with the costs determined "on the basis of a reasonable approximation of the additional costs of terminating such calls." 47 U.S.C. § 252(d)(2)(A)(i), (ii).

While section 252(d)(2) expressly does not "preclude arrangements that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that waive mutual recovery (such as bill-and-keep arrangements)," *id.* § 252(d)(2)(B)(i), any regulatory regime that imposes bill and keep for out-of-balance traffic will need to address whether the scheme "afford[s]" or "provide[s] for the mutual . . . recovery by each carrier of costs." The Commission suggested in its *Local Competition Order* that some degree of balance generally is necessary, ruling that states may impose mandatory bill and keep arrangements only where traffic between carriers is "roughly balanced." First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16054-55 ¶¶ 1111-13 (1996) ("*Local Competition Order*"). Of course, the Commission could squarely amend this rule, but ultimately the challenge before the Commission with respect to fashioning a bill and keep regime for ISP traffic will be to ensure that any such regime complies with the principles set forth in the body of section 252 itself. The proposals discussed below lay out ways in which the Commission could proceed.

The very reason the Commission is considering action with respect to ISP dial-up is that the traffic flows between incumbent and competitive carriers *are* out of balance.[1/] Thus, the best way for the Commission to implement bill and keep would be to reaffirm its conclusion that Internet-bound calls do not come within the scope of section 251(b)(5) at all; then, any

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[1/] Whereas the imbalance between ILEC and CLEC traffic flows for Internet-bound calls arises solely as a result of the CLECs' regulatory arbitrage, the asymmetrical traffic flows between wireline and CMRS networks are entirely real, resulting from differences in network costs, pricing, and customer usage preferences. As discussed below, this inherent traffic imbalance between wireline and CMRS networks suggests that CMRS traffic should *not* be included in whatever general bill and keep rule the Commission chooses to adopt.

intercarrier compensation rule adopted for such traffic would not be bound by the limitations of section 252(d)(2). Such an approach would require a thorough analysis of the D.C. Circuit's decision in *Bell Atlantic v. FCC*, but would not otherwise be vulnerable to challenge under the Act. The Commission could then subject some or all of the remaining local traffic to a bill and keep structure pursuant to sections 251(b)(5) and 252(d)(4).

If, on the other hand, the Commission were to modify its earlier conclusion concerning the non-local nature of ISP-bound traffic (or were to revisit its conclusion that 251(b)(5) is limited to local traffic) the Commission could still implement a bill and keep compensation structure under section 251(b)(5). The Commission could find that under ordinary principles of cost causation, the costs of ISP dial-up are "associated," for purposes of section 252(d)(2), with serving the ISP, not its subscribers. Alternatively, the Commission could hold that carriers that have intentionally limited the customers they serve simply to create traffic imbalances are not entitled to "reciprocal" compensation arrangements under section 251(b)(5). Finally, the Commission could decide under its section 10 authority, 47 U.S.C. § 160(a) that it is appropriate to forbear from applying section 252(d)(2) to ISP-bound traffic. Each of these approaches, however, presents its own set of issues that the Commission would have to address before proceeding.

Whichever route the Commission chooses, it clearly has jurisdiction to act. Whatever other concerns the D.C. Circuit had in *Bell Atlantic*, the court expressly reaffirmed the Commission's end-to-end methodology for determining whether traffic comes within its regulatory jurisdiction: "There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate." *Bell Atlantic*, 206 F.3d at 5. The D.C. Circuit further acknowledged

that, when ISP subscribers dial their ISPs' local modem banks, they do so to initiate communications that most commonly terminate out of state and around the world. *See id.* (in the case of ISP dial-up, "there is some communication taking place between the ISP and out-of-state websites"). Thus, nothing in the D.C. Circuit's opinion displaces the Commission's jurisdiction to prescribe an intercarrier compensation rule for ISP dial-up traffic, whether or not the Commission deems that traffic the subject to section 251(b)(5).[2]

II. Removing ISP Dial-Up from the Scope of Section 251(b)(5).

As noted above, section 252(d)(2) presents a potential obstacle to imposing bill and keep on out-of-balance traffic *only* if that traffic is held to come within the scope of section 251(b)(5). If the Commission reaffirms its conclusion that ISP dial-up traffic falls outside section 251(b)(5) because ISP subscribers' Internet-bound communications do not terminate at the ISP's modem bank, then the Commission simply is not constrained by section 252(d)(2).

A. The D.C. Circuit's Opinion in *Bell Atlantic* Does Not Require That ISP Traffic Be Included in Section 251(b)(5).

The *Bell Atlantic* decision held that the Commission had not sufficiently supported its initial determination that ISP traffic is not subject to section 251(d)(5). However, the D.C. Circuit did not base its objections to the *Reciprocal Compensation Declaratory Ruling* on any fundamental disagreement with the substance of the Commission's decision on the merits. Nor did the Court hold that ISP traffic is, in fact, subject to section 251(b)(5). Rather, the opinion

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[2] Moreover, the Commission could assert jurisdiction over the residual portion of Internet-bound traffic reflecting communications with *in-state* web servers by finding that there is no practical way for carriers to monitor the destinations of the individual Internet-bound packets they carry or segregate in-state from interstate traffic. *See Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, 375 n.4 (1986). The preponderance of commenters confirmed that fact in response to the Commission's April 27, 1999 NPRM in this docket.

found that the Commission had not adequately justified its reasoning under the Administrative Procedure Act. The Court left open to the Commission the option to revisit and explain its initial decision, fully contemplating that the Commission could well reach the same conclusions. If the Commission does decide to continue to analyze ISP traffic as subject to section 201 rather than section 251(b)(5), it can address the *Bell Atlantic* decision as follows:

1. There is ample Commission precedent for using an "end-to-end" analysis to determine the substantive classification of services as "local." Despite CLECs' arguments to the contrary, the D.C. Circuit did not forbid the Commission from determining the regulatory classification of a service by examining the endpoints of the larger chain of communication of which that service is a part — the approach traditionally used by the Commission in analyzing a service's jurisdictional classification. Instead, the court simply held that the Commission "*has yet to provide an explanation* why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs." *Bell Atlantic*, 206 F.3d at 5 (emphasis added).

