NARUC Attorneys Conference
Intercarrier Compensation Panel

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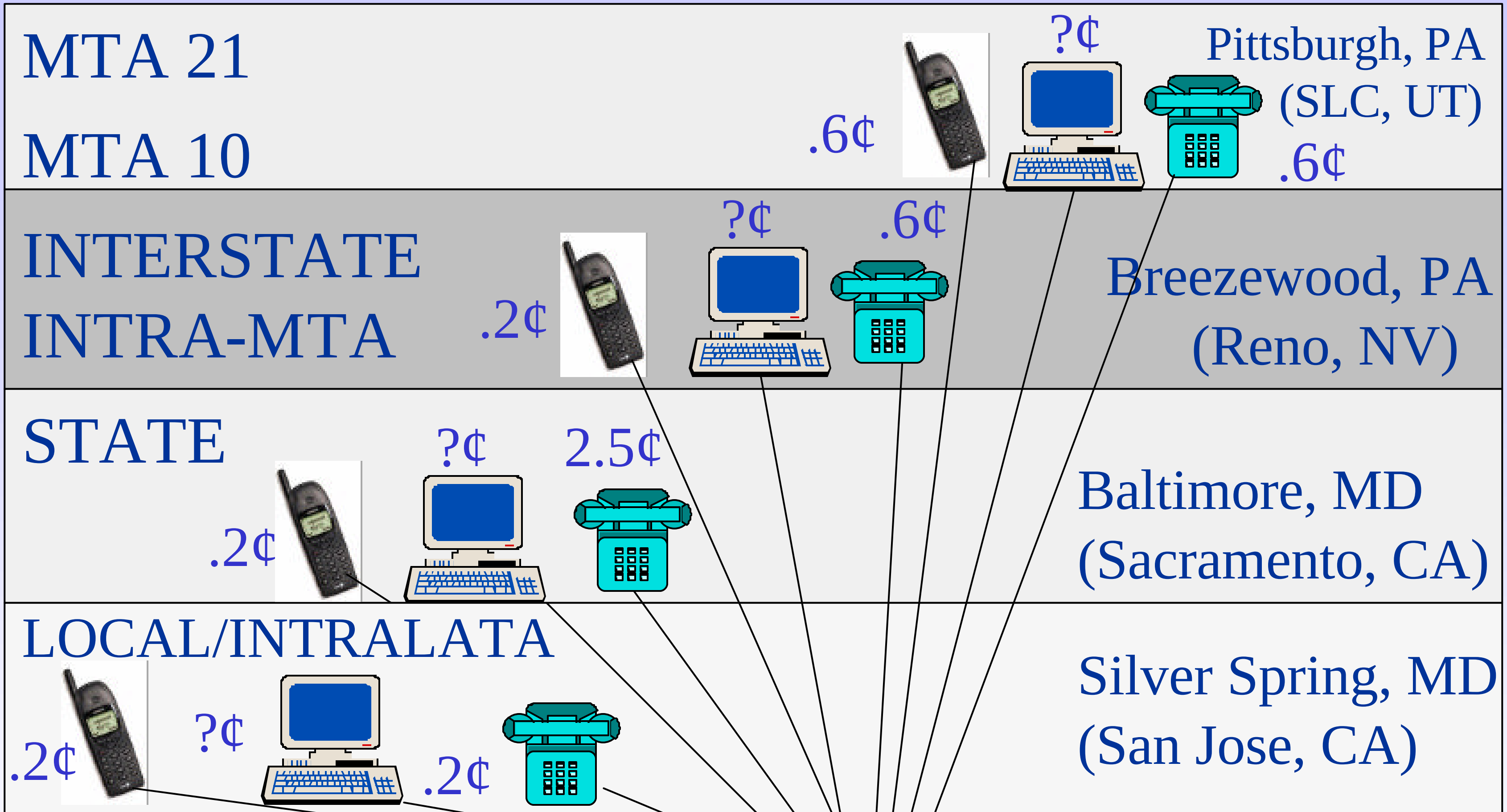
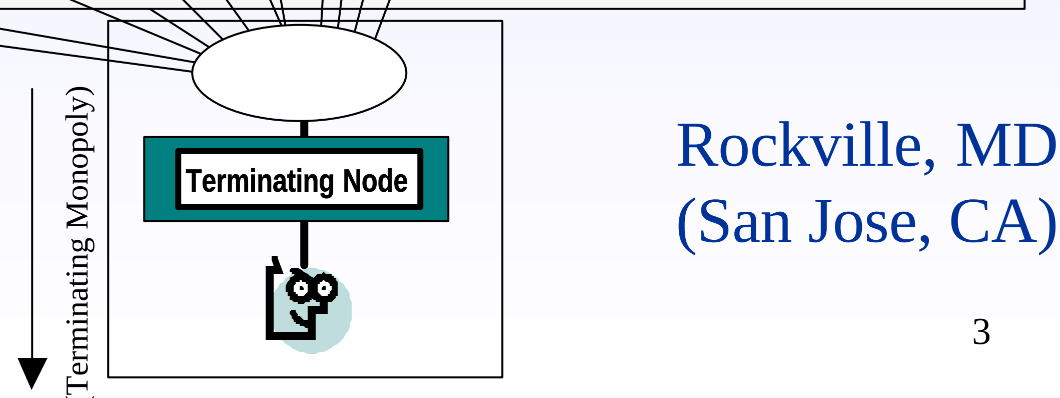
The System is Broken

- Even When the Services are Fundamentally Alike, the Present System:
  - Establishes financial responsibility for the origination, interconnection and termination of traffic in a disparate and uneconomic manner;
  - Applies different rate structures; and
  - Applies different rate levels.
- Competition and new technology make this system obsolete and unsustainable.

