terminating calls are "too high" or in any sense not "cost-based."[38] For this reason, there is simply no merit to Ameritech's plaintive observation that "[r]eciprocal compensation was never meant to be a 'cash cow.'"[39] Similarly without merit is Ameritech's complaint that CLECs are using "extra" funds from terminating compensation payments to "offer special deals."[40] New competitors will always strive to improve their market share by offering "special deals" to some customers. The fact that many CLECs apparently choose to use some of the cash they legitimately receive, but do not immediately need for operating expenses, to offer low rates to ISPs is simply an example of marketplace competition at work.

2. CLECs Will Logically Target Customers With High Incoming Usage To Achieve Economies Of Scale.

CLECs face an intense economic imperative to increase their total volume of traffic in order to obtain the economies of scale inherent in operating a highly capital-intensive telecommunications network. The ILECs already enjoy the benefit of enormous economies of scale; the CLECs, at least in the short run, do not. At least in the short run, therefore, a call termination rate that is "cost based" for the ILEC will almost certainly be much too low for the CLEC ***at the CLEC's initial low levels of usage.*** The only way for a CLEC to get its actual unit costs anywhere near an efficient long-run level is for the CLEC to do everything it possibly can to drive up the usage of its network. Targeting customers with high incoming usage subject to a usage-sensitive payment structure (*i.e.*, call termination payments) will accomplish this purpose.

---

[38] In any case, under Section 252(d)(2)(A)(ii), terminating compensation is only supposed to be a "reasonable approximation" of the costs of terminating calls. As a result, if a particular CLEC is able to negotiate a terminating compensation rate that is on the high end of the range of "reasonable approximations," nothing in the statute or in competitive policy suggests that this is a problem.

[39] Ameritech Comments at 18.

[40] *See* Ameritech Comments at 17-18.

Theoretically, this purpose could also be achieved by selling to customers with high levels of originating usage. In practical terms, however, driving up traffic volumes by means of customers with high originating usage suffers from two problems. The first is cash. Customers with high originating usage will generate call termination obligations to ILECs. This will require outlays of scarce cash that can be put to much better uses in developing the CLEC's business, as outlined above. Moreover, many existing ILEC pricing structures include large (and, in some cases, unlimited) "free calling" allowances. Driving up usage by targeting such customers will not generate cash in proportion to usage.[41]

Second, if the ILECs are to be believed, their end user loop rates are significantly underpriced as a result of implicit universal service subsidies embedded in their rates. Eventually, a fair and competitively neutral universal service mechanism will allow CLECs to have access to the same per-line subsidies as the ILECs enjoy. At present, however, the ILECs' implicit universal service subsidy mechanisms are not yet available to CLECs. As a result, it would make little sense for a CLEC, at this time, to base its business strategy on targeting customers with high levels of outgoing local usage.[42]

---

[41] Flat-rated local calling is popular with customers, and actually works, economically, as long as (a) the flat-rated calling plan is priced high enough to cover the costs of the "average" user's usage; and (b) the firm offering the plan has enough customers with different calling patterns so that the assumed "average" will, over time, be approximately correct. The second condition is probably met for a typical ILEC with a large and established customer base. As to the first, *see infra.*

[42] Assuming for these purposes that the CLEC and ILEC are equally efficient, the CLEC, at least at present, would have to set its end user rates below the ILEC's subsidized rates in order to win customers from the ILEC. It is simply not rational to target such customers prior to the actual implementation of a competitively neutral universal service mechanism.

3. Market Factors Other Than Terminating Compensation Payments Make ISPs Especially Attractive Customers.

If a terminating compensation rate is set exactly equal to a CLEC's cost of terminating calls, from a cost perspective alone — that is, putting aside cash needs and economies of scale — it is probably true that the CLEC should be essentially indifferent between customers who generate high incoming usage, high outgoing usage, or a more balanced traffic pattern. If calls are received, the costs of terminating them are covered; if not, then those costs may be avoided.

But factors other than the terminating compensation rate may act to create an incentive for CLECs to target any particular group of customers. Where this situation exists, CLECs will focus their efforts on those customers. As a result, the fact that some CLECs are targeting ISPs as customers does not imply that anything is amiss with the system of terminating compensation or the level of terminating compensation payments. All it means is that some factor or factors other than the cost of call termination lead CLECs to view ISPs as desirable customers.

One obvious example of a factor unrelated to call termination costs that can make particular customer groups attractive is lower marketing costs. ISPs are, on the whole, large and relatively sophisticated consumers of telecommunications services. They are likely to be "early adopters" of new telecommunications alternatives, such as CLEC services. As a result, CLECs would probably find the costs of marketing to ISPs to be lower, on average (in terms of marketing dollars per revenue dollar generated), than the costs of marketing to "business customers" (or "residence customers") in general. Moreover, ISPs use a wide variety of telecommunications services, including POTS lines and more advanced data lines. It makes business sense for CLECs to target customers with a variety of growing telecommunications needs, and ISPs fit the bill. Unless terminating compensation payments are set so low that the CLEC loses money whenever it terminates a call, CLECs will naturally gravitate to ISPs as customers.

