventh R&O and NPRM*, 16 FCC Rcd at 9932-33 para. 24.

[2038] *Call Blocking Declaratory Ruling*, 22 FCC Rcd at 11632, para. 7. As the Commission noted, the *Call Blocking Declaratory Ruling* had " no effect on the right of individual end users to choose to block incoming calls from unwanted callers." *Id*. at para. 7 n.21.

[2039] *Call Blocking Declaratory Ruling*, 22 FCC Rcd at 11631, para. 5.

[2040] *See supra* note 1969 and accompanying text.

[2041] *See, e.g.*, *Call Blocking Declaratory Ruling*, 22 FCC Rcd at 11629.

[2042] We do not decide the classification of such services in this Order.

[2043] For example, an interexchange carrier that is a wholesale partner of such a VoIP provider could evade our directly-applicable restrictions on blocking under section 201 of the Act by having the blocking performed by the VoIP provider instead. An IXC generally would be prohibited from refusing to deliver calls to telephone numbers associated with high intercarrier compensation charges. If that IXC's VoIP provider wholesale customer were free to block calls to such numbers, the IXC thus could evade the directly-applicable restrictions on blocking (and the VoIP provider would benefit from lower wholesale long distance costs to the extent that, for example, its agreement provided for a pass-through of the intercarrier compensation charges paid by the IXC). In addition, blocking or degrading of a call from a traditional telephone customer to a customer of a VoIP provider, or vice-versa, would deny the traditional telephone customer the intended benefits of telecommunications interconnection under section 251(a)(1).

(ii) Other Pending Matters

975. Our conclusions in this Order effectively address, in whole or in part, certain pending petitions. For one, Global NAPS filed a petition for declaratory ruling regarding the manner and extent to which VoIP traffic could be subject to access charges generally, and intrastate access charges in particular.[2044] AT&T also filed a petition requesting that, on a transitional basis, the Commission declare that interstate and intrastate access charges may be imposed on VoIP traffic in certain circumstances, as well as limited waivers that would enable it to offset forgone revenues from voluntary reductions in intrastate terminating access charges.[2045] In addition, Vaya Telecom (Vaya) filed a petition seeking a declaration that "a LEC's attempt to collect intrastate access charges on LEC-to-LEC VoIP traffic exchanges is an unlawful practice."[2046] Because our transitional intercarrier compensation framework for VoIP-PSTN declines to apply all existing intercarrier compensation regimes as they currently exist, Global NAPS's and Vaya's petitions are granted in part and AT&T's is denied in part.[2047] To the extent that AT&T proposes a specific approach for alternative rate reforms and revenue recovery, we find the mechanisms adopted in this Order to be more appropriate for the reasons discussed above, and thus deny its requests in that regard.[2048] Further, Grande filed a petition seeking a Commission declaration that carriers categorically may rely on a customer's certification that traffic originated in IP and therefore is enhanced and not subject to access charges.[2049] To the extent that this would deviate from the regime we adopt, the petition is denied.[2050] We decline to address the classification of VoIP services generally at this time, nor do we otherwise elect to grant the other requests for declaratory rulings raised by the Global NAPS, Vaya, AT&T, and Grande petitions.[2051]

XV. INTERCARRIER COMPENSATION FOR WIRELESS TRAFFIC

A. Introduction

976. In this section, we address compensation for non-access traffic exchanged between LECs and CMRS providers. As discussed further below, two compensation regimes currently apply to non-access LEC-CMRS traffic. Under section 20.11, LECs have a duty to provide interconnection to CMRS providers and LECs and CMRS providers must pay each other "reasonable compensation" in connection with traffic that originates on the other's network.[2052] Under the reciprocal compensation regime in

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[2044] *See* Global NAPS Petition for Declaratory Ruling and for Preemption of the PA, NH and MD State Commissions, WC Docket No. 10-60 (filed Mar. 5, 2010).

[2045] *See* AT&T Petition for Interim Declaratory Ruling and Limited Waivers, WC Docket No. 08-152 (filed July 17, 2008).

[2046] Petition of Vaya Telecom, Inc. Regarding LEC-to-LEC VoIP Traffic Exchanges, CC Docket No. 01-92 at 1 (filed Aug. 26, 2011).

[2047] *See generally supra* Section XIV.C.1.

[2048] *See supra* Section XIII.

[2049] *See* Grande Petition for Declaratory Ruling, WC Docket No. 05-283 (filed Oct. 3, 2005).

[2050] *See generally* paras. 964-966 (establishing an approach under which terminating carriers can use interconnection agreements to obtain compensation for toll VoIP-PSTN traffic, including a means to identify VoIP-PSTN traffic).

[2051] It is well-established that the Commission has broad discretion whether to issue such a ruling. *See* 47 C.F.R § 1.2; *Yale Broadcasting Co. v. FCC*, 478 F.2d 594, 602 (D.C. Cir. 1973) (Commission did not abuse its discretion by declining to grant a declaratory ruling.).

[2052] 47 C.F.R. § 20.11.

section 251(b)(5), LECs have an obligation to establish reciprocal compensation arrangements for the transport and termination of telecommunications traffic,[2053] and CMRS providers that have entered into a reciprocal compensation arrangement with a LEC must compensate the LEC for terminating traffic originating on the CMRS provider's network.[2054]

977. The Commission has not addressed the relationship between these two regimes and has not clarified what "reasonable compensation" pursuant to 20.11 means. As a result, application of these provisions has been a continuing and growing source of confusion and dispute. Moreover, following the Commission's 2009 *North County Order*, which addressed a competitive LEC's complaint against a CMRS provider seeking "reasonable compensation" under section 20.11, requests to clarify this area of intercarrier compensation have increased.[2055] The *North County Order* held that the state public utility commission was the appropriate forum under the rule for determining a reasonable rate for termination of the CMRS provider's intrastate, intraMTA traffic, and also declined to establish any federal methodology governing how the state should determine a reasonable rate.[2056] CMRS providers have raised concerns that as a result, costly litigation is proliferating and the incidence of intraMTA traffic stimulation is growing.[2057]

978. As part of our comprehensive ICC reform, we believe it is now appropriate for the Commission to clarify the system of intercarrier compensation applicable to non-access traffic exchanged between LECs and CMRS providers. Accordingly, as described herein, we clarify that the compensation obligations under section 20.11 are coextensive with the reciprocal compensation requirements under section 251. In addition, consistent with our overall reform approach, we adopt bill-and-keep as the default compensation for non-access traffic exchanged between LECs and CMRS providers. To ease the move to bill-and-keep for rural, rate-of-return regulated LECs we adopt an interim default rule limiting their responsibility for transport costs for this category of traffic. We find that these steps are consistent with our overall reform and will support our goal of modernizing and unifying the intercarrier compensation system.

979. We also address certain pending issues and disputes regarding what is now commonly known as the intraMTA rule, which provides that traffic between a LEC and a CMRS provider that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations rather than interstate or intrastate access charges.[2058] We resolve two issues that have been raised before the Commission regarding the correct application of this rule to specific traffic patterns. First, one wireless service provider claims that calls that it receives from other carriers, routes through its own base stations, and passes on to third-party carriers for termination have "originated" at its

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[2053] 47 U.S.C. § 251(b)(5); *see also* 47 C.F.R. § 51.703.

[2054] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016-18, paras. 1041-45. Specifically, the Commission determined that, pursuant to section 251(b)(5), CMRS providers will "receive reciprocal compensation for terminating certain traffic that originates on the networks of other carriers, and will pay such compensation for certain traffic that they transmit and terminate to other carriers." *Id*. at 16018, para. 1045.

[2055] *See North County Communications Corp. v. MetroPCS California, LLC*, Order on Review, 24 FCC Rcd 14036 (2009) (*North County Order*), *aff'd*, *MetroPCS California LLC v. FCC*, 644 F.3d 410 (D.C. Cir. 2011).

[2056] *See North County Order*, 24 FCC Rcd at 14036-37, para. 1, 14044, para. 21.

[2057] *See*, *e.g.*, CTIA Section XV Comments at 4.

[2058] *See Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; *see also* 47 C.F.R. § 24.202(a) (defining the term "Major Trading Area").

own base stations for purposes of applying the intraMTA rule.[2059] As explained below, we disagree. Second, we affirm that all traffic routed to or from a CMRS provider that, at the beginning of a call, originates and terminates within the same MTA, is subject to reciprocal compensation, without exception. In addition to these clarifications, we also deny requests that the intraMTA rule be modified to encompass a larger geographic license area, the regional economic area grouping, or REAG.[2060]

B. Background

980. There are currently two regimes affecting intercarrier compensation for non-access traffic exchanged between LECs and CMRS providers. Before the 1996 Act was passed, the Commission, pursuant to section 332 and 201(a) of the Act, adopted rule 20.11 to govern LEC interconnection with CMRS providers.[2061] Section 20.11(a) required a LEC to provide the type of interconnection reasonably requested by a CMRS provider, and section 20.11(b) required mutual and reasonable compensation for the exchange of traffic between LECs and CMRS providers.[2062] In particular, Section 20.11(b) required the originating carrier, whether LEC or CMRS provider, to pay "reasonable compensation" to the terminating carrier in connection with traffic that terminates on the latter's network facilities.[2063]

981. As noted elsewhere, section 251(b)(5), part of the 1996 Act, obligates LECs to establish reciprocal compensation arrangements for the transport and termination of telecommunications.[2064] In the *Local Competition First Report and Order*, the Commission determined that, pursuant to that provision, "traffic to or from a CMRS network that originates and terminates within the same MTA is subject to [reciprocal compensation obligations] under section 251(b)(5) rather than interstate and intrastate access charges."[2065]

982. At the same time, the Commission amended section 20.11 to provide that LECs and CMRS providers "shall also comply with applicable provisions of part 51 of this chapter."[2066] Thus, the "reasonable compensation" requirements under section 20.11 continued to apply in parallel with the new

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[2059] Letter from W. Scott McCollough, Counsel for Halo Wireless, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, Attach. at 9 (filed Aug. 12, 2011) (Halo Aug. 12, 2011 *Ex Parte* Letter); Letter from W. Scott McCollough, Counsel for Halo Wireless, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 (filed Oct. 17, 2011) (Halo Oct. 17, 2011 *Ex Parte* Letter). *But see* Letter from Michael R. Romano, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. at 7 (filed July 18, 2011) (NTCA July 18, 2011 *Ex Parte* Letter); ERTA July 8, 2011 *Ex Parte* Letter at 1, 3; NECA et al. Sept. 23, 2011 *Ex Parte* Letter at 1.

[2060] T-Mobile *August 3 PN* Comments at 11-14.

[2061] *See Implementation of Sections 3(n) and 332 of the Communications Act and Regulatory Treatment of Mobile Services*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd 1411, 1499, paras. 231-32 (1994) (*CMRS Second Report and Order*) (subsequent history omitted). Section 332(c)(1)(B) provides in part that "[u]pon reasonable request of any person providing commercial mobile service, the Commission shall order a common carrier to establish physical connections with such service pursuant to the provisions of section 201 of this Act." 47 U.S.C. § 332(c)(1)(B).

[2062] *CMRS Second Report and Order*, 9 FCC Rcd at 1498, paras. 231-32; *see also* 47 C.F.R. § 20.11(a), (b).

[2063] 47 C.F.R. § 20.11(b).

[2064] 47 U.S.C. § 251(b)(5); *see* Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). *See also Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1041.

[2065] *Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; *see also* 47 C.F.R. § 51.701(b)(1).

[2066] 47 C.F.R. § 20.11(c).

obligations under section 251(b)(5) and implementing rules in Part 51.[2067] The Commission has not, however, clarified what "reasonable compensation" pursuant to section 20.11 means.

983. The Commission's decision not to interpret "reasonable compensation" has led to disputes. In 2009, the Commission addressed a complaint brought by North County Communications Corp. (North County), a competitive LEC, against MetroPCS California, LLC (MetroPCS), a CMRS provider, alleging that although there was no compensation agreement between the parties, MetroPCS had violated section 20.11(b) of the Commission's rules by failing to pay reasonable compensation to North County for terminating its traffic and asking the Commission to prescribe a termination rate and award appropriate damages.[2068]

984. In an Order reviewing an earlier decision by the Enforcement Bureau, the Commission affirmed the Bureau's finding that the California PUC was the more appropriate forum for determining a reasonable termination rate under section 20.11 for the intrastate traffic at issue and that the competitive LEC therefore was required to obtain a rate determination by the state before its section 20.11 claim before the Commission could proceed.[2069] In declining to establish an applicable rate, the Commission noted its previous decision to interpret section 20.11 to preserve state authority over intrastate traffic and concluded that if the Commission decides to depart from this precedent, it should do so in "a more general rulemaking proceeding."[2070] The Commission also declined to provide guidance to the California PUC about how to establish a reasonable termination rate.[2071] The U.S. Court of Appeals for the D.C. Circuit upheld the Commission's decision, finding that even if the Commission had authority under sections 201 and 332 of the Act to regulate intrastate rates for mobile termination, the Commission was not required to exercise this authority in every instance.[2072] The court also noted with approval the Commission's determination to defer reconsideration of its policy under section 20.11 to a general rulemaking proceeding.[2073]

985. CMRS providers have argued that the Commission's *North County Order*, by declining to determine reasonable compensation under section 20.11 and deferring such determinations to the states without providing any guidance, has caused the problem of traffic stimulation to grow. They argue that the Commission's decision has led to competitive LECs seeking terminating compensation rates far above cost and to a dramatic increase in litigation as competitive LECs seek to establish or enforce termination rates in state administrative and judicial forums.[2074] They have asked the Commission to address the issue as part of its comprehensive effort to reform the intercarrier compensation system.

[2067] *See* 47 C.F.R. §§ 51.701-51.717; *Developing a Unified Intercarrier Compensation Regime; T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination Tariffs*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, 20 FCC Rcd 4855, 4863, para. 14 (2005) (*T-Mobile Order*), *petitions for review pending*, *Ronan Tel. Co. et al. v. FCC*, No. 05-71995 (9th Cir. filed Apr. 8, 2005). We address pending petitions for reconsideration of these provisions elsewhere in this order.

[2068] *North County Order*, 24 FCC Rcd at 14040, para. 12.

[2069] *Id.*

[2070] *Id*. at 14039, para. 10, 14042, para. 16 (internal quotations omitted).

[2071] *Id*. at 14044, para. 21. The U.S. Court of Appeals for the D.C. Circuit subsequently upheld the Commission's decision. *MetroPCS California v. FCC*, 644 F.3d 410.

[2072] *MetroPCS California v. FCC*, 644 F.3d at 412, 414.

[2073] *Id.* at 414.

