BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Re: FCC Intercarrier Compensation - Workshop and Solicitation of Comments on the Missoula Plan	)))	Docket No. M-00061972

COMMENTS OF VERIZON AND VERIZON WIRELESS

I. INTRODUCTION AND SUMMARY

Pursuant to the Commission's August 23, 2006 Notice and September 1, 2006 Secretarial Letter, Verizon[1] and Verizon Wireless (hereinafter "Verizon") provide the following comments concerning the Missoula Plan ("Missoula" or the "Plan") filed on July 17, 2006 by certain parties at the Federal Communications Commission ("FCC") in CC Docket No. 01-92.[2]

By Order entered August 23, 2006, this Commission sought input from members of the telecommunications industry and others to "assist the Commission in formulating" its own written comments to be filed with the FCC on the Missoula Plan. In response to this request, Verizon submits these comments to outline the fundamental flaws and substantial shortcomings of the Missoula Plan. If the Commission chooses to file comments with the FCC on this matter, then it should be fully aware of these problems and should not support the Missoula Plan in its current form. Instead, it should urge the FCC to carefully examine these issues and to adopt a plan that will achieve fair and meaningful reform of intercarrier compensation – which the Missoula Plan will not do.

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1 "Verizon" includes ILECs Verizon Pennsylvania Inc. and Verizon North Inc., CLEC MCImetro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services, and IXCs MCI Communications Services Inc., and Verizon Select Services Inc.

2 As requested in the Notice, Verizon's contact person responsible for these comments is Leigh Hyer, 1717 Arch Street, Philadelphia, Pennsylvania, 19103, Leigh.A.Hyer@verizon.com, (215) 466-6070. Verizon will have additional representatives present at the Workshop to address Staff's questions concerning these comments.

While the Missoula Plan has some positive aspects, such as some unification of rates and rate structures, its flaws far outweigh these few benefits and are too numerous and substantial for it to be implemented by the FCC. The Plan is unduly complex, would be extremely costly to implement, is disproportionately favorable to rural carriers at the expense of other carriers, and either fails to address, or exacerbates, some of the main challenges of the existing intercarrier compensation regime.

The Commission's inquiry into the "interlinked effects of the Missoula Plan within Pennsylvania," as they relate to interstate and intrastate access charges, federal and Pennsylvania universal service fund ("USF") contributions and support payments, and the setting of rates for intrastate regulated telecommunications services under Chapter 30, highlights the peril of the Commission trying to address these complex issues on the basis of a fundamentally flawed minority proposal like Missoula. Moreover, there is no reason to believe that the current version of the Missoula Plan will serve in any way as the basis for FCC resolution of its intercarrier compensation docket. Indeed, the Missoula Plan is only one of several proposals that have been filed in that docket, and it lacks industry consensus. The Commission has more pressing issues to address before to wading too far into the Missoula Plan. Specifically, to the extent the Commission engages in any access charge reform prior to the final outcome of the FCC's intercarrier compensation proceeding, it should focus its attention on the strikingly high access charges imposed by rural carriers in Pennsylvania.[3] By contrast, Verizon's access rates have already been dramatically reduced since the *Global Order,* and for that reason the Commission should await the final results at the FCC before further addressing Verizon's access rates.

[3] *See* Verizon's Response as Amicus Curiae to Motion for Reconsideration, Docket Nos. R-00061377 and P-00981430F1000, filed July 20, 2006; Letter from Suzan Paiva to James McNulty, dated August 10, 2006, Re: Docket Nos. R-00061377 and P-00981430F1000.

II. THE MISSOULA PLAN DOES NOT ACCOMPLISH THE GOALS THAT INTERCARRER COMPENSATION REFORM SHOULD ACCOMPLISH

In its NPRM,[4] the FCC identified a number of goals for intercarrier compensation reform, including the simplification of existing regimes, closing loopholes and unifying rates to minimize arbitrage opportunities, and lowering some of the highest access rates. The FCC further stated that it was most interested in promoting economic efficiency through competitively and technologically neutral rules, decreasing the need for regulatory intervention, and solving current arbitrage problems.[5] As described below,[6] the Missoula Plan meets none of these objectives, and in some cases would make achieving them far more difficult.

