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EX PARTE OR LATE FILED

May 8, 1998

ORIGINAL

Ex Parte

Ms. Magalie R. Salas
Secretary
Federal Communication Commission
Room 222
1919 M. Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 80-286, Jurisdictional Separations Reform and Referral to the Federal-State Joint Board

CC Docket No. 96-45, Federal-State Joint Board on Universal Service

CC Docket No. 96-262, Access Charge Reform

CCB/CPD CC Docket No. 97-30, Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic

Dear Ms. Salas:

In reference to the issues surrounding Internet Service Provider (ISP) usage, SBC Communications Inc. (SBC) provides the following information regarding:

- The jurisdiction of ISP Internet usage.
- The barrier to local competition and uneconomic market behavior caused by inappropriately applying reciprocal compensation to interstate ISP Internet usage.
- The discriminatory treatment of service providers (IXCs and ISPs) even though their use of local exchange network access is the same (i.e., unequal treatment for same or similar use of access facilities).

- The uneconomic effect of the FCC's exempting IXC access use of the local network.
- Financial and growth data regarding Internet usage.
- A brief analysis of the incorrect arguments of others claiming that ISP Internet usage is subject to reciprocal compensation.

ISP usage is interstate and under the jurisdiction of the FCC. Recognizing the interstate nature of such traffic ensures the intrastate ratepayers do not bear an improper burden, in the form of costs allocated to them, that should be imposed on the interstate jurisdiction, wherein the true costs are situated. The public interest (particularly in the areas of local competition and equality of treatment of service providers) is not advanced by the continuation of the FCC's exemption and the inappropriate application by certain State Commissions of reciprocal compensation to ISP Internet usage.

SBC thanks the Commission for its attention to this very important matter. An original and one copy of this letter and the attachment are being submitted. Acknowledgement and date of receipt of this transmittal are requested. A duplicate transmittal letter is attached for this purpose.

Please include this letter in the record of these proceedings in accordance with Section 1.1206(a)(2) of the Commission's Rules.

Sincerely,

BJ Zimmerman

Attachment

USE OF THE LOCAL EXCHANGE NETWORK BY ISPs IS INTERSTATE ACCESS WHICH IS NOT SUBJECT TO LOCAL RECIPROCAL COMPENSATION

A. IN ITS UNIVERSAL SERVICE REPORT TO CONGRESS, THE FCC ADDRESSED ISP INTERNET USAGE.

1. Several aspects of the report discusses the fact that ISPs carry phone-to-phone Internet usage (¶¶ 14, 83-93), acknowledging that where information is provided for an Internet call, a continuous end-to-end call exists (a transmission component is required to carry the call) (¶¶ 55, 57, 63, 66, 71, 72, 73, 89, 144, FN 138).

2. The report recognizes the hybrid or mixed use nature of Internet calling (¶¶ 61, 64, 75, 91). For instance, Internet calling is telecommunications possibly with an information component and can often simultaneously be interstate or intrastate and performing multiple functions (E-mail, information retrieval, chat, etc.)

3. The report indicates that the USF distinction used to determine the basis of paying support (the status of an ISP as a telecommunications carrier vs. an information service provider) is not determinative as to whether or not reciprocal compensation is appropriate (FN 220).

4. The Commission found that telecommunications are interstate when the communication or transmission originates in any state territory or possession and terminates in another state territory or possession. ¶ 112

5. The report indicates that the FCC will further evaluate the applicability of reciprocal compensation (FN 172, FN 220) and an alternate access structure for Internet usage (¶¶ 91, 100).

B. IMMEDIATE ACTION IS REQUIRED BECAUSE THE CURRENT SITUATION IS HARMING THE PUBLIC INTEREST.

1. Reciprocal compensation for Internet usage creates a jurisdictional overlap of responsibility. The FCC has already asserted jurisdictional interstate authority over Internet calls and usage. (Tab 1, Section A) Where State Commissions have addressed the jurisdiction of Internet usage, they have usurped the FCC jurisdiction, by declaring Internet usage to be local as a result of the FCC's exemption.

    - Interstate Internet costs and usage being claimed as intrastate local by certain State Commissions violates FCC Part 36 Rules.

- These policies of certain State Commissions are at odds with FCC precedent and court cases, beginning with Smith v. Illinois, that require usage and costs to be jurisdictionally assigned based on end-to-end use. (Tab 1, Section B)

2. Inappropriate application of local reciprocal compensation to Internet usage by State Commissions is deterring real competition for residential and business customers.

    - No competitor will willingly service a telecommunications customer who also is an Internet customer because reciprocal compensation payments will exceed the local service rate, as the Example in Tab 2 illustrates. In other words, becoming a local service provider to these customers would result in guaranteed financial losses to the provider.

