

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of)	
)	
Developing a Unified Inter-carrier)	CC Docket No. 01-92
Compensation Regime)	

**Reply Comments on the
Initial Regulatory Flexibility Analysis and
Notice of Proposed Rulemaking of the
Office of Advocacy, U.S. Small Business Administration**

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Summary

The Commission's Notice of Proposed Rulemaking (NPRM) on intercarrier compensation proposes sweeping changes to the current compensation regime. Advocacy is not convinced that a complete restructure is necessary when Calling Party's Network Pays (CPNP) is a fairly accurate representation of the benefits of the call. While both parties do benefit from a call, they do not benefit equally. The caller often receives a far greater benefit from the call than the called party. CPNP is not an inaccurate assessment of the costs and a change in the regulatory paradigm is not necessary at this time.

The Commission's proposed alternative to CPNP, Bill and Keep (B&K), will affect different classes of small business consumers differently. Small businesses who are net callers will pay less under B&K. Small businesses who are net receivers will end up paying more under B&K. Small businesses in rural areas are usually net receivers of calls so they will end up

paying more. For B&K to provide any benefit to small businesses, the Commission must require the carriers pass through on a proportional basis all cost savings to end users.

Under B&K, costs that were covered by access charges to long distance carriers will be moved to end users. To counter these increases, the Commission must off set any reductions in access charges to rural carriers, with increases in the universal service fund. The Commission should refer universal service issues of this proposed rule to the Joint Board for further review and consideration.

Finally, the NPRM lacks specific rules and the FCC is using it to gather basic industry information about the impact of B&K. Commission should transfer this rulemaking to a Notice of Inquiry which is much more suited as a means to gather information. The Commission can use the comments gained in response to this NPRM to analyze the small business impacts in an IRFA.

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The Office of Advocacy of the United States Small Business Administration (Advocacy) submits these Reply Comments to the Federal Communications Commission’s (FCC or Commission) *Notice of Proposed Rulemaking* (NPRM),ⁱ in the above-captioned proceeding.

The intention of the proposed rule is to revise the complex and often arbitrary regulations on intercarrier compensation with a single unified regime that more accurately reflects the economic benefits to the parties of a call and to remove sources of regulatory arbitrage. The Commission proposes replacing the current Calling Party’s Network Pays (CPNP) regime with a Bill and Keep (B&K) regime. The Commission presents two different versions of B&K: Central Office Bill and Keep (COBAK)ⁱⁱ and Bill Access to Subscribers – Interconnection Cost Split (BASICS).ⁱⁱⁱ

Advocacy believes that while costs are shared between the calling party and the called party, the calling party receives more of the benefit and therefore, should carry most of the cost. Advocacy notes that a B&K system would have an enormous impact on small businesses.

Advocacy urges the Commission to continue its assessment of the small business impacts and to take several steps to ensure that small business telecommunications providers are not unfairly burdened by the new regulatory regime and to adequately fund and maintain universal service. Finally, the Commission's general questions in this rulemaking are more appropriate to a Notice of Inquiry (NOI) than an NPRM. Advocacy recommends that the Commission change this rulemaking to an NOI.

I. Advocacy Background

Congress established the Office of Advocacy in 1976 by Pub. L. No. 94-305^{iv} to represent the views and interests of small business within the Federal government. Advocacy's statutory duties include serving as a focal point for concerns regarding the government's policies as they affect small business, developing proposals for changes in Federal agencies' policies, and communicating these proposals to the agencies.^v Advocacy also has a statutory duty to monitor and report to Congress on the Commission's compliance with the Regulatory Flexibility Act of 1980 (RFA),^{vi} as amended by the Small Business Regulatory Flexibility Act, Subtitle II of the Contract with America Advancement Act (SBREFA).^{vii}

The RFA was designed to ensure that, while accomplishing their intended purposes, regulations did not unduly inhibit the ability of small entities to compete, innovate, or to comply with the regulation.^{viii} The major objectives of the RFA are: (1) to increase agency awareness and understanding of the potential disproportionate impact of regulations on small business; (2) to require that agencies communicate and explain their findings to the public and make these explanations transparent; and (3) to encourage agencies to use flexibility and provide regulatory relief to small entities where feasible and appropriate to its public policy objectives.^{ix} The RFA does not seek preferential treatment for small businesses. Rather, it establishes an analytical

