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

In the Matter of	)	
	)	
Establishing Just and Reasonable Rates for Local Exchange Carriers	)	WC Docket No. 07-135
	)	

NOTICE OF PROPOSED RULEMAKING

Adopted: October 2, 2007 **Released: October 2, 2007**

Comment Date: [30 days after publication in the Federal Register]
Reply Comment Date: [45 days after publication in the Federal Register]

By the Commission:

I. INTRODUCTION

1. In this Notice, we initiate a rulemaking proceeding to consider whether the current rules governing the tariffing of traffic-sensitive switched access services by local exchange carriers (LECs) are ensuring that rates remain just and reasonable, as required by section 201(b) of the Communications Act of 1934, as amended (the Act).[1] In particular, we focus on allegations that substantial growth in terminating access traffic may be causing carriers' rates to become unjust and unreasonable because the increased demand is increasing carriers' rates of return to levels significantly higher than the maximum allowed rate. Although it is reasonable for carriers to seek to increase demand for their services, it is also critical to ensure that rates remain just and reasonable over time as costs and demand change. It has become increasingly important to ensure the reasonableness of rates since the deemed lawful provision in section 204(a)(3) of the Act was adopted because that provision protects unsuspended rates from refund liability.[2] As discussed in detail below, to achieve these goals we tentatively conclude that certain rule modifications are necessary, and we seek comment on those as well as other proposals.

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[1] 47 U.S.C. § 201(b) (declaring unlawful any common carrier charges, practices, classifications, or regulations that are unjust or unreasonable).

[2] 47 U.S.C. § 204(a)(3); Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). Prior to the 1996 Act, tariffs that took effect without suspension or investigation were legal (i.e., procedurally valid), but not necessarily lawful (i.e., substantially just and reasonable).

II. BACKGROUND

A. Tariff Process for Local Exchange Carriers

2. Incumbent LECs are required to file and maintain tariffs with the Commission.[3] Carriers subject to rate-of-return regulation must file tariffs every two years for a two-year period as provided in section 69.3(f), but may file tariffs at any time pursuant to the policy that tariffs are carrier initiated.[4] The National Exchange Carrier Association, Inc. (NECA) files an access tariff each year on behalf of the carriers that participate in that tariff. Tariffs must be filed in advance of their effective date in order to provide the Commission and the public with notice of changes in carriers' rates, terms, and conditions of service, and to provide an opportunity for interested parties to evaluate and comment on proposed tariffs.[5] Pursuant to section 204 of the Act, the Commission, during the notice period, may suspend the effectiveness of a tariff and initiate an investigation to determine whether the tariff is just and reasonable.[6] In the *Streamlined Tariff Order*, the Commission concluded that the statute "contemplates pre-effective tariff review by identifying specific actions that we can take, i.e., suspension and investigation, prior to the effective date of the tariff [and that] pre-effective review is a useful tool to assure carriers' compliance with sections 201 through 203 of the Act."[7] If a tariff investigation has not been completed within five months of the tariff's specified effective date, the proposed tariff goes into effect subject to the results of the investigation.[8] At the conclusion of the investigation, the Commission may prescribe rates prospectively and order refunds as necessary for any period in which the tariff was in effect.[9]

3. In the 1996 Act, Congress enacted section 204(a)(3), which provides that LEC tariffs that take effect on seven days notice after filing (when rates are reduced) or 15 days notice (for any other change) after filing are "deemed lawful" unless rejected or suspended and investigated by the Commission.[10] In the *Streamlined Tariff Order,* the Commission concluded that a tariff filed pursuant to section 204(a)(3) (a "streamlined" tariff) that takes effect, without prior suspension and investigation, is

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[3] *See* 47 U.S.C. § 203. A tariff is a schedule of rates and regulations filed by a common carrier. 47 C.F.R. § 61.3(rr).

[4] 47 C.F.R. § 69.3(f).

[5] *See* 47 U.S.C. § 203(b).

[6] 47 U.S.C. § 204(a)(1).

[7] *Implementation of Section 402(b)(1) of the Telecommunications Act of 1996*, CC Docket No. 96-187, Order, 12 FCC Rcd 2170, 2197, para. 52 (1997) (*Streamlined Tariff Order*), *recon. on other grounds*, 17 FCC Rcd 17039 (2002) (*Streamlined Tariff Reconsideration*).

[8] 47 U.S.C. § 204(a)(1). The Commission is to issue an order concluding a tariff investigation within 5 months after the date the tariff would have gone into effect. 47 U.S.C. § 204(a)(2)(A). This time limit was intended only to spur Commission action, not to limit its authority. *1993 Annual Access Tariff Filings*, CC Docket Nos. 93-193, 94-65, Order, 19 FCC Rcd 14949, 14960, para. 24 (2004). It does not operate as a statute of limitations, and its violation does not constrain the Commission's authority to act. *Id*. at 14959-60, para. 22 (citing *Southwestern Bell Tel. Co. v. FCC*, 138 F.3d 746, 748 (8th Cir. 1998)).

[9] 47 U.S.C. § 204(a)(1).

[10] *See* 47 U.S.C. § 204(a)(3); *see also Streamlined Tariff Order*, 12 FCC Rcd at 2202-03, paras. 67-68.

conclusively presumed to be reasonable under section 201 and is thus protected from retrospective refund liability in a formal complaint proceeding, even if the carrier is ultimately found to have overearned.[11]

4. The Commission may investigate the lawfulness of an effective tariff pursuant to section 205 of the Act.[12] In this case, if the Commission finds that the tariff is unlawful, the Commission may prescribe lawful rates prospectively and require that any subsequently filed tariffs conform to such prescription.[13] The section 204 refund mechanism, however, is unavailable in a section 205 proceeding.[14]

5. Parties may also challenge the lawfulness of effective tariffs through the formal complaint process.[15] Rate-of-return carriers are required to set their tariff rates at levels targeted to produce no more than an 11.25 percent return on investment based on an analysis of historical or projected cost data and the historical or projected demand for services,[16] but may ultimately exceed the target rate of return up to the allowed maximum.[17] Section 65.700 of the Commission's rules establish a maximum allowable rate of return for carriers subject to that section that is equal to the prescribed rate plus the amount specified in either section 65.700(a), (b), or (c).[18] Compliance with the prescribed rate of return is measured over a two-year period (the "monitoring period").[19] Carriers that exceed the maximum allowable rate of return

[11] *Streamlined Tariff Order*, 12 FCC Rcd at 2182, para. 18; *see also ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 412 (D.C. Cir. 2002) (when filed in conjunction with section 204(a)(3), rates are considered to be reasonable for purposes of section 201 without inquiring into a carrier's rate of return). This contrasts with the legal status of a filed tariff prior to the 1996 Act. Then, tariffs that took effect without suspension or investigation were legal (i.e., procedurally valid), but not necessarily lawful (i.e., substantively just and reasonable). *Id. at* 410-11. Customers that purchased service pursuant to an unsuspended and uninvestigated tariff prior to February 8, 1997, could challenge the tariff's lawfulness through the formal complaint process, and, if successful, could be awarded a refund. 47 U.S.C. § 208.

[12] *See* 47 U.S.C. § 205.

[13] *Id.*; *see also American Tel. & Tel. Co. v. FCC*, 487 F.2d 865, 880-81 (2d Cir. 1973) (recognizing that the power to prescribe prospectively includes the power to adjust a carrier's existing tariffs).

[14] *See Illinois Bell Tel. Co. v. FCC*, 966 F.2d 1478, 1483 (D.C. Cir. 1992) (holding that Commission does not have authority to order refunds for unsuspended tariffs under section 205 of the Act).

[15] *See* 47 U.S.C. § 208.

[16] *AT&T Corp. v. Virgin Islands Tel. Corp.*, Memorandum Opinion and Order, 19 FCC Rcd 15978, 15979, para. 3 (2004). This rate of return is intended to provide a carrier with the opportunity "to earn a return that is high enough to maintain the financial integrity of the company and to attract new capital to the business," and ensure that rates are not excessive. *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507, 7532, para. 213 (1990).

[17] *AT&T Corp. v. Virgin Islands Tel. Corp.*, 19 FCC Rcd at 15980, paras. 4-5.

[18] *See* 47 C.F.R. § 65.700. Section 61.39 carriers are exempt from the requirements of section 65.700. *See* 47 C.F.R. § 61.39(c).