3. Reciprocal compensation for Internet usage encourages uneconomic and possibly anti-competitive pricing as well as uneconomic, false competition.

    - CLECs are focused on signing up ISPs solely in order to receive windfall reciprocal compensation. (Tab 3)
    - Inducements to ISPs to sign up include below cost pricing by CLECs or even payments by CLECs to ISPs. (Tab 3)
    - Customers may be encouraged to place more and longer calls by CLECs.

4. Other customers using the network in the same manner as ISPs to provide interstate services are subsidizing ISPs and encouraged to engage in uneconomic behavior. (Tab 4)

    - IXCs, resellers and others who use the network in the same manner as ISPs are paying access. They are paying for ISPs' originating interstate use of the loop through the PICC and CCL charges.
    - However, ISPs were provided with an access charge exemption by the FCC.
    - Because the ISPs are no longer an infant industry, the exemption represents an undue preference for ISPs leading to unreasonable access rate discrimination between ISPs, IXCs and resellers for their respective use of local exchange network access.
    - IXCs and resellers are consequently encouraged to uneconomically redirect their usage to ISPs or bypass the local exchange network in order to avoid this harm.
    - IXCs are now creating long-distance calling plans to avoid access and take advantage of the exemption loophole. (Tab 5)

5. Reciprocal compensation for Internet usage has significant financial and operational consequences for incumbent LECs (ILECs).

    - Thousands of trunks are being added and switches reinforced to handle Internet usage. (Tab 6)
    - ILECs are receiving no compensation for these additional access costs when the ISP is connected to a CLEC.
    - ILECs will pay CLECs windfall levels of local reciprocal compensation. (Tab 6)

6. Reciprocal compensation for Internet usage is harming the implementation of the interconnection process intended by Congress.

    - Disputes about the usage between incumbent LECs, CLECs and State Commissions are hampering developing interconnection agreements and the smooth implementation of interconnection.

7. Reciprocal compensation for Internet usage is harming local customers.

    - Competitive options for residential customers will be unavailable.
    - Service quality may deteriorate as customer's increasing Internet usage and holding times stress network capacity.

C. THE FCC's STATED OBJECTIVES ARE:

(1) elimination of unreasonable discrimination and undue preferences among rates for interstate (access) services;
(2) efficient use of the local network;
(3) prevention of uneconomic bypass;
(4) preservation of universal service; and
(5) establishing a pro-competitive and deregulatory policy.

Each of these objectives is undone if Internet usage is considered to be local and subject to reciprocal compensation.

- ISPs receive undue rate preferences compared to IXCs and resellers.
- Customers are uneconomically encouraged to adopt usage patterns that result in inefficient network usage.
- Uneconomic bypass by IXCs is promoted and encouraged due to the undue preference granted to ISPs.
- The financial implications for ILECs will result in harm to service quality and universal service.
- Uneconomic competition for ISPs is incented while a barrier to true competition for residential and business customers is created.

D. TO REMEDY THIS SITUATION IMMEDIATE FURTHER ACTION IS REQUIRED BY THE FCC.

1. Clearly articulate that local reciprocal compensation is inapplicable for this interstate access usage. To recover their access costs for ISP traffic, ILECs and CLECs should be directed by the FCC to charge applicable access rates. With the exemption, the applicable rate is the local business rate. When the exemption is lifted, the rate will be the access rate adopted by the FCC and billed on a meet point basis by the ILEC and CLEC to the ISP.

2. Eliminate the ESP exemption and replace it with an access structure, not only for phone-to-phone Internet services, but for all Internet usage. If usage-based access rates are unacceptable (because of the differing characteristics of Internet calls and the potential effect on Internet users), the FCC should immediately evaluate and implement alternative access structures and rates which would be applicable to this access usage.

3. The jurisdictional issue is and/or has been settled - Internet usage is jurisdictionally interstate. Others are wrong in their assertions that ISP Internet usage is local. (Tab 7) However, the Joint Board in CC Docket 80-286 evaluations could:

   a) Evaluate various measurement identification procedures for Internet usage.

   b) If the FCC believes necessary, evaluate and reaffirm the applicability of the mixed use procedure to Internet.

