DEPARTMENT OF TELECOMMUNICATIONS AND CABLE
DATA REQUESTS TO AT&T CORP.

Witness Responsible: Ola Oyefusi and Christopher Nurse

DATE PROPOUNDED: September 3, 2008

DTC-ATT 1-1 On page 12 lines 5-7 of AT&T's testimony you state "The CLECs have incentives to maintain high access rates, for the reasons we have discussed" (i.e., an inefficient regulatory scheme leading to CLECs gaining market power)." Is it the position of AT&T that CLEC access rates have no basis in cost and are wholly attributable to those "reasons discussed"? Please elaborate.

RESPONSE: It is AT&T's position that an individual CLEC's cost of providing access is not relevant to a "reasonable" charge in a competitive market. The relevant issue does not hinge on the relationship between the market price and the cost of any individual firm in a competitive market. In a competitive market where incumbent firms already exist, new firms are "price takers." The decisions by customers whether or not to purchase from a particular supplier are not influenced directly by a particular supplier's cost. Assuming that the suppliers provide homogenous products, customers have the natural tendency to choose the lower priced product, regardless of any cost differential that may exist among the companies. In the current CLEC pricing system in Massachusetts, the IXCs who are customers of the CLECs are unable to make that choice. That said, AT&T would not expect that any CLEC's forward looking long-run incremental costs of providing access services would exceed the Verizon access rates being proposed as the access rate cap.

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DTC-ATT 1-2 On page 14 of AT&T's testimony you state that "If the Massachusetts market for switched access services functioned well to constrain CLEC access rates, the switched access rates charged by the CLECs would converge toward a single rate, Verizon's rate level." Why is Verizon's rate level that rate at which a functioning market would find equilibrium? As Verizon's rate is a regulatorily capped rate, and CLEC's have different operational costs, wouldn't you expect different rates among CLECs even in a well functioning market?

RESPONSE: No, in a competitive market, competitors with higher costs would be unable to induce consumers to pay more than the market price for a homogenous product. This is intuitively obvious – after all, why would a rational consumer pay twice as much, or tens times as much, for a homogenous product like exchange access? They would not; in a competitive market, firms are free to, but do not, price based on costs, because if they priced higher than the market price they will make zero sales (in a competitive market.)

In a well functioning competitive market where incumbent firms already exist as other smaller firms enter to compete with the incumbents, the new entrants must set their prices at or below the price charged by the incumbent firms in order to attract any customer. If new entrants priced above the incumbents – above the market price – they would make no sales, all else being equal. The decisions by the customers to shift their demand to the lower priced firm provide the necessary discipline and determine the price level that would be sustainable, not cost differential among the firms. Every firm must adjust its cost structure below the market price to survive. That is not what we observe with the CLEC pricing system in Massachusetts. We observe CLECs able to charge enormously higher prices, for a commodity product, and IXC consumers are demonstrable captive; if IXC could avoid paying higher prices for nothing, they would; high priced sales would plummet, driving prices to converge towards the competitive market price.

DEPARTMENT OF TELECOMMUNICATIONS AND CABLE
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Witness Responsible: Ola Oyefusi and Christopher Nurse

DATE PROPOUNDED: September 3, 2008

DTC-ATT 1-3 On page 15 AT&T asserts that higher access charges put pressure on IXC's to raise long-distance toll rates. Please provide any information you have on the impact that CLEC access charges have had on Massachusetts long-distance rates.

RESPONSE: AT&T's wireline toll service in Massachusetts as elsewhere faces relentless competitive pressure not only from other wireline IXCs but from wireless carriers as well. As the Department well knows, in a highly competitive market, prices are inexorably driven to competitive cost levels, and competitors are constantly seeking ways to reduce the costs to which prices are driven. And, indeed, IXCs have been on a continuous cost reduction program for years, with the result that long distance toll rates have been continuously falling. However, switched access rates are the single largest cost element of wireline long distance service offered by AT&T and other IXCs, and that is the single cost element that IXCs cannot reduce on their own. Thus, the decline in AT&T's per minute toll revenues has been consistent with, and even greater than, declines in AT&T's per minute switched access costs. But the fact remains that higher access rates mean toll rates higher than they otherwise would have been, and lower access rates mean toll rates lower than they otherwise would have been.

There is a very simple reason why wireline IXC toll rates are so sensitive to the switched access rates the IXCs pay: none of the competitors – e.g., wireless carriers, e-mail, VoIP providers, social networking websites – are paying switched access charges. Wireline IXCs are, therefore, always at a competitive cost disadvantage because their prices must recover switched access costs their competitors do not incur. Because switched access costs keep wireline IXC toll rates above those of other carriers, the wireline IXCs must reflect lower access costs in their prices in an effort to prevent further loss of toll traffic.

DEPARTMENT OF TELECOMMUNICATIONS AND CABLE
DATA REQUESTS TO AT&T CORP.

Witness Responsible: Ola Oyefusi and Christopher Nurse

DATE PROPOUNDED: September 3, 2008

DTC-ATT 1-4 Refer to your testimony at page 14. If higher access charges result in more long-distance traffic using alternative "services and technologies that are not subject to high access costs" does this not provide an incentive to keep costs low in order to preserve the market? Please explain.

RESPONSE: No. It does not provide an incentive to push down the cost of access because IXCs are not free to choose an alternative, lower cost access provider. The IXC must use the access provider (LEC) chosen by the end user. If AT&T was able to avoid high-priced access providers, it would simply move all its traffic to the lowest priced access provider in the Commonwealth, and this is not currently possible. Moreover, the end user does not see the higher prices his CLEC is charging the IXCs, so the end-user does not have an incentive to choose an alternative lower-priced access provider. Thus, the high-access charging CLEC experiences no material loss of business as a result of its decision to impose high access rates. This is completely contrary to a competitive market result where if a supplier increased its price above the competitive market price it would lose all its sales. Indeed, to the extent that the high-access charging CLEC is using access revenues to subsidize local exchange service, end users actually have the incentive to choose CLECs with high access charges. The loss of access minutes to these alternative technologies is not because the IXC networks are inferior; rather it is in large part caused by the fact that IXCs face different type of pricing regulation that the alternative competitors do not experience, i.e. the high access rates discriminatorily inflates the IXCs operation costs and curtails their ability to compete more effectively. And, as explained above, there is no market mechanism for these high access costs to be driven down, or else the prices would have converged.

DEPARTMENT OF TELECOMMUNICATIONS AND CABLE
DATA REQUESTS TO AT&T CORP.

Witness Responsible: Ola Oyefusi and Christopher Nurse

DATE PROPOUNDED: September 3, 2008

DTC-ATT 1-5 Refer to your testimony on page 16, line 5. Provide all documents and information relied on in making the determination that traffic pumping is taking place in Massachusetts. Where applicable, provide details of any specific instance of traffic pumping in Massachusetts that AT&T is aware of.

RESPONSE: Over the past two years, AT&T has observed a significant increase in schemes designed to artificially stimulate terminating access traffic to certain high cost local exchange carriers around the country. In November 2007, the FCC issued a Notice of Proposed Rulemaking, specifically designed to address this practice.[1] AT&T, along with a number of other interested parties, filed Comments on December 17, 2008, Reply Comments on January 16, 2008, and an ex parte filing on February 21, 2008. *See* Exhibits A, B and C to DTC-ATT 1-5. These comments describe in detail several 'traffic pumping' schemes, as well as AT&T's recommendations to for rule changes to stop the practice.

In Massachusetts as well, AT&T has observed evidence of such "traffic pumping." As part of AT&T's regular processes, access service invoices from local exchange carriers are reviewed for accuracy. This review identifies invoices that reflect inordinately large volumes of terminating access minutes of use. One of the criteria for determining unusual traffic volumes is a comparison of the average terminating MOUs per working telephone number. Recently AT&T identified a Massachusetts CLEC that appeared to be engage in 'traffic pumping' activity resulting in extraordinary large access billing to AT&T. Attached to this response are two charts that AT&T relied on in determining that the CLEC was engaged in activity that resulted in suspicious volumes of terminating traffic. *See* Exhibit D to DTC-ATT 1-5. The first chart provides a

[1] *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, FCC 07-176, released Oct. 2, 2007, *published at* 72 Fed. Reg. 64179 (Nov. 15, 2007) ("*NPRM*").

DEPARTMENT OF TELECOMMUNICATIONS AND CABLE
DATA REQUESTS TO AT&T CORP.

Witness Responsible: Ola Oyefusi and Christopher Nurse

DTC-ATT 1-5
(Cont'd)

comparison of the average terminating MOUs per working TN for all CLECs currently billing AT&T for terminating access services in excess of one million MOUs per month in Massachusetts. As shown by the highlighted entry, the CLEC in question is billing AT&T sixteen (16) times more terminating minutes than the average of the other CLECs included in this analysis. Once the CLEC was identified based on the abnormal activity, AT&T investigated the nature of the numbers to which the abnormally high call volume was terminated. AT&T did this by actually calling the telephone numbers and by searching for the numbers in Google. The results of that effort are shown in the second chart. As indicated there, the called number frequently is a "chat room" or platform for other services.

D.T.C. 07-9
DTC-ATT 1-5 Exhibit A
September 11, 2008
Consisting of 117 pages

AT&T COMMENTS
WC DOCKET NO. 07-135, ESTABLISHING JUST AND REASONABLE RATES FOR LOCAL EXCHANGE CARRIERS

DATED DECEMBER 17, 2007

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
	)	

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December 17, 2007

TABLE OF CONTENTS

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
	)	

COMMENTS OF AT&T INC.