The D.C. Circuit's conclusion that the Commission had never applied its end-to-end analysis outside of jurisdictional inquiries is simply incorrect. For nearly a decade, the Commission has examined the entire chain of transmission of which a service is a part (and, in particular, examined where that transmission begins and ends) to determine the applicability of substantive rules that turn on whether the service is truly local or merely transits the local exchange network as part of a long distance call. For example, in *Teleconnect Co. v. Bell Tel. Co.*, 6 FCC Rcd 5202 (1991), *recon. denied*, 10 FCC Rcd 1626 (1995), the Commission used such an analysis to determine the appropriate application of access charges to calls made with

Teleconnect's 800 calling card. The Commission looked at the endpoints of these calls to decide whether they consisted of one continuous communication or two separate ones. In determining that there was only one call, the Commission noted that "the end-to-end nature of the communications [is] more significant than the facilities used to complete such communications," and accordingly considered the calling card calls "from [their] inception to [their] completion." 10 FCC Rcd 6 ¶ 12. The Commission has repeatedly applied the same end-to-end analysis to determine the appropriate application of access charges to resold 800 services, *see* Memorandum Opinion and Order, *International Telecharge, Inc. v. Southwestern Bell Tel. Co.*, 11 FCC Rcd 10061, 10069-70 ¶¶ 21-22 (1996), and to a variety of optional services including call waiting, call forwarding, voice mail storage, and paging. *See* Memorandum Opinion and Order, *AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, 578-79 ¶ 47 (1998).[3]

The Commission did not cite these precedents in its *Reciprocal Compensation Declaratory Ruling* or its briefs to the D.C. Circuit. A careful explication of these precedents on remand would establish that the use of an end-to-end analysis to exclude Internet-based traffic from section 251(b)(5) in fact comports with longstanding agency practice, and that it would have been error *not* to apply an end-to-end analysis here.

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[3] The Commission has applied an end-to-end analysis to resolve substantive issues in contexts other than access charges as well. In *Request by RCN Telecom Services and Bell Atlantic for Clarification of Bell Atlantic's Authority to Carry Local Traffic Between Exchanges on Behalf of Competitive Local Exchange Carriers,* 14 FCC Rcd 13861 (1999), RCN Telecom and Bell Atlantic petitioned the Commission for a determination of whether section 271 permits Bell Atlantic to transport RCN's calls between two points within Bell Atlantic's local calling area, even though RCN's point of interconnection is located outside of Bell Atlantic's local calling area. In holding that Bell Atlantic could transport such calls, the Commission again focused on "the end-to-end nature of the communication[]," stating that it could "find no reason for why RCN traffic that *begins and ends* within BA's local calling area cannot pass through an interconnection point outside of the BOC's local calling area." 14 FCC Rcd at 13866 ¶ 13 (emphasis added).

2. Internet-bound dial up traffic does not "terminate" at the ISP's modem bank within the meaning of the Commission's rules. The Commission's second error, according to the D.C. Circuit, was its failure "to apply, or even to mention, its definition of 'termination,' namely 'the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises." *Bell Atlantic*, 206 F.3d at 6 (quoting 47 C.F.R. § 51.701(d)). Again, the Commission can easily correct any failure of explanation on remand.

First, it appears that the D.C. Circuit misread 47 C.F.R. § 51.701(d), the Commission definition of "termination" in question. On its face, that rule is not intended to define the local traffic subject to section 251(b)(5); rather, it applies only *after* the traffic has been determined by the Commission based on *other* rules to be "subject to section 251(b)(5)." 47 C.F.R. § 51.701(d). The point of the Commission's rule is simply to classify the universe of section 251(b)(5) traffic as one of two services: "termination" as opposed to "transport." *See* 47 C.F.R. § 51.701(c) (complementary definition of "transport"). The Commission was correct to consider this rule irrelevant; should it choose to reaffirm this conclusion, it need only explain why.

Second, ample Commission precedent confirms the technical reality that ISP's local modem bank is not the "called party" that the ISP subscriber ultimately aims to reach, and hence the call does not "terminate" with the ISP under any permissible reading of that word. The Commission has consistently defined the "called party" in terms of the caller's intention, and it has ruled multiple times that when a caller first dials a "local" telephone number to reach an intermediate platform before directing his call to its final destination, the intermediate platform is not a "called party." *See, e.g., Teleconnect Co. v. Bell Tel. Co.,* 10 FCC Rcd 1626, 1627, 1630 ¶¶ 5, 14 (1995) (long distance platform reached through an 800 number); Memorandum Opinion

and Order, *Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corp.*, 7 FCC Rcd 1619, 1620, 1621 ¶¶ 9, 11 (1992) (voice mail); *cf. Local Competition Order*, 11 FCC Rcd at 15935 n.2091 (discussing operation of Feature Group A).[4] An ISP subscriber does not dial a local telephone number because he wants to speak to the ISP's modem bank; rather, he does so to connect to the servers *beyond* that modem bank, that contain the content of the Internet.