1

INTERNET CALLS AND USAGE ARE UNDER THE JURISDICTION OF THE FCC

A. THE FCC ASSERTED ITS JURISDICTION OVER ALL INTERNET USAGE AND COSTS TO ACCESS THE INTERNET.

Beginning in 1983, the FCC asserted jurisdictional authority over rates, calls, usage and costs for access to the Internet.

a) The FCC recognized that ESPs (and ISPs) use local exchange facilities (like IXCs and resellers) to complete interstate calls.

b) The FCC recognized that all entities that used the local exchange network should pay for that use on a non-preferential and non-discriminatory basis.

c) The FCC exercised its authority over Internet calls accessing the Internet by granting a transitional exemption from usage based access charges to (1) avoid rate shock and (2) allow usage measurement procedures to be developed to identify Internet usage.

d) Under the FCC exemption, ISPs were treated as end users (only for access rate purposes) and were allowed to obtain network access by purchasing local business lines out of state tariffs.

e) This FCC mandated network access allowed customers to dial seven digits to reach the Internet and initially (as with FGA) traditional jurisdictional measurement procedures assigned this usage to local (because seven digits, not 1+ or 0+, were dialed).

In the March 25, 1998 Ex Parte letter from SBC to the FCC on pages 2 to 8, are brief excerpts from FCC orders dealing with ESP and ISP Internet usage that clearly show that the FCC, over a period of nearly 15 years, viewed this usage to be interstate and under its jurisdiction. The FCC continued to exercise this jurisdictional authority in its First Report and Order, Released May 16, 1997, In the Matter of Access Charge Reform, etc., Docket Nos. 96-262, 94-1, 91-213 and 95-72. In this current Order, the FCC stated:

1. "The term 'enhanced services', which includes access to the Internet ....". 'Enhanced services' are defined in § 64.702(a) of our rules: 'For the purposes of this subpart, the term *enhanced services* shall refer to services, offered over common carrier transmission facilities <u>used in interstate communications</u> . . ' " FN 498. (emphasis added)

2. " . . . usage of interstate information services, and in particular the Internet and other interactive computer networks, has increased significantly." ¶ 341 (emphasis added)

3. "As a result of the decisions the Commission made in the *Access Charge Reconsideration Order,* ISPs may purchase services from incumbent LECs under the same intrastate tariffs available to end users. ISPs may pay business line rates and the appropriate subscriber line charge, rather than interstate access rates, even for calls that appear to traverse state boundaries. The business line rates are significantly lower than the equivalent interstate access charges, given the ISP's high volumes of usage." ¶ 342

4. "In the NPRM, we initially concluded that ISPs should not be required to pay interstate access charges as currently constituted." ¶ 343

5. "We therefore concluded that ISPs should remain classified as end users for purposes of the access charge system." ¶ 348

These comments and others in the 1997 Order clearly show that the FCC, as it has in all of its proceedings from 1983 to the present, continues to assert its jurisdictional authority over rates, usage and costs for access to the Internet.

B. ON AN END-TO-END BASIS, INTERNET CALLS ARE JURISDICTIONALLY INTERSTATE. CONSEQUENTLY, INTERNET ACCESS FACILITIES ARE JURISDICTIONALLY INTERSTATE.

The legal and FCC standard for determining the jurisdiction of a call is its end-to-end use. Even if the transmission has identifiable sub-parts or components (circuit or packet switched, voice or information, LEC or ISP, etc.) an end-to-end transmission must always be analyzed as a single event from its initiation to the ultimate destination that a customer expects to reach.

In the glossary of Part 36 of the FCC's Rules and Regulations (the Separations Manual), station-to-station or end-to-end is defined as: "...The term applied to the basis of toll ratemaking which contemplates that the message toll service charge...covers the use made of all facilities between the originating station and the terminating station, including the stations and the services rendered in connection therewith." In other words, usage is to be measured from the originating customer's end or station to the terminating customer's end or station (not at some intermediate point such as the ISP's location) to determine the call or message jurisdiction. The Manual also defines "message" in the glossary as:

"A completed call, i.e., a communication in which a conversation or exchange of information took place between the calling and called parties." For Internet calls, the ISP's charge to the customer is analogous to the toll charge discussed in the Manual. The jurisdiction of the network access used by ISP customers is determined by the end-to-end destination that the customer wants to reach. On an end-to-end basis, the vast majority of Internet calls are not local but are interstate or international.

C. USAGE MEASUREMENT PROCEDURES ARE NOW AVAILABLE TO IDENTIFY INTERNET ACCESS USAGE.

In the FCC's Memorandum Opinion and Order in CC Docket No. 78-72, released August 22, 1983, at ¶ 84, the FCC stated regarding the ESP exemption that:

> "The case for a transition to avoid this rate shock is made more compelling by our recognition that it will take time to develop a comprehensive plan for detecting all such usage..."

In the FCC's NPRM in CC Docket No. 89-79, released May 9, 1989, at Footnote 67, regarding the ESP usage measurement issue, the FCC stated:

> "We recognize that jurisdictional measurement of enhanced service traffic may present particular difficulties. ESPs may not always be able to discern the ultimate destination of a call (for example, when traffic is transmitted from one packet network to another) and there may be questions concerning whether a single call can have both interstate and intrastate components (for example, when a computer user during a single session interacts sequentially with a number of data bases in different states). Nevertheless, we think the EES method, perhaps with some reasonable accommodations for special circumstances presented by certain types of enhanced traffic, should be workable for ESPs."