[19] 47 C.F.R. § 65.701. The two-year monitoring period begins on January 1 in odd-numbered years and ends on December 31 in even-numbered years. *Id*. Carriers subject to section 65.701 of the Commission's rules must file "interim monitoring reports" at the end of the first year and may make access rate adjustments as needed throughout the monitoring period to try to ensure that they do not exceed or fall short of the prescribed rate of return. *AT&T Corp. v. Virgin Islands Tel. Corp.*, 19 FCC Rcd at 15980, para. 4. Section 61.39 carriers are exempt from the requirements of section 65.701. *See* 47 C.F.R. § 61.39(c).

at the end of the two-year monitoring period have unlawfully "overearned" – i.e., their rates have violated the "just and reasonable" rate requirement in section 201 – and are subject to formal complaint on that basis alone.[20] Prior to the adoption of the 1996 Act, a successful complainant could seek retrospective damages for any overpayments made during the period in which the unlawful tariff was in effect.[21] As explained in paragraph 3, retrospective damages no longer are available for tariffs filed under section 204(a)(3) of the Act that take effect without prior suspension and investigation.

B. The Commission's Rules for Establishing Tariff Rates

6. *Rate-of-return carriers*. Commission rules provide rate-of-return LECs with alternative means for filing interstate access tariffs. Most rate-of-return LECs participate in the traffic-sensitive pool managed by NECA and participate in the traffic-sensitive tariff filed annually by NECA for participating members.[22] The rates in the traffic-sensitive tariff are set based on the projected aggregate costs (or average schedule settlements) and demand of all pool members and are targeted to achieve an 11.25 percent return.[23] Each participating carrier receives a settlement from the pool based on its costs plus a pro rata share of the profits, or based on its settlement pursuant to the average schedule formulas. Stated differently, revenues in excess of costs are shared among all pool members. Cost and average schedule carriers may choose to enter or leave the NECA pool on July 1 of any year by providing notice to NECA by the preceding March 1.[24]

7. Alternatively, a rate-of-return carrier may file access tariffs pursuant to the provisions of section 61.38 (section 61.38 carrier) or section 61.39 (section 61.39 carrier). Under section 61.38, a carrier is required to file access tariffs in even numbered years to be effective for a two-year period.[25] A section 61.38 carrier files tariffed rates based on its projected costs and demand and targets its rates to earn an 11.25 percent return. If the demand of a section 61.38 carrier increases above the level projected by the carrier in its tariff filing during the tariff period, it does not share the increased revenues with any other carrier. Accordingly, a section 61.38 carrier retains the increased revenues to the extent they exceed any increase in costs, protected from retrospective refund liability by the deemed lawful provision of the Act, but rates that result in earnings over 11.25 percent are subject to complaint and the Commission could order prospective rate changes.

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[20] *See ACS of Anchorage, Inc. v. FCC*, 290 F.3d at 412; *AT&T Corp. v. Virgin Islands Tel. Corp.*, 19 FCC Rcd at 15991-92, paras. 40-41 (noting that rate of return prescription has force of statute).

[21] *See, e.g., American Tel. & Tel. Co. v. Northwestern Bell Tel. Co.*, Memorandum Opinion and Order, 5 FCC Rcd 143 (1990) (holding that section 208 complainant can recover damages from carrier that has violated rate of return prescription), *appeal dismissed sub nom. Mountain States Tel. and Tel. Co. v. FCC*, 951 F.2d 1259 (10th Cir. 1991) (*per curiam*), *damages determined in AT&T Comm. v. Northwestern Bell Tel. Co.*, Memorandum Opinion and Order, 8 FCC Rcd 1014 (1993).

[22] National Exchange Carrier Association, Inc., Tariff FCC No. 5, Title Pages 1-68.

[23] In lieu of cost studies, average schedule carriers are compensated by formulas that establish settlements for average schedule carriers that are comparable to the settlements received by comparable cost companies. The average schedule settlements are added to the costs of the cost companies to form the revenue requirement for the pool. *See infra* para. 8.

[24] 47 C.F.R. § 69.3(e)(6).

[25] 47 C.F.R. § 69.3(f)(1).

8. Finally, a rate-of-return carrier that has 50,000 or fewer access lines in a study area may elect to file its access tariffs in accordance with section 61.39 of the Commission's rules, which was adopted in the *Small Carrier Tariff Order*.[26] A carrier choosing to proceed under this rule is required to file access tariffs in odd numbered years to be effective for a two-year period.[27] The initial rates of section 61.39 carriers are set based on historical costs (or average schedule settlements) and associated demand for the preceding year.[28] These carriers do not share their costs and revenues with any other carrier. Thus, if demand increases, the carrier retains the revenues to the extent they exceed any cost increase, protected from retrospective refund liability by the deemed lawful provision of the Act. Section 61.39 carriers' rates are required to be just and reasonable, may be challenged in a complaint proceeding, and the Commission can order prospective rate changes for rate-of-return violations.[29] Section 61.39 carriers were required to file tariffs this year.[30]

9. *Price cap carriers*. In 1990, the Commission adopted a new pricing structure for larger LECs that focused on prices rather than earnings to maintain just and reasonable interstate access rates.[31] Pursuant to rules set forth in Part 61 of the Commission's rules, the rates of price cap LECs must comply with a series of price cap indexes or ceilings that are designed to give price cap LECs some pricing flexibility, while at the same time ensuring that interstate access rates remain just and reasonable.[32] Price cap carriers are permitted to earn returns significantly higher, or potentially lower, than the prescribed rate of return that incumbent LECs are allowed to earn under rate-of-return regulation. Price cap LECs are not subject to complaints for excess earnings. Price cap LECs file access tariffs annually to become effective on July 1.[33]

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[26] *Regulation of Small Telephone Companies*, 2 FCC Rcd 3811 (1987) (*Small Carrier Tariff Order*).

[27] 47 C.F.R. § 69.3(f)(2). These carriers have the option of filing tariffs pursuant to either section 61.38 or section 61.39. 47 C.F.R. §§ 61.38 and 69.3(f)(1).

[28] 47 C.F.R. § 61.39(b); *see Small Carrier Tariff Order*, 2 FCC Rcd at 3812, para. 7 (noting that this process "should not permit or provide incentives for small companies to file access tariffs producing excessive returns"). For subsequent tariff filings, cost carriers establish rates based on a cost of service study for Traffic Sensitive elements for the total period since the local exchange carrier's last annual filing, with related demand for the same period, while average schedule carriers establish rates based on an amount calculated to reflect the Traffic Sensitive average schedule pool settlement the carrier would have received if the carrier had continued to participate in the NECA pool, based upon the most recent average schedule formulas approved by the Commission. 47 C.F.R. § 61.39(b)(2)(ii).

[29] The Commission indicated that it stood ready to undertake necessary corrective measures if the use of historical data to set rates proved not to be rate neutral in practice, or if switching between the use of prospective and historical costs and demand as a basis for ratemaking appeared likely to violate the principle of rate neutrality in a given case. *Small Carrier Tariff Order,* 2 FCC Rcd at 3813, para. 14. The Commission exempted section 61.39 carriers from sections 65.700-701 of the Commission's rules, the obligation to file Form 492 and the obligation to make automatic refunds. This latter point has been supplanted by the deemed lawful provision of the Act, which protects these carriers from refund liability.

[30] 47 C.F.R. § 69.3(f)(2).

[31] *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*).

[32] 47 C.F.R. §§ 61.41-49.

[33] 47 C.F.R. § 69.3(h).

10. *Competitive local exchange carriers*. Competitive LECs are considered nondominant carriers and are thus subject to minimal rate regulation. Section 61.26 allows competitive LECs to tariff interstate access charges if the charges are no higher than the rate charged for such services by the competing incumbent LEC (the benchmarking rule).[34] The Commission established an exemption for rural competitive LECs[35] competing against non-rural incumbent LECs, pursuant to which rural competitive LECs may file tariffs provided that their rates are no higher than the access rates prescribed in the NECA access tariff, assuming the highest rate band for local switching.[36] Competitive LECs may not tariff rates that are higher than those noted above, but may negotiate any such higher charges with interexchange carriers (IXCs).