A second example of a legitimate business consideration not directly related to call termination costs is the fact that ISPs have pre-established groups of end user subscribers who are themselves relatively heavy users of telecommunications services and — even in the case of residential customers — relatively sophisticated users as well. This group of subscribers would be attractive to a CLEC seeking to eventually market to small businesses and individual end users (when, for example, alternative loop technologies for individual customer locations become widely available, or ILEC unbundled loop prices are established at affordable levels). In this circumstance, a CLEC's relationship with an ISP would provide an entree to the end user market, particularly if the ISP's subscribers view the ISP's telecommunications arrangements supplied by the CLEC (*i.e.*, dial-in lines and "back-end" connections to the Internet) to be reliable and of high quality

These examples show that, if call termination rates are properly set to recover CLEC call termination costs, CLECs will then be free to focus their marketing efforts on customers who are attractive for reasons ***other than*** call termination rates. Since ISPs are plainly attractive customers for other reasons, the fact that some CLECs are targeting ISPs as customers does not imply that established call termination rates are too high or the terminating compensation system in general is functioning improperly.

* * * * *

The considerations discussed in this section show that a CLEC will logically and, from a regulatory and competitive perspective, legitimately target ISPs and other customers with high levels of incoming usage, particularly in the early years of ILEC/CLEC competition. This is true even if the terminating compensation rate the CLEC is receiving is an economically "perfect" cost-based rate. As a result, if some CLECs are targeting ISPs, that does not show that there is anything wrong with the terminating compensation system, either in general or applied to those customers. To

the extent that the ILECs did not expect this to occur, that only means that they had not fully anticipated and analyzed the economic forces affecting their new competitors.

B. The Telecommunications Act Of 1996 Provides No Basis For Relieving ILECs Of Any Consequences They May Suffer By Virtue Of Being Out-Negotiated By CLECs.

The discussion above shows that CLECs will have legitimate and powerful business reasons to target customers with high incoming call levels even if the call termination payments they receive from ILECs are strictly cost-based. But even assuming that CLECs are being significantly over-compensated for terminating calls from ILECs, that is no reason for regulators to step in. To the contrary, the Telecommunications Act of 1996 relies heavily on negotiations for establishing interconnection arrangements, including call termination rates. As a result, even if it is concluded that some CLECs have successfully obtained call termination rates that exceed their costs, the statute's primary reliance on negotiations between ILECs and CLECs shows that — particularly where the claim is that the new competitors may have out-negotiated the incumbents — there is no reason to use the regulatory system to "correct" any such alleged "problem."[43]

1. The ILECs Should Not Be Relieved Of The Consequences Of Their Own Failure To Negotiate Wisely Or To Compete Effectively.

Although the considerations that go into negotiating an interconnection agreement are complex (and vary greatly with the precise business plan the new

[43] Ameritech flatly claims that some CLECs with whom it has interconnection agreements have "opted into" the higher interconnection rates available, out of a range that apparently goes from $0.002 to $0.015. *See* Ameritech Comments at 17. Given the range of termination rates that Ameritech itself has accepted in negotiations, it is odd indeed for Ameritech to be advancing an argument that is based on a complaint that CLECs are responding to allegedly non-cost-based termination rates.

competitor expects to implement), with regard to the terminating compensation rate, matters are actually quite simple. A LEC that expects to be a net originator of calls will prefer either a bill-and-keep system (which eliminates call termination liabilities) or the lowest possible call termination rate (which minimizes those liabilities). A LEC that expects to be a net receiver of calls will prefer the highest call termination rate that can be negotiated or arbitrated. Finally, a LEC that expects its incoming and outgoing traffic to be roughly balanced will be indifferent to most reasonable variations in the call termination rate, since the rate will effectively apply to only a small number of "net" minutes either way.[44]

The ILECs repeatedly opposed bill-and-keep arrangements before this Commission and in state arbitration proceedings. In addition, the ILECs generally objected to the call termination rate levels proposed by the Commission on the grounds that those rate levels were too low. The logical implication of these positions is that the ILECs in general believed that they would be net receivers of calls. Otherwise, their negotiating and regulatory positions would not make any sense.

Now consider the matter from the CLECs' point of view. A CLEC could reasonably conclude, based on the ILECs' strong opposition to bill-and-keep, that some form of terminating compensation payments would be established. And CLECs could readily observe that many ILECs were seeking the highest remotely plausible rate for call termination. The ILECs' own negotiating position, therefore, presented the CLEC with a situation that contained both risk and opportunity: if the CLEC accepted a high call termination rate, the CLEC would face large call termination obligations to the ILEC if — as the ILECs obviously expected — the CLEC was a net originator of calls.

---

[44] In this regard, SNET has it exactly backwards when it states that "the main assumption behind reciprocal compensation is that originating and terminating usage would balance out between the parties." SNET Comments at 2. If it was generally assumed that traffic would "balance out," the most logical "compensation" mechanism is actually bill-and-keep, since with balanced traffic there is no need to incur the cost of tracking and billing for usage.

But if the CLEC could market effectively to customers who receive calls, then the CLEC would be able to turn the ILEC's own negotiating plan into an advantage.[45]

The ILECs' own negotiating strategy, therefore, created the conditions in which customers with high levels of incoming calls became especially desirable to CLECs. It is theoretically possible that the ILECs were so naive about how competition works that they simply did not understand the consequences of their actions. More likely, however, they were either over-confident in their own abilities to retain customers or under-appreciative of the competitive attraction of CLECs to some end user groups. Either way, what has apparently occurred is the result of the ILECs' betting that CLECs would be unable to attract the business of customers who receive large volumes of calls — and then losing the bet

From this perspective, the ILECs' current effort to exempt calls to ISPs from terminating compensation obligations is nothing more than an effort to get regulators to relieve the ILECs of the consequences of their own poor business judgment. The ILECs misjudged the likely balance of calls, and misjudged the competitive abilities of the CLECs to perceive and focus on the customers who were made most attractive as a result of the ILECs' own negotiating position. Rather than accept (and possibly learn from) the business consequences of their mistakes, however, the ILECs are attempting to bully the CLECs into submission by unilaterally declaring that calls to ISPs are not subject to call termination payments.

