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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

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

REPLY COMMENTS OF QWEST CORPORATION

William T. Lake
Lynn R. Charytan
Jonathan J. Frankel
Mary E. Kostel
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000

Robert B. McKenna
Jeffry A. Brueggeman
Qwest Communications International, Inc.
1020 19th Street, N.W.
Washington, D.C. 20036
(303) 672-2799

Of Counsel: Dan L. Poole

Counsel for Qwest Corporation

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Summary

As the opening comments demonstrated, the Commission should reaffirm its holding that ISP-bound traffic is not subject to reciprocal compensation under section 251(b)(5) of the Communications Act because it is not "local" traffic. In light of the ESP access charge exemption, no appropriate mechanism currently exists for inter-carrier compensation for joint carriage of ISP-bound traffic. Some states have applied reciprocal compensation in the absence of a clear federal rule, notwithstanding the basic principles of cost causation. Enormous market distortions have resulted from these states' imposition of reciprocal compensation obligations on such traffic. Accordingly, it is critical that the Commission adopt a uniform rule dictating an inter-carrier compensation method for ISP-bound traffic. Several commenters, including SBC, have made compromise proposals to resolve this issue. Qwest proposes that the Commission adopt a bill-and-keep rule, either for ISP-bound traffic alone, or for ISP-bound and local traffic, as an interim solution.

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Introduction

As the comments filed in this proceeding overwhelmingly demonstrate, the Commission correctly determined in the *Reciprocal Compensation Declaratory Ruling* that ISP-bound traffic is not "local"; accordingly, LECs delivering traffic to ISPs do not provide "transport and termination," and therefore such traffic is not subject to the reciprocal compensation obligations of section 251(b)(5) of the Communications Act. *Reciprocal Compensation Declaratory Ruling,* 14 FCC Rcd 3689 ¶¶ 1, 9 (1999). Rather, as the Commission has consistently held, LECs provide interstate access service when they carry Internet-bound calls from subscribers to the subscribers' ISPs. *See MTS and WATS Market Structure,* 97 F.C.C.2d 682, 711 ¶ 78 (1983) (describing "enhanced service providers" as "users of access service"); *Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture,* 6 FCC Rcd 4524, 4535 ¶ 61 (1991) ("ESPs generally take lineside access"); *Access Charge Reform Order,* 12 FCC Rcd 15982, 16131 ¶ 314 (1997) (ISPs "may use incumbent LEC facilities to originate and terminate interstate calls"). Thus, as Qwest and many other commenters explained at length in their comments, the Commission should reaffirm its holding that ISP-bound traffic is not subject to reciprocal compensation under section 251(b)(5) and articulate the extensive support for its conclusion.

Notwithstanding the Commission's decision in the *Reciprocal Compensation Declaratory Ruling,* and pursuant in part to the Commission's invitation, many states have continued to impose reciprocal compensation obligations on ISP-bound traffic. The comments demonstrate the widely disparate views of several state commissions regarding the propriety of and grounds for such decisions. Some states, like Colorado, have recognized that, even if the Commission has not prohibited reciprocal compensation for ISP-bound traffic, basic economics

counsels against it: the "cost causer" in an end user/ILEC/CLEC/ISP transaction is not the ILEC; rather, because of its business relationship with the end user, the ISP is in essence the cost causer. As a result, some states recognize that in seeking compensation for their carriage of such a call, the CLEC and the ILEC should look to the ISP, not to each other. Yet despite these clear principles and the Commission's unassailable finding that ISP-bound traffic is not "local," the reciprocal compensation question is far from settled at the state level.

The need for Commission guidance is clear. One state commission describes its proceedings considering whether to impose reciprocal compensation obligations on ISP-bound traffic as "challenging, burdensome, controversial, and seemingly never-ending," and implores the Commission to issue "clearer . . . direction [on the issue] -- even if it means preemption." *See* Comments of Massachusetts Department of Telecommunications and Technology at 2, 3-4; *see also* Comments of Missouri Public Service Commission at 1 ("urg[ing] the Commission to assert jurisdiction and make a decision on the nature of reciprocal compensation for ISP-bound traffic without delay."); *Starpower Communications, LLC, Petition for Preemption of Jurisdiction of the Virginia State Corporation Commission,* Memorandum Opinion and Order, FCC 00-216, CC Dkt. 00-52, at 2 n.7 (rel. June 14, 2000) (quoting Virginia SCC's statement that Commission's "failure to act on . . . inter-carrier compensation . . . for ISP-traffic . . . has created great regulatory uncertainty."). As Internet traffic grows, the confusion resulting from the lack of a federal rule will have increasingly far-reaching effects, and the economic distortions caused by the imposition of reciprocal compensation on ISP-bound traffic will become a significant burden on the provision of facilities-based telecommunications services to residential and business customers. Thus, it is incumbent on the Commission to articulate what compensation rules *should* apply to ISP-bound traffic and to impose such rules uniformly.

