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August 25, 2004

VIA ELECTRONIC FILING

Marlene R. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: Intercarrier Compensation for ISP-Bound Traffic, CC Docket Nos. 99-68, 96-98

Dear Ms. Dortch:

Enclosed for filing please find the attached Response of Pac-West Telecomm, Inc. to the Bell Operating Companies' Ex Parte Regarding Section 251(b)(5) and ISP-Bound Traffic.

Sincerely,

/s/

Richard M. Rindler

Enclosure

cc: (via e-mail, w/encl.)
Chairman Michael K. Powell
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Commissioner Kevin J. Martin
Daniel Gonzalez
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Jeffrey Carlisle
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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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

**RESPONSE OF
PAC-WEST TELECOMM, INC. TO BELL OPERATING COMPANIES' EX PARTES
REGARDING SECTION 251(b)(5) AND ISP-BOUND TRAFFIC**

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Dated: August 25, 2004

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SUMMARY

In response to several filings by the Bell operating companies to discourage the Commission from ruling that reciprocal compensation is owed for ISP-bound traffic, Pac-West submits that not only are the BOCs wrong, but based on Commission and federal court precedent, it is clear that Section 251(b)(5) provides the only authority for an intercarrier compensation regime for traffic to ISPs, and the Commission should so find without further ado. By doing so, the Commission would be making the correct legal and policy decision and take one step toward a unified intercarrier compensation regime.

Any further decision by the Commission on the issue of reciprocal compensation for ISP-bound traffic must fit within the four corners of the 1999 *ISP Declaratory Ruling*, the 2000 *Bell Atlantic* decision by the United States Court of Appeals for the District of Columbia Circuit, the 2001 *ISP Remand Order*, and the 2002 *WorldCom* decision by the D.C. Circuit. Accordingly, any decision from the Commission should recognize the following:

1. The analysis of a particular communication to determine whether it falls within the Commission's jurisdiction properly considers the geographic beginning point of the communication and the ending point. An Internet session may have a single beginning point at the premises of the ISP subscriber, but it is likely to have numerous ending points, based on the location of the servers that the ISP subscriber accesses through the course of an Internet session. In general, Internet traffic is of mixed jurisdiction, with a substantial interstate portion.

2. The regulatory treatment of a particular communication is not necessarily tied to the jurisdictional analysis. The regulatory treatment may consider a particular communication in severable components without doing violence to the jurisdictional analysis. In the case of

ISP-bound traffic, the dial-up telecommunications to the ISP is severable from the subsequent information service provided by the ISP.

3. Calls to ISPs “terminate” at the ISP. Calls to ISPs fit the Commission’s definition of “termination,” based on the functionality performed, and termination in the context of call delivery may be considered apart from termination in the context of a jurisdictional analysis.

4. Calls to ISPs cannot satisfy the definition of “exchange access” because they are not used for the purpose of originating or terminating telephone toll service. They are used for the purpose of originating or terminating information services.

5. Section 251(b)(5) applies to the “transport and termination of telecommunications,” and there is no geographic (or jurisdictional) limitation on the scope of section 251(b)(5). To the extent Commission compensation regimes that pre-date the Telecom Act address compensation for “exchange access,” they are retained by section 251(g) until expressly superseded by the Commission.

6. Accordingly, section 251(b)(5) obligations for the establishment of reciprocal compensation arrangements for the transport and termination of telecommunications apply between local exchange carriers that exchange traffic delivered to Internet service providers.

The BOCs also misstate the history of the dispute. When Commission precedent is properly applied to the facts of this dispute, it is clear that the Commission has always regulated the “data processing,” “enhanced services,” or “information services” component of an interstate communication as a separate component regardless of its jurisdictional classification. The Commission should re-affirm that principle here and resolve this dispute finally by ruling that reciprocal compensation is owed for ISP-bound traffic.

Finally, a legally sustainable ruling that reciprocal compensation is owed for ISP-bound traffic is also consistent with public policy. A compensation regime that compensates carriers for the costs of the transport and termination services they perform for other carriers sends the appropriate signals to the marketplace. A regulatory regime that denies compensation for a particular service will have the effect of discouraging the performance of that service, thereby reducing competitive alternatives and denying certain end users—in this case ISPs—the benefits of competition.

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**RESPONSE OF
PAC-WEST TELECOMM, INC. TO BELL OPERATING COMPANIES' EX PARTE
REGARDING SECTION 251(b)(5) AND ISP-BOUND TRAFFIC**

I. INTRODUCTION

Pac-West Telecomm, Inc. (“Pac-West”), by its counsel, submits its response to the numerous attempts by the Bell operating companies (“BOCs”) to discourage the Commission from ruling, once and for all, that section 251(b)(5) of the Telecommunications Act of 1996 (“Telecom Act”) applies to traffic to Internet service providers (“ISPs”). In particular, this filing responds to the May 17, 2004, *ex parte* filing by Verizon and BellSouth (“Verizon”), the May 21, 2004 *ex parte* filing by Qwest, the July 20, 2004, “supplemental white paper” by Verizon and BellSouth (“BellSouth”), and the August 6, 2004 *ex parte* letter filed by SBC.

Pac-West submits that not only are the BOCs wrong, but based on Commission and federal court precedent, it is clear that Section 251(b)(5) provides the only authority for an intercarrier compensation regime for traffic to ISPs, and the Commission should so find without further ado. By doing so, the Commission would be making the correct legal and policy decision and take one step toward a unified intercarrier compensation regime.

Any further decision by the Commission on the issue of reciprocal compensation for ISP-bound traffic must fit within the four corners of the following decisions: the 1999 *ISP Declaratory Ruling*,¹ the 2000 *Bell Atlantic* decision by the United States Court of Appeals for the District of Columbia Circuit,² the 2001 *ISP Remand Order*,³ and the 2002 *WorldCom* decision by the D.C. Circuit.⁴ The Commission has ruled that Section 251(b)(5) applies to all telecommunications other than traffic addressed by Section 251(g). Now that the Commission has been rebuffed by the D.C. Circuit in its attempt to rely on Section 251(g) to exclude ISP-bound traffic from Section 251(b)(5), law and basic logic require that the Commission find that Section 251(b)(5) applies to ISP-bound traffic. This filing will examine each of the four decisions, supplementing and correcting the BOCs' distorted presentation of the law and the history.

Further, any approach that does not address the applicability of Section 251(b)(5) to ISP-bound traffic, but instead relies solely on Section 201 to implement an intercarrier compensation regime, should be abandoned. The Commission cannot wish away its obligation to respond to the remand instructions from the D.C. Circuit. Failure to do so will almost certainly result in a third adverse decision from the D.C. Circuit. One recourse by the Court for failure to respond

¹ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Declaratory Ruling and Notice of Proposed Rulemaking, 14 FCC Rcd. 3689 (1999), *vacated and remanded*, *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (“*ISP Declaratory Ruling*”).

² *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

³ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68, Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001), *remanded*, *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. den.* 538 U.S. 1012 (2003) (“*ISP Remand Order*”).

⁴ *WorldCom v. FCC*, 288 F.3d 429 (D.C. Cir. 2002), *cert. den.* 538 U.S. 1012 (2003).

adequately to its instructions is to take the matter out of the hands of the Commission and order a particular result.⁵

II. ANY SUBSEQUENT DECISION MUST REMAIN CONSISTENT WITH THE *ISP DECLARATORY RULING*, THE *BELL ATLANTIC DECISION*, THE *ISP REMAND ORDER*, AND THE *WORLDCOM DECISION*

A. Summary of the Four Decisions

As will be demonstrated below, the four decisions on the issue of reciprocal compensation for ISP-bound traffic have narrowed the inquiry considerably. Any subsequent decision by the Commission on this issue must fit within these four decisions. Accordingly, any decision from the Commission should recognize the following:

1. The analysis of a particular communication to determine whether it falls within the Commission's jurisdiction properly considers the geographic beginning point of the communication and the ending point. An Internet session may have a single beginning point at the premises of the ISP subscriber, but it is likely to have numerous ending points, based on the location of the servers that the ISP subscriber accesses through the course of an Internet session. In general, Internet traffic is of mixed jurisdiction, with a substantial interstate portion.

2. The regulatory treatment of a particular communication is not necessarily tied to the jurisdictional analysis. The regulatory treatment may consider a particular communication in severable components without doing violence to the jurisdictional analysis. In the case of ISP-bound traffic, the dial-up telecommunications to the ISP is severable from the subsequent information service provided by the ISP.

⁵ *Radio-Television News Directors Ass'n v. FCC*, 229 F.3d 269, 272 (D.C. Cir. 2000) (after stating that "the court can only conclude that its remand order for expeditious action was ignored," the Court ordered a repeal of the Commission rules in question without further consideration by the Commission).

3. Calls to ISPs “terminate” at the ISP. Calls to ISPs fit the Commission’s definition of “termination,” based on the functionality performed, and termination in the context of call delivery may be considered apart from termination in the context of a jurisdictional analysis.

4. Calls to ISPs cannot satisfy the definition of “exchange access” because they are not used for the purpose of originating or terminating telephone toll service. They are used for the purpose of originating or terminating information services.

5. Section 251(b)(5) applies to the “transport and termination of telecommunications,” and there is no geographic (or jurisdictional) limitation on the scope of section 251(b)(5). To the extent Commission compensation regimes that pre-date the Telecom Act address compensation for “exchange access,” they are retained by section 251(g) until expressly superseded by the Commission.

6. Accordingly, section 251(b)(5) obligations for the establishment of reciprocal compensation arrangements for the transport and termination of telecommunications apply between local exchange carriers that exchange traffic delivered to Internet service providers.

B. The *ISP Declaratory Ruling* Made Clear that Commission Precedent Recognizes a Distinction Between “Jurisdictional Analysis” and “Regulatory Treatment” for a Particular Service

In February 1999, the Commission released its *ISP Declaratory Ruling*, in which the Commission first attempted to find that Section 251(b)(5) of the Telecom Act did not apply to ISP-bound traffic. The Commission attempted to support its decision on two key conclusions: first, Section 251(b)(5) applies only to local traffic; and second, ISP-bound traffic is not local traffic because calls to ISPs do not terminate at the ISP server. At the same time, the Commission recognized that from a regulatory perspective, calls to ISPs have all the appearances

of local traffic, and but for the Commission's conclusion regarding the jurisdiction of ISP-bound traffic, Section 251(b)(5) would apply:

While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic.⁶

The *ISP Declaratory Ruling* made clear what had always been the Commission's policy regarding traffic to enhanced service providers: the locally dialed connection to an ISP is regulated as a local service, and from a regulatory perspective, individual components of an otherwise interstate service may be decoupled. The Commission expressly divided its analysis into two major components: one focusing on the jurisdictional nature of ISP-bound traffic, and the other on the separate issue of what regulatory treatment should be accorded such calls. Although the Commission concluded that ISP-bound traffic is largely interstate in nature, it made this determination in the context of its jurisdictional analysis – not its analysis of the appropriate regulatory treatment – and repeatedly emphasized that its examination was intended to resolve only the jurisdictional issues. Thus, for example, in its examination of what some called “the two-call theory,” the FCC made clear that it was addressing only the jurisdictional implications of the argument:

We disagree with those commenters that argue that, for jurisdictional purposes, ISP-bound traffic must be separated into two components: an intrastate telecommunications service, provided in this instance by one or more LECs, and an interstate information service, provided by the ISP. As discussed above, the Commission analyzes the totality of the communication when determining the jurisdictional nature of a communication.