---

[45] In this regard, nothing in the law requires that a call termination rate strictly reflect either the ILEC's or the CLEC's cost of terminating calls. In a negotiated agreement, the parties can agree to any rate they want. And even in an arbitrated agreement, all that is required is that the call termination rate be based on a "reasonable approximation" of cost, a standard that plainly allows some leeway to establish a rate somewhat above or below what would result from a precise determination of cost. *See* 47 U.S.C. §§ 252(d)(2)(A)(ii), 252(d)(2)(B)(2).

In this regard, if losing the ISPs as customers is such a problem for the ILECs, they have — and have always had — a simple solution: compete for the ISPs' business. If CLECs offer ISPs special deals for local exchange lines, the ILECs should respond in kind. If CLECs offer ISPs improved service quality (*e.g.*, special network monitoring or maintenance arrangements), the ILECs should respond in kind. These are the normal business responses one would expect to see from competitors. There is no explanation — other than entrenched monopolistic thinking — for the ILECs' paradoxical position of bemoaning the effectiveness of CLEC competitive efforts while making no competitive counter-moves of their own.[46]

The Eighth Circuit's recent decision emphasizes the critical role that negotiated interconnection agreements play in developing the competitive local exchange market envisioned by Congress.[47] It would make a mockery of the negotiation process, and of the Eighth Circuit's order, for regulators to sanction the ILECs' effort to be relieved of the consequences of their own negotiating mistakes. To the contrary,

---

[46] As the Joint Commenters noted, the Commission has not been persuaded by ILEC claims that network congestion or other network-related effects from calls to ISPs warrant special regulatory treatment for such calls. *See* Joint Comments at 13. To the extent that the ILECs are complaining about network-related problems that arise from ***losing*** ISPs as customers as well as network-related problems that arise from ***having*** them as customers, they should not be permitted to have it both ways. If losing ISPs as customers causes problems for the ILECs, then the ILECs should compete for their business. If keeping the ISPs as customers causes problems for the ILECs, then the ILECs should be happy to see them go. In fact, to the extent that the ILECs have network-related problems related to calls to ISPs, those problems are caused by the fact that the ILECs' ***individual end users*** place many calls to ISPs. This is not a problem with the terminating compensation system, however. *See* Section IV.B.2, *infra.*

[47] Slip Opinion at 97; *id.* at 114-117 (discussing Section 252(i)); *id.* at 116 (Sections 252(a)(1) and 252(b)(1) "reveal that the Act establishes a preference for incumbent LECs and requesting carriers to reach agreements independently ... .").

the only response to the ILECs' effort that is consistent with the statute is for regulators to reject it out of hand.[48]

2. The ILECs Should Not Be Permitted To Manipulate Terminating Compensation Requirements To Alleviate Unrelated Regulatory And Business Problems.

Ameritech suggests that requiring that local calls to the Internet be subject to reciprocal compensation would be "contrary to the Commission's espoused goal of establishing cost-based rates."[49] This claim is baseless. If the ILECs think that they are not recovering the costs of calls to ISPs (or other local calls with long holding times), they should propose tariff changes to state regulatory bodies to alleviate that problem (*e.g.*, mandatory measured local service, special charges for local calls of unusual length, etc.). This is exactly the conclusion the Commission reached in the *Access Charge Order*.[50]

Many ILECs, however, probably are not literally "free" to adjust their local rates, because they have previously committed to state-level regulators that such rates will remain capped.[51] ILECs with capped local rates generally claim (as in the case of

---

[48] This is particularly true in light of the fact that bill-and-keep is an option specifically recognized by the statute and specifically addressed by numerous CLECs during the regulatory process. From the very first day negotiations began under Section 251 and 252, the ILECs have had it in their power to absolutely insulate themselves from any possibility that they might have to make terminating compensation payments. All they had to do was propose bill-and-keep, or accept bill-and-keep when CLECs proposed it. They did not do so for one simple reason: they thought that, on balance, they would be net recipients of calls. The fact that the ILECs misjudged the market is no reason to relieve them of the consequences of the negotiating posture they actually adopted.

[49] Ameritech Comments at 15 (footnote omitted).

[50] *Access Charge Order* at ¶ 364.

[51] *See, e.g.*, Letter from J.G. Cullen (Vice Chairman, Bell Atlantic) to *Business Week*

(continued...)

federal price cap regulation) that, when their local rates cannot be increased on the basis of cost increases, the ILECs have healthy incentives to operate their businesses so as to meet their customers' needs in the most efficient way possible. Doing so produces profits; failure to do so produces losses.

Here, their customers want to call the Internet — a lot more frequently than the ILECs may have planned for.[52] Dealing with that customer demand, however, is exactly the kind of business challenge the ILECs claimed they were ready for when they advocated, and received, capped local rates. It would be totally inappropriate — and, indeed, unhealthy for the ILECs' own development into businesses that are actually responsive to their customers' needs — for the Commission (or, for that matter, state regulators) to relieve the ILECs of the consequences of their failure to anticipate the nature of their customers' demand for calls to the Internet and to engineer their networks in a manner to handle such calls efficiently.

In reality, therefore, the ILECs' problem does not arise from the requirement that they pay terminating compensation on calls their end users make to the Internet. The problem arises from their own failure to anticipate their customers' demand and to engineer their networks accordingly. There is absolutely no public policy basis for "solving" these ILEC-generated problems by manipulating and distorting their terminating compensation obligations.

