# An Evaluation of the Proposals in the FCC's Intercarrier Compensation Reform Docket Related to Tandem Transit Services

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## I. INTRODUCTION AND SUMMARY

In November of 2008, as part of its Intercarrier Compensation Reform Docket,[1] the FCC requested comments on a proposal for intercarrier compensation reform offered by former FCC Chairman Kevin Martin and the Staff of the FCC (Reform Proposal).[2] Among his proposed suggestions are regulations related to "tandem transit" services.

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1. Developing a Unified Intercarrier Compensation Regime, *Notice of Proposed Rulemaking*, 16 F.C.C.R. 9610 (2001) [hereinafter *Unified Intercarrier Compensation Regime Proposed Rulemaking*].

2. Developing a Unified Intercarrier Compensation Regime, *Order on Remand and Report and Order and Further Notice of Proposed Rulemaking*, CC Docket No. 01-92 (rel. Nov. 5, 2008), *available at* 2008 WL 4821547 [hereafter the *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*]. Initially, Commissioner Martin intended for a full vote to be had on his Reform Proposal at the FCC's November 4, 2008 meeting. At the last minute, the item was deferred. *See Martin Pulls ICC/USF Reform Item from November*

Tandem transit services are the switching and transport services that enable the delivery of local telecommunications calls between telecommunications carriers that are not directly connected with each other. These services were historically provided, though not always willingly, by incumbent local exchange carriers (ILECs) such as AT&T, Verizon, and Qwest to enable competitive local exchange carriers (CLECs), cable telephony providers and wireless carriers, to complete calls to and from each other's networks. [3]

A number of state regulatory commissions have recently considered disputes involving tandem transit services provided by Neutral Tandem, Inc., an alternative provider of tandem transit services.[4] These cases appear to be the first ones in the country addressing issues surrounding the provisioning of tandem transit services on a competitive basis. These commissions considered public policy questions such as the benefits of competitive tandem transit service, interconnection rights for tandem transit providers, and financial responsibility for calls that are delivered using competitive tandem transit services.

The Authors suggest that the state commissions generally recognized that public policy interests are served by establishing rules that facilitate the development of competition in the market for tandem transit services.[5] As the state commissions found, competition in the tandem transit market can best be facilitated by affording nondiscriminatory interconnection rights for carriers seeking to deliver tandem transit traffic. The state commissions

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*Commission Meeting*, TR DAILY, Nov. 3, 2008, *available at* 2008 WLNR 21007095. Instead, further comments were sought on the proceeding. While the FCC next intended to address the issue at their December 2008 meeting, this item also was withdrawn. *See Martin Did Not Consult with All Offices Before Cancelling Meeting, Sources Say*, TR DAILY, Dec. 15, 2008, *available at* 2008 WLNR 24026173. On January 16, 2009, Commissioner Martin resigned as Chairman of the FCC. As of January 20, 2009, the FCC had not scheduled any further proceedings relating to intercarrier compensation.

3. *Unified Intercarrier Compensation Regime Proposed Rulemaking*, *supra* note 1; Notice of Ex Parte Presentation of Nat'l Ass'n of Regulatory Util. Comm'r, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. July 24, 2006).

4. *See generally* Petition of Neutral Tandem, Inc. for Interconnection with Level 3 Communications and Request for Emergency Relief, Docket No. 24844-U (Georgia Pub. Serv. Comm'n Aug. 27, 2007) (final order) [hereinafter the Georgia Order]; Neutral Tandem, Inc., Docket No. 07-277 (Ill. Comm. Comm'n July 10, 2007) (final order) [hereinafter the Illinois Order]; Neutral Tandem, Inc., Case No. U-15230 (Mich. Pub. Serv. Comm'n Nov. 2, 2007) (final order) [hereinafter the Michigan Order]; Neutral Tandem, Inc., Docket Nos. P5733/C-07-296 and P733, 6403/M-07-354 (Minn. Pub. Util. Comm'n Mar. 24, 2008) (order) [hereinafter the Minnesota Order]; Neutral Tandem – New York, L.L.C., Case No. 07-C-0233 (N.Y. Pub. Serv. Comm'n June 22, 2007) (order) [hereinafter the New York Order].

5. This Article is limited to a discussion of the tandem transiting proposals contained in the FCC's Reform Proposal, the Missoula Plan, and the other proposals concerning intercarrier compensation reform before the FCC. This Article is not intended to nor does it address the merits of any other proposals addressed therein.

also generally recognized that the originating carrier—not the transiting provider—should continue to maintain responsibility for paying the costs necessary to deliver the call to the terminating carrier's point of interconnection.

The Authors submit, however, that certain price regulation proposals could harm the development of competition among tandem transit providers. In particular, proposals to require ILECs to provide tandem transit services at prices based on the total element long-run incremental cost rate (TELRIC)[6] methodology seem likely to inhibit the development of competition in this market. The Authors suggest that competition has already developed in this market in many areas. The Authors further suggest that, in markets where facilities-based competition already exists, there does not appear to be a need for any price regulation.

Part II of this Article provides an overview of tandem transit services. Part III reviews the state commission decisions addressing the public policy issues posed by nascent competition in the tandem transit market. Part IV discusses the various plans proposed by the FCC for regulating tandem transit services. Part V concludes by offering the Authors' suggestions for optimal regulations of the tandem transit market.

## II. TANDEM TRANSIT SERVICES: AN OVERVIEW

Tandem transit services include switching and transport services that enable the indirect delivery of local telecommunications calls between different carriers.[7] Transiting enables an end-user of a competitive telecommunications provider (or the "originating carrier") to make a call to an end-user of another competitive provider (or the "terminating carrier") by allowing the originating carrier to deliver the call to an intermediary's[8] tandem switch, who then routes the call to the terminating carrier.[9]

In the absence of transiting, telecommunications providers would be forced to establish direct connections with every switch in a market to

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6. TELRIC refers to the total element long-run incremental cost rate methodology. Under the TELRIC methodology, rates are set "based on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration." 47 C.F.R. § 51.505(b)(1) (2008); *see also* Verizon Comm. Inc. v. FCC, 535 U.S. 467 (2002).

7. Developing a Unified Intercarrier Compensation Regime, *Further Notice of Proposed Rulemaking*, 20 F.C.C.R. 4685 para. 121 (2005) [hereinafter *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*].

8. As discussed in more detail below, the intermediary historically was an ILEC. Recently, competitive tandem transit providers have begun to offer independent transiting services. *See infra* note 20.

9. *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at para. 120. In other words, the originating carrier first routes its call to the transiting tandem, which then routes the call to the terminating carrier.

exchange calls between their networks. Creating a direct connection, and incurring the costs of establishing and maintaining the direct interconnection, only makes sense from the carriers' perspectives if sufficient traffic is exchanged between the two relevant switches over the direct connection to make the connection economically efficient. Specific switches often do not exchange sufficient traffic to justify a direct connection.[10] Thus, in an era where a wide variety of telecommunications carriers provide telecommunications services to consumers—including traditional CLECs, cable telephony providers, and wireless carriers—many providers depend on tandem transiting to efficiently and effectively route calls to the many other carriers to which they are not directly connected.[11]

Traditionally, competitive carriers could obtain indirect interconnection with one another only through ILECs like AT&T, Verizon, and Qwest. Because ILECs compete with the competitive carriers for end-user customers, their control of this bottleneck facility raised the concern that incumbents could impose unreasonable terms and conditions on competitive carriers in order to gain a competitive advantage.[12] Certain incumbents have also resisted the notion that they are required to provide tandem transit services to their competitors. Although the FCC has never resolved this issue,[13] it has suggested that ILECs may be able to refuse to

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10. *Id.* at para. 121.

11. *See* Petition of Worldcom, Inc. Pursuant to Section 252(e)(5) of the Comm. Act for Preemption of the Jurisdiction of the Va. State Corp. Comm'n, *Memorandum Opinion and Order*, 17 F.C.C.R. 27039, para. 118 (2002) [hereinafter the *Virginia Arbitration Order*].

12. *See infra* notes 151-157.

13. The FCC has routinely refused to decide this issue, stating that "[t]o date, the [FCC]'s rules have not required incumbent LECs to provide transiting." Review of the Section 251 Unbundling Obligations of Incumbent Local Carriers, *Report and Order and Order on Remand and Further Notice of Proposed Rulemaking*, 18 F.C.C.R. 19020, par. 534, n.1640 (2003); *see also* Petition of Worldcom, Inc. Pursuant to Section 252(E)(5) of the Comm. Act for Preemption of the Jurisdiction of the Va. State Corp. Comm'n, *Order on Reconsideration*, 19 F.C.C.R. 8467, para. 3 (2004); Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, *Report and Order on Remand and Further Notice of Proposed Rulemaking*, 18 F.C.C.R. 16978, para. 534, n.1640 (2003); *Virginia Arbitration Order*, *supra* note 11, at para. 117.

In the absence of such a ruling by the FCC, one court and some, but not all, state commissions have concluded that incumbents are required to offer transiting to non-dominant providers. *Compare* Joint Petition by TDS Telecomm. et. al., Objecting to and Requesting Suspension and Cancellation of Proposed Transit Traffic Service Tariff, Order No. PSC-06-0776-FOF-TP, 2006 Fla. PUC LEXIS 543, at *36-37 (Flor. Pub. Serv. Comm'n Sept. 18, 2006) (order) [hereinafter Florida TDS Telecomm. Petition] (refusing to find incumbents are required to provide tandem transiting service), *and* AT&T Comm. of N.Y., Inc., Case No. 01-C-0095, at 37 (N.Y. Pub. Serv. Comm'n July 30, 2001) (order resolving arbitration issues) (refusing to find incumbents are required to provide tandem transiting service), *with* Telcove Inv., LLC Petition for Arbitration, Docket No. 04-167-U (Ark. Pub. Serv. Comm'n Sept. 15, 2005) (memorandum and order). In that case, the Arkansas Public Service Commission held that:

continue providing transiting services when the levels of traffic exchanged between two competitive carriers justify the establishment of a direct connection between those carriers.[14]

Notwithstanding the lack of comprehensive regulation, some issues related to tandem transiting services have been raised in enforcement proceedings before the FCC and before various state commissions. For example, the FCC has declared that originating carriers must continue to pay reciprocal compensation[15] even if traffic is routed through an intermediary, such as a tandem transit provider. The FCC has held that, under controlling federal rules, originating carriers pay for the delivery of local traffic to the terminating carrier[16] whether the traffic is exchanged directly or indirectly.[17] For this reason, the FCC repeatedly has found that

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> [I]f incumbents such as SBC were not required to provide transit service, they could deprive competitors of the economies of scale and scope inherent in a ubiquitous network, a network largely paid for by captive ratepayers. The incumbent could substantially raise rivals' costs by forcing them to choose between paying supra-competitive prices for the service or constructing direct trunking connections with other carriers that cannot be economically justified by the anticipated volumes of traffic. Because transit service is required to be provided pursuant to [47 U.S.C. §] 251(c)(2), there is no question that the applicable terms are arbitrable . . . under Section 252.

*Id.* at 37-38; *see also* Qwest Corp. v. Cox Nebraska Telecom, LLC, No. 08-3035, 2008 WL 5273687, at *2-3 (D. Neb. 2008) (incumbent is required to provide transiting under Section 251(c)(2) of the Telecommunications Act of 1996); Mich. Bell Tel. Co. v. Chappelle, 222 F. Supp. 2d 905, 917-18 (E.D. Mich. 2002) (holding that state commissions were not preempted by federal law from imposing a mandatory transiting obligation); Sw. Bell. Tel., Docket No. 05-081-U, Ark. PSC Order No. 6 (Ark. Pub. Serv. Comm'n Nov. 14, 2005) (memorandum and order) (holding incumbents required to provide transiting); CLEC Coalition for Arbitration, Docket Nos. 05-BTKT-365-ARB, 05-AT&T-366-ARB, 05-TPCT-369-ARB, 05-NVTT-370-ARB, at 29, (Kan. Comm. Comm'n June 6, 2005) (order) [hereinafter Kansas CLEC Arbitration]; Sw. Bell Tel., LP, Case No. TO-2005-0336, at Sec. 1(C) (Mo. Pub. Serv. Comm'n June 21, 2005) (final arbitrator's report).

14. The FCC has suggested that incumbents need not provide tandem transiting services when it would be more economical for the non-dominant provider to directly connect with another carrier. For example, the FCC approved an interconnection agreement over the objection of the non-dominant carrier, which provided that once the non-dominant provider routed more than a DS-1 level of traffic, or, 200,000 minutes of traffic, the incumbent could either terminate its provision of transit services or require the non-dominant provider to pay additional charges for the service. *Virginia Arbitration Order*, *supra* note 11, at para. 117.

15. Under the Telecommunications Act of 1996, Congress declared that reciprocal compensation (whereby the originating carrier pays the cost to deliver the call to the ultimate end-user) would be the default compensation method for all local calls transmitted between carriers. *See* 47 C.F.R. § 51.703(b) (2008); *see also* § 51.701 (reciprocal compensation also applies to the delivery of wireless traffic); Developing a Unified Intercarrier Compensation Regime, *Declaratory Ruling and Report and Order*, 20 F.C.C.R. 4855, para. 12 (2005).

16. When the traffic being exchanged is long-distance or access traffic, access charges apply.

17. *See, e.g.*, TSR Wireless, LLC v. U.S. West Comm., Inc., *Memorandum Opinion and Order*, 15 F.C.C.R. 11166, para. 34 (2000).

transiting carriers should not be forced to serve as a billing clearinghouse—that is, to help terminating carriers collect reciprocal compensation from the originating carrier.[18] A number of states have found that they have authority, not only to require ILECs to provide transiting services, but to do so at regulated prices.[19]

Recently, alternative tandem services, provided by non-incumbent, competitive carriers, have become available in several markets.[20] This competition for tandem switching service has been recognized as bringing many benefits to the telecommunications industry including lower transit costs, increased network reliability, and the promotion of market entry and competition among facilities-based providers.[21] Nevertheless, despite the

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18. *See, e.g.* Rural Iowa Indep. Tel. Ass'n v. Iowa Util. Bd., 385 F.Supp.2d 797, 816-20 (S.D. Iowa 2005) (affirming the Iowa Utilities Board holding that terminating LECs needed to seek compensation from originating carriers and not the transit provider); TexCom, Inc. v. Bell Atlantic Corp., *Memorandum Opinion and Order*, 16 F.C.C.R. 21493, paras. 9-10 (2001).

Various state commissions have issued rulings consistent with this finding. *See, e.g.*, Petition of Cox Conn. Telcom, LLC for Investigation of the Southern New England Tel. Co.'s Transit Service Cost Study and Rates, Docket No. 02-01-23, 2003 Conn. PUC LEXIS 11, at *15 (Conn. Dep't Pub. Util. Control Jan. 15, 2003) (opinion) [hereinafter Cox Connecticut Petition] (holding that transit providers are not a "bill clearinghouse"); Nextel Partners of Upstate N.Y., Inc. Complaint Against Frontier Tel. of Rochester, Inc. Concerning Transit Charges, Case No. 06-C-1217, at 9 (N.Y. Pub. Serv. Comm'n Dec. 20, 2006) (order resolving complaint) ("transiting carriers should have no responsibility to pay for the completion" of calls they deliver on originating carriers behalf); AT&T Comm. of Ohio, Inc.'s and TCG Ohio's Petition for Arbitration of Interconnection Rates, Terms, and Conditions and Related Agreements with Ameritech Ohio, Case No. 00-1188-TP-ARB, 2001 Ohio PUC LEXIS 366, at *15 (Pub. Util. Comm'n of Ohio June 21, 2001) (opinion and arbitration award) (noting that a transiting carrier is not required "to act as a clearinghouse or billing agent"); Petition of Cellco P'ship for Arbitration Pursuant to Section 252 of the Telecomm. Act of 1996 to Establish an Interconnection Agreement with Alltel Pa. Inc., Docket No. A-310489F7004, at 27 (Pa. Pub. Util. Comm'n Jan. 13, 2005) (opinion and order) ("[T]he cost responsibility for third-party transit [is] on the originating carrier."); Petition for Arbitration of Cellco P'ship, Docket No. 03-00585, at 24 (Tenn. Regulatory Authority Jan. 12, 2006) (order of arbitration award) (In a transiting situation, "the company that originates the call is responsible for paying the party terminating the call.").

