

ORIGINAL  
RECEIVED

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

NOV 5 2001

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )  
 )  
Developing a Unified Intercarrier )  
Compensation Regime )

CC Docket No. 01-921

REPLY COMMENTS OF  
FOCAL COMMUNICATIONS CORPORATION,  
PAC-WEST TELECOMM, INC.,  
RCN TELECOM SERVICES, INC.  
AND US LEC CORP.

Richard J. Metzger  
FOCAL COMMUNICATIONS CORPORATION  
7799 Leesburg Pike  
Suite 850 North  
Falls Church, VA 22043  
(703) 637-8778

Andrew D. Lipman  
Richard M. Rindler  
Patrick J. Donovan  
Michael W. Fleming  
SWIDLER BERLIN SHEREFF FRIEDMAN, LLP  
3000 K Street, N.W., Suite 300  
Washington, D.C. 20007

John Sumpter  
PAC-WEST TELECOMM, INC.  
1776 March Lane  
Suite 250  
Stockton, CA 95207  
(209) 926-3300

Tel: (202) 424-7500  
Fax: (202) 424-7645

Counsel for FOCAL COMMUNICATIONS  
CORPORATION, PAC-WEST TELECOMM,  
INC., RCN TELECOM SERVICES, INC., AND  
US LEC CORP.

Joseph O. Kahl  
Patrick McGuire  
RCN TELECOM SERVICES, INC.  
105 Carnegie Center  
Princeton, NJ 08540  
(609) 734-3827

Sumner N. Smith  
US LEC CORP.  
Three Morrocroft Centre  
6801 Morrison Blvd.  
Charlotte, NC 28211  
(704) 319-1119

No. of Copies rec'd 014  
USLABODE

## TABLE OF CONTENTS

SUMMARY .....	iii
I. THE COMMISSION SHOULD TAKE GUIDANCE FROM STATE AUTHORITIES .....	1
II. THE COMMENTS PROVIDE NO BASIS FOR THE COMMISSION TO REVERSE ITS DECISION IN THE 1996 <i>LOCAL COMPETITION ORDER</i> REGARDING BILL-AND-KEEP .....	4
III. BILL-AND-KEEP SHOULD NOT BE SEPARATELY IMPLEMENTED FOR ISP-BOUND TRAFFIC .....	8
A. The Call for a Phased-In Approach .....	9
B. The Perils of Phased-In Implementation .....	13
C. Piecemeal Implementation Would Not Be Competitively Neutral .....	15
D. Impact on Market to Serve ISPs .....	17
IV. THE ECONOMIC THEORIES UNDERPINNING BILL-AND-KEEP PROPOSALS HAVE BEEN INVALIDATED .....	20
A. The “Equal Benefits” Principle Has Been Discredited .....	20
B. Bill-and-Keep Would Not Be Prevalent In <i>An</i> Unregulated, Competitive Market .....	25
C. Bill-and-Keep Does Not Provide “Equal Responsibility” For A Call .....	27
D. Proponents of Bill-and-Keep Do Little To Shore Up Their Case .....	28
V. THE FCC LACKS LEGAL AUTHORITY TO IMPLEMENT BILL-AND-KEEP .....	29
A. Local Traffic .....	29
B. ISP-bound Traffic .....	37
C. Interstate Access Charges .....	39
D. Intrastate Access Charges .....	40
VI. IMPOSING BILL-AND-KEEP WILL REQUIRE MAJOR NEW FEDERAL PROGRAMS .....	41
VII. THE COMMISSION SHOULD REITERATE THAT ILECS MUST ABIDE BY ITS “RULES OF THE ROAD” .....	43
A. The BOCs Acknowledge the Soundness of the Single POI per LATA Requirement .....	43
B. The Commission Should Not Abandon its Tandem Treatment Rule .....	<b>46</b>
C. Calls to ISPs Are Subject to the <i>ISP Traffic Remand Order</i> Regardless of Whether the LEC Assigns the ISP a Physical or Virtual NXX .....	47
VIII. CONCLUSION .....	52

## SUMMARY

In their initial comments in this proceeding, Focal, Pac-West, RCN, and US LEC opposed implementation of bill-and-keep for any class of traffic. The initial comments of other parties provide no basis for the Joint Commenters to depart from their initial conclusions. If anything, initial comments reinforce the lack of wisdom of bill-and-keep. The record shows that, other than the CMRS industry, no one really wants bill-and-keep. ILECs qualify their support on fundamental preconditions that show that in reality they do not support a unified implementation of bill-and-keep. Instead of urging a rapid implementation of a unified scheme of bill-and-keep, ILECs prefer to use this proceeding as merely another opportunity to repeat their pleas for premature deregulation. State commissions, consumer groups, and ISPs also oppose or offer little support for bill-and-keep. For their part, CLECs also show that bill-and-keep would harm competition and favor ILECs. The nearly total lack of industry support for a unified scheme of bill-and-keep is sufficient reason by itself not to adopt it.