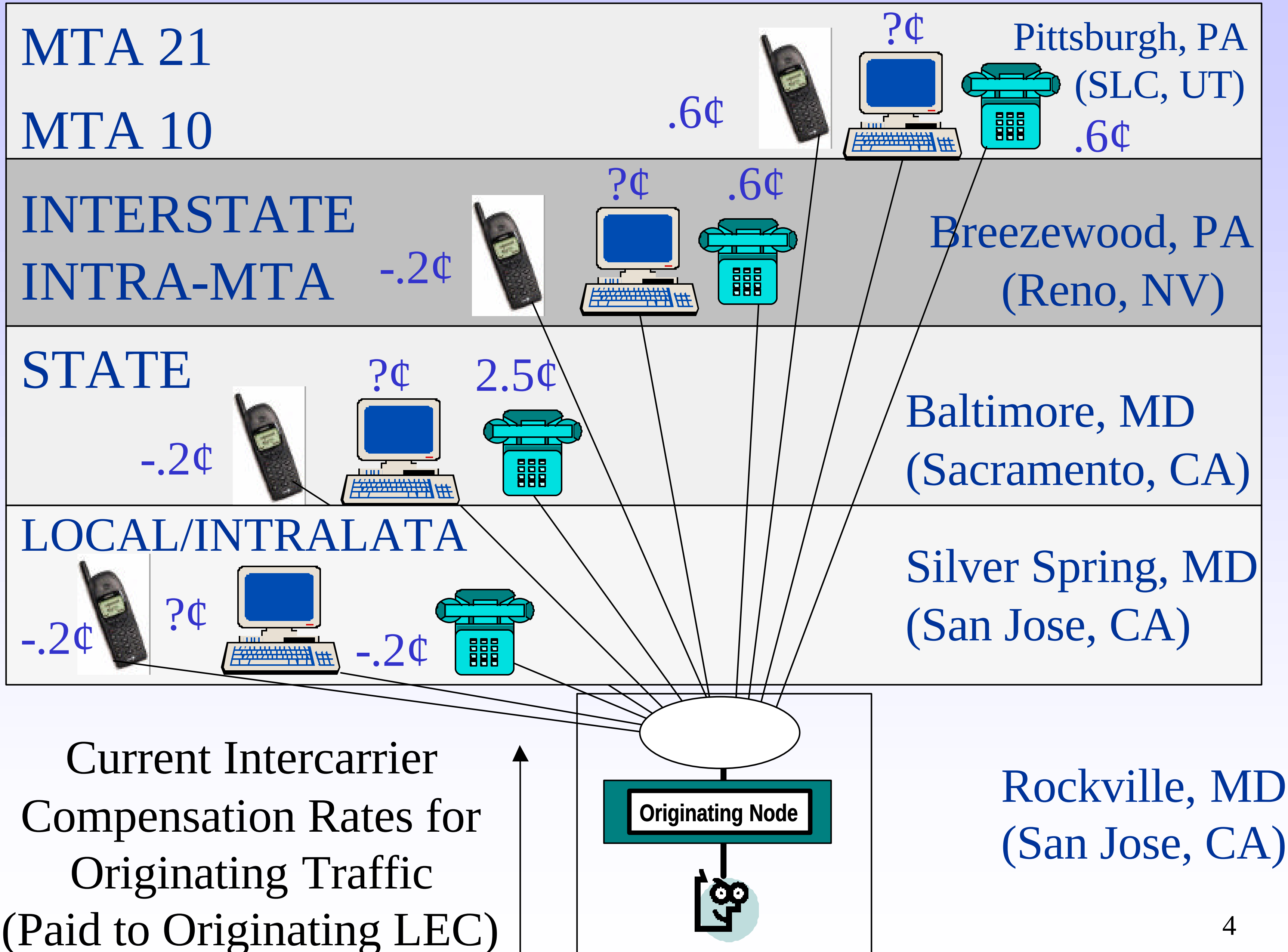
CURRENT INTERCARRIER COMPENSATION MECHANISM





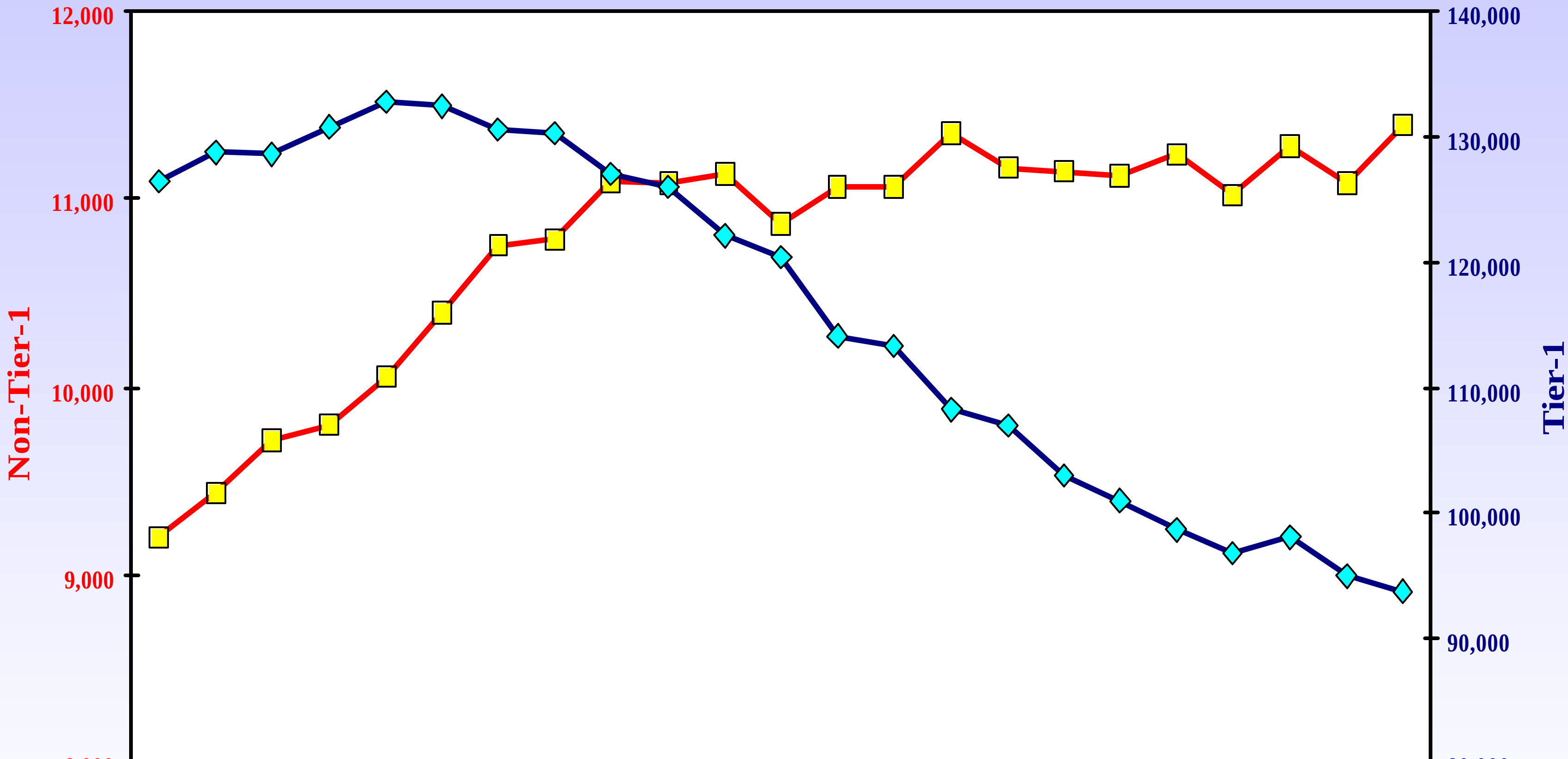
Current Intercarrier Compensation Rates for Terminating Traffic

CURRENT INTERCARRIER COMPENSATION MECHANISM