Given the access charge exemption for ISPs, there is no existing compensation mechanism that would appropriately compensate LECs involved in jointly carrying interstate ISP-bound traffic. However, SBC and others set out in their opening comments the outlines of several interesting compromise compensation proposals designed to address the unique problems presented by such traffic. These proposals provide a productive starting point for analyzing the matter of inter-carrier compensation for ISP-bound traffic. Qwest suggests that the following proposals made by SBC and others merit further consideration:

- Bill-and-keep for ISP-bound traffic, with a modified reciprocal compensation rule for carriers that cannot distinguish between ISP-bound and local traffic
- Bill-and-keep for ISP-bound and local traffic

Although these solutions are attractive for a variety of reasons described below, they are not necessarily appropriate permanent solutions. Until the distorting effects of the current patchwork regime have lifted, it will be difficult to get an accurate view of the market, so as to discern which entities are real competitors in the local service market and which are merely gaming the system. Any Commission-designed compensation method must ensure not only that carriers are compensated for costs that truly are imposed on them by others, but also that consumers' rights to reasonably priced telecommunications services are protected and that facilities-based competition is encouraged. It therefore may be most appropriate for the Commission first to adopt one of these solutions on an interim basis, and then seek industry studies that will help it determine what the correct cost recovery method should be going forward.[1]

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[1] Ultimately, once the market is rationalized, inter-carrier compensation structures can be left to market forces.

Qwest's support for these compromise compensation proposals is not meant to imply that any part of the reciprocal compensation scheme under section 251(b)(5) or the Commission's rules implementing it -- including the "bill-and-keep" approach specified in section 51.713(b) of the rules, 47 C.F.R. § 51.713(b) -- applies to ISP-bound traffic.[2] As Qwest argued in its appeal of the *Reciprocal Compensation Declaratory Ruling,* the Commission's suggestion that states retain the authority to impose reciprocal compensation for ISP-bound traffic was inconsistent with the principle that reciprocal compensation could not be ordered -- by *any* entity -- beyond the terms of section 251(b)(5). As an interim solution to a thorny problem, Qwest nonetheless believes that these compromises are lawful, pursuant to the Commission's authority under section 201 of the Act, 47 U.S.C. § 201, to regulate rates for interstate traffic. *See MTS and WATS Market Structure,* 93 FCC 2d 241 ¶¶ 37-41 (citing authority under 201(a) to regulate interstate access). To the extent any local traffic is covered by these proposals, the Commission's authority under section 251, 47 U.S.C. § 251, would support the compromise, as well.

I. The Commission Should Consider Adopting an Interim Compromise Resolution to the Problem of Inter-Carrier Compensation for ISP-Bound Traffic.

The Commission has correctly determined that LECs provide interstate access when they carry ISP-bound traffic. A LEC carrying such traffic does not provide transport and termination of that traffic, and is not entitled to compensation under section 251(b)(5) of the Act. Under Commission precedent for jointly provided access, two LECs that jointly carry traffic to an ISP should *share* the revenues for providing this interstate access service; thus, the CLEC serving an

[2] Because section 51.713(b) does not apply to ISP-bound traffic, its requirement that traffic be "roughly balanced" is no impediment to these compromise proposals.

ISP should share with the ILEC any "access" compensation it receives from the ISP.[3] The ESP exemption, of course, excuses ISPs from having to pay access charges, and instead allows them to purchase access service at local business rates. Moreover, in contrast to the ordinary operation of the access charge regime, CLECs have not shared the revenues they collect from ISPs with ILECs.

Despite the enormous burden on ILECs of providing uncompensated access service that has resulted from burgeoning Internet use and CLECs' lopsided preference for serving ISPs, Qwest recognizes that it is unlikely that the Commission will revisit the access charge exemption. However, the Commission must step in to correct the distortions that have been caused by state commissions' application of reciprocal compensation obligations to ISP-bound traffic, and the Commission should affirmatively state that its rulings regarding what traffic is covered by the Act's reciprocal compensation provisions are binding on the states. *See AT&T Corp. v. Iowa Utilities Board,* 525 U.S. 366, 384-85 (1999).

As ILECs have demonstrated in numerous submissions in this proceeding, requiring reciprocal compensation for ISP-bound traffic has thrown the scheme grossly out of balance, rendering it anything but "reciprocal."[4] For example, Qwest's most recent figures reveal that 96% of the allegedly "local" traffic that it sends to CLECs is ISP-bound traffic; by contrast, only

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[3] *See* William E. Taylor, et al., *An Economic and Policy Analysis of Efficient Intercarrier Compensation Mechanisms for ISP-Bound Traffic* at 6 (Nov. 12, 1999) (submitted in a November 12, 1999 *ex parte* on behalf of U S WEST, Inc.) (*"Taylor Paper"*) ("[U]nder an economically efficient system of compensation, . . . the ISP -- as the agent of the cost-causer -- would pay the ILEC (and the CLEC that also serves it) usage charges analogous to carrier access charges paid by IXCs.").