Pursuant to Section 1.1415 of the Commission's Rules (47 C.F.R. §1.415), AT&T Inc. ("AT&T") respectfully submits these comments in response to the Commission's Notice of Proposed Rulemaking in this proceeding.[1]

INTRODUCTION AND SUMMARY

The Commission should promptly adopt modest rule changes to put a stop, once and for all, to the concerted and ever-expanding campaign being waged by a small minority of rapacious LECs to abuse the existing rules to bilk hundreds of millions of dollars from their customers. The many variants of these "traffic pumping" schemes include offers on Internet websites of "free" or very low cost chat lines (often with pornographic content), conferencing services, voicemail, and international calling. The schemes depend on using the promise of service at little or no charge to entice callers across the country (and the world) to place millions of long-distance calls to telephone numbers assigned to rural LECs with extraordinarily high access charges (falsely premised on assumptions of the low traffic volumes typical in such rural areas), with the LECs and their calling service partners sharing the access charges paid by AT&T and

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[1] *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, Notice of Proposed Rulemaking, FCC 07-176, released Oct. 2, 2007 ("*NPRM*"), *published at* 72 Fed. Reg. 64179 (Nov. 15, 2007) ("*NPRM*").

other IXCs for supposed "termination" of those calls. The enormous public interest harms associated with these patently unreasonable practices are well known and indisputable.

Initially, traffic pumping was confined to a relative handful of unscrupulous small ILECs, but in the past two years both the number and the magnitude of schemes has mushroomed.[2] Encouraged by the success of these scams, dozens of small ILECs with visions of traffic pumping riches sought to exit the NECA traffic sensitive access pool in the most recent annual tariff filing. It took a Commission order suspending those tariffs to stop them: faced with the need to disclose their plans for vastly increasing the traffic to which their proposed rates would be applied, those ILECs either returned to the NECA pool or agreed to tariff language that would trigger automatic mid-course rate corrections in response to any substantial traffic increases.[3] But even in the face of the Commission's subsequent decision in a formal complaint proceeding finding that traffic pumping schemes lead to unjust and unreasonable rates,[4] traffic pumping activities continue to grow, and more fundamental rule changes plainly remain urgently necessary.

The industry and the Commission should not and cannot continue to rely exclusively on case-by-case suspensions, investigations and litigation to combat this problem. History teaches that small ILECs inclined to such misbehavior and the coterie of brokers, consultants and fly-by-

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[2] *See AT&T Corp.* v. *Beehive Tel. Co., Inc*, 17 FCC Rcd 11641 (2002); *AT&T Corp.* v. *Frontier Communications of Mt. Pulaski, Inc.*,17 FCC Rcd 4041 (2002); *AT&T Corp. v. Jefferson Tel. Co.*, 16 FCC Rcd 16130 (2001); *Total Telecoms. Services, Inc. v. AT&T Corp.*, 16 FCC Rcd 5726 (2001) *aff'd in part, rev'd in part and remanded sub nom. AT&T Corp. v. FCC*, 317 F.3d 227 (D.C. Cir. 2003).

[3] *See July 1, 2007 Annual Access Charge Tariff Filings*, WCB/Pricing No. 07-10, Order, DA 07-2862 (rel. June 28, 2007).

[4] *Qwest Communications Corp. v. Farmers and Merchants Mut. Tel. Co.*, File No. EB-07-MD-001, Memorandum Opinion and Order, FCC 07-175 (rel. October 2, 2007), *petition for reconsideration pending.*

night Internet-based communications service providers that seek to share in the spoils are remarkably creative, and it is inevitable that, absent rule changes, they will continue to develop and deploy new schemes that make a mockery of the Commission and its core Communications Act mandates. The Commission should attack the problem at its source, and enact modest rule changes that will eliminate those aspects of the current rules that have inadvertently encouraged these schemes.

Equally important, however, even as recent Commission attention has caused some ILECs to scale back their traffic stimulation activities, "rural" CLECs – most of which are operated solely to exploit the Commission's rules and do not serve any actual rural customers – are rapidly *expanding* their traffic pumping activities. CLECs now account for more than *three quarters* of the traffic pumping minutes being billed to AT&T. The access charge rules governing CLECs, however, make it far more difficult for the Commission to prevent CLEC traffic pumping through individual tariff suspensions and investigations. Nor will exclusive reliance on after-the-fact enforcement stop these CLEC schemes, because (in contrast to ILECs) it is very easy for these tricksters to start new CLECs to replace those whose traffic pumping operations have been exposed and halted.

A few relatively modest rule changes would largely end these schemes. For both ILECs and CLECs, two types of rule changes are necessary. First, the Commission's current rules do not provide sufficient mechanisms for early detection and deterrence of schemes to stimulate traffic to levels inconsistent with the LEC's tariffed rates. To address these deficiencies, the Commission should adopt targeted reporting and certification rules that will improve transparency and clarify the consequences of misbehavior, including loss of the ability to shield unreasonable rates and returns behind "deemed lawful" status when the LEC's conduct is

inconsistent with the promises upon which the Commission relies in accepting its streamlined tariff filing without suspension. Second, to reduce LECs' underlying incentives and ability to engage in traffic stimulation schemes, given the inevitable long lag between inception of a traffic pumping scheme and any judicial or Commission action shutting down the scheme, the Commission should implement rule changes that will require prompt, automatic tariff filings and rate reductions once the existence of a traffic pumping scheme becomes apparent.

Accordingly, the Commission should adopt the following specific rule changes for ILECs and CLECs. First, the Commission should require ILECs filing under Rules 61.38 and 61.39 and CLECs that seek to benchmark to a rural ILEC rate or to take advantage of the rural exemption: (1) to report their access traffic quarterly (and rural CLECs should also report their access lines); (2) to certify upon the filing of a tariff that they will not enter into any traffic pumping arrangement (as defined below); and (3) to include in all tariffs a commitment to revise the tariff and reduce rates in the event traffic exceeds specified thresholds (and to make appropriate refunds to access customers injured before the reduced rates become effective). If an ILEC's traffic exceeds those specified thresholds (measured in percentage growth in terminating switched access minutes) in any given quarter, the Commission's rules should require the ILEC to file new tariffed rates within 45 days under Rule 61.38. If a CLEC's traffic patterns (measured by access minutes of use per access line) exceed the specified thresholds, the Commission's rules should require a new tariff filing within 45 days subject to special ILEC benchmarks (*i.e.*, CLECs operating in non-rural ILEC's rural areas would lose the rural exemption, and CLECs operating in a rural ILEC's area would benchmark to the lowest NECA rate (Band 1)). And, as explained below, the Commission should also (i) declare access revenue sharing arrangements, in which the LEC is a net payor of money to its purported "customer," to

be an unreasonable practice under Section 201(b); (ii) declare unjust and unreasonable the increasingly common small LEC practice of inflating access charges by designating an interconnection point with a centralized equal access provider that is scores or hundreds of miles away from the LEC's actual physical interconnection with the centralized provider; and (iii) prevent small LECs from attempting to evade rule changes designed to discourage traffic pumping by electing price cap treatment, declare that no small LEC may elect price cap treatment without prior Commission approval.

The vast majority of responsible, law-abiding ILECs and CLECs that have nothing to do with these schemes would be almost entirely unaffected by these rule changes. For example, the rule changes proposed here would not change any of the procedural options available to small ILECs opting into the NECA tariff or Rules 61.38 and 61.39; they would merely add modest reporting, certification and mid-course tariff-filing requirements that would not have any impact on an ILEC unless it experienced truly extraordinary traffic growth. AT&T has carefully analyzed historical data on ILEC traffic fluctuations, and it has proposed traffic thresholds here that would far exceed historically observed traffic growth from seasonal variations or even from rapid population growth. Similarly, AT&T's proposed rule changes would not eliminate any procedural tariffing option available today to CLECs; again, they would merely add certification and mid-course tariff-filing requirements that would never have any impact unless a CLEC's actual traffic patterns demonstrated that the assumptions underlying the generally applicable benchmark "safe harbors" are inappropriate for that CLEC and that special benchmarks should instead apply. In short, these rule changes would, with negligible burdens, deter the most egregious instances of traffic pumping, and the Commission should promptly adopt these rules in advance of 2008 annual access tariff filings.

ARGUMENT

I. THE LECs' WIDE VARIETY OF ACCESS STIMULATION SCHEMES IS WELL DOCUMENTED.

The traffic pumping schemes AT&T has identified vary in their specific details, but they generally share certain characteristics: An unscrupulous ILEC or CLEC (1) establishes high terminating access charges (typically based on false pretenses), (2) enters into traffic pumping kickback arrangements with pornographic chat-lines or other calling services that agree to advertise the service on Internet websites and other media and to route the millions of calls associated with their nominally "free" services through the LEC's exchange, and (3) bills terminating access charges to interexchange carriers for these calls between non-residents of the rural communities they serve and shares those spoils with the calling service partners that directed the traffic to or through the LEC's exchange. AT&T has uncovered an endless variety of such schemes, in which ILECs or CLECs combine these three basic elements to generate enormous volumes of traffic and exorbitant terminating access charges to interexchange customers. And while ILECs have historically been the worst offenders, CLEC traffic pumping schemes are now growing faster than ILEC schemes and represent the most pressing problem going forward.

These traffic stimulation schemes, and some of the most common variations, are described in detail in the declaration of Adam Panagia, Associate Director – Network Fraud Investigations for AT&T (attached hereto). For example, one of the most prolific methods of artificial traffic stimulation are "chat lines" – many of which offer "adult" or sexual subject matter[5] – that allow as many as 270 callers simultaneously to conduct conversations over a single line, generally with the capability for callers to access a "back room" to conduct one-on-one

[5] *See* Panagia Decl. ¶ 12.

conversations.[6] In the month of November, 2007 alone, 2,160 such chat lines generated over 47.4 *million* minutes of calling over AT&T's network, with an average call duration of 20 minutes.[7]

A variant of chat lines are "free" teleconferencing services, which like "chat lines" make use of conference bridges but are primarily geared to on-demand conferencing use by small businesses and individuals. Hundreds of simultaneous conversations may be conducted on a single access line.[8] In November, 2007, AT&T transported and terminated over 22.6 *million* minutes to just 99 particular conference lines that are associated with traffic pumping schemes.[9]

Another scheme that has been heavily used by traffic pumpers is "free" international calling service. In this arrangement, callers who reach a platform by dialing a telephone number at a LEC with high access charges may then input a telephone number for a set of foreign destinations, and that traffic is then carried to the international calling points via wholesale

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[6] *Id.* ¶ 11.

[7] *Id.*

[8] *Id.* ¶ 13.

