

a tandem interconnection option

deny all reciprocal compensation for the delivery of Internet-bound traffic; or, if compensation is provided, limit it to "direct variable cost"³⁰

require all local exchange carriers to provide "geographically relevant interconnection points" (GRIPs) when they assign customers numbers outside the rate centers in which the customers are located."

Frontier describes what it considers to be the current regime's disastrous effects on ILECs and undesirable results for society as a whole. It goes on to propose that Internet traffic be excluded from reciprocal compensation and treated on a bill-and-keep basis, as the Commission is legally permitted to do. Termination of non-Internet convergent traffic should be compensated on the basis of the CLEC's own costs rather than the ILEC's, which Frontier believes to be legally permissible; if the ILEC's costs are to be used, they should be limited to the ILEC's "tandem switching cost, not [including] its local switching and termination costs."³²

³⁰ Direct variable cost excludes (in addition to vertical features) depreciation, return, and any allocation of joint and common costs.

³¹ Users, such as ISPs, may request such service in order to establish a presence outside their geographic areas, making it possible for their own customers to call them without incurring toll charges.

³² Frontier's Initial Brief, p. 10. As noted, Frontier uses "tandem costs" to refer to the lower of the alternatives.

Time Warner stresses the variation among CLECs with respect to business plans, network configuration, and traffic patterns. Asserting that its own traffic imbalance is less extreme and less relevant than that of some other CLECs, it argues that what it terms "responsible CLECs" design their networks to carry originating as well as terminating traffic and build those networks to serve a broad range of customers.

In its view, the optimal reciprocal compensation rate is a negotiated blended rate (such as those in Time Warner's own interconnection agreements) falling between the ILEC's tandem and end-office rate; the blend takes account of both carriers' network design, customer types, and traffic patterns. Time Warner urges us to avoid disturbing blended rate arrangements but where these arrangements are inappropriate (because the CLEC does not build out its network and serve two-way traffic), it would establish a sliding scale framework that ties the reciprocal compensation rate to the CLEC's traffic patterns and number of interconnection points.

MCIW favors maintenance of the status quo and denies that traffic patterns are a proper indicator of costs. It suggests, however, that an extreme traffic imbalance (an incoming to outgoing ratio of 100:1 or more) could trigger an audit of the CLEC's network configuration to determine whether it in fact met the functional equivalence test for receiving reciprocal compensation at the tandem rather than the end-office rate.

CPB regards traffic patterns as a fair indicator of functional equivalence (or its absence) and suggests a below-tandem rate where the incoming to outgoing ratio is 5:1 or more. But it would apply that remedy only after it had been shown that the local market was, in fact, open to competition, to avoid the risk that the CLEC's traffic pattern (or, more fundamentally, its serving only the convergent traffic niche market) may have been caused by the ILEC's failure to open the

³³ Time Warner's Initial Brief, p. 4.

market in a manner that permits CLECs to become full-service providers.

Parties Favoring the Status Quo

CLECs other than those identified in the foregoing section generally urge maintenance of the status quo, offering a variety of arguments in its support. They contend, among other things, that no showing has been made of pertinent differences between how traffic is handled by ILECs and by CLECs, and that traffic imbalances say nothing about a carrier's costs or about whether a CLEC's network is functionally equivalent to an ILEC's. Indeed, some say, reciprocal compensation contemplates a traffic imbalance; and ILECs, which initially sought reciprocal compensation rather than bill-and-keep because they thought the imbalance would favor them, should not be heard to change their position simply because the imbalance in fact turned out to work against them. They note that ILECs benefit, through avoided costs, when CLECs deliver calls; and they warn against denying CLECs the opportunity to recover their costs and, where those costs are, in fact, less than the CLEC's, to enjoy the benefits of their innovations and efficiencies.

Some CLECs warn against depriving carriers of legitimate opportunities to pursue niche markets as a means of entry or growth, and some suggest that barriers to broader entry leave them no choice but to seek out convergent traffic.

They note in particular the unfairness that would result from taking away those opportunities after they had acted in reliance on them. Some CLECs deny that traffic imbalances imply any abuse of the system; others, as already noted, distance themselves from putative abusers, and urge that any remedy be properly targeted.

With regard to non-Internet traffic, some CLECs contend any change from the existing arrangements would violate applicable legal constraints, including the FCC's commitments to functional equivalence as the measure of

whether the tandem rate should be allowed and to TELRIC as the measure of costs. With regard to Internet traffic, CLECs recognize the FCC ISP Ruling has provided the states more discretion (though some raise legal concerns about deaveraging by type of customer) but urge maintenance of the status quo on policy grounds.

Finally, CLECs object to specific aspects of the various proposals for change, raising both legal and policy issues.

