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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

December 5, 2000

EX PARTE

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

CC Docket Nos. 96-98; 99-68

EX PARTE OR LATE FILED

Dear Ms. Salas:

On December 4, 2000, Rick Whitt and I of WorldCom met with Anna Gomez of Chairman Kennard's office and Deena Shetler of Commissioner Tristani's office, and on December 5, 2000, Mr. Whitt and I met with Kyle Dixon of Commissioner Powell's office, Rebecca Beynon of Commissioner Furchtgott-Roth's office, and Jordan Goldstein of Commissioner Ness's office, to discuss reciprocal compensation issues. We made the points outlined in the attached documents, which were distributed at the meetings.

In accordance with section 1.1206(b) of the Commission's rules, 47 C.F.R. § 1.1206(b), an original and three copies of this memorandum and attachments are being filed with your office.

Sincerely,

Lori Wright

Lori Wright
Senior Manager, Regulatory Affairs

cc: Anna Gomez (w/o attachments)
Deena Shetler (w/o attachments)
Kyle Dixon (w/o attachments)
Rebecca Beynon (w/o attachments)
Jordan Goldstein (w/o attachments)

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Addressing The D.C. Circuit's Remand of the FCC's <u>ISP Reciprocal Compensation Order</u>

Richard S. Whitt
WorldCom, Inc.
December 4, 2000

Summary

- ✓ Jurisdiction is not an issue - - the FCC has ample jurisdiction over both intrastate and interstate traffic under Sections 251 and 252 of the Act
- ✓ Local exchange carriers provide either "telephone exchange service" or "exchange access"
- ✓ ISPs are end users of telecommunications, not telecommunications carriers themselves
- ✓ ISP-bound calls within the same local service area terminate locally
- ✓ Dial-up calls to ISPs within the same local service area constitute telephone exchange service
- ✓ CLECs incur actual economic costs on behalf of the ILECs when terminating local calls to ISPs
- ✓ Thus, CLECs must receive reciprocal compensation pursuant to Section 251(b)(5) of the Act

The Crux of the Issue

- **The issue presented is straightforward: how does a local carrier get paid for participating in the origination or termination of a telephone call?**

The relevant statutory, regulatory, and equity principles are clear:

✓ *The telecommunications services provided by a local carrier constitute either telephone exchange service or exchange access service.*

✓ *In both cases, local carriers incur actual economic costs for originating, transporting, and terminating telecommunications.*

✓ *Local carriers are paid access charges for providing exchange access to create an interexchange call.*

✓ *Local carriers are paid reciprocal compensation for providing telephone exchange service to create an intra-exchange (local) call.*

The Crux of the Issue

When applied to calls connecting one set of end users (an ILEC's residential customers) to another set of end users (a CLEC's ISP customers), these principles yield a consistent conclusion.

- ✓ *The ILEC's customers originate the calls, and the CLEC's customers receive the calls.*
- ✓ *Because the ILEC's customers are both the cost causers and the party responsible for paying for the calls, the ILEC must compensate the CLEC for the cost of terminating the calls.*
- ✓ *Where calls originate and terminate within the same local service area, the compensation to be paid is dictated by Section 251 of the Telecommunications Act of 1996 (as interpreted by the Commission).*

Thus, when ILEC residential customers call an ISP served by a CLEC within the same local service area, the ILEC must pay reciprocal compensation to the CLEC.

<u>The Remand Issues</u>

ISPs Do Not Provide Telephone Toll Services

- ✓ *The FCC determined that, under the Telecommunications Act, all local traffic is either "telephone exchange service" or "exchange access."*

  <u>Advanced Service Order</u>, 13 F.C.C.R. 24011, 24032 (1998);

  <u>Advanced Services Order on Remand</u>, 15 F.C.C.R. 385 (1999).