---

[51](...continued)
(published July 28, 1997) ("Bell Atlantic hasn't raised basic residential rates a cent since the passage of the Telecommunications Reform Act of 1996. And we won't, ***because those rates are capped almost everywhere***.")

[52] *See* Joint Comments at 8-10 & n. 15.

V. CONCLUSION.

Everyone except the ILECs agrees that local calls to the Internet are subject to compensation under Sections 251(b)(5) and 252(d)(2) of the Act. That conclusion is supported by the Act's definitions of "telephone exchange service," "telephone toll service," and "interstate communications." Moreover, because local calls to the Internet are jurisdictionally interstate, the Eighth Circuit's recent decision does not limit, and actually affirms, the Bureau's authority to rule that such calls are subject to reciprocal compensation. Finally, there is no merit to Ameritech's claim that it would be unfair to the ILECs to allow compensation for calls to the Internet. Even with cost-based rates, any number of legitimate business factors would lead CLECs to target ISPs as customers. Moreover, the ILECs could have avoided the entire problem by negotiating for bill-and-keep.

Respectfully submitted,

ADELPHIA COMMUNICATIONS CORPORATION, BENCHMARK COMMUNICATIONS, INC., CENTURY COMMUNICATIONS CORP., DANIELS CABLEVISION, INC., FREDERICK CABLEVISION, INC., GREATER MEDIA, INC., INTERMEDIA PARTNERS, JAMES CABLE PARTNERS, L.P., JONES INTERCABLE, INC., MARCUS CABLE COMPANY, L.P., RIFKIN AND ASSOCIATES, INC., STARSTREAM COMMUNICATIONS, INC., AND WINDKEEPER COMMUNICATIONS, INC.

By: _____

Christopher W. Savage
Robert G. Scott
COLE, RAYWID & BRAVERMAN, L.L.P.
1919 Pennsylvania Avenue, N.W., Suite 200
Washington, D.C. 20006
202-659-9750

Their Attorneys

July 31, 1997

CERTIFICATE OF SERVICE

I, Linda M. Blair, a secretary with the law firm of Cole, Raywid & Braverman, L.L.P., do hereby certify that copies of the foregoing were sent this 31st day of July 1997, via first class, postage prepaid, United States mail to the following:

Wanda Harris*
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 518
Washington, D.C. 20554

James D. Schlichting*
Chief, Competitive Pricing Division
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 518
Washington, D.C. 20554

Richard Welch*
Federal Communications Commission
1919 M Street, N.W., Room 544
Washington, D.C. 20554

Kevin Werbach*
Office of Plans and Pricing
Federal Communications Commission
1919 M Street, N.W., Room 822
Washington, D.C. 20554

ITS*
1231 20th Street, N.W.
Washington, D.C. 20036

Andrew D. Lipman
Michael W. Fleming
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Kecia Boney and Lisa B. Smith
MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Dana Frix and Douglas G. Bonner
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Cheryl A. Tritt and Charles Kennedy
Morrison & Foerster, LLP
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006-1888

Messrs. Lampert, Harvie & Valentino
Mintz, Levin, Cohn, Ferris, et al.
701 Pennsylvania Ave., N.W., Suite 900
Washington, D.C. 20004

Teleport Communications Group Inc.
Teresa Marrero
Senior Regulatory Counsel - Federal
Two Teleport Drive
Staten Island, NY 10311

Ronald Plesser and Mark J. O'Connor
Piper & Marbury, L.L.P.
1200 Nineteenth Street, N.W., Suite 700
Washington, D.C. 20036

Douglas Bonner and Tamar Haverty
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Werner K. Hartenberger
Dow, Lohnes & Albertson, PLLC
1200 New Hampshire Ave., N.W.
Suite 800
Washington, D.C. 20036

Morton J. Posner
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Brad E. Mutschelknaus
Kelley Drye & Warren, LLP
1200 19th Street, N.W., Suite 500
Washington, D.C. 20036

Leon M. Kestenbaum
Sprint Corporation
1850 M Street, N.W., Suite 1110
Washington, D.C. 20036

Mark C. Rosenblum
AT&T Corp.
295 North Maple Avenue, Rm. 3252J1
Basking Ridge, NJ 07920

Raymond G. Bender, Jr.
Dow, Lohnes & Albertson, PLLC
1200 New Hampshire Ave., N.W.
Suite 800
Washington, D.C. 20036

Messrs. Blau and Rindler
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Glenn B. Manishin
Blumenfeld & Cohen - Tech Law Group
1615 M Street, N.W., Suite 700
Washington, D.C. 20036

Messrs. Rindler and Posner
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Phyllis A. Whitten
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Robert V. Zener
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Messrs. Wilson and Strick
Frost & Jacobs LLP
2500 PNC Center
201 East Fifth Street
Cincinnati, OH 45202

Thomas E. Taylor
Cincinnati Bell Telephone Company
201 East Fourth Street, 6th Floor
Cincinnati, OH 45202

Wendy S. Bluemling
The Southern New England
Telephone Company
227 Church Street
New Haven, CT 06510

Messrs. Canis and Leibow
Kelley Drye & Warren, LLP
1200 9th Street, N.W., Suite 500
Washington, D.C. 20036

Lawrence G. Malone
N. Y. State Department of Public Service
Three Empire State Plaza
Albany, NY 12223-1350

Messrs. Kiddoo, Cooper & Petrilla
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Mark. A. Stachiw, Esq.
AirTouch Paging
12221 Merit Drive, Suite 800
Dallas, TX 75251

Randolph J. May
Sutherland, Asbill & Brennan
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404

Gary L. Phillips
Ameritech
1401 H Street, N.W., Suite 1020
Washington, D.C. 20005

Douglas G. Bonner
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Messrs. Haney, Townsend & Kent
USTA
1401 H Street, N.W., Suite 600
Washington, D.C. 20005

*via hand delivery

Linda M. Blair

Linda M. Blair

EXHIBIT C

STAMP & RETURN

COLE, RAYWID & BRAVERMAN, L.L.P.