19. Some state commissions have set mandatory transiting rates. *See, e.g.*, Cox Connecticut Petition, *supra* note 18, at *50; Kansas CLEC Arbitration, *supra* note 13, at 29; To Review the Costs of Telecomms. Servs. Provided by SBC Mich., Case No. U-13531, at ex. A (Mich. Pub. Serv. Comm'n Jan. 25, 2005) (opinion and order); Arbitration of Non-Costing Issues for Successor Interconnection Agreements, Docket No. 28821, at 23 (Tex. Pub. Util. Comm'n Feb. 23, 2005) (arbitration award). *But see* Florida TDS Telecomms. Petition, *supra* note 13, at *36-37 (concluding that market rates should be set by the market); Re Sprint Comm. Co., Order No. 08-486, 2008 WL 4493108, at *6, *20-22 (Pub. Util. Comm'n of Or. Sept. 30, 2008) (order) (refusing to order incumbent to provide transit service under TELRIC rates).

20. *See, e.g.*, Reply Comments of AT&T at 8-9, Petition for Interconnection of Neutral Tandem, Inc., FCC WC Docket No. 06-159 (rel. Sept. 25, 2006).

21. For example, the FCC has stated:

increasingly important role tandem transit services play in the evolving competitive marketplace, many policy issues surrounding the development of competition in the tandem transit market remain unresolved.

## III. RECENT STATE COMMISSION DEVELOPMENTS

Several state commissions recently addressed many of these developing issues when Neutral Tandem, a competitive tandem transit provider, filed petitions for interconnection with a large CLEC. Neutral Tandem filed the petitions after the CLEC, which previously had received

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> By further reducing barriers to competition in switched access services, our actions will benefit all users of tandem switching. . . . Our actions also should promote more efficient use and deployment of the country's telecommunications networks, encourage technological innovation, and exert downward pressure on access charges and long-distance rates, all of which should contribute to economic growth and the creation of new job opportunities. In addition, these measures should increase access to diverse facilities, which could improve network reliability.

Expanded Interconnection with Local Tel. Co. Facilities, Transport Phase II, *Third Report and Order*, 9 F.C.C.R. 2718, para. 2 (1994). The FCC has further noted:

> [T]he availability of transit service is increasingly critical to establishing indirect interconnection – a form of interconnection explicitly recognized and supported by the Act. It is evident that competitive LECs, CMRS carriers, and rural LECs often rely upon transit service from the incumbent LECs to facilitate indirect interconnection with each other. Without the continued availability of transit service, carriers that are indirectly interconnected may have no efficient means by which to route traffic between their respective networks.
>
> Moreover, it appears that indirect interconnection via a transit service provider is an efficient way to interconnect when carriers do not exchange significant amounts of traffic. . . . This conclusion appears to be supported by the widespread use of transiting arrangements.

*Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at paras. 125-26.

In addition, the FCC noted in once case that the petition filed with the FCC to permit Neutral Tandem to direct interconnection with Verizon Wireless was "in the public interest" because

> Neutral Tandem's platform provides an additional means of interconnection between wireless and wireline carriers, and thereby promotes competition between Neutral Tandem and Verizon Communications in New York. As described in Neutral Tandem's petition, if Verizon Wireless directly connects to Neutral Tandem in New York, it will enable competitive local exchange carriers, cable companies and independent CMRS providers to bypass the Verizon tandem. Verizon Wireless, however, appears to be engaging in the very behavior the Commission cautioned against. Consequently, the Commission should order interconnection so that Neutral Tandem and other carriers may seek alternative, competitive means of establishing interconnection.

Reply Comments of the N.Y. Dep't of Pub. Serv., Petition of Neutral Tandem, Inc. for Interconnection with Verizon Wireless, Inc. Pursuant to Sections 201(a) and 332(c)(1)(B) of the Communications Act of 1934, as Amended, FCC WC Docket No. 06-159, at 2, 3 (rel. Sept. 25, 2006) (internal citations omitted). *See also*, New York Order, *supra* note 4, at 9 ("The availability of an independent tandem in turn furthers the development of facilities-based competition among wireless, cable and landline telephony, by offering the providers of all such services an economically advantageous alternative to the [ILEC] tandem.").

tandem transit traffic from Neutral Tandem, indicated that it would no longer allow Neutral Tandem to continue delivering tandem transit traffic.

The dispute was tried to a decision before several state commissions. Each of the commissions that addressed the merits of the dispute considered many of the public policy issues that are also being debated before the FCC in the Intercarrier Compensation Docket. Although each state commission addressed the dispute under applicable state law,[22] the rulings were based, at least in part, on the commissions' findings that a direct interconnection between Neutral Tandem and the terminating CLEC was necessary to the public interest and consistent with federal law and policy. The decisions thus provide useful guidance for federal regulators as they address this important and pressing issue in the Intercarrier Compensation Docket.

### *A. Background*

Since 2004, Neutral Tandem and the CLEC had been interconnected pursuant to a series of commercial contracts.[23] Under the commercial contracts, the carriers had a two-way relationship. Neutral Tandem delivered both the CLEC's originating traffic to other carriers and the terminating traffic to the CLEC sent by other competitive carriers through Neutral Tandem.[24]

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22. The state commission decisions discussed herein are some of a few notable examples where state commissions have intervened in interconnection disputes involving two competitive carriers. *See, e.g.*, Pac-West Telecomm., Inc. v. AT&T Comm. of Cal., Inc., Case No. 04-10-024, 2007 Cal. PUC LEXIS 310, at *2-4 (Cal. Pub. Util. Comm'n Mar. 1, 2007) (order denying rehearing) (holding that the California Commission may order the originating CLEC to pay termination charges set forth in intrastate tariffs of the terminating CLEC); Petition of Nex-Tech, Inc. for Arbitration Against RCC Holdings, Inc., Docket No. 05-NTHT-754-ARB, 2005 Kan. PUC LEXIS 785, at *2-3 (Kan. Comm. Comm'n June 20, 2005) (order) (approving interconnection agreement between CLECs, but noting that decision should not be interpreted that agreements between CLECs are subject to arbitration pursuant to Section 252 and/or require approval pursuant to that section, since the commission has not had the opportunity to address the merits of that issue); Generic Docket to Develop Policy for the Submission and Review of CLEC-to-CLEC Interconnection Agreements, Docket No. 05-00327, 2007 Tenn. PUC LEXIS 411, at *1 (Tenn. Reg. Util. Comm'n Nov. 30, 2007) (order denying rulemaking) (holding that the TRA has the jurisdiction to review and approve CLEC-CLEC agreements "pursuant to state law, however there is no need to develop a formal policy or rulemaking at this time"); Petition for Approval of the Interconnection Agreement Between Jackson Energy Authority and Aeneas Comm., LLC, Docket No. 04-00128, at 4-5 (Tenn. Reg. Util. Comm'n July 19, 2005) (order approving interconnection agreement) (approving interconnection agreement negotiated between two competing local exchange carriers under state law, which grants the TRA authority "to ensure that interconnection agreements, in general, are nondiscriminatory and contain reasonable terms and conditions").

23. Illinois Order, *supra* note 4, at 2; Michigan Order, *supra* note 4, at 2; New York Order, *supra* note 4, at 2.

24. New York Order, *supra* note 4, at 3.

In early 2007, the CLEC notified Neutral Tandem that it sought to terminate several of its existing agreements with them.[25] Because the CLEC's correspondence indicated that it planned to terminate the parties' direct connection,[26] Neutral Tandem filed petitions in several states seeking to maintain the existing connection between them and to require the CLEC to continue to receive terminating transit traffic delivered by Neutral Tandem on behalf of the originating carriers.

### *B. Commission Rulings*

After full hearings on the merits and post-hearing briefings, state commissions in Georgia,[27] New York,[28] Illinois,[29] Michigan,[30] and Minnesota[31] all determined that, as a matter of sound public policy, the CLEC should be required to continue accepting tandem transit traffic delivered by Neutral Tandem. A summary of these decisions, including the principal public policy rationales employed by each commission, is set forth below.

#### 1. Georgia

The Georgia Public Service Commission ruled that Georgia law required carriers to permit "reasonable interconnection"[32] and that the continuation of the existing direct interconnection between the CLEC and the transit provider was reasonable and therefore mandatory.[33]

The CLEC had argued before the Georgia Commission that it could satisfy its obligation to provide reasonable interconnection with Neutral

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25. Michigan Order, *supra* note 4, at 2-3.

26. Illinois Order, *supra* note 4, at 3; New York Order, *supra* note 4, at 3-4.

27. *See generally* Georgia Order, *supra* note 4; *see also* Petition of Neutral Tandem Inc. for Interconnection with Level 3 Comm. and Request for Emergency Relief, Docket No. 24844-U (Georgia Publ. Serv. Comm'n Dec. 20, 2007) (order denying rehearing) [hereinafter the Georgia Rehearing Order].

28. New York Order, *supra* note 4, at 12; *see also* Petition of Neutral Tandem—New York, LLC for Interconnection with Level 3 Comm. and Request for Order Preventing Service Disruption, Case No. 07-C-0233 (N.Y. Pub. Serv. Comm'n Sept. 24. 2007) (order denying rehearing) [hereinafter New York Rehearing Order]. The New York Commission also initiated a separate docket pursuant to New York state law to "investigate the rates, charges, rules and regulations under which the parties provide call transport and termination services to one another." New York Order, *supra* note 4, at 1-2.

29. Illinois Order, *supra* note 4, at 12.

30. Michigan Order, *supra* note 4, at 15.

31. Minnesota Order, *supra* note 4, at 18.

32. The Georgia statute states that "[a]ll local exchange companies shall permit reasonable interconnection with other certificated local exchange companies. This subsection includes all or portions of such services as needed to provide local exchange services." GA. CODE ANN. § 46-5-164(a) (2008).

33. Georgia Order, *supra* note 4, at 10-11.

Tandem as long as the CLEC maintained an indirect connection with Neutral Tandem via the tandem of the incumbent LEC.[34] In other words, the CLEC believed that if its direct connection with Neutral Tandem was discontinued, Neutral Tandem—like any other CLEC—still could route traffic to the terminating CLEC's end-users as follows: the call would flow from the originating carrier to one tandem transit provider (Neutral Tandem) then to a second tandem transit provider (the incumbent LEC) and then to the terminating carrier (the CLEC). Other state commissions referred to this proposed arrangement as a "double-indirect connection."

The Georgia Commission disagreed that this alternative proposed connection was reasonable saying,

> It would not serve any purpose for a carrier to transport a call originating on its network through Neutral Tandem if that call still must be transported through [the incumbent LEC] in order to terminate on [the CLEC's] system. The carrier would simply use [the incumbent LEC] as the transit provider and exclude Neutral Tandem from the process.[35]

The Georgia Commission also concluded that the CLEC's "refus[al] to interconnect directly with Neutral Tandem unless Neutral Tandem pays it reciprocal compensation or some other fee in addition to its cost[]" was

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34. *Id.* at 7-8. The CLEC also argued that the Georgia Commission's authority under GA. CODE ANN. § 46-5-164(a) was preempted by federal law. The Georgia Commission disagreed—holding that the ruling was not inconsistent with federal law and (to the contrary) fell within the savings clause of 47 U.S.C. § 261(b)-(c) because the connection was necessary to further competition within the state. Georgia Order, *supra* note 4, at 3.

35. *Id.* at 8. For similar reasons, the Georgia Commission rejected the CLEC's argument that its ruling was preempted by 47 U.S.C. § 251(a)(1). Georgia Rehearing Order, *supra* note 27, at 6-8. The Georgia Commission further rejected the argument that its ruling was preempted by the FCC's *Local Competition Order*, which Level 3 alleged gave it the right to interconnect with Neutral Tandem either directly or indirectly. *Id.* (citing Implementation of the Local Competition Provisions in the Telecomm. Act of 1996, *First Report and Order*, 11 F.C.C.R. 1549 (1996)). The Georgia Commission stated that:

> [The CLEC's] argument that it has the right to choose whether to interconnect directly or indirectly, apparently regardless of whether that choice is reasonable, fails to consider the impact that its choice would have on other carriers. For instance, Neutral Tandem is being denied its choice to interconnect directly with [the CLEC], even though [the CLEC] cannot explain why it would be worse off as a result of the interconnection. In addition, the direct interconnection with Neutral Tandem results in indirect interconnection between [the CLEC] and the carrier customer of Neutral Tandem.

*Id.* at 7. Moreover, the Georgia Commission noted that there is no indication that the FCC's *Local Competition Order*

> was considering an instance in which a transit service provider was willing to pay all reasonable costs of direct interconnection. To the contrary, the FCC's intent is clearly to promote competition and not to place unnecessary burdens on parties that may not have market power. Requiring direct interconnection in this case promotes competition because the transit service offered by Neutral Tandem offers a competitive option to the [ILEC].

*Id.* at 8.

unduly discriminatory and a violation of Georgia law.[36] Although the CLEC did not dispute that it offered different terms and conditions to the incumbent tandem providers as opposed to the rates it attempted to impose on Neutral Tandem, the CLEC argued that its relationship with the ILECs, rather than Neutral Tandem, was sufficiently distinct to permit the differing rate structures.[37] The Georgia Commission disagreed:

> That AT&T is an ILEC and Neutral Tandem is a CLEC does not by itself constitute a reasonable basis for discriminating between the two providers. . . .
>
> . . . [I]t is likely that there will always be differences in the business relationships between two sets of carriers, but the issue is whether the services involved are the same. In this instance, it is agreed that the transit traffic service provided by AT&T is essentially the same as the service provided by Neutral Tandem. [The CLEC] does not offer any reasonable explanation as to why the more extensive relationship it has with AT&T would justify refusing direct interconnection with Neutral Tandem when the terms of the transit service are as favorable.[38]

Further, the Georgia Commission found that the CLEC's attempt to impose reciprocal compensation on either Neutral Tandem or the incumbent transiting provider would be "inconsistent with federal law and [Georgia Commission precedent]," thus confirming that reciprocal compensation should be sought from the originating and not the transiting carrier.[39] The Georgia Commission noted that in prior orders it had "relied upon the FCC's *Texcom Orders* in endorsing the 'calling party pays' principle."[40] In these orders, "[t]he FCC stated that 'the LEC may charge the terminating carrier for the cost of the portion of these facilities used for transiting traffic, and the terminating carrier may seek reimbursement of these costs from originating carriers through reciprocal compensation.'"[41]

### 2. New York

The New York Commission similarly concluded that the CLEC could not disconnect its existing connection with a tandem transit provider like Neutral Tandem because of the many benefits the public received from the connection, among other reasons.

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36. *See* Georgia Order, *supra* note 4, at 9-11. *See also* GA. CODE ANN. § 46-5-164(b) ("The rates, terms, and conditions for such interconnection services shall not unreasonably discriminate between providers and shall be negotiated in good faith between the providers and filed with the commission.").

37. *See* Georgia Order, *supra* note 4, at 9-10.

38. *Id.* (internal citations omitted).

39. *Id.* at 10.

40. *Id.*

41. *Id.* (quoting TexCom Inc., v. Bell Atlantic Corp., *Order on Reconsideration*, 17 F.C.C.R. 6275, para. 4 (2002)).

Before reaching the merits of the dispute, the New York Commission first addressed the CLEC's argument that any direct interconnection obligation between non-dominant providers in any circumstance would be inconsistent with the terms of § 251(a)(1) which states that every carrier is obligated to "interconnect directly or indirectly with other carriers."[42] The New York Commission rejected this position, finding:

> That the [Telecommunications Act of 1996 (1996 Act)] recognizes indirect interconnection does not imply that the Act forecloses direct interconnection when the later is more appropriate. The network configuration contemplated in the Act is one that provides the originating CLEC and its end users the opportunity to choose their preferred routing based on consideration of all relevant factors such as cost, reliability, and efficiency. . . .
>
> . . . [The CLEC's] interpretation of the 1996 Act would perversely transform the options assured the originating [carrier] under 47 USC § 251(a)(1) into a supposed power on [the CLEC's] part to dictate that the originating [carrier] cannot chose direct interconnection with [the CLEC].[43]

The New York Commission also indicated its conclusion that interconnection between a competitive tandem transit provider such as Neutral Tandem and a terminating carrier like the CLEC must be maintained to promote the public interest, as follows:[44]

> Among telecommunications providers in the New York market, Neutral Tandem is unique in offering a competitive alternative to the ILEC's tandem switch, and in providing transport and termination services only to CLECs without having end-user customers of its own.
>
> . . . .
>
> Direct interconnection between Neutral Tandem and [the CLEC] enables Neutral Tandem to maintain its independent tandem switch as a viable alternative to [the ILEC]. The availability of an independent tandem in turn furthers the development of facilities-based competition among wireless, cable, and landline telephony, by offering the providers of all such services an economically advantageous alternative to the [ILEC] tandem.
>
> . . . .
>
> [T]he redundancy resulting from alternative tandem switching options enhances the diversity and reliability of the public switched

42. 47 U.S.C. § 251 (a)(1) (2000).