* * *

⁶ *ISP Declaratory Ruling* at ¶ 25.

The 1996 Act is consistent with this approach. For example, as amended by the 1996 Act, Section 3(20) of the Communications Act defines “information services” as “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications.” This definition recognizes the inseparability, for purposes of jurisdictional analysis, of the information service and the underlying telecommunications.

* * *

Thus, we analyze ISP traffic for jurisdictional purposes as a continuous transmission from the end user to a distant Internet site.⁷

The FCC carefully crafted its analysis to address only the jurisdictional issues and abstained from determining the regulatory treatment of ISP traffic. Instead, it expressly left the door open for state determination of the regulatory issues concerning the propriety of applying reciprocal compensation to such calls.

The *ISP Declaratory Ruling* also makes clear in other places that there is a distinct difference between “jurisdictional analysis” and “regulatory treatment.” The first sentence of the *Declaratory Ruling* after the Introduction says, “Identifying the jurisdictional nature and regulatory treatment of ISP-bound communications requires us to determine how Internet traffic fits within our existing regulatory framework.”⁸ This two-part analytical approach is reflected in the structure of the Discussion section, Part III, which is divided into Section A, “Jurisdictional Nature of Incumbent LEC and CLEC Delivery of ISP-Bound Traffic” (jurisdictional analysis), and Section B, “Inter-Carrier Compensation for Delivery of ISP-Bound Traffic” (regulatory treatment).

⁷ *Id.* at ¶ 13 (emphasis added).

⁸ *Id.* at ¶ 2 (emphasis added).

The decoupling of the Commission's "jurisdictional analysis" from its "regulatory treatment" was nothing new. The entire arrangement under which ISPs obtain local exchange service for the provision of interstate information service demonstrates that the distinction exists. The existence of a rule applicable to enhanced service providers ("ESPs") that permits them to purchase tariffed local exchange service to provide an interstate service is a clear and compelling demonstration of the difference between jurisdictional analysis and regulatory treatment. As the Commission stated, "although recognizing that it was interstate access, the Commission has treated ISP-bound traffic as though it were local."⁹

The distinction between "jurisdictional analysis" and "regulatory treatment" is also evident elsewhere in Commission precedent. In the *Local Competition Order* the Commission imposed reciprocal compensation obligations on traffic to or from Commercial Mobile Radio Service ("CMRS") networks. As stated by the Commission, "traffic to or from a CMRS network that originates and terminates within the same [Major Trading Area] is subject to transport and termination rates under section 251(b)(5), rather than interstate and intrastate access charges."¹⁰ Yet there would be no need to articulate that CMRS traffic (much of which is, in fact, interstate) was subject to reciprocal compensation, and alter the applicability of access charges to CMRS traffic, if the Commission were bound by a requirement that wedded its jurisdictional analysis to its regulatory treatment. If CMRS traffic otherwise complied with the Commission's restriction for wireline traffic originating and terminating within a single local calling area, a rule applicable only to CMRS traffic would be unnecessary. The promulgation of a separate rule for CMRS

⁹ *Id.* at ¶ 23.

¹⁰ *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) at ¶ 1036, *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd in part, aff'd in part sub nom., AT&T Corp. v. Iowa Utils. Bd.*, 119 S.Ct. 721 (1999) ("*Local Competition Order*").

traffic not only proves conclusively that Section 251(b)(5) is not limited to “local” traffic, but that the Commission on more than one occasion has made the determination to treat interstate, interexchange traffic the same as local traffic for regulatory purposes.¹¹

The ability of the Commission to make this distinction and create such a regulatory regime has been affirmed by the United States Court of Appeals. In their appeal of the Commission’s *Access Charge Reform Order*,¹² BellSouth and Verizon’s predecessor Bell Atlantic challenged the Commission’s authority to exempt ESPs from certain aspects of interstate regulation and delegate to the states the regulation of the telecommunications services ESPs use. As summarized by the United States Court of Appeals for the Eighth Circuit,

The BellSouth petitioners and the Bell Atlantic parties next allege that the interstate access charge exemption for ISPs [here, information service providers] impermissibly requires state regulatory commissions to recover interstate costs. They argue that “[t]hat there is no question” that ISPs, like IXCs, use the local network to provide interstate services. . . . The petitioners contend that the FCC’s suggestion that LECs “address their concerns to state regulators,” amounts to a dereliction of the Commission’s obligation to retain exclusive jurisdiction over interstate communications and forces state regulatory commissions to overstep their authority by recovering interstate costs.¹³

The Eighth Circuit rejected BellSouth’s and Bell Atlantic’s arguments. By permitting jurisdictionally interstate information services to be regulated as local services, “the Commission has appropriately exercised its discretion[.]”¹⁴ Moreover, “[i]n these circumstances, we cannot say that the FCC has shirked its responsibility to regulate interstate telecommunications.”¹⁵

¹¹ See also Section III.E below (discussing reciprocal compensation applicable to CMRS traffic).

¹² *Access Charge Reform*, First Report & Order, 12 FCC Rcd. 15982 (1997), *aff’d*, *Southwestern Bell Telephone Co. v. FCC*, 153 F.3d 523 (8th Cir. 1998) (“*Access Charge Reform Order*”).

¹³ *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 542 (8th Cir. 1998), *citing Access Charge Reform Order*.

¹⁴ *Id.* at 543. This analytical decoupling of the jurisdiction and regulatory treatment of an otherwise unified communication has other examples. One standard function of a PBX—or an end office switch operated by one of

Nothing in the *ex partes* undercuts this analysis. In fact, Verizon's assertion that the end-to-end analysis has been used for both jurisdiction and compensation is correct for *some* traffic, but it is abundantly clear as explained above that it is not correct for *all* traffic.¹⁶ The *ISP Declaratory Ruling* makes that decoupling clear in stark terms.

C. The *Bell Atlantic* Decision Further Defined the Scope of the Issue

The *ISP Declaratory Ruling* was vacated and remanded by the D.C. Circuit in the *Bell Atlantic* decision. The D.C. Circuit further defined the scope of the issue and provided the Commission with guidance on four key issues. First, the Court endorsed the approach evident from the *ISP Declaratory Ruling* of decoupling the Commission's jurisdictional analysis from the regulatory treatment of a particular service. Second, the Commission provided support for the conclusion that calls to ISPs terminate when answered by the ISP modem. Third, the Court instructed the Commission to explain better how calls to ISPs fit within the statutory definitions of "exchange access" and "telephone exchange service." And fourth, the Court expressed its concern that the Commission had needlessly limited the scope of section 251(b)(5) to only local traffic.

the BOCs—is the ability to forward calls. The user of a PBX can program the unit to automatically forward an incoming call to another telephone number. The transmission to the second telephone number may be an intrastate toll call, or an interstate access call, but the separate legs of the transmission are subject to entirely different regulatory treatment. As the law has been applied, the jurisdictional nature of the call using call forwarding or three-way calling is disregarded when assessing the appropriate form of regulatory treatment. Further, unlike ISP traffic, the remote-call-forwarding call is all telecommunications on an end-to-end basis, yet the BOCs have yet to suggest that they should be required to identify all remote-call-forwarding calls and make them subject to the regulatory requirements applicable to the call on an end-to-end basis, rather than the requirements applicable to the individual legs of the call.

¹⁵ *Id.*

¹⁶ Verizon *ex parte* at 36.

(1) The Court Embraced the Decoupling of Jurisdictional Analysis from Regulatory Treatment

The distinction between the jurisdictional analysis of a call and the regulatory treatment of components of the call was plainly evident in the D.C. Circuit's decision. The Court made clear that it was not taking issue with the use of the end-to-end analysis to conclude that ISP-bound traffic is jurisdictionally interstate.¹⁷ The Court vacated and remanded the *ISP Declaratory Ruling* because, among other concerns, it took issue with the Commission's failure to explain how its "end-to-end" jurisdictional analysis was applicable to determine whether reciprocal compensation was owed for ISP-bound traffic. In the Court's assessment, there is a clear difference between the analysis the Commission conducts to determine jurisdiction, and the analysis the Commission conducts to determine regulatory treatment under the 1996 Act:

The Commission's ruling rests solely on its decision to employ an end-to-end analysis for purposes of determining whether ISP-traffic is local. There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate. But it has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.¹⁸

The Court rejected the Commission's view that its jurisdictional analysis also disposed of the question of whether reciprocal compensation applied to ISP-bound traffic:

The end-to-end analysis applied by the Commission here is one that it has traditionally used to determine whether a call is within its interstate jurisdiction. Here it used the analysis for quite a different purpose, without explaining why such an extension made sense in terms of the statute or the Commission's own regulations.

¹⁷ See *Bell Atlantic*, 206 F.3d at 5.

¹⁸ *Id.*

Because of this gap, we vacate the ruling and remand the case for want of reasoned decisionmaking.¹⁹

The Court was puzzled by the Commission's decision to rely on the interstate nature of a call to an ISP as grounds to exclude ISP-bound traffic from the scope of Section 251(b)(5) when it had rejected application of the interstate access charge regime to ISPs in the *Access Charge Reform Order* docket. To the Court, the Commission's position in the *Access Charge* appeal "rested. . . on an acknowledgment of the real differences between long-distance calls and calls to information service providers. It is obscure why those have now dropped out of the picture."²⁰ The Court instructed the Commission to explain "its decision to treat end-to-end analysis as controlling"—in other words, provide a substantial reason why "jurisdictional analysis" and "regulatory treatment" cannot be decoupled—in the context of reciprocal compensation for traffic to ISPs.

(2) "Termination" Includes Delivery of Calls to ISPs

The *Bell Atlantic* decision also makes clear that the term "termination" embraces the delivery of calls to ISPs. The *Bell Atlantic* Court acknowledged that the meaning of "termination" from a regulatory perspective could mean the endpoint of one kind of service and the beginning of another kind of service in the same interstate communication. The Court stated that "the mere fact that the ISP originates further telecommunications does not imply that the original telecommunications does not 'terminate' at the ISP."²¹ In the very next paragraph, the Court states, "the mere fact that the ISP originates further telecommunications does not imply

¹⁹ *Id.* at 3.

²⁰ *Id.* at 8.

