Q. Has the Commission continued to emphasize the regulatory goal of incenting more efficient operation throughout its periodic reviews of the NRF regime?

A. Yes, it has. In the first review of the NRF which began in 1992, the Commission adopted adjustments to the plan that were expressly designed to maintain the efficiency incentives established in the original NRF.[50] During the second NRF review in 1995 that I referenced earlier in my testimony, the Commission reset the productivity offset factors for Pacific and GTEC to zero (i.e., adopted a freeze on the NRF price caps), but did not alter the basic regulatory objectives that it had already established for the NRF regime.[51]

Q. Does this conclude your direct testimony at this time?

A. Yes, it does.

49. D.95-12-052, 63 CPUC 2d 377, 381.
50. *See* Docket I.87-11-033 et al, D.94-06-011, 55 CPUC 2d 1, 17.
51. *See* D.95-12-052, 63 CPUC 2d 377, 381-382.

E

US OFFICE PRODUCTS

ATTACHMENT E

EXHIBIT NO. _____
R.00-02-005
ICG (WOOD)

BEFORE THE
PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into reciprocal compensation for telephone traffic transmitted to Internet Service Providers modems.	))))	Rulemaking 00-02-005

DIRECT TESTIMONY OF

DON J. WOOD

On behalf of

ICG TELECOM GROUP, INC.

July 14, 2000

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Don J. Wood. My business address is 914 Stream Valley Trail, Alpharetta, Georgia 30022. I am a principal in the firm of Wood &Wood, an economic and financial consulting firm. I provide economic and regulatory analysis of the telecommunications and related "convergence" industries, with an emphasis on economic policy, development of competitive markets, and cost of service issues.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

A. I received a BBA in Finance with distinction from Emory University and an MBA with concentrations in Finance and Microeconomics from the College of William and Mary. My telecommunications experience includes employment at both a Regional Bell Operating Company ("RBOC") and an Interexchange Carrier ("IXC").

I was employed in the local exchange industry by BellSouth Services, Inc. in its Pricing and Economics, Service Cost Division. My responsibilities included performing cost analyses of new and existing services, preparing documentation for filings with state regulatory commissions and the Federal Communications Commission ("FCC"), developing methodology and computer models for use by other analysts, and performing special assembly cost studies. I was also employed in the interexchange industry by MCI Telecommunications Corporation, as Manager of Regulatory Analysis for the Southern Division. In this capacity I was responsible for the development and implementation of

regulatory policy for operations in the southern U. S. I then served as a Manager in the Economic Analysis and Regulatory Affairs Organization, where I participated in the development of regulatory policy for national issues.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE STATE REGULATORS?

A. Yes. I have testified on telecommunications issues before the regulatory commissions of twenty-six states, Puerto Rico, and the District of Columbia. I have also presented testimony regarding interconnection and cost of service issues in state, federal, and overseas courts, before arbitration panels, and have presented comments to the FCC. A listing of my previous testimony is attached as Exhibit DJW-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by ICG Telecom Group, Inc. ("ICG") to respond to the following Factual Issues Subject to Prepared Testimony as set forth in the May 2, 2000 *Assigned Commissioner's Ruling Adopting Scoping Memo and Setting Evidentiary Hearing*: 3, 4, 5, 9, and 10. It is my understanding that issue 8 has been deferred to a subsequent proceeding.

Q. AS AN INITIAL MATTER, HOW SHOULD THE COMMISSION PROCEED WITH THIS INVESTIGATION?

A. The task before the Commission is one that it has faced before: to determine the appropriate mechanism and rates for reciprocal compensation such that (1) carriers who receive traffic originated by the end user customer of another carrier, and who deliver[1] that traffic to the destination chosen by that end user customer, can recover the relevant cost of performing this essential task, and (2) the continued development of competition for local exchange services will not be adversely affected.

