Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of Comment Sought On Remand Of The Commission's Reciprocal Compensation Declaratory Ruling By The U.S. Court Of Appeals For The D.C. Circuit	CC Docket Nos. 96-98, 99-68

REPLY COMMENTS OF GLOBAL NAPS, INC.

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Summary

The record clearly establishes that ISP-bound calls should be treated like local calls for purposes of Section 251(b)(5), as a matter of statutory interpretation and regulatory precedent.

The Commission should not be taken in by the ILECs' propaganda purporting to link compensation for ISP-bound calls with a host of supposed "problems" in the development of competition under the 1996 Act. If CLECs are more efficient than ILECs in serving ISPs, then CLECs should enter that market segment and take business away from the ILECs. If CLECs are not more efficient, but are entering anyway, that can only be because the ILECs themselves have insisted on inflated call termination rates. Forcing the ILECs to pay those rates is the simplest and most effective means available for bringing them into line with costs.

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REPLY COMMENTS OF GLOBAL NAPS, INC.

1. The ILECs Are Wrong As A Statutory And Regulatory Matter.

The record is quite plain on the legal and regulatory issues. ISP-bound calls may be interstate or intrastate for jurisdictional purposes, but either way they are "local" for all other purposes. ISP-bound calls do not credibly meet the statutory definition of "exchange access," since they are not made "for the purpose of the origination or termination of telephone toll services;" but even if they ***are*** "exchange access," that is irrelevant, because reciprocal compensation is all about economics, not abstract juridical categories; and no one seriously questions that today, under the ESP Exemption, ISP-bound calls are economically "local."[1]

For this reason, no matter how many pre-1996-Act precedents the ILECs can trot out about how fees from "users of access service" are supposed to be split between LECs providing that "access service," anyone can see that applying those precedents to ISP-bound calls is economically laughable. The Commission didn't do it in the *Reciprocal Compensation Order*, and the court's decision is in accord. Indeed, the court distinguished the pre-1996-Act precedents that the ILECs continue to cite; focused on the post-1996-Act precedents that treated ISPs as end users; and directed the Commission to focus on which compensation model — shared access charges or

[1] On this latter point, *see generally* Attachment 1 hereto, Reply Affidavit of Lee L. Selwyn ("Selwyn Aff."), *passim*.

reciprocal compensation — "works" for purposes of ISP-bound calls. This is a practical economic inquiry, not, at bottom, an abstract legal one.

Indeed, the statutory and regulatory record is so clear, and so clearly establishes that the ILECs are wrong, that Global NAPs does not further address these issues here.

2. The Commission Should Reject The ILECs' Propaganda Campaign As The Anticompetitive Nonsense That It Is.

a. The ILECs' Financial Pain Reflects The Fact That The Reciprocal Compensation System Is Working, Not That It Is Broken.

Perhaps recognizing that scuttling about in old access charge precedent is not really going to get the job done, the ILECs — notably but not exclusively Verizon and SWB — engage in what can only be described as a propaganda campaign, relying on the tried-and-true "Big Lie" approach.[2] This approach was aptly described by one court as "a concept by which an untruth repeated often enough and loud enough becomes, in the mind of the listener, the truth."[3]

The subject of the ILECs' Big Lie is the economic and competitive aspects of compensation for ISP-bound calls. To hear the ILECs tell it, compensation is the scourge of sound and effective competition everywhere; it slows down the development of competition for residence customers; it slows down deployment of advanced services; and it is even going to get us into international trouble with our Southeast Asian telecom trading partners. *See* SBC Communications Comments

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[2] *See generally* Comments of Verizon Communications ("Verizon Comments") at 10-30 & Attachments; Comments of SBC Communications, Inc. ("SBC Communications Comments) at 24-56 & Attachment.

[3] *People v. Eckstrom*, 43 Cal. App. 3d 996, 1000; 118 Cal. Rptr. 391 (1974).

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Washington, DC 20554

In the Matter of	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	CC Docket No. 96-98
Inter-Carrier Compensation for ISP-bound traffic	CC Docket No. 99-68

COMMONWEALTH OF MASSACHUSETTS)
) ss.
COUNTY OF SUFFOLK)

REPLY AFFIDAVIT OF LEE L. SELWYN

Lee L. Selwyn, of lawful age and being first duly sworn on oath, deposes and says as follows:

1. My name is Lee L. Selwyn. I am President of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108. Economics and Technology, Inc. (ETI) is a research and consulting organization specializing in telecommunications economics,

at 30-40; Verizon Comments at 11-21. One can only be relieved that no ILEC appears to link compensation for ISP-bound calls with psoriasis, shingles, male pattern baldness, or littering.[4]

The ILECs' entire case on this point is complete, anticompetitive nonsense.