In light of the FCC's stated goals, Verizon has identified a set of principles that should govern any reform of existing intercarrier compensation regimes.[7] In significant respects, the Missoula Plan is inconsistent with these principles as well.

First, any attempt at intercarrier compensation reform must account for the fact – already reflected in market-based arrangements – that interconnection in some cases does not always benefit both networks equally. Today's marketplace provides numerous examples of different networks interconnecting on commercially negotiated terms in the absence not only of any regulation of the rates on which they exchange traffic, but also in the absence of any regulatory mandate to interconnect in the first place. The Internet is a prime example. What is commonly referred to as "the Internet" in fact consists of a series of individual networks, owned and operated by a variety of private entities that have entered into purely voluntary interconnection arrangements. Another example is direct interconnection between wireless networks, which

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4 *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, FCC 05-33, Further Notice of Proposed Rulemaking (released March 3, 2005) ("Intercarrier NPRM").

5 *Id* at ¶¶ 29-36.

6 *See infra* pp. 7-12.

7 *See generally* Verizon's comments, filed in CC Docket No. 01-92, May 23, 2005, at 3-5.

occurs not because of any regulatory mandate, but because large traffic volumes, a relative balance of traffic, and equal bargaining power justify such arrangements.

Carriers make different decisions on whether to undertake the significant investment required to build and improve networks. As a result, although interconnection may result in an equal exchange of value in some cases, in other cases interconnection may provide greater benefits to one of the interconnecting carriers – typically the carrier that has chosen not to invest in network infrastructure. Commercially negotiated agreements in the context of the Internet recognize this fact, as companies agree to forgo intercarrier compensation when they believe interconnection provides roughly equal value to each, but insist on some form of compensation when that is not the case. An approach that did not recognize this reality would drastically cut incentives for carriers to build and improve network infrastructure, because network builders would not be able to recover the value created by those investments, while non-network providers would have increased incentives to free ride on the investments of the network builders.

The Missoula Plan creates a disincentive to network investment by ignoring existing network and related infrastructure and assuming that all participants are working from an imaginary "clean slate" that supposes no existing network investment. For example, the Plan adopts default rules that would force interconnection at "Track 1" carriers' access tandems, even though today traffic is efficiently routed to Track 1 local and access tandems. The Plan would also require every carrier, including wireless carriers, to permit direct connection at an Edge, regardless of the fact that there are more efficient indirect connection arrangements currently in place. The Plan would thus require massive network architecture changes with little benefit. The Plan would also provide many carriers little choice but to make extensive changes to billing systems and to make billing records on trunks that are today not recorded. Intercarrier compensation should reduce the transaction costs associated with interconnection, not increase them. Implementing the Plan's provisions for network interconnection, transport, passing of call information (to address the issue of phantom traffic), and billing would require carriers to invest large sums. And this substantial investment would be mandated at the same time that current technology is increasingly being displaced by more efficient Internet Protocol (IP) networks.

Second, any reform plan should preserve existing negotiated arrangements and facilitate additional ones. In particular, any new approach should not interfere with the commercially negotiated arrangements that exist between carriers. Nor should reform apply default rules where networks exchange packets on an Internet protocol ("IP") basis without using the circuit-switched network – regardless of whether the packets are carrying voice, data, or video, and regardless of the carrier involved. Moreover, any new regime should encourage carriers exchanging circuit-switched wireline and wireless traffic to make investment and interconnection decisions driven by economics rather than regulatory gamesmanship. Accordingly, a reform plan should not establish default rules that, in practice, will replace economic behavior with artificial regulatory rules.

The Missoula Plan directly contradicts this principle by overriding many existing market-based arrangements. For example, the Plan would supersede existing contractual arrangements that are in "evergreen" periods, *i.e.*, in cases where the initial term of the agreement has lapsed. The Plan would also only protect existing arrangements where there is specific language in the contract mandating that it does so, which is inconsistent with the "change of law" provisions contained in most agreements in place today. In fact, the Plan would gut most of the interconnection arrangements Verizon companies maintain today with other carriers. The only interconnection agreements that the Plan would leave intact are those that both explicitly reject agreement changes based on changes in law and are not in evergreen status.[8] Virtually none of Verizon's agreements would qualify because they provide that a change in law either automatically modifies the agreement or requires the parties to renegotiate. As a result, Missoula would override and cancel literally thousands of existing interconnection agreements.