Of course, a specific sub-issue to be addressed is whether calls that are originated by the end user customers of one carrier, and that are received and delivered by a second carrier, should be excluded from the reciprocal compensation[2] mechanism merely because they are being delivered – pursuant to the desires of the end user customer who originated the call – to an Internet Service Provider ("ISP"). For the sound economic and public

[1] In this testimony, I am using the term call delivery (or simply delivery) to refer to the act of transporting a call from the point of interconnection to the final point of switching on the public switched telephone network ("PSTN") and switching the call so that it is directed to the facility that is used to connect the called party to the PSTN. In other words, when a local exchange carrier ("LEC") receives a call originated by the customer of another LEC (thereby accepting responsibility for ensuring that the call reaches its intended destination), and then transports the call from the point of interconnection to its switch and switches the call so that it is routed to the called party, it has delivered the call for the purposes of reciprocal compensation. It is also accurate to say that the LEC delivering the call is terminating the call on the PSTN; i.e., it is conducting the necessary transport and switching functions to terminate the call as requested by the calling party.

[2] Pacific Bell has indicated in response to ICG Data Request Nos. 44, 48, and 54 that it will propose that a bill and keep mechanism be applied to calls made to ISPs, while the existing rates should continue to apply to calls to all other end users. GTEC indicated in response to ICG Data Request No. 44 that it would assert that calls to ISPs are jurisdictionally interstate and, presumably (in GTEC's view), therefore not subject to reciprocal compensation.

policy reasons described in my testimony, the Commission should require that reciprocal compensation be required for calls to ISPs. Before the Commission could exclude ISP-bound calls from reciprocal compensation, it would first have to conclude that the arguments in favor of excluding such calls (whatever they may be) outweigh (1) the interest of permitting a carrier to recover the relevant cost of performing the essential role of accepting and delivering traffic originated by the end user customers of another carrier, and (2) the benefits to California consumers resulting from the continued development of competition in the market for local exchange services. Because of the clear and significant economic and policy implications of permitting an exclusion for traffic merely because it is being delivered to an ISP, I urge the Commission -- from a public interest standpoint -- to reject any arguments in favor of exclusion of this traffic from reciprocal compensation.

Q. FACTUAL ISSUE 3 REFERS TO THE "TRAFFIC CHARACTERISTICS" OF ISP-BOUND TRAFFIC. ARE THESE TRAFFIC CHARACTERISITICS RELEVANT TO A DETERMINATION OF WHETHER RECIPROCAL COMPENSATION SHOULD BE DUE FOR SUCH CALLS, OR THE LEVEL OF COMPENSATION THAT IS DUE?

A. Potentially yes, but *only* if certain essential conditions are met. Specifically, any differences in traffic characteristics between calls delivered to ISPs and calls delivered to

other end users within the calling party's local calling area are relevant *only* if the traffic characteristic in question is a cost driver that directly impacts the cost incurred by the carrier that delivers the call. Observed differences in the characteristics of calls to different types of end users do not, in and of themselves, justify segregating out calls to certain end users for different rate treatment. In fact, the opposite is true: disparate rate treatment of calls based on characteristics that are not cost drivers creates the potential for anti-competitive structures that can have serious adverse consequences for the development of competition for local exchange services in California.

For example, it may be determined that calls to ISPs are, on average, longer in duration than local calls made to other end users. The question then becomes the following: is call duration a cost driver of the cost of delivering a local call? As described in more detail below, an analysis of the relevant costs reveals that the answer is no. The traffic-sensitive costs of delivering a call to the called party (the costs that form the basis for reciprocal compensation) do not vary as a function of call duration; the cost per minute of delivering a three minute call (i.e. providing the final point of switching on the PSTN, and transport to that final point of switching) is the same as the cost per minute of delivering a ten minute call.[3] As a result, call duration is an example of a call

[3] As I will explain later in my testimony, the appearance of the sensitivity of the costs to call duration is a function of spreading the call set-up cost over an assumed number of minutes of use. The cost per minute of maintaining a path through a switch does not vary based on the duration of the call, however. As a result, the impact of call duration is a purely a rate structure issue and is not a cost distinction that can be used to justify segregating ISP-bound traffic for different rate treatment.

characteristic that appears to be different (on average) for calls delivered to ISPs than for calls to other end users (on average), but which does *not* justify different rate treatment for the ISP-bound call.

