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April 10, 1998

HAND DELIVERY

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Ex Parte Presentation
CC Dkt. No. 96-45 (Report to Congress)

Dear Ms. Salas:

This letter is to notify you that Robert Collet and Barbara Dooley, of the Commercial Internet eXchange Association ("CIX"), Ronald Plesser, and I met yesterday with Commissioner Susan Ness and James Casserly. During the meeting, CIX discussed its position on USF issues and the Commission's upcoming report to Congress, as described in CIX's prior presentations in the above-captioned docket. CIX also provided Commissioner Ness and Mr. Casserly with copies of the attached CIX April 3 and April 7 *ex parte* presentations. In addition, CIX discussed the technical differences of the "connectionless" communications of the Internet as compared to "connection-oriented" communications that prevail in non-Internet and PSTN communications. CIX also discussed the difficulty of classifying an ISP engaged in self-provisioning as an "other provider of interstate telecommunications" under Section 254(d) of the Act.

CIX also met yesterday with Robert Pepper, Chief of the Commission's Office of Plans and Policy, and discussed its position on USF issues and the Commission's upcoming report to Congress, as described in CIX's prior presentations in the above-captioned docket. CIX also provided Mr. Pepper with copies of the attached CIX April 3 and April 7 *ex parte* presentations.

An original and two copies of this letter is transmitted herewith for inclusion in the above-referenced dockets. Should you have any questions concerning this matter, please feel free to contact the undersigned.

Sincerely,

Mark J. O'Connor

cc: Commissioner Susan Ness
James Casserly, Esq.
Dr. Robert Pepper

STAMP IN

April 3, 1998

Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Robert M. Pepper
Chief of Office of Plans and Policy
Federal Communications Commission
1919 M Street, N.W., Room 822
Washington, D.C. 20554

Re: Ex Parte Presentation
CC Docket No 96-45 (Report to Congress)

Dear Chairman Kennard and Dr. Pepper:

The Commercial Internet eXchange Association ("CIX") writes to provide the Commission with additional information for its report to Congress concerning universal service issues. In its comments, CIX set forth responses addressing the questions posed by Congress. In this submission, which is supported by the Coalition of Utah Independent Internet Service Providers (CUISP), the Internet Service Providers Consortium (ISP/C), the Mississippi Internet Service Providers Association (MISPA), and the Western Regional Networks (rural western Utah and Colorado) [Attachment B], we wish to provide additional factual information concerning Internet service providers' (ISPs') payments to support the PSTN.

CIX supports the goals of universal service to keep the cost of telephone service affordable for residential and rural customers. We are strongly opposed, however, to efforts to regulate Internet Service Providers as telecommunications providers in order to subsidize this program.

Far from receiving "subsidized" telecommunications service, as some commentators have suggested in this proceeding, ISPs pay significant percentages of their annual revenues to telecommunications providers. Some of these payments -- multi-line business SLC and PICC charges -- are paid directly as access charges, and were increased by the Commission's access charge order. Other payments, such as those for T1 lines and

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other private lines are paid to carriers, whom we believe pass along federal and state universal service charges to ISPs.

Although no one knows the number of ISPs in the United States, the growth in this industry has been explosive to the great benefit of our economy. In a 1997 survey, CIX established that almost 66% of ISPs in the US were small businesses which had been in business less than three years with less than $1 million in revenues. *Boardwatch* Magazine currently estimates there are over 4000 US ISPs, a 20% increase over 1997; in fact, the number of companies and the growth rate is likely to be considerably higher. Most of this increase can be linked to the establishment of new small businesses in the past two years. Many of these providers are providing service to residential and rural customers—consumers and small businesses—not served by the large national online and Internet service providers.

In Attachment A, we report March 1998 findings from ten Internet service providers which corroborate our March 1997 survey results and give additional details regarding the impact of telecommunication costs on their businesses. Most of the sample (7 companies) are small businesses, two are medium-sized companies, and one is a division of a large multinational company. Most of the companies are either not profitable or only marginally so. Telecommunications costs represent by far the largest percent of both cost of sales and revenues in almost every case. These companies are spending 30-50% or more of revenues on telecommunications costs, and these costs represent 30-50% or more of cost of sales.