²¹ *Id.* at 7.

that the original telecommunication does not ‘terminate’ at the ISP.”²² The Court’s reasoning could not be clearer. One component of an interstate communication can be viewed as separate from another component, from a regulatory perspective: “However, sound the end-to-end analysis may be for jurisdictional purposes, the Commission has not explained why viewing these linked telecommunications as continuous works for purposes of reciprocal compensation.”²³

The Court even used the Commission’s own regulations to support this view. The Court noted that the Commission’s regulations provide for reciprocal compensation for traffic that “originates and terminates within a local service area,” and “termination” is defined by the Commission as “the switching of traffic that is subject to section 251(b)(5) at the terminating carrier’s end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party’s premises.”²⁴ Based on these definitions, the *Bell Atlantic* Court found, “Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the ‘called party.’”²⁵

Regarding this language, Verizon says that the *Bell Atlantic* Court was merely paraphrasing comments made by WorldCom.²⁶ Given the Court’s view that termination in the jurisdictional context is not necessarily the same thing as termination in the regulatory context, Verizon’s argument is not credible. In fact, Verizon’s argument underscores the weakness of its

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 6, quoting 47 C.F.R. § 51.701(b), (d).

²⁵ *Id.* (emphasis added).

²⁶ Verizon *ex parte* at n.18.

presentation relying as it does on taking words away from the Court and attributing them to another party.

The Court came to its conclusion that calls to ISPs could “terminate” at the ISP after comparing ISPs to interexchange carriers. The Court distinguished calls carried by IXC from calls to ISPs, and concluded that cases involving calls carried by interexchange carriers “are not on point.”²⁷ Based on their identity as information service providers, rather than telecommunications carriers, the Court said the distinction between ISPs and IXCs “appears relevant for the purposes of reciprocal compensation.”²⁸ To the Court, the relevant dividing line was the point at which telecommunications provided by LECs end, and information services using telecommunications provided by ISPs begin: “the ISP’s origination of telecommunications as a result of the user’s call is instantaneous. . . . But this does not imply that the original communication does not ‘terminate’ at the ISP.”²⁹

In fact, the concluding paragraph of the decision can be read as the Court’s definitive answer to the question of whether calls to ISPs are considered to “terminate” at the ISP. The Court said, “Because the Commission has not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as ‘terminat[ing] . . . local telecommunications traffic. . . , we vacate the ruling and remand the case to the Commission.”³⁰ The Court’s instructions to the Commission begin with the premise that calls terminate at the ISP, and asks the Commission to explain why the performance of this function does not fall within the scope of section 251(b)(5) and the Commission’s regulations.

²⁷ *Bell Atlantic* at 6.

²⁸ *Id.*

²⁹ *Id.* at 7.

³⁰ *Id.* at 9 (emphasis added).

Verizon's *ex parte* essentially ignores the *Bell Atlantic* decision. Verizon argues that ISP-bound traffic is not subject to the reciprocal compensation obligations required by section 251(b)(5). First, Verizon maintains that section 251(b)(5) cannot apply to ISP-bound traffic because 251(b)(5) applies only to traffic that terminates on the network of an interconnecting LEC.³¹ Yet this position begs the question what "terminates" means in this context (*see also* Verizon *ex parte* at 31-32 ("the determinative question, therefore is where this traffic 'terminates.'")) As explained above, the term "termination" can have different meanings in different contexts. In the context of section 251(b)(5), it refers to a function provided by an interconnected LEC. In the context of a jurisdictional analysis, it may refer to one of the endpoints in an end-to-end communication. Verizon's approach is fatally flawed because it presumes that "termination" can have only one meaning, a position squarely contradicted by the *Bell Atlantic* decision. The *Bell Atlantic* Court did not challenge the Commission's use of its end-to-end analysis to determine the jurisdiction of a particular call. The Court questioned the Commission's use of the same test to determine whether reciprocal compensation is owed for a call to an ISP. Verizon fails to answer the Court's basic question: "why such an extension [of the end-to-end jurisdictional test] made sense in terms of the statute or the Commission's own regulations."³² To Verizon, the Commission can just say so and be done with it.³³ The Commission cannot just say so, but must provide a rationale consistent with the *Bell Atlantic* decision.

³¹ Verizon *ex parte* at 26-27.

³² *Bell Atlantic* at 3.

³³ Verizon *ex parte* at 35-36.

In its “supplemental white paper,” BellSouth tries to paper over this omission by arguing that calls to ISPs cannot “terminate” at the ISP because telecommunications are also a component of the “information service” provided by an ISP.³⁴ Yet what is missing from the Verizon/BellSouth filings is recognition that BellSouth itself used the term “termination” to describe the function of delivering traffic to ISPs. In one of the earliest letters sent by BellSouth to CLECs serving ISPs regarding reciprocal compensation, BellSouth refused to pay reciprocal compensation for “traffic terminated to an ESP.”³⁵ According to BellSouth, “Traffic originated by and terminated to information service providers and internet access providers enjoys a unique status, especially call termination.” BellSouth’s use of the word “termination” was entirely consistent with the Commission’s definition of the word in the local competition regulations.

As BellSouth recognized, in the context of delivery of traffic by a CLEC to ISPs, telecommunications terminate at the ISP. The CLEC provides the final switching and delivery to the called party, the ISP. The call to the ISP is answered by modems and answer supervision is returned. Answer supervision is “the term telephone companies use to describe the signal which the called station (or other customer premises equipment (CPE)) emits to tell telephone companies’ billing equipment that a call has been answered and billing should commence.”³⁶ It is provided by the local exchange carrier terminating a telephone call, whether the call is local or long distance. The term “answered” encompasses analog telephones, modems, facsimile devices and any other Part 68 registered terminal equipment.³⁷ Answer supervision is widely recognized

³⁴ BellSouth *ex parte* at 4-8.

³⁵ Letter dated August 12, 1997 from Ernest L. Bush, Assistant Vice President – Regulatory Policy & Planning, BellSouth Telecommunications, Inc., to All Competitive Local Exchange Carriers.

³⁶ *Petition for Adoption of a New Section 68.314(h) of the Commission’s Rules*, Report and Order, FCC 90-337, 5 FCC Rcd 6202 (Oct. 24, 1990) at n. 2.

³⁷ *Id.* at ¶ 18.

as clear indicia that a call has been terminated. The Commission has stated in another proceeding that “Bell Atlantic contends that the most important quality characteristic for call termination is answer supervision[.]”³⁸ In fact, answer supervision is so essential in determining when a call is terminated for billing purposes that providing it was one of the requirements for “equal access” under the Modified Final Judgment in the AT&T breakup.³⁹ Prior to the MFJ, interexchange carriers were unable to bill accurately because they could not determine when a call was terminated. Applying the long-held industry approach, it is clear that the call to the ISP terminates for the regulatory purpose of reciprocal compensation when the call is answered and answer supervision is returned.⁴⁰

Moreover, even under Verizon’s previously rejected end-to-end analysis, in today’s Internet environment, a substantial number of calls do not go beyond the ISP’s server. Thus, these calls would be considered local, even under Verizon’s theory. Pac-West has filed testimony in the *Unified Inter-carrier Compensation* that there is currently a significant amount of ISP-bound traffic that is never transmitted on to the Internet backbone.⁴¹ As Pac-West’s witness Fred Goldstein describes it, this occurs in a number of situations. The ISP maintains its

³⁸ *Amendment of Part 69 of the Commission’s Rules and Regulations, Access Charges, to Conform it with Part 36, Jurisdictional Separations Procedures*, FCC 87-271, 2 FCC Rcd 6447 (Aug. 18, 1987) at ¶ 82.

³⁹ *See United States v. American Telephone & Telegraph Co.*, 552 F. Supp. 131, 228 (D.D.C. 1982), *aff’d sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

⁴⁰ The technology used in Internet communications provides further proof that the ISP is the appropriate place to separate the information service from the telecommunications service for regulatory purposes. Local exchange carriers use traditional circuit-switched telecommunications to connect the ISP subscriber to the ISP. A circuit between the ISP and its subscriber is established for the duration of the Internet communication. Beyond the ISP’s modem pool, the ISP (or the ISP’s underlying telecommunications provider) uses packet switching to send and receive information across the Internet. There is no open circuit established between the ISP and the location of the information requested. The information is sent in packets that may take many separate transmission paths before reaching the same destination at the ISP. Therefore, as a technical as well as a regulatory matter, the local telecommunications between a subscriber and an ISP are distinct from the service provided by the ISP.

⁴¹ *See* Testimony of Fred Goldstein on Behalf of Pac-West Telecomm, Inc. Before the Public Utilities Commission of the State of California at *7-9, July 14, 2000 (Attachment B to Pac-West Comments in Docket 01-262, filed August 4, 2000.)

own server, and if the caller is sending or receiving electronic mail the caller's computer generally communicates with the ISP's mail server. The mail server performs a store-and-forward function of relaying outgoing mail to the Internet, and storing incoming mail from the Internet until the customer's mail client requests it. Consequently, an end-user that merely wishes to check its mail can connect to the mail server and never pass any traffic on to the Internet backbone. According to Mr. Goldstein, this probably accounts for a significant number of dial-up calls.⁴² Similarly, when an end user connects to an ISP's news server, like Usenet News, the end user retrieves information from the news server which stores news articles locally for days or weeks.⁴³ Or, if the ISP subscriber is browsing the World Wide Web, then the ISP may be providing a web cache that keeps local copies of frequently-viewed pages in order to speed response time. Some ISPs have reported being able to cache up to 30-40% of web pages regularly visited by their customers.⁴⁴ In these situations as well, the end user retrieves information from the ISP's server.

In short, the *Bell Atlantic* decision makes clear that dial-up traffic terminates at the ISP. Verizon's and BellSouth's argument that calls to ISPs do not "terminate" with the ISP is clearly contradicted by law and by fact.

(3) ISP-Bound Traffic Cannot Be Considered "Exchange Access" Under the Act

As "an independent ground" for vacating the *ISP Declaratory Ruling*, the *Bell Atlantic* Court questioned how the Commission's decision regarding reciprocal compensation fit within

⁴² See *id.* at 7.

⁴³ See *id.* at 7-8.

⁴⁴ See *id.* at 8.

the governing statute.⁴⁵ The Court noted that the Commission has limited telecommunications traffic under the 1996 Act to two categories, “exchange access,” and “telephone exchange service.” The Court criticized the Commission’s view that traffic to ISPs was “access service” because that term appeared to amalgamate “exchange access” with “telephone exchange service.”⁴⁶ To the Court, this approach “sheds no light.”⁴⁷

The Court also seemed persuaded that calls to ISPs do not fit within the statutory definition of “exchange access” because ISPs do not connect to the network for the purpose of originating or terminating telephone toll services as required by the statutory definition.⁴⁸ “Telephone toll service” is defined by the Telecom Act as a “telephone service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service.”⁴⁹ ISPs do not provide telephone service; instead, they provide information services. Therefore, calls to ISPs cannot be made “for the purpose of origination or termination of telephone toll services.”

The Court has signaled that the Commission has discretion to adopt the position that calls to ISPs are “telephone exchange service” within the Telecom Act. Because the statutory terms appear ambiguous, “any agency interpretation would be subject to judicial deference.”⁵⁰ The Commission should exercise such discretion, rule that ISP-bound traffic is “telephone exchange

⁴⁵ *Bell Atlantic* at 8.

⁴⁶ *Id.* at 8.