The Attorney General, whose office filed only a reply brief, asks us to "consider[,] as [our] first order of concern, how or if any , . . changes [to the existing reciprocal Compensation regime) would adversely affect availability of affordable internet access for New York consumers." He therefore urges us to "move with extreme caution" in considering whether to make any such changes.³⁴

This Opinion

We begin with the question of burden of proof, unusual in this case because the rates at issue are the CLECs' but the costs on which they are based are the ILECs'. We then consider the parties' views on the broad question of whether the existing system is broken and in need of repair. We next present, one by one, the specific proposals for change and the arguments for and against them. Finally, we evaluate the record and describe the remedies we are adopting.

In view of the large number of CLECs filing briefs, it is not surprising that many cover *the* Same ground and present the same arguments. We present the pertinent arguments that have been offered, but we make no attempt to summarize each individual brief or to attribute each argument to each party making it.

BURDEN OF PROOF

³⁴ Attorney General's Reply Brief, p. 3.

The issue of burden of proof arose at the prehearing conference, where the CLECs generally saw the burden as resting with the ILECs, as in a traditional rate case, while the ILECs saw the burden as shared. In his ensuing ruling, the Administrative Law Judge declined to resolve conclusively questions that might require further briefing but, as already discussed, required the CLECs to provide threshold information.³⁵

In its brief, Bell Atlantic-New York contends that the rates at issue here are the CLECs' and that, accordingly, they bear the burden of proof, even with respect to proposals made by ILECs. It cites the Public Service Law's (PSL's) provision that

at any hearing involving a change or a proposed change of rates, the burden of proof to show that the change or proposed change if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable shall be upon the utility.³⁶

It adds that it makes sense for the CLEC to bear the burden of proof inasmuch as it has the best information related to its rates, including how it serves its customers and how it realizes efficiencies by specializing in convergent traffic. Asserting that the CLECs have offered no analysis in support of their slogan that "a minute is a minute," i.e., that all types of traffic impose the same switching and transport costs, Bell Atlantic-New York contends that the proposition must be rejected on burden of proof grounds alone. Frontier,

³⁵ Case 99-C-0529, Ruling on Procedure and Schedule (issued April 27, 1999), p. 3.

³⁶ PSL §92(2)(f). Bell Atlantic-New York notes that in 1921, the statute was amended to impose on the utility the burden of proof with respect to all proposed rate changes, not merely rate increases proposed by the utility itself. It observes as well that CLECs come within the statute's definition of a utility.

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meanwhile, sees the CLECs' failure to provide information on their actual costs as warranting an inference that those costs are over-recovered by reciprocal compensation rates based on the ILEC's TELRIC.

In response, CTSI ~~et al.~~ argue that the purpose of the proceeding is not necessarily to reduce rates but, quoting from the Instituting Order, "to reexamine whether existing reciprocal compensation rates are affected" by convergent traffic. The first step in that reexamination is to determine whether there are differences in network costs that warrant a different rate, and the burden of that showing is on Bell Atlantic-New York, as the party that instituted the proceeding and that advocates a change in the existing regulatory regime. The CLECs' own costs, they continue, are not at issue, given that the ILECs's costs are used as a proxy. CTSI et al. add that Bell Atlantic-New York has not borne its burden, in view of, among other things, the CLECs' "uncontroverted evidence that they utilize the same facilities to terminate all types of traffic and that their costs to terminate traffic are the same regardless of the nature of their traffic." "

The PSL's imposition of the burden of proof on the utility defending its existing rate or proposing a higher one does not resolve the matter here, for it contemplates a very different kind of proceeding, in which the utility's costs, concerning which it has by far the greatest access to pertinent information, come under scrutiny in an attempt to determine their reasonableness and prudence. Here, in contrast, the configurations of the CLECs' systems are pertinent, which is why the CLECs were directed to provide system descriptions, but the reasonableness of the actual costs incurred by CLECs in constructing their networks are not at issue. Moreover, what is at issue is less the CLECs' rates than the proper way to understand and apply the regulatory structure pursuant to which those rates are set. The parties

" CTSI et al.'s Reply Brief, p. 15.

advocating changes (the ILECs, Time Warner, and CPB) have, at a minimum, the burden of going forward and making at least a prima facie case that change is needed and, even more, that their specific proposals represent reasonable responses to problems that have been identified. And, in the face of substantive responses to their prima facie cases, they face a substantial burden of persuasion as well.³⁸

When all is said and done, however, this case should not be decided on the basis of burden of proof. In a traditional rate case, if a consumer group goes forward with a prima facie showing that forecast tree-trimming expense, for example, should be reduced, the utility's burden of proof means it must respond persuasively to that showing or risk suffering a reduction in its allowance for that item. Here, in contrast, the issue is one of broader policy development and application, and we have the authority to range further afield to craft a just and reasonable result, based on substantial evidence in the record but less tied to burden of proof considerations than a traditional rate case decision might have been.