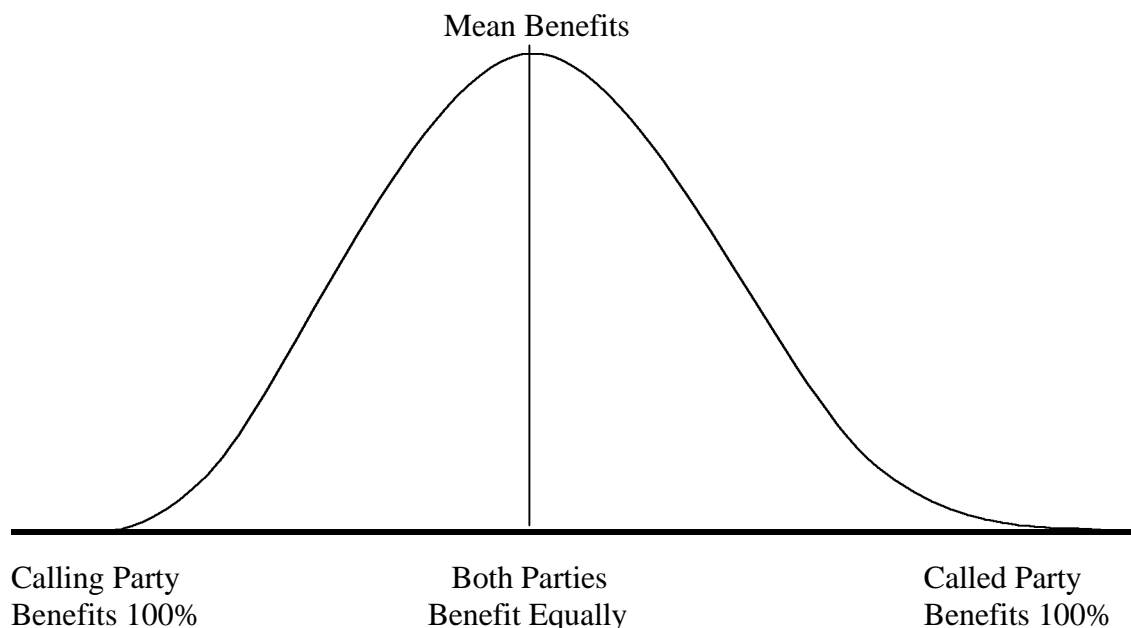
requirement for determining how public issues can best be resolved without erecting barriers to competition. To this end, the RFA requires the FCC to analyze the economic impact of proposed regulations on different-sized entities, estimate each rule's effectiveness in addressing the agency's purpose for the rule, and consider alternatives that will achieve the rule's objectives while minimizing any disproportionate burden on small entities.^x

II. Calling Party Receives the Larger Benefit and Should Pay the Larger Cost

At the core of the Commission's proposed rule is a complete revision of how costs for interconnection are allocated. One of the purposes of the NPRM is to assign costs so that they reflect who receives the benefit.^{xi} The Commission relies upon two Office of Plans and Policy working papers that propose that the benefit of a call is shared equally and therefore the cost of the call should be shared equally.^{xii}

In his Office of Plans and Policy working paper, Patrick DeGraba states that for a vast majority of calls, both parties receive some benefit.^{xiii} He does recognize that some calls are unwanted, but states that they represent a small fraction of telephone traffic.^{xiv}

Advocacy agrees that while in a vast majority of calls both parties do benefit, they do not benefit equally. Instead, a call will benefit both parties in an array of varying percentage. As the Commission suggests, most calls will have mutual benefits to both parties. Few calls would be solely for the benefit of one party. So without any additional influences, the distribution of benefits would resemble a bell curve.