[9] *Id.* By contrast, AT&T's conference bridges are associated with 4ESS and 5ESS switching systems within its own network; the specific locations that are selected for the switching systems and the associated bridges are determined solely by considerations of efficient network management, such as trunking capacity, and not by the terminating access rates applicable to calls to those locations. *See id.* ¶ 13, n.2. Moreover, AT&T charges its end user customers for such services, and to the extent AT&T charges an access rate, the access rates merely reflect the low "target rate" for such charges established by the Commission's *CALLS Order* (because all of AT&T's conference bridges are situated in locations where the *CALLS Order* governs access rates). *See Access Charge Reform, et al.*, Sixth Report and Order, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"). *See id.* AT&T does not pay calling service providers to stimulate traffic on AT&T's network. *See id.*

arrangements the calling service has made with other carriers at no additional charge to the calling party.[10]

There is really no limit to the ingenuity of some LECs in concocting these schemes. One of the most egregious schemes that AT&T recently uncovered was one where a LEC appeared to be using autodialing equipment to place tens of thousands of calls to wireless and wireline customers that entice customers in various ways (*e.g.*, offering free commercial credit cards) to call a telephone number in the LEC's local exchange, and when such customers place those calls, the LEC charges terminating access to the IXC that carried the call.[11] There are undoubtedly myriad other traffic pumping techniques that AT&T has yet to uncover.

These schemes are increasing in popularity because participating LECs believe their rates will be "deemed lawful" under 47 U.S.C. § 204(a)(3), freeing them to bill millions of additional dollars to IXCs for access services with no fear of ever having to pay damages if the scheme is later challenged and the patently unjust and unreasonable rates associated with these huge calling volumes are declared unjust and unreasonable. Because the perpetrators operate in very rural areas with only a few hundred or at most a few thousand access lines, they historically generated only a few thousand minutes per month of terminating access. Based on these historical demand figures, small ILECs file tariffs with the Commission with terminating access rates that are very high, usually several cents per minute, and sometimes as high as 10 or more cents per minute.[12]

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[10] Panagia Decl. ¶ 14.

[11] *See* Panagia Decl. ¶¶ 15-20.

[12] As discussed below, some traffic pumping LECs also have begun to implement schemes to further artificially increase terminating access rates even beyond setting such rates based on demand that does not reflect enormous demand generated by traffic pumping. For example, certain LECs, through arrangements with an intermediary centralized equal access carrier arrangements approved by the Commission to *reduce* access charges (typically centralized providers owned, in part, by these same LECs) are shifting the locations where the LECs claim

Because the Commission's rules permit these ILECs to set rates based on historical demand figures, the Commission typically does not suspend or investigate these tariffs. While the tariffs assume very low traffic volumes, however, the ILECs secretly enter into traffic pumping agreements which are not disclosed to the Commission. These schemes typically result in millions of additional calls to the ILEC's exchange, and consequently these ILECs' access bills to AT&T and other IXCs typically increase from thousands of dollars per month to millions of dollars per month virtually overnight. The ILEC and its traffic pumping partner then share the millions of dollars of profits from the scheme. Indeed, as discussed further below, once the ILEC has reached the number of access minutes on which its rates are based, that LEC has fully recovered its revenue requirement, and every additional access minute charged to its IXC customers is almost entirely windfall profit. The additional minutes associated with the traffic pumping schemes thus allow the ILEC to earn returns that vastly exceed those on which its tariffs are based. These ILECs then argue that their tariffs' "deemed lawful" status shields them from having to pay retroactive damages even though their rates and practices are patently unlawful.

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to "interconnect" with the intermediary carrier in order to grossly inflate the "transport" component of their access charges. For example, one LEC has established a new "interconnection" point with an intermediary carrier that is more than two hundred miles from the local exchange served by the LEC (and the LEC's actual physical interconnection with centralized facilities, thereby inflating the transport component of the access charges from tenths of a cent to several additional cents per minute. These LECs do not appear to have constructed any new facilities, and the actual physical routing of calls from AT&T to the LECs remains unchanged; yet on the basis of its paper change in "interconnection" points, the LECs claim entitlement to several cents more for each minute of traffic they supposedly terminate in connection with the traffic pumping schemes in which they are engaged. *See, e.g., Application of Indiana Switch Access Division*, 1 FCC Rcd. 643, ¶ 5 (1986) (granting operational authority to centralized facilities provider, but warning "our decision permitting [Indiana Switch] to proceed should not be interpreted as unbounded authority on the part of [independent LECs], or their affiliates, to determine points of interconnection with IXCs").

The CLECs' schemes are even easier to implement. CLECs typically exploit one of two soft spots in the Commission's current CLEC access charge rules: they either (1) "enter" the rural areas of non-rural ILECs (*i.e.*, the RBOCs), which allows them to establish a token presence using below-cost UNE arrangements while simultaneously using the rural exemption to charge high access charges benchmarked to the highest NECA rate, or (2) gravitate to (and may be affiliated with) rural ILECs in extremely high-cost rural areas that have left the NECA pool, thus allowing the CLEC to "benchmark" to the ILEC's extremely high access charges. The CLEC then engages in a traffic pumping scheme, resulting in traffic volumes that far exceed those on which the benchmark ILEC's rates are based (or the traffic on which the highest NECA rate is based), and thus earns extraordinary returns. Because these CLEC rates are in tariffs filed on a streamlined basis, the CLEC argues that even if its conduct, rates, and returns are later determined to be unlawful, it is shielded from paying refunds by the "deemed lawful" status of its tariffs.[13]

These ILEC and CLEC traffic pumping schemes are being implemented in multiple rural areas of multiple states. AT&T alone has identified schemes by such LECs in Iowa, Minnesota, and South Dakota, among other states. AT&T has filed lawsuits against many of these ILECs and CLECs, which remain pending in federal courts. But these lawsuits will not adequately address the problem because LECs are becoming more and more creative in the methods they are

[13] Nor are CLEC going to be willing voluntarily to commit to the safeguard mechanisms the Commission has imposed on ILECs. Recently, AT&T began receiving invoices from a new CLEC in South Dakota that appeared to reflect a pattern of traffic pumping. AT&T contacted the CLEC and requested that the CLEC confirm that it had not entered into any agreements to pay compensation, or provided anything of value, to any entity improperly to stimulate traffic, defining "improper stimulation of traffic" as including, but not limited to, "any arrangement by the CLEC to pay a communications service provider or other entity to direct calls to or through the CLEC's exchange that can be expected over the life of the arrangement to produce net payments from the CLEC to such entity." The CLEC summarily rejected AT&T's request.

using to maximize their returns from such schemes and to avoid detection. Many holding companies own several ILECs, and they simply rotate traffic pumping among the subsidiary or affiliate ILECs, closing down the traffic pumping scheme for a particular ILEC upon the expiration of its tariff (or being caught) and shifting the activities to another subsidiary or affiliate ILEC. In other instances, ILECs have sought to carve out their most rural areas, set up a "new" ILECs serving only those very rural areas, file tariffs for those ILECs with very high rates based on very low demand, and then implement a traffic pumping scheme that increases volumes from thousands of minutes a month to millions of minutes per month. ILECs are also apparently creating CLEC subsidiaries through which they implement their traffic pumping schemes.[14] When these CLEC subsidiaries are caught engaging in traffic pumping, the ILEC can merely shift the traffic to other, sometimes newly created, CLECs. Similarly, CLEC holding companies create CLECs to engage in traffic pumping activities, and when they are caught, they simply re-direct the stimulated traffic to a new CLEC.

Although these schemes have their antecedents in abuses by only a few carriers, more and more LECs have been entering into such schemes, and the annualized harm to customers and the public has already mushroomed to hundreds of millions of dollars per year. Moreover, although the Commission has recently taken action against some ILECs – *e.g.*, by suspending the tariffs of the ILECs that exited NECA and sought to file their own tariffs in July 2007 – much of

[14] An early example of this phenomenon is Beehive Telephone Company, a rural ILEC that serves sparsely populated areas of Utah and Nevada. Within the past two years, however, no less than three CLECs have commenced operations within Beehive's service territories, apparently providing service through the purchase of unbundled service from the incumbent. These CLECs are operating "free" chat and conference lines and charging interexchange carriers at Beehive's high access rates under the guise of compliance with the Commission's "benchmark" rates for such rural CLECs. Given the paucity of legitimate subscribers in Beehive's operating area, it comes as little surprise that evidence suggests these "competitive" carriers have ties to the ILEC; for example, the attorney who incorporated one of the CLECs is a director of Beehive.

the problem has simply shifted to the CLECs, which can evade Commission oversight more easily than ILECs. Indeed, CLECs today account for about *three quarters* of all traffic pumping minutes being billed to AT&T.

As the Commission points out, the extraordinary returns derived from these traffic pumping schemes are not remotely offset by the little, if any, incremental costs of carrying that additional traffic. *NPRM* ¶ 14 (when "demand increases significantly, a [traffic pumping] carrier's increased revenues generally will exceed any cost increases"). Indeed, in *Qwest v. Farmers*, the Commission expressly agreed with the analysis in the declaration of Peter B. Copeland (submitted in support of Qwest's formal complaint against Farmers and Merchants Mutual Telephone Co. ("Farmers")), which shows that the enormous increases in access minutes associated with Farmers' traffic pumping activities were not accompanied by a proportional increase in office switching costs and tandem transport costs. AT&T's own extensive analysis has confirmed that Mr. Copeland's analysis applies generally to all of the traffic pumping ILECs and CLECs that experience similarly enormous increases in access minutes – it is an indisputable fact that a LEC's costs do not increase materially with the enormous traffic volume increases associated with traffic pumping.[15]

[15] AT&T also has confirmed that Mr. Copeland's Farmer's-specific evidence using the average schedule formula approved by the Commission extends generally to all traffic pumping LECs. AT&T has identified several LECs whose traffic during the past three years has increased by at least 100% during any year. The average level of monthly traffic for these LECs in 2004 was 1.3 million minutes per month. AT&T then computed the average schedule settlement associated with a 30%, 100%, and 1000% increase in minutes (*see NPRM* ¶ 16), and the results show that the traffic-sensitive settlement per minute associated with these increases declined on average by only 18.6%, 43.3%, and 88.9%, respectively, notwithstanding that the formula was never designed to address volume increases of this magnitude and greatly overestimates associated cost increases.