[2074] *See* CTIA Section XV Comments at 4 (asserting that the *North County Order* has "reduced the LECs' incentives to negotiate reasonable agreements and created confusion among state commissions and federal courts, leading to an (continued…)

986. In the *USF/ICC Transformation NPRM*, we sought comment on a number of issues relating to the reform of our rules regulating wireless termination charges. As part of a general reduction of intercarrier compensation rates to eventually eliminate per-minute rates, we sought comment on whether to set a specific rate for wireless termination charges, and whether we should address certain pending compensation disputes, including disputes over the application of section 20.11.[2075] We also sought comment on allegations that traffic stimulation involving reciprocal compensation between CMRS providers and competitive LECs was increasing,[2076] and we sought comment on the steps that could be taken to address this activity.[2077] We also sought comment on the impact of the *North County* decisions on traffic stimulation and asked whether, as an interim measure, we should adopt any procedural or substantive rules governing competitive LEC-CMRS compensation arrangements under section 20.11 of the Commission's rules, such as establishing a default compensation rate.[2078]

987. We also sought comment on the proper interpretation of the intraMTA rule, which provides that traffic between a LEC and a CMRS provider that originates and terminates within the same Major Trading Area (MTA) is subject to reciprocal compensation obligations rather than interstate or intrastate access charges.[2079] The Commission had previously sought comment on this question in 2005, finding that rural LECs took the position that traffic between a LEC and a CMRS provider that must be routed through an IXC should be treated as access traffic even if it is intraMTA, while CMRS providers argued that all such traffic was subject to reciprocal compensation.[2080] In the *USF/ICC Transformation NPRM*, we invited parties to refresh the record, and sought comment on how issues involving the intraMTA rule were affected by our broader proposals for intercarrier compensation reform.[2081]

C. LEC-CMRS Non-Access Traffic

988. Given our adoption of a uniform, federal framework for comprehensive intercarrier compensation reform, we believe it is now appropriate to clarify the system of intercarrier compensation applicable to non-access traffic exchanged between LECs and CMRS providers. First, we clarify that the scope of compensation obligations under section 20.11 are coextensive with the scope of the reciprocal compensation requirements under section 251 of the Act. Next, we exercise our authority to set a pricing

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upsurge in costly litigation"); Leap Section XV Comments at 5; MetroPCS Section XV Comments at 11-12 (asserting CMRS providers must "continuously monitor innumerable LEC and CLEC filings at the state level and be compelled to defend themselves against unreasonable rates before 50 separate state utilities commissions); Sprint Nextel Section XV Comments at 22 (between 2009 and 2010, charges for Sprint Nextel's intraMTA traffic terminating to Tekstar increased by 71 percent); Verizon Section XV Comments at 36-39 ("[T]raffic pumping schemes have flourished in the wake of the *North County Order*, which opened the door to pumping of intraMTA CMRS traffic by CLECs.").

2075 *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4721-22, paras. 539, 540.

2076 *Id.* at 4771, para. 672 (citing CTIA Aug. 26, 2010 *Ex Parte* Letter, Attach. at 5).

2077 *Id*.

2078 *Id*. at 4771, para. 673 (citing Letter from Tamara Preiss, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket no. 01-92, WC Docket No. 07-135 at 3 (filed June 28, 2010) (Verizon June 28, 2010 *Ex Parte* Letter) (proposing an immediate rate of $0.0007/minute for all intraMTA CLEC-CMRS traffic)).

2079 *Id*. at 4777, para. 684.

2080 *See Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4744-46, paras. 134-38.

2081 *Id.* The Commission also sought comment in 2005 on whether to eliminate or modify the intraMTA rule. *See id*.

methodology for LEC-CMRS intraMTA traffic and adopt bill-and-keep as the immediately applicable default compensation methodology for non-access traffic between LECs and CMRS providers under section 20.11 and Part 51 of our rules.

989. As outlined above, two compensation regimes currently apply to non-access LEC-CMRS traffic, and the Commission has not clarified the intersection between the two.[2082] We conclude, based on the record, that it is appropriate for the Commission to clarify the relationship between the obligations in sections 20.11 and 251(b)(5).

990. To bring the 20.11 and section 251 obligations in line, we first harmonize the scope of the compensation obligations in section 20.11 and those in Part 51. We accordingly conclude that section 20.11 applies only to LEC-CMRS traffic that, since the *Local Competition First Report and Order*, has been subject to the reciprocal compensation framework under section 251(b)(5) of the Act. Thus, section 20.11 does not apply to access traffic that, prior to this Order, was subject to section 251(g). Furthermore, we clarify that the terms "mutual compensation" in section 20.11 and "reciprocal compensation" in section 251(b)(5) and Part 51 are synonymous when applied to non-access LEC-CMRS traffic.[2083]

991. Next, we find that it is in the public interest to establish a default federal pricing methodology for determining reasonable compensation under section 20.11. Commenters urge the Commission to address the current absence of guidance on compensation rates for traffic between competitive LECs and CMRS providers and to address the growing problem of traffic stimulation.[2084] They argue that the decision in the *North County Order* to defer setting of reasonable compensation under section 20.11 for intrastate traffic to the states without providing any guidance has led to CLECs seeking terminating compensation rates far above cost and to a dramatic increase in litigation as CLECs seek to establish or enforce termination rates in state administrative and judicial forums.[2085] They recommend that the Commission resolve this problem by establishing a default federal termination rate for CLEC-CMRS traffic of $0.0007 or by adopting a bill-and-keep methodology.[2086]

[2082] *See supra* paras. 980-982.

[2083] *See* 47 C.F.R. § 51.701(b)(2) (providing that traffic exchanged between a LEC and a CMRS provider is subject to reciprocal compensation if "at the beginning of the call, [it] originates and terminates within the same Major Trading Area"). Because they are coextensive, we use the terms "reciprocal compensation" and "mutual compensation" synonymously.

[2084] *See* CTIA Section XV Comments at 4-5; Sprint Nextel Section XV Comments at 22; Verizon Section XV Comments at 35, 45. *See also* Leap Section XV Comments at 6 (traffic pumping involving reciprocal compensation rates for traffic between CMRS providers and LECs is "indeed increasing"); MetroPCS Section XV Comments at 2 (traffic pumping is a "growing problem" for wireless services); T-Mobile Section XV Comments at 4 ("T-Mobile has observed traffic stimulation involving intraMTA traffic, resulting from reciprocal compensation rates that exceed the actual costs of terminating traffic.").

[2085] *See* CTIA Section XV Comments at 4 (asserting that *North County* has "reduced the LECs' incentives to negotiate reasonable agreements and created confusion among state commissions and federal courts, leading to an upsurge in costly litigation"); Leap Section XV Comments at 5; MetroPCS Section XV Comments at 11-12 (asserting CMRS providers must "continuously monitor innumerable LEC and CLEC filings at the state level and be compelled to defend themselves against unreasonable rates before 50 separate state utilities commissions); Sprint Nextel Section XV Comments at 22 (between 2009 and 2010, charges for Sprint Nextel's intraMTA traffic terminating to Tekstar increased by 71 percent); Verizon Section XV Comments at 36-39 ("[T]raffic pumping schemes have flourished in the wake of the *North County Order*, which opened the door to pumping of intraMTA CMRS traffic by CLECs.").

[2086] *See* Verizon Section XV Comments at 45 (arguing that "the Commission must close, once and for all, the longstanding gap in its intercarrier compensation regime and adopt rules to actually govern CMRS-CLEC intraMTA compensation arrangements," and proposing a default rate of $.0007); MetroPCS *USF/ICC Transformation NPRM*
(continued…)

992. Currently, reciprocal compensation under the Part 51 rules is subject to a federal pricing methodology. Reciprocal compensation under section 20.11, however, is not currently subject to a federal pricing methodology. As we recently explained in the *North County Order*, we have instead traditionally regarded state commissions as the "more appropriate forum for determining the reasonable compensation rate [under section 20.11] for . . . termination of intrastate, intraMTA traffic," and have to date declined to provide guidance to the states on how to carry out that responsibility.[2087] We have long made clear, however, that we "would not hesitate to preempt any rates set by the states that would undermine the federal policy that encourages CMRS providers and LECs to interconnect."[2088] And we observed in the *North County Order* that the various "policy arguments" in favor of a greater federal role in implementing section 20.11 were "better suited to a more general rulemaking proceeding," citing this proceeding in particular.[2089]

993. We now conclude, based on the record in this proceeding, that we should establish a federal methodology for implementing section 20.11's reasonable compensation mechanism.[2090] Although we believed in the *North County Order* that the interconnection process under section 20.11 would likely not be "procedurally onerous,"[2091] the record shows that the absence of a federal methodology has been a growing source of confusion and litigation.[2092] MetroPCS, for example, states that it is embroiled in disputes over traffic stimulation schemes in a number of jurisdictions and notes other proceedings in New York and Michigan. The California commission, the state commission implicated by the *North County Order*, also "recommends that the FCC provide guidance on what factors should be considered in setting a 'reasonable rate' for such arrangements."[2093] Adoption of a federal pricing methodology promotes the policy goals outlined in this Order of avoiding wasteful arbitrage opportunities caused by disparate intercarrier compensation rates and modernizing and unifying the intercarrier compensation system to promote efficiency and network investment.[2094] It is also necessary

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Comments at 22 (proposing immediate bill-and-keep for all traffic to or from wireless carriers); *see also* Sprint Nextel Section XV Comments at 22 (arguing that CMRS-CLEC traffic should be subject to reciprocal compensation regime, and that in the absence of an interconnection agreement, all traffic should be subject to bill-and-keep).

[2087] *North County Order*, 24 FCC Rcd at 14040, para. 12, 14044, para. 21.

[2088] *MetroPCS California, LLC v. FCC*, 644 F.3d 410, 413 (D.C. Cir. 2011) (citing *Implementation of Sections 3(n) and 332 of the Communications Act; Regulatory Treatment of Mobile Servs.*, GN Docket No. 93-252, Second Report and Order, 9 FCC Rcd. 1411, 1497, para. 228 (1994)).

[2089] *North County Order*, 24 FCC Rcd at 14042, para. 16 (internal quotation marks omitted).

[2090] *See FCC v. Fox Television Stations, Inc*., 129 S. Ct. 1800, 1811 (2009) (holding that an agency need not show that "reasons for the new policy are better than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better, which the conscious change of course adequately indicates").

[2091] *See North County Order*, 24 FCC Rcd at 14041-42, para. 15.

[2092] *See* CTIA Section XV Comments at 4-5 & Attach. A; MetroPCS Section XV Comments at 9-10.

[2093] CPUC Section XV Comments at 9.

[2094] We note that North County, which argues that the Commission should continue to defer to the states to establish a rate for section 20.11 claims, has itself noted in another proceeding that the overall process under section 20.11 as a consequence of the current deferral to states is time-consuming and burdensome. *See North County Order*, 24 FCC Rcd at 14041-42, para. 15. *See also* California PUC Section XV Comments at 9 (recommending that the FCC provide guidance on setting a "reasonable rate" for such arrangements); RNK Section XV Comments at 12-13 (the Commission should provide a federal pricing methodology for reciprocal compensation between CMRS providers and CLECs, and states should implement that methodology).

to effectuate our decision to harmonize section 20.11 with section 251(b)(5), which, as noted, has long been governed by a federal pricing methodology.

994. We have already concluded above that a bill-and-keep methodology for intercarrier compensation, including reciprocal compensation, best serves our policy goals and requirements of the Act.[2095] Consistent with that determination and our clarification above that compensation obligations under section 20.11 are coextensive with reciprocal compensation requirements, we conclude that bill-and-keep should also be the default pricing methodology between LECs and CMRS providers under section 20.11 of our rules.[2096] Thus, we conclude that bill-and-keep should be the default applicable to LEC-CMRS reciprocal compensation arrangements under both section 20.11 or Part 51. We reject claims that a default rate set via a bill-and-keep methodology under any circumstances would be inadequate because it would be less than the actual cost of terminating calls that originate with a CMRS provider.[2097] As we explain above, a bill-and-keep regime requires each carrier to recover its costs from its own end-users.[2098]

995. We further conclude that, under either section 20.11 or the Part 51 rules, for traffic to or from a CMRS provider subject to reciprocal compensation under either section 20.11 or the Part 51 rules, the bill-and-keep default should apply immediately. Although we have adopted a glide path to a bill-and-keep methodology for access charges generally and for reciprocal compensation between two wireline carriers, we find that a different approach is warranted for non-access traffic between LECs and CMRS providers for several reasons. First, we find a greater need for immediate application of a bill-and-keep methodology in this context to address traffic stimulation. The record demonstrates there is a significant and growing problem of traffic stimulation and regulatory arbitrage in LEC-CMRS non-access traffic.[2099] In contrast, we find little evidence of such problems with regard to traffic between two LECs, where traffic stimulation appears to be occurring largely within the access regime, rather than for traffic currently subject to reciprocal compensation payments. This likely reflects in part the fact that the applicable "local calling area" for CMRS providers within which calls are subject to reciprocal

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[2095] *See supra* Section XII.A.1.

[2096] By default, we mean that bill-and-keep will satisfy terminating compensation obligations except where carriers mutually agree to the contrary.

[2097] North County Section XV Reply at 8, 9; *see also, e.g.*, Core Section XV Comments at 13-14 (reciprocal compensation rates are set by state commissions pursuant to TELRIC, and use of a lower rate would require carriers to terminate traffic below cost, resulting in a windfall for originating carriers); Earthlink Section XV Reply at 11 (footnote omitted) (arguing that "a bill-and-keep arrangement does not 'comply with the principles of mutual compensation' under FCC Rule 20.11(b)"); PAETEC Section XV Reply at 23 (arguing that "[t]he Commission should not reverse rule 20.11 in this proceeding. Instead, the Commission should affirm the right to mutual compensation at reasonable rates").

[2098] *See supra* para. 742.

[2099] *See, e.g.*, MetroPCS Section XV Comments at 8 ("Access stimulation . . . is not confined to the long-distance market. The local terminating compensation market also has proven to be a troubling source of regulatory arbitrage."), 11-12; Sprint XV Comments at 22 (noting an increase in intraMTA traffic pumping); Verizon Section XV Reply at 27 ("Verizon and other carriers have seen a large increase in intraMTA arbitrage in the wake of the Commission's *North County Order*"). *See also* Letter from Scott Bergman, CTIA-The Wireless Association, to Marlene H. Dortch, Secretary, FCC, WC Docket 07-135, CC Docket 01-92 (filed Nov. 24, 2010); *see generally* Verizon June 28, 2010 *Ex Parte* Letter; Leap Wireless *Access Stimulation NPRM* Reply; MetroPCS *Access Stimulation NPRM* Comments.

compensation is much larger than it is for LECs.[2100] Thus, what would be access stimulation if between a LEC and an IXC will in many cases arise under reciprocal compensation when a CMRS provider is involved.[2101] For similar reasons, CMRS providers are more likely to be exposed to traffic stimulation that is not subject to the measures we adopt above to address this problem within the access traffic regime. Further, although the record reflects that LEC-CMRS intraMTA traffic stimulation is growing most rapidly in traffic terminated by competitive LECs,[2102] we are concerned that absent any measures to address traffic stimulation for intraMTA LEC-CMRS traffic, incumbent LECs that sought revenues from access stimulation may quickly adapt their stimulation efforts to wireless reciprocal compensation. For these reasons, we find addressing the traffic stimulation problem in reciprocal compensation is more urgent for LEC-CMRS traffic, and the bill-and-keep default methodology we adopt today should eliminate the opportunity for parties to engage in such practices in connection with such traffic.[2103]

996. Although, as discussed above, we find that adopting a gradual glide path to a bill-and-keep methodology for intercarrier compensation generally, including reciprocal compensation between LECs, will help avoid market disruption to service providers and consumers, we conclude that an immediate transition for reciprocal compensation traffic exchanged between LECs and CMRS providers presents a far smaller risk of market disruption than would an immediate shift to a bill-and-keep methodology for intercarrier compensation more generally. First, for reciprocal compensation between CMRS providers and competitive LECs, we have until recently had no pricing methodology applicable to competitive LEC-CMRS traffic, as reflected in the fact that the carriers in the recent *North County Order* had specifically asked the Commission to establish one for the first time. Competitive LECs thus had no basis for reliance on such a methodology in their business models, and we see no reason why, in setting a methodology for the first time, we should not require competitive LECs to meet that methodology immediately, particularly given that competitive LECs are not subject to retail rate regulation in the manner of incumbents, and therefore have flexibility to adapt their businesses more quickly.

