

ORIGINAL

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Susanne Guyer
Executive Director
Federal Regulatory Division

EX PARTE OR LATE FILED



September 17, 1998

Ex Parte

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, DC 20554

RECEIVED

SEP 17 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: **Docket CCB/CPD 97-30 and CC Docket No. 96-98, Reciprocal Compensation**

Dear Ms. Salas:

Yesterday, Mr. F. Gumper and I, representing Bell Atlantic, met with Mr. Y. Varma, Deputy to the Common Carrier Bureau Chief and Mr. R. Cameron, Legal Advisor to Mr. Varma. During the meeting, the Bell Atlantic representatives raised the issue of reciprocal compensation. The Bell Atlantic representatives explained the significant public policy consequences of the continued application of reciprocal compensation payments to Internet bound calls. The Commission should address the issue now and declare that Internet-bound calls are not local and therefore not subject to reciprocal compensation payments. The attached letters, previously filed with the Commission, were used as a basis for discussion.

In accordance with Section 1.1206(a)(1) of the Commission's rules, an original and one copy of this notice are being submitted to the Secretary.

Sincerely,

Susanne Guyer
Susanne Guyer

Attachment

cc: Y. Varma
R. Cameron

No. of Copies rec'd 023
List A B C D E

Bell Atlantic
1300 I Street, N.W.
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Washington, D.C. 20005
(202) 336-7900



July 1, 1998

By Hand

The Honorable William E. Kennard
Chairman
Federal Communications Commission
1919 M Street, NW – Room 814
Washington, D.C. 20554

Re: Reciprocal Compensation for Internet Traffic

Dear Chairman Kennard:

The payment of reciprocal compensation for Internet-bound calls is distorting the market, undermining competition in residential telephony, and discouraging the deployment of high-speed networks.

Therefore, there is an urgent need for action by the Federal Communications Commission to confirm that Internet-bound calls are not local calls, and are not subject to the payment of reciprocal compensation.

Based on a mistaken interpretation of this Commission's prior orders, state commissions have classified calls bound for the Internet – and through it to other Internet users around the globe – as "local" calls. These decisions require telephone companies that provide local service to residential and other dial-up users of the Internet to pay "reciprocal" compensation when these calls are handed off to another carrier for delivery to an Internet service provider.

As one independent analyst puts it, this creates the "single greatest arbitrage opportunity and hence market distortion in the telecom sector today;" deters competition for residence and other dial-up users of the Internet because it has the "perverse effect of turning customers from assets into liabilities;" and discourages economically sound investment. (Attachment 1).

Reciprocal compensation pays carriers not to compete. Because it is available only when a customer's line is served by another carrier, Internet reciprocal compensation actually pays carriers not to invest in their own competing facilities and not to provide their own competing service to residence or small business customers.

The reason is simple: If competing carriers sign up residential or other dial-up Internet users for their own local services, they can kiss the risk-free cash from reciprocal compensation on those lines goodbye. Plus, they then have to pay reciprocal compensation when they hand off calls to another carrier for delivery to an Internet service provider.

The amount that carriers are being paid to not compete has ballooned along with the use of the Internet. Bell Atlantic alone will pay more than \$150 million during 1998 and more than \$300 million during 1999. The overwhelming majority of this money, roughly three-quarters in our case, currently goes to only two massive combines – Worldcom/MCI and AT&T/TCG.

Ironically, if a family or small business uses the Internet for as little as two hours a day, the reciprocal compensation typically totals more than the customer pays for the line. And if the customer leaves its computer connected to the Internet all the time, the reciprocal compensation can total \$300 per month.

The ability to receive this kind of windfall deters competition, and at the same time creates an enormous drain on companies that have made the investment necessary to provide local service.

Reciprocal compensation pays people money for nothing. The ability to get reciprocal compensation without providing local dial tone service to even a single customer distorts behavior in other ways.

For example, Internet service providers have begun setting up shop as “carriers” for the sole purpose of getting paid reciprocal compensation for the Internet traffic that is delivered to them. One example is illustrative: During the first quarter of this year alone, just one of these “carriers” that provides no dial tone to anyone, sends essentially no traffic to us, and whose customer service representative says is not offering local telephone service, collected several million dollars in reciprocal compensation – all to provide the same Internet service it provided before it re-labeled itself a “carrier.”

The payment of Internet reciprocal compensation has so distorted incentives that, region-wide, the number of minutes we hand off to competing carriers is approaching ten times the number of minutes they send to us. In some of our states, the ratio is more than fifty to one. These ratios are driven, of course, by the carriers’ increasing focus on fronting for Internet service providers in order to get the easy cash from reciprocal compensation.

The lure of free cash also inspires conduct bordering on fraud. Because reciprocal compensation is available only for calls that begin and end in the same local calling area,

some carriers have assigned multiple blocks of numbers to Internet service providers – each attributable to a different local calling area – in order to make calls to those providers from distant calling areas appear “local.” In fact, one Internet service provider cum carrier has locked up well over 100 NXXs – representing over a million numbers – all without a single local telephone customer.

These illicit activities only exacerbate the problem, deprive the originating carriers of toll revenues they are entitled to, and contribute to the rapid exhaustion of numbers to boot.

Reciprocal compensation deters investment. The payment of reciprocal compensation not only deters investment in local facilities by competitors, it also deters investment by all carriers in new technologies that could be used to handle this traffic more efficiently.