Q. HOW THEN SHOULD THE COMMISSION EVALUATE PURPORTED DIFFERENCES IN CALL CHARACTERISTICS?

A. The appropriate analysis is based on a two-pronged test:

1. Is the purportedly different call characteristic both demonstrable and measurable; e.g. can calls to ISPs be demonstrated to be different in the manner asserted than calls to other end users in the local calling area, and can the magnitude of the difference be measured in a meaningful way?, and equally importantly

2. Is the purportedly different call characteristic a cost driver of the cost incurred by a carrier to deliver the call to the called party; e.g. does the fact that the called party is an ISP *cause* the cost of delivering the call to change in a way that justifies segregating out these calls for unique rate treatment?

A clearly affirmative answer to both prongs of the test should be required before the applicable reciprocal compensation rate is changed for calls to any subset of end users.

Q. HAVE THE INCUMBENT LECS ARGUED THAT DISTINCT CALL CHARACTERISTICS FOR ISP-BOUND TRAFFIC EXIST?

A. Yes. Incumbent LECs ("ILECs") typically make such claims,[4] and the responses of Pacific Bell and GTEC to ICG's Data Requests suggests that they will make the same or similar claims in this proceeding.

Q. HAVE ILECS IN OTHER STATES BEEN ABLE TO DEMONSTRATE THAT, BECAUSE OF DIFFERENCES IN CALL CHARACTERISTICS, THE IDENTITY OF THE CALLED PARTY AS AN ISP IS A COST DRIVER FOR THE COST OF DELIVERING THE CALL?

A. No. Most recently, Pacific Bell's sister company, Southwestern Bell, made such arguments before the Public Utility Commission of Texas ("PUCT").[5] The PUCT disagreed with Southwestern Bell that calls to ISPs had different characteristics that justified the application of a different reciprocal compensation rate. Undeterred, Pacific Bell has made similar claims in this proceeding. In response to ICG's Data Request Nos. 14 and 58, Pacific Bell stated that the following call characteristics are different for calls to ISPs than to other called parties in a way that affects the cost of delivering such a call:[6]

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[4] In this testimony, references to ILECs in California should be understood to mean Pacific Bell Telephone Company, GTE California Incorporated, and Roseville Telephone Company.

[5] PUCT Docket No. 21982, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996.

[6] GTEC objected to these requests, but did indicate that it believed that the cost of switching is impacted by the fact that the called party is an ISP. GTEC will presumably provide more details about this novel theory in its direct testimony.

1. Calls delivered to an ISP are "high volume."
2. Calls delivered to an ISP are "uni-directional," or "one-way."
3. The connection between the ISP and the CLC delivering the call may consist of high volume facilities, or they may even be collocated.
4. Calls delivered to an ISP are longer, on average, in duration.

I expect that the ILECs will present some version of these claims in their direct testimony, and I will provide a complete response to any such claims in rebuttal. Because these claims have been made (and generally rejected) in other states, I will provide an initial response to these claims below.

Calls delivered to an ISP are "high volume." Pacific Bell states in response to ICG Data Request No. 58 that "ISP-bound calls represent a high volume of calling to a limited number of customers," and that as a result "the cost of handling these calls to ISPs should be less than the normal cost of terminating a traditional voice call." This theory has two obvious problems.

First, busy hour traffic on an ILEC or CLC switch is fungible; it is created equally by all users of the network during that time. The incremental minute of use or call attempt that creates the busy hour for a switch cannot be associated with any given customer. I am not aware of any existing rate structure for any LEC that attempts to charge differentiated usage rates based on an assertion that the customer in question has "caused" a disproportionate portion of the switch busy hour.

Second, even if it were possible and desirable to single out "high volume" customers, Pacific Bell is not attempting to do so. There can be no serious disagreement that ISPs are not the only end users that have a large number of calls to a given telephone number. Even if Pacific Bell could have demonstrated that the number of calls to a given telephone number in a given month is a driver of the cost of call delivery (and all available information indicates that it cannot do so), doing so would not make the identity of the customer as an ISP a cost driver. In order to implement the Pacific Bell theory, calls delivered to all customers, including voice customers, with "a high volume of calling" would need to be singled out for special reciprocal compensation rate treatment. Pacific Bell is not proposing to do so, but instead is explicitly attempting to parse out only those "high volume" customers that also happen to be ISPs.[7] It demonstrated no basis for doing so, and did not demonstrate that such "high volume" customers, including but not limited to ISPs, did not exist (and therefore were not fully accounted for) at the time the existing reciprocal compensation rates were established.

