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EX PARTE

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

Re: CC Docket No. 99-68

Dear Ms. Salas:

On March 21, 2001, representatives from WorldCom, Inc. ("WorldCom") met with Jordan Goldstein, Legal Advisor to Commissioner Susan Ness, to discuss the issue of reciprocal compensation for ISP-bound traffic. During that meeting, WorldCom was asked to provide information on the appropriate forward-looking cost-based rates that should be used as a baseline to establish intercarrier compensation for ISP-bound traffic. In response, WorldCom files this ex parte letter.

Introduction

The Commission must consider three seminal issues as it prepares to respond to the D.C. Circuit's remand of its previous reciprocal compensation order. WorldCom has addressed two of these issues in other recent ex parte filings. There should no longer be any dispute either that (1) a CLEC is entitled to receive compensation for terminating calls that originate on another carrier's network, or that (2) such calls terminate when they are delivered to the CLEC's end user customers, including Internet Service Providers ("ISPs"). The remaining critical question – the appropriate level of compensation – is addressed herein.

Under one of the proposed transition plans currently being considered by the Commission, reciprocal compensation rates for ISP-bound traffic apparently would be reduced over a three-year period to approximately 0.07 cent per minute. While WorldCom consistently has supported the Commission's efforts to bring compensation for the termination of all communications traffic – including ISP-bound traffic -- closer to cost, this transition plan would grossly discriminate against competitive local exchange carriers ("CLECs"), and continue to protect incumbent local exchange carriers ("ILECs") from the effects of local competition. If the Commission decides nonetheless to impose a unique compensation scheme on ISP-bound traffic, the record evidence shows that the economic cost of such transport and termination is no less than approximately 0.20 to 0.40 cent per minute. Ensuring that rates are set at economic cost will eliminate any incentives the Commission might believe would cause a competitor to build a customer base with a disproportionate number of inbound calls. It is also most consistent with the Commission's overarching implementation of the Telecommunications Act of 1996.

In evaluating whether the rates being considered by the Commission are within a range of economic, forward-looking costs, the Commission is fortunate to have a number of pertinent data points it can use to reference the reasonableness of its selection. These data points include interstate terminating access rates, intrastate terminating access rates, market-based contract rates, FCC proxy rates, unbundled switching and transport network element rates, FCC synthesis cost model rates, and even Level 3's recent contract with Verizon. In WorldCom's view, each of these data points justifies a rate for reciprocal compensation that is no less than approximately 0.20 to 0.40 cent per minute. In any event, the data clearly rules out any equitable use of the 0.07 cent end point that WorldCom understands the Commission currently is considering. This confiscatory rate is well below the rates now paid to ILECs for performing the same terminating functions, and is even below a reasonable range based on forward-looking costs. Below, we discuss the evidence that the Commission should use to derive a reasonable forward-looking end point and transition plan for reciprocal compensation.

1. <u>The Necessary Nexus To Access Charges</u>

The Commission long has held that ISPs are not required to pay access charges. Indeed, its rules are quite clear – ISPs are end users, and end users may, but are not required to, purchase telecommunications services from carrier access tariffs. This treatment often has been labeled inaccurately an ISP "exemption." However, there is no exemption, but instead a conclusion compelled by the FCC's rules and the law. The smokescreen created by this inartful use of a label – encouraged in large part by the ILECs -- has obscured a more salient issue. Carriers (often CLECs) who deliver calls to ISPs are entitled to <u>receive</u> terminating access charges when they complete an interexchange call to their customer on behalf of a customer of another carrier. Today, both ILECs and CLECs receive terminating access when they deliver interexchange calls to their customers, including in some cases ISPs. So, if the Commission continues to hold – as it should <u>not</u> – that all calls to ISPs should be treated as though they are interstate communications, then it follows that all carriers should receive interstate terminating access charges for delivering calls to their ISP customers. Similarly, if this Commission (or a state regulatory commission) labels these calls intrastate interexchange communications, then carriers should receive intrastate terminating access charges.

Of course, a significant portion of all dialed calls to ISPs originate and terminate to NXXs associated with the same, state commission-approved, local rate center. Thus, these calls have been and should continue to be treated as local calls. It is no accident that the vast majority of dialed calls to ISPs are local, as most ISPs have established points-of-presence within multiple rate centers to help minimize the dial-up costs for their customers.

