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ATTORNEYS AT LAW

April 10, 2001

EX PARTE – Via Electronic Filing

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: *Ex Parte* Communication
Inter-Carrier Compensation for ISP-Bound Traffic
CC Docket 99-68

Dear Ms. Salas:

On April 6, 2001, Ms. Patricia Paoletta (of Level 3), Ms. Staci Pies (of Level 3) and John Nakahata (of Harris, Wiltshire & Grannis representing Level 3) met with Ms. Dorothy Attwood, Chief, Common Carrier Bureau, and Mr. Glenn Reynolds, Deputy Chief, Common Carrier Bureau. During their meeting, Ms. Paoletta provided the attached letter to Ms. Attwood, and Ms. Paoletta, Ms. Pies and Mr. Nakahata discussed the points outlined in that letter. In particular, they made the point that a growth cap would be arbitrary and capricious in the results imposed on individual firms, and an inappropriate policy tool as applied to the industry as a whole. They pointed out that a growth cap as applied to specific firms suffers two distinct fatal flaws:

(1) problems created by the regulatory lag in imposing a cap based on minutes served during a prior historical period, penalizing companies that are growing and protecting companies that are not growing; and

(2) because the growth cap allocates compensable minutes in proportion to existing market share, the growth cap creates a new, artificial and arbitrary competitive advantage for companies with large amounts of existing ISP traffic when they are competing to retain that business in the face of challenges from newer CLECS. The growth cap, as described in the ALTS/Comptel ex parte letter dated March 26, 2001 is not competitively neutral among companies competing to serve ISP customers.

In short, the growth cap is discriminatory, and discourages competition. Level 3 further observed that the competitive inequities created by the growth cap could reduce competition among CLECs, to the detriment of ISPs, who could become captive customers, without sufficient competitive choice of vendors.

In response to Ms. Attwood's point that the Commission's goal was to reduce total reciprocal compensation payments (i.e. reducing total reciprocal compensation revenue, rather than just the per-minute rate for reciprocal compensation), Level 3 argued that this was not a proper objective. Rather, the objective should be to bring all actors, both incumbents and competitors, under a coherent intercarrier compensation mechanism that impacts the industry on the same time-frame. Level 3 also argued that the growth cap was an arbitrary way to achieve the objective of reducing total reciprocal compensation payments because of the competitive distortions it creates between companies that currently have traffic, and those seeking to obtain traffic.

If the Commission truly sought to reduce total revenue, then it ought to be more straightforward. One more straightforward mechanism -- which Level 3 believes the Commission also should not try to implement because the goal of capping revenues is itself not the right goal -- would be to use a pooling mechanism that sets total overall reciprocal compensation to be paid for traffic not otherwise subject to binding and valid interconnection agreements, and then allocates the pooled compensation revenue among CLECs according to the minutes actually delivered. Of course, simply the description of such a mechanism demonstrates the extent to which it would be an unwise intervention into the marketplace. But as compared to the growth cap, a pooling approach would not create a competitively unequal playing field as between CLECs seeking to serve ISPs. A growth cap is simply not a rational way to achieve the Commission's wholly erroneous objective of revenue reduction.

In accordance with the rules, this letter and the attached letter to Ms. Attwood are being filed electronically in the above-captioned docket.

Sincerely,

John T. Nakahata

Attachment

c: Ms. Dorothy Attwood
Mr. Glenn Reynolds
Mr. Kyle Dixon
Mr. Jordan Goldstein
Mr. Sam Feder
Ms. Sarah Whitesell

Level(3)℠ COMMUNICATIONS

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April 6, 2001

Ms. Dorothy Attwood
Chief, Common Carrier Bureau
Federal Communications Commission
445 12th Street, N.W.
Washington, D.C. 20554

Dear Ms. Attwood:

I am writing on behalf of Level 3 Communications LLC to respond to two recent ex parte letters sent by CompTel and SBC Corporation concerning issues relating to reciprocal compensation for ISP bound traffic and the proper scope of the calling area for such calls. In addition, I would like to inform you that Level 3 has reached an intercarrier compensation agreement with BellSouth Communications.