[4] In these comments, a number of statistics are submitted concerning traffic between Qwest and other carriers. These statistics relate to Qwest's operations as an ILEC.

44% of the same allegedly "local" traffic flowing from CLECs to Qwest is ISP-bound.[5] As noted below, Qwest delivers nine times more traffic to CLECs than it receives, entirely as a result of ISP-bound traffic. In other words, CLECs are taking advantage of the reciprocal compensation windfall to serve only ISPs, not the public.

Several characteristics of ISP-bound traffic cause this enormous imbalance. First, ISP-bound traffic is by its nature one-way traffic: ISPs receive calls but do not make calls.[6] Second, the hold times for ISP-bound calls are at least nine times greater than the hold times for local calls. The average hold time for ISP-bound calls carried by Qwest is 26.5 minutes per call, while the average hold time for local traffic is approximately 3 minutes per call. *See* Comments of SBC at 29 & n.59 ("SBC"); Comments of BellSouth at 10 & n.12 ("BellSouth"). As a result of these two characteristics, the typical ILEC is finding that the number of minutes for which it pays termination compensation to a CLEC serving ISPs is several orders of magnitude greater than the number of minutes for which the CLEC pays it. And many CLECs accordingly focus on obtaining ISPs as customers -- or become ISPs themselves -- so that the bulk of their traffic is ISP-bound. ISP reciprocal compensation is a gravy train that naturally attracts many CLECs to serve ISPs as customers to the exclusion of all other service. This greatly exacerbates the

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[5] The Colorado Public Utilities Commission recognized this general disparity in its recent decision ordering bill-and-keep for ISP-bound traffic, where it noted the "substantial and growing volume of ISP traffic and the imbalance of that traffic on U S WEST's network as compared to CLECs' networks." *See Petition of Sprint Communications Co., L.P., for Arbitration Pursuant to U.S. Code 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S WEST Communications, Inc.,* Initial Commission Decision, Dkt. No. 00B-011T at 12 (Colo. Pub. Utils. Comm'n May 3, 2000) (*"Colorado Decision"*).

[6] As the Commission has previously found, ISPs do not "receive" calls any more than AT&T "receives" a call from an originating long distance customer. We use the word "receive" here for the sake of simplicity.

problem. Significantly, between August 1999 and May 2000, over 91% of *all* traffic between Qwest and CLECs flowed from Qwest to the CLECs. *See also* Comments of Verizon at 11 (describing its traffic flow ratio at 21:1) ("Verizon").

A third factor relating to ISP-bound traffic adds to these skewed results: it costs CLECs less to carry traffic to the ISPs they serve than it costs ILECs to transport and terminate local traffic. This is true for several reasons. First, as economist Bill Taylor of the National Economic Research Associates explained in an *ex parte* on behalf of U S WEST, Inc., on November 12, 1999, because of the relationship between fixed and incremental costs, the longer the call, the lower its average per-minute cost. *See Taylor Paper* at 7-8. This is true because the full per-minute cost of a call includes both the incremental and fixed costs involved in making the call, with the fixed costs averaged over the length of the entire call. The longer a call is, the lower the average fixed cost of the call's total cost will be. *Id.* at 7. Because Internet calls are so much longer, on average, than other calls, their total per-minute costs are lower.[7]

Moreover, as other ILECs have demonstrated, CLECs serving ISPs have a variety of technological efficiencies available to them that do not apply to LECs serving non-ISP customers. For example, ISPs can collocate with their CLEC and save "huge transmission costs." SBC at 33 (quoting Global NAPS); *see also* Verizon at 23. In addition, an ISP can be served by a trunk-to-trunk connection, rather than the trunk-to-line connection required for most non-ISP customers, thus saving the end office cost.[8] *See* SBC at 33. And manufacturers have

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[7] Of course, lowering the fixed cost across the board to reflect a presumed 26.5 minute ISP-bound call would have the effect of *under*compensating CLECs and ILECs alike when they actually do provide transport and termination of local traffic for each other.

[8] The ILEC-CLEC compensation imbalances are further exacerbated to a significant degree by the fact that ILECs have incurred enormous, uncompensated capital expenses in providing trunks for interconnection with CLECs serving ISPs at the request of those CLECs.

developed equipment that eliminates the need for switching ISP-bound traffic altogether. *See* SBC at 34; Verizon at 23-24. Notwithstanding these cost-saving factors, ILECs' costs for terminating regular local traffic typically are used by states imposing reciprocal compensation obligations on ISP-bound traffic as a proxy for the costs involved in carrying ISP-bound traffic.