Finally, the *NPRM* asks for details regarding any agreements between the traffic pumping LECs and the web-based (and other) partners that help implement these schemes. Although AT&T generally is not privy to the details of these agreements, it has attempted to obtain such information and has developed data that provides some limited insight into the compensation arrangements between traffic pumpers and their partners.[16] Clearly, the best sources of any information on the terms, conditions and payments that support these schemes are the traffic pumping LECs themselves, but those LECs and their partners have been working hard to conceal such information.[17] There can be no genuine dispute, however, that those schemes are funded through sharing of the LECs' access revenues with the entities that offer "free" chat lines, conferencing and other services. This practice has become so blatant that the owner of one notorious traffic pumping ILEC in Iowa and the provider of the "free" conferencing service with

[16] For example, one of the Iowa LECs engaged in traffic pumping prepared form agreements with other entities that were expected to generate traffic for the "free" conferencing and other traffic pumping schemes that the LEC offered in conjunction with other service providers. The form agreements offered those parties a "marketing fee" of $0.007 per minute for generating up to 2 million minutes of monthly inbound usage, and $0.013 per minute for generating such traffic above 2 million minutes monthly. Panagia Decl., ¶¶ 7-8. In another case, a traffic pumping provider offered other entities a tiered fee arrangement, ranging from $ .005 per minute for up to one million minutes to as high as $ .01 per minute for four million or more minutes, to generate traffic for its services. *See id.*

[17] For example, in a recent complaint filed by Qwest with the Commission against one of these traffic pumping LECs, Qwest argued that the traffic pumping calls were not actually being "terminated" by the traffic pumping LEC to its traffic pumping partners, because those websites were not "customers" within the meaning of the LECs' tariff. The defendant LEC submitted bills to the Commission purporting to show that the traffic pumping partners were in fact purchasing services from the LEC, and thus were customers, and the Commission relied on those documents in rejecting Qwest's arguments. But the LEC subsequently admitted that those bills were created during the litigation and backdated to make it appear as though the LEC's traffic pumping partners were actually LEC customers. Moreover, the LEC has since resisted efforts to submit more complete documentation of these backdated contracts to the Commission. In an Iowa Utilities Board's investigation of traffic pumping, the defendant LEC appears to have submitted more detailed information subject to protective order about the true relationship with their traffic pumping partners. When Qwest sought permission from the IUB to submit those same documents to the Commission notwithstanding the IUB's protective order, the defendant LEC opposed disclosing these documents to the Commission.

which the LEC was allied actually boasted about the success of their scheme in a recent interview published in *The Wall Street Journal.*[18] The fact that these LECs and their partners have no compunction about admitting their activities underscores the need for Commission action to bring an end to these abuses.

II. THE COMMISSION HAS AMPLE AUTHORITY TO MODIFY ITS RULES TO END THE UNLAWFUL TRAFFIC PUMPING SCHEMES.

The Commission not only has ample authority to modify its rules to prevent ILECs and CLECs from effectively implementing traffic pumping schemes – it has a duty to do so. The Communications Act gives the Commission broad authority to regulate interstate communications services and to adopt tariff filing rules that ensure that rates for such services are just and reasonable.[19] This broad authority includes the power to establish a system of rate-of-return regulation, and to specify under such a system tariff filing and other requirements.[20] The Commission thus has used this authority to adopt rules governing mandatory tariff-filing periods,[21] submission of data for monitoring purposes,[22] mandatory certifications,[23] authorized

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[18] *See* Dionne Searcey, "How 2 Guys' Iowa Connection Took Big Telecoms for a Ride," *The Wall Street Journal,* Oct. 4, 2007; *see also* Panagia Decl. ¶ 6 (discussing the article).

[19] *Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968) ("legislative discretion implied in the rate making power necessarily extends to the entire legislative process embracing the method used in reaching the legislative determination as well as that determination itself").

[20] *See, e.g., Nader v. FCC*, 520 F.2d 182, 203-04 (D.C. Cir. 1975); *Regulatory Reform For Local Exchange Carriers Subject To Rate Of Return Regulation,* 8 FCC Rcd. 4545, ¶ 25 (1993); *Regulation of Small Telephone Companies,* 2 FCC Rcd. 3811, ¶¶ 20-21 (1987) ("*Small Carrier Order*"); 47 U.S.C. § 154(i).

[21] *See, e.g., Regulatory Reform For Local Exchange Carriers Subject To Rate Of Return Regulation,* 8 FCC Rcd. 4545, ¶ 25 (1993) (selecting two-year rather than one-year mandatory tariff filing interval is "a lawful exercise of our statutory discretion to tailor our regulatory systems").

[22] *See, e.g., Small Carrier Order*, 2 FCC Rcd 3811, ¶ 18 ("we have modified the proposed rules to clarify that the Commission may request . . . carrier[s] to submit the data specified by the data filing provisions in the Commission's rules").

returns,[24] and procedures for "streamlined" tariff filings under § 204(a)(3) of the Act.[25] The Commission also has ample authority to declare practices to be "unreasonable" under Section 201(b).[26]

The Commission has already acknowledged its authority to modify its tariffing rules at issue here. The tariffing rules being exploited to implement traffic pumping schemes were adopted by the Commission to ease the administrative burdens on rural LECs by allowing small ILECs to rely on historical demand data in setting rates and to avoid submitting various types of data supporting its rates, and by allowing CLECs to benchmark their rates to rural ILEC rates. The Commission also recognized, however, that there could be unexpected consequences that could require modifications of these rules, and, accordingly, the Commission emphasized that it "stand[s] ready to undertake necessary corrective measures" in such circumstances.[27] As the Commission has elsewhere acknowledged, it has "an *affirmative duty* to re-evaluate our policies

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[23] *See, e.g., Regulation of Prepaid Calling Card Services,* 21 FCC Rcd. 7290, ¶ 31 (2006) ("We find that certain certification and reporting requirements are necessary to ensure compliance with our existing access charge rules. . . . As with any other service subject to the Commission's rules, if . . . providers do not comply with these rules they will be subject to the Commission's enforcement authority, including complaints and forfeitures").

[24] *See, e.g., Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Order*, 5 FCC Rcd. 7507, ¶¶ 1, 216, 231 (1990) (prescribing an 11.25% return for rate-of-return carriers).

[25] *See, e.g., Implementation of Section 402(b)(1) of the Telecommunications Act of 1996*, 12 FCC Rcd 2170, (1997).

[26] Order on Reconsideration, *Business Discount Plan, Inc. Apparent Liability for Forfeiture*, 15 FCC Rcd. 24396, ¶ 8 (2000) ("Congress gave the Commission broad authority over unjust and unreasonable practices 'for and in connection with communication services.' In enacting section 201(b), Congress did not enumerate or otherwise limit the specific practices to which this provision applies. Instead, it granted us [the Commission] a more general authority to address such practices as they might arise in a changing telecommunications marketplace").

[27] *Small Carrier Order* ¶ 14.

in light of changed circumstances, to be alert to the consequences of our policies and stand ready to alter our rule if necessary to serve the public interest more fully."[28]

These traffic pumping schemes present an especially clear-cut case warranting prompt corrective action. These schemes are being implemented by more and more ILECs and CLECs, and they are patently unlawful, for they are designed for only one purpose: to allow ILECs and CLECs to charge excessive rates and to earn returns that far exceed just and reasonable levels in violation of Section 201(b) of the Act. The Commission has already reached precisely this conclusion. *Qwest v. Farmers,* ¶¶ 1-2 (agreeing with Qwest's allegations that "Farmers violated section 201(b) of the Act by earning an excessive rate of return" from its traffic pumping activities); *see also NPRM* ¶¶ 14-15 (access stimulation often results in "unjust and unreasonable" rates in violation of Section 201(b) of the Act for ILECs operating under Sections 61.38 or 61.39 of the Commission's rules and for CLECs operating under Section 61.26).

These Commission findings are manifestly correct. For an ILEC, the per-minute access rate it may charge under Sections 61.38 and 61.39 of the existing rules is the ILEC's revenue requirement for access services – *i.e.,* the total amount required to recover the ILEC's access cost plus a reasonable return – divided by the number of access minutes. Once the ILEC has reached the number of access minutes on which its rates are based, that ILEC has fully recovered its revenue requirement. The massive additional traffic volumes generated by access stimulation

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[28] *Inquiry into Section 73.1910 of the Commission's Rules and Regulations Concerning Alternatives to the General Fairness Doctrine Obligations of Broadcast Licensees*, 3 FCC Rcd 2050, ¶ 7 n.11 (1988) (emphasis added); *see also FCC v. WNCN Listeners Guild*, 450 U.S. 582, 603 (1981); *American Trucking Associations, Inc. v. Atchison, Topeka & Santa Fe R. Co.*, 387 U.S. 397, 416, *reh'g. denied*, 389 U.S. 889 (1967); *Implementation of the Telecommunications Act of 1996: Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; IP-Enabled Services*, 22 FCC Rcd. 6927, ¶ 37 (2007) ("While we realize that this is a change in Commission policy, we find that new circumstances force us to reassess our existing regulations").

schemes are nearly all profit,[29] and therefore such additional minutes increase the actual return earned by the ILEC far above the prescribed return. In the schemes at issue here, ILECs typically are selling *tens of millions* of access minutes in excess of the volumes on which their rates are based, rendering those rates grossly unjust and unreasonable.

