VI. Transport and Termination of Local Calls, Commission Issue No. 3

Q. Regarding Issue No. 3, intercarrier transport and termination charges for local calls, how are these charges treated in Act 225 and TA96?

A. Act 225 requires the Commission to ensure that carriers are fairly compensated for transport and termination services, including "reasonable and necessary" costs of provision. The Act allows carriers to negotiate reasonable arrangements, including bill and keep, "pending tariff access rates to be set by the Commission." [Section 269-D.]

TA96 provides that determinations by a state commission of just and reasonable rates for these services is to be reciprocal and cost-based:

> (2) CHARGES FOR TRANSPORT AND TERMINATION OF TRAFFIC-
> (A) IN GENERAL- For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless--
> (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and
> (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls. [Section 252(d)(2).]

Q. How does the FCC treat transport and termination charges in its *Interconnection Order?*

A. In a stayed portion of the Order, the FCC gives states a choice of methods in setting prices for local interconnection: they can conduct their own cost studies or adopt a default price using FCC guidelines. A state choosing the second option must subsequently adopt a cost study, request the FCC to do so, or accept dictation from the FCC on modifications to its default pricing. As a third alternative, in some circumstances states may order a "bill and keep" arrangement. [Para.1055.]

The FCC's Order requires that interconnecting carriers use a forward-looking, economic cost-based approach in pricing mutual transport and termination. [Para. 1054.] Furthermore, the Order specifies that with respect to traffic termination, this total element long run incremental cost (TELRIC) approach must not include loop costs. [Para. 1057.] This is in sharp contrast with switched access pricing (for the transport and termination of long distance calls), where prices have historically been set at relatively high levels, based upon recovery of embedded costs, including local loop costs.

Because the FCC has ruled that the rates for transport and termination of local traffic are presumptively symmetrical [Para. 1089.], the rates for the dominant incumbent LEC, established on the basis of a cost study or a default proxy, will be the rates charged by all competing carriers in the ILEC's service area, but the FCC assumes that large ILECs will conduct the studies. [Para. 1085.]

In other words, the FCC allows this Commission to use the cost study results of GTE Hawaiian Tel not only as the basis for prices charged by the Company for the termination of local calls on its network, but also as the basis for the prices charged by its competitors for the termination of local calls on their networks. The reciprocal nature of these rates is extremely important to understanding the impact of these rates. Regardless of whether relatively high or low interconnection rates are set, the net impact on individual LECs will be muted, since all of the LECs will be both paying and receiving the rates in question.

Q. Doesn't this imply that bill-and-keep is the obvious choice?

A. Under some conditions, bill-and-keep (i.e., mutual traffic exchange) is an economical and administratively simple method for the settling of interconnection charges. GTE Hawaiian Tel and AT&T have agreed on that method for their temporary compensation arrangement. Some parties have argued that it is also a good permanent system to use, assuming there is a lack of clear evidence of traffic imbalances. The FCC sanctions bill-and-keep "if traffic is roughly balanced in the two directions and neither carrier has rebutted the presumption of symmetrical rates." [*Interconnection Order,* para. 1112.] Furthermore,

> [W]e observe that carriers have an incentive to agree to bill-and-keep arrangements if it is economically efficient to do so, and that nothing in the Act prevents parties from agreeing to bill-and-keep arrangements even if a state declines to mandate such arrangements. [*Interconnection Order,* ¶1113.]

Problems can arise with bill-and-keep if the local traffic moving onto one carrier's network does not approximate the traffic moving in the other direction. If the two interconnecting carriers have similar customer mixes, traffic should be in rough balance. However, where a competitive carrier is concentrating on niche markets, traffic may be heavily one-way. I have seen evidence from other states which suggests that substantial traffic imbalances can arise between some LECs in some areas. Thus, any determination in favor of mutual traffic exchange (bill and keep) should include some provision for periodic reviews and true-ups, and for abandonment of the mechanism if the need becomes apparent.

It is also generally presumed that the local calling areas of the incumbent and its competitors will be the same, so that a local call one way will also be a local call the other way. But this may not always be true. In such cases where the local calling scopes differ, the FCC has left the matter to the state commission's discretion.