Instead, the Commission should promptly reinstate the determinations of *the Local Competition Order*. There, the Commission considered, and rejected, adoption of bill-and-keep as the default reciprocal compensation rule. None of the comments from the few supporters of bill-and-keep in this proceeding provide any new facts or logic to change that decision. For the Commission to reverse the conclusions in the *Local Competition Order*, the Commission would need far more compelling reasons than anything offered by the few proponents of bill-and-keep.

While it is always useful to take a hard look at current regulatory schemes and to consider wholesale replacements, the current exercise has shown that there is no basis for the sweeping changes contemplated in the *Intercarrier Compensation NPRM*. Comments show that this would

reward ILECs for failing to set reasonable rates for reciprocal compensation, favor carriers with balanced traffic – ILECs, require a host of impossible-to-implement federal regulatory programs, and be unlawful as well. Amazingly, one of the authors of the initial papers that served as a foundation of the *Intercarrier Compensation NPRM* has filed comments on his own paper virtually eliminating whatever theoretical economic basis bill-and-keep may have appeared to possess initially. At this point, there is no legal or policy justification to move forward with implementation of a unified scheme of bill-and-keep. To the extent the Commission looks to specific guidance in the record, it should look to state commenters, who nearly across-the-board oppose bill-and-keep.

While there is no basis for moving forward with bill-and-keep generally, the worst alternative would be for the Commission to single out one type of traffic for this treatment. If bill-and-keep has any theoretical validity, which it does not, there could not be any basis for applying it based on the nature of the traffic, *i.e.* ISP-bound traffic, rather than all traffic generally. As stated in Joint Commenters' initial comments, to do so would represent a decision by the Commission to punish those carriers that have successfully competed against ILECs in serving ISPs merely because they have been successful. None of the economic theories advanced in the *Intercarrier Compensation NPRM* justify application of bill-and-keep based on the nature of traffic. It would be arbitrary for the Commission to do so. Instead, if the Commission chooses to move forward with bill-and-keep, it should implement it at the same time for all traffic.

Accordingly, the Commission should abandon its bill-and-keep proposals.



default rule;<sup>2</sup> bill-and-keep is inconsistent with the 1996 Act;<sup>3</sup> COBAK and BASICS are anticompetitive, and had they been in effect in prior years, competitive local exchange carriers (“CLECs”) probably would not exist;<sup>4</sup> bill-and-keep could seriously undermine entry;<sup>5</sup> the *Intercarrier Compensation NPRM* elevates the theoretical goal of economic efficiency over more important goals such as fairness in rate design, minimization of rate shock, and reasonable allocation of joint and common costs;<sup>6</sup> bill-and-keep would shield incumbent local exchange carriers (“ILECs”) from market pressures, whether from CLECs or Internet Protocol telephony;<sup>7</sup> bill-and-keep would enhance incentives to “cream skim” by serving few customers that originate large volumes of traffic;<sup>8</sup> tariff arbitrage is likely to result from a federal bill-and-keep regime, especially in the absence of states adopting bill-and-keep for intrastate services;<sup>9</sup> the proposals would subsidize telemarketers and stimulate telemarketing calls;<sup>10</sup> bill-and keep violates principles of economic efficiency;<sup>11</sup> the Commission should not preempt state authority over

---

<sup>2</sup> New York Public Service Commission Comments at 1-2.

<sup>3</sup> National Association of State Utility Consumer Advocates Comments (NASUCA) at 6.

<sup>4</sup> Maryland Office of People’s Counsel Comments at 14.

<sup>5</sup> Office of Public Utility Counsel of Texas Comments at 46-47.

<sup>6</sup> California Public Utilities Commission Comments at 2.

<sup>7</sup> *Id.* at 8.

<sup>8</sup> New York Public Service Commission Comments at 2.

<sup>9</sup> Public Utility Counsel of Texas Comments at 38.

<sup>10</sup> Maryland Office of People’s Counsel Comments at 27-28; Public Utility Counsel of Texas Comments at 18-19.

<sup>11</sup> NASUCA Comments at 23-24.

intrastate interconnection matters and rates;<sup>12</sup> bill-and-keep would harm end users;<sup>13</sup> if ILECs are troubled by the flow of payments to CLECs, they should start to compete for Internet service providers (“ISPs”);<sup>14</sup> imposing flat-rated charges on end users would cause low volume subscribers to subsidize high volume subscribers, effectively increase the price of obtaining basic local service, and harm affordability and universal service;<sup>15</sup> and bill-and-keep could make retail rates less affordable, less comparable between rural and urban areas, and less conducive to universal service.<sup>16</sup>

State regulators also contend that instead of bill-and-keep, the Commission should reform the CPNP regime to the extent necessary. They state that: instead of bill-and-keep, regulators should replace charges that are excessive with charges that are reasonable;<sup>17</sup> opportunities for arbitrage under the existing system have been, or can be, reduced by less disruptive regulatory measures or reliance on market forces;” and as long as reciprocal compensation rates are based on the ILEC’s TELRIC costs, ILECs should be indifferent to paying CLECs \$2 billion in

---

<sup>12</sup> Regulatory Commission of Alaska Comments at 2, 6-8, National Association of Regulatory Utility Commissions (NARUC) Comments at 1; NASUCA Comments at 28.