43. New York Order, *supra* note 4, at 7-8.

44. Unlike other state commissions, the New York Commission did not address in its order the terms and conditions that should govern the continued interconnection between Neutral Tandem and Level 3. Instead, the Commission initiated a separate docket to address the merits of that issue. *See* Proceeding on Motion of the Comm'n as the Rates, Charges, Rules and Regulations of Neutral Tandem—New York, LLC and Level 3 Comm. LLC for Transport and Termination Services, Case No. 07-C-1332, at 1 (N.Y. Pub. Serv. Comm'n Nov. 9, 2007) (order instituting proceedings). Neutral Tandem and Level 3 jointly requested the dismissal of the proceeding in June 2008.

> telephone network. These objectives have consistently been recognized on several occasions, particularly as a response to lessons of the September 11, 2001 attacks and Hurricane Katrina. While [the CLEC] disputes the benefits of redundancy on the basis that Neutral Tandem's tandem switch is just as vulnerable as other CLECs' facilities sharing the same physical location with Neutral Tandem's, even an arrangement where Neutral Tandem and CLECs collocate provides clear diversity and reliability advantages as compared with relying only on an ILEC's tandem switch maintained solely at the ILEC's location.
>
> [D]enial of the relief sought by Neutral Tandem would create potential impediments to competition, by enhancing [the CLEC's] capacity to act as a bottleneck between its end users and CLECs . . . . [The CLEC's] potential bottleneck function becomes an ever greater concern insofar as [the CLEC] may seek to provide tandem switch service in competition with Neutral Tandem.[45]

### 3. Illinois

The Illinois Commerce Commission also ordered the CLEC to continue accepting terminating traffic delivered over its direct connection with Neutral Tandem.[46] Like the other state commissions, the Illinois Commission's decision was motivated by concerns that disconnecting the network could result in less efficient connections and hinder competition within Illinois.

Specifically, the Illinois Commission found that the CLEC's attempt to disconnect from Neutral Tandem would force other carriers that wished to use Neutral Tandem's services to route traffic to the CLEC's end-users via a double-indirect connection. The Illinois Commission noted that this double-indirect connection is an "inferior connection[]"[47] that would "invariably" force originating carriers to return to the more expensive incumbent LEC's tandem transiting services.[48] It continued, saying "[t]his

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45. New York Order, *supra* note 4, at 2-11 (internal citations omitted).

46. Illinois Order, *supra* note 4, at 14 (citing 220 ILL. COMP. STAT. 5/13-514 (2008)). The Illinois statute reads:

> A telecommunications carrier shall not knowingly impede the development of competition in any telecommunications service market. The following prohibited actions are considered per se impediments to the development of competition . . . (1) unreasonably refusing or delaying interconnections or collocation or providing inferior connections to another telecommunications carrier; (2) unreasonably impairing the speed, quality, or efficiency of services used by another telecommunications carrier . . . [and] (6) unreasonably acting or failing to act in a manner that has a substantial adverse effect on the ability of another telecommunications carrier to provide service to its customers.

220 Ill. Comp. Stat. 5/13-514.

47. Illinois Order, *supra* note 4, at 6.

48. *Id.*

scenario will degrade the ability of [Neutral Tandem] to do business, and will impede the development of competition in Illinois."[49]

For similar reasons, the Illinois Commission concluded that its Order was entirely consistent with federal law. To begin, the Illinois Commission disagreed with the CLEC's position that "Section 251(a)(1) [of the 1996 Act] justif[ied] its termination of the existing direct interconnection."[50] The Illinois Commission noted that nothing in the 1996 Act allows the CLEC to impose a double-indirect connection on another competitive carrier.[51]

Finally, the Illinois Commission also concluded that under state and federal law, Neutral Tandem, as a transit provider, "is not obligated to pay reciprocal compensation to [the CLEC]" when it delivers tandem transit traffic to the CLEC.[52] Instead, the CLEC had the ability to use the signaling information provided by the transit provider to bill originating carriers for the reciprocal compensation.[53]

### 4. Michigan

The Michigan Commission similarly concluded that under Michigan law,[54] the CLEC was barred from "refusing or delaying provision of direct

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49. *Id*. In fact, the Illinois Commission concluded that "[the CLEC's] scheme, with two transit providers, two sets of costs, and mandatory routing of traffic through the ILEC, as functionally equivalent of a refusal by [the CLEC] to interconnect with [Neutral Tandem]." *Id.* The Illinois Commission also rejected the CLEC's argument that it is being forced to provide a direct interconnection with Neutral Tandem in perpetuity and noted that "our holding is not that [the CLEC] must permanently maintain the exact status quo, but rather that [the CLEC] must comply with the law." *Id.* at 8. The Commission explained that:

> to the extent that [the CLEC] seeks to redefine its relationship with [Neutral Tandem], it must do so without violating Section 13-514 or any other section of the Act, and without taking actions that are detrimental to the public interest. As applied to the facts of the instant case, this means that the direct interconnection between [Neutral Tandem] and [the CLEC] must remain intact.

*Id.*

50. *Id.* at 5.

51. *Id.* at 6 (noting that the CLEC's conduct "violates the requirement of Section 251(a) of the Telecommunications Act to interconnect directly or indirectly. Notwithstanding [the CLEC's] arguments that it is shielded by Section 251(a), that Section does not explicitly authorize doubly-indirect interconnection or preempt enforcement of State law claims.").

52. *Id.* at 10.

53. *Id.* The Illinois Commission also concluded that the CLEC would not incur additional costs—above and beyond the costs it incurs to interconnect with the incumbent—to directly interconnect with Neutral Tandem. Indeed, the Illinois Commission found that "the evidence of record demonstrates that [Neutral Tandem] pays 100% of the cost of the facilities of the [Neutral Tandem/CLEC] interconnection, leaving no room for [the CLEC] to argue that there is any unrecovered or additional cost per minute for transited calls terminated on the [CLEC's] network." *Id.* at 10.

54. MICH. COMP. LAWS § 484.2305 (2007) ("A provider of basic local exchange service shall not do any of the following: (a) Discriminate against another provider by refusing or delaying access service to the local exchange. (b) Refuse or delay interconnections or provide inferior connections to another provider.").

interconnection with Neutral Tandem on non-discriminatory terms and conditions."[55]

Initially, the Michigan Commission determined that it was not preempted by federal law from ordering a CLEC to maintain its existing connection with a tandem transit provider[56] because "[r]equiring interconnection on a non-discriminatory basis is not inconsistent with federal law."[57] Moreover, the Michigan Commission concluded that

> [n]owhere in federal or state law is there a right to demand what would effectively be a double indirect interconnection. To read that right into the federal Act would create an opportunity for [the CLEC] unilaterally to increase the costs of its competitors by economically mandating that they either move away from using Neutral Tandem for transiting their traffic or pay to transit traffic twice, once to Neutral Tandem and once to the ILEC. The Commission finds that result would be inconsistent with the federal Act, the desire for a competitive, efficient telecommunications market, as well as state law.[58]

The Michigan Commission also found that Michigan law barred the CLEC from "refusing or delaying provision of direct interconnection with Neutral Tandem on non-discriminatory terms and conditions."[59] Although the CLEC argued that it incurred costs by maintaining the existing interconnection with Neutral Tandem, the Michigan Commission noted that "costs properly recovered through reciprocal compensation should not also be charged to Neutral Tandem, as they must be recovered from the originating carrier."[60]

Notably, the Michigan Commission was clear that its Order was only intended to promote the right of the originating carrier to determine how best to route traffic to other carriers, and was *not* intended to create "forced direct interconnection between every CLEC."[61] The Michigan Commission noted that "[t]he requesting provider is in the best position to determine

55. Michigan Order, *supra* note 4, at 11.

56. *Id.* at 4-6.

57. *Id.* at 8.

58. *Id.* at 8-9.

59. *Id.* at 11.

60. *Id.* at 16. Moreover, the Michigan Commission was "not persuaded that direct interconnection has been or will be a significant cost to [the CLEC]." *Id.* at 11. In fact, the Michigan Commission noted that "[the CLEC] has not provided convincing evidence that it incurs costs for which it is not able to obtain compensation" and that Neutral Tandem "commits that it will pay 100% of the transport costs of that traffic delivered over the direct interconnection." *Id.* at 11-12.

61. *Id.* at 13. The CLEC also argued that the Michigan Commission had no authority to interfere with the lawful termination of the two contracts it held with Neutral Tandem. *Id.* at 17. The Michigan Commission disagreed: "[t]he rights and obligations under the properly terminated contracts are irrelevant to whether Neutral Tandem has a right to non-discriminatory interconnection terms and conditions for delivering tandem transit traffic to [the CLEC]." *Id.* at 18.

when it is efficient for it to directly connect with the network of another provider."[62] Thus, ordering a continuation of the existing interconnection was necessary to further the public interest: "[a]dopting [the CLEC's] position could simultaneously create extra costs for Neutral Tandem's CLEC customers and have a severe negative effect on the transit provider's business."[63] In conclusion, the Michigan Commission noted that "[t]he only manner in which competitive tandem transit service will have a market is if the requesting providers have the right to request direct interconnection on a reasonable, non-discriminatory basis."[64]

### 5. Minnesota

The Minnesota Commission also denied the CLEC's request to disconnect[65] from Neutral Tandem in Minnesota,[66] because "the public

62. *Id.* at 13.

63. *Id.*

64. *Id.*

65. The parties settled the dispute before the Minnesota Commission addressed the CLEC's application for rehearing on the merits.

66. *See* MINN. STAT. § 237.12(1)-(2) (2006). The Minnesota statute reads

> Subdivision 1. **Interconnection.** When public convenience requires the same, every telephone company shall, for a reasonable compensation, permit a physical connection or connections to be made, and telephone service to be furnished between any telephone exchange system operated by it, and the telephone toll line or lines operated by another company, or between its telephone toll line or lines and the telephone exchange system of another telephone company, or between its toll line and the toll line of another company, whenever such physical connection or connections are practicable and will not result in irreparable injury to the telephone system so compelled to be connected. . . .
>
> Subd. 2. **Discontinuance.** Wherever a physical connection or connections exist between any telephone exchange system operated by a telephone company and the toll line or lines operated by another telephone company or between its toll line or lines and the telephone exchange system of another telephone company, or between its toll line and the toll line of another telephone company, neither of the companies shall cause such connection to be severed or the service between the companies to be discontinued without first obtaining an order from the commission upon an application for permission to discontinue such physical connection. Upon the filing of an application for discontinuance of such a connection, the department shall investigate and ascertain whether public convenience requires the continuance of such physical connection, and if the department so finds, the commission shall fix the compensation, terms and conditions of the continuance of the physical connection and service between the telephone companies.

*Id.*

In § 237.74, the Minnesota statute further provides:

> Subd. 9. **Discontinuance.** If a physical connection exists between a telephone exchange system operated by a telephone company and the toll line or lines operated by a telecommunications carrier, neither of the companies shall have the connection severed or the service between the companies discontinued without first obtaining an order from the commission upon an application for permission to discontinue the physical connection. Upon the filing of an application for discontinuance of the connection, the department shall investigate and ascertain

convenience requires the maintenance of the physical connection between Neutral Tandem and [the CLEC]."[67] The Minnesota Commission offered several reasons why the CLEC's proposal to disconnect its network from Neutral Tandem would be harmful to the public interest, including that the disconnection would require the re-routing of a substantial amount of traffic (more than 20 million minutes of traffic[68]), increase tandem exhaust, and enhance the risk of call blocking,[69] while also increasing the costs to

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> whether public convenience requires the continuance of the physical connection, and if the department so finds, the commission shall fix the compensation, terms, and conditions of the continuance of the physical connection and service between the telephone company and the telecommunications carrier. Prior commission approval is not required for severing connections where multiple local exchange companies are authorized to provide service. However, the commission may require the connections if it finds that the connections are in the public interest.

MINN. STAT. § 237.74(9).

Finally, the Minnesota rules state:

> Subp. 10. **Interconnection.** A CLEC must allow physical connections to its network and pay appropriate compensation for interconnection with and access to the networks of other local service providers as determined by the commission consistent with the requirements of the federal act.
>
> Subp. 11. **Commission approval to discontinue service or physical connection to another carrier.** In accordance with Minnesota Statutes, section 237.74, subdivisions 6, paragraph (a), and 9, a CLEC must obtain prior commission approval before discontinuing a service or physical connection to a telephone company or a telecommunications carrier if end users would be deprived of service because of the discontinuance or disconnection.

MINN. R. 7812.2210(10), (11) (2008).

67. Minnesota Order, *supra* note 4, at 12.

68. *Id.* at 12 ("[S]evering the physical connection between Neutral Tandem and [the CLEC] would require re-routing more than *20 million* minutes of [traffic] per month," an amount of traffic that the FCC has deemed "substantial."). The Minnesota Commission further stated:

> For guidance on this question [of what amount of transit traffic is substantial], the ALJ observes that in its Verizon Virginia decision the FCC directed carriers to seek a direct physical interconnection when they began exchanging 200,000 minutes of telecommunications per month. Thus, if severing the physical connection between Level 3 and Neutral Tandem would alter the flow of 200,000 or more minutes to telecommunications per month, or would result in increased costs to Minnesota telephone customers without meaningful improvement in service, or would otherwise fail "to further the public convenience," the ALJ would recommend maintaining the connection.
>
> . . . .
>
> As noted above, the [Minnesota Supreme Court] found that the public convenience justified prohibiting a disconnection that would have "substantially" altered the flow of communications between telephone systems, and the FCC directed parties to begin seeking direct interconnection when they began exchanging 200,000 minutes of traffic each month. . . . This fact supported the ALJ's conclusion that disconnection would substantially alter the flow of communications.

*Id.* at 10-12 (internal citations omitted).

69. *Id.* at 12.

> Some of the costs [of disconnection] would be systemic: Tandem switches have a finite capacity for routing call traffic, and increasing call traffic to [the

carriers and their consumers to route calls.[70] In comparison, the Minnesota Commission concluded that retaining the connection would both promote consumer choice[71] and promote the redundancy of its networks.[72]

The Minnesota Commission also declared that the CLEC could not condition its continued interconnection on payments from Neutral Tandem because "federal and state law discourage discrimination in the provision to utility services"[73] and "[the CLEC] does not require the other tandem

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> ILEC's] tandems exacerbates the problem of 'tandem exhaust.' . . . This diminishes the public switched telephone network's capacity to meet demand, to maintain some functionality during emergencies, and to restore full functionality quickly following an emergency.
>
> And some of the cost would take the form of the risk of blocked calls.

*Id*.

70. Minnesota Order , *supra* note 4, at 12 ("Some of [the costs of disconnection] would be direct: In the absence of a physical connection between Neutral Tandem and [the CLEC], Neutral Tandem's other clients would need to route calls to [the CLEC] via [the incumbent's] tandem, which costs more.").

71. *Id*. at 15 ("[R]etaining the connection would be consistent with the goal of 'promoting customer choice'; by offering CLECs – which are Neutral Tandem's and [the incumbent's] customers – greater choices in how to route calls to [the CLEC].").

72. *Id.* ("[I]t is undisputed that severing the physical connection would reduce system redundancy. [The CLEC] offers caveats regarding the magnitude of the benefits provided by the redundancy, but [the CLEC] never denies that the connection provides an alternate path for routing calls, or that this alternative path provides system benefits.").