III. DISCUSSION

11. With this Notice, we initiate a rulemaking proceeding to examine whether our existing rules governing the setting of tariffed rates by LECs provide incentives and opportunities for carriers to increase access demand endogenously with the result that the tariff rates are no longer just and reasonable. Several IXCs have filed complaints, either with this Commission or with United States federal district courts pursuant to sections 206-209 of the Act, alleging that such increases in access traffic have caused the involved LECs to earn a rate of return grossly in excess of the maximum allowed rate of return.[37] As discussed below, we tentatively conclude that we must revise our tariff rules so that we can be confident that tariffed rates remain just and reasonable even if a carrier experiences or induces significant increases in access demand.[38]

12. In the cases that have given rise to this inquiry, increased switched access traffic appears to be caused by the deployment of chat lines, conference bridges, or other similar high call volume

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[34] *See* 47 C.F.R. § 61.26; *see also 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, 9925, para. 3 (*CLEC Access Reform Order*).

[35] The Commission defined rural competitive LEC as a competitive LEC that does *not* serve any end users located within: (1) any incorporated place of 50,000 inhabitants or more, based on the most recently available population statistics of the Census Bureau; or (2) an urbanized area, as defined by the Census Bureau. *See* 47 C.F.R. § 61.26(a)(6).

[36] 47 C.F.R. § 61.26(e).

[37] *See Qwest Communications Corporation v. Farmers and Merchants Mutual Telephone Company*, File No. EB-07-MD-001 at 13 (filed May 2, 2007) (Qwest Complaint) (alleging that, in the first half of 2005 before Farmers left the NECA traffic-sensitive pool, Qwest delivered between 32,000 and 45,500 minutes of use per month to Farmers, while in August 2005, Qwest delivered 732,977 minutes, and a year later, it delivered 2,221,767 minutes to Farmers); *AT&T Corporation v. Superior Telephone Cooperative, et. al*., Case No. 04-07-cv-00043-JEG-RAW at 15-16 (S.D. Ia., filed Fed. 20, 2007) (AT&T Complaint) (alleging that its access bills from Superior averaged $2,000 per month prior to mid-2006 and now its access bills exceed $2,000,000 per month); *Sprint Communications Company, L.P. v. Superior Telephone Cooperative, et. al*. Case No. 04-07-cv-00194 at 13 (S.D. Ia., filed May 7, 2007) (Sprint Complaint) (alleging that from March 2006 to March 2007, Superior's billing increased from approximately 14,945 minutes to 3,854,390 minutes per month).

[38] We need not address reductions in demand because carriers may make a carrier-initiated tariff filing whenever they want and presumably would do so if their rate of return declined sharply, either because of increased costs, or reduced demand.

operations in the service areas of certain rate-of-return or competitive LECs.[39] The LECs may provide space in their central offices for the call operators' equipment and may provide other services, including telephone numbers, for the call service operators. The chat lines or conference services, along with the associated number(s), are advertised, generally on the Internet, as being free (or for the cost of a long-distance call). Users of these services make interstate calls to those numbers and the local exchange carriers assess interstate access charges on the IXCs that deliver the calls.[40] The applicable per minute access charge rates are often high because many of the carriers involved in these arrangements are small carriers whose rates were set based on higher than average per minute costs and a low volume of traffic based on historical levels. AT&T and Qwest allege that the LECs experiencing or creating this access growth share the access revenues they receive with the service providers whose services are generating the demand growth.[41] As a direct result of the increase in traffic volume, the LECs are alleged to be earning returns on these access services that are substantially above the maximum rate of return authorized by the Commission.[42]

13. *Factual background*. To understand the effect of our current rules on carrier behavior and to assess whether any rule changes are necessary, we need to establish a more complete record as to the activities that are occurring, how the services are provided, and how compensation occurs between the involved parties. We believe that traffic may be stimulated through a variety of means, including conference bridges, chat line facilities, call center operations, and help desk provisioning. We invite interested persons to comment on the prevalence of these types of operations and to describe in detail how each type of service is provisioned. Interested persons should also identify other types of operations that may result in significant stimulation of access traffic and describe their provisioning arrangements. Parties should explain what fees, including both interstate and intrastate fees, the service provider pays to the LEC. We also ask interested parties to describe in detail what monies or other benefits the LEC provides to the provider of the stimulating activity, including, for example, direct payments, revenue sharing, commissions, or free services. If possible, parties should quantify these benefits to the provider of the stimulating service. We understand that carriers complaining about the access stimulation arrangements also offer conferencing and other services that may result in increased traffic. We ask such carriers to explain how they provide each of the above mentioned services, including what charges they assess on the provider, whether access charges are assessed on such calls, and what compensation, if any, is paid to such provider.

14. *Just and reasonable rates*. Section 201(b) of the Act, which requires that rates be just and reasonable, guides the Commission in its review of carriers' rates.[43] Oversimplifying somewhat, to

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[39] We take no position on the appropriateness of any such service, but confine our inquiry to whether the switched access rates of the LEC are, or will be, just and reasonable.

[40] Intrastate calls may also be made to these numbers, but those calls are beyond the jurisdiction of this Commission and thus are not the subject of this order.

[41] *See* Letter from James W. Cicconi, Senior Executive Vice President, AT&T, to Kevin J. Martin, Chairman, FCC (dated April 4, 2007) at 3 (Cicconi Letter); Qwest Complaint at 7.

[42] *See* 47 C.F.R. § 65.700.

[43] *See generally American Telephone and Telegraph Co.*, Docket No. 19129 Phase I, 38 FCC 2d 213 (1972), *aff'd sub nom., Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1974); *Phase II*, 64 FCC 2d 1 (1977) (*Docket No. 19129 Phase II*), *recon. in part*, 67 FCC 2d 1429 (1978); *Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, CC Docket No. 86-497, Report and Order, 2 FCC Rcd 269 (1987), *recon.*, 4 FCC Rcd 1697 (1989).

establish their rates, rate-of-return carriers calculate a revenue requirement, which is intended to recover expenses plus a reasonable rate of return. Once the revenue requirement is determined, carriers propose prices for all interstate services, which, when multiplied by historical or projected demand, are targeted to equal the revenue requirement. If, after rates are set, actual demand and expenses differ from the estimated demand and expenses, the realized rate-of-return may be greater or less than the targeted rate of return. The limited information we have suggests that, in certain instances, some LECs are experiencing dramatic increases in demand for switched access services. If the average cost per minute falls as demand grows, the realized rates of return are likely to exceed the authorized rate of return and thus the tariffed rates become unjust and unreasonable at some point. It is well established that there is a large fixed cost to purchasing a local switch and that the marginal or incremental cost of increasing the capacity of a local switch is low (some contend that it is zero) and certainly less than the average cost per minute of the local switch. Thus, if the average revenue per minute remains constant as demand grows, but the average cost per minute falls (which occurs if the marginal cost per minute is less than the average cost per minute) then profits (or return) will rise. This principle is equally applicable to all LECs. Moreover, the cost of local switching increases incrementally, while the price for local switching is established based on average costs, which are significantly higher. As a result, most of the switch costs are recovered by the demand used to establish the local switching rate. Carriers offering tandem switching services would experience a similar effect for their tandem switching costs. Accordingly, when local switching demand increases significantly, a carrier's increased revenues generally will exceed any cost increases. As a result, a carriers' rate of return at some point is likely to exceed the maximum allowed rate of return, making the rates unjust and unreasonable.

15. A similar effect to that associated with local switching would also occur in the transport segment of the exchange access network. As demand increases, the number of circuits needed for transmission will increase. Again, the incremental cost is lower than the average cost (although the disparity is likely not as great as in the local switching case), which would lead to the rates for transport becoming unreasonable at some point as demand increases.