Current Intercarrier Compensation Rates for Originating Traffic (Paid to Originating LEC)

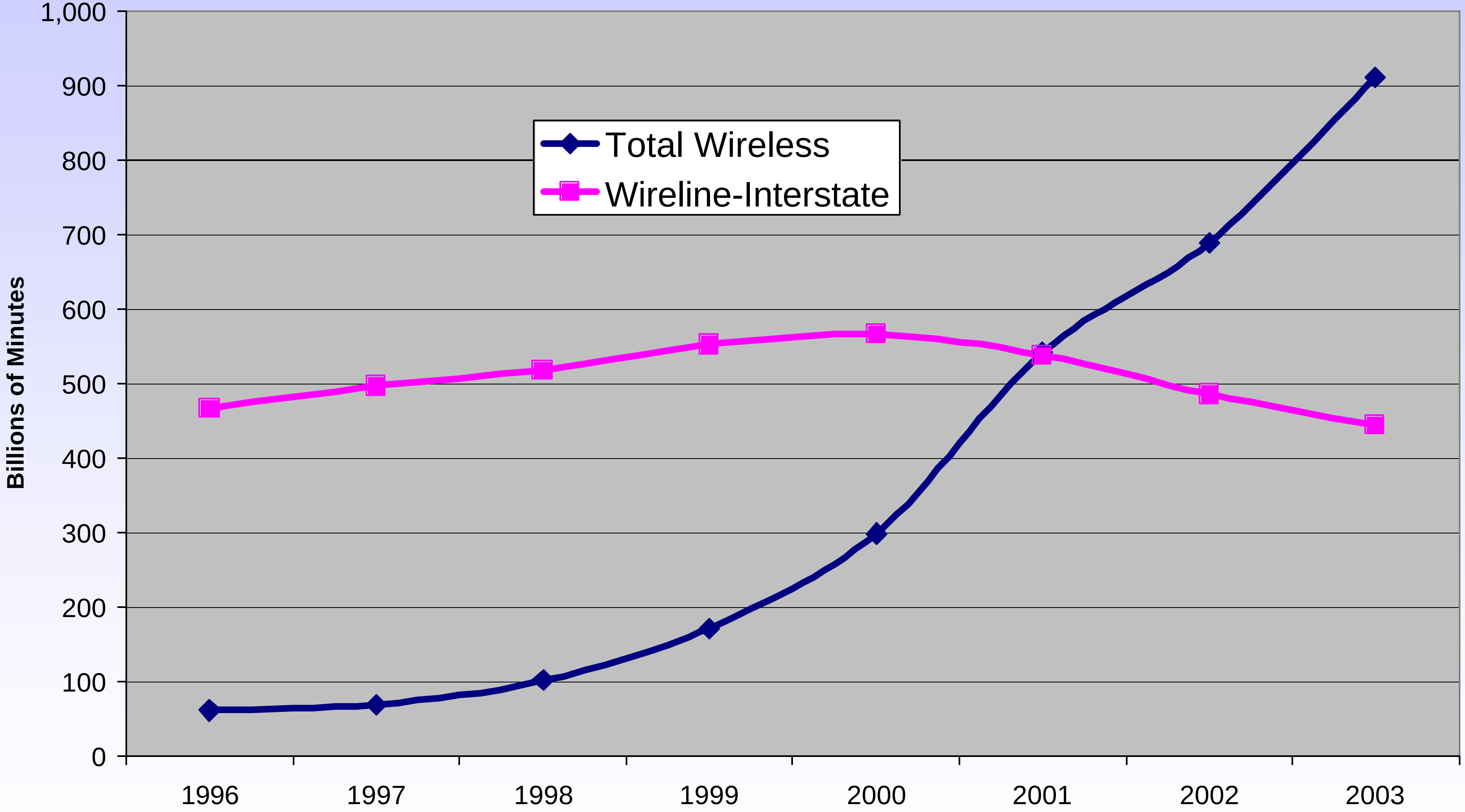
Interstate Access Minutes (Millions) of Non-Tier-1 & Tier-1 ILECs