73. *Id.* at 17 (citing 47 U.S.C. § 251 (2000)). *See also* MINN. STAT. § 237.74(2) (2007) ("No telecommunications carrier shall offer telecommunications service within the state upon terms or rates that are unreasonably discriminatory."). Furthermore, the Minnesota rules provide:

> **Subp. 5. Discrimination.** No CLEC may offer telecommunications service within the state on terms or rates that are unreasonably discriminatory. At a minimum, a CLEC must provide its telecommunications services in accordance with items A to D:
>
> A. A CLEC shall charge uniform rates for local services within its service area. However, a CLEC may, upon a filing under subpart 2:
>
> (1) offer unique pricing to certain customers or to certain geographic locations for promotions as provided in subpart 6;
>
> (2) provide volume or term discounts;
>
> (3) offer prices unique to particular customers, or groups of customers, when differences in the cost of providing a service, market conditions, or LEC pricing practices justify a different price;
>
> (4) offer different prices in different geographic areas when (a) differences in the cost of providing a service, or market conditions, justify a different price; (b) the areas are served by different LECs; (c) different prices are charged by the LEC serving the areas; or (d) an area is not served by an LEC;
>
> (5) pass through any legislatively authorized local taxes, franchise fees, or special surcharges imposed by local or regional governmental units on the services provided by the CLEC in specific geographic areas from which the taxes, fees, or surcharges originate; or
>
> (6) furnish service free or at a reduced rate to its officers, agents, or employees in furtherance of their employment.

MINN. R. 7812.2210(5) (2008).

service provider – [the incumbent] – to make similar payments."[74] The Minnesota Commission realized that this ruling "intrude[d] on [the CLEC's] autonomy" but concluded that the ruling would put "[the CLEC] in a financial position no worse off than it was in before it interconnected with Neutral Tandem."[75] After all, following the Minnesota Commission's ruling, the CLEC remained free to collect reciprocal compensation, if appropriate, from originating carriers to cover its interconnection costs.[76]

## IV. PROPOSED REGULATIONS CONCERNING TRANSITING IN THE FCC'S *UNIFIED INTERCARRIER COMPENSATION* DOCKET

Many of the issues related to tandem transiting services that were resolved by the state commissions in the Neutral Tandem dockets above also are at issue in the FCC's *Unified Intercarrier Compensation* Docket.[77]

### *A. The Intercarrier Compensation Docket*

On April 27, 2001, the FCC issued a Notice of Proposed Rulemaking, concerning broad reforms of how telephone calls were to be delivered between carriers, and how the carriers were to be compensated for the calls.[78] Among other things, the Notice solicited comments concerning how the delivery of traffic via an intermediary impacted the existing intercarrier compensation rules.[79] In comments filed in response to the docket, numerous carriers urged the FCC to resolve intercarrier compensation issues relating to transiting.[80]

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74. Minnesota Order, *supra* note 4, at 15.

75. *Id*. at 17. Like the Illinois and Michigan Commissions, the Minnesota Commission concluded that the CLEC had failed to provide *any* evidence establishing that it had incurred costs to interconnect with Neutral Tandem. *See id.*

76. *Id.* Specifically, the Minnesota Commission found that "[c]arriers may not exploit the quirks of interconnection agreements to evade their duty to act in a nondiscriminatory manner." *Id.*

77. *See Unified Intercarrier Compensation Regime Proposed Rulemaking*, *supra* note 1.

78. *Id.*

79. The notice stated:

> We ask commenters to address this and other issues related to the transport obligations of interconnected LECs under a bill-and-keep regime. CMRS carriers also originate and terminate three-carrier calls, some of which are governed by reciprocal compensation. We seek comment on the issues or problems that the current intercarrier compensation rules present for three-carrier calls. We seek comment on how bill and keep might affect such calls.

*Id.* at para. 71.

80. *See, e.g.*, Comments of Sprint Corp. at 33, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Aug. 21, 2001); Reply Comments of VoiceStream Wireless Corp. at 20, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 5, 2001).

Later in 2005, the FCC sought further comments regarding transiting because of the increased importance that transiting played in ensuring the seamless exchange of traffic between competitive carriers:

> The record suggests that the availability of transit service is increasingly critical to establishing indirect interconnection – a form of interconnection explicitly recognized and supported by the Act. It is evident that competitive LECs, CMRS carriers, and rural LECs often rely upon transit service from the incumbent LECs to facilitate indirect interconnection with each other. Without the continued availability of transit service, carriers that are indirectly interconnected may have no efficient means by which to route traffic between their respective networks.
>
> Moreover, it appears that indirect interconnection via a transit service provider is an efficient way to interconnect when carriers do not exchange significant amounts of traffic. . . . This conclusion appears to be supported by the widespread use of transiting arrangements.[81]

The FCC requested comments regarding (1) whether transiting was "currently available at reasonable rates, terms and conditions";[82] (2) the bases of the FCC's authority over tandem transiting services; (3) whether the ILEC is required to provide tandem transiting services and if so, the limits of that obligation; and (4) whether the FCC should regulate the rates at which transiting is provided.[83] Numerous comments were filed in response to the request.[84]

## *B. The Missoula Plan*

Over the years, many industry providers submitted proposals for intercarrier compensation reform to the FCC.[85] The most comprehensive

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81. *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at paras. 125-26 (internal citations omitted).

82. *Id.* at para. 129.

83. *See id.* at paras. 127-32.

84. *See, e.g.*, Reply Comments of Cox Comm., Inc. at 8, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. July 20, 2005) [hereinafter Cox Comm. July 2005 Reply Comments]; Comments of Qwest Comm. Int'l, Inc. on Further Notice of Proposed Rulemaking at 39-40, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. May 23, 2005) [hereinafter Qwest May 2005 Comments].

85. Other industry supporters have submitted proposed plans regarding regulating tandem transit services. For example, the Intercarrier Compensation Forum (ICF) plan argued that transiting is a "common carrier" obligation subject to FCC regulation, and "incumbent LECs already providing transit service would continue to offer the service for the entire term of the ICF plan." *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at para. 124 (citing Ex Parte Brief of the Intercarrier Compensation Forum, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 at Tab A, 25-29 (rel. Oct. 5, 2004) [hereinafter ICF Proposal]). The ICF plan also proposed that rate caps are set for transit service and traffic threshold levels, in order to prevent tandem exhaust. *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at para. 124 n.357 (citing ICF Proposal, *supra*, at 30-

of these proposals is the Missoula Plan, which was submitted to the FCC by the National Association of Regulatory Utility Commissions (NARUC) Task Force on Intercarrier Compensation on July 24, 2006.[86] The Plan was the result of several years of meetings and discussion between various industry participants.[87]

Among other things, the Missoula Plan contained detailed guidelines for regulating interconnection between carriers and, specifically, regulating tandem transiting services. For example, the Missoula Plan proposes the following default rules[88] for regulating interconnection: "A carrier must permit other carries with the financial obligation for interconnection to physically interconnect at its Edge[89] for the purpose of direct interconnection . . . [and] is also obligated to provide physical

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31). In addition, a Cost-Based Intercarrier Coalition (CBICC) proposal suggested that transiting would be charged at TELRIC rates. *Unified Intercarrier Compensation Regime Further Proposed Rulemaking*, *supra* note 7, at para. 124, n.358 (citing COST-BASED INTERCARRIER COALITION CBICC PROPOSAL, *submitted with* Notice of Ex Parte of the Cost-Based Intercarrier Compentsation Coalition, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92, 2 (rel. Sept. 2, 2004)). A Western Wireless proposal sought to require ILECs to "offer transit service at capped rates." *Unified Intercarrier Compensation Regime Further Proposed Rulemaking supra* note 7, at para. 124 (citing WESTERN WIRELESS INTERCARRIER COMPENSATION REFORM PLAN at attach. 6, *submitted with* Ex Parte Presentation of Western Wireless Corp., Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 10-92 (rel. Dec. 1, 2004)). Finally, in September 2008, Verizon submitted an intercarrier compensation proposal. Comments of Verizon at 3, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Sept. 12, 2008). Under this proposal, originating carriers are able to dictate whether to deliver their calls directly or indirectly to the other carrier. *Id.* § 1(d). Verizon also would freeze transiting rates, and the FCC would issue a rulemaking proposal concerning the circumstances under which the cap would be modified or eliminated." *Id.* § 1(e).

86. *See* TASK FORCE FOR INTERCARRIER COMPENSATION, NAT'L ASS'N REGULATORY UTIL. COMM'RS, THE MISSOULA PLAN FOR INTERCARRIER COMPENSATION REFORM, *submitted with* Ex Parte Submission of the Missoula Plan Supporters, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. July 24, 2006) [hereinafter MISSOULA PLAN].

87. *See* Comments of the Supporters of the Missoula Plan at 9, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Missoula Plan Supporters Oct. 2006 Comments]. The Supporters of the Missoula Plan included AT&T, Embarq, Windstream, Cingular, Level 3, and Global Crossing. *See* Reply Comments of AT&T Inc. on the Missoula Plan at 2-3, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter AT&T Feb. 2007 Reply Comments].

88. The Missoula Plan is clear that "[c]arriers are free to reach mutual agreement for the interconnection of their networks" if possible. MISSOULA PLAN, *supra* note 86, at 41.

89. "An Edge refers to the location on a carrier's network where it receives traffic for routing within its network and where it performs the termination function for traffic received from other carriers." *Id.* at 42.

interconnection to transit carriers for their provision of indirect interconnection."[90]

The Missoula Plan also proposes default rules[91] for tandem transit services[92] provided by incumbent and competitive tandem transit providers.[93]

*Incumbent Obligations*: The Plan suggests that "ILECs that provided tandem transit service on the eve of the Plan must continue to do so, pursuant to the rules set forth herein."[94]

*Rights and Obligations of Ordering Carrier*: Under the Plan, the Ordering Carrier (or the carrier that has a financial obligation for transport) "has the right to select the Tandem Transit Provider" and must "ensure the trunk groups between the Ordering Carrier and the Tandem Transit Provider are not chronically or persistently underutilized."[95]

*Tandem Transit Provider Obligations*: The Tandem Transit Provider "must provide Tandem Transit Service at rates, terms, and conditions that

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90. *Id.* at 42. To help minimize disputes between originating and terminating carriers, the Plan proposes:

> d. For purposes of interconnection . . . each carrier, and each communications service provider served by a carrier, will: i. collaborate to complete calls that originate or terminate on the [Public Switch Telephone Network (PSTN)] and will not block or hinder the exchange of such traffic between interconnecting carriers; . . .
>
> e. *Direct or Indirect Interconnection:* The carrier with the financial obligation for interconnection decides whether it will interconnect through a direct interconnection arrangement or an indirect interconnection arrangement."

*Id.* The Missoula Plan gives the right of interconnection to "any telecommunications carrier, as defined in 47 U.S.C. § 153(44), regardless of whether it offers telecommunications services on a retail basis, a wholesale basis or both." *Id.* at 41.

91. The Missoula Plan notes that,

> As with other aspects of this Plan, these rules are default rules only. Carriers may negotiate other (including "premium") transit arrangements. The incremental revenue the provider earns from the provision of such arrangements shall not be included in any calculation to determine its compliance with the nationwide transit rate cap discussed below.

*Id.* at 50.

92. The Missoula Plan defines "Tandem Transit Service" as a "switched transport service provided by a third-party carrier using its tandem switch to effectuate indirect interconnection between two carriers within a LATA" and includes "both tandem switching and tandem switched transport (also called common transport), or the functional equivalent, between the transit tandem location and a terminating carrier's Edge." *Id.* at 49.

93. The Missoula Plan also includes suggestions for issues concerning "phantom traffic proposal," that is, the delivery of originating traffic via an intermediary without sufficient information available for the terminating carrier to recover necessary payments for the service. *Id.* at 56.

94. *Id.* at 49.

95. *Id.* at 50.

are just, reasonable, and not unreasonably discriminatory."[96] The Tandem Transit Provider is not obligated to:

> 1) serve as the arbiter of disputes between the Ordering and Non-Ordering Carrier, except to the extent the dispute is caused by the functionalities provided by the Tandem Transit Provider . . .;
>
> 2) bear the financial responsibility for the intercarrier compensation charges related to the traffic it delivers in connection with its provision of Tandem Transit Service; or
>
> 3) bill the Ordering Carrier or Non-Ordering Carrier for intercarrier compensation charges that one charges the other, or collect such charges on either's behalf.[97]

*Congestion and Exhaust*: Under the Missoula Plan, "Tandem Transit Providers may constrain the use of Tandem Transit Service in situations of tandem congestion or exhaust."[98] Moreover, once the Ordering Carrier's use of service from the Tandem Transit Service Provider exceeds 400,000 minutes of use for more than three months, the Tandem Transit Provider may charge higher rates for transiting service.[99]

*Rates for Service*: Initially, the rate charged by the Tandem Transit Provider would be capped at $0.0025 per minute of use.[100] In time, the cap would increase annually with inflation, and in major cities the capped rates would be lifted. The FCC also would consider what competitive triggers should serve to eliminate the rate cap.[101]

## *C. The 2008 FCC Reform Proposal*

In October 15, 2008, Chairman Martin and the staff of the FCC presented a draft proposal (Reform Proposal) for comprehensive intercarrier compensation reform.[102]

In the Reform Proposal, recommendations were made concerning new federal regulations for tandem transiting services. For example, in response to concerns that originating carriers were misidentifying traffic in

96. *See* MISSOULA PLAN, *supra* note 86.
97. *Id.* at 51.
98. *Id.* at 53.
99. *Id.* at 52.
100. *Id.* at 51.
101. *Id.* at 51.
102. *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*, *supra* note 2, at para. 40. The October 15, 2008 proposal was attached as Appendix A to the *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*. In response to *ex parte* responses to the proposal, the Chairman circulated an alternative draft on the evening of November 5, 2008. *Id.* at para. 40. The November 5, 2008 proposal was attached as Appendix C to the *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*. While the proposals are different, their regulations relating to tandem transiting are almost identical. Thus, for the purposes of this article, both proposals will be jointly referred to as the Reform Proposal.

order to exploit the existing intercarrier compensation rules,[103] the Reform Proposal set forth rules to ensure proper billing which directly impacted transit providers.[104] Under the Reform Proposal, a transit provider would be responsible for paying the termination provider for its termination charges, if the transit provider "deliver[ed] traffic that lacks any of the signaling information required by our rules as amended herein, or that does not otherwise provide the required call information."[105] The transit carrier then could pass along the termination charge to the originating carrier.[106] Notably, the rule would not apply to transit providers who provide "information sufficient to identify the provider that delivered the traffic to the intermediate provider."[107]

The Reform Proposal also implicitly reaffirmed that a transiting carrier has a right to direct interconnection. Specifically, it stated that the originating carrier has a right to chose whether it would deliver telecommunications traffic directly, via its own facilities or the facilities of the terminating carrier, *or* via a tandem transit provider.[108] However, tandem providers only would be provided with this implicit interconnection right after the ten-year period ended.[109]

Unlike the Missoula Plan, the Reform Proposal did not recommend any further transit regulations. Instead, it recommended that the FCC request further comment on "whether the reforms we adopt today necessitate the adoption of any rules or guidelines governing transit service."[110]

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103. *Id.* app. A, at para. 326; *id.* app. C, at para. 322.

104. *Id.* app. A, at para. 326-342; *id.* app. C, at paras. 322-38.

105. *Id.* app. A, at para. 337; *id.* app. C, at para. 333.

106. *Id.*

107. *Id.* app. A, at para. 337 n.1014; *id.* app. C, at para. 333 n.2159.

108. *Id*. app. A, at para. 275; *id.* app. C, at para. 270. Like Missoula Plan, this term would only serve as the "default" industry provisions. *Id*. app. A, at para. 275 n.865; *see also id.* app. C, at para. 270 nn.2005, 2006. The Reform Proposal was clear that parties could negotiate alternative arrangements. *Id.*

109. The rule would only come into effect after the end of the FCC's ten-year transition period. *Id.* app. C, at para. 187. The transition period was designed to implement the changes in the Reform Proposal, while also "minimiz[ing] market disruptions and adverse economic effects." *Id.* In stage 1, "intrastate access rates are reduced to the levels of interstate rates. During stage two, carriers will reduce their rates to an interim uniform termination rate. . . . During stage three, the rates carriers charge at the end of stage two . . . will be gradually reduced" to the reciprocal compensation rates that will be set by the state commissions. *Id.* Once the transition period ended, then the default interconnection rules will become effective. *Id.*

110. *Id.* app. A, at para. 347; *id.* app. C, at para. 344.

