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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

VIA HAND-DELIVERY

Magalie Roman Salas, Secretary
Federal Communications Commission
445 Twelfth Street, SW, Room TW-A325
Washington, DC 20554

Re: Reply Comments of Pac-West Telecomm, Inc. and Connect Communications Corporation In the Matter of Inter-Carrier Compensation for ISP-Bound Traffic CC Docket Nos. 99-68 and 96-98 – Public Notice of June 23, 1999

Dear Ms. Salas:

On behalf of Pac-West Telecomm, Inc. ("Pac-West") and Connect Communications Corporation ("Connect"), enclosed for filing please find an original and five copies of Pac-West's and Connect's reply comments in the above-referenced dockets. Please return the extra file-stamped copy to the courier.

Respectfully submitted,

Robin L. Redfield

Enclosure

cc: Chief, Competitive Pricing Division (One copy via hand-delivery)
International Transcription Services (One copy via hand-delivery)

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AUG 4 2000

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of	)	
	)	
Inter-Carrier Compensation For ISP-Bound Traffic	)	**CC Docket No. 99-68**
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	**CC Docket No. 96-98**

REPLY COMMENTS OF PAC-WEST TELECOMM, INC AND CONNECT COMMUNICATIONS CORPORATION RELATED TO REMAND OF THE COMMISSION'S RECIPROCAL COMPENSATION ISP RULING BY THE U.S. COURT OF APPEALS FOR THE D.C. CIRCUIT

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Pac-West Telecomm, Inc ("Pac West") and Connect Communications Corporation ("Connect") hereby submit these Reply Comments concerning the remand of the Commission's reciprocal compensation Internet service provider ("ISP") ruling.

INTRODUCTION AND SUMMARY

As evidenced by the incumbent local exchange carrier ("ILEC")[1] comments, at this point in time, there is little new to say with respect to the legal issues. ILECs continue to argue that dial-up ISP-bound traffic is not local traffic based on the Commission's end-to-end analysis. ILECs argue -- unsuccessfully -- that an ISP call terminates beyond the ISP, that the ISP is not the "called party," and that the ISPs status as an information service provider has no bearing on whether telecommunications terminate at the ISP. Moreover, ILEC SBC attempts to demonstrate that the regulatory definition of termination does not apply to determine the local nature of an ISP-bound call. As a fall back position, SBC contends that reciprocal compensation should be denied for ISP-bound traffic because of what are purported to be public policy concerns. According to SBC, reciprocal compensation should be denied for ISP-bound traffic

[1] ILECs refers to SBC Communications, Inc. ("SBC"), Verizon Communications ("Verizon"), BellSouth Corporation ("BellSouth") and Quest Corporation ("Quest").

because ISP revenues are sufficient to cover the costs of terminating ISP-bound traffic, competitive local exchange carriers ("CLECs") have more efficient, less costly networks, and because reciprocal compensation allegedly deters CLECs from pursuing other markets.

ILECs base their claims on a less than credible cost study and misapprehension of legal precedent. Furthermore, they totally ignore and fail to address the fact that thirty-three (33) state commissions have found that calls to ISPs should be treated as any other local call for reciprocal compensation purposes. The Commission should carefully consider whether there is a need to second guess the judgment of these state commissions who have rejected – in many cases multiple times – all of the arguments the ILECs make today. The Commission should also note that every court that has reviewed state commission decisions on the merits, including the Fifth, Seventh and Ninth Circuit United States Court of Appeals, have found that reciprocal compensation is due for calls to ISPs.

If this were not enough reason for the Commission to require the continued payment of reciprocal compensation for calls to ISPs, the fact that the 1996 Act[2] is demonstrably working provides an independent basis for the Commission to conclude that there is no need to revisit the issue of whether calls to ISPs should be subject to reciprocal compensation like all calls that are not subject to access charges. As the Commission is well aware, the ILECs dilemma with reciprocal compensation is one of their own making. When interconnection agreements were first negotiated and/or arbitrated, the ILECs demanded a high reciprocal compensation rate which, at that time, they alleged represented their costs for transport and termination of local calls. It is now clear that the ILECs set their rates based on their expectation that their monopoly in the local market would result in their terminating more traffic for the CLECs than the CLECs would terminate for the ILECs. That, as everyone now knows, proved to be a miscalculation by the ILECs. Faced with the advent of actual competition for some customers, ILECs are now seeking lower reciprocal compensation rates through negotiations and arbitrations. These

[2] Telecommunications Act of 1996, Pub. L. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C.) (the "1996 Act or "Act").

substantially reduced rates are also allegedly based on the ILECs' cost of transporting and terminating local calls. A reduction from $.01 per minute of use to rates more in the order of $.004 does not reflect some sudden new efficiency on the part of the ILECs, but a rate apparently more reflective of their actual cost. This reduction in rates is, of course, the desired end of competition and a classic result of an arbitrage situation -- in this case one created by the ILECs.