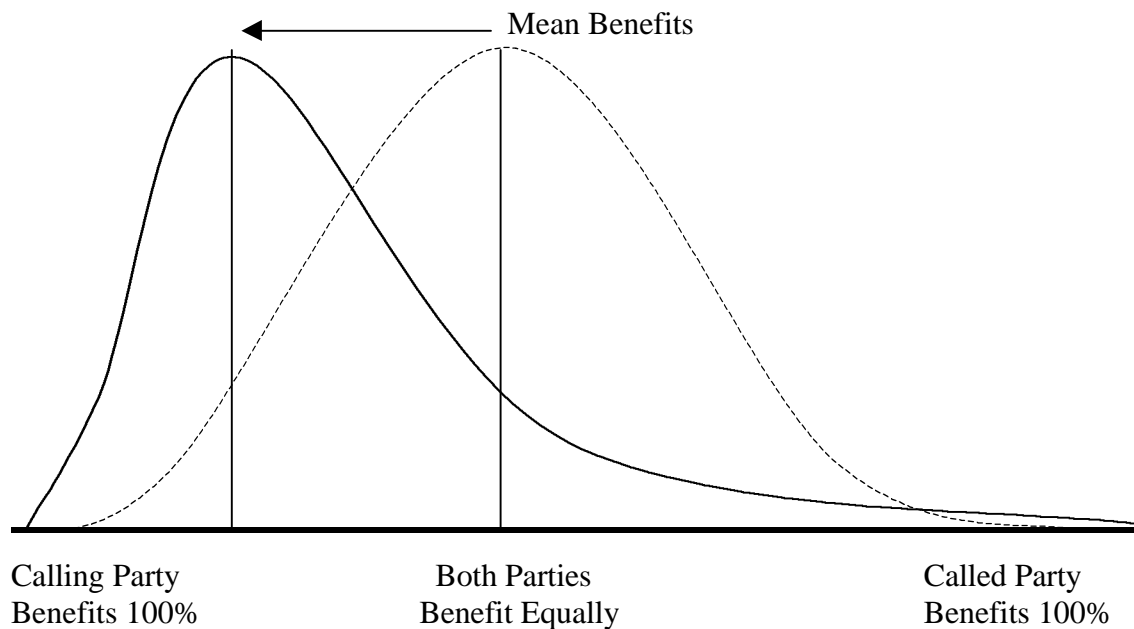
But there are additional influences at work. The calling party is making the effort to place the call. Because people tend to take action that benefits them, it is reasonable to assume that if a person initiates the call, they are gaining a benefit out of the call. Advocacy can envision few instances where the calling party receives no benefit. Even in the case of a wrong number, the calling party learns that it has the wrong number or that it misdialed.

On the other hand, a called party often receives no benefit from a wrong number or a telephone solicitation. DeGraba does not give any specific information on the number of unwanted calls, and Advocacy believes that DeGraba greatly underestimates the number of misdials, telemarketer calls, and other unwanted calls. If the cost to originate calls drops, as it will under B&K, the number of these calls will likely increase.

As National Telephone Cooperative Association (NTCA) points out, the calling party has all the information on whether or not a call is desired.^{xv} The called party must answer the call to obtain enough information to decide if the phone call is necessary. Caller ID is not an absolute

cure for this, as many calls are blocked or are otherwise unavailable, leaving the called party without any information to determine if a call is wanted or not.

Therefore, Advocacy agrees with Focal Communications that calling benefits the calling party more.^{xvi} Our earlier bell curve should skew slightly to the left to show calling parties benefit more from a call than the called parties. We keep the earlier curve in to show that, under the present set of circumstances, mean benefits do shift towards the calling party—at the expense of the called party.



While it may be appropriate to have the called parties responsible for a portion of the cost, the calling party should be responsible for the majority of the cost of the call. This would make COBAK a more accurate assessment of costs based on benefits than BASICS. More importantly, this suggests that the current regulatory paradigm of CPNP is not as inequitable as suggested by the Commission and lends weight to NTCA's assertion that CPNP places the costs where the benefits are.^{xvii}

If we agree with the assertion made by NTCA, that CPNP places the costs where the benefits are, then Advocacy does not see a need to push for a change in the regulatory paradigm. To be sure, fine-tuning the current regime has always been an option, but the drawbacks associated with CPNP are not sufficient to warrant simply doing away with it. Given that the telecommunications universe is interconnected, any change as fundamental as the implementation of B&K is bound to send shockwaves throughout the industry. The Commission should only take such a drastic step when there is clear evidence that such a course is needed.