### *D. Comments in Response to the Missoula Plan & the Reform Proposal*

The FCC has sought comments from industry participants concerning the Missoula Plan[111] and the Reform Proposal.[112] A wide-range of comments were received in response, both from those opposed to any regulation at all of tandem transiting (mostly ILECs) and from those in favor of mandatory transiting requirements at TELRIC rates (mostly non-dominant telecommunications providers).

#### 1. Should Transit Providers Be Granted Non-Discriminatory Interconnection Rights?

One area of dispute is whether originating carriers should be able to decide how to route calls to the terminating carrier, even if the terminating carrier disagrees with the routing choice.

Although there are some differences, both the Reform Proposal and the Missoula Plan would create a right for transit carriers to interconnect, by mandating that it is always the option of the originating carrier to choose how to transport its traffic to the terminating carrier's point of interconnection: direct interconnection via its own facilities, use of the terminating carrier's facilities, or through the facilities of a tandem transit provider.[113]

Although most commenters have not taken issue with the direct interconnection requirements, a few argued that this aspect of the Missoula Plan was unlawful because it implied a right of direct interconnection into the 1996 Act.[114] The objectors noted that an interconnecting carrier "could demand direct interconnection, irrespective of the terminating carrier's preference."[115] One commenter[116] even argued that the imposition of direct

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111. *See* Comment Sought on Missoula Intercarrier Compensation Reform Plan, *Public Notice*, 21 F.C.C.R. 8524 (2006). Subsequently, the Missoula Plan supporters filed additional details concerning specific aspects of the plan, on which the Commission continued to seek comment. *See* Comment Sought on Missoula Plan Phantom Traffic Interim Process and Call Detail Records Proposal, *Public Notice*, 21 F.C.C.R. 13179 (2006); Comment Sought on Amendments to the Missoula Plan Intercarrier Compensation Proposal to Incorporate a Federal Benchmark Mechanism, *Public Notice*, 22 F.C.C.R. 3362 (2007).

112. *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*, *supra* note 2, at para. 40.

113. *See supra* notes 90 (discussing the Missoula Plan) and 109 (discussing the Reform Proposal).

114. Verizon Wireless Comments at 4, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Verizon Wireless Oct. 2006 Comments].

115. Comments of CTIA – The Wireless Ass'n at 12, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter CTIA Oct. 2006 Comments]. Another commenter noted:

interconnection is per se impermissible because it could require carriers to build inefficient and unduly expensive connections.[117]

Others, however, squarely disagreed with the objectors' application of federal law: "[t]andem transit service is the essential link that enables carriers to interconnect indirectly. That statutory objective [of § 251(a)(1)] would be frustrated if the Commission were powerless to regulate a carrier's continued provision of the transit link needed to interconnect two carriers indirectly."[118]

In addition, most commenters felt that the direct interconnection requirement with the tandem provider would further the public interest.[119]

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> The fact that two telecommunications carriers might wish to fulfill their respective duties in different manners—one through indirect connection, the other through direct connection—does not give either carrier the right to impose its choice on the other; instead, each must independently ensure that it fulfills its respective duty.

Verizon Wireless Oct. 2006 Comments, *supra* note 114, at 4-5. S*ee also* Verizon Comments at 32, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Verizon Oct. 2006 Comments].

116. Notably, other than Verizon Wireless—who at the time of the Missoula Plan was litigating a dispute with Neutral Tandem regarding tandem transit providers' right to direct connection—the only other commenter taking issue with the provision (CTIA) *did not* suggest that the terminating carrier should be able to force originating carriers to pay for the cost of delivering traffic to the terminating carrier via the terminating carrier's chosen route. Instead, the carriers proposed a "simple and non-discriminatory" plan where each *terminating* carrier would "assume responsibility for carrying, all the way to the end user, any call delivered to any of its edges in a LATA." CTIA Oct. 2006 Comments, *supra* note 115, at 13.

117. Verizon Wireless Oct. 2006 Comments, *supra* note 114, at 9.

118. Missoula Plan Supporters Oct. 2006 Comments, *supra* note 87, at 19. Another commenter added:

> . . . transit is a critical component of an interconnection regime, given the inefficiency of expecting each carrier in a geographic region to interconnect directly with every other carrier. And transit should become an even more important option under the Plan, as originating carriers face new incentives to find the most efficient means of delivering their traffic to terminating carriers. It thus is vital to create explicit rules delineating the interconnection rights and obligations of Tandem Transit providers.

AT&T Feb. 2007 Reply Comments, *supra* note 87, at 66-67.

119. A related issue not addressed in the Reform Proposal is whether a non-dominant provider must switch from indirect connection to direct connection if the provider delivers enough traffic over a long enough period of time for a direct connection to be efficient. The Missoula Plan mandates that if an originating carrier orders more than 400,000 monthly minutes of use between two-switch points for three consecutive months, the tandem transit provider may assess significantly higher charges for the service. *See* MISSOULA PLAN, *supra* note 86, at 52-53. Most non-incumbents argued that the traffic threshold is much too low. One stated,

> Although NCTA is not opposed to establishing a threshold at which a transit provider could require customers to establish direct connections with other providers or pay a higher transit rate, 400,000 minutes is equivalent to approximately two DS1s of traffic, which is an unreasonably low threshold at which to allow incumbent LECs to impose such a choice on competitors.

For example, some commenters noted that the rules would enable originating carriers to choose the most efficient method to route traffic and to manage their transit costs.[120] Other commenters argued that the "absolute right of interconnection" for transit providers created by the 1996 Act will increase competition in the market by giving independent tandem transit providers incentives and opportunities to enter.[121] As one commenter noted, the rule "will facilitate the provision of tandem transit by competitors. The availability of tandem transit service will provide an incentive for the terminating carrier to offer its transport services and facilities to originating carriers at the most efficient and attractive rates possible."[122]

However, some carriers expressed concern about the delay in the imposition of the implicit tandem interconnection rights (and the other interconnection proposals) in the Reform Proposal.[123] The commenters noted that ten years was far too long to wait for the changes, given the rapid growth of IP-enabled networks.[124]

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Comments of the Nat'l Cable & Telecomm. Ass'n at 12-13, Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter NCTA Oct. 2006 Comments].

Another non-incumbent noted,

> The Ohio Commission believes that the approach adopted by the Plan will have negative implications for telephone competition . . . . In many instances, and for many competitive carriers, the transit provider is the ILEC. Under the Plan, competitive carriers who must rely on the ILEC to deliver their traffic may be subjected, if they exceed the MOU threshold, to punitive transit rates that have no basis in the cost actually incurred by the ILEC in providing the transit service. . . . This will have a chilling effect on competition and should not be adopted under any plan for intercarrier compensation reform.

Pub. Util. Comm'n of Ohio Comments at 47, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Pub. Util. Comm'n of Ohio Oct. 2006 Comments].

120. Reply Comments of the United States Telecom Assoc. at 11, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter USTA Feb. 2007 Reply Comments].

121. AT&T Feb. 2007 Reply Comments, *supra* note 87, at 22; Missoula Plan Supporters Oct. 2006 Comments, *supra* note 87, at 14 ("The Plan creates an obligation for Edge owners to interconnect with transit carriers, which should fuel the competitive market for the provision of Tandem Transit service.").

122. Reply Comments of the Missoula Plan Supporters at 25-26, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter Missoula Plan Supporters Feb. 2007 Reply Comments] (citations omitted).

123. *See, e.g.*, CTIA Comments at 33-34, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 25, 2008).

124. As one comment stated:

> The silliness of the entire notion is demonstrated by the fact that the new network interconnection rules would not take effect for 10 years. Clearly, if replacing the existing network interconnection rules was an important precondition to comprehensive intercarrier compensation reform, the changes could not wait for a decade. Beyond that, it is nonsensical to create new rules for

### 2. Should Tandem Transit Service Providers Ever Serve as a Bill Collector to Help the Terminating Carrier Collect Reciprocal Compensation?

Another area of dispute concerns whether the FCC should solve the problem of misallocated traffic and phantom traffic by allowing terminating carriers to seek payment for reciprocal compensation from the transit provider, as envisioned by the Reform Proposal. As a general matter, most commenters agreed that a solution to the "phantom traffic" problem was necessary and favored the recommendations in the Reform Proposal.[125]

However, some carriers took issues with certain aspects of the Reform Proposal. Most notably,[126] many incumbents argued that a transit provider should be required to serve as the middleman in order to help the terminating carrier collect these fees. These carriers, primarily incumbents,

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> interconnection of circuit switched networks when they likely will be replaced in large measure by IP-based interconnection by the time that they are scheduled to take effect.

Broadview Reply Comments, at 4, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Dec. 22, 2008).

125. *See, e.g.*, Comments of Oklahoma Corp. Comm'n at 3, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 25, 2008). Comments of Frontier Comm. at 10, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008); Comments of the Wisc. Pub. Serv. Comm'n, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008).

126. An additional argument, made by some commenters, included urging the FCC to impose additional bill collection responsibilities on the transit providers to further simplify the collection process.

> [O]nce rates are unified, if tandem operators are given the responsibility to pay for all calls that they deliver, including third-party calls for which they are the transit provider, then they could simply bundle the uniform termination rate into their transit fees. This would substantially simplify intercarrier billing. It also happens to be closer to the Internet's business model, wherein "upstream" carriers deliver packets between their "downstream" customers without additional bilateral payments.

Comments of the Coalition for Rational Universal Service and Intercarrier Reform, at 7, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter Coalition for Rational Reform Nov. 2006 Comments]. This sentiment was echoed by another commenter:

> AT&T does not object to the adoption of the latter compensation structure as a default for all traffic so long as the Commission removes any vestige of the *other* compensation structure, under which the terminating carrier may sometimes recover directly from the carrier responsible for payment (the carrier delivering the call to the transit provider). . . .
>
> . . . And the transit provider must have certainty about what charges it is collecting and what charges it is paying for any wholesale inputs (such as the call-termination function provided by the called party's LEC).

Comments of AT&T Inc., at 37, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter AT&T Nov. 2008 Comments].

argued that this regulation would be contrary to the long-standing FCC principle that the "cost-causer" is responsible for paying for the cost of call delivery.[127] After all, the transit providers are not in a position to control the information submitted by the originating provider. Thus, the rule could penalize transit providers who are acting in good faith to comply with the law. [128]

In addition, the commenters were concerned that the ruling would only serve to push the burden of forcing originating carriers to recover reciprocal compensation from the terminating carrier and onto the transit provider.[129] As one incumbent noted, "[t]andem owners will be placed in

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127. Comments of Qwest Comm. Int'l Inc. at 25, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter Qwest Nov. 2008 Comments]; Qwest Reply Comments of Qwest Comm. Int'l Inc., at 15, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Dec. 22, 2008) [hereinafter Qwest Dec. 2008 Reply Comments].

128. As an example, the incumbents noted that if they have a mandatory transiting obligation, then the incumbent would be compelled to deliver the traffic of originating carriers who flagrantly refused to submit accurate billing information.

> As transit service providers have no end user involved in the traffic at issue, the only potential source of compensation for their services (unlike the originating and terminating carriers, each of which have end users involved in the call) are the carriers that hand them traffic for termination. At the same time, as a general rule, transit service providers currently have no ability to prevent other carriers from using them as transit service providers -- *i.e.*, they can not stop the traffic from coming to them once the originating carrier is interconnected with the tandem for other non-transit services. As a result, transit service providers have become embroiled in disputes both with originating carriers who refuse to enter into appropriate agreements for their services or to compensate them at reasonable rates and with terminating carriers who seek to bill the transit provider rather than seeking compensation from the originating party.

Qwest Nov. 2008 Comments, *supra* note 127, at 23. In another example, some commenters arguably did not exempt transit providers who supplied sufficient information for the terminating carrier to identify the transit providers. This initial rule was sharply criticized because the transit providers are in no position to identify whether the call is appropriately rated by the originating carrier. *See, e.g.* Ex Parte Comments of Neutral Tandem at 3, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 29, 2008) [hereinafter Neutral Tandem Oct. 2008 Ex Parte Comments]. After all, the tandem transit provider noted that for local traffic, no regulatory obligation exists for a carrier to identify the type of call being transferred. *Id.* at 3. However, in his revised proposal, Chairman Martin clarified that transit providers supplying this information should not be held liable for termination costs. *See supra* note 107. The authors agree with this clarification and believe that any regulation not containing this limitation would be unduly harsh.

129. One commenter stated:

> The proposed order has plainly overreached, however, by requiring tandem owners to essentially be placed in a "banker role" by requiring them to pay the subtending carrier's highest rate and bear the burden of collecting from carriers upstream in the call signaling path. Such rules will establish unintended, new opportunities for terminating carriers to simply bill the intermediate tandem owners for traffic that is uncollectable [sic] for reasons other than simply being "unidentified" due to lack of CPN in the signaling stream.

the position of facing increased risk and costs without the ability to increase prices to offset these new factors. Such a result is contrary to sound business practices and would produce a bad public policy outcome."[130]

At the same time, the commenters were concerned that the Reform Proposal's phantom traffic rules could create *more* interconnection disputes. To some incumbents, the Reform Proposal would create the perverse incentive for a terminating carrier to attempt to collect transiting charges from the transiting carrier—simply because it would be easier to do so.[131] To avoid these disputes, the FCC was urged to provide more detailed guidelines concerning when the terminating provider can seek compensation from the transit provider, and when it cannot.[132]

In a more controversial proposal, some commenters urged the FCC to grant incumbents and competitive carriers the right to demand interconnection agreements from any other carrier or telecommunications provider under §§ 251 and 252 of the 1996 Act. To the commenters, even if additional call information was provided, transit providers and terminating carriers still may have difficulty recovering reciprocal compensation directly from the terminating carrier.[133] However, some non-incumbents

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> For instance, many CLECs and CMRS carriers prefer to not negotiate interconnection agreements with rural ILECs and establish network connections. Given that the Commission has not extended the *T-Mobile Order* to CLECs, rural ILECs have experienced difficulty bringing many competitive carriers to the negotiation table to establish the terms and conditions governing the exchange of their traffic as the competitive carriers benefit from the lack of an agreement. Therefore, much of this traffic has been terminated on the small ILEC network for no compensation.

Comments of Embarq at 58-59, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter Embarq Nov. 2008 Comments].

130. Embarq Nov. 2008 Comments, *supra* note 129, at 65. *See also* Reply Comments of Embarq at 58, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Dec. 22, 2008) [hereinafter the Embarq Dec. 2008 Reply Comments] (stating the proposal would "force[] transit providers into an awkward, expensive, dispute-prone, and unjustified middleman role"); Qwest Nov. 2008 Comments, *supra* note 127, at 26-27 ("[T]his new obligation would now put transit service providers entirely at the mercy of both originating and terminating carriers and into the middle of their disputes.").

131. *See, e.g.*, Embarq Nov. 2008 Comments, *supra* note 129, at 60.

132. *See, e.g.*, Embarq Dec. 2008 Reply Comments, *supra* note 130, at 41; Qwest Nov. 2008 Comments, *supra* note 127, at 29.

133. *See, e.g.*, Embarq Nov. 2008 Comments, *supra* note 129, at 56-57. As the Wisconsin Public Service Commission noted, "absent rules to compel the establishment of interconnection arrangements, progress is likely to proceed slowly, if at all. For these reasons, all providers will need the right to compel interconnection arrangements with all other providers for the exchange of local traffic." Reply Comments of the Wisc. Pub. Serv. Comm'n at 5, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Jan. 26, 2007) [hereinafter Wisc. Pub. Serv. Comm'n Jan. 2007 Reply Comments].

opposed the idea, noting that the reform was both impractical[134] and not consistent with the terms of the 1996 Act.[135]

### 3. Is Any Further Regulation of Tandem Transit Providers Necessary and Appropriate?

Another area of debate relates to whether the FCC should go beyond the recommendations in the Reform Proposal and adopt any further regulations relating to transiting services—such as ordering incumbents to offer transiting services or setting default rates for tandem transit services.