3. ISPs are fundamentally different from businesses that use the telephone just as part of their operations. The D.C. Circuit noted that the Commission "ha[d] not satisfactorily explained why an ISP is not . . . simply a communications-intensive business end user selling a product to consumer and other business end users." *Bell Atlantic*, 206 F.3d at 7 (internal quotation marks omitted). Again, the court held only that the Commission had not *explained* the difference between an ISP and a pizza-delivery firm, not that it *could* not provide such an explanation. The Commission has since articulated the missing explanation (indeed, to the same court that decided *Bell Atlantic*, and to two of the same three judges) in its recent brief defending the *Advanced Services Remand Order*:

> Moreover, ISP-bound traffic differs decisively from calls to other businesses that use telecommunications, such as "pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies." [Citation omitted] Those businesses might place separate calls of their own to assist the customers that have called them; for example, a taxi dispatcher ordinarily takes one call from a customer before placing a separate call (to which the customer is not usually a

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[4] The D.C. Circuit suggested that the *Teleconnect* and *BellSouth* precedents might not apply because ISPs provide "information services," *see Bell Atlantic*, 206 F.3d at 6, but this concern is misplaced. The Commission has applied this same understanding of where communications begin and end to ESP services, of which ISP services are simply a subset. As the Commission has explained, a call to an ESP is an "interstate call[] which *transit[s the ESP's] location*" on the way to its final destination. Memorandum Opinion and Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 682, 711-12 ¶ 78 (1983) (emphasis added). Even if an ESP "might terminate a few calls at its own location," the Commission recognized, most of the calls it receives will "transit its location" and continue on to interstate destinations. *Id.* at 712 ¶ 78.

> party) to a taxi driver. As a general matter, those businesses do not provide their customers with anything remotely resembling what an ISP provides: a service supplied by means of a seamless, real time transmission between the customer himself and interstate or foreign Internet sites to which the customer seeks access.

Brief for Respondents at 55, *WorldCom, Inc. v. FCC*, No. 00-1002 (D.C. Cir. Feb. 21, 2000). The Commission now can and should turn this argument from a litigation submission into a formal holding.

B. The Commission May Regulate ISP Dial-Up Traffic Under Section 201.

If the Commission does reaffirm on remand that Internet-bound calls are not governed by section 251(b)(5), the Commission may then use its general power over the "charges" for interstate traffic (47 U.S.C. § 201) to prescribe an intercarrier compensation rule for ISP dial-up, just as it used that authority to adopt compensation rules to govern where two LECs collaborate to carry a call to an IXC. *See* Third Report and Order, *MTS and WATS Market Structure,* 93 F.C.C.2d 241, 254-55 ¶¶ 37-41 (1983) (citing authority under section 201(a) to regulate jointly provided interstate access). Indeed, the Commission had previously used this same authority to adopt an interim bill and keep rule for CMRS traffic. *See* Notice of Proposed Rulemaking, *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 5020, 5023 ¶ 3 (1996); Notice of Proposed Rulemaking and Notice of Inquiry, *Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services,* 9 FCC Rcd 5408, 5455-56 ¶ 113 (1994).

Adopting a bill and keep rule for Internet-bound traffic under section 201 would conform with longstanding Commission precedent.[5] When an ordinary long distance call transits two LECs' networks on its way from the local caller to an interstate service provider (or vice versa),

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[5] It is important to recognize that section 251 expressly recognizes and preserves Commission authority under section 201. *See* 47 U.S.C. § 251(i).

Commission precedent deems the LECs to be *co*-providers of the interstate carrier's access service, and the LECs *share* both the costs of access and the access revenues from the interstate provider. *See Reciprocal Compensation Declaratory Ruling*, 14 FCC Rcd at 3695 ¶ 9 ("When two carriers jointly provide interstate access (*e.g.*, by delivering a call to an interexchange carrier (IXC)), the carriers will share access revenues received from the interstate service provider."); Memorandum Opinion and Order, *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1176-77 (1984) (rejecting mandatory single-carrier billing for jointly provided access services).[6] ISPs also are interstate service providers, but unlike ordinary long-distance carriers, ISPs are currently exempt from paying carrier access charges, other than the relatively small special access surcharge. Hence, there is no (or relatively little) carrier access revenue for the two LECs serving the ISP to divide.[7] A bill and keep rule is equivalent to finding that the two LECs serving an ISP are co-providers of the ISP's local dial-up connections, but that there is no carrier access revenue that the two LECs should share. As discussed in more detail in Appendix A below, this course of action has already been well vetted in the most recent round of comments in this docket, and the Commission could easily pursue this course without further notice and comment.

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[6] *See also* Memorandum Opinion and Order, *Access Billing Requirements for Joint Service Provision*, 4 FCC Rcd 7183, 7185-86 ¶¶ 21-26(1989); Memorandum Opinion and Order, *Waiver of Access Billing Requirements and Investigation of Permanent Modifications*, 2 FCC Rcd 4518, 4519 ¶ 7 (1987).

[7] The Commission may decide that the amount of special access surcharges at issue is too small to justify the administrative costs required to track and share these amounts. *See Local Competition Order*, 11 FCC Rcd at 16055 ¶ 1112 ("bill-and-keep arrangements may minimize administrative burdens and transaction costs," even where the amounts of compensation due between carriers would not be precisely equal).

C. The Commission May Regulate the Remaining Wireline Traffic Under Section 251(b)(5).

Once ISP-bound calls are taken out of the mix, the Commission would be free to address genuine local traffic pursuant to the provisions of sections 251(b)(5) and 252(d)(2) and its existing rules. Thus, the Commission could adopt a bill and keep structure for such traffic with little difficulty, upon a finding that the remaining traffic flows between wireline LECs are "roughly balanced." *See Local Competition Order*, 11 FCC Rcd at 16055 ¶ 1113. (As we discuss in Appendix B below, certain types of local traffic may not properly be subject to bill and keep and should be addressed separately.) The net result would be a bill and keep structure that applies to both ISP and non-ISP traffic, although the Commission would be basing the bill and keep approach in each instance on a different source of statutory authority.

To adopt a bill and keep rule for non-ISP traffic in this proceeding, the Commission would have to determine that the record before it to date provides parties with sufficient notice of that possibility. We address this question in Appendix A.