Likewise, the CLEC traffic pumping schemes are designed solely to exploit Section 61.26 of the Commission's rules to allow CLECs to charge unjust and unreasonable rates and to earn unjust and unreasonable returns. The Commission adopted that rule in response to a showing that CLECs were abusing their terminating access monopolies, and the Commission's intent was to permit CLECs to tariff their rates only when they were no greater than the rates charged by the competing incumbent LEC in the same service area. The Commission assumed that the ILEC's rate would be "presumptively just and reasonable,"[30] and the Commission's benchmark rule is based on the assumption that a CLEC offering service in any particular ILEC's service area would have a network and customer base similar to that of the ILEC's. Thus, a CLEC entering an extremely rural area is assumed to have operations similar to the "competing" rural ILEC – an assumption that was critical to the Commission's conclusion that "if operation in these [rural] areas justifies higher access rates for the regulated incumbents, we conclude that it justifies equivalent rates for any competitor in the area."[31] That assumption plainly does not hold true, however, for the traffic pumpers: if the new entrant CLEC's traffic volumes are much higher than the historical demand on which the incumbent LEC's rates are based, that fact is a clear indication that the CLEC's operations are fundamentally different than

[29] As noted, any additional costs associated with the increased traffic volumes do not remotely rise in proportion to the increases in traffic associated with traffic pumping schemes.

[30] *Access Charge Reform, et al.*, Seventh Report and Order, 16 FCC Rcd 9923, ¶ 41 (2001) ("*CLEC Access Charge Order*").

[31] *Id.* ¶ 51.

the rural ILEC's, and that the Commission can no longer simply assume that the benchmark rate is an appropriate proxy for a reasonable CLEC rate. Thus, as the Commission notes in the *NPRM* (¶ 34), where a CLEC's demand substantially exceeds that of the benchmark LEC, then the CLEC's return will necessarily exceed just and reasonable levels.

In addition to imposing millions of dollars in access overcharges on IXCs, all of these schemes cause significant harm to the public interest, competition, and consumers. In many cases, they involve the marketing and provision of pornographic materials that can be accessed by children – indeed, they directly advertise the phone numbers on the Internet and provide no safeguards to prevent children from dialing them or to allow parents to block them – thus circumventing myriad Commission policies aimed at preventing such conduct. Moreover, the perceived loopholes in the Commission's rules are also distorting proper investment incentives. Rather than upgrading their facilities and making other investments to provide the best possible service to their customers, the traffic pumping ILECs and CLECs are investing their resources in kickback arrangements and other inefficient activities, and IXCs are investing millions of dollars to detect and address these practices on a case-by-case basis. In addition, these traffic pumping and other activities, if left unchecked, will inevitably result in increased long-distance prices throughout the country because the Commission's geographic averaging rules will require IXCs to recover the increased costs associated with these activities from all of their customers, not only those located in the areas where this unlawful conduct takes place. If these schemes are allowed to continue, both IXCs and their customers will end up subsidizing these renegade LECs and their partners in otherwise unsupportable business plans. On this record, there is no question that the Commission promptly should adopt the modest rule changes described immediately below to end traffic pumping.

III. THE COMMISSION SHOULD ADOPT MODEST CHANGES TO ITS RULES TO PREVENT THE SIGNIFICANT PUBLIC HARMS CAUSED BY ILEC AND CLEC ACCESS STIMULATION SCHEMES.

The Commission can deter and prevent small ILECs and "rural" CLECs from engaging in illegal traffic stimulation schemes with targeted modifications to its rules to eliminate the incentives and abilities LECs have to engage in such conduct. *Accord* NPRM ¶ 11 ("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"). Two general types of changes are necessary.

First, under the Commission's existing rules, the Commission cannot adequately detect these unlawful schemes at the time the LEC files its tariff because, as the Commission points out, "[t]he type of increased demand" at issue "occurs after the tariffs become effective." *NPRM* ¶ 11. Therefore, the Commission should adopt mechanisms at the tariff-filing stage that will deter LECs from trying these traffic pumping schemes.

Second, even if it later becomes obvious that a LEC is engaging in traffic stimulation that renders its rates unlawful, under the current rules it can take months or even years to obtain a Commission or court ruling in that regard, and even then, such a ruling may have only prospective effect due the possible applicability of "deemed lawful" status for such tariffs. Thus, the Commission should also adopt rule changes that will trigger immediate rate reductions once the existence of a traffic pumping scheme becomes apparent and that will deny deemed lawful status to tariffs that are filed under false pretenses.

To accomplish these twin goals and address shortcomings in the rules, the Commission should promptly modify its access charge rules for both ILECs and CLECs by adopting the following interrelated requirements:

(1) requirements that certain ILECs and CLECs report their quarterly access traffic, to provide transparency that will both deter traffic pumping schemes and enable quick discovery of schemes that do develop;

(2) requirements that certain ILECs and CLECs submit certifications with their tariffs that they will not enter into improper access revenue sharing arrangements and that their traffic will not experience increases of specified percentages, with loss of "deemed lawful" status if the promises made in the certifications are not kept; and

(3) requirements that will trigger prompt reductions in tariffed rates in the event any of these ILECs or CLECs do experience extraordinary increases in traffic above specified benchmarks.

These modest changes to the Commission's rules, described in greater detail below, should go a long way toward eliminating the significant incentive and ability unscrupulous LECs have today to game the system, while at the same time keeping to a minimum the burdens on honest LECs.[32]

A. Quarterly Reporting Requirements.

The first step towards deterring and preventing unscrupulous LECs from engaging in unlawful traffic stimulation schemes is to implement measures that enable the Commission and customers to detect and expose such schemes. Accordingly, it is critically important the Commission adopt requirements to file publicly quarterly reports with the Commission of the number of access minutes and, for certain CLECs, the number of access lines served.[33]

Specifically, any small ILEC that files its own tariff should be required to file a quarterly report with the Commission stating the number of access minutes served in the past quarter. In addition, during the first year that these new rules are effective, all small ILECs that file tariffs

[32] As to CLECs, traffic-pumping is largely attractive because the Commission's benchmarking rules – the rural exemption in Rule 61.26(e) that allows a CLEC operating in rural areas of an RBOC's service area to tariff the highest NECA rate and the opportunity for CLECs that operate in rural ILEC areas to benchmark to the rural ILEC rate – allow a traffic-pumping CLEC to charge a very high access rate. The most simple solution to CLEC traffic pumping, therefore, would be to revisit the *CLEC Access Charge Order* and eliminate CLECs' ability to freely rely on these ILEC and NECA benchmarks.

[33] *See NPRM* ¶ 21 (asking whether "any additional or revised reporting is necessary").

under Rules 61.38 or 61.39 also should be required to submit their prior year's quarterly volumes so that the Commission can assess the degree to which such ILECs' current volumes have increased relative to the year-ago period.

Similarly, all CLECs that take advantage of the rural exemption to the Commission's benchmarking rules, or that benchmark to a rural ILEC's rate, *see* 47 C.F.R. § 61.26, should be required to file quarterly reports with the Commission of the number of access lines they serve, as well as the quarterly access minute totals in the same manner as AT&T has proposed for small ILECs.

The Commission and access customers could then use these reports to quickly identify significant increases in LEC demand, and such traffic reporting will facilitate the additional remedial measures set forth below. These reporting requirements would place only a very small additional burden on the LECs, which already compile this same data for their own purposes, including to issue bills to their IXC customers.[34]

B. Mandatory Certifications.

The Commission should also adopt a certification requirement, which should help to deter most LECs from attempting to game the Commission's rules with traffic stimulation schemes. As with the reporting requirements, this certification requirement would apply to small ILECs that file their own tariffs pursuant to section 61.38 or 61.39 and also to CLECs that take advantage of the rural exemption or that benchmark to a rural ILEC's rate.

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[34] Further, NECA already reports monthly traffic volumes to the Commission for Tier 1 and Tier 2 (Tier 2, subset 2) LECs but currently reports only aggregated data for Tier 3 LECs. Quarterly reporting will not only obviate claims of undue burden on the part of these small carriers, but will better control for variations in monthly data that AT&T has observed in its own access billings from LECs.

Specifically, the Commission should require that these carriers submit in connection with any switched access tariff filing a statement by an executive officer of the LEC certifying that the LEC is not currently stimulating traffic and it will not do so during the tariff period. The ILEC certification should state:

> I hereby certify that [name of LEC] has not entered into, and will not enter into during the term of this tariff, any agreement or arrangement that: (i) directly or indirectly compensates a third party or third parties, including any entity affiliated with [name of LEC], for stimulating calls to or through [name of LEC]'s exchange(s), and results in compensation to such third parties that exceeds the revenues [name of LEC] receives from the customers to which it terminates the calls stimulated by the arrangement, or (ii) has the effect of increasing the amount of access traffic terminated by the [name of LEC] by more than [X][35] percent in any quarter compared to the amount of access traffic terminated by [name of LEC] during the same quarter in the prior year.

The CLEC certification should state:

> I hereby certify that (i) [name of LEC] has not entered into, and will not enter into during the term of this tariff, any agreement or arrangement that directly or indirectly compensates a third party or third parties, including any entity affiliated with [name of LEC], for stimulating calls to or through [name of LEC]'s exchange(s) and results in compensation to such third parties that exceeds the revenues [name of LEC] receives from the customers to which it terminates the calls stimulated by the arrangement, and (ii) [name of LEC]'s monthly average terminating minutes per active access line shall not exceed 2,000 minutes during the term of this tariff.

The Commission should state in its order adopting this proposal and in its implementing rules that if a LEC subject to the certification requirement fails to submit such a certification with a streamlined tariff application, the Commission will either reject the tariff or suspend the tariff and set it for investigation, thus eliminating the "deemed lawful" status of the tariff.

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[35] As described below, the applicable benchmark would vary depending on the size of the carrier: for carriers reporting up to ten million MOUs annually, the specified percentage would be 100 percent; for carriers with between ten million and 50 million MOUs annually, the specified percentage would be 75 percent; and for carriers reporting more than 50 million MOUs annually, the specified percentage would be 50 percent.

Further, to address the problem of CLECs that are not subject to periodic tariff filing requirements and that may already be engaged in traffic stimulation activities that render their rates under existing tariffs patently unjust and unreasonable, the Commission should require such a certification from all CLECs with existing tariffs that take advantage of the rural exemption or that benchmark to a rural ILEC's rate. Any such CLEC that is unable or unwilling to submit such certifications should be prohibited from continuing to rely on those benchmarks (*i.e.*, under the Commission's rules, there would be mandatory detariffing for these CLECs' access services unless they filed new tariffs at the lower benchmarks that should be established for CLECs engaged in traffic stimulation as detailed below).