- ✓ *The FCC did not explain how ISPs can be viewed as users of "exchange access" where they connect to the local network for the purpose of providing information services, not for the "origination or termination of telephone toll services." <u>Bell Atlantic v. FCC</u>, 206 F.3d at 5, <u>quoting</u> 47 U.S.C. § 153 (16).*

- ✓ *The FCC did not explain why its traditional "end-to-end" communications analysis is relevant to whether a call to an ISP is telephone exchange or exchange access; in fact, such an analysis "yields intuitively backwards results."*

The Remand Issues

ISPs are end users

- ✓ *The FCC did not explain why an ISP is not "simply a communications-intensive business end user selling a product to other consumer and business end-users." Bell Atlantic v. FCC, 206 F.3d at 7.*

Calls to ISPs terminate locally under the FCC's own regulations

- ✓ *Local traffic terminates at the ISP, "clearly" the called party: "the mere fact that the ISP originates further telecommunications does not imply that the original telecommunications does not 'terminate' at the ISP." Bell Atlantic v. FCC, 206 F.3d 1,7 (D.C. Cir. 2000).*

The Remand Issues

Thus, the D.C. Circuit found that "the Commission has not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as 'terminat[ing]… local telecommunications traffic,'" and why "such traffic is 'exchange access' rather than 'telephone exchange service….'"

Bell Atlantic v. FCC, 206 F. 3d at 8.

The Commission now must address these specific concerns in order to satisfy the D.C. Circuit.

The D.C. Circuit Pointed The Way

The FCC can achieve its goal of overseeing the pricing of reciprocal compensation, while maintaining the current carrier arrangements, by finding that calls terminating to ISPs constitute local exchange service

✓ *As Affirmed By The U.S. Supreme Court's Iowa Utilities Board Decision, The FCC Has Ample Jurisdiction To Determine The Pricing Methodology For Local Exchange Services.*

✓ *Under The Telecommunications Act of 1996, The Great Majority Of Calls To ISPs Logically Fit Within The Definition Of "Telephone Exchange" Service.*

✓ *Most State Commissions, And All Courts, Considering The Issue Have Concluded That Calls To ISPs Within The Same Local Service Area Are Local Under The Terms Of The Parties' Interconnection Agreements.*

Calls To ISPs Constitute Local Telephone Exchange Under The Act

The Commission plainly has jurisdiction over ISP-bound traffic under Sections 251 and 252 of the Telecommunications Act of 1996

✓ The FCC - "Sections 251 and 252 address both interstate and intrastate aspects of interconnection, resale services, and access to unbundled elements. The 1996 Act moves beyond the distinction between interstate and intrastate matters that was established in the 1934 Act, and instead expands the applicability of national rules to historically intrastate issues, and state rules to historically interstate issues. Local Competition Order, 11 F.C.C.R. 15499, 155137 (1996).

✓ The Supreme Court - "The FCC has rulemaking authority to carry out the provisions of this Act, which include sections 251 and 252, added by the Telecommunications Act of 1996.... Section 201 (b) explicitly gives the FCC jurisdiction to make rules governing matters to which the 1996 Act applies."

AT&T v. Iowa Utilities Bd., 525 U.S. 366, 378, 380 (1999).

Calls To ISPs Constitute Local Telephone Exchange Under The Act

Contrary to the ILECs' dismissal of the statute as "irrelevant," the Commission must come to terms with the statutory classification of ISP-bound traffic

✓ *The FCC has acknowledged that local telecom carriers provide either telephone exchange or exchange access.*

✓ *Calls to ISPs cannot be "exchange access."*

✓ *The statute defines "exchange access" as "for the purpose of the origination and termination of telephone toll service." 47 U.S.C. § 153 (16).*

✓ *End users do not connect to ISPs for this purpose - they connect to obtain information services.*

✓ *End users do not pay a "separate charge" for toll service. 47 U.S.C. § 153 (48).*

✓ *ISPs do not provide telecommunications services - they utilize telecom services to provide information services.*

✓ *The "two services" theory is alive and well - telecom services are provided to the calling party, while information services are provided by the called party.*

Calls To ISPs Constitute Local Telephone Exchange Under The Act

ISPs subscribe to "telephone exchange service."

