Jay Bennett
Director-
Federal Regulatory

SBC Communications Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8889
Fax 202 408-4805

EX PARTE OR LATE FILED

December 7, 1998

Memorandum of Ex Parte Communication

Magalie Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Street Lobby – TW A325
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Dear Ms. Salas:

Re: *CC Docket No. 96-98 – Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Regarding Reciprocal Compensation for Information Service Provider Traffic*

Please enter the attached letter to Mr. Jim Casserly, Mr. Kyle Dixon, Mr. Paul Gallant, Mr. Kevin Martin and Mr. Tom Power into the record for the above-listed proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me at (202) 326-8889 should you have any questions.

Sincerely,

Jay Bennett

Attachment

Jay Bennett
Director -
Federal Regulatory

SBC Telecommunications, Inc.
1401 I Street, N.W.
Suite 1100
Washington D.C. 20005
Phone 202 326-8889
Fax 202 408-4805

December 7, 1998

Mr. Tom Power
1919 M Street, N.W., Room 814
Washington, D. C. 20554

Mr. Kyle Dixon
1919 M. Street, N.W., Room 844
Washington, D.C. 20554

Mr. Jim Casserly
1919 M Street, N.W. , Room 832
Washington, D. C. 20554

Mr. Paul Gallant
1919 M Street, N.W., Room 826
Washington, D. C. 20554

Mr. Kevin Martin
1919 M Street, N.W., Room 802
Washington, D. C. 20554

Re: Reciprocal Compensation for Dial-up Internet Traffic

Dear Messrs. Casserly, Dixon, Gallant, Martin and Power:

The attached article ("Should Your ISP Become A CLEC") demonstrates again the economic distortions which result from the current situation regarding reciprocal compensation for dial-up Internet traffic. ISPs are advised that "[m]utual compensation could be a new revenue source for ISPs that heavily utilize channelized circuits to serve dial-up customers." The article goes on to state, "[a]s mutual compensation obligations are measured by the number of call minutes terminated or received and not the number of minutes originated, the balance of payments will thus be in favor of the ISP." The complete article can be found at www.nortel.com/pcn/isp/goals/should.htm.

As SBC has advocated previously, the Commission should immediately issue an Order finding that dial-up Internet traffic is a single call, subject to Interstate jurisdiction. Additionally, the Commission should direct that meet point billing is the appropriate billing arrangement when two or more local carriers provide facilities to transport an interexchange call. Of course, such an Order would not impact the existing ESP exemption.

Please do not hesitate to contact me if you would like to discuss this further.

Sincerely,

Attachment

cc: Jim Schlichting
Suzanne Tetreault
Tamara Preiss

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Should Your ISP Become a CLEC?

(The following article is provided courtesy of ISG Telecom)

Through dial-up and point-to-point dedicated Internet offerings, Internet service providers have made a substantial emergence into the telecommunications industry. Local telephone companies, on the other hand, such as incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs), have aggressively begun pursuing the Internet business as a corollary to their existing telephone company services. For telephone companies, this makes sense. Local telephone companies own the lines which are required to reach end-user Internet customers. They can act not only as the suppliers of lines to ISPs, but by installing remote Internet access equipment in their existing central offices, they are able to provide Internet services. As local telephone companies are now aggressively getting into the Internet business, ISPs are beginning to follow the same path by becoming telephone companies.

Why should an ISP get into the telephone company game and file to become a CLEC?

There are several reasons:

- State by State mandated 17 to 25 percent below-tariff wholesale rates on circuits and services for switchless reseller CLECs
- Greater discounts of 20 to 45 percent below-tariff wholesale rates on circuits and services for facility-based CLECs
- Mutual compensation at least the next six months or so
- Availability of carrier class services unavailable at retail levels
- Most importantly, the ability to profit from the telecom services used by your existing customer base and community

Becoming a CLEC can lead to substantial cost savings, and potential new revenue streams for ISPs that currently pay tariff prices on circuits provided by ILECs or CLECs.

The Telecommunications Act of 1996 requires that ILECs open up their markets to competition by allowing competitors to interconnect with their facilities, unbundled their networks and/or resell network elements. The states are charged with implementing interconnection under the Act. An entity, such as an ISP, which desires to interconnect with an ILEC, must become a certified CLEC, file retail tariffs and negotiate an interconnection agreement with the telephone company. If only offering intrastate services, the entity need only apply for carrier certification at the state level. However, if offering interstate services, the carrier must become certified and post a tariff with the Federal Communications Commission (FCC) as well.

The first thing an ISP should do to become a CLEC is to create a wholly owned separate subsidiary, which can be owned by the same shareholders as the Internet company. It is important to keep separation between the activities and revenues of the unregulated ISP and the regulated CLEC side. Once the CLEC entity is established, the ISP-CLEC (as we will call the new entity), as mentioned, must make the appropriate filings with its state public utility commission (PUC) and/or the FCC. This process may take as long as a year, or as little as 120 days from date of filing and each state handles these applications differently.

The ISP-CLEC must also negotiate an interconnection agreement with the ILEC whose services it intends to purchase, and whose territory it plans to enter. The interconnection agreement must reflect mutually agreed loop and circuit rates as well as other agreed upon interconnection points, rates and processes. Over several thousands of these agreements have been negotiated and approved by state public utility commissions since the passage of the Telecommunications Act, leading to the development of some measurable local telephone competition in the largest local telephone markets.

In addition to establishing the interconnection rate, the basic interconnection agreement should reflect the type of interconnection, i.e., how to connect the networks, unbundled network element (UNE's) pricing, and/or resale, the quality of service elements, and the agreed-on mutual compensation rate for terminating traffic, amongst other issues.