	1 1999	2 1999	3 1999	4 1999	1 2000	2 2000	3 2000	4 2000	1 2001	2 2001	3 2001	4 2001	1 2002	2 2002	3 2002	4 2002	1 2003	2 2003	3 2003	4 2003	1 2004	2 2004	3 2004
Non-Tier 1	9,207	9,444	9,713	9,798	10,054	10,396	10,760	10,786	11,096	11,084	11,132	10,871	11,068	11,067	11,352	11,162	11,152	11,126	11,237	11,025	11,284	11,083	11,394
Tier 1	126,486	128,754	128,584	130,694	132,817	132,425	130,554	130,226	126,978	126,019	122,156	120,336	114,152	113,344	108,155	106,948	103,031	100,963	98,736	96,761	97,997	94,993	93,784

Year/Quarter

Traffic Trends: Total Wireless vs. Wireline Interstate

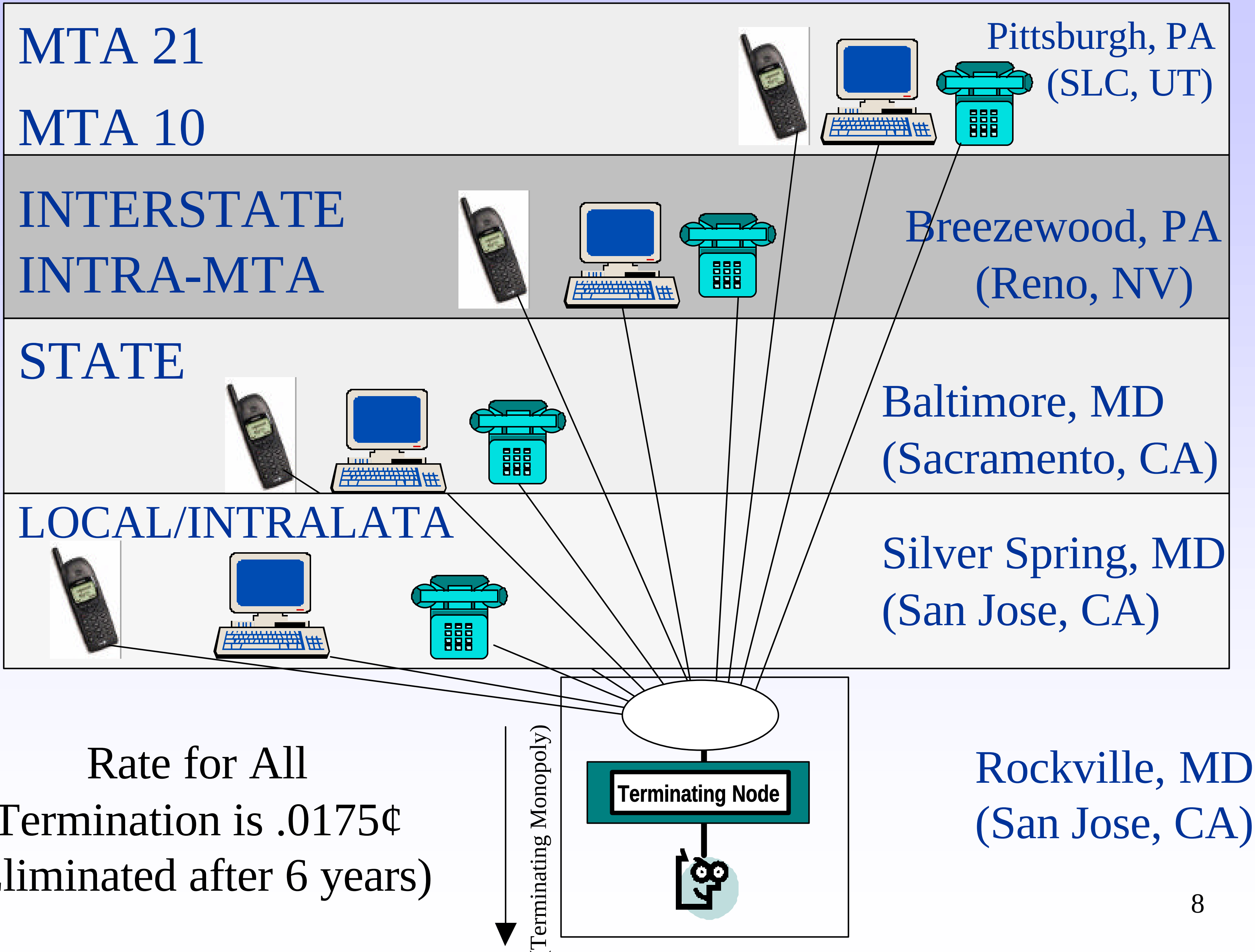


Source: FCC, NECA and CTIA

The ICF Results After 3 Years

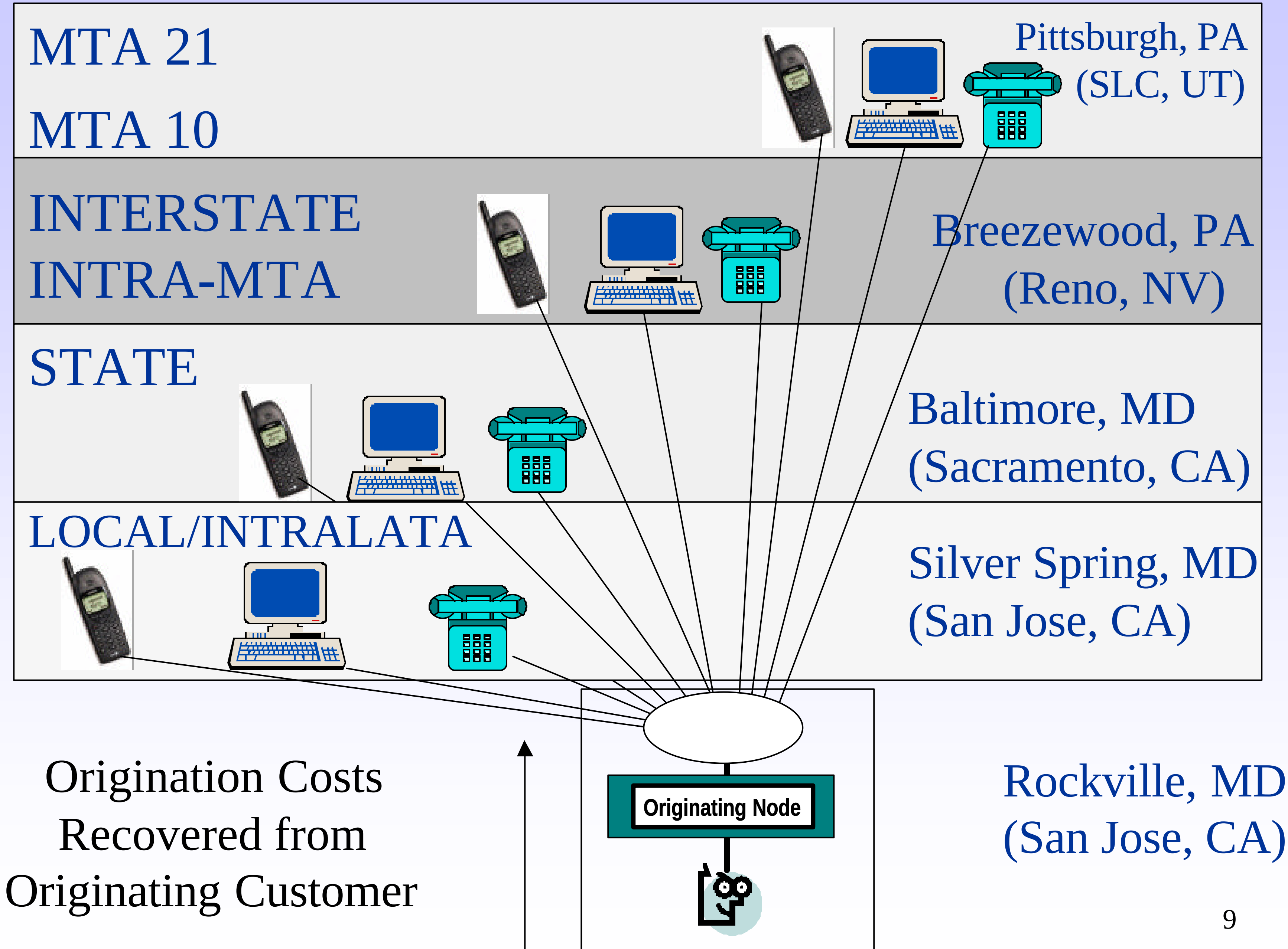
- The ICF Plan Achieves:
  - Uniform Network Interconnection Rules.
  - Uniform Rate Structure.
  - Uniform Rate Levels.
  - Universal Service Reform and Stability.
- The ICF Plan Resolves the Myriad of Problems Present in Today's Broken System.