✔ *The statute defines "telephone exchange" as service which occurs within a local exchange or system of exchanges, and which is covered by the exchange service charge. 47 U.S.C. § 153 (47)(A).*

- *Both elements are met by ISP-bound traffic.*
- *ISPs utilize local exchange services just as any other end user.*

✔ *The FCC repeatedly equates "telephone exchange" service with "local" service.*

Calls To ISPs Constitute Local Telephone Exchange Under The Act

"Information access" is not a stand-alone, separate category of service under the 1996 Act.

- *FCC already has ruled that information access is only a specialized form of exchange telecom service. Advanced Services Order on Remand, 15 F.C.C.R. 385 (1999).*
- *The MFJ defines "information access" as exchange service. Modified Final Judgement, Section IV (I).*

Thus, calls to ISPs qualify as telephone exchange service.

ISPs Are End Users, And Almost All Calls To ISPs Terminate Locally

The ILECs would have the Commission classify and treat ISPs as carriers, not end users

✓ *The "end-to-end" jurisdictional analysis only applies to telecom services and improperly renders ISPs as de facto common carriers.*

✓ *ISPs are end users, and end users are not carriers.*

- *ISPs "are not regulated under title II of the Act." 47 CFR § 64.702(a).*
- *End users are "any customer of an interstate or foreign telecommunications service that is not a carrier ...." 47 CFR § 69.2(m).*
- *It is the policy of the United States "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive media." 47 U.S.C. § 230 (b)(2).*

✓ *Telecommunications and information services are mutually exclusive categories of services under the 1996 Act.*

ISPs Are End Users, And Almost All Calls To ISPs Terminate Locally

The Federal Courts Agree That ISP-Bound Traffic Terminates Locally

✓ D.C. Circuit - *"Calls to ISPs appear to fit this definition [of termination]: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"*

Bell Atlantic, 206 F.3d at 6.

✓ Fifth Circuit - *"termination occurs when [the ISP's carrier] switches the call at its facility and delivers the call to 'the called party's premises,' which is the ISP's local facility. Under this usage, the call indeed 'terminates' at the ISP's premises."*

Southwestern Bell, 208 F.3d at 483.

ISPs Are End Users, And Almost All Calls To ISPs Terminate Locally

The Facts Demonstrate That ISP-Bound Traffic Terminates Locally

ISP-Bound Traffic Mirrors Other Local Calls to End Users

✓ *End-user uses computer (CPE) to dial ISP's local access number.*

✓ *Terminating LEC provides notice of call connection when call is answered by ISP and of call completion when end-user disconnects.*

