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February 17, 2004

EX PARTE – Via Electronic Filing

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Re: *Level 3 Petition for Forbearance*, WC Docket No. 03-266

Dear Ms. Dortch:

On February 16, 2005, Chairman Michael K. Powell convened a group of industry representatives to discuss the merits of Level 3's Petition for Forbearance. Representatives of Level 3 Communications LLC ("Level 3"), Vonage Holdings Corp. ("Vonage"), and the VON Coalition,<sup>1</sup> and representatives of the Verizon, BellSouth Corporation ("BellSouth"), SBC Telecommunications, Inc. ("SBC"), Qwest, and OPASTCO represented incumbent and rural local exchange carriers. A list of the members of the VON Coalition is attached. Representatives from various offices within the Commission also attended the meeting. (A complete list of attendees is attached as Exhibit A to this letter.) This *ex parte* letter, filed on behalf of Level 3, Vonage, and the VON Coalition summarizes the principal points presented during the meeting by these three parties. This letter does not attempt to summarize the presentations of the incumbent local exchange carriers, except where necessary to put points in context.

**The FCC Should Clearly Articulate Now "Who Pays Whom" and "How Much" for IP-PSTN Traffic, Pending Comprehensive Intercarrier Compensation Reform**

The Level 3 Petition is not, as some have alleged, an attempt to "jump the gun" on comprehensive intercarrier compensation reform. To the contrary, comprehensive intercarrier

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<sup>1</sup> The VON Coalition's members include Acceris, AT&T, BMX, BT Americas, CallSmart, Convedia, Covad, Earthlink, IceNet, iBasis, Intel, Intrado, Level 3, MCI, Microsoft, PointOne, pulver.com, Skype, Teleglobe, Texas Instruments, USA Datanet, VocalData, and Voiceglo.

compensation reform is about rules for the future, while the Level 3 Petition is about the “rules of the road” that exist now and until comprehensive intercarrier compensation reform. At its core, Level 3’s request for forbearance is really a plea for clarity with respect to two fundamental questions governing intercarrier compensation for IP-PSTN traffic—Who pays whom, and how much?—for the interim period pending the resolution of the Commission’s comprehensive intercarrier compensation reform proceeding.

The communications industry lacks any certainty about the intercarrier compensation rules that currently apply to IP-PSTN traffic. Indeed, the ILECs present at the meeting with the Chairman offered (either in their comments or during the meeting) at least four different versions of whether and how access charges or reciprocal compensation apply to IP-PSTN traffic. Level 3 agrees with SBC’s statement from May 2004 that the “surest way to depress investment in any industry is to sow confusion about what the ground rules are for competition and everyday operation.”<sup>2</sup> In comments filed in the IP-Enabled Services proceeding, SBC implored the Commission to resolve “the uncertainty concerning the intercarrier compensation obligations of IP-enabled service providers that send traffic onto or receive traffic from the PSTN . . . immediately, preferably by the end of this year [2004]; because these issues are discrete, [the Commission] need not await resolution of all other public policy issues that are before it to decide these issues.”<sup>3</sup>

The public interest will be well-served if the FCC grants the Level 3 Petition. With regulatory clarity, IP-PSTN service providers can make rational investment decisions, and this new technology can develop fully to the ultimate benefit of consumers. As the VON Coalition explained, IP-PSTN service providers are typically small enterprises, and they rely on a clear understanding of the rules when developing business plans and taking steps to expand. For small companies, regulatory clarity is critical to investment and business planning. Indeed, as the VON Coalition noted, the current uncertainty has forced a variety of providers to mothball innovations and defer product roll-outs. Furthermore, while VoIP stimulates broadband subscription today, regulatory certainty would stimulate it even more.