ICF PLAN: TERMINATION RATES AFTER 3 YEARS

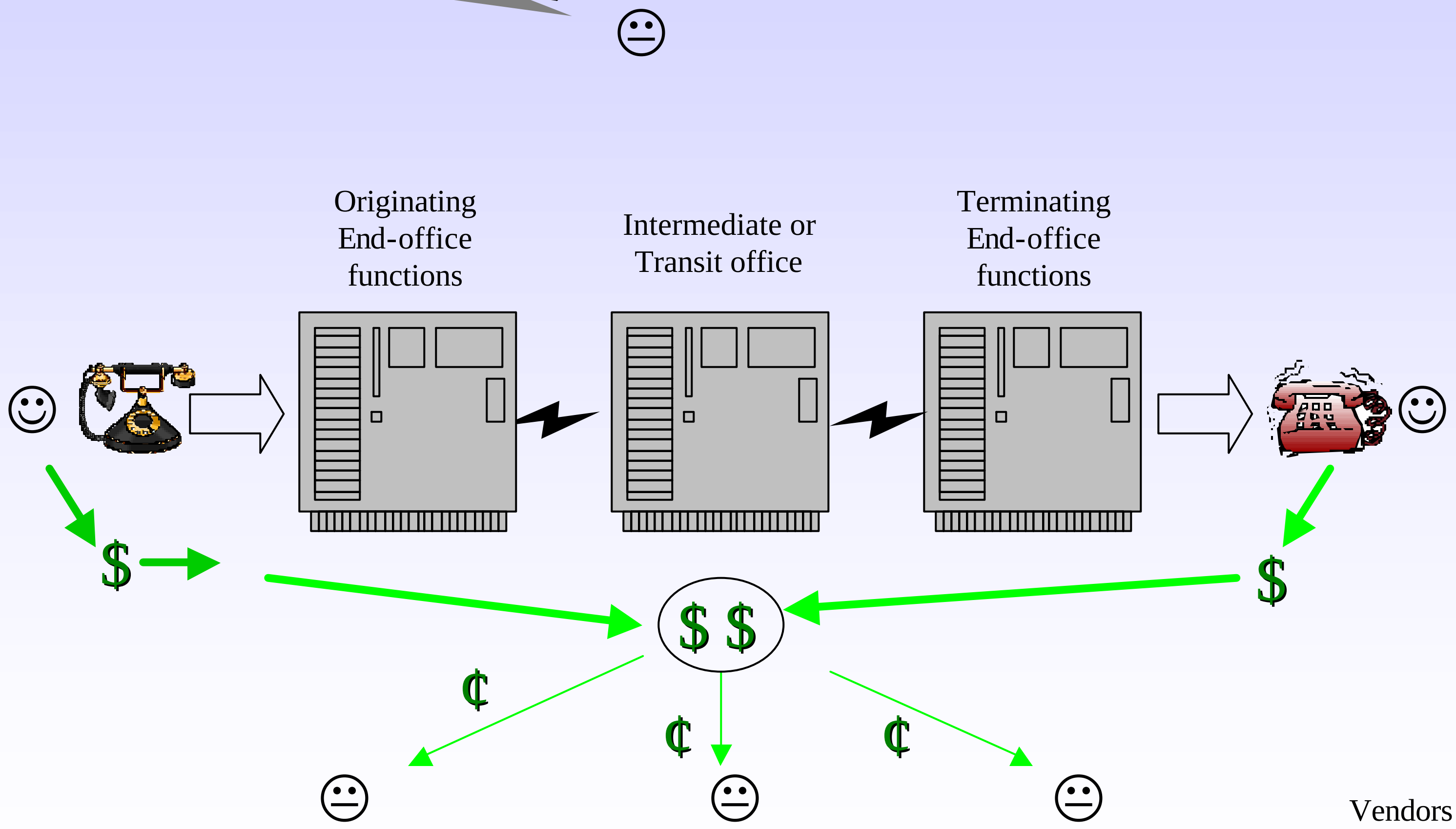


Rate for All
Termination is .0175¢
(Eliminated after 6 years)