In 1991 in a Report and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking in CC Docket Nos. 89-79 and 87-313, released July 11, 1991, at ¶¶ 67 and 68, the FCC rejected the notion that ESP traffic should be measured as local usage:

> "Florida states its belief that '<u>the nature of the access should be determined from the point of the call's origination to the point of the ESP's location</u>' ...Most ESPs argue that the EES method is inadequate. They argue that neither ESP customers nor ESPs are able to ascertain accurately which calls are interstate and

> which are intrastate. They complain that the cost of measuring currently unmeasured traffic would be prohibitive ... Decision. The record does not clearly indicate that a new rule is necessary." (Underlining added, Footnotes deleted).

In a NPRM and NOI in CC Docket Nos. 96-262, 94-1, 91-213 and 96-263 released December 24, 1996, at ¶ 315, the FCC was still seeking information on measurement of Internet usage:

> "...we seek comment on jurisdictional, metering and billing questions, given the difficulty of applying jurisdictional divisions or time sensitive rates to packet-switched networks such as the Internet." (Footnotes deleted)

The FCC, in this series of Orders dealing with measurement of Internet usage has clearly indicated that:

1. Lack of usage measurements for Internet traffic is one of the reasons for continuing the access charge exemption.
2. The jurisdiction of Internet usage is not local because it is not determined based on the location of the originator of the call and the location of the ISP or ESP, but based on the end-to-end destination.
3. Entry/Exit Surrogates (EES) may be used to determine the jurisdiction of Internet usage. Under this method, the jurisdiction would be determined from the ISP's point of presence (POP) to the interstate destination of the call.
4. Further comments on other measurement procedures were requested. For some time SBC has been attempting to develop procedures to identify intrastate usage. EES has not been available from ISPs. Consequently, SBC pursued other measurement possibilities.

As previously discussed in January 20, 1998 and February 23, 1998 letters to the FCC, SBC explained that it has developed measurement procedures to identify Internet usage. These procedures are briefly described in SBC's response to questions in the February 23, 1998 letter and were more fully described in a February 27, 1998 meeting on this issue with the FCC. The procedure SBC utilized requires that SBC identify the seven-digit ISP Internet access number used by the customer and then match all measured originating ISP Internet usage with that number. A more efficient and straightforward process would be for the CLEC to provide to SBC all Internet access numbers for ISPs connected to it which could then be matched with SBC's measured originating usage to determine Internet usage. SBC is providing to CLECs these numbers for its identification of ISP Internet usage. Unfortunately, CLECs have,

as yet, been unwilling to reciprocate. As Internet usage is identified through SBC's measurement process, it is being removed from local and assigned to interstate.

In the March 25, 1998 Ex Parte letter on page 2 are excerpts from three FCC orders regarding the end-to-end basis for determining the jurisdiction of a call.

In addition to the cases cited in that letter, the following FCC and Court cases make it clear that the end-to-end use by the customer determines the jurisdiction of a call. Jurisdiction is not determined by (a) location of facilities (local exchange facilities within a state), (b) the type of facility (circuit switched or packet) or (c) the nature of regulation of the facilities provider.

a) Smith v. Illinois Bell, 282 U.S. 133,150-51 (1930): Notwithstanding "the practical difficulty of dividing the property between the interstate and intrastate services," one cannot "ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden."

b) *United States v. AT&T,* 57 F. Supp. 451, 454 (S.D.N.Y. 1994), *aff'd sub nom. Hotel Astor v. United States,* 325 U.S. 837 (1945) (per curiam). "That the Communications Act contemplates the regulation of interstate wire communication <u>from its inception to its completion</u> is confirmed by the language of the statue and by judicial decisions."

c) *Southwestern Bell Tel. Co. Transmittal Nos. 1537 and 1560 Revisions to Tariff F.C.C. No. 68, Order Designating Issues for Investigation,* CC Docket 88-180 (released April 22, 1988), 3 FCC Rcd. 2339. The FCC confirmed that a call forming a transmission "loop" that passes between two states is interstate, even if one or more segments of its communications path pass through systems that also could serve purely local traffic. For instance, when long-distance carriers began using 1-800 numbers (for credit-card calls and similar purposes), Southwestern Bell contended that two calls were created by the "second dial tone" heard when the long-distance carrier was reached. The FCC rejected that theory because the entire transaction was required to be treated as one communications event. *Id.* ¶¶ 24 - 28, Citing *NARUC v. FCC,* 746 F.2d 1492 (D.C. Cir. 1984), the FCC held that "[s]witching at the credit card switch is an intermediate step in a <u>single end-to-end communication</u>." *Id.* ¶ 28. "[T]he jurisdictional nature of a call is determined by its <u>ultimate</u> origination and termination, and not ... its intermediate routing." *Id.* ¶ 26. *See also United States v. AT&T,* 57 F. Supp. 451 (S.D.N.Y 1944)