Companies already exchange IP-PSTN traffic with each other under a variety of arrangements, and they do so without the benefit of clear intercarrier compensation rules. At some point, perhaps years down the road, a decision-maker will decide the rules that apply today. If the FCC does not clarify the current rules *now*, then a court (or, worse, various courts) will reach a decision *much later*, even though that later decision would affect traffic and compensation that is exchanged *today*. That will occur because companies will dispute the appropriate billing for traffic exchanged. Eventually, one carrier will sue another—likely an ILEC seeking payment of access charges. The carrier serving the VoIP provider will then defend, arguing that access charges were not due under the current rules. Civil litigation will follow. Later, after years of billing disputes and litigation, the courts (or the FCC, if the courts defer to its primary jurisdiction) will render a final decision as to the rules that apply *today*. Then there will be appeals. Moreover, if a variety of trial courts ultimately resolve the matter separately (as is likely), the industry would face an utterly fractured and inconsistent system,

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<sup>2</sup> Comments of SBC Communications, WC Docket No. 04-36, at 65 (filed May 28, 2004) (“SBC IP-Enabled Services Comments”).

<sup>3</sup> *Id.* at 64.

which could vary by federal judicial district or circuit. By making today's rules clear today, the Commission can avoid all of this uncertainty, many of these litigation costs, and the drag on investment that will occur as carriers serving VoIP providers (or VoIP providers themselves) establish accounting reserves or place monies in escrow under interconnection agreements. To avoid these unnecessary costs, reduced investment, protracted delays and inconsistent results, as well as to eliminate the reigning uncertainty, the Commission should grant the Level 3 Petition and clarify the rules *now*.

The current uncertainty affects non-carrier service providers as well as carriers. As an information service provider, Vonage purchases telecommunications services from a variety of carriers. Vonage pays a blended rate for terminating its traffic through these carriers. The uncertainty concerning which intercarrier compensation mechanism applies to VoIP communications acts as a price floor and reduces investment in new products and services. Any attempt to apply geographic, non-cost based access charges to Vonage's non-geographic VoIP service would be arbitrary and irrational.

As a policy matter, Vonage advocates prompt adoption of the Level 3 Petition. Such action will clarify that the current system of compensation is wholly inappropriate for new, innovative IP-enabled services that defy geographic boundaries. Forbearance from this framework should not await resolution of larger, more complex, and wholly irrelevant issues pertaining to legacy PSTN services. Vonage maintains that adoption of the Petition will offer IP carriers and VoIP providers further clarity that will enhance the growth of IP-enabled services and thereby encourage broadband deployment and adoption.

Furthermore, inaction by the Commission now will lead to inconsistent state actions as states confront issues of IP-PSTN intercarrier compensation in interconnection arbitrations. State commissions, lacking clear guidance regarding the applicable rules, have already adopted or proposed at least three divergent intercarrier compensation regimes for IP-PSTN traffic. Michigan and Indiana have implemented bill-and-keep systems, California has adopted a reciprocal compensation system, and Kansas has implemented an access charge regime. When faced with these muddied waters, an administrative law judge in Illinois declined altogether to opine on the governing regime. Inaction by the FCC will mean that, for the interim pending comprehensive intercarrier compensation reform, there will be no clear *federal* policy on IP-PSTN IP-enabled services intercarrier compensation—creating the risk of 50 different state solutions.

The existing regulatory uncertainty about the rules that apply to IP-PSTN traffic—and the need for the FCC to step in to provide clear interim rules of the road pending comprehensive intercarrier compensation reform—is highlighted by the fact that the ILECs themselves lack agreement on how and when access charges apply to IP-PSTN traffic, and when reciprocal compensation applies. For example:

- BellSouth argues that access charges apply to IP-PSTN traffic whenever the ILEC end user and the IP end user are in different local calling areas. According to BellSouth, however, if the IP end user purchases service for a location in one local calling area (such as if I were to buy a broadband VoIP service for my home in Washington, DC), but then takes the VoIP media terminal adapter and travels to another local calling area (such as to my parents home in California), the PSTN

portion of the call should still be rated as if the IP end user had not traveled (*i.e.*, a call from my next door neighbor in Washington to me while traveling in California would be treated as “local”). By contrast, if my parents in California bought the broadband VoIP service themselves and obtained a Washington, DC telephone number, BellSouth argues that the PSTN portion of the call would be subject to access charges.