What's really going on is simple. First, ILECs have historically been grossly inefficient in serving the unique telecommunications needs of ISPs. Second, when reciprocal compensation was mandated in the 1996 Act, the monopolist ILECs made a bet that since they had all the customers now, most CLEC customers would want to call them, not vice versa, so they worked the regulatory process to get unreasonably high rates set for terminating compensation — despite their own publicly-stated awareness that if they set rates too high, CLECs would throng to customers like ISPs, who receive a lot of incoming calls.[5] So, with high compensation rates in place — ***surprise!*** — certain CLECs sought out to customers like ISPs who receive a lot of incoming calls.

This is not a "distortion" of competition. It is competition at work.

From one economic perspective, an ILEC's reciprocal compensation rate is an offer to either buy or sell call termination services at the stated price. ILECs do not like being forced to make this offer. They like access charges, where they get paid to terminate traffic from other carriers, but also get paid to originate traffic to other carriers; since they are monopolists, under an access charge system, they will get paid — and have gotten paid — a ***lot.*** The point of a compensation obligation, however, is precisely to deprive ILECs of this opportunity to exploit their monopoly, and instead to place rival LECs on a peer-to-peer basis. This levels the playing field in competing for any type of customer — those who make calls, and those who receive them.

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[4] In making this latter statement, Global NAPs confesses that it has not fully reviewed all ILEC *ex parte* filings in this matter.

[5] As the Commission is aware, Verizon said precisely this in its reply comments on the topic of bill-and-keep in the original rulemaking leading up to the August 1996 *Local Competition Order.*

If the system works as it is supposed to, the ILEC's compensation rate will equal the ILEC's cost of call termination. As such, the ILEC is fully compensated when it completes a call coming in from a CLEC, and breaks even when it sends a call to a CLEC. This latter point is true because — as compared to a monopoly environment — the call termination fee it pays to the CLEC reflects the cost the ILEC would have incurred in handling the call itself. As a result, compensation payments to CLECs are not really "costs" in the normal sense at all. Instead, they reflect a form of sharing revenues from end users, and are therefore measures of the ILEC's competitive losses in the market.[6]

In economic terms, though, if the call termination rate properly reflects the ILEC's costs, then the only CLECs who will focus on serving customers who receive calls are CLECs who can actually perform the call termination function more efficiently — that is, using fewer resources — than the ILEC can. In terms of competitive policy, therefore, a system that encourages efficient CLECs to focus on serving customers who receive calls is a ***good*** thing. It is ***exactly*** what you would expect in a competitive market — the more efficient providers (here, CLECs performing call termination functions) drive the less efficient providers (here, ILECs performing call termination functions) out of the business.[7]

Contrary to some ILEC claims, if this occurs — that is, if ILECs are literally driven from the market of serving ISPs — this is not a case of "deliver[ing] the entire ISP market" to the CLECs "by making available ... an enormous subsidy." SBC Communications Comments at 46. If ILEC call termination rates are properly set to reflect the ILEC's costs, the ILECs will not be "subsidizing" anything. They will pay out to the CLECs what it would have cost them to serve the

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6 *See* Selwyn Aff. at ¶¶ 9-16; *id.* at ¶¶ 27-41.

7 For this reason, there is no possible basis for SBC's claim that compensation attracts CLECs to the ISP market "indiscriminately — without regard to whether those CLECs can efficiently serve the market." SBC Communications Comments at 46. If an ILEC's call termination rate properly reflects the ILEC's own call termination costs, then the only CLECs who will enter are those which are ***more efficient*** than the ILEC. Inefficient entry would only occur if the ILEC overstated its call termination rate, but even that situation is, upon fuller consideration, pro-competitive, as described below.

ISPs themselves. Now, SBC and other ILECs may not ***want*** to serve ISPs; they may want to provide poor service and generally make their lives difficult out of frustration at not being able to charge them access charges. But in the competitive environment created by the 1996 Act, ILECs are no longer quite as free to have their way with disfavored customer groups as they were when their local exchange monopoly was truly unsullied.

Now, there is no question that if ILECs are sufficiently nearsighted that they try to inflate their call termination rates, that will "distort" these economic incentives in one sense. This is really nothing more than another twist on the old divestiture-era debates about "economic bypass" versus "uneconomic bypass." Then, the ILECs complained that regulators ***forced*** them to price certain services above cost, so that other firms (then, the CAPs), who were allegedly not as efficient as the ILECs, could nonetheless profitably enter the market. The difference here, of course, is that if ILEC call termination rates are higher than the ILECs' own costs — thereby enabling less efficient firms to profitably enter — the ILECs have no one to blame but themselves. They are, and have always been, free to negotiate compensation rates that actually reflect their costs, and certainly have been free to cooperate fully with state regulators in establishing accurate cost-based rates. Many ILECs clearly did not follow this course in the first round of interconnection negotiations and rate arbitrations. And they are being duly and appropriately punished financially for that business error.[8]

In other words, just as a call termination rate based on ILEC costs provides a healthy "first-level" incentive ***on CLECs*** to enter only when they are more efficient, the ILECs' current economic pain constitutes an appropriate and healthy "second-level" incentive ***on ILECs*** to be very sure they do not try to game the system by overstating their call termination costs. Proof that this second-