Having created the problem of what ILECs now claim are non-cost based rates for transport and termination of local calls, it ill behooves the ILECs to come running to the Commission claiming financial distress. As indicated, even if rates were too high, the market is addressing those rates. But, of course, it is demonstrably not true that reciprocal compensation has resulted in financial distress. Verizon's claim of a projected payment of nearly $1 billion for reciprocal compensation (Verizon Comments at 2),[3] must be examined in the context of its revenues and profits. In 1998 Bell Atlantic and GTE (now merged as Verizon) had regulated revenues of just over $38 billion. In 1999 Verizon's regulated revenues climbed to $41.5 billion, an 8.69% increase. Net income in the same period was $6.5 billion in 1998 and $7.1 billion, a 10% increase.[4] This is not exactly the picture of a company in financial distress.

Moreover, whatever the financial impact, the Commission must not lose sight of the fact that just as this issue was created by the ILECs, it can be solved by them without Commission action. Not by more repetitive litigation which "needlessly consume[s] both carrier and public resources" (Verizon Comments at 20), but instead through long overdue acceptance of the fundamental premise of the 1996 Act. ILECs could, of course, compete to serve ISPs and this issue would be minimized. This rather obvious solution seems to elude the ILECs. CLEC success in obtaining ISPs as customers is based on the CLECs willingness to address the needs of ISPs as valued customers, needs that the ILECs refuse to address. CLECs were able to provide substantial reductions in provisioning times. CLECs were prepared to provide

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[3] Comments of the participating parties shall be referred to throughout as, for example, "Verizon Comments at ___", SBC Comments at _____," etc.

[4] *See* FCC Automated Reporting Management Information System (ARMIS) Database (Information from annual reports) (2000)

controlled environments for ISP equipment. The fact that the growth of Internet usage is rapidly expanding demand for Internet access makes ISPs natural potential CLEC customers.

In its response to competition, the ILECs conduct reflects that of a monopolist. Rather than compete, the ILECs seek regulatory relief and attempt to divide the market for local telephone service so that calls to particular customers are treated differently – customers which because of their growth and needs are particularly attractive to CLECs as a means of market entry. This monopoly approach reflects an effort to protect the past while stealing the future.

The ILECs' actions under the 1996 Act substantiate this mindset. The ILECs have continuously delayed, opposed and challenged the Commission's efforts to implement the Act. The ILECs' argument here that reciprocal compensation delays the rollout of advanced services illustrates this conscious strategy. Asymmetric Digital Subscriber Line (ADSL) technology was available to ILECs prior to the 1996 Act. ILECs did not, however, deploy this technology until it was being rolled out by competitors who identified an opportunity to address underserved customers. ILECs fought this competitive incursion by opposing cageless collocation, by opposing line sharing and by seeking to deregulate their provision of competing services so that they would not be required to unbundle facilities associated with such services and could refuse to resell these services. The leading CLEC provider of ADSL service recently testified that 40% of all homes and businesses in the United States are within its footprint; that it expects 50% by year end and 75% by the end of next year to be within its footprint.[5] This is hardly the picture of a market deterred from rolling out advanced services.

Again, despite ILEC intransigence, the 1996 Act is working. New choices are available to customers. The monopolist has been forced to deploy advanced services in response to the

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[5] *Hearing on* H.R. 2420 *before the Telecommunications, Trade and Consumer Protection Subcommittee of the House Commerce Committee,* 106th Cong. 2nd Sess. (2000) (Statement of Dhruv Khanna, Executive Vice President, General Counsel and Secretary, Covad Communications) at *17-18 (See excerpts Attachment A).

competitive challenge, and prices for the services have been dramatically reduced. These facts bear little resemblance to the picture the ILECs seek to conjure.

The Commission should confirm that calls to ISPs are subject to all of the Commission's rules relating to reciprocal compensation, including rules relating to symmetrical rates, tandem treatment and the reliance on ILEC forwarding looking costs.

DISCUSSION

I. ILECS CONTINUE TO ADHERE TO THE REJECTED THEORY THAT THE END-TO-END ANALYSIS IS APPROPRIATE TO DETERMINE RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC UNDER §251(b)(5) OF THE 1996 ACT

SBC and other ILECs assert that the end-to-end analysis is not merely limited to jurisdiction, but may be "used to determine the boundaries of a communication for regulatory purposes." (SBC Comments at 10, BellSouth Comments at 6, Verizon Comments at 6, and Quest Comments at 4-5). SBC claims that legal precedent supports its argument that the end-to-end analysis has been applied to determine the regulatory status of a communication and not just to address jurisdiction. In the first instance, SBC ignores the *Bell Atlantic* Court's instruction to answer the question -- why the end-to-end analysis is relevant to determine entitlement to reciprocal compensation under §251(b)(5), in the face of all the other evidence that ISP-bound traffic is local traffic. SBC misconstrues the Court's concerns about the application of the end-to-end analysis when it states, "[o]ne of the principal bases for the court's skepticism was its apparent belief that the end-to-end analysis has been used only for jurisdictional purposes to the present context." (SBC Comments at 10). SBC, however, is wrong, the Court's principal concern was that the Commission failed to explain why the end-to-end analysis was appropriate to determine the regulatory treatment of ISP-bound traffic in the face of the requirements of the 1996 Act and

the Commission's own regulations. The Court was clear on this point when it stated:

> The end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction. *Here it used the analysis for quite a different purpose, without explaining why such an extension made sense in terms of the statute or the Commission's own regulations.* Because of this gap, we vacate the ruling and remand the case for want of reasoned decisionmaking.[6]

SBC and other ILEC comments are no more elucidating on this point; they fail to address this question, but instead attempt to demonstrate that the end-to-end analysis should apply simply because the FCC has allegedly, in the past, interpreted the rule as applying to determine the regulatory status of a given service.