<sup>13</sup> Maryland Office of People’s Counsel Comments at 14.

<sup>14</sup> Public Utility Counsel of Texas Comments at 26-28.

<sup>15</sup> Maryland Office of People’s Counsel Comments at 44-45, Public Utility Counsel of Texas Comments at 20.

<sup>16</sup> New York Public Service Commission Comments at 2.

<sup>17</sup> Maryland Office of People’s Counsel Comments at iii.

<sup>18</sup> California Public Utility Commission Comments at 3.

reciprocal compensation because they are saving \$2 billion in termination costs on their own networks.”

In short, state authorities, far more than the Commission, have gotten this issue right. Joint Commenters urge the Commission to follow the recommendations of the state authorities that have commented in this proceeding.

**11. THE COMMENTS PROVIDE NO BASIS FOR THE COMMISSION TO REVERSE ITS DECISION IN THE 1996 LOCAL COMPETITION ORDER REGARDING BILL-AND-KEEP**

The Commission has already considered, and rejected, the adoption of bill-and-keep as the default reciprocal compensation rule. None of the comments from the few supporters of bill-and-keep in this proceeding provide any new facts or logic to change that decision. For the Commission to reverse itself from the conclusions in the *Local Competition Order*, the Commission would need far more compelling reasons than anything offered by the proponents of bill-and-keep.

There is nothing new today that the Commission did not already consider in 1996. The Commission already anticipated that “all carriers – incumbent LECs as well as competing carriers – have a greater incentive and opportunity to charge prices in excess of economically efficient levels on the terminating end [than on the originating end].”<sup>20</sup> To avoid this result, the Commission placed limitations on the “additional costs” that could be recovered for transport

---

<sup>19</sup> Public Utility Counsel of Texas Comments at 31.

<sup>20</sup> *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd in part, aff'd in part, AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721 (1999) (“*Local Competition Order*”) at ¶ 1058.

and termination under section 252(d)(2).<sup>21</sup>

The Commission even recognized that CLECs would, and should, have a profit motive to provide termination services below ILEC cost: “A symmetric compensation rule gives the competing carriers correct incentives to minimize its [sic] own costs of termination because its termination revenues do not vary directly with changes in its own costs.”<sup>22</sup> As the Commission said in 1996, “we believe that using the incumbent LEC’s cost studies to establish the presumptive symmetrical rates will establish reasonable opportunities for local competition, *including opportunities for small telecommunications companies entering the local exchange market.*”<sup>23</sup> That CLECs have seized the opportunities that the Commission expected does not mean the underlying reasoning was wrong and needs to be changed.

The Commission even considered the favorable economics that arise in a situation in which the traffic exchanged between carriers was “substantially unbalanced.”<sup>24</sup> In that situation, the Commission explained how a reduction in the ILEC’s terminating switching costs might reduce its reciprocal compensation revenues when it terminated significantly more traffic than it originated, but it would be an overall boon to the ILEC by reducing network costs overall. Because only a relatively small portion of traffic crossing the network would be exchanged between carriers, and the ILEC would retain a vastly greater portion of traffic entirely on its own network, cost-based reciprocal compensation rates gave the ILEC the proper economic

---

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at ¶ 1086.

<sup>23</sup> *Id.* at ¶ 1088 (emphasis added).

<sup>24</sup> *Id.* at n. 2624.

incentives. The Commission used the example of the exchange of traffic between an ILEC and a CMRS carrier, which would be out of balance in the ILEC's favor. But "[i]n situations closer to traffic balance, the incentive is even more favorable."<sup>25</sup> It follows that if the "substantial imbalance" were in the *CLEC's* favor, the ILEC has *an even greater* incentive to lower terminating switching costs, because it would not only reduce its reciprocal compensation obligation, but it also "reduces its cost of switching on many millions of other minutes that do not involve other networks at the same time."<sup>26</sup> Absolutely nothing has changed between 1996 and the present to change that fundamental logic. None of the comments provide the Commission with any reason to move away from cost-based reciprocal compensation rates in order to maximize efficiency.

