

November 25, 2003

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Room TW-A325
445 12th Street, S.W.
Washington, D.C. 20554

Re: CC Docket No. 01-92, WC Docket Nos. 02-361, 03-211

Dear Ms. Dortch:

This letter is written on behalf of Time Warner Telecom (“TWTC”) for the purpose of requesting that the Commission provide clear policy guidance as soon as possible as to the circumstances under which interstate carrier access charges apply to VoIP traffic.

The telecommunications industry continues to experience profound difficulties that are preventing it from benefiting from the improved fundamentals of the broader economy.¹ As has long been the case, regulatory uncertainty contributes significantly to this trend. In many aspects of telecommunications regulation the need for some stability is at least as important as the need for sound policy outcomes. As one analyst recently explained, it is critical that the Commission reach decisions “as quickly as you can.”² As another analyst put it, “[d]on’t be afraid to make decisions. Investors value a firm decision.”³ This is especially true with regard to the application of carrier access charges to VoIP. The Commission has appropriately announced that it will soon initiate a comprehensive rulemaking proceeding to address all of the many long-term regulatory issues that affect VoIP. But in the meantime, it must provide as much policy guidance as possible regarding the circumstances in

¹ See e.g., “Telecom Hemorrhage and Separation from Economic Growth Continues,” Precursor Group (Nov. 17, 2003).

² “At NARUC Convention,” Communications Daily (Nov. 19, 2003) at 4-5 (quoting Schwab Washington Research Group analyst Paul Glenchur).

³ *Id.* at 5 (quoting James Henry of the Babcock Group).

which interstate carrier access charges apply to VoIP *until* a comprehensive regime for VoIP is adopted in the broader rulemaking proceeding.

Controversies associated with the application of interstate carrier access charges to VoIP are imposing real costs on carriers like TWTC. For example, Internet service providers (“ISPs”) frequently order local ISDN service from TWTC. Where traffic originating on those ISDN lines is destined for the telephone number of a non-TWTC customer within the same local calling area, TWTC’s switches automatically route the traffic to local interconnection trunks for delivery to the called party’s local exchange carrier. Nevertheless, during the course of investigations, some ISPs have informed TWTC that some of the traffic they deliver to TWTC’s switches *via* ISDN lines is VoIP traffic that originates in a distant exchange, is carried over an IP backbone and/or handed off to an ISP soft switch at the terminating local exchange, and then passed over the TWTC ISDN lines to the TWTC switch. Without conducting a costly audit, however, TWTC cannot generally determine the extent to which this is the case. Nevertheless, incumbent LECs have in some cases become aware that some of the traffic exchanged over local interconnection trunks with TWTC might be long distance VoIP traffic. This has caused incumbent LECs to perform their own audits. If they discover that calls have in fact originated from a telephone number in a distant exchange, the incumbent LECs send TWTC a bill for interstate carrier access charges (rather than for reciprocal compensation). Although the *Report to Congress*⁴ established a policy against the application of carrier access charges at this time to any VoIP traffic, this has not stopped the incumbents from aggressively seeking such compensation (as well as other remedies). Moreover, it is often impossible for TWTC to recover these charges from its ISP customers because they refuse to pay, and TWTC often lacks a contractual right to recover the charges.⁵ TWTC is therefore needlessly caught in the middle of difficult and costly disputes.

Problems such as these are likely only to grow in size and number as the volume of VoIP traffic grows. It is critical, therefore, that the Commission act quickly to clarify the circumstances under which interstate carrier access charges apply to VoIP traffic. The optimal approach to this issue is as follows.

First, the Commission should promptly release a declaratory ruling addressing the issues raised in AT&T’s petition for declaratory ruling regarding VoIP.⁶ In that petition, AT&T sought a

⁴ *Federal-State Joint Board on Universal Service*, Report to Congress, 13 FCC Rcd 11501, ¶ 39 (1998) (“*Report to Congress*”).