16. We invite interested persons to comment on the analysis of the previous two paragraphs. If possible, parties should provide data that quantifies the projected increase in investment and plant-related expenses associated with increases in switched access minutes. Carriers experiencing significant increases in local switching demand may also see a projected increase in their non-plant related expenses related to their switched access services. We ask parties to identify with specificity any additional projected non-plant related costs that may be incurred as a result of the increased demand. Parties should quantify the amount of such projected increases to the extent possible in order to permit us to evaluate the effect of the demand increase on the projected realized rate of return. If possible, parties should provide switched access investment and cost data they would expect to incur for increases in local switching demand of 30, 100, and 1000 percent over a representative base period. Parties should indicate the effect that such increased demand would have on the carrier's rate of return. We also ask interested persons to comment on the methodologies and conclusions of the May 1, 2007, declaration of Peter Copeland that estimates the incremental costs of adding significant amounts of switched access traffic.[44]

17. In making the above projections, commenting parties that are section 61.38 carriers should use the revenues, expenses, and investment from their 2006 or 2007 annual access tariff filing as the base from which the estimates are made. Commenting parties that are section 61.39 average schedule carriers should use their 2006 average schedule settlements as the base from which their estimates of increased

[44] This declaration was filed in support of a formal complaint in the Qwest Complaint at Exhibit C. The declaration is hereby incorporated in this proceeding.

expenses are made.[45] Commenting parties that are average schedule carriers should estimate what the change in their projected book investment and expenses would be at the different increased demand levels. In addition, applying the formulas used to obtain the 2006 average schedule baseline information, they should provide the investment and expenses that the formulas would have produced if the increased demand had been used. Finally, we ask NECA to file the observed ranges of costs and demand upon which the 2007-2008 average schedule formulas for switched access services were based.

18. *Revenue sharing or other compensation*. Parties allege that at least some LECs involved in access stimulation activities have been actively encouraging this activity through revenue sharing or the payment of some other form of compensation to the entity stimulating the terminating traffic.[46] To the extent that a LEC includes any such payments in its operating expenses, it would increase its revenue requirement and thereby its access rates. The inclusion of the costs of providing the stimulating activity directly would also raise access costs. In these cases, the customer using the access stimulating service is not paying separately for the service. If compensation costs are included in a LEC's operating expense and thus bundled with access costs, the IXCs are paying for the costs of the stimulating service through the higher access charges assessed by the exchange carrier.

19. We tentatively conclude that a rate-of-return carrier that shares revenue, or provides other compensation to an end user customer, 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.[47] On its face, the compensation paid by the exchange carrier to the entity stimulating the traffic is unrelated to the provision of exchange access.[48] We invite parties to comment on this analysis. Parties believing that the inclusion of the costs of such payments, or the direct cost of providing the access stimulating activity, in the revenue requirement for switched access should explain what these costs contribute to the provision of exchange access.

20. It is possible that a carrier could pay some form of compensation to a provider of a stimulating activity and not include the compensation in its access costs. We ask parties to comment on whether, if the costs are not included in revenue requirements, the Commission has satisfied its obligation to ensure that just, reasonable, and non-discriminatory rates are maintained. Parties are asked to comment on whether the Commission should examine any such payments, and, if the commenters believe that such payments should be examined, they should identify the actions the Commission can or should take. AT&T has urged the Commission to find such payments to be unlawful in violation of section 201, 202,

[45] Other parties may use tariff support materials filed with the most recent annual tariff of any of these carriers as the base for their estimates and should provide a detailed explanation of how the estimates were calculated.

[46] *See, e.g.,* Answer of Farmers and Merchants Mutual Telephone Company, EB 07-MD-001 at 8 (filed May 29, 2007) ("Farmers has agreed to commercial arrangements with conference call companies").

[47] In evaluating whether proposed rates are just and reasonable, the Commission employs the "used and useful" doctrine and its associated prudent expenditure standard. *See generally American Telephone and Telegraph Co.*, Docket No. 19129 Phase I, 38 FCC 2d 213 (1972), *aff'd sub nom., Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1974); *Phase II*, 64 FCC 2d 1 (1977) (*Docket No. 19129 Phase II*), *recon. in part*, 67 FCC 2d 1429 (1978); *Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers*, CC Docket No. 86-497, Report and Order, 2 FCC Rcd 269 (1987), *recon*., 4 FCC Rcd 1697 (1989). Under these principles, the Commission examines whether the expense promotes customer benefits, or is primarily for the benefit of the carrier.

[48] It follows from our tentative conclusion that it would not be proper to include such costs in the development of access rates under the rubric of marketing expense, or by including them in another regulated account.

and 203 of the Act.[49] We seek comment on AT&T's contention that the payment of compensation by a carrier to a customer, such as an entity providing an access stimulation service, violates section 201 or 202, even if the carrier does not seek to recover the cost of the compensation through access charges. Further, to the extent that an entity engaged in access stimulation is a customer of the LEC tariffed services, and that LEC is paying compensation to that entity for stimulating traffic, parties should discuss whether this untariffed compensation is an unlawful rebate under section 203 of the Act, as urged by AT&T.[50]

21. *Tariff language*. We tentatively conclude that average per minute switching costs do not increase proportionately to average per minute revenues as access demand increases, and that, as a result, rates that may be just and reasonable given a specific level of access demand may not be just and reasonable at a higher level of access demand. The type of increased demand we are considering in this proceeding occurs after the tariffs become effective and was not included in the development of the carrier's filed switched access charges. Thus, the pre-review of the filed tariff, which the Commission identified as its primary means to ensure filed rates are just and reasonable in the *Streamlined Tariff Order,* may not enable the Commission to identify, prior to the time the tariff becomes effective, those cases in which significant increases in access demand will occur after the effective date of the tariff and will result in unreasonable rates. In these circumstances, the deemed lawful provisions would be protecting rates that are unjust and unreasonable rather than protecting customers. We tentatively conclude that the Commission should have the opportunity to review the relationship between rates and average costs through the filing of a revised tariff when a section 61.38 or 61.39 carrier experiences significant increases in traffic to ensure that just and reasonable rates are maintained. Accordingly, we tentatively conclude that section 61.38 and 61.39 carriers that file their own tariffs should be required to include language in their traffic-sensitive tariffs similar to the following:

> If the monthly local switching minutes of the issuing carrier exceeds [__] percent of the local switching demand of the same month of the preceding year, the issuing carrier will file revised local switching and transport tariff rates to reflect this increased demand within [__] days of the end of that month.

We invite interested parties to comment on whether this conceptual approach and language is adequate to address the problems identified, or whether another approach would be more effective. Parties should comment on whether any additional or revised reporting is necessary, and if so, explain what those reports should contain. We recognize that this approach of establishing a tariffed trigger to require a new tariff filing is unlikely to address any cases of access stimulation by carriers participating in the NECA pooling process, given the higher access demand of the NECA traffic-sensitive pool. We invite parties to comment on the incentives of carriers in the NECA traffic-sensitive pool to engage in traffic stimulation and the methods they could employ to realize the benefits of the stimulation. Parties should also address what steps, if any, should be employed to address possible traffic stimulation by carriers in the NECA traffic-sensitive pool.[51]

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[49] *See* Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Kevin Martin, Chairman, FCC at 4 (dated July 30, 2007) (Phillips Letter). AT&T defines "traffic pumping kickback arrangements" as "any LEC arrangement to pay a communications service provider to direct calls to or through the LEC's exchange that can be expected over the life of the arrangement to produce net payments from the LEC to its communications service 'customer.'"

[50] *Id*.

[51] *See infra* paras. 25-26 for specific questions about average schedule carriers in the NECA traffic-sensitive pool.

22. *Access traffic growth rate*. We are aware that some variation in demand levels and patterns is to be anticipated, and we do not intend to constrain normal variations that are based on exogenous changes in demand. Because we find that increased demand beyond some normal traffic growth level will likely result in rates that are unreasonable, we invite interested parties to comment on what an appropriate growth rate would be to trigger a carrier's having to make a new tariff filing, e.g., a 30, 50, or 100 percent growth in demand over the demand used in setting the rates in the currently effective tariff, or over the local switching demand in the same month of the preceding year. The appropriate percentage increase threshold would appear to depend to some degree on the length of time over which the demand is measured and the size of the carrier. As the measurement period gets longer, we believe that the growth factor should decrease because the longer measurement period neutralizes possible spikes in demand that otherwise would need to be compensated for if a shorter time period were used. Parties should comment on whether the appropriate measurement time period is one month, two months, a quarter, or some other period of time. We invite parties to comment on whether we should establish different trigger levels depending on the size of carriers, and at what levels any such triggers should be set. In addition, parties should comment on whether we should establish different trigger points depending on whether the increase in traffic is endogenous or exogenous. Alternatively, we ask parties to comment on whether the Commission should adopt a rule requiring carriers to file revised tariffs whenever they enter into an arrangement that would have the effect of stimulating switched access traffic by some percentage. If such a rule is adopted, parties should address whether the Commission should forbear from applying deemed lawful status to the new tariff rates. Finally, parties should address how the proposals contained in this order can be applied to carriers who are engaged in access stimulation activities today, or how such proposals can be adapted to address that situation. Alternatively, parties should describe how current access stimulation activities can be identified and addressed, for example through existing enforcement procedures or otherwise.

