Gary L. Phillips
General Attorney &
Associate General Counsel

AT&T Services, Inc.
1120 20th St. NW, Suite 1000
Washington, D.C. 20036
Phone 202 457-3055
Fax 202 457-3074

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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW – Lobby Level
Washington, D.C. 20554

Re: ***Developing a Unified Intercarrier Compensation Regime*, CC Dkt No. 01-92; *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Dkt No. 96-98; *Intercarrier Compensation for ISP-Bound Traffic*, CC Dkt No. 99-68**

Dear Ms. Dortch:

As the Commission is aware, the D.C. Circuit left intact the Commission's rules governing reciprocal compensation for ISP-bound traffic because, even though it rejected the Commission's prior basis for them under section 251(g), it concluded that the Commission might well succeed in justifying the same rules under a different legal rationale.[1] AT&T encourages the Commission to consider three independent legal paths to sustaining those rules:

- Section 251(i) provides that nothing in section 251, including section 251(b)(5), "shall be construed to limit or otherwise affect the Commission's authority under section 201." That language preserves the Commission's traditional authority to continue setting rates it deems "just and reasonable" under its traditional section 201 authority for jurisdictionally interstate traffic, including ISP-bound calls. That argument has particular force where, as here, FCC ratemaking authority is needed to preserve the integrity of its pre-1996 rules. In this case, the Commission needs to exercise that authority to make sense of the "ESP exemption" in a new, post-1996 communications environment in which CLECs cooperate with ILECs to deliver traffic to ISPs.

- The Commission can and should also follow the D.C. Circuit's suggestion to justify its current scheme under the bill-and-keep savings clause of section 252(d)(2)(B)(i).[2]

- The Commission can and should also conclude that, in light of the ESP exemption, the "additional costs" of terminating ISP-bound traffic for purposes of section

[1] *WorldCom, Inc. v. FCC*, 288 F.3d 429, 434 (D.C. Cir. 2002); *see* Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 16 FCC Rcd 9151 (2001) ("*ISP Recip Comp Remand Order*").

[2] *WorldCom*, 288 F.3d at 434 (declining to vacate order because "there is plainly a non-trivial likelihood that the Commission has authority to elect [a bill-and-keep] system (perhaps under §§ 251(b)(5) and 252(d)(B)(i))").

252(d)(2)(A)(ii) —*i.e.*, the costs not recovered by retail rates under the ESP exemption—are zero.

Each of these legal rationales is independent of the others, and each supports adopting bill-and-keep as the ultimate rule for ISP-bound traffic, subject to the Commission's discretion to maintain positive rates for a transitional period. To create greater industry certainty by minimizing the possibility of another judicial remand, the Commission should consider adopting a belt-and-suspenders approach under which it relies on each of these rationales in the alternative.

I. The Commission Should Rely on Section 251(i) to Assert Plenary Section 201 Ratemaking Authority Over ISP-Bound Traffic.

The Commission has long determined Internet-bound traffic is jurisdictionally interstate and therefore falls squarely within its section 201 regulatory authority. Nothing in either of the D.C. Circuit's two decisions on ISP-bound traffic casts any doubt on that jurisdictional determination.[3] Instead, the main issue presented by those decisions is whether the "reciprocal compensation" rule of section 251(b)(5) places substantive restrictions on the Commission's exercise of its section 201 authority over this interstate traffic.[4]

It does not. Section 251(i) provides that "[n]othing in this section"—including section 251(b)(5)—"shall be construed to limit or otherwise affect the Commission's authority under section 201." And section 201 has always authorized the FCC to set whatever rates it deems "just and reasonable" for jurisdictionally interstate services such as ISP-bound traffic. Indeed, long before the 1996 Act was passed, the Commission relied on its section 201 authority to establish the compensation rules collectively known as the "ESP exemption." As discussed below, those rules assert preemptive federal jurisdiction over dial-up information services and entitle ISPs to pay retail business-line rates to LECs that connect them with their subscribers. The rules thus exempt such providers from paying the interstate and intrastate access charges they would have to pay for these access services if they were treated instead like conventional interexchange carriers. Moreover, section 201 authorizes the FCC to prescribe compensation rules, not just for LECs and their ISP customers, but also for two LECs that cooperate to connect ISPs to their own customers—just as section 201 has always authorized the Commission to oversee compensation rules when two LECs cooperate on one end of a conventional interstate call. In all of these contexts, the Commission derives this ratemaking authority from its section 201 jurisdiction to regulate interstate traffic.