⁴⁷ *Id.*

⁴⁸ *Id.* at 8-9.

⁴⁹ 47 U.S.C. § 153(48).

⁵⁰ *Bell Atlantic* at 9.

service” under the Telecom Act, and order reciprocal compensation to be paid for its transport and termination.

Verizon essentially concedes its case in the section of its *ex parte* addressing this issue. Verizon asserts that the type of traffic eligible for reciprocal compensation is “telephone exchange service.” Verizon also asserts that the types of services exchanged between local exchange carriers are either telephone exchange service or exchange access. As explained above, however, dial-up calls to ISPs cannot be “exchange access” because they are not made “for the purpose of originating telephone toll service.” Hence, ISP-bound calls are “telephone exchange service,” which Verizon concedes is subject to reciprocal compensation. Later in its filing, Verizon attempts to shoehorn ISP-bound traffic into the definition of “exchange access” on the grounds that dial-up traffic to ISPs is “telephone toll service” after all.⁵¹ Yet Verizon’s basis for this argument is the *Advanced Services Remand Order*, a decision vacated by the D.C. Circuit precisely because it failed to adequately explain how ISP-bound traffic satisfied the definition of “exchange access” or “telephone toll service.”⁵² In essence, Verizon articulates the same rationale that the D.C. Circuit has already called “defective reasoning.”⁵³ Verizon’s approach runs into a legal dead-end.

BellSouth takes a second bite at the apple in its filing, but it fares no better.⁵⁴ BellSouth asserts that the Commission’s conclusion that ISP-bound traffic satisfied the definition of “exchange access” in the *Advanced Services Remand Order* was vacated by the D.C. Circuit “simply because it had relied on the conclusion . . . that ISP-bound traffic does not terminate at

⁵¹ Verizon *ex parte* at 40, n.33.

⁵² *WorldCom*, 246 F.3d at 696.

⁵³ *Id.*

⁵⁴ BellSouth *ex parte* at 9-16.

the ISP.”⁵⁵ This statement is simply wrong. Quoting its *Bell Atlantic* decision, the D.C. Circuit said the Commission “had ‘not provided a satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as ‘terminat[ing] ... local telecommunications traffic,’ *and* why such traffic is ‘exchange access’ rather than ‘telephone exchange service.’”⁵⁶ In *Bell Atlantic*, the Court said that the “exchange access” argument was “an independent ground requiring remand[.]”⁵⁷ BellSouth, however, conflates the two “independent ground[s]” into one.

Further, in an attempt to squeeze ISP-bound traffic into the definition of “exchange access,” BellSouth simply equates “information services” with “telephone toll service.”⁵⁸ In order for ISP-bound traffic to be considered “exchange access,” the service provided by the LEC must be “for the purpose of the origination or termination of telephone toll services.”⁵⁹ BellSouth tries to explain how access to the vast worldwide network of interconnected computers is “telephone toll service.” It should be noted first that the definition of “telephone toll service” was in the original Communications Act of 1934.⁶⁰ The term “telephone toll service” predates the use of telephone networks to access computer networks by some 30 years, so it is difficult to understand how reference to “telephone toll service” in the definition of “exchange access” can have any meaning other than the meaning intended by its use in 1934.

Despite this glaring problem, BellSouth soldiers on. To BellSouth, since the service provided by the ISP is provided over a telecommunications device, and it involves data

⁵⁵ *Id.* at 10.

⁵⁶ *WorldCom*, 246 F.3d at 696 (emphasis added).

⁵⁷ *Bell Atlantic*, 206 F.3d at 8.

⁵⁸ BellSouth *ex parte* at 11.

⁵⁹ 47 U.S.C. § 153(16).

⁶⁰ *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 98-147, 98-11, 98-26, 98-32, 98-78, 98-91, Order on Remand, FCC 99-413, *vacated WorldCom, Inc. v. FCC*, 246 F.3d 690 (2001) (“*Advanced Services Remand Order*”) at ¶ 36.

communications, this means that it has to be a “telephone service.” The “separate charge” requirement in the definition of “telephone toll service” is satisfied by the ISP’s purchase of interexchange capacity from IXCs. Thus, to BellSouth, the information service provided by the ISP is “telephone toll service,” and the service provided by the LEC to the ISP fits within “exchange access.”

In contrast to this contorted effort to shoehorn ISP-bound traffic into the definition of “exchange access,” it is far simpler to see that ISP-bound traffic easily satisfies the definition of “telephone exchange service,” particularly the (B) section of the definition added by the Telecom Act of 1996:

The term "telephone exchange service" means (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.⁶¹

Under definition (A), the local exchange service provided by LECs out of their local exchange service tariffs to their end users that provide Internet access is “within a telephone exchange. . .and which is covered by the exchange service charge.” Further, under definition (B), which clearly expanded the definition to be more inclusive of the types of service provided in competitive markets, LEC service to an ISP is “comparable” to basic local service, and it permits a LEC subscriber to originate a telecommunications service to an ISP (leaving aside whether termination is involved in calls to ISPs.)

⁶¹ 47 U.S.C. § 153(47).

BellSouth asserts that if the Commission were to rule that ISP-bound traffic were “telephone exchange service,” it would lose jurisdiction over all ISP-bound traffic by operation of section 221(b).⁶² This argument is specious. It is nothing more than a regurgitation of the argument rejected by the U.S. Supreme Court that the Commission has no jurisdiction over intrastate communications.⁶³ *AT&T* makes clear that the Commission has jurisdiction over all aspects of implementation of the Telecom Act, including deciding whether ISP-bound traffic is subject to section 251(b)(5). The Commission does not cede jurisdiction over ISP-bound traffic, or any other aspect of competition in the local exchange market, by ruling that ISP-bound traffic is “telephone exchange service.”

(4) The Court Also Expressed Reservations About Limiting Reciprocal Compensation to Local Traffic

It is clear that the *Bell Atlantic* Court was also troubled by the Commission’s limitation of reciprocal compensation to local traffic. On a number of occasions, the Court stated that this limitation was imposed by the Commission, not by the statute. The Court said, “By regulation the Commission has limited the scope of the reciprocal compensation requirement to ‘local telecommunications traffic.’”⁶⁴ “[The Commission has] taken the calls to ISPs out of §251(b)(5)’s provision for ‘reciprocal compensation’ (as it interpreted it)[.]”⁶⁵ “Although §251(b)(5) purports to extend reciprocal compensation to all ‘telecommunications,’ the Commission has construed the reciprocal compensation requirement as limited to local traffic.”⁶⁶ “[The Commission was] [f]aced with the question whether such traffic is ‘local,’ for purposes of

⁶² BellSouth *ex parte* at 13-14.

⁶³ See *AT&T Corp. v. Iowa Utilities Board*, 119 S. Ct. 721, 730-731 (1999).

⁶⁴ *Bell Atlantic*, 206 F.3d at 2.

⁶⁵ *Id.*

⁶⁶ *Id.* at 4.

its regulation limiting §251(b)(5) reciprocal compensation to local traffic...⁶⁷ In every case, the Court made clear that the limitation of Section 251(b)(5) was the Commission's own creation. The Commission wisely responded to this reaction by the Court by subsequently abandoning the limitation on "local" traffic in the subsequent *ISP Remand Order*.

Verizon, however, clings to the rejected notion that section 251(b)(5) is limited to local traffic. Verizon makes a number of mistakes in this section of its filing. First, Verizon is wrong that "no party sought review of [the] interpretation" that section 251(b)(5) was limited to local traffic, and that "no party took issue with the Commission's interpretation of § 251(b)(5) as limited to local traffic."⁶⁸ Like most of Verizon's filing, this statement misses the point. Most parties, including Verizon, contended that traffic to ISPs *was* local traffic. In particular, MFS Communications Company, Inc., sought clarification from the FCC that reciprocal compensation applied to traffic to information service providers.⁶⁹

Second, Verizon is simply wrong that "[n]othing in *Bell Atlantic* called into question the Commission's interpretation of § 251(b)(5)."⁷⁰ As explained above, the Court repeatedly noted that the Commission had unnecessarily limited the scope of § 251(b)(5) to local traffic by its regulations when no such restriction is evident from the statutory text.

Further, Verizon repeats the same mistake that the Commission made in the *ISP Declaratory Ruling*: it equates IXC's with ISPs, even though the D.C. Circuit made clear that

⁶⁷ *Id.*

⁶⁸ Verizon *ex parte* at 29, 13.

⁶⁹ Petition for Partial Reconsideration and Clarification of MFS Communications Company, Inc., CC Docket No. 96-98, filed Sep. 30, 1996, at 28. *See also ISP Declaratory Ruling*, n.1 (citing MFS Petition as one of "a number of requests to clarify whether a local exchange carrier (LEC) is entitled to receive reciprocal compensation for traffic that it delivers to an information service provider, particularly an Internet service provider.")

⁷⁰ Verizon *ex parte* at 29.

“the difference between ISPs and traditional long distance carriers . . . appears relevant for purposes of reciprocal compensation.”⁷¹ Along these lines, Verizon stretches the scope of the inquiry on remand by assailing in advance a Commission decision that applies reciprocal compensation to traffic exchanged between a LEC and “another carrier.”⁷² The only traffic in question here is traffic exchanged between two LECs and terminated with an ISP, no other carrier is involved. Assuming, *arguendo*, that section 251(b)(5) is limited to traffic between LECs, this argument does not prevent the Commission from ruling that section 251(b)(5) applies to traffic to ISPs. This approach would also be consistent with the *Bell Atlantic* Court’s view that the Commission unnecessarily limited the scope of section 251(b)(5) by ruling initially that it applied only to “local” traffic.

BellSouth’s filing, in which it attached the transcript of the oral argument in the *Bell Atlantic* case at the D.C. Circuit, does not support its case either. BellSouth seems to believe that because the panel appeared to disagree with counsel for WorldCom that the Court had decided that ISP-bound traffic was local, that the Commission cannot now rule that ISP-bound traffic is local.⁷³ Yet that argument misses the point. It is clear that fitting ISP-bound traffic into “local” and “non-local” categories was not the proper exercise for the Commission—the inquiry is whether ISP-bound traffic falls under section 251(b)(5), and while the D.C. Circuit may have been “rigorously agnostic” whether ISP-bound traffic was “local,” it was unequivocal that it thought ISP-bound traffic “terminated” at the ISP, as the term was used by the Commission.

⁷¹ *Bell Atlantic* at 6-7.

⁷² Verizon *ex parte* at 30.

⁷³ BellSouth *ex parte* at 1.