Although Internet-bound traffic could be handled more efficiently by moving it off the circuit-switched network, and onto more efficient packet-switched technologies, there is no incentive to deploy these technologies if they won't be used. But the fundamental problem is that, as long as Internet service providers (or their carrier affiliates) can get paid reciprocal compensation if they stay on the circuit-switched network, they have little incentive to move to new packet-switched technologies, no matter how reasonably priced. And so long as no one is willing to use these new technologies, there is little incentive for originating carriers to deploy them in the first place.

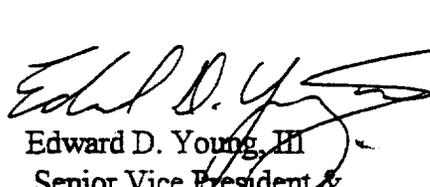
In light of these facts, the Commission must act now to correct the mistaken interpretation of its orders by the state commissions that have classified Internet calls as local.

As the attachment explains in further detail, while the Commission did exempt Internet and other enhanced service traffic from the payment of interstate access charges, it consistently has held that the traffic remains interexchange and interstate in nature – not local. (Attachment 2). Indeed, if this were not the case, there would be no need for an access charge “exemption,” and the Commission would have had no jurisdiction to create one to begin with.

As a result, we urge you to quickly adopt an order in response to the petition filed by ALTS last summer declaring that, under the Commission's prior orders, Internet-bound traffic is not “local” and is not subject to reciprocal compensation.

We would appreciate the opportunity to meet with you to discuss this further.

Sincerely,


Edward D. Young, III
Senior Vice President &
Deputy General Counsel


Thomas J. Tauke
Senior Vice President
Government Relations

cc: Commissioner Furtchgott-Roth
Commissioner Ness
Commissioner Powell
Commissioner Tristiani
Kathy Brown

Reciprocal Comp For Internet Traffic--Gravy Train Running Out Of Track

(Part V of Internet Regulation Preview Series)

Summary: In a classic case of what you see is not necessarily what you get, investors should not expect the current reciprocal compensation arrangement for Internet traffic to continue much past the end of the year. Given that this issue is probably the single greatest opportunity for arbitrage in the whole sector, over 4,000 percent in some instances, TPG cautions investors that this extraordinary arbitrage "gravy train" will run out of track--probably this year. It is simply not sustainable long-term.

Moreover, investors should not be lulled into a false sense of security that 19 consecutive state public utility commissions have ruled (in addition to a recent Federal Court in Texas) that Internet service provider (ISP) traffic passed through a competitive local exchange carrier (CLEC) is classified as a local call. In the coming months, TPG expects the FCC to trump these state decisions by clarifying that Internet traffic is indeed interstate, effectively reasserting its federal jurisdiction over data or Internet transport. *(Reciprocal compensation is a regulatory arrangement where local telecom providers pay each other for "the cost" of terminating the calls they originate. In most cases, reciprocal compensation traffic is two-way and thus largely offsetting. However, since Internet/data traffic is one-way, there is little "reciprocal" about this arrangement. It is just a regulatory compensation windfall for CLECs/ISPs.)*

A Big Deal for Investors: This reciprocal compensation arbitrage is a significant part of the existing "data growth engine" of many CLEC and ISP business models. Consequently, investors need to be aware that in some instances, short-term projected results may be artificially "juiced up," potentially providing an illusion of faster-than-real long-term growth. The flip side of this problem is that reciprocal compensation is a significant and growing liability, primarily for the Baby Bells. It is growing at such a rapid rate that it could be a significant threat to earnings roughly in 1999, if not fixed by the FCC by then.

Why the FCC Will Fix It: First, reciprocal compensation for one-way Internet traffic is arguably the single greatest arbitrage opportunity and hence market distortion in the telecom sector today. TPG flagged this important issue in our April 6 "Internet Regulation Preview" bulletin as akin to a broken bank ATM machine that only allows withdrawals and

takes no deposits. No other place in the sector can compare as much as a 4,000 percent arbitrage for minimal, value-added service. No competitive market, legal or illicit, can generate such gargantuan arbitrage. Only regulatory distortion can generate this size arbitrage over an extended period of time.

Second, this arbitrage opportunity is greatly contributing to artificial misalignment of the market structure of this new emerging competitive voice/data niche. Reciprocal compensation is driving many alliances, mergers and acquisitions for purely regulatory and not economic competitive reasons. Thus, in some instances, an ISP is currently an asset to a CLEC, but could become a serious liability without the arbitrage of reciprocal compensation. Third, it discourages economically sound facilities-based local investment and inhibits the development of an efficient competitive market. It has the perverse effect of turning customers from assets into liabilities. Why would a competitor want to win a customer if that customer would cost them more in reciprocal compensation terminating minutes than they could earn in revenue from that customer?

What to Expect From the FCC: Investors need to appreciate that it is not that hard for the FCC to fix this in the coming months. ALTS, the association representing the CLECs, has an active petition (dated June 20, 1997) requesting that the FCC issue a clarification that the traffic in question is local and not interstate. ALTS argues in its petition that "this clarification is clearly in the Commission's (FCC) exclusive jurisdiction." For FCC legal authority, ALTS cites a 1980 Computer II FCC decision which was subsequently upheld in the DC Court of Appeals in 1982 and again in 1984. Now that the states have ruled the CLECs' way, the association likely regrets having requested this clarification from the FCC.

