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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
Intercarrier Compensation for ISP-Bound Traffic	)	CC Docket No. 99-68

ORDER ON REMAND AND REPORT AND ORDER

Adopted: April 18, 2001 **Released:** April 27, 2001

By the Commission: Chairman Powell issuing a statement; Commissioner Furchtgott-Roth dissenting and issuing a statement.

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I. INTRODUCTION

1. In this Order, we reconsider the proper treatment for purposes of intercarrier compensation of telecommunications traffic delivered to Internet service providers (ISPs). We previously found in the *Declaratory Ruling*[1] that such traffic is interstate traffic subject to the jurisdiction of the Commission under section 201 of the Act[2] and is not, therefore, subject to the reciprocal compensation provisions of section 251(b)(5).[3] The Court of Appeals for the District of Columbia Circuit held on appeal, however, that the *Declaratory Ruling* failed adequately to explain why our jurisdictional conclusion was relevant to the applicability of section 251(b)(5)

[1] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd 3689 (1999) (*Declaratory Ruling* or *Intercarrier Compensation NPRM*).

[2] *See* 47 U.S.C. § 201, Communications Act of 1934 (the Act), as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). Hereinafter, all citations to the Act and to the 1996 Act will be to the relevant section of the United States Code unless otherwise noted.

[3] 47 U.S.C. § 251(b)(5).

and remanded the issue for further consideration.[4] As explained in more detail below, we modify the analysis that led to our determination that ISP-bound traffic falls outside the scope of section 251(b)(5) and conclude that Congress excluded from the "telecommunications" traffic subject to reciprocal compensation the traffic identified in section 251(g), including traffic destined for ISPs. Having found, although for different reasons than before, that the provisions of section 251(b)(5) do not extend to ISP-bound traffic, we reaffirm our previous conclusion that traffic delivered to an ISP is predominantly interstate access traffic subject to section 201 of the Act, and we establish an appropriate cost recovery mechanism for the exchange of such traffic.

2. We recognize that the existing intercarrier compensation mechanism for the delivery of this traffic, in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets. As we discuss in the *Unified Intercarrier Compensation NPRM,*[5] released in tandem with this Order, such market distortions relate not only to ISP-bound traffic, but may result from any intercarrier compensation regime that allows a service provider to recover some of its costs from other carriers rather than from its end-users. Thus, the *NPRM* initiates a proceeding to consider, among other things, whether the Commission should replace existing intercarrier compensation schemes with some form of what has come to be known as "bill and keep."[6] The *NPRM* also considers modifications to existing payment regimes, in which the calling party's network pays the terminating network, that might limit the potential for market distortion. The regulatory arbitrage opportunities associated with intercarrier payments are particularly apparent with respect to ISP-bound traffic, however, because ISPs typically generate large volumes of traffic that is virtually all one-way -- that is, delivered to the ISP. Indeed, there is convincing evidence in the record that at least some carriers have targeted ISPs as customers merely to take advantage of these intercarrier payments. Accordingly, in this Order we also take interim steps to limit the regulatory arbitrage opportunity presented by ISP-bound traffic while we consider the broader issues of intercarrier compensation in the *NPRM* proceeding.

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[4] *See Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

[5] Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (rel. April 27, 2001) ("*Unified Intercarrier Compensation NPRM*" or "*NPRM*").

[6] "Bill and keep" refers to an arrangement in which neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers from its own end-users the cost of both originating traffic that it delivers to the other network and terminating traffic that it receives from the other network. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 16045 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom., AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); Order on Reconsideration, 11 FCC Rcd 13042 (1996); Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997); *further recon. pending*. Bill and keep does not, however, preclude intercarrier charges for transport of traffic between carriers' networks. *Id.*

II. EXECUTIVE SUMMARY

3. As presaged above, we must wrestle with two difficult issues in this Order: first, whether intercarrier compensation for ISP-bound traffic is governed by section 251 or section 201; and, if the latter, what sort of compensation mechanism should apply. The first question is difficult because we do not believe it is resolved by the plain language of section 251(b)(5) but, instead, requires us to consider the relationship of that section to other provisions of the statute. Moreover, we recognize the legitimate questions raised by the court with respect to the rationales underlying our regulatory treatment of ISPs and ISP traffic. We seek to respond to those questions in this Order. Ultimately, however, we conclude that Congress, through section 251(g),[7] expressly limited the reach of section 251(b)(5) to exclude ISP-bound traffic. Accordingly, we affirm our conclusion in the *Declaratory Ruling* that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5).

4. Because we determine that intercarrier compensation for ISP-bound traffic is within the jurisdiction of this Commission under section 201 of the Act, it is incumbent upon us to establish an appropriate cost recovery mechanism for delivery of this traffic. Based upon the record before us, it appears that the most efficient recovery mechanism for ISP-bound traffic may be bill and keep, whereby each carrier recovers costs from its own end-users. As we recognize in the *NPRM*, intercarrier compensation regimes that require carrier-to-carrier payments are likely to distort the development of competitive markets by divorcing cost recovery from the ultimate consumer of services. In a monopoly environment, permitting carriers to recover some of their costs from interconnecting carriers might serve certain public policy goals. In order to promote universal service, for example, this Commission historically has capped end-user common line charges and required local exchange carriers to recover any shortfall through per-minute charges assessed on interexchange carriers.[8] These sorts of implicit subsidies cannot be sustained, however, in the competitive markets for telecommunications services envisioned by the 1996 Act. In the *NPRM*, we suggest that, given the opportunity, carriers always will prefer to recover their costs from other carriers rather than their own end-users in order to gain competitive advantage. Thus carriers have every incentive to compete, not on basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers, a troubling distortion that prevents market forces from distributing limited investment resources to their most efficient uses.

5. We believe that this situation is particularly acute in the case of carriers delivering traffic to ISPs because these customers generate extremely high traffic volumes that are entirely one-directional. Indeed, the weight of the evidence in the current record indicates that precisely the types of market distortions identified above are taking place with respect to this traffic. For example, comments in the record indicate that competitive local exchange carriers (CLECs), on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is

[7] 47 U.S.C. § 251(g).

[8] Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 15998-99 (1997) (*Access Charge Reform Order*), *aff'd, Southwestern Bell Telephone Co. v. FCC,* 153 F.3d 523 (8th Cir. 1998).

for ISP-bound traffic.[9] Moreover, the traffic imbalances for some competitive carriers are in fact much greater, with several carriers terminating more than forty times more traffic than they originate.[10] There is nothing inherently wrong with carriers having substantial traffic imbalances arising from a business decision to target specific types of customers. In this case, however, we believe that such decisions are driven by regulatory opportunities that disconnect costs from end-user market decisions. Thus, under the current carrier-to-carrier recovery mechanism, it is conceivable that a carrier could serve an ISP free of charge and recover all of its costs from originating carriers. This result distorts competition by subsidizing one type of service at the expense of others.

6. Although we believe this arbitrage opportunity is particularly manifest with respect to ISP-bound traffic, we suggest in the *NPRM* that any compensation regime based on carrier-to-carrier payments may create similar market distortions. Accordingly, we initiate an inquiry as to whether bill and keep is a more economically efficient compensation scheme than the existing carrier-to-carrier payment mechanisms. Alternatively, the record developed in that proceeding may suggest modifications to carrier-to-carrier cost recovery mechanisms that address the competitive concerns identified above. Based upon the current record, however, bill and keep appears the preferable cost recovery mechanism for ISP-bound traffic because it eliminates a substantial opportunity for regulatory arbitrage. We do not fully adopt a bill and keep regime in this Order, however, because there are specific questions regarding bill and keep that require further inquiry, and we believe that a more complete record on these issues is desirable before requiring carriers to recover most of their costs from end-users. Because these questions are equally relevant to our evaluation of a bill and keep approach for other types of traffic, we will consider them in the context of the *NPRM*. Moreover, we believe that there are significant advantages to a global evaluation of the intercarrier compensation mechanisms applicable to different types of traffic to ensure a more systematic, symmetrical treatment of these issues.

7. Because the record indicates a need for immediate action with respect to ISP-bound traffic, however, in this Order we will implement an interim recovery scheme that: (i) moves aggressively to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound by lowering payments and capping growth; and (ii) initiates a 36-month transition towards a complete bill and keep recovery mechanism while retaining the ability to adopt an alternative mechanism based upon a more extensive evaluation in the *NPRM*

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[9] *See, e.g.,* Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet-bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001)(ILECs owed $1.98 billion in reciprocal compensation to CLECs in 2000). On June 23, 2000, the Commission released a Public Notice seeking comment on the issues raised by the court's remand. *See* Comment Sought on Remand of the Commission's Reciprocal Compensation Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit, CC Docket Nos. 96-98, 99-68, Public Notice, 15 FCC Rcd 11311 (2000) (*Public Notice*). Comments and reply comments filed in response to the *Public Notice* are identified herein as "Remand Comments" and "Remand Reply Comments," respectively. Comments and replies filed in response the 1999 *Intercarrier Compensation NPRM* are identified as "Comments" and "Reply Comments," respectively.

[10] *See, e.g.,* Verizon Remand Comments at 11, 21.

proceeding. Specifically, we adopt a gradually declining cap on the amount that carriers may recover from other carriers for delivering ISP-bound traffic. We also cap the amount of traffic for which any such compensation is owed, in order to eliminate incentives to pursue new arbitrage opportunities. In sum, our goal in this Order is decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users, consistent with the tentative conclusion in the *NPRM* that bill and keep is the appropriate intercarrier compensation mechanism for ISP-bound traffic. In this regard, we emphasize that the rate caps we impose are not intended to reflect the costs incurred by each carrier that delivers ISP traffic. Some carriers' costs may be higher; some are probably lower. Rather, we conclude, based upon all of the evidence in this record, that these rates are appropriate limits on the amounts recovered from other carriers and provide a reasonable transition from rates that have (at least until recently) typically been much higher. Carriers whose costs exceed these rates are (and will continue to be) able to collect additional amounts from their ISP customers. As we note above, and explain in more detail below, we believe that such end-user recovery likely is the most efficient mechanism.

8. The basic structure of this transition is as follows:

* Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. Any additional costs incurred must be recovered from end-users. These rates reflect the downward trend in intercarrier compensation rates contained in recently negotiated interconnection agreements, suggesting that they are sufficient to provide a reasonable transition from dependence on intercarrier payments while ensuring cost recovery.