The agreement, which covers the nine-state BellSouth operating territory, sets the following rate schedule for ISP-bound traffic: .00175 cents per minute of use in 2001; .0015 cents per minute of use ("MOU") in 2002 and .001 cents per MOU in 2003. (A copy of a press release is attached.) This agreement was reached through negotiations and does not contain any "growth caps" or "super-traffic ratios" that artificially cap or constrain either party's economic obligations.

The conclusion of this agreement – the third one that Level 3 has reached with an RBOC - demonstrates that market-based solutions to intercarrier compensation for ISP-bound traffic can be negotiated without federally mandated pricing. The Commission need not take the path of intervening in the market to dictate prices between private parties in this instance. Marketplace participants can negotiate their own reasonable rates, and can do so without artificial ratios or limits such as the "growth cap" described in a March 26, 2001, letter to you from John Windhausen and Russell Frisby. Such caps are ill advised because they can only distort the marketplace and send misguided economic signals to private parties.

Based on that letter, Level 3 understands that the Commission may impose an annual growth ceiling of 10% on the amount of terminating ISP-bound traffic for which a CLEC could receive compensation. Any such cap, as described in the letter, would be calculated based upon the historic number of minutes terminated by the CLEC to its ISP customers during the previous 12-month period. Determining whether a particular minute of traffic would be compensable based upon the identity and history of the terminating carrier renders any cap patently arbitrary, capricious and discriminatory. The cap would discourage growth. In addition, the concept of a cap ignores long-standing economic principles by punishing those carriers who succeed in the marketplace by attracting new customers.

Level3 is not aware of a single economic principle or model that relies upon denying compensation as a way of rewarding success.

The following examples illustrate the extent to which a growth cap would yield arbitrary and capricious results, without any public policy justification:

Example 1 – The New Entrant. Assume CLEC A terminates 10,000 minutes of above-ratio ISP-bound traffic in its first and only month of operation. Under the growth cap, this CLEC would be compensated for only 11,000 minutes of above-ratio traffic in the first year, or on average 917 minutes per month.[1] This reduces the total compensation paid by the ILEC under the new regime, simply by averaging months of no operation with the single month of operation. There is no conceivable policy justification for reducing the amount of compensable minutes for this new entrant to a trickle in the name of a reasonable transition.

Example 2 – Last Year's Big New Account. Assume CLEC A had 600,000 minutes (100,000 minutes per month) of above-ratio ISP-bound minutes in the first 6 months of the previous 12-month period. It then wins a new customer that doubles the compensable above-ratio ISP-bound minutes to 1,200,000 for the second six months (200,000 minutes per month). The average monthly above-cap traffic during the previous 12 months would be only 150,000 minutes per month. The 10% growth cap would allow 165,000 compensable minutes per month the following year.

Again, there is no conceivable policy justification for reducing the amount of compensable minutes simply because this new customer was added mid-way through the previous year, rather than six months earlier.

Example 3 – The Big New Account from Another CLEC. Assume CLEC A averages 1,000,000 minutes per month for a year. Assume that CLEC A now has the opportunity to land a new account (ISP 1) that will add 500,000 minutes per month of additional ISP-bound above-ratio traffic. This new customer is being served by CLEC B, and all 500,000 minutes are above-ratio for CLEC B. Under the proposed growth cap, all the traffic would be compensable if delivered by CLEC B. But 400,000 of those minutes would not be compensable if delivered by CLEC A. Under this scenario, CLEC A is at a wholly artificial and economically irrational disadvantage to CLEC B in competing for the business of any ISP based solely on the operation of the growth cap.

Example 4 – The Big New Account Taken from Another CLEC Last Month. Assume, the facts as in Example 3, except that ISP 1 switched from CLEC B to CLEC A one month before the growth cap went into effect. As in Example 2, CLEC A would see the number of compensable minutes drop immediately. However, CLEC B, which lost the customer, would

[1] Throughout these examples, we have converted the cap into minutes per month on an annualized basis for ease of comparison. The point remains the same if the below "growth cap" minutes are taken all in an initial block, with all subsequent minutes being non-compensable.

be able to replace the lost minutes plus a 10% annual growth on the lost minutes, and have the replacement minutes be compensable. This is ironic, because these replacement minutes potentially are "new" minutes subject to compensation, far beyond the 10% permissible growth rate.

