



Statement by

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On behalf of the

National Telecommunications Cooperative Association

Before the

U.S. Senate Committee on Commerce, Science, and Transportation

In the Matter of

“Phantom Traffic”

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Introduction

Good afternoon Senators, and thank you for this opportunity to share with you today the serious financial problems that phantom or unbillable traffic is presenting for America's small rural telecommunications carriers. For the past 10 years I have served as the General Manager of the Rock Port Telephone Company in Rock Port, Missouri, and my professional career in the telecommunications industry spans more than 38 years.

In addition to Rock Port and the National Telecommunications Cooperative Association (NTCA), I am also appearing on behalf of the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO), and the Western Telecommunications Alliance (WTA).

Specific Company Dynamics

Organized as a cooperative, Rock Port's top priority has always been to provide every one of its consumers, who are also its owners, with the very best telecommunications and customer service possible. Rock Port serves 1,695 access lines across its 187 square mile rural service area. This is about 9 lines per square mile. The population throughout our service area is aging, and the average county wage is \$21,373. We employ a total of 9 people – yes, 9 - and our annual revenue is \$1.6 million. By comparison, Embarq, which is a Tier 2, or midsize, carrier, has 18,000 employees and total revenues for 2007 of \$6.37 billion.¹ Verizon, which is a Tier 1, or large carrier, has 235,000 employees and last year generated consolidated operating revenues of \$93.5 billion.²

The entrepreneurial spirit of Rock Port is representative of its approximately 1,100 small rural counterparts in the industry, who together serve 50% of the nation's land mass. We have always been early adopters of new technologies, and it's been no different with regard to Internet Protocol (IP) capabilities. Presently, Rock Port makes high speed broadband available to 90% of its customers and we expect that figure to be 100% within three months. Due to this commitment, rural Americans today are enjoying universal telephone service, access to broadband Internet services, and enhanced emergency preparedness.

Yet, small rural companies simply do not enjoy the economies of scale and scope that would permit them to interconnect with every service provider in America who might send a call to one of their customers. Most small rural carriers, including Rock Port, interconnect with a larger carrier, such as Embarq or Verizon, who in turn provides them with access to all other telecom service providers. We call these intermediary carriers "tandem providers."

¹ See, <http://investors.embarq.com/phoenix.zhtml?c=197829&p=irol-irhome>

² See <http://investor.verizon.com/>

Rural Telecom Network Cost Recovery

Due to the extremely high costs associated with serving rural markets, small carriers like Rock Port depend on three primary sources of revenue to provide the cost recovery that is necessary to provide advanced, high quality services to rural Americans. They are: 1) intercarrier compensation payments from other carriers, 2) direct payments from our own customers, and 3) support from the federal Universal Service Fund (USF). Using the analogy of a three legged stool, if any one of these three legs are missing or shortened, the stool is thrown off balance and the company mission is toppled.

Intercarrier compensation payments are made by one carrier to another for the use of its network, for example when one of Carrier A's customers calls one of Carrier B's customers. Intercarrier compensation takes the form of either interstate access charges, intrastate access charges, or reciprocal compensation charges.

The term "phantom traffic" refers to voice communications traffic on the public network that lacks sufficient information for billing purposes. In other words, carriers do not receive the information necessary to know who to bill or what rate to bill for the call – thus under today's policy the call remains unbilled. In some cases, because rural carriers do not receive the billing information, they cannot identify the traffic traversing their networks - thus the term "phantom." Increasingly, rural carriers are discovering blatant schemes intended to avoid the payment of access charges entirely. This translates into dramatic losses of legitimate cost recovery revenue for telecommunications carriers of all sizes, while the carriers are still obligated to provide and maintain the facilities.

NECA has estimated that small rural carriers across the nation typically receive about 29% of their total net telephone company operating revenue from intercarrier payments. For some companies, this percentage is as high as 49% of total net operating revenue. So, you can see how important these intercarrier payments are for providing affordable service to rural consumers. You can see why we view the growth of phantom traffic and other schemes to avoid paying intercarrier fees with such concern. And you can see why this is a topic critical enough for this Committee and federal policymakers in general to address.

Identification of Phantom Traffic

Recognizing or identifying phantom, or unbillable, traffic is not always automatic or easy. The inherent dilemma with phantom traffic is that, by its very definition, it is essentially hidden and thus extremely difficult to identify or track. And by extension, it is very difficult to quantify its overall negative impact.