The Commission even considered in the *Local Competition Order* the potential benefits of bill-and-keep, and nonetheless rejected it. The Commission specifically identified one benefit of bill-and-keep advanced by proponents as "elimination of incentives to 'game' the LEC-to-LEC relationship by soliciting (or avoiding) customers with high incoming or outgoing usage."<sup>27</sup> It identified "economic efficiency" as another purported benefit of bill-and-keep.<sup>28</sup> The Commission even cited the argument of one bill-and-keep opponent that new entrant traffic is likely to be out of balance "because new entrants will engage in niche marketing to get a toehold

---

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at ¶ 1101.

<sup>28</sup> *Id.*

in a new service area.”<sup>29</sup> The Commission also cited one carrier’s argument that “using compensation systems other than bill-and-keep would encourage new entrants to focus entry strategies on niches that exploit compensation levels.”<sup>30</sup> Ameritech is even cited in the *Local Competition Order* for the wise prediction that “the period during which the new carriers first enter a local market will be the time during which traffic is most unbalanced between the new entrants and the incumbent LEC.”<sup>31</sup> There is nothing presented by commenters in this proceeding that the Commission did not already consider in the *Local Competition Order*. Nevertheless, the Commission chose not to adopt bill-and-keep as a default rule for the exchange of traffic in 1996. There is no principled reason to reverse that decision now.

In short, the Commission rejected bill-and-keep arrangements in the *Local Competition Order* on two grounds. First, the Commission rejected bill-and-keep arrangements on statutory grounds. The Commission ruled that bill-and-keep arrangements did not satisfy the standard of section 252(d)(2)(A)(i) because “bill-and-keep arrangements that lack any provisions for compensation do not provide for recovery of costs.”<sup>32</sup> Second, the Commission rejected bill-and-keep arrangements as “not economically efficient.” In “certain circumstances” the benefits of bill-and-keep arrangements may outweigh the disadvantages, but the Commission did not see “why, in such circumstances, parties themselves would not agree to bill-and-keep

---

<sup>29</sup> *Id.* at ¶ 1103.

<sup>30</sup> *Id.* at n. 2671

<sup>31</sup> *Id.* at ¶ 1104.

<sup>32</sup> *Id.* at ¶ 1112.

arrangements.”<sup>33</sup> Nothing in the Comments in this proceeding refutes either of those conclusions. The Commission has no basis to reverse its decision regarding bill-and-keep in the *Local Competition Order* and should promptly reinstate them.

### III. BILL-AND-KEEP SHOULD NOT BE SEPARATELY IMPLEMENTED FOR ISP-BOUND TRAFFIC

In their initial Comments, Joint Commenters urged the Commission not to implement bill-and-keep solely, or separately, for ISP-bound traffic. Joint Commenters noted that such discriminatory implementation would be ill advised for a number of reasons. One, it would send the wrong message to investors, *i.e.*, that CLECs that developed a legitimate market niche in an area underserved by the incumbents would be penalized, not rewarded, for such industriousness.<sup>34</sup> Two, such an approach would undercut the validity of the Office of Plans and Policy (“OPP”) proposals which made no distinction in the type of traffic and called for unified and simultaneous implementation.<sup>35</sup> Three, such a selective implementation would contradict the Commission’s determination that there is no basis to distinguish between voice and data traffic for purposes of reciprocal compensation.<sup>36</sup> Finally, Joint Commenters noted that implementation of bill-and-keep is not competitively neutral, and singling out ISP-bound traffic for such treatment would exacerbate the anticompetitive effects.<sup>37</sup>

---

<sup>33</sup> *Id.*

<sup>34</sup> Focal/PacWest/RCN/US LEC Comments at 19-22.

<sup>35</sup> *Id.* at 22.

<sup>36</sup> *I .* at 23.

<sup>37</sup> *Id.* at 24.

The positions of the Joint Commenters have generally been echoed by other parties. There are some parties, however, that would favor the implementation of bill-and-keep for ISP-bound traffic initially and a later-day implementation of bill-and-keep for access charges.<sup>38</sup> Such a phased-in implementation will be ill-advised, and given the laundry list of issues the proposing carriers want “reformed” before bill-and-keep would be implemented for access charges, would effectively mean that bill-and-keep would only be applied to ISP-bound traffic for years to come. Such an approach would not be desirable, and directly contradicts the stated goal of this proceeding to create a unified compensation mechanism.

**A. The Call for a Phased-In Approach**

There are some carriers that favor a phased-in implementation of bill-and-keep. SBC supports bill-and-keep for local, wireless, and ISP-bound traffic, but suggests that a “comprehensive reform plan” needs to be implemented for access charges before bill-and-keep is implemented for access charges.<sup>39</sup> For local traffic, however, SBC argues that end-user-pricing reform needs to take place, suggesting that this will bifurcate implementation for local traffic vis-a-vis ISP-bound traffic. Verizon suggests that the Commission should move to bill-and-keep for ISP-bound traffic in the “near-term,” but defer implementation of a single intercarrier compensation regime for other types of traffic until certain “long-term” issues are resolved.<sup>40</sup> It should come as no surprise to the Commission that the Bell companies seek immediate conversion to bill-and-keep for traffic for which they are net payors of terminating compensation

---

<sup>38</sup> See SBC Comments at 2; Verizon Comments at 1; Sprint Comments at 2.