The fact that a called party receives a high volume of calls in a given period of time (i.e. has a high call frequency) does not impact the cost of delivering the call. Even

[7] In its response to ICG Data Request No. 54, Pacific Bell states that "For ISP-bound traffic, Pacific proposes bill and keep. For other than ISP traffic, the rates would be those adopted by the Commission in OANAD." If this response is accurate, Pacific Bell's hypocrisy is clear: it is arguing that end users who receive "a high volume of calling" have a materially different cost that justifies a different rate, but is not suggesting that the reciprocal compensation rate for other called parties who receive "a high volume of calling" be changed from existing levels.

if call volume was demonstrated to be a cost driver, such a conclusion would not justify disparate rate treatment for calls to ISPs. Other end user customers also generate high incoming call volumes (restaurant take-out services, for example). A rate structure for reciprocal compensation that excluded calls to certain "high volume" customers while including others would distort the development of competition and have adverse effects for consumers.

Calls delivered to an ISP are "uni-directional", or "one way." When making this argument, Pacific Bell ignores the fact that all calls are "one way;" each has an originating and terminating end. The fact that such "one way" calls are delivered to an ISP (as they are to every other customer of both the CLCs and ILECs) in no way makes the identity of an ISP a driver of the cost of delivering a call, however.

Certain end users, by the nature of their business, can be expected to originate more calls than they receive, while others are likely to receive more calls than they generate. The net direction of the customer's traffic in the aggregate has no cost consequence for any of the individual calls, however: the cost of a given call is not a function of the volume or "direction" of other calls originated and received by the customer. Customers with predominately outbound or inbound calls may have an impact on the aggregate reciprocal compensation payments made between carriers (this effect is discussed in response to issue 5), but do not impact the cost or appropriate reciprocal compensation rate to be applied to any given call.

The connection between the ISP and the CLC delivering the call may consist of high volume facilities, or they may even be collocated. Both Pacific Bell and GTEC state in response to ICG Data Request No. 14 that the nature of the facility used to connect the CLC and the ISP, and the proximity of the CLC to the ISP, impact the cost of delivering a call made to an ISP. In other words, Pacific Bell and GTEC are arguing that the facilities beyond the final point of switching have a different cost that the faciltities typically used to connect non-ISP end users to the network.

To my knowledge, there is no dispute regarding the fact that ISPs, like other CLC and ILEC customers, use a variety of facilities to connect their premises with the serving LEC's switch. Reciprocal compensation, however, is based on the switching and transport costs incurred by a carrier to deliver a call from the point of interconnection to the final pint of switching on the PSTN; the cost associated with the local loop or other facilities used to carry the call from the CLC (or ILEC) switch to the customer's location is not typically usage sensitive and does not vary when a carrier is asked to deliver a call originated by the end user customer of another carrier. Whether the ISP is connected to the CLC via individual local loops, a high volume facility, or short jumpers to a collocation space has no impact on the usage sensitive costs that are to be recovered through reciprocal compensation payments. The nature of the facilities used to connect the ISP's customer premises to the CLC (or ILEC) switch is not a cost driver of the cost

of call delivery, and the fact that LECs may use various facilities for this purpose does not make the fact that the customer is an ISP a driver of the cost of call delivery.

Calls delivered to ISPs are longer in duration. Pacific Bell makes such a claim in response to ICG Data Request No. 58.