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[8] *Cf.* B. Tuchman, *The March of Folly* 4-5 (1992). In this book, the eminent historian Barbara Tuchman defines "folly," basically, as taking a course that is not only counter-productive in retrospect, but which was pointed out to be counter-productive at the time the decision was made, and as to which better alternatives were available. Her paradigmatic examples are the Trojans taking the famed horse within their walls, leading to their destruction, and America's prosecution of the Viet Nam war, which was conducted in a manner that made it unwinnable. The ILECs' decision to go for high, rather than low, call termination rates seems to fit Ms. Tuchman's definition of "folly" perfectly. *Cf.* Selwyn Aff. at ¶ 33 (ILECs should be careful what they wish for, since they might get it).

level incentive works is shown by, *e.g.*, Verizon's own actions. Where it has recognized that in practical terms it can't really escape its payment obligations, it has negotiated interconnection agreements with lower per-minute rates (*e.g.*, its deal with Level 3 that it touts as a model for all CLECs) and has proposed substantial downward revisions to call termination rates established by regulators (*e.g.*, in New York).

So, the ILECs really have two different problems here. First is the result of their own business folly — they set call termination rates too high and are being punished for it economically (which, not to be too cynical about it, is the only kind of punishment that they care about, or which has any prospect of altering their behavior into more pro-competitive patterns). Their exposure to this type of punishment is limited by the duration of the interconnection agreements they signed containing unreasonably high call termination rates. This "problem" — although, as noted above, it is really a salutary second-level incentive on ILECs to be honest about their costs — will solve itself — indeed, is solving itself — over time.

The ILECs' second problem is a bit more profound — their own, actual inefficiency.

There is something surreal in watching the ILECs rail against the audacity of CLECs who had the temerity not only to ***identify an under-served market segment*** but to actually ***deploy new, innovative, and efficient technology*** to serve it, and then — the outrage continues — expect to receive economic rewards for being more efficient. The sheer ***nerve*** of some people!

What the ILECs never mention are the following obvious facts: (1) They could deploy exactly the same technologies that the CLECs have deployed; (2) They could do so for less money than the CLECs, due to their low capital costs and leverage with suppliers; and (3) If they did that, they would be able to establish low call termination rates on an ongoing basis.[9] Indeed, if the

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[9] *See, e.g.*, Verizon Comments at 23-27, touting various apparently efficient arrangements for serving ISPs, with not the slightest indication that Verizon has even considered implementing any of

(footnote continued)..

ILECs did these things, (a) they would win back a lot of ISP customers (which, under this scenario, they would be serving efficiently); and (b) they would be paying the CLECs less for traffic bound for CLEC customers, ISP and otherwise. The entire "problem" of compensation for ISP-bound calls would disappear, in other words, ***if only the ILECs would respond to CLEC competition for the business of ISPs by competing, instead of by demonizing their competitors and playing regulatory games.***[10]

A beneficial side effect of ILECs competing for ISPs' business, as outlined above, is that competition for residence customers would become more, not less, viable, as well. One of the economic challenges of serving residence customers is that they like flat-rated service. So, the more calls they make, the more expensive it is to serve them. (No one questions that, other things being equal, the increase in consumer interest in connecting to the Internet has led to increased use of the PSTN, with some degree of increased cost for the LECs serving those customers.) The more ISPs the ILECs can win back, the lower their costs (since they would be using new, efficient equipment and arrangements). And as, over time, the ILEC's own improved efficiency is reflected in lower call termination rates, a CLEC serving residence customers would discover that the cost of serving them had declined, making entry more viable.

(...continued)
them. *See also* Selwyn Aff. at ¶¶ 36-40. Indeed, completely ignoring the prospect of improving its own efficiency and winning back ISPs as customers, Verizon relies on the hoary old monopolistic regulatory technique of threatening a basic rate increase if the regulators won't see things its way. *See* Verizon Comments at 16 ("Payment of compensation could lead to per-minute Internet charges or general local rate increases").

[10] In fairness to the ILECs — Ms. Tuchman's historical analysis notwithstanding — they are probably not completely crazy to be trying to hang in with high call termination rates, even considering ISP-bound calling. The reason is twofold. First, with xDSL and cable modem service on the rise, the demand for dial-up Internet access will probably peak in the foreseeable future, so the problem ILECs face with high rates is, in that sense, inherently self-containing. Second, the continued explosive growth of cellular and PCS service provides light at the end of the tunnel. As wireless traffic ***to*** the ILECs grows unabated, and ISP-bound traffic ***from*** them peaks and declines, at some point — possibly even within current ILEC business planning periods of five years or so — ILECs really will be net receivers of traffic, even considering ISP-bound calls. This, of course, is a situation where high call termination rates would be good, not bad, for the ILECs.