⁵ It is also very difficult for TWTC to determine which long distance carrier or carriers have delivered traffic to the ISP. This information is not contained in either the SS7 or billing records TWTC keeps. Only the ISP knows the identity of the long distance carrier or carriers. ISPs generally resist sharing this information and, in all events, the transaction costs (including potentially the need for litigation) associated with obtaining this information are extremely high.

⁶ See Petition for Declaratory Ruling That AT&T’s Phone-to-Phone IP Telephony Services Are Exempt From Access Charges, WC Dkt. No. 02-361 (Oct. 18, 2002) (“AT&T VoIP Petition”).

clarification from the Commission that interstate carrier access charges do not apply to traffic that originates and terminates in TDM format at telephones connected to circuit switches but that traverses an IP network (either the public Internet or a “private” IP backbone) in the long-haul portion of the call. See AT&T VoIP Petition at 24-26. As explained below, AT&T correctly argued in its petition that the *Report to Congress* announced a Commission policy against applying carrier access charges to this traffic. The Commission is required, however, to reassess its approach to account for changed circumstances.⁷ The policy against the application of interstate carrier access charges to VoIP traffic was established in an environment in which a relatively small amount of voice traffic traversed IP networks. But as *The New York Times* recently reported, “[a]bout 10 percent of all telephone calls now rely at some point on VoIP, and that percentage is expected to rise dramatically during the next decade.”⁸ Accordingly, continuing to exempt long distance VoIP telecommunications service traffic (*i.e.*, phone-to-phone traffic that undergoes no net protocol conversion and that does not qualify as an information service for any other reason) from carrier access charges offers carriers an unlimited opportunity to bypass the access charge regime simply by “laundering” the traffic through an IP gateway. If long distance carriers are allowed to exploit this opportunity in the future, the access charge regime is likely to collapse, leaving incumbent and competitive LECs with serious revenue shortfalls and without any ability to compensate adequately with rebalanced rates.⁹ Moreover, retaining the current regime would give long distance carriers an inefficient incentive to invest in IP gateway functionalities solely as a means of avoiding access charges. The Commission should therefore issue a declaratory ruling explaining that interstate carrier access charges apply to VoIP traffic exchanged in the *future* that undergoes no end-to-end protocol conversion.¹⁰

A different approach is warranted, however, for such traffic exchanged between the time of the *Report to Congress* in 1998 and the effective date of a declaratory ruling that interstate carrier access charges apply in the future. As AT&T explained in its petition, the FCC announced a clear policy in the *Report to Congress* that interstate carrier access charges would not apply to VoIP, even phone-to-phone traffic that it deemed a telecommunications service. The Commission explained that, “to the extent we conclude that certain forms of phone-to-phone IP telephony services are

⁷ See *Geller v. FCC*, 610 F.2d 973, 980 (D.C. Cir. 1979).

⁸ “SBC to offer cheaper VoIP service,” Ben Charny, Staff Writer, CNET News.com (Nov. 20, 2003) available at http://www.nytimes.com/cnet/CNET_2100-7352_3-5109668.html.

⁹ See Reply Comments of SBC Communications, WC Docket No. 02-361 at 3 (Jan. 24, 2003) (“If, on the other hand, the Commission continues to allow IXCs to evade switched access charges simply by routing their traffic over an IP backbone, it will have disastrous consequences for the Commission’s access charge regime”).

¹⁰ To the extent that the Commission determines that there is VoIP traffic that undergoes no end-to-end protocol conversion but that is not covered by the AT&T VoIP Petition, the Commission should clarify in a Policy Statement that it will presume in the future that such traffic is subject to carrier interstate access charges.

The Commission should also clarify that, under its rules, all providers of telecommunications services that utilize Signaling System 7, including providers of VoIP telecommunications services, are required in the future to pass calling party number. See 47 C.F.R. §64.1601.