These certification requirements are necessary because unscrupulous LECs are tempted by the possibility that their tariffed rates will be "deemed lawful" and shielded from any damages liability, even when a more complete analysis of the LECs' business practices would show that there is nothing lawful about the rates, because the carriers expect that their traffic volumes will increase substantially and the rates bear no relationship whatsoever to legitimate costs. The certification requirements can act as a partial substitute for more searching review of these LECs' tariffs. Where an officer of the LEC has certified that the LEC will not engage in traffic stimulation activities, the Commission and access customers can more comfortably believe that the tariffs filed on a "streamlined basis" in fact contain rates that are likely to be reasonable and thus truly deserving of "deemed lawful" status. And where the conditions in the certification upon which deemed lawful status is premised are violated during the tariff period, the Commission will be on solid legal ground in refusing to accord the rates deemed lawful status.

Indeed, the Commission has ample authority under Section 204(a)(3) to deny by rule "deemed lawful" status for tariffs supported by false certifications. The language, structure, and purposes of § 204(a)(3) and the Communications Act all confirm that intentional concealment of material information can preclude a rate from obtaining "deemed lawful" status. First, § 204(a)(3) permits a LEC to file tariffs "on a streamlined basis," but the Act does not define these terms and thus Congress has left the precise meaning and implementation of this phrase to the Commission. It has always been understood that the Commission, in interpreting and implementing § 204, may prescribe the precise forms of support that a carrier must file so that the Commission can perform its own functions under § 204 – *i.e.*, to review and, if necessary, to suspend the carrier's rates. The statute certainly cannot be read as protecting a *carrier's* right to choose unilaterally what supporting information it will provide and what it will withhold. And since the initial filing is even more important under the streamlined procedures of § 204(a)(3), the Commission could reasonably interpret the statute as imposing a heightened standard of candor regarding expected costs and traffic volumes for tariffs filed "on a streamlined basis." Accordingly, the Commission has the statutory latitude to conclude that a carrier has not made a tariff filing that satisfies this requirement of § 204(a)(3) if it has intentionally concealed information that establishes the unlawfulness of the proposed rates.[36]

As the Commission notes (¶ 28), the D.C. Circuit has already recognized that such withholding of material information can result in a forfeit of "deemed lawful" status: in *ACS*, it

[36] Indeed, the statute already imposes a duty of candor on those seeking regulatory benefits from the Commission. *RKO General, Inc.* v. *FCC*, 670 F.2d 215, 232 (D.C. Cir. 1981) (statute gives the Commission "an affirmative obligation" to perform certain tasks in "the public interest," and "[a]s a result, the Commission must rely heavily on the completeness and accuracy of the submissions made to it, and its applicants in turn have an *affirmative duty* to inform the Commission of the facts it needs in order to fulfill its statutory mandate" (emphasis added)); *see also FCC* v. *WOKO, Inc.*, 329 U.S. 223 (1946).

upheld the Commission's position that when rates are filed under the streamlined procedures, they are "deemed lawful" and are not subject to damage awards, but it made clear that it was not "addres[sing] the case of a carrier that furtively employs improper accounting techniques in a tariff filing, thereby concealing potential rate of return violations."[37]

This interpretation is also fully consistent with the Commission's recent holding in *Qwest* v. *Farmers*, as the Commission recognizes both in that order and in the *NPRM*. The Commission's decision in that case to recognize the "deemed lawful" status of Farmers' tariff turned entirely on the Commission's interpretation of the existing access charge rules – specifically, the Commission's conclusion that the Rule 61.39 procedures do not currently contain an explicit or implicit duty to make representations about future traffic growth.[38] The Commission acknowledged in the *Qwest* order that a LEC might be liable under different facts,[39] and with a *change* in the tariff-filing rules, a false certification would clearly involve the sort of "improper accounting techniques" that the D.C. Circuit has said would lead to negation of a carrier's "deemed lawful" status. And in the *NPRM* itself, the Commission states that "[w]e 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."[40]

A certification requirement would thus close a gap in the Commission's rules and should deter most LECs from even trying access stimulation schemes. This fact was dramatically proven earlier this year when thirty-eight ILECs left NECA, most of which with the obvious intention of entering into traffic pumping schemes. The Commission suspended their tariffs –

[37] *ACS*, 290 F.3d 403, 413 (D.C. Cir. 2002).

[38] *Qwest v. Farmers* ¶ 27.

[39] *See id.*

[40] *NPRM* ¶ 28.

thus denying them deemed lawful status – and *all* of the ILECs jumped at the chance the Commission gave them either to re-enter NECA or to amend their tariffs to require new rates if their traffic increased. Moreover, to the extent that a LEC executive executes a false certification, the executive may be subject to addition civil or criminal penalties, which will further deter unscrupulous LECs from engaging in illegal traffic stimulation schemes. The Commission has taken this approach in other areas where there is a significant potential for unlawful behavior, such as universal service and prepaid cards.[41]

While this certification requirement would significantly reduce the incentives of LECs to engage in traffic pumping schemes, such a requirement would impose only very minimal burdens on honest LECs. For them, it requires only the preparation of one additional document. Honest LECs rarely, if ever, will experience such extraordinary increases in total traffic volume (in the case of ILECs) or terminating minutes per line (in the case of CLECs). And to the extent that that an honest LEC does for reasons beyond its control experience such unusual increases, then its existing rates would be rendered unjust and unreasonable and it would be entirely appropriate to allow customers to obtain refunds for excessive charges and to require the LEC to submit a new tariff that reflected the increased demand.[42]

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[41] *See, e.g., Regulation of Prepaid Calling Card Services,* 21 FCC Rcd. 7290, ¶ 31 (2006). A certification requirement would be superior to a rule that simply treated existing tariff filings as an implicit representation to the same effect. There is significant value in forcing the executives of these carriers to focus on and sign a statement – potentially on pain of even criminal punishment – that the carrier will not engage in a traffic pumping scheme during the term of the tariff.

[42] Further, the Commission retains its ability to grant waivers of these certification rules when the LECs subject to the requirements demonstrate good cause why the certification is unnecessary due to particularized circumstances.

C. Benchmarks That Trigger Reduced Rates.

As discussed above, even after it is clear to a customer that a LEC is engaged in an unlawful traffic stimulation scheme, it often can take months or even years to litigate such issues and to obtain a prospective finding from the Commission or a Court that the LECs' rates are unjust and unreasonable. As a result, access customers continue to be subject to millions of dollars in excessive charges every month for months or even years after it is clear that a LEC's rates are unlawful. To eliminate this lag, and thereby protect customers from the unlawful effects of any schemes that are in fact implemented, the Commission should adopt rules that require LECs subject to the reporting and certification requirements to reduce rates immediately when specified traffic stimulation benchmarks are met. The benchmarks would be easily calculated from the data that, as described above, these LECs will be required to report.

Specifically, for small ILECs that file tariffs pursuant to section 61.38 or 61.39, the Commission should promulgate a rule requiring such LECs to file updated tariffs, with revised rates based on updated data and traffic volumes, within 45 days after the end of any quarter in which the LEC's traffic in fact increased by more than a specified percentage compared to the same quarter a year ago. AT&T has conducted an extensive, multi-year analysis of annual traffic volume changes for small ILECs of various sizes to determine appropriate percentage triggers for three "tiers" of these LECs. In particular, for all 61.38 and 61.39 ILECs, AT&T has examined year-over-year quarterly growth rates in access minutes for the past ten years. These data show that year-over-year growth rates in access minutes for these ILECs are often negative and, in any event, are generally well below 20 percent.[43] However, the data show that the

[43] These findings are illustrated in the attached Appendices A-1 (61.38 ILECs) and A-2 (61.39 ILECs), depicting the January 2005 through June 2006 data. The significant growth rates in

variation in year-over-year quarterly access minutes is greatest for ILECs with fewer than 10 million access minutes per quarter, and smaller for ILECs with between 10 million and 50 million access minutes per quarter, and the smallest for ILECs with more than 50 million access minutes per quarter.[44] Accordingly, to account for the larger variations in year-over-year annual growth rates for smaller ILECs, and lower variations for larger ILECs, AT&T suggests that the Commission adopt the following percentage triggers for three categories of small ILECs (defined by the LEC's number of access minutes per year):

Category of LEC by Annual Minutes	**Year-Over Year Quarterly Growth Rate Trigger**
10 million MOUs or less	100 percent
10 million MOUs to 50 million MOUs	75 percent
50 million or more MOUs	50 percent

As shown in Exhibits A-1 and A-2, these suggested triggers are set far above the natural variations in traffic that have historically been observed for ordinary, non-traffic-pumping LECs, and they are set at levels that make it very unlikely that natural variations in traffic will trigger a tariff filing. These triggers also recognize the mathematical proposition that a LEC with relatively larger demand may engage in significant traffic pumping without necessarily achieving a 100 percent growth level, and mitigate the potential that affiliated LECs may engage in "traffic management" to allocate their additional demand from traffic pumping among those carriers to avoid triggering the need for refiling the tariff of any one of those entities.

Concomitantly, AT&T supports a slightly revised version of the Commission's proposal to require all LECs that file their own tariffs under Section 61.38 or 61.39 to include the following language in their tariffs:

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year-over-year access minutes for the known traffic pumping LECs are highlighted in red, and they all far exceed the tariff filing triggers proposed in the table below.

[44] *See id.*

> If quarterly local switching minutes of the issuing carrier exceed [insert applicable percentage from the above table] of the local switching demand of the same quarter of the preceding year, the issuing carrier will file revised local switching and transport tariff rates pursuant to Commission Rule 61.38 to reflect this increased demand within 45 days of the end of that quarter. The issuing carrier will issue refunds to Customers equal to the difference between the local switching and transport charges paid by the customers under the existing tariffs and those contained in the revised tariffs for each day from the first day of the quarter in which increased traffic volumes triggered the new tariff filing requirement to the day on which the revised local switching and transport tariff rates become effective.