III. Including ISP-Dial Up in Section 251(b)(5).

As noted above, the Commission should be able to implement bill and keep for Internet-bound traffic (and other wireline traffic) if the Commission reverses course and rules that ISP dial-up traffic *is* covered by section 251(b)(5). But in this case, as discussed above, any compensation rule would have to comply with section 252(d)(2). We see three possible approaches that the Commission could use to adopt bill and keep for ISP traffic consistent with sections 251(b)(5) and 252(d)(2).

A. Implement Bill and Keep Based on Ordinary Principles of Cost Causation by Finding That the Costs of ISP Dial-Up Are "Associated" with the ISP, Not the ISP's Subscribers.

As the economic analyses provided by Qwest and other parties demonstrate, in the context of ISP dial-up it is the ISP — in particular, the pre-existing relationship between the ISP and its own subscribers — and not the ILEC residential subscriber that is the true economic causer of the CLEC's call termination costs. It is not an unexpected fortuity that so many calls reach the lines of a CLEC serving an ISP; rather, it is an inherent and expected aspect of providing service to that ISP customer, and indeed, the sole function for which the CLEC receives compensation from the ISP.

As the CLEC is fully aware, ISPs offer their own subscribers a product that is integrated with and usable only in conjunction with telephone access. As Bill Taylor of National Economic Research Associates explained in an *ex parte* to the Commission, the most appropriate way to view a person making an ISP dial-up call is

> as an [ISP] customer placing an Internet-bound call, not a[s an ILEC] customer placing a local call. Although the portion of her Internet call that lies entirely within the circuit-switched network . . . *resembles* a local call, its economic function is very different, since [the ISP] is not simply a passive end-user recipient of her call. Rather, [the ISP] designs, markets, and sells [the caller] the service, collects her monthly fee for Internet access, answers her questions, establishes telephone numbers at which she can access its services without paying toll charges, and pays the CLEC for access to the public switched telephone network. Moreover, [the ISP] performs standard carrier functions such as transport and routing, as well as maintains leased facilities within the backbone network. [The ILEC] and the CLEC simply provide access-like functions to help the Internet call on its way.

William E. Taylor, et al., *An Economic and Policy Analysis of Efficient Intercarrier Compensation Mechanisms for ISP-Bound Traffic* at 5 ¶ 12 (Nov. 12, 1999) (emphasis in

original) (quoted in Comments of Qwest).[8] *See also* Initial Commission Decision, *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.*, Dkt. No. 00B-011T, at 14 (Colo. Pub. Utils. Comm'n May 3, 2000) (adopting bill and keep for ISP-bound traffic because "[w]e view the originator of the Internet-bound call as acting primarily as a customer of the ISP, not as a customer of U S WEST"). In this sense the ISP uses the LEC's and the CLEC's service much as an IXC does, and it would be economically reasonable for an ISP, like an IXC, to compensate the LEC and CLEC for the access they jointly provide.[9] In lieu of this, however, a bill and keep structure is the most rational approach.

A CLEC that targets an ISP and agrees to provide it with the dial-up access portion of its offering thus understands that its primary role as a carrier will be to terminate large volumes of traffic to that ISP from the ISP's subscribers. The CLEC knows what the ISP's business is, and the CLEC is fully aware of the costs it will face from its choice to serve that customer. Those costs are not *imposed* on the CLEC by the residential subscribers' carrier; rather, they are *caused* by the ISP and *assumed* by the CLEC in its choice to serve that ISP customer. The CLEC does or can account for those costs in the rates it charges the ISP. It unquestionably is more efficient and consistent with economic principles of cost causation for the ISP itself to bear these costs under its contract with the CLEC and to factor them into its cost of doing business, rather than

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[8] All comments and reply comments cited herein were submitted in response to the Public Notice which followed the D.C. Circuit's remand of the *Reciprocal Compensation Declaratory Ruling*. Comments were filed on July 21, 2000, reply comments on August 4, 2000.

[9] Indeed, the ISP already compensates the CLEC for such access in whatever service charges it pays the CLEC, which provides the ISP with only that one service -- access; thus, reciprocal compensation paid to the CLEC for serving the ISP would constitute double recovery of the CLECs' costs.

force these costs on non-Internet-using incumbent LEC ratepayers via reciprocal compensation payments to the ISP's carrier. Indeed, the Commission has stated that it would expect an incumbent LEC choosing to serve a customer with high inbound call volume to bear and adjust its own rates to reflect the termination costs caused by serving that customer, *see Access Charge Reform*, 12 FCC Rcd 15982, 16134 ¶ 347 (1997), and there is no reason why the same expectation should not apply to a CLEC serving that same customer. Any intercarrier compensation rule for ISP dial-up traffic should therefore reflect that the ILEC serving the ISP's subscribers is not the causer of the CLEC's costs.

This approach is consistent with section 252(d)(2). As noted above, section 252(d)(2) requires that compensation arrangements negotiated under section 251(b)(5) "provide for the mutual and reciprocal recovery by each carrier of costs *associated with* the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(i) (emphasis added). The Commission can find on the basis of the comments submitted in this proceeding that the costs of terminating Internet-bound traffic are *not* "associated with" the transport and termination of ordinary local traffic originated by various incumbent LEC subscribers; rather, they are "associated with" the ISP's primary business offering, which includes dial-in capability as an inherent component. Likewise, the CLEC's costs are "associated with" its choice to serve that ISP and provide the dial-in capacity that the ISP requires. The Commission could accordingly implement a bill and keep rule for all ISP-bound traffic without concern that it was failing to accord recovery of any costs mandated by section 252(d)(2).