These imbalances, in turn, have produced massive market-distorting effects, creating incentives for CLECs to pursue the business of ISPs and avoid serving residential and other business customers, while draining the resources of ILECs that could otherwise be used to invest in improved technologies. In light of these dramatic effects, and in the absence of a reexamination of the access charge exemption, the Commission should exercise its authority under section 201 of the Communications Act, *see* 47 U.S.C. § 201,[9] to adopt a compromise solution that would rebalance the marketplace and bring uniformity and finality to this confused and troublesome area of inter-carrier compensation.

For example, from 1997 through the first half of 2000, Qwest incurred over $275 million in capital costs to install 23,800 DS1 equivalent new trunks serving CLECs, but because the trunks were constructed under contracts which assumed compensation, via reciprocal compensation, for *two-way* traffic, Qwest will be compensated for only the small fraction of that cost (approximately one-ninth) that in fact corresponds to two-way (rather than one-way ISP-bound) traffic. When coupled with the reciprocal compensation expense, Qwest has expended over $600 million in serving CLEC/ISP needs, with virtually no recovery.

As the Arizona Corporation Commission stated in its decision imposing a bill-and-keep rule for ISP-bound traffic, "it is inappropriate for this Commission to order U S WEST to construct facilities to handle additional traffic and pay for the privilege of doing such." *Petition of Sprint Communications Co., L.P., for Arbitration of Interconnection Rates, Terms, Conditions and Related Arrangements with U S WEST Communications, Inc.*, Dkt. Nos. T-02432B-00-0026, T-01051B-00-0026 at 7 (Arizona Corp. Comm'n June 13, 2000).

[9] The Commission's authority to subject ISP-bound traffic to a compromise solution would not rest on section 251(b)(5) of the Act, because delivering traffic to an ISP does not involve "transport and termination." 47 U.S.C. § 251(b)(5).

II. The Commission Should Adopt an Interim Rule of Bill-and-Keep for ISP-Bound Traffic, With A Modified Reciprocal Compensation Rule for Carriers that Cannot Distinguish Between ISP-Bound and Local Traffic.

A. Bill-and-Keep is the Best Compromise Cost Recovery Rule for ISP-Bound Traffic.

A bill-and-keep rule is the most appropriate compromise solution for inter-carrier compensation for ISP-bound traffic.[10] Such a proposal would best recognize the differences between ISP-bound and local traffic. Local traffic would remain, as it should, under the reciprocal compensation regime of section 251(b)(5) and the Commission's rules implementing that section. On the other hand, carriers would "bill and keep" their costs from their own customers for ISP-bound traffic.[11]

Imposing a bill-and-keep rule for ISP-bound traffic would have a variety of pro-competitive effects. First, it would have the effect of shifting at least somewhat the cost burden of ISP-bound traffic onto the entities that are the agents for the cost-causers in an ISP-bound call:

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[10] Although some carriers have suggested otherwise, Qwest firmly believes that none of the solutions proposed in these reply comments should apply to wireless traffic. Wireless traffic is local traffic that presents a unique situation: unlike most local wireline traffic, the wireless carrier is paid by its customer for each call. Thus, it is reasonable for the wireless carrier to compensate the carrier that terminates the call.

[11] Interstate long distance traffic that travels over the public switched telephone network should not be included in such a plan, regardless of whether it is circuit-switched or IP traffic; access charges should apply to such traffic. Although CLECs have disputed the Commission's characterization of ISP-bound traffic as access traffic, it is beyond dispute that Internet telephony uses the access services of LECs. *See U S WEST Petition for Declaratory Ruling Affirming Carriers' Carrier Charges on IP Telephony* (filed April 5, 1999). Some of these calls are virtually indistinguishable from a traditional long distance call. The only difference between the calls is the technology used to complete them. The Commission has made clear that differences in technology should not be determinative of how a service is regulated. *See, e.g., Advanced Services Order,* 13 FCC Rcd 24012 ¶ 11. In light of the fact that voice-over-IP providers currently bill separately for voice traffic and standard Internet-bound calls, there should be no difficulty distinguishing between these two types of traffic and subjecting the former to access charges.

the ISPs. Under the principle of cost causation, requiring cost causers to bear the costs they cause helps to "ensure that society's scarce [telecommunications] resources are put to their best use and that only the [telecommunications] goods and services of the highest value to society are produced and consumed." *See Taylor Paper* at 4. In the words of the Colorado Commission, "a bill and keep approach is appropriate because it emphasizes the need . . . for carriers to recover their costs from charges imposed upon *their own customers*." *Colorado Decision* at 18 (emphasis added). By requiring CLECs to recover their costs from the ISPs, rather than depending on an uneconomic (and unfair) subsidy from the ILECs and local ratepayers in general, a bill-and-keep rule would create incentives for CLECs to make their networks more efficient so as to earn a reasonable return from their ISP customers.

A bill-and-keep rule also would remove the skewed incentives that currently exist for CLECs to prefer ISPs as customers over residential or other business end users. No longer lured by the unlawful windfall of excessive reciprocal compensation for ISP-bound traffic, CLECs finally should begin to tailor their businesses to the demands of ordinary end users as well as ISPs. This would further the goal of the 1996 Act to encourage competition in the local telecommunications market.