23. *Tariff filing issues*. As discussed above, under the proposed growth trigger approach, a carrier would be required to file a revised tariff if its growth in access minutes during a specified period exceeded a stated trigger level. We invite interested parties to comment on the appropriate period of time within which a carrier should be required to file a revised tariff after it learns it has exceeded the growth trigger. In this regard, we recognize that a carrier will need to obtain traffic data, determine whether it has exceeded the limit, and, if so, to prepare and file a revised tariff. We ask parties to provide data on how long it takes to obtain traffic data and on the time needed to prepare and file the revised tariff.

24. If a section 61.38 carrier's demand exceeds the demand trigger, it will have to file a revised tariff with required support materials. Parties should address what cost support should be required to ensure that the Commission will have the data necessary to prescribe just and reasonable rates, if that becomes necessary. Parties should comment on what additional data would be necessary if they believe that incremental cost factors will be necessary to establish revised rates that will be just and reasonable. Parties should also comment on how the demand estimates used in the revised tariff filing should be determined.

25. Similarly, if a section 61.39 carrier's demand exceeds the selected demand trigger, it will have to file a revised tariff with required support materials. Section 61.39(b)(2)(ii) requires an average schedule carrier to propose traffic-sensitive rates for subsequent filings, based on "an amount calculated to reflect the traffic sensitive average schedule pool settlement the carrier would have received if the carrier had continued to participate, based upon the most recent average schedule formulas approved by the Commission."[52] This rule, adopted in the *Small Carrier Tariff Order*, was premised on the existence

[52] 47 C.F.R. § 61.39(b)(2)(ii).

of a stable traffic and cost pattern for the average schedule carrier in order to maintain rate neutrality. In developing the average schedule formulas, carriers are grouped by a variety of characteristics, which, among other things, include the size of the carrier and the type and amount of traffic the carrier handles. The formulas therefore are developed based on an examination of the costs and demand of comparably sized cost companies and are designed to produce disbursements to an average schedule company that simulate the disbursements that would be received by a cost company that is representative of the average schedule company.[53] We tentatively conclude that the average schedule formulas can only yield reasonable estimates of an average schedule carrier's cost when the demand is within the range used to develop the formulas. When an average schedule carrier experiences a significant growth in demand that takes it outside the observed range of demand used to establish the average schedule formulas, the process of running the increased demand data through the formulas produces what appear to be extreme increases in costs for the carrier.[54] This increase appears to be inconsistent with the efficiencies carriers would be expected to realize as access demand increases. We invite parties to comment on the validity of this tentative conclusion with respect to both section 61.39 average schedule carriers and to average schedule carriers in the NECA traffic-sensitive pool that experience increased traffic that is beyond the demand observed in establishing the average schedule formulas. If parties believe that the average schedule formulas produce an incorrect estimate of an average schedule carrier's costs when demand has increased dramatically over some baseline period, they should suggest ways the Commission could revise section 61.39 or other rules to address average schedule carriers in the NECA traffic-sensitive pool. Parties should also comment on the extent to which historical and prospective demand should be used in establishing revised rates.

26. Parties are also invited to comment on two alternatives for establishing rates for section 61.39 average schedule carriers or average schedule carriers in the NECA traffic-sensitive pool that experience significant increases in demand. First, the Commission could require NECA, as part of its development of the average schedule formulas, to define the range over which the formulas were valid. Once a carrier's demand reached the top of the range, it would be presumed to have recovered all of its costs. The carrier's settlement would be set at the amount produced by the formula at that demand level. That amount would then be used to calculate the carrier's switched access rates. Alternatively, the Commission could require NECA to extend the range of the formulas in a manner that addressed the reduced incremental costs of increased traffic. Parties are asked to comment on these two approaches, or suggest other approaches that would produce cost estimates that better reflect the costs incurred by a section 61.39 average schedule carrier, or an average schedule carrier in the NECA traffic-sensitive pool, when significant increases in demand occur.

27. *Carrier certification*. We also seek comment on proposals that the Commission require section 61.39 carriers to file a certification with their tariff filings.[55] Basically, the carrier would be

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[53] 47 C.F.R. § 69.606(a).

[54] *See* July 2007 Annual Access Charge Tariff Filings, WCB/Pricing No. 07-10, Petition of AT&T Corp. to Suspend and Investigate LEC Tariffs Filed Pursuant to Section 61.39 at 23 (filed June 22, 2007) (AT&T Petition to Suspend).

[55] *See* AT&T Petition to Suspend at 7 (challenging the tariff filing of Reasnor Telephone Company, which based on the average schedule formula, claimed a 107, 236 percent increase in costs on a growth in access minutes of use of 12,717 percent); July 2007 Annual Access Charge Tariff Filings, WCB/Pricing No. 07-10, Qwest Conditional Petition to Suspend and Investigate at 9 (filed June 19, 2007); July 2007 Annual Access Charge Tariff Filings, WCB/Pricing No. 07-10, Petition to Suspend and Investigate of Sprint Nextel Corporation at 3 (filed June 22, 2007).

required to certify that it was not currently stimulating traffic and would not do so during the tariff period. We invite parties to comment on this idea, either as a stand-alone proposition, or as part of a broader package of rule revisions. We are especially interested in how such a certification process would be enforced, and how such a process would directly assist in achieving the goal of just and reasonable rates. Parties should address how they would define traffic stimulation for purposes of such a certification. Since some form of enforcement action outside the tariff review process appears to be contemplated, a clear delineation of what is objectionable traffic stimulation is necessary to avoid inadvertently penalizing carriers engaging in legitimate activities due to ambiguous rules. For example, it is not clear that merely saying traffic increased by some percentage, without looking at the reasons for the increases, would be adequate. Parties should also address whether there is a specific form that the certifications should take.

28. As an alternative to the proposed certification requirement, the Commission could make clear that by filing a tariff pursuant to the Commission's rules, a carrier is making certain specific representations. For example, in the *Small Carrier Tariff Order*, the Commission adopted the use of historical average schedule settlements as a basis for rate setting because it believed that this data would be a "reasonable proxy" for future costs.[56] The Commission could adopt a rule providing that by filing under section 61.39, a carrier is certifying that its use of historical average schedule settlement data to establish its rates is in fact a reasonable proxy for its future costs. More broadly, the Commission could establish an ongoing requirement that carriers bring to the Commission's attention all significant operational changes that could materially affect the reasonableness of their rates. Parties should comment on the need for requirements such as these and should provide rule language that would specify the extent of a carrier's obligation. In doing so, parties should address how "significant" and "material" should be defined. We contemplate that a finding that a carrier had failed to disclose any required information could be the basis for denying deemed lawful status to the carrier's rates. This is consistent with the reasoning of the D.C. Circuit in the ACS case, which identified the possibility that section 204(a)(3) deemed lawful status might not apply to a tariff if a carrier took improper action that would conceal potential rate-of-return violations.[57]

29. *Possible Forbearance*. Under section 10, we can forbear from applying "any regulation or any provision of this Act to a telecommunications carrier or telecommunications service, or class of telecommunications carriers or telecommunications services" if the Commission determines that: (1) enforcement of the regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just, reasonable, and not unjustly or unreasonably discriminatory; (2) enforcement is not necessary for the protection of consumers; and (3) forbearance from applying the regulation or provision is consistent with the public interest.[58] The extraordinary increases in local switching demand raises issues about the existing application of cost and average schedule procedures. Without reasonable and reliable methods of establishing new cost and demand levels, the Commission could be unable to determine whether revised switched access rates filed based on this higher demand will be just and reasonable. The potential exists for demand volatility to lead to repeated tariff filings in which the carriers and the Commission would be attempting to estimate a moving target. Parties should address whether it would be appropriate for the Commission, on its own motion, to forbear from enforcing the deemed lawful provision of section 204(a)(3) for the remainder of the two-year tariff period if a mid-

[56] *Small Carrier Tariff Order*, 2 FCC Rcd at 3812, 3819, para. 12 and n.22.