Nothing in section 252(d)(2) reverses ordinary principles of cost causation or suggests a legislative determination that costs shall be deemed to be "caused" by the ILEC no matter what

true economic cost principles would dictate. At the same time, however, the Commission has never proffered an interpretation of "association" language under 252(d)(2). This approach would require that the Commission affirmatively embrace cost causation as a guiding principle under sections 251(b)(5) and 252(b)(2). Moreover, applying strict cost causation principles could change the dynamics of serving not just ISPs but all ESPs, and perhaps other entities as well. The Commission should consider these questions in analyzing this approach; it is an approach that would well serve both the public interest and the intent of Congress when it adopted section 252(d)(2).

B. Limit Reciprocal Compensation to Genuine Two-Way Carriers.

By its plain language, section 251(b)(5) obligates LECs only "to establish *reciprocal* compensation arrangements for the transport and termination of telecommunications." "Reciprocal" arrangements can exist only where carriers are exchanging traffic with each other in both directions. Section 251(b)(5) does not address the situation where a LEC intentionally restricts its operations and the customers it serves to create an aggregate traffic flow that is by design not reciprocal. CLECs that serve a mix of customers should have an overall aggregate return traffic flow that is not grossly disproportionate to the traffic sent to it by the LEC. However, a CLEC serving only or primarily ISPs likely will have minimal return traffic flows, creating a significant imbalance.

The Commission could adopt bill and keep for all wireline traffic by finding that carriers that intentionally limit their operations to engineer unidirectional traffic flows have no legal entitlement under section 251(b)(5) to demand *reciprocal* compensation arrangements. To be sure, the proposed rule could easily be evaded and may have unanticipated implications for carriers serving other customers with traffic flows that tend to be uni-directional; this would have

to be analyzed carefully. One approach the Commission might consider is identifying and establishing a non-*de minimis* threshold for return traffic (considering all the CLEC's circuits) for any CLEC seeking to qualify for reciprocal compensation. The critical challenge would be to craft a rule that would prevent a CLEC from defeating the rule simply by serving a token number of residential subscribers.

As noted above, the Commission would have jurisdiction to prescribe an intercarrier compensation rule for carriers that do not meet the threshold, since the D.C. Circuit did not disturb the Commission' end-to-end jurisdictional analysis of ISP dial-up traffic. But because this rule would be based on section 201 rather than section 251(b)(5), the Commission would not be bound by the requirements of section 252(d)(2), and could impose a bill and keep rule for such traffic even though it would not be in balance.[10] On the other hand, LECs that do not restrict who they serve and that exchange significant volumes of traffic in both directions *would* be entitled to reciprocal compensation under section 251(b)(5) — and for *all* the wireline traffic they exchange, including ISP dial-up traffic, subject only to certain limitations explained in Appendix B below. The Commission could make a specific finding on the basis of the record in this docket that the traffic flows among such carriers are roughly balanced. As laid out above, under section 252(d)(2) and the Commission's existing rules, mandatory bill and keep is a permissible and appropriate compensation rule for such balanced traffic.

Such a position could be seen as inconsistent with the Commission's earlier holding, in the context of wireline LEC-CMRS interconnection, that "*any* telecommunications carrier[]" has a right to establish reciprocal compensation arrangements with a LEC. *Local Competition*

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[10] The Commission could also take the approach of adopting a rebuttable presumption that a bill and keep regime is appropriate unless a carrier can demonstrate that such a structure is not justified; however the Commission would have to clarify that an intentional traffic imbalance caused by serving ISPs exclusively or primarily is not sufficient to overcome the presumption.

Order, 11 FCC Rcd at 16016 ¶ 1041 (emphasis added). The Commission would have to be able to draw a defensible line between ISP-only CLECs and CMRS carriers. Such a distinction would be reasonable: CMRS carriers do not intentionally restrict the customers they serve simply to create traffic imbalances and exploit regulatory anomalies; any traffic imbalances between CMRS and LEC networks is a function of the nature of the service the CMRS providers offer and the way subscribers use such services. The Commission would be justified in holding that wireline LECs that exploit the Act's market-opening provisions to *create* traffic anomalies that otherwise would not exist are not entitled to a presumption that they engage in "reciprocal" exchanges of traffic — especially when their actions in fact thwart the purposes of section 251 by affirmatively discouraging the extension of facilities-based competition to residential subscribers.

C. Forbear from Applying Section 252(d)(2).

In the alternative, the Commission could choose to forbear from the application of 47 U.S.C. § 252(d)(2) to ISP-bound traffic. Section 10(a) of the Act (47 U.S.C. § 160(a)) directs the Commission to "forbear from applying any . . . provision of this Act to a . . . class of telecommunications carriers or telecommunications services" where the Commission determines that (1) the provision is not needed to guard against unreasonable carrier practices, (2) the provision is not needed to protect consumers, and (3) forbearance would be in the public interest. The Commission could avoid the legal difficulties of imposing bill and keep on out-of-balance Internet-bound traffic by forbearing, for this particular "class of . . . telecommunications services," from enforcing section 252(d)(2)'s requirement that transport and termination rates afford carriers a mutual recovery of their additional costs. As discussed above in Part III.A, the

Commission could generally apply bill and keep to the remaining traffic by finding that it is roughly balanced.

Although the Act gives carriers the right to petition the Commission for forbearance, *see* 47 U.S.C. § 160(c), the Commission may exercise its forbearance authority *sua sponte* without waiting for carriers to file a petition. *See, e.g.*, Notice of Proposed Rulemaking, *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd 7141 (1996) (launching section 10 proceeding on IXC detariffing without requiring the filing of a petition under section 10(c)). The Commission should be able to make all of the necessary findings for forbearance on the record of this proceeding:

- Enforcement of section 252(d)(2) is not "necessary to ensure that the charges, practices, classifications or regulations" of carriers in connection with ISP dial-up traffic "are just and reasonable and not unjustly or unreasonably discriminatory." 47 U.S.C. § 160(a)(1). In this case, forbearance is necessary to *prevent* carriers from imposing unjust and unreasonable charges on incumbent LECs and local exchange ratepayers.