III. B&K Will Have Varying Impact on Small Businesses End Users

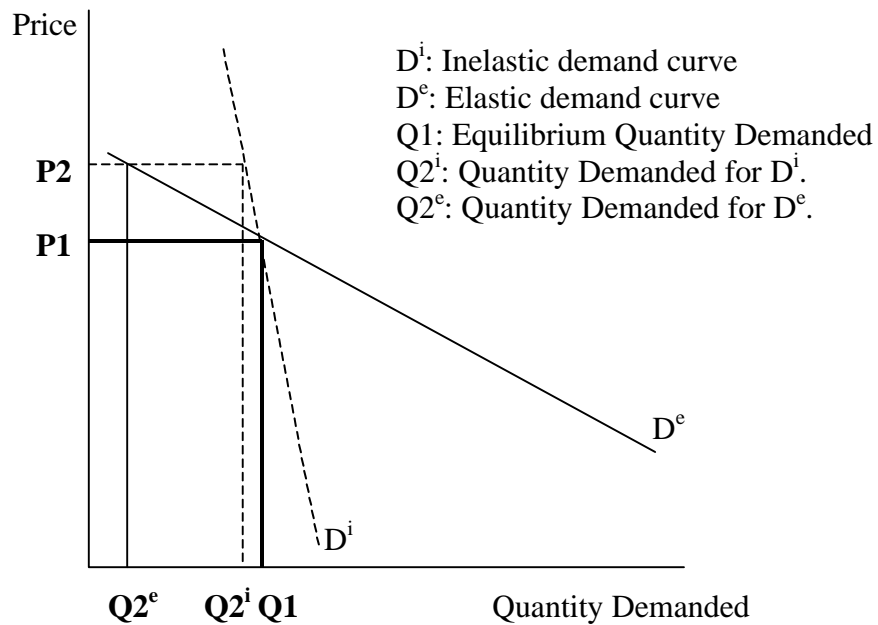
Because Bill and Keep would require carriers to recover their costs from end users, the Commission is seeking comment on whether or not the proposals impact end users.^{xviii} The Commission also requested comment on the impact of B&K on small entities.^{xix}

The impact on the end user depends greatly upon the elasticity of the demand for telephone services. Because of the presence of competition, the demand for long distance services is at least moderately elastic. In addition, long distance service has historically been viewed as a convenience or a luxury good and not a day-to-day necessity. With the advent of 10-10 numbers and calling cards, the need to have a permanent long distance carrier has decreased in significance. As a result, no long distance carrier can price service at levels higher than the competition. A slight increase in price would cause customers to restructure their contracts and opt for a long distance provider with better rates.

Demand for local service is very different than that for long distance. Unless you are a high volume user and in an urban center, competition for your business is limited. If you are a residential customer, there is no effective competition for your business. This is even more so if you live in a rural area. Furthermore, local phone service is almost a necessity in day to day life.

It is possible to replace a wireline service with a wireless service, but because of costs and equipment issues, few residential customers and small businesses have done so. These characteristics make the demand for local services only slightly elastic or possibly inelastic.

The elasticity of demand for these services is important, because, the more elastic demand is, the less carriers will be able to pass the change in costs to the consumers. In this situation, the carriers will bear the brunt of the economic impact. If elasticity is low or if demand is perfectly inelastic then the costs could be passed directly to the consumer without limit. Therefore, the end user will carry all the costs of the regulatory change.



With respect to the figure above, the current CPNP regime is reflected at the combination (P1, Q1). For the carrier to adopt any change in regime, knowledge of the elasticity of the demand for his/her product is crucial. If facing an inelastic demand curve, D^i , an increase in price to P2 would lead to a corresponding change in quantity demanded from Q1 to $Q2^i$. Similarly, if facing a relatively more elastic demand curve such as D^e , the corresponding change in quantity demanded is $Q1 - Q2^e$. One can clearly see that the carrier would much rather face

D^i , because $Q1 - Q2^i$ is much less than $Q1 - Q2^e$. In a world with D^i , to which corresponds the current system with respect to local services, consumers do not have many viable alternatives that can substitute for the services offered by the carrier.

But what are the costs to consumers of changing from CPNP to COBAK or BASICS?

Advocacy has taken a close look at the two proposals and constructed the following chart to show how the costs to consumers change.