997. Even for incumbent LECs, we are confident the impact is not significant, particularly when balanced against the overall benefits of providing the clarification. For one, incumbent LECs and

[2100] More specifically, the area within which a LEC-CMRS call is subject to reciprocal compensation rather than access is the Major Trading Area (MTA), which is generally much larger than the applicable local calling area for LEC-LEC calls. *See TSR Wireless, LLC v. U.S. West Communications, Inc.*, 15 FCC Rcd 11166, 11178 para. 31 (2000) (noting MTAs typically are large areas that may encompass multiple LATAs, and often cross state boundaries). Thus traffic that would be subject to access rules if exchanged between LECs falls under the reciprocal compensation regime when exchanged with a CMRS provider.

[2101] *See* Leap Wireless *Access Stimulation NPRM* Reply, at 9 (arguing against proposals that "fail to even consider the circumstances in which the stimulated traffic is access traffic for landline carriers but intraMTA or 'local' traffic for the wireless carrier that originates the traffic").

[2102] *See, e.g.*, CTIA *Access Stimulation NPRM* Reply, at 4 ("CLECs now account for more traffic stimulation than ILECs, as access stimulation schemes have shifted from ILECs to CLECs to avoid increased Commission oversight of rural ILECs.").

[2103] *See* Leap Wireless *Access Stimulation NPRM* Reply, at 2 (asserting that traffic stimulation is a significant and growing problem in both access and local traffic and proposing adoption of bill-and-keep to address the problem). In light of our decision to adopt a default bill-and-keep methodology for traffic exchanged between LECs and CMRS providers, we find it is not necessary to adopt special rules proposed by some commenters to curb traffic stimulation with respect to such traffic. *See, e.g.*, CTIA Section XV Comments at 7-8; AT&T Section XV Comments at 21; Leap Section XV Comments at 6-7; MetroPCS Section XV Comments at 4-5, 10; T-Mobile Section XV Comments at 8-9; Verizon Section XV Reply Comments at 31. Further, such measures would not be as effective in eliminating regulatory arbitrage schemes, as we note above. *See also* Leap Wireless *Access Stimulation NPRM* Reply, at 7 ("the only truly effectively global resolution of these issues is for the Commission to adopt bill and keep compensation for all traffic").

CMRS providers that fail to pursue an interconnection agreement do not receive any compensation for intraMTA traffic today.[2104] For incumbent LECs that do have agreements for compensation for intraMTA traffic, most large incumbent LECs have already adopted $0.0007 or less as their reciprocal compensation rate.[2105] For rate-of-return carriers, there is no allegation in the record that reforming LEC-CMRS reciprocal compensation obligations in this manner would have a harmful impact on them. And, in any event, we have adopted mechanisms that should address any such impacts. First, we adopt a new recovery mechanism, which includes recovery for net reciprocal compensation revenues, to provide all incumbent LECs with a stable, predictable recovery for reduced intercarrier compensation revenues.[2106] Second, we adopt an additional measure to further ease the move to bill-and-keep LEC-CMRS traffic for rate-of-return carriers. Specifically, we limit rate-of-return carriers' responsibility for the costs of transport involving non-access traffic exchanged between CMRS providers and rural, rate-of-return regulated LECs.

998. Some commenters proposed a rule allocating the responsibility for transport costs for non-access traffic to the non-rural terminating provider, stating that in the absence of such a rule, rural LECs could be forced to incur unrecoverable transport costs at a time when ICC reforms may already have a negative impact on network cost recovery.[2107] We recognize that immediately moving to a default bill-and-keep methodology for intraMTA traffic raises issues regarding the default point at which financial responsibility for the exchange of traffic shifts from the originating carrier to the terminating carrier.[2108] Therefore, in the attached FNPRM, we seek comment on whether and how to address this aspect of bill-and-keep arrangements.[2109] We find it appropriate, however, to establish an interim default rule allocating responsibility for transport costs applicable to non-access traffic exchanged between CMRS providers and rural, rate-of-return regulated LECs to provide a gradual transition for such carriers. Given our commitment to providing a measured transition, we believe it is appropriate to help ensure no flash cuts for rate-of-return carriers. We note that price cap carriers did not raise concerns about transport costs, and we conclude that no particular transition is required or warranted for traffic exchanged between

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[2104] *See T-Mobile Order*, 20 FCC Rcd at 4863-65, paras. 14-16. *See also id.* at 4863 n.57 ("Under the amended rules, . . . in the absence of a request for an interconnection agreement, no compensation is owed for termination.").

[2105] *See, e.g.*, T-Mobile Section XV Comments at n.16 (stating that "in T-Mobile's experience, the vast majority of RBOC agreements provide for terminating rates at or below $0.0007 per minute").

[2106] For a detailed description of the recovery mechanism, *see supra* Section XIII.

[2107] *See, e.g.*, NECA et al. *August 3 PN* Comments at 41-42 (proposing a "Rural Transport Rule"); *see also* Letter from Michael Romano, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket 10-90, CC Docket 01-92, at 6 (filed Oct. 19, 2011); Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 2 (filed Oct. 20, 2011).

[2108] AT&T *USF/ICC Transformation NPRM* Reply at 24-25. *See also* CTIA *USF/ICC Transformation NPRM* Comments at 39 (proposing that the originating carrier would be responsible for assuming the costs of delivering a call, including securing any necessary transport services, to the terminating carrier's network edge).

[2109] *See infra* Section XVII.N. We have previously sought comment on the allocation of transport costs for non-access traffic on several occasions. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4774-76 paras. 680-82; *2008 Order and ICC/USF FNPRM*, 24 FCC Rcd at 6619-20, App.C, para 270 (seeking comment on interconnection proposal including "rural transport rule" that would have limited the transport and provisioning obligations of a rural rate-of-return regulated incumbent LEC to its meet point when the non-rural terminating carrier's point of presence is located outside of the rural rate-of-return incumbent LEC's service area); *Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4727 para. 90, 4729 para. 93 (seeking comment on a proposal to require competitive carriers seeking to exchange traffic with an incumbent LEC to be responsible for transport costs outside the incumbent's local calling area).

CMRS providers and these carriers.

999. Specifically, for such traffic, the rural, rate-of-return LEC will be responsible for transport to the CMRS provider's chosen interconnection point[2110] when it is located within the LEC's service area.[2111] When the CMRS provider's chosen interconnection point is located outside the LEC's service area, we provide that the LEC's transport and provisioning obligation stops at its meet point and the CMRS provider is responsible for the remaining transport to its interconnection point. Although we do not prejudge our consideration of what allocation rule should ultimately apply to the exchange of all telecommunications traffic, including traffic that is considered access traffic today, under a bill-and-keep methodology, we believe that this rule is warranted for the interim period to help minimize disputes and provide greater certainty until rules are adopted to complete the transition to a bill-and-keep methodology for all intercarrier compensation.[2112]

1000. Beyond adopting these measures, we also emphasize that, although we establish bill-and-keep as an immediately applicable default methodology, we are not abrogating existing commercial contracts or interconnection agreements or otherwise allowing for a "fresh look" in light of our reforms.[2113] Thus, incumbent LECs may have an extended period of time under existing compensation arrangements before needing to renegotiate subject to the new default bill-and-keep methodology. As a result, while we are concerned that an immediate transition from reciprocal compensation to a bill-and-keep methodology more generally would risk overburdening the universal service fund that underlies the interim recovery mechanism, we think that the impact on the fund resulting from an immediate transition for LEC-CMRS reciprocal compensation alone will not do so.[2114] For the reasons discussed, we find that an immediate transition away from reciprocal compensation to a bill-and-keep methodology in this context is practical.

1001. As we found above, we believe that sections 251 and 252 affirmatively provide us authority to establish bill-and-keep as the default methodology applicable to traffic within the scope of section 251(b)(5), including for traffic exchanged between LECs and CMRS providers.[2115] Further, as we have concluded above that we have authority under section 332 to regulate intrastate access traffic exchanged between LECs and CMRS providers and thus authority to specify a transition to bill-and-keep for such traffic, we conclude for similar reasons that we have authority to regulate intrastate reciprocal

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[2110] *See* 47 C.F.R. § 51.701(c)(defining transport as "from the interconnection point between the two carriers to the terminating carrier's end office switch").

[2111] *See* 47 U.S.C § 214(e)(5)(defining "service area" in the context of universal service).

[2112] We note that some commenters proposed a similar but broader rule that would have applied to traffic exchanged between a rural, rate-of-return LEC and any other provider, CMRS or not. *See* NECA et al. *August 3 PN* Comments at 41-42 (proposing a "Rural Transport Rule"); Letter from Michael R. Romano, Senior Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45 at 2 (filed Oct. 20, 2011). Because we adopt this as an interim rule to address concerns arising from our immediate adoption of bill-and-keep for non-access traffic with CMRS providers, a narrower rule that applies only to traffic between rural, rate-of-return LECs and CMRS providers is warranted.

[2113] *See supra* para. 815.

[2114] Adoption of bill-and-keep for this subset of traffic will also inform our understanding of the potential impact that the larger transition to bill-and-keep will have and, although we do not envisions any concerns arising based on the reforms adopted in this Order, would enable us, if necessary, to make any adjustments as part of that larger transition. *See* MetroPCS Comments at 22-23 (arguing that "[m]oving just wireless traffic immediately to bill-and-keep would provide a worthwhile reference without having a major disruptive effect on the intercarrier compensation regime" and supporting immediate application of bill-and-keep to LEC-CMRS traffic).

[2115] *See supra* Section XII.A.2.

compensation between LECs and CMRS providers.[2116] Indeed, in *Iowa Utilities Board*, the Eighth Circuit specifically upheld Commission rules regulating LEC-CMRS reciprocal compensation based on these provisions.[2117]

1002. In the *North County Order*, the Commission found that any decision to reverse course and regulate intrastate rates under section 20.11 at the federal level was more appropriately addressed in a general rulemaking proceeding.[2118] Now that we are considering the issue in the context of this rulemaking proceeding, we find it appropriate to take this step for the reasons discussed above, and we conclude that our decision to establish a federal default pricing methodology for termination of LEC-CMRS intraMTA traffic as part of our broader effort in this proceeding to reform, modernize, and unify the intercarrier compensation system is consistent with our authority under the Act.

D. IntraMTA Rule

1003. In the *Local Competition First Report and Order,* the Commission stated that calls between a LEC and a CMRS provider that originate and terminate within the same Major Trading Area (MTA) at the time that the call is initiated are subject to reciprocal compensation obligations under section 251(b)(5), rather than interstate or intrastate access charges.[2119] As noted above, this rule, referred to as the "intraMTA rule," also governs the scope of traffic between LECs and CMRS providers that is subject to compensation under section 20.11(b). The *USF/ICC Transformation NPRM* sought comment, *inter alia,* on the proper interpretation of this rule.

1004. The record presents several issues regarding the scope and interpretation of the intraMTA rule. Because the changes we adopt in this Order maintain, during the transition, distinctions in the compensation available under the reciprocal compensation regime and compensation owed under the access regime, parties must continue to rely on the intraMTA rule to define the scope of LEC-CMRS traffic that falls under the reciprocal compensation regime. We therefore take this opportunity to remove any ambiguity regarding the interpretation of the intraMTA rule.

1005. We first address a dispute regarding the interpretation of the intraMTA rule. Halo Wireless (Halo) asserts that it offers "Common Carrier wireless exchange services to ESP and enterprise customers" in which the customer "connects wirelessly to Halo base stations in each MTA."[2120] It further

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[2116] *See supra* para. 779 .

[2117] In *Iowa Utilities Board v. FCC*, the Eighth Circuit found that "[b]ecause Congress expressly amended section 2(b) to preclude state regulation of entry of and rates charged by [CMRS] providers . . . and because section 332(c)(1)(b) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers." *Iowa Utils Bd. v. FCC*, 120 F. 3d 753, 800 n.21 (8th Cir. 1997) (vacating the Commission's pricing rules for lack of jurisdiction except for "the rules of special concern to CMRS providers" based in part upon the authority granted to the Commission in 47 U.S.C. § 332(c)(1)(B)). *See also Qwest v. FCC*, 252 F.3d 462, 465-66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. Bd. v. FCC* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion). On this basis, the court upheld several rules relating to reciprocal compensation for LEC-CMRS traffic, including rules governing charges for intrastate traffic. For example, the court upheld on this basis the adoption of section 51.703(b) of our rules, which prohibits LECs from assessing charges on any other telecommunications carrier for non-access traffic that originates on the LEC's network. 47 C.F.R. § 51.703(b).

[2118] *North County Order*, 24 FCC Rcd at 14039-40, para. 10, 14042, para. 16 (internal quotations omitted).

[2119] *Local Competition First Report and Order*, 11 FCC Rcd at 16014, para. 1036; 47 C.F.R. § 51.701(b)(2). The definition of an MTA can be found in section 24.202(a) of the Commission's rules. 47 C.F.R. § 24.202(a).