The crux of the debate concerns whether any regulation of the tandem transiting market is necessary or if the market is already sufficiently competitive. Even among those advocating for further regulation of tandem transit services, for the most part, commenters agreed that any price regulation of transiting would only be appropriate until the market is sufficiently competitive.[136] In other words, there appeared to be some agreement that no justification exists for regulating transit prices if the

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134. As one company noted, "[t]his means that any one carrier could potentially be required to enter into hundreds of separate interconnection agreements." Comments of Cavalier Tel., LLC at 34, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Cavalier Tel. Oct. 2006 Comments].

135. *See, e.g.*, Ex Parte Comments of NuVox Comm., One Comm. Corp., and XO Comm. at 3-4, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Mar. 11, 2008).

136. *See, e.g.*, Cal. Pub. Util. Comm'n Reply Comments at 11, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter Cal. Pub. Util. Comm'n Feb. 2007 Reply Comments] ("[T]he California Commission is concerned that lifting the transit rate cap would result in enormous cost increases and would deregulate the tandem transit market, leaving some carriers with few or no competitive options for the exchange of traffic."). The Pennsylvania Public Utilities Commission shared this concern.

> [T]he PaPUC suggests that the FCC consider an approach to transit service in which that service is deregulated only upon a showing that there are multiple alternative service providers ubiquitously available throughout any MSA/MTA in which transit service is deregulated. Moreover, the PaPUC further suggests an additional requirement that any deregulation of transit service in an MSA/MTA will be reversed when the users of transit service establish that there is less than a predetermined number of alternative transit service providers.

Pa. Pub. Util. Comm'n Comments at 18-19, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006); *see also* Comments of Sprint Nextel Corp. at 15, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Sprint Nextel Oct. 2006 Comments]; Reply Comments of Sprint Nextel Corp. at 15; Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter Sprint Nextel Feb. 2007 Reply Comments].

market is already competitive.[137] The primary policy dispute therefore revolved around whether sufficient competition is present.[138]

Many providers (mainly incumbents and competitive transit providers) argued that the market already is sufficiently competitive to foreclose the need for *any* regulation.[139] As one incumbent noted,

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137. *E.g.*, Comments of Neutral Tandem, Inc. at 5, Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Neutral Tandem Oct. 2006 Comments].

138. A side dispute exists concerning whether transiting should be addressed by the FCC as part of the intercarrier compensation reform docket. At least one ILEC noted that any such regulation was far outside the scope of the proceeding:

> The purpose of this proceeding is to reform the rules that remedy the "terminating access monopoly"—that is, the rules that restrict how much each carrier may charge others for *terminating their calls* in a network environment characterized by government-imposed interconnection obligations, tariffs, and, in most cases, only one pipe leading to any given called party. By definition, transit providers do not terminate traffic, and they therefore have no terminating access monopoly. Any arguments about the degree of competition for the provision of transit services raise entirely distinct issues and are thus appropriately addressed, if at all, in other proceedings.

Reply Comments of AT&T Inc. at 20-21, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Dec. 22, 2008) [hereinafter AT&T Dec. 2008 Reply Comments] (internal citations omitted). Others disagreed:

> Qwest has recommended that the FCC explicitly exclude transit traffic from intercarrier compensation reform. This is because Qwest, along with other ILECs, in many cases has a near monopoly with respect to the provision of transit traffic and seek to benefit by charging rates significantly in excess of cost. . . .
>
> . . . .
>
> . . . The FCC should not deprive carriers of cost-based compensation for terminating access services, while at the same time allowing the ILECs to exploit their dominant position as a transiting provider.

Comments of Integra Telecom, Inc. at 20-23, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008).

139. *See* Embarq Dec. 2008 Reply Comments, *supra* note 130, at 7. The commenter added:

> In any event, markets for interoffice transport are quite competitive. Indeed, competition for competitive interoffice services first emerged decades ago. Today, competitive transit services are available from many providers, including large local and long distance carriers and competitive local exchange carriers. Nonetheless, the Commission is confronted with calls for extensive regulation of transit services, including below-cost pricing along the lines of the incremental cost proposed for terminating traffic over dedicated loops. Transport networks are constructed equally or all traffic, and the cost of such networks is inherently traffic sensitive. Accordingly, it would make no sense to require. [sic]

*Id.* On a previous occasion, Embarq had argued:

> Rather, the rates, terms and conditions for transit services should be negotiated as part of a commercial transit agreement. Given that competition for transit services exists in most urban and suburban territories and is increasing, buyers of transit services have real and growing alternatives for the provision of transit services. One such competitive alternative in the transit market is Neutral Tandem. Neutral Tandem provides competitive transit services to over 70 wireless, CLEC, cable and VoIP providers. Embarq's tandem serving areas overlap Neutral Tandem's markets throughout Florida and the Las Vegas, NV market, as well as extensive

> [A]s a policy matter, transit does not need to be tightly regulated, because it has become a competitive service. While ILECs are the traditional providers of that service, competitors are increasingly entering the field. Neutral Tandem, for example, recently reported that it was operating in 91 markets, carried 15.9 billion minutes of traffic in the third quarter of 2008, and could connect calls to an estimated 372 million telephone numbers assigned to carriers. Another competitive transit provider is HyperCube, LLC, which describes itself as a "premiere provider of local and national tandem services to other carriers throughout the United States via interconnected tandem switches." Indeed, even some proponents of regulating transit grudgingly acknowledge the emerging "market for competitive tandem switching" in at least some areas.[140]

Moreover, many commenters argued that pro-competitive features would likely lead to lower prices and efficient routing of traffic regardless of price regulation.[141] Similarly, several incumbents argued that no mandatory transiting obligation and no price caps would result in a competitive tandem transiting market.[142] Too much price regulation would discourage investment into alternative transit providers (*e.g.* transit providers other than incumbents): "[r]egulation of prices in a competitive market is likely to be contrary to the public interest, as it would either deter competitive entry (if the regulated price is below the market level) or

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> coverage in Ohio, and some parts of Pennsylvania, and Indiana. In addition, Neutral Tandem's website lists Embarq's Kansas and Missouri rural markets as "Planned for Development."

Embarq Nov. 2008 Comments, *supra* note 129, at 65 (internal citation omitted).

140. AT&T Dec. 2008 Reply Comments, *supra* note 138, at 21-22 (quoting HyerCube LLC, http://www.hypercube-llc.com/corporate/network.html (last visited Feb. 1, 2009), and Coalition for Rational Reform Nov. 2006 Comments, *supra* note 126, at 6) (other internal citations omitted).

141. Missoula Plan Supporters Feb. 2007 Reply Comments, *supra* note 122, at 25 ("[O]ver time, the Plan should actually exert significant downward pressure on such costs" due to increased competition in the tandem transit market); USTA Feb. 2007 Reply Comments, *supra* note 120, at 11 ("[T]he Plan offers carriers other options — including the choice of a competitive transit provider, such as Neutral Tandem, or direct interconnection — to facilitate carrier's ability to choose the most efficient methods to manage their transit traffic costs.").

142. Indeed, in its Reply Comments, Qwest argued that "[w]hile transiting services generally are provided by large ILECs today, Qwest believes there is a niche market for other carriers to provide such transport particularly under Qwest's bill-and-keep at the edge proposal." Reply Comments of Qwest Comm. Int'l, Inc. at 14, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb, 1, 2007) [hereinafter Qwest Feb. 2007 Reply Comments].

promote inefficient and wasteful entry (if the regulated price is above the market level)."[143]

However, not all commenters were convinced that the market was sufficiently competitive for the FCC to forego any further regulation over the market. For example, one commenter noted that "[w]hile there may well be a market for competitive tandem switching in many top-tier markets, this primarily exists to support CMRS carriers, and rarely extends to rural markets (such as Rockford) where 'donut' ILEC patterns exist."[144] Another cable provider noted that unless transit rates were regulated (and decreased), "[p]articularly where transport must be obtained from a terminating RLEC, transport rates, rather than ICC charges, could become the primary tollbooth used by dominant carriers to impose burdensome costs on their competitors."[145] The carriers therefore maintained that public policy considerations continued to support the imposition of mandatory transiting obligations for incumbents at TELRIC rates.[146]

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143. Neutral Tandem Reply Comments at 2-3, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter Neutral Tandem Feb. 2007 Reply Comments]. Neutral Tandem therefore proposed that the Missoula Plan be modified so that the price caps on transiting rates would only apply to incumbent LECs. *Id.*; *see also* AT&T Feb. 2007 Reply Comments, *supra* note 87, at 22 (arguing "rate caps lower than those prescribed by the Plan would perversely nip such competition in the bud by artificially inhibiting the entry of competitive transit providers"); Missoula Plan Supporters Feb. 2007 Reply Comments, *supra* note 122, at 14 ("The Plan creates an obligation for Edge owners to interconnect with transit carriers, which should fuel the competitive market for the provision of Tandem Transit service.").

144. *See* Coalition for Rational Reform Nov. 2006 Comments, *supra* note 126, at 6.

145. Comments of T-Mobile USA, Inc. at 14, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter T-Mobile Nov. 2008 Comments]. The full comment reads:

> Because transport rates are excessive, failing to address those rates will undermine much of the efficiency and competitive gains from ICC reform. Particularly where transport must be obtained from a terminating RLEC, transport rates, rather than ICC charges, could become the primary tollbooth used by dominant carriers to impose burdensome costs on their competitors. Thus, the Commission should consider requiring significant reductions in transport service rates and, while the Further Notice is pending, it should cap transport rates at current levels.

*Id.*

146. For example, Comcast argued:

> Unfortunately, the remaining regional Bell operating companies ("RBOCs") are dominant in the provision of transit service, with the incentive and ability to raise prices unilaterally in order to disadvantage competitors. The most effective, pro-competitive action the Commission could take at this point would be to affirm unequivocally that transit arrangements are subject to the section 251/252 negotiation and arbitration process.

Comments of Comcast Corporation at iv, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008). Additionally, as the Coalition for Rational Universal Service and Intercarrier Reform noted:

> The proposed edge concept makes the network edge a non-tandem switch . . . when the destination carrier is not the owner of the tandem which the end point subtends. Calling parties *may* utilize the services of third carriers to reach these

Moreover, some commenters were further dismissive of any suggestion that transiting may become competitive in the future, calling this notion "merely speculation" because "a competitive transiting market may never materialize to produce incentives to keep transiting rates low."[147] The commenters therefore warned against taking any prospective action to encourage alternatives to the incumbents' tandem transiting services because deregulation would risk leaving providers "with few or no competitive options for the exchange of traffic."[148]

### 4. If Further Regulation is Necessary, Are ILECs Obligated To Provide Tandem Transit Services?

One of the most contentious issues concerning tandem transiting regulations is whether incumbents are obligated to offer tandem transiting services. While the Reform Proposal is silent on this point, the Missoula Plan "does not create an obligation in the first instance to provide tandem transit service, but it prohibits the discontinuance of such service."[149]

Many non-dominant providers argued that the Missoula Plan did not go far enough to ensure the availability of tandem transiting services. The

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> edges, but the price of such tandem transit is undefined. This creates an untenable situation in many areas, especially rural, where one ILEC owns the tandem and one or a few nearby urban end offices, and another owns the surrounding end offices. For example, in LATA 360, Verizon-North has four host switches and nine remotes subtending the AT&T Rockford tandem. All are within the Rockford retail local calling area. It would be highly uneconomical for a CLEC to need interconnection with all four hosts in order to establish local connectivity within a LATA. In LATA 360, the tandem owner itself only has three host switches in the LATA. This is not an uncommon arrangement. . . .
>
> Thus the rate for tandem switching and transport to third parties (collectively, transit) must continue to be regulated at cost-based levels, albeit levels that allow the transit operator to make a fair profit. (TELRIC is thus a reasonable option.)

Coalition for Rational Reform Nov. 2006 Comments, *supra* note 126, at 6; *see also* Comments of Sprint Nextel Corp. at 11-12, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008) [hereinafter the Sprint Nextel Nov. 2008 Comments].

147. Mich. Pub. Serv. Comm'n Comments at 3-4, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Mich. Pub. Serv. Comm'n Oct. 2006 Comments]; *see also* Cal. Pub. Util. Comm'n Feb. 2007 Reply Comments, *supra* note 136, at 11. *Compare* CTIA Oct. 2006 Comments, *supra* note 115, at 4, *and* NCTA Oct. 2006 Comments, *supra* note 119, at 8, 13, *and* Sprint Nextel Oct. 2006 Comments, *supra* note 136, at 12 *with* AT&T Feb. 2007 Reply Comments, *supra* note 87, at 22 (noting that "competition from independent providers such as Neutral Tandem may well keep transit rates from increasing beyond their existing levels in the first place. Indeed, the Plan will invigorate such competition precisely because . . . it creates an absolute right of interconnection for all transit providers").

148. Cal. Pub. Util. Comm'n Feb. 2007 Reply Comments, *supra* note 136, at 11.

149. Missoula Plan Supporters Oct. 2006 Comments, *supra* note 87, at 18. Notably, the Supporters argued that the "[t]he Commission clearly has the authority under §§ 201(a) and 251(a) of the Act to regulate the provision of tandem transit service in this manner." *Id.*

non-dominant providers argued that federal law required incumbents to provide this service, pursuant to 47 U.S.C. § 251(a)(1) or 47 U.S.C. § 251(c)(2).[150] And even if the 1996 Act does not require incumbents to perpetually offer transiting, the commenters argued that the FCC must impose this requirement because transit services are vital to the "fundamental goals of universal connectivity to the PSTN and promoting economic efficiency and competition."[151] The commenters noted that the ILECs "currently face scant competition in the market for transit services,"[152] so any loss of regulation would allow the ILECs to take advantage of the deregulation in order to harm their competitors.[153] The

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150. *See, e.g.*, NCTA Oct. 20006 Comments, *supra* note 119, at 23; *see also* Comments of Broadview Ntwk. at 59-60, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Broadview Oct. 2006 Comments]; Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 18; Cox Comm. July 2005 Reply Comments, *supra* note 84, at 8 (noting that statements by the FCC "presume[] the existence of transit service, and an obligation for incumbent LECs to provide transit on request; otherwise it would make no sense."); Reply Comments of TW Telecom, Inc. at 14, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 26, 2008).

151. Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 18. Another comment noted,

> The provision of tandem transit service is essential to competition in communications markets. Without it, indirect interconnection would be a virtual impossibility, and competitive carriers would have to take the costly steps of establishing direct interconnection agreements with all other carriers regardless of whether the traffic volumes exchanged with particular carriers economically justified such interconnection.

Broadview Oct. 2006 Comments, *supra* note 150, at 59-62; *see also* Sprint Nextel Oct. 2006 Comments, *supra* note 137, at 12 ("They must rely upon the ILEC for the vast majority of their transport needs – for example, approximately 92% of Sprint Nextel's dedicated switched transport expense is for ILEC facilities or service."); Comments of Time Warner Cable at 19, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Time Warner Cable Oct. 2006 Comments] ("Mandating cost-based transit service is a necessary component of any workable intercarrier compensation regime because competitors lack the resources to interconnect directly with every incumbent LEC, and doing so where traffic volumes are low would be highly inefficient.").

152. NCTA Oct. 2006 Comments, *supra* note 119, at 10-11. The NCTA further noted

> [D]eregulation clearly would be detrimental to the development of facilities-based competition because of the ILECs' continuing market dominance for this essential service. . . .
>
> . . . If transit service were unavailable, a competitive service provider would have to directly connect with every ILEC, CLEC and CMRS provider in each local market before it could even begin to deploy services. As the Commission has recognized, transit is the only practical and economical way for a competitive carrier to originate and terminate calls with all other providers because constructing such a large number of direct connections for often minimal amounts of traffic is cost prohibitive and immensely inefficient.

*Id.*

153. Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 17 ("The fact that ILECs possess market power in provision of transit services is evident by their actions to discourage competitive provision of transit services. For example, Verizon has thwarted the

commenters were further concerned that the Missoula Plan would remove transiting from the protection of state-commission arbitration proceedings[154] and into commercial negotiation,[155] which would enable ILECs to impose unreasonable rates, terms, and conditions on transiting services.[156] Some commenters even feared that unless transiting was made mandatory, the ILECs could eventually discontinue their provision of tandem transiting services, creating "the very real possibility of complete chaos and balkanization of the PSTN."[157]

Other commenters, including the Missoula Plan supporters, state commissions,[158] and some incumbent carriers,[159] did not agree that the public interest mandated the imposition of mandatory transiting on

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ability of Neutral Tandem to offer competitive transit service, both directly and through its CMRS affiliate, Verizon Wireless.").

