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TELECOMMUNICATION TRAFFIC PUMPING

Over the past decade, a new, and relatively unknown business practice in the telecommunications industry, known as “traffic pumping” has begun to take hold throughout rural South Dakota, Iowa, and Minnesota causing outcry from major telecommunications providers and forcing state and federal officials to consider taking regulatory actions. So what is traffic pumping and why is it a concerning practice?

Traffic pumping, also known as access stimulation, occurs when a small local exchange company that provides local telephone service in one area contracts with a call service, paying them to route calls through the local exchange carrier’s telephone lines on the way to a different market. The local exchange carrier then collects a per-minute access charge on each call from the long-distance carrier for merely providing connecting service through the local exchange carrier’s lines and shares the access charge with the call service. This practice has allowed local exchange companies to increase income and continue providing telephone services when profits would have otherwise diminished due to the increased use of cellular phones and a decreased use of traditional land lines. Although this practice is legal under federal and state laws, many long-distance carriers have found the practice concerning.

Traditionally, the access fee was not a cause for concern for the large telephone companies. This is because the person making a call paid the long distance carrier a certain amount per minute to make a call and the access fee was included in the per minute long distance cost. When the long distance call ended in, or was routed through a local exchange line, the long distance carrier paid that exchange a fee for use of the line. However, the recent ability to begin telephone calls with the internet, cellular telephones, and free conference call services means the long distance providers are no longer collecting the per minute fee from customers, yet are still forced to pay the fee to local exchange carriers. As a result, the long distance carriers are putting pressure on state and federal governments to put an end to the practice they view as a scam. Yet local exchange carriers view the practice as legitimate and as a viable way to continue providing services to rural telephone customers when their otherwise decreased revenues may force the closure, merger, or sale of the business.

DEVELOPMENT AND TECHNOLOGICAL ADVANCES CONTRIBUTING TO TRAFFIC PUMPING

The long history and development of the telecommunications system in South Dakota has provided the perfect environment for traffic pumping schemes to take root in the

state. In 1878, before South Dakota became a state, one of the first telephone exchange lines in the nation was established between the mining towns of Lead and Deadwood. After the efficiency and cost savings of the exchange line was recognized, an influx of new, local exchange lines were established throughout the state, providing local telephone service to small local markets. Eventually, larger long-distance and connecting carriers began to put up telephone lines to provide connecting service between the some eight hundred small, local exchange markets located in South Dakota as well as service to other states. Through the years, many of these local carriers consolidated or were sold, however, there are still around 80 competitive local exchange companies and around 40 independent, cooperative, municipal, or foreign local exchange companies operating in South Dakota today.

The technological advances over the past decade have also created an atmosphere where traffic pumping has become possible and to a certain extent, necessary. As the popularity of cellular telephones have taken over the traditional land-line telephone services people relied on over the last century, local exchange carriers have lost a large amount of call volume and, as a result, a high percentage of the per-minute connection fees previously received from the connecting carriers. This has forced many carriers to merge or sell off their lines to the larger connectors due to lack of profitability and the high cost of maintaining the telephone wires in the area. The local exchange carriers that have not merged or sold the lines have been left with few options to increase profits due to the set access fee.

Additionally, technological advancements such as the ability to begin free telephone calls through the internet and the advancement and increased use of free conference calls have fostered the increase in traffic pumping schemes. Although these calls may be free to the person initiating the call, the call is eventually routed through traditional land-lines and to a final destination. When the call travels through long-distance lines and onto local exchange lines, the long-distance carrier remains responsible for paying the per-minute access fee to the local exchange carrier at the receiving end of the call, as well as any exchange carrier that the call is routed through. This allows the local exchange carriers to receive money for providing no additional services, so each dollar is purely profit.

Call centers and conference call businesses have recognized the potential behind this scheme and they have contracted with the local exchange carriers to make a profit. In exchange for routing a large volume of calls through a local exchange carrier's lines, the carrier pays the business a portion of the access fee collected from each call which allows the business to offer free services and still make a profit. As a result, long-distance carriers have been left with the bill, subsidizing both the local exchange carrier and the call centers, causing outrage and a demand for change by long-distance carriers.