B. For LECs That Cannot Distinguish Between ISP-Bound and Local Traffic, A Reasonable Alternative Solution Would Be a Presumptive Cap on the Amount of Reciprocal Compensation that a Carrier Could Recover for ISP-Bound and Local Traffic, Basing the Cap on a Ratio Between the Carrier's Terminating and Originating Minutes.

SBC has proposed an alternative plan, imposing a cap on the amount of reciprocal compensation that a carrier can recover to account for the imbalance caused by ISP-bound traffic. *See* SBC at 54-55. While Qwest does not believe the Commission should adopt a proposal that applies reciprocal compensation to ISP-bound traffic as a general matter, Qwest

believes this proposal may be appropriate for those carriers that are not capable of distinguishing between -- and therefore measuring -- ISP-bound and local traffic.[12] For these carriers, it may be appropriate for the Commission to establish a rule requiring reciprocal compensation for ISP-bound and local traffic, but to adjust the rule to roughly correct for the enormous imbalances that currently result from treating ISP-bound traffic identically with local traffic. The number of minutes for which a carrier could recover reciprocal compensation for terminating another carrier's traffic would be presumptively tied to the number of minutes the first carrier *originates.* The carrier could rebut the presumptive limit by demonstrating that the traffic it terminated was in fact local.

SBC proposes a ratio of 2:1 for such a cap. *See* SBC at 54. Under SBC's proposal, the number of minutes for which Carrier A could recover reciprocal compensation for terminating Carrier B's traffic would be two times the number of minutes that Carrier A originates for termination on Carrier B's network. Carrier A could rebut the presumptive cap by showing that the number of minutes of truly local traffic that it terminated on behalf of Carrier B's subscribers was more than twice the number of minutes that it originated for termination by Carrier B. Qwest believes that, for carriers that are not capable of distinguishing between ISP-bound and local traffic, the 2:1 cap proposed by SBC is reasonable. As demonstrated above, the traffic imbalance measured by Qwest demonstrates that many CLECs that focus on ISP customers will "terminate" significantly more traffic than they originate (on average, approximately nine times

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[12] Qwest has the capability to distinguish between ISP-bound and local traffic. *See, e.g., Colorado Decision* at 18 ("the Commission believes that U S WEST will be able to differentiate ISP traffic from the traffic between U S WEST and Sprint that is subject to reciprocal compensation.").

as much), thus a large majority of their "terminating" traffic will be ISP-bound. Setting a cap at 2:1 therefore is more than fair.

Setting a presumptive cap based on *originating* minutes is a sensible solution to the huge imbalance in terminating minutes that has been caused by states' inclusion of ISP-bound traffic in the reciprocal compensation scheme. Such a cap will have the benefit of at least tempering the incentive that CLECs now have to prefer ISPs to other customers, by limiting the amount of revenues that the CLECs will recover from ILECs for such traffic. In addition, by tying the cap to originating minutes, the cap will encourage CLECs to diversify their customer base to include the types of customers that, unlike ISPs, actually originate traffic.

III. A Second-Best Alternative is Bill-and-Keep for ISP-Bound *and* Local Traffic.

As noted above, the Commission has consistently held that ISP-bound traffic is non-local, interstate access traffic. As a result, there is no legal basis for requiring that ISP-bound traffic be accorded the same treatment as local traffic.[13] Nevertheless, in the spirit of compromise, Qwest suggests that the Commission could bring the two types of traffic together into a single bill-and-keep regime. This proposal, elaborated in SBC's comments, would expand on the first, by requiring ILECs to offer bill-and-keep not just for ISP-bound traffic, but also for local traffic.[14]

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[13] AT&T's argument to the contrary is meritless. *See* AT&T Comments at 17-22. AT&T argues that because "no cost differences have been demonstrated" between ISP-bound and local traffic -- a premise with which Qwest strongly disagrees, and which has been repeatedly disproved by ILECs' submissions in this docket -- the two types of traffic must be accorded the same treatment. But, in any event, AT&T does not -- and cannot -- cite any authority for the proposition that interstate access traffic, such as ISP-bound traffic, must be subject to the same regulations as local traffic, even if the two share certain characteristics. To the contrary, the Commission's treatment under the access charge regime of Feature Group A traffic -- which involves the same type of intermediate, local stop on the way to a final, non-local destination as ISP-bound traffic -- proves this point.

[14] As in the first option, interstate long distance traffic that traverses the public switched telephone network would not be covered by the bill-and-keep plan. In addition, because

Under this proposal, ISP-bound traffic would be subject to a bill-and-keep rule as long as the ILEC offers to exchange local traffic with the CLEC under the same bill-and-keep arrangement. The CLEC would have the option of either accepting the ILEC's offer and proceeding under a bill-and-keep system for both types of traffic, or rejecting the offer, in which case the bill-and-keep rule would govern the ISP-bound traffic and the CLEC could negotiate with the ILEC for reciprocal compensation for local traffic.