[57] *ACS of Anchorage v. FCC*, 290 F.3d at 413.

[58] 47 U.S.C. § 160.

course tariff filing is triggered by a sufficient increase in demand.[59] We also ask whether we should forbear from enforcing the deemed lawful provision of section 204(a)(3) with respect to a carrier's rates if it fails to file a revised tariff when required. Each of these approaches would have the effect of excluding such tariffs from the streamlined filing process. We ask parties to comment on how the Commission should determine if a violation has occurred, or whether such violation can be determined at a later time in a complaint proceeding, with the deemed lawful forbearance relating back to the date on which the revised tariff should have been filed. Parties should address what language should be included in a carrier's tariff to implement the forbearance from deemed lawful, if the Commission should adopt this approach. Parties are also asked to comment on what reporting requirements, if any, should be established for any carrier whose rates may no longer be deemed lawful if the Commission adopts this proposal.

30. If we were to forbear from deemed lawful in these limited circumstances, carriers whose traffic doubles, for example, may be subject to refunds because deemed lawful would not apply to their tariffed rates.[60] Parties should comment on what approach the Commission should use in determining whether section 61.38 and 61.39 carriers should be required to make a refund and how to determine the amount of any such refund. Alternatively, we could adopt a rule that would require a LEC whose traffic exceeded the demand trigger to thereafter negotiate its access rates with IXCs delivering traffic to its exchange. We seek comment on the legal and operational considerations involved with such an approach. In addition, commenters are encouraged to suggest alternative means besides forbearance to eliminate the prohibition on refunds resulting from deemed lawful. For example, parties should comment on the possibility of requiring carriers to file revised tariffs on a notice period such that deemed lawful status would not apply, rather than forbearing from its application.

31. *Section 61.39(b) clarification*. Finally, section 61.39(b)(2)(ii) requires the use of the "most recent average schedule formulas approved by the Commission." This language may be ambiguous in its reference to the appropriate formula to use and does not mention demand at all. For example, the Commission generally approves the proposed average schedule formulas in late May or early June. With the tariff being filed in mid-June, parties should address whether the carrier should use the just approved formula that NECA uses in developing its rates to be filed that June, the average schedule formulas used for NECA's rates in its previous access tariff, or the formulas approved two years earlier. To have matching demand data, it would need to be the last of these options since the data for the second is not complete until the end of June. To clarify the application of this rule, we invite parties to comment on when a carrier should switch from one formula to the next. Parties should also consider whether a calendar year should be used as the period for measurement in order to get more recent historical data. Parties should suggest rule language to reflect any clarifications they propose.

32. *NECA pool participation*. In the *Small Carrier Tariff Order*, the Commission emphasized that it expected the rates of section 61.39 carriers to remain just and reasonable, and expected that over and under earnings would offset each other over time. The IXCs allege that the section 61.39 carriers have exhibited a pattern of exiting the traffic-sensitive pool when their demand is low, thus establishing a

[59] The repeated filings could result because the lower switched access rate could mean that the compensation being paid to access stimulation service providers that is integral to these operations could not be paid and the LECs would have to terminate them.

[60] This would be a corrective action referred to in the *Small Carrier Tariff Order,* 12 FCC Rcd at 3813, para. 14. Parties should also comment on the possibility of requiring carriers to file revised tariffs on a notice period such that deemed lawful status would not apply, rather than forbearing from its application.

high rate for the two-year effective period of the tariff.[61] The IXCs further allege that, after a single two-year period as a section 61.39 carrier, the carriers reenter the traffic-sensitive pool to avoid basing rates for the next two years on the high demand realized while they were not in the NECA pool.[62] We note that most of the section 61.39 carriers that are defendants in complaint proceedings reentered the NECA traffic-sensitive pool in June 2007 and therefore did not file reduced rates for the next two years based on the significant increases in demand they experienced.[63] To address this, the Commission could make the section 61.39 election one-way, could require that carriers remain out of the NECA traffic-sensitive pool for a stated number of tariff cycles, or could eliminate the section 61.39 option altogether. We invite interested parties to comment on these and other options the Commission has to ensure that rates remain just and reasonable and that section 61.39 does not itself provide incentives for carriers to engage in regulatory arbitrage.

33. *Price cap LECs*. Although the complaints to date about access stimulation have generally been directed at section 61.38 and 61.39 carriers, we are interested in understanding the full breadth of possible access stimulation activities. We, therefore, invite parties to indicate the extent to which price cap carriers have an incentive to engage in or are engaging in access stimulation. We ask parties to address whether price cap carriers have a similar incentive to engage in stimulating activities that involve providing some form of incentive payment to the provider of the stimulating activity. If parties believe that price cap LECs have such an incentive, they should discuss whether this incentive exists at all switched access rate levels, or only when switched access rates exceed some level. If price cap carriers are engaging, or can economically engage in access stimulation, we invite parties to address what actions we should take to ensure that rates are just and reasonable.

34. *Competitive LECs*. Finally, we address the potential for access stimulation by competitive LECs. Competitive LECs may file access tariffs if their rates comply with the benchmarking requirements of section 61.26.[64] That section allows competitive LECs to file tariffs if the rates are no higher than those charged by the incumbent LEC serving the same area, or, in the case of rural competitive LECs competing against a non-rural incumbent LEC, to charge a rate no higher than NECA's access rates, assuming the highest band for local switching.[65] Under these rules, a competitive LEC has the same incentive to stimulate access traffic as does an incumbent LEC. Because a competitive LEC's tariff rates are not based on a review of the competitive LEC's costs, ensuring the reasonableness of competitive LEC rates, should they experience significant increases in demand, raises unique concerns.

35. Verizon proposes that the Commission could address these concerns by requiring a competitive LEC relying on the rural exemption to tariff access rates higher than the competing incumbent LEC's rates, or that benchmark their rates to rural LEC rates, to file quarterly reports of

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[61] *See, e.g.,* AT&T Petition to Suspend at 3-4.

[62] *See*, *e.g.,* Cicconi Letter at 3; *July 2007 Annual Access Charge Tariff Filings*, Petition of Verizon to Suspend and Investigate Tariff Filings at 10 (June 19, 2007) (identifying several carriers that have a history of exiting the NECA traffic-sensitive pool and having their access minutes increase significantly and then reentering the pool, after which minutes of use return to pre-exiting levels).

[63] *See* Letter from Jeffrey E. Dupree, Director-Access Tariffs and Planning, to Thomas Navin, Chief, Wireline Competition Bureau (dated June 8, 2007); *see generally* network usage reports available at http://www.fcc.gov/wcb/iatd/neca.html (reflecting sizeable traffic growth for a significant number of carriers).

[64] 47 C.F.R. § 61.26.

[65] 47 C.F.R. § 61.26(e).

interstate access minutes and modify its tariffs in specified circumstances.[66] For example, if a competitive LEC exceeds a defined volume threshold for a rural competitive LEC, the competitive LEC would be required to use the competing incumbent LEC rates as the benchmark. Verizon also proposes that a competitive LEC that benchmarks to a rural incumbent LEC should be required to benchmark to a non-rural incumbent LEC if its actual access minutes for any quarter exceeded the competing rural incumbent LEC's demand by a specified amount.[67] We invite parties to comment on Verizon's proposals. In particular, parties are invited to address how the volume limitations should be determined and how the non-rural incumbent LEC rate to be used as a benchmark should be determined.

36. Parties should also identify other alternatives to address the impact significant increases in access traffic have on the Commission's ability to rely on existing benchmarking mechanisms to ensure just and reasonable rates for competitive LECs. More generally, if we adopt an access demand trigger for competitive LECs that would result in a revised tariff filing, we ask parties to comment on how competitive LEC access traffic should be measured, e.g., by rate of growth in total minutes, or by average minutes per access line, and how such traffic measures could be verified. Parties should also comment on what level would be appropriate for the trigger.