Because carriers perform the same functions to terminate a local dialed call to an ISP as they do to terminate dialed calls to their other customers, the issue of appropriate compensation remains. The Telecommunications Act requires the FCC (as well as the states) to remove subsidies from the access charges it approves. In 1999, the Commission accepted an ILECsponsored plan gradually to reduce interstate access rates closer to cost. In several more years, that plan will reduce interstate terminating access charges to about 0.40 cent per minute. Most states have not yet adopted a similar rate reduction plan. The Commission would seem to be unreasonably discriminating against new entrants if it were to order a significantly lower level of compensation for CLEC termination of local calls than it has allowed the ILECs to charge for performing the same functions. Simple equity would demand that 0.40 cent per minute become the LOWEST level of reciprocal compensation for local calls, unless and until the FCC once again addresses the pricing of interstate terminating access.

Unfortunately, it is not readily apparent that this Commission has any kind of consistency in mind as it considers setting the appropriate rate level for reciprocal compensation. Therefore, even though the Commission allows ILECs to continue to charge excessive interstate access rates a full five years after Congress mandated cost-based access, WorldCom discusses below the proper basis for establishing cost-based rates for reciprocal compensation.

2. Determining Cost-Based Compensation Rates

The Commission has concluded that prices for interconnection and unbundled network elements ("UNEs"), pursuant to sections 251(c)(2), 251(c)(3), and 252(d)(1) of the Act, should be based on the ILECs' total element long-run incremental cost ("TELRIC") of a particular element, plus a reasonable share of forward-looking joint and common costs.[1] WorldCom long has supported the Commission's decision to establish TELRIC as the proper basis for costing elements of the ILEC network, as well as intercarrier compensation. To the extent the Commission decides to set the specific, federally-mandated rates for reciprocal compensation -- a decision which WorldCom does not believe is supported by any record evidence of market failure -- WorldCom consistently has advocated the adoption of TELRIC-based rates.

Market-Based Rates

As the first generation of interconnection agreements negotiated and arbitrated under the Telecommunications Act expire, newly negotiated agreements have produced dramatically lower rate levels for reciprocal compensation. Rates are now one-third of what they were three to four years ago, and fall within the TELRIC-based, per-minute proxy rate range the Commission set up in 1996. For example, under recent market-based contracts negotiated with the ILECs, WorldCom is paying reciprocal compensation rates that are based on the current state commission-approved TELRIC rates established with the use of RBOC cost studies -- between 0.15 and 0.50 cent per minute.[2]

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[1] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (rel. Aug. 8, 1996), ¶ 672 ("Local Competition Order").

[2] *See*, Letter from Bradley Stillman, WorldCom to Magalie Roman Salas, Secretary, Federal Communication Commission, CC Docket Nos. 96-98, 99-68 (Nov. 10, 2000). This reduction in rates proves that the market is effectively driving transport and termination rates to cost. As the competitive market continues to develop, rates naturally will reach the appropriate level that reflects costs, as would happen in a free market. Given time, the market will resolve the issue on its own.

State Arbitrated Rates

A survey of state reciprocal compensation decisions demonstrates that the states are carrying out their responsibilities to ensure that calls between local telecommunications providers, including calls terminated by ISPs, are being correctly compensated. As first-generation interconnection agreements expire by their terms, several state commissions have arbitrated the issue of reciprocal compensation for ISP-bound traffic for second-generation interconnection agreements. These states have approved recent interconnection agreements that encompass rates that fall well within the market-based range discussed above. The states have been systematically lowering reciprocal compensation rates to a level that approximates forward-looking costs of transport and termination.[3] In California, for example, the state commission ordered reciprocal compensation payments to drop from 0.75 to 0.20 cents per minute.[4]

State Generic Rates Mirroring Market Rates

A number of state commissions have instituted generic proceedings to adopt a statewide policy regarding inter-carrier compensation for ISP traffic. In these cases, state commissions have required reciprocal compensation for ISP traffic at rates between 0.10 to 0.35 cent per minute.[5] For example, both the New York and Texas Commissions recently examined the costs associated with the transport and termination of ISP-bound traffic and have come up with generic rates that apply when no contract exists between the parties.[6] Although WorldCom believes it is too low, the Texas Commission established a rate of 0.1042 cent per minute. The rate in New York is 0.298 cent per minute. Both rates are exclusive of other related charges, such as use of the switch, port, call set-up fees, and transport charges.

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[3] *See, e.g., Proceeding on Motion of the Commission to Reexamine Reciprocal Compensation,* Case No. 99-C-0529, Opinion No. 99-10, 1999 WL 1020550, Opinion and Order Concerning Reciprocal Compensation (N.Y. P.S.C. Aug. 26, 1999)(establishing a rebuttable presumption that, where traffic imbalances exceed 3:1, terminating LECs may not charge the tandem switching rate); *see also, Proceeding to Examine Reciprocal Compensation,* Docket No. 21982, 2000 WL 1424921 (Tex. P.U.C. July 14, 2000)(reducing the per minute end office rate from 0.1507 to 0.10423 cents per minute). The Texas decision should be read to represent that the 0.07 cent proposed end point is too low.