These companies buy both business and T-1 and private lines, the mix of which depends on their customer base. The impact of the new SLC and PICC charges, in addition to what is paid on their behalf into universal service by carriers is substantial. With small or non-existent margins today, increased telecommunications costs and business growth requiring more circuits (most ISPs are growing at 5-10% or more *per month*), the portion of operating budget devoted to telecommunications will have a noticeable impact on many companies' ability to stay in business or remain competitive. For ISP businesses to grow and become profitable, they must be able to invest in other areas of their businesses besides telecommunications services.

Even though ISPs indirectly pay into the universal service fund, it remains to be seen whether any have received any benefits from it. One state association of ISPs reports, for example, that not a single member of the association is participating in the USF program to subsidize Internet access for schools and libraries, though they would like to be able to compete for this business.

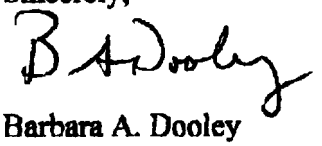
Furthermore, Internet service providers operate in a highly competitive, very low margin business which provides little room to pass along universal service charges or access charges to customers. For this reason, CIX is convinced that imposing increased charges on ISPs would hasten the consolidation of this highly competitive, dynamic industry, significantly reducing the choices available to consumers today.

Exposing ISPs to state and foreign nation regulation by declaring parts of their services to be "telecommunications" would do further damage to the industry, significantly raising the ISPs' regulatory costs and exposing them to being excluded from markets on the ground that they were providing unlicensed telecommunications service.

We strongly urge the FCC to continue to reduce regulation in the implementation of the Telecommunications Act of 1996 and to affirm its decision that Internet Service Providers are not obligated to make direct contributions to the Universal Service Fund.

In accordance with the Commission's *ex parte* rules, two copies of this letter will be submitted to the Commission's Secretary.

Sincerely,



Barbara A. Dooley
Executive Director

ATTACHMENT A

Case 1
A small central Midwestern ISP serving rural and urban customers in two states which has been in business three years. This company has annual revenues of less than $500,000 and telecommunications costs in 1997 represented more than 30% of revenues. Telecommunications costs represented almost 36% of cost of sales in 1997. This company is experiencing 6% increase in its telco orders monthly, almost 75% increase for 1998. The company was profitable in 1997 "because of low salaries."

Case 2
A small provider in Arizona serving both rural and urban customers which has been in business three years. This company's revenues were approximately $650,000 in 1997 and telecommunications costs represented more than 42% of subscriber revenues. It spent 34% of its operating budget on telco in 1997. The company is seeing a phenomenal increase in provisioning expenses, expanding at greater than 200 percent per month. It ran a substantial deficit in 1997.

Case 3:
A small ISP serving urban and rural customers three Northeastern states says it has been in business almost 3 years and it reports "marginal" profitability. The company's revenues approached $400,000 and it paid out 30% of that number in telecommunications costs. The company's telecommunications bill represented 40% of the cost of sales in 1997. This ISP projects a 15% monthly increase in telecommunications circuit provisioning.

Case 4
A small provider in the Southeast (which has done business in several forms since 1993) experienced a cost of communications almost as high as its subscriber revenues and therefore suffered a major loss in 1997. The company's subscriber revenue totaled $360,000 in 1997 and telecommunications costs alone came to 87.5% of subscriber revenues. The provider is expecting to expand its telecommunications provisioning at the rate of 10% per month this year.

Case 5
A small service provider covers urban and rural customers in two north central Midwestern states for the past two years and says it was "barely" profitable in 1997. The company's subscriber revenues came to approximately $400,000 and its telecommunications expenses came to 35% of that. .This company reported telecommunications costs of 40% of the cost of sales. It expects to increase circuit provisioning 10% per month in 1998. The service provider reports that the SLC and PICC charges on its telecommunications bills this year amount to a total telecommunications cost increase of 10%.

Case 6
A small provider in the Mountain region has been in business 4 years and showed a profit in 1997. The company reported revenues of approximately $1 million. Telecommunications costs which represented 34% of those revenues. This company is looking at a 5% monthly increase in telecommunications provisioning in 1998 and says that the new SLC and PICC charges by themselves will affect a 26% increase in telecommunications this year.