D. The *ISP Remand Order* Recognized that All Telecommunications Are Subject to Section 251(b)(5), Except as Limited by Section 251(g)

The third of the four decisions that define the boundaries for a subsequent decision by the Commission on the issue of reciprocal compensation for traffic to ISPs is the *ISP Remand Order*. In that decision, ostensibly responding to the *Bell Atlantic* decision, the Commission chose not to answer the questions posed by the Court, but decided instead to take an entirely new approach to the problem. Instead of answering “why LECs that terminate calls to ISPs are not properly seen as ‘terminat[ing] . . . local telecommunications traffic, and why such traffic is ‘exchange access’ rather than ‘telephone exchange service,’”⁷⁴ the Commission took another cue from the Court and rewrote their interpretation of the scope of section 251(b)(5). In the view of the Commission, “[t]he rationale underlying the two orders. . .differs substantially.”⁷⁵

The cue was the *Bell Atlantic* Court’s reservation with limiting the scope of section 251(b)(5). First, the Commission abandoned the position first stated in the *Local Competition Order* that section 251(b)(5) applied only to local traffic.⁷⁶ “[W]e created unnecessary ambiguity for ourselves, and the court, because the statute does not define the term ‘local call,’ and thus that term could be interpreted as meaning either traffic subject to local rates or traffic that is *jurisdictionally* intrastate.”⁷⁷ “In the *Local Competition Order*, as in the subsequent *Declaratory Ruling*, use of the phrase ‘local traffic’ created unnecessary ambiguities, and we correct that mistake here.”⁷⁸

⁷⁴ *Bell Atlantic* at 9

⁷⁵ *ISP Remand Order* at n.56.

⁷⁶ *Id.* at ¶ 34.

⁷⁷ *Id.* at ¶ 45 (italics in original).

⁷⁸ *Id.* at ¶ 46.

Second, the Commission held that the telecommunications subject to the requirements of section 251(b)(5) “are all such telecommunications not excluded by Section 251(g).”⁷⁹ Section 251(g), in the view of the Commission, was intended by Congress to exempt the services identified therein from reciprocal compensation obligations and “to ensure that section 251(b)(5) is not interpreted to override either existing or future regulations prescribed by the Commission.”⁸⁰ “[U]nless and until the Commission by regulation should determine otherwise, Congress preserved the pre-Act regulatory treatment of all the access services enumerated under section 251(g).”⁸¹ One of these enumerated services, “information access,” was defined to include “the access services that incumbent LECs provide (either individually or jointly with other local carriers) to connect subscribers with ISPs for Internet-bound traffic.”⁸² “When read as a whole, the most natural reading of section 251 is as follows: subsection (b) sets forth reciprocal compensation requirements for the transport and termination of “telecommunications”; subsection (g) excludes certain access services (including ISP-bound traffic) from that requirement; and subsection (i) ensures that, on a going-forward basis, the Commission has the authority to establish pricing for, and otherwise to regulate, interstate access services.”⁸³ As a result, dial-up communications between an end user and an ISP were deemed to be outside the scope of section 251(b)(5).

What the Commission did not do is respond to the remand instructions from the Court. With respect to the second question posed by the Court—how the exchange of traffic fits within

⁷⁹ *Id.*

⁸⁰ *Id.* at ¶ 36.

⁸¹ *Id.* at ¶ 39.

⁸² *Id.* at ¶¶ 39, 44.

⁸³ *Id.* at ¶ 49.

the statutory definitions of “exchange access” and “telephone exchange service”—the Commission responded, “Regardless of whether this traffic falls under the category of ‘exchange access’ . . . we conclude that this traffic, at a minimum, falls under the rubric of ‘information access[.]’”⁸⁴ In other words, the Commission chose not to provide an answer. With respect to the second question posed by the Court—why LECs that terminate calls to ISPs are not properly seen as terminating local telecommunications traffic—the Commission dismissed the question as not being “germane” under its new approach.⁸⁵ To one Commissioner, the new approach was “a set of convoluted arguments that sidestep the court’s objections to its previous order[.]”⁸⁶ “[T]he Commission fails to answer any of the court’s questions.”⁸⁷ Quite simply, the Commission explained away the concerns of the *Bell Atlantic* Court by redefining the applicable terms. Nevertheless, the legacy of the *ISP Remand Order* is the legal conclusion that section 251(b)(5) applies to all telecommunications not specifically excluded by section 251(g).

E. The *WorldCom* Decision Rejected the Commission’s Interpretation of Section 251(g)

The *ISP Remand Order* was remanded, without being vacated, by the D.C. Circuit in the *WorldCom* decision. In a short opinion, the Court rejected the Commission’s reading of section 251(g) because under the Commission’s new interpretation, the Commission “could override virtually any provision of the 1996 Act so long as the rule it adopted were in some way,

⁸⁴ *Id.* at ¶ 42.

⁸⁵ *Id.* at ¶ 56.

⁸⁶ *Id.*, Dissenting Statement of Commissioner Furchtgott-Roth at 66.

⁸⁷ *Id.* at 68.

however remote, linked to LECs' pre-Act obligations.”⁸⁸ Instead, the Court viewed section 251(g) as only a transitional mechanism that allowed the Commission to retain and modify existing obligations regarding interstate access, but not invoke it to promulgate new obligations.⁸⁹ Because “there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic,”⁹⁰ “§ 251(g) is not susceptible to the Commission’s reading.”⁹¹ The Court remanded the Commission’s order back to the Commission on the grounds that “there may well be other legal bases for adopting the rules chosen by the Commission for compensation between the originating and the terminating LECs in calls to ISPs.”⁹² (The Commission should also note that yet again the D.C. Circuit used language that indicates it has already decided that LECs “terminate” calls to ISPs.)

III. VERIZON MISCHARACTERIZES THE HISTORY OF THE DISPUTE

As explained above, Commission and D.C. Circuit precedent make clear that section 251(b)(5) provides the only authority for an intercarrier compensation regime for traffic to ISPs. In an attempt to argue otherwise, Verizon traces the history of the dispute from its headwaters under the ESP Exemption to the torrent of litigation between 1997 and the *ISP Remand Order*. Verizon’s retelling of that history reflects Verizon’s own biases and advocacy. Rather than completely rewrite that history to reflect a CLEC’s perspective, Pac-West will add to

⁸⁸ *WorldCom* at 433.

⁸⁹ *Id.* at 433-434.

⁹⁰ *Id.* at 433.

⁹¹ *Id.* at 432.

⁹² *Id.* at 430.

the Verizon description where necessary to complete the picture, and correct Verizon's description in those places where Verizon clearly misstated the history.

A. Communications Act of 1934

The origins, of course, date back to the original statute providing the Commission with the authority to regulate interstate communications, the Communications Act of 1934. The Communications Act provides definitions for numerous terms that are still in dispute, particularly "telephone exchange service" and "telephone toll service." Additional terms, especially "reciprocal compensation," "exchange access," "information service," "telecommunications," and "telecommunications service," were created by the Telecommunications Act of 1996.

B. First and Second Computer Inquiries

The issue also has its origins in the Commission's initial examinations of the interplay between traditional telephone networks and the emerging computer networks. The *First Computer Inquiry* was initiated in 1966.⁹³ The *First Computer Inquiry* decision came five years later, and, in terms of regulatory treatment, the local dial-up telecommunications of a computer-network-related communication was considered a separate component from the services provided over the computer network.⁹⁴ As the FCC stated regarding the *First Computer Inquiry*,

⁹³ *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities*, Notice of Inquiry, 7 FCC 2d 11 (1966). To put this important proceeding in some historical perspective, the commencement of the First Computer Inquiry was closer in time to the 1934 Communications Act (32 years) than the Commission's 1999 Declaratory Ruling (33 years).

⁹⁴ *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities*, Memorandum Opinion and Order, 28 FCC 2d 267 (1971).

Regulatory forbearance with respect to data processing services made it necessary to distinguish regulated communications services from unregulated data processing services. . . The thrust of this definitional approach was to distinguish between unregulated data processing and permissible carrier utilization of computers by establishing a dichotomy between data processing and message or circuit switching.⁹⁵

The reason for this approach was not just to keep data processing companies free from regulation; the reason was also to offset the market power of the phone companies. The original decision to separate the data processing component from the circuit-switched component was to impose separate subsidiary requirements on AT&T, the enormously powerful provider of local and long distance communications.⁹⁶ By imposing requirements on AT&T that provided some separation between its telephone service subsidiaries and its data processing subsidiaries, the Commission intended to make it difficult for AT&T to engage in conduct that harmed competition in providing data processing services to the benefit of its own subsidiaries.

The initial rules issued to effectuate this approach were overtaken by technology.⁹⁷ The Commission found the review required to distinguish data processing services from telephone services cumbersome.⁹⁸ When the Commission revisited its regulation of data processing companies, primarily to protect unaffiliated data processing companies from the monopoly power of AT&T and GTE, it established the regulatory classification of “enhanced services.” In the 1980 *Second Computer Inquiry*, computer-network providers were determined to be providers of “enhanced services” to distinguish them from the traditional telephone network

⁹⁵ *Amendment of Section 64.702 of the Commission’s Rules and Regulations*, Docket No. 20828, 77 FCC 2d 384 (1980) *aff’d sub. nom.*, *Computer & Communications Indus. Assn. v. FCC*, 693 F.2d 198 (D.C. Cir. 1982) (“*Second Computer Inquiry*”), at ¶ 17 (emphasis added).

⁹⁶ *Computer & Communications Indus. Assn. v. FCC*, 693 F.2d 198, 213 (D.C. Cir. 1982).

⁹⁷ *Second Computer Inquiry*, at ¶¶ 20-24.

⁹⁸ *Id.*

providers of "basic services." The Commission determined that ESPs would not be regulated in the same way as traditional telephone companies, so the Commission rewrote the federal regulations to make clear that ESPs were end users of basic services exempt from regulation under Title II of the Communications Act.⁹⁹ Again, this built upon the initial decision to require AT&T and GTE to provide data processing services through a separate affiliate, to curb potential market power abuses.

Thus, for almost as long as computer networks have been commercially available, and for much longer than the rise of the Internet, computer network providers have been classified by the Commission as basic telephone service consumers. Whatever services ESPs provide to their customers, they do so separately from the local telecommunications provided to that customer. The foundation for this approach was an intent to provide data processing companies with a modicum of regulatory protection from the anticompetitive tactics of the telephone company monopolies.

Jurisdiction by the FCC over ESPs was largely presumed. At all times, the inquiry was the extent of regulation that was necessary for users of the interstate communications network.

To fully appreciate the significance of this, it is helpful to understand the dynamics of the marketplace in light of our current regulatory scheme. There are literally thousands of unregulated computer service vendors offering competing services connected to the interstate telecommunications network. The services they provide are many and varied. The only limitation on the types of

⁹⁹ See *id.*, at ¶ 119. The regulation, as written in 1980 and unchanged to date, is as follows:

For the purpose of this subpart, the term "enhanced service" shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information. Enhanced services are not regulated under Title II of the Act.