In this context, the ILECs' propaganda campaign gets especially high marks for hiding their own marketplace failures and anticompetitive dithering.[11] A brief review of the bidding is in order:

- The Commission and others originally thought that national carriers such as AT&T and (then) MCI and Sprint could provide immediate competition to ILECs nationwide by means of economically viable resale under Section 251(c)(4). To this end the Commission established a presumptive wholesale discount of 25%-28% off retail. The ILECs killed that in the 8th Circuit by a stay in October 1996 and a final order in July 1997, and, when that ruling was reversed by the Supreme Court, they killed it by means of a different legal theory just last month.
- The Commission and others originally thought that established CAPs such as MFS and TCG would provide competitive service to business customers, and then residence customers, by means of collocation and access to unbundled loops under Sections 251(c)(3) and 251(c)(6). To this end the Commission established proxy loop rates, TELRIC pricing, and (it thought) reasonable collocation rules. The ILECs killed the rates in the 8th Circuit, and, when that ruling was reversed, just last month killed it again on a different legal theory. Moreover, ILEC resistance to reasonable and efficient collocation arrangements is the stuff of industry legend.[12]
- The ILECs have contended since time out of mind that residential service is subsidized, *i.e.*, offered to customers below cost, *i.e.*, priced in a manner that would be illegal under the antitrust laws but for the state action exemption. Competition for residence customers in this situation is not viable until and unless the implicit subsidies built into other ILEC rates were made explicit and transferable to CLECs. Universal service issues are complicated and politically charged, which probably explains ***why*** intrastate portable subsidies are generally unavailable, but what matters for competitive purposes is simply ***that*** intrastate portable subsidies are generally unavailable.[13]

So, in trying to enter the residence market, CLECs can't effectively resell; they haven't been able to effectively collocate; and they are competing against a preditorily priced service. But as the ILECs apparently see it, the thing that is keeping CLECs out of the residence market is not any of that; it is, of course — ***compensation for ISP-bound calls!***

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[11] *See* Verizon Comments at 11-14; SBC Communications Comments at 40.

[12] On this point, *see, e.g.*, In the Matter of GTE Service Corporation, *Order*, File No. EB-00-IH-0133, Acct. No. X32080012 (August 1, 2000) ("voluntary" fine of $2.7 million paid under consent decree for violations of the Commission's cageless collocation rules).

[13] To SBC's credit, it at least acknowledges that below-cost residential rates act as an economic disincentive to CLEC entry into the residential POTS market. *See* SBC Communications Comments at 50. But the other ILEC-created barriers to entry into the residence local exchange market are nowhere acknowledged in SBC's presentation. There is no evidence that Verizon acknowledges ***any*** of these issues. *See, e.g.*, Verizon Comments at 11-15.

What a load of nonsense.

The fact is that at least two different classes of CLECs ***are*** competing for residence customers' voice business. First, wireless carriers' increasingly competitive pricing plans — including flat-rated plans that include traditional toll calls within the "free" call allowance — are slowly making inroads into that market.[14] Second, some cable operators are offering voice service to residence customers over their cable plant.[15] What these two classes of competitors have in common is that ***they do not resell ILEC services; they do not need to collocate; and they do not need to pay ILECs for loops.*** In other words, the competitors who are entering the residence market, however slowly, are the competitors not subject to the "death of a thousand cuts" that faces firms that would have to incur thousands of dollars of collocation expense in the hope of garnering a few dozen, or even a few hundred, intrepid early adopters per end office as customers. Instead, in this market — as in other telecommunications markets opened to competition — competitors are focusing first on high-volume, geographically concentrated customers — *i.e.*, business customers. This is what one would logically expect, and this is what is occurring.[16]

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[14] *See, e.g.*, K. Marchocki, "'Cutting the cord' isn't for everyone. Fiberoptic brings Meredith closer" NEW HAMPSHIRE SUNDAY NEWS (July 23, 2000) (Verizon Wireless spokesperson states that "[t]otally cutting the cord, right now in the year 2000, is somewhat a misnomer. More than likely, people are using the wireless phone instead of the teen line or the second or third line in the house." Even so, according to the Yankee Group, for about 2% of the millions of cellular customers nationwide, cellular is their only phone). In this regard, Centennial de Puerto Rico has reported to the Universal Service Administrative Company show more than 21,000 residential wireless "Home Phone" customers as of June 2000.

[15] Examples include Jones (now Comcast) in Alexandria, Virginia and MediaOne in the Atlanta and Boston areas. Cable operator activity on this front will likely increase now that Cable Labs, the industry's research arm, has published specifications for a "PacketCable" architecture that can be used to offer voice telephony, should a cable operator choose to pursue that market. *See, e.g.*, information available at www.cablelabs.com.

[16] In this regard, Verizon seems to think that there is a fixed amount of capital available to CLECs and that if that capital is spent serving ISPs, it will not be spent serving residence customers. *See* Verizon Comments at 15 & Declaration of William Taylor. Verizon is evidently confusing what happens at its internal budget meetings with what happens in real-world capital markets. If serving a market segment is profitable, capital will be made available to that segment; if not, it won't. But as

(footnote continued)...