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[3] *See, e.g., Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1, 5 (D.C. Cir. 2000) (reaffirming that "[t]here is no dispute that the Commission has historically been justified in relying on [the end-to-end] method when determining whether a particular communication is jurisdictionally interstate," but rejecting Commission's assumption that this jurisdictional classification alone was sufficient to avoid the application of section 251(b)(5)); *see also ISP Recip Comp Remand Order*, ¶ 58 (reaffirming jurisdictional conclusion).

[4] Some carriers argue that that the Commission should revive its earlier determination that section 251(b)(5) is inapplicable in this context because it addresses only "local" traffic between two LECs—a determination the Commission abandoned in the *ISP Recip Comp Remand Order* (at ¶ 34) after the first D.C. Circuit remand. AT&T has previously explained that reinstating this narrow interpretation of section 251(b)(5) could unduly constrict the Commission's authority to reform intercarrier compensation more generally. *See* Letter from Gary L. Phillips to Marlene H. Dortch, CC Dkt No. 01-92 (Sept. 13, 2004).

By its plain terms, section 251(i) makes clear that nothing in section 251, including section 251(b)(5), "limit[s] or otherwise affect[s]" that ratemaking authority. Moreover, the legislative history underscores the critical importance of section 251(i) in this precise context—preserving the FCC's authority to establish rules governing carrier-to-carrier exchanges of interstate traffic. As the Conference Report explained: "New subsection 251(i) makes clear the conferees' intent that the provisions of new section 251 are in addition to, and in no way limit or affect, the Commission's existing authority *regarding interconnection* under section 201 of the Communications Act." H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess., reprinted at 1996 U.S.C.C.A.N. 10, 126 (1996) (emphasis added).

These points are not new; indeed, the Commission has already adopted this view of section 251(i). In the *ISP Recip Comp Remand Order*, the Commission explained: "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. . . . Thus, subsection (i) expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[5] Significantly, the D.C. Circuit did not disturb that determination on review and focused entirely on the Commission's interpretation of section 251(g), perhaps because the Commission's appellate brief relied exclusively on section 251(g) to justify exempting ISP-bound traffic from the scope of section 251(b)(5).[6] The Commission should now make clear that section 251(i) independently justifies the Commission's retention of plenary ratemaking authority for such traffic as a species of interstate traffic subject to the Commission's section 201 authority.

Indeed, section 251(i) logically must preserve the Commission's plenary ratemaking authority in this context if it is to have any significance at all. On a substantive level, to the extent that section 251(b)(5) imposes restrictions on the "just and reasonable" rates that could be set for this traffic, enforcing those restrictions against the Commission would necessarily "limit or otherwise affect the Commission's authority under section 201." And on a procedural level, to the extent that subjecting ISP-bound traffic to the section 251 framework under the 1996 Act would transfer actual ratemaking authority to the states, that would also obviously "limit or otherwise affect the Commission's authority under section 201." If section 251(i) did *not* preserve the Commission's traditional authority in these respects, the provision would be meaningless surplusage. No one would dispute that, if section 251(i) had never been enacted, section 201 would still apply in the contexts *not* covered by section 251. Thus, to have independent significance, section 251(i) must preserve the Commission's plenary authority over

[5] *ISP Recip Comp Remand Order*, ¶¶ 49-50.

[6] *See* Br. for the FCC, *WorldCom v. FCC*, No. 01-1218 and consolidated cases, Sept. 27, 2001, at 45 ("[S]ection 251(i) has no direct role in the Commission's interpretation of section 251(b)(5)—which rests instead on a reading of sections 251(b)(5) and 251(g) in light of statutory goals."). Section 251(g), which preserves the pre-Act access charge regime, does not render 251(i) unnecessary, but in fact underscores its purpose. While 251(g) provides that carriers must continue to comply with *pre-existing* access charge regime until the FCC decides otherwise, that regime did not address what, if any, compensation should be due in the scenario where two LEC exchange ISP-bound traffic, because that scenario did not arise as a practical matter until after 1996. Section 251(i) makes clear that the Commission retains the same 201 jurisdiction it has always had to address such new industry developments as they happen.

interstate traffic even where, as here, a given provision of section 251 might otherwise be read to "limit" that authority.