THE ALLEGED NEED FOR RELIEF

The ILECs' Claims"

Frontier sums up the ILECs' view of the situation as follows:

The battle lines in this proceeding are well-drawn. The incumbents are experiencing a hemorrhage of cash in the

" As added warrant for imposing the burden of proof on the parties proposing changes, CTSI et al. cite State Administrative Procedure Act (SAPA) 6306, which provides that the burden of proof shall be on the party who initiated the proceeding. That provision is not pertinent here, however, since this is not an adjudicatory proceeding subject to Article 3 of SAPA.

³⁹ These presentations of parties' positions include, on occasion, responsive points as well.

form of reciprocal compensation, and the more they pay in reciprocal compensation, the more they have to invest in facilities to carry the traffic to their competitors in order to pay even more. The competitors are earning tremendous profits on this traffic, because they charge rates all out of proportion to their actual costs. The customers who are creating all this incoming traffic are also sharing in the gravy train, and some are receiving free service or even being paid to take service merely because they generate large amounts of incoming traffic. A whole industry is growing up to feed on the revenue stream from the incumbents, and the focus of local exchange competition is shifting to the attraction of one-way incoming service.⁴⁰

Frontier goes on to compare the incentives provided to CLECs by reciprocal compensation arrangements to those offered to qualifying energy producing facilities by the federal Public Utility Regulatory Policies Act of 1978 and New York's "Six Cent Law," both of which, it suggests, encourage the production of otherwise uneconomic products. Frontier warns of disastrous impacts on ILECs and alleges adverse effects on society in general. These include the invention of services such as chatlines, which, Frontier says, we found were not necessarily beneficial; the creation of disincentives to the provision by CLECs of service to flat-rate residential customers, whose monthly payments to their LEC will likely just exceed the LECs reciprocal compensation payments on their account; and the need for uneconomical investments on the part of the ILEC to carry traffic originated by their flat rate customers for delivery to CLECs' customers.

Frontier contends further that the existing arrangements encourage CLECs to charge discriminatory rates to benefit convergent customers and to invest in switches that otherwise would not be economic; it cites a CLEC that has installed two switches, one a tandem and the other a local

⁴⁰ Frontier's Initial Brief, p. 1 (footnote omitted).

exchange switch, alongside its voice mail platform in Rochester "in an attempt to charge reciprocal compensation for incoming traffic and to obtain the lion's share of access revenues for incoming toll calls."⁴¹ Frontier disputes the premise that society benefits from CLECs reducing rates to ISPs, contending that any such benefit is simply a poorly thought through, unnecessary, and anti-competitive subsidy.

Relief from this situation is warranted, Frontier continues, because reciprocal compensation makes sense only where, in its absence, the originating LEC would receive compensation for the call and the terminating LEC would not, and where the costs borne by both LECs are nearly equal. Internet traffic, it argues, does not meet these conditions, inasmuch as most of it originates from flat rate residential subscribers who pay no additional charges for their calls to ISPs. Meanwhile, even in the absence of reciprocal compensation, the CLEC receives incremental revenues from its ISP customer, while the ILEC is required not only to pay reciprocal compensation but to incur substantial expenses for the Internet traffic it carries." (CPB responds that these costs, attributable to the demands imposed by Frontier's own customers, are irrelevant to the proper level of reciprocal compensation.)

Bell Atlantic-New York presents similar arguments... It cites statements, drawn from CLEC web sites and submitted in Bell Atlantic-New York's comments in the Chatline Proceeding, to the effect that many CLECs seek customers with convergent traffic "simply for the purpose of collecting

⁴¹ Frontier's Initial Brief, p. 4, n. 11.

⁴² Frontier observes that the party actually responsible for the costs is the ISP, which charges its end users for its services and, in some situations, receives from the CLEC a portion of the reciprocal compensation revenues received by the CLEC on its account. Frontier suggests that ISPs should, in fact, be regarded as carriers who, rather than receiving compensation from ILECs, should be obligated to pay carrier access charges.

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intercarrier compensation payments from incumbent LECs.

Indeed, in many cases intercarrier Compensation has become the principal line of business for such carriers." " Noting that during the first quarter of 1999, the aggregate measured traffic flow from Bell Atlantic-New York to CLECs was more than ten times greater than the flow in the reverse direction," Bell Atlantic-New York contends that the market is being shaped by regulation, that ILECs are being forced to finance their competitors, and that customers are injured because CLECs are discouraged from becoming the kind of full service providers who will bring the benefits of true competition.