* We also impose a cap on total ISP-bound minutes for which a local exchange carrier (LEC) may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the 2002 ceiling. These caps are consistent with projections of the growth of dial-up Internet access for the first two years of the transition and are necessary to ensure that such growth does not undermine our goal of limiting intercarrier compensation and beginning a transition toward bill and keep. Growth above these caps should be based on a carrier's ability to provide efficient service, not on any incentive to collect intercarrier payments.

* Because the transitional rates are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps or on a bill and keep basis (or otherwise have not required payment of

compensation for this traffic). The rate caps are designed to provide a transition toward bill and keep, and no transition is necessary for carriers already exchanging traffic at rates below the caps.

* In order to limit disputes and costly measures to identify ISP-bound traffic, we adopt a rebuttable presumption that traffic exchanged between LECs that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic subject to the compensation mechanism set forth in this Order. This ratio is consistent with those adopted by state commissions to identify ISP or other convergent traffic that is subject to lower intercarrier compensation rates. Carriers that seek to rebut this presumption, by showing that traffic above the ratio is not ISP-bound traffic or, conversely, that traffic below the ratio is ISP-bound traffic, may seek appropriate relief from their state commissions pursuant to section 252 of the Act.

* Finally, the rate caps for ISP-bound traffic (or such lower rates as have been imposed by states commissions for the exchange of ISP-bound traffic) apply only if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. An incumbent LEC that does not offer to exchange section 251(b)(5) traffic at these rates must exchange ISP-bound traffic at the state-approved or state-negotiated reciprocal compensation rates reflected in their contracts. The record fails to demonstrate that there are inherent differences between the costs of delivering a voice call to a local end-user and a data call to an ISP, thus the "mirroring" rule we adopt here requires that incumbent LECs pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

III. BACKGROUND

9. In the *Declaratory Ruling* released on February 26, 1999, we addressed the regulatory treatment of ISP-bound traffic. In that order, we reached several conclusions regarding the jurisdictional nature of this traffic, and we proposed several approaches to intercarrier compensation for ISP-bound traffic in an accompanying *Intercarrier Compensation NPRM*. The order, however, was vacated and remanded on appeal.[11] This Order, therefore, again focuses on the regulatory treatment of ISP-bound traffic and the appropriate intercarrier compensation regime for carriers that collaborate to deliver traffic to ISPs.

10. As we noted in the *Declaratory Ruling*, an ISP's end-user customers typically access the Internet through an ISP server located in the same local calling area.[12] Customers generally pay their LEC a flat monthly fee for use of the local exchange network, including connections to their local ISP.[13] They also generally pay their ISP a flat monthly fee for access to the Internet.[14] ISPs then combine "computer processing, information storage, protocol

[11] *See Bell Atlantic*, 206 F.3d 1.

[12] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[13] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[14] *Declaratory Ruling*, 14 FCC Rcd at 3691.

conversion, and routing with transmission to enable users to access Internet content and services."[15]

11. ISPs, one class of enhanced service providers (ESPs),[16] also may utilize LEC services to provide their customers with access to the Internet. In the *MTS/WATS Market Structure Order*, the Commission acknowledged that ESPs were among a variety of users of LEC interstate access services.[17] Since 1983, however, the Commission has exempted ESPs from the payment of certain interstate access charges.[18] Consequently ESPs, including ISPs, are treated as end-users for the purpose of applying access charges and are, therefore, entitled to pay local business rates for their connections to LEC central offices and the public switched telephone network (PSTN).[19] Thus, despite the Commission's understanding that ISPs use *interstate* access services, pursuant to the ESP exemption, the Commission has permitted ISPs to take service under *local* tariffs.

12. The 1996 Act set standards for the introduction of competition into the market for local telephone service, including requirements for interconnection of competing telecommunications carriers.[20] As a result of interconnection and growing local competition, more than one LEC may be involved in the delivery of telecommunications within a local service area. Section 251(b)(5) of the Act addresses the need for LECs to agree to terms for the mutual

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[15] *Declaratory Ruling*, 14 FCC Rcd at 3691 (citing Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11531 (1998) (*Universal Service Report to Congress*)).

[16] The Commission defines "enhanced services" as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a). The 1996 Act describes these services as "information services." *See* 47 U.S.C. § 153(20) ("information service" refers to the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."). *See also Universal Service Report to Congress*, 13 FCC Rcd at 11516 (the "1996 Act's definitions of telecommunications service and information service essentially correspond to the pre-existing categories of basic and enhanced services").

[17] MTS and WATS Market Structure, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 711 (1983)(*MTS/WATS Market Structure Order)*(ESPs are "[a]mong the variety of users of access service" and "obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit [their] location and, commonly, another location.").

[18] This policy is known as the "ESP exemption." *See MTS/WATS Market Structure Order*, 97 FCC 2d at 715 (ESPs have been paying local business service rates for their interstate access and would experience rate shock that could affect their viability if full access charges were instead applied); *see also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2633 (1988) (*ESP Exemption Order*) ("the imposition of access charges at this time is not appropriate and could cause such disruption in this industry segment that provision of enhanced services to the public might be impaired"); *Access Charge Reform Order*, 12 FCC Rcd at 16133 ("[m]aintaining the existing pricing structure ... avoids disrupting the still-evolving information services industry").

[19] *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. *See also Access Charge Reform Order*, 12 FCC Rcd at 16133-35.

[20] 47 U.S.C. §§ 251-252.

exchange of traffic over their interconnecting networks. It specifically provides that LECs have the duty to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[21] The Commission determined, in the *Local Competition Order,* that section 251(b)(5) reciprocal compensation obligations "apply only to traffic that originates and terminates within a local area," as defined by state commissions.[22]

13. As a result of this determination, the question arose whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP in the same local calling area that is served by a competing LEC.[23] The Commission determined at that time that resolution of this question turned on whether ISP-bound traffic "originates and terminates within a local area," as set forth in our rule.[24] Many competitive LECs argued that ISP-bound traffic is local traffic that terminates at the ISP's local server, where a second, packet-switched "call" then begins.[25] Thus, they argued, the reciprocal compensation obligations of section 251(b)(5) apply to this traffic. Incumbent LECs, on the other hand, argued that no reciprocal compensation is due because ISP-bound traffic is interstate telecommunications traffic that continues through the ISP server and terminates at the remote Internet sites accessed by ISP customers.[26]

14. The Commission concluded in the *Declaratory Ruling* that the jurisdictional nature of ISP-bound traffic should be determined, consistent with Commission precedent, by the end points of the communication.[27] Applying this "end-to-end" analysis, the Commission

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[21] 47 U.S.C. § 251(b)(5).

[22] *See Local Competition Order*, 11 FCC Rcd at 16013 ("With the exception of traffic to or from a CMRS network, state commissions have the authority to determine what geographic areas should be considered 'local areas' for the purpose of applying reciprocal compensation obligations under section 251(b)(5), consistent with the state commissions' historical practice of defining local service areas for wireline LECs."); *see also* 47 C.F.R. § 51.701(b)(1-2). For CMRS traffic, the Commission determined that reciprocal compensation applies to traffic that originates and terminates within the same Major Trading Area (MTA). *See* 47 C.F.R. § 51.701(b)(2).

[23] *See, e.g.,* Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53922 (1996); Petition for Partial Reconsideration and Clarification of MFS Communications Co., Inc. at 28; Letter from Richard J. Metzger, ALTS, to Regina M. Keeney, Chief, Common Carrier Bureau, FCC (June 20, 1997); Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CCB/CPD 97-30, DA 97-1399 (rel. July 2, 1997); Letter from Edward D. Young and Thomas J. Tauke, Bell Atlantic, to William E. Kennard, Chairman, FCC (July 1, 1998). The Commission later directed parties wishing to make *ex parte* presentations regarding the applicability of reciprocal compensation to ISP-bound traffic to make such filings in CC Docket No. 96-98, the local competition proceeding. *See Ex Parte* Procedures Regarding Requests for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CC Docket No. 96-98, Public Notice, 13 FCC Rcd. 15568 (1998).

[24] *Declaratory Ruling,* 14 FCC Rcd at 3693-94.

[25] *Declaratory Ruling,* 14 FCC Rcd at 3694.

[26] *Declaratory Ruling,* 14 FCC Rcd at 3695.

[27] *Declaratory Ruling,* 14 FCC Rcd at 3695-3701; *see also* Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation, Memorandum Opinion and Order, 7 FCC Rcd 1619 (1992) (*BellSouth*
(continued....)

determined that Internet communications originate with the ISP's end-user customer and continue beyond the local ISP server to websites or other servers and routers that are often located outside of the state.[28] The Commission found, therefore, that ISP-bound traffic is not local because it does not "originate[] and terminate[] within a local area."[29] Instead, it is jurisdictionally mixed and largely interstate, and, for that reason, the Commission found that the reciprocal compensation obligations of section 251(b)(5) do not apply to this traffic.[30]

15. Despite finding that ISP-bound traffic is largely interstate, the Commission concluded that it had not yet established a federal rule to govern intercarrier compensation for this traffic.[31] The Commission found that, in the absence of conflicting federal law, parties could voluntarily include ISP-bound traffic in their interconnection agreements under sections 251 and 252 of the Act.[32] It also found that, even though section 251(b)(5) does not *require* reciprocal compensation for ISP-bound traffic, nothing in the statute or our rules prohibits state commissions from determining in their arbitrations that reciprocal compensation for this traffic is appropriate, so long as there is no conflict with governing federal law.[33] Pending adoption of a federal rule, therefore, state commissions exercising their authority under section 252 to arbitrate, interpret, and enforce interconnection agreements would determine whether and how interconnecting carriers should be compensated for carrying ISP-bound traffic.[34] In the *Intercarrier Compensation NPRM* accompanying the *Declaratory Ruling*, the Commission requested comment on the most appropriate intercarrier compensation mechanism for ISP-bound traffic.[35]

16. On March 24, 2000, prior to release of a decision addressing these issues, the court of appeals vacated certain provisions of the *Declaratory Ruling* and remanded the matter to the Commission.[36] The court observed that, although "[t]here is no dispute that the Commission has

(Continued from previous page)
MemoryCall), *aff'd, Georgia Pub. Serv. Comm'n v. FCC*, 5 F.3d 1499 (11th Cir. 1993)(table); Teleconnect Co. v. Bell Telephone Co. of Penn., E-88-83, 10 FCC Rcd 1626 (1995) (*Teleconnect*), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997).

