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Ms. Magalie R. Salas
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

Ex Parte: Intercarrier Compensation for ISP-Bound Traffic – CC Docket No. 99-68

Dear Ms. Salas,

On Wednesday, December 13, 2000, Susanne Guyer, Ed Shakin, and myself, representing Verizon, met with Jordan Goldstein of Commissioner Ness' office to discuss intercarrier compensation for ISP-bound traffic. We discussed the Commission's authority to impose a bill and keep regime for reciprocal compensation, as well as its authority to impose interim caps on traffic imbalances. The attached material was used in the discussions.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, and original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceeding indicated above.

If you have any questions regarding this matter, please call me at (202) 463-5293.

Sincerely,

W. Scott Randolph
Director - Regulatory Matters

cc: Jordan Goldstein

The Commission Should Reaffirm Its Existing Rules and Move To Bill and Keep Based on Section 201 of the Act

- **A core purpose of the Internet is non-local interstate communication.** The Internet is "an international network of interconnected computers that enables millions of people to communicate with one another in 'cyberspace' and to access vast amounts of information from around the world." *Reno v. ACLU*, 521 U.S. 844 (1997) (cited in *Bell Atlantic v. FCC*).

- **As a result, calls to the Internet are not subject to section 251(b)(5) reciprocal compensation requirements.** This conclusion is consistent with the Commission's long held position that section 251(b)(5) only applies to "local traffic" while "charges for interstate long distance traffic are governed by sections 201 and 202 of the Act." *Local Competition*, First Report and Order, ¶ 1033. This conclusion is also consistent with section 251(i) of the Act, which makes clear that nothing in section 251 (including subsection (b)(5)) should be construed to limit or otherwise effect Commission authority under section 201.

- **The D.C. Circuit in *Bell Atlantic v. FCC* did not upset any of these conclusions. Instead, it remanded for further explanation on how the prior reciprocal compensation ruling fits in with the Commission's preexisting regulations. The Commission can address the Court's concerns without a change in policy.**

  - **A call to the Internet is not a local call because traffic does not terminate at the ISP.** The Court sought clarification how the "one-call analysis" fit with the ESP exemption. **The ESP exemption confirms that Internet-bound calls are non-local – there would be no reason for an exemption, if traffic to the Internet weren't otherwise subject to access charges.** The Court recognized that "there is no dispute that the Commission has historically been justified" in relying on a one-call analysis "when determining whether a particular communication is jurisdictionally interstate." The Court sought clarification as to whether this same analysis applies outside that context. It has. For example, in the *Teleconnect* case, the Commission found that using 800 service to connect to IXC switch is still one call. (Bells "attempt to distinguish the so-called 'jurisdictional' nature of a call from its status for 'billing' purposes, they present no persuasive argument nor any authority to support their contention that this distinction has legal significance.") *Teleconnect Co. v. Bell Tel. Co. of Pa.*, 6 FCC Rcd 5202 (1991), *recon.*, 10 FCC Rcd 1626 (1995).

- **The DC Circuit also rejected the reciprocal compensation decision because the Commission had never addressed the ambiguous statutory terms "telephone exchange service" and "exchange access." Since that order, it has addressed those terms in a manner consistent with its prior reciprocal compensation decision.** In the *Advanced Services Remand Order*, the Commission held that "[t]he primary distinction between [telephone exchange service and exchange access] is that, while telephone exchange services permit communication 'within a telephone exchange' or 'within a connected system of telephone exchanges within the same exchange area,' exchange access refers to access to telephone exchange services or facilities for the purpose of originating or terminating communications that travel outside an exchange." 15 FCC Rcd 385 at 391, ¶ 15 Given those definitions, Internet traffic is exchange access.

- When the Court talks about an ISP [as opposed to the ultimate Internet web site] being the "called party," it is paraphrasing MCI's arguments, not making new law. This was the question the Court left to the FCC to resolve on remand. In a more recent opinion, however, the Court has understood that the destination of a call to an ISP is the distant web site. ("Access to a web site reflects nothing more than a telephone call by a District resident to the defendants' computer servers, all of which apparently are operated outside of the District." *GTE New Media Services*, 199 F.3d at 1350 (DC Cir. 2000)).

- **Retaining a "one-call" analysis reaffirms Commission authority over the Internet and does *not* leave the Internet subject to 50 local regulators.**

- **Once the Commission resolves the concerns of the Court, it should find that a bill and keep regime is "just and reasonable" under the broad parameters of section 201.** Indeed, bill and keep is the only way to put the charges on the cost causer. Bill and keep is consistent with how other non-local transport charges are applied, with the ISP bearing the cost of its own service. A contrary policy forces the ILEC and its customers to support ISP users. The ILEC has only two options in that scenario – either subsidize the service, or require calling end-users to pay through their local rates. In either alternative, the cost causer does not pay. Moreover, CLECs may already be recovering their cost of handing off calls to ISPs. A bill and keep regime eliminates excess recovery beyond actual costs.

The FCC Shift to Bill and Keep for Reciprocal Compensation of Imbalanced Traffic Should Be Mandatory

- **The present crisis was precipitated by the FCC's failure in its prior reciprocal compensation order to set firm requirements for the states.** Indeed, despite some states' efforts to reduce reciprocal compensation arbitrage, in the twenty months since the Commission's March 1999 *Declaratory Ruling*, reciprocal compensation billings have almost doubled, and absent a change in policy, billings are expected to continue to increase almost 50% each year. Only a firm national policy to transition to bill and keep will solve this problem.