- Enforcement of section 252(d)(2) is not "necessary for the protection of consumers." *Id.* § 160(a)(2). In the absence of forbearance, local exchange consumers are harmed by being forced to subsidize CLECs (and their ISP customers) that do not to serve them — indeed, that are affirmatively discouraged by the current rules from doing so.

- Finally, forbearance "is consistent with the public interest," *id.* § 160(a)(3), and will "enhance competition among providers of telecommunications services." *Id.* § 160(b). The payment of per-minute transport and termination charges for ISP dial-

> up causes massive market distortions, stunts competition for residential customers, and discourages carriers from building out their networks broadly. Forbearance would enhance competition by encouraging all carriers to compete for all customers, and to do so on the basis of price and service quality rather than regulatory advantage.

By grounding its resolution of the ISP reciprocal compensation question on an exercise of section 10 forbearance power, the Commission would also have a clear source of authority for preventing states from issuing contrary decisions. Once the Commission forbears from enforcing a provision of the Act under section 10, the Act expressly forbids the states from continuing to apply that provision. *See* 47 U.S.C. § 160(e).

One potentially significant limitation to this approach is that the section 271 checklist specifically requires BOCs to offer "[r]eciprocal compensation arrangements in accordance with the requirements of section 252(d)(2)." 47 U.S.C. § 271(c)(2)(B)(xiii). To permit the BOCs to implement any bill and keep rule that the Commission adopts, the Commission would additionally have to rule that section 252(d)(2) no longer imposes any "requirements" once the Commission forbears from it. Alternatively, the Commission could forbear from enforcing the section 271 checklist's cross-reference to section 252(d)(2); however, the Commission has previously taken the view that it is prohibited by section 10(d) from forbearing from any provision of section 271 until that section is fully implemented. *See* 47 U.S.C. § 160(d); Memorandum Opinion and Order and Notice of Proposed Rulemaking, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 13 FCC Rcd 24011, 24047-48 ¶ 77 (1998). This interaction with section 271 may limit the utility of any forbearance approach.

Conclusion

The Commission has several options before it, any of which might allow it to adopt a defensible bill and keep structure for ISP-bound traffic, as well as some broader class of traditional local traffic as appropriate. If the Commission reaffirms its earlier conclusion that ISP-bound traffic is not subject to section 251(b)(5), the Commission may base its intercarrier compensation for ISP traffic on its authority under section 201, free from any constraints imposed by section 252(d)(2), while imposing bill and keep on the remaining (roughly balanced) traffic under section 251(b)(5). The Commission could also adopt bill and keep if it reverses course and *includes* ISP dial-up in section 251(b)(5), by making the careful findings described above regarding the economic and statutory grounds supporting such an approach, and confronting the various remaining issues that the various options would present. A well-reasoned decision on such grounds should withstand judicial scrutiny and eliminate the gross inequities of today's circumstances.

Appendix A

The Commission's Notice and Comment Obligations

Any decision the Commission reaches on bill and keep would have to be grounded in the record before it. In fact, the extensive record that has been created, and the various proposals and arguments made by dozens of commenters during this extended process, have provided ample notice of almost any route the Commission could pursue with respect to reciprocal compensation for ISP traffic without further comment. The record would likely support a decision to apply bill and keep to a broader class of local traffic as well. While bill and keep for non-ISP traffic was not specifically the subject of the proceedings to date, several commenters *did* squarely propose bill and keep rules that covered non-ISPs as well as ISP traffic, and the Commission may reasonably conclude that parties had sufficient notice of such alternatives as well. Alternatively, the Commission could ask for a new round of comments specifically on the application of bill and keep to non-ISP traffic after it implements bill and keep for ISP dial-up traffic.

I. There Is No Need for Further Comments Before Applying Bill and Keep to ISP Traffic.

The Commission has provided more than adequate notice that it will decide whether ISP-bound traffic falls within section 251(b)(5) and what compensation model shall be applied to that traffic, and it has offered parties ample opportunities to comment on these matters. This record should support any basis for applying bill and keep to ISP traffic, regardless of the legal theory supporting that proposal. The Administrative Procedure Act requires that "[g]eneral notice of proposed rule making shall be published in the Federal Register" and that "[t]he notice shall include . . . either the terms or substance of the proposed rule or a description of the subjects and

issues involved." 5 U.S.C. § 553(b). These "notice . . . requirements are met when" an agency's final rule "is the 'logical outgrowth' of the proposed rule." *Association of Battery Recyclers, Inc. v. EPA,* 208 F.3d 1047, 1058 (D.C. Cir. 2000) ("*Battery Recyclers*") (quoting *Fertilizer Inst. v. EPA,* 935 F.2d 1303, 1311 (D.C. Cir. 1991)).

> [T]he key focus is on whether the purposes of notice and comment have been adequately served. . . . [A] final rule will be deemed to be the logical outgrowth of a proposed rule if a new round of notice and comment would not provide commenters with 'their first occasion to offer new and different criticisms which the agency might find convincing.'

Id. at 1059 (quoting *United Steelworkers of America v. Marshall*, 647 F.2d 1189, 1225 (D.C. Cir. 1980)).