- Verizon argues that access charges apply to IP-PSTN communications under the existing regime when the end users are in different local calling areas, and that providers should rate calls based on the geographic endpoints (or NPA-NXX codes) of the call. Thus, according to Verizon, reciprocal compensation applies to calls that, based on the telephone numbers, appear to be “local,” intrastate access applies to calls that appear to be between different local calling areas in the same state, and interstate access applies to calls that appear to be between different local calling areas in different states.<sup>4</sup> (Verizon did not, however, offer any theory that would reconcile its geography-based view of the applicability of reciprocal compensation, interstate access charges and intrastate access charges with the Commission’s conclusion in the *Vonage Order* that IP-PSTN communications defy geography and that such communications are therefore subject to federal, not state, jurisdiction.)
- SBC argues that access charges should apply whenever an IP-enabled call touches the PSTN, either on the originating end or the terminating end.<sup>5</sup> Notably, SBC argues that access charges should apply even if the geographic end-points would be “local” and thus otherwise subject to reciprocal compensation.
- Qwest argues that, pursuant to the ESP exemption, calls from an “ESP POP” to a PSTN end-user are not subject to terminating access charges when the “ESP POP” is located in the same local calling area as the PSTN end user.<sup>6</sup> However, if the ESP POP is physically located in a different local calling area, even within the same LATA, Qwest argues that terminating access applies. Qwest also believes that a call originating on the PSTN that reaches an ESP POP over a “local” NPA-NXX number is not subject to originating access, but that originating access applies to that call when the ESP POP is not physically located in the same local calling area as the originating PSTN end user.<sup>7</sup> (In Level 3’s view, limiting the ESP exemption to cases in which the ESP POP is in the same local calling area as the PSTN end user conflicts with the “single POI per LATA” rule for Section 251(c)(2) interconnection, and would result in illogical and unnecessary network arrangements.)

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<sup>4</sup> See, *e.g.*, Letter from Kathleen Grillo (Verizon Vice President, Federal Regulatory) to Marlene H. Dortch, WC Docket Nos. 04-36, 03-266, attach. 1 at 3 (filed Dec. 13, 2004).

<sup>5</sup> See SBC IP-Enabled Services Comments at 68-76.

<sup>6</sup> See Letter from Cronan O’Connell, Vice President – Federal Regulatory, Qwest Communications International, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 03-266, attach. at 2, 5 (filed Feb. 7, 2005).

<sup>7</sup> See *id.*

In contrast to this diversity of ILEC opinions, Level 3's Petition asks the Commission confirm a simple rule: when IP-PSTN traffic is exchanged within the same LATA between the carrier serving the IP services provider and the carrier serving the PSTN end of the call, reciprocal compensation applies. In addition, as discussed below, reciprocal compensation rates should apply when a circuit-switched interexchange call is delivered to a carrier serving an IP-services provider for termination to an IP-based end user.

Delaying resolution of the current regulatory uncertainty until the Commission completes comprehensive reform subjects IP-enabled services providers, and the carriers serving them, to an unreasonably long period of uncertainty. As it is, the Commission is unlikely even to complete an order on comprehensive reform until, at the earliest, the end of this year. Moreover, even when comprehensive reform is adopted, it will be some time before it is fully implemented. Even if the ICF Plan were implemented in July 2006, for example, it would not unify reciprocal compensation and access rates until July 2009. IP-enabled services providers and the carriers that serve them must have a clear sense of the rules that will govern during the intervening years.

Accordingly, Level 3, Vonage, and the VON Coalition all urged the Commission to provide regulatory clarity by granting the Petition promptly.