[28] *Declaratory Ruling,* 14 FCC Rcd at 3695-97.

[29] *Declaratory Ruling,* 14 FCC Rcd at 3697.

[30] *Declaratory Ruling,* 14 FCC Rcd at 3690, 3695-3703.

[31] *Declaratory Ruling,* 14 FCC Rcd at 3703.

[32] *Declaratory Ruling,* 14 FCC Rcd at 3703.

[33] *Declaratory Ruling,* 14 FCC Rcd at 3706.

[34] *Declaratory Ruling,* 14 FCC Rcd at 3703-06. The Commission did recognize, however, that its conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusions that reciprocal compensation is due to the extent that those conclusions were based on a finding that this traffic terminates at the ISP's server. *Id.* at 3706.

[35] *Declaratory Ruling,* 14 FCC Rcd at 3707-09.

[36] *See Bell Atlantic*, 206 F.3d 1.

historically been justified in relying on this [end-to-end] method when determining whether a particular communication is jurisdictionally interstate,"[37] the Commission had not adequately explained why the jurisdictional analysis was dispositive of, or indeed relevant to, the question whether a call to an ISP is subject to the reciprocal compensation requirements of section 251(b)(5).[38] The court noted that the Commission had not applied its definition of "termination" to its analysis of the scope of section 251(b)(5),[39] and the court distinguished cases upon which the Commission relied in its end-to-end analysis because they involve continuous communications switched by interexchange carriers (IXCs), as opposed to ISPs, the latter of which are not telecommunications providers.[40] As an "independent reason" to vacate, the court also held that the Commission had failed to address how its conclusions "fit . . . within the governing statute."[41] In particular, the court found that the Commission had failed to explain why ISP-bound traffic was not "telephone exchange service," as defined in the Act.[42]

17. In a public notice released June 23, 2000, the Commission sought comment on the issues raised by the court's remand.[43] The *Public Notice* specifically requested that parties comment on the jurisdictional nature of ISP-bound traffic, the scope of the reciprocal compensation requirement of section 251(b)(5), and the relevance of the concepts of "termination," "telephone exchange service," "exchange access service," and "information access."[44] It invited parties to update the record by responding to any *ex parte* presentations filed after the close of the reply period on April 27, 1999. It also sought comment on any new or innovative intercarrier compensation arrangements for ISP-bound traffic that parties may have considered or entered into during the pendency of the proceeding.

IV. DISCUSSION

A. Background

18. The nature and character of communications change over time. Over the last decade communications services have been radically altered by the advent of the Internet and the nature of Internet communications. Indeed, the Internet has given rise to new forms of communications such as e-mail, instant messaging, and other forms of digital, IP-based services. Many of these new services and formats have been layered over and integrated with the existing

[37] *Bell Atlantic*, 206 F.3d at 5.

[38] *Bell Atlantic*, 206 F.3d at 5; *see also id.* at 8 (the Commission had not "supplied a real explanation for its decision to treat end-to-end analysis as controlling" with respect to the application of section 251(b)(5)).

[39] *See Bell Atlantic*, 206 F.3d at 6-7.

[40] *See Bell Atlantic*, 206 F.3d at 6-7.

[41] *Bell Atlantic*, 206 F.3d at 8.

[42] *Bell Atlantic*, 206 F.3d at 8-9; 47 U.S.C. § 153(47) (defining "telephone exchange service").

[43] *Public Notice*, 15 FCC Rcd 11311.

[44] *Id.; see also* 47 U.S.C. § 251(g); 47 U.S.C. § 153(20).

public telephone systems. Most notably, Internet service providers have come into existence in order to facilitate mass market access to the Internet. A consumer with access to a standard phone line is able to communicate with the Internet, because an ISP converts the analog signal to digital and converts the communication to the IP protocol. This allows the user to access the global Internet infrastructure and communicate with users and websites throughout the world. In a narrowband context, the ISP facilitates access to this global network.

19. The Commission has struggled with how to treat Internet traffic for regulatory purposes, given the bevy of its rules premised on the architecture and characteristics of the mature public switched telephone network. For example, Internet consumers may stay on the network much longer than the design expectations of a network engineered primarily for voice communications. Additionally, the "bursty" nature of packet-switched communications skews the traditional assumptions of per minute pricing to which we are all accustomed. The regulatory challenges have become more acute as Internet usage has exploded.[45]

20. The issue of intercarrier compensation for Internet-bound traffic with which we are presently wrestling is a manifestation of this growing challenge. Traditionally, telephone carriers would interconnect with each other to deliver calls to each other's customers. It was generally assumed that traffic back and forth on these interconnected networks would be relatively balanced. Consequently, to compensate interconnecting carriers, mechanisms like reciprocal compensation were employed, whereby the carrier whose customer initiated the call would pay the other carrier the costs of using its network.

21. Internet usage has distorted the traditional assumptions because traffic to an ISP flows exclusively in one direction, creating an opportunity for regulatory arbitrage and leading to uneconomical results. Because traffic to ISPs flows one way, so does money in a reciprocal compensation regime. It was not long before some LECs saw the opportunity to sign up ISPs as customers and collect, rather than pay, compensation because ISP modems do not generally call anyone in the exchange. In some instances, this led to classic regulatory arbitrage that had two troubling effects: (1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services, potentially driving ISP rates to consumers to uneconomical levels. These effects prompted the Commission to consider the nature of ISP-bound traffic and to examine whether there was any flexibility under the statute to modify and address the pricing mechanisms for this traffic, given that there is a federal statutory provision authorizing reciprocal compensation.[46] In the *Declaratory Ruling,* the Commission concluded that Internet-bound traffic was jurisdictionally interstate and, thus, not subject to section 251(b)(5).

22. In *Bell Atlantic*, the court of appeals vacated the *Declaratory Ruling* and remanded the case to the Commission to determine whether ISP-bound traffic is subject to

[45] *See* Digital Economy 2000, U.S. Department of Commerce (June 2000) ("Three hundred million people now use the Internet, compared to three million in 1994.")

[46] 47 U.S.C. § 251(b)(5).

statutory reciprocal compensation requirements. The court held that the Commission failed to explain adequately why LECs did not have a duty to pay reciprocal compensation under section 251(b)(5) of the Act and remanded the case to the Commission.

B. Statutory Analysis

23. In this section, we reexamine our findings in the *Declaratory Ruling* and conclude that ISP-bound traffic is not subject to the reciprocal compensation requirement in section 251(b) because of the carve-out provision in section 251(g), which excludes several enumerated categories of traffic from the universe of "telecommunications" referred to in section 251(b)(5). We explain our rationale and the interrelationship between these two statutory provisions in more detail below. We further conclude that section 251(i) affirms the Commission's role in continuing to develop appropriate pricing and compensation mechanisms for traffic -- such as Internet-bound traffic -- that travels over convergent, mixed, and new types of network architectures.

1. Introduction

24. In the *Local Competition Order*, the Commission determined that the reciprocal compensation provisions of section 251(b)(5) applied only to what it termed "local" traffic rather than to the transport and termination of interexchange traffic.[47] In the subsequent *Declaratory Ruling,* the Commission focused its discussion on whether ISP-bound traffic terminated within a local calling area such as to be properly considered "local" traffic. To resolve that issue, the Commission focused predominantly on an end-to-end jurisdictional analysis.

25. On review, the court accepted (without necessarily endorsing) the Commission's view that traffic was either "local" or "long distance" but faulted the Commission for failing to explain adequately why ISP-bound traffic was more properly categorized as long distance, rather than local. The Commission had attempted to do so by employing an end-to-end jurisdictional analysis of ISP traffic, rather than by evaluating the traffic under the statutory definitions of "telephone exchange service" and "exchange access." After acknowledging that the Commission "has historically been justified in relying on" end-to-end analysis for determining whether a communication is jurisdictionally interstate, the court stated: "But [the Commission] has yet to provide an explanation of 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."[48] After reviewing the manner in which the Commission analyzed the parameters of section 251(b)(5) traffic in the *Declaratory Ruling*, the court found that the central issue was "whether a call to an ISP is local or long distance."[49] The court noted further that "[n]either category fits clearly."[50]

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[47] *Local Competition Order*, 11 FCC Rcd at 16012.

[48] *Bell Atlantic*, 206 F.3d at 5.

[49] *Id.*

[50] *Id.*

26. Upon further review, we find that the Commission erred in focusing on the nature of the service (*i.e.*, local or long distance) and in stating that there were only two forms of telecommunications services -- telephone exchange service and exchange access -- for purposes of interpreting the relevant scope of section 251(b)(5).[51] Those services are the only two expressly defined by the statute. The court found fault in the Commission's failure to analyze communications delivered by a LEC to an ISP in terms of these definitions.[52] Moreover, it cited the Commission's own confusing treatment of ISP-bound traffic as local under the ESP exemption and interstate for jurisdictional purposes.[53]

27. Part of the ambiguity identified by the court appears to arise from the ESP exemption, a long-standing Commission policy that affords one class of entities using interstate access -- information service providers -- *the option* of purchasing interstate access services on a flat-rated basis from intrastate local business tariffs, rather than from interstate access tariffs used by IXCs. Typically, information service providers have used this exemption to their advantage by choosing to pay local business rates, rather than the tariffed interstate access charges that other users of interstate access are required to pay.[54] In fending off challenges from those who argued that information service providers must be subject to access charges because they provide interexchange service, the Commission has often tried to walk the subtle line of arguing that the service provided by the LEC to the information service provider is an access service, but can justifiably be treated as akin to local telephone exchange service for purposes of the rates the LEC may charge. This balancing act reflected the historical view that there were only two kinds of intercarrier compensation: one for local telephone exchange service, and a second (access charges) for long distance services. Attempting to describe a hybrid service (the nature being an access service, but subject to a compensation mechanism historically limited to local service) was always a bit of mental gymnastics.