In the *WorldCom* litigation, before the Commission disclaimed reliance on section 251(i), some CLECs argued that section 251(i) *should* be construed to have no substantive significance on the ground that, as a general matter, "[a] 'savings' provision cannot preserve rights that would be inconsistent with the provisions of the Act itself."[7] This is nonsense. Although courts disfavor aggressive readings of savings clauses that would cause a statute to "destroy itself" by canceling out its own provisions,[8] they also disfavor construing any statutory provision to be a pointless waste of ink.[9] Here, the Commission's task is to "read the savings clause narrowly to avoid swallowing the rule, but not so narrowly as to render it a dead letter."[10] That is easily accomplished. Under AT&T's interpretation, section 251(b)(5) still applies to all telecommunications traffic—subject, however, to the section 251(g) carve-out for pre-1996 access rules and, under section 251(i), to the Commission's continuing discretion to regulate *interstate* traffic directly under its section 201(a) rate-setting authority. That construction harmonizes section 251(b)(5) with section 251(i) and gives robust meaning to each provision.

Finally, even if it were appropriate to limit section 251(i) to contexts where the Commission's exercise of section 201 authority fully comports with the substantive provisions of section 251, that condition would be satisfied here. Under the D.C. Circuit's decision in *WorldCom*, section 251(g) preserves any compensation regime the Commission had adopted for access traffic before 1996.[11] One such regime is the ESP exemption for providers of dial-up information services. As explained below, the Commission can maintain the integrity of that regime, as section 251(g) anticipates, only by exercising its section 201 authority to prescribe intercarrier compensation rates for ISP-bound traffic in this new environment in which two local carriers exchange such traffic—a scenario that did not arise until after 1996 and that the Commission accordingly had not already addressed in the rules "preserved" by section 251(g).

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[7] Br. for Petitioner WorldCom, et al., *WorldCom v. FCC*, No. 01-1218 and consolidated cases, Nov. 15, 2001, at 33 (citing *AT&T Corp. v. Central Office Tel.*, 524 U.S. 214 (1998)). The CLECs also cited a lone sentence in the *Local Competition Order* for the proposition that section 251(i) preserves existing FCC rules "to the extent that they are consistent with" the substantive provisions of the 1996 Act. *See* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, at ¶ 610 (1996) ("*Local Competition Order*"). The cited passage did not, however, state that section 251(i) preserves FCC rules *only* in those circumstances, nor did the Commission have occasion to address that issue. In any event, the Commission should now make clear that any such reading of section 251(i) would be erroneous.

[8] *Central Office Tel.*, 524 U.S. at 228 (internal quotation marks omitted).

[9] *See, e.g.*, *Duncan v. Walker*, 533 U.S. 167, 174 (2001) ("It is our duty to give effect, if possible, to every clause and word of a statute.") (internal quotation marks omitted); *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (describing this as a "cardinal principle of statutory construction").

[10] *Bastien v. AT&T Wireless Servs., Inc.*, 205 F.3d 983, 987 (7th Cir. 2000).

[11] *WorldCom*, 288 F.3d at 432. The D.C. Circuit further "assume[d] without deciding" that the Fifth Circuit was correct in indicating that section 251(g) also permits the FCC to "*modify* LECs' pre-Act 'restrictions' or 'obligations,' pending full implementation of the relevant sections of the Act." *Id.* at 433 (citing *Texas Office of Pub. Utils. Counsel v. FCC*, 265 F.3d 313, 324-25 (5th Cir. 2001)).

Intercarrier compensation has traditionally assumed a "calling party's network pays" (CPNP) model. That model's central premise is that the originating LEC is fully responsible for the cost of originating, transporting, and terminating a call, and that it must therefore compensate the terminating LEC for the termination functions it performs (such as end office switching). Under that CPNP regime, therefore, the terminating carrier's own customers do *not* pay that carrier for performing those termination functions. But the ESP exemption created a critical exception to this CPNP rule. A LEC serving an ESP typically provides *only* termination functions to that ESP, and the Commission's rules assume that the relevant LEC customer" in this context—the ESP—*will* pay for those termination functions and that the originating carrier *will not*.[12] In requiring LECs to recover termination costs from their customers rather than from originating carriers, the ESP exemption has thus always embodied a key bill-and-keep premise.