Why would the FCC believe such Internet calls are not local but interstate? The FCC has exempted this traffic from interstate access charges for over a decade. Why would an exemption from interstate access charges be needed if the FCC thought it was a local call? Moreover, in the FCC's April report to Congress, (paragraph 106) the FCC said that ISPs "are not entitled to reciprocal compensation for terminating local telecommunications traffic." However, the FCC explicitly did not comment on whether CLECs that serve ISPs are entitled to reciprocal compensation for terminating Internet traffic. The FCC said that issue was now before the FCC. * * * * *

Attachment 2

Internet Traffic Is Not Subject to Reciprocal Compensation

As the Commission's own prior decisions make clear, calls bound for the Internet are interexchange and predominantly interstate, rather than local, and are not subject to the payment of reciprocal compensation.

1. Internet calls are not local. When a person sitting at a keyboard at home in Washington, D.C. dials in to the Internet, he or she is able to communicate with, and receive information from, other Internet users around the world. During any given call, he or she may read the day's news in the electronic version of the New York Times stored in New York City, check on breaking stories in the computers of CNN in Atlanta, and/or tap into historical archives stored half the world away in New Zealand.

Despite this fact, a number of state commissions have concluded that calls bound for the Internet should be treated as "local" calls, and should be subject to the payment of reciprocal compensation.

They have done so, in large part, based on a mistaken reading of this Commission's orders creating the so-called "ESP exemption." But those orders merely exempt Internet and other enhanced service providers from paying the interstate access charges that otherwise would apply. They do not classify the traffic as "local." On the contrary, the only reason for an exemption in the first place is that the Commission recognized that this is not local traffic – it is interexchange. If it wasn't, no exemption would be needed.

Indeed, the Commission consistently has classified this traffic as interexchange, and predominantly interstate, since its first order creating the ESP exemption and continuing through the present – reiterating the conclusion most recently in its report to Congress on universal service. See, e.g., MTS and WATS Market Structure, 97 FCC 2d 682, ¶ 78 (1983) (ESPs use "local exchange services or facilities . . . for the purpose of completing interstate calls"); *id.* at ¶ 83 (ESPs use "exchange service for jurisdictionally interstate communications"); Amendments of Part 69 of the Commission's Rules, 2 FCC Rcd 4305, 4306 (1987) (ESPs "like facilities-based interexchange carriers and resellers, use the local network to provide interstate services"); In re Access Charge Reform, 11 FCC Rcd 21354, ¶ 284 (ESPs use "incumbent LEC facilities to originate and terminate interstate calls"); Universal Service Report, ¶ 146 (ESPs use "local exchange networks to originate and terminate interstate services").

2. Internet calls are not two calls. Despite this unbroken chain of decisions extending over 15 years, some parties now assert that Internet calls should be treated as two separate calls, and that the first "call" to the Internet service provider should be

classified as "local." But the short answer to this claim is that it too is foreclosed by a long and consistent line of prior decisions by this Commission.

As the Commission itself has explained, when a customer calls his or her Internet service provider, the call does not stop at that point, but is instead connected to the Internet, and through it, to the caller's chosen destinations around the world. As the Commission puts it: "An end-user may obtain access to the Internet from an Internet service provider, by using dial-up or dedicated access to connect to the Internet service provider's processor. The Internet service provider, in turn, connects the end user to an Internet backbone provider that carries traffic to and from other Internet host sites." Non-Accounting Safeguards Order, 11 FCC Rcd 21905, ¶ 127, n. 291 (1996).

Under identical circumstances, the Commission consistently has held that the "nature of a call is determined by its ultimate origination and termination, and not . . . its intermediate routing." See Southwestern Bell Tel. Co., 3 FCC Rcd 2339, ¶ 26 (1988). For example, in the context of calling cards and other services where a customer first dials an 800 number and receives a second dial tone before connecting to his or her ultimate destination, the Commission repeatedly has rejected arguments that there are two calls involved. Id. at ¶ 28; see also Long Distance/USA, Inc., 10 FCC Rcd 1634, ¶ 13 (1995) ("[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;" "[A] single interstate communication does not become two communications because it passes through intermediate switching facilities."); Teleconnect Company v. Bell Tel. of Pa., 10 FCC Rcd 1626, ¶ 12 (1995) (same), aff'd sub nom. 116 F.3d 593 (D.C. Cir. 1997).

This conclusion does not change merely because the customer has the option of dialing a local, rather than 800, number prior to being connected to his or her ultimate destination. This is no different than a call made to a Feature Group A access line to place a long distance call. Even though the caller's line and the Feature Group A line are in the same local calling area, and the customer dials a local number, the Commission always has looked to the ultimate destination to determine that calls made using these arrangements are interexchange and interstate. See, e.g., Determination of Interstate and Intrastate Usage of Feature Group A, 4 FCC Rcd 8448 (1989).

Nor does the conclusion change merely because some portion of the end to end communication may be stored locally before being retrieved by the customer. Again, the Commission has decided this very issue in the context of voice mail services, where it rejected a claim that the delivery of a voice message involves two separate, jurisdictionally distinct calls. According to the Commission, "the key to jurisdiction is the nature of the communication itself rather than the physical location of the technology," and the local storage and local delivery of a message left by an out of state caller does not change the interstate nature of the end to end communication. BellSouth Emergency Petition, 7 FCC Rcd 1619, ¶ 12 (1992), quoting New York Tel. Co. V. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980). On the contrary, "an out-of-state call to [a] voice

mail service is a jurisdictionally interstate communication, just as is any other out-of-state call to a person or service.” Id.