Regime	Costs to Calling Party	Costs to Called Party	Total Costs to Both Parties
CPNP	$L_a + L_b + Tr$	0	$L_a + L_b + Tr$
COBAK	$L_a + Tr$	L_b	$L_a + L_b + Tr$
BASICS	$L_a + Tr/2$	$L_b + Tr/2$	$L_a + L_b + Tr$

Where:

L_a = calling party's local loop cost

L_b = called party's local loop cost

Tr = transport costs

This chart reveals two results. First, in a perfectly regulated or perfectly competitive marketplace, the overall cost to society is unchanged. Resources are simply being redistributed. The second result is that segments of society will face significant cost changes.

As can be seen, both COBAK and BASICS increase costs to consumers who receive a call. Currently, the cost to receive a call is 0. Under COBAK, this cost increases to the cost of the called party's local loop. Under BASICS, the cost increases the cost of the called party's local loop and half of the transport costs.

If every customer made as many calls as they received, then the change in costs would wash. Advocacy has no economic data on whether this is the case or not for residential consumers. For small business consumers, Advocacy has found that they can be grouped into three categories: the net callers, the balanced users, and the net receivers.

Net callers are small businesses who need to contact their customers. Examples of such businesses are telemarketers, companies that must contact their customers, and brokers. These companies would receive a benefit under COBAK, even more so under BASICS.

Balanced users are small businesses whose outgoing calls roughly equal their incoming calls. Most offices fall into the category, as do retail stores. For these companies, the increased cost of receiving calls would balance out the savings for initiating calls.

Net receivers are small businesses who need to have their customers contact them. Examples of such businesses are catalog companies, pagers, ISPs, any delivery company, small businesses that depend on customers to contact them, messenger services, voicemail services, ticket sellers, taxi services, media outlets, and support services.^{xx} In addition, the National Exchange Carrier Association (NECA) states that rural carriers receive far more traffic than they originate.^{xxi} It stands to reason then that rural end users receive far more traffic than they originate and would be net receivers as well. These companies would see their costs increase under COBAK and more so under BASICS.

Everything that Advocacy has discussed above is assuming a perfectly competitive or regulated marketplace. It assumes that when costs are shifted due to regulation, that the carriers will shift the costs as well. This has not always proven the case. Prices in general have been historically sticky downward. As NECA points out, long distance carriers failed to pass through previous rate reductions or selectively passed through the reductions.^{xxii} This is especially a danger for rural customers, and low-volume business and residential users, as there is not enough competition to force carriers to pass through the savings.

If the carriers are not required to pass on cost savings to the consumer, then it is very likely that they will take the same path that long distance carriers did with previous access charge

reductions. Any savings will be either retained by the carrier or passed through to large business customers who have many lines, and are therefore a target of competitive carriers. Therefore, Advocacy agrees with the Regulatory Commission of Alaska which asks the Commission to require carriers to pass through the savings on a proportional basis if the FCC adopts a B&K system.^{xxiii}

IV. Universal Service Must Be Protected

The proposed B&K regime would eliminate terminating and originating access charges.^{xxiv} The Commission asks for comment on the impact of B&K on universal service.^{xxv} Advocacy agrees with commenters who warn that B&K will have enormous impact on rural areas and will greatly increase rates in rural areas. Advocacy also agrees that the matter should be referred to the Joint Board on Universal Service for further consideration and analysis.

Access charges are crucial to rural carriers who are often small businesses. The Home Telephone Company (HTC) states that access charges account for 66 percent of total revenue,^{xxvi} and NECA states that B&K could shift \$1.5 billion in access charges from long distance carriers to end users charges.^{xxvii} The impact of these changes on end users in rural areas is enormous. Advocacy is staggered by NECA's prediction that the average impact for an end user would be \$9.80 per month and a few end users in truly remote areas could see increases of \$175 per month.^{xxviii} Advocacy agrees with commenters that without adequate universal service, telephone service will become unaffordable over large areas of the country,^{xxix} and telecommunications development in rural areas may very well stall.^{xxx}

Moreover, HTC states that the value of the phone network grows geometrically with the number of subscribers^{xxxi} and that urban users achieve benefit from service to rural carriers as they may need to reach people and businesses in rural areas quickly and economically.^{xxxii}

Advocacy agrees with HTC that not only do rural areas benefit from affordable connections to telecommunications network, but so do the nation and the public interest as a whole.

