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ANALYSIS OF A CHANGING INDUSTRY

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INTERCARRIER COMPENSATION REFORM PLAN REACHES THE FCC; REACTION TO MISSOULA PLAN WILL SHAPE THE FUTURE

In 1860, entrepreneurs C. P. Higgins and Francis Worden established a store in a Montana settlement known as Hell Gate. Higgins and Worden obviously had no idea their modest settlement would have significance to the telecommunications industry in 2006. The fortunes of Higgins and Worden improved when the search for gold opened up travel through Hell Gate, and their tenuous settlement became known as Missoula, taken from an American Indian word meaning "near the cold, chilling waters." More recently, the National Association of Regulatory Utilities Commissioners (NARUC) held one of its first task force meetings in the Missoula Valley. The meeting represented the start of the process to consolidate the diverse intercarrier compensation reform efforts sponsored by various industry coalitions. Because Missoula was the place where this consolidation effort appears to have begun, Missoula is the name attached to a plan that was delivered to the Federal Communications Commission (FCC) on July 24.

Now that the Missoula Plan has reached the FCC, JSI issues this edition of *News & Commentary* to highlight some of the key factors that will likely play a significant role in the future of the Missoula Plan. JSI, along with other industry consultants, has participated in the Rural Alliance effort as an advisor to the steering committee. All "interested parties" now have the opportunity to review the plan and voice their opinions, a critical process indeed since it will eventually shape the future of the industry.

For our part, JSI strongly recommends that clients participate in this process. Voicing your support will add your energy to the plan, and if you have concerns about certain aspects, expressing them to the FCC will enable you to direct attention to your apprehension. Regardless of your position, JSI encourages you to express your view of the plan now. We anticipate filing reply comments at the FCC regarding the plan, and we also stand ready to assist you in reviewing the plan and filing your own comments at the FCC. We believe expressing your views on the Missoula Plan requires your immediate attention and focus.

Reform Focus

The Missoula Plan begins with the premise shared by many in our industry that the current intercarrier compensation regimes are in desperate need of reform. Intercarrier compensation refers to the regimes, or processes, by which carriers make payments to each other for the use of their networks to originate and/or terminate telephone calls. These regimes include interstate and

intrastate switched access for interstate and state toll calls, respectively, and reciprocal compensation for what are commonly referred to as “local” calls. EAS compensation arrangements are distinct from reciprocal compensation and are identified separately in the Missoula Plan. The various compensation regimes require different treatment for similar originating and terminating functionality. Consequently, the current intercarrier compensation environment is a hodgepodge, in the middle of which exist perverse incentives for carriers to manipulate, mask, or otherwise alter the true nature of their calls to reduce their payments (compensation) to other carriers.

As contemplated by its authors, the Missoula Plan sets out to provide “comprehensive solutions for some of the hardest intercarrier compensation problems facing the industry while providing a stable cost-recovery mechanism that does not unduly burden rural consumers. (It) also sets straightforward and balanced interconnection rules that should eliminate many intercarrier disputes ... (and) would thus create greater regulatory certainty and allow carriers to concentrate on investing in their networks and deploying new services for the benefit of their customers.” The ability to deliver on this scope is the key to understanding the Missoula Plan.

The Missoula Plan is a compromise proposal developed by nearly a dozen participating stakeholders. Once this proposal was developed, it was offered to a wider industry audience for adoption. After its review of the Missoula Plan, NARUC offered the proposal to the FCC without endorsement. In some quarters, it may seem odd that the brokering entity, NARUC, took neither a pro nor con position. NARUC claims its silence is a strong asset, showing its independence and neutrality for the reform movement. The neutral stance adopted by NARUC should not obscure the likely chasm between certain state commissions regarding the plan. The commissions that view their states as “net payers” to the reform plan can be counted on to oppose it, while state commissions perceived as “net receivers” under the reform will likely support it. This dichotomy is but one of many dimensions to the Missoula Plan.

Since the compromise plan is so comprehensive, you should not be surprised to discover that you disagree with certain aspects. These aspects should be fully explored in the context of the overall plan, and you should express and discuss your concerns. Hoping for blanket acceptance of the plan by the FCC is laudable; however, it would seem unrealistic, at best. Calling to mind the industry’s experience with the MAG plan, for instance, JSI believes it is clear that the FCC will have its own view of intercarrier compensation reform and that this view may not coincide completely with all the provisions of the Missoula Plan. This reality underscores the importance of expressing your support and concerns about the plan as the FCC evaluates the details.