Finally, the Commission’s recent report to Congress on universal service does nothing to change all this. The parties who argue otherwise base their claim on the fact that the Commission said an Internet call has two distinct components, one of which is a telecommunications service and one of which is an information service. But the simple fact is that this has nothing to do with the end-to-end nature of the communication. The Commission itself expressly said as much: “We make no determination here on the question of whether competitive LECs that serve Internet service providers (or Internet service providers that have voluntarily become competitive LECs) are entitled to reciprocal compensation for terminating Internet traffic. That issue, which is now before the Commission, does not turn on the status of the Internet service provider as a telecommunications carrier or information service provider.” Report to Congress, CC Dkt 96-45, at n. 220 (rel. Apr. 10, 1998) (emphasis added).

3. Internet calls are not subject to reciprocal compensation. The significance of all of this is straightforward: Because Internet traffic is not “local,” it is not subject to the payment of reciprocal compensation when it is handed off to another carrier for delivery to an Internet service provider.

The Commission has firmly established that; as a matter of law, interconnecting carriers are entitled to receive reciprocal compensation only for the transport and termination of local calls. As the Commission has explained, “[t]he Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic.” Local Interconnection Order, 11 FCC Rcd 15499, ¶¶ 1033 (1996). For this reason, the reciprocal compensation obligations imposed by the Act “apply only to traffic that originates and terminates within a local calling area, as defined [by a state commission];” they “do not apply to the transport and termination of interstate or intrastate interexchange traffic.” Id., ¶¶ 1034-35. This distinction between local and interexchange traffic, moreover, was upheld on appeal and is now final. Comptel v. FCC, 117 F.3d 1068 (8th Cir. 1997).

In sum, Internet-bound traffic is not local, and is not subject to the payment of reciprocal compensation.

* * * * *

July 31, 1998



By Hand

The Honorable William E. Kennard
Chairman
Federal Communications Commission
1919 M Street, NW – Room 814
Washington, D.C. 20554

Re: Reciprocal Compensation for Internet Traffic

Dear Chairman Kennard:

The responses to our July 1 letter do little to try to rebut our key point – that the payment of reciprocal compensation for Internet-bound calls is distorting the market, undermining competition in residential telephony, and discouraging the deployment of high-speed networks.

Instead, the responses – filed by Worldcom/MCI and Comptel/ALTS – devote the bulk of their effort to trying to distract attention from the real issue. For example, they incorrectly suggest that Bell Atlantic agreed that Internet traffic is local and subject to reciprocal compensation, and that an order by the Commission confirming that Internet calls are not local under its own prior orders would intrude on the role assigned to the states in the 1996 Act.

We respond to each of their points below.

Reciprocal compensation discourages competition and investment. As an initial matter, the responses do not deny that Internet reciprocal compensation actually pays carriers not to invest to provide competing service to residential or other dial-up users of the Internet. Nor could they. As one analyst puts it, it is indisputable that paying reciprocal compensation for this traffic has the “perverse effect of turning customers from assets to liabilities.”

Instead, they say that reciprocal compensation does provide an incentive to “compete” to deliver traffic from originating carriers to Internet service providers. This, of course, is precisely our point. Once a carrier makes the minimum investment in routers or other equipment needed to deliver this one-way traffic – which can be next to

nothing if it or an affiliate is the Internet service provider – reciprocal compensation pays the carrier not to invest in facilities to provide competing two-way voice and data services to residential or small business customers. And the so-called competition to serve the Internet service providers often consists of little more than agreeing to share the reciprocal compensation booty.

Reciprocal compensation distorts the market. The responses also do not deny that the lure of free cash is causing Internet service providers to declare themselves “carriers” – without providing local dial tone service to anyone – just to get reciprocal compensation. Nor do they deny it has led these and other carriers to misrepresent the identity of the calling area where the traffic is delivered in order to qualify for reciprocal compensation – locking up millions of unused numbers in the process.

Instead, they argue the remedy lies elsewhere because Bell Atlantic can challenge the state certifications of these so-called carriers or file complaints with state commissions. Of course, these same parties would be the first to cry foul if Bell Atlantic did so. And they miss the point in any event. The point is that paying reciprocal compensation on Internet traffic distorts the market and encourages economically irrational behavior. These are merely some of the current examples, and there will be others if the underlying problem is not fixed.

Other carriers can recover legitimate costs to the same extent as incumbents. The responses argue that at least some competing carriers incur legitimate costs in order to deliver Internet traffic that they need to recover. But this completely ignores the fact that these carriers already can recover their costs in exactly the same way and to exactly the same extent as the incumbents – through the intrastate business line rates they charge to Internet service providers.

Despite this fact, the responses try to justify reciprocal compensation on the theory that incumbents may save money if they don't have to upgrade their end office switches serving Internet service providers. But this looks at only part of the picture. It ignores the fact that any supposed savings (presuming any were to materialize) are offset by the enormous expenditures required for added trunking and switch upgrades in order to hand-off traffic to other carriers for delivery. In the case of Bell Atlantic alone, for example, we will spend almost \$300 million during 1998, and expenditures are projected to nearly double in 1999. And, given that the ratio of traffic we hand off to other carriers is approaching ten times what they send to us, these expenditures obviously are being driven in large part by Internet traffic.

Finally, the responses say that Internet reciprocal compensation helps carriers raise capital. But the vast majority of reciprocal compensation is paid to companies like Worldcom/MCI and AT&T/TCG that hardly need any help. In any event, analysts long have recognized that Internet reciprocal compensation is a temporary aberration that cannot last.

Bell Atlantic did not agree that Internet calls are local and subject to reciprocal compensation. In an effort to distract attention from the merits, the responses devote most of their efforts to trying to conjure phantom procedural hurdles to forestall Commission action.