Case 7

A small provider in the Southeast says that it did record a profit in 1997 starting out with 1997 subscriber revenues of just over $ 2 million. This company has been in business for 4 years and serves a cross section of urban and rural subscribers. It saw telecommunications as representing 55% of the cost of sales. The company says its plans for 1998 includes a 5% monthly growth in telecommunications provisioning.

Case 8

A large national provider providing backbone services to businesses and ISPs in businss more than five years but not yet profitable. It reported that telecommunications came to 54% of its cost of sales. This company expects to grow its telecommunications circuit provisioning by almost 100% percent this year. The company estimates that since January 1998 there has been a 3% increase in telco costs as a result of SLC increases, but is unable to estimate the impact of PICC charges on its telco costs. It anticipates that these increases will have a small total impact on its total cost of sales in 1998.

Case 9

A growing national provider concentrating on dialup and business customers in the majority of states. They are an established company, in business more than five years, but not yet profitable. In 1997, telecommunications costs represented 30% of revenue. Telco services represented more than 40% of cost of sales in 1997. This company notes that its telco costs are rapidly increasing in 1998 for a number of reasons: 1) their RBOC vendors often will only sell high-cost trunk-side services to them; 2) they are seeing a monthly increase since January 1998 of more than $200,000 because of SLC/PICC and USF costs with an estimated impact on their telecommunications costs in 1998 over more than $2.5 million. These increases are already noticeable in the company's inability to rapidly add QoS and other value-added services which are critically necessary for them to remain competitive in the industry.

Case 10

A large national provider servicing dialup and business customers in the majority of states. Telecommunications services represented more than 22% of its total 1997 costs; their 1998 budget estimated telco costs again at 22% but the estimated impact of increases in SLC/PICC and contributions will cause a significant overall increase in telecommunications costs of more than 5% of almost $4 million this year.

ATTACHMENT B

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November 1997

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Aliant Communications
ANS CO+RE Systems
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JC Information Systems
JTNET Research Institute
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LDS I-America
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Logical NET Corp. (Micros)
MCI Telecommunications
MediaOne
Mikrotec
MIND (Mitsubishi Electric Network Information Co.)
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April 3, 1998

HAND DELIVER

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: Commercial Internet eXchange Association
CC Dkt. No. 96-45 (Report to Congress)
Ex Parte Presentation

Dear Mr. Caton:

In conformity with the Commission's rules, enclosed please find two copies of a written *ex parte* presentation for inclusion in the above-referenced docket. Originals of the attached letter were hand-delivered this day to Chairman Kennard and Mr. Pepper.

Should you have any questions concerning this matter, please contact the undersigned directly.

Sincerely,

Mark J. O'Connor
Counsel for the Commercial Internet
eXchange Association

/mjo
Enclosures

STAMP IN

April 7, 1998

HAND DELIVERY

Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Robert M. Pepper
Chief of Office of Plans and Policy
Federal Communications Commission
1919 M Street, N.W., Room 822
Washington, D.C. 20554

Re: Ex Parte Presentation
CC Docket No. 96-45 (Report to Congress)

Dear Chairman Kennard and Dr. Pepper:

The Commercial Internet eXchange Association ("CIX") writes to provide the Commission with additional information for its report to Congress concerning universal service issues.

CIX would like to clarify the business and carrier relationships which prevail in the ISP industry today. There are any number of entities which provide Internet access services today, including, but not limited to: satellite companies, cable companies, telephone companies, commercial non-facilities-based enhanced service providers, universities and other non-profit organizations, and community or other "freenets." There are literally thousands of Internet access providers in the United States; of the commercial providers, only a small number of the thousands of such providers are carriers or facilities-based providers.

To provide connectivity to the global Internet, an Internet access provider must connect directly or indirectly with an Internet backbone provider which provides the IP routing service for the Internet access provider. These connections are typically T-1 or

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other leased line circuits; the local loop is typically purchased from an ILEC or CLEC and long-haul circuits are purchased from an interexchange carrier.