### **Forbearance Will Advance Comprehensive Reform**

Grant of the Level 3 Petition will advance, not frustrate, comprehensive intercarrier compensation reform. The current intercarrier compensation regime is fundamentally flawed, suffering from the parallel, yet incoherent, existence of two separate systems: access charges and reciprocal compensation. Recognizing that it needs to establish a single system in the long term, the Commission launched a rulemaking proceeding to do so four years ago, and it voted to issue a second notice of proposed rulemaking last week. Level 3 explained in the meeting with the Chairman that the structure of the reciprocal compensation regime provides the best model for a comprehensively reformed system, just as the ICF has suggested. (The ICF Plan unifies the access charge and reciprocal compensation regimes after three years.) Bearing in mind the likelihood of a substantial restructuring of the intercarrier compensation system, Level 3 noted that there is no good reason to move IP-PSTN traffic from a system of reciprocal compensation (based on the ESP exemption) to a system of interstate (and possibly intrastate) access charges, only to then shift to a reformed system that is likely to be structurally similar to reciprocal compensation.

Under the ESP exemption, IP-PSTN traffic falls outside of the access charge regime today. If the Commission grants Level 3's Petition, it will confirm today's cost-based intercarrier compensation system for IP-PSTN traffic, and it will thereby spur IP-based innovation, promote broadband deployment, and expand consumer choice. If, by contrast, it begins applying access charges for the first time (as the ILECs urge), the Commission would succeed only in taking a step away from reform and toward the archaic regime of the past.

To be frank, the biggest obstacle to comprehensive reform are not carriers such as Level 3 that seek a comprehensive solution, but those that seek to preserve outmoded, legacy intercarrier compensation revenue streams that have little to do with the economic costs of terminating traffic originated by other carriers.

### **Level 3's Interest in Long-Term Reform**

In response to SBC, Level 3 explained in the meeting with the Chairman that forbearance would not dampen Level 3's interest in working toward comprehensive intercarrier compensation reform. Forbearance would provide a short-term answer only for IP-PSTN traffic, but, as Level 3 noted, intercarrier compensation on IP-PSTN traffic represents only a tiny portion of the overall intercarrier compensation payments that Level 3 makes and receives. Separate and apart from the traffic covered by its Petition, Level 3 pays access charges on traffic that originates and terminates on the PSTN. Level 3 also receives ISP-bound compensation.

As the outgoing President of the National Association of Broadcasters recently said, "[i]n Washington, there are no final defeats and no final victories." Even if the Commission grants Level 3's petition, ILECs will surely continue to challenge that decision in the courts, in the Congress, and at the Commission. And the political might of the ILECs will only increase if they consummate the SBC/AT&T and Verizon/MCI proposed transactions. Level 3 understands that the only way to achieve defensible stability in this environment is to have comprehensive intercarrier compensation reform. In other words, regardless of the outcome of the forbearance proceeding, Level 3 will have an enormous interest in the rates that apply outside of the IP-PSTN context.

Even more fundamentally, Level 3 has explained repeatedly that forbearance would provide only a *transitional* remedy, and that comprehensive reform would ultimately displace the transitional rules. Thus, regardless of the Commission's decision in this proceeding, Level 3 will have a stake in the comprehensive reform proceeding because the new comprehensive regime will apply no matter what the Commission does here.

### **Symmetrical Rates**

Level 3 also explained that it will **not** levy access charges when terminating PSTN-to-IP calls that transit interexchange carriers on their way to IP-end users served by Level 3. To the contrary, Level 3 explained that it will assess reciprocal compensation charges to terminate such traffic, just as will pay reciprocal compensation when it originates IP-to-PSTN calls. Indeed, Level 3 has explained the complete symmetry of its approach to billing in a detailed *ex parte* filed in this proceeding and under oath in a variety of state proceedings.