<sup>39</sup> SBC Comments at 1-2.

<sup>40</sup> Verizon Comments at 1-3.

(reciprocal compensation), but seek indefinite postponement of conversion to bill-and-keep for traffic for which they are net recipients of terminating compensation (access charges). Indeed, their greed is plainly evidenced by the fact that the terminating compensation that they receive is admittedly well above cost, while the terminating Compensation that they pay, and seek to stop paying, is cost-based.

Sprint favors the prompt implementation of bill-and-keep for both local and ISP-bound traffic, but says it is premature to apply bill-and-keep to access traffic “at this time.”<sup>41</sup> Rural LECs are not as concerned about reciprocal compensation, but call for the delay of consideration of bill-and-keep for access charges at least until reform of rate-of-return LEC access charges has taken effect for a few years.<sup>42</sup>

All the carriers calling for delay of this Commission’s consideration of bill-and-keep for access charges have major issues that they say the Commission must address, or reforms that need to take place, before bill-and-keep is implemented. SBC states that residential local service rates must be overhauled to account for implicit subsidies, universal service support must be increased, federal and state end user recovery mechanisms must be implemented, and ILECs will need to be provided with more pricing flexibility.<sup>43</sup> Verizon argues that issues such as so-called “virtual NXX” need to be addressed in what it terms the “near-term” before a unified intercarrier

---

<sup>41</sup> Sprint Comments at 2.

<sup>42</sup> National Telephone Cooperative Association (NTCA) Comments at 1,5; National Rural Telecom Association and Organization for the Promotion and Advancement of Small Telecommunications Companies (NRTA/OPASTCO) Comments at 3-4.

<sup>43</sup> SBC Comments at 3-4. Thus while SBC advocates bill-and-keep for both local and ISP-bound traffic, it is clear that such implementation would not be simultaneous since bill-and-keep for local traffic would be deferred

(con’t.)

compensation scheme is contemplated.<sup>44</sup> Sprint says that implicit subsidies need to be removed from access rates, rate shock to end users needs to be addressed, and jurisdictional obstacles need to be overcome before bill-and-keep for access charges is implemented.<sup>45</sup> Rural and independent LECs seek to delay bill-and-keep for access charges until adverse impacts on rural carriers are assessed and addressed.<sup>46</sup>

In addition to demonstrating the numerous implementation issues of bill-and-keep that the OPP Papers did not anticipate, these positions demonstrate that resolution of these issues in regard to access charges could take years. The Joint Commenters agree with the need to defer consideration of bill-and-keep for access charges until these issues are addressed,<sup>47</sup> but strongly disagree with the implicit suggestion in some of these Comments that bill-and-keep for ISP-bound traffic could be implemented before bill-and-keep for other types of traffic. As was demonstrated in Joint Commenters' initial comments, and will be demonstrated further in these reply comments, there are significant obstacles for the implementation of ISP-bound traffic as well that counsel against implementation of bill-and-keep for such traffic at all. Implementing bill-and-keep solely for ISP-bound traffic, or earlier for ISP-bound traffic than for other traffic, would undercut the central goal of the OPP proposals and *NPRM* to create a unified intercarrier

---

pending the pricing reform SBC seeks.

<sup>44</sup> Verizon Comments at 3.

<sup>45</sup> Sprint Comments at 2.

<sup>46</sup> NTCA Comments at 1; CenturyTel Comments at 1; National Exchange Carrier Association (NECA) Comments at ii-iii.

<sup>47</sup> In fact, Joint Commenters suggest that the numerous implementation issues further demonstrate that the existing system is not only adequate, but also better attuned to the realities of the current industry.

compensation system. There is no operational or legal basis for such a selective implementation. Equally important, such an approach would not be competitively neutral. Implicit in the suggestions of phased-in implementation is the idea that certain revenue streams and market segments should be protected to the detriment of others. For instance, when ILECs talk of residential pricing reform and universal service support reform, they are clearly asking the Commission to protect and enhance their revenues before bill-and-keep is implemented across-the-board. ILECs dominate the residential market and are the primary recipients of universal service support, so calls for “reform” in this area are clearly calls for protection of ILEC revenues.<sup>48</sup> Meanwhile, CLECs would be asked to forego a significant source of revenue with no such offsetting compensation.<sup>49</sup> As AT&T astutely observes, this approach to reform is a type of “reverse triage” which largely ignores areas in which reform is needed and would focus on areas in which reform is least needed.<sup>50</sup> If bill-and-keep is to be implemented, it must be implemented uniformly. As AT&T concludes, “singling out only one compensation regime for reform, while leaving other flawed legacy regimes in place, is more likely to undermine, rather than promote, efficiency and competitive neutrality.”<sup>51</sup>