LAWS AND REGULATIONS CONTRIBUTING TO TRAFFIC PUMPING IN SOUTH DAKOTA

In addition to the historical development throughout the state and the technological advances that have contributed to traffic pumping, federal and state regulations have provided the structure and mandates that have made traffic pumping a profitable practice. Though the federal government began to regulate telecommunications in 1887 it was not until 1934 that the first massive piece of telecommunications legislation, the Communications Act of 1934, was passed by the Federal Government. This Act, created the Federal Communications Commission (FCC) and was intended to expand affordable and reliable service across the nation, reduce interference and noise over the telephone lines, and provide secure services for the purpose of national defense communications. However, the regulations over telephone services provided little incentive for carrier competition and solidified a monopoly in one large interstate long-distance carrier service. Over the years, smaller long distance carriers began to challenge the monopoly over the long distance market and after numerous court challenges, the large company was broken up into smaller regional carriers.

In response, the government passed the Telecommunications Act of 1996 to prevent a new monopoly from developing and to foster competition in the telecommunications area. To further protect competition, the Act mandated that long-distance carriers pay an access fee to local exchange carriers for each minute of a call made to, or routed through, the local exchange lines. This fee was intended to protect rural telephone service by assuring the local exchange carriers collected enough revenue to maintain telephone lines in the area. However, even with the guarantee of the access charge, the decrease in land line use has left many local exchange carriers to find additional sources of revenue.

State laws and regulations over the years have also contributed to this practice. South Dakota has followed the Federal lead and has implemented laws meant to protect communications in the telecommunications area. The state laws protect local exchange carriers and provide for increased competition among carriers. The state has also followed the federal lead and implemented the assessment of access charges on long-distance carriers. Through the years, the Public Utilities Commission has continually supported and approved increases in these charges allowing local exchange carriers within the state to remain viable. In addition, the access charges have allowed stable and reliable telephone services to remain in use throughout the state.

RECENT LAWS AND REGULATIONS THAT ADDRESS TRAFFIC PUMPING

Although traffic pumping is currently a legal and viable practice under both federal and South Dakota law some states, including South Dakota, have recently begun to address the issue. In 2010 South Dakota State Representative Deb Peters introduced HB1097 that would prohibit local exchange carriers providing free or below cost services, or otherwise engaging in traffic pumping practices from assessing access stimulation charges on long distance carriers. The access stimulation charges could still be assessed for reasonable and usual business practices. The bill failed to pass the full House and in 2011, then State Senator Deb Peters introduced SB 87, modeled after the

previous year's legislation. Although this bill eventually passed through the Senate Commerce and Energy Committee, it failed to pass the Senate floor.

Iowa has also taken action on the matter. In 2010, the Iowa Utilities Board passed new rules that allow long-distance companies to petition the Board to change a local exchange carrier's access charges if the calls into the carrier's service area increase by one hundred percent or more over the course of six months. This new rule has recently been used, and eight long distance companies were awarded refunds for the access charges that were paid to certain local exchange carriers.

Despite these efforts, state regulations only reach so far because the states only have authority and jurisdiction to regulate calls that take place entirely within the boundaries of the state. Any calls that cross state lines are considered interstate and must be regulated by the federal government. As such, the FCC has also begun to take action. In 2011, the FCC passed new rules to address the problem by reducing and gradually phasing out some of these access charges.

CONCLUSION

The end result of these regulations is yet to be seen, but the recent Iowa Utilities Board ruling for the refund of access charges paid as a result of traffic pumping may be indicative of the result. If federal and state rules eliminate traffic pumping practices completely, local exchange carriers may not have the ability to make a profit, and may slowly go out of business, merge with other local exchange carriers, or sell to larger companies. This could potentially lead to a decrease in the availability of land line services for rural residents. However, if no action is taken and local exchange carriers continue to use traffic pumping practices, long-distance carriers will continue to pay to subsidize the local exchange companies. As a result, some connecting and long distance carriers have warned that the cost of the access charges will be passed on to long distance customers through an increase in fees and potentially a decrease in services.

This issue memorandum was written by Amanda Reiss, Legislative Attorney for the Legislative Research Council. It is designed to supply background information on the subject and is not a policy statement made by the Legislative Research Council.