(hotel PBX used to make or receive long-distance calls is not a distinct local exchange service, but rather is part of a single end-to-end communication), *aff'd sub nom. Hotel Astor v. United States,* 325 U.S. 837 (1945) (per curiam). (emphasis added)

d) *In re Long Distance/USA, Inc.* (released Feb. 14, 1995), 10 FCC Rcd. 1634, ¶ 13; *see also In re Teleconnect Co.* (released Feb 14, 1995), 10 FCC Rcd. 1626 ¶ 12 (same principles applied). The FCC explained:

"[B]oth court and Commission decisions have considered the end-to-end nature of the communications more significant than the facilities used to complete such communications ... [W]e regulate an interstate wire communication ... from its inception to its completion ... [A] single interstate communication ... does not become two communications because it passes through intermediate switching facilities."

Under this extensive body of precedent, an Internet communication is a single telecommunications event for purposes of jurisdictional analysis, and the location of intermediate facilities cannot transform an interstate event into two jurisdictionally separate components.

That result is not altered in any way by the FCC's Universal Service decision (*Universal Service Order* ¶ 83). That FCC order and the majority of the recent FCC Report to Congress dealt not with whether Internet traffic should be treated as local or interstate, but rather with the wholly unrelated issue of which kinds of services should receive or pay for "Universal Service" support. Nothing in that order or the Report to Congress undermined either the consistent FCC decisions treating Internet communications as interstate or the equally uniform FCC precedent rejecting attempts to bifurcate a single end-to-end communication.

D. THE MIXED USE PRINCIPLE IS APPLICABLE TO INTERNET USAGE

The mixed use of principle, previously applied by the FCC, is applicable to Internet usage, which may be (possibly during a single call) interstate, international or local because:

- Like Feature Group A service, the customer does not dial 1+ or 0+, but normally dials only seven digits to reach an ISP. Consequently, the jurisdiction is not readily identifiable or measurable as a result of the number of digits dialed.

- Numerous interconnected companies including LECs, Competitive Local Exchange Carriers (CLECs), IXCs and ISPs may be involved in handling the

call which may be terminated anywhere in the United States or the world. Consequently, without significant administrative expense to develop a jurisdiction reporting, auditing and verification procedure for all of the parties handling the calls, or significant investment in measuring equipment by all of the parties, the end-to-end jurisdiction of the call cannot be determined. Even if reporting or measuring is attempted, it may be virtually impossible to measure or to determine appropriate reported jurisdictional usage because of the ability of the Internet, on a real time basis, to deliver calls (interstate, intrastate or international) simultaneously.

- Like 800 service calls, numerous calls from anywhere in the United States or the world may be delivered to an Internet bulletin board or a chat line. Consequently, calling can be international, interstate or intrastate.

For these reasons, determining the jurisdiction of ISP Internet usage and segregating it between local, intrastate intraLATA and interstate and intrastate access may be impossible. Even if the Commission were inclined to order ISPs to track the jurisdiction of all calls, it would be virtually impossible for ISPs to comply because the end user may "visit" many different sites during a single connection to the Internet, including more than one site at the same time. Consequently, the usage is interstate because, like the special access service dealt with in the FCC's "contamination" order, (CC Docket Nos. 78-72, 80-286, Released July 20, 1989, Decision and Order), the jurisdiction of ISP Internet calls cannot practically be measured or reported, but on an end-to-end basis, at least ten percent is interstate.

Imperical analysis as well as the few studies that have been done, indicates that well more than 10% of Internet usage is interstate or international. For instance, an analyses performed by SBC indicates that 92 to 99% (depending on the state) of the Internet usage it carries is interstate.

E. RECENT COURT CASES HAVE TREATED INTERNET USAGE AS INTERSTATE

The courts have treated Internet usage as interstate. During the summer of 1996, a three-judge federal panel treated Internet traffic as interstate in nature. The issue in *ACLU v. Reno,* 929 F. Supp. 824 (E.D. Pa. 1996), was whether First Amendment rights for Internet communications were infringed by the Communications Decency Act (the "CDA"; part of the 1996 Act, codified at 47 U.S.C § 223). Because the relevant provision applies only to "interstate or foreign communications" (47 U.S.C. § 223(a)(1)), the statue would be entirely inapplicable to Internet traffic if it were not interstate. While the court struck down portions of the CDA, the pertinent point here is that the court

necessarily understood Internet communications to be interstate. See, 929 F. Supp. at 830-44 (describing the nature, function and uses of the Internet).