The requirement that any new tariffs be filed pursuant to Rule 61.38 is entirely appropriate. If a LEC's demand has increased by the enormously high percentages in the proposed triggers, that LEC's traffic has strayed extremely far above the zone in which it would be reasonable to assume that the LEC's historical demand for switched access minutes is a reasonable proxy for future demand or that the average schedule formula will accurately predict costs.[45] Accordingly, Section 61.39 is not a legitimate method for computing new rates triggered by such massive increases in demand, and such LECs therefore should be required comply with the Section 61.38 requirements with respect to its mid-course tariff filing.[46]

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[45] As the Commission recognizes, 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" and "when an average 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 carriers." *NPRM* ¶ 25.

[46] In subsequent voluntary filings (or when the next two year filing is made), such LECs, however, should be permitted to again file tariffs pursuant to the Section 61.39 requirements. In such circumstances, however, the Commission should modify its rules to require LECs to submit information with their tariff filings demonstrating that compliance with Section 61.39 is likely to produce just and reasonable rates. Cost schedule companies should, therefore, be required to submit data showing that their 12-month historical demand is a reasonable proxy for future demand. Further, average schedule companies should be required to submit data showing that their demand falls within the rage of demand used to develop the average schedule formula und which they seek to compute rates.

For CLECs, the Commission would modify its existing rules so that CLECs could not rely on the rural exemption or benchmark to a rural ILEC's rate where their traffic patterns exhibit clear indicia of traffic pumping. Unlike ILECs, however, a CLEC's traffic levels, particularly in the first couple of years that it operates in an area, may vary considerably year over year, and CLECs frequently enter and leave particular service areas. Consequently, year over year monthly traffic comparisons could be a poor proxy for separating traffic pumping CLECs from the herd. Instead, the Commission should adopt a trigger based on the number of access minutes per line. Where a "rural" CLEC's per line traffic is multiples of the minutes per line experienced by rural ILECs (other than those that are themselves engaged in traffic pumping) – whose rates serve as the CLEC's rate benchmark – there can be no question that the CLEC is engaged in traffic pumping, and not the true competition for rural customers that the benchmarking rules were intended to foster.

The Chart in Appendix B, attached hereto, shows the total number of access lines and minutes that rate of return ILECs reported to the Commission in 2006. These data show that the monthly average per line access minutes for all such ILECs is 215, and that out of 1400 small ILECs there are only 21 (less than 2%) with per line access minutes that exceed 1,000, virtually all of which are documented traffic pumpers. Based on these ILEC data, AT&T proposes a rural CLEC trigger of 2,000 access minutes per line. This trigger is very conservative and provides substantial latitude for CLEC growth through legitimate business practices, but would trigger the obligation for refiling by entities that clearly seek to inflate their access demand through traffic pumping. Under this proposal, therefore, a rural CLEC that exceeds the specified benchmark of 2,000 minutes per access line, by Commission rule, would no longer be able to file a tariff that

relies on the rural exemption or benchmarks to a rural ILEC's rate.[47] Such CLECs would have the following options: offer services on a mandatorily detariffed basis (as is true now of CLECs that want to offer services above the Commission-specified benchmark rates) or file new tariffs with a benchmark that would become either (1) the competing ILEC's rate, if the CLEC is using the rural exemption, or (2) the NECA band 1 rate, if the CLEC is benchmarked to a rural ILEC's rate.

Requiring new CLEC tariff filings in these circumstances is fully consistent with, if not compelled by, the rationale behind the *CLEC Access Charge Order*. One of the premises of the benchmarking rule was the assumption that a CLEC could match the higher rates of the "competing ILEC." *See CLEC Access Charge Order*, 16 FCC Rcd. 9923, ¶ 51 ("*If* operation in these [rural] areas justifies higher access rates for the regulated incumbents, we conclude that it justifies equivalent rates for any competitor operating in the area") (emphasis added). If a CLEC is engaged in traffic pumping instead – generating enormous traffic through relatively few lines – the CLEC clearly has very different operating structure than the ILEC that is actually serving these rural communities. If the trigger has been met, permitting the CLEC to continue to benchmark to the NECA band 8 rate in the case of CLECs operating in RBOC territory or the rural ILEC rate in the case of CLECs operating in rural ILEC territory would be inappropriate because it would necessarily lead to unjust and unreasonable rates.

These modest rule changes strike an appropriate balance between the interests in stopping unlawful traffic stimulation schemes and minimizing any potential additional burdens placed on

[47] To ensure that CLECs do not circumvent this triggering mechanism by artificially reducing their per line access minutes by giving away access lines or otherwise expanding the number of access lines used in the denominator of this per line trigger, the Commission also should prohibit rural CLECs from providing access lines at prices lower than the subscriber line charge associated with such access lines.

honest LECs. The threshold triggers are set high enough to catch only traffic stimulation schemes. Most honest ILECs, which already serve most of the customers in their service areas, will rarely, if ever, experience such large annual percentage increases in demand (or minutes per access line), and thus will not be caught up in these rules. In the unlikely event that an honest LEC does experience such extraordinary increases in demand, it would be entirely appropriate to require that LEC to submit new tariffs that account for those demand increases.

IV. THE COMMISSION SHOULD ISSUE DECLARATORY RULINGS THAT CERTAIN TRAFFIC PUMPING LEC PRACTICES ARE UNJUST AND UNREASONABLE.

Finally, the Commission should issue declaratory rulings that (1) any LEC revenue sharing arrangement in which the LEC becomes the net payor of the customer is an unreasonable practice under Section 201(b); (2) the practice of manipulating interconnection points to artificially inflate access charges is an unreasonable practice under Section 201(b); and (3) no small LEC may opt into the Commission's current price cap rules absent express permission from the Commission.

Revenue Sharing Agreements. The Commission should adopt its tentative conclusion (*NPRM* ¶¶ 18-20) that it is an unreasonable practice in violation of Section 201(b) for a LEC to enter into an access revenue sharing agreement in which it becomes a net payor to an end user customer. AT&T has previously defined the kickback schemes that should come within this declaratory ruling as "any LEC arrangement to pay a communications service provider to direct calls to or through a 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.'"[48] It is well-

[48] *See NPRM* ¶ 20 n.49.

settled that the Commission may declare a practice to be unreasonable,[49] and any LEC agreement that meets this definition would be unreasonable because there are no circumstances in which such schemes can serve a lawful purpose.

As the Commission's experience has abundantly confirmed, any arrangement in which the LEC is paying more to the end-user from access revenues than the end-user is paying to the LEC for local service makes economic sense *only* if the LEC is earning exorbitant returns on access services – *i.e.*, such arrangements' only function is to facilitate traffic pumping schemes.[50] There are no circumstances in which a LEC could "reasonably" use its access revenues to pay an end-user for the privilege of serving that end-user, nor has any party to these proceedings identified any legitimate basis for such revenue sharing agreements that is consistent with the LEC's obligations to charge just and reasonable access rates. The Commission should therefore declare the practice to be *per se* unreasonable.[51]

In the *NPRM* (¶ 19), the Commission also asks whether such arrangements would be unreasonable if the ILEC included the revenue sharing or other compensation amounts in its revenue requirement. Explicitly including such amounts in the revenue requirement would

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[49] Order on Reconsideration, *Business Discount Plan, Inc.; Apparent Liability for Forfeiture*, 15 FCC Rcd. 24396, ¶ 8 (2000) ("Congress gave the Commission broad authority over unjust and unreasonable practices 'for and in connection with communication services.' In enacting section 201(b), Congress did not enumerate or otherwise limit the specific practices to which this provision applies. Instead, it granted us [the Commission] a more general authority to address such practices as they might arise in a changing telecommunications marketplace.").

[50] This is just simple arithmetic: such agreements necessarily assume that the LEC will generate returns on its access services that will be enough to cover the costs of both the LEC's access business and its website partner's separate calling business.

[51] In addition, the Commission should declare that LECs must exclude from the definition of their tariffed access services, traffic associated with revenue-sharing arrangements, and that LECs are therefore subject to damages for revenues derived from such traffic because those revenues would not be protected by the "deemed lawful" provisions of the Act.

unquestionably violate Section 201(b), because as the Commission notes, such payments are unrelated to the provision of exchange access.[52] Indeed, it is well-settled that access charges may not recover costs that are unrelated to – *i.e.*, not "used and useful" for – the provision of exchange access.[53] In light of the ever-growing pattern of abuse facilitated by these agreements, however, the time has now come to declare such all agreements to be an unreasonable practice.[54]

Manipulating Points of Interconnection To Artificially Inflate Access Charges. The Commission should also declare as unreasonable practices under section 201(b) certain schemes

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[52] *See id.*

[53] *See, e.g., American Telephone and Telegraph Co.*, 38 FCC 2d 213 (1972), *aff'd sub nom., Nader* v. *FCC,* 520 F.2d 182 (D.C. Cir. 1975); *American Tel. & Tel. Co. (Phase II),* 64 FCC 2d 1 (1977), *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,* 2 FCC Rcd. 269 (1987), *recon.* 4 FCC Rcd. 1697 (1989). In the past, certain ILECs and CLECs engaged in traffic pumping schemes erroneously have argued that that Commission has held revenue sharing schemes to be lawful under § 201(b). As the Commission recognized in its recent *Qwest* v. *Farmers and Merchants* decision, that is not true. Rather, the Commission has held only that access sharing arrangements do not necessarily violate a LEC's duty as a common carrier to hold one's services out indifferently. *Beehive*, 17 FCC Rcd. 11641, ¶ 29; *Frontier*,17 FCC Rcd 4041; *Jefferson Tel. Co.*, 16 FCC Rcd. 16130, ¶¶ 7-15 ("based on the record in this case, in which AT&T argues that Jefferson's access revenue-sharing arrangement with IAN violated section 201(b) solely because it allegedly breaches common carriage duties, we conclude that AT&T has not met its burden of demonstrating that Jefferson's practice here is unjust and unreasonable"). The Commission merely found "based on the record" developed in those cases that the LEC had not acted contrary to a common carrier – *i.e.*, the LECs there had delivered calls indifferently to all customers and had not attempted to steer traffic to any particular customer. The Commission "emphasize[d] the narrowness of [its] holding" in those cases, *see Jefferson Tel. Co.*, 16 FCC Rcd. 16130, ¶ 16, and acknowledged that such arrangements might be violate § 201(b) or be otherwise unlawful for other reasons.