[2120] Halo Aug. 12, 2011 *Ex Parte* Letter, Attach. at 7; *see also* Halo Oct. 17, 2011 *Ex Parte* Letter. Halo is a nationwide licensee of non-exclusive spectrum in the 3650-3700 MHz band.

asserts that its "high volume" service is CMRS because "the customer connects to Halo's base station using wireless equipment which is capable of operation while in motion."[2121] Halo argues that, for purposes of applying the intraMTA rule, "[t]he origination point for Halo traffic is the base station to which Halo's customers connect wirelessly."[2122] On the other hand, ERTA claims that Halo's traffic is not from its own retail customers but is instead from a number of other LECs, CLECs, and CMRS providers.[2123] NTCA further submitted an analysis of call records for calls received by some of its member rural LECs from Halo indicating that most of the calls either did not originate on a CMRS line or were not intraMTA, and that even if CMRS might be used "in the middle," this does not affect the categorization of the call for intercarrier compensation purposes.[2124] These parties thus assert that by characterizing access traffic as intraMTA reciprocal compensation traffic, Halo is failing to pay the requisite compensation to terminating rural LECs for a very large amount of traffic.[2125] Responding to this dispute, CTIA asserts that "it is unclear whether the intraMTA rules would even apply in that case."[2126]

1006. We clarify that a call is considered to be originated by a CMRS provider for purposes of the intraMTA rule only if the calling party initiating the call has done so through a CMRS provider. Where a provider is merely providing a transiting service, it is well established that a transiting carrier is not considered the originating carrier for purposes of the reciprocal compensation rules.[2127] Thus, we agree with NECA that the "re-origination" of a call over a wireless link in the middle of the call path does not convert a wireline-originated call into a CMRS-originated call for purposes of reciprocal compensation and we disagree with Halo's contrary position.[2128]

1007. In a further pending dispute, some LECs have argued that if completing a call to a CMRS provider requires a LEC to route the call to an intermediary carrier outside the LEC's local calling area,[2129] the call is subject to access charges, not reciprocal compensation, even if the call originates and

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[2121] Halo Aug. 12, 2011 *Ex Parte* Letter, Attach. at 8.

[2122] *Id.* Attach. at 9.

[2123] ERTA July 8, 2011 *Ex Parte* Letter, at 3.

[2124] NTCA July 18, 2011 *Ex Parte* Letter at 7.

[2125] NTCA July 18, 2011 *Ex Parte* Letter at 1; ERTA *Ex Parte* Letter at 1, 3 (traffic from Halo includes "millions of minutes of intrastate access, interstate access, and CMRS traffic originated by customers of other companies;" one day study of Halo traffic showed traffic was originated by customers of "176 different domestic and Canadian LECs and CLECs and 63 different Wireless Companies").

[2126] CTIA *August 3 PN* Comments at 9.

[2127] *See Texcom, Inc. d/b/a Answer Indiana v. Bell Atlantic Corp,* Order on Reconsideration, 17 FCC Rcd 6275, 6276 para. 4 (2002) ("Answer Indiana's argument assumes that GTE North receives reciprocal compensation from the originating carrier, but our reciprocal compensation rules do not provide for such compensation to a transiting carrier."); *TSR Wireless, LLC v. U.S. West Communications, Inc.*, Memorandum Opinion and Order, 15 FCC Rcd 11166, 11177 n.70 (2000).

[2128] *See* NECA Sept. 23, 2011 *Ex Parte* Letter Attach. at 1; Halo Aug. 12, 2011 *Ex Parte* Letter at 9. We make no findings regarding whether any particular transiting services would in fact qualify as CMRS. *See* CTIA *August 3 PN* Comments at 9 & n.29 ("the information available does not reveal whether [Halo's] offering is a mobile service").

[2129] This occurs when the LEC and CMRS provider are "indirectly interconnected," i.e. when there is a third carrier to which they both have direct connections, and which is then used as a conduit for the exchange of traffic between them.

terminates within the same MTA.[2130] One commenter in this proceeding asks us to affirm that such traffic is subject to reciprocal compensation.[2131] We therefore clarify that the intraMTA rule means that all traffic exchanged between a LEC and a CMRS provider that originates and terminates within the same MTA, as determined at the time the call is initiated, is subject to reciprocal compensation regardless of whether or not the call is, prior to termination, routed to a point located outside that MTA or outside the local calling area of the LEC.[2132] Similarly, intraMTA traffic is subject to reciprocal compensation regardless of whether the two end carriers are directly connected or exchange traffic indirectly via a transit carrier.[2133]

1008. Further, in response to the *USF/ICC Transformation NPRM*, T-Mobile proposed that we expand the scope of the intraMTA rule to reflect the fact that CMRS licenses are now issued for REAGs, geographic areas that are larger than MTAs.[2134] T-Mobile notes that the intraMTA rule was promulgated

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[2130] *See, e.g.*, Letter from Sylvia Lesse, Counsel to the Missouri Companies, to William F. Caton, Acting Secretary, Federal Communications Commission, WT Docket No. 01-316 and CC Docket No. 01-92, Attach. (filed Mar. 22, 2002) (Missouri Companies Mar. 22 *Ex Parte* Letter); Letter from W.R. England, III, Counsel for Citizen Telephone Company of Missouri, *et al*, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, and 95-116 (filed Oct. 31, 2003) (Citizen Oct. 31, 2003 *Ex Parte* Letter). *See also* Letter from Glenn H. Brown, Counsel to Great Plains Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 8 (filed Sept. 23, 2003) (stating that the local exchange is the incumbent LEC's local service area rather than the MTA). We also sought comment on this issue in 2005 but have not since taken action to address it. *See Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4745-46 paras. 137-38.

[2131] T-Mobile *August 3 PN* Comments at 11.

[2132] In a letter filed on Oct. 21, 2011, Vantage Point Solutions alleged "difficulties associated with the implementation of intraMTA local calling" between LECs and CMRS providers, and, while not advocating repeal of the rule, urged the Commission to "proceed with substantial caution" when "handling the rating and routing of intraMTA calls" that involve an interexchange carrier. Letter from Larry D. Thompson, Vantage Point Solutions, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, at 1-2 (filed Oct. 21, 2011) (Vantage Point Oct. 21, 2011 Ex Parte Letter). We find that the potential implementation issues raised by Vantage Point do not warrant a different construction of the intraMTA rule than what we adopt above. Although Vantage Point questions whether the intraMTA rule is feasible when a call is routed through interexchange carriers, many incumbent LECs have already, pursuant to state commission and appellate court decisions, extended reciprocal compensation arrangements with CMRS providers to intraMTA traffic without regard to whether a call is routed through interexchange carriers. *See, e.g.*, *Alma Communications Co. v. Missouri Public Service Comm'n*, 490 F.3d 619, 623-34 (8th Cir. 2007) (noting and affirming arbitration decision requiring incumbent LEC to compensate CMRS provider for costs incurred in transporting and terminating land-line to cell-phone calls placed to cell phones within the same MTA, even if those calls were routed through a long-distance carrier); *Atlas Telephone Co. v. Oklahoma Corp. Comm'n*, 400 F.3d 1256 (10th Cir. 2005). Further, while Vantage Point asserts that it is not currently possible to determine if a call is interMTA or intraMTA, Vantage Point Oct. 21, 2011 Ex Parte Letter at 2-3, the Commission addressed this concern when it adopted the rule. *See Local Competition First Report and Order*, 11 FCC Rcd at 16017, para. 1044 (stating that parties may calculate overall compensation amounts by extrapolating from traffic studies and samples).

[2133] *See* Sprint Nextel Section XV Comments at 22-23 (arguing that the Commission should reaffirm that all intraMTA traffic to or from a CMRS provider is subject to reciprocal compensation). This clarification is consistent with how the intraMTA rule has been interpreted by the federal appellate courts. *See Alma Communications Co. v. Missouri Public Service Comm'n*, 490 F.3d 619 (8th Cir. 2007); *Iowa Network Services, Inc. v. Qwest Corp.*, 466 F.3d 1091 (8th Cir. 2006); *Atlas Telephone Co. v. Oklahoma Corp. Commission*, 400 F.3d 1256 (10th Cir. 2005).

[2134] *See* T-Mobile *August 3 PN* Comments at 11-14. T-Mobile's proposal is also supported by MetroPCS. *See* MetroPCS *August 3 PN* Reply at 6-7.

at a time the MTA was the largest CMRS license area.[2135] T-Mobile argues that the REAG is currently the largest license being used to provide CMRS and that this change would move more telecommunications traffic under the reciprocal compensation umbrella pending the unification of all intercarrier compensation rates.[2136] We decline to adopt T-Mobile's proposal. Given the long experience of the industry dealing with the current rule, the very broad scope of the changes to the intercarrier compensation rules being made in this Order that will, after the transition period, make the rule irrelevant, and the limited support in the record for the suggested change even from CMRS commenters, we do not believe it is either necessary or appropriate to expand the scope of this rule as proposed by T-Mobile.

XVI. INTERCONNECTION

1009. Interconnection among communications networks is critical given the role of network effects.[2137] Historically, interconnection among voice communications networks has enabled competition and the associated consumer benefits that brings through innovation and reduced prices.[2138] The voice communications marketplace is currently transitioning from traditional circuit-switched telephone service to the use of IP services, and commenters observe that many carriers "apparently are equipped to receive IP voice traffic but are taking the position they will not use this equipment for years (until a prohibition on current per-minute charges takes effect)."[2139] These parties thus propose that in the immediate future the Commission "should (a) encourage all TDM network operators to investigate the steps they need to take to support IP-IP interconnection, and (b) put all TDM network operators on notice that they will be likely required to support IP-IP interconnection before any phase down of current ICC rates is complete."[2140]

1010. We anticipate that the reforms we adopt herein will further promote the deployment and use of IP networks. However, IP interconnection between providers also is critical. As such, we agree with commenters that, as the industry transitions to all IP networks, carriers should begin planning for the transition to IP-to-IP interconnection, and that such a transition will likely be appropriate before the completion of the intercarrier compensation phase down. We seek comment in the accompanying FNPRM regarding specific elements of the policy framework for IP-to-IP interconnection. We make clear, however, that our decision to address certain issues related to IP-to-IP interconnection in the FNPRM should not be misinterpreted to suggest any deviation from the Commission's longstanding view

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[2135] *See* T-Mobile *August 3 PN* Comments at 12.

[2136] *Id*. at 13.

[2137] *See, e.g.*, *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations*, WT Docket Nos. 04-70, 04-254, 04-323, Memorandum Opinion and Order, 19 FCC Rcd 21522, 21578, para. 143 (2004) (citing Carl Shapiro and Hal Varian, *Information Rules*, Harvard Business School Press, Boston, 1999, at 13).

[2138] *See, e.g.*, *Interconnection Clarification Order*, 26 FCC Rcd at 8265-66, paras. 12-13; *Local Competition First Report and Order*, 11 FCC Rcd at 15506, para. 4; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Third Report and Order, Transport Phase II, 9 FCC Rcd 2718, 2724, para. 25 (1994).

[2139] Sprint Nextel *USF/ICC Transformation NPRM* Comments at 28. *See also, e.g.*, Letter from Howard J. Symons, counsel for Cablevision, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket No. 01-92, 96-45, GN Docket No. 09-51, Attach. at 1-4 (filed Oct. 20, 2011); Letter from Thomas Jones, counsel for Cbeyond et al., to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 11-119, 10-90, 07-135, 05-337, 03-109, CC Docket No. 01-92, 96-45, GN Docket No. 09-51, Attach. A at 5 (filed Oct. 3, 2011).

[2140] Sprint Nextel *USF/ICC Transformation NPRM* Comments at 28.

regarding the essential importance of interconnection of voice networks.[2141]

1011. In particular, even while our FNPRM is pending, we expect all carriers to negotiate in good faith in response to requests for IP-to-IP interconnection for the exchange of voice traffic. The duty to negotiate in good faith has been a longstanding element of interconnection requirements under the Communications Act and does not depend upon the network technology underlying the interconnection, whether TDM, IP, or otherwise. Moreover, we expect such good faith negotiations to result in interconnection arrangements between IP networks for the purpose of exchanging voice traffic. As we evaluate specific elements of the appropriate interconnection policy framework for voice IP-to-IP interconnection in our FNPRM, we will be monitoring marketplace developments, which will inform the Commission's actions in response to the FNPRM.[2142]

XVII. FURTHER NOTICE OF PROPOSED RULEMAKING

A. Broadband Public Interest Obligations

1012. In this section, we seek further comment on the public interest obligations of funding recipients.

1. Measuring Broadband Service

1013. In the Order, we adopt a rule requiring that actual speed and latency be measured on each ETC's access network from the end-user interface to the nearest Internet access point, and we require that ETCs certify to and report the results to USAC on an annual basis. Here, we seek comment on whether the Commission should adopt a specific measurement methodology beyond what is described in the Order and the format in which ETCs should report their results.

1014. The *Measuring Broadband America Report* concludes that "a standardized set of broadband measurements can be implemented across a range of ISPs and scaled to support detailed regional assessments of broadband deployment and performance."[2143] We note that commercial hardware and software as well as some free, non-commercial options are available. Should we adopt a uniform methodology for measuring broadband performance? If so, should that methodology be uniform across different technologies? We note that the Commission has requested more information on measurement approaches for mobile broadband and seeks to incorporate that proceeding's record with ours.[2144] How should wireless providers measure speed? Should we require fixed funding recipients to install SamKnows-type white boxes at consumer locations in order to monitor actual performance in a standardized way?

1015. Should we specify a uniform reporting format? Should test results be recorded in a format that can be produced to USAC and auditable such that USAC or the state commissions may confirm that a provider is, in fact, providing broadband at the required minimum speeds?

[2141] *See, e.g.*, *Interconnection Clarification Order*, 26 FCC Rcd at 8265-66, paras. 12-13; *CLEC Access Charge Order*, 16 FCC Rcd at 9960, para. 92; *Local Competition First Report and Order*, 11 FCC Rcd at 15506, para. 4; *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Third Report and Order, Transport Phase II, 9 FCC Rcd 2718, 2724, para. 25 (1994); *MTS & WATS Market Structure*, Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980); *Lincoln Tel. & Tel. Co.*, Declaratory Order, 72 FCC 2d 724 (1979). *See also infra* Section XVII.P.1.

[2142] *See infra* Section XVII.P.

[2143] *Measuring Broadband America Report* at 28.

[2144] *Comment Sought on Measurement of Mobile Broadband Network Performance and Coverage*, CG Docket No. 09-158, CC Docket No. 98-170, WC Docket No. 04-36, Public Notice, 25 FCC Rcd 7069 (2010).

1016. Should providers be required to provide the underlying raw measurement data to USAC? Are there legitimate concerns with confidentiality if such data are made public? Is it sufficient to have a provider certify to USAC that its network is satisfying the minimum broadband metrics and retain the results of its own performance measurement to be produced on request in the course of possible future audits?

1017. Should we consider easing the performance measuring obligations on smaller broadband providers? If so, what would be the appropriate threshold for size of provider before granting relief for measuring broadband? If we ease performance measuring obligations on smaller broadband providers, how can we ensure that their customers are receiving reasonably comparable service?

2. Reasonably Comparable Voice and Broadband Services

1018. In the Order, we direct the Wireline Competition Bureau and Wireless Telecommunications Bureau (the Bureaus) to develop and conduct a survey of voice and broadband rates in order to compare urban and rural voice and broadband rates. Here, we seek comment on the components of the survey.

1019. With respect to determining reasonable comparability of voice service rates for universal service purposes, should we separately collect data on fixed and mobile voice telephony rates? Should fixed and mobile voice services have different benchmarks for purposes of reasonable comparability?