For example, the responses claim that incumbents agreed during negotiations that Internet calls properly are classified as local and subject to reciprocal compensation. In Bell Atlantic's case, this is flatly not true. On the contrary, our consistent and firmly stated position since the issue first was raised in contract negotiations – in reliance on this Commission's prior orders – has been that Internet traffic is interstate and interexchange, and is not subject to reciprocal compensation.

As a result, none of the interconnection agreements signed by Bell Atlantic say that Internet traffic is subject to reciprocal compensation. Instead, those contracts – illustrative examples of which are attached – expressly provide that only traffic that is local on an end-to-end basis is subject to reciprocal compensation. And after competing carriers began to argue to state commissions that Internet calls should be treated as local, Bell Atlantic took added steps to protect itself by including provisions in its agreements expressly stating its view that Internet calls are not local.

The responses also are wrong that Bell Atlantic implicitly conceded in the local interconnection proceeding that Internet calls are subject to reciprocal compensation. It supposedly did so, the story goes, by citing Internet calls among other types of one-way traffic that new entrants potentially could target if reciprocal compensation rates for transport and termination of calls were set too high.

At the time, however, the long distance carriers were arguing that the reciprocal compensation provisions applied to interexchange calls – which include Internet calls – as well as to local calls. While Bell Atlantic disagreed, the issue had not yet been decided. In its order in that proceeding, however, the Commission rejected the long distance carriers' argument, held that reciprocal compensation applies only to local traffic, and was upheld by the Eighth Circuit.

Finally, the responses are off base by suggesting that the problem is of our own making because we did not agree to bill and keep. Adopting bill and keep would have produced the same problem in reverse. It would have created an incentive for other carriers to sign up customers with large amounts of originating local calls, such as outgoing local calls from office complexes, and hand off the calls to incumbents without paying any compensation to terminate the calls.

An order by this Commission will not intrude on a role assigned to the states. After themselves urging the Commission to address the Internet reciprocal compensation issue for the last year, the responses here do an about-face. They now say that, by urging it to act promptly on the same issue, we are asking the Commission to intrude on a role

assigned to the states by the 1996 Act, or to override arbitration results by re-interpreting individual contracts.

Again, they are wrong. We are not asking this Commission to interpret specific contracts, nor are we asking it to intrude on a legitimate role of the states. We simply are asking the Commission to confirm what it said in its own previous orders – which no party suggests it lacked authority to issue – by once again declaring that Internet traffic is interstate and interexchange, and, therefore, is not subject to reciprocal compensation under the Act as the Commission previously interpreted it.

Many of the state orders (excerpts of which are attached) said they were addressing the issue only because this Commission has not yet done so, and made it clear that their orders are subject to correction once this Commission does act. And, as we pointed out in our previous letter, the state commissions have based their decision on a mistaken interpretation of this Commission's prior orders. While the Commission did exempt Internet and other enhanced service providers from paying interstate access charges, it did not, and could not, change the underlying nature of the end-to-end communication, which remains interstate and interexchange.

Moreover, under the terms of the Act, parties voluntarily may agree to terms that differ from the requirements of the Act, and it is possible that – unlike Bell Atlantic – some carriers expressly and unambiguously may have agreed that Internet traffic would be subject to reciprocal compensation under their individual interconnection agreements. The task of determining whether other carriers did so remains one for the state commissions.

The Commission has authority to issue an order. Finally, the responses claim that the Commission can no longer act because ALTS withdrew its year old letter asking it to address the Internet reciprocal compensation issue. This is nonsense.

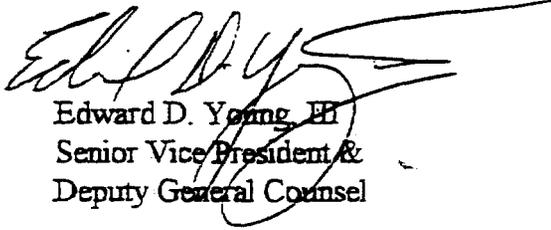
There is no rule that says the Commission can act only if ALTS wants it to. The simple fact is that, after ALTS submitted its letter, the Commission issued a public notice asking for comments on the issue. As a result, all interested parties have had an opportunity to be heard, the Commission has a complete record, and nothing more is required to issue a declaratory ruling resolving the issue. What's more, the Commission's own rules (47 C.F.R. § 1.2) expressly allow it to issue a declaratory ruling on its motion, and it should do so based on the record before it.

* * * *

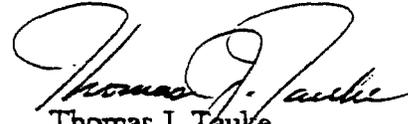
For all these reasons, and the reasons laid out in our previous letter, the Commission should issue an order immediately to again confirm that Internet traffic is interstate and interexchange, not local.

For convenience, we have attached proposed language to be included in an ordering clause.

Sincerely,



Edward D. Young, III
Senior Vice President &
Deputy General Counsel



Thomas J. Lauke
Senior Vice President
Government Relations

cc: Commissioner Furtchgott-Roth
Commissioner Ness
Commissioner Powell
Commissioner Tristiani
Kathryn C. Brown

ATTACHMENT 1

Proposed Ordering Clauses

I. Pursuant to sections 4(i), 4(j), 201, 251(b)(5), (g), and (i), and 303(r) of the Communications Act of 1934, as amended, it is hereby ORDERED that this declaratory ruling is adopted, to be effective immediately upon release.