In the first instance, two of these cases cited by SBC were already found unpersuasive by the *Bell Atlantic* Court – *Teleconnect v. Co. v. Bell Tel. Co. Pa.*[7] and *Petition for Emergency Relief and Declaratory Ruling.* [8] As the Court noted, when distinguishing the calls at issue in those cases from ISP-bound calls, "[b]oth involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination."[9] Second, many of the cases cited by SBC clearly concern calls that fit more within the call model of two LECs collaborating with a long distance carrier to complete

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[6] *Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 3 (D.C. Cir. 2000) ("*Bell Atlantic*") (emphasis added).

[7] *Teleconnect Co. v. Bell Tel. Co.*, 10 F.C.C. Rcd. 1626 (1995), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997).

[8] *Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corp.*, 7 F.C.C. Rcd. 1619 (1992) ("*MemoryCall*").

[9] *See Bell Atlantic* 206 F.3d at 6.

a call, rather than two LECs collaborating to complete a call.[10] Third, there was no dispute in many of these cases as to whether a call was interstate and subject to access charges. Instead, the disputes were over whether both originating and terminating carrier common line ("CCL") type access charges applied.[11]

For example, in *Teleconnect Co. v. Bell Tel. Co. of PA*, a dispute arose over whether the interstate access CCL charge was appropriately assessed for an 800 call.[12] Teleconnect, an interexchange carrier, alleged that local exchange carriers (LECs) improperly assessed the higher CCL charge on the originating end of calls using Teleconnect's 800 Nationwide travel service, when it was also assessed the higher CCL charge on the terminating end. The LECs argued that the call involved two calls and therefore a higher CCL charge was due on both the originating and terminating end of the call. The Commission's rules provided that for certain 800 calls, the higher CCL charge could not be assessed on both ends because the terminating end does not use carrier common lines; the terminating end of these calls used special access circuits. The claim of two calls was based on the theory that the call terminated at the interexchange carrier's intermediate switch, and a second call was originated when a second number was dialed before the calls terminated to the end-user. The Commission concluded that the call did not end at the

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[10] *See Teleconnect Co. v. Bell Tel. Co.*, 10 F.C.C. Rcd. 1626 (Call did not terminate at Teleconnect's intermediate switch where LECs collaborated with interexchange carrier to complete an 800 call.); *International Telecharge, Inc. v. Southwestern Bell et al.*, 11 F.C.C. Rcd. 10061 (1996) (Commission held that where LECS were collaborating with interexchange carrier to complete a call using 800 lines did not terminate at an intermediate switching point); *AT&T Corporation, et al., v. Bell Atl.-PA, et al.*, 14 F.C.C. Rcd. 556 (1998) (Where LECs collaborate with an interexchange carrier to complete a call that is forwarded from the called party's premises to another location, LECs may not charge an interstate common line charge at the called party's premises because the call does not terminate at that location.)

[11] *See Teleconnect Co.*, 10 F.C.C. Rcd. at 1626 ¶1.; *International Telecharge, Inc.*, 11 F.C.C. Rcd. at ¶19; *AT&T Corp.*, 14 F.C.C. Rcd. at 577 ¶44; *Bill Collectors, Inc. et al. v. Pacific Bell*, 10 F.C.C. Rcd 2305 (1995).

[12] *See Teleconnect Co.*, 10 F.C.C. Rcd. at 1626 ¶1.

intermediate switch but was a single continuous call.[13] Obviously, there are glaring differences between this case and the situation where a call is placed to an ISP. There was no dispute in the *Teleconnect* case that the calls were interstate for all purposes and that the calls were being delivered to an interexchange carrier, not an ISP providing information services.

Other distinctions between the cases cited by SBC and dial-up ISP bound calls, include some raised by the *Bell Atlantic* Court. For instance, ISPs are *information service providers* "which upon receiving a call originate further communications to deliver and retrieve information to and from distant websites.[14] In this regard, they are not like the interexchange carriers in the cases cited by SBC, and as the Commission has acknowledged, do not use the public switched network in a manner similar to interexchange carriers. Also, ISPs use telecommunications to provide information service and are not themselves telecommunications providers.[15] Thus, these cases do not support excluding ISP-bound traffic from reciprocal compensation treatment under §251(b)(5).