In its most insidious form, phantom traffic is a result of some carriers stripping the data completely, manipulating the data into an unreadable form, or the outright refusal to pay the intercarrier bill for the calls they send to another carrier's network. In other cases, phantom traffic materializes as a result of an originating service provider's failure to attach appropriate

call signaling information to its traffic. And in its most subtle form, phantom traffic is merely the outcome of flawed policies that allow for false jurisdictional classification of calls, which results in the erroneous billing of lower charges. All forms distort marketplace competition and force carriers inappropriately to seek cost recovery through other means. For rural carriers this means higher access charges for those who do pay and increased reliance on the Universal Service Fund.

At Rock Port, the unbillable or phantom traffic traversing our network is substantial -- over 18% of total minutes. Unfortunately, Rock Port is not alone. They say misery loves company, and we seem to have plenty of it. Industry estimates show between 20% and 30% of such intercarrier traffic cannot be billed because it lacks sufficient billing information.³ This figure is growing as service providers find new ways to avoid paying intercarrier compensation.

In 2007 alone, Rock Port lost access revenue equal to about \$37 per access line per year - because we did not have enough information to bill for the calls. Over the course of eight years, say from 2000 to 2008, this would amount to about a half million dollars. While this may seem like peanuts up here in Washington D.C., where I come from it translates into meat and potatoes. I would not like to have to tell my customers that their phone bills have to go up to pay for someone else's free ride on the network we are obligated to build, maintain and support. Unlike the industry's larger carriers, we small rural carriers do not have the scale, market alternatives, or customer numbers to make up the revenue elsewhere – nor should we have to. And if we do not meet our financial targets, our sources of financing for introducing new technology and modern, advanced communications services dry up PDQ - pretty darn quick.

Key Phantom Traffic Problems

One of the key causes of phantom traffic is the failure of certain carriers to send all of the call signaling information (intentionally or unintentionally) required for proper billing. The FCC does have a rule requiring carriers sending an interstate call to transmit the Calling Party's Number (CPN). This information helps carriers establish what rate to bill and can help identify what service provider sent the call. This information is also required in order for law enforcement officers to trace the call, for emergency workers to track the calling party, and to provide Caller ID services. Yet, if the number is altered or stripped off entirely, as it often is, these statutory and regulatory objectives are easily frustrated.

A case in point involves the Alaska Communications Systems Group which in 2005 sent a letter to the FCC describing traffic being terminated in Alaska as "local" traffic, but which in fact originated from out-of-state phones.⁴ In this case, the intermediary carrier had replaced the

³ E.g., Letter from Donna Epps, Verizon, to Marlene H. Dortch, FCC, CC Docket No. 01-92 (Nov. 1, 2006), attachment, at 11. Letter from Karen Brinkmann, Latham & Watkins, to Marlene H. Dortch, FCC, CC Docket No. 01-92 (July 1, 2005), attaching presentation entitled "Phantom Traffic: Problem and Solutions", Balhoff & Rowe (May 2005), at 5.

⁴ Letter from Karen Brinkmann, Latham & Watkins, LLP, to Marlene H. Dortch, FCC, CC Docket No. 01-92 (Dec. 12, 2005).

telephone number of the originating caller with a local Alaska number in order to disguise the jurisdiction of the call and thereby avoid paying the access charge. ACS indicated that in the month of October 2005 alone, over 20% of minutes to Fairbanks had this problem.

Recent analysis shows about 11% of calls other carriers sent Rock Port for termination on our network lacked a CPN. Another Kansas company received about 11.7% of calls without CPN. Sherburne Telephone in Minnesota recently performed a similar analysis only to discover, to their surprise, that about 30% of their terminating traffic arrives without a valid CPN.

A second key problem faced by Rock Port and most other small rural carriers is we don't receive all the detailed call records from the intermediate "tandem" carrier who provides us with connection to the outside world. If we don't receive this information, we cannot bill for the traffic.

In 2000, we at Rock Port discovered that we were not receiving call records for about 25% of the minutes traveling over our network. Because we could not bill for them without these records, they were traveling for free. Armed with this information, we negotiated with the tandem provider to alter how its network switches were configured so that they could send us complete records. We thought the problem was essentially solved. In 2007, however, we did a comparison of the minutes our own switches recorded with the number of minutes contained in the bill records we receive from the tandem provider. We had recorded 10.5 million minutes, but received call records for only 8.6 million minutes. That left 1.9 million minutes that we could not bill for. The percent of phantom traffic on our network had climbed from 14.5% in 2006 to 18.2% in 2007. There is no logical technical reason why we should not be receiving accurate call records from the tandem provider that tracks our network's actual traffic volume.