Bell Atlantic-New York goes on to describe the FCC's symmetry and functional equivalence principles for reciprocal compensation, and it argues that though the FCC ISP Ruling permits states to apply those requirements to ISP traffic, it does not require them to. It points as well to the Framework Order and urges us to reaffirm and apply the Framework Order's principles of universal service (which Bell Atlantic-New York sees as favoring "intercarrier compensation rules that provided incentives for provision of a broad range of services to a wide variety of customers"⁴³); symmetry (meaning that the ILEC's rate levels should apply to the CLEC as well, the question being which rate applies under which circumstances), functional equivalence, defined as "the ability to terminate calls to all customers served by a carrier's unique, stand alone network by delivery to a single point of interconnection"⁴⁴); and efficient interconnection (requiring, as a further condition of charging tandem rates, that CLECs "provide the incumbent appropriate interconnection options

⁴³ Bell Atlantic-New York's Initial Brief, p. 1.

⁴⁴ Tr. 96, 165-166.

⁴⁵ Bell Atlantic-New York's Initial Brief, p. 15.

⁴⁶ Framework Order, p. 6, n. 1, cited at Bell Atlantic-New York's Initial Brief, p. 16, n. 40.

within their network that would allow the incumbent access to more efficient connections"⁴⁷). Bell Atlantic-New York adds that the symmetry principle, as we and the FCC have adopted it, makes actual CLEC costs irrelevant.

As discussed in more detail in connection with its specific proposals, Bell Atlantic-New York maintains that the termination of convergent traffic enjoys efficiencies that are unavailable when more broadly dispersed traffic is terminated. The CLECs respond that these claims are unsubstantiated.

The CLECs' Positions

Although the CLECs' briefs vary in their treatment of the issues, several common themes may be identified. This section is organized around those themes.

1. The Significance of Carrying Convergent Traffic

AT&T, among others, argues that traffic imbalances say nothing about the proper level of reciprocal compensation and that reciprocal compensation, in fact, contemplates traffic imbalances, without which the simpler bill-and-keep system could have been adopted. It contends as well that Bell Atlantic-New York overlooks other traffic imbalances that run in its favor, such as its termination of 2.7 times as many minutes of wireless traffic as CLECs terminate for it. Mid-Hudson/Northland and MCI, among others, note that it was the ILECs that, over the CLECs' objection, favored creation of the reciprocal compensation mechanism; these parties urge that the ILECs be required to accept the consequence of their tactics and not be bailed out now that their bet has gone sour.

Looking to the genesis of the traffic imbalance rather than its implications, several CLECs, such as CTSI et al, attribute the tendency of some CLECs to seek convergent traffic customers to Bell Atlantic-New York's continued

⁴⁷ Framework Order, p. 6, cited at Bell Atlantic-New York's Initial Brief, p. 16.

imposition of barriers to more broad-based market entry.

CTSI et al. assert that

If Bell Atlantic effectively denies access to loops, and it is cost-prohibitive for the entrant to deploy them, serving customers that require fewer loops is clearly rational business behavior. If Bell Atlantic provides woefully inadequate operations support systems that make large-scale ordering and provisioning completely unreliable, providing services that are less dependent on effective OSS interfaces is also logical. If Bell Atlantic neglects a market segment by failing to offer collocation arrangements that customers in that market segment want, providing those collocation arrangements is one way to compete. And if Bell Atlantic makes it extremely difficult to transition a customer from Bell Atlantic to a CLEC, targeting customers that are establishing businesses is also logical. In all of these cases, ISPs are excellent customers for CLECs.⁴⁶

CPB responds that reciprocal compensation rates should be cost-based regardless of who pays whom.

Some CLECs broaden this point, asserting that pursuing niche markets is not merely a reaction to barriers erected by ILECs but is a proper strategy for entering the market, either enroute to becoming a full-service provider or as an inherently reasonable business plan in itself. Mid-Hudson/Northland, TRA, and others urge us to avoid making changes that would undermine the expectations of small, innovative carriers who had relied in good faith on the existing regulatory structure to provide them revenue streams from niche markets--and especially not to do so in order to protect ILEC monopolists from the consequences of their own mistakes in favoring reciprocal compensation. (Bell Atlantic New York challenges the premise of reliance, asserting that CLECs recognized the possibility that the existing rules might

⁴⁶ CTSI et al.'s Initial Brief, pp. 10-11.

change; for that reason, among others, it sees no need for a transition period before new arrangements are introduced.)

Mid-Hudson/Northland add that the sharing by CLECs of revenues with ISP customers (which Bell Atlantic-New York cites as evidence that reciprocal compensation revenues that were improperly above cost) is nothing more than the sharing of cost savings with end user customers, in a manner conceptually the same as an ILEC's attracting a prospective customer with an individual case basis pricing arrangement substantially below the tariffed price. Since the beneficiaries of the practice are end users, Mid-Hudson/Northland suggest, the practice should be encouraged, not discouraged."