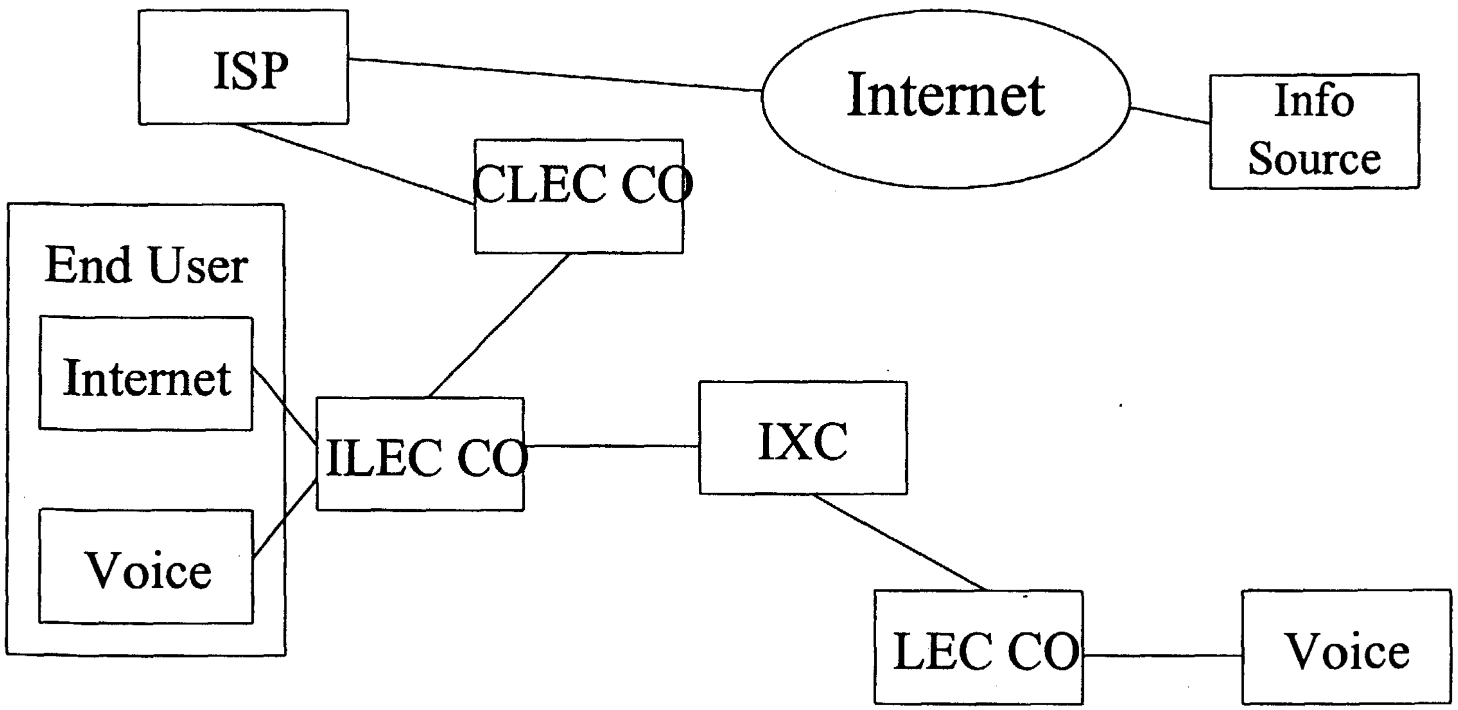
Even Under The ILECs' Mistaken Jurisdictional Theory, Calls To ISPs Are Predominantly Local

✓ *According to the Hyperion Study, only 9 % of an ISP customer's total online connection time is interstate. Reply Comments of Hyperion Telecom, Inc., CC Docket No. 98-79, filed 1/19/99.*

✓ *ISPs increasingly use considerable local caching of website content.*

✓ *Many consumers interact with local content residing with local ISPs.*

ISPs Are End Users, And Almost All Calls To ISPs Terminate Locally



<u>The Act Requires Reciprocal Compensation For Terminating ISP-Bound Traffic</u>

The ILECs would have CLECs incur the cost of terminating traffic without receiving just compensation

- ✓ *LECs use the same local networks to terminate ISP-bound traffic as for other types of voice and data traffic.*
- ✓ *LECs incur actual costs to terminate traffic bound for ISPs -- cost imposed by the originating LEC's customers.*
  - *"...no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network." <u>ISP Declaratory Ruling</u>, 14 F.C.C.R. 3689, 3707 (1999).*
- ✓ *ILEC costs to both originate and terminate ISP-bound traffic already are or could be recovered in their retail local end user rates.*
- ✓ *No cost differences have been demonstrated that would justify allowing the ILECs to discriminate against this particular type of end user-bound traffic.*
  - *ILECs ignore other end users of predominantly inbound calling (call centers, credit card validation centers, travel reservation agencies, home shopping networks, call-in radio shows, ticket outlets, pizza delivery outlets, taxicab companies, etc.).*

The Act Requires Reciprocal Compensation For Terminating ISP-Bound Traffic

The ILECs would have CLECs incur the cost of transporting and terminating traffic without receiving just compensation

✓ *"Bill and keep" is an appropriate compensation mechanism only where telecommunications traffic between carriers is roughly balanced*

✓ *ILECs derided the concept in 1996 as "bilk and keep."*

✓ *The FCC rejected "bill and keep" as a mandatory compensation mechanism. Local Competition Order, 11 FCCR. 15499, 16058 (1996).*

✓ *Parties remain free to agree to "bill and keep" as part of interconnection negotiations.*

The Act Requires Reciprocal Compensation For Terminating ISP-Bound Traffic

The ILECs seek to avoid the larger implications of subjecting ISP-bound traffic to a forward-looking costing methodology.