In light of the extreme increases in the costs, Advocacy believes that if the FCC adopts a B&K system, it must address universal service. As stated by other commenters, if an intercarrier compensation reduces access charges to rural carriers, then the reductions must be offset by increases in the universal service fund.^{xxxiii} Since this would have an impact on the nation's universal service system, Advocacy supports NECA's suggestion that the Commission should refer universal service issues of this proposed rule to the Joint Board.^{xxxiv}

V. The Commission Should Convert the Rulemaking to a Notice of Inquiry

The proposals in this NPRM are very general and seem to be seeking information from commenters about what would be the effect if the Commission were to adopt a different regulatory paradigm. NECA notes the NPRM does not propose any specific rules.^{xxxv} This sort of request for comments is more appropriate for a Notice of Inquiry. As Advocacy has stated in a previous letter to the Commission:

A Notice of Inquiry should be used whenever the Commission lacks information about the industry to be regulated or the exact nature of the problem to be addressed, as its purpose is to gather information and intelligence about the scope of a problem, factors that contribute to a problem, the benefits or limitations of different regulatory alternatives and the different impacts of each alternative.^{xxxvi}

Therefore, Advocacy agrees with commenters that recommend that the Commission convert this rulemaking process to a NOI.^{xxxvii}

VI. The Commission Should Minimize Impact on Small Businesses

Several commenters addressed the Commission's Initial Regulatory Flexibility Analysis (IRFA), and Advocacy believes that they raised points the Commission should consider. At the macro level, the NPRM proposes a complete revision of how carriers compensate each other. This is going to have an enormous impact on small business carriers and end users. The sheer

scope of the proposed rule changes can be seen by the number of different industries that the Commission lists in the IRFA as affected by the NPRM.

In its comments, Focal Communications states that B&K is inherently discriminatory against new entrants,^{xxxviii} because the traffic flows are primarily in one direction in a ILEC-CLEC relationship.^{xxxix} Ad Hoc Telecommunications Users Committee states that the only time B&K would not distort the market is when carriers are close in balance.^{xl} Advocacy's analysis agrees with these two commenters. The efficiencies of B&K are optimized when carriers interconnection traffic with other carriers is balanced. When traffic is skewed drastically one way, B&K can create drastic problems in the form of inefficiencies and costs for small business carriers and end users.

Commenters do point out some benefits to B&K. HTC comments that a unified rate structure will help the industry.^{xli} Level 3 states that the patchwork of regulatory is inefficient, and B&K eliminates constant regulatory litigation and oversight on access rates.^{xlii} Lessening regulatory requirements, while unifying and simplifying regulations is of benefit to small businesses. However, Advocacy agrees with Level 3 Communications who states that the FCC must provide encouragement to incumbent carriers to place a sufficient number of points of interconnection efficiently or B&K will create a substantial barrier to entry.^{xliii} Even with if the Commission provides incumbent carriers with sufficient incentive, the Commission must balance the benefits of B&K to small businesses against the discrimination against new entrants.

NECA points out that the Commission did not analyze in the IRFA how the proposed rules would affect small businesses.^{xliv} Advocacy believes that this is because of the general nature of the proposed rule, which limited the Commission from doing a thorough analysis. To correct this, the Commission should switch the NPRM to an NOI. This would allow the FCC

use the comments gathered in this comment round to assess the impacts for the IRFA contained within an NPRM that proposes specific rules.

Should the Commission decide to push ahead with switching to B&K – a path that Advocacy does not support at this time -- small carriers must be provided regulatory certainty and predictability. They have built their business plans built around existing regulatory structure. Therefore, the FCC should give a long lead time before adopting B&K. A preferable path to this is to follow the suggestion made by the Rural Telecommunications Group and permit carriers to chose B&K as an option for settling intercarrier compensation.^{xlv}

Conclusion

The Commission's NRPM on intercarrier compensation proposes sweeping changes to the current compensation regime. Advocacy is not convinced that a complete restructure is necessary when CPNP is a fairly accurate representation of the benefits of the call. If the Commission adopts a B&K regime, the Commission must require the carriers pass through on a proportional basis all cost savings to end users and it must take steps to ensure that universal service is adequately funded. Finally, because of the nature of the Commission's inquiries and lack of specific rules, the Commission should transfer this rulemaking to an NOI as a means to gather information. The Commission can then use the comments gained in response to this NPRM to analyze the small business impacts in an IRFA.