---

<sup>48</sup> In the residential and small business market, Regional Bell Operating Companies (“RBOCs”) alone control over 140 million lines while CLECs have a mere 8 million lines. Jason Krause, *Dawn of the Big Bells*, The Industry Standard Magazine, p. 1 (April 22, 2001) (“*Krause Article*”). <http://www.thestandard.com/article/0,1902,23871,00.html>

<sup>49</sup> For instance, SBC argues that if residential rates are “reformed,” *i.e.*, made higher, then bill-and-keep would provide for the mutual recovery of costs in regard to local traffic. It is hard to see how this can be the case since ILECs dominate the residential market. This “reform” would only enhance the revenue advantages ILECs would possess in a bill-and-keep regime.

<sup>50</sup> AT&T Comments at 2-3.

<sup>51</sup> *Id.* at 2.

## **B. The Perils of Phased-In Implementation**

Proponents of bill-and-keep acknowledge that any possible advantages a bill-and-keep approach could provide would be undercut by piecemeal implementation. As Mr. DeGraba notes, implementing bill-and-keep for ISP-bound traffic would maintain opportunities for regulatory arbitrage in regard to access services and delay the realization of some of the efficiency “benefits” COBAK is intended to provide.<sup>52</sup> Another proponent of bill-and-keep, Level 3, notes that certain advantages of bill-and-keep are reduced substantially if only some traffic is subject to bill-and-keep and distorts the price signals sent to subscribers.<sup>53</sup> In addition, Level 3 observes that “having two different interconnection pricing schemes for what is largely the same function will open the door to strategic pricing gamesmanship, and potentially impose inefficient network engineering costs.”<sup>54</sup> SBC admits that bifurcated approaches create “additional arbitrage opportunities.”<sup>55</sup>

Time Warner observes that piecemeal implementation of bill-and-keep for ISP-bound traffic could result in inefficiencies that are worse than those complained of in the existing regime.<sup>56</sup> It certainly would not reduce the inefficiencies because carriers would simply have the incentive to originate traffic as opposed to terminate traffic. As Time Warner notes, under COBAK, “the equation flips and competitive carriers will fight to serve customers with

---

<sup>52</sup> WorldCom Comments, Attachment, “Implementing Bill and Keep Inter-carrier Compensation When Incumbent LECs Have Market Power,” Declaration of Patrick DeGraba, Charles River Associates, at 30-32.

<sup>53</sup> Level 3 Comments at 24.

<sup>54</sup> *Id.* at 25.

<sup>55</sup> SBC Comments at 25.

<sup>56</sup> Time Warner Comments at 19.

predominantly originating traffic, while ILECs will more likely serve ISPs.”<sup>57</sup> ILECs would still argue that a lack of pricing flexibility renders them “unable to meet this competition with lower prices.”<sup>58</sup> Thus, according to Time Warner, “even assuming there is a problem with arbitrage for ISP-bound traffic, COBAK may simply replace old inefficiencies created by arbitrage with new inefficiencies (‘of unknown magnitude’) created by arbitrage.”<sup>59</sup> AT&T notes that “B&K would provide carriers with inefficient incentives to target customers that originate more calls than they receive – *e.g.*, telemarketers.”<sup>60</sup>

Global NAPs argues that implementing bill-and-keep for ISP-bound traffic before exchange access traffic would only “proliferate opportunities for arbitrage.”<sup>61</sup> For instance, ISPs and providers of VoIP traffic would have powerful incentives to disguise ISP-bound traffic as Section 251(b)(5) traffic.<sup>62</sup> Carriers would also have incentives to terminate long distance traffic through ISPs regardless of whether the calls actually traversed the Internet.<sup>63</sup>

AT&T contends that piecemeal implementation would only “*increase* the extent to which different types of carriers are arbitrarily subjected to disparate regulatory treatment.”<sup>64</sup> The

---

<sup>57</sup> *Id.* at 11.

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> AT&T Comments, citing Declaration of Janusz A. Ordovery and Robert D. Willig On Behalf of AT&T Corp., at 30; *see also*, Maryland Office of People’s Counsel Comments at 27-28; Public Utility Counsel of Texas Comments at 18-19; NTCA Comments at 18.

<sup>61</sup> Global NAPs Comments at n. 30.

<sup>62</sup> Time Warner Comments at 20.

<sup>63</sup> Public Utility Counsel of Texas Comments at 53, 78-79.

<sup>64</sup> AT&T Comments at 47 (emphasis in original).