In the interest of unification, the Missoula plan would force changes in existing arrangements that would be harmful. For example, many of the minutes Verizon exchanges with other ILECs today are handled on a "bill-and-keep" basis under various EAS arrangements. The Missoula plan would override those agreements for Track 2 carriers, and would give Track 3 carriers an incentive not to renew them, because the default rules would allow those carriers to charge interstate access rates for that traffic. The result would be that compensation would actually increase for a large category of traffic, and EAS arrangements that have benefited consumers would be threatened.

Third, any reform plan should provide for a more uniform rate structure for various types of traffic than exists currently. The desirability of this feature follows from the first two principles. Greater rate uniformity for various types of traffic reduces opportunities for carriers to benefit from non-compliance with the rules. The Missoula Plan, while espousing this principle, actually contravenes it by maintaining separate rate levels and structures for different types of carriers, leaving the door open for existing arbitrage opportunities, and by making states' reform of intrastate access rates optional, creating additional ones. A major aspect of this problem is that the Plan fails to unify rates and rate structures for "Track 3" carriers.

Fourth, any reform plan should provide sufficient flexibility to ensure that carriers can recover the costs currently recovered through intercarrier compensation and can be compensated for the value provided by interconnection with other networks. Intercarrier compensation reform

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8 *See* Plan at 4.

provides the opportunity to promote competition and eliminate regulatory arbitrage. While the Missoula Plan seeks to preserve carrier revenues through the Restructure Mechanism, the Plan does not explain how it will be funded. Moreover, as with other elements of the Plan, the Restructure Mechanism is too heavily weighted in favor of perpetuating the massive subsidy flows from other carriers to the RLECs.

Fifth, a reform plan should avoid disruptive changes to existing interconnection architectures. Carriers have been interconnecting their networks for nearly a decade under the rules implementing the 1996 Act – and for much longer for interLATA and wireless traffic. After considerable litigation about the requirements of the statute and FCC and state commission rules, most of those requirements are now settled and have been internalized – and built into physical network architecture – by market participants. Adoption of a new set of interconnection rules would serve primarily to upset settled expectations and potentially strand massive investments. For example, the plan would move the "edge" of Track 1 carriers from the end office to the access tandem. This would create a new incentive for those carriers who have already established direct trunking to end offices, or to local tandems, to drop those trunks, and to route their traffic instead through the tandem. Adapting to those rules, at the same time carriers are transitioning to a new intercarrier compensation regime, will impose significant costs on carriers that will likely outweigh any benefits provided by those rules, while inevitably creating yet another set of arbitrage opportunities.

III. THE MISSOULA PLAN IS EXCESSIVELY COMPLEX AND COSTLY AND FAILS TO RESOLVE SOME OF THE MOST VEXING PROBLEMS WITH THE EXISTING INTERCARRIER COMPENSATION REGIME

There is no "one-size–fits-all" approach to resolving the myriad issues involved in intercarrier compensation reform. Since the passage of the Telecommunications Act in 1996, this Commission (and others) and carriers of every stripe have spent vast sums litigating against arbitrage schemes that arose from the first well-intentioned regulatory compensation regime. There is no certainty that the next well-intentioned regulatory compensation regime will be any more successful in avoiding non-economic results and arbitrage opportunities that are inherent in any set of complex regulatory mandates. The Missoula Plan is unduly complex: one hundred and ninety three pages of new default rules, and interconnection terms and conditions that would maintain a system of multiple varying rates for different classes of carriers. The Plan establishes different rules for three separate categories of carriers, Track 1 (all RBOCs, including Verizon Pennsylvania Inc., and "other non-rural carriers (e.g., ILECs such as Verizon North Inc., CLECs, IXCs and CMRS carriers")), Track 2 ("most mid-sized rural carriers") and Track 3 (rural rate of return regulated carriers). The Plan establishes a series of option elections which could potentially drive further disparities among carriers, even those within the same Track. The Plan relies upon voluntary participation by the states in reducing intrastate originating access rates.[9] Because some states may choose not to participate in the Plan, some intrastate originating rates would be outside of the Plan and inconsistent with Plan rates, undermining the goal of uniformity for all affected carriers. To the extent reform is meant to simplify existing rules, this plan fails to do so.