This *Reno* decision was consistent with other contemporaneous precedent treating the Internet as inherently interstate. For example, *Malarkey-Taylor Assocs., Inc., v. Cellular Telecomm. Indus. Ass'n, 929* F. Supp. 473 (D.D.C 1996), applied the Lanham Act, which has an "interstate commerce" element, to statements made on an Internet site. In addition, ISPs had been recognized as intermediaries, not the "termination" point of Internet connections. *Religious Tech. Ctr. v. Netcom On-Line Comm. Servs., Inc.*, 907 F. Supp. 1361 (N.D. Cal. 1995), involved Netcom, a "large Internet access provider" (*id.* at 1365) that did "not create or control the content of the information available to its subscriber" (*id.* at 1368). The court noted that although Netcom's computer systems copied and stored information its subscribers sent onto or gathered from the Internet, "Netcom compares itself to a common carrier that merely acts as a passive conduit for information." *Id.* at 1369 & n. 12.

The Supreme Court issued an opinion agreeing with the District Court's ruling in *Reno* and again treated Internet communications as subject to the CDA (and, thus, as jurisdictionally interstate traffic). *Reno v. American Civil Liberties Union,* ____ U.S. ____, 117 S.Ct. 2329 (1997). Describing the Internet as "an international network of interconnected computers" (*id.*, 117 S.Ct. at 2334) that allowed information "stored in different computers all over the world" to be available to a "world-wide audience" (*id* at 2335), the Court analyzed section 223(a) (*id.* at 2338) and partially invalidated it (*id* at 2351). The Court made it clear that the Internet is a world-wide network, not "located in [any] particular geographical location" (*id.* at 2335).

Other federal court decisions are in accord with this understanding. For instance, in *American Libraries Ass'n v. Pataki,* 969 F. Supp. 160 (S.D.N.Y. 1997), the district court struck down a New York State statute that purported to regulate Internet communications. Describing the Internet as "a decentralized, global communications medium" (*id.* at 164), the court rejected the State's argument that its Act was "aimed solely at intrastate conduct" (*id.* at 169). "The New York Act," wrote the court, "cannot effectively be limited to purely intrastate communications over the Internet because no such communications exist. No user could reliably restrict her communications only to New York recipients." *Id.* at 171.

In *Planned Parenthood Federation v. Bucci,* 1997 WL 133313, S.D.N.Y., S.D.N.Y., Mar. 24, 1997, at *3, the court wrote that "Internet users constitute a national, even international, audience, who must use interstate telephone lines to access defendant's web site on the Internet." The court also held that web

sites accessible to Internet users "satisfy the Lanham Act's 'in [interstate] commerce' requirement") (copy in Appendix B, at Tab B-2). *See also United States v. Carroll,* 105 F.3d 740, 742 (1st Cir. 1997) ("Transmission of photographs by means of the Internet is tantamount to moving photographs across state lines and thus constitutes transportation in interstate commerce" for purposes of federal criminal laws), *cert. denied* 117 S.Ct. 2424 (1997); *Bensusan Restaurant Corp. v. King,* 937 F. Supp. 295 (S.D.N.Y 1996) (for *in personam* jurisdiction analysis, a web site located in Missouri is not "local" in New York, and the site's accessibility from there does not create personal jurisdiction).

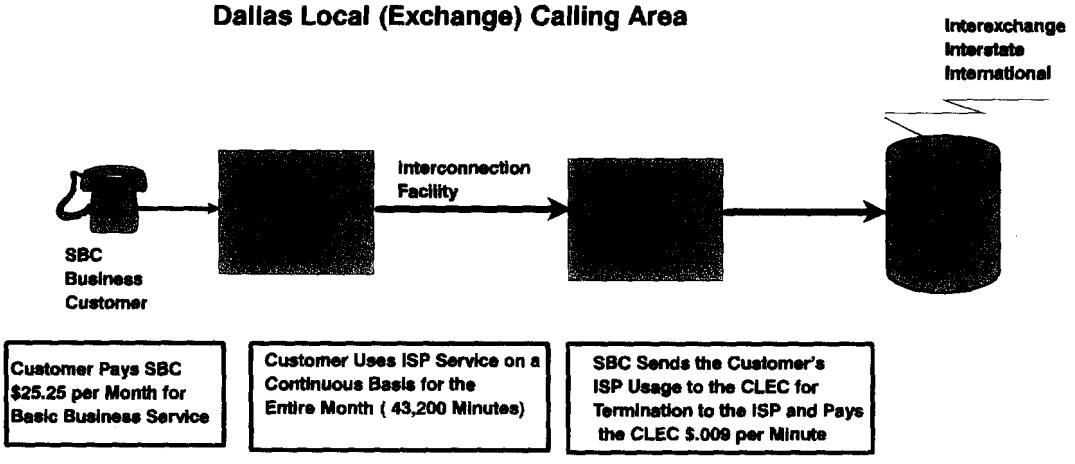
These decisions establish beyond doubt that the law in existence at the time these agreements were executed -- and indeed the law in existence today -- was that Internet communications constitute interstate and thus not "local traffic."

