ORIGINAL

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
CHRISTIN S. MCMELEY+
HEATHER M. WILSON
DAVID N. TOBENKIN*

+ADMITTED IN OKLAHOMA ONLY
*ADMITTED IN CALIFORNIA ONLY

ALAN RAYWID
(1930-1991)

OF COUNSEL
FRANCES J. CHETWYND
ELLEN S. DEUTSCH

FACSIMILE
(202) 452-0067

INTERNET
WWW.CRBLAW.COM

RECEIVED
MAY 17 1999

May 17, 1999

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

Re: Notice of Permitted Ex Parte Contact, CC Docket No. 96-98 and CC Docket No. 99-68 (Intercarrier Compensation for ISP-Bound Calls).

Dear Ms. Salas:

The purpose of this letter is to advise the Commission of permitted *ex parte* contacts in the above-referenced proceeding. On Friday, May 14, 1999, Mr. Christopher W. Savage and Mr. William J. Rooney, Jr., on behalf of Global NAPs, Inc., had separate meetings with Mr. Kevin Martin of Commissioner Furtchgott-Roth's office; with Ms. Linda Kinney of Commissioner Ness's office; and with Ms. Sarah Whitesell of Commissioner Tristani's office.

At each of these meetings, the attendees discussed issues raised in Global NAPs' Comments and Reply Comments in the above-referenced docket. These issues included the economic basis for inter-carrier compensation for ISP-bound calls and the relative merits of using a state-PSC-determined TELRIC call termination rate, as opposed to an FCC-determined interstate local switching rate, as a reasonable "proxy" for CLEC costs of delivering ISP-bound calls to ISPs served by the CLEC. The attendees also discussed the legal theories upon which the Commission might rely in setting rules governing such compensation. The theories discussed were direct

92718.1

No. of Copies rec'd 0+2
List ABCDE

Commission action under Section 201(a) (on the theory that ISP-bound traffic is subject to Commission jurisdiction), and/or the promulgation of rules binding on states in their implementation of Section 251(b)(5), which would be promulgated in light of the Supreme Court's declaration of the scope of the Commission's rulemaking authority under Section 201(b).

The attached outline was discussed at the meeting and a copy left with each of the above-mentioned Commission staff members.

Please contact the undersigned if you have any questions about this matter.

Very truly yours,

Christopher W. Savage

cc: Mr. Martin
Ms. Kinney
Ms. Whitesell

Inter-Carrier Compensation for ISP-Bound Calls

1. Basic Economics

   a. Pre-competition:

      The ILEC charges end users to carry calls to ISPs. ***These end users are the cost-causers.***

      The ILEC switches the call at the end user's serving central office, routes it to the ISP's serving central office (owned by the ILEC). The ILEC then switches the call to the proper line, and transmits it to the ISP.

      All of these costs, except the ISP's line, are caused by the end user making the calls and should be recovered from the ILEC's end user.

   b. Post-competition:

      The ILEC charges end users to carry calls to ISPs. ***These end users are the cost-causers.***

      The ILEC switches the call at the end user's serving central office and routes it to the ISP's serving central office (***owned by the CLEC***). The ***CLEC*** then switches the call to the proper line, and transmits it to the ISP.

      All of these costs, except the ISP's line, are caused by the end user making the calls and should be recovered from the ILEC's end user.

      Since the CLEC (which does the terminating switching) has no relationship with the ILEC's end user, the ILEC ***must*** compensate the CLEC for the terminating switching work the CLEC performs. Otherwise, the CLEC cannot compete with the ILEC for the business of ISPs.

   c. Note that this economically sound result is the same, totally irrespective of the jurisdictional nature of the traffic in question; totally irrespective of whether the calls to the ISPs are viewed as "local," "toll," "access," or something else; and totally irrespective of whether the ILEC actually charges its end users enough to cover the costs of calling ISPs.

2. Legalities: Section 201(a) or rules under Section 201(b), interpreting Sections 251(b)(5) and 252(d)(2)?

   a. To the extent that the traffic is truly interstate, the Commission may act under either legal theory to accomplish the same result.

b. To the extent that the traffic is partially intrastate and severable (which it is; *see* below) the Commission would be better advised to adopt rules interpreting how Section 251(b)(5) and 252(d)(2) should be applied. This will assure uniform results and avoid technically sophisticated jurisdiction-shopping.

c. Possible rules:

i. "Any traffic not subject to access charges under Section 201 shall be subject to reciprocal compensation under Section 251(b)(5)."

ii. "ISP-bound calls shall be treated as local for purposes of Section 251(b)(5) to the same extent that ISPs may purchase local exchange lines to receive local calls pursuant to the 'access charge exemption' for ISPs."

d. If the Commission chooses to act under Section 201(a), the logical "proxy" for the function the terminating LEC is performing is interstate local switching. Under this theory, the rate for ISP-bound calls should be pegged to the ILEC's interstate local switching rate applicable to the affected state.

e. Note that whatever rate compensation for ISP-bound calls is "pegged" to, the ILEC will have a healthy incentive to lower that rate to economic cost, as Bell Atlantic itself has recognized.

3. CLEC v. ILEC pricing/Technology Changes.

a. Some have suggested that pricing for delivery of calls to ISPs should be based on the specific costs the CLEC incurs in doing so, based on its own particular technology and cost structure. This is a terrible idea.

i. From a broad policy perspective, regulatory rules should encourage CLECs to take on the task of serving ISPs when they can do so more efficiently than ILECs.

ii. To accomplish this the pricing signal in the market should be the ***ILEC's costs***. CLECs that can perform these functions profitably while receiving the ILEC's costs as compensation will do so; those that cannot, will not.

b. This is the same logic that underlies the Commission's reliance on price cap regulation. Rates based on carrier-specific cost analysis do not encourage efficiency.

c. If CLECs are willing and able to deploy advanced technologies that perform these functions much more efficiently than the ILECs do, that is not a basis for penalizing them; that is a basis for rewarding them.

d. Note also that trying to reflect CLEC-specific costs would be an administrative nightmare. Each CLEC has different costs of capital and overhead costs, for example, and depending on the particular markets served, may have very different appropriate depreciation rates for otherwise similar equipment.

e. The obligation to undertake this effort would substantially deter market entry by entrepreneurial firms that will not tolerate the delay and uncertainty such a regime would create.

4. Traffic Separability.

a. Unlike "always on" services such as DSL, in a dial-up session, the vast majority of signals exchanged between the end user and the ISP never go beyond the end user's and ISP's CPE (their modems). A reasonable estimate is that approximately 90% of signaling is modem-to-modem and does not extend even into the ISP's routers and servers, much less "the Internet."

b. Increasingly, ISPs are deploying "web caches" that allow web sites to be downloaded entirely locally. This is done specifically to avoid the costs the ISP would otherwise incur in accessing "the Internet" to obtain and re-obtain these sites over the course of a day. These transmissions, too, are "local" in nature.

c. If there is any difference in the compensation associated with "interstate" data communications between an end user and an ISP, and "intrastate" data communications between an end user and an ISP, this will create a regulatory incentive to adopt technical arrangements in order to take advantage of the differing rate. These might include encouragement or discouragement of web caching, for example.

d. While it is not particularly difficult to establish a reasonable estimate of inter- versus intrastate use (90%-95% of traffic is almost certainly intrastate), avoidance of regulatorily-induced technical responses suggests that the Commission should adopt a rule that subjects all ISP-bound traffic to the same compensation arrangement.