1020. In the landline context, we have previously surveyed the basic R-1 voice rate. What would the equivalent basic offering be in the mobile context? How should we take into account packages that offer varying numbers of minutes of usage and/or additional features such as texting?

1021. With respect to determining reasonable comparability of broadband services, should we separately collect data on fixed and mobile broadband pricing and capacity requirements (if any)? For purposes of that analysis, how should we consider, if at all, data cards provided by mobile providers?

1022. In the Order, we conclude that services meeting our public interest standard should be reasonably comparable to comparable offerings in urban areas in terms of pricing, speed, and usage limits (if any).[2145] For fixed broadband offerings subject to our initial CAF requirements of 4 Mbps downstream/1 Mbps upstream, should we survey advertised rates for such service, or the closest available offering in urban areas? How should we take into account promotional pricing that may require a specific contractual commitment for a period of time?

1023. Should fixed and mobile broadband services have different or the same benchmarks for purposes of reasonable comparability?

1024. We also seek comment on how to compare mobile broadband to fixed broadband as product offerings evolve over time.

1025. In the Order, we also determine that rural rates for broadband service would be "reasonably comparable" to urban rates under section 254(b)(3) if rural rates fall within a reasonable range of the national average urban rate for broadband service. Here, we seek comment on how specifically to define that reasonable range for broadband.

1026. We note that in the voice context, today we require states to certify that basic R-1 voice rates for non-rural carriers are no more than two standard deviations above the national average R-1

[2145] As explained in the Order, by limiting reasonable comparability to "comparable services," we intend to ensure that fixed broadband services in rural areas are compared with fixed broadband services in urban areas, and similarly that mobile broadband services in rural areas are compared with mobile broadband services in urban areas.

rate.[2146] Would using two standard deviations be the appropriate measure for reasonable comparability in the broadband context, or should we adopt a different methodology for establishing such a reasonable range? Do unregulated broadband prices show relatively small variations, making another methodology more appropriate? For example, would prices normalized to disposable income be appropriate?

1027. Should we adopt a presumption that if a given provider is offering the same rates, terms and conditions (including capacity limits, in any) to both urban and rural customers, that is sufficient to meet the statutory requirement that services be reasonably comparable?

3. Additional Requirements

1028. Some commenters have proposed to require CAF recipients to comply with certain interconnection requirements.[2147] We seek comment on whether the Commission should require CAF recipients to offer IP-to-IP interconnection for voice service, beyond whatever framework it adopts more broadly.[2148] If so, what would the scope and nature of any such requirement be? Should any obligations be based on the requirements of section 251(a)(1), since, as ETCs, the providers subject to these requirements will be telecommunications carriers? How would any such obligations be enforced?

1029. We also seek additional comment on the proposal of Public Knowledge and the Benton Foundation that CAF recipients be required to make interconnection points and backhaul capacity available so that unserved high-cost communities could deploy their own broadband networks.[2149] How would such a requirement operate? Is it sufficient to require CAF recipients to negotiate in good faith with community broadband networks to determine a point of interconnection? If there are disputes, who should resolve them? Should there be reporting requirements associated with such an obligation (i.e., should CAF recipients be required to report annually on unfulfilled requests for interconnection from community broadband networks)? What benefits might such a requirement bring that the Commission's other universal service policies are not meeting? What would the costs of such a requirement be, on funding recipients and on administration of the requirement?

1030. We also seek comment on the proposal of Public Knowledge and the Benton Foundation that the Commission should create a fund for a Technology Opportunities Program in order to assist communities with deploying their own broadband networks. How much money should the Commission set aside for such a program? Are there any legal impediments to the Commission running such a pilot program out of the Universal Service Fund? We acknowledge the important role that WISPs, non-profits, and other small and non-traditional communications providers play in extending broadband in rural America, including in areas where traditional commercial providers have not deployed. Are there other things the Commission should be doing to enable such entities to further extend broadband coverage, particularly in currently unserved areas?

[2146] The standard deviation is a measure of dispersion. The sample standard deviation is the square root of the sample variance. The sample variance is calculated as the sum of the squared deviations of the individual observations in the sample of data from the sample average divided by the total number of observations in the sample minus one. In a normal distribution, about 68 percent of the observations lie within one standard deviation above and below the average and about 95 percent of the observations lie within two standard deviations above and below the average.

[2147] Public Knowledge and Benton *USF/ICC Transformation NPRM* Comments at 5-7; Hypercube *August 3 PN* Comments at 12-13.

[2148] *See infra* section XVII.P (IP-to-IP interconnection issues).

[2149] Public Knowledge and Benton *USF/ICC Transformation NPRM* Comments at 5-7; Letter from John Bergmayer, Public Knowledge, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al. (filed July 28, 2001); Public Knowledge and Benton *August 3 PN* Comments at 6-10.

B. Connect America Fund for Rate-of-Return Carriers

1031. In the Order, we establish the CAF and begin the transition of legacy high-cost universal service support to a broadband-focused CAF.[2150] We conclude that all universal high-cost support should ultimately be distributed through CAF for all recipients. Starting in 2012, rate-of-return carriers will receive CAF ICC support. In the near term, such carriers will receive the remainder of their universal service support through existing high-cost support mechanisms, as reformed in the Order.

1032. In response to the *USF/ICC Transformation NPRM*, the Rural Associations proposed the creation of a new broadband-focused CAF mechanism that ultimately would entirely replace existing support mechanisms for rate-of-return carriers. We sought comment in the *August 3rd Public Notice* on this proposal, but received limited response.[2151] Subsequently, the Rural Associations provided draft rules that provide additional context regarding the operation of their proposed CAF.[2152] We now seek focused comment on this proposal and ask whether and how it could be modified consistent with the framework adopted in the Order to provide a path forward for rate-of-return or carriers to invest in extending broadband to unserved areas. We set forth in Appendix G draft rules, modified to take into account the rule changes adopted in this Order, and seek comment on those draft rules.

1033. Under the Rural Association Plan, loop costs would be allocated to the interstate jurisdiction based on the current 25 percent allocator or the individual carrier's broadband adoption rate, whichever is greater. This would have the practical effect of reducing over time the size of legacy support mechanisms, like HCLS, that offset some intrastate costs. The new interstate revenue requirement would also include certain key broadband-related costs (*i.e.*, middle mile facilities and Internet backbone access). In conjunction with this proposal, the Rural Associations also propose that their authorized rate-of-return be reduced from 11.25 percent to 10 percent. CAF support would be provided under this new mechanism for any provider's broadband costs that exceeded a specified benchmark representing wholesale broadband costs in urban areas. In particular, under this proposal CAF funding would be computed by subtracting the product of an urban broadband transmission cost benchmark times the number of broadband lines in service, from the actual company broadband network costs (which would be the sum of last mile, second mile, middle mile, and Internet connection costs). The broadband transmission benchmark would have a fixed component that would increase from $19.25 in the first year to $24.75 in the eighth year, and a variable component that is tied to an individual company's broadband take rate. In addition, there would be certain provisions to mitigate the impact on companies that would receive reduced support under the modified mechanism. The purpose of the transitional stability mechanism would be to ensure that no study area would experience a reduction in total support of more than five percent, on an annual basis, which would be funded by carriers that receive a net increase in support.[2153]

1034. The Rural Associations explain that their plan is calibrated to aim for a budget target of $2.05 billion in combined funding for USF and their suggested access restructure mechanism in the first year of implementation, and may grow to $2.3 billion by the sixth year. In the Order, we adopt an overall budget target for rate-of-return companies of $2 billion over the next six years. Given that, how could we best accommodate the Rural Association Plan within the budgetary framework adopted today? If savings are realized in other components of the CAF—for example, if competitive bidding leads to less support

[2150] *See supra* Section VII.

[2151] *August 3 Public Notice*, 26 FCC Rcd at 11112-11113.

[2152] Letter from Michael R. Romano, NTCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al. (filed Oct. 5, 2011).

[2153] Rural Associations *USF/ICC Transformation NPRM* Comments at 27-36.

being disbursed through the CAF for price cap areas than has been budgeted for—should those savings be used to increase funding for rate-of-return carriers under the Rural Association Plan? Could we more quickly transition existing support mechanisms to the framework proposed by the Rural Associations in order to stay within the overall budget? We seek year-by-year financial projections of any new mechanisms and the related impact on legacy support mechanisms, as well as the associated data and assumptions supporting those projections.

1035. With respect to plan specifics, we seek comment on the benefits and the costs of providing support for "middle mile" facilities and access to the Internet backbone under the Rural Associations' proposal. On average for smaller carriers, approximately what proportion of the costs to deploy broadband networks and provide broadband services are attributable to middle mile and Internet backbone costs today? Commenters are encouraged to provide factual information to support any projections they submit into the record. Consistent with the overall framework adopted in the Order to impose reasonable limits on recovery of loop expenses, how could we impose a constraint on the recovery of middle mile costs under this proposal?[2154]

1036. The Rural Associations propose that costs be shifted to the interstate jurisdiction based on an individual carrier's "Broadband Take Rate," which equals its total broadband lines divided by its total working access lines. Should this calculation be limited to residential lines? The Associations define "Broadband Line" to include any line that supports voice and broadband, or only broadband, at a minimum speed of 256 Kbps downstream. We seek comment on that proposal, and ask whether broadband lines should be defined consistent with the broadband characteristics required in our public interest obligations. What would be the impact of a more stringent definition of a broadband line in this context? If we were to adopt this proposal but shift costs to the interstate jurisdiction only for loops that provide speeds of at least 4 Mbps downstream and 1 Mbps upstream, how would that affect the financial projections regarding this proposal? Are there any legal, policy or practical implications to providing CAF support for lines where the end user customer does not subscribe to voice service from the ETC?[2155] The Rural Associations Plan contemplates that rate-of-return carriers may offer standalone broadband; to the extent they do so, absent any other rule changes, what would be the impact on USF support for rate-of-return carriers? What rule changes would help provide appropriate incentives for investment in broadband-capable networks, while limiting unrestrained growth in support provided to rate-of-return companies?

1037. How does the Rural Associations' proposal to alter the current 25 percent allocation of loop costs fit within, or inform, the Federal-State Joint Board on Jurisdictional Separations' ongoing work to reform the separations process?[2156] Are there components of the Rural Association plan that should be referred to the Separations Joint Board and examined directly in that ongoing process?

[2154] *See supra* Section VII.D.3 and *infra* Section XVII.E.

[2155] Today, incumbent local exchange carriers are required to allocate amounts recorded in their Part 32 accounts between regulated and nonregulated activities. 47 C.F.R. § 64.901. The costs and revenues allocated to nonregulated activities are excluded from the jurisdictional separations process. However, rate-of-return companies offer broadband transmission as a Title II common carrier service through a NECA tariff. The cost of loops that provide both voice and broadband is included in cost studies that determine whether and how much HCLS and ICLS a rate-of-return company receives.

[2156] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Notice of Proposed Rulemaking, 24 FCC Rcd 4227, 4229 (2009). Pursuant to section 36.154(a), 25 percent of the cost of cable and wire facilities used to provide voice telephony is deemed interstate, and 75 percent is deemed intrastate. Wholesale broadband transmission is considered a special access service, however, which is classified as 100 percent interstate.

(continued…)

1038. In the Order, we adopt a requirement that rate-of-return carriers offer speeds of 4 Mbps downstream and 1 Mbps upstream upon reasonable request. Should we adopt a rule that rate-of-return carriers are not required to serve any location within their study area that is served by an unsubsidized competitor and will not receive support for those lines to the extent they choose to extend service to areas of competitive overlap? How would we implement the Rural Associations' proposal in conjunction with such a rule? In particular, what would be the methodology for removing the broadband costs associated with areas of competitive overlap from the calculation of the proposed CAF support?

1039. Is a broadband urban wholesale benchmark the right approach to determine support under a new rate-of-return mechanism, or would another approach be more in keeping with the statute and our prior precedent? How does comparing wholesale urban costs relate to our obligation to ensure that rural retail rates are reasonable? Should such a benchmark be based on the wholesale cost of providing broadband, or another metric? Can wholesale broadband costs be calculated reliably, particularly where wholesale broadband services are not typically offered in urban areas? As an alternative, should the relevant benchmark be set based on the price of comparable retail services in a sample of urban areas?

1040. The Rural Associations' benchmark proposal contemplates a fixed and variable component of the rural benchmark. How should the Commission establish the levels for those components, and should there be a company-specific component of the benchmark? If the benchmark is tied in any manner to NECA tariff rates or another industry metric, does that proposal bear any risks of gamesmanship by carriers to raise or lower individual rates to maximize universal service receipts?

1041. What information would we need to require from carriers in order to evaluate and implement that Rural Association proposal? Prior to implementation, should we, for instance, require carriers to submit analyses showing their broadband adoption trends for service at varying speeds for the last five years in order for us to develop reasonable projections regarding broadband penetration in the future? What information should we obtain regarding their middle mile costs in order to better understand the implications of the proposal to include middle mile costs in support calculations?

1042. How would the proposed "transitional stability plan" mechanism operate? What would be the distributional impact of this proposal in terms of the number of companies that would see increases in support, compared to the number of companies that would see decreases in support?

1043. The Rural Associations propose that incremental broadband build-out commitments would be tied to an individual company's ability to receive incremental CAF support for new investment, subject to prospective capital investment constraints and the budget target adopted by the Commission. If the Commission were to adopt such an approach, what specific metrics or build-out milestones should be established, and what reporting and certifications should be imposed to improve the Commission's ability to enforce such commitments? How should CAF associated with intercarrier compensation reform be incorporated into any rate-of-return CAF mechanism? Would the public interest obligations for CAF associated with intercarrier compensation reform be updated to reflect any new obligations? We seek comment more broadly on how our universal service policies can best accelerate broadband deployment to consumers served by rate-of-return carriers, many of whom reside in rural America. In the long term, should universal service support for rate-of-return carriers be distributed through separate mechanisms from the mechanisms used to distribute support for other types of carriers, or is a uniform national approach preferable to achieve our universal service objectives? We seek comment on any other proposals to transition areas served by rate-of-return carriers to CAF, or any other analysis or recommendations that could facilitate this process.