Conclusion

For the reasons set out above and in Qwest's opening comments, the Commission should reaffirm its conclusion that ISP-bound traffic is not "local" and therefore is not subject to the reciprocal compensation obligation under section 251(b)(5). In addition, the Commission should exercise its authority under section 201 of the Act to adopt an interim national rule for inter-carrier compensation for ISP-bound traffic that represents a compromise solution to the issue. Bill-and-keep for ISP-bound traffic, which properly removes ISP-bound traffic from the reciprocal compensation scheme while leaving truly local traffic within the ambit of section 251(b)(5), presents the most reasonable alternative.

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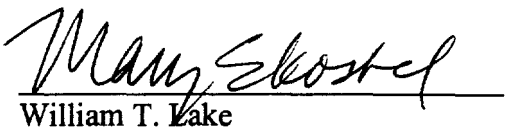
intraLATA toll traffic and switched access traffic are not "local," they would not be covered by this plan.

Respectfully submitted,



William T. Lake
Lynn R. Charytan
Jonathan J. Frankel
Mary E. Kostel
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037
(202) 663-6000

Robert B. McKenna
Jeffry A. Brueggeman
Qwest Communications International, Inc.
1020 19th Street, N.W.
Washington, D.C. 20036
(303) 672-2799

Of Counsel: Dan L. Poole

DATE: August 4, 2000

Counsel for Qwest Corporation

CERTIFICATE OF SERVICE

I, John Meehan, do hereby certify that on this 3rd day of August, 2000, the foregoing Reply Comments of Qwest Corporation have been served by hand, where indicated by asterisk, or by first class mail, postage prepaid, upon the parties on the attached service list.

John Meehan

John Meehan

SERVICE LIST

Chairman William E. Kennard*
Federal Communications Commission
445 Twelfth Street, S.W.
Room 8-B201
Washington, DC 20554

Commissioner Gloria Tristani*
Federal Communications Commission
445 Twelfth Street, S.W.
Room 8-C302
Washington, DC 20554

Commissioner Susan Ness*
Federal Communications Commission
445 Twelfth Street, S.W.
Room 8-B115
Washington, DC 20554

Jane E. Jackson, Chief*
Competitive Pricing Division
Federal Communications Commission
445 Twelfth Street, S.W.
Fifth Floor, Room A225
Washington, DC 20554

Commissioner Harold Furchtgott-Roth*
Federal Communications Commission
445 Twelfth Street, S.W.
Room 8-A302
Washington, DC 20554

Commissioner Michael Powell*
Federal Communications Commission
445 Twelfth Street, S.W.
Room 8-A204
Washington, DC 20554

Tamara Preiss*
Common Carrier Bureau
Federal Communications Commission
445 Twelfth Street, S.W., Fifth Floor
Washington, DC 20554

John Edward Ingle*
Christopher Wright
Laurence N. Bourne
Federal Communications Commission
445 Twelfth Street, S.W.
12th Street Lobby, Room TW-A325
Washington, D.C. 20554

Nancy Caroline Garrison*
Room 10535
U.S. Department of Justice
Antitrust Division
601 D Street, N.W.
Patrick Henry Building
Washington, DC 20530

David A. Gross
AirTouch Communications
1818 N Street, NW
Suite 800
Washington, DC 20036

James P. Young
Sidley & Austin
1722 Eye Street, NW
Suite 600
Washington, DC 20006-3795

Peter Arth, Jr.
Lionel B. Wilson
Ellen S. Levine
People of the State of California &
The California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

K:\822947\0033\8719 72100 comment
service list 8-3-00.doc

Mark C. Rosenblum
American Telephone & Telegraph
295 North Maple Avenue
Basking Ridge, NJ 07920

Robert L. Hoggarth
Angela E. Giancarlo
Personal Communications Industry Association
500 Montgomery Street, Suite 700
Alexandria, VA 22314-1561

Curtis T. White
Law Offices of Curtis T. White
4201 Connecticut Avenue, N.W., Suite 402
Washington, DC 20036

Richard M. Rindler
Michael W. Fleming
Swidler Berlin Shereff Friedman, LLP
3000 K Street, NW., Suite 300
Washington, DC 20007
Counsel for RCN Telecom Services, Inc.

Robert J. Aamoth
Kelley, Drye & Warren
1200 19th Street, N.W., Suite 500
Washington, DC 20036-2423

John David Seiver
Cole, Raywid & Braverman LLP
1919 Pennsylvania Avenue, N.W.
Second Floor, Suite 200
Washington, DC 20006

Lorinda Ackley-Mazur
Richmond Telephone Company
1416 State Rd.
Richmond, MA 01254

Robert M. Lynch
Roger K. Toppins
Michael J. Zpevak
Kathleen E. Palter
SBC Communications, Inc.
One Bell Plaza, Room 3014
Dallas, TX 75202

Albert H. Kramer
David Michael Janas
Robert F. Aldrich
Dickstein Shapiro Morin & Oshinsky LLP
2101 L Street, N.W.
Washington, DC 20037-1526
Counsel for ICG Communications, Inc.

