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March 10, 2005

EX PARTE – Via Electronic Filing

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

Re: *Level 3 Petition for Forbearance,* WC Docket No. 03-266
IP-Enabled Services, WC Docket No. 04-36

Dear Ms. Dortch:

Level 3 Communications, LLC ("Level 3") hereby responds to Verizon's assertions that grant of Level 3's forbearance petition would amount to a "subsidy" for VoIP providers because originating VoIP providers would pay ILECs "only" reciprocal compensation rates – which Verizon claims are "below cost" – to terminate calls.[1]

Verizon's hypocrisy is truly astonishing: just two months ago, Verizon argued that when calls *originate* on its network (*i.e.*, PSTN-to-IP traffic), Verizon should either pay *nothing* for termination (bill-and-keep) or should actually *be paid* (under the access charge regime) whenever the ESP is located outside the caller's local calling area (defined according to the ILEC's local calling areas).[2] At that time, Verizon certainly did not suggest that paying nothing – or, more drastically, actually receiving access charges – would amount to a subsidy for originating LECs like itself.

1 *See, e.g.*, Level 3's Forbearance Petition Should Be Denied, WC Docket 03-266, at 46 (Feb. 11, 2005) (filed as an attachment to Letter from Kathleen Grillo, Verizon Vice President – Federal Regulatory, to Marlene H. Dortch, FCC Secretary, WC Docket Nos. 03-266, 04-36 (filed Feb. 11, 2005)).

2 *See* Letter from Donna Epps, Verizon Vice President – Federal Regulatory, to Marlene H. Dortch, FCC Secretary, CC Docket Nos. 99-68, 01-92, attach. at 9 (filed Jan. 7, 2005).

Indeed, Verizon has long maintained that requiring the originating carrier to pay anything for the termination of ISP-bound traffic constitutes pernicious "arbitrage."[3]

Of course that was then, and this is now. *Then*, just two months ago, Verizon advocated bill-and-keep when addressing the rate that it would *pay* to carriers that terminate traffic originated by Verizon's customers (or, alternatively, it contended that it should receive access charge payments when originating such calls). And *now*, in the context of the Level 3 Petition, Verizon advocates access charges when addressing the rate that Verizon would *charge* to other carriers for terminating traffic that originates on their networks. More specifically, Verizon claims in the Level 3 proceeding that any rate below its intrastate and interstate access rates would be confiscatory; it argues that forbearance would result in "below cost" rates if Verizon were allowed to charge no more than the state-arbitrated TELRIC rates or the $.0007/minute ISP-bound rate, which applies only when Verizon has opted into the Commission's ISP-bound compensation regime.

Since Verizon never reconciles these inconsistent positions, it cannot have it both ways. In both contexts (*i.e.*, termination of ISP-bound traffic on a CLEC's network (a type of PSTN-to-IP traffic), and termination of IP-PSTN VoIP traffic), the intercarrier compensation charge covers transport and termination—that is, carriage of traffic from the point of interconnection to the called party end user. The Commission's $.0007 ISP-bound rate (or the lower rates for ISP-bound traffic in the Level 3-Verizon interconnection agreements) cannot be both high enough to compel "uneconomic arbitrage" when Verizon *pays* the charge, and also low enough to constitute a "below cost" "subsidy" when Verizon *collects* the payment.

The Commission has long rejected ILECs' pleas for asymmetric compensation – and for good reason, as it has seen the impact of their one-way schemes for intercarrier compensation. Prior to the implementation of the 1996 Act, incumbent LECs "used their unequal bargaining position to impose asymmetrical rates for CMRS providers and, in some instances, have charged CMRS providers origination as well as termination charges."[4] The impact of that discriminatory scheme was predictable: ILECs were able to raise the costs (and thus the prices) of wireless companies, impeding the ability of wireless services to substitute for wireline services. Economists, antitrust scholars, and the Commission have long recognized the risks of anticompetitive harm posed by such "raising rivals costs" strategies.[5]

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3 *See, e.g.*, Letter from Donna Epps, Verizon Vice President – Federal Regulatory Advocacy, to Marlene H. Dortch, FCC Secretary, CC Docket Nos. 99-68, 01-92 (filed Jan. 28, 2005).

4 *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, First Report and Order, 11 FCC Rcd. 15,499, 16,041 ¶ 10807 (1996) ("*Local Competition Order*").

5 *See, e.g.*, Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 Yale L.J. 209, 214 (1986) (suggesting a unified standard to assess exclusionary conduct, including raising rivals' costs); Thomas G. Krattenmaker et al., *Monopoly Power and Market Power in Antitrust Law*, 76 Geo. L.J. 241, 263-64 (1987) (arguing that the presence of either of the two types of anticompetitive economic power, raising one's own prices and raising competitors' costs, should suffice for a violation); *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's*

The Commission should not permit Verizon and other ILECs to apply similar strategies to minimize competition from VOIP providers, especially when VoIP providers deliver tangible consumer benefits such as flat-rate calling plans for as little as $11.99 per month. Allowing ILECs to impose access charges on VoIP providers would result in precisely this form of anticompetitive harm, however. By charging access rates, which far exceed the actual additional costs of termination, ILECs would increase the costs of their IP-based rivals, including IP application providers such as Vonage and cable-based providers. And since at least some ILECs believe that the current rules do not require reciprocal compensation for such traffic, ILECs would have no incentive to moderate their pricing demands. In short, applying access charges to VoIP – especially, but not limited to, applying such charges in a manner that results in one-way termination compensation – would permit ILECs to use intercarrier compensation charges to erect a price umbrella shielding their own PSTN-based services from IP-based competition.