Illinois Commerce Commission discourages the Commission from implementing bill-and-keep only for ISP-bound traffic, noting that it would be “discriminatory to differentiate compensation mechanisms based upon the types of services being provided without making determinations as to the cost of service.”<sup>65</sup> The Public Utility Commission of Texas would not support a “regime for local intercarrier compensation that differentiated between voice and ISP-bound traffic.”<sup>66</sup>

**C. Piecemeal Implementation Would Not Be Competitively Neutral**

Numerous parties find the implementation of bill-and-keep would benefit ILECs to the detriment of competitive carriers. Joint Commenters observed that bill-and-keep would favor mature carriers with balanced traffic because only mature carriers have ubiquitous networks serving a sufficiently large customer base so that individual customer imbalances will cancel each other out. The balanced traffic of ILECs would give ILECs a substantial advantage in recovering their costs.<sup>67</sup> Allegiance noted how bill-and-keep gives substantial advantages to carriers with established networks.<sup>68</sup> KMC observed that since CLECs have a much smaller customer base over which to spread termination costs, it will make it more difficult for CLECs to recover these costs.<sup>69</sup>

---

<sup>65</sup> Illinois Commerce Commission Comments at 2-3.

<sup>66</sup> Public Utility Commission of Texas Comments at 11.

<sup>67</sup> Focal/PacWest/RCN/US LEC Comments at 12.

<sup>68</sup> Allegiance Comments at 18-22.

<sup>69</sup> KMC Comments at 4.

The Maryland Office of People's Counsel contends that the OPP proposals are so "anti-competitive" that had they been in effect in prior years, CLECs "probably would not exist."<sup>70</sup> The Office of Public Utility Counsel of Texas remarks that under the FCC's estimates, "the CLEC industry is about to forfeit about two billion dollars in annual intercarrier compensation payments" when bill-and-keep is implemented for ISP-bound traffic.<sup>71</sup> As the Public Utility Counsel of Texas goes on to observe:

The ILECs have a much greater ability than the CLECs to absorb increases in end-user rates that the FCC's bill-and-keep proposal may cause. As a result of their large and diverse customer base, ILECs will be able to strategically raise some rates while leaving other rates relatively unaffected. That is, ILECs can selectively raise certain rates – *in regions or for customer classes where competition is absent* – and keep other rates – *in regions or for customer classes where they do face competition* – relatively stable. By contrast, most CLECs have a far smaller and more homogeneous customer base, *all of which is subject to competition.*<sup>72</sup>

As the Public Utility Counsel of Texas concludes, "one may cynically note, that a few more regulatory shocks, and the issue of compensation between competing carriers for intercarrier traffic will be permanently resolved – there won't be such traffic."<sup>73</sup>

The competitive advantages that ILECs possess will be exacerbated because ILECs set local rates using a sent-paid methodology to ensure recovery from a subscriber of all costs of local calls that the customer originates, including originating switching, interoffice transport, and

---

<sup>70</sup> Maryland Office of the People's Counsel Comments at 14.

<sup>71</sup> Public Utility Counsel of Texas Comments at 45.

<sup>72</sup> *Id.* at 46.

<sup>73</sup> *Id.* at 37.

terminating switching.<sup>74</sup> Under a bill-and-keep regime, ILECs would not need to recover extra termination costs since they are already recovering those costs.<sup>75</sup> Under the existing regime, if termination rates are set at the ILEC's forward-looking costs, ILECs should be indifferent to whether CLECs terminate their traffic or they terminate it themselves.<sup>76</sup> Under a bill-and-keep approach, ILECs would receive a windfall.

#### **D. Impact on Market to Serve ISPs**

The selective implementation of bill-and-keep for ISP-bound traffic could have a detrimental impact on the market to serve ISPs. The Joint Commenters noted that implementation of bill-and-keep for ISP-bound traffic will limit the amount of competitive options that ISP providers have.<sup>77</sup> As noted, ILECs will experience a windfall under bill-and-keep because termination costs are built into their local rates. Thus, ILECs may not need to raise rates, and may even be able to reduce rates temporarily to reclaim ISP market share.<sup>78</sup> CLECs, however, would be forced to pass on their higher termination costs to the ISPs, who in turn would have to pass on the higher costs to their end users. In this environment, many ISPs may be forced to migrate to ILECs.<sup>79</sup> This would not be an economically efficient decision, however,

---

<sup>74</sup> Focal/PacWest/RCN/US LEC Comments at 10; Time Warner Comments at 23.

<sup>75</sup> Time Warner Comments at 24.

<sup>76</sup> Public Utility Counsel of Texas Comments at 31; AT&T Comments at 15.

<sup>77</sup> Focal/PacWest/RCN/US LEC Comments at 25.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

because it is a choice that ISPs would not normally make in the absence of this Commission's regulatory intervention.