Moreover, the ILECs claim that the Commission's end-to-end analysis for jurisdictional analysis is inextricably intertwined with its regulatory authority. However, what the ILECs fail to recognize is that at the time the Commission established the enhanced service provider ("ESP") exemption, it determined that ISP traffic should be treated one way for jurisdictional purposes and another for regulatory purposes. In all respects, except jurisdiction, calls to ISPs are treated as local calls. Thus, not only do ILECs fail to answer the Court's question, but SBC and other ILECs misinterpret the Commission's prior rulings as is borne out by an evaluation of the cases cited.

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[13] *See id. at* 1629 ¶12.
[14] *See Bell Atlantic,* 206 F.3d at 6.

[15] *See id.* at 7.

Moreover, SBC and other ILECs argue on the basis of the faulty application of the end-to-end analysis that an ISP-bound call terminates for purposes of assessing the Commission's jurisdiction at the web sites visited by the originating caller, and it terminates there for purposes of determining whether reciprocal compensation applies. That of course does not answer the Court's question on remand, but simply restates the theory rejected by the Court. The ILECs argue that the ISP's server is simply an intermediate switch. They take the position that the ISPs status an information service provider has no impact on whether a call terminates at the ISP, and the Commission's definition of termination does not apply. They are mistaken on all counts.

Their positions completely ignore the *Bell Atlantic* Courts determination that an ISPs status as an information provider is crucial to this analysis. This too ignores the Commission's conclusion in the *Universal Service Order* that a connection to an Internet service *"is a telecommunications service and is distinguishable from the Internet service provider's service offering."*[16]

Further, SBC also mistakenly relies on the Commission's decision in *MemoryCall* to attempt to prove that the Commission rejected the argument that telecommunications terminate at the point an information service begins. (SBC Comments at 18). However, *MemoryCall* is inapposite as was aptly pointed out by the *Bell Atlantic* Court. First, the issue in that case was whether the state had *jurisdiction* over the end portion of an interexchange call from the switch to the caller's voice mailbox. Second, *MemoryCall* did not address the question of whether telecommunications may terminate, for *regulatory* purposes, at the ISP. Again as the *Bell South*

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[16] *In the Matter of Federal-State Joint Board on Universal Service,* Report and Order, CC Docket No. 96-45, 12 F.C.C. Rcd. 8776, 9180 ¶789 (rel. May 8, 1997) ("*1997 Universal Service Order*").

court noted, *MemoryCall* was a case involving a single continuous transmission, originated by the end-user, switched by a long distance carrier and delivered to the end-user.

Next, SBC argues that the Commission's definition of "termination" is inapplicable in determining whether calls to ISPs terminate at the ISP. SBC essentially argues that the definition was not established for the purpose of determining whether a call is interstate or local, but to distinguish transport from termination. Even *assuming arguendo* that SBC is right, which it is not, this does not negate the fact that the definition still defines an end point of a call in terms of when it reaches the "called party." Nor does it negate the fact that calls to ISPs fit squarely within this definition. A call to an ISP involving two local carriers is switched by the LEC serving the ISP and delivered to the ISP as the "called party." Realizing the weakness of this argument, SBC also argues that ISPs are not the "called party." This issue has been extensively addressed in the initial comments, and it suffices to say, here, that when a call reaches the ISP it is answered and answer supervision is returned. In addition, the second component is an information service, not a telecommunications service.

Moreover, even under the ILEC's misapplied end-to-end analysis, in today's' Internet environment, a substantial number of calls do not go beyond the ISPs server. Thus, these calls would be considered local, even under the ILECs' theories. As was described by Mr. Fred Goldstein in testimony to the California Commission, there is currently a significant amount of ISP-bound traffic that is never transmitted on to the Internet backbone.[17] As Mr. Goldstein describes it, this occurs in a number of situations. The ISP maintains its own server, and if the caller is sending or receiving electronic mail the caller's computer generally communicates with the ISP's mail server. The mail server performs a store-and-forward function of relaying

[17] *See* Testimony of Fred Goldstein on Behalf of Pac-West Telecomm, Inc. Before the Public Utilities Commission of the State of California at *7-9, July 14, 2000 (Attachment B).

outgoing mail to the Internet, and storing incoming mail from the Internet until the customer's mail client requests it. Consequently, an end-user that merely wishes to check its mail can connect to the mail server and never pass any traffic on to the Internet backbone. According to Mr. Goldstein, this probably accounts for a significant number of dial-up calls.[18] Similarly, when an end user connects to an ISP's news server, like Usenet News, the end user retrieves information from the news server which stores news articles locally for days or weeks.[19] Or, if the ISP subscriber is browsing the World Wide Web, then the ISP may be providing a web cache that keeps local copies of frequently-viewed pages in order to speed response time. Some ISPs have reported being able to cache up to 30-40% of web pages regularly visited by their customers.[20] In these situations as well, the end user retrieves information from the ISP's server. Also, if the end-user contacts the ISP for technical help or seeks some other administrative service, it is usually done by e-mail and again the public Internet is not used.