[4] *Petition of PacBell for Arbitration of an Interconnection Agreement with MFS/WorldCom Pursuant to Section 252(b) of the Telecommunications Act,* 2000 WL 1022238, Order Modifying Decision 99-09-069 (Cal. P.U.C. May 18, 2000)(reducing the end office rate from 0.75 to 0.20 cent per minute).

[5] *See, e.g., ITC-DeltaCom Communications, Inc. v. BellSouth Telecommunications, Inc.,* Docket No. P-55, Sub. 1197, 2000 WL 1089559 (N.C. U.C. Jul. 12, 2000)(enforcing reciprocal compensation between interconnecting parties for calls that terminate traffic to ISPs); *ICG Telecom Group, Inc.,* Case No. 99-1153-TP-ARB, 1999 WL 1489378 (Ohio P.U.C. Dec. 15, 1999)(stating that CLECs incur costs above the *de minimus* level when delivering ISP-bound traffic); *On the Commission's Own Motion, to Consider the Total Service Long Run Incremental Costs for All Access, Toll, and Local Exchange Services Provided by Ameritech,* Case No. U-11831 (Mich. P.S.C. Nov. 16, 1999)(adopting costs studies that enumerate transport and termination costs above *de minimis* levels).

[6] *See, e.g., Proceeding on Motion of the Commission to Reexamine Reciprocal Compensation,* Case No. 99-C-0529, Opinion No. 99-10, 1999 WL 1020550, Opinion and Order Concerning Reciprocal Compensation (NY P.S.C. Aug. 26, 1999)(establishing a 3:1 traffic imbalance ratio, beyond which all traffic – including ISP-bound traffic – will be compensated at end office rates rather than tandem rates); *Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996,* Docket No. 21982, Revised Arbitration Award (Tex. P.U.C. Aug. 14, 2000)(establishing a bifurcated end office rate, a composite tandem-served rate and a 3:1 traffic imbalance ratio applicable to all local traffic, including ISP-bound traffic).

The FCC's Proxy Rate Range

The Commission has unquestionably determined that, as a matter of economics, prices above *de minimis* levels are appropriate for unbundled switching and shared transport. In recognition of this, the Commission has established pricing rules for unbundled network elements, including switching and shared transport, and established interim proxy rates.[7] In particular, the Commission has stated that the TELRIC-based per-minute proxy rate for unbundled local switching should be between 0.20 and 0.40 cent.[8] The Commission has found that a price within this proxy range "should allow carriers the opportunity to recover fully their additional cost of terminating a call....".[9] The Commission has also found that the TELRIC-based per-minute default proxy rate for termination of local telecommunications traffic should be between 0.20 and 0.40 cent.[10] Thus, compensation rates for ISP-bound traffic roughly should be in the same range as the proxy rates for all local termination.

UNE Pricing Derived By State Commissions

Port and switching costs also provide useful proxies for costs to transport and terminate traffic, since these involve similar network functions for ISP-bound traffic. Thus, compensation rates for ISP-bound traffic should be the same as rates for all other end user-bound traffic. State commissions in some of the more populous states -- New York, Texas, Illinois Pennsylvania, and Michigan -- have recognized this and have used ILEC UNE rates for transport and local switching as the basis for the costs for the transport and termination of calls to ISPs. Alone, the unbundled terminating switching costs per minute set by commissions in these states range from 0.05 to 0.29 cent per minute. When an allowance for monthly port charges is considered, compensation rates for ISP-bound traffic equal or exceed the sum of rates established for ILEC UNE switching and transport.[11] The Commission should look at these five states, where UNE pricing is relatively low, in developing the lower boundary of reasonable costs.

The Commission's Synthesis Model

The cost of transport and termination for reciprocal compensation includes the cost of both switching and transport. The Commission's Synthesis Model ("SM") provides one estimate of the TELRIC cost of providing network elements. The Commission's own estimate of switching costs alone using the SM indicates that the national average cost of transport and termination should be no less than 0.18 cent per minute.[12] However, this cost includes only the

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[7] 47 C.F.R. § 51.505-51.515. The 8th Circuit rejected the inclusion of "hypothetical" costs within TELRIC, but left in place the rest of the Commission's forward-looking cost methodology. Thus, the Commission retains the authority to set forward-looking, cost-based rates.

[8] *Local Competition Order*; *Inter-Carrier Compensation for ISP-Bound Traffic*, 14 F.C.C.R. 3689, *vacated, Bell Atlantic v. FCC*, 206 F.3d 1 (D.C. Cir. 2000); 47 C.F.R § 51.707(b)(1).