ATTORNEYS AT LAW
SECOND FLOOR
1919 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20006-3458
(202) 659-9750

JOHN P. COLE, JR.
BURT A. BRAVERMAN
ROBERT L. JAMES
JOHN D. SEIVER
WESLEY R. HEPPLER
PAUL GLIST
DAVID M. SILVERMAN
JAMES F. IRELAND, III
STEVEN J. HORVITZ
CHRISTOPHER W. SAVAGE
ANN FLOWERS
ROBERT G. SCOTT, JR.
SUSAN WHELAN WESTFALL
THERESA A. ZETERBERG
KARLYN D. STANLEY
JOHN DAVIDSON THOMAS
JOHN C. DODGE
FREDERICK W. GIROUX
GEOFFREY C. COOK*
MARIA T. BROWNE
DONNA C. RATTLEY
THOMAS SCOTT THOMPSON
ADAM S. CALDWELL
SANDRA GREINER
JAMES W. TOMLINSON
MARK S. KRISTIANSEN†

*ADMITTED IN MASSACHUSETTS ONLY
†ADMITTED IN MARYLAND ONLY

ALAN RAYWID
(1930-1991)

OF COUNSEL
FRANCES J. CHETWYND

FACSIMILE
(202) 452-0067

INTERNET
WWW.CRBLAW.COM

WRITER'S DIRECT DIAL
(202) 828-9811

WRITER'S E-MAIL ADDRESS
CSAVAGE@CRBLAW.COM

CC 96-98
CC 97-3

RECEIVED
AUG - 6 1998

August 6, 1998

By Hand

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

Re: Reciprocal Compensation for Internet Traffic

Dear Chairman Kennard:

ALEC, Inc. has observed with interest the exchange of letters between Bell Atlantic and others regarding reciprocal compensation for calls to Internet Service Providers ("ISPs"). ALEC is a certificated competitive local exchange carrier ("CLEC") in Kentucky that provides service to an ISP within its service territory. ALEC is involved in a dispute with BellSouth at the Kentucky PSC regarding reciprocal compensation for calls to ISPs. ALEC, therefore, has a direct interest in this issue. ALEC's perspective on the question, however, appears to differ not only from Bell Atlantic's, but also in some respects from others who have previously responded to Bell Atlantic's original letter. We offer the discussion below for the Commission's consideration.

To place the matter in perspective, the issue of reciprocal compensation for calls to ISPs arises only because of two positive, pro-competitive developments: (a) the proliferation of CLECs made possible by passage of the Telecommunications Act of 1996 (the "1996 Act"); and (b) the explosive growth of consumer interest in accessing the Internet. These developments both reflect and embody the increasing scope and variety of telecommunications and information services available to American consumers. This problem

exists, in short, because competition in telecommunications and information services markets is beginning to take root. Indeed, it is precisely for this reason that the matter is of such concern to Bell Atlantic and other incumbent local exchange carriers ("ILECs").

Bell Atlantic's most recent letter claims that reciprocal compensation for calls to the Internet discourages competition and investment. Bell Atlantic's real problem, however, is that competition — and the investments to support it — are not developing in ways that Bell Atlantic and other ILECs anticipated. Bell Atlantic wants the Commission to forestall the competition for which it was not prepared (and to which it is most vulnerable) in order to force its rivals to compete in ways for which Bell Atlantic was prepared (and to which, therefore, it is least vulnerable).

The Commission should decline Bell Atlantic's invitation to micromanage the development of competitive markets in the littoral zone between the public switched network ("PSN") and the Internet. To the contrary, the Commission should frame any ruling it makes on this issue with an eye towards encouraging innovative investment — such as the investments being made by CLECs that serve ISPs and by ISPs seeking to take advantage of the benefits of CLEC status. This is the only result that is consistent with the procompetitive purposes of the 1996 Act.

Bell Atlantic's central claim is that calls to ISPs should not be subject to terminating compensation. On a fundamental economic level, this claim is ludicrous. Bell Atlantic is simply trying to distract the Commission from the business and competitive realities of the situation. To see how this is so, one need only follow the money.

In a monopoly environment, the ILEC collects revenues from end users. That money is intended to recover not only the cost of the end user's line, but also the cost of the use of that line to make local calls. Those costs are, primarily: (a) originating switching; (b) transmission to the terminating switch; and (c) terminating switching. This regime applied before the 1996 Act was passed, and applies today when an ILEC customer calls an ISP that buys its dial-in lines from the ILEC.[1]

In a competitive environment, when a CLEC serves a customer receiving a call, some call termination costs — specifically, terminating switching costs — are lifted from the

---

[1] As the Commission has noted in the *Access Reform Order*, if the ILEC's charges to its end users are not high enough to recover those costs, the ILEC should either become more efficient or raise those charges. *See* Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, and End User Common Line Charges, *First Report and Order*, 12 FCC Rcd 15982 (1997) at ¶¶ 346. That problem, therefore, is independent of the issue of terminating compensation.