Finally, of the remaining data that actually does go onto the backbone, some leaves the state and some does not. In California, for instance, since a disproportionately large percentage of World Wide Web traffic converges in California, "the average share of interstate traffic generated out of every 64000 bps dial-up telephone connection is probably well below 8%."

So, not only have the ILECs failed to demonstrate that the end-to-end analysis is appropriate to determine whether ISP-bond traffic is subject to reciprocal compensation under §252 (b)(5), there is sufficient evidence that, even under the ILECs end-to-end analysis, much of the ISP-bound traffic does not go beyond the ISP's server.

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[18] *See id.* at 7.

[19] *See id.* at 7-8.

[20] *See id.* at 8.

II. ILEC'S SO CALLED "POLICY" ARGUMENTS DO NOT SUPPORT THE CONCLUSION THAT RECIPROCAL COMPENSATION IS NOT DUE FOR DIAL-UP ISP-BOUND TRAFFIC "

ILECs allege as a fall back position that dial-up ISP calls, as a matter of policy, should not be subject to reciprocal compensation because such calls: 1) are different from other local calls, in that they are one-way, have longer holding times, and are interconnected by users by means of interstate or foreign communications, 2) CLECs serve their customers more efficiently and at lower cost, 3) CLECs recover their terminating costs from ISP revenues, 4) CLEC services to ISPs reduces their incentive to serve other markets and to deploy ADSL services, 5) service to ISPs skews economic incentives, and 6) results in CLEC scams. Aside from the fact that these allegations have little to do with the questions raised by the Court on remand -- whether calls to ISPs terminate at the ISP, or are otherwise subject to §252(b)(5) -- they are based on factual inaccuracies and misdirected logic.

A. Under the Guise of Presenting a Public Policy Argument, ILECs Raise Unsubstantiated and Irrelevant Claims That CLEC Costs are Below ILEC Costs and that CLECs' Recover Their Costs From ISPs

ILECs seek to persuade the Commission that reciprocal compensation is not due for ISP-bound traffic based on unsubstantiated claims of lower CLEC costs for termination of calls to ISPs. ILEC's however, have presented no credible evidence that CLEC costs are in fact lower. Instead, SBC offers remnants of a cost study that was rejected by a state commission after a thorough evaluation of the evidence. Nor do ILECs provide any legitimate reason why the Commission should abandon the long-standing principle that the cost causer, the originating end user in this case, pays for the service provided to it. Reciprocal compensation is intended to ensure that when one local carrier uses the facilities of another local carrier to terminate calls, the carrier terminating the calls is compensated by the competiting carrier for the use of its network.

Similarly, the CLECs' revenues from ISPs have no bearing on whether CLECs should recover the costs of terminating calls from ILECs. ISPs pay CLECs for access to business lines, not for termination of calls made by ILEC customers. Moreover, the Commission has already concluded that CLEC costs are not the appropriate proxy for determining reciprocal compensation.

In its First Report and Order, after much debate, this Commission correctly determined that from a legal and factual perspective, transport and termination costs should be symmetrical and based on an ILEC's Total Element Long Run Incremental Costs (TELRIC).[21] The Commission concluded that this method of assessing costs is consistent with section 252(d)(2)(B)(ii), and the Commission identified the many benefits of using symmetrical rates. Among these benefits are: (1) incentive to competing carriers to minimize their costs of termination because their termination revenues do not vary directly with changes in their own costs, (2) maintenance of an ILEC's incentives to control costs, (3) reduction in an ILEC's ability to use its bargaining strength to negotiate excessively high termination charges that competitors would pay the ILEC and excessively low termination rates that the ILEC would pay interconnecting carriers, and (4) symmetrical compensation rates that are administratively easier to derive and manage than asymmetrical rates based on the costs of each of the respective carriers.[22] In addition, the Commission concluded that "using the incumbent LEC's cost studies to establish the presumptive symmetrical rates will establish reasonable opportunities for local

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[21] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No.96-98, First Report and Order, 11 FCC Rcd 15499, 16040-16042 ¶¶1085-1089 1111 (1996) (*"Local Competition Order"*), *vacated in part, aff'd in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *cert. granted on other grounds sub nom. AT&T Corp. v. Iowa Utils.* Bd., 118 S.Ct. 879 (1998).

[22] *Id.* at 16040-16041 ¶1086-1088.

competition, including opportunities for small telecommunications companies entering the local exchange market."[23]

As it turns out, the Commission was right. CLECs have gained the opportunity to compete on some levels, including in the provision of services to ISPs. In addition, the rates for reciprocal compensation have been significantly reduced since the first interconnection agreements were executed. Yet, despite the evidence of the benefits of rates based on the ILECs forward looking costs, ILECs in this proceeding seek to argue that the Commission should consider the CLECs' costs in determining an appropriate rate structure.