And it is certainly not just Rock Port. Our industry colleagues in Montana had a problem big enough to convince state lawmakers to address the issue of phantom traffic by adopting a state law in 2003 that required carriers to send call signaling information and required tandem transit providers such as Qwest to provide complete call records. The rural carriers use this data to crosscheck their own network data, which has helped reduce phantom traffic loss levels from 10% to less than 5% of their volume. A similar initiative was enacted in South Dakota in 2004, though it was recently overturned on procedural grounds tied to preemption. Likewise, industry colleagues in Washington and Oregon took their phantom traffic case to their state PUCs, providing data showing as much as 50% of the traffic on their local interconnection trunks was "phantom." In 2005, however, these PUCs decided that it was more appropriate to bring these issues to the FCC for consideration. Clearly with this level of state activity, it is obvious this is an issue that is crying out for federal action.

Some industry players argue that when we don't receive call signaling or records, we can still bill based on "traffic factors". These are percentages given to us by the sending carriers that are to be used for assigning traffic into the interstate, intrastate or local categories - by which we then assign rates. The sending carriers provide absolutely no supporting data to back up these unilateral traffic factors, and studies have shown that the factors do not represent the actual

traffic patterns on the network. Therefore, the third “phantom traffic” problem is that we have no means to verify the accuracy of these traffic factors. These carriers will only accept and pay a bill reflecting these factors.

This is particularly critical for traffic from wireless carriers. Rural companies in South Dakota ran a study to compare the non-local wireless traffic factor (for calls that cross a wireless Major Trading Area, i.e., inter-MTA calls) given to them by one wireless carrier with the actual percent of non-local wireless (inter-MTA) calls on their networks. They found that as much as 30% of total wireless traffic terminating on their network was inter-MTA, compared to the 3% inter-MTA factor given to them by this wireless carrier. And many of their wireless agreements have a 0% inter-MTA factor. These South Dakota companies are, therefore, not able to bill the correct rate for the 25-30% of wireless traffic that is legally subject to access charges. In 2004, the amount of access revenue lost due to these unrealistic factors represented an astonishing \$12 to \$39 per access line per year. In light of this demonstrated lack of “good faith”, it is clear that small rural carriers need the FCC to provide them with additional negotiating leverage to be able to negotiate inter-MTA traffic factors that are realistic and reflect the actual usage on the network

The final dilemma associated with phantom traffic that I will discuss today involves the outright refusal of so-called VoIP providers to pay their access charge bills. Rural carriers across the nation are receiving an increasing number of letters from interconnected carriers refusing to pay access charge bills, claiming the calls were “IP.” Laurel Highlands Tel (PA) has provided the FCC evidence that carriers such as ChoiceOne are not only refusing payment of access charges, but may also be enticing other carriers to migrate their traffic to its “free” network. Montana Telecom Association provided the FCC with similar letters from CommPartners, which admitted that 90%-100% of its terminating traffic to various Montana ILECs is interexchange, but stated that “because this traffic represents VoIP transmissions rather than circuit-switched telephone calls, your company is not entitled to collect access charges on these calls.” NECA has also provided a number of such letters to the FCC.

At the end of the day, you and I both know these are nothing more than voice calls – people talking to people. But because these companies have sprinkled “IP fairy dust” on them, they think they should get a free ride on our network.

IP technology has never been magic - controlled by a few magicians in their Internet labs. I have IP technology in my network, AT&T has it and Verizon has it. Public telephone networks around the world are introducing IP technology into their networks. IP is a technology – it is not a service, it is not a network, and it is not the same as the Internet. IP is today’s iteration of communications technology – not tomorrow’s iteration – and once again, however delivered these calls are just voice calls.

But because the FCC has not yet confirmed that access charges apply to interconnected VoIP service, these CLECs are claiming their services are “enhanced” and, therefore, exempt from access charges. Because the FCC has remained silent, more and more rural phone companies are

receiving letters from service providers who refuse to pay the intercarrier bills for calls they agree they sent to rural telecom company networks. And current federal policy requires us to continue giving our product away to companies who refuse to pay for it, even when we do send them a bill.

Please tell me why we allow other utilities to stop service when we are late in payment, why I could not check into my hotel until my credit card company agreed to make payment, and we let banks foreclose on homeowners and take their homes from them when they don't pay their mortgages, but we do not take service away from these "high tech" companies who won't pay their bills?