Reinforcing the propriety of pursuing of niche markets, MCIW, the Cable Association, and others assert that Bell Atlantic-New York itself does so, citing its recent introduction of Internet Protocol Routing Service (IPRS) to attract ISP customers. The Cable Association notes that the service was introduced following our denial of Bell Atlantic-New York's request *for* immediate relief from reciprocal compensation obligations relating to ISP-bound traffic: and it suggests that granting the request, which the Cable Association characterizes as one for protection from competitive forces, would have vitiated Bell Atlantic-New York's incentive to introduce the new service. In response, Bell Atlantic-New York denies that IPRS was a reaction to our decision, arguing it could never have been planned and introduced that quickly. More broadly, it objects to the premise that it should be encouraged to compete to retain its customers by being required to subsidize its competitors.

In contrast to the CLECs who emphasize the propriety of pursuing niche markets, others point to the distinctions among CLECs, some of which are, or aspire to be, full service providers. They urge us to do nothing in this proceeding that

⁴⁹ Mid-Hudson/Northland's Initial Brief, p. 17.

would interfere with their ability to function in that capacity. Without suggesting that a focus on ISP or convergent traffic is inherently abusive, they argue that CLECs that may be found to be abusing the existing regulatory structure should be pursued separately, in a manner that does not protect the ILECs from competition by full service, facilities-based providers. CTSI et al., for example, cite testimony that they have not limited themselves to high volume convergent traffic customers, and they object to a one-size-fits-all approach.⁵⁰

The point is emphasized by Time Warner and Lightpath. Lightpath contends that it serves a diverse customer base and points to the blended reciprocal compensation rate in its interconnection agreement with Bell Atlantic-New York, which permits it to receive reciprocal compensation based on end-office rates for traffic terminated via end-office trunks and on tandem rates for traffic terminated via tandem trunks." It charges that Bell Atlantic-New York's effort to seek broad changes in existing reciprocal compensation arrangements rather than pursuing the few CLECs who allegedly abuse the system represents an effort to use the regulatory system to undermine competitive carriers in the area where they have succeeded in eroding Bell Atlantic-New York's market share." It asks us "to maintain the status quo--especially with respect to full-service, facilities-based carriers. . . ."⁵¹

Time Warner, meanwhile, urges recognition of the variation in CLECs' business plans and operating networks, asserting that "responsible CLECs, those that design their networks and their points of interconnection . . . based on

⁵⁰ CTSI et al.'s Initial Brief, p. 21.

⁵¹ Lightpath's Initial Brief, p. 16.

⁵² Ibid., pp. 5-6. The Cable Association argues to similar effect. Cable Association's Initial Brief, p. 4.

"Lightpath's Reply Brief, p. 3.

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sound engineering principles for the **flow** of both originating and terminating traffic, have built their networks to serve a broad range of local telephone customers." " It adds that "the ILECs have offered no evidence to dispute the fact that responsible CLECs have built out, and continue to augment, their networks **as** necessary to handle actual and anticipated two-way traffic volumes among providers."⁵⁵ Recognizing this degree of variation among CLECs, and attempting to provide incentives for CLECs to build out their networks, Time Warner offers its own proposed modification, described in detail below, to the existing reciprocal compensation scheme.

Bell Atlantic-New York responds that there is no basis for distinguishing among CLECs in this way and that its proposals **arc** intended not to punish vice or reward **virtue** but only to reflect the fact that it costs less to deliver convergent traffic than to deliver traffic to numerous, widely dispersed customers. It therefore would apply its proposals to the convergent traffic carried by FSPs as well as to niche players.

⁵⁴ Time Warner's Initial Brief, p. 4, footnotes omitted.

⁵⁵ Ibid., p. 5.

2. Relationship between
Traffic Ratios and Costs

Many CLECs assert that the ILECs have shown no relationship between the type of traffic carried and the costs incurred to terminate it; they insist that "a minute is a minute," regardless of the type of traffic being carried." ComTel, for example, cites Bell Atlantic-New York's witness's confirmation that it uses the same network facilities for all types of traffic, and e-Spire/Intermedia note the witness's statement that network components are not related to traffic imbalances.⁵⁷ Bell Atlantic-New York disputes these characterizations of its witness's testimony, contending, among other things, that the use of similar facilities, referred to by the witness, does not mean the facilities are identical.⁵⁸

MCIW similarly contends that Bell Atlantic-New York failed to show that CLECs' costs are lower than ILECs' because they provide service to convergent customers; it cites its own witness's statement that

virtually all of the CLECs in this case provided information that, in aggregate, demonstrates that ISP traffic is being routed through the same interconnection, transport, and circuit switching equipment that all other traffic is being routed over. [Bell Atlantic-New York] provided similar testimony stating that, to the extent that it could identify ISPs separately from other end users, calls to those ISPs are also being routed through the same interconnection, transport, and switching equipment and facilities as any other type of end user call.⁵⁹

⁵⁶ TRA's Initial Brief, pp. 3-4.

⁵⁷ ComTel's Initial Brief, p. 4, citing Tr. 296, 307, 308; e-Spire/Intermedia's Initial Brief, pp. 6-7, citing Tr. 297-298.