With respect to the type of arrangement that should be pursued, most ISPs, at least initially, will probably want to become resellers of local telephone company services rather than purchasing their own switching equipment and unbundling elements of the local telephone company network. An ISP-CLEC reseller can later file with the regulatory body and re-negotiate an interconnection agreement to expand its interconnection flexibility and unbundled ILEC network elements.

Becoming a CLEC can be highly advantageous because it allows the ISP to obtain a minimum State by State mandated 17 to 25 percent discounts on the lines purchased by the CLEC subsidiary, including dial tone lines and private point-to-point lines. Even greater discounts can be obtained by entering into a term and volume discount agreements with ILECs and other CLECs. For example, an ISP that has purchased T-1 lines from an ILEC at the tariffed price could save 17 to 25 percent below that tariff price on those same lines if it purchased them as a CLEC reseller under the posted resale tariff. A savings of 17 to 25 percent across the board, or higher under a privately negotiated agreement or the use of switching facilities, can be extremely substantial and put any ISP in a much more competitive position within its markets. The savings on local loop lines can translate into either higher profits and/or lower price, both of which are key ingredients for a growing ISP company.

Further, the ISP-CLEC will be able to participate in mutual compensation arrangements with other carriers. Mutual or reciprocal compensation is the term used to describe the fees that interconnecting local carriers pay to terminate traffic on each other's network. For example, where Carrier A and Carrier B have an interconnection agreement, Both Carrier A and Carrier B must pay each other for the amount of traffic per minute that each carrier terminates on the other's network over the interconnected lines. The payments for mutual compensation are typically between 0.2 and 1.04 cents per minute.

Mutual compensation could be a new revenue source for ISPs that heavily utilize channelized circuits to serve dial-up customers. As traffic generated over the lines that ISPs control is typically one way, this can be beneficial to the ISP. End-user Internet customers typically originate local calls over the ILEC network which terminate at the ISP POP (or on the ISP network). But few calls are originated on the ISP network and terminated onto the ILEC network. As mutual compensation obligations are measured by the number of call minutes terminated or received and not the number of minutes originated, the balance of payments will thus be in favor of the ISP.

ISPs that choose to become carriers to participate in mutual compensation arrangements should be aware of the current regulatory climate. Some ILECs have taken the position that mutual compensation for ISP-related traffic is not contemplated by the existing FCC and state rules. The ILECs do not consider that the typically one way traffic into an ISP to be mutual nor reciprocal and thus are fighting the reciprocal compensation payments for ISP traffic. The ILECs also claim that mutual compensation is meant only for local calls, not calls to ISPs, which they claim are interstate in nature. These ILECs have withheld payments to CLECs who serve ISPs, who the ILECs believe are accumulating large amounts of ISP traffic for mutual compensation purposes. In over 17 challenges to State PUCs, the reciprocal compensation payments for ISP traffic has been upheld as both local in nature and subject to the payment of reciprocal compensation on those states. In other words, the ILECs have lost every case, with the State PUCs, in which it has challenged the payment of reciprocal compensation. The FCC and numerous states are currently addressing this issue, which likely will be resolved, as part of total access reform and/or new internet service regulatory actions.

In addition to obtaining discounts on lines and potentially advantageous mutual compensation arrangements, being a CLEC elevates an ISP's ability to negotiate on a relatively level playing field. As opposed to an end-user customer, as a CLEC, the ISP can obtain a whole new bundle of negotiation rights, including quality of service, good faith negotiation, and regulatory protections/enforcement mechanisms.

Aside form the benefits of being an ISP-CLEC, there are certain regulatory burdens attached. First, regulated telecommunications companies are required to collect and/or pay fees to their regulatory bodies. These fees, are typically based on revenues from lines,usage, and interstate access, as well as a host of taxes and surcharges. These fees and can be quite substantial depending on the revenues generated by the contributing ISP-CLEC. Second, regulated CLECs are required to make contributions into the Universal Service Fund (USF), that are also based on revenues from lines. The USF is used to subsidize basic telephone service to rural and urban poor residents as well as provide subsidies for providing advanced telecommunications capabilities to schools, libraries, and rural health care facilities. However, ISP-CLECs who provide services to schools or libraries that obtain USF discounts on those services under the USF program may offset their USF contribution by amounts they would be owed from the USF Fund Administrator for providing those discounted services directly. Furthermore, regulated carriers must make contributions into the telecommunications relay services (TRS) fund, which is used to support telecommunications services for the hearing impaired. Last, regulated carriers must file tariffs with their regulatory body and obtain prior approval before expanding service offerings or geographic coverage.

From the broader perspective, the direction of telecommunications industry development suggests that ISPs who want to remain competitive in the future telecommunications industry should probably become CLECs. As the industry is certainly moving closer to a model where voice, video and data will traverse the same telecommunications lines into end-user homes, becoming a CLEC may ultimately be a critical step for a current ISP to position itself competitively. ISP-CLECs who control their own lines will more likely be in a position to rapidly bring advanced new services, such as Internet telephony, to customers.

Internet telephony is a promising business opportunity for ISPs that has become a substantial issue at the FCC since it affects the traditional regulatory model for voice telephony. The FCC and the states will likely require ISPs who are providing Internet voice telephony to become regulated carriers since, among other reasons, any contrary FCC or state PUC decision might be considered discriminatory regulation against traditional voice carriers such as ILECs. Thus, an ISP that is already a certified carrier may be better positioned under a regulatory model to enter into new lines of business such as voice telephony, than an ISP that is not a certified carrier.

The bottom line is that telecommunications is a rapidly changing industry, and ISPs can't afford to be left behind in position for the future. Therefore, ISPs should be seriously consider taking the next step -- and become ISP-CLECs.

Authors: Tamra Burgwardt & Joseph Isaacs Further details on ISG-Telecom can be found at ISG Telecom's Web Site.