II. By adoption of this Order, we confirm, as we have held in previous orders, that calls bound for the Internet are properly classified as interexchange and interstate in nature, not local. As such, these calls are not subject to the reciprocal compensation obligations imposed by section 251(b)(5) of the Act when handed off by a carrier serving the customer originating the call to another carrier that terminates the call to an Internet service provider.

III. By adoption of this Order, we also clarify that, while our previous orders exempting Internet and other information service providers from the payment of interstate exchange access charges allowed those providers to purchase services from a local exchange carrier's intrastate tariffs, our orders did not, and could not, change the nature of the end-to-end communication that is involved with Internet-bound calls. Those calls remain interexchange and interstate in nature.

IV. By adoption of this Order, we do not, however, prejudge whether any individual carriers may have expressly and unambiguously agreed to go beyond the requirements of the Act and to pay reciprocal compensation on Internet-bound calls, as they may do under section 252(a)(1). That determination is best made by state commissions based on their review of specific interconnection agreements.

ATTACHMENT 2

Excerpts From State Orders

1. "[T]he Commission agrees that a final determination on this matter rests with the FCC. . . . If the FCC should change its position, then the Commission expects interconnection agreements to be applied in accordance with the FCC's new policy. Moreover, the parties will be directed to bring the FCC's final determination to the Commission's attention in order to allow it to consider whether any further action is appropriate." MCI Telecommunications Corporation, Case No. 97-1210-T-PC at 29-30 (W.Va. PSC Jan. 13, 1998).
2. "Moreover, we note this issue is currently being considered by the FCC and may ultimately be resolved by it. . . . In the event the FCC issues a decision that requires revision to the directives announced herein, the Commission expects the parties will so advise it." Letter Order by Daniel Gahagan, Executive Secretary, Maryland Public Service Commission, at 1 (Md. PSC Sept. 11, 1997).
3. "[P]rior to a decision from the Federal Communications Commission on the issue of reciprocal compensation for traffic to ISPs within a local calling scope, the parties shall compensate one another for such traffic in the same manner that local calls to non-ISP end users are compensated, subject to a true-up following the Federal Communication Commission's determination on the issue." In re Birch Telecom of Missouri, Inc., 1998 WL 324141 *5 (Mo. PSC Apr. 24, 1998).
4. "As to the meaning of the FCC's prior rulings and pronouncements, the Commission is not persuaded that the FCC has ruled as Ameritech asserts. . . . When the FCC rules in the pending docket, the Commission can determine what action, if any, is required." In re Brooks Fiber Communications of Michigan, Inc., Case No. U-1178, et al., at 14-15 (Mich. PSC Jan. 28, 1998).
5. "[T]he precise issue under review in the instant case is currently being decided by the FCC. . . . Any ruling by the FCC on that issue will no doubt affect future dealings between the parties on the instant case." "Instead of classifying the web sites as the jurisdictional end of the communication, the FCC has specifically classified the ISP as an end user. [citation omitted] Given the absence of an FCC ruling on the subject, this court finds it appropriate to defer to the ICC's finding of industry practice regarding termination." Illinois Bell Tel. Comp. v. Worldcom Technologies, Inc., No. 98 C 1925, Mem. Op. and Order at 18, 27 (N.D. Ill. July 21, 1998).
6. "The Commission will adopt the exemption permitted by the FCC. However, the Agreement should indicate that if and when the FCC modifies the access charge exemption, the Agreement will also be modified." MFS Communications Comp., Inc., 1996 WL 787940 *5 (Ariz. Corp. Com'n Oct. 29, 1996).

7. An important consideration is "whether or not pending FCC proceedings counsel in favor of deferring action," but "the FCC has had occasion to state its position on the issue and has not, thus far, definitively addressed the issue." Petition for Declaratory Order of TCG Delaware Valley, Inc., P-00971256 at 20 (Pa. PUC June 16, 1998).

8. "Irrespective of how the FCC's 1983 access charge exemption policy might otherwise be interpreted, for purposes of this cause the more recent Telecommunications Act and the FCC's Universal Service Order would provide the controlling federal precedent. . . . No support has been offered to show that the FCC has acted in any manner to limit or dictate the type of compensation local exchange carriers can assess each other under an interconnection agreement for termination of traffic destined to ISPs." In re Application of Brooks Fiber Communications of Oklahoma, Inc., Cause No. 970000548, Order 423626, at 10-11 (Okla. PSC June 3, 1998).

9. "The FCC has not squarely addressed this issue, although it may do so in the future. While both parties presented extensive exegeses on the obscurities of FCC rulings bearing on ISPs, there is nothing dispositive in the FCC rulings thus far." In re Interconnection Agreement Between BellSouth Telecommunications, Inc. And US LEC of North Carolina, LLC, Docket No. P-55, SUB 1027 at 7 (N.C. PUC Feb. 26, 1998).

10. "We have searched the Act and the FCC Interconnection Order and find no reference to this issue." In re Petition of MFS Communications Comp., Inc., Docket No. 96A-287T, at 30 (Colo. PUC Nov. 5, 1996).

11. Based on MFS's argument that the issue is governed by the enhanced service provider exemption, "[t]here is no reason to depart from existing law or speculating what the FCC might ultimately conclude in a future proceeding." In re MFS Communications Comp., Inc., 1996 WL 768931 *13 (Or. PUC Dec. 9, 1996).