[9] Local Competition Order, ¶ 815.

[10] *Id.* at ¶ 824.

[11] *See, e.g.*, Opinion and Order Concerning Reciprocal Compensation (NY P.S.C. Aug. 26, 1999), *supra* note 6; Revised Arbitration Award (Tex. P.U.C. Aug. 14, 2000), supra note 6; On the Commission's Own Motion, to Consider the Total Service Long Run Incremental Costs for All Access, Toll, and Local Exchange Services Provided by Ameritech, Case No. U-11831 (Mich. P.S.C. Nov. 16, 1999).

[12] WorldCom used Commission data from 95 companies in this computation. Using switching costs alone, the range across the companies is 0.12 to 0.92 cent per minute. When overhead costs are added, the range across the companies is 0.15 to 0.975 cent per minute.

capital, carrier-to-carrier, and plant-specific and plant non-specific costs. When the Commission's estimate of switching costs is modified to include an allocation of wholesale overhead cost, the minimum TELRIC for transport and termination becomes 0.24 cent per minute. Even this estimate of the cost of transport and termination for use in reciprocal compensation is conservatively low, because it does not include any transport costs.

Conclusion

The evidence supports a cost-based rate of compensation for termination and transport of ISP-bound traffic at no less that 0.20 cent per minute. In contrast, there is no evidence in the record of this proceeding, or any state proceeding, to support a cost-based rate at less than 0.10 cent as an end-point of a transition plan for ISP-bound traffic. Indeed, this Commission already has decided that the appropriate compensation to ILECs for terminating interstate calls should transition over five years to 0.40 cent per minute. The rate for reciprocal compensation should mirror that transition. If instead of treating compensation for terminating traffic the same for all carriers, the Commission decides to force new carriers to charge a cost-based rate years before the ILECs are required to, ample record evidence must support that decision.

We understand that, to reach a rate below 0.10 cent, the Commission may be relying on reciprocal compensation rates in recent contracts between Verizon and Level 3. However, the rates that Verizon and Level 3 mutually agreed to pay and to receive seem to reflect considerable discounts that account for, and apparently balance to the parties' satisfaction, a variety of factors including but not limited to reciprocal compensation. This negotiated agreement alone should not be relied upon by the Commission in determining a baseline for inter-carrier compensation of ISP-bound traffic. Level 3 itself has stressed that it is important to recognize that "reciprocal compensation rates are just one component of these agreements, which also address other interconnection and network architecture issues."[13] As is the case in almost any negotiated settlement of a long-standing dispute, both Verizon and Level 3 gave up something in return for something else. In this case, Level 3 gave up reciprocal compensation in exchange for predictability about future payments and resolution of an on-going dispute about previous payments.[14] Level 3 could agree to a reciprocal compensation rate so much lower than actual cost because at the time of the settlement, Level 3, "[a]s an all IP network…[was] not in a position to deploy originating local voice traffic…"[15] Level 3 further distinguishes its settlement with Verizon by stating that "market-based solution[s], negotiated between two private entities, is the best indication of what is just and reasonable pursuant to Sections 201, 251(b)(5) and 252."[16] Clearly, Level 3 did not intend the Commission to use its settlement with Verizon as a proxy for reciprocal compensation rates for ISP-bound traffic. Thus, the Verizon-Level 3 agreement represents an outlier that does not challenge the reasonable range of forward-looking cost established elsewhere.

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[13] Letter of John T. Nakahata on behalf of Level 3 Communications to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 99-68 (Jan. 4, 2001).

[14] "Level 3, Bell Atlantic Settle Billing Dispute," InternetNews.com, Oct. 21, 1999 >http://www.internetnews.com/isp-news/article/0,,8_223271,00.html (quoting Daniel P. Caruso, Senior Vice President, Network Services, Level 3).

[15] Letter from Karen L. Gulick on behalf of Level 3 Communications to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 99-68 (Dec. 22, 2000) at p.2.

[16] *Id.*

The Commission has sufficient evidence to conclude that setting rates for compensation of ISP-bound traffic at economic cost is the best policy, as it is most consistent with the Commission's implementation of the Telecommunications Act generally. Applying forward-looking, cost-based rates as a baseline for inter-carrier compensation of ISP-bound traffic will eliminate arbitrage opportunities between carriers and protect carriers from devastating revenue reductions specifically. In WorldCom's view, all of the data points the Commission has at hand justify a rate that is no less than approximately 0.20 cent per minute. In any event, the data clearly rules out use of the 0.07 cent end point, which is well outside a reasonable range of forward-looking cost.

Sincerely,

Richard S. Whitt

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