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February 23, 2007

VIA ELECTRONIC FILING

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Public Utility Commission of Oregon
PO Box 2148
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Re: Docket No. ARB 665

Enclosed for filing is Level 3 Communications Inc.'s Exceptions to the Arbitrator's Decision issued in this docket on February 13, 2007. A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Lisa F. Rackner

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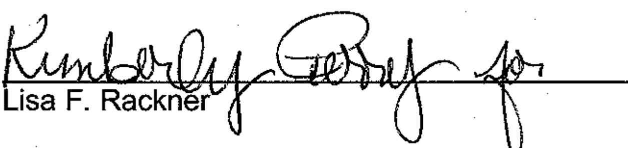
18 

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1 **BEFORE THE PUBLIC UTILITY COMMISSION**
OF THE STATE OF OREGON
2
3 **ARB 665**

4 In the Matter of Level 3 Communications, LLC's Petition for Arbitration Pursuant to
5 Section 252(b) of the Communications Act of 1934, as amended by the Telecommunications
6 Act of 1996, and the Applicable State Laws for Rates, Terms, and Conditions of
7 Interconnection with Qwest Corporation
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12 **LEVEL 3 COMMUNICATIONS, LLC'S**
13 **EXCEPTIONS TO ARBITRATOR'S DECISION**
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16 **February 23, 2006**
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I. INTRODUCTION AND SUMMARY

Level 3 appreciates the challenges presented by this case, and is grateful for the work and attention that Administrative Law Judge Petrillo and Commission Staff put into handling it.[1] While, as described below, we disagree with certain aspects of his decision, we applaud his effort to grapple with the new and unique technologies and network architectures that Level 3 uses to provide its services to Internet Service Providers ("ISPs"), Voice-over-Internet-Protocol ("VoIP") providers, and others. A full and fair recognition of the fundamental ways that the communications industry is changing—and Level 3 is at the forefront of that change—is critical to this Commission's ability to develop regulatory policies appropriate for the 21st Century.

Unfortunately, in two critical respects, Judge Petrillo's ruling creates a profoundly discriminatory regulatory landscape, in which Qwest Communications, Inc. ("Qwest") is able to reap significant financial and market advantages over Level 3—including advantages obtained solely by virtue of flouting this Commission's rules.[2]

First, the Arbitrator's Decision unfairly and discriminatorily cripples Level 3's ability to offer affordable dial-up connectivity to ISPs by means of VNXX arrangements, as compared to

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[1] *LEVEL 3 COMMUNICATIONS, LLC, Petition for Arbitration of an Interconnection Agreement with Qwest Corporation, Pursuant to Section 252(b) of the Telecommunications Act,* Arbitrator's Decision, ARB 665 (Feb. 13, 2007) ("Arbitrator's Decision").

[2] Level 3 formally does not waive, and, to the contrary, preserves, its objections to all aspects of the Arbitrator's Decision which reject Level 3's proposed resolution of any issue. However, with respect to issues not addressed in these Exceptions, we rest on our opening and closing briefs, and the record, and reserve our right to appeal the Commission's final decision, to the extent that it affirms the Arbitrator's Decision. We urge the Commission to review our briefing before Judge Petrillo and to adopt our proposed resolution on all issues. In this regard, we appreciate Judge Petrillo's decision to simply defer any decision regarding VoIP issues to the FCC. *See* Arbitrator's Decision at 6-13. Assuming the Commission chooses instead to address VoIP issues, we urge the Commission to establish reciprocal compensation for all VoIP traffic at the FCC's $0.0007 rate, for the reasons Judge Petrillo notes (but did not choose to follow) at pages 11-12 of the Arbitrator's Decision.

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1 Qwest's FX-based service for ISPs. As Judge Petrillo observed, VNXX is not specifically
2 banned either by Oregon law or regulation. Arbitrator's Decision at 28. Yet he imposed
3 unreasonable burdens on Level 3's use of VNXX to serve ISPs—depriving Level 3 of any
4 compensation from Qwest for call termination and requiring Level 3 to pay ***retail*** access rates to
5 its direct competitor for the privilege of interconnecting networks to exchange of Internet traffic.
6 In contrast, Qwest uses FX services to provide ***the exact same*** centralized connectivity to ISPs,
7 and those services have been banned for nearly 25 years. Despite Qwest's plain admission—
8 both on the stand and in written evidence—that it uses banned FX arrangements, and receives
9 reciprocal compensation from other carriers for locally-dialed calls to those ISPs,[3] Judge Petrillo
10 allowed those arrangements to stand, subject only to the outcome of an as-yet-unstarted
11 investigation into Qwest's practices.
12
13 We do not believe that Judge Petrillo affirmatively intended to tilt the competitive
14 playing field in favor of Qwest in this market segment, but without question that is precisely
15 what the result of upholding his ruling will be. Level 3's ability to serve dial-up ISPs has been
16 hobbled while Qwest's banned FX architecture continues blissfully along. This is unjust and
17 discriminatory. Until and unless the Commission enforces its FX-related rules against Qwest, it
18 is unjust, unreasonable, and discriminatory to extend those rules to embrace the substantially
19 different network technology used by Level 3 to compete in the same markets for the same
20 customers.[4] The only fair way to deal with this issue is to deal with it for all carriers at the same
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24 [3] *See* Transcript of Hearings, Volume II ("Tr. II") at 18, 33, 36-37, 40; Qwest Response to Level 3 Data Request Set #1, Question Nos. 26, 27, 30. A copy of these Qwest data request answers is attached hereto
25 as Exhibit A.