Call setup costs occur on a per call, rather than per minute, basis, and an effort to recover setup costs equally from all minutes of use associated with a given call will result in a change to the *calculated* per-minute cost. Call duration takes on the appearance of a cost driver, therefore, only when a rate structure is used that attempts to recover the call setup cost equally from all minutes of use rather than as a separate charge.[8]

Even when setup costs are treated in this manner, however, establishing call duration as a possible cost driver is in no way equivalent to establishing the customer's identity as a cost driver. Not all calls to ISPs are "long," and not all "long" calls are to ISPs. Pacific Bell is not attempting to parse out all end user customers who receive calls with "long" holding times; instead it attempted to exclude only calls made to ISPs. While the details have not yet been presented (and presumably will be in their direct testimony), both Pacific Bell and GTEC have been clear that they are not attempting to segregate all "long" calls out for separate rate treatment,[9] but instead wish to isolate only those calls

[8] Of course, a rate structure for reciprocal compensation that separately charges for call setup and usage eliminates call duration as a cost driver and thereby eliminates any justification for the segregation of "long duration" calls. It is my understanding that Pacific Bell currently has such a rate structure, while GTEC does not.

[9] See Pacific Bell response to ICG Data Request Nos. 44,48, and 54, and GTE response to ICG Data Request No.

made to ISPs (some of which may be long, some of which are not). As a result, the ILECs' proposed "solution" is a poor fit for the observed "problem," assuming that one exists. If calls with a "long" holding time have a demonstrably different cost, the appropriate rate remedy is to address the rate charged for long calls. There is no basis whatsoever to arbitrarily address only the rates for calls delivered to ISPs; "customer profiling" is simply not a meaningful means of identifying cost drivers. Depending on the rate structure (and particularly whether call setup is charged separately from usage), call duration may or may not be appropriately recognized as a cost driver. The fact that the customer to which a call is delivered is an ISP, however, clearly does not, in and of itself, determine cost and therefore does not form the basis for a disparate reciprocal compensation rate.

Q. CAN A DISPARATE RATE TREATMENT FOR CALLS TO ISPS BE JUSTIFIED IF NO COST DRIVERS ARE IMPACTED BY THE FACT THAT A CALL IS BEING DELIVERED TO AN ISP?

A. No. Any attempt to segregate calls to ISPs from other local calls, without a cost justification, is merely a class of service distinction that will permit the ILECs to engage in an overtly anti-competitive strategy to disadvantage their competitors. If reciprocal

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44.

compensation for calls to ISPs is limited in any way that is not based on a demonstrated cost differential, CLCs will not be compensated for costs that they incur when providing a service to the customers of the ILEC (the party originating the call to the ISP). As a result, both CLCs and ILECs will be discouraged from providing service to ISPs.

Establishing a different reciprocal compensation rate for calls to ISPs is merely a class of service distinction unless the ILECs can demonstrate that the rate differential reflects a difference in the underlying cost. Rate distinctions based on the identity of the customer, rather than the cost of providing service to that customer, are overtly discriminatory and are incompatible with a developing competitive marketplace.

Q. IS SUCH A "CLASS OF CUSTOMER" DISTINCTION PERMITTED BY THE APPLICABLE FCC RULES?

A. No. The FCC, through its Local Competition Order and related §51 Rules, prohibits such "non cost based" pricing. §51.503 (c), which the FCC explicitly states is applicable to the pricing of interconnection, states in part that rates "shall not vary on the basis of the class of customers served." As described above, the ILECs are apparently proposing just such a "class of customer" distinction: because they have not demonstrated that the identity of a customer as an ISP is a cost driver of the cost of call delivery, the ILECs are proposing a separate rate treatment based purely on the fact that the customer is a member of a class of customers called ISPs. By attempting to create class of customer distinctions

with no underlying cost basis, the ILECs in California are engaging in an effort to turn back the clock in California through a movement away from cost-based, economically efficient pricing.

Q. FACTUAL ISSUE 3 ALSO SEEKS TO ADDRESS THE RELATIVE VOLUMES OF ISP-BOUND TRAFFIC ORIGINATED BY ILEC AND CLC CUSTOMERS. DO THESE RELATIVE TRAFFIC VOLUMES IMPACT THE COST OF DELIVERING THESE CALLS?

A. No. Because the fact that the call is being delivered to an ISP has no impact on the cost incurred to deliver the call, the volume of calls delivered to ISPs by ILECs and CLCs should have no impact on the reciprocal compensation rate applied. When a call to an ISP served by a CLC is originated by an ILEC customer, the CLC performs the service of delivering the call to the called party. The CLC incurs the cost of doing so; this is a cost which is indistinguishable from the cost incurred to deliver the call to a called party that is not an ISP. The appropriate reciprocal compensation rate should likewise be indistinguishable.