12. "All parties agree that the FCC has for many years declared that enhanced service providers, which include ISPs, may obtain services as end users under intrastate tariffs." "Based upon the long-standing position of the FCC that existed years before the execution of the Interconnection Agreement, the Hearing Officer concludes that the term 'Local Traffic' . . . includes, as a matter of law, calls to ISPs." In re Petition of Brooks Fiber, Docket No. 98-00118 (Tenn. Reg. Auth. Apr. 21, 1998).

13. Recognizing that the issue is pending at the FCC but concluding that "postponing a Commission decision to await a Federal Communications Commission decision is not in the parties' interest or in the public interest." Letter Order from Lynda L. Dorr, Secretary to the Public Service Comm'n of Wisconsin, to Rhonda Johnson and Mike Paulson, 5837-TD-100, 6720-TD-100 (Wisc. PSC May 13, 1998).

ATTACHMENT 3

**INTERCONNECTION AGREEMENT UNDER SECTIONS 251 AND 252 OF THE
TELECOMMUNICATIONS ACT OF 1996**

Dated as of July 16, 1996

by and between

BELL ATLANTIC-VIRGINIA, INC.

and

MFS INTELENET OF VIRGINIA, INC.

1.39. "Line Status Verification" or "LSV" means an operator request for a status check of the line of a called party. The request is made by one Party's operator to an operator of the other Party. The verification of the status check is provided to the requesting operator.

1.40 "Local Access and Transport Area" or "LATA" is As Defined in the Act.

1.41 "Local Exchange Carrier" or "LEC" is As Defined in the Act. The Parties to this Agreement are or will shortly become Local Exchange Carriers.

1.42. "Local Serving Wire Center" means a Wire Center that (i) serves the area in which the other Party's or a third party's Wire Center, aggregation point, point of termination, or point of presence is located, or any Wire Center in the LATA in which the other Party's Wire Center, aggregation point, point of termination or point of presence is located in which the other Party has established a Collocation Arrangement or is purchasing an entrance facility, and (ii) has the necessary multiplexing capabilities for providing transport services.

1.43 "Local Telephone Number Portability" or "LTNP" means "number portability" As Defined in the Act.

1.44 "Local Traffic," means traffic that is originated by a Customer of one Party on that Party's network and terminates to a Customer of the other Party on that other Party's network, within a given local calling area, or expanded area service ("EAS") area, as defined in BA's effective Customer tariffs. Local Traffic does not include traffic originated or terminated by a commercial mobile radio service carrier.

1.45. "Main Distribution Frame" or "MDF" means the primary point at which outside plant facilities terminate within a Wire Center, for interconnection to other telecommunications facilities within the Wire Center.

1.46. "MECAB" means the Multiple Exchange Carrier Access Billing (MECAB) document prepared by the Billing Committee of the Ordering and Billing Forum ("OBF"), which functions under the auspices of the Carrier Liaison Committee ("CLC") of the Alliance for Telecommunications Industry Solutions ("ATIS"). The MECAB document, published by Bellcore as Special Report SR-BDS-000983, contains the recommended guidelines for the billing of an Exchange Access service provided by two or more LECs, or by one LEC in two or more states within a single LATA.

1.47 "MECOD" means the Multiple Exchange Carriers Ordering and Design (MECOD) Guidelines for Access Services - Industry Support Interface, a document developed by the Ordering/Provisioning Committee under the auspices of OBF. The MECOD document, published by Bellcore as Special Report SR-STIS-002643, establishes methods for processing orders for Exchange Access service which is to be provided by two or more LECs.

1.48 "Meet-Point Billing" or "MPB" means an arrangement whereby two or more LEC jointly provide to a third party the transport element of a Switched Exchange Access Service to or

1.58 "Rate Center Area" or "Exchange Area" means the specific geographic point and corresponding geographic area which has been identified by a given LEC as being associated with a particular NPA-NXX code assigned to the LEC for its provision of Telephone Exchange Services. The Rate Center Area is the exclusive geographic area which the LEC has identified as the area within which it will provide Telephone Exchange Services bearing the particular NPA-NXX designation associated with the specific Rate Center Area. A "Rate Center Point" is a specific geographic point, defined by a V&H coordinate, located within the Rate Center Area and used to measure distance for the purpose of billing Customers for distance-sensitive Telephone Exchange Services and Toll Traffic.

1.59 "Rate Demarcation Point" means the point of minimum penetration at the Customer's premises or other point, as defined in a Party's Tariffs, where network access recurring charges and LEC responsibility ends and beyond which Customer responsibility begins.

1.60 "Rating Point" or "Routing Point" means a specific geographic point identified by a specific V&H coordinate. The Rating Point is used to route inbound traffic to specified NPA-NXXs and to calculate mileage measurements for distance-sensitive transport charges of switched access services. Pursuant to Bellcore Practice BR-795-100-100, the Rating Point may be an End Office location, or a "LEC Consortium Point of Interconnection." Pursuant to that same Bellcore Practice, examples of the latter shall be designated by a common language location identifier (CLLI) code with (x)KD in positions 9, 10, 11, where (x) may be any alphanumeric A-Z or 0-9. The Rating Point/Routing Point must be located within the LATA in which the corresponding NPA-NXX is located. However, the Rating Point/Routing Point associated with each NPA-NXX need not be the same as the corresponding Rate Center Point, nor must it be located within the corresponding Rate Center Area, nor must there be a unique and separate Rating Point corresponding to each unique and separate Rate Center.

1.61 "Reciprocal Compensation" is As Described in the Act, and refers to the payment arrangements that recover costs incurred for the transport and termination of Local Traffic originating on one Party's network and terminating on the other Party's network.