(Continued from previous page)

C. Interstate Rate of Return Represcription

1044. As explained in the Order, rate-of-return carriers will continue to receive for some time a modified version of their legacy universal service support. The level of support they receive depends, in part, on the interstate rate of return allowed for plant in service. As a result, we concluded it was necessary to evaluate the authorized interstate rate of return for rate-of-return carriers, which has not been updated in over 20 years.[2157] Three major associations representing rate-of-return carriers, as well as the State Members of the Federal-State Joint Board on Universal Service, have proposed a reduction in the current rate of return, which is currently set at 11.25 percent, in the context of overall reform.[2158] We agree that it is appropriate at this time to reexamine the rate of return as part of comprehensive reform of the universal service fund. We seek comment more generally on how this prescription fits within the broader reform framework for rate-of-return carriers, and specifically in what manner this prescription process should be linked to other proposals in this FNPRM, including the separate CAF support mechanism for rate-of-return carriers.[2159]

1045. With respect to the prescription process itself, our statutory authority under section 205 provides "the power to determine and prescribe those elements that make up the charge," including the interstate rate of return.[2160] The rate of return must be high enough to provide confidence in the "financial integrity" of the carrier, so that it can maintain its credit and attract capital.[2161] The return should also be "commensurate with returns on investments in other enterprises having corresponding risks."[2162] On the other hand, "[t]he return should not be higher than necessary for this purpose."[2163]

1046. The Commission last prescribed the authorized interstate rate of return in 1990, reducing it from 12 percent to 11.25 percent.[2164] We believe fundamental changes in the cost of debt and equity since 1990 no longer allow us to conclude that a rate of return of 11.25 percent is necessarily "just and reasonable" as required by section 201(b).[2165] The rate-of-return carrier associations propose a reduction in the interstate rate of return from the current 11.25 percent to 10 percent.[2166] The State Members of the Federal-State Joint Board propose that the rate be reduced further to 8.5 percent.[2167] The State Members highlight that the interest rate on a three month Treasury Bill has fallen from 7.83 percent in 1990 to 0.15

[2157] This prescription will be limited to interstate common line and special access services as the rules adopted in the Order remove switched access services from rate-of-return regulation. *See supra* Section XIII.E.3.

[2158] ABC Plan Joint Letter Attachs. 1, 2; State Members *USF/ICC Transformation NPRM* Comments at 36-37.

[2159] *See supra* Section XVII.B.

[2160] *Nader v. FCC*, 520 F.2d 182, 204 (D.C. Cir. 1975).

[2161] *U.S. v. FCC*, 707 F.2d 610, 612 (D.C. Cir. 1983) (quoting *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)).

[2162] *Illinois Bell Tel. Co. v. FCC*, 988 F.2d 1254, 1260 (D.C. Cir. 1993) (quoting *Hope Natural Gas Co.*, 320 U.S. at 603).

[2163] *U.S. v. FCC*, 707 F.2d at 612 (citing *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968)).

[2164] *1990 Prescription Order*, 5 FCC Rcd at 7532.

[2165] "All charges, practices, classifications, and regulations for an in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful . . . ." 47 U.S.C. § 201(b).

[2166] Letter from Walter B. McCormick, Jr., US Telecom, to Chairman Genachowski, Commissioner Copps, Commissioner McDowell, and Commission Clyburn, WC Docket No. 10-90, at 2 (filed Jul. 29, 2011).

[2167] State Members *USF/ICC Transformation NPRM* Comments at 36-37.

percent in January 2011.[2168] Further, we observe that the average 10-year treasury constant maturity rate has declined from approximately 8.1 percent in January 1991 to approximately 2 percent in September 2011.[2169]

1047. We find compelling evidence that our presently applied interstate rate-of-return, 11.25 percent, is no longer reflective of the cost of capital. We believe updating the rate of return is necessary for rate-of-return carriers to both attract capital on reasonable terms in today's markets and encourage economically sound network investments. We welcome input from state regulators that may have insights from conducting intrastate rate of return represcriptions in recent years. We also invite comment on how the Commission can ensure that the rate of return over time remains consistent with changes in the financial markets and cost of capital. We seek comment on means by which the rate of return can be adjusted automatically based on some set of financial triggers, and how any such triggers would operate.

1048. When it last initiated an interstate rate of return prescription proceeding in 1998, the Commission sought comment on the methods by which it could calculate incumbent LECs' costs of capital.[2170] Today, we seek comment on the issues raised in the *1998 Prescription Notice* generally and ask parties to provide the data responsive to the previous requests. In particular, we seek comment on the following:

1049. *WACC.* Weighted average cost of capital (WACC) identifies the rate of return required to maintain the current value of a firm; alternatively, it is the minimum rate of return the firm needs to offer to investors to maintain access to its current supply of capital. WACC is the key component for prescribing the rate of return. We seek comment on how to calculate the WACC for the relevant companies. We ask whether the formula to determine the WACC in sections 65.301-305 of the Commission's rules is the proper framework for this represcription, and whether any modification or update to the formula or inputs is warranted or necessary.[2171] Specifically, the Commission's rules provide that WACC is the sum of the cost of debt, the cost of preferred stock, and the cost of equity, each weighted by its proportion in the capital structure.[2172] Does this remain the correct approach? Should the Commission augment, or replace, its WACC calculation with any other analysis or approaches? Looking to the WACC calculated for an entire company, rather than for a specific line of business, is appropriate, for example, when thinking about setting an allowed rate-of-return for an entire company. In contrast, this overall WACC would not in general inform a business as to whether to undertake a specific project. Typically, specific projects that have greater risk and therefore a greater cost of capital than the entire company are only undertaken when much higher rates of return are expected. Given that many rate-of-return companies have diversified beyond regulated voice services, for example to offer broadband, video, or wireless services, should the WACC be computed for only the regulated portion of the company's business, or at the level of the entire company? We seek comment on this analysis, and how, if at all, it should impact our rate-of-return calculation, and use of WACC for these purposes.

1050. *Data.* We seek comment on the appropriate data and methodologies the Commission should use to calculate the WACC. We note that some of the formulas in the rules rely on ARMIS data,

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[2168] *See id.* at n.79.

[2169] *See* 10-Year Treasury Constant Maturity Rate (GS10), Federal Reserve Bank of St. Louis, *available at* http://research.stlouisfed.org/fred2/series/GS10 (last visited Oct. 21, 2011).

[2170] *See 1998 Prescription Notice*, 13 FCC Rcd at 20563.

[2171] 47 C.F.R. §§ 65.301-.305.

[2172] 47 C.F.R. § 65.305.

which are no longer collected.[2173] In the absence of ARMIS data, what additional data should the Commission require and rely upon, and who should be required to file the data? Are there other publicly available data that could provide the necessary information? Does the absence of any particular data necessitate a different approach to any of the necessary calculations?

1051. *Capital Structure.* Under the Commission's WACC calculation, the estimated cost of debt, preferred stock, and equity of a company are all weighted relative to their proportion in the firm's capital structure. A firm's capital structure can be measured on a "book" basis or "market" basis. We seek comment on whether the formula in section 65.304 of the Commission's rules based on book values remains the correct approach, and whether any modification to the formula or inputs is warranted or necessary.[2174] Are there other components of the cost of capital that should be included in the capital structure, and should any of the elements listed in the rules be excluded?

1052. *Surrogates.* Because the vast majority of rate-of-return carriers are not publicly traded, the Commission must select an appropriate set of surrogate firms, for which financial data is available publicly, to use as a basis for the cost of capital analysis. To do so, the Commission must select a group of companies for which there is available financial data and that face similar risks to rate-of-return carriers. The Commission's rules provide that the proper group of surrogates is all local exchange carriers with annual revenues equal to or above the indexed revenue threshold, which is $146 million this year.[2175] In the *1998 Prescription Notice* the Commission sought comment on what group of companies should be selected as surrogates and tentatively concluded at that time that the Regional Bell Operating Companies' (RBOCs) risk most closely resembled the risk encountered by the rate-of-return carriers.[2176] We seek comment on whether that group should be used as surrogates here, or whether another group of providers, for example smaller publicly traded carriers, not including the RBOCs, would better serve this purpose. Should the surrogate group include publicly traded rate-of-return companies only, or a mixture of publicly traded rate-of-return companies and smaller price-cap companies? Commenters proposing a particular surrogate group should clearly define that group, identify the publicly available financial data for that group, and explain how that group best reflects the business risks and cost of capital of rate-of-return carriers.

1053. *Cost of Debt.* A firm's cost of debt can be estimated by dividing its total annual interest expense by its average outstanding debt measured on a historic "book" basis, or alternatively, on a "market" basis using the current yield to maturity. We seek comment on the cost of debt formula in section 65.302 of the Commission's rules based on book values.[2177] We have previously noted that the "book" basis is more objectively ascertainable, but may not fully reflect current investor expectations. We seek comment on that assessment, and the relative weight either the "book" or "market" approach should be given in our calculations. The Commission's rules provide that this measurement should occur for the most recent two years.[2178] Is this the correct time period, or is a longer or shorter period warranted?

[2173] *See, e.g., Petition of Qwest Corporation for Forbearance from Enforcement of the Commission's ARMIS and 492A Reporting Requirements Pursuant to 47 U.S.C. § 160(c)*, WC Docket No. 07-204, Memorandum Opinion and Order, 23 FCC Rcd 18483 (2008).

[2174] 47 C.F.R. § 65.304.

[2175] 47 C.F.R. § 65.300.

[2176] *1998 Prescription Notice*, 13 FCC Rcd at 20570-71, paras. 19-20.

[2177] 47 C.F.R. § 65.302.

[2178] 47 C.F.R. § 65.302.

1054. *Cost of Preferred Stock.* A firm's cost of preferred stock can be calculated by dividing the total annual preferred dividends by the total proceeds from the issuance of preferred stock. We ask whether the formula in section 65.303 of the Commission's rules remains the correct one, and whether any modification to the formula or inputs is warranted or necessary. The Commission's rules provide that this measurement should occur for the most recent two years.[2179] Is this the correct time period, or is a longer or shorter period warranted?[2180] Can the WACC calculation be simplified by ignoring the cost of preferred stock (and the amount of preferred stock in the capital structure) without significantly affecting the accuracy of the WACC?

1055. *Cost of Equity.* A firm's cost of equity can be estimated using a number of different approaches. The Commission's rules do not provide a specific formula for determining the cost of equity. In 1990, the Commission relied heavily on the discounted cash flow (DCF) methodology, which assesses a firm's stock price and dividend rate and forecasted growth rates to determine the cost of equity.[2181] There are a number of different variations of DCF, including historic and classic calculations.[2182] Alternatively, a firm's cost of equity can be calculated using the capital asset pricing model (CAPM).[2183] To use the CAPM, estimates of the risk free rate, the market risk premium, and the correlation of surrogate companies' common stock returns with the returns of the entire market of securities (or "betas") must be made. We seek comment on these approaches, and ask whether any other methodologies should be incorporated into our analysis. For instance, should we rely upon any cost of equity calculations made in state proceedings addressing intrastate rate of return, or other benchmarks based on the stock market as a whole, or a subset of companies or industries? Proponents of any particular methodology should detail their preferred approach and the relevant data required to perform the necessary calculations. Commenters should also justify the relative weight any particular methodology or comparison should have in our ultimate calculation. We also seek comment on the need, if any, to make adjustments with respect to flotation costs (i.e., costs of selling new securities in the market) or dividends.

1056. *Zone of Reasonableness.* The cost of equity, based on different methodologies and sets of reasonable assumptions and input values, as well as the WACC calculation using the inputs described above, can be used to develop a range from which the Commission can prescribe the new authorized interstate rate of return. This "zone of reasonableness" allows the Commission to take into account additional policy considerations before finalizing the new rate of return.[2184] We seek comment on the factors the Commission should consider in determining the rate of return from within that "zone of reasonableness." We ask how infrastructure deployment, particularly broadband deployment, and today's reforms should be accounted for in our analysis. Is the deployment of broadband significantly more risky than the voice telephony business, and does it have a significantly greater cost of capital? We note, for instance, that voice telephony has nearly universal penetration, while broadband adoption is more than 65 percent nationally. If some or all of the surrogates on which the WACC estimates are based are large companies such as Verizon and AT&T, should unique competitive and market conditions for rate-of-return carriers be reflected, and should any differences in diversification in rate-of-return carrier offerings compared to large carrier offerings, which now may include voice, video, wireless, and data services, be reflected, if at all? Should any allowances made in 1990, or proposed in 1998, apply here? We also seek

[2179] 47 C.F.R. § 65.303.

[2180] 47 C.F.R. § 65.303.

[2181] *See 1990 Prescription Order*, 5 FCC Rcd at 7508, para. 9.

[2182] *1998 Prescription Notice*, 13 FCC Rcd at 20573-75, paras. 26-30.

[2183] *1998 Prescription Notice*, 13 FCC Rcd at 20576, para. 33.

[2184] *1998 Prescription Notice*, 13 FCC Rcd at 20578-80, paras. 39-42.

comment on the need to make any adjustments to capture changes in the telecommunications market generally, and ask commenters proposing any such adjustments to explain why they are necessary to prescribe the allowable rate of return for multi-use plant that can provide voice, data, video and other services, in particular, and how any such adjustments should be structured. Lastly, we ask whether any of these policy considerations should also be reflected in any other components of the WACC calculation, and, if so, in what manner.

1057. *Preliminary Analysis.* We estimate, using recent public data, the WACC for AT&T and Verizon and find it in the range of 6 to 8 percent.[2185] This range is consistent with other analysts' estimates.[2186] We find a similar range when considering other mid-size and competitive carriers.[2187] Even if the interest rate were to increase by 1.5 percent,[2188] which seems unlikely in today's economy,[2189] the WACC would remain in the range of approximately 7 to 8 percent. This preliminary analysis would conservatively suggest that the authorized interstate rate of return should be no more than 9 percent. We seek comment on this analysis and note that this preliminary analysis does not prejudge the Commission's ability to select a higher or lower rate of return in this proceeding.

1058. *Impact on Universal Service Funding.* We propose that any reduction in the rate of return be reflected in our universal service rules by reducing the HCLS cap by a corresponding amount, and repurposing that funding amount consistent with the CAF framework and budget adopted today. We also propose that ICLS support be reduced by a corresponding amount as well. We seek comment on these proposals and how to calculate any such reductions. We seek comment on whether any savings realized from reducing the rate of return should be used to establish a new CAF mechanism for rate of return companies that would support new broadband investment. How would a change in the rate of return impact the Rural Association's CAF proposal discussed in this FNPRM, and does this prescription process impact the timing or operation of that proposal or any other transition of rate-of-return carriers to CAF-based support?[2190] In the alternative, we seek comment on the potential benefits of retaining the HCLS cap at the same amount even if the rate of return is reduced, which would have the effect of allowing funding to be redistributed to lower cost rate-of-return carriers that are ineligible for HCLS support today. Are there any other changes to other universal service distribution mechanisms that should be made to reflect a change to the rate of return?

1059. *Tribally-Owned and Operated Carriers.* We seek comment on how to account for Tribally-owned and operated carriers in this prescription, and whether a different rate of return is warranted for these carriers. Tribal governments, and by extension, Tribally-owned and operated carriers,

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[2185] AT&T, 2010 Annual Report, *available at* http://www.att.com/gen/investor-relations?pid=19234; Verizon, 2010 Annual Report, *available at* http://www22.verizon.com/investor/app_resources/interactiveannual/2010/index.html.

[2186] *See, e.g.*, Bernstein Research— US TELECOMMUNICATIONS AND CABLE & SATELLITE: CAPITAL PUNISHMENT, (December 2010 and May 25, 2011).