28. The court opinion underscores a tension between the jurisdictional nature of ISP-bound traffic, which the Commission has long held to be interstate, and the alternative compensation mechanism that the ESP exemption has permitted for this traffic. The court seems to recognize that, if an end-to-end analysis were properly applied to this traffic, this traffic would be predominantly interstate, and consequently "long distance." Yet it also questions whether this traffic should be considered "local" for purposes of section 251(b)(5) in light of the ESP exemption, by which the Commission has allowed information service providers at their option to be treated for compensation purposes (but *not* for jurisdictional purposes) as end-users.

29. The court also expresses consternation over what it perceives as an inconsistency in the Commission's reasoning. On the one hand, the court observes, the Commission has

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[51] *Id.* at 8.

[52] *Id.* at 8-9.

[53] *Id.*

[54] Significantly, however, the compensation mechanism effected for this predominantly interstate access traffic is the result of a federal mandate, which requires states to treat ISP-bound traffic for compensation purposes in a manner similar to local traffic if ISPs so request. *See infra* note 105.

argued that calls to ISPs are predominantly interstate for jurisdictional purposes because they terminate at the ultimate destination of the traffic in a distant website or e-mail server (*i.e.*, the "one call theory"). On the other hand, the court notes, the Commission has defended the ESP exemption by analogizing an ISP to a high-volume business user, such as a pizza parlor or travel agent, that has different usage patterns and longer call holding times than the average customer.[55] The court questioned whether any such differences should not, as some commenters argued, lend support to treating this traffic as "local" for purposes of section 251(b)(5). As discussed in further detail below, while we continue to believe that retaining the ESP exemption is important in order to facilitate growth of Internet services, we conclude in section IV.C.1, *infra*, that reciprocal compensation for ISP-bound traffic distorts the development of competitive markets.

30. We respond to the court's concerns, and seek to resolve these tensions, by reexamining the grounds for our conclusion that ISP-bound traffic falls outside the scope of section 251(b)(5). A more comprehensive review of the statute reveals that Congress intended to exempt certain enumerated categories of service from section 251(b)(5) when the service was provided to interexchange carriers or information service providers. The exemption focuses not only on the nature of the service, but on to whom the service is provided. For services that qualify, compensation is based on rules, regulations, and policies that preceded the 1996 Act and not on section 251(b)(5), which was minted by the Act. As we explain more fully below, the service provided by LECs to deliver traffic to an ISP constitutes, at a minimum, "information access" under section 251(g) and, thus, compensation for this service is not governed by section 251(b)(5), but instead by the Commission's policies for this traffic and the rules adopted under its section 201 authority.[56]

2. Section 251(g) Excludes Certain Categories of Traffic from the Scope of "Telecommunications" Subject to Section 251(b)(5)

a. Background

31. Section 251(b)(5) imposes a duty on all local exchange carriers to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[57] On its face, local exchange carriers are required to establish reciprocal

[55] *Access Charge Reform Order*, 12 FCC Rcd at 16134 ("Internet access does generate different usage patterns and longer call holding times than average voice usage.").

[56] Some critics of the Commission's order may contend that we rely here on the same reasoning that the court rejected in *Bell Atlantic*. We acknowledge that there is a superficial resemblance between the Commission's previous order and this one: Here, as before, the Commission finds that ISP-bound traffic falls outside the scope of section 251(b)(5)'s reciprocal compensation requirement and within the Commission's access charge jurisdiction under section 201(b). The rationale underlying the two orders, however, differs substantially. Here the Commission bases its conclusion that ISP-bound traffic falls outside section 251(b)(5) on its construction of sections 251(g) and (i) -- not, as in the previous order, on the theory that section 251(b)(5) applies only to "local" telecommunications traffic and that ISP-bound traffic is interstate. Furthermore, to the extent the Commission continues to characterize ISP-bound traffic as interstate for purposes of its section 201 authority, it has sought in this Order to address in detail the *Bell Atlantic* court's concerns.

[57] 47 U.S.C. § 251(b)(5).

compensation arrangements for the transport and termination of *all* "telecommunications" they exchange with another telecommunications carrier, without exception. The Act separately defines "telecommunications" as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[58]

32. Unless subject to further limitation, section 251(b)(5) would require reciprocal compensation for transport and termination of *all* telecommunications traffic, -- *i.e.*, whenever a local exchange carrier exchanges telecommunications traffic with another carrier. Farther down in section 251, however, Congress explicitly exempts certain telecommunications services from the reciprocal compensation obligations. Section 251(g) provides:

> On or after the date of enactment of the Telecommunications Act of 1996, each local exchange carrier . . . shall provide exchange access, *information access*, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the [Federal Communications] Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment.[59]

33. The meaning of section 251(g) is admittedly not transparent. Indeed, section 251(g) clouds any plain reading of section 251(b)(5). Nevertheless, the Commission believes the two provisions can be read together consistently and in a manner faithful to Congress's intent.[60]

b. Discussion

34. We conclude that a reasonable reading of the statute is that Congress intended to exclude the traffic listed in subsection (g) from the reciprocal compensation requirements of subsection (b)(5).[61] Thus, the statute does not mandate reciprocal compensation for "exchange

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[58] 47 U.S.C. § 153(43).

[59] 47 U.S.C. § 251(g) (emphasis added).

[60] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999)("It would be a gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. . . . But Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency. . . . We can only enforce the clear limits that the 1996 Act contains.").

[61] In the *Declaratory Ruling*, the Commission did not explain the relevance of section 251(g) nor discuss the categories of traffic exempted from reciprocal compensation by that provision, at least until the Commission should act otherwise. Reflecting this omission in the underlying order, the *Bell Atlantic* court does not mention the relationship of sections 251(g) and 251(b)(5), nor the enumerated categories of services referenced by subsection (g). Rather, the court focuses its review on the possible categorization of ISP-bound traffic as "local," terminology we now find inappropriate in light of the more express statutory language set forth in section 251(g).

access, information access, and exchange services for such access" provided to IXCs and information service providers. Because we interpret subsection (g) as a carve-out provision, the focus of our inquiry is on the universe of traffic that falls within subsection (g) and *not* the universe of traffic that falls within subsection (b)(5). This analysis differs from our analysis in the *Local Competition Order*, in which we attempted to describe the universe of traffic that falls within subsection (b)(5) as all "local" traffic. We also refrain from generically describing traffic as "local" traffic because the term "local," not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g).

35. We agree with the court that the issue before us requires more than just a jurisdictional analysis. Indeed, as the court recognized, the 1996 Act changed the historic relationship between the states and the federal government with respect to pricing matters.[62] Instead, we focus upon the statutory language of section 251(b) as limited by 251(g). We believe this approach is not only consistent with the statute, but that it resolves the concerns expressed by the court in reviewing our previous analysis. Central to our modified analysis is the recognition that 251(g) is properly viewed as a limitation on the scope of section 251(b)(5) and that ISP-bound traffic falls under one or more of the categories set forth in section 251(g). For that reason, we conclude that ISP-bound traffic is not subject to the reciprocal compensation provisions of section 251(b)(5). We reach that conclusion regardless of the compensation mechanism that may be in place for such traffic under the ESP exemption.

36. We believe that the specific provisions of section 251(g) demonstrate that Congress did not intend to interfere with the Commission's pre-Act authority over "nondiscriminatory interconnection . . . obligations (including receipt of compensation)"[63] with respect to "exchange access, information access, and exchange services for such access" provided to IXCs or information service providers. We conclude that Congress specifically exempted the services enumerated under section 251(g) from the newly imposed reciprocal compensation requirement in order to ensure that section 251(b)(5) is not interpreted to override either existing or future regulations prescribed by the Commission.[64] We also find that ISP-bound traffic falls within at least one of the three enumerated categories in subsection (g).

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[62] *Bell Atlantic*, 206 F.3d at 6; *see also AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 377-87.

[63] Authority over rates (or "receipt of compensation") is a core feature of "equal access and nondiscriminatory interconnection" obligations. Indeed, one of the Commission's primary goals when designing an access charge regime was to ensure that access users were treated in a nondiscriminatory manner when interconnecting with LEC networks in order to transport interstate communications. *See National Ass'n of Regulatory Util. Comm'nrs v. FCC*, 737 F.2d 1095, 1101-1108, 1130-34 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1227 (1985)(*NARUC v. FCC*).

[64] This view is consistent with previous Commission orders construing section 251(g). The Commission recognized in the *Advanced Services Remand Order*, for example, that section 251(g) preserves the requirements of the AT&T Consent Decree (*see United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982)(hereinafter AT&T Consent Decree or Modification of Final Judgment ("MFJ"), but that order does not conclude that section 251(g) preserves *only* MFJ requirements. Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147 et al., Order on Remand, 15 FCC Rcd 385, 407 (1999)(*Advanced Services Remand Order*). Indeed, the ultimate issue addressed in that part of the order was *not* the status or scope of section 251(g) as a carve-out provision at all, but rather the question -- irrelevant for our purposes here -- whether "information access" is a (continued....)

37. This limitation in section 251(g) makes sense when viewed in the overall context of the statute. All of the services specified in section 251(g) have one thing in common: they are all access services or services associated with access.[65] Before Congress enacted the 1996 Act, LECs provided access services to IXCs and to information service providers in order to connect calls that travel to points – both interstate and intrastate – beyond the local exchange. In turn, both the Commission and the states had in place access regimes applicable to this traffic, which they have continued to modify over time. It makes sense that Congress did not intend to disrupt these pre-existing relationships.[66] Accordingly, Congress excluded all such access traffic from the purview of section 251(b)(5).

38. At least one court has already affirmed the principle that the standards and obligations set forth in section 251 are not intended automatically to supersede the Commission's authority over the services enumerated under section 251(g). This question arose in the Eighth Circuit Court of Appeals with respect to the access that LECs provide to IXCs to originate and terminate interstate long-distance calls. Citing section 251(g), the court concluded that the Act contemplates that "LECs will continue to provide exchange access to IXCs for long-distance service, and continue to receive payment, under the *pre-Act* regulations and rates."[67] In

(Continued from previous page)
category of service that is mutually exclusive of "exchange access," as the latter term is defined in section 3(16) of the Act. *See id.* at 407-08; *see also infra* para. 42 & note 76. By contrast, when the Commission first addressed the scope of the reciprocal compensation obligations of section 251(b)(5) in the *Local Competition Order*, it expressly cited section 251(g) in support of the decision to exempt from those obligations the tariffed interstate access services provided by all LECs (not just Bell companies subject to the MFJ) to interexchange carriers. 11 FCC Rcd at 16013. The *Bell Atlantic* court did not take issue with the Commission's earlier conclusion that section 251(b)(5) is so limited. 206 F.3d at 4. The interpretation we adopt here -- that section 251(g) exempts from section 251(b)(5) information access services provided to information service providers, as well as access provided to IXCs – thus is fully consistent with the Commission's initial construction of section 251(g), in the *Local Competition Order,* as extending beyond the MFJ to *our own* access rules and policies.