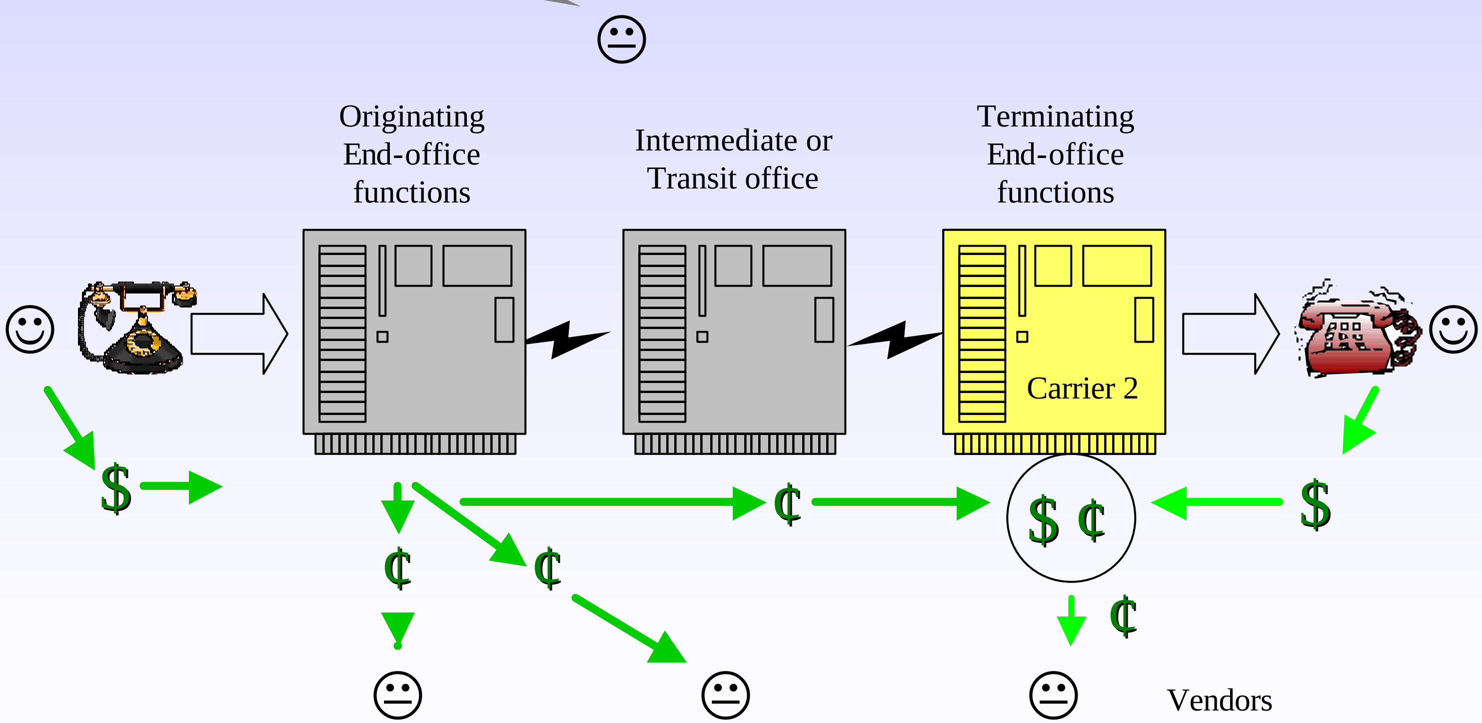
ICF PLAN: ORIGINATION AFTER 3 YEARS



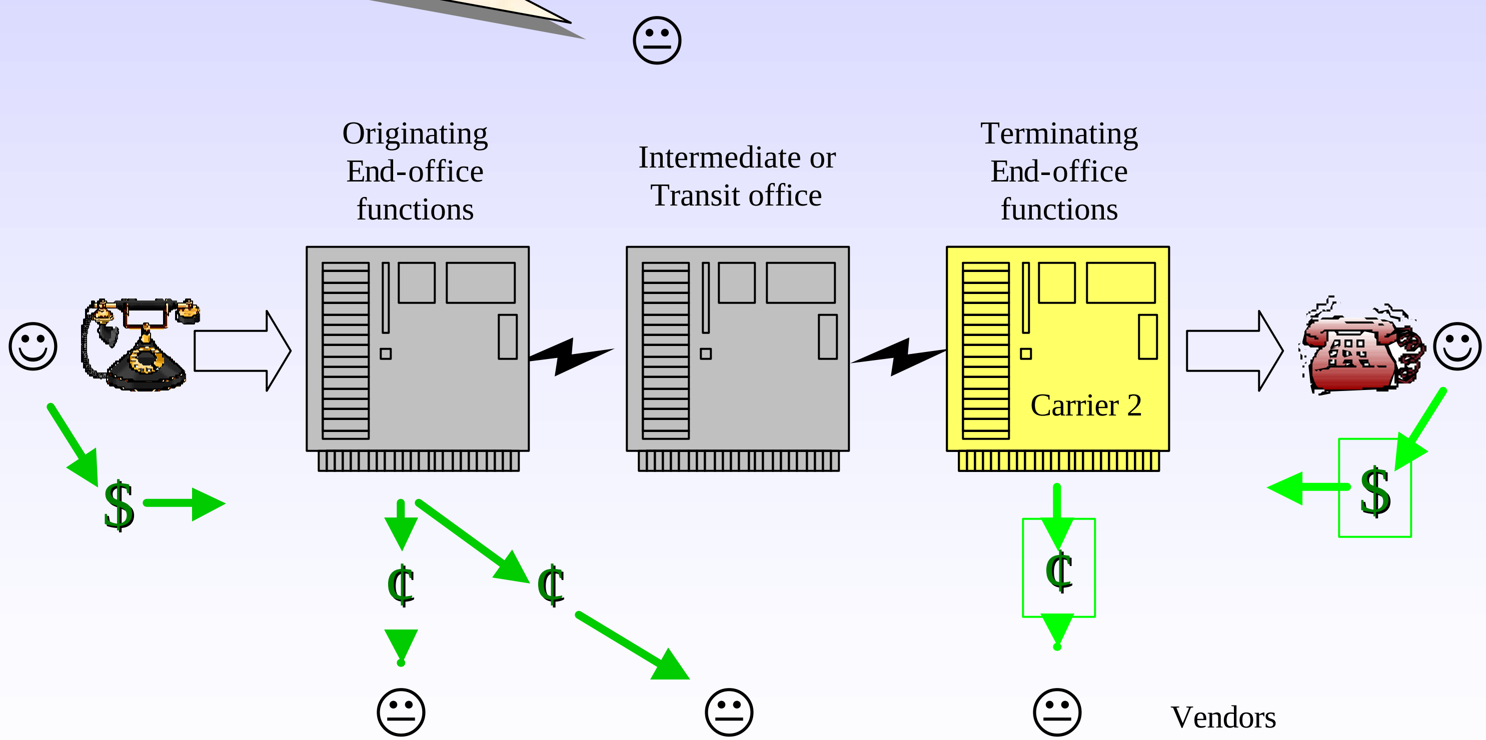
The starting point. Before competition – a single carrier serves two customers. Follow the money. The originating and terminating customers pay the carriers for the ability to make and receive calls.
The carrier pays its vendors, and earns its profits. Government regulates the carrier's rates.



What happens when there is a second carrier – a competitor? With intercarrier compensation, Carrier 1 pays Carrier 2. Carrier 2 can use both its charges to its own customer and its charges to other carriers to pay its vendors, and earn its profits. But with mandatory interconnection, Carrier 2 has a terminating monopoly (i.e, it is the only carrier that can terminate traffic to this called party). So government has to regulate the termination price, and if costs and rates are not aligned, market distortions develop.