Of course, the converse is also true: when a call to an ISP served by an ILEC is originated by a CLC customer, the ILEC performs the service of delivering the call to the called party. The ILEC incurs the cost of doing so and should be compensated at a rate that reflects the cost of delivering the call to the called party.

At the end of the day, the volumes of traffic originated by ILEC and CLC customers when calling ISPs is merely a fungible component of the total volume of local calls originated by those customers. Some local calls, whether or not an ISP is the calling or called party, will be between customers served by the same LEC. Others will be between customers served by different LECs. Reciprocal compensation allows each LEC to recover its costs, and should be unaffected by the fact that some of the local traffic exchanged between LECs happens to be destined for an ISP.

Q. FACTUAL ISSUE 5 REFERS TO THE FACT THAT CALLS TO ISPS ARE "ONE-DIRECTIONAL." DOES THIS CHARACTERISTIC IMPACT THE APPLICABLILITY OF RECIPROCAL COMPENSATION?

A. No. As described above, all local calls are properly described as one directional; each has an originating and terminating end. At the level of the individual call – the level at which costs are incurred -- there is no cost impact.

It is also possible to look at the potential cost impact at the level of the customer. The question then becomes the following: does the fact that ISPs, or other types of business customers, are likely to be net recipients of local calls impact the cost (and therefore appropriately impact the rate)? The answer is again no; the fact that a carrier is delivering a large volume of calls to a given local number (even if all calls associated with that customer are inbound) does not impact the cost of transporting and switching

each call. Even if the fact that a customer is a net recipient of local calls were to be demonstrated to be a cost driver,[10] the ILEC rate proposal (to exclude calls to ISPs from the reciprocal compensation mechanism) completely fails to capture such an impact. Other kinds of end users are both telecommunications intensive and net recipients of calls, yet it is my understanding that the ILECs are not attempting to segregate out pizza parlors, banks, or homecoming queens for special treatment when reciprocal compensation is applied. When all the blown smoke clears, the simple fact remains that the identity of a called party as an ISP does not impact the cost of delivering the call and no legitimate basis exists for applying a different (or no) reciprocal compensation rate.

Q. GIVEN THE ONE DIRECTIONAL NATURE OF THE TRAFFIC, ARE THE COSTS INCURRED TO TERMINATE THE TRAFFIC COMENSURATE WITH THE RECIPROCAL COMPENSATION RATE RECEIVED?

A. Yes, if reciprocal compensation rates have been established pursuant to TELRIC principles, as I understand (for Pacific Bell) they have in California. Both ILECs and CLCs are delivering calls to ISPs, some of which have been originated by customers of other carriers. The costs incurred are the same as the costs incurred to deliver other local calls to other end users. TELRIC-based rates will reflect the costs that would be incurred

[10] Based on my review of numerous cost studies over the past ten years, I have concluded that there is no basis for such a conclusion. In order to make such a demonstration in this proceedings, the ILECs would have to present a totally unprecedented set of cost data from an as yet unrevealed source.

by an efficient carrier. As a result, an efficiently operating ILEC or CLC will receive reciprocal compensation revenues that reflect the costs that it incurs.[11]

Q. SHOULD THE SUCCESS OF CLCS IN THEIR EFFORTS TO ATTRACT AND SERVE ISPS IMPACT THE RESOLUTION OF THE ISSUES IN THIS PROCEEDING?

A. No. If a net flow of local traffic from ILEC customers to CLC customers has been created by the CLC's success to date in serving ISPs, the place to resolve that issue (and to restore any perceived "imbalance" in such traffic) is in the competitive marketplace. The ILECs have the opportunity to offer quality service and attractive rates to ISPs, and in fact are attempting to do so. It is neither necessary nor desirable to compromise the existing reciprocal compensation mechanism —which has not been shown to be flawed in any way – in order to eliminate the need for ILECs to learn how to compete for and serve ISP customers.