[65] The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ. Rather, the term "exchange service" is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purpose of originating or terminating interexchange telecommunications." *United States v. AT&T*, 552 F. Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. Consistent with that, in section 251(g), the term is used as part of the longer phrase "exchange services for such [exchange] access to interexchange carriers and information service providers." The phrasing in section 251(g) thus parallels the MFJ. All of this indicates that the term "exchange service" is closely related to the provision of exchange access and information access.

[66] Although section 251(g) does not itself compel this outcome with respect to *intrastate* access regimes (because it expressly preserves only *the Commission's* traditional policies and authority over *interstate* access services), it nevertheless highlights an ambiguity in the scope of "telecommunications" subject to section 251(b)(5) -- demonstrating that the term must be construed in light of other provisions in the statute. In this regard, we again conclude that it is reasonable to interpret section 251(b)(5) to exclude traffic subject to parallel intrastate access regulations, because "it would be incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms." *Local Competition Order*, 11 FCC Rcd at 15869.

[67] *CompTel*, 117 F.3d at 1073 (emphasis added). The court continued that the Commission would be free under section 201 to alter its traditional regulatory treatment of interstate access service in the future, but that the standards set out in sections 251 and 252 would *not* be controlling. *Id.*

CompTel, the IXCs had argued that the interstate access services that LECs provide properly fell within the scope of "interconnection" under section 251(c)(2), and that, notwithstanding the carve-out of section 251(g), access charges therefore should be governed by the cost-based standard of section 252(d)(1), rather than determined under the Commission's section 201 authority. The Eighth Circuit rejected that argument, holding that access service does not fall within the scope of section 251(c)(2), and observing that "it is clear from the Act that Congress did *not* intend all access charges to move to cost-based pricing, at least not immediately."[68] Neither the court nor the parties in *CompTel* distinguished between the situation in which *one LEC* provides access service (directly linking the end-user to the IXC) and the situation here in which *two LECs* collaborate to provide access to either an information service provider or IXC. In both circumstances, by its underlying rationale, *CompTel* serves as precedent for establishing that pre-existing regulatory treatment of the services enumerated under section 251(g) are carved out from the purview of section 251(b).

39. Accordingly, unless and until the Commission by regulation should determine otherwise, Congress preserved the pre-Act regulatory treatment of all the access services enumerated under section 251(g). These services thus remain subject to Commission jurisdiction under section 201 (or, to the extent they are *intra*state services, they remain subject to the jurisdiction of state commissions), whether those obligations implicate pricing policies as in *CompTel* or reciprocal compensation.[69] This analysis properly applies to the access services that incumbent LECs provide (either individually or jointly with other local carriers) to connect subscribers with ISPs for Internet-bound traffic. Section 251(g) expressly preserves the Commission's rules and policies governing "access . . . to information service providers" in the same manner as rules and policies governing access to IXCs.[70] As we discuss in more detail

[68] *CompTel*, 117 F.3d at 1072 (emphasis added).

[69] For further discussion of the jurisdictionally interstate nature of ISP-bound traffic, *see infra* paras. 55-64. *See also NARUC v. FCC*, 737 F.2d at 1136 (determining that traffic to ESPs may properly constitute interstate access traffic); Access Billing Requirements for Joint Service Provision, CC Docket 87-579, Memorandum Opinion and Order, 4 FCC Rcd 7183 (1989).

[70] The Commission has historically dictated the pricing policies applicable to services provided by LECs to information service providers, although those policies differ from those applicable to LEC provision of access services to IXCs. Prior to the 1996 Act, it was the Commission that determined that ESPs either may purchase their interstate access services from interstate tariffs or (at their discretion) pay a combination of local business line rates, the *federal* subscriber line charges associated with those business lines, and, where appropriate, the *federal* special access surcharge. *See* note 105, *infra*. We conclude that section 251(g) preserves our ability to continue to dictate the pricing policies applicable to this category of traffic. We do not believe, moreover, that section 251(g) extends only to those specific carriers providing service on February 7, 1996. At the very least, subsection (g) is ambiguous on this point. On the one hand, the first sentence of this provision states that its terms apply to "each local exchange carrier, to the extent that it provides wireline services," without regard to whether it may be a BOC or a competitive LEC. 47 U.S.C. § 251(g). On the other hand, that same sentence refers to restrictions and obligations applicable to "such carrier" prior to February 8, 1996. *Id.* We believe that the most reasonable interpretation of that sentence, in this context, is that subsection (g) was intended to preserve pre-existing regulatory treatment for the enumerated *categories* of carriers, rather than requiring disparate treatment depending upon whether the LEC involved came into existence before or after February 1996.

below, ISP-bound traffic falls under the rubric of "information access," a legacy term carried over from the MFJ.[71]

40. By its express terms, of course, section 251(g) permits the Commission to supersede pre-Act requirements for interstate access services. Therefore the Commission may make an affirmative determination to adopt rules that subject such traffic to obligations different than those that existed pre-Act. For example, consistent with that authority, the Commission has previously made the affirmative determination that certain categories of interstate access traffic should be subject to section 251(c)(4).[72] Similarly, in implementing section 251(c)(3), the Commission has required incumbent LECs to unbundle certain network elements used in the provision of xDSL-based services.[73] In this instance, however, for the reasons set forth below,[74] we decline to modify the restraints imposed by section 251(g) and instead continue to regulate ISP-bound traffic under section 201.

41. Some may argue that, although the Commission did not analyze subsection (g) in the *Declaratory Ruling,* a passing reference to section 251(g) in one paragraph of the Commission's brief filed with the court in that proceeding suggests that the argument we make here has been specifically rejected by the court. We disagree. Because our analysis of subsection (g) was not raised in the order, the court, under established precedent, probably did not consider the argument when rendering its decision.[75] Indeed, subsection (g) is not mentioned in the court's opinion.

3. ISP-Bound Traffic Falls within the Categories Enumerated in Section 251(g)

42. Having determined that section 251(g) serves as a limitation on the scope of "telecommunications" embraced by section 251(b)(5), the next step in our inquiry is to determine whether ISP-bound traffic falls within one or more of the categories specified in section 251(g): exchange access, information access, and exchange services for such access provided to IXCs and information service providers. Regardless of whether this traffic falls under the category of

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[71] *See United States v. AT&T,* 552 F. Supp. at 229; *Advanced Services Remand Order*, 15 FCC Rcd at 406-08.

[72] *See* Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, Second Report and Order, 14 FCC Rcd 19237 (1997), *petition for review pending, Ass'n of Communications Enterprises v. FCC*, D.C. Circuit No. 00-1144. In effect, we have provided for concurrent authority under that provision and section 201 by permitting a party to purchase the same service under filed tariffs or to proceed under interconnection arrangements to secure resale services.

[73] *See* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3775 (1999). *See also Advanced Services Remand Order,* 15 FCC Rcd at 385, 386. We emphasize that these two examples are illustrative and may not be the only instances where the Commission chooses to supersede pre-Act requirements for interstate access services.

[74] *See infra* paras. 67-71.

[75] *See, e.g., SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943).

"exchange access" -- an issue pending before the D.C. Circuit in a separate proceeding[76] - - we conclude that this traffic, at a minimum, falls under the rubric of "information access," a legacy term imported into the 1996 Act from the MFJ, but not expressly defined in the Communications Act.

a. Background

43. Section 251(g) by its terms indicates that, in the provision of exchange access, information access, and exchange services for such access to IXCs and information service providers, various pre-existing requirements and obligations "including receipt of compensation" are preserved, whether these obligations stem from "any court order, *consent decree*, or regulation, order or policy of the Commission." (Emphasis added.) Similarly, in discussing this provision, the Joint Explanatory Statement of the Committee of Conference explicitly refers to preserving the obligations under the "AT&T Consent Decree."[77]

b. Discussion

44. We conclude that Congress's reference to "information access" in section 251(g) was intended to incorporate the meaning of the phrase "information access" as used in the AT&T Consent Decree.[78] The ISP-bound traffic at issue here falls within that category because it is traffic destined for an information service provider.[79] Under the consent decree, "information access" was purchased by "information service providers" and was defined as "the provision of specialized exchange telecommunications services . . . in connection with the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services."[80] We conclude that this definition of "information access" was meant to include all access traffic that was routed by a LEC "to or from" providers of information services, of which ISPs are a subset.[81] The record in this

[76] *See Worldcom, Inc. v. FCC*, No. 00-1022 et al. (D.C. Cir.). In that proceeding, the Commission has argued that the category previously labeled "information access" under the MFJ is a subset of those services now falling under the category "exchange access" as set forth in section 3(16) of the Act, 47 U.S.C. 153(16), while incumbent LECs and others have argued that the two categories are mutually exclusive. We need not reargue here whether "information access" is a subset of "exchange access" or whether instead they are mutually exclusive categories. The only issue relevant to our section 251(g) inquiry in this case is whether ISP-bound traffic falls, at a minimum, within the legacy category of "information access." Both the Commission and incumbent LECs have agreed that the access provided to ISPs satisfies the definition of information access.

[77] *Joint Explanatory Statement of the Committee of Conference*, S. Conf. Rep. No. 230, 104th Cong., 2d Session at 123 (February 1, 1996).

[78] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[79] *See* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000)(stating that section 251(g) applies by its very terms to "information access").