‘telecommunications services’ and to the extent the providers of those services obtain the same circuit-switched access as obtained by other interexchange carriers, and therefore impose the same burdens on the local exchange as to other interexchange carriers,” the Commission “*may* find it reasonable that they pay *similar* access charges.” *Report to Congress* ¶ 91 (emphasis added). The clear message was that the Commission would not apply carrier access charges to telecommunications service VoIP traffic *until* such future time as it reached a binding decision on that issue in the future.

The purpose of policy statements such as the one contained in the *Report to Congress* is to provide an indication of an agency’s current position on a particular regulatory issue and to allow the regulated industry to engage in long-term planning that may otherwise be impossible.¹¹ Although (as explained) the Commission should rule in the declaratory ruling that interstate carrier access charges apply *in the future* to VoIP traffic that does not undergo an end-to-end protocol conversion, VoIP providers have up until now relied on the federal policy articulated in the *Report to Congress*. The Commission should not therefore apply its holding in the declaratory ruling retroactively to telecommunications service VoIP traffic exchanged between the release of the *Report to Congress* and the effective date of the declaratory ruling.

A bar against retroactive application of access charges for this period is fully justified under the relevant case law. In *SEC v. Chenery*, 332 U.S. 194, 203 (1947), the Supreme Court held that courts must review the reasonableness of applying administrative orders retroactively by balancing the “ill effect of the retroactive application of a new standard” against the policy goal of ensuring a result that is consistent with the requirements of the relevant statute or requirements of law. Since then, courts have employed different tests for balancing these competing concerns. Probably the leading test for determining whether a rule adopted in a quasi-adjudication such as declaratory ruling proceeding¹² should be retroactive was established by the D.C. Circuit in *Retail, Wholesale & Dep’t Stores Union v. NLRB*, 466 F.2d 380, 390 (D.C. Cir. 1972). As the court in that case explained,

[a]mong the considerations that enter into a resolution of the problem are (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill a void in an existing unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

Id. As the D.C. Circuit subsequently explained, these factors “boil down to . . . a question of concerns grounded in notions of equity and fairness.” *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) (citations omitted).

¹¹ *Pacific Gas & Elec. Co. v. Fed. Power Comm’n*, 506 F.2d 33, 38 (D.C. Cir. 1974).

¹² A declaratory ruling that resolves an open dispute (such as the ruling sought by AT&T in its VoIP petition) is treated as an adjudication under the Administrative Procedure Act. *See* 5 U.S.C. § 554(e).

When applied to the instant situation, the *Retail, Wholesale & Dep't Stores Union* factors weigh heavily against retroactive application of interstate carrier access charges to telecommunication service VoIP traffic. To begin with, as explained, the Commission established a policy against imposing access charges on any VoIP traffic in the *Report to Congress* until it reached a different conclusion in the future. The *Report to Congress* was never subject to appeal, by either the incumbent LECs or anyone else, and the Commission has not veered from the approach adopted therein for five years now. In fact, as AT&T pointed out in its petition, the FCC refused even to consider a petition for declaratory ruling filed by U S West soon after the release of the *Report to Congress* in which U S West argued that the FCC should require that access charges apply to "phone-to-phone IP telephony services." See AT&T VoIP Petition at 16-17. Where, as here, an agency establishes a clear policy and subsequently changes that policy (as it should), there is an especially strong interest in avoiding retroactive application of the new policy.¹³ Even where an agency's established policy or rule is deemed to be ambiguous and regulated entities rely on a reasonable interpretation of such rules, there is a strong interest in avoiding retroactive application of a new policy that is inconsistent with the regulated companies' prior interpretation.¹⁴ Applying access charges in the future to VoIP traffic will surely constitute a departure from the established FCC policy. Moreover, an entire industry segment has developed around the expectation that access charges do not currently apply to any VoIP traffic. This is a situation, therefore, in which the question of whether to apply interstate carrier access charges has been addressed in the past by the FCC, where the necessary policy of applying access charges in the future would represent a 180 degree change from prior policy, and where numerous firms have planned their businesses up until now in reliance on the past FCC policy. Accordingly, the first three *Retail, Wholesale & Dep't Stores Union* factors all weigh heavily against retroactive application.