In addition, the Plan would not resolve some of the most challenging problems with the existing intercarrier compensation regime. For example, the Plan permits Track 3 carriers (rural ILECs) to continue to distinguish between, and charge varying rates for access and reciprocal compensation traffic. This perpetuates the incentive to disguise the jurisdictional nature of traffic in order to game the system and invites even more carrier efforts to generate new arbitrage schemes.

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[9] Executive Summary at 2.

In fact, the Plan could make an existing arbitrage opportunity relating to ISP traffic even worse. Instead of keeping the current ISP rule, the Plan modifies the existing approach: if traffic is out of balance beyond the 3:1 ratio, the recipient still gets paid the same terminating rate as for any other traffic – but must pay 100% of the transport between the two carriers. Thus, the Plan creates a new incentive – instead of serving customers with only inbound calling, like ISPs, as has been the case under the existing regime, under Missoula, carriers will focus on serving customers with only outbound calling, like call centers, in order to shift their transport costs onto the receiving carriers.

In addition, the Plan also would exacerbate rather than resolve the disputes surrounding the Major Trading Area ("MTA") rule. By relying upon telephone numbers to determine jurisdiction instead of the end points of a call, roaming traffic that is properly considered subject to reciprocal compensation will instead be subject to access charges, even when the calling and called party are right around the corner from each other. The Plan would undermine settled federal court decisions finding that all traffic exchanged between LECs and CMRS providers is subject to reciprocal compensation regardless of whether it is carried by an IXC. Moreover, it would further condition the ability of wireless carriers to collect reciprocal compensation for traffic originated by LECs.

Finally, the Plan fails to bring down the highest access rates, another major problem with the existing regime. The interstate access rates that the Plan reduces the fastest are those for the Track 1 carriers, rates that were the lowest to begin with and have dropped even further over the last few years. At the same time, however, the Plan does not touch the interstate rates for Track

3 carriers, rates that are five times higher than the rates of the Track 1 carriers, and in some cases are rising rather than falling.[10]

By imposing a patchwork of rules applicable to different carriers, the Plan's complexity fails to meet a fundamental goal of intercarrier compensation reform. By failing to reduce the highest access rates, the Plan fails to meet a critical challenge of the existing environment. In sum, the Missoula Plan is, at best, a seriously flawed start to a still-evolving process.

IV. THE MISSOULA PLAN IS NOT COMPETITIVELY NEUTRAL

The Plan unduly favors rural ILECs,[11] by protecting their existing access charges and, by so doing, protecting them from the financial effects of competition. That, in turn, undercuts the incentive for CLECs and other carriers to bring choice and competition to rural areas because they would have to compete with highly subsidized service rates. There is no longer a reason for the government to protect rural carriers from the competition that is ubiquitous everywhere else in the telecommunications market.

First, the Plan leaves RLECs' interstate rates, the highest interstate rates being charged, untouched. If states opt out of participating in the Plan, then the RLECs' high originating intrastate access rates will remain high as well. In fact, in that case the only reductions the RLECs would face under the Plan would be for their terminating intrastate access rates, which would be reduced to interstate levels.

Second, under the Rural Transport Rule,[12] the RLECs benefit from a highly favorable and inequitable transport regime. Today, RLECs often get other carriers to pay 50% of the transport to and from the RLEC switch. Under the Plan, other carriers would be required to pay an even

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10 As Verizon recently made clear in a filing with the FCC, rural carriers who are part of the NECA pool are earning in excess of their authorized rate of return and rather than reducing switched access rates, the NECA pool carriers are seeking to increase their switched access rates by approximately 6 percent. *See* Petition of Verizon, WCB/Pricing File No. 06-15, Transmittal No. 1129, dated June 23, 2006, at 2-3.