[80] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[81] This finding is consistent with our past statements on the issue. In the *Non-Accounting Safeguards Order*, we found that the access that LECs provide to enhanced service providers, including ISPs, constitutes "information access" as the MFJ defines that term. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed (continued....)

proceeding also supports our interpretation.[82] When Congress passed the 1996 Act, it adopted new terminology. The term "information access" is not, therefore, part of the new statutory framework. Because the legacy term "information access" in section 251(g) encompasses ISP-bound traffic, however, this traffic is excepted from the scope of the "telecommunications" subject to reciprocal compensation under section 251(b)(5).

45. We recognize, as noted earlier, that based on the rationale of the *Declaratory Ruling*, the court indicated that the question whether this traffic was "local or interstate" was critical to a determination of whether ISP-bound traffic should be subject to reciprocal compensation.[83] We believe that the court's assessment was a result of our statement in paragraph nine of the *Declaratory Ruling* that "when two carriers collaborate to complete a *local call*, the originating carrier is compensated by its end user and the terminating carrier is entitled to reciprocal compensation pursuant to section 251(b)(5) of the Act."[84] We were mistaken to have characterized the issue in that manner, rather than properly (and more naturally) interpreting the scope of "telecommunications" within section 251(b)(5) as being limited by section 251(g). By indicating that all "local calls," however defined, would be subject to reciprocal compensation obligations under the Act, we overlooked the interplay between these two inter-related provisions of section 251 -- subsections (b) and (g). Further, we created unnecessary ambiguity for ourselves, and the court, because the statute does not define the term "local call," and thus that term could be interpreted as meaning either traffic subject to local *rates* or traffic that is *jurisdictionally* intrastate. In the context of ISP-bound traffic, as the court observed, our use of the term "local" created a tension that undermined the prior order because the ESP

(Continued from previous page)
Rulemaking, 11 FCC Rcd 21905, 22024 & n.621 (1996). Although we subsequently overruled our statement in that order that ISPs do not also purchase "exchange access" under section 3(16), we have not altered our finding that the access provided to enhanced service providers (including ISPs) is "information access." *Advanced Services Remand Order*, 15 FCC Rcd at 404-05.

[82] *See, e.g.*, Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000). Some have argued that "information access" includes only certain specialized functions unique to the needs of enhanced service providers and does not include basic telecommunications links used to provide enhanced service providers with access to the LEC network. *See, e.g.*, Brief of WorldCom, Inc., D.C. Circuit No. 00-1002, *et al.*, filed Oct. 3, 2000, at 16 n.12. The MFJ definition of information access, however, includes the telecommunications links used for the "origination, termination, [and] transmission" of information services, *and* "*where necessary*, the provision of network signalling" and other functions. *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Others have argued that the "information access" definition engrafts a geographic limitation that renders this service category a subset of telephone exchange service. *See* Letter from Richard Rindler, Swindler, Berlin, to Magalie Roman Salas, Secretary, FCC, at 3 (Apr. 12, 2001). We reject that strained interpretation. Although it is true that "information access" is necessarily initiated "in an exchange area," the MFJ definition states that the service is provided "*in connection with* the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services" *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Significantly, the definition does not further require that the transmission, once handed over to the information service provider, terminate within the same exchange area in which the information service provider first received the access traffic.

[83] *Bell Atlantic*, 206 F.3d at 5.

[84] *Declaratory Ruling*, 14 FCC Rcd at 3695 (emphasis added).

exemption permitted ISPs to purchase access through local business tariffs,[85] yet the jurisdictional nature of this traffic has long been recognized as interstate.

46. For similar reasons, we modify our analysis and conclusion in the *Local Competition Order*.[86] There we held that "[t]ransport and termination of *local* traffic for purposes of reciprocal compensation are governed by sections 251(b)(5) and 251(d)(2)." We now hold that the telecommunications subject to those provisions are all such telecommunications not excluded by section 251(g). In the *Local Competition Order*, as in the subsequent *Declaratory Ruling*, use of the phrase "local traffic" created unnecessary ambiguities, and we correct that mistake here.

47. We note that the exchange of traffic between LECs and commercial mobile radio service (CMRS) providers is subject to a slightly different analysis. In the *Local Competition Order,* the Commission noted its jurisdiction to regulate LEC-CMRS interconnection under section 332 of the Act[87] but decided, at its option, to apply sections 251 and 252 to LEC-CMRS interconnection.[88] At that time, the Commission declined to delineate the precise contours of or the relationship between its jurisdiction over LEC-CMRS interconnection under sections 251 and 332,[89] but it made clear that it was not rejecting section 332 as an independent basis for jurisdiction.[90] The Commission went on to conclude that section 251(b)(5) obligations extend to traffic transmitted between LECs and CMRS providers, because the latter are telecommunications carriers.[91] The Commission also held that reciprocal compensation, rather than interstate or intrastate access charges, applies to LEC-CMRS traffic that originates and terminates within the same Major Trading Area (MTA).[92] In so holding, the Commission expressly relied on its "authority under section 251(g) to preserve the current interstate access charge regime" to ensure that interstate access charges would be assessed only for traffic "currently subject to interstate access charges,"[93] although the Commission's section 332 jurisdiction could serve as an alternative basis to reach this result. Thus the analysis we adopt in this Order, that section 251(g) limits the scope of section 251(b)(5), does not affect either the

[85] This is the compensation mechanism chosen by the ISPs. *See* note 105, *infra*.

[86] *Local Competition Order*, 11 FCC Rcd at 1033-34.

[87] 47 U.S.C. § 332; *Local Competition Order*, 11 FCC Rcd at 16005-06.

[88] *Local Competition Order*, 11 FCC Rcd at 16005-06; *see also Iowa Utils. Bd. v. FCC*, 120 F.3d at 800 n. 21 (finding that the Commission had jurisdiction under section 332 to issue rules regarding LEC-CMRS interconnection, including reciprocal compensation rules).

[89] We seek comment on these issues in the *NPRM*.

[90] *Local Competition Order*, 11 FCC Rcd at 16005.

[91] *Id.* at 16016.

[92] *Id.* at 16016-17.

[93] *Id.* at 16017.

application of the latter section to LEC-CMRS interconnection or our jurisdiction over LEC-CMRS interconnection under section 332.

4. Section 251(i) Preserves the Commission's Authority to Regulate Interstate Access Services

48. Congress also included a "savings provision" – subpart (i) – in section 251, which provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[94] Under section 201, the Commission has the authority to regulate the *interstate* access services that LECs provide to connect end-users with IXCs or information service providers to originate and terminate calls that travel across state lines.

49. We conclude that subpart (i) provides additional support for our finding that Congress has granted us the authority on a going-forward basis to establish a compensation regime for ISP-bound traffic.[95] When read as a whole, the most natural reading of section 251 is as follows: subsection (b) sets forth reciprocal compensation requirements for the transport and termination of "telecommunications"; subsection (g) excludes certain access services (including ISP-bound traffic) from that requirement; and subsection (i) ensures that, on a going-forward basis, the Commission has the authority to establish pricing for, and otherwise to regulate, interstate access services.

50. When viewed in the overall context of section 251, subsections (g) and (i) serve compatible, but different, purposes. Subsection (g) preserves rules and regulations that existed at the time Congress passed the 1996 Act, and thus functions primarily as a "backward-looking" provision (although it does grant the Commission the authority to supersede existing regulations). In contrast, we interpret section 251(i) to be a "forward-looking" provision. Thus, subsection (i) expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201. This reading of section 251 is consistent with the notion that section 251 generally broadens the Commission's duties, particularly in the pricing context.[96]

51. We expect that, as new network architectures emerge, the nature of telecommunications traffic will continue to evolve. As we have already observed, since Congress passed the 1996 Act, customer usage patterns have changed dramatically; carriers are sending traffic over networks in new and different formats; and manufacturers are adding creative features and developing innovative network architectures. Although we cannot

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[94] 47 U.S.C. § 251(i).

[95] *See also* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 8 (Dec. 14, 2000).

[96] For example, section 251 has expanded upon our historic functions by providing us with the authority to set the framework for pricing rules applicable to unbundled network elements, purchased under interconnection agreements.

anticipate the direction that new technology will take us, we do expect the dramatic pace of change to continue. Congress clearly did not expect the dynamic, digital broadband driven telecommunications marketplace to be hindered by rules premised on legacy networks and technological assumptions that are no longer valid. Section 251(i), together with section 201, equips the Commission with the tools to ensure that the regulatory environment keeps pace with innovation.

5. ISP-Bound Traffic Falls Within the Purview of the Commission's Section 201 Authority

52. Having found that ISP-bound traffic is excluded from section 251(b)(5) by section 251(g), we find that the Commission has the authority pursuant to section 201 to establish rules governing intercarrier compensation for such traffic. Under section 201, the Commission has long exercised its *jurisdictional* authority to regulate the interstate access services that LECs provide to connect callers with IXCs or ISPs to originate or terminate calls that travel across state lines. Access services to ISPs for Internet-bound traffic are no exception. The Commission has held, and the Eighth Circuit has recently concurred, that traffic bound for information service providers (including Internet access traffic) often has an interstate component.[97] Indeed, that court observed that, although some traffic destined for information service providers (including ISPs) may be intrastate, the interstate and intrastate components cannot be reliably separated.[98] Thus, ISP traffic is properly classified as interstate,[99] and it falls under the Commission's section 201 jurisdiction.[100]

53. In its opinion remanding this proceeding, the court appeared to acknowledge that the end-to-end analysis was appropriate for determining the scope of the Commission's jurisdiction under section 201, stating that "[t]here is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[101] The court nevertheless found that we had not supplied a logical nexus between the jurisdictional end-to-end analysis (which delineates the contours of our section 201 authority) and our interpretation of the scope of section 251(b)(5). In that regard, the court appeared not to question the Commission's longstanding assertion of jurisdiction over ESP traffic, of which Internet-bound traffic is a subset.[102] It did, however, unambiguously question whether, for purposes of interpreting section 251(b)(5), the

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[97] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 543 (8th Cir. 1998) (affirming the jurisdictionally mixed nature of ISP-bound traffic).

[98] *Id.*

[99] *See, e.g., Louisiana PSC v. FCC*, 476 U.S. 355, 375 n.4.

[100] *See* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC (Dec. 8, 2000)(attaching *A Legal Roadmap for Implementing a Bill and Keep Rule for All Wireline Traffic*, at 10-11)(*Qwest Roadmap*).