47 C.F.R. § 64.702(a).

services offered are those arising from the constraints of their own entrepreneurial capabilities and, in a very real sense, the implicit requirement that they structure their services so as to avoid crossing a regulatory boundary that would subject them to regulation.¹⁰⁰

The focus of the inquiry was how to regulate either services provided by data processing companies or the telephone service inputs they needed to offer their products.¹⁰¹

C. Access Charges to Use the Local Exchange Network and the “ESP Exemption”

As a result of the 1980 *Second Computer Inquiry* decision in which ESPs were deemed to be end users apart from entities that would be subject to common carrier regulation, ESPs continued to obtain their connections to the public switched telephone network by ordering local exchange service from the local exchange carriers. They were communications-intensive business service end users. In connection with the divestiture of AT&T and the emergence of competitive interexchange carriers, however, the Commission re-examined its earlier decision that classified ESPs as end users in the context of deciding how to compensate monopoly local exchange carriers for the use of the local exchange telephone network. Again, it must be noted that the Commission’s inquiry regarding compensation for the use of the local network came well after its decisions to segregate interstate communications into “data processing” and

¹⁰⁰ *Second Computer Inquiry*, at ¶ 109.

¹⁰¹ The separate affiliate restrictions resurfaced following passage of the 1996 Telecom Act when the Commission considered the mechanisms needed to protect against anticompetitive behavior by the BOCs once they obtained section 271 authority. In connection with whether a BOC, together with its affiliated ISP, was providing a service that would violate section 271, the Commission determined that the local call placed to an ISP was separate from the subsequent information service provided. The severability of these components was key to the Commission’s conclusion that if each component was provided, purchased, or priced separately, the combined transmissions did not constitute a single interLATA transmission. *Implementation of the Non-Accounting Safeguards Order of Sections 271 and 272 of the Communications Act of 1934*, First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-149, 11 FCC Rcd 21905 (1996) ¶ 120 (“*Non-Accounting Safeguards Order*”).

“message or circuit switching” components, which evolved into the distinction between enhanced service and basic service components.¹⁰²

Rather than extend the obligation to pay these new “access charges” to end users providing enhanced services, the Commission limited the obligation to carriers. ESPs continued to obtain their connections to the local exchange network through the purchase of local exchange services from the local exchange carrier’s business services tariffs. Thus, the term “ESP exemption” is a bit of a misnomer since ESPs were not exempted from anything; the Commission decided not to extend a new regulatory regime to include them, based primarily on their status as non-carriers. The name stuck, however, and the underlying legal and policy rationale was reaffirmed in 1988 and again in 1997.¹⁰³ The bedrock legal principle that ESPs are not carriers, but instead are end users of local exchange services, has remained unchanged for more than 30 years.

Even in the “ESP Exemption” cases, the jurisdiction of the Commission to regulate ESPs was not challenged. To the extent the enhanced services provided by ESPs constituted interstate communications, they fell within the purview of the Commission. But regardless of the jurisdictional classification of the communications at issue, the applicable regulatory treatment of ESPs was the same as any other end user: ESPs were permitted to obtain telecommunications services from the tariffed retail local exchange services offered by the local exchange carrier.

¹⁰² In this regard, it is important to recognize that the Commission’s rules regarding access charges are codified at Part 69 (“Access Charges”), while the Commission’s rule that identified enhanced service providers as entities not regulated as common carriers is codified at Part 64 (“Miscellaneous Rules Relating to Common Carriers.”)

¹⁰³ *Amendment of Part 69 of the Commission’s Rules Relating to Enhanced Service Providers*, CC Docket No. 87-215, Order, 3 FCC Rcd 2631(1988); *Access Charge Reform Order*, 12 FCC Rcd 15982 (1997).

The telecommunications component of interstate enhanced services was regulated as a local service.

The history of the “ESP exemption” also makes clear that the SBC argument in its August *ex parte* letter is erroneous.¹⁰⁴ To the extent that the “ESP exemption” is a pre-existing regulation, order, or policy preserved under section 251(g) of the Act, that would mean that LEC service to ESPs has been codified as local exchange service. Rather than support an argument that service to ESPs is exempt from reciprocal compensation obligations, the SBC *ex parte* letter actually undermines SBC’s case and provides further evidence that traffic to ESPs is telephone exchange service subject to reciprocal compensation.

SBC’s second argument that the ESP exemption establishes a “rate structure” that already compensates carriers that serve ESPs and no additional intercarrier compensation is necessary is equally weightless. The ESP exemption makes clear that ESPs will continue to be classified as end users and not carriers under the Commission’s access charge regime. Thus, ESPs are end users the same as local businesses, residences, or other purchasers of local exchange services. To the extent there is a “rate structure” in place by which those end users compensate their LECs for local exchange service, there would be no need for any intercarrier compensation mechanisms between carriers providing telephone exchange service. SBC’s argument simply ignores the fact that reciprocal compensation is a statutory requirement for compensation between carriers, even if the end users served by interconnected LECs pay for their connections to the local network.

¹⁰⁴ Letter from Eric Einhorn, Executive Director—Federal Regulatory, SBC Telecommunications, Inc., to Marlene H. Dortch, Secretary, dated August 6, 2004.

D. Telecommunications Act of 1996

The Telecommunications Act of 1996 (the “Telecom Act” or “Act”) codified the regulatory distinction from the *Second Computer Inquiry* between “enhanced services” and “basic services.” Enhanced services became a subset of the broader category of “information services” defined as “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications[.]”¹⁰⁵ Basic services remained essentially the same as “telecommunications,” defined as “the transmission, between or among points specified by the user, of information of the users’ choosing, without change in the form or content of the information as sent and received.”¹⁰⁶ Nothing in the Act altered the Commission’s regulation of ESPs as end users of basic telephone services.

The Act also established the terms that have been in dispute ever since the Act was passed: “reciprocal compensation,” “exchange access,” and a new separate definition of “telephone exchange service.” Under section 251(b)(5) of the Act, every local exchange carrier has “[t]he duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.” There is nothing within that language that limits its application to “local traffic.” As the *Bell Atlantic* Court recognized, that limitation was added by the Commission in the *Local Competition Order*.¹⁰⁷ The Act created a statutory definition of “exchange access” as “the offering of access to telephone exchange services or facilities for the

¹⁰⁵ 47 U.S.C. §153(20).

¹⁰⁶ 47 U.S.C. §153(43). *See also Non-Accounting Safeguards Order* at ¶¶ 99-103 (1996) (discussing the evolution of terminology from the *Second Computer Inquiry* to the 1996 Act).

¹⁰⁷ See Section II.C(4) above.

purpose of the origination or termination of telephone toll services.”¹⁰⁸ “Telephone exchange service” and “telephone toll service” had been part of the Communications Act since 1934, and the 1996 Act definition of “exchange access” provided a bridge within the statutory framework between the two: exchange access was the use of the services or facilities for one type of traffic (telephone exchange service) to provide the other type of traffic (telephone toll service).

The Telecom Act also added Section 251(g), which provided for “Continued enforcement of exchange access and interconnection requirements.” As explained in the Conference Report to the Telecom Act, “Because the Act completely eliminates the prospective effect of the AT&T Consent Decree, some provision is necessary to keep these requirements in place... Accordingly, the conference agreement includes a new section 251(g).”¹⁰⁹ The Commission later described Section 251(g) as “a transitional enforcement mechanism.”¹¹⁰ The Commission further stated, “this provision is merely a continuation of the equal access and nondiscrimination provisions of the Consent Decree until superseded by subsequent regulations of the Commission.”¹¹¹ As discussed above, the D.C. Circuit has interpreted section 251(g) to be only a transitional mechanism that the Commission cannot rely upon to promulgate an entirely new regulatory regime.¹¹²

¹⁰⁸ 47 U.S.C. §153(16).

¹⁰⁹ H.R. Rep. 104-458, at 122-23 (1996).

¹¹⁰ *Advanced Services Remand Order* at ¶ 47.

¹¹¹ *Id.*

¹¹² *See* Section II.E above.

E. Local Competition Order

Following passage of the Telecom Act, the Commission solicited comments on its proposed rules to implement the Act's local competition provisions. With respect to implementation of the reciprocal compensation provisions of Section 251(b)(5), the Bell companies opposed a requirement that traffic eligible for reciprocal compensation should be exchanged on a "bill-and-keep" basis. In particular, Bell Atlantic assured the Commission that paying per-minute-of-use charges for reciprocal compensation traffic was economically rational. Bell Atlantic made abundantly clear that it "would find itself writing large monthly checks" if it set reciprocal compensation rates too high because "new entrants, who are in a much better position to selectively market their services, will sign up customers whose calls are predominantly inbound, such as credit card authorization centers and internet access providers."¹¹³ Bell Atlantic was not the only one that was aware of this likelihood. For example, in the Commission's *Access Charge Reform* docket, the ILEC trade association, United States Telecom Association, filed comments making clear that CLECs were in the position to receive large amounts of compensation for serving ISPs: "CLECs that provide serving wire center service to major information service providers can obtain significant termination revenues for inbound traffic to these providers."¹¹⁴

In the *Local Competition Order*¹¹⁵ in which the Commission promulgated its rules implementing the reciprocal compensation provisions, the Commission considered arguments from some carriers that section 251(b)(5) applied to all telecommunications, including traffic

¹¹³ Reply Comments of Bell Atlantic, CC Docket No. 96-98, May 30, 1996, at 21 (emphasis added).

¹¹⁴ Comments of the United States Telecom Association, CC Docket No. 96-262, Jan. 29, 1997, at 84.

¹¹⁵ *Local Competition Order*, 11 FCC Rcd 15499 (1996).

previously subject to access charges. Verizon notes in its *ex parte* the comments of Frontier Communications, and accuses Frontier of trying “to use §251(b)(5) to avoid the payment of access charges.”¹¹⁶ Verizon neglects to mention that Frontier presented itself in its comments as having a unique perspective on the issue because in addition to operating an interexchange carrier, Frontier was the parent company of Rochester Telephone Company, the second largest incumbent local exchange carrier in New York. Frontier’s proposal was an admirable attempt to infuse some economic rationality into the debate of intercarrier compensation—to Frontier, all transport and termination costs, including those that Rochester Telephone Company would receive from IXC’s, should be based on cost, consistent with section 251(b)(5).¹¹⁷ Verizon further mischaracterizes the debate in 1996 when it says “virtually all commenters” believed section 251(b)(5) was limited to local traffic, and then identifies Frontier communications as the lone hold-out. In fact, Sprint Communications stated that “[w]hether or not the obligations of § 251(b)(5) are limited to transport and termination of local traffic is far from clear on the face of the statute.”¹¹⁸ Sprint proposed creating such a limitation because the statutory language did not do so.

At the heart of the Commission’s review of this issue in the *Local Competition Order* was the view that Section 251(b)(5) does not expressly limit its obligation or exclude any particular category of traffic. Section 251(g), however, requires continued enforcement of the existing access charge regime, until it is changed by the Commission. That access charge regime provides for an alternative system of compensation for the transport and termination of

¹¹⁶ Verizon *ex parte* at 12.

¹¹⁷ Reply Comments of Frontier Corporation, CC Docket No. 96-98, May 30, 1996, at 19.