26 [4] In this regard, the 9th Circuit in *Verizon California, Inc. v. Peevey,* 462 F.3d 1142 (9th Cir. 2006) ("*Peevey*") refers to the basic logic of VNXX – treating calls as "local" or not based on the dialed

(note continued)...

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time. So if Qwest is permitted, even on an interim basis, to us its FX arrangements to provide statewide connectivity to dial-up ISPs—and collect reciprocal compensation for calls to those ISPs—while Level 3 cannot use its facilities-based network architecture to compete in the same markets for the same customers and receive the same compensation—then simple fairness demands that Level 3 be permitted to do so as well, until and unless the Commission enforces its rules against all carriers at the same time.

In fact, however, the record in this case conclusively demonstrates that there is no policy reason to apply the Commission's rule against FX service either to Level 3 or to Qwest in the context of dial-up calls to ISPs. The policy basis for that rule was concerns that FX service would lead to loss of toll and access revenues by ILECs—particularly smaller ILECs—on the theory that traditional FX service is a form of toll bypass.[5] But Judge Petrillo found below, correctly, that consumers simply will not call ISPs as a toll call and will not pay toll or access-like rates for dial-up calls to ISPs. Arbitration Decision at 24, 26. So just as there can be no question that rules should not be applied in a discriminatory manner, there can be no question that they should not be equally applied in a manner that destroys competition and penalizes Oregonians because some of the Commission's rules have not caught up with the evolution of technology, networks, services, and market offerings over the past 25 years.

...(note continued)
numbers rather than location – as recognizing "essential differences between the ...network architectures" of ILECs and CLECs. 462 F.3d at 1155-56. A copy of *Peevey* is attached for the Commission's convenience as Exhibit B. The Commission's rules against FX service were established decades before CLECs came onto the scene and were plainly crafted with traditional ILEC network architectures in mind. *See* Section II.D., *infra.*

[5] *See Access Provisions and Charges of Telephone Utility Companies in Oregon, Public Utility Commission of Oregon,* UT 5, Order No. 83-869 (Or. PUC 1983) ("*1983 FX Order*"); *Investigation Into the Use of Virtual NPA/NXX Calling Patterns,* Docket UM-1058, Order 03-329 (Ore. PUC May 27, 2003) at 7.

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As a result, the best solution is the very compromise Level 3 proposed in response to Judge Petrillo's request after a day of reviewing in detail how technology, networks, services and markets had evolved over time. This same compromise was recently approved by the 9th Circuit in *Peevey,* 462 F.3d 1142. The essence of *Peevey* is to recognize that VNXX traffic is ***economically*** local even while it is ***geographically*** non-local: "[F]or rating purposes, [VNXX] traffic is a local call but for routing purposes, it is an interexchange call because it terminates outside of the originating calling area." *Peevey,* 462 F.3d at 1157.[6] *Peevey* approved a regulatory mandate that the originating ILEC pay the FCC's $0.0007/minute rate for VNXX ISP-bound traffic, but at the same time, approved a requirement that the CLEC pay the ILEC a reasonable, compensatory TELRIC rate for getting traffic from the originating local calling area to the CLEC's network.

In this regard, the *Peevey* regime—or something very like it—has already become the norm for all major states within the 9th Circuit. California, of course, follows *Peevey;* it was a California regulatory decision that the 9th Circuit upheld. But Arizona, Nevada and Washington also follow this general approach. In Arizona, in the recent Qwest-Level 3 arbitration, the Arizona Corporation Commission ruled that Level 3 should receive $0.0007/minute for locally-dialed calls to distant ISPs, while absorbing a fair estimate of the costs of transporting those calls outside the originating local calling area—the essence of *Peevey.* In Nevada, Level 3 and AT&T

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[6] It appears based on his partial quotations from *Peevey* that Judge Petrillo may have understood that case to simply declare that VNXX traffic is or should be viewed as "interexchange" for all purposes—and, particularly, for purposes of intercarrier compensation. *See, e.g.,* Arbitrator's Decision at 17 (asserting that the 9th Circuit found VNXX traffic is "interexchange" without noting or dealing with its affirmance of terminating compensation requirement for such traffic); *id* at 21 (to the same effect). With due respect, to the extent that this was Judge Petrillo's understanding, that is an obvious misreading both of what the California regulators did in *Peevey,* and what the 9th Circuit found in approving their actions.