ILEC and borne by the CLEC. The ILEC saves resources because the CLEC is doing some of what was previously the ILEC's work. The ILEC got paid for that work — and will continue to get paid — by the originating customer. The terminating compensation obligation simply ensures that CLECs get paid when they do the work instead.

In some sense, it's that simple. As long as Bell Atlantic and other ILECs continue to charge their end users for making local calls to ISPs — whether as part of a fixed-charge unlimited usage package, part of an increased SLC on second lines, or in individual message units or measured service charges — it is unfair — a form of unjust enrichment — to allow them to shed the terminating switching *cost*, but keep the money.[2]

The regime Bell Atlantic apparently endorses — no terminating compensation for calls to ISPs — would dampen, not encourage, investment in the telecommunications infrastructure. If Bell Atlantic is to be believed, dozens if not hundreds of ISPs and their CLEC confederates have deployed switches, routers or similar devices to be able to receive incoming calls from the PSN. Bell Atlantic apparently disapproves of this investment, and would prefer that its competitors make other investments (*e.g.*, in standard Class 5 switches or copper loops).

Bell Atlantic, however, is not entitled to second-guess the market, and the Commission should not do so either. The new investments that competitors are actually making promote increased integration between ISPs in particular (and the Internet in general) on the one hand, and the PSN on the other. In this sense, this situation is simply another facet of the same economic phenomenon that is driving ILECs and CLECs alike to develop and invest in xDSL technology. The market has recognized that the Internet — and widespread access to it — is critically important to the nation's communications infrastructure, and — as markets do — it is voting with its money. The intense investment

---

[2] The hard fact — that Bell Atlantic basically ignores — is that when a *CLEC* terminates calls to an ISP, it is performing a function for which the *ILEC* gets paid by its customers. Fairness requires that a portion of that revenue be passed on to the CLEC, which is, in effect, what Section 251(b)(5) requires as well. It is no answer to this fact to complain, as Bell Atlantic does, that connecting to the CLEC entails new trunking and related transmission costs. The calls that are carried over the newly established trunks are no longer carried over ILEC facilities connecting the ILEC's originating switch to the ILEC's (former) terminating switch. As a result, the need to expand those facilities is deferred or avoided altogether. And the more calls that get carried over facilities running to the CLEC, the greater the savings (in the form of deferred expansion) on the embedded facilities. At bottom, if Bell Atlantic had not spent the money needed to route calls its customers make to ISPs via CLECs, it would have had to spend money to beef up the capacity of its own inter-switch network. The need to spend that money is driven by increasing consumer interest in calling the Internet, not by the terminating compensation obligation.

and competitive focus on areas of interface between the Internet and the PSN may not have been the conventional wisdom about how markets would develop when the 1996 Act was passed, but that only shows that competition is difficult to predict.[3]

This brings us to the somewhat metaphysical debate about whether calls to ISPs are really "interstate" or not. In its most recent letter, for example, Bell Atlantic boldly proclaims that "Internet traffic is interstate and interexchange" and asks the Commission to so rule. As described below, Bell Atlantic is — at most — half right.

No one will dispute that the passage of Sections 251 and 252 of the Act created something of a jurisdictional muddle; this is the key issue before the Supreme Court in its review of the 8th Circuit's order in the *Iowa Utilities Board* case. In the new and complex legal regime established by the 1996 Act, therefore, blithe generalities such as that put forward by Bell Atlantic can only confuse matters. What is required here is not bold but vague statements, but, instead, a careful parsing of both the language of the Act and the technical realities of dial-up access to the Internet.

Section 251(b)(5) requires all LECs to enter into reciprocal compensation arrangements "for the transport and termination of telecommunications." Section 252(d)(2)(A)(i) and (ii) show that the reciprocal compensation obligation applies to "calls" that one LEC hands off to another for termination. The statutory question, therefore, is whether the "call" that an ILEC's customer makes to a local ISP "terminates" at the ISP's location.[4]

While the term "call" is not defined in the Communications Act, it is used throughout Title II in a manner that shows that the straightforward, common meaning applies: a "call" is what happens when two stations on the PSN are connection to each other.[5] A call

---

[3] If the only activities allowed under the 1996 Act are those that conform to the conventional wisdom at the time of its passage, then (among other post-1996-Act developments) Bell Atlantic should never have been allowed to buy NYNEX, and should not be allowed to merge with GTE.

[4] Bell Atlantic uses of the generic term "traffic" to describe communications between an ILEC's customer and the Internet. While this generic term is acceptable in some contexts, here the generic term confuses rather than clarifies the appropriate analysis.

[5] *See, e.g.*, references to "calls," "called telephone numbers," and similar usage in 47 U.S.C. § 222(d)(3); § 223(a)(1); § 223(b)(1)(A); § 225(d)(1)(D); § 226, *passim*; § 227, *passim*, including, specifically: § 227(a)(1)(A); § 227(b)(1)(A); § 227(b)(2)(C); § 227(c)(3)(G); § 227(d)(3)(B); § 228, *passim*; § 229; § 271(c)(2)(B)(vii)(III); § 271(c)(2)(B)(x); § 271(j); § 274(i)(7); § 275(d);

(continued...)

"terminates," therefore, when one station on the PSN dials another station, and the second station answers.

In literal statutory terms, any particular "call" is an instance either of "telephone exchange service" as defined in 47 U.S.C. § 153(47) (when the two PSN stations are within the same local calling area) or of "telephone toll service" as defined in 47 U.S.C. § 153(48) (when they are not). In the former case – telephone exchange service – the call is a local call. In the latter case it is a toll call.