Q. IS THERE EVIDENCE TO SUGGEST THAT CLCS HAVE BEEN MORE RESPONSIVE THAN ILECS TO THE NEEDS OF ISPS?

[11] Of course, any LEC – ILEC or CLC – that is able (through investment in new equipment or cost reduction measures) to increase its efficiency while a given reciprocal compensation rate is in effect will be rewarded for those efforts. Such an incentive also exists in fully competitive markets.

A. Anecdotal reports from ISPs indicate that CLCs have made a greater attempt to respond to the needs of these customers. Pacific Bell's and GTEC's responses to ICG's Data Requests provide support for this assumption. In response to Nos. 14 and 58, both Pacific Bell and GTE indicate their belief that ISPs are often collocated with the CLCs that serve them. It is reasonable to assume, therefore, that the ability to collocate with the LEC providing service is important to many, if not all, ISPs. In response to ICG Data Request No. 20, however, GTEC states that while it has been approached by ISPs seeking collocation, it "does not allow ISPs to collocate facilities in its central office." Similarly, Pacific Bell responds to the same request that while it will permit collocation by ISPs "in accordance [with] terms, conditions, and rates set forth in Pacific Bell's Expanded Interconnection Service (EIS) tariff...to date Pacific has not received a completed application for Expanded Interconnection Service from an ISP." If Pacific Bell's and GTEC's assertions are correct, ISPs are not having the same difficulty complying with the terms, conditions, rates, and applications for collocation with CLCs.

This is an obvious area in which both Pacific Bell and GTEC could increase their responsiveness to the needs to ISPs. If the reciprocal compensation mechanism remains in place for calls to ISPs, ILECs will have the incentive to increase their responsiveness in the marketplace. If reciprocal compensation is eliminated for these calls, the ILECs will have no such incentive.

Q. ARE OTHER MEANS CURRENTLY AVAILABLE TO ILECS TO CHANGE THE BALANCE OF TRAFFIC SUBJECT TO RECIPROCAL COMPENSATION?

A. Yes. In addition to competing for ISPs as customers, the ILECs can accelerate deployment of the facilities necessary to make direct (non dial-up) Internet connections available. While there is no basis for excluding dial-up calls to ISPs from reciprocal compensation, ILECs can act proactively to reduce the number of such calls in the future by making xDSL and other arrangements available that will permit the ISP's customers to obtain Internet access without utilizing the switched network. The continued application of reciprocal compensation to calls made to ISPs will keep this important incentive in place. Without reciprocal compensation, the ILECs will be able to have calls originated by their customers delivered to ISPs by a CLC for free; the ILEC avoids both the cost of completing the call itself and a payment to the carrier that has performed this service for it. Under such a scenario, ILECs will have little incentive to deploy the facilities necessary to move their end user customers' Internet access off of the PSTN.

Q. FACTUAL ISSUE 4 CONCERNS THE NATURE AND CHARACTERISTICS OF COSTS ASSOCIATED WITH THE TRANSPORT AND DELIVERY OF ISP-BOUND TRAFFIC. WHAT ARE THESE COSTS?

A. The reciprocal compensation-related costs associated with the transport and delivery of ISP-bound traffic are the same as the costs for the transport and delivery of any other local call.

When an end user customer served by an ILEC (the calling party) dials the number of a local customer that subscribes to ICG, the call travels from the originating customer's premises to the ILEC central office switch, which then routes the call (either directly or through a tandem) to the ILEC-ICG point of interconnection and ultimately on to the ICG switch. From the ICG switch the call is then directed to the end user customer based on the number dialed by the SWBT-subscribed caller. Some calls, of course, flow in the opposite direction from the ICG network to the ILEC network. For calls in either direction, reciprocal compensation is the mechanism that the LEC delivering the call uses to recover the costs of receiving the call at a point of interconnection, transporting the call to the switch that serves the called party, and switching the call onto the facility that connects the called party with the terminating carrier's switch. The cost of the facility used to connect the calling party to the originating LEC's network and the facility used to connect the called party to the terminating LEC's network are recovered from the end users and are not a part of the costs to be recovered through reciprocal compensation.

Q. DOES THE PATH FOLLOWED BY A CALL DIFFER WHEN THE CALLED PARTY IS AN ISP?