James B. Ramsay
State Members of the Docket # 80-286
Joint Board on Separations
P.O. Box 684
Washington, DC 20044-0684

James Bradford Ramsay
Charles Douglas Gray
National Association of Regulatory Utility Commissioners
1101 Vermont Avenue, Suite 200
Washington, DC 20005

David Cosson
Kraskin, Lesse & Cosson, LLP
2120 L Street, N.W., Suite 520
Washington, DC 20037
Counsel for Telephone Association of New England

Donald B. Verrilli, Jr.
Jodie Lyn Kelly
Jenner & Block
601 13th Street, N.W.
12th Floor
Washington, DC 20005

Randall B. Lowe
Julie A. Kaminski
Renee Roland Crittendon
Piper & Marbury, L.L.P.
1200 19th St., N.W., Suite 700
Washington, DC 20036
Counsel for Prism Communications Services, Inc.

William J. Rooney, Jr.
General Counsel
Global NAPs Inc.
Ten Merrymount Road
Quincy, MA 02169

Joseph Kahl
RCN Telecom Services, Inc.
105 Carnegie Center
Princeton, NJ 08540

Barry Pineles
GST Telecom Inc.
4001 Main Street
Vancouver, WA 98663

Douglas S. Denny-Brown
RNK Inc.
1044 Central Street
Stoughton, MA 02072

Angela D. Ledford
Keep America Connected, *et al.*
P.O. Box 27911
Washington, DC 20005

Leon M. Kestenbaum
Jay C. Keithley
H. Richard Juhnke
Sprint Corporation
1850 M Street, N.W., 11th Floor
Washington, DC 20036

Douglas M. Meredith
John Staurulakis, Inc.
6305 Seabrook Road
Seabrook, MD 20706

Charles C. Hunter
Catherine M. Hannan
Hunter Communications Law Group
1620 I Street, N.W., Suite 701
Washington, DC 20006
Counsel for the Telecommunications Resellers Association

Susan M. Eid
Richard A. Karre
MediaOne Group, Inc.
1919 Pennsylvania Avenue, N.W., Suite 610
Washington, DC 20006

Pat Wood III
Judy Walsh
Brett A. Perlman
Public Utility Commission of Texas
1701 N. Congress Avenue
P.O. Box 13326
Austin, TX 78711-3326

Lawrence G. Malone
Public Service Commission of the State of New York
Three Empire State Plaza
Albany, NY 12223-1530

Brian Conboy
Thomas Jones
Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20036
Counsel for Time Warner Telecom

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W., Suite 1200
Washington, DC 20036

Cheryl A. Tritt
Charles H. Kennedy
Morrison & Foerster LLP
2000 Pennsylvania Avenue, N.W.
Washington, DC 20006-1888
Counsel to Verio Inc.

Richard M. Rindler
Michael L. Shore
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Counsel for KMC Telecom, Inc.

Samuel E. Ebbesen
Virgin Islands Telephone Company
P. O. Box 6100
St. Thomas, USVI 00801-6100

Richard S. Whitt
MCI WorldCom, Inc.
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Ray J. Riordan, Jr.
Executive Vice President & General Counsel
Wisconsin State Telecommunications Association
6602 Normandy Lane
Madison, WI 53719

L. Marie Guillory
Jill Canfield
National Telephone Cooperative Association
4121 Wilson Boulevard
10th Floor
Arlington, VA 22203

Lawrence E. Sarjeant
Linda Kent
Keith Townsend
John W. Hunter
United States Telephone Association
1401 H Street, N.W., Suite 600
Washington, DC 20005

Gary L. Phillips
1401 H Street, N.W., Suite 1020
Washington, DC 20005
Counsel for Ameritech

Lynda L. Dorr
Secretary to the Commission
Public Service Commission of Wisconsin
610 North Whitney Way
P.O. Box 7854
Madison, WI 53707-7854

Peter Bluhm
Vermont Public Service Board
112 State Street
Drawer 20
Montpelier, VT 05620-2701

Ray J. Riordan, Jr.
Executive Vice President and General Counsel
Wisconsin State Telecommunications
Association By Its Wisconsin Internet Service
Provider Division
6602 Normandy Lane
Madison, WI 53719

International Transcription Service, Inc.*
1231 20th Street, N.W.
Washington, DC 20036

Joseph Sutherland
Executive Secretary to the Commission
Indiana Utility Regulatory Commission
302 West Washington, St., Suite E306
Indianapolis, IN 46204

Cynthia Brown Miller
Public Service Commission of Florida
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0562

Donna N. Lampert
Donna N. Lampert Associates, P.C.
701 Pennsylvania Avenue, N.W., Suite 200
Washington, DC 20004
Counsel for America Online, Inc.