[2187] *See, e.g.*, Windstream 2011 Annual Report, *available at* http://investors.windstream.com/drip.aspx?iid=4121400 (visited Oct. 6, 2011); Frontier 2010 Annual Report, *available at* http://corporate.frontier.com/default.aspx?m=4&p=4 (visited Oct. 6, 2011); TDS 2010 Annual Report, *available at* http://media.corporate-ir.net/media_files/irol/67/67422/tds2010AR/index.html (visited Oct. 25, 2011); Cincinnati Bell 2010 Annual Report, *available at* http://investor.cincinnatibell.com/phoenix.zhtml?c=111332&p=irol-reportsAnnual (visited Oct. 25, 2011).

[2188] McKinsey and Company, *Farewell to cheap capital?*, 6-8 (December 2010).

[2189] *See* Binyamin Appelbaum, *Its Forecast Dim, Fed Vows to Keep Rates Near Zero,"* N.Y. Times (August 9, 2011).

[2190] *See supra* Section XVII.B.

play a vital role in serving the needs and interests of their local communities, often in remote, low-income, and underserved regions of the country.[2191] Tribally-owned and operated carriers serve cyclically impoverished communities with a historical lack of critical infrastructure. Reservation-based economies lack fundamental similarities to non-reservation economies and are among the most impoverished economies in the country. Tribal Nations also cannot collateralize trust land assets, and as a result, have more limited abilities to access credit and capital. We seek comment on how such considerations should be reflected in our analysis.

1060. *Other Considerations.* Finally, we ask commenters to address any other changes that are needed to: (1) the data used in the prescription process; or (2) the calculations the Commission must perform to prescribe a new interstate rate of return. We also invite commenters to provide any other relevant evidence or studies that could assist in this represcription.

D. Eliminating Support for Areas with an Unsubsidized Competitor

1061. In the Order above, we conclude that we will phase out all high-cost support received by incumbent rate-of-return carriers over three years in study areas where an unsubsidized competitor, or combination of unsubsidized competitors, offering voice and broadband service that meets our performance obligations serves 100 percent of the residential and business locations in the incumbent's study area.[2192] In this FNPRM, we seek comment on a proposed methodology for determining the extent of overlap, a process for preliminary determinations of such overlap, a process for the affected ETC to challenge the accuracy of the purported overlap, with input from the relevant state commission and the public, and how to adjust support levels in situations with less than 100 percent overlap.[2193]

1062. To determine what rate-of-return study areas have 100 percent overlap by an unsubsidized competitor, staff performed a preliminary analysis as described below. The analysis relies on two sets of data: TeleAtlas Wire Center Boundaries (6/2010) and data from the State Broadband Initiative (SBI) program administered by NTIA as of December, 2010.[2194]

1063. First, staff identified which census blocks are in each rate-of-return study area, including a census block in a study area if the centroid of that census block is within the TeleAtlas boundaries for a wire center associated with the study area. Next, staff identified study areas where a wired provider other than the incumbent local exchange carrier offered broadband service at speeds of at least 3 Mbps

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[2191] *See Telecommunications Carriers Eligible for Universal Service Support; Standing Rock Telecommunications, Inc. Petition for Designation as an Eligible Telecommunications Carrier; Petition of Standing Rock Telecommunications, Inc. to Redefine Rural Service Areas; Petition for Reconsideration of Standing Rock Telecommunications, Inc.'s Designation as an Eligible Telecommunications Carrier on the Standing Rock Sioux Reservation* , WC Docket No. 09-197, Memorandum Opinion and Order on Reconsideration, 26 FCC Rcd 9160, 9161 (2011) (*Standing Rock Final ETC Designation Order*).

[2192] As discussed above, for purposes of this requirement, broadband service at speeds of at least 3 Mbps downstream/768 kbps upstream, with capacity limits (if any) that are comparable to residential fixed broadband offerings in urban areas, represents a reasonable proxy. *See supra* para. 103.

[2193] We previously sought comment on proposals to utilize a challenge process to identify areas overlapped by unsubsidized facilities-based competitors. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4674, para. 391; *Aug. 3rd Public Notice*, 26 FCC Rcd at 11117-11118.

[2194] *See* National Broadband Map, Download Data, *available at* http://www.broadbandmap.gov/data-download. All analysis was conducted using 2000 census geographies.

downstream/768 kbps upstream to all of the census blocks in the study area. Staff excluded all resellers as identified in the SBI data and included only xDSL, cable, and fiber technologies.[2195]

1064. We seek comment on whether this is an appropriate methodology for determining areas of overlap, which will result in adjustments to support levels for the rate-of-return ETC.

1065. As summarized in Figure 12 below, using this methodology, staff performed a preliminary analysis examining census blocks smaller than two square miles and identified 18 rate-of-return study areas with 99 percent or greater overlap; and an additional 19 with greater than 95 percent overlap (a total of 37 study areas with greater than 95 percent overlap).[2196]

Percent overlap	**Number of study areas**	**Annual support (2010)**	**Number of lines supported (2010)***
≥ 99%	18	$17.0 million	54,952
At least 95% and less than 99%	19	$16.7 million	71,794
At least 80% and less than 95%	51	$98.5 million	511,912

* Maximum number of lines supported by any high-cost universal service mechanism in 2010.

Figure 12

1066. This analysis has several potential limitations. TeleAtlas data may not represent the actual incumbent local exchange carrier footprint in all instances.[2197] In addition, TeleAtlas data generally assign all geographies to one incumbent provider's footprint or another; however, in reality, there are large, generally unpopulated areas not served by any incumbent carrier facilities. As such, this analysis may over-estimate the rate-of-return ETC's footprint and under-estimate the extent to which the populated portions of that footprint are completely overbuilt by competitive networks.

1067. SBI data have their limitations as well, as we acknowledged in our most recent Broadband Progress Report.[2198] In addition, SBI data only measure the availability of broadband capable of delivering at least 768 kbps downstream and 200 kbps upstream. There is no direct measure of the availability of voice service, but we presume that an unsubsidized xDSL, fiber, or cable competitor that has deployed a broadband network that meets the SBI standard also is offering voice services.

[2195] Specifically, staff used technology codes 10, 20, 40, 41, and 50 from the SBI data submission, excluding 30 to reduce the possibility that the competitor would be a business-focused competitive LEC.

[2196] Staff examined blocks smaller than two square miles because of the treatment of such small blocks in SBI data. Small blocks are characterized as either having service at a given speed with a given technology or not. The Commission has noted challenges with this binary treatment of small blocks and taken a lack of reporting about a block as an indication that the block lacks service. *See Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, as Amended by the Broadband Data Improvement Act*, GN Docket No. 10-159, Seventh Broadband Progress Report and Order on Reconsideration, 26 FCC Rcd 8008, 8082-83, App. F. at paras. 9-13 (2011) (*Seventh 706 Report*). Reporting for larger blocks is more complex, incorporating address- and street-segment level reporting. *See id.* at App. F, n.35.

[2197] *See, e.g.*, Letter from David Cosson, Counsel to Accipiter Communications Inc. to Marlene H. Dortch, Secretary, FCC, CC Docket. No. 96-45, App. A (filed Mar. 11, 2011).

[2198] *See, e.g.*, *Seventh 706 Report*, 26 FCC Rcd at 8081-85, App. F (2011)

1068. We note that small blocks could be reported as served if as few as one location in that block has service or could have service within a typical service interval.[2199] We seek comment on whether this could lead us to count areas as served by an unsubsidized competitor even if a meaningful number of locations are, in fact, not served.

1069. We seek comment on how best to deal with data relating to large blocks. Since neither NTIA nor the Commission has access to the actual location of businesses or homes, SBI population estimates data relies on estimating home locations by random placement of locations along roads. While this will provide an accurate view of the fraction of large blocks that are served in aggregate, it will likely lead to over- or under-estimates in any small number of some large blocks. How can the Commission use such data to determine whether a large block is served or not?

1070. As stated in the Order, after receiving further public input on the proposed methodology, the Wireline Competition Bureau will publish a finalized methodology for determining areas of overlap. Using the methodology chosen, the Wireline Competition Bureau will then publish a list of companies for which there is a 100 percent overlap.[2200]

1071. We seek comment on a process for identifying areas with greater than 75 percent overlap. We propose that the Wireline Competition Bureau identify areas with greater than 75 percent overlap, utilizing the finalized methodology, and then publish the results of that analysis. We propose that the Bureau provide the affected ETC an opportunity to challenge the accuracy of the purported overlap and to take public comment for a period of time, such as 45 days. We seek comment on this proposal.

1072. Several commenters supported state involvement in a process to determine areas of overlap.[2201] How could state commissions play a role in determining the extent of overlap? For instance, after the Bureau performs the overlap analysis, should there be a period of time for the relevant state commission to comment on the analysis? What would be a reasonable time frame to request an evaluation from a state commission regarding such overlap? Alternatively, could we establish a process in which state commissions advise us, by a date certain, which study areas served by rate-of-return carriers have unsubsidized facilities-based competitors, and therefore should be subject to potential adjustments in high-cost support?

1073. We also seek comment on whether support levels would need to be adjusted in areas where there is less than 100 percent overlap by an unsubsidized facilities-based provider of terrestrial fixed voice and broadband service. To the extent support levels do need to be adjusted, we seek further comment on how to do so.

1074. In the *Aug. 3rd Public Notice*, we sought comment on how to allocate costs between the overlap areas and the ILEC-only areas, including whether we should use a cost model to accomplish that allocation.

1075. In response to the *Aug. 3rd Public Notice*, NCTA recommended that "the Commission should identify study areas served by rate-of-return regulated incumbent LECs where (1) unsubsidized broadband providers serve more than 75 percent of homes; and (2) current high-cost support exceeds projected support under the cost model for the remaining areas by more than 10 percent. During the

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[2199] Department of Commerce, NTIA, State Broadband Data and Development Grant Program, Docket No. 0660-ZA29, Notice of Funds Availability, 74 Fed. Reg. 32545, 32548 (July 8, 2009) (*NTIA State Mapping NOFA*), *available at* http://www.ntia.doc.gov/frnotices/2009/FR_BroadbandMappingNOFA_090708.pdf.

[2200] *See supra* para. 284.

[2201] *See*, *e.g.*, NASUCA *August 3 PN* Comments at 90; New York PSC *August 3 PN* Comments at 7; Missouri PSC *August 3 PN* Comments at 7, n.10.

interim period, in any study area that meets those criteria, the Commission should provide notice to the carrier that support will be reduced to the level suggested by the cost model unless it can demonstrate that a higher amount is necessary."[2202] We seek comment on this proposal.

1076. We note that in the Order, we are directing the Wireline Competition Bureau to develop and finalize a cost model for use in price cap territories. Would it be appropriate to use such a model, after appropriate public input, in the way described by NCTA to create a presumptive reduction in support levels for rate-of-return carriers? For purposes of determining whether model-determined support in the "remaining areas" (*i.e.*, the areas of no overlap) exceeded current support by more than 10 percent, would we need to allocate the current high-cost support between the areas of overlap and the areas where there is no overlap? To the extent that support would need to be allocated between areas of overlap and no overlap, what criteria or standards would govern any such allocation? Should there be a rebuttable presumption that all costs are divided pro rata among access lines, and allocated to the census block in which that access line is located, so that absent an appropriate showing the recipient would receive the same support amounts per line, but only for those lines that fall outside the area of overlap? Cablevision suggests that only costs solely attributable to the non-competitive area should be supported, and that most of the costs of overhead (which presumably are largely associated with customers in the areas where there is competitive overlap) should not be recoverable.[2203] Would that be a workable approach? How should the Commission allocate costs associated with cable and wire facilities, and central office equipment, between competitive and non-competitive areas?

1077. NCTA suggests that there be a process in which a carrier subject to reductions could demonstrate that a higher amount is necessary. Should reductions commence within a specified time period, such as 120 days, absent a showing that additional support is necessary? What process should be established for rate-of-return carriers subject to potential support adjustments to contest any such adjustments? For instance, should they be required to show that the adjusted levels would be inadequate to continue to provide voice service to consumers, for example, using the criteria we set forth above for petitions for waiver? Should we undertake a total company earnings review in those circumstances? Should we seek input from the relevant state commission on whether support amounts should be adjusted, and how that would impact consumers in the relevant communities?

1078. If we were to adopt any of these proposals to adjust support levels, over what time period should support levels be transitioned to new levels in situations where there is less than 100 percent overlap?

E. Limits on Reimbursable Capital and Operating Costs for Rate-of-Return Carriers

1079. In the Order, we adopt a rule to use benchmarks for reasonable costs to impose limits on reimbursable capital and operating costs for high-cost loop support received by rate-of-return companies. A specific methodology for calculating individual company caps for HCLS is set forth in Appendix H. We seek comment on using this methodology to impose limits on reimbursement from HCLS and propose to implement this methodology for support calculations beginning July 1, 2012.

1080. As described in more detail in Appendix H, the methodology uses quantile regression analyses to generate a set of limits for each rate-of-return cost company study area. These would limit the values used in eleven of the twenty-six steps in NECA's Cost Company Loop Cost Algorithm, which is

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[2202] NCTA *August 3 PN* Comments at 12, Attach. at 10. *See also* Time Warner Cable *August 3 PN* Comments at 25.

[2203] Letter from Howard J. Symons, Counsel to Cablevision, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al. (filed Oct. 12, 2011).

used to calculate the study area's total unseparated cost per loop, and ultimately its HCLS.[2204] The regression-derived limits are set at the 90th percentile of costs for each individual step in NECA's Cost Company Loop Cost Algorithm, compared to similarly situated companies for each individual step. In other words, a company whose actual costs for a particular step in the algorithm are above the 90th percentile, compared to similarly situated companies, would be limited to recovering amounts that correspond to the 90th percentile of cost, i.e. the amount of cost that ninety percent of similarly situated companies are at or below when they submit costs for that particular step in the algorithm.[2205] We seek comment on whether the 90th percentile is the appropriate dividing line to disallow recovery of cost, or whether we should establish a lower or higher threshold, such as the 85th percentile or the 95th percentile.

1081. For the dependent variable in the regression analysis, Commission staff limited its analysis to cost data filed by rural rate-of-return companies that submit cost data, and excluded cost data filed by price cap carriers.[2206] For the independent variables, staff used 2010 block-level Census data that it mapped to each study area.[2207] The independent variables included: number of loops, number of housing units (broken out by whether the housing units are in urbanized areas, urbanized clusters, and nonurban areas), as well as several geographic measures such as land area, water area, and the number of census blocks (all broken out by urbanized areas, urbanized clusters, and nonurban areas). The analysis thereby recognizes that many smaller study areas (those with lower populations to serve) and more rural geographies (those with lower population densities) legitimately have higher costs per line (*i.e.*, compared to the national average cost per loop) than larger study areas that contain significant urban populations.

1082. As explained more fully in Appendix H, quantile regression has several advantages over other statistical techniques for identifying outliers. For example, quantile regression estimates the median (or other percentile), rather than the mean, so quantile regression will be more robust in response to large outliers than ordinary least squares regression. Although we find that quantile regression is an appropriate technique to use in setting benchmarks on reimbursable investment and expenses, we invite further comment on alternative statistical techniques.