For example, when the ESP-serving LEC is an ILEC, the Commission has held that the charges collected pursuant to the ESP exemption should fully compensate the ILEC for all termination functions. Under the ESP exemption, ISPs may "pay local business rates and interstate subscriber line charges for their switched access connections to local exchange company central offices. [They] also pay special access surcharges for private lines under the conditions set out in [the Commission's] rules."[13] The Commission has held that the payments made pursuant to this regime are intended to compensate the LEC for *all* switching functions it performs for its ISP customer. That is why, when some LECs complained to the Commission in 1997 that they were not fully recovering their costs of providing call "termination" services to ISPs, the Commission told them that their appropriate remedy was to raise the rates they charged their ISP customers pursuant to the ESP exemption rate structure.[14] Since, as the Commission has found, the ESP compensation regime fully covers the costs of an ISP-serving LEC, permitting that LEC to recover reciprocal compensation for the *same* services, simply because the traffic originates with another carrier, would entitle it to double recovery. For example, an ILEC serving an ISP would be able to recover both the standard business line rate from the ISP, which theoretically already covers all costs of delivering calls to the ISP, plus reciprocal compensation rates designed to cover *those same costs* from CLECs that originate calls from the ISP's subscribers. Such double-recovery is no less perverse and unlawful when the carriers' roles are reversed: *i.e.*, when a CLEC serves the ISP and the ILEC serves the ISP's subscribers.

Moreover, in these circumstances, where two LECs cooperate to deliver traffic to the ISP customer of one of them, the justification for the ESP exemption – that a LEC is fully compensated by the business line revenue from the ISP – is inapplicable to the LEC that does not

[12] *See ISP Recip Comp Remand Order*, ¶ 88 ("We also are not convinced by the claim of CLECs that limiting intercarrier compensation for ISP-bound traffic will result in a windfall for the incumbent LECs. . . . CLECs have not demonstrated that ILEC end-user rates are designed to recover from the originating end-user the costs of delivering calls to ISPs.").

[13] Order, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd 2631, ¶ 2 n.8 (1988); *see generally* Mem. Op. & Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 682, ¶¶ 76-83 (1983).

[14] *See* First Report and Order, *Access Charge Reform*, 12 FCC Rcd 15982, ¶ 346 (1997), *aff'd, Southwestern Bell Tel. Co. v. FCC*, 153 F.2d 523 (8th Cir. 1998); *see also ISP Recip Comp Remand Order*, ¶ 88 (acknowledging this point in the ISP reciprocal compensation context).

have the ISP as a customer. Without the ESP exemption, this LEC would be entitled to a portion of the revenue from what would be a jointly provided access service. It would be an absurd result if the ESP exemption operated in these circumstances not only to deprive that LEC of this access revenue, but to saddle it with a significant expense liability. To avoid that result and maintain the viability of the ESP exemption in the post-1996 Act competitive environment, section 251(i) preserves the Commission's authority to establish appropriate compensation rates.

In sum, even if the Commission could exercise its section 201 authority pursuant to section 251(i) only where doing so comports with the substantive provisions of section 251, the Commission's exercise of that authority here would easily meet that condition, because it would be necessary to preserve the integrity of a regime adopted before 1996 and thus preserved by section 251(g).

II. The Commission Should Also Rely in the Alternative on the Bill-and-Keep Savings Clause of Section 252(d)(2)(B)(i).

Even if, despite section 251(i), the substantive provisions of the 1996 Act were found to constrain the Commission's section 201 authority over interstate traffic, the "bill-and-keep savings clause" of section 252(d)(2)(B)(i) would permit the Commission to adopt bill-and-keep for this traffic. Section 252(d)(2)(B)(i) preserves compensation rules "that afford the mutual recovery of costs through the offsetting of reciprocal obligations, including arrangements that *waive mutual recovery (such as bill-and-keep arrangements)*." (Emphasis added). In 2002, the D.C. Circuit all but invited the Commission to rely on this provision to justify its current rules. The court left those rules intact precisely because "there is plainly a non-trivial likelihood that the Commission has authority to elect [a bill-and-keep] system (perhaps under §§ 251(b)(5) *and 252(d)(B)(i))*."[15]

To accept the court's invitation, the Commission would need to modify its current rules, adopted in 1996, which permit bill-and-keep only when the traffic between two carriers is "balanced."[16] The groundwork for that rule change is already in place. The Commission adopted the "balanced traffic" restriction because of a policy concern that "bill-and-keep arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic."[17] The Commission has already rejected that policy concern as inconsistent with subsequent industry experience and has concluded that, specifically in the ISP-bound traffic context, bill-and-keep arrangements are optimally efficient.[18]

One sentence in the *Local Competition Order* also suggested that the "balanced traffic" restriction was needed to address a legal concern: that section 252(d)(2) entitles each carrier to

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[15] *WorldCom*, 288 F.3d at 434 (emphasis added).