154. *See, e.g.*, NCTA Oct. 2006 Comments, *supra* note 119, at 24; Reply Comments of the Nat'l Cable & Telecomm. Ass'n at 7-8, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter NCTA Feb. 2007 Reply Comments].

155. *See, e.g.*, NCTA Oct. 2006 Comments, *supra* note 119, at 11. NCTA further noted,

> [i]mposing an ongoing transit obligation on incumbent LECs pursuant to Sections 251(b)(5) and 251(c)(2) would promote facilities-based competition because it would ensure that the terms and conditions for transit service are contained in interconnection agreements. In addition, such an approach would continue to ensure a fair, cost-based pricing standard for transit service and the availability of a dispute resolution mechanism with state commissions.

*Id.* at 24. Comments of Mo. Pub. Serv. Comm'n at 52, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) (noting that under the Missoula Plan "much of the transit traffic will no longer be subject to interconnection agreements under Section 251 and 252, thus no longer subject to state commission purview. Under the Plan, the Tandem Transit provider will have unfettered control over the rates, terms, and conditions of Tandem Transit service.").

156. *See* Comments of Time Warner Telecom, Inc. at 8, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (Oct. 25, 2006) [hereinafter Time Warner Telecom Oct. 2006 Comments] ("The Missoula Plan does not subject ILECs to the negotiation and arbitration obligations for tandem transit commercial agreements, essentially calling a free-for-all on tandem transit rates."); *see also* Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 19; NCTA Oct. 2006 Comments, *supra* note 119, at 11; T-Mobile Nov. 2008 Comments, *supra* note 145, at 14-15 ("ILEC refusals to provide tandem transit services can undermine competition and effectively force inefficient interconnection arrangements on competitors.").

157. Cavalier Tel. Oct. 2006 Comments, *supra* note 119, at 19.

158. *See, e.g.*, Pub. Util. Comm'n of Ohio Oct. 2006 Comments, *supra* note 119, at 45.

> To promote a uniform, seamless telecommunications system, the Ohio Commission believes that carrying transit traffic should be an obligation of all carriers. The Missoula Plan recognizes this as well and requires that any ILEC carrying transit traffic on the eve of the Plan's implementation . . . to continue to [sic] carrying such traffic under the Plan.

*Id.*

159. *See, e.g.*, Embarq Dec. 2008 Reply Comments, *supra* note 130, at 7; Qwest Feb. 2007 Reply Comments, *supra* note 142, at 9; Verizon Oct. 2006 Comments, *supra* note 115, at 34.

incumbents.[160] Instead, the commenters believed that the existing regulations were more than sufficient to ensure the continued availability of transiting services because transiting was already widely available[161] and

160. Even among those who felt that the FCC need not make transiting services a mandatory incumbent service, a disagreement exists concerning the basis for the FCC's authority to order any incumbents to offer transiting for any period of time under 47 U.S.C. §§ 201 and 251(a)(1). *See* AT&T Feb. 2007 Reply Comments, *supra* note 87, at 68-69. Although the Missoula Plan supporters recognized that neither provision explicitly regulated transiting, the supporters reasoned that "[t]he Commission may reasonably find that implementation of section 251(a), and the public interest in a fully interconnected network, would best be served by imposing the minimal obligation on carriers that have indicated that they are willing and able to provide transit services to continue doing so." *Id.* at 68-69. The incumbents disagreed, arguing that nothing in the plain language of either § 251(a)(1) or § 251(c)(2) requires such a result.

> Section 251(a), on its face deals only with physical connections and imposes no such duty on carriers. Similarly, Section 251(c)(2) plainly only speaks to the ILEC duty to provide interconnection with *the ILEC's* network. Neither of these provisions can reasonably be read to obligate an ILEC or any other carrier to provide transiting between the networks of two other carriers.

Qwest May 2005 Comments, *supra* note 84, at 37 (internal citations omitted); *see also* AT&T Reply Dec. 2008 Comments, *supra* note 138, at 21; Qwest Dec. 2008 Comments, *supra* note 127, at 23-24; Comments of Qwest Comm. Int'l, Inc. at 29, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Oct. 25, 2006) [hereinafter Qwest Oct. 2006 Comments]; Reply Comments of Verizon on the Missoula Plan at 18, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Feb. 1, 2007) [hereinafter Verizon Feb. 2007 Reply Comments]. The incumbents reasoned that the FCC has made clear that interconnection only refers to the "physical connections" of networks. *See* Qwest May 2005 Comments, *supra* note 84 at 30; Verizon Feb. 2007 Reply Comments, *supra*, at 18-20 (citing AT&T Corp. v. FCC, 317 F.3d 227, 234-35 (D.C. Cir. 2003); Total Telecoms. Servs., Inc. v. AT&T Corp., 16 F.C.C.R. 5726, para. 23 (2001)). Indeed, incumbents were even divided over whether the FCC could regulate transiting under Section 201. For example, Qwest argued that transiting is an interconnection section that may be regulated under Sections 201 and 202 of the Act so "[w]hile there might be instances where a carrier could compel transiting interconnection under the Act, those circumstances will be very limited." Qwest Feb. 2007 Reply Comments, *supra* note 143, at 9. By contrast, Verizon argued that

> Section 201(a) does not, of its own force, impose any obligations at all, let alone an obligation to provide transiting service. . . . No such finding could be made on the record here, even if § 201(a) encompassed transiting service (and it does not). . . .
>
> In any event, Verizon and the other ILECs do not provide transiting service on a "common carrier" basis, as § 201(a) contemplates. Instead they do so pursuant to voluntarily negotiated agreements. For this reason, § 201(a) is inapplicable to transiting service.

Verizon Feb. 2007 Reply Comments, *supra*, at 21-22 (internal citation omitted).

161. For example, AT&T noted,

> But [tandem transiting service] is already widely available today without a regulatory mandate, and the Plan's provisions ensuring that transit providers have interconnection rights should increase the availability of transit — at even more competitive rates. In any event, as noted, the Plan does ensure that any carrier that provides transit on the day before the Plan is adopted must continue to provide that service for the life of the Plan.

AT&T Feb. 2007 Reply Comments, *supra* note 87, at 19 n.31.

the existing voluntary transit arrangements at reasonable rates "have proven successful."[162] In the face of these arguments, one incumbent opined that those arguing in favor of imposing a mandatory transiting obligation were simply trying "to use the regulatory process to cut their costs to artificial and uneconomic levels, and to shift those costs to incumbents."[163]

### 5. Should the FCC Regulate Transit Rates?

A related dispute concerns whether transit rates should be set by the market or by regulators. While the Reform Proposal does not contain any specific recommendations on this point, the Missoula Plan recommends that the FCC exercise its authority under §§ 251(a)(1) and 201 of the 1996 Act to "ensure that charges for tandem transit service are just and reasonable"[164]—a rate of $0.0025 per record.[165] The supporters of the Missoula Plan argued that the rate cap benefits all carriers by "settl[ing] an area of dispute regarding transit charges by bringing certainty to the area."[166]

Various CLECs, cable companies, and other non-dominant providers argued that the mandated rate of $0.0025 was too high because the rates were above costs,[167] and because the arbitrary rate would "increase ILEC tandem transit and transport rates," leaving carriers "seeking to deliver calls to ILECs for termination [to] face [an] excessive transit rate[] . . . and burdensome direct interconnection requirements."[168]

Some commenters argued instead that the FCC should mandate that transiting rates must be set at TELRIC or a forward-looking rate "based on the use of the most efficient telecommunications technology currently

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162. Verizon Feb. 2007 Reply Comments, *supra* note 160, at 16-17; Verizon Oct. 2006 Comments, *supra* note 115, at 34.

163. Verizon Feb. 2007 Reply Comments, *supra* note 160, at 17.

164. Missoula Plan Supporters Oct. 2006 Comments, *supra* note 87, at 18.

165. MISSOULA PLAN, *supra* note 86, at 62-63.

166. USTA Feb. 2007 Reply Comment, *supra* note 120, at 11. The U.S. Telecommunications Association further argued the Missoula Plan "does not establish a new source of revenues. And by capping the rates and eventually bringing transit associated with jointly provided access under the tandem transit rules, the Plan's transit rules should benefit all carriers." *Id.*

167. *See, e.g.*, Pub. Util. Comm'n of Ohio Oct. 2006 Comments, *supra* note 119, at 46 (noting that the Missoula Plan does not set rates for transit traffic at cost-based rates); *see also* Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 20 (noting that the Missoula Plan does not set rates for transit traffic at cost-based rates); Time Warner Cable Oct. 2006 Comments, *supra* note 151, at 20 (noting that the Missoula Plan does not set rates for transit traffic at cost-based rates).

168. CTIA Oct. 2006 Comments, *supra* note 99, at 4; *see also*, Broadview Oct. 2006 Comments, *supra* note 150, at 3; NCTA Oct. 2006 Comments, *supra* note 119, at 8, 13; Sprint Nextel Feb. 2007 Reply Comments, *supra* note 136, at 13-14; Sprint Nextel Oct. 2006 Comments, *supra* note 136, at 12, 16.

available and the lowest cost network configuration."[169] Some commenters justified this position by arguing that TELRIC rates are mandatory because transiting is a mandatory incumbent obligation under § 251(b)(2) of the Telecommunications Act.[170] Others argued, instead, that rates must be set at "forward-looking costs"[171] simply because ILECs are the dominant providers of tandem transiting service.[172] The commenters argued that a market-based rate would simply enable the monopolist incumbents to raise their competitors' costs[173] and to impose discriminatory terms and conditions on their competitors.[174] Indeed, one cable provider argued that

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169. 47 C.F.R. § 51.505(b)(1) (2008); *see also* Verizon Comm. Inc. v. FCC, 535 U.S. 467 (2002). The "forward-looking economic cost per unit" is then determined by dividing the TELRIC for the network element by "the sum of the total number of units of the element that the incumbent LEC is likely to provide to requesting telecommunications carriers and the total number of units of the element that the incumbent LEC is likely to use in offering its own services." § 51.511(a). "TELRIC pricing is based upon the cost of operating a hypothetical network built with the most efficient technology available." AT&T Corp. v. Iowa Utilities Bd., 525 U.S. 366, 374 n.3 (1999). Thus, TELRIC rates may fall below the costs actually incurred by the incumbents.

170. *See e.g.*, Sprint Nextel Oct. 2006 Comments, *supra* note 136, at 13.

171. CTIA Oct. 2006 Comments, *supra* note 115, at 14; Broadview Oct. 2006 Comments, *supra* note 150, at 64-65.

172. *See* Cavalier Tel. Oct. 2006 Comments, *supra* note 134, at 16 ("LECs interconnect with the ILEC out of necessity because the ILEC is the dominant provider in its service territories. As such, the ILEC is dominant in provision of transiting."); CTIA Oct. 2006 Comments, *supra* note 115, at 14 ("Because of the ubiquity of RBOC . . . they provide almost all of the tandem transit services used by competitive carriers today."); NCTA Oct. 2006 Comments, *supra* note 119, at 13 ("This deregulation of transit services is completely unjustified given the dearth of competition that incumbent LECs face for these services."); Sprint Nextel Oct. 2006 Comments, *supra* note 136, at 12.

173. For example, Sprint Nextel noted,

> When one party provides an essential service for which there is virtually no competitive alternative, that party will most assuredly charge its captive customers a rate which is well above cost. The fact that transit customers accept such rates is merely a reflection of their unequal bargaining positions (a contract of adhesion), not of balanced or competitive market conditions. Where, as here, market forces are insufficient to ensure just, reasonable and cost-based rates, regulation must act as their surrogate.

Sprint Nextel Feb. 2007 Reply Comments, *supra* note 136, at 15; *see also* Pub. Util. Comm'n of Ohio Oct. 2006 Comments, *supra* note 119, at 47 ("[C]ompetitive carriers who must rely on the ILEC to deliver their traffic may be subjected . . . to punitive transit rates that have no basis in the cost actually incurred by the ILEC in providing the transit service" which would have "negative implications for telephone competition."); Time Warner Telecom Oct. 2006 Comments, *supra* note 156, at 7 ("It is necessary therefore to tightly regulate ILEC tandem service rates so that ILECs do not have the opportunity to use them as a means of raising rivals' costs.").

174. *See e.g.*, NCTA Oct. 2006 Comments, *supra* note 119, at 11 (noting that ILECS "make every effort to leverage this dominant position to disadvantage their competitors"); Sprint Nextel Oct. 2006 Comments, *supra* note 136, at 12 ("ILECs should not be allowed to abuse their position of market control in the dedicated switched transport market by charging excessive and uncapped rates."). Sprint also argued that "[t]he $.0025 rate also has serious competitive repercussions, since the major tandem transit service providers (the

"[a]llowing monopoly pricing for transit is tantamount to authorizing incumbent LECs to withhold the service altogether."[175] The commenters favoring the imposition of a cost-based or other fixed rate also have argued that cost-based rates are necessary to achieve the Commission's intercarrier compensation goals.[176]

The incumbents disagreed, arguing that regulations imposing *any* price regulation of transiting rates would go too far,[177] because "mandating an arbitrary transit rate removes the ability of the marketplace to determine the most economic means of transporting traffic."[178] Moreover, the incumbents felt that pricing flexibility was necessary to prevent additional administrative and legal costs, which would actually raise the cost of transiting.[179]

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RBOCs) also happen to compete against Sprint Nextel and other carriers that rely upon their tandem transit services in the provision of local, toll and wireless services." *Id.* at 15-16.

175. Time Warner Cable Oct. 2006 Comments, *supra* note 151, at 20; *see also* Sprint Nextel Nov. 2008 Comments, *supra* note 146, at 12.

> Given that tandem facilities create a natural bottleneck in the circuit switched network and given that ILECs are the primary suppliers of tandem facilities, Sprint Nextel is concerned that ILECs will exercise their market dominance in this area to continue to charge unreasonable prices unless the Commission establishes a reasonable pricing mechanism and ensures that future networks benefit from the interconnection scheme established by §251(b)(5) of the Act.

Sprint Nextel Nov. 2008 Comments, *supra* note 146, at 12.

176. *See, e.g.*, Comments of MetroPCS Comm., Inc. at 26-27, Developing a Unified Intercarrier Compensation Regime, FCC CC Docket No. 01-92 (rel. Nov. 25, 2008). One commenter further argued:

> Currently, ILECs are trying to charge significantly higher than "market" rates for transit services. Since one of the goals of the unified intercarrier compensation regime is to conform prices for elements that provide the same services, transit charges should be at the same rate as the underlying network functionality provided on a UNE basis.

*Id.*

177. *See, e.g.*, Qwest Oct. 2006 Comments, *supra* note 160, at 30 ("[T]here is no legal basis for the Plan's use of a non-market-based pricing methodology for transiting. The Commission should allow the market to establish transiting rates and those rates should be deemed reasonable absent a showing to the contrary on a case-by-case basis."); Verizon Feb. 2007 Reply Comments, *supra* note 160, at 22 (TELRIC rates are inappropriate because none of the relevant federal provisions require ILECs to provide tandem transiting services).

178. Qwest Oct. 2006 Comments, *supra* note 160, at 31. Some commenters also noted that setting a default rate would unfairly prejudice rural LECs who face higher costs than urban LECs, due to the "location of the tandem switch (urban vs. rural areas) and the utilization level of the tandem switch providing the intermediary service." Embarq Nov. 2008 Comments, *supra* note 129, at 64.