- ✓ *CLECs seek to cover forward-looking costs, nothing more.*
- ✓ *To the extent the reciprocal compensation rates originally demanded by the ILECs now are above forward-looking cost, the ILECs are incented to adopt lower, cost-based rates for other interconnection services and network elements as well.*

The ILECs seek to deny ISPs any competitive alternative for local exchange services.

What The Commission Should Do On Remand

The FCC should conclude that:

✓ Calls to ISPs within the same LSA are compensable under Section 251 (b) (5) of the Telecommunications Act

✓ The Commission retains jurisdiction over ISP-bound local traffic via that same provision

✓ Compensation rates for ISP traffic should be:

- *the same as rates for all other end user-bound traffic*
- *symmetrical*
- *based on forward-looking costs*
- *based on the ILECs' costs of termination*
- *equal or exceed sum of rates established for ILEC UNE switching and transport plus a portion of the local loop*

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WHY THE FCC SHOULD REJECT MANDATORY "BILL AND KEEP" FOR ISP-BOUND LOCAL TRAFFIC

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December 5, 2000

Summary

Mandatory bill and keep for ISP-bound traffic would be inconsistent with:

- The Telecom Act
- The FCC's rules
- The Local Competition Order
- The first ISP Recip Comp Order
- The D.C. Circuit remand decision
- Most state commissions
- The ILECs' own prior positions and admissions
- The UNE rates for switching and transport
- Incentives to adopt lower, cost-based UNE rates
- Cost causation principle
- Just compensation principles
- Market-based solutions
- Avoiding regulatory arbitrage
- The FCC's stated policy goals
- The FCC's forbearance authority
- The APA's requirement for sufficient notice
- Nondiscrimination requirements of the Communications Act
- Local compensation incentives
- ILEC deployment incentives
- Treatment of ISPs as end users
- ILEC terminating access charges
- Sound policymaking

Mandatory "bill and keep" is forbidden by the Telecommunications Act

The Telecommunications Act of 1996 plainly requires that carriers be allowed to recover the costs of transporting and terminating telecommunications.

Section 251(b)(5) directs that each local exchange carrier "establish reciprocal compensation arrangements for the transport and termination of telecommunications."

Section 252(d)(2)(A) states that the terms and conditions for reciprocal compensation are not just and reasonable unless they:

(1) "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…", and

(2) "determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."

The Telecommunications Act only contemplates that carriers will adopt "bill and keep" arrangements after each carrier expressly waives its statutory right to recover costs incurred in transporting and terminating telecommunications.

Section 252(d)(2)(B)(i) states that the Act does not preclude "arrangements that waive mutual recovery (such as bill-and-keep arrangements)…"

Mandatory "bill and keep" would be contrary to the FCC's rules

The FCC rules implementing Section 251 of the Telecom Act require that carriers pay each other reciprocal compensation for transporting and terminating local telecommunications

Sections 51.701-51.717 establish the rules for the payment of reciprocal compensation.

The <u>only</u> exception to the general reciprocal compensation requirement is a provision that allows adoption of a "bill and keep" arrangement where a state commission concludes that traffic between the two local networks is roughly in balance.

Section 51.713 only allows a state commission to impose a bill-and-keep arrangement "if the state commission determines that the amount of local telecommunications traffic from one network to the other is roughly balanced with the amount of local telecommunications traffic flowing in the opposite direction, and is expected to remain so...."