- **A voluntary order has the potential to actually make things worse than the status quo.** Currently, some states appropriately understood FCC decisions to date to exclude internet-bound traffic from the reciprocal compensation provisions of the Act (section 251(b)(5)). An FCC order that undercut those decisions could actually open the door to increased reciprocal compensation billing – precisely the opposite result of the intended impact of an FCC order.

- If the FCC policy is a transition to bill and keep, it should not allow states to put in place regimes that allow reciprocal compensation payments over any transitional traffic imbalance caps adopted by the FCC. By the same token, it should not require states that are already at bill and keep (or have at least gone further than the FCC's contemplated transitional traffic imbalance caps) to go backwards. Those states at bill and keep or with lower caps than the FCC transition plan should keep their rules in place. A contrary rule would only increase reciprocal compensation billings, and make the transition to bill and keep more difficult.

- Even if internet-bound traffic were subject to the reciprocal compensation provision of the Act (section 251(b)(5)), which it is not, the FCC has the authority to mandate bill and keep and keep as well as an associated transition. The Supreme Court has affirmed that the "FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252." *AT&T v. Iowa Utilities Board*, 525 US 366, 378. Indeed, despite some state's efforts to reduce reciprocal compensation arbitrage, in the twenty months since the Commission's March 1999 *Declaratory Ruling*, reciprocal compensation billings have almost doubled, and absent a change in policy, billings are expected to continue to increase almost 50% each year (1999).

- A bill and keep regime was contemplated by Congress as a possible method of reciprocal compensation. Indeed, section 252(d)(2)(B) specifically identifies bill and keep arrangements as a potential regime that, consistent with the Act, affords "the mutual recovery of costs through the offsetting of reciprocal obligations." In doing so, the Act makes clear that this is a potential regulatory regime for cost recovery, and not merely reciprocal compensation with a price of zero. Moreover, under the federal transition plan, the rates would still be set under the state supervised negotiation process, the caps would only dictate for which traffic those rates applied.

Regardless of How it Gets to Bill and Keep for Internet-Bound Traffic, the Commission Also has the Authority to Mandate Bill and Keep for Local Traffic

- **If Internet-bound traffic is subject to a bill and keep regime, it is reasonable to assume that the remaining traffic is roughly balanced between incoming and outgoing calls to CLEC-served customers. The Commission may require bill and keep for this traffic as well.**

- **Indeed, to the extent that there remain serious imbalances in traffic, this may attributable to a distortion in the compensation mechanism.** To the extent, reciprocal compensation overcompensates carriers for the transport and termination of traffic, they have an incentive to serve customers with an imbalance of in-bound traffic.

- The Commission has found that the state experience has resulted in a wide range of compensation rates. Rather than function as an efficient compensation mechanism, it has been viewed as a loophole, with potential abuse and outright fraud in some instances. *See BellSouth Telecommunications, Inc. v. US LEC of North Carolina Inc.*, Order Denying Reciprocal Compensation, Docket No. P-561, Sub 10 (N.C. U.C. March 31, 2000).

- **Because a rate that compensates without overcompensating will result in roughly balanced traffic, the most efficient way to reach that balance is to mandate bill and keep as the compensation mechanism for all local traffic.** Such a rule allows carriers mutual recovery and was specifically recognized as acceptable in the Act for this purpose. 47 U.S.C. § 252(d)(2)(b)(i).

- Requiring Bill and Keep for all local, as well as Internet-bound, traffic offers several ancillary benefits. It removes a need to attempt to distinguish internet-bound traffic from local – a distinction that has caused considerable regulatory dispute to date -- because all non-access traffic will be subject to the same compensation system. By equalizing the incentive to serve all customers, it encourages competing carriers to build-out their own networks and offer competitive service to a larger number of customers.

Even if the Commission Finds that Section 251(b)(5) Applies to Internet-Bound Traffic, It can Still Establish a Bill and Keep Regime Consistent with Section 252(d)(2)

- **The Commission has already recognized that section 252(d)(2) is not an absolute bar to a Commission mandate of bill and keep.** *Local Competition*, First Report and Order, ¶ 1111.

- In the Local Competition First Report and Order, the Commission rejected the argument that costs for terminating local traffic are not de minimis (¶ 1112). But the Commission did not consider the question with respect to internet-bound traffic. This presents a different question for two reasons.

  - First, the ILECs have presented evidence that there are network efficiencies associated with serving an ISP and its concentration of inbound-only traffic. These efficiencies result in lower costs to transport and terminate internet-bound traffic relative to local traffic. *See* Affidavit of William Taylor, attached to Verizon Comments (filed July 21, 2000).

  - Second, and more fundamentally, under the terms of the ESP exemption, the cost of delivering calls to the ISP were to be paid by the ISP through local charges imposed by the LEC serving the ISP.

    - In one of the original access charge orders, the FCC expressly noted that the local business line rate paid by ESPs covers the cost, not only of the ESP's telephone line, <u>but also the switching function used to deliver interstate traffic to the ESP</u> – the very function covered by reciprocal compensation. (97 FCC2d 682 ¶ 88)

    - Moreover, when, in the *Access Reform Proceeding* in 1997, ILECs argued that they were unable to recover their costs associated with ISP-bound traffic as a result of the access charge exemption, the FCC stated that if this were the case, <u>they should raise the rates they charge ISPs</u>. (12 FCC Rcd. at 16134)

- Given that the CLECs serving the ISPs are free to price their charges without regulatory constraint, they are free to recover all of their transport and termination costs from their ISP customers. Thus, there are no additional costs that must be recovered through reciprocal compensation. Moving to a bill and keep regime avoids double recovery and puts the costs on the cost-causer rather than on all local rate payers.