As Joint Commenters noted in their initial Comments, and corroborated by many parties, ISPs chose to be served by CLECs because they offered "efficient and affordable high quality networks and connections."<sup>80</sup> The Public Utility Counsel of Texas contends that "ILECs have consistently been at war with ISPs and when given the opportunity will discriminate against this class of customers."<sup>81</sup> To demonstrate ILEC unwillingness to serve ISPs, the Public Utility Counsel of Texas quotes from a brief filed by the Texas Internet Service Provider Association ("TISPA") in which that organization stated:

ISPs have been fortunate that competitive carriers have sought to provide service to them – at reasonable prices and terms. SWBT never competed for service to ISPs; rather the ILEC has been *hostile, unyielding, and antagonistic*. SWBT has refused to provide PRI service to ISPs in many areas, despite Commission rules requiring statewide availability. SWBT favors the SBC Internet affiliate in numerous ways, for dial-up and DSL service. SWBT has continually sought to leverage its continued dominance in the local market into a large share of the enhanced services market and has done everything it can to harm ISPs. At every turn, ISPs throughout the state have discovered that SWBT perceives them to be competitors; a group that must be driven from business, and certainly not deserving of high-quality, reliable and affordable local service.<sup>82</sup>

TISPA goes on to note that "ISPs use CLECs because they were chased away by the ILECs."<sup>83</sup> CLECs "welcomed ISPs and provided them with all the services and responsiveness

---

<sup>80</sup> *Id.* at 27.

<sup>81</sup> Public Utility Counsel of Texas Comments at 26-27.

<sup>82</sup> *Id.* at 27, *quoting* Proceeding to examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, Public Utility Commission of Texas, Docket No. 2 1982, Texas Internet Service Providers Association (TISPA) *Amicus Curiae* Brief at 3.

<sup>83</sup> *Id.* at 29, n. 45, *quoting*, TISPA *Amicus Curiae* Brief at 3, n. 2.

they did not receive from ILECs” such as “efficient collocation arrangements, affordable ISDN services, and timely responses to service requests.”<sup>84</sup>

As NASUCA observes, “CLECs and ISPs have become natural business associates because CLECs also provide certain synergies that are not present in the ILEC-ISP relationship.”<sup>85</sup> As NASUCA goes on to conclude:

The FCC has failed to provide any evidence that the traffic imbalances observed for CLECs serving ISPs is a result of structural flaws in the intercarrier compensation mechanism, or reciprocal compensation rates that have been set at excessive levels by the state commissions. Conversely, there is evidence indicating that CLECs have gained a disproportionate share of ISP business because the CLECs made a conscious effort to tailor collocation rates and services to the fast growing ISP market. The cost savings provided by the CLECs to ISPs through collocation are substantial. Therefore, the FCC should not contribute to the ILECs anticompetitive tactics by eliminating just and reasonable reciprocal compensation payments that are required by law. Rather, the FCC should do more to encourage the ILECs to comply with the competitive provisions of the 1996 Act.<sup>86</sup>

AOL remarks that if the Commission “raises CLEC costs to offer services to ISPs, the Commission will constrain competition between CLECs and ILECs and ultimately undermine transmission options for ISPs and consumers alike.”<sup>87</sup> The Public Utility Counsel of Texas suggests that “these proceedings may mark the end of the independent ISP industry” particularly given the fact that “the ISP industry is in such bad shape.”<sup>88</sup> The Maryland Office of People’s

---

<sup>84</sup> *Id.*

<sup>85</sup> NASUCA Comments at 20.

<sup>86</sup> *Id.*

<sup>87</sup> AOL Comments at 6.

<sup>88</sup> Public Utility Counsel of Texas Comments at 36.

Counsel suggests that “both [OPP] proposals propose effectively to kill the Internet for the general public.””

#### **IV. THE ECONOMIC THEORIES UNDERPINNING BILL-AND-KEEP PROPOSALS HAVE BEEN INVALIDATED**

##### **A. The “Equal Benefits” Principle Has Been Discredited**

The Joint Commenters noted in their initial Comments that the fundamental premise of the OPP Papers for a change to bill-and-keep, *i.e.*, that the responsibility for paying for calls should be based on “benefits,” which the bill-and-keep proponents view as being shared equally by the calling and called party, does not support abandonment of the CPNP regime.” In fact, Joint Commenters observed that it is hard to imagine a more unsatisfactory basis for the wholesale shifting of billions of dollars in industry cost recovery from carriers to end users than an evaluation of “benefits” between the calling and the called party.<sup>91</sup> The Joint Commenters also stated that any evaluation of benefits in this area is unverifiable.<sup>92</sup> Joint Commenters noted that, as explained in the *ETI Report*, it is more reasonable to assume that the calling party benefits more.<sup>93</sup> When one adds unsolicited calls into the equation, which would increase under bill-and-keep and which many consumers do not view as conferring any benefit, the more

---

<sup>89</sup> Maryland Office of People’s Counsel Comments at 18.

<sup>90</sup> Focal/PacWest/RCN/US LEC Comments at 43.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *See* ETI Report at 46-47, attached to Focal/PacWest/RCN/US LEC Comments.