An alternative cost recovery system for competition. Assume no intercarrier compensation. The originating customer pays its carrier for the ability to make and receive a call; the originating carrier pays its vendors. The terminating carrier, Carrier 2, charges its customer for the ability to make and receive calls, and pays its vendors. Carrier 2's costs are recovered from its customer, and not the customers of the originating carrier. No government oversight of the termination rate is necessary. This is similar to the Internet, in which each user pays for its own connectivity.



Legal Authority for a Uniform Intercarrier Compensation System

- Section 251(b)(5) – All LECs required to enter into reciprocal arrangements for termination. No origination fees under FCC rules.
- Section 252(d)(2) – Governs rate setting for 251(b)(5).
- Section 251(g) – Preserved pre-1996 access charge arrangements, but only until the FCC superceded such arrangements.
- Section 251(d)(3) – Doesn't address access charges, but access to UNEs. In any event, state regulations can be superceded.

Key Features of the Plan

- The Plan has three primary components:
  - Rate Restructuring
    - The Plan begins to restructure rates on July 1, 2005 to bring immediate relief from today's broken system.
    - Staged transition achieves a uniform system of intercarrier compensation on July 1, 2008, with a single termination rate of $0.000175/minute for all traffic, with no origination fee.
    - This termination rate remains unchanged for two years and then transitions to zero by July 1, 2011.
    - Plan includes protections for rural America, including a continuing optional transport revenue stream for rural carriers.
  - Network Interconnection
    - The Plan contains clear and explicit network rules regarding the technical and financial obligations for the efficient interconnection of diverse carrier networks.
    - New rules take effect on July 1, 2007, giving carriers sufficient time to implement.
    - Network rules provide a framework for voluntary carrier negotiations.
  - Universal Service
    - New explicit support replaces implicit support in intercarrier compensation.
    - Stabilizes and broadens the universal service funding base.
    - Plan contains modifications that enhance incentives for rural investment.

Summary of Key Events in the ICF Plan

Step	Year beginning July 1:	Network Interconnection	SLC Transition		Pricing Flexibility for Price Cap Carriers	Intercarrier Payments				Universal Service
			Large Carriers	CRTCs		Large Carriers		CRTCs		
						Access Charges	Non-Access	Access Charges	Non-Access	
1	2005	No Change	SLC caps rise in a 4-step transition subject to three constraints: (1) Neither the $6.50 residential SLC cap nor the average residential SLC rate can increase by more than $0.75/month in steps 1 and 2, or by more than $1.00 in Steps 3 and 4. (2) No individual residential SLC rate can increase by more than $0.95/month in Steps 1 and 2, or by more than $1.20/month in Steps 3 and 4. (3) Other SLC caps (non-primary residential and MLB) increase only to the extent they would otherwise be below the residential SLC cap.	Between Step 1 and Step 5, residential SLC caps increase from $6.50 to $9.00 in $0.50 annual increments. In Steps 1-3, other SLC caps increase only to the extent that they would otherwise be below the residential SLC cap.	Step 1 SLC pricing flexibility (subject to revenue limits, constraints to prevent shifting recovery from business to residential users, and safeguards to prevent any effect on USF).	Four equal step plan transitions all interstate and intrastate access charges to SLCs, new universal service support, and a single, uniform rate of $0.000175 per terminating minute.	At step 1, non-access compensation rates unified at $0.0003525 per minute. Between Step 1 and Step 4, a four-step plan transitions all non-access compensation to SLCs, new universal service support, and a single, uniform rate of $0.000175 per terminating minute.	Four equal step plan transitions all interstate and intrastate access charges to SLCs, new universal service support, and a single, uniform rate of $0.000175 per terminating minute.	$0.0125 per minute default recip comp rate established for CRTC-CMRS traffic. Other non-access compensation rates unified at $0.0003525 per minute. Four-step plan transitions all non-access compensation to SLCs, new universal service support, and a single, uniform rate of $0.000175 per terminating minute.	**All at Step 1:** New support mechanisms (ICRM and TNRM) provide support for intercarrier compensation amounts otherwise not recoverable. Maintain rate-of-return principles for rate-of-return carriers. Cap removed from rural high cost loop support mechanism. Changes to Safety Valve Mechanism take effect. Certain rural price cap carriers gain option to elect support from non-rural mechanism. Telephone number and capacity-based unit contribution methodology replaces current interstate revenue-based system.
2	2006									
3	2007	New "Edge" rules take effect. New rates for edge-to-edge interconnection transport, transiting, and optional CRTC terminating transport take effect.						At Step 3, CRTC option to take terminating transport rates to an average of $0.0095 per terminating minute for interconnecting carriers electing to use such transport to reach CRTC network edges.		
4	2008			At Step 4, the MLB SLC cap increase to $10.00.	Additional Step 4 SLC pricing flexibility (subject to safeguards that prevent any effect on USF), including removing end user charges from price caps.	Uniform termination rate of $0.000175 per terminating minute. (Terminating transport rates for CRTCs preserved).				
5	2009		All SLC caps uniform at $10.00 (USF calculated accordingly); inflation indexing takes effect			No Change				
6	2010			(Optional) Residential SLC caps increase to $9.50		Termination rate reduced by 50% to $0.0000875/terminating minute. (Terminating transport rates for CRTCs preserved).				
7	2011			(Optional) Residential SLC cap increases to $10.00		Termination rate reduced to zero. (Terminating transport rates for CRTCs preserved).				
8	2012			No Change		Termination rate remains at zero. (Terminating transport rates for CRTCs preserved).				