Companies like Covad are the exception that proves the rule. Covad is going after the residence market, not for traditional voice services, but for high-speed data services. To the extent that Covad is achieving success, it is because it is not selling against a service that has historically been subsidized like traditional voice service.[17] And, at bottom, the new DSL services may well have high enough margins to make the pain of collocation arrangements worth the bother. But, given Covad's business focus — selling high-speed access to the Internet as a replacement for dial-up — it is hardly surprising that Covad's executives would take a dim view of compensation for ISP-bound calls. *See* SBC Communications Comments at 40; Verizon Comments at 14-15. As demonstrated in Global NAPs' initial comments and earlier submissions in the rulemaking, without reciprocal compensation for ISP-bound calls, ISPs — *i.e.,* the companies whose dial-up arrangements Covad is, in effect, trying to replace — will face higher prices, fewer options, and poor service from hostile ILECs.[18]

(...continued)
shown above, if providing residence customers with POTS service is not now profitable, the blame for that situation cannot be laid at the door of compensation for ISP-bound calling. *See* Selwyn Aff. at ¶¶ 42-51, esp. ¶ 45.

[17] The lack of historical subsidies for xDSL service, of course, did not prevent the ILECs from trying to create new ones. As the Commission is aware, it took firm regulatory action to force the ILECs to allow CLECs like Covad to have comparable access to loops that were in-service for POTS, on the same terms that the ILECs themselves were using those in-service loops.

[18] In one state-level arbitration in which Global NAPs was involved, the ILEC grandly introduced a Covad interconnection agreement disclaiming reciprocal compensation on ISP-bound calls as evidence of what a "good" CLECs would do. Of course, since Covad at that time (and, as far as Global NAPs is aware, today) did not have plans to deploy any circuit-switching gear ***at all,*** it hardly matters — even to Covad — what reciprocal compensation terms it agreed to.

Still focusing on DSL, SBC notes that "one of the many factors driving ILECs' deployment of xDSL services" is the fact that they have to pay compensation for dial-up calls to ISPs. SBC Communications Comments at 41. xDSL is a useful, viable, and exciting Internet access technology precisely because it provides greater functionality and efficiency than dial-up. It follows that requiring ILECs to pay compensation for dial-up at a rate based on the ILECs' own costs provides exactly the proper economic signals to spur ILEC xDSL efforts. Indeed — while Global NAPs does not recommend this course — if the Commission's long-run policy is to promote and encourage the use of xDSL technologies for Internet access, one way to do so would be to actually ***increase*** the call termination rate applicable to ISP-bound circuit-switched traffic.

b. Other ILEC Broadsides Against Compensation For ISP-Bound Calls Are Also Wrong.

The discussion above shows that what the ILECs are really railing against is the consequences of their own bad business judgment in deciding to initially seek high call termination rates, combined with the consequences of their admitted failure to adopt the same efficient technologies to serve ISPs that their competitors are adopting — *i.e.*, their own failure to actually ***compete***. The ILECs' various efforts to paint themselves as the victims, and CLECs or ISPs as malign arbitrageurs, scam artists, or worse must be viewed in this light. *See, e.g.*, SBC Communications Comments at 39-41, Verizon Comments at 16-20. This section provides a few responses to particularly outrageous ILEC claims in this regard.[19]

As to SBC's claims of "arbitrage," in this context, that is simply a fancy term for the fact that CLECs appear to be able to deliver ISP-bound calls for less money than it costs the ILECs to perform the same function. On the other hand, if what is really going on is that CLECs are responding to inflated ILEC call termination rates, then the problem will abate as soon as the ILECs lower those inflated rates. If ILECs lower their rates to the level of their own costs and ***still*** lose ISPs as customers, though, that means that the CLECs ***really are*** more efficient than the ILECs, and society is served by having CLECs perform this work.

It is particularly odd to see ILECs — erstwhile champions of the efficiency-enhancing effects of price cap regulation — urge that CLEC call termination rates be set at a level designed to reflect ***CLEC*** costs. *See, e.g.*, Verizon Comments at 20; Attached Declaration of Wm. Taylor, *passim*. The Commission's intimate familiarity with price cap regulation makes it easy to see that

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[19] The temptation to list various ILEC "bad acts" in response to Verizon's catalog of supposed CLEC transgressions is strong, but as the Commission is likely aware of most of them already, Global NAPs will demur. *But cf.* n.12, *supra*.