ILECs seek to convince the Commission of their position by arguing that CLECs' costs to deliver ISP-bound traffic are lower. SBC, in particular, relies on a cost study that was firmly rejected by the Texas Public Utility Commission. SBC touts the study as proof that the cost of delivering calls to an ISP is 1/3 less than delivering a local voice call. (SBC Comments at 35-36). The Texas Commission described SWBT's assertion regarding this same cost study as follows:

> SWBT relies on its ISP-bound traffic (IBT) cost study to demonstrate that ISP-bound traffic is fundamentally different from voice traffic and should not be subject to reciprocal compensation, although SWBT does not propose that the cost study be used to set rates. SWBT's cost sudy measures costs associated only for dial-up, 56 kilobit Internet calls. SWBT contends that the difference in call duration between voice and ISP-bound traffic justifies separating the traffic for rate purposes, with ISP-bound traffic costing approximately 20% of the cost of voice traffic. In addition to using a 29-minute average hold time for ISP-bound traffic, SWBT states that the IBT cost study assumes that the switches terminating the ISP-bound traffic have no vertical services, which it contends are unnecessary for ISP-bound calls, and are the absolute minimum necessary to complete the ISP connection. SWBT explains that its voice traffic study, however, does not make these assumptions, but rather includes the programming of vertical and other services into the switch, thereby

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[23] *See id.* at 16041 ¶1088.

> increasing the switching costs for voice traffic, regardless of the call duration.[24]

The Texas Commission then went on to note that, "[d]espite these differences in the cost studies, SWBT admitted on cross-examination that ISP-bound traffic uses the same switches and the same network as voice traffic."[25] Further, after evaluating all of the evidence, the Texas Commission rejected SWBT's allegation of lower costs stating:

> [t]he Commission rejects the adoption of different inter-carrier compensation for voice and ISP-bound traffic. At present, the Commission is not persuaded that the methodologies used by SWBT to identify and segregate voice traffic from ISP-bound traffic are reliable or consistent.[26]
>
> The Commission concludes that the SWBT IBT cost study is not a TELRIC study and also cannot be used to justify differentiating ISP-bound traffic and voice traffic for costing purposes. At this time, the Commission declines to distinguish voice from ISP-bound traffic for purposes of setting reciprocal compensation rates.[27]
>
> Moreover, the Commission does not accept minutes-of-use (MOU), number tracking, or billing records as accurate discriminators of voice and ISP-bound traffic.[28]

So, not only did the Texas Commission conclude that the SWBT study did not comply with the TELRIC methodology, but it also determined that it was not credible evidence of the difference in costs between voice and ISP-bound traffic. Accordingly, SBC has failed to provide any credible evidence and its claims of lower CLEC costs should be rejected.

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[24] *Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996,* Docket No. 21982, at *43-44 (Tex. P.U.C. July 13, 2000).

[25] *Id.* at *44.

[26] *Id.* at *19.

[27] *Id.* at *47.

[28] *Id.* at *19.

1. CLECs Are Entitled to Receive Compensation for Termination From the Cost-Causer

In a "cut and paste" fashion, ILECs attempt to demonstrate that the Commission should deny reciprocal compensation because CLECs are recovering their costs from ISPs. Instead of basing its argument on legitimate cost studies, SBC takes isolated comments from financial reports related to CLEC revenues and attempts to prove that somehow these revenue numbers demonstrate that CLEC revenues from ISPs are covering the costs of terminating ISP-bound traffic. This is nothing more than a diversion from the Commission's task at hand which is to determine whether ISP-bound traffic is subject to reciprocal compensation. What a CLEC's revenues are from selling business lines to ISPs has nothing to do with the costs it incurs to terminate traffic from an ILEC's end-user customer. SBC, through its related company SWBT, attempted to make this very same argument before the Texas Commission. However, the Texas Commission was not persuaded.[29] In the Texas proceeding, SWBT argued that CLECs should be required to demonstrate that revenues received from ISPs are insufficient to cover the cost of termination before permitting recovery of termination costs from ILECs. As one expert noted in rejecting this concept:

> The costs in question – those for which reciprocal compensation is intended to recover – are not related in any way to the CLEC providing network access to its end user customers, including ISPs. The costs at issue are those incurred by a CLEC when it delivers a call originated by a SWBT end user customer; it is the cost of serving SWBT's customer that originates the call, not the CLEC's customer that receives the call, that must be addressed. The rate that SWBT charges to its customer is intended (alone or in conjunction with universal service disbursements) to permit recovery of the costs associated with serving that customer. In a monopoly environment, SWBT incurs the cost of originating and terminating all of the local calls made by that customer. In a competitive environment, SWBT continues to receive the same revenue from that customer, but a

[29] *See id.*

> portion of the costs previously incurred to serve it – those associated with the delivery of calls to certain other end users – have been transferred to a CLEC. If reciprocal compensation rates accurately reflect the cost that SWBT avoids when another LEC delivers these calls . . . SWBT should be indifferent; its revenues from the customer are the same, and the final cost that it incurs to serve the customer is the same."[30]

By making the argument that the ISP and not the end-user should pay, ILECs seek to turn the concept of cost-causation on its head. As recently noted in expert testimony presented in a California rulemaking proceeding to determine reciprocal compensation, the sent-paid arrangement which requires the originating end-user to pay both the originating and terminating charge, has been in place since the introduction of local telephone service more than a century ago, and "has provided the framework for the interchange of traffic as well as the allocation of usage revenues as between two incumbent local exchange carriers . . . ."[31] This procedure is not confined to the telecommunications industry, but is used extensively in the airline industry where competing connecting carriers share revenues from tickets.[32] The payment by the ILEC to the CLEC is simply a remittance of monies collected from the ILEC's customer for the total service, a portion of which is furnished by a connecting carrier rather than by the ILEC itself.[33] Simply because the concept of an end user paying is not beneficial to ILECs when terminating ISP-bound traffic, should not influence the Commission to abandon this long standing compensation structure.