In the case of a call to an ISP, if the calling party and the ISP are in the same local calling area, the call is local. It is, therefore, subject to reciprocal compensation. As with the basic economics of the situation, discussed above, it really is that simple. No matter how one characterizes what the ISP does with the information the end user sends over the local connection, *the connection itself* is a local call subject to terminating compensation.

This is true even if an end user in Washington, D.C. obtains a World Wide Web page from a computer in California (or, for that matter, in Calcutta). Whatever the packet-switched transactions amongst the ISP, various backbone providers, and the host computers may be, they are not, by any stretch of the imagination, a "call." In this regard, the Commission has properly and repeatedly noted that the ISP's functions in dealing with the Internet are reasonably distinguishable from the plain vanilla POTS call that the end user makes to the ISP.[6]

As a result, it actually doesn't matter whether the signals carried between the end user and the Internet are jurisdictionally interstate or not. The idea that it *does* matter arises from a confusion between: (a) the distinction between local calls and toll calls (embodied in 47 U.S.C. §§ 153(47) and 153(48)); and (b) the distinction between intrastate and interstate communications embodied in 47 U.S.C. § 153(22).

---

[5](...continued)
and § 276(b)(1)(A). *See also* Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, *First Report and Order and Further Notice of Proposed Rulemaking*, 11 FCC Rcd 21905 (1996) at ¶ 107 (noting that a "telephone call" takes place over a "basic transmission path"). The connection between and end user and an ISP is a "basic transmission path." The Internet is not.

[6] *See, e.g.*, Federal-State Joint Board on Universal Service, *Report and Order*, CC Docket No. 96-45 (released May 8, 1997) at ¶¶ 788-90; Federal-State Joint Board on Universal Service, *Report To Congress*, CC Docket No. 96-45 (April 10, 1998) at ¶¶ 13, 21, 105.

The Commission's jurisdiction extends to interstate communications. A "communication" (by wire or radio) is:

> the transmission ... of writing, signs, signals, pictures and sounds of all kinds [and] all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission.

See 47 U.S.C. §§ 153(33) (radio communication) and 153(51) (wire communication). When the communication is between different states (or between a state and a foreign country), the communication is jurisdictionally interstate; when it remains within a single state, the communication is jurisdictionally intrastate.

What matters here – and what Bell Atlantic ignores – is that the definition of "communication" under the Act is much, much broader than the definition of "telecommunications," and broader still than the particular *type* of telecommunications represented by local calls and toll calls under 47 U.S.C. §§ 153(47) and 153(48). The broad definition of "communication" encompasses the entirety of the Commission's subject matter jurisdiction, and includes, for example, radio and television broadcast signals and cable television service. Most relevant here, it also includes information services such as those provided by ISPs and other entities involved in the Internet.

From this perspective, the Commission probably does have statutory jurisdiction over a communication that starts with an end user in Washington that (in various formats) traverses the Internet to a host computer in California (or Calcutta). But that doesn't mean that the connection between the end user and the ISP down the street is anything other than a local call. To the contrary, the gravamen of the Commission's rulings on this issue is that the overall communication in such a case can reasonably be broken down into a local call and an information service. The local call to the ISP is subject to terminating compensation under Sections 251(b)(5) and 252(d)(2)(A). Nothing in the language of those sections (or anything else in the Act) suggests that the status of the underlying communication as interstate or intrastate affects this conclusion.[7]

---

[7] This conclusion also does not violate the so-called "one call" rule. If, when all the dust settles, the communication at issue is a POTS call linking an exchange station on the PSN in one local calling area with an exchange station on the PSN in another local calling area, the existence of intermediate connections does not somehow exempt the communication from the statutory definition of "telephone toll service," which is the connection (by whatever means) of exchange stations in different exchange areas. *See* 47 U.S.C. § 153(48). But in the case of dial-in access to the Internet, we have a local POTS call connecting two local exchange stations (the end user's and the ISP's), combined with an information service – the latter being replete with data storage,

(continued...)

The Commission should also be aware that, as a purely technical matter, for the vast majority of the time that a typical dial-up customer is on line, the signals being exchanged do not either come from or go to "the Internet" as such. Instead, most signals begin and end with the end user's and the ISP's customer premises equipment ("CPE"). Once the end user's modem and the ISP's modem are connected, they talk to each other constantly. This constant CPE-to-CPE exchange of information is needed to keep the two devices synchronized so that the maximum possible amount of data can be sent over analog exchange lines.[8] These signals are neither noise on the line nor mere communications overhead. To the contrary, they are carefully structured communications devised by the modem equipment, and are critical to the integrity of the connection. These signals continue constantly, even when higher-level information is not being transmitted. For the vast majority of the duration of an average dial-in session with an ISP, these purely local signals are the only traffic being exchanged.[9]

Moreover, many ISPs have configured their systems so that even higher-level information, supposedly from "the Internet," is actually stored and retrieved locally. For example, when a customer receives email, the message is sent to the customer's ISP, which maintains a local email server — a computer on the ISP's premises that stores email messages. When a customer logs on to check his or her email, the messages are downloaded from the ISP's local email server to the customer's computer. These are purely local data transmissions.[10]

As another example, the World Wide Web is basically a system for identifying files of interest to end users and downloading them (*i.e.*, a massive, jointly-provided

---

[7](...continued)
interaction with stored data, packet switching, etc. There is no reason to think that the "one call" rule should apply to this situation, and it does not.