2

RECIPROCAL COMPENSATION FOR ISP USAGE CAUSES A BARRIER TO RESIDENTIAL AND BUSINESS COMPETITION

As the following example shows, because of the financial losses that will be incurred due to payment of (or potential payment of) reciprocal compensation, CLECs will be disincented from being the local exchange telecommunications provider for residential or business customers who are also ISP customers (i.e., have Internet service from an ISP).

A SBC local exchange customer with individual line business service in Dallas, Texas pays an average basic local service flat rate of approximately $25.25 per month. If that customer dials an Information Service Provider connected behind a Competitive Local Exchange Company ("CLEC") and maintains the connection during the entire month, SBC would inappropriately be required to pay the CLEC $388.80 (24 hours x 60 minutes per hour x 30 days x $.009 terminating compensation) reciprocal compensation. Consequently, SBC would lose $363.55 in the provision of service to that customer. Even if the ISP customer only uses ISP access for slightly more than 1½ hours per day,[1] SBC's $25.25 monthly rate is wiped out and SBC would receive no revenue for its cost of providing normal[2] local business service.



[1] The study described in Tab 6, Section C 2, indicates that the actual per day Internet per customer usage is 100 minutes or 1.67 hours. This equates to approximately $27.00 per month (100 min./day x 30 days x .009¢/MOU).

[2] This comparison assumes the local business residential service flat rate was intended to provide revenue sufficient to cover ISP Internet usage. However, local rates for SBC services are unrelated to ISP usage. SBC made this comparison to illustrate the financial loss associated with applying reciprocal compensation to interstate Internet usage. Local flat rates were, however, designed to cover average local exchange calling of approximately 3.6 minutes per call in Texas for SBC not ISP Internet calls, which in Texas are averaging over 26 minutes per call. More importantly, ISP calls, like IXC toll calls are access calls. The ISP should pay the access provider, CLEC or LEC, for its use of the local exchange network and not assume, wrongly, that local exchange flat rates cover the costs of ISP access. The local flat rate is for service that the local service provider SBC or CLEC provides to its customers, not service provided to ISP customers.

This situation is even worse for a residential customer who pays SBC in Texas an average basic local service flat rate of approximately $9.50 per month. Here, even if the ISP customer only uses ISP access for slightly more than ½ hour per day,[1] SBC's monthly residential flat rate is wiped out and SBC would receive no revenue for its cost of providing normal[2] local residential service.

It is clear that if local reciprocal compensation is paid for Internet usage, any new competitive local company would not willingly replace SBC as the customers local provider because of the financial losses that it would incur if that customer has ISP service. It is also unlikely that the CLEC would be willing to serve these customers even if it also had the ISP connected to it because of the likelihood that the ISP could be incented to disconnect and reconnect its service to another CLEC.

As this real world example shows, allowing the continuation of local reciprocal compensation for any interstate Internet usage is not furthering competitive entry as alleged by some, but is in fact a barrier to local competition for residential and business customers.

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[2] This comparison assumes the local business residential service flat rate was intended to provide revenue sufficient to cover ISP Internet usage. However, local rates for SBC services are unrelated to ISP usage. SBC made this comparison to illustrate the financial loss associated with applying reciprocal compensation to interstate Internet usage. Local flat rates were, however, designed to cover average local exchange calling of approximately 3.6 minutes per call in Texas for SBC not ISP Internet calls, which in Texas are averaging over 26 minutes per call. More importantly, ISP calls, like IXC toll calls are access calls. The ISP should pay the access provider, CLEC or LEC, for its use of the local exchange network and not assume, wrongly, that local exchange flat rates cover the costs of ISP access. The local flat rate is for service that the local service provider SBC or CLEC provides to its customers, not service provided to ISP customers.

3

RECIPROCAL COMPENSATION FOR INTERNET USAGE IS INCENTING UNECONOMIC AND POSSIBLY ANTI-COMPETITIVE MARKET BEHAVIOR BY CLECs.

With the expectation of receiving reciprocal compensation payments by ILECs for ISP Internet usage, CLECs may be pricing service to ISPs below cost or even paying ISPs to sign up.