"rewarding" efficient CLEC activity by ratcheting their revenues downward is (to take the D.C. Circuit's phrase out of context) "intuitively backwards." Again, the proper rate for CLECs delivering calls is a rate based on the costs the ILEC would incur in performing that function, using the ILECs' (plainly, it seems, inefficient) serving arrangements.[20]

SBC also complains that it constitutes a CLEC "scam" for the CLEC to "assign NXX codes to switches that are nowhere near the calling area with which that NXX is associated." SBC Communications Comments at 43. *See also* Verizon Comments at 18-19. It is hard to see what the real ILEC gripe is here. ILECs have embedded networks that evolved over many decades. Technological advances since (*e.g.*) 1990 have vastly lowered the cost of both transmission and switching. A company entering the local exchange market with a clean slate will therefore logically want to use fewer (and less expensive) switches to cover a wider geographic area. In these circumstances, particularly if the ILEC has artificially and unreasonably small local calling areas — as many do — it is inevitable that a CLEC deploying efficient technology will have switches "that are nowhere near" the non-cost-based, outmoded, and unreasonably small "calling area with which" the NXXs assigned to the switch are associated.[21] Perhaps life would be more manageable for ILECs if their competitors were required to duplicate their embedded and in many respects inefficient networks, but that is decidedly not the situation mandated by the 1996 Act.

SBC also accuses Global NAPs in particular of "giving away service to ISPs" in Massachusetts, presumably in order to receive more reciprocal compensation revenue. *See* SBC Communications Comments at 45. *Cf.* Verizon Comments at 12 & n.29. Global NAPs is not sure what materials SBC thinks it has that supposedly demonstrate this assertion, but it is not, in fact, true. Global NAPs' ISP customers pay for their connections to the PSTN (typically ISDN PRI

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[20] As Dr. Selwyn explains, there is no basis for establishing some special, separate rate for ISP-bound calls as opposed to other types of calls. *See* Selwyn Aff. at ¶¶ 37-52.

[21] In this regard, the steadily decreasing costs of fiber transmission mean that the fact that "the ILEC is responsible for hauling originating traffic to the CLEC switch," SBC Communications Comments at 43, is not much of a burden, when considered in light of the ILEC's highly efficient high-capacity inter-switch fiber network.

trunks) and, when they collocate their servers and other equipment in Global NAPs-provided space, they pay for that as well.[22]

And it's a good thing they do. As the Commission is aware (even if SBC was not), Global NAPs and Bell Atlantic have been locked in various regulatory battles over this issue since at least late 1998, and Bell Atlantic has not paid its multi-million dollar Massachusetts reciprocal compensation bills in nearly a year and a half. Interestingly in this regard, while SBC quotes a Verizon (nee Bell Atlantic) pleading supposedly showing that the same thing (free service for ISPs) is occurring in New York, it curiously neglects to mention that after a full and complete hearing on the matter, the New York PSC ***rejected*** Verizon's claims that compensation for ISP-bound calls should be eliminated.

Finally, SBC argues that if the FCC does not eliminate compensation for dial-up calls to ISPs within the domestic United States PSTN, the United States' "efforts to defeat" a proposal to apply international settlements-like arrangements to unswitched international data lines carrying Internet traffic "could be compromised." SBC Communications Comments at 47. Now, it is certainly possible that our international telecom trading partners could willfully misunderstand or ignore the distinction between an exchange of circuit-switched traffic between carriers (to which reciprocal compensation or, in the international realm, settlements, apply) and the interconnection of data circuits (to which settlements do not apply). But that would hardly be the Commission's fault. Today, both internationally and domestically, the exchange of circuit-switched traffic results in per-minute compensation for the carrier to whom the traffic is handed off; and both internationally and domestically, the exchange of non-circuit-switched data traffic is not subject to such per-minute compensation. The existing domestic regime — including inter-LEC

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[22] Global NAPs notes that the pre-*Reciprocal Compensation Ruling* record in this docket contains a detailed rebuttal of the notion that even if some CLECs offer reduced rates for their customers' PSTN connections, this is nothing more than a reasonable use of the funds made available from the CLECs' greater efficiency compared to the ILECs' call termination costs/rates. *See* Reply Comments of Adelphia Communications et al., DA 97-1399 CCB/CPD 97-30 (July 31, 1997).

compensation for dial-up calls to ISPs — is in complete accord with the existing international regime, which (in this context) the United States is trying to preserve.[23]

[23] The more interesting international comparison is the Commission's efforts to force monopolist foreign telecom entities, often arms of a foreign government, to bring their call termination rates down to cost-based levels. In the domestic market, the Commission's powers under the 1996 Act give it an ability to prevent ILECs from exploiting their historical monopoly positions that simply does not exist in the international sphere.

3. Conclusion.

As a legal and regulatory matter, it is clear that ISP-bound calls should be treated as local calls under Section 251(b)(5). The Commission should not be taken in by the ILECs' propaganda campaign attempting to demonize CLECs and tie compensation for ISP-bound calls to unduly slow development of residential competition, inefficient entry, or other supposed problems. ILECs have served ISPs inefficiently and poorly, and have inflated their call termination rates for other reasons. What is happening today (in areas where compensation has been required by states) is the logical and appropriate consequence of that ILEC behavior. To make it stop, all the ILECs have to do is adopt the same efficient serving arrangements they chide the CLECs for having adopted, and then to compete for, rather than ignore, the ISP segment of the local exchange market.