[8] Improved intelligence in modems, reflected in more complex encoding of information within the signals the modems send to each other, is what has allowed the rate of data transmission over an analog modem line to increase from 9600 bits per second in the early- to mid-1980s to nearly 30,000 bits per second today. This can be improved to a download rate of more than 50,000 bits per second if the ISP has a digital (as opposed to analog) link between its modems and the LEC switch providing the ISP's connections to the PSN.

[9] This occurs because end users typically take a certain amount of time to review the data they get before requesting more data. The modems continue with their synchronization signals even when previously downloaded files are being reviewed by the end user — a process that can take much longer than the downloading itself.

[10] This applies to newsgroups and lists as well, which are essentially a form of group email.

information service). When an end user clicks on a Web page's URL, what really happens is that a short message is sent to the end user's ISP requesting a copy of the files that make up the Web page. In an increasing number of cases, ISPs are implementing caching arrangements where the ISP maintains current local copies of the Web pages that the ISP (aided by software) believes that its customers are most likely to request. If the ISP correctly anticipates these requests, it will already have on hand, locally, at least some of the Web pages that its customers want to visit. When this occurs, the customer receives the requested Web page in an entirely local communication.

The predominantly local nature of the signals sent between end users and their ISPs merely emphasizes the critical distinction between: (a) the issue of whether the dial-in connection to an ISP is a local call subject to terminating compensation (it is) and (b) the issue of whether the FCC has statutory jurisdiction over communications between and among end users, ISPs, the Internet backbone, and distant Web sites (maybe, but it doesn't matter to the question at hand). In statutory terms, whether a local call (subject to terminating compensation) has occurred is determined by applying Section 153(47) (defining "telephone exchange service"). Whether the underlying *communication* is interstate or intrastate is determined by applying Sections 153(33) or 153(51) (defining radio or wire communications) and Section 153(22) (defining "interstate" communication). These are distinct statutory inquires that must be undertaken separately, precisely because the ISP's *information services* are legally and technically distinct from the *telecommunications service* that customers use to connect to their ISPs.

In light of the technical and legal distinction between the local call to an ISP (a "telephone exchange service") and the ISP's interactions with the Internet (an "information service"), and in light of the fact that increasing amounts of "Internet traffic" between ISPs and end users is actually local end-to-end, it is clear that Bell Atlantic's bold assertion — "Internet traffic is interstate and interexchange" — is at most half right. Some — maybe even all — communications between end users and the Internet may be jurisdictionally interstate. But for such a communication to be "interexchange," it would have to be a form of "telecommunications," and, in particular, a form of "telephone toll service" involving the establishment of a connection between two PSN exchange lines in different local calling areas. This is not what happens when an end user (for example) retrieves files from a distant World Wide Web site. To the contrary, the only exchange lines connected to each other when an end user calls a local ISP are the end user's and the ISP's – in the same local calling area. These calls, therefore, are subject to terminating compensation under Section 251(b)(5).

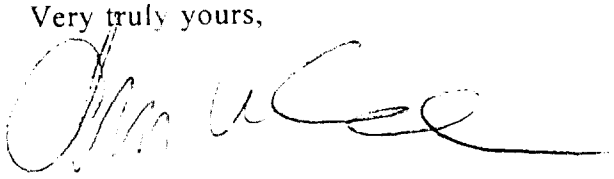
* * * * *

For all of the reasons stated above, if the Commission issues any order in this matter, that order should expressly state that the question of whether communications between end users and ISPs over dial-in lines are jurisdictionally interstate is separate and distinct

from the question of whether the calls end users make to ISPs are subject to terminating compensation. The Commission should also expressly state that, to the extent such calls *are* jurisdictionally interstate, the terminating compensation obligation of Section 251(b)(5) fully applies to them.

For convenience, ALEC has attached proposed language to be included in an ordering clause.

Very truly yours,



Christopher W. Savage
Counsel for:
ALEC, Inc.

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

Proposed Ordering Clauses

I. Pursuant to sections 4(i), 4(j), 201, 251(b)(5), 251(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 that telephone exchange service subscribers make to exchange services of Internet Service Providers (ISPs) are a form of telecommunications that is separate and distinct from the information services that the ISPs themselves provide. We confirm, therefore, that it there is no sound legal or policy basis for evaluating the status of local calls by end users to ISPs any differently than any other local calls. This ruling specifically applies to the reciprocal compensation obligations imposed by section 251(b)(5) of the Act. Therefore, when a call from an end user is handed off by a carrier serving the customer originating the call to another carrier that terminates the call to an ISP, such a call is fully subject to reciprocal compensation obligations, as long as the end user and the ISP are in the same local calling area.

III. By adoption of this Order, we also clarify that, while our previous orders exempting ISPs 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 affect the nature of the end-to-end communication that is carried, in part, on the local exchange calls by which some end users connect to their ISPs. The fact that the communication itself may be jurisdictionally interstate, however, does not resolve the question of whether the portion of the communication that constitutes a local call is or is not subject to terminating compensation under Section 251(b)(5). To the extent that we have jurisdiction over such local calls by virtue of the interstate nature of the underlying communication, we now expressly hold that such calls *are* subject to terminating compensation under Section 251(b)(5).

IV. By adoption of this Order, we do not prejudge whether any individual carriers may have expressly and unambiguously agreed to forgo their rights under the Act and voluntarily exempted from the reciprocal compensation obligation calls that end users of one carrier make to ISPs served by another carrier. Under Section 252(a)(1), a carrier may waive its right to receive such compensation, despite the fact that the carrier would otherwise be entitled to it under the Act. Such individual determinations are best made by state commissions based on their review of specific interconnection agreements.