¹³ See e.g., *Microcomputer Technology Inst., v. Riley*, 139 F.3d 1044, 1051-1052 (5th Cir. 1998) (overturning retroactive application of a new standard where a party had relied on a different pre-existing standard described in a memorandum from the agency's general counsel); *Retail, Wholesale & Dep't Stores Union v. NLRB*, 466 F.2d at 391 (prohibiting retroactive application of a change in a "well established and long accepted" policy where such application would punish parties for complying with prior policy). See also *National Labor Relations Board v. Majestic Weaving Co.*, 355 F.2d 854, 860-861 (2d Cir. 1966) ("the problem of retroactive application has a somewhat different aspect in cases not of first but of second impression, where an agency alters an established rule defining permissible conduct which has been generally recognized and relied throughout the industry that it regulates. As a result of the nature of the task Congress has confided to the agencies and the vagueness of the directions it has given, they are, and ought to be, much likelier to engage both in new departures and in alterations than courts with their more limited 'molecular motions,' and this makes it peculiarly important for them to take full advantage of their power to act prospectively, whether by rule-making or adjudication.") (citations omitted).

¹⁴ See *Standard Oil Co. v. Dep't of Energy*, 596 F.2d 1029, 1065 (Temp. Emerg. Ct. 1978). See also *J.L. Foti Constr. Co. v. Occupational Safety and Health Review Comm'n*, 687 F.2d 853, 858-859 (6th Cir. 1982) (overturning retroactive application of a newly adopted standard where the agency's previous attempts to adopt a standard "had generated little more than hopeless confusion"); *Louisiana v. Dep't of Energy*, 507 F. Supp. 1365, 1376 (W.D. La. 1981) ("The cases are clear that a post hoc agency interpretation of an ambiguous regulation should not be enforced retroactively against a regulated party who adopted and applied an alternate reasonable interpretation of the regulation during the period between the initial promulgation of the ambiguous regulation and the later agency interpretation") (citations omitted).

The same must be said of the fourth factor, since the burden on the industry of retroactive application of access charges would be enormous. Such an approach would almost certainly lead to endless incumbent LEC audits to determine the extent to which the millions of minutes of VoIP traffic exchanged over the past five years should have been subject to access charges. In many cases the underlying VoIP service provider would be either no longer in existence or unable to pay the applicable access charge bills when they came due. Where such traffic had traversed a competitive LEC's network, the competitive LEC could end up "holding the bag" as described above.¹⁵ It is also important to emphasize that the incumbent LECs would have the incentive to exploit the chaos and enormous potential costs associated with retroactive application as a means of raising their competitors' costs and potentially driving them out of business.

Finally, there is no legitimate "statutory interest in applying a new rule despite the reliance of a party on the old standard" for the application of access charges to VoIP. As then Commissioner Powell explained in his concurrence to the *Report to Congress*, the premature application of telecommunications service regulation, including universal service and access charges, to VoIP was "likely to chill, if not freeze, innovation in broadband digital services." *See Report to Congress*, Powell Concurrence at 4. This result, he concluded, was contrary to "the Act's stated goal of fostering a pro-competitive, *deregulatory* environment." *Id.* (emphasis in original). At the very least, the *Report to Congress* stood for the proposition that new and innovative VoIP services should not be subjected to regulations otherwise applicable under Title II unless and until it became clear that such regulation furthers an identifiable statutory goal. Until recently, the volume of VoIP traffic that does not undergo an end-to-end protocol conversion has not been significant enough to require application of access charges, and the statutory goal of nurturing new and innovative offerings appropriately prevailed. That is now fast-changing, and the access charge regime will soon be threatened. But recent developments in no way undermine the soundness of the FCC's hands-off approach in the past. Moreover, it cannot be that any statutory purpose is advanced by exposing the already beleaguered telecommunications industry to the endless disputes and general chaos that retroactive application of carrier access charges