37. We ask parties to comment on whether a competitive LEC should be subject to any of the other remedies on which comment is sought when a competitive LEC enters into an access stimulation arrangement. For example, AT&T has suggested that a competitive LEC be required to certify that it is not engaging in, and will not engage in, any traffic pumping kickback scheme during the period in which its tariff is effective and that competitive LEC tariffs will not be accepted for filing in the absence of such a certification.[68] If we conclude that access stimulation payments violate sections 201, 202, or 203, we ask parties to address the steps the Commission should take to extend these findings to competitive LECs. As discussed above for other carriers, parties should address how the proposals contained in this order can be applied to competitive LECs who are engaged in access stimulation activities today, or how such proposals could be adapted to address that situation. Alternatively, parties should identify how current access stimulation activities can be identified and addressed, for example through existing enforcement procedures, or otherwise, because competitive LECs are subject to Title II of the Act, including the requirements in section 201 that their rates be just and reasonable and section 202 that they not unreasonably discriminate. We also invite parties to address whether special rules are necessary when the competitive LEC is affiliated with the incumbent LEC. Finally, a competitive LEC may be benchmarking to the rates of an incumbent LEC that has stimulated traffic and been required to file a revised tariff or take some other action to reduce its rates. Parties should comment on whether a competitive LEC that benchmarks against an incumbent LEC should be affected by any of the changes in the incumbent LEC's tariffs that are the result of the incumbent LEC's access stimulation activities.

38. *Other Intercarrier Issues*. Finally, while the previous sections have addressed stimulation in the context of access charges, we are also interested in understanding the full breadth of possible traffic stimulation activities. We, therefore, invite parties to address whether carriers are adopting traffic stimulation strategies with respect to forms of intercarrier compensation other than interstate access

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[66] *See* Letter from Donna Epps, Vice President Federal Regulatory Advocacy, Verizon, to Thomas Navin, Chief, Wireline Competition Bureau, FCC (dated June 8, 2007).

[67] *Id.*

[68] Phillips Letter at 5.

charges.[69] We ask parties to identify situations in which this is occurring and to explain the physical provisioning and compensation arrangements that make these strategies work. Parties should also address what remedies may be available to the Commission to address such activities.

IV. PROCEDURAL MATTERS

A. *Ex Parte* Presentations

39. This proceeding shall be treated as a "permit-but-disclose" proceeding in accordance with the Commission's *ex parte* rules.[70] Persons making oral *ex parte* presentations are reminded that memoranda summarizing the presentations must contain summaries of the substance of the presentations and not merely a listing of the subjects discussed. More than a one- or two-sentence description of the views and arguments presented is generally required.[71] Other rules pertaining to oral and written presentations are set forth in Section 1.1206(b) of the Commission's rules as well.

B. Comment Filing Procedures

40. Pursuant to Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments and reply comments on or before the dates indicated on the first page of this document. All filings related to this Notice of Proposed Rulemaking should refer to **WC Docket No. 07-135**. Comments may be filed using: (1) the Commission's Electronic Comment Filing System (ECFS), (2) the Federal Government's rulemaking Portal, or (3) by filing paper copies. *See* Electronic Filing of Documents in Rulemaking Proceedings, 63 Fed. Reg. 24,121 (1998).

- Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://www.fcc.gov/cgb/ecfs or the Federal eRulemaking Portal: http://www.regulations.gov. Filers should follow the instructions provided on the website for submitting comments.

  - For ECFS filers, if multiple dockets or rulemaking numbers appear in the caption of this proceeding, filers must transmit one electronic copy of the comments for each docket or rulemaking number referenced in the caption. In completing the transmittal screen, filers should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To get filing instructions, filers should send an e-mail to ecfs@fcc.gov, and include the following words in the body of the message, "get form." A sample form and directions will be sent in response.

- Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers must submit two additional copies for each additional docket or rulemaking number.

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[69] *See* Letter from Carl W. Northrop, counsel to Metro PCS Communications, Inc., to Kevin J. Martin, Chairman, FCC (dated Sept. 7, 2007).

[70] 47 C.F.R. §§ 1.1200, 1.1206; *Amendment of 47 C.F.R. § 1.1200 et seq. Concerning Ex Parte Presentations in Commission Proceedings*, GC Docket No. 95-21, Report and Order, 12 FCC Rcd 7348 (1997).

[71] 47 C.F.R. § 1.1206(b)(2).

Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail). All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

- The Commission's contractor will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, DC 20002. The filing hours at this location are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building.

- Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

- U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12th Street, S.W., Washington, DC 20554.

41. Comments and reply comments and any other filed documents in this matter may be obtained from Best Copy and Printing, Inc., in person at 445 12th Street, S.W., Room CY-B402, Washington, DC 20554, via telephone at (202) 488-5300, via facsimile at (202) 488-5563, or via e-mail at FCC@BCPIWEB.COM. The pleadings will also be available for public inspection and copying during regular business hours in the FCC Reference Information Center, Room CY-A257, 445 12th Street, S.W., Washington, DC 20554, and through the Commission's Electronic Comment Filing System (ECFS) accessible on the Commission's Web site, http://www.fcc.gov/cgb/ecfs.

42. To request materials in accessible formats for people with disabilities (braille, large print, electronic files, audio format), send an e-mail to fcc504@fcc.gov or call the Consumer & Governmental Affairs Bureau at 202-418-0530 (voice), 202-418-0432 (TTY).

43. Commenters who file information that they believe should be withheld from public inspection may request confidential treatment pursuant to Section 0.459 of the Commission's rules. Commenters should file both their original comments for which they request confidentiality and redacted comments, along with their request for confidential treatment. Commenters should not file proprietary information electronically. *See Examination of Current Policy Concerning the Treatment of Confidential Information Submitted to the Commission*, Report and Order, 13 FCC Rcd 24816 (1998), *recon.*, 14 FCC Rcd 20128 (1999). Even if the Commission grants confidential treatment, information that does not fall within a specific exemption pursuant to the Freedom of Information Act (FOIA) must be publicly disclosed pursuant to an appropriate request. *See* 47 C.F.R. § 0.461; 5 U.S.C. § 552. We note that the Commission may grant requests for confidential treatment either conditionally or unconditionally. As such, we note that the Commission has the discretion to release information on public interest grounds that does fall within the scope of a FOIA exemption.

C. Initial Regulatory Flexibility Analysis

44. Pursuant to the Regulatory Flexibility Act (RFA),[72] the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by

[72] *See* 5 U.S.C. § 603. The RFA has been amended by the Contract with America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

the proposals considered in this Notice. The text of the IRFA is set forth in the Appendix. Written public comments are requested on this IRFA. Comments must be filed in accordance with the same filing deadlines for comments on the Notice, and they should have a separate and distinct heading designating them as responses to the IRFA. The Commission will send a copy of the Notice, including the IRFA, to the Chief Counsel for Advocacy of the Small Business Administration.[73]

D. Initial Paperwork Reduction Act of 1995 Analysis

45. The Notice discusses potential new or revised information collection requirements. The reporting requirements, if any, that might be adopted pursuant to this Notice are too speculative at this time to request comment from the OMB or interested parties under section 3507(d) of the Paperwork Reduction Act, 44 U.S.C. § 3507(d). Therefore, if the Commission determines that reporting is required, it will seek comment from the OMB and interested parties prior to any such requirements taking effect. Nevertheless, interested parties are encouraged to comment on whether any new or revised information collection is necessary, and if so, how the Commission might minimize the burden of any such collection.

V. ORDERING CLAUSES

46. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 160, 201-204, and 254(g) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 160, 201-204, and 254(g), that this Notice of Proposed Rulemaking IS ADOPTED.

47. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this Notice of Proposed Rulemaking, including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

48. IT IS FURTHER ORDERED that pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's rules, 47 C.F.R. §§ 1.415, 1.419, interested parties may file comments on this Notice of Proposed Rulemaking on or before 30 days after publication in the Federal Register, and reply comments on or before 45 days after publication in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch
Secretary

[73] 5 U.S.C. § 603(a).