This simple fact bears repeating in light of the ILECs' unfounded obstinacy on this point: In perfectly symmetrical fashion, Level 3 will *collect* reciprocal compensation for IP-PSTN traffic it terminates, and it will *pay* reciprocal compensation for IP-PSTN traffic it originates. It will not pay or collect access charges for *any* IP-PSTN traffic. As Level 3 has previously stated, it has no objection if the Commission wishes to make this point clear as to Level 3 and any similarly situated carrier in any Order the Commission issues.

### **The Sky Will Not Fall On Universal Service**

Contrary to the ILECs' alarmist assertions, there is no evidence in the record that forbearance will have a significant impact on ILEC access revenues or on any implicit universal service funding buried in access charge rates. Notably, the ILECs fail to offer any data in support of their panicky arguments, and they fail to mention their sky-high interstate rates of return. (In 2003, BellSouth's interstate rate of return was 21.93%, Qwest's was 23.03%, SBC's was 20.37%, and Verizon's was 12.36%.)

In contrast to the ILECs' unfounded warnings that the sky is falling, Level 3 has presented the Commission with detailed data demonstrating that forbearance *will not* have a significant impact on the ILECs' revenues (and thus on USF funding). Most notably, Level 3 provided the Commission with a comprehensive cost model contrasting the limited impact of granting the Petition (*i.e.*, reiterating and clarifying the existing rules) with the obvious problems of subjecting IP-PSTN to above-cost access charges for the first time. The model demonstrates that applying access charges in 2005 would generate a modest 1.17% increases in non-rural ILEC revenues. More fundamentally, the study shows that surging wireless subscriptions (the vast majority to services provided by the wireless affiliates of SBC, BellSouth and Verizon) pose the greatest threat to ILECs' market share and access revenues.

In addition, there is no legal basis for levying intrastate access charges (as some ILECs would, ostensibly to preserve implicit universal service funding) on IP-PSTN traffic in light of the Commission's conclusion in the *Vonage Order* that IP-PSTN traffic is jurisdictionally interstate. Indeed, the Petition merely confirms explicitly the inevitable legal result of the Commission's Order—intrastate access charges no longer can legally apply to IP-PSTN traffic. Thus, any loss of "implicit" support in intrastate rates (which no ILEC has actually quantified in any opposition to the Petition) resulting from the difference between intrastate access rates and interstate access rates has already occurred as a result of the *Vonage Order*.

### **The Industry Must Know the Rules for "Who Pays Whom" and "How Much" Before It Can Fully Develop Systems to Implement Those Rules**

In response to ILEC scaremongering regarding implementation problems (such as tracking IP-to-PSTN traffic), Level 3 explained that all of the ILECs' implementation concerns are susceptible to commonsense solutions both in the near term and the long term. Even more fundamentally, however, Level 3 noted that the industry can fully tackle these issues *only after it knows the rules*. In other words, as Level 3 explained, the Commission should grant the Petition to clarify the rules, and then the industry can resolve the implementation problems the ILECs have identified.

Indeed, the Commission has always left the industry to resolve implementation issues stemming from intercarrier compensation rules, and the industry has always been up to the task. Neither the Part 69 access charge rules nor the reciprocal compensation rules address the types of implementation issues the ILECs are raising. Instead, the industry resolved those issues in tariffs and interconnection negotiations. The Commission should take the same approach here and require the industry (using its engineering know-how and relying on competitive forces) to come up with implementation solutions. But, as a first step, the Commission has to clarify the rules, because the industry can implement the rules only once it knows what they are.

Finally, it is important to recognize that through the process for disputing bills, carriers have the ability to protect themselves. The prospect of billing disputes will incent all industry players to develop practical, implementable solutions that effectuate the Commission's rules on "who pays whom" and "how much." But these core "rules-of-the-road" must first be clearly set forth.