11 Not surprisingly, members of the Rural Alliance make up the overwhelming majority of the Plan's proponents.

12 *See* Plan, at 30-34.

higher percentage of the RLECs' transport costs, in some cases even bearing 100% of transport costs in both directions. While there are two transport options, both end up with other carriers paying at least 75% of the RLEC's transport cost.

Third, the Plan contains a Restructure Mechanism that disproportionately favors RLECs. The theory behind the Restructure Mechanism ("RM") is that carriers will recover from the RM what they lose through reduced access charges. Carriers figure out how much they should recover from the RM by 1) identifying how much revenue will be lost with the reduced access rates; 2) raising the subscriber line charge ("SLC") to new capped levels as identified in the Plan; and 3) whatever part of the revenues lost which cannot be recovered through SLC increases are recovered from the Fund. If a carrier chooses not to increase the SLCs to the maximum extent possible, that foregone revenue cannot be recovered from the RM.

But these recovery rules are stacked to benefit the RLECs in two important ways. First, the new SLC cap differs for the three Tracks. The Plan calls for Track 1 carriers, who operate in the most competitive markets (and thus are least able to increase SLCs), to increase SLCs to $10 (with increases for inflation). For these carriers, most of the revenue forgone through reductions in access charges would be recovered through SLC increases, rather than from the RM. But because the SLC increases are unlikely to be sustainable in the markets Track 1 carriers serve, the Plan does not provide those carriers with a reasonable opportunity for recovery. By contrast, Track 3 carriers, who compete in the least competitive markets, only have to raise their SLCs to $8.75, with no inflation adjustment. Most of their recovery will come from the RM, rather than from their own end users. In effect, RLEC customers will contribute less "self-help" in the form of end-user rate increases, and Verizon's customers will then be asked to make up the resulting shortfall through contributions to the RM.

Second, even if a Track 1 carrier can qualify for the RM, its compensable loss due to the Plan (and its SLC increases) is calculated on a per line basis – which means that any recovery does not compensate Track 1 carriers for line loss.[13] Carriers in Tracks 2 and 3 carriers, on the other hand, are compensated both for losses due to lower access rates and losses due to line loss. As a result, the RLECs would receive a substantially disproportionate amount of cost recovery from the RM.

V. THE MISSOULA PLAN LEAVES A NUMBER OF QUESTIONS UNANSWERED

While it is promoted as being "comprehensive" the Plan leaves important issues unaddressed. For example, the Plan does not explain how the RM would be funded —or even whether it will be considered "universal service." And while it does address VoIP to PSTN traffic, the Plan does not address PSTN to VoIP traffic, which is likely to be growing just as fast over the next few years.

Perhaps most important among the unanswered questions, the Plan does not address state preemption issues. Instead, the Plan sidesteps preemption, presuming instead that FCC can garner the necessary legislative affirmation of the Plan's provisions wherever necessary.[14] To be effective, however, new intercarrier compensation rules must apply at both the interstate and intrastate levels. Many of the concerns regarding the current regulatory scheme – and some of the primary opportunities for arbitrage – are rooted in the efforts by some carriers to exploit the disparity between the interstate rates regulated by the FCC and the intrastate and local rates currently regulated by state commissions. A Plan with voluntary state participation invites a

[13] As the Commission is aware, under the revenue neutrality mandate of 66 Pa. C.S. § 3017, the Commission cannot require Verizon to reduce its access rates except on a revenue-neutral basis by rebalancing revenue lost from access charge reductions onto its basic local exchange rates. Further increases to the rates paid by its wireline end users through additional SLCs would inevitably lead to more rapid line loss.

[14] *See* Executive Summary at 3.

continuation of such disparities and the arbitrage they drive. Full analysis of the Plan's potential outcomes is impossible without more definitive information on how many states might opt out.