¹⁵ The courts have repeatedly recognized that financial hardship caused by retroactive application of a new rule must be considered as a factor weighing against retroactive application. *See Microcomputer Technology Inst., v. Riley*, 139 F.3d at 1051 (relying in part on a party's obligation to repay "millions of dollars in Pell Grants" previously disbursed to students under retroactive application of a new standard as the basis for prohibiting retroactive application); *J.L. Foti Constr. Co. v. Occupational Safety and Health Review Comm'n*, 687 F.2d at 858 (concluding that the court's "strongest objection to this particular instance of retroactivity is the fact that Foti was thereby subjected to an almost doubled fine"). The courts have found that such considerations are relevant where the financial hardship caused by retroactive application results in a corresponding benefit to other private parties. *See McDonald v. Watt*, 653 F.2d 1035, 1045-1046 (5th Cir. 1981) (ruling that the loss of leasehold rights to other private parties as a result of the retroactive application of a new standard would result in "extreme prejudice" that weighs against retroactive application). *See generally Standard Oil Co. v. Dep't of Energy*, 596 F.2d 1029 (prohibiting retroactive application of a new rule where such application would result in lower prices charged by regulated oil refiners but would result in refunds to oil purchasers).

would engender.¹⁶ No statutory goal is therefore served by applying access charges to traffic exchanged in the past.

Second, the Commission should also clarify its policy approach with regard to VoIP traffic that undergoes a net protocol conversion. Such a conversion takes place with services like Vonage that originate in IP protocol where the subscriber initiates a call and terminate in TDM where the called party is served by a circuit switch.¹⁷ Traffic that undergoes such an end-to-end conversion has been generally viewed by the Commission as information service traffic and not telecommunication service traffic.¹⁸ Under the Commission's rules, information services are not subject to carrier access charges. *See* 47 C.F.R. § 69.5 (applying carrier access charges only to "interexchange carriers"). It is not clear that it makes sense to apply this rule to VoIP, but that is a complex question that the FCC should address in its upcoming comprehensive rulemaking.¹⁹ Moreover, exempting VoIP traffic that undergoes an end-to-end protocol conversion from carrier access charges is unlikely to pose a serious threat to the interstate carrier access charge regime for some time because the volumes of such traffic are likely to be significantly smaller than is the case with VoIP traffic that originates and terminates on the PSTN in TDM format. Thus, for now, in order to establish some regulatory stability while the rulemaking proceeding is pending, the FCC should clarify in a policy statement accompanying the declaratory ruling that it will presume that calls from VoIP subscribers that undergo a net conversion are exempt from interstate carrier access charges.

¹⁶ *Cf. McDonald v. Watt*, 653 F.2d at 1046 (ruling that the relevant statutory purpose would be affirmatively frustrated where retroactive application of a new rule would create "'chaotic, piecemeal title challenge(s)'" to leasehold rights) (citation omitted).

¹⁷ Some Vonage-type traffic originates and terminates at Vonage customers, both of whom use broadband connections. Such traffic does not undergo an end-to-end protocol conversion. Nevertheless, this traffic is *de minimis* in volume and, in any event, it should not implicate access charges since it never traverses a circuit switch.

¹⁸ *See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order, 11 FCC Rcd 21905, ¶ 104 (1996)

¹⁹ In this regard it is worth noting that numerous different types of voice services that the Commission treats as telecommunications services and as subject to access charges undergo end-to-end protocol conversions. For example, a call from an incumbent LEC customer served by a circuit switch to a Vonage customer undergoes an end-to-end protocol conversion. But the Commission views such calls as subject to access charges. This fact just illustrates the complexity of this issue and the need for a thorough review in a rulemaking proceeding.

Ms. Marlene H. Dortch

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In accordance with the Commission's rules, a copy of this letter is being filed electronically for inclusion in the public record of each of the above-referenced proceedings.

Sincerely,

/s/

Thomas Jones

Counsel for Time Warner Telecom

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