BEFORE THE SENATE COMMITTEE ON

COMMERCE, SCIENCE AND TRANSPORTATION

Hearing on Phantom Traffic

April 23, 2008

TESTIMONY OF LAWRENCE E. SARJEANT

VP FEDERAL LEGISLATIVE AND
REGULATORY AFFAIRS
QWEST

Good morning Mr. Chairman and Members of the Committee. My name is Lawrence Sarjeant, and I am Vice President for Federal Legislative and Regulatory Affairs for Qwest Communications International, Inc. (Qwest). I appreciate the opportunity to share Qwest's views with you at today's hearing on the issue of phantom traffic.

Before I address the phantom traffic issue directly, I just want to give a little background about who Qwest is and why we care so much about this issue. As you may know, Qwest provides local telephone service, broadband Internet access service, and VOIP (voice services using an IP protocol) service in fourteen states across the Central, Mountain and Pacific time zones. Qwest also operates a long-haul long distance network and operates one of the world's largest Internet backbones. Qwest also provides a variety of other telecommunications and information services on a nation-wide basis (i.e. both inside and outside of its local service area). These services include VOIP service and a broad variety of other innovative telecommunications solutions provided to businesses and state and federal government agencies. In providing these services, Qwest utilizes a network that consists of both traditional Public Switched Telephone Network (PSTN) facilities and state-of-the-art broadband and other IP-based facilities. Qwest commits considerable investment capital and other resources on an annual basis to operate and maintain these facilities. By way of example, Qwest invested approximately $800 million in 2007 to augment the broadband capabilities of its network, including delivering higher speeds to all of its sales channels.[1] This was a part of the approximately $1.67 billion in total Qwest capital investment for 2007.[2] On top of that, Qwest recently announced a planned 2008 capital

[1] As stated in the Earnings Release for Qwest's 4th Quarter and Full-Year 2007 results.
[2] *Id.*

investment of $300 million to extend fiber optics deeper into its local network supporting state-of-the-art Internet services.[3]

<u>Promoting an Investment-friendly, Consumer-friendly, Market-based Environment</u>

Given the breadth and scope of its services and the size of its capital investment, Qwest cares deeply about ensuring that the public policy environment in which it operates is one that is investment friendly. This is certainly a primary focus of the 1996 Telecommunications Act, as evidenced by the specific requirement in Section 157 that the Federal Communications Commission (the "FCC") "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans … by utilizing … regulating measures that remove barriers to infrastructure investment." It is this goal of bringing advanced telecommunications capability to all Americans that should guide our communications policy deliberations and actions. Policies that discourage investment in communications infrastructure by making such investment uneconomic operate at cross-purposes with the goal of encouraging the timely and ubiquitous deployment of advanced communications capability to all Americans. Phantom traffic bears on a carrier's ability to make investments in advanced telecommunications capabilities by depriving it of the compensation it is due for handling the traffic of other communications providers. We are experiencing a serious problem with certain industry participants avoiding their intercarrier compensation obligations to those carriers that own and operate the PSTN. Facilities-based providers of communications services such as Qwest have high fixed costs. If we cannot recover our legitimate costs because of such arbitrage, less capital is available to us for future network investments to achieve the Congress's goal of bringing advanced telecommunications capability to all Americans. If this happens, consumers lose.

[3] As stated in the Earnings Release for Qwest's 3rd Quarter of 2007 results.

Qwest commends the Committee for its interest in this issue and shining a spotlight on it by holding this hearing.