¹¹⁸ Comments of Sprint Corporation, CC Docket No. 96-98, May 16, 1996, at 76.

telecommunications carried by two or more carriers.¹¹⁹ The Commission concluded that traffic not subject to access charges, *i.e.*, traffic that originates or terminates within a local calling area established by the state, would be subject to reciprocal compensation obligations.¹²⁰ The simple logic that the Commission drew from the Telecom Act was that access charges and reciprocal compensation were intended to dovetail to cover all types of traffic carried by two or more carriers; such traffic was to be treated either through reciprocal compensation or access charges, and no traffic was to incur both types of treatment. (As explained above, the Commission reaffirmed this principle in the *ISP Remand Order*.) Thus, the FCC clearly established in the *Local Competition Order* that, under the Telecom Act, the termination of traffic carried by two or more carriers not otherwise subject to access charges would be subject to reciprocal compensation.

Verizon relies on this section of the *Local Competition Order* to conclude that the Commission ruled that “interstate or interexchange” traffic cannot be subject to reciprocal compensation.¹²¹ Yet it is just as reasonable to read these references to “interstate or interexchange” traffic in paragraphs 1033 and 1034 as the Commission’s means of identifying traffic already compensated through access charges, in order to distinguish them from traffic subject to reciprocal compensation. It does not necessarily indicate a Commission directive that interstate or interexchange traffic cannot be subject to reciprocal compensation—such a directive would be clearly wrong: traffic that Verizon has rated as “local” traffic subject to reciprocal compensation can be both interstate and interexchange. The Commission’s *Starpower Damages*

¹¹⁹ *Local Competition Order* at ¶ 1034.

¹²⁰ *Id.* at ¶¶ 1034- 1035.

¹²¹ Verizon *ex parte* at 12.

Order makes clear that even interstate, interexchange traffic is eligible for reciprocal compensation.¹²²

CMRS traffic is a further example of interstate, interexchange traffic that is subject to reciprocal compensation obligations. Had the Commission included a description of ISP-bound traffic in its discussion of reciprocal compensation obligations, it is likely that it would have been explained along the lines of the application of Section 251(b)(5) to traffic terminated by CMRS providers. That is, it is subject to reciprocal compensation based upon the initial set-up of the connection between end users.

In the *Local Competition Order*, the Commission characterized CMRS traffic by saying,

CMRS customers may travel from location to location during the course of a single call, which could make it difficult to determine the applicable transport and termination rate or access charge. . . This could complicate the computation of traffic flows and the applicability of transport and termination rates, given that in certain cases, the geographic locations of the calling party and the called party determine whether a particular call should be compensated under transport and termination rates established by one state or another, or under interstate and intrastate access charges.¹²³

Moreover, “a significant amount of LEC-CMRS traffic crosses state lines, because CMRS service areas often cross state lines and CMRS customers are mobile.”¹²⁴ For this reason, in order to determine whether reciprocal compensation or access charges are owed for CMRS traffic, the cell site engaged by the mobile customer when the call was initially established would serve as the geographic location to determine the end points of the communication for

¹²² *Starpower Communications, LLC v. Verizon South, Inc.*, File No. EB-00-MD-19, FCC 03-278, Memorandum Opinion and Order (rel. Nov. 7, 2003) (“*Starpower Damages Order*”) at ¶¶ 13-14.

¹²³ *Id.* at ¶ 1044.

¹²⁴ *Local Competition Order* at n.2487 (citations omitted).

compensation purposes. Thus, the Commission utilized Section 251(b)(5) for communications that have mixed jurisdiction.

The Commission's description of Internet communications is quite similar to its description of CMRS traffic:

An Internet communication does not necessarily have a point of 'termination' in the traditional sense. An Internet user typically communicates with more than one destination point during a single Internet call, or 'session,' and may do so either sequentially or simultaneously. In a single Internet communication, an Internet user may, for example, access websites that reside on servers in various states or foreign countries, communicate directly with another Internet user, or chat on-line with a group of Internet users located in the same local exchange area or in another country. Further complicating the matter of identifying the geographical destinations of Internet traffic is that the contents of popular websites increasingly are being stored in multiple servers throughout the Internet, based on 'caching' or website 'mirroring' techniques.¹²⁵

Like CMRS traffic, the geographic end points of the communication are difficult to ascertain because they change constantly. Just as the Commission adopted an approach for CMRS providers that, for purposes of intercarrier compensation, took a snapshot of the communication at the moment that the call was set up and the two communicating end users established a connection, it is perfectly reasonable for the Commission to have done the same for ISP-bound communications. Just as CMRS traffic may be eligible for reciprocal compensation even though the "termination" points of the call may vary throughout the communication, so too should ISP-bound traffic qualify for reciprocal compensation.

In addition, to the extent ISP-bound traffic is considered to have an interstate character, any interconnected LEC that serves a community that straddles a state line already pays and

¹²⁵ *ISP Declaratory Ruling* at ¶ 18.

receives reciprocal compensation for interstate traffic. For example, a telephone call from the Commission's headquarters in Washington, D.C. to Reagan National Airport in Virginia would be eligible for reciprocal compensation as a local call, yet the call is interstate. For this reason, the Commission already recognizes a category of "local interstate" traffic. For example, in Table 2.11 of the Commission's report "Statistics of Communications Common Carriers," ILECs report revenues in the category of Interstate Basic Local Service.¹²⁶ Thus, there is no doubt that traffic may be jurisdictionally interstate yet still qualify as telephone exchange service subject to reciprocal compensation. The same is true of dial-up traffic to ISPs.

F. Universal Service Order

This Commission's *Universal Service Order* also affirms the view, first adopted in 1971 that the "data processing" segment of a telephone call is considered a separate regulated component from the "message or circuit switching" component of the call.¹²⁷ The Commission relied on the "separate components" view of Internet access in at least three key places when it established its universal service regime. First, the Commission determined that Internet access was not one of the services under Section 254(c)(1) that would be supported by universal service funds because such services were limited to telecommunications services:

We agree with the Joint Board's determination that Internet access consists of more than one component. [Footnote: . . . Internet access consists of both a network transmission component and an information service component.] Specifically, we recognize that Internet access includes a network transmission component, which is the connection over a LEC network from a subscriber to an Internet service provider, in addition to the underlying information

¹²⁶ Statistics of Communications Common Carriers, 2002/2003 Edition, March 2, 2004, Table 2.11, page 102.

¹²⁷ *Matter of Federal State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, ¶ 788-9 (1997) ("*Universal Service Order*").

service. We also concur with the Joint Board's observation that voice grade access to the public switched network usually enables customers to secure access to an Internet Service Provider, and, thus, to the Internet. We conclude that the information service component of Internet access cannot be supported under section 254(c)(1), which describes universal service as "an evolving level of telecommunications services."¹²⁸

Second, the Commission determined that the services provided by ISPs were not telecommunications subject to universal service contribution requirements.¹²⁹ Relying on the "separate components" view, the Commission determined that the portion of Internet access provided by an ISP was distinct from the dial-up communications used to connect to the ISP:

[W]e agree with the Joint Board that information service providers (ISP) and enhanced service providers are not required to contribute to support mechanisms to the extent they provide such services. . . . When a subscriber obtains a connection to an Internet service provider via voice grade access to the public switched network, *that connection is a telecommunications service and is distinguishable from the Internet service provider's service offering.*¹³⁰

Because the ISP's service offering was distinguishable from the dial-up connection to the ISP, the ISP was not required to contribute to the Universal Service Fund.

Third, the Commission ruled that universal service funds for schools and libraries under section 254(h) were not limited only to services provided by telecommunications carriers and telecommunications providers that were also providing information services.¹³¹ The Commission ruled that schools and libraries could use universal service funds to obtain Internet

¹²⁸ *Id.* at ¶ 83 (footnotes omitted, except as indicated).

¹²⁹ *Id.* at ¶¶ 788-789.

¹³⁰ *Id.*

¹³¹ *Id.* at ¶¶ 594-595.

access from ISPs independently of the telecommunications provided by local exchange carriers.¹³²

In all of these examples, the Commission's universal service regime as it applied to Internet service providers was predicated on the view, first established in 1966, that the "data processing" component of entities using the local telephone network was separate from the "message or circuit switching" component that connected an end user to an enhanced service provider.¹³³

G. Access Charge Reform Order

In its *Access Charge Reform Order*,¹³⁴ the Commission also considered the interplay between the dial-up component of Internet access and the information services component. After first recognizing that subscribers reach their ISP "through a local call," "even for calls that appear to traverse state boundaries,"¹³⁵ the Commission made three key conclusions. First, the Commission re-affirmed its view that ISPs should not pay access charges to LECs for traffic they receive in connection with providing information services. The Commission was reluctant to impose IXC access charges on ISPs, especially since "it is not clear that ISPs use the public switched telephone network in a manner analogous to IXCs. Commercial Internet access, for example, did not even exist when access charges were established. As commenters point out,

¹³² *Id.*

¹³³ *See also* 1998 Report to Congress, FCC 98-67, at ¶ 73 (services offered by Internet service providers "are appropriately classed as information, rather than telecommunications, services.")

¹³⁴ *Access Charge Reform Order*, ¶¶ 344-348, n.502.

¹³⁵ *See id.* at ¶ 342, and n. 502.

many of the characteristics of ISP traffic (such as large numbers of incoming calls to Internet service providers) may be shared by other classes of business customers.”¹³⁶

Second, the Commission rejected ILEC complaints that usage of the local network by ISPs left ILECs undercompensated: “To the extent that some intrastate rate structures fail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming calls, incumbent LECs may address their concerns to state regulators.”¹³⁷ Seven years later, Pac-West is not aware of any ILEC that has gone to a state commission to increase its local rates so as to be compensated for the increase in traffic attributable to ISPs.

Third, the Commission rejected the idea that imposing access charges on ISPs was needed in order to *reduce* use of the public switched network by ISPs: “The access charge system was designed for basic voice telephony provided over a circuit-switched network, and even when stripped of its current inefficiencies it may not be the most appropriate pricing structure for Internet access and other information services.”¹³⁸

As mentioned above, the United States Court of Appeals for the Eighth Circuit affirmed the Commission when BellSouth and Verizon’s predecessor Bell Atlantic challenged the Commission’s authority to exempt ESPs from certain aspects of interstate regulation and delegate to the states the regulation of the telecommunications services they use.¹³⁹ By permitting jurisdictionally interstate information services to be regulated as local services, the Court said, “the Commission has appropriately exercised its discretion[.]”¹⁴⁰ Moreover, “[i]n

¹³⁶ See *id.* at ¶¶ 345-346.

¹³⁷ *Id.* at ¶ 346.

¹³⁸ *Id.* at ¶ 347.

¹³⁹ See Section II.C(3), above.

¹⁴⁰ *Southwestern Bell*, 153 F.3d at 543.

these circumstances, we cannot say that the FCC has shirked its responsibility to regulate interstate telecommunications.”¹⁴¹ The *Access Charge Reform Order* makes clear that the Commission’s regulation of dial-up access to the Internet as a local service is consistent with federal law, and as local service, it is subject to reciprocal compensation obligations.