The Details of the Plan

Following, JSI highlights key aspects of the plan that will affect rural carriers:

- The Missoula Plan divides the industry into three tracks, based largely on company size and regulatory classification. Track 1 includes the lines of the RBOCs and other non-rural, non-incumbent carriers – *e.g.*, CLEC, IXC, and CMRS carriers; Track 2 includes the lines of most mid-sized rural carriers; and, Track 3 includes the lines of rate-of-return incumbent rural carriers. The majority of JSI’s incumbent clients fall in

Track 3, so that is where we have concentrated our review in this article. (For companies with issues or concerns about Tracks 1 and 2, JSI will be glad to discuss these with you separately.)

- Over a four-year process, Track 3 carriers will see reform of intercarrier compensation, primarily through the reduction of intrastate switched access charges to the interstate level. Track 3 carriers whose intrastate rates do not exceed current interstate rates will stay at their existing levels for the duration of the plan. Reciprocal compensation for Track 3 carriers will be capped at levels no higher than the interstate rates. This cap does not affect the ability to negotiate and arbitrate reciprocal compensation rates lower than the cap; it merely places a maximum level for reciprocal compensation.
- Existing mandatory and optional local calling arrangements between Track 3 incumbent LECs and all other incumbent LECs will not be affected. While the Missoula Plan maintains the *status quo* for EAS arrangements with other incumbent LECs, it also proposes that this type of traffic exchange be extended to CLEC and CMRS providers on a bill-and-keep basis for CLEC- and CMRS- provider telephone numbers assigned to an EAS Track 3 ILEC rate center.
- Track 3 carriers will be able to recover some of the revenue lost in the plan's adoption through increased interstate end-user rates. Federal residential and single-line subscriber line charges (SLCs) will increase by \$0.75 per line each year over a three-year period, a total increase of \$2.25 at the end of the three years. Combined with the existing \$6.50 per line charge, the residential and single-line business SLC will total \$8.75 per line per month. Multi-line business SLCs for Track 3 carriers will not change from the current level.
- Track 3 carriers may participate in a federally funded Restructure Mechanism to recover residual lost revenues. Track 3 carriers' eligibility to participate in the federal Restructure Mechanism depends on whether their state regulatory commission accepts the provisions of the Missoula Plan. Specifically, state regulators must accept the plan provisions related to intrastate switched access rates. Clearly, the details of the Restructure Mechanism are among the most important aspects of the entire plan, both in funding and distribution.
- The Missoula Plan offers general intercarrier compensation rules for non-access traffic. Particular to rural carriers is the creation of a Rural Transport Rule, which requires Track 1 carriers (including CLEC and CMRS providers) to bear all the financial obligation for interconnection transport beyond the rural carrier's (identified in the plan as a "covered rural telephone company," or CRTC) meet point – typically at the CRTC's service area boundary.
- Finally, one aspect of the Missoula Plan does not appear to be getting as much attention as some of the others, and that is the incentive regulation provision made available to rate-of-return CRTCs. Under the plan, CRTCs may convert to incentive

regulation for interstate operations. This choice is offered to Track 3 carriers; however, if selected, the carrier would be moved to Track 2.

Several Observations

The Missoula Plan takes great pains to balance federal and state regulation. Nowhere is this more apparent than with the Restructure Mechanism and the Early Adopter Fund (EAF). The EAF is designed to provide some amount of compensation for state-led efforts to restructure intrastate access. The receipt of federal funds is conditioned on state acceptance of all aspects of the Missoula Plan. The justification of such “carrot-and-stick” incentives relies in part on court decisions addressing dual jurisdiction regarding universal service.

Many participants in the rural reform effort, including the Rural Alliance, strongly contend that the Restructure Mechanism must not be regarded as a federal universal service program. To the extent the FCC treats the Missoula Plan funding mechanisms as universal service, JSI cautions that the ongoing, well-orchestrated campaign against the universal service program demonstrate that the federal funds are at significant potential risk, even before the addition of two new programs proposed by the Missoula Plan – the Restructure Mechanism and the EAF. Therefore, the rural industry should exercise diligence that the Missoula Plan not be tagged as “another” federal universal service program. And, considering the Joint Board’s recent request for comments on using a reverse auction to determine federal universal service distribution (*see FCC 06J-1*), such concerns are even more clear-cut.

Rural advocates insist that the Restructure Mechanism must remain part of the access regime; this position should be supported to the extent non-common-line intrastate access charges are reduced. Non-common-line costs are access in nature and not related to the purposes of universal service; therefore, they should not be placed in any federal universal service mechanism. The classification of the Restructure Mechanism and the EAF are still subject to disagreement, even among supporters of the Missoula Plan, so you should monitor how this develops and, more importantly, make your voice heard regarding treatment of the Restructure Mechanism as a component of the existing access regime, not universal service.