VI. INSTEAD OF WADING INTO THE MISSOULA PLAN, THE COMMISSION SHOULD FOCUS ON RURAL ILEC ACCESS REFORM

The Commission's Notice seeks comments addressing "the interlinked effects" of the Missoula Plan within Pennsylvania, arising from the following areas:

1. Interstate Carrier Access Charges;
2. Intrastate Carrier Access Charges;
3. Federal universal services fund (USF) contributions and support payments;
4. Pennsylvania USF contribution and support payments; and
5. The setting of rates for intrastate regulated telecommunications services under the Chapter 30 law, 66 Pa. C.S. Sections 3011-3019

The Commission seeks further comment "on how the Missoula Plan parameters may affect existing interconnection agreements and agreements between competing telecommunication carriers within the Commonwealth."[15] To the extent this Notice could be read to suggest that the Commission may be seeking ways to adapt the Missoula Plan to the existing state of the USF and access charges in Pennsylvania, any such use of this document would be quite premature and unjustified at this point. As noted above, the Missoula Plan would gut most of Verizon's agreements with competing carriers in Pennsylvania and impose default rules that would ignore the terms and conditions of many market-based commercial agreements. Beyond its identified flaws, Missoula raises numerous unanswered questions that Verizon cannot address in response to the Commission's Notice. Accordingly, the Commission should recognize the Missoula Plan for what it is: merely the latest seriously flawed minority proposal in the FCC's intercarrier compensation reform docket. As such, the Missoula Plan merits no special consideration by the Commission at this time.

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[15] Notice at 2.

To the extent the Commission is interested in addressing access charge reform in Pennsylvania before resolution of the FCC proceeding, it should start, not with Missoula, but with the bloat already built into RLEC access rates. As Verizon recently made clear in response to three carriers (D&E and its affiliates Buffalo Valley and Conestoga) that unilaterally *increased* their already high access rates,[16] it is beyond time to end the practice of requiring Verizon to provide a double subsidy to rural carriers – in the form of universal service fund support *plus* intrastate access rates that are very much higher than the access rates that Verizon itself is allowed to charge. While Act 183 requires CLECs operating in Verizon's territory to charge access rates no higher than Verizon's, rural ILECs are charging access rates many multiples of the rates Verizon is charging. *See,* 66 Pa. C.S. § 3017(c). In light of D&E's recent actions, it is time for this double disparity to be addressed.

VII. THE COMMISSION SHOULD NOT ACT ON VERIZON'S ACCESS RATES PRIOR TO THE RESOLUTION OF THE FCC'S INTERCARRIER COMPENSATION PROCEEDING

By contrast, it makes no sense for the Commission to focus on Verizon's access rates, which, after repeated deep reductions, are among the very the lowest in the state and which ALJ Fordham recently recognized are "well below the national average."[17] As the Commission is aware, Verizon has filed Exceptions in Docket No. C-20027195 asking the Commission to refrain from considering additional Verizon intrastate access rate rebalancing until the FCC settles some of the fundamental intercarrier compensation issues raised in its proceeding. In sharp contrast to D&E and its affiliates, Verizon has already reduced its access rates by approximately *$140 million* since the *Global Order*, and rebalanced $50 million of access revenue onto basic local rates just last year. Verizon has not proposed to increase any of its

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[16] *See* Verizon's Response as Amicus Curiae to Motion for Reconsideration, Docket Nos. R-00061377 and P-00981430F1000, filed July 20, 2006; Letter from Suzan Paiva to James McNulty, dated August 10, 2006, Re: Docket Nos. R-00061377 and P-00981430F1000.

[17] *See* Docket No. C-20027195, RD at 64.

access rates in its own PCO/PSI filings, but has recovered that revenue from local rates or by banking the increases. Accordingly, the Commission should stay any further consideration of Verizon's already low access rates pending the outcome of the FCC's CC Docket No. 01-92.

VIII. CONCLUSION

The Missoula Plan, while an ambitious undertaking, is too complex, too costly to implement, leaves open or creates too many arbitrage opportunities, is far too generous to rural carriers at the expense of the rest of the industry, and leaves too many important questions unanswered for the Commission to rely upon it in Pennsylvania. To the extent the Commission wants to focus on access charge reform, it should address RLEC access charges, which are far in excess of those charged by Verizon and other Track 1 carriers, and await the outcome of the FCC's intercarrier compensation proceeding before taking any additional actions.

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