Respectfully submitted,

GLOBAL NAPS, INC.

By: _____

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regulation, and public policy. My Statement of Qualifications appears as Attachment 1 to this affidavit and is made a part hereof. I have testified before numerous state regulatory agencies and submitted reports and affidavits before this Commission on numerous occasions dating back to the mid-1970s. I have previously submitted a joint declaration (with Patricia D. Kravtin) in this proceeding, filed July 20, 2000, on behalf of AT&T.

2. This Affidavit is being submitted on behalf of Global NAPs, Inc. ("Global NAPs"). Global NAPs is a competitive local exchange carrier ("CLEC") with operations in Massachusetts, New York, New Hampshire and other states. Global NAPs provides many Internet Service Provider ("ISP") customers with telephone service on the public switched network that allows the ISPs' end users to reach them by means of a dial-in connection between the end users' modem equipment and the modem equipment of Global NAPs' ISP customers. Global NAPs, therefore, has a direct interest in the regulatory rules governing inter-carrier compensation for such calls. Global NAPs has asked me to address the economic issues relevant to reciprocal compensation and the questions raised by the D.C. Circuit's remand of the reciprocal compensation issue to the Commission, *see Bell Atlantic v. FCC*, 206 F3d 1 (D.C. Cir. 2000), with particular reference to the arguments put forth by Dr. William Taylor of NERA on behalf of Verizon.[1] In this regard, I note that some other ILEC commenters make arguments generally similar to those raised by Dr. Taylor.

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1. Declaration of William E. Taylor ("Taylor Declaration"), attached to Comments of Verizon Communications, July 21, 2000 ("Verizon Comments").

Because ISP-bound calls have been determined by the FCC to be sent-paid calls, "local" for purposes of the end user making the call and the ISP receiving it over their respective telephone services obtained from their respective LECs, reciprocal compensation is the only settlement mechanism for compensating terminating LECs for their work in completing such calls.

3. When two LECs collaborate to provide a service, the end-user has a direct business relationship with, and pays, the carrier that originates the call and, although the end-user is also being served by the second carrier that terminates the call, he or she generally has no direct business relationship with, and no convenient mechanism by which to pay, that second carrier. Under these circumstances, the carrier that gets paid by the end-user (the originating LEC in this case) has to compensate the one that does not (the terminating LEC). Otherwise, the collaboration to provide the service becomes an *exploitation* of the LEC that does not get paid. ILEC refusals to pay CLECs compensation for ISP-bound calls are an example of this exploitation.

4. The basic economic logic of reciprocal compensation for ISP-bound calls is straightforward and sound. Local calls are "sent-paid," which means that the LEC serving the originating end user gets paid by the end user to carry the call from its point of origin all the way to its destination. When two carriers collaborate to provide a local call, an interchange of traffic takes place at a predetermined "point of interconnection" ("POI"). At the POI, the carrier that originated the call hands it off to the carrier that serves the called party. That second carrier will then terminate the call to its final destination. This "peer-to-peer" hand-off of traffic has been the common practice in the US telecommunications industry for more

than a century. There were at one point in excess of 2,000 local exchange carriers in the US. In many cases, two different carriers (e.g., a Bell company and an Independent company, or two independent companies, or two Bell companies) would be involved in originating and terminating a local call. Although there are far fewer ILECs than there once were, this basic and long-standing settlement process persists to this day.

5. When two carriers participate in furnishing a local call, some arrangement is required to assure that each is adequately compensated for its work in handling the call. In general, for calls handled among ILECs with non-overlapping serving areas, a settlement arrangement known as "bill-and-keep" was employed. Under "bill-and-keep," the originating carrier would bill its customer for the entire charge for the call, and the terminating carrier would complete the call without any explicit compensation from the originating carrier. Its compensation would be "in kind," in that it would similarly bill its customers for calls they originate that are destined for the other carrier, and the latter would terminate the call without an explicit charge. If the traffic flow in each direction was roughly equal ("in balance"), bill-and-keep provided an adequate and fair compensation mechanism.

6. While hand-offs of traffic between non-overlapping ILECs had been common practice ever since the earliest days of the telephone industry, the same basic process is also applicable for the interchange of traffic between an ILEC and a CLEC. While many CLECs argued for and attempted to negotiate bill-and-keep arrangements when reciprocal compensation was first being discussed in the 1994-95 time frame, ILECs generally would not agree to a bill-and-

keep type of settlement because they expected that the volume of traffic that would be delivered to them by CLECs for termination to ILEC subscribers would exceed, perhaps by a significant amount, the volume of traffic that the ILEC would hand-off to the CLEC. Consequently, the ILECs insisted upon a settlement arrangement known as "reciprocal compensation," under which each LEC would make an explicit payment to the other for all traffic handed-off for termination.