[101] *Bell Atlantic*, 206 F.3d at 5; *see Qwest Roadmap* at 4.

[102] The D.C. Circuit itself has long recognized that ESPs use interstate access. *See, e.g., NARUC v. FCC*, 737 F.2d at 1136.

jurisdictional end-to-end analysis was dispositive. Accordingly, the court explained its basis for remand as follows: "Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling [in interpreting the scope of section 251(b)(5)] . . . we must vacate the ruling and remand the case."[103]

54. As explained above, we no longer construe section 251(b)(5) using the dichotomy set forth in the *Declaratory Ruling* between "local" traffic and interstate traffic. Rather, we have clarified that the proper analysis hinges on section 251(g), which limits the reach of the reciprocal compensation regime mandated in section 251(b). Thus our discussion no longer centers on the jurisdictional inquiry set forth in the underlying order. Nonetheless, we take this opportunity to respond to questions raised by the court regarding the differences between ISP-bound traffic (which we have always held to be predominantly interstate for jurisdictional purposes) and intrastate calls to "communications-intensive business end user[s],"[104] such as travel agencies and pizza parlors.

55. Contrary to the arguments made by some IXCs, the Commission has been consistent in its jurisdictional treatment of ISP-bound traffic. For compensation purposes, in order to create a regulatory environment that will allow new and innovative services to flourish, the Commission has exempted enhanced service providers (including ISPs) from paying for interstate access service at the usage-based rates charged to IXCs.[105] The ESP exemption was and remains an affirmative *exercise* of federal regulatory authority over interstate access service under section 201, and, in affirming pricing under that exemption, the D.C. Circuit expressly recognized that ESPs use *interstate* access service.[106] Moreover, notwithstanding the ESP exemption, the Commission has always *permitted* enhanced service providers, including ISPs, to purchase their interstate access out of interstate tariffs -- thus underscoring the Commission's

[103] *Bell Atlantic*, 206 F.3d. at 8.

[104] *Bell Atlantic*, 206 F.3d at 7.

[105] As noted, the Commission has permitted ESPs to pay local business line rates from intrastate tariffs for ILEC-provided access service, in lieu of interstate carrier access charges. *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 715; *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. ESPs also pay the *federal* subscriber lines charges associated with those business lines and, where appropriate, the *federal* special access surcharge. The subscriber line charge (SLC) recovers a portion of the cost of a subscriber's line that is allocated, pursuant to jurisdictional separations, to the interstate jurisdiction. *See* 47 C.F.R. § 69.152 (defining SLC); 47 C.F.R. Part 36 (jurisdictional separations). The special access surcharge recovers for use of the local exchange when private line/PBX owners "circumvent the conventional long-distance network and yet achieve interstate connections beyond those envisioned by the private line service." *NARUC v. FCC*, 737 F.2d at 1138. *See* 47 C.F.R. § 69.115.

[106] With judicial approval, the Commission initially adopted this access service pricing policy in order to avoid rate shock to a fledgling enhanced services industry. *NARUC v. FCC*, 737 F.2d at 1136-37. In the decision affirming this pricing policy, the court expressly recognized that ESPs use interstate access service. *Id.* at 1136 (enhanced service providers "may, at times, heavily use exchange access"). The Commission recently decided to retain this policy, largely because it found that it made little sense to mandate, for the first time, the application of existing non-cost-based interstate access rates to enhanced services just as the Commission was reforming the access charge regime to eliminate implicit subsidies and to move such charges toward competitive levels. *Access Charge Reform Order*, 12 FCC Rcd at 16133, *aff'd, Southwestern Bell Telephone Co.*, 153 F.3d at 541-42.

consistent view that the link LECs provide to connect subscribers with ESPs is an interstate access service.[107]

56. We do not believe that the court's decision to remand the *Declaratory Ruling* reflects a finding that such traffic constitutes two calls, rather than a single end-to-end call, for jurisdictional purposes. The court expressly acknowledged that "the end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction."[108] The court also said that "[t]here is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[109] And the court appeared to suggest, at least for the sake of argument, that the Commission had not misapplied that analysis *as a jurisdictional matter* in finding that ISP-bound traffic was interstate.[110] We do recognize, however, that the court was concerned by how one would categorize this traffic under our *prior* interpretation of section 251(b)(5), which focused on whether or not ISP-bound calls were "local." That inquiry arguably implicated the compensation mechanism for the traffic (which included a local component), as well as the meaning of the term "termination" in the specific context of section 251(b); but neither of these issues is germane to our assertion of jurisdiction here under our section 201 authority.

57. For jurisdictional purposes, the Commission views LEC-provided access to enhanced services providers, including ISPs, on the basis of the end points of the communication, rather than intermediate points of switching or exchanges between carriers (or other providers).[111] Thus, in the *ONA Plans Order*, the Commission emphasized that "when an enhanced service is interstate (that is, when it involves communications or transmissions between points in different states on an end-to-end basis), the underlying basic services are subject to [our jurisdiction]."[112] Consistent with that view, when end-to-end communications involving

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[107] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711-12, 722; Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Memorandum Opinion and Order, 4 FCC Rd 1, 141 (1988), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993) (*ONA Plans Order*); GTE Telephone Operating Cos., CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466 (1998).

[108] *Bell Atlantic*, 206 F.3d at 3.

[109] *Id. at 5.*

[110] *See, e.g., id.* at 6, 7 (accepting, *arguendo*, that ISP-bound traffic is like IXC-bound traffic for jurisdictional purposes).

[111] *See, e.g., BellSouth MemoryCall*, 7 FCC Rcd at 1620 (voicemail is interstate because "there is a continuous path of communications across state line between the caller and the voice mail service"); *ONA Plans Order*, 4 FCC Rcd at 141 (an enhanced service is subject to FCC authority if it is interstate, "that is, when it involves communications or transmissions between points in different states on an end-to-end basis").

[112] *ONA Plans Order*, 4 FCC Rcd at 141; *see also id.*, Memorandum Opinion and Order on Reconsideration, 5 FCC Rcd 3084, 3088-89 (1990), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993)(rejecting claim that basic service elements, consisting of features and functions provided by telephone company's local switch for benefit of enhanced service providers and others, are separate *intra*state offerings even when used in connection with end-to-end transmissions).

enhanced service providers cross state lines, the Commission has categorized the link that the LEC provides to connect the end-user with an enhanced service provider as interstate access service.[113] Internet service providers are a class of ESPs. Accordingly, the LEC-provided link between an end-user and an ISP is properly characterized as *interstate* access.[114]

58. Most Internet-bound traffic traveling between a LEC's subscriber and an ISP is indisputably interstate in nature when viewed on an end-to-end basis. Users on the Internet are interacting with a global network of connected computers. The consumer contracts with an ISP to provide access to the Internet. Typically, when the customer wishes to interact with a person, content, or computer, the customer's computer calls a number provided by the ISP that is assigned to an ISP modem bank. The ISP modem answers the call (the familiar squelch of computers handshaking). The user initiates a communication over the Internet by transmitting a command. In the case of the web, the user requests a webpage. This request may be sent to the computer that hosts the webpage. In real time, the web host may request that different pieces of that webpage, which can be stored on different servers across the Internet, be sent, also in real time, to the user. For example, on a sports page, only the format of the webpage may be stored at the host computer in Chicago. The advertisement may come from a computer in California (and it may be a different advertisement each time the page is requested), the sports scores may come from a computer in New York City, and a part of the webpage that measures Internet traffic and records the user's visit may involve a computer in Virginia. If the user decides to buy something from this webpage, say a sports jersey, the user clicks on the purchase page and may be transferred to a secure web server in Maryland for the transaction. A single web address frequently results in the return of information from multiple computers in various locations globally. These different pieces of the webpage will be sent to the user over different network paths and assembled on the user's display.[115]

59. The "communication" taking place is between the dial-up customer and the global computer network of web content, e-mail authors, game room participants, databases, or bulletin board contributors. Consumers would be perplexed to learn regulators believe they are communicating with ISP modems, rather than the buddies on their e-mail lists. The proper focus for identifying a communication needs to be the user interacting with a desired webpage, friend, game, or chat room, not on the increasingly mystifying technical and mechanical activity in the middle that makes the communication possible.[116] ISPs, in most cases, provide services that

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[113] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711 ("[a]mong the variety of users of access service are ... enhanced service providers"); Amendment of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305, 4305, 4306 (1987) (noting that enhanced service providers use "exchange access service"); *ESP Exemption Order*, 3 FCC Rcd at 2631 (referring to "certain classes of exchange access users, including enhanced service providers").

[114] *See, e.g., Access Charge Reform Order*, 12 FCC Rcd at 16131-32; GTE Telephone Operating Cos., 13 FCC Rcd at 22478. *Cf. Bell Atlantic*, 206 F.3d at 4, 6-7.

[115] Of course, the Internet provides applications other than the World Wide Web, such as e-mail, games, chat sites, or streaming media, which have different technical characteristics but all of which involve computers in multiple locations, often across state and national boundaries.

[116] *See Qwest Roadmap* at 4-5, 9-10.

permit the dial-up Internet user to communicate directly with some distant site or party (other than the ISP) that the caller has specified.

60. ISP service is analogous, though not identical, to long distance calling service. An AT&T long distance customer contracts with AT&T to facilitate communications to out-of-state locations. The customer uses the local network to reach AT&T's facilities (its point of presence). By dialing "1" and an area code, the customer is in essence addressing his call to an out of state party and is instructing his LEC to deliver the call to his long distance carrier, and instructing the long distance carrier to pick up and carry that call to his intended destination. The caller on the other end will pick up the phone and respond to the caller. The communication will be between these two end-users. This analogy is not meant to prove that ISP service is identical to long distance service, but is used merely to bolster, by analogy, the reasonableness of not characterizing an ISP as the destination of a call, but as a facilitator of communication.