[54] In addition to being clear violations of Section 201(b) of the Act, there are serious questions as to whether some or all of these revenue sharing schemes – which use traditional POTS telephone numbers and sometimes 8YY numbers – violate the very important policies underlying 47 U.S.C. § 223 and the Telephone Disclosure and Dispute Resolution Act (TDDRA) (47 U.S.C. § 228). Many of the revenue sharing schemes involve the transmission of "adult" pornographic content to the caller, but have no safeguards to protect against children making such calls and receiving the content. These schemes thus significantly subvert the important policies underlying these provisions of the Act, and as such the Commission can and should use its Section 201 authority to declare these schemes unlawful.

whereby LECs seek to manipulate the points at which they interconnect with an intermediate centralized access provider in order to substantially inflate the mileage-based charges that apply to these transport access services.

In many states, access traffic is initially terminated by an IXC to an intermediate centralized access provider, which has built a transport ring around a state to aggregate traffic from numerous end offices, and then handed off to the terminating LEC at an interconnection point on the centralized equal access ring designated by the terminating LEC. The terminating LEC then charges the IXC a transport charge to carry the traffic from the designated interconnection point to the LEC's end office. As the Commission found when it initially authorized these centralized facilities, the "aggregation of traffic should reduce the access charges [the LEC] assesses IXCs."[55] In an increasing number of cases, however, certain LECs are turning the purposes of these centralized facilities upside-down, and using them to *increase* access charges for transport services. These LECs manipulate the interconnection point to designate a very distant location far removed from their actual physical interconnection with the centralized provider's ring, and then assess IXCs an exorbitant mileage-based charge for transport from that point.

In one variant of these schemes, the terminating LEC changes its interconnection point so that calls from an IXC are handed off to a centralized intermediate access provider that is located in an entirely different state, many hundreds of miles away from the terminating LEC. For example, AT&T has learned that Aventure, a CLEC in Iowa, has specified that calls destined for Iowa customers be handed off to a centralized access provider in Minnesota, even though AT&T directly connects with another such centralized provider, Iowa Network Services (INS), that has

[55] *E.g.*, *Application of Iowa Network Access Division*, 3 FCC Rcd. 1468, ¶ 14 (C.C.B. 1988).

an interconnection point in the very town in which Aventure's switch is located. To make matters worse, the traffic is then routed from Minnesota through South Dakota, and then from South Dakota to Iowa, and only then to Aventure's facilities in Iowa. As a result of this highly circuitous and entirely unnecessary path from Minnesota to South Dakota and then to Iowa, Aventure bills AT&T for more than 230 miles of transport charges, notwithstanding that Aventure could charge only a few miles of transport if it designated its interconnection point efficiently at the nearby INS interconnection point. Further, although as a CLEC, Aventure may choose to deliver long distance traffic to AT&T outside the LATA in which it originates, it should not be able to charge AT&T the cost of moving traffic to its chosen inefficient point of delivery in order to inflate its revenues. Similarly, AT&T should not be compelled to deliver traffic destined for a carrier's customers through an inefficient, and overly expensive route solely to support a carrier's desire to impose excessive charges on AT&T.

In another variant of the scheme, the LEC utilizes the centralized access provider in its own state, but rather than designate the closest interconnection point on the centralized provider's ring, the LEC designates the most distant interconnection point on the ring as its "official" interconnection point with the centralized provider, often the exact location where IXCs deliver their traffic to the centralized provider. The LEC's actual physical interconnection remains, of course, at the closest interconnection point, and the actual routing of the call remains over the centralized provider's ring to that actual physical interconnection point. But through the paper change of designating the distant "official" interconnection point, the LEC then claims the

right to charge the IXC up to hundreds of miles of transport (in addition to the transport charges the IXC pays the centralized provider for transport anywhere on the ring).[56]

By way of example, Readlyn Telephone Company of Iowa is located in Readlyn, Iowa, only 1 miles from the INS ring. Yet, Readlyn designates Des Moines – nearly 50 miles further away and the very point where AT&T interconnects with INS – as Readlyn's official interconnection point with INS, thereby nearly doubling the per-minute terminating access charges it claims are due. Of course, Readlyn's facilities, in fact, connect to the INS ring at the nearby interconnection point, not in Des Moines. Many LECs in Iowa and elsewhere are now engaging in this patently unreasonable practice which is designed solely to inflate access charges.

In each case, these LECs' manipulations of interconnection points are patently unlawful, and result in manifestly unreasonable charges for access services. These LECs have asserted that, when the Commission and state regulatory agencies approved these centralized access arrangements, the LECs were allowed complete discretion in selecting an interconnection point with the centralized providers, but this is flatly wrong. In one of the very first decisions approving these centralized access arrangements, the Commission allowed the LECs some control over the location of interconnection points, but it expressly declined to "authoriz[e] a blanket policy" and cautioned that its approval of these facilities "should not be interpreted as

[56] AT&T believes that these modifications are the result of LECs leasing facilities from centralized equal access providers that originally provided, and billed, AT&T for the same transport services. Further, while some LECs modified the point at which they take traffic from the intermediate carrier simultaneously with beginning traffic pumping, the onslaught of traffic pumping also revealed that some LECs apparently instituted the modifications much earlier, and that AT&T only identified the change when traffic levels increased substantially.

unbounded authority on the part of [LECs] to determine points of interconnection with IXCs."[57] In particular, the Commission determined that a LEC should not propose "significant[] increases [in] IXCs' operating costs" with no corresponding improvements in service or otherwise "unreasonably designate[] points of interconnection with IXCs."[58] That is precisely what is occurring here with the current schemes of these LECs. They have not offered any legitimate basis for why the transport services are being routed and billed in the manner described above. The reality is that these interconnection points and call routing mechanisms have been devised solely to increase the mileage-based charges that these LECs impose on IXCs. The Commission should use its broad authority under Section 201(b) and promptly declare such practices to be unjust and unreasonable.

Participation In Price Cap Regulation. Finally, because the current price cap rules would be patently inappropriate if applied to small and mid-sized ILECs, the Commission should issue a declaratory ruling making clear that no ILEC is permitted to opt into the Commission's current price cap rules absent express permission from the Commission. Allowing mid-sized and small LECs to opt in to the current price cap regime would be inappropriate because the Commission has made many changes to the price cap rules over the years – such as the elimination of the sharing requirement – on the assumption that those rules apply only to large LECs. The most significant of these changes was the CALLS Plan, which was an industry agreement in which most of the then-existing price cap carriers agreed to specific and very low rate levels for

[57] *Application of Indiana Switch Access Division*, 1 FCC Rcd. 634, ¶ 5 (1986).
[58] *Id.*

switched access services, and a 6.5% X-Factor as a mechanism for transitioning to those agreed upon rates.[59]

Although a small ILEC with legitimate customers would have no reason to opt in to the current price cap rules, that regime as written could tempt traffic-pumping LECs to opt in. Those LECs could leave NECA, establish very high switched access charges, and then opt into price caps, which would result in application of the price cap formula set out in the rules – *i.e.*, a 6.5% X-Factor applied to switched access each year until the switched access target rates are reached, which in the case of the traffic pumping LECs could take many years. In the intervening years, however, the rules would permit these ILECs to earn astronomical returns from traffic pumping, because the price cap regime does not regulate returns.

The Commission has already tentatively concluded that the CALLS plan rules are not available to any LEC that was not already a price cap carrier at the time of CALLS:

> The debate over incentive regulation is often clouded by uncertainty as to whether the CALLS plan contemplated that additional study areas would enter that plan during its five-year term. Three years have passed and no rate-of-return carrier has sought entry. To eliminate the uncertainty, *we tentatively conclude that the CALLS plan was not designed to be open to new carriers or study areas.* The CALLS plan began as a voluntarily negotiated agreement among price cap carriers and certain IXCs that addressed pricing and universal service concerns as a package, without consideration of possible participation by carriers that were then under rate-of-return regulation. That CALLS was not intended to accommodate additional entry is most clearly indicated by the fact that in adopting the plan, the Commission made no provision for how the universal service component of the CALLS plan would address future expansion to new carriers. We therefore believe the rules should be amended to clarify that new carriers or carrier study areas may not elect this plan. We invite parties to comment on this tentative conclusion.[60]

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[59] *CALLS Order*, 12 FCC Rcd 12962, ¶¶ 150-82.

[60] *Multi-Association Group Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 19 FCC Rcd. 4122, ¶ 93 (2004); *see also Valor Communications Group, Inc.*, 21 FCC Rcd. 859, ¶¶ 3, 7 (2006).

The Commission should now formally adopt this tentative conclusion and make crystal clear that rural ILECs are not allowed to opt into the current price cap system without prior Commission approval.[61] The Commission is considering a range of proposals for small and mid-sized LEC incentive regulation in another proceeding, and no current rate-of-return LEC should be permitted to opt into any form of incentive regulation until the Commission has completed that rulemaking.[62]

[61] An example of an ILEC that has expressly sought Commission approval to opt into the price cap mechanism is Windstream Corporation. *See Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief,* WC Docket No. 07-171 (dated Aug. 6, 2007). AT&T has submitted comments in support of Windstream's request. *See* Comments of AT&T Inc., *Windstream Petition for Conversion to Price Cap Regulation and for Limited Waiver Relief,* WC Docket No. 07-171 (dated Sep. 24, 2007).

[62] There is no need to modify the price cap rules as they apply to price cap carriers. With respect to *those* carriers, the CALLS price caps are extremely low, are presumed to be just and reasonable, and would not yield the sort of profits the traffic-pumpers have extorted from IXCs and that encourage traffic-pumping. And in all events, it is well-settled that, for price cap carriers, the Commission regulates only prices, not profits.

CONCLUSION

For the reasons stated above, the Commission should adopt the foregoing changes to its tariffing regime for ILECs and CLECs to preclude traffic pumping abuses, and should issue declaratory rulings that practices described above are unjust and unreasonable practices in violation of Section 201(b) of the Communications Act.

Respectfully submitted,

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