[16] *Local Competition Order,* ¶¶ 1111-12.

[17] *Id.* ¶ 1112.

[18] *See ISP Recip Comp Remand Order*, ¶¶ 72-76.

recover its termination costs from originating carriers, and that a LEC will be denied that opportunity under a bill-and-keep regime if it receives more traffic from another carrier than it delivers.[19] But as the D.C. Circuit indicated in *WorldCom*, section 252(d)(2) is susceptible to a contrary interpretation that is at least as reasonable. On its face, section 252(d)(2)(B)(i) permits, without limitation, any compensation regime that "*waive[s]* mutual recovery" of costs between carriers. And although the statute provides that each carrier will have the opportunity to "recover" its "costs," it does not entitle each carrier to recover those costs *from another carrier*, so long as it can recover those costs from *its own end users*, as any bill-and-keep rule anticipates.

To be sure, the bill-and-keep savings clause is hardly a model of clarity, but that is true of many provisions of the 1996 Act. Congress "is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency."[20] Here, the Commission would receive substantial deference for a broad interpretation of the bill-and-keep savings clause, particularly given the D.C. Circuit's near-endorsement of that interpretation.

III. The Commission Should Also Rely on the Ground that the "Additional Costs" of Terminating ISP-Bound Traffic Under Section 252(d)(2)(A)(ii), Beyond Those Already Recovered Under the ESP Compensation Regime, Are Zero.

Finally, given the unique characteristics and regulatory history of ISP-bound traffic, the Commission would be free to justify a bill-and-keep regime in this context under the "additional cost" rule of section 252(d)(2)(A)(ii) even if Congress had never enacted the bill-and-keep savings clause of section 252(d)(2)(B)(i). The additional cost rule provides that reciprocal compensation rates should reflect "a reasonable approximation of the *additional costs* of terminating" the calls at issue. (Emphasis added.) If the "additional costs" of terminating those calls are zero, the appropriate rate for that call-termination function is also zero—that is, a bill-and-keep regime.

Here, the "additional" costs of terminating Internet-bound traffic to an ISP's modem bank must be determined by reference to the existing compensation regime for such traffic, governed by the "ESP exemption" to the access charge rules. Because, as discussed above, the Commission has consistently determined that the existing regime already permits a terminating carrier to recover all costs it incurs in terminating traffic to an ESP, there are, by definition, no "*additional* costs" that a terminating carrier has any entitlement to recover from other carriers. And because the "additional costs" of terminating calls to ISPs are zero, entitling a terminating carrier to recover a positive rate from an originating carrier for calls terminated to an ISP would be arbitrary and capricious. The only rational and lawful regime in this context is therefore bill-and-keep.

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In sum, the Commission has at least three mutually independent legal rationales for adopting a bill-and-keep regime for ISP-bound traffic, and it should adopt all three. Under the first rationale, based on section 201, the Commission would have discretion to adopt any rate for

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[19] *Local Competition Order*, ¶ 1112.

[20] *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999).

this traffic that it finds just and reasonable. Under the other two, the Commission would be confined to the selection of a zero rate as the ultimate rule. But even under these latter two legal rationales, the Commission would retain authority to maintain the existing transitional rate structure for ISP-bound traffic in lieu of an immediate switch to bill-and-keep.

Since the FCC implemented its current rules, the disparities in intercarrier compensation rates among different classes of traffic—*e.g.*, reciprocal compensation for "local" traffic, *interstate* access charges for some interexchange calls, and *intrastate* access charges for others—have become increasingly severe. These rate disparities have generated significant arbitrage. Comprehensive intercarrier compensation reform would alleviate this problem by, among other things, reducing access charges towards the rate levels used for local traffic. But in the absence of comprehensive reform, an immediate flash-cut to bill-and-keep for ISP-bound traffic, or even for all traffic covered by section 251(b)(5), would only increase incentives and opportunities for arbitrage, because it would further exacerbate the rate disparities among classes of traffic. To ameliorate such arbitrage, the Commission can and should reasonably determine that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform.

Sincerely,

/s/ Gary L. Phillips

cc: Dana Shaffer
Matthew Berry
Joseph Palmore
Christopher Killion
Marcus Maher
Randolph Clarke
Albert Lewis
Deena Shetler
Victoria Goldberg
Jay Atkinson