61. Moreover, as the local exchange carriers have correctly observed, the technical configurations for establishing dial-up Internet connections are quite similar to certain network configurations employed to initiate more traditional long-distance calls.[117] In most cases, an ISP's customer first dials a seven-digit number to connect to the ISP server before connecting to a website. Long-distance service in some network configurations is initiated in a substantially similar manner. In particular, under "Feature Group A" access, the caller first dials a seven-digit number to reach the IXC, and then dials a password and the called party's area code and number to complete the call. Notwithstanding this dialing sequence, the service the LEC provides is considered *interstate* access service, not a separate local call.[118] Internet calls operate in a similar manner: after reaching the ISP's server by dialing a seven-digit number, the caller selects a website (which is identified by a 12-digit Internet address, but which often is, in effect, "speed dialed" by clicking an icon) and the ISP connects the caller to the selected website. Such calling should yield the same jurisdictional result as the analogous calls to IXCs using "Feature Group A" access.

62. Commission precedent also rejects the two-call theory in the context of calls involving enhanced services. In *BellSouth MemoryCall*, the Commission preempted a state commission order that had prohibited BellSouth from expanding its voice mail service -- an enhanced service -- beyond its existing customers.[119] In doing so, it rejected claims by the state that the Commission lacked jurisdiction to preempt because, allegedly, out-of-state calls to the voice mail service really constituted two calls: an *inter*state call from the out-of-state caller to the telephone company switch that routes the call to the intended recipient's location, and a separate *intra*state call that forwards the communication from the switch to the voice mail apparatus in the event that the called party did not answer.[120] The Commission explained that,

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[117] *See, e.g.*, Verizon Remand Reply at 9 (Internet traffic is indistinguishable from Feature Group A access service).

[118] *See Local Competition Order*, 11 FCC Rcd at 15935 n. 2091 (describing "Feature Group A" access service); *see also MCI Telecomm. Corp. v. FCC*, 566 F.2d 365, 367 n.3 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978).

[119] *BellSouth MemoryCall*, 7 FCC Rcd at 1619.

[120] *Id.* at 1620.

whether a basic telecommunications service is at issue, or whether an enhanced service rides on the telephone company's telecommunications service, the Commission's jurisdiction does not end at the local switchboard, but continues to the ultimate destination of the call.[121]

63. The Internet communication is not analogous to traditional telephone exchange services. Local calls set up communication between two parties that reside in the same local calling area. Prior to the introduction of local competition, that call would never leave the network of the incumbent LEC. As other carriers were permitted to enter the local market, a call might cross two or more carriers' networks simply because the two parties to the communication subscribed to two different local carriers. The two parties intending to communicate, however, remained squarely in the same local calling area. An Internet communication is not simply a local call from a consumer to a machine that is lopsided, that is, a local call where one party does most of the calling, or most of the talking. ISPs are service providers that technically modify and translate communication, so that their customers will be able to interact with computers across the global Internet.[122]

64. The court in *Bell Atlantic* noted that FCC litigation counsel had differentiated ISP-bound traffic from ordinary long-distance calls by stating that the former "is really like a call to a local business" -- such as a pizza delivery firm, a travel reservation agency, a credit card verification firm, or a taxicab company -- "that then uses the telephone to order wares to meet the need."[123] We find, however, that this citation to a former litigation position does not require us to alter our analysis. First, the Commission itself has never analogized ISP-bound traffic in the manner cited in the agency's brief in *Southwestern Bell*. Indeed, in the particular order that the Commission was defending in *Southwestern Bell*, the Commission distinguished ISP-bound traffic from other access traffic on *other* grounds -- *e.g.*, call direction and call holding times[124] -- which have no arguable bearing on whether the traffic is one interstate call (as the Commission has always held) or two separate calls (one of which allegedly is intrastate) as some parties have contended. Second, the cited portion of the Commission's brief was not addressing jurisdiction at all. Rather, the brief was responding to a claim that the ESP exemption *discriminated* against IXCs and in favor of ISPs.[125] Finally, in the very case in which litigation counsel made the cited analogy, the Eighth Circuit affirmed the Commission's consistent view that ISP-bound traffic is, as a *jurisdictional* matter, predominantly interstate.[126] In any event, to the extent that our prior briefs could be read to conceptualize the nature of ISP service as local, akin to intense users of

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[121] *Id.* at 1621.

[122] It is important to note that a dial-up call to an ISP will not even be required when broadband services arrive. Those connections will be always on and there will be no phone call in any traditional sense. Indeed, the only initiating event will be the end-user interacting with other Internet content or users. Thus, increasingly, notions of two calls become meaningless.

[123] *Bell Atlantic*, 206 F.3d at 8 (citing FCC Brief at 76, *Southwestern Bell v. FCC*, 153 F.3d 523).

[124] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34.

[125] *See* FCC Brief at 75-76, *Southwestern Bell v. FCC*, 153 F.3d 523.

[126] *Southwestern Bell v. FCC*, 153 F.3d at 534.

local service, we now embrace a different conceptualization that we believe more accurately reflects the nature of ISP service.

65. For the foregoing reasons, consistent with our longstanding precedent, we find that we continue to have jurisdiction under section 201, as preserved by section 251(i), to provide a compensation mechanism for ISP-bound traffic.

C. Efficient Intercarrier Compensation Rates and Rate Structures

66. Carriers currently recover the costs of call transport and termination through some combination of carrier access charges, reciprocal compensation, and end-user charges, depending upon the applicable regulatory regime. Having concluded that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5), we must now determine, pursuant to our section 201 authority, what compensation mechanism is appropriate when carriers collaborate to deliver calls to ISPs. In the companion *NPRM*, we consider the desirability of adopting a uniform intercarrier compensation mechanism, applicable to all traffic exchanged among telecommunications carriers, and, in that context, we intend to examine the merits of a bill and keep regime for all types of traffic, including ISP-bound traffic. In the meantime, however, we must adopt an interim intercarrier compensation rule to govern the exchange of ISP-bound traffic, pending the outcome of the *NPRM*. In particular, we must decide whether to impose (i) a "calling-party's-network-pays" (CPNP) regime, like reciprocal compensation, in which the calling party's network pays the network serving the ISP; (ii) a bill and keep regime in which all networks recover costs from their end-user customers and are obligated to deliver calls that originate on the networks of interconnecting carriers; or (iii) some other cost recovery mechanism. As set forth more fully below, our immediate goal in adopting an interim compensation mechanism is to address the market distortions created by the prevailing intercarrier compensation regime, even as we evaluate in a parallel proceeding what longer-term intercarrier compensation mechanisms are appropriate for this and other types of traffic.

1. CPNP Regimes Have Distorted the Development of Competitive Markets

67. For the reasons detailed below, we believe that a bill and keep approach to recovering the costs of delivering ISP-bound traffic is likely to be more economically efficient than recovering these costs from originating carriers. In particular, requiring carriers to recover the costs of delivering traffic to ISP customers directly from those customers is likely to send appropriate market signals and substantially eliminate existing opportunities for regulatory arbitrage. As noted above, we consider issues related to the broader application of bill and keep as an intercarrier compensation regime in conjunction with the *NPRM* that we are adopting concurrently with this Order. In this Order, however, we adopt an interim compensation mechanism for the delivery of ISP-bound traffic that addresses the regulatory arbitrage opportunities present in the existing carrier-to-carrier payments by limiting carriers' opportunity to recover costs from other carriers and requiring them to recover a greater share of their costs from their ISP customers.

68. In most states, reciprocal compensation governs the exchange of ISP-bound traffic

between local carriers.[127] Reciprocal compensation is a CPNP regime in which the originating carrier pays an interconnecting carrier for "transport and termination," *i.e.*, for transport from the networks' point of interconnection and for any tandem and end-office switching.[128] The central problem with any CPNP regime is that carriers recover their costs not only from their end-user customers, but also from *other carriers*.[129] Because intercarrier compensation rates do not reflect the degree to which the carrier can recover costs from its end-users, payments from other carriers may enable a carrier to offer service to its customers at rates that bear little relationship to its actual costs, thereby gaining an advantage over its competitors. Carriers thus have the incentive to seek out customers, including but not limited to ISPs, with high volumes of incoming traffic that will generate high reciprocal compensation payments.[130] To the extent that carriers offer these customers below cost retail rates subsidized by intercarrier compensation, these customers do not receive accurate price signals. Moreover, because the originating LEC typically charges its customers averaged rates, the originating end-user receives inaccurate price signals as the costs associated with the intercarrier payments are recovered through rates averaged across all of the originating carrier's end-users. Thus no subscriber faces a price that fully reflects the intercarrier payments. An ISP subscriber with extensive Internet usage may, for example, cause her LEC to incur substantial reciprocal compensation obligations to the LEC that serves her ISP, but that subscriber receives no price signals reflecting those costs because they are spread over all of her LEC's customers.

69. The resulting market distortions are most apparent in the case of ISP-bound traffic due primarily to the one-way nature of this traffic, and to the tremendous growth in dial-up Internet access since passage of the 1996 Act. Competitive carriers, regardless of the nature of their customer base, exchange traffic with the incumbent LECs at rates based on the incumbents' costs.[131] To the extent the traffic exchange is roughly balanced, as is typically the case when LECs exchange voice traffic, it matters little if rates reflect costs because payments in one direction are largely offset by payments in the other direction. The rapid growth in dial-up Internet use, however, created the opportunity to serve customers with large volumes of

[127] In the *Declaratory Ruling*, we stated that, pending adoption of a federal rule governing intercarrier compensation for ISP-bound traffic, state commissions would determine whether reciprocal compensation was due for such traffic. *Declaratory Ruling*, 14 FCC Rcd at 3706. Since that time, most, though not all, states have ordered the payment of reciprocal compensation for ISP-bound traffic.

[128] 47 C.F.R. § 51.703(a).

[129] Recovery from other carriers is premised on the economic assumption that the carrier whose customer originates the call has "caused" the transport and termination costs associated with that call, and the originating carrier should, therefore, reimburse the interconnecting carrier for "transport and termination." The companion *NPRM* evaluates the validity of that assumption and tentatively concludes that it is an incorrect premise.

[130] *Cf. Local Competition Order*, 11 FCC Rcd at 16043 (symmetrical termination payments to paging providers based on ILECs' costs "might create uneconomic incentives for paging providers to generate traffic simply in order to receive termination compensation").

[131] 47 C.F.R. § 51.705 (an incumbent LEC's rates for transport and termination shall be established on the basis of the forward-looking economic costs of such offerings); 47 C.F.R. § 51.711 (subject to certain exceptions, rates for transport and termination shall be symmetrical and equal to those that the incumbent LEC assesses upon other carriers for the same services).