1083. This methodology utilized variables that are currently available to the Commission. We acknowledge that in their analysis using proprietary cost data, the Nebraska Companies also included

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[2204] *See* National Exchange Carrier Assoc., Inc., NECA's Overview of Universal Service Fund, Submission of 2010 Study Results, at App. B (filed Sept. 30, 2011) (NECA 2010 USF Overview), *available at* http://transition.fcc.gov/wcb/iatd/neca.html; 47 C.F.R. §§ 36.621, 36.631.

[2205] The "costs" in each step of the NECA algorithm are based on the costs in various categories that the cost companies report to NECA, but some of the steps calculate intermediate values that are used in subsequent steps of the algorithm. *See* Appendix H.

[2206] Rate-of-return study areas affiliated with price cap carriers were excluded because support in those study areas will be frozen at 2011 levels in Phase I CAF and transitioned to Phase II CAF. *See supra* para. 133. Also excluded were the exchanges that were acquired by other carrier study areas. Pursuant to section 54.305 of the Commission's rules, the acquiring carrier receives support for the acquired exchanges at the same per-loop support as calculated at the time of transfer. *See* 47 C.F.R. § 54.305. Rural carriers who incorporate acquired exchanges into an existing study area are required to provide separately the cost data for the acquired exchanges and the pre-acquisition study area. *See* NECA 2010 USF Overview, at 5, App. F, http://transition.fcc.gov/wcb/iatd/neca.html. The Commission does not have readily available data allowing it to separate these exchanges out from the acquiring exchange, but should be able to do so when running the final analysis. Because of the stable nature of the regression analysis used, staff expects the inclusion of these additional exchanges to have only a small effect on the regression coefficients and therefore on the limits created by the analysis.

[2207] 2010 United States Census Data, http://www2.census.gov/census_2010/01-Redistricting_File--PL_94-171/ and documentation at http://www.census.gov/prod/cen2010/doc/pl94-171.pdf; Study Area Boundaries: Tele Atlas Telecommunications Suite, June 2010.

variables for frost index, wetlands percentage, soils texture, and road intersections frequency. As noted in the Order, the soils data from the Natural Resource Conservation Service (NRCS) that the Nebraska study used do not cover all the study areas used in our regressions.[2208] We seek comment on sources of other soil data that completely cover all the study areas or how to deal with those study areas where the SSURGO data are missing or incomplete. To the extent any commenter advocates use of a methodology that includes additional independent variables, they should identify with specificity the data source and the completeness and cost of the additional data, if not publicly available.

1084. The methodology described in the Appendix establishes limits on recovery from the HCLS mechanism for study areas for which costs in any of the NECA algorithm steps are limited. In the Order, we conclude that support will be redistributed to those carriers whose unseparated loop cost is not limited by operation of the benchmark methodology.[2209] Based on 2010 NECA data filed with the Commission, we estimate this proposed methodology would reduce HCLS payments to about 280 rural rate-of-return cost study areas by an estimated $110 million, with approximately $55 million redistributed to approximately 340 cost company study areas whose unseparated loop cost is not limited by operation of the benchmark methodology.[2210] We thus estimate that more study areas could see increases in HCLS than would see decreases.

1085. In the Order, we conclude that we should also limit recovery of excessive capital and operating costs through the interstate common line support mechanism. In this FNPRM, we seek comment on how specifically to implement such a limit for ICLS.

1086. Interstate common line support is calculated as the residual amount of a rate-of-return carrier's interstate common line revenue requirement minus SLCs and other miscellaneous interstate revenues.[2211] Part 69 of the Commission's rules details how carriers are to apportion net investment and expenses in various cost categories for purpose of determining their annual interstate revenue requirements and requires participants in NECA pools and tariffs to file cost data with NECA, but unlike the Part 36 rules, does not require NECA to submit those data to the Commission.[2212] To calculate ICLS, USAC receives only a total interstate revenue requirement amount and the interstate revenue amounts for each ICLS recipient. Although the Commission currently does not receive detailed cost data for determining ICLS, we believe the best approach for calculating benchmarks to limit reimbursable capital and operating costs for ICLS would be to use a methodology similar to the one developed for HCLS, and seek comment on this proposal. As discussed above, we modify our rules to require NECA to provide to the Commission upon request underlying data collected from ETCs to calculate payments under the

[2208] *See supra* para. 217 and note 349. These data, called the Soil Survey Geographic Database or SSURGO, do not cover about 24 percent of the United States land mass, including Puerto Rico, Guam, American Samoa, US Virgin Islands and Northern Mariana Islands as well as Alaska which accounts for much of the missing land area. Thus, there are some study areas where there is no SSURGO data (such as the study area served by Adak Tel Utility) and other study areas where the SSURGO data not cover the entire study area.

[2209] *See supra* para. 220.

[2210] For purposes of this analysis, we estimate the national average cost per loop for purposes of redistributing support to those carriers not affected by the benchmarks to be approximately $455. This estimate does not take into consideration the impact on the national average cost per loop of other rule changes that we adopt in this Order, such as the removal of price cap-affiliated study areas from HCLS and the updated corporate operations expense limitation formula. Both of these other changes to HCLS will also affect the distribution of HCLS, making it difficult, at this time, to estimate the combined impact of the proposed benchmark methodology and these other changes. Therefore, the actual redistribution among carriers that continue to receive HCLS may vary.

[2211] *See* 47 C.F.R. §54.901(a).

[2212] *Compare* 47 C.F.R. §§ 69.301-69.310, 69.401-69.415, 69.605, *with* 47 C.F.R. §§ 36.611-36.612.

current support mechanisms, including ICLS.[2213] In the Order, we direct NECA to file the detailed revenue requirement data it receives from carriers no later than thirty days after release of the Order so that the Wireline Competition Bureau can evaluate whether it should adopt a methodology using these data.

1087. In the alternative, we seek comment on two other alternatives that would not use the detailed revenue data from NECA or require carriers to file additional data. First, we could run a single regression using the total interstate revenue requirement for each carrier, but this approach does not distinguish between capital and operating costs. Second, we could use the decrease in cost per loop resulting from the regressions used to limit HCLS to limit a carrier's interstate revenue requirement. While we recognize that there are some differences between the costs used to calculate unseparated loop costs and the common line revenue requirement, and between loops and access lines, we seek comment on whether they are equivalent enough for purposes of establishing benchmarks for reasonable costs.

1088. We seek comment generally on whether network operation and investment by Tribally-owned and operated carriers is significantly different from non-Tribal conditions to warrant special treatment for purposes of establishing benchmarks for permissible capital and operating costs. We seek comment above on whether the 90th percentile is the appropriate dividing line to disallow recovery of costs, or whether we should establish a lower or higher threshold, such as the 85th percentile or the 95th percentile. We seek comment here on whether a different percentile is appropriate for Tribally-owned and operated carriers, or whether we should otherwise alter the methodology to take into account the unique circumstances of Tribally-owned and operated carriers that are just beginning to serve their communities.

F. ETC Service Obligations

1089. The Connect America Fund will target funding to areas where federal support is needed to maintain and expand modern networks capable of delivering broadband and voice services where people live, work, and travel. In this section, we seek comment on what Commission action may be appropriate to adjust ETCs' existing service obligations as funding shifts to these new, more targeted mechanisms. We aim to ensure that obligations and funding are appropriately matched, while avoiding consumer disruption in access to communications services.

1090. Under section 214 of the Act, the states possess primary authority for designating ETCs and setting their "service area[s],"[2214] although the Commission may step in to the extent state commissions lack jurisdiction.[2215] Section 214(e)(1) provides that once designated, ETCs "shall be eligible to receive universal service support in accordance with section 254 and shall, throughout the service area for which the designation is received . . . offer the services that are supported by Federal universal service support mechanisms under section 254(c)." Although we require providers to offer broadband service as a condition of universal service support, under the legal framework we adopt today, the "services" referred to in section 254(e)(1) means voice service, either landline or mobile.

1091. The Act and the Commission's rules define the term "service area" and how it is established for each ETC. An ETC's "service area" is a geographic area within which an ETC has

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[2213] *See supra* para. 225 (requiring NECA to provide data to the extent USAC does not directly receive such data from carriers).

[2214] 47 U.S.C. § 214(e)(2)–(3). The term "service area" means "a geographic area established by a State commission (or the Commission under section 214(e)(6)) for the purpose of determining universal service obligations and support mechanisms." 47 U.S.C. § 214(e)(5).

[2215] 47 U.S.C. § 214(e)(6).

universal service obligations and may receive universal service support.[2216] Although a carrier seeking to become an ETC usually requests designation in a specific service area, it is the commission designating that carrier—not the ETC itself—that establishes an ETC's service area.[2217] Nothing in the statute precludes the redefinition of an existing service area, however, for either an incumbent ETC or a competitive ETC at a later date.

1092. The Act defines the service area of each rural telephone company to be that "company's 'study area' unless and until the Commission and the States, after taking into account recommendations of a Federal-State Joint Board . . . establish a different definition of service area for such company."[2218] When it originally implemented the 1996 Act, acting on the recommendations of the Joint Board, the Commission interpreted this language to mean that "neither the Commission nor the states may act alone to alter the definition of service areas served by rural carriers."[2219]

1093. In reviewing a potential redefinition of a rural service area when evaluating a request for ETC designation by a competitive ETC, the Commission and the states have traditionally taken into account the three factors recommended by the Joint Board: creamskimming, the Act's special treatment of rural telephone companies, and the administrative burdens of redefinition.[2220] The Commission's rules set forth the procedures for considering redefinition petitions and allow either the state commission or the Commission to propose to redefine a rural telephone company's service area.[2221] A proposed redefinition, however, does not take effect until the Commission and the appropriate state commission agree upon a new definition.[2222]

1094. Relinquishment of ETC status is governed by section 214(e)(4) of the Act. That provision directs states (or the Commission, for federally designated ETCs) to "permit an eligible telecommunications carrier to relinquish its designation as such a carrier in any area served by more than one eligible telecommunications carrier."[2223]

1095. Under the new funding mechanisms established in the Order and proposed in the FNPRM, ETCs may receive reduced support in their existing service areas, and ultimately may no longer receive any federal high-cost support. We seek comment on whether such reductions should be accompanied by relaxation of those carriers' section 214(e)(1) voice service obligations in some cases. For example, under the CAF Phase II process, an incumbent LEC that declines to undertake a state-level service commitment may lose some or all of its ongoing support in that state. Similarly, we will gradually phase out all high-cost support received by incumbent rate-of-return carriers in study areas

[2216] *See* 47 U.S.C. § 214(e)(5); 47 C.F.R. § 54.207(a).

[2217] *See* 47 U.S.C. § 214(e)(5); 47 C.F.R. § 54.207(a).

[2218] 47 U.S.C. § 214(e)(5); *see also* 47 C.F.R. § 54.207(b); 47 U.S.C. § 153(44) (defining "rural telephone company").

[2219] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8880, para. 187 (1997) (*Universal Service First Report and Order*) (subsequent history omitted).

[2220] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Recommended Decision, 12 FCC Rcd 87, 179–80, paras. 172–74 (1996) (*1996 Recommended Decision*); *see also Highland Cellular Order,* 19 FCC Rcd at 6426, para. 9. A carrier "cream-skims" when it serves only those consumers that are least expensive to serve. *See Universal Service First Report and Order,* 12 FCC Rcd at 8881–82, para. 189.

[2221] 47 C.F.R. § 54.207(c), (d).

[2222] 47 C.F.R. § 54.207(c)(3), (d)(2).

[2223] 47 U.S.C. § 214(e)(4).

where an unsubsidized competitor – or a combination of unsubsidized competitors – offers voice and broadband service that meets the performance requirements for 100 percent of the residential and business locations in the incumbent's study area. Likewise, competitive ETCs that today receive support under the identical support rule will see funding in their existing service areas phased down over time as set forth in the Order, although those ETCs will be eligible for targeted funding to extend advanced mobile services through the Mobility Fund Phase I and Phase II. Some commenters have proposed that as these reductions occur, the Commission should relax or eliminate ETCs' voice service obligations.[2224] We seek comment on this suggestion.

1096. In addition, even in service areas where ETCs retain existing support levels or receive greater funding under the Connect America Fund, that funding will increasingly be targeted at the census block level, or to other precisely defined geographic areas. For example, in the Order, we direct the Wireline Competition Bureau to develop a cost model to estimate on a granular level, such as the census block, the amount of support necessary for deployment of a broadband-capable wireline network in high-cost areas above a specified threshold, and to use the output of that model to calculate the support that incumbent price cap companies would receive if they undertake state-level broadband service commitments. These price cap ETCs will still be subject to section 214(e)(1) voice service obligations, however, and the model-derived support amount will not include a separate estimate of support for the cost of providing voice service to locations below the specified threshold or those locations that will receive funding from the Remote Areas Fund. Likewise, competitive ETCs that bid for Phase I Mobility Fund support will be required to offer advanced mobile service in specific unserved census areas, but their state or federally-defined service territory may be substantially larger than their bid areas. We seek comment on whether, in situations such as these, some adjustment in affected ETCs' section 214(e)(1) obligation to offer service "throughout [their] service area" may be appropriate. Alternatively, we seek comment on whether we should adopt a federal framework for the process to be used in redefining service areas, by the states or this Commission, as appropriate. What specific modifications to section 54.207 of our rules would be appropriate? Should there be uniform procedures for service area redefinition for ETCs that are incumbent carriers, regardless of whether the incumbent is classified as a rural carrier or a non-rural carrier in a particular study area?

1097. We propose that existing ETC relinquishment and service area redefinition procedures, backstopped by the availability of forbearance from federal requirements, provide an appropriate case-by-case framework in which to address these issues in the near term, but we also seek comment on other approaches. To the extent that carriers find that the ETC relinquishment and service area redefinition procedures prove insufficient, we propose that case-by-case federal forbearance would provide an appropriate remedy in the near term, as the Commission gains experience under the new universal service mechanisms established in the Order. Under section 10 of the Act, the Commission must "forbear from applying any regulation or any provision of [the] Act to a telecommunications carrier . . . in any or some of its or their geographic markets," if we find that three conditions are met. As applicable here, these conditions are: "(1) such regulation or provision is not necessary to ensure that the charges [or] practices . . . for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable . . . [;] (2) enforcement of such regulation or provision is not necessary for the protection of consumers; and (3) forbearance from applying such provision or regulation is consistent with the public interest."[2225] The Commission has forborne from the section 214(e)(1) requirement that ETCs offer

[2224] Comments of US Telecom Association, GN Docket No. 09-51 et al., at 17 (filed July 12, 2010); ABC Plan Joint Letter, Attach. 1 at 13; Letter from Heather Zachary, Counsel to AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al., at 2-3 (filed Oct. 19, 2011); Letter from Kathleen Grillo, Verizon, , to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al. (filed Sept. 16, 2011); *but see* Letter from Regina Costa, NASUCA, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 10-90 et al., at 3 (filed Oct. 3, 2011).

[2225] 47 U.S.C. § 160(a).