7. In taking this posture, ILECs apparently failed to consider the possibility that a compensation mechanism based upon the volume of terminated traffic would actually induce CLECs to seek out potential customers with high inward calling requirements, and that CLECs would be capable of being that selective in their choice of customers to serve. The ILECs then compounded this fundamental misassessment of CLEC responses to the pricing signals stemming from a reciprocal compensation type of settlement arrangement by also misassessing the potential impact of the Internet and the potential demand for dial-up Internet access. These serious and fundamental errors in the ILECs' business judgment lies at the heart of their present efforts to get the FCC and state regulators to effectively bail them out of the consequences of these profound business missteps.

8. The per-minute reciprocal compensation rates were typically negotiated in interconnection agreements between an ILEC and a CLEC, and were generally symmetric, i.e., the per-minute rate that the ILEC would charge the CLEC for terminating CLEC-originated traffic was equal to the per-minute rate that the CLEC would charge the ILEC for

terminating ILEC-originated traffic.[2] If, in fact, the traffic flows were exactly in balance, there would be no net settlement payment in either direction, and in that one special case the reciprocal compensation arrangement would be financially equivalent, in terms of its result, to bill-and-keep.

9. Under reciprocal compensation, the originating carrier collects the entire charge for the call from the originator of the call, and remits to the interconnecting carrier that portion of the total revenue that represents the terminating carrier's share of the work involved in handling the total call. It bears emphasis that these payments are distinctly not *costs* to the originating carrier in an economic sense. Instead, these payments represent remittances of funds collected by the originating carrier, in effect, on behalf of the terminating carrier. To the extent that the originating carrier *could have* provided the same call termination service — and ILECs clearly *could have* taken steps to retain and expand their business of serving ISPs, as discussed below — its hand-off of that traffic to a CLEC competitor and its remittance of reciprocal compensation payments to that CLEC constitute *competitive losses* to the ILEC. As I shall explain, this distinction is important in understanding how the reciprocal compensation mechanism should operate to produce economically efficient outcomes.

10. Consider the following example. I purchase an airline ticket for a trip from Boston to San Francisco. The flights I select are an American Airlines flight from Boston to

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2. The FCC rules actually require such symmetry except under certain special cases. See para. 41, *infra*.

Chicago, connecting to a United Airlines flight from Chicago to San Francisco. The ticket for the entire trip is issued by American Airlines and I pay the entire fare for the trip to American Airlines. However, because a portion of the trip will be on United, American is required to remit a portion of the total fare to United for its portion of my trip. In this context, American is acting as a sales agent for United, is collecting all of the revenue, and is remitting to United that portion to which United is entitled for its share of my trip. This remittance is in no normal sense a "cost" to American Airlines; it is a payment to United for monies collected by American on United's behalf.

11. This raises an important, but confusing and misleading, point in Dr. Taylor's presentation, which is, who is whose "customer" under various scenarios (e.g., an end user making a long distance call, an end user calling a local bank served by another LEC, and an end user calling an ISP served by another LEC). One way of looking at the question of who is whose "customer" is to look simply at who pays who for what. From this perspective, when an end user makes a long distance call, the end user is the "customer" of the IXC (to whom it pays all per-minute charges associated with the call). From this perspective, although the end user actually makes use of the originating LEC's switching and transmission facilities (and the switching and transmission facilities of the terminating LEC as well), the end user is neither the originating nor terminating LEC's customer for purposes of this call. On this level (trivial from an economic perspective), who is whose "customer" is simply a matter of regulatory fiat. In this regard, while I am not a lawyer, I note that Section 201(a) of the Act expressly states that the FCC generally can decide who pays whom in cases where

multiple carriers collaborate to provide an interstate service — referred to in the statute as a "through route." This illustrates why this "who pays who" perspective is not helpful in sorting out the economics of the situation.

12. From an economic perspective, what matters in assessing who is the ultimate "customer" in a multi-party transaction are familiar principles of cost causation. An end user making a call causes the costs associated with that call and, ultimately (except in situations where a subsidy has purposely been built into the system) should pay those costs. As a result, from an economic perspective, the end user making a call that involves multiple carriers is the customer of all of the carriers involved in getting the call to its intended destination. Now, for various practical or other reasons, the customer may not write separate checks to each of the entities involved. To the contrary, the more common practice is for the customer to pay only one of the carriers, who then becomes responsible, directly or indirectly, for passing money on to the other carriers who are jointly involved in carrying the call to its ultimate destination.

13. Dr. Taylor ignores this simple rule for determining customer relationships cost causation — and instead tries to concoct a rationale under which the end user *is* the originating LEC's customer when the customer calls a local bank (irrespective of whether another LEC is involved), but where the end user is *not* the customer of the originating LEC when the call is a long distance call or a call to an ISP. However, Dr. Taylor offers no principled basis for his conclusions, which are, in fact, nonsensical. As noted above, in