These examples illustrate how arbitrary and capricious a growth cap would be when applied at the level of individual firms. The Commission cannot conceivably develop a principled and economically rational method for defending the result obtained under such a cap. Adoption of a "growth cap" would therefore be arbitrary and capricious.

Level 3 would also like to address another issue that SBC Telecommunications, Inc. ("SBC") raised in a March 28, 2001 *ex parte* letter. In that letter, SBC requested that the Commission take steps to "avoid disputes as to what traffic qualifies for compensation under the Commission's new regime" by declaring that ISP-bound traffic must terminate to an ISP who is physically located in the same local calling area as the calling party. To the contrary, SBC's request, if adopted, would undermine the Commission's efforts to bring closure to this issue. In short, regardless of what the Commission adopts as an intercarrier compensation mechanism, that mechanism will be meaningless if SBC's request is adopted here because of the manner in which many ISPs are served.

Most ISPs do not maintain a physical presence in every local calling area, but they do need telephone numbers in every local calling area in order to provide end users the ability to dial into the Internet through a local call. Indeed, a requirement that ISPs deploy equipment in every local calling area in order for their carrier service providers to avoid having calls to the ISPs treated as toll calls would create great harm in the Internet access market and turn decades of industry practice upside down. Take the example of an ISP who maintains its modem banks and server equipment in downtown Chicago but offers dial-up access to customers in suburban Chicago calling areas through telephone numbers local to those areas. Under SBC's request, there are two possible results:

(1) The call would no longer be local in nature based upon the physical location of the ISP receiving the call. Rather, the customer dialing into the Internet would face toll charges from SBC (because, as SBC argues, the call is toll based upon its local calling areas). SBC would then seek to charge originating access to the carrier serving the ISP, as the call would be considered toll in nature. SBC would refuse to pay reciprocal compensation to the carrier serving the ISP because the call would be considered toll in nature; or

(2) *For intercarrier compensation purposes*, the call would no longer be local in nature based upon the physical location of the ISP receiving the call. SBC would seek to charge originating access to the carrier serving the ISP, as the call would be considered toll in nature. SBC would refuse to pay reciprocal compensation to the carrier serving the ISP because the call would be considered toll in nature. *For all other purposes*, however, the call would

remain local – SBC would route the call over local interconnection facilities, handle the call under its end user's local calling plan, and decline to impose any toll calling charges on the customer.

Neither result constitutes sound policy or consistent reasoning. In the first result, a great deal of customers seeking Internet access would for the first time face the prospect of paying per-minute toll charges to dial in. The Commission certainly should not adopt any policy that fosters such a result. The second result, while avoiding this concern about directly discouraging Internet access through toll charges, raises additional problems. Under this second result, the call to the ISP would be rated as local at retail, and routed over the same local interconnection facilities and through the same point of interconnection as every other local call. However, under this result, the call to the ISP would be treated as non-local (toll) *for intercarrier compensation purposes only*. This result is therefore contrary to the costs involved in routing the call and the manner in which the call is treated for SBC's own purposes. It could also call for carriers to make substantial changes to billing systems to break out calls that appear local according to the decades-old industry standard of comparing NXX codes and are treated as local for retail purposes in order to treat them differently solely for intercarrier compensation purposes. (For example, Level 3 understands that it took BellSouth at least 6 months to implement such system changes to stop billing reciprocal compensation on calls terminating to its own foreign exchange customers. It is unclear how much this effort cost, or what kind of time and resources such an effort might require of a smaller competitor.)

For these reasons, the Commission should not act on SBC's overly simplified request to clarify that "the relevant local service area is the local calling area of the *originating LEC*." (emphasis in original) Instead, the Commission should reaffirm that calls treated as local for retail purposes – those calls where customers dial a local call to reach the Internet – will be included in any intercarrier compensation decision the Commission adopts in this docket.

Very truly yours,

Staci L. Pies, on behalf of

William P. Hunt, III
Vice President – Public Policy