⁵⁸ Bell Atlantic-New York's Reply Brief, p. 15, n. 30.

⁵⁹ Tr. 722, cited in MCIW's Initial Brief, p. 4.

CTSI et al. cite in particular what they characterize as Bell Atlantic-New York's testimony that the length of the loop is "nothing to do with the carrier's terminating costs."

Lightpath, apparently distinguishing full-service CLECs from others, states that "despite extensive testimony filed by both incumbent and competitive carriers, no evidence has been presented to demonstrate that terminating large volumes of calls to single customers is more cost effective for full service, facilities-based providers than terminating other types of traffic."⁶¹

Several CLECs stress the centrality of the functional equivalence determination in deciding whether the rate should be set at the tandem or end-office level or at some point in between. AT&T notes our statement in the Framework Order that functional equivalence does not depend on a CLEC's network architecture as long as the CLEC can terminate calls to all customers served by its network through a single point of interconnection. Disputing Bell Atlantic-New York's suggestion that CLECs' use of a single-switch network architecture may provide them efficiencies and lower costs that would warrant withholding reciprocal compensation at tandem rates, AT&T explains that a CLEC must use the single-switch network architecture in the early stages of competition until it gains volumes that would warrant the installation of additional end-office and tandem switches.⁶² CompTel notes the FCC's determination that a CLEC is entitled to a tandem rate in cases where its switch serves a geographic area comparable to that served by the ILECs tandem switch. MCIW see the functional equivalence doctrine as permitting a state commission to determine whether a particular CLEC is entitled to the tandem rate on the basis of "economically

⁶⁰ Tr. 178, cited in CTSI et al.'s Initial Brief, pp. 8-9.

⁶¹ Lightpath's Initial Brief, p. 2.

⁶² AT&T's Initial Brief, p. 8.

relevant considerations, mainly the geographic coverage that the CLEC's switch supports" " instead of on the **basis of such** irrelevant considerations **as** traffic ratios. Lightpath argues that its system **meets** both the **FCC's** geographic area standard and our single point of interconnection standard and that its consequent tandem functionality is not vitiated by the fact that **it** serves some convergent customers. It asserts that

once a CLEC has made the necessary investment to build out a full facilities-based network that meets the commissions' (i.e., FCC's and PSC's) definitions of tandem functionality, it is entitled to be compensated for its costs using tandem switching **as a proxy**. . . Thus, a **CLEC's** right to receive tandem termination rates is based on the overall functionality of the switch with respect to calls and all customers served by the **CLEC's** switch, and not on the characteristics of a particular call or type of traffic.⁶³

In response, CPB maintains that tandem functionality is not needed to terminate calls to **a** small number of large-volume customers and that such customers can be served using high-capacity facilities having a lower cost-per-minute than the low-capacity facilities used to serve **a** large number of widely dispersed customers. It **urges** us to reflect these cost differences in the reciprocal compensation rates applicable to traffic terminated to large-volume customers. Frontier asserts that these differences mean that **a** lower compensation rate for **this** type of traffic would be consistent with the federal requirements, and it points to Time Warner's recognition of cost differences between convergent and other traffic.

⁶³ MCIW's Initial Brief, p. 5.

⁶⁴ Lightpath's Initial Brief, pp. 14-15 (emphasis in original),

3. Other Cost-Related Issues

Several CLECs argue that the cost calculus should recognize the fact ILECs avoid costs when CLECs terminate traffic that they originate. AT&T states, for example, that.

[Bell Atlantic-New York's] own TELRIC costs form the basis for the existing rates. If [Bell Atlantic-New York] terminates less in-bound ISP traffic because such traffic is terminated instead by CLECs, [Bell Atlantic-New York] saved the costs of delivering such traffic. As long as such costs are appropriately calculated, [Bell Atlantic-New York] suffers no loss and cannot complain that an "unbalance" in traffic or payments represents a basis for altering rates.⁶⁵

TRA adds that the ILEC's retail rates recover termination costs and that allowing an ILEC to avoid responsibility for those costs, by delivering traffic to a CLCC for termination without paying full compensation, would unjustly enrich the ILEC and represent "a classic monopoly abuse of the ILEC's customers."⁶⁶

Some CLEC's respond to Bell Atlantic-New York's concern that its reciprocal compensation payments exceed the revenues it receives from end-users that place calls to ISPs.

CTSI et al., for example, note that any averaged rate structure contemplates customers that generate more costs than revenues being offset by others that generate more revenues than costs; that if Bell Atlantic-New York's residential retail rate is inadequate, it should be examined elsewhere; that dial-up access to the Internet generates other sources of revenues for an ILEC, such as additional lines and vertical features; and that the existence of Bell Atlantic-New York's own ISP (Bell Atlantic.net) suggests that its end-user rate structure supports dial-up access to ISPs, for if it did not,

⁶⁵ AT&T's Initial Brief, p. 7.