<u>The Phantom Traffic Problem</u>

The term "phantom traffic" describes a number of different situations in which traffic is not adequately identified, making appropriate billing for the traffic difficult or impossible. This happens for a variety of reasons, but generally occurs because the current intercarrier compensation regime has not kept pace with technological and competitive changes in the communications market, and as a result, has made certain arbitrage opportunities possible. In today's telecommunications world, both traditional telecommunications carriers and service providers utilizing more recent technologies all depend upon the ability to interconnect with one another. The intercarrier compensation regime, in turn, governs the manner in which interconnecting communications service providers give or receive compensation when these service providers exchange traffic. Because the exchange of traffic sometimes involves different types of services that are accorded different regulatory treatment, intercarrier compensation is accomplished through a variety of arrangements. In some circumstances, service providers agree to exchange no compensation while accepting each other's traffic. This is called "bill and keep." In other cases, local exchange carriers exchange or carry traffic pursuant to tariffs or carrier agreements that define the terms and conditions for the provision of compensation. For long distance services, there are both interstate and intrastate tariffed access charge regimes that are regulated by the FCC and state public service commissions, respectively. Under these regimes, long distance carriers typically pay local exchange carriers to deliver and receive long distance calls to and from local customers. Among competing local exchange carriers, there are the reciprocal compensation rules, which allow a local exchange carrier to be compensated by another local exchange carrier for the termination of local traffic. When wireless carriers exchange traffic with wireline carriers, there are yet additional rules. In some cases, traffic merely transits an intermediate carrier's network, but the transit provider neither originates nor terminates the call. In any compensation arrangement where service providers must compensate each other, it is essential that they not only negotiate agreements that spell out the terms and conditions by which they exchange traffic, but that they also exchange adequate call data to enable accurate billing.

Phantom traffic occurs, in part, because not all service providers obtain adequate agreements that ensure that other carriers receive the call data necessary for billing, particularly in those circumstances where the call signaling data is not adequate. Moreover, because intercarrier compensation treatment varies by jurisdiction, some service providers have the incentive to engage in arbitrage when they exchange traffic. For example, because interstate access rates are typically lower than intrastate access rates, access traffic is sometimes erroneously designated as interstate when in fact it is jurisdictionally intrastate. Similarly, access traffic is sometimes erroneously designated as local traffic because intercarrier compensation rates for local traffic are lower and/or because such a designation improperly seeks to shift the compensation burden to another carrier (e.g. an originating carrier may be due compensation for access traffic but owe compensation for local traffic). In other words, phantom traffic occurs because certain service providers seek to pay less than they should, seek to avoid their compensation obligations altogether, or seek to receive compensation when they should be paying. Regardless of how it happens, phantom traffic is a large problem. Estimates as to the amount of revenue lost annually to phantom traffic have varied in filings in the FCC's intercarrier compensation proceeding (Docket WC No. 01-92) from $600M to $2B. The FCC is currently studying potential intercarrier compensation reform proposals that would largely address this problem by eliminating differences in intercarrier compensation treatment based on the type of traffic. However, it may be some time before comprehensive intercarrier compensation reform occurs. Because of this, Qwest and numerous other industry representatives are encouraging the FCC to at least adopt interim measures that would provide significant relief from the phantom traffic problem.

Qwest's Phantom Traffic Position

Qwest and a diverse group of industry representatives have asked that the FCC address phantom traffic on an interim basis by: (1) reinforcing that the 1996 Act requires and enables all types of service providers to enter into agreements for the exchange of traffic; and (2) expanding the scope of FCC rules requiring the passage of information necessary for accurate billing. The first principle is important because signaling is just one method of passing some of the information necessary for accurate billing. The exchange of call records pursuant to agreement also provides information to facilitate billing and is, in fact, the industry standard and the most common way in which information is exchanged for billing purposes. While service providers are already able to negotiate commercial terms for the exchange of these calls records as part of their agreements, they all too often fail to obtain agreements in the first place and, when they do, fail to negotiate for the necessary call records. The second principle is important because the FCC's existing call signaling rules were targeted to a narrow subset of traffic – i.e. interstate traffic using the most common traditional PSTN signaling protocol. The rules do not cover, for example, voice calls originated in IP protocol which terminate on the PSTN. As the communications marketplace becomes increasing diverse and PSTN-based services become a complement to a variety of non-PSTN-based services, it is necessary to expand the FCC's signaling rules.

Again, Qwest believes that the best interim solution to phantom traffic is to merely expand the scope of current rules as discussed above. To be clear, given the nature of the arbitrage problem underlying phantom traffic, Qwest believes that comprehensive intercarrier compensation reform that creates a holistic bill-and-keep-at-the edge regime for all traffic is the only true and complete solution to the phantom traffic problem. The solution described above, addressing agreements and signaling rules, is only an interim step. But, it is an important step, and Qwest hopes it can be taken expeditiously.

Thank you.