Attached is an Internet advertisement by Pac-West (a CLEC in California) which offers free service to ISPs (clearly below Pac-West's cost) or is even offering to pay ISPs to sign up. This advertisement explains that ISPs can "Get Paid For Offering FREE Internet Access." In other words, instead of charging the ISP to connect to their network, CLECs instead can remit some of their inappropriately gained* local reciprocal compensation payments to pay these ISPs for connecting to the CLECs. These incentives, offered by Pac-West and other CLECs to sign up ISPs, are not based on the CLEC being an efficient carrier. Instead, these incentives are being supported by a regulatory framework that allows carriers to "game" the system by receiving local reciprocal compensation payments from other LECs that transport originating interstate Internet traffic.

This practice is the equivalent of a broken ATM machine giving away money to whomever plugs into it. It is obvious that this arrangement is fundamentally unfair to the carrier that does not serve the ISP and at odds with the goal of true local exchange competition. It is readily apparent that this type of recovery, if sanctioned, leads to competitive abuses.

Note also that Pac-West is offering 4.9¢ per minute long-distance rates by inappropriately using the FCC's ISP exemption to avoid access rates.

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* Internet usage is not appropriately subject to local reciprocal compensation because Internet usage is interstate access which is subject to the FCC's jurisdiction.

Advanced Telecommunications for Today's Business

Your Full Service Telephone Company Throughout California!

- Home
- Company Info
- Employment
- Contacts
- Customer Service
- Online Sign-Up

NEW! Internet Service Providers SERVICES

HearMail E-Mail to Voice Fax to Voice

Long Distance as low as 4.9¢ per min

Data BACKUP only $9.95/month

Win $1000 California Residents

Local Dial-Up Services for Internet Service Providers

Click Here to find out why you should be with Pac-West

NEW! 56Kbps Modems: Questions and Answers

NEW! Bargain Priced High Quality Long Distance
Fiber Optic Quality and 5 Star Service from 4.9¢ per minute
Click Here for details.

Constant Touch® VoiceMail has arrived!
Click Here for details on this exciting new service.

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Services for Internet Service Providers

A New Concept in Incoming Telephone Service Offers ISP's These Benefits

Better Service, Lower Costs, More Customers
Get Paid for Offering FREE Internet Access
Local Access Numbers Everywhere in Northern or Southern California
With No Mileage Charges
Multiple Simultaneous Calls On Every Number - No Hunting Charges
Service From a Major California Based Telephone Company
100% Compatible With 56Kbps Modems (based on manufacturer's information)

Better Service, Lower Costs, More Customers

If someone could help you:

- Improve your level of customer service while spending less
- Increase your "local telephone number" coverage while reducing your phone bill
- Expand your service offering into new geographic areas at a minimal cost
- Offer FREE Internet access and get paid for it
- Offer 56Kpbs dial up service at a very reasonable cost

Would that interest you?

Pac-West allows all of the above and more! If that interests you, please read on...

FREE Internet Access

Would the ability to advertise and offer FREE Internet access to your customers, while getting paid approximately the same per hour of use as you receive on your high usage $19.95 per month Internet access help you get new customers?

Would that interest you?

No Mileage Charges

Would foreign exchange type service that offers a local call from virtually any city in Northern or Southern California for only $10 per month with NO per minute charges and NO mileage costs,

help you get more sales and more profits?

Would that interest you?

Multiple Simultaneous Calls

What if each telephone number your customers dial could carry multiple simultaneous calls for the same single $10 a month charge? What if any additional trunks needed to carry your calls to the telephone company's switch were added without you having to ask, and without any charge to you? Would that increase your level of service, decrease your customer complaints and save you money?

Would that interest you?

Better Service with Fewer Modems

What if all your calls from all over Northern or Southern California were aggregated into one common modem pool so you could increase the number of users per modem while actually increasing the level of service you provide? Think of the money you would save on modems as you grow and the customer complaints that would go away.

Would that interest you?

Offered By A Major Telephone Company

What if the company that offered you that service was a large telephone company with over fifteen years experience in California and is already handling over 2 1/2 million calls a day?

Would that interest you?

Offers Digital Trunks That Support 56Kbps Modems

What if there were a very economic way to offer 56Kbps dial up service with any one or all of the three 56Kbps modem technologies being offered?

Would that interest you?

Your Competitors Are Doing It

What if your competitors took advantage of this offer to expand their service areas, improve their quality of service and reduce their costs and you didn't?

Would that affect your business ?

To receive a written proposal on the new
telecommunications service for ISP's
Click Here

To arrange to talk to us about how you can take advantage
of the
new telecommunications service for ISP's, email us at:
ispsales@pacwest.com

To find out more about offering 56Kbps service
Click Here

To find our more about Pac-West Telecomm
Click Here