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[30] *See* Rebuttal Testimony of Don J. Wood on Behalf of ICG Choicecom, L.P. Before the Public Utility Commission of Texas at *23, March 31, 2000 (Attachment C)

[31] *See* Direct Testimony and Exhibit of Lee L. Selwyn on Behalf of Pac West Telecomm, Inc. Before the Public Utilities Commission of California at *11, July 18, 2000 (Attachment D).

[32] *See Selwynn Testimony* at *12-13. (Attachment D)

[33] *See id.* at *13.

ILECs also argue that CLECs are free to charge ISPs whatever they want in order to recover their costs. (SBC Comments at 32). However, as previously mentioned, it is the ILEs' end-user customer that is responsible for both the origination and termination costs that ILECs -- in fact -- charge and collect from their end-users. Moreover, the ILECs' suggestion that CLECs charge ISPs more, is nothing more than an anti-competitive attempt to force CLECs into a position where ISPs will find it more desirable to purchase services from ILECs. Thus, ILECs seek to expand their already explosive revenues at the expense of CLECs.[34]

2. CLECs Should be Rewarded for Greater Efficiency Not Penalized

Moreover, even if CLECs are more efficient in terminating services to ISPs, that should not be a basis for denying compensation to CLECs. Instead, as intended by the Commission, this should force ILECs to become more efficient so that termination costs will be lower. The solution is not for CLECs to be denied reciprocal compensation, but for ILECs to become more efficient to drive costs down. As has been noted, the loss of call termination may be a competitive loss to ILECs, however, the loss results from "mis-assessments of the market and mispricing of services by incumbents, and is not the fault of CLECs who made entirely

[34] ILECs financial reports demonstrate that they are far from suffering significant losses due to competition in the local market but are instead enjoying significant growth in revenues overall. *See* Bell Atlantic 10-K, filed March 30, 2000 p.F-5 ("Data revenues (including those from high-bandwidth, packet-switched, and special access services and network integration businesses) reached over $2.9 billion for the year 1999, nearly 26% over 1998 levels. Data revenues in 1998 totaled $2.3 billion, an increase of 33% over 1997."); BellSouth 10-K, filed March 2, 2000, p 28 ("Local service revenues increases $854 million during 1999 and $1.016 billion during 1998, attributable to growth in switched access lines and strong demand for digital and data services and convenience features."); SBC 10-K, filed March 10, 2000, p. 96 ("Local service revenues increased $1.887 billion, or 10.9% in 1999, and $1.375 billion, or 8.7%, in 1998 due primarily to increases in demand, which totaled approximately $1.245 in 1999 and $1.270 in 1998, including increases in access lines, vertical services and data-related service revenues.").

legitimate market responses to pricing signals that they were receiving from ILECs.[35] "If a CLC is able to furnish the call termination service more efficiently than the ILEC, the goals of competition are served when customers requiring this service are induced to switch from the ILEC to a CLC."[36] SBC cites a list of technological innovations that CLECs allegedly employ to reduce their costs of providing a service. Although CLECs do attempt to serve customers in the most efficient means possible, there is no evidence that many CLECs are not using circuit switching to terminate traffic. CLECs essentially have networks comprised of the same three components as ILECs, subscriber loop, end office switching systems and interoffice network trunking and switching. The major differences are in the economic trade offs made with respect to the mix of the various components within a network.[37] "The specific mix of switching vs. transport facilities in a network depends heavily upon the relative cost of each and the overall scale of operations of the network."[38] Because CLECs serve a customer population that is a fraction of the size of an ILEC's customer base, in order to gain efficiencies , they must employ a small number of large switches. Although CLECs may collocate with certain customers, collocation is identical to serving customers that are not collocated, except the transport occurs over a shorter distance. This does not mean that switching or transport costs are eliminated.

Further, there is no concrete evidence of the extent to which CLECs may be experiencing reductions in costs as a result of technology. Second, even if *assuming arguendo* this has resulted in reductions in cost for CLECs, the appropriate response in not to change the rate structure to help ILECs compete. If ILECs lower their own costs this will result in lower

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[35] *See Selwynn Testimony* at *24. (Attachment D).

[36] *See id.* at *25.

[37] *See id.* at *44-45.