H. Conclusion

All of this history is well-known to the Commission. Based on these precedents, the Commission realized in 1999 that, but for the Commission’s application of its end-to-end analysis to exclude ISP-bound traffic from reciprocal compensation obligations, section 251(b)(5) would apply:

While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic.¹⁴²

When Commission precedent is properly applied to the facts of this dispute, it is clear that the Commission has always regulated the “data processing,” “enhanced services,” or “information services” component of an interstate communication as a separate component regardless of its jurisdictional classification. The Commission should re-affirm that principle here and resolve this dispute finally by ruling that reciprocal compensation is owed for ISP-bound traffic.

¹⁴¹ *Id.*

¹⁴² *Access Charge Reform Order* at ¶ 25.

IV. THE BELL COMPANIES' OTHER ARGUMENTS REGARDING THE SCOPE OF SECTION 251(b)(5) ALSO LACK MERIT

A. Reciprocal Compensation Is Not Limited To Balanced Exchanges Of Traffic

Verizon asserts that section 251(b)(5) cannot apply to ISP-bound traffic because calls to ISPs are one-way, meaning any compensation regime for the termination of ISP-bound traffic would not be “reciprocal.”¹⁴³ Yet Verizon concedes its argument by noting that calls to paging carriers are subject to reciprocal compensation, even though they are just as one-way as calls to ISPs.¹⁴⁴ Verizon attempts to sidestep this logical fallacy by noting that calls to paging companies are shorter than calls to ISPs so they are acceptable under a reciprocal compensation regime. In other words, to Verizon the real issue is not whether the traffic is one-way and out of balance; it is whether it results in a loss of revenue to the originating carrier. But Verizon’s complaint about having no mechanism to recover its costs has already been rejected by the Commission in the *Access Charge Reform Order*: “To the extent that some intrastate rate structures fail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming calls, incumbent LECs may address their concerns to state regulators.”¹⁴⁵

Further, the idea of compensating a terminating carrier to perform the function of call termination assumes that traffic will not be in balance. The New York Public Service Commission pointed out this fact when it ruled that reciprocal compensation was owed for ISP-bound traffic:

In assessing the significance of the traffic imbalances that are so much at issue here, one must begin with the very basic point that reciprocal compensation was chosen over bill-and-keep in part

¹⁴³ Verizon *ex parte* at 41-43.

¹⁴⁴ *Id.* at n.34, citing *TSR Wireless, LLC v. US West Communications, Inc.*, 15 FCC Rcd 11166 (2000) at ¶ 21.

¹⁴⁵ *Access Charge Reform Order* at ¶ 346.

because some imbalances were seen as likely. The ILECs' earlier advocacy of reciprocal compensation over bill-and-keep does not legally estop them from now urging changes in reciprocal compensation, or even its total abandonment; but it does suggest at least that the existence of imbalances should not be seen by them as a complete surprise.¹⁴⁶

If traffic were expected to be in balance, then bill-and-keep would be preferable because it would eliminate the transaction costs. Only if one party were owed more than it had to pay would the costs of tracking and billing reciprocal compensation traffic be justifiable. The notion that reciprocal compensation is owed only for reciprocal exchanges of traffic strains credulity.

B. Policy Considerations Do Not Support Denying Reciprocal Compensation For ISP-Bound Traffic

Verizon also asserts that, due to policy considerations, the Commission cannot say that ISP-traffic should be regulated the same as local voice traffic.¹⁴⁷ Along these lines, Verizon asserts that the Commission promulgated its intercarrier compensation regime on policy grounds, which cannot be reversed now; namely that the payment of reciprocal compensation for ISP-bound traffic created “severe market distortions” that required “immediate action” to fix an “exigent market problem.”¹⁴⁸ Qwest asserts largely the same arguments in its *ex parte* filing.¹⁴⁹ In response, Pac-West refers the Commission to the example set by SBC Communications, Inc., the second largest ILEC in the country, throughout its 13-state territory. The “market distortions” were so “severe” over SBC’s 13-state territory that SBC waited two years to begin to

¹⁴⁶ *Proceeding on Motion of Commission to Reexamine Reciprocal Compensation*, Opinion and Order Concerning Reciprocal Compensation, Case No. 99-C-0529 (N.Y. P.S.C. Aug. 26, 1999) at 56.

¹⁴⁷ Verizon *ex parte* at 48-53.

¹⁴⁸ Verizon *ex parte* at 49-50, quoting *ISP Remand Order*.

¹⁴⁹ Qwest *ex parte* at 1, 5-8.

implement the FCC intercarrier compensation regime, and then only in selected states.¹⁵⁰ Since dial-up minutes to ISPs have plateaued,¹⁵¹ whatever factors went into SBC's decision to invoke the FCC regime two years late are more likely the result of other elements in the mix of traffic SBC exchanges with other carriers. The argument about "exigent market problems" is a canard; if there is an "exigent market problem," it was the lack of competition in Verizon territories that permitted Verizon to set terminating compensation rates significantly above cost, and then have the fallout from those high rates blow back onto Verizon. A terminating compensation rate based on cost is the most rational and economically efficient answer to concerns about "regulatory arbitrage."

Further, an arbitrage opportunity occurs when there is a disparity between the cost of producing a good or service and the price at which the good or service can be sold. Big disparities will prompt market entry until competitive forces bring the price down to reflect the cost of producing the good or service. In this case, whatever arbitrage opportunities existed were the result of the rates set to terminate traffic. The costs to terminate the calls are the same, as the Commission acknowledged in the *ISP Remand Order*.

Finally, whatever policy considerations the Commission may have on this issue must be answered consistent with the law applicable to the dispute. The Commission may not avoid application of the law in this case in order to achieve a particular outcome. And the Commission

¹⁵⁰ See letter from Eddie A. Reed, Jr., Director—Contract Management, SBC Telecommunications, Inc., to John Sumpter, Vice President, Pac-West Telecomm, Inc., dated June 16, 2003 (ostensibly invoking terms of FCC's compensation regime for traffic to Internet service providers in California).

¹⁵¹ Verizon asserts that dial-up traffic to ISPs "has not declined," Verizon *ex parte* at 50, but Verizon does not suggest that the minutes have grown, either. Simple logic dictates that the heaviest users of Internet access will migrate off the circuit switched network onto broadband connections, leaving the lightest users of Internet access with dial-up connections that would be subject to reciprocal compensation. See also letter from Charles D. Breckinridge, Counsel to Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, dated June 25, 2004, Attachment "Bernstein Research Call" at 3.

should certainly avoid the situation, stated eloquently by Commissioner Furchtgott-Roth in his dissent from the *ISP Remand Order*:

Today's order is the product of a flawed decisionmaking process that occurs all too frequently in this agency. It goes like this. First, the Commission settles on a desired outcome, based on what it thinks is good "policy" and without giving a thought to whether that outcome is legally supportable. It then slaps together a statutory analysis. The result is an order like this one, inconsistent with the Commission's precedent and fraught with legal difficulties.¹⁵²

Finally, a legally sustainable ruling that reciprocal compensation is owed for ISP-bound traffic, as described in Section II above, is also consistent with public policy. A compensation regime that compensates carriers for the costs of the transport and termination services they perform for other carriers sends the appropriate signals to the marketplace. A regulatory regime that denies compensation for a particular service will have the effect of discouraging the performance of that service, thereby reducing competitive alternatives and denying certain end users—in this case ISPs—the benefits of competition.

C. Any Decision Regarding The Prospective Effect Of A Commission Order Must Be Consistent With The *AT&T VoIP* Order

Verizon also argues at length that any decision by the Commission to apply reciprocal compensation to ISP-bound traffic must be given prospective effect only.¹⁵³ On this matter, Pac-West asserts that the Commission ruled in the *AT&T VoIP* access charge proceeding that it would defer to the courts to determine the retroactive effect of its decision under applicable

¹⁵² *ISP Remand Order*, Dissenting Statement of Commissioner Harold Furchtgott-Roth at 66.

¹⁵³ *Verizon ex parte* at 53-56.

interconnection agreements.¹⁵⁴ Pac-West is hard-pressed to imagine how the Commission could rule otherwise in this proceeding. Any decision here must be consistent with the decision in that case.

D. The Commission Has Already Ruled That The Payment Of Reciprocal Compensation For Virtual NXX Traffic Is Consistent With Federal Law

Verizon also spends a great part of its *ex parte* filing trying to explain how, if the Commission were to rule that reciprocal compensation was owed for ISP-bound traffic, it cannot apply that ruling to ISP-bound traffic using Virtual NXX arrangements.¹⁵⁵ The basis for this position is that Virtual NXX traffic is interexchange traffic, and interexchange traffic cannot be subject to reciprocal compensation. As explained above, the interexchange nature of a particular call does not mean it cannot be subject to reciprocal compensation. The Commission ruled in the *Starpower Damages Order* that reciprocal compensation for Virtual NXX traffic did not violate federal law. When asked by Verizon to vacate the *Starpower Damages Order*, the Commission declined on the grounds that the decision should be retained because it represented the Commission's views on reciprocal compensation for Virtual NXX traffic.¹⁵⁶ Further, Verizon has conceded that it bills and collects intercarrier compensation for interexchange Foreign Exchange traffic.¹⁵⁷

¹⁵⁴ *Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, FCC 04-97 (rel. Apr. 21, 2004) at ¶¶ 21-23.

¹⁵⁵ Verizon *ex parte* at 57-63.

¹⁵⁶ *Starpower Communications, LLC v. Verizon South, Inc.*, File No. EB-00-MD-19, FCC 04-102, Order (rel. April 21, 2004) ("*Starpower Denial of Vacatur Order*").

¹⁵⁷ *Starpower Damages Order* at ¶ 10.

Moreover, at the heart of the Verizon argument is the notion, already rejected by the Commission, that section 251(b)(5) is limited to “local” traffic. To support Verizon’s proposal to exclude Virtual NXX traffic from reciprocal compensation obligations, Verizon must resuscitate the rejected that reciprocal compensation applies only to traffic between end users physically located in the same local calling area. The Commission was correct in rejecting this approach, and it should not attempt to revive it now. Pac-West asserts that reciprocal compensation is owed for all locally dialed traffic, because the accepted industry practice is to rate a call for intercarrier compensation purposes by comparing the NPA/NXX codes of the calling party and the called party. This was the approach adopted by the Wireline Competition Bureau in the *FCC Arbitration Order*, as well as by the full Commission in the *Starpower Damages Order*.

E. Conclusion

There are a number of issues that the BOC *ex partes* choose not to address. In particular, the BOCs never address the fundamental conclusion of the *ISP Remand Order*: 251(b)(5) is not limited to local traffic, but applies to all telecommunications not subject to 251(g). Instead of explaining how the Commission can now reject its earlier conclusion that 251(b)(5) applies to all telecommunications, the BOCs try to squeeze the genie back into the bottle by asserting that 251(b)(5) is limited to local traffic after all. Pac-West has explained above how the Commission can approach the issue of reciprocal compensation for ISP-bound traffic and remain within the four corners of the 1999 *ISP Declaratory Ruling*, the 2000 *Bell Atlantic* decision, the 2001 *ISP Remand Order*, and the 2002 *WorldCom* decision. The BOCs do not.

Respectfully submitted,

/s/

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