As the D.C. Circuit has made clear, an agency may in fact legally adopt a rule that it never formally proposed in response to suggestions made in submitted comments. *Battery Recyclers*, 208 F.3d at 1059. *See also Sierra Club v. Costle*, 657 F.2d 298, 353-55 (D.C. Cir. 1981) ("*Sierra Club*"). This is particularly true where the record is well developed and parties have, in fact, commented on the matters in question. Complainants may not claim inadequate notice where they are unable to identify any "relevant information they might have supplied had they anticipated [the agency's] final rule." *Battery Recyclers*, 208 F.3d at 1059. For example, in *BASF Wyandotte Corp. v. Costle*, 598 F.2d 637 (1st Cir. 1979) ("*BASF Wyandotte*"), the court rejected petitioner's claim that they were taken "entirely by surprise" by an EPA rule not specifically identified as an alternative in the initial NPRM. *Id.* at 643. The court explained that "[t]he essential inquiry is whether the commenters have had a fair opportunity to present their views on the contents of the final plan." *Id.* at 642. The NPRM is not determinative, since "[a]n agency's promulgation of proposed rules is not a guarantee that those rules will be changed only

in the ways the targets of the rules suggest." *Id.* In particular, the court found noteworthy the fact that there was no basis for believing that commenters'

> comments would have differed fundamentally if they had known what EPA would do. Though they would have had a different proposition against which to argue, their proposed solutions would, presumably, have been the same for the same reasons. They might have responded in greater volume or more vociferously, but they have not shown us that the content of their criticisms would have been different to the point that they would have stood a better chance of convincing the Agency. . . . In short, they had a fair opportunity to present their views. . . . Their real complaint is that EPA rejected those views.

Id. at 644.

Under this standard, the Commission has provided sufficient notice that it might decide to regulate ISP-bound traffic under a bill and keep system. In its Declaratory Ruling, the Commission explained that it had "conclude[d] that ISP-bound traffic is jurisdictionally mixed and appears to be largely interstate," and sought comment on "an alternative proposal that we adopt a set of federal rules governing inter-carrier compensation for ISP-bound traffic pursuant to which parties would engage in negotiations concerning rates, terms, and conditions applicable to delivery of interstate ISP-bound traffic." *Reciprocal Compensation Declaratory Ruling*, 3689-90, 3708 ¶¶ 1, 31 (1999). The Commission subsequently sought "comment on the issues identified [in the *Bell Atlantic*] decision," including the court's stance that the Commission had not provided an adequate explanation for its treatment of ISP-bound calls as outside section 251(b)(5). Public Notice, *Comment Sought on Remand of the Commission's Reciprocal Compensation Declaratory Ruling By the U.S. Court of Appeals for the D.C. Circuit*, 15 FCC Rcd 11311 (1999) ("*Public Notice*"). The Commission also sought "comment regarding any new or innovative inter-carrier compensation arrangements for ISP-bound traffic that parties may be considering or may have entered into, either voluntarily or at the direction of a state commission, during the pendency of this proceeding." *Id.* at 11312. The Commission thus

specifically raised the question of new compensation mechanisms that might be adopted, and the issue was clearly made relevant both in the context of non-local treatment of ISP-bound traffic, and the context of revisiting entirely the applicability of section 251(b)(5) to ISP-bound traffic.

The comments filed in response to the Commission's notice and the significant *ex parte* record are evidence of its sufficiency. For example, SBC argued that ISP-bound traffic is not entitled to reciprocal compensation "irrespective of whether ISP traffic is classified as exchange access, telephone exchange service, or otherwise." Comments of SBC at 24. SBC then specifically suggested that the Commission adopt a bill and keep compensation system for ISP-bound traffic. *Id.* at 48-55. SBC explained in detail why it believes that bill and keep is less market distorting and more equitable than reciprocal compensation in these circumstances. *See also, e.g.*, Reply Comments of Qwest at 5-13.

Other Commenters specifically responded to this proposal. Focal Communications, for instance, expressly opposed bill and keep for ISP-bound traffic. "[S]everal parties urged the Commission either to eliminate reciprocal compensation for ISP traffic entirely in favor of a 'bill and keep' arrangement or, alternatively suggested that the burden of compensation rested on the ISP, not the originating carrier. The Commission should reject these arguments entirely." Comments of Focal at 17-18.[11] Those opposing bill and keep for ISP-bound traffic advanced both economic and legal arguments.[12] The arguments on both sides were fleshed out considerably in the *ex parte* record, as well.

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[11] *See also, e.g.,* Comments of Pac-West at 16; Reply Comments of Pac-West at 22-23 (bill and keep should not apply to ISP traffic).

[12] *See, e.g.*, Comments of Pac-West at 19; Comments of Focal at 18-23; Reply Comments of Pac-West at 12-22.

The proposal to apply bill and keep regime to ISP traffic, even if that traffic were deemed to come within section 251(b)(5), fits squarely within this dialogue; indeed, it is difficult to envision what additional arguments commenters could make if the Commission were once again to place the issue before them with even more specific proposals. Moreover, as in *Sierra Club*, this public discussion provided additional actual notice that the Commission might act on the matters as proposed by commenters. While the precise legal arguments contained here may not have been discussed in these very terms, the same general legal and policy issues were raised.

For example, commenters have thoroughly considered the questions of what costs are actually related to termination, how high those costs are, and to whom they should properly be ascribed.[13] Commenters also have fully argued the question of whether applying section 251(b)(5) to ISP-bound traffic creates inappropriate opportunities for regulatory arbitrage and disincentives to facilities-based competition.[14] Likewise, the findings that would have to support a Commission decision to forbear in applying 251(b)(5) to ISP-bound traffic — whether the provision is "necessary to ensure that the charges, practices, classifications, or regulations . . . are just and reasonable and are not unjustly discriminatory," and whether enforcement is necessary to protect consumers and the public interest. 47 U.S.C. § 160(a) — have all been fully vetted.[15] As the court noted in *BASF Wyandotte*, one "cannot think how [the] comments would have differed fundamentally if [commenters] had known" the specific conclusions the Commission

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[13] *See, e.g.,* Comments of SBC at 28-37; Comments of Qwest at 13-18; Comments of Verizon at 22-27; Comments of Focal at 18-20; Comments of Pac-West at 19-20.