⁶⁶ TRA's Initial Brief, pp. 4-5.

its provision of a competitive ISP service would be unlawfully subsidized by its monopoly ratepayers.⁶⁷ Lightpath argues that any mismatch between revenues from calls with long holding times and the costs of carrying those calls should not be solved through adjustments to reciprocal compensation: to do so, it says, would force CLECs to subsidize calls with long holding times originated by ILECs.

Finally, several CLECs, including Global NAPs, assert that even if it made more sense to recover ISP termination costs through carrier access charges (on the premise that ISPs are analogous to carriers rather than final destinations for traffic), doing so is precluded. The only way to recover those costs, accordingly, is through reciprocal compensation.

4. Legal and Procedural Points

Lightpath, among others, contends that the existing reciprocal compensation framework is legally binding for local (i.e., for purposes of this case, non-ISP) traffic, pointing to the doctrine of functional equivalence as determinative. Bell Atlantic-New York does not really dispute that point, though it takes a very different view of what "functional equivalence" entails. CTSI et al. cite the provision of the FCC's rules that prohibit an ILEC from charging a CLEC element rates that "vary on the basis of the class of customers served by the requesting carrier, or on the type of service that the requesting carrier purchasing such elements uses them to provide."⁶⁸ Bell Atlantic-New York responds that it is proposing to distinguish among types of traffic, not types of customer,⁶⁹ and that such distinctions are clearly permitted, as evidenced by the authorization to apply different rates to

⁶⁷ CTSI et al.'s Initial Brief, pp. 25-26.

⁶⁸ 47 C.F.R. §51.503(c).

⁶⁹ The exception is for ISP customers, no longer subject to the FCC's rule.

tandem-routed and end-office-routed traffic.

In addition, Lightpath, CTSI et al., and others assert that regardless of what may otherwise be decided in this case, existing interconnection agreements should prevail at least until the ends of their terms.

Bell Atlantic-New York responds that its proposals should be incorporated into existing agreements only to the extent those agreements, by their own terms, require or allow that incorporation. The proposals, in its view, should guide interconnection negotiations, be incorporated in LEC tariffs, and be applied in resolving disputes, but should not alter existing agreements.

On a more specific matter, **Bell Atlantic-New York** observed in its initial brief that "agreements already in force **should be** interpreted in accordance with normal principles of contract interpretation."⁷⁰ Citing its comments in the Chatline Proceeding, it went on to assert that those agreements, properly interpreted, would not provide for inter-carrier compensation for Internet traffic, presumably because such traffic ~~does~~ not "terminate" on the receiving carrier's network (consistent with the FCC's finding in its ISP Ruling).

In its reply brief, Lightpath strongly disputes that reading, insisting its agreement with **Bell Atlantic-New York** was intended to include Internet traffic, and it asks us to clarify that Bell Atlantic-New York must continue to honor its contractual agreements until they expire.⁷¹

Positions of State Agencies

1. CPB

CPB attributes traffic imbalances to multiple **factors**: like the CLECs, it sees the imbalances **as** resulting from the ILECs' failure to **open** markets adequately and from

⁷⁰ Bell Atlantic-New York's Initial **Brief**, p. 5.

This specific issue, along with others, is resolved below, in the "Discussion and Conclusions" section.

the CLECs' own logical business plans: but, like the ILECs, it also assigns a role to the incentives provided by the reciprocal compensation structure. It suggests that **excessive** reciprocal compensation rates **artificially** discourage competition for customers that originate telephone calls, such as residential and **small** business customers, and it therefore sees a need to adjust the existing system while still providing compensation for all call termination. (Its proposal is described in detail below.) To ensure, however, that the traffic imbalances that are dealt with by its proposal **do** not result from the **ILECs'** failure to open their markets to **CLECs**, it would defer application of its remedy until the **ILECs'** local market **is** fully open **to competition.**⁷²

In response, Bell Atlantic-New York **argues** that if the market **is** not yet fully open (a premise it rejects) continuing to make niche markets artificially attractive **will** work against the development of local competition, not in **favor** of it. And even if its actions prevented **CLECs** from maturing to tandem functionality (another premise it **rejects**) that would be no **reason** to provide reciprocal compensation at above-cost levels. **AT&T**, citing **CPB's** statement that "one reason for the current imbalance in the exchange of traffic between **ILECs** and **CLECs** is that **ILECs'** local markets **are** not yet open to competition," **asserts** that "as recognized by the **CPB**, the real reason for the current imbalance in traffic flows **is** that [Bell Atlantic-New York] has not yet opened the local market to broad based competition."⁷³

⁷² **CPB's** Initial Brief, p. 19.

⁷³ **Id.**; **AT&T's** Reply Brief, p. 3 (emphasis supplied in both quotations).