### **Reciprocal Compensation Rates Are Reasonable**

Verizon argued that forbearance would result in the application of TELRIC rates, and it asserted that such rates are artificially low and frequently below cost. As Level 3 responded

during the meeting, the economics of actual industry practice belie Verizon's assertions. In the communications marketplace, numerous providers (including Verizon itself) exchange traffic voluntarily at rates that are equal to or lower than TELRIC rates. Verizon's (and others') *voluntary* use of TELRIC (or lower) rates demonstrates clearly that these rates are not uneconomically low. This observation reveals Verizon's true objective in presenting this argument – it is happy to pay low rates when it *owes* intercarrier compensation, but it wants to get inflated access charges when it is on the receiving end.

### **The Commission's Procedural Options**

During the meeting, Verizon professed concern that Level 3's request would require the Commission to establish new intercarrier compensation rules for this type of traffic, and Verizon asserted that such rulemaking is not appropriate in the forbearance context.

As a threshold response, Level 3 explained that its Petition does not seek a rulemaking. Rather, it asks only that the Commission forbear from enforcing Section 251(g) (to the extent it applies at all), which would place IP-PSTN traffic under the *existing* default compensation system of Section 251(b)(5). Nothing about the request would require rulemaking.

Level 3 also explained that the Commission has plenty of procedural flexibility to address Verizon's concerns, if necessary. Under the Communications Act's forbearance provision, for instance, the Commission may grant or deny a petition "in whole *or in part*," 47 U.S.C. § 160(c) (emphasis added), meaning that the Commission can, on its own initiative, modify the precise contours of the requested forbearance. The Commission could use this flexibility to clarify that IP-PSTN service providers may not collect access charges when they terminate IP-PSTN traffic.

In addition, Level 3 noted that the Commission has launched a sweeping rulemaking with respect to IP-enabled services, and that it incorporated the Level 3 docket into that proceeding. Thus, to the extent necessary to alleviate Verizon's concerns, the Commission could issue decisions in that rulemaking docket alongside any decision in this docket to clarify the intercarrier compensation rules that apply.

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As the foregoing summary illustrates, Level 3, Vonage, and the VON Coalition argued that the communications industry urgently needs regulatory clarity with respect to the intercarrier compensation rules applicable to IP-PSTN traffic. They explained that the Commission should grant Level 3's Petition *now* in order to provide that clarity, or else a court (or various courts) will determine today's rules in decisions issued years from now. By taking a "do-nothing" approach, the Commission would seriously jeopardize the nascent IP-enabled services industry, push many IP-PSTN providers out of business, and, as a result, prevent consumers from reaping the full benefits of this promising new technology.

Sincerely,

/s/

John T. Nakahata

*Counsel for Level 3 Communications LLC*

## **Exhibit A**

### **Meeting Attendees**

#### **Federal Communications Commission**

Chairman Michael K. Powell  
Christopher D. Libertelli  
Aaron Goldberger  
Jeffrey Carlisle  
Michelle Carey  
Pamela Arluk  
Lisa Gelb  
Tom Navin  
John Stanley  
Linda Kinney  
Austin Schlick  
Jeremy Marcus  
Jennifer McKee  
Tamara Preiss  
Steve Morris

#### **Verizon**

Mike Glover  
Kathy Grillo

#### **SBC Communications**

Jim Smith  
Jack Zinman

#### **BellSouth Corporation**

Bennett Ross  
Jon Banks

#### **OPASTCO**

John Rose  
Bob Williams  
Stuart Polikoff

#### **Qwest**

Cronan O'Connell  
Wendy Moser

#### **VON Coalition**

Jim Kohlenberger

#### **Vonage**

Brooke Schulz  
Bill Wilhelm (Swidler Berlin)

#### **Level 3 Communications LLC**

John Ryan  
Bill Hunt  
Cindy Schonhaut  
Rogier Ducloo  
John Nakahata (Harris, Wiltshire & Grannis LLP)  
Tim Simeone (Harris, Wiltshire & Grannis LLP)