TELRIC for ILECs, which will result in lower termination rates for both ILECs and CLECs. If such efficiencies are in fact available, it would be incumbent on ILECs to seek to gain such efficiencies. Whether they have done so or not the ILECs have come to the Commission seeking a hand out. As an expert witness, Don Wood, explained in the California Rulemaking proceeding, the practical affect of cost-based TELRIC rates is that at some points CLEC or ILEC costs will actually be higher or lower than the established rates. Specifically, Mr. Wood stated:

> First, a cost-based rate may need to be adjusted over time in order to accurately reflect ongoing changes (increases or decreases) in the forward-looking cost of providing the service in question. The trade-off involves accuracy and administrative reality; while forward-looking costs may change over relatively short periods of time, it is not practical to adjust the rates on a continuous basis. Of course, this trade-off is not unique to the rates for reciprocal compensation; the rate for UNEs provided by the ILECs, including but not limited to the transport and switching elements that make up reciprocal compensation, may need to be changed upward or downward to reflect ongoing changes in the forward-looking cost of providing these elements. The practical limitations of rate regulation mean that the costs experienced by both ILECs and CLCs may be higher or lower than the established "cost-based" rate. Reciprocal compensation rates should be reviewed (and adjusted up or down if necessary) at the same time that ILEC UNE rates are reviewed and adjusted, if the Commission concludes that such an adjustment is necessary.[39]
>
> Second, cost-based rates for reciprocal compensation, subject to the periodic adjustments described above, closely emulate the incentives to invest in new technologies and continuously seek ways to provide quality services at a reduced cost. To the extent they are successful in doing so, they will be rewarded for their efforts until the next rate adjustment. This mechanism is directly comparable to the operation of competitive markets: competing firms seek to reduce cost and increase efficiency. If they are successful, they will be rewarded with higher returns for the period of time that it takes their competitors to

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[38] *See id.* at *46.
[39] *See* Direct Testimony of Don J. Wood on Behalf of ICG Telecom Group, Inc. at *32 (July 14, 2000)(Attachment C).

> "catch up" with this cost saving measures. Of course, competing firms may also forego these increased returns in favor of a competitive price advantage for the period of time in which they have a cost advantage, in hopes of increasing market share. Either way, the firm making the effort to reduce costs receives a benefit for a limited but definite period of time.[40]

Accordingly, to the extent some CLECs may have been able to take advantage of new technologies to reduce costs, is not a basis for eliminating compensation, but may signify a need for adjustment in the rates. This is assuming that the ILECs' cost study reveals appropriate ILEC cost reductions as a result of these types of innovations.

B. Reciprocal Compensation is Not the Cause of Reduced Competition for Residential Services or Reduced Incentive to Deploy Advanced Services

Somehow, reciprocal compensation, according to SBC and Verizon, has become the "root of all evil." Through mere supposition , with no proof at all, they both assert that reciprocal compensation strips CLECs of their incentive to serve residential customers. This is based on the mere fact that any customer that becomes a CLEC originating end-user no longer generates reciprocal compensation. This ignores the fact that there are still many customers that are not originating ISP calls, and would be valuable market opportunities for a variety of CLEC services. Just as ILECs make substantial profit in the sale of first lines loaded with high margin vertical features, CLECs could obtain these profits. In fact there are CLECs that have targeted the residential market. Obviously, the fact that CLECs networks are newly constructed and have not fully been built out, is one of many reasons they cannot immediately be expected to serve customers as extensively as ILECs.

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[40] *Id.* at 33.

Similarly, SBC and Verizon again miss the mark when they contend that reciprocal compensation is reducing incentives to provide advanced services and in particular ADSL. Market demand for higher speed access to the Internet is driving carriers to deploy advanced services in an expeditious fashion. For example, in testimony provided to Congress, an executive of Covad Communications represented that its network deployment exceeds that of SBC and Verizon. Further, that its current footprint covers 40% of all homes and business in the United States, and it expects to increase to 50% by the end of this year and 75% next year.[41] Certainly this is not evidence that reciprocal compensation discourages deployment of ADSL advanced services.

Accordingly, each of these alleged policy concerns has no basis in fact. After raising these unsupportable legal and policy arguments, some ILECs propose bill-and-keep for all traffic except, interstate access charges and voice over ISP calls. For many reasons this proposal is not appropriate.

III. BILL-AND-KEEP IS NOT AN APPROPRIATE ALTERNATIVE FOR OF COMPENSATION

For many reasons that the Commission has already espoused, bill-in-keep is not the appropriate approach to address compensation for termination of one LECs traffic by another LEC. In the *Local Competition Order*, the Commission established the circumstances under which bill and keep would be an acceptable method of reciprocal compensation. The Commission stated that states may not impose bill-and-keep arrangements unless traffic flow that

[41] *Hearing on* H.R. 2420 *before the Telecommunications, Trade and Consumer Protection Subcommittee of the House Commerce Committee,* 106th Cong. 2nd Sess.(2000) (Statement of Dhruv Khanna, Executive Vice President, General Counsel and Secretary, Covad Communications), at *17-18. (*See* excerpts at Attachment A).