1.62 "Service Control Point" or "SCP" means the node in the common channel signaling network to which informational requests for service handling, such as routing, are directed and processed. The SCP is a real time database system that, based on a query from a service switching point and via a Signaling Transfer Point, performs subscriber or application-specific service logic, and then sends instructions back to the SSP on how to continue call processing.

1.63 "Signaling Transfer Point" or "STP" means a specialized switch that provides SS7 network access and performs SS7 message routing and screening.

1.64 "Switched Access Detail Usage Data" means a category 1101XX record as defined in the EMR Bellcore Practice BR-010-200-010.

1.65 "Switched Access Summary Usage Data" means a category 1150XX record as defined in the EMR Bellcore Practice BR-010-200-010.

group, it will supply an auditable Percent Interstate Use ("PIU") report quarterly, based on the previous three months' terminating traffic, and applicable to the following three months. In lieu of the foregoing PLU and/or PIU reports, the Parties may agree to provide and accept reasonable surrogate measures for an agreed-upon interim period.

5.6.4 Measurement of billing minutes for purposes of determining terminating compensation shall be in conversation seconds.

5.7 Reciprocal Compensation Arrangements – Section 251(b)(5).

Reciprocal Compensation arrangements address the transport and termination of Local Traffic. BA's delivery of Traffic to MFS that originated with a third carrier is addressed in subsection 7.3. Where MFS delivers Traffic (other than Local Traffic) to BA, except as may be set forth herein or subsequently agreed to by the Parties, MFS shall pay BA the same amount that such carrier would have paid BA for termination of that Traffic at the location the Traffic is delivered to BA by MFS. Compensation for the transport and termination of traffic not specifically addressed in this subsection 5.7 shall be as provided elsewhere in this Agreement, or if not so provided, as required by the Tariffs of the Party transporting and/or terminating the traffic.

5.7.1 Nothing in this Agreement shall be construed to limit either Party's ability to designate the areas within which that Party's Customers may make calls which that Party rates as "local" in its Customer Tariffs.

5.7.2 The Parties shall compensate each other for transport and termination of Local Traffic in an equal and symmetrical manner at the rates provided in the Detailed Schedule of Itemized Charges (Exhibit A hereto) or, if not set forth therein, in the applicable Tariff(s) of the terminating Party, as the case may be. These rates are to be applied at the M-IP for traffic delivered by BA, and at the BA-IP for traffic delivered by MFS. No additional charges, including port or transport charges, shall apply for the termination of Local Traffic delivered to the BA-IP or the M-IP, except as set forth in Exhibit A. When Local Traffic is terminated over the same trunks as Toll Traffic, any port or transport or other applicable access charges related to the Toll Traffic shall be prorated to be applied only to the Toll Traffic.

5.7.3 The Reciprocal Compensation arrangements set forth in this Agreement are not applicable to Switched Exchange Access Service. All Switched Exchange Access Service and all Toll Traffic shall continue to be governed by the terms and conditions of the applicable federal and state Tariffs.

5.7.4 Compensation for transport and termination of all Traffic which has been subject to performance of INP by one Party for the other Party pursuant to Section 14 shall be as specified in subsection 14.5.

5.7.5 The designation of Traffic as Local or Toll for purposes of compensation shall be based on the actual originating and terminating points of the complete end-to-end call, regardless of the carrier(s) involved in carrying any segment of the call.

5.7.6 Each Party reserves the right to measure and audit all Traffic to ensure that proper rates are being applied appropriately. Each Party agrees to provide the necessary Traffic data or permit the other Party's recording equipment to be installed for sampling purposes in conjunction with any such audit.

5.7.7 The Parties will engage in settlements of alternate-billed calls (e.g. collect, calling card, and third-party billed calls) originated or authorized by their respective Customers in Virginia in accordance with the terms of an appropriate billing services agreement for intraLATA intrastate alternate-billed calls or such other arrangement as may be agreed to by the Parties.

6.0 TRANSMISSION AND ROUTING OF EXCHANGE ACCESS TRAFFIC PURSUANT TO 251(c)(2).

6.1 Scope of Traffic

Section 6 prescribes parameters for certain trunks to be established over the Interconnections specified in Section 4 for the transmission and routing of traffic between MFS Telephone Exchange Service Customers and Interexchange Carriers ("Access Toll Connecting Trunks"). This includes casually-dialed (10XXX and 101XXXX) traffic.

6.2 Trunk Group Architecture and Traffic Routing

6.2.1 MFS shall establish Access Toll Connecting Trunks by which it will provide tandem-transported Switched Exchange Access Services to Interexchange Carriers to enable such Interexchange Carriers to originate and terminate traffic to and from MFS's Customers.

6.2.2 Access Toll Connecting Trunks shall be used solely for the transmission and routing of Exchange Access to allow MFS's Customers to connect to or be connected to the interexchange trunks of any Interexchange Carrier which is connected to an BA Access Tandem.

6.2.3 The Access Toll Connecting Trunks shall be two-way trunks connecting an End Office Switch MFS utilizes to provide Telephone Exchange Service and Switched Exchange Access in a given LATA to an Access Tandem BA utilizes to provide Exchange Access in such LATA.

6.2.4 The Parties shall jointly determine which BA Access Tandem(s) will be subtended by each MFS End Office Switch. MFS's End Office switch shall subtenant the BA Access Tandem that would have served the same rate center on BA's network. Alternative configurations will be discussed as part of the Joint Plan.

6.3 Meet-Point Billing Arrangements