The Commission has long recognized the core value of symmetric compensation in redressing ILECs' market power to set prices for traffic exchange. In the *Local Competition Order*, for instance, the Commission noted the ILECs' reliance on their superior bargaining strength to negotiate asymmetric compensation with wireless carriers, and found that "symmetrical rates may reduce an incumbent LEC's ability to use its bargaining strength to negotiate excessively high termination charges that competitors would pay the incumbent LEC and excessively low termination rates that the incumbent LEC would pay interconnecting carriers."[6] The Commission reasoned that "symmetrical rates largely eliminate such [unequal bargaining] advantages because they require incumbent LECs, as well as competing carriers, to pay the same rate for reciprocal compensation."[7]

In a similar vein, in the *ISP Remand Order*, the Commission found that "[i]t would be unwise as a policy matter, and patently unfair, to allow incumbent LECs to benefit from reduced intercarrier compensation rates for ISP-bound traffic, with respect to which they are net payors, while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher . . . , when the traffic imbalance is reversed."[8] Again, the Commission recognized the incumbent LECs' ability to dictate anticompetitive rates: "Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to 'pick and choose' intercarrier compensation regimes."[9] Of course, that is exactly what Verizon seeks to do with carriers such as Level 3 that handle both voice-based IP-PSTN traffic and data-based IP-PSTN traffic (*e.g.*, ISP-bound traffic). Verizon

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Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace, Third Report and Order, 12 FCC Rcd. 15,756, 15,802-03 & n.214 ¶ 83 (1997) (recognizing the competitive harm inherent in an exercise of "Bainian" market power, "which is the ability of a firm profitably to raise and sustain its price significantly above the competitive level by raising its rivals' costs and thereby causing the rivals to restrain their output").

6 *Local Competition Order*, 11 FCC Rcd. at 16,041 ¶ 1087.

7 *Id*.

8 *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, 16 FCC Rcd. 9151, 9193 ¶ 89 (2001) ("*ISP Remand Order*"), *rev'd on other grounds, sub nom. WorldCom v. FCC*, 288 F.3d 429 (2002).

9 *ISP Remand Order*, 16 FCC Rcd. at 9193 ¶ 89.

wants to "pick" the higher access rates for the IP-PSTN traffic it terminates, but to "choose" the lower ISP-bound rates for the traffic terminated by a CLEC serving an ISP.

Finally, the Commission's recently released *Further Notice of Proposed Rulemaking* in the Intercarrier Compensation docket ("*FNPRM*"), and the accompanying staff report, cast substantial doubt on Verizon's claims that its access rates reflect its additional costs of originating or terminating IP-PSTN traffic and that lower reciprocal compensation rates are "below cost." As the Commission noted in its *FNPRM*, "most network costs, including switching costs, result from connections to the network rather than usage of the network itself."[10] "This development in infrastructure costs," the Commission observed, "calls into question whether intercarrier compensation mechanisms based on per-minute charges remain appropriate or necessary."[11] The Commission also noted that a number of state commissions, as well as the Wireline Competition Bureau, have found that ILEC end office switching costs are not traffic-sensitive and thus do not vary with minutes of use, as switched access charges do.[12] The Staff Analysis went even further, noting that "it appears that switching costs are primarily a function of the number of subscribers, rather than the number of calls or [minutes of use], because a reduction in call minutes per subscriber would not substantially reduce the investment and operating cost of the switch serving those customers, at least in the case of wireline networks."[13]

In light of the Commission's observations in the *FNPRM* and accompanying staff analysis, the negotiated intercarrier compensation rates embodied in the Level 3-Verizon interconnection agreements are more likely to reflect the actual "additional cost" of terminating an IP-originated, PSTN-terminated VoIP call than are either of Verizon's interstate or intrastate access rates. The Commission's observations, albeit preliminary, strongly support the conclusion that ILEC access rates remain far above the actual additional cost of origination or termination.

Thus, notwithstanding Verizon's protestations, there is simply no evidence that forbearance would require Verizon to "subsidize" Level 3 or other VoIP providers. Instead, grant of the Level 3 Petition will ensure that IP-PSTN IP-enabled services remain outside the morass of the legacy access charge regime pending the transition to a unified intercarrier compensation mechanism.

Sincerely,

/s/

John T. Nakahata
Counsel for Level 3 Communications LLC

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10 *In re: Developing a Unified Intercarrier Compensation Regime*, Further Notice of Proposed Rulemaking, FCC 05-33, ¶ 23 (rel. March 3, 2005).

11 *Id*.

12 *Id*. at ¶ 67 & n. 235, Appendix C (Staff Analysis) at p. 103 & n. 40.

13 *Id*., Appendix C at p. 103.