Sincerely,

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ⁱ *In the matter of* Developing a Unified Inter-carrier Compensation Regime, *Notice of Proposed Rulemaking*, CC Docket No. 01-92, et al, FCC 01-132 (rel. April 27, 2001).

ⁱⁱ FCC, OPP Working Paper, Bill and Keep at the Central Office as the Efficient Interconnection Regime (authored by Patrick DeGraba) (December 2000)

ⁱⁱⁱ FCC, OPP Working Paper, A Competitively Neutral Approach to Network Interconnection (authored by Jay M. Atkinson and Christopher C. Barnekov) (December 2000).

^{iv} *Id.*

^v 15 U.S.C. § 634(c)(1)-(4).

^{vi} Pub. L. No. 96-354, 94 Stat. 1164 (1980)(codified at 5 U.S.C. § 601 et seq.).

^{vii} Pub. L. No. 104-121, 110 Stat. 857 (1996)(codified at 5 U.S.C. § 612(a)).

^{viii} 5 U.S.C. § 601(4)-(5).

^{ix} *See generally*, Office of Advocacy, U.S. Small Business Administration, *The Regulatory Flexibility Act: An Implementation Guide for Federal Agencies*, 1998 (“*Advocacy 1998 RFA Implementation Guide*”).

^x 5 U.S.C. § 604.

^{xi} NPRM at para. 37.

^{xii} *Id.*

^{xiii} NPRM at para. 55.

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- ^{xiv} NPRM at para. 54.
- ^{xv} Comments of National Telephone Cooperative Association, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 17 (Aug. 21, 2001).
- ^{xvi} Comments of Focal Communications, Pac-West Telecomm, RCN Telecom Service, and US LEC Corp. to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 42 (Aug. 21, 2001).
- ^{xvii} *NTCA* at 18.
- ^{xviii} *NPRM* at para. 123.
- ^{xix} *NPRM* at para. 128.
- ^{xx} While they are not small businesses, it is interesting to note that it is likely that Congressional offices are likely to be net receivers of phone calls as well. In fact, all political offices are likely to be net receivers of phone calls.
- ^{xxi} Comments of National Exchange Carrier Association, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 7 (Aug. 21, 2001).
- ^{xxii} *NECA* at FN 14.
- ^{xxiii} Comments of the Regulatory Commission of Alaska, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 8 (Aug. 21, 2001).
- ^{xxiv} *NPRM* at paras. 23-5.
- ^{xxv} *NPRM* at para. 123-4.
- ^{xxvi} Comments of the Home Telephone Company, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 1 (Aug. 21, 2001).
- ^{xxvii} *NECA* at 5.
- ^{xxviii} *Id.* at 5.
- ^{xxix} *NECA* at 3.
- ^{xxx} Comments of the Nation Rural Telecom Association (NRTA) and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 12 (Aug. 21, 2001).
- ^{xxxi} *HTC* at 5 .
- ^{xxxii} *HTC* at 7.
- ^{xxxiii} *NECA* at p. 9; *NRTA and OPASTCO* at 17.
- ^{xxxiv} *NECA* at 14.
- ^{xxxv} *Id.* at 16.
- ^{xxxvi} Letter from Mary K. Ryan, Deputy Chief Counsel, Office of Advocacy, U.S. Small Business Administration, to Michael K. Powell, Chairman, Federal Communications Commission (February 6, 2001).
- ^{xxxvii} *NTCA* at 26.
- ^{xxxviii} *Focal* at 12.
- ^{xxxix} *Id.* at 14.
- ^{xl} Comments of the Ad Hoc Telecommunications Users Committee, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 3 (Aug. 21, 2001).
- ^{xli} *HTC* at 10.
- ^{xlii} Comments of Level 3 Communications, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 24-5 (Aug. 21, 2001).
- ^{xliii} *Id.* at 27.
- ^{xliv} *NECA* at 17.
- ^{xlv} Comments of the Rural Telecommunications Group, to the *Notice of Proposed Rulemaking* in CC Dkt. No 01-92, at 4 (Aug. 21, 2001).