While a number of the largest U.S. backbone providers today are carriers, many national and regional U.S. backbone providers are not. Many of these companies are extremely large and important customers of carriers; among CIX members, which include many of the largest and growing backbone providers, I am aware of no non-facilities-based enhanced service provider which is engaged in self-provisioning of circuits. In the past three years, I am aware of one former CIX member, no longer in business, which attempted that model. CIX concludes that, of the thousands of commercial ISPs providing Internet access today, few, if any, are ISPs which "self-provision" circuits.

We strongly urge the FCC to continue to reduce regulation in the implementation of the Telecommunications Act of 1996 and to affirm its decision that Internet Service Providers are not obligated to make direct contributions to the Universal Service Fund. I am attaching to this letter a CIX position paper which provides further explanation of our position on the universal service fund report issues.

In accordance with the Commission's *ex parte* rules, two copies of this letter will be submitted to the Commission's Secretary.

Sincerely,

By: Barbara A. Dooley /mjo

Barbara A. Dooley
Executive Director
Commercial Internet eXchange
Association

Enclosure

cc: John Nakahata
James Casserly
Paul Misener
Kyle Dixon
Paul Gallant
Richard Metzger
Regina Keeney

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Commercial Internet eXchange Association
Ex Parte Presentation
CC Docket No. 96-45 (Report to Congress)

The FCC Should Not Back Away From Its Pro-Competitive Internet Policy

One of the major accomplishments of FCC policy during the Clinton Administration has been not to regulate the Internet. By adhering to the Commission's Enhanced Service Provider (ESP) exemption, the FCC has provided the basis for dynamic competition and growth in this new medium. This non-regulatory policy has been critical to the Internet's rapid development as the most promising avenue for convergence, for new forms of commerce, and for human communication.

As the Commission conducts yet another review of the 1996 Act's definitions of "information" and "telecommunications service" in the context of its universal service report to Congress, it should proceed with great care, with full process and opportunities for public comment, lest it undermine this important legacy and risk opening the door to broad regulation of the Internet.

1. Facilities-Based Internet Service

One Commissioner recently floated the notion that facilities-based Internet providers should pay universal service charges in the same way that telecommunications carriers do. While the general aim of this proposal is positive because it seeks to avoid Internet regulation except for payment of universal service charges, the proposal addresses a non-existent problem and would place the FCC's deregulatory legacy toward the Internet at risk:

- The proposal would be very difficult to contain. Establishing that facilities-based Internet service is telecommunications for purposes of USF would invite the FCC and other regulatory bodies to parse other types of Internet services, and to classify them as telecommunications as well.

- The proposal would prompt state PUCs to conduct similar reviews of Internet services, and to consider imposing licensing, rate regulation and other forms of regulation on a competitive medium that is singularly ill-suited to and unprepared for such regulation.

- As a recent Commercial Internet eXchange Association ("CIX") study filed with the FCC indicates, Internet service providers make significant contributions to support the PSTN. They already spend between 30% and 50% *of their annual revenues* on

payments to telecommunications carriers, from which the carriers must make payments directly into the federal and state USF funds.

- The proposal addresses a theoretical concern. The Commission hasn't identified a significant number of facilities-based Internet providers who do not already pay into USF. The additional USF contributions captured from such providers would be minimal.

- The existing system under which telecommunications carriers pay into USF does not create an appreciable incentive for ISPs to provide facilities-based, rather than leased-line, service. The decision whether to lease or to provide facilities-based service in different segments of a ISP's network is a much more complex question than arbitraging the small contribution to the USF fund.

2. Internet Telephony

The Commission is also examining Title II regulation of packet-switched Internet telephony.

- The Commission should gather more information about the nature of such services through an Notice of Inquiry before formulating policy to address the still-nascent Internet telephony business. For example, such services may include significant enhancements that will differ from traditional voice services.

- Classifying such services as "telecommunications" or regulating them would invite foreign governments to shut down Internet phone and other Internet providers for operating without a telecommunications license, thereby eliminating a very useful restraint on foreign settlement charges and aggravating the U.S. trade deficit.

- ISPs are not equipped to police the Internet and are prohibited by law from examining transient communications to know if an end user may be augmenting the ISP's service with the user's own Internet phone software. Accordingly, it is not appropriate to tax ISPs for these end user communications or to ask them to police this traffic.