Andrew David Lipman
Richard Martin Rindler
Swidler Berlin Shereff Friedman
3000 K Street, NW
Suite 300
Washington, DC 20007-5116

Jonathan Jacob Nadler
Squire Sanders & Dempsey
1201 Pennsylvania Avenue NW
Washington, DC 20044

Laura H. Phillips
J.G. Harrington
Dow, Lohnes & Albertson, PLLC
1200 New Hampshire Avenue, N.W.
Suite 800
Washington, D.C. 20036

George Vradenburg, III
Jill A. Lesser
Steven N. Teplitz
America Online, Inc.
1101 Connecticut Avenue, N.W., Suite 400
Washington, DC 20036

Maureen Lewis
Alliance for Public Technology
P.O. Box 27146
Washington, DC 20038-7146

Cherie R. Kiser
Gil M. Strobel
Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, PC
701 Pennsylvania Avenue, N.W., Suite 900
Washington, DC 20004-2608
Counsel for Cablevision Lightpath, Inc.

M. Robert Sutherland
Richard M. Sbaratta
BellSouth Corporation
1155 Peachtree Street, N.E., Suite 1700
Atlanta, GA 30309-3610

Christopher J. Wilson
Cincinnati Bell Telephone Company
201 East 4th St., Room 102-620
Cincinnati, OH 45201

Lawrence W. Katz
Donna M. Epps
1320 North Court House Road, Eighth Floor
Arlington, VA 22201
Counsel for Bell Atlantic

Dana Frix
Pamela S. Arluk
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007-5116
Counsel for Choice One Communications, Inc.

Caressa D. Bennet
Bennet & Bennet, PLLC
1019 19th Street, N.W., Suite 500
Washington, DC 20036
Counsel for CT Cube, Inc. & Leaco Rural Telephone Cooperative, Inc.

Kathy L. Shobert
General Communication, Inc.
901 15th Street, N.W., Suite 900
Washington, DC 20005

George N. Barclay
Michael J. Ettner
General Services Administration
1800 F Street, N.W., Room 4002
Washington, DC 20405

Eric J. Branfman
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Counsel for Corecomm Limited

David Ellen
Cablevision Lightpath, Inc.
1111 Stewart Avenue
Bethpage, NY 11714-3581

Ronald L. Plesser
Mark J. O'Connor
Piper & Marbury, LLP
1200 19th Street, N.W., Suite 700
Washington, DC 20036
Counsel for Commercial Internet Exchange Association

Richard M. Rindler
Patrick J. Donovan
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, DC 20007
Counsel for Focal Communications Corp.

Jan F. Reimers
ICORE, Inc.
326 S. Second St.
Emmaus, PA 18049

Richard Metzger
Focal Communications Corporation
1120 Vermont Avenue, N.W.
Washington, DC 20005

Michael J. Shortley III
Frontier Communications
180 South Clinton Avenue
Rochester, NY 14646

Jonathan E. Canis
Ross A. Buntrock
Kelley Drye & Warren LLP
1200 19th St., N.W., Fifth Floor
Washington, DC 20036
Counsel for Intermedia Communications, Inc.

Susan Grant
Vice President, Public Policy
National Consumers League
1701 K Street NW
Suite 1200
Washington, DC 20006

Marc D. Poston
Attorney for the
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

James Connelly
Chairman
Massachusetts Department of
Telecommunications and Energy
One South Station
Boston, MA 02110

Richard A. Askoff
National Exchange Carrier Association
80 South Jefferson Road
Whippany, NJ 07981

Joel H. Cheskis
555 Walnut Street, Forum Place, 5th Floor
Harrisburg, PA 17101-1923

John M.Goodman
1300 I Street N.W.
Washington, DC 20005

John Cleven Tooker
President
Western Telephone Integrated
Communications
303 East Jackson Street
Medford, OR 97501

Brenda Boykin
Cole, Raywid and Braverman
1919 Pennsylvania Avenue, NW
Suite 200
Washington, DC 20006
Counsel for Centennial Communications Corp.

David Cosson
Kraskin, Lesse & Cosson
2120 L Street NW
Suite 520
Washington, DC 20037
Counsel for Rural Independent Competitive Alliance

Patrick Donovan
Swidler Berlin Shereff Friedman
3000 K Street NW
Suite 300
Washington, DC 20007
Counsel for Pac-West Telecomm, Inc.

Mark D. Schneider
Jenner & Block
601 13th Street NW
Washington, DC 20005
Counsel for WorldCOM, Inc.

Brad E. Mutschelknaus
Kelley Drye & Warren.
1200 19th Street N.W.
Fifth floor
Washington, DC 20036
Counsel for Advanced Telecom Group, Inc.

Jonathan Askin
Association for Local Telecommunications Services
888 17th Street NW
Suite 900
Washington, DC 20006