APPENDIX

Initial Regulatory Flexibility Analysis

1. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),[74] the Commission has prepared the present Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities that might result from this Notice. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the Notice provided above. The Commission will send a copy of the Notice, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration.[75] In addition, the Notice and IRFA (or summaries thereof) will be published in the Federal Register.[76]

A. Need for, and Objectives of, the Proposed Rules

2. In the Notice, we initiate a rulemaking proceeding to consider whether the current rules governing the tariffing of traffic-sensitive switched access services by local exchange carriers (LECs) are ensuring that rates remain just and reasonable, as required by section 201(b). In particular, we focus on allegations that substantial growth in terminating access traffic may be causing carriers' rates to become unjust and unreasonable because the increased demand is increasing carriers' rates of return to levels significantly higher than the maximum allowed rate. In the Notice, we seek comment on the causes for the increased terminating access demand and the effect that the increase in demand has on a carrier's cost of providing switched access service.[77] We also tentatively conclude that average per minute switching costs do not increase proportionately to average per minute revenues as access demand increases, and that, as a result, rates that may be just and reasonable given a specific level of access demand may not be just and reasonable at a higher level of access demand.[78]

3. We tentatively conclude that a rate-of-return carrier that shares revenue with, or provides other compensation to, an end user customer that is engaged in access stimulating activity, or itself provides the access stimulating activity, and bundles the costs of obtaining or providing an access stimulating activity with its costs for access is engaging in an unreasonable practice that violates section 201(b).[79] We tentatively conclude that to ensure that just and reasonable rates are maintained, the Commission should have the opportunity to review the relationship between rates and average costs through the filing of a revised tariff when a section 61.38 or 61.39 carrier experiences significant increases in traffic. We seek comment on whether tariff language should be included in a tariff that would require a carrier to file a revised tariff if a specified increase in traffic occurs, the level of increased demand that should trigger any such filing, when that filing should be made, and whether revised tariff

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[74] *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601-12, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, 110 Stat. 857 (1996).

[75] *See* 5 U.S.C. § 603(a).

[76] *See id*.

[77] *See* Notice at paras. 13-17.

[78] *See id.* at paras. 14-15

[79] *See id.* at para. 19.

support should be required.[80] We also seek comment on whether it would be appropriate for the Commission to forbear from enforcing the deemed lawful provision of section 204(a)(3) if a mid-course tariff filing is triggered by a sufficient increase in demand, or if a carrier fails to file a revised tariff when required.[81] We also seek comment on whether carriers should be required to certify that they are not, and do not intend to, stimulate traffic, or whether some general rules should be adopted regarding a carrier's representations as to the reasonableness of the historical data submitted in support of its tariff filings.[82] The Notice also seeks comment on whether section 61.39(b)(2)(ii) should be clarified.[83]

4. We also invite comment on whether price cap LECs and competitive LECs have an incentive to stimulate access traffic and what steps should be taken if they do have such incentives.[84] We invite comment on a variety of means of ensuring that access charges of competitive LECs remain just and reasonable if access stimulation occurs. These include establishing growth triggers that would require a competitive LEC to refile a tariff, and redefining the benchmark rate that competitive LECs can target.[85]

B. Legal Basis

5. The legal basis for any action that may be taken pursuant to the Notice is contained in sections 1, 4(i), 4(j), and 201-205 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i)-(j), 201-205.

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules May Apply

6. The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the proposed rules.[86] The RFA generally defines the term "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[87] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.[88] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any

[80] *See id.* at paras. 21-26.

[81] *See id.* at paras. 29-30.

[82] *See id.* at paras. 27-28.

[83] *See id.* at para. 31.

[84] *See id.* at paras. 33-37.

[85] *See id.* at paras. 34-37.

[86] 5 U.S.C. §§ 603(b)(3), 604(a)(3).

[87] 5 U.S.C. § 601(6).

[88] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in the Small Business Act, 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such terms which are appropriate to the activities of the agency and publishes such definitions(s) in the Federal Register."

additional criteria established by the Small Business Administration (SBA).[89]

7. *Small Businesses.* Nationwide, there are a total of approximately 22.4 million small businesses, according to SBA data.[90]

8. *Small Organizations*. Nationwide, there are approximately 1.6 million small organizations.[91]

9. *Small Governmental Jurisdictions.* The term "small governmental jurisdiction" is defined generally as "governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand."[92] Census Bureau data for 2002 indicate that there were 87,525 local governmental jurisdictions in the United States.[93] We estimate that, of this total, 84,377 entities were "small governmental jurisdictions."[94] Thus, we estimate that most governmental jurisdictions are small.

10. We have included small incumbent local exchange carriers in this present RFA analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g*., a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[95] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent local exchange carriers are not dominant in their field of operation because any such dominance is not "national" in scope.[96] We have therefore included small incumbent local exchange carriers in this RFA analysis, although we emphasize that this RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

11. *Incumbent Local Exchange Carriers (LECs).* Neither the Commission nor the SBA has developed a small business size standard specifically for incumbent local exchange services. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[97] According to

[89] 15 U.S.C. § 632.

[90] *See* SBA, Programs and Services, SBA Pamphlet No. CO-0028, at page 40 (July 2002).

[91] Independent Sector, The New Nonprofit Almanac & Desk Reference (2002).

[92] 5 U.S.C. § 601(5).

[93] U.S. Census Bureau, Statistical Abstract of the United States: 2006, Section 8, page 272, Table 415.

[94] We assume that the villages, school districts, and special districts are small, and total 48,558. *See* U.S. Census Bureau, Statistical Abstract of the United States: 2006, section 8, page 273, Table 417. For 2002, Census Bureau data indicate that the total number of county, municipal, and township governments nationwide was 38,967, of which 35,819 were small. *Id.*

[95] 15 U.S.C. § 632.

[96] Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC (May 27, 1999). The Small Business Act contains a definition of "small-business concern," which the RFA incorporates into its own definition of "small business." *See* 15 U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. *See* 13 C.F.R. § 121.102(b).

[97] 13 C.F.R. § 121.201, NAICS code 517110 (changed from 513310 in Oct. 2002).

Commission data,[98] 1,307 carriers have reported that they are engaged in the provision of incumbent local exchange services. Of these 1,307 carriers, an estimated 1,019 have 1,500 or fewer employees and 288 have more than 1,500 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by our action.

12. *Competitive Local Exchange Carriers, Competitive Access Providers (CAPs), "Shared-Tenant Service Providers," and "Other Local Service Providers."* Neither the Commission nor the SBA has developed a small business size standard specifically for these service providers. The appropriate size standard under SBA rules is for the category Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.[99] According to Commission data,[100] 859 carriers have reported that they are engaged in the provision of either competitive access provider services or competitive local exchange carrier services. Of these 859 carriers, an estimated 741 have 1,500 or fewer employees and 118 have more than 1,500 employees. In addition, 16 carriers have reported that they are "Shared-Tenant Service Providers," and all 16 are estimated to have 1,500 or fewer employees. In addition, 44 carriers have reported that they are "Other Local Service Providers." Of the 44, an estimated 43 have 1,500 or fewer employees and one has more than 1,500 employees. Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, "Shared-Tenant Service Providers," and "Other Local Service Providers" are small entities that may be affected by our action.

D. Description of Projected Reporting, Recordkeeping and Other Compliance Requirements

13. Should the Commission decide to adopt any regulations to address access stimulation by LECs, the associated rules potentially could modify the reporting and recordkeeping requirements of LECs. We could, for instance, require LECs to make additional reports on switched access traffic demand, or provide additional supporting materials with their tariff filings.[101] These proposals may impose additional reporting or recordkeeping requirements on entities. We seek comment on the possible burden these requirements would place on small entities. Also, we seek comment on whether a special approach toward any possible compliance burdens on small entities might be appropriate. Entities, especially small businesses, are encouraged to quantify the costs and benefits of any reporting requirement that may be established in this proceeding.

E. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

14. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include (among others) the following four alternatives: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of

[98] FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, "Trends in Telephone Service" at Table 5.3, page 5-5 (February 2007) (Trends in Telephone Service). This source uses data that are current as of October 20, 2005.

[99] 13 C.F.R. § 121.201, NAICS code 517110 (changed from 513310 in Oct. 2002).

[100] Trends in Telephone Service at Table 5.3.

[101] *See* Notice at paras. 21, 29.

compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.[102]

15. The Commission's primary objective is to develop a framework for ensuring that rates remain just and reasonable, as required by section 201(b). We seek comment here on the effect the various proposals described in the Notice will have on small entities, and on what effect alternative rules would have on those entities.[103] We invite comment on ways in which the Commission can achieve its goal of protecting consumers while at the same time imposing minimal burdens on small entities.

F. Federal Rules that May Duplicate, Overlap, or Conflict with the Proposed Rules

16. None.

[102] 5 U.S.C. § 603(c).

[103] *See* Notice at paras. 21, 29.