Turning Point

So, the big question is – what can be done about phantom traffic.

First, the FCC needs to require all service providers to send all the telephone numbers and other traffic identifiers – just like is required for an ATM cash transaction to take place. NECA has filed a petition for an interim order with the FCC asking it to: a) Extend their existing call signaling rules to all interconnected voice service providers; b) Require accurate CPNs be transmitted with all calls, regardless of jurisdiction and regardless of technology used; c) Clarify that the true CPN must be provided, not a number associated with intermediate switches, gateways, or platforms; d) Require all intermediate service providers to transmit signaling information unaltered; and e) Clarify that the originating and terminating telephone numbers can be used as a default proxy to determine jurisdiction of calls for billing purposes, when traffic factors cannot be mutually agreed or data on the actual origination or termination point is not provided. Almost every segment of the telecom industry in America has expressed support for strengthened call signaling rules. Yet, we are still awaiting some action on this front.

Second, I need to be able to bill for all the calls on my network. I need to receive call records for all the calls, and when I don't, I need the tools to hold the person who sent those calls to me accountable. The Montana state law may provide a good model for federal action. It requires the tandem transit providers to provide call records to the terminating carriers. However, when I don't receive those call records, I need to be able to charge the guy at the other end of the trunk who is sending me those calls without the records. Just like in the children's game of telephone, I can only see the person next to me who is passing me the message. I cannot see the person originating the message. The guy at the other end of the trunk can then pass the charges down to the next guy who is sending him the traffic, and so on down the food chain. I cannot hold some unknown, unnamed service provider accountable without such tools.

Third, we need a federally-approved tool that will provide small carriers with the ability to negotiate realistic traffic factors for non-local, inter-MTA wireless calls with wireless carriers. The NECA petition has proposed the use of the "telephone numbers rule" as a reasonable proxy for when actual traffic data is not provided or a traffic factor cannot be mutually agreed. A 2004 South Dakota study has demonstrated that using call records and using telephone numbers

produces fairly close results. We believe the telephone numbers rule is a reasonable proxy, and will give wireless carriers a strong incentive to bring real traffic data with them to the negotiating table.

And finally, we need the FCC to affirm that all users of the network must pay for its use. The FCC has stated that this is the policy, has implemented rules, has said that VoIP services are the same as telephone services in the customer's eyes. But the FCC has not yet confirmed that VoIP calls are subject to its access charge rules just like all other voice calls. This has allowed service providers to sprinkle the "IP fairy dust" over their refusals to pay their access bills and to claim they should be treated different – that they are Internet Service Providers - rather than what they really are, which is providers of voice calls used by people to talk to other people.

If the FCC lets this continue, Americans who live in rural areas will likely see their phone bills increase and the quality of their services decrease. IP-originated voice services are expected to account for more than 20 percent of all voice calls in 2008, 33 percent in 2010, and 40 percent in 2011. We simply cannot afford to give the use of our networks away for free. The Coalition of Telecom Manufacturers has said that if this continues, it will result in large reductions in telecom infrastructure investment, particularly investment in broadband access technologies. I can tell you, Senators, this will certainly be true in rural America, and will jeopardize the national objective of ubiquitous broadband Internet access.

Conclusion

Senators, time is of the essence. With each passing day, small rural carriers lose millions in intercarrier compensation revenue. We are not asking for special treatment. We are only asking for carriers that use our network to pay for its use. It is anti-competitive to allow some carriers to avoid these fees while others pay, and it is affecting the ability of small rural carriers to roll out new technology and services to rural America.

Americans today uniformly rely on communications infrastructure and services to satisfy their commerce, safety, security, entertainment, and leisure needs. Moving forward, these needs will be met via a combination of 2-way voice, video, and data options. Ensuring that small rural companies have the financial wherewithal to meet these needs is the primary reason to take action to exterminate phantom traffic. Lack of action on phantom traffic is putting in jeopardy rural carrier's ability to help us achieve our shared national objective - ubiquitous and robust broadband capable infrastructure.

Senator Stevens has been hard at work drafting a legislative proposal that would go a long way toward helping resolve the phantom traffic issue by providing the FCC with specific guidance on actions it could take to ensure this practice is stopped. Please support Senator Stevens in his efforts to address phantom traffic through this legislation. And please urge the FCC to take immediate action by granting NECA's Petition. You know – Missouri is the "Show me" state, and we'd sure be pleased if you could show support for our concerns on this crucial matter. Thank you.