Our second observation is that the Missoula Plan is a *compromise* brokered by NARUC. On the one hand, to ensure a fair showing, the plan needs to be viewed as a compromise with pluses and minuses intended to address concerns of all supporters. On the other, we realize that because of the absence of notable industry players; *e.g.*, Verizon, the Missoula Plan may not be adopted as a package by the FCC. Thus, care must be exercised to evaluate the plan as it relates to *specific* company operations. Because of this dynamic, JSI notes that it is very difficult to handicap the plan and predict the FCC’s response, yet another reason why it is important for you to voice your opinion of the plan in the current environment. Without information about your operations and interests, the FCC will not be able to evaluate the impact of its decision on your company.

As a final consideration, we emphasize that intercarrier compensation reform will not fade into the sunset even with the adoption of the Missoula Plan. In the fourth year of the plan, there are provisions for the FCC to address how to possibly move intercarrier compensation from its current per-minute-of-use rate structure to a capacity-based structure. The Missoula Plan is

portrayed as the *first baby steps* necessary to accomplish industry-wide reform under a dual regulatory structure. To the extent it moves this effort forward in a positive manner, the industry as a whole should be supportive of the Missoula Plan.

If you have questions or comments concerning the Missoula Plan, please call JSI. The particular aspects of interconnection and intercarrier compensation vary widely among our clients, and we believe these issues are best addressed on a case-by-case basis. As you review the plan in the coming weeks, JSI is prepared to assist you in preparing comments for your company. And, if you have any questions or comments about this article, contact Manny Staurulakis (mstaurulakis@jsitel.com) in JSI's Greenbelt, Md. office, at 301-459-7590, or Douglas Meredith (dmeredith@jsitel.com) in the Salt Lake City office, at 801-294-4576.

JSI URGES FCC TO MAINTAIN SEPARATIONS RULES WITH SLIGHT MODIFICATIONS

In response to the FCC's request for comments on separations reform, JSI plans to file [comments](#) demonstrating that significant changes to the separations process would be detrimental to rate-of-return local exchange carriers (LECs). Instead, JSI will propose only a few minor changes that would benefit LECs, including addressing an imbalance in the rules pertaining to Dialed Equipment Minutes (DEM). The comments also will urge the FCC to dramatically downsize a proposed data request that in its current form is unnecessarily burdensome.

The driving force behind major separations reform has come from the state-regulator members of the Federal-State Joint Board. Proposing various options for reform in two reports known as the "Glide Path" papers, the state members assert that due to technological, market, legislative, and regulatory changes in the industry, the separations process must "glide" from the separations freeze that is currently in place to some other regime.

JSI believes that many of the primary concerns of the state members of the Joint Board, as well as those voiced by the National Association of Regulatory Utility Commissioners, would be addressed if the large price-cap carriers were no longer subject to separations rules. Accordingly, in its comments, JSI will offer a two-tiered approach, in which the large, mandatory price-cap (Tier 1) LECs are no longer subject to the separations rules while the factor "freeze" remains in place for all rate-of-return (Tier 2) LECs. JSI observes that this could be accomplished if the FCC were to grant BellSouth's petition seeking forbearance from all separations rules and extend such a decision to all mandatory price-cap companies.

Minor Changes Should Be Made to Benefit Rate-of-Return Companies

JSI believes that any major reform would be detrimental to Tier 2 rate-of-return LECs. As the FCC has previously recognized, the freeze provides "much needed simplification and stability" to the separations process. JSI believes, however, that some companies could benefit by a few minor changes in the separations process:

- First, allowing cost companies a one-time opportunity to convert to average schedule.

- Second, allowing rate-of-return LECs the option to adjust their allocation factors if they found such adjustments beneficial. Under this proposal, the FCC would treat the current frozen factors similar to the way it treats the “safe harbor” Universal Service Fund contribution percentages for wireless and VoIP providers. That would mean that if a rate-of-return LEC wanted to use its own factors, it could submit traffic studies to the National Exchange Carrier Association or the FCC. When approved, the studies could be used to establish revised, frozen factors.
- Third, revising the DEM rules so that changes in DEM weighting apply to both increases and decreases in access lines across a weighting factor threshold. The FCC’s current rule requires that a study area in which access lines increase over a weighting factor threshold move to a lower DEM factor for the remainder of the freeze period; however, the rule is silent regarding decreases in access lines to a level below the threshold. As a result, rural LECs that have dropped below a DEM weighting factor threshold due to a decline in line counts are penalized in the calculation of Local Switching Support.

Data Request Must Be Significantly Downscaled

In addition to separations reform, the FCC has also sought comment on a draft data request developed by state members of the Joint Board to “better assess” the impact of the separations freeze on LECs. In its comments, JSI will contend that to minimize the impact on small companies, the FCC should limit the request only to data that has been generated through the separations process. JSI also will recommend that the FCC eliminate all questions that seek opinions or are speculative in nature.