[14] *See, e.g.*, Comments of SBC at 39-47, 51- 53; Comments of Pac-West at 19; Comments of Focal at 18-23; Reply Comments of SBC at 37-38; Reply Comments of Qwest at 12; Reply Comments of Pac-West at 12-22.

[15] *See generally, e.g.*, Comments of SBC; Comments of U S WEST; Comments of Pac-West; Comments of Focal; Reply Comments of SBC; Reply Comments of Qwest; Reply Comments of Pac-West.

was going to draw based on the record before it. *BASF Wyandotte*, 598 F.2d at 644. Under these circumstances, the Commission is fully justified in promulgating any of our suggested methods of imposing bill and keep on ISP-bound traffic.

II. The Current Record Supports Applying Bill and Keep to Non-ISP Traffic.

Although the proceedings below have focused primarily on the treatment of ISP-bound traffic, the broader question whether local traffic generally should be subject to bill and keep was introduced as well. For example, commenters suggested to the Commission that ISP and general local traffic could be brought "together into a single bill-and-keep regime." Reply Comments of Qwest at 12. *See also* Comments of SBC at 51-53; Reply Comments of SBC at 37-38 (proposing bill and keep for local traffic); as noted above, these issues haven been significantly amplified in the *ex parte* record. Parties have accordingly had ample opportunity to comment on the idea of a broader bill and keep rule. Thus, as set forth above, the Commission could reasonably conclude that it need not take more comments before applying bill and keep to all local traffic.

Nonetheless, should the Commission conclude that further comment would be preferable, it could address ISP and non-ISP traffic separately, and have a further round of comments just on the latter. If the Commission proceeds in this manner, it might consider immediately adopting an interim order imposing bill and keep (or establishing a rebuttable presumption that bill and keep is appropriate) during the pendency of its further round of comment, and providing for a true-up if it ultimately rejected the bill and keep approach. Alternatively, it could simply leave existing interconnection arrangements for non-ISP traffic in place pending completion of any rulemaking.

Appendix B

The Precise Contours of Bill and Keep

Although the Commission is currently focusing on whether it can bring Internet-bound traffic under a more comprehensive bill and keep rule, the Commission should also consider what types of *non*-ISP traffic would be brought under the rule. A sweeping bill and keep rule covering *all* exchange traffic without exception would create some undesirable effects and discourage the construction of network facilities. This section briefly outlines some limitations the Commission should consider before adopting a final bill and keep rule for non-ISP traffic.

I. Exclude CMRS Traffic from Bill and Keep.

The Commission should consider whether to exclude wireline-CMRS interconnection from any bill and keep rule, and it has a strong basis for doing so. As noted above, the existing traffic imbalances between carriers with respect to ISP dial-up traffic are entirely an artifact of current regulations. Once the regulatory incentives to cherry-pick ISP customers and shun residential subscribers are gone, one would expect the distribution of ISPs among LECs to become more even, and bill and keep would not result in any LEC unfairly bearing a disproportionate share of unrecovered termination costs. On the other hand, the traffic imbalances between wireline and wireless carriers are very real. As a result of network costs, pricing policies, and differences in customers' calling habits, wireline LECs currently terminate a far greater proportion of traffic than CMRS carriers do. CMRS carriers do deserve and are receiving reciprocal compensation for the calls they in fact terminate, but they also do generate significant amounts of traffic that is terminated by wireline LECs. While the imbalances persist, the Commission may find it appropriate to leave existing reciprocal compensation arrangements in place.

II. Exclude Transiting Traffic from Bill and Keep.

The Commission should likewise acknowledge that a pure bill and keep rule does not work where *three* LECs are involved — that is, where two LECs exchange local traffic with each other indirectly by routing that traffic over a third carrier. A pure bill and keep regime fails to compensate that third (intermediary) carrier for its costs of transporting the transiting traffic that originates on the other two LECs' networks, since the intermediary carrier in this scenario has no "customer" and thus receives no compensation for its transport of the call. Moreover, if the true originating and terminating LECs are permitted to receive transiting traffic for free, they have no incentive to expand their networks and build direct interconnection points with each other; it is cheaper for them to dump all of their traffic onto the intermediary's network and saddle that LEC with all the costs of transport.

The Commission should therefore allow LECs to continue charging each other for delivering transiting traffic that originates on the networks of other carriers. This is a widespread and accepted practice incorporated into almost all interconnection agreements today, and disturbing it would be immensely and unnecessarily disruptive. The Commission has repeatedly held that transiting traffic should be kept out of the section 251(b)(5) reciprocal compensation regime, most recently in its *TSR Wireless* decision. *See* Memorandum Opinion and Order, *TSR Wireless, LLC v. U S WEST Communications, Inc.*, 15 FCC Rcd 11166 n.70 (2000) (reaffirming that paging companies are required to pay for transiting traffic, notwithstanding the Commission's rules implementing 47 U.S.C. § 251(b)(5)); *see also Local Competition Order*, 11 FCC Rcd at 16016-17 ¶¶ 1041-1043 (stating intent to continue treating transit traffic arising from

CMRS roaming under access charge regime, not reciprocal compensation rules). The Commission should not disturb that settled industry-wide practice now.[16]

[16] Moreover, the Act does not require the Commission to include transiting traffic in any general bill and keep rule. The reciprocal compensation provisions of the Act do not address the three-LEC situation; section 252(d)(2), for example, addresses only the case where two carriers have a bilateral arrangement governing the "recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls *that originate on the network facilities of the other carrier*." 47 U.S.C. § 252(d)(2)(A)(i) (emphasis added). And the Commission itself has recognized that "reciprocal compensation for transport and termination of calls is intended for a situation in which *two* carriers collaborate to complete a local call." *Local Competition Order*, 11 FCC Rcd at 16013 ¶ 1034 (emphasis added).