2. The Attorney General

As noted, the Attorney General emphasizes the need to avoid any steps that would impede widely available Internet access.

SPECIFIC PROPOSALS

Bell Atlantic-New York's Proposals

1. Exclusion of Vertical Feature Costs

Bell Atlantic-New York proposes to exclude from the Phase 1 switching costs on the basis of which reciprocal compensation rates are set all costs associated with "vertical features," such as call waiting, which are not used in the simple routing and delivery of traffic. Acknowledging that the amount to be excluded cannot be determined on the basis of the record in Phase 1 of the First Network Elements Proceeding, it suggests a reduction of 304, subject to true-up following a closer examination of the issue in the Second Network Elements Proceeding. Characterizing the proposal as a "modest" one that "has been inexplicably controversial,"⁷⁴ it suggests that parties opposing it have misunderstood the purpose of the Phase 1 studies, which were concerned with switching costs in general and not their relationship to intercarrier compensation rates, in connection with which disaggregation of switching costs into "originating" and "terminating" components is warranted.

Several CLECs, including AT&T, Lightpath, and Global NAPs, suggest that the vertical features proposal, which applies to all traffic, not only to large-volume traffic to single customers, is beyond the scope of this case and may or should be examined elsewhere. Lightpath and CTSI et al. assert as well that Bell Atlantic-New York has offered no support for its proposal, either to show that vertical features are not used in call termination or to show that the 304 adjustment is a reasonable place holder pending further

⁷⁴ Bell-Atlantic-New York's Initial Brief, p. 17.

inquiry in the Second Network Elements Proceeding.

Some CLECs question the motivation for Bell Atlantic-New York's proposal. CTSI et al. suggest that Bell Atlantic-New York is contriving to remove these costs from reciprocal compensation (so it will pay less) while leaving them in network element rates (so it will receive more). Global NAPS suggests that Bell Atlantic-New York has become concerned that reciprocal compensation rates may be too high only in light of its realization that it will have to pay compensation, not merely receive it. It sees this as a benefit of the present system's imposition on Bell Atlantic-New York of competitive pressures to establish the lowest reasonable call termination rate.³ Frontier, in its reply brief, accepts that challenge and urges reduction of the rate to zero, that is, its replacement by bill-and-keep.

2. Non-ISP Convergent Traffic

Bell Atlantic-New York proposes to allow Meet Point B (tandem-rate) reciprocal compensation to be charged **"only** when traffic is being delivered or terminated (a) through a tandem point of interconnection, or (b) through facilities that are 'functionally equivalent' to a tandem. This rule should be applied symmetrically to all carriers, both CLECs and incumbents. It would call for different results, however, depending upon the type of network architecture used by the carrier in question." " More specifically, a CLEC would be paid tandem-rate reciprocal compensation if, like Bell Atlantic-New York itself, it installed one or more tandem switches, used them to provide an actual tandem functionality, and offered other carriers the option of interconnecting either at the tandem or at the end office. In addition, tandem rate compensation would be paid

³ "Global NAPS' Initial Brief, p. 2, n. 3.

"Bell Atlantic-New York's Initial Brief, p. 20 (emphasis in original, footnote omitted).

to a CLEC that did not use tandem switching but whose facilities were nevertheless functionally equivalent to a tandem switch. As the wording of its proposal suggests, Bell Atlantic-New York sees it as consistent with the doctrines of functional equivalence and symmetry, properly understood. In Bell Atlantic-New York's view, however, the functional equivalence test cannot be met for large volume one-way traffic.

The claim of functional equivalence for a tandemless network is based on the premise that long loops, SONET rings, and other facilities take the place of the tandem and provide similar functionality. But Bell Atlantic-New York maintains that such wide area functionality need not be used in delivering traffic to a small number of large volume customers (in contrast to a widely dispersed base including substantial numbers of small customers). In the former instance, the delivering carrier can use high capacity facilities having a lower per-minute cost than the voice grade facilities needed to deliver traffic to a widely dispersed group of customers. In addition, Bell Atlantic-New York cites Global NAPs' witness's statement that ISP-bound traffic makes more efficient use of switching and transport capacity than does conventional voice telephony." Beyond these factors, Bell Atlantic-New York continues, delivery of traffic to a small number of large volume customers permits a carrier to avoid the costs associated with substantial numbers of idle distribution facilities.

To show that its proposal is consistent with the FCC's rule, Bell Atlantic-New York points to the rule's statement that a CLEC is entitled to tandem interconnection rates when its switch "serves a geographic area comparable to the area served by the incumbent ILEC's tandem switch"⁷⁶; and

⁷⁶ Ibid., p. 24, citing Tr. 649. (Bell Atlantic-New York refers to the witness as Cablevision's rather than Global NAPs'.)

⁷⁷ 47 C.F.R. §51.711(a)(3) (emphasis supplied).