JSI will file its comments on separations reform issues on August 22. If you have any questions regarding these [comments](#) or would like a copy when they are filed, contact John Kuykendall (jkuykendall@jsitel.com) or Steve Meltzer (smeltzer@jsitel.com) in JSI’s Maryland office, at 301-459-7590.

JSI’S CLIENT EFFORTS LEAD TO SNA SUPPORT REFUNDS FOR ALL QUALIFYING COMPANIES

With JSI’s help, three rural LECs won appeals filed with the FCC regarding a Universal Service Administrative Co. (USAC) decision that significantly reduced their safety net additive (SNA) support. The SNA is a universal service support mechanism available to carriers whose investment in rural infrastructure exceeds a certain threshold. The FCC’s order, released August 7, not only granted the three appeals, but also overturned a previous finding by the FCC Wireline Bureau, resulting in refunds for all companies that qualify for SNA in a year succeeding their initial filing.

The three LEC clients, Darien Telephone Company (Georgia), Logan Telephone Cooperative (Kentucky), and Roanoke & Botetourt Telephone Company (Virginia), qualified for SNA in multiple years and, prior to March 2005, had received SNA support for each year in which they qualified. In March 2005, however, these companies, and others that qualified for SNA in

multiple years, received letters from USAC notifying them that the Wireline Bureau had ruled that the SNA support calculation should be based only on the first qualifying year. In its letter, USAC noted that this “clarification” required that all funds advanced to date that were calculated based on subsequent year filings must be paid back immediately, and that SNA support on a going-forward basis must be reduced to reflect only the first qualifying year.

For the client companies, this development meant that USAC immediately deducted the SNA amount in dispute from their overall Universal Service Fund disbursements, and their monthly SNA support was reduced significantly on a going-forward basis. Subsequently, in May 2005, the LECs filed appeals with the FCC, seeking to overturn USAC’s decision. Although company and JSI representatives conducted several *ex parte* meetings with FCC staff urging prompt resolution of the matter, the appeals remained pending for well over a year.

In its order, the FCC found that the Wireline Bureau’s “clarification” was flawed and that USAC must go back to the way it had initially calculated SNA support. As an example, the FCC stated that if a company qualified in the first year for \$5.00 per month support and then qualified in the second year for an additional \$5.00, it should receive \$5.00 per month the first year and \$10.00 per month in the second and following years. The FCC also instructed USAC to refund the amounts deducted from the three companies and to restore monthly support on a going-forward basis to the same level that the companies had received prior to USAC’s March 2005 letter.

Since the FCC overturned the Wireline Bureau’s “clarification,” the ruling benefits all companies that qualify for SNA support in multiple years. LECs that had their SNA support reduced in 2005 will receive refunds and have that support restored. Also of note, first-time qualifiers for SNA support will no longer be forced into a guessing game of whether or not they may be limiting their amount of future support when they make their initial filing.

JSI is awaiting information from USAC regarding when and how it will refund the SNA support. If you have questions about the order or the SNA rules, contact John Kuykendall (jkuykendall@jsitel.com) or Brian Sullivan (bsullivan@jsitel.com) in JSI’s Maryland office, at 301-459-7590.

JSI SEMINAR REMINDER: FALL EDUCATIONAL SCHEDULE

As reported in this issue of *JSI News & Commentary*, the FCC is now considering the industry’s Missoula Plan, as well as revisiting the vital area of separations reform. Not to mention, we all still await summer’s end and the progress, if any, of the Telecom Act rewrite in Congress. These issues are sure to have implications for JSI clients for years to come. Thus, it appears an appropriate time to remind clients and others that these developments – and more – will be discussed and reviewed in-depth at this fall’s sessions of the 2006 JSI Seminar Series.

JSI’s three remaining seminars will be held in October. Content information, details about hotel reservations, and registration are available online on our website at www.jsitel.com for:

- The JSI Part 32 & Part 64 Accounting Seminar, which will include an update on intercarrier compensation and the Missoula Plan, in a day-and-a-half session, Thurs.-Fri., **October 5-6**, at the Marriott Rivercenter in San Antonio.
- The JSI Carrier Access Billing Services (CABS) Seminar, presented by Creative Support Solutions, which will include a comprehensive regulatory update, on Thurs., **October 12**, at the Airport Marriott in Atlanta.
- The JSI Separations and Access Seminar, which will include a thorough review of proper cost allocation and maximized cost recovery, in a two-and-a-half-day session, Wed.-Fri., **October 18-20**, at the Airport Marriott in Atlanta.

For more details on program content, contact Chris Lehner (clehner@jsitel.com) or Brenda Cordwell (bcordwell@jsitel.com); for registration and hotel information, contact Kim Waldvogel (kwaldvogel@jsitel.com). All can be reached in JSI's Greenbelt, Md. office, at 301-459-7590.

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