179. Qwest Nov. 2008 Comments, *supra* note 127, at 27-28. As Qwest previously explained:

> [A]ny non-market-based pricing brings the industry backwards to artificial regulatory burdens reminiscent of failed concepts like TELRIC that are unnecessary in competitive markets. . . . This only assures more years of costly arbitrage, carrier disputes and litigation. The proposed rules for "Congestion and Exhaust" . . . impose vague rules that could invite similar problems. That section

All of the incumbents agreed that if the FCC did decide that some price regulation was appropriate, rates should not be set at TELRIC. To begin with, the incumbents noted that TELRIC rates were only appropriate if transiting was required by § 251(c)(2), an obligation the incumbents vigorously argued did not exist.[180] Moreover, the commenters argued that TELRIC was a "discredited" methodology that should not be extended to tandem transiting,[181] given the high administrative costs to administer and monitor TELRIC rates.[182] Indeed, the incumbents argued that TELRIC is especially inappropriate in the transiting context because the methodology may not allow transiting providers to fully recover their costs and because transiting carriers have no end-user customers to whom they can turn to subsidize the rates.[183]

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> would, among other things, appear to create situations where the network would become congested to unacceptable levels. All of these issues are better handled by using industry-recognized traffic engineering concepts and by the market, rather than by arbitrary and artificial regulatory mechanisms.

Qwest Oct. 2006 Comments, *supra* note 160, at 31; *see also* Verizon Oct. 2006 Comments, *supra* note 115, at 34 (noting that "tandem transiting service could become more costly or administratively burdensome in light of the Plan's proposed requirements").

180. *See, e.g.*, Qwest May 2005 Comments, *supra* note 84, at 38-39 (noting that Section 252(d)(1) only requires TELRIC pricing for Section 252(c)(2) interconnection and Section 251(c)(3) UNEs); *see also* AT&T Dec. 2008 Reply Comments, *supra* note 138, at 21; Qwest Dec. 2008 Reply Comments, *supra* note 127, at 24; Qwest Feb. 2007 Reply Comments, *supra* note 142, at 9.

181. *See, e.g.*, AT&T Feb. 2007 Reply Comments, *supra* note 87, at 21. In its comments, AT&T further argued,

> [N]othing in law or public policy requires regulators to set termination rates at TELRIC, as some propose. First, continued reliance on 51 state commissions to prescribe 51 different sets of TELRIC-based rates would preclude the main goal of this proceeding — national unification of intercarrier compensation — and would waste millions of dollars per year in administrative litigation. Second, the Commission all but conceded in 2003 that TELRIC is flawed because it rests on incompatible economic premises and is subject to pervasive result-oriented manipulation. Indeed, given those well-founded concerns, it would be arbitrary and capricious for the Commission to *retain* TELRIC as a cost methodology for intercarrier compensation.

*Id.* at 16-17 (internal citations omitted); *see also id.* at 50 (noting that nothing requires the FCC to continue to apply TELRIC in other circumstances); Verizon Feb. 2007 Reply Comments, *supra* note 160, at 23 (noting that TELRIC has been "widely and rightly criticized as anti-competitive and harmful to consumers").

182. *See, e.g.*, Missoula Plan Supporters Feb. 2007 Reply Comments, *supra* note 122, at 14; *see also* Neutral Tandem Feb. 2007 Reply Comments, *supra* note 143, at 2-3 ("Regulation of prices in a competitive market is likely to be contrary to the public interest, as it would either deter competitive entry (if the regulated price is below the market level) or promote inefficient and wasteful entry (if the regulated price is above the market level).").

183. For example, AT&T noted that transit rates

> . . . *must* be at least cost-based to be rational. Whereas originating and terminating carriers have *end-user customers* they can bill for any costs they do not recover from other carriers, transit providers by definition have no such relevant customers from whom they can collect the costs of transit and therefore must recover those costs from the carriers on either end of the call.

## V. A PROPOSAL TO FACILITATE COMPETITION FOR TANDEM TRANSIT SERVICES

The Authors believe that the FCC's consideration of proposals regarding the regulation of tandem transit services should be guided by the goals of the Telecommunications Act of 1996. These goals include promoting competition, minimizing undue regulation, and ensuring the continuous and uninterrupted completion of calls between the incumbent carriers and new competitive carriers.[184]

Any FCC regulation of tandem transit service should be aimed at promoting facilities-based competition in the tandem transit market. The recent state commission litigation has established that the presence of alternative transit providers brings benefits to consumers, other telecommunications providers, and the public switched telephone network (PSTN).[185] A competitive transiting market contributes to the viability of the PSTN and to the seamless and uninterrupted exchange of traffic between telecommunications providers. Competitive tandem transit providers will strengthen the PSTN and the telecommunications network by building redundancy and reliability into the PSTN. Moreover, the presence of independent transit providers will foster other facilities-based competition by offering increased routing options, lower rates, and neutral transiting choices.[186]

Notably, alternative tandem transit providers have made significant inroads in the market, even without regulatory assistance.[187] Several non-dominant carriers appear to have begun providing competitive tandem transit services, including Neutral Tandem, Level 3, and others. Moreover, in some markets, these alternative providers are effectively competing against the incumbents by winning a significant percentage of the tandem

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AT&T Feb. 2007 Reply Comments, *supra* note 87, at 20 n.34; *see also* Qwest Oct. 2006 Comments, *supra* note 160, at 31-32.

184. *See* H.R. Conf. Rep. No. 104-458, at 113 (1996), *reprinted in* 1996 U.S.C.C.A.N. 124. Indeed, the 1996 Act is labeled "An Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 56. The Supreme Court found that the 1996 Act "fundamentally restructures local telephone markets" by transforming the "longstanding regime of state-sanctioned monopolies" into a competitive market. AT&T Corp. v. Iowa Utils. Bd., 525 U.S 366, 371 (1999); *see also* Mich. Bell Tel. Co. v. MCIMetro Access Transmission Serv., Inc., 323 F.3d 348, 351 (6th Cir. 2003).

185. *See supra* Section III.

186. *See supra* Section III.

187. Notably, the Missoula Plan's four year rate cap proposal was submitted to the FCC more than two years ago. Presumably, the Missoula Plan Supporters suggested the four year cap in the hopes that the transiting market would be fully competitive in four years. In the two years since the Missoula Plan was proposed, competitive transit providers have expanded their presence in the nation.

transit traffic in those states.[188] Thus, the Authors believe a strong case could be made that either pricing should be deregulated in these states or that there is not a pressing need for the FCC to address transiting issues as part of intercarrier compensation reform *at all*, particularly given the potential for regulation to create unintended negative impediments to what appears to be a growing competitive market.

However, certain proposals related to tandem transiting services do have the potential to facilitate competitive entry by removing uncertainty regarding the "rules of the road" for transit services. Specifically, the Authors propose that the FCC should immediately adopt clear rules granting tandem transit providers the right to interconnect directly with other telecommunications providers.[189] And further, that the originating carrier (or the carrier with the obligation to pay for call routing) should decide how to route its calls to the terminating carrier, including calls in which the terminating carrier does not want to use the services of an alternative transit provider chosen by the originating carrier.[190] As different types of providers enter the market and the number of overall providers expands, it is essential that they both minimize interconnection costs and avoid unnecessary disputes relating to interconnection via tandem transit providers.[191]

Moreover, while the Authors agree that phantom traffic is an issue that needs to be addressed, tandem transit providers only should be required to collect reciprocal compensation from the originating carrier on the terminating carrier's behalf if the transit providers contribute to the problem.[192] At minimum, as the Reform Proposal envisions, the transiting carrier should not be held fiscally accountable if it provides enough information for the terminating carrier to identify the telephone carrier responsible for originating the call.

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188. For example, in Illinois, Neutral Tandem delivers traffic on behalf of nineteen of the largest facilities-based carriers in the state, and also transits approximately fifty percent of all local transit traffic in the state. *See* Illinois Order, *supra* note 4, at 2.

189. Although not the subject of this article, the Authors recognize that it may be appropriate to install some limitations to the transit provider's nondiscriminatory right to interconnection. For example, if a terminating carrier receives only a *de minimis* amount of traffic from a certain tandem transit provider, the originating carrier's choice to use the tandem transit provider could impose an inefficient, costly connection on the terminating carrier. For this reason, it may be appropriate to limit nondiscriminatory interconnection rights to situations when the competitive tandem provider pays the terminating carrier for the direct connection and efficient amounts of traffic are exchanged between the two.

190. MISSOULA PLAN, *supra* note 86, at 50.

191. *See Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*, *supra* note 2, app. C, at para. 269.

192. *See also* MISSOULA PLAN, *supra* note 86, at 51.

The FCC also should look unfavorably at demands for mandatory caps on transit rates. To be sure, where the former monopolist incumbents are the only source of tandem transiting services, some price regulation of transiting rates may be appropriate. However, as it has in other contexts, one would expect the FCC to find that once facilities-based competitive alternatives are available, allowing the market to set rates is the best method to encourage the continued growth of competition in those markets.[193]

Attempting to regulate ILEC transit rates based on TELRIC methodology would appear to raise particular concerns.[194] The TELRIC methodology historically has been applied only to the prices of network elements or unbundled network elements (UNEs), that "enable new firms to enter the field despite the advantages of the incumbent[s]."[195] And even in this context, many critics have argued that the TELRIC methodology discourages investment, market entry, and competition.[196] TELRIC rates often do not cover the actual costs incurred by incumbents because the prices are established from the "regulators" estimate of the costs that would

193. Notably, in the past, the FCC has favored market pricing for incumbent services when competitive alternatives are available. *See, e.g.*, Access Charge Reform, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 F.C.C.R. 14221, para. 80 (Aug. 27, 1999) [hereinafter *Pricing Flexibility Order*].

194. Under the Proposed Order, some interconnection costs would be regulated under the "incremental cost methodology." *Comprehensive Reform Order and Nov. 2008 Proposed Rulemaking*, *supra* note 2, app. A, at paras. 236-68; *see also id.* app. C, at paras. 231-63. While the incremental cost standard is not the subject of this Article, the Authors do not believe that this standard should have any applicability in the transiting context. As some have noted, the rule "forces each terminating carrier to *look first to its own end users* for recovery of joint and common costs." Embarq Dec. 2008 Reply Comments, *supra* note 130, at 19-20 (quoting AT&T Nov. 2008 Comments, *supra* note 126, at 10). On its face, the proposal should not be applicable to competitive transit providers who have no end-users. Setting rates at such levels could therefore hurt the growth of competitive transit providers.

195. U.S. Telecom Ass'n v. FCC, 359 F.3d 554, 561 (D.C. Cir. 2004) (referencing 47 U.S.C. § 251(c)(3), (d) (2000)). Notably, when the Supreme Court issued its ruling affirming the FCC's implementation of TELRIC pricing in the context of UNEs, the Supreme Court did not state that it believed that TELRIC pricing was the best or even a good pricing methodology. It only concluded that the FCC's adoption of the methodology did not abuse its discretion. *See* Verizon Comm. Inc. v. FCC, 535 U.S. 467, 495 (2002).

196. *See e.g.*, Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Services by Incumbent Local Exchange Carriers, *Notice of Proposed Rulemaking*, 18 F.C.C.R. 18945 (Sept. 15, 2003) (noting the administrative costs imposed on state commissions to set transiting rates and the criticism of commenters of TELRIC rates); Johannes M. Bauer & Steven S. Wildman, *Looking Backwards and Looking Forwards in Contemplating the Next Rewrite of the Communications Act*, 58 FED. COMM. L.J. 415, 425-26 (2006) (noting generally that TELRIC rates may fail to accurately reflect actual costs); Richard A. Epstein, *Takings, Commons, and Associations: Why the Telecommunications Act of 1996 Misfired*, 22 YALE L.J. ON REG. 315 (2005) (noting that TELRIC likely fails to accurately reflect actual costs incurred).

be borne today by a hypothetical firm building the most efficient network the regulator believes possible."[197] "Each unbundling of an element imposes costs of its own, spreading the disincentive to invest in innovation and creating complex issues of managing shared facilities."[198] In fact, for this reason, the FCC has been directed to not automatically classify all incumbent facilities as a UNE subject to TELRIC rates.[199] Instead, the FCC will consider whether "the failure to provide access to such network elements would *impair* the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer."[200]

Irrespective of the legal merits of the TELRIC pricing concept in the UNE context, it seems particularly ill-suited as applied to a market where facilities-based competition has already arisen. It is hard to imagine why any carriers would enter the transit market knowing that they may not be able to earn any profits—or potentially not recover even the capital invested to build the facilities—from offering the service.[201]

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197. Jerry Ellig & James Nicholas Taylor, *What Did the Unbundled Network Element Platform Cost?* 14 COMMLAW CONSPECTUS 1, 10, 17-19 (2005).

198. U.S. Telecom Ass'n v. FCC, 290 F.3d 415, 427 (D.C. Cir. 2005).

199. *U.S. Telecom Ass'n*, 359 F.3d at 570.

200. *Id.* at 561 (citing 47 U.S.C. § 251(d)(2) (2000)). Although this is not the focus of this Article, the Authors also note that the impairment standard in § 251(d)(2) which mandates the imposition of TELRIC rates is not appropriate in the transit context. Section 251(d)(2)'s impairment standard

> . . . is not [designed] to provide the widest possible unbundling, or to guarantee competitors access to ILEC network elements at the lowest price that government may lawfully mandate. Rather, its purpose is to stimulate competition-preferably [sic] genuine, facilities-based competition. Where competitors have access to necessary inputs at rates that allow competition not only to survive but to flourish, it is hard to see any need for the Commission to impose the costs of mandatory unbundling.

*U.S. Telecom Ass'n*, 359 F.3d at 576. Thus, the FCC's decision to impose TELRIC must consider the availability of other equivalent services. *See id.* Notably, the D.C. Circuit's decision in *U.S. Telecom Association* pertained to ILEC access services. ILEC special access and switched access services can provide a substitute for transit service by enabling third parties to use ILEC facilities to terminate transit traffic. *Id.* at 574. Moreover, like in the transiting context, thriving growth and competition in the cellular carrier industry "demonstrates that existing rates outside the compulsion of § 251(c)(3) don't impede competition;" and therefore cannot "justify a finding of impairment." *Id.* at 576-77. Similarly, as a result of the widespread ILEC and non-ILEC alternatives to transit, the significant growth and competition across the telecommunications industry, and the availability of more limited measures, classifying transit as a UNE and applying TELRIC pricing does not appear consistent with the impairment standard.

201. For example, Howard Shelanski noted that the low rates set by TELRIC "deter the incumbent from investing in its network and deter entrants from building their own networks by providing them with subsidized use of the incumbent's network. The result is less investment by incumbents and entrants alike, less innovation, and less price competition over time for consumers." Howard A. Shelanski, *Adjusting Regulation to Competition: Toward a New Model for U.S. Telecommunications Policy*, 24 YALE J. ON REG. 55, 82-83 (2007); *see also* Thomas W. Hazlett, *Rivalrous Telecommunications Networks With and*

Notably, many of the comments advocating continued rate regulation for transit services, under TELRIC or otherwise, appear to base their arguments on the assumption that effective competition does not exist for transiting services. To be sure, the competitive landscape surrounding transit services may look significantly different today from how it looked even a few years ago. But those differences can be very important in terms of the FCC's consideration regarding whether and to what extent regulation is appropriate in this market segment.

## VI. CONCLUSION

In sum, the Authors believe that if the FCC addresses tandem transit services as part of intercarrier compensation reform, it should only adopt the proposals in the Missoula Plan and in the November 5, 2008 Reform Proposal that would facilitate the continued development of competition in this market segment. Specifically, the FCC should act quickly to ensure that tandem providers have a clear right to direct interconnection. Rate regulation is inappropriate in markets where facilities-based competition already exists, and regulating transit rates based on a TELRIC methodology is particularly problematic. If the FCC intends to address transit pricing, it should carefully study whether continued rate regulation is needed in such markets.[202]

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*Without Mandatory Sharing*, 58 FED. COMM. L.J. 477, 488 (2006) (noting that as UNE-P lines increased, facilities-based entry flattened and ILEC investment in networks fell to just 13.5% of revenue).

202. For example, in the context of private line services, the FCC has previously used the status of competition in the market as a benchmark for deregulating pricing of incumbent services. *See Pricing Flexibility Order*, *supra* note 193, paras. 72-80 (adopting a two-tier framework for relaxing regulation of incumbent provisioning of dedicated transport services, once certain competitive thresholds have been met in a given metropolitan statistical area); *see also* Worldcom, Inc. v. FCC, 238 F.3d 449, 452-53 (D.C. Cir. 2001) (rejecting a challenge to the FCC's *Pricing Flexibility Order*, *supra* note 193).