Testimony of Commissioner Ray Baum
Public Utility Commission of Oregon
before the
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Hearing on Rural Telecommunications
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Mr. Chairman and Members of the Committee. I am Commissioner Ray Baum of the Public Utility Commission of Oregon. I also chair the NARUC Task Force on Intercarrier Compensation. Finally, I am a member of the Federal State Joint Board on Universal Service. Today, I hope to do three things:

1. Convince you that intercarrier compensation reform is extremely important and closely tied to universal service reform;

2. Make you aware of the major role that our task force is playing and give you a status report on our activities;

3. Talk about some broad principles that, in my view, should guide us as we undertake intercarrier compensation reform.

Intercarrier compensation comes about because many calls aren't carried exclusively on one network all the way from the calling to the called party. Intercarrier compensation includes all of the different fees carriers pay to each other for the use of their networks to originate and/or terminate their calls. It includes interstate access charges paid to the originating and terminating local exchange carrier for interstate long distance calls. It also includes intrastate access charges for intrastate long distance calls. It includes reciprocal compensation for the transport and termination of "local" calls. Finally, it includes traditional Extended Area Service (EAS) agreements for the exchange of local calls between local telephone companies.

There's a great deal of money involved. Our estimate is that intercarrier compensation totals about $10 billion per year. In comparison the universal service high cost fund is $4.2 billion and the total federal universal service program is about $7.1 billion. As a revenue stream to the carriers as a whole, intercarrier compensation is more important than federal universal service funding.

The bad news is that this intercarrier compensation is in serious jeopardy. Here's the rub. All of these different payments for use of local networks are essentially for the same thing—originating and terminating calls. These widely varying charges for the same thing grew up in a regulated monopoly environment to meet various jurisdictional and ratemaking purposes. Competition from wireless services and VOIP are eroding them. Carriers that have to pay the charges find various ways of avoiding the charges or paying a lesser charge than actually applies—a phenomenon called arbitrage. Traffic increasingly arrives at

the local exchange carrier's network without the information that is necessary to bill for it—the phantom traffic problem.

To give you a sense of just how serious the rate differences are, consider the following. Small incumbent carriers typically charge about 1.8¢ per minute for terminating interstate toll calls and about 5.1¢ per minute for terminating intrastate toll calls. These same carriers may charge just a few tenths of cent for terminating some local calls and nothing at all for other local calls, particularly EAS calls. You can see the opportunities this creates and why reform is necessary.

Author Thomas Friedman got it right when he wrote in his book The World is Flat:

> As consumers get more VOIP choices, the competition will be such that telecom companies won't be able to charge for time and distance much longer. Voice will become free. What phone companies will compete for, and charge for, will be the add-ons.

At least in their current form, access charges probably don't survive in a flat world.

What's the link to universal service? If carriers lose intercarrier compensation revenues, policy-makers only have so many choices. We can make the companies absorb the losses, we can allow consumer rates to go up, or we can recover some of the lost revenues from the Universal Service Fund. Let me consider each of these in turn.

Letting the companies absorb the losses may be an attractive option to some and, if the companies were given pricing flexibility, might well be a good option for some of the larger carriers. For some of the smaller, rural carriers, however, the consequences would likely be disastrous because the losses would be too great to absorb or make up elsewhere.

Allowing consumer rates to go up is a part of most plans for intercarrier compensation reform that I have seen. Typically, these proposals increase the mandatory federal Subscriber Line Charge that we all pay on our monthly bills for telephone service. Some proposals increase the SLC from the current $6.50 to $10 and allow for deaveraging so that some consumers would pay even more than $10. Some argue that increases of this magnitude would be a threat to affordability, a key component of universal service.

Finally, a portion of the losses from intercarrier compensation reform can be shifted to the federal Universal Service Fund. Many proposals shift from $1 to $2 billion to the USF. Given that the entire High Cost Fund is about $4.2 billion, these are large numbers. Before this could even be considered, there would have to be contribution reform that would broaden the base of contributors to USF.

I hope I have convinced you of the importance of intercarrier compensation reform and of its tight linkage to universal service.

The Intercarrier Compensation Task Force was created by the NARUC leadership in 2004 to address this critical issue from a state perspective. The Task Force's approach has been to actively engage all stakeholders from the beginning in order to develop consensus. The goal of the Task Force has not been to create official NARUC policies, but rather to facilitate consensus. We have held twelve, typically two-day, stakeholder workshops in all regions of the country. Typically, about 50 stakeholders attend representing all segments of the industry, consumer groups, and state regulators. It has been a constructive process, stakeholders have a better appreciation of each others' positions and there has been some narrowing of the issues. However, it is very difficult to negotiate with fifty people participating, so, after consulting with the Task Force, I made the decision in January to designate a smaller group of eleven stakeholders from large, mid-size and rural carriers, as well as a consumer representative that would develop a proposal and bring it back to the broader group. They have been working feverishly since that time, holding meetings and calls on a nearly continuous basis. They tell me they are very close to agreement on a proposal for reform. I have scheduled a meeting of the Task Force tomorrow for a status report from the group.

If this group comes forward with a proposal, the other stakeholders and the Task Force will decide whether to support it, oppose it, or take no position. NARUC as a whole may or may not take a position.

Let me turn finally to the principles that I believe should guide intercarrier compensation reform. Some time ago, at the request of the stakeholders, the Task Force developed a discussion proposal. It contained the following principle:

> Intercarrier compensation for origination and termination should be unified at rates that . . . are economically viable in a competitive market environment. Unified means that the rates should be the same for all traffic in both interstate and intrastate jurisdictions, the same for all interconnecting carriers, and same for exchange and exchange access interconnection.

This does not mean that every local company would charge the same rate. Some high cost carriers might charge a higher rate to terminate a call, but to avoid arbitrage, that rate would have to be the same for all comers, whether long-distance or local, wireless or wireline, VOIP or circuit-switched.

For this Task Force member at least, this statement is what we are about. It recognizes that, in order for unification to occur, intrastate intercarrier compensation rates must be brought in line with interstate rates. While not the subject of today's hearing, I want to note that the Task Force proposal also envisioned that states would be given the authority to determine the distribution

of universal service funds to eligible carriers within our jurisdictions under a State Allocation Mechanism (block grant). This is an area where we can do a better job than the FCC because we possess essential knowledge regarding our states and the carriers who serve them.

Unfortunately, it appears that we may not be able to get all the way to unified rates for the foreseeable future. The impact on the Universal Service Fund and consumers rates may be simply too great. Here's the issue. Congress mandated in Section 252 a cost standard for traffic subject to Section 251. That has resulted in low, cost-based rates for local transport and termination. Bringing access charges down to that level, which would be required for unification, is very costly.

If we can't get there, we need to get as close as we can and we need to set policies that allow us to make further progress in the future.

All carriers are probably not going to be able to get to the same point at the same time. Smaller carriers start with much higher access charges than larger carriers. They are more dependent on access charge revenues. This means that we may have to establish different "tracks" for large and small carriers as we progress toward the ultimate goal.

Thank you, Mr. Chairman, and I would be happy to answer any questions.