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June 14, 1999

RECEIVED
JUN 14 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

Re: Notice of Permitted Ex Parte Contacts, CC Docket Nos. 96-98 and CC Docket No. 99-68 (Intercarrier Compensation for ISP-Bound Calls); 99-154 (Preemption of New Jersey Board of Public Utilities); 99-169 (Preemption of Pennsylvania Public Utility Commission); 99-198 (Preemption of Virginia State Corporation Commission)

Dear Ms. Salas:

The purpose of this letter is to advise the Commission of permitted *ex parte* contacts in the above-referenced proceeding. On Thursday, June 3, 1999, Mr. Christopher W. Savage and Mr. William J. Rooney, Jr., on behalf of Global NAPs, Inc., had separate meetings with Mr. Kyle Dixon of Commissioner Powell's office; with Mr. Tom Power of Chairman Kennard's office; and with members of the staff of the Common Carrier Bureau (Ms. Jessica Rosenworcel; Mr. Yog Varma; and Mr. Richard Lerner) in connection with the above-referenced matters. Mr. Dixon and Mr. Power were left with copies of the attached outline.

In the case of the ongoing rulemaking regarding inter-carrier compensation for ISP-bound calls (CC Docket Nos. 96-98 and 99-68), the substance of the discussion was to briefly review the economic basis for such compensation and to discuss the need for action on

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the pending rulemaking as promptly as possible. In the case of the various petitions for preemption (CC Docket Nos. 99-154, 99-169, and 99-198), the discussion was simply a brief review of the procedural status of the matters at the state level that led to the need for Global NAPs to have filed its petitions for preemption in the first place.

Please contact the undersigned if you have any questions or if I can be of further assistance in any way. My direct dial is 202-828-9811.

Very truly yours,

Christopher W. Savage

cc: Mr. Power
Mr. Dixon
Ms. Rosenworcel
Mr. Varma
Mr. Lerner

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.