agreed to an arrangement—which the regulators there approved—under which reciprocal compensation is offset by an allowance for AT&T's costs of out-of-calling-area transport. And in Washington, regulators have treated VNXX ISP-bound calls as economically local, requiring the $0.0007/minute terminating compensation with no offset for transport at all. In light of this overwhelming regional trend, this Commission should not remain an outlier – and risk reversal in federal court—simply to extend to VNXX an anti-FX policy position created decades ago, at divestiture, to protect ILEC toll and access revenues, which does not logically apply to ISP-bound calls. Applying that policy in this context effectively benefits no one but Qwest—even as Qwest itself has been ignoring it, with complete impunity, for the last ten years.

The other key problem in the Arbitrator's Decision is that it unfairly and discriminatorily bans Level 3 from competing with Qwest for tandem switching and termination of long distance traffic by prohibiting Level 3 from sending long distance traffic that Level 3 itself originates on so-called "Local Interconnection Service," or "LIS" trunks. Qwest's language, which the Arbitrator's Decision approved, permits Level 3 to use LIS trunks to deliver unlimited amounts of terminating Feature Group D traffic from 3rd-party IXCs. The ***only*** terminating Feature Group D traffic that Qwest's language purports to exclude is traffic where Level 3, as opposed to a 3rd party, happens to provide the tandem switching. This means that all of Qwest's arguments against permitting terminating Feature Group D traffic on LIS trunks were extremely misleading. Qwest's basic objection was that its end offices are not configured to record call details on incoming long distance traffic on LIS trunks and that it needs such recordings for its own purposes and to meet its commitments to its QPP wholesale customers. But Qwest's language permits an unlimited amount of terminating Feature Group D traffic to flow through Level 3 over the LIS trunks, with Qwest necessarily relying on Level 3 for any necessary call recording

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functions. As a result, it is completely irrational to exclude Feature Group D traffic where Level 3 happens to provide tandem switching. Indeed, taking the Arbitrator's Decision literally—since Judge Petrillo apparently did not realize that Level 3 was ***permitted*** to send 3rd party long distance traffic over LIS trunks—thus his decision effectively stands for the proposition that Level 3 may not provide tandem switching of IXC calls in competition with Qwest.

II. ARGUMENT.

A. The Commission Must Modify The Arbitrator's VNXX Decision To Prevent Unfair And Unreasonable Discrimination Against Level 3.

1. The Arbitrator's Decision Is Discriminatory.

Judge Petrillo's ruling on VNXX violates federal law in a fundamental way—it discriminates against Level 3, in favor of Qwest. In fact, that ruling essentially hands Qwest the market for serving dial-up ISPs in Oregon on a silver platter, even though the arrangements that Qwest uses to serve that market violate the Commission's 25-year-old ban on FX service.[7] There is no reason to permit Qwest to continue serving ISPs using its banned FX-based service—subject only to the possible outcome of some future investigation—while crippling Level 3's VNXX-based service, which Judge Petrillo correctly found is not, in fact, specifically banned by Oregon laws or regulations.

Judge Petrillo correctly recognized that the era of "mom-and-pop" ISPs, with locally-situated modems, is dead. Arbitrator's Decision at 26 & n.92. There may be isolated exceptions, but, fundamentally, technology has moved on, and the only economically feasible and

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[7] *See* Qwest Response to Level 3 Data Request Set #1, Question Nos. 26, 27, & 30 (Exhibit A hereto); Tr. I at 12:16-22 (Greene) (in an FX service the customer pays for the line in the foreign exchange and transport back to the customer's location); Tr. II at 65:22-66:5 (Brotherson) ("Q [by ALJ Petrillo]: So, in essence, when I think about PRI service, similarities with FX service come to mind. ***Isn't it essentially an FX type substitute?*** A: ***It is an FX type substitute*** in virtually all states. Q: And you are saying that that is what distinguishes it from the VNXX situation; is that correct? A: Yes.")

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technically viable way to provide low-priced and widely available consumer dial-up Internet access is by means of centrally-located equipment that performs numerous functions on an integrated basis—which is what both Level 3 and Qwest do. (*See* Exhibit 3/701, 3/702; 3/716 (at pages 18 & 25 (Qwest admits that QCC uses centralized switching & does not require ISPs to maintain equipment within local calling areas); page 26 (Qwest admits that it pays for transport out of the same local calling areas where Level 3 offers service). Arbitrator's Decision at 23-24, 26. *Cf. Bell Atlantic v. FCC,* 206 F.3d 1, 5 (D.C. Cir. 2000) (calls even to mom-and-pop ISPs are "not quite local" but also "not quite long distance"). Judge Petrillo also recognized that dial-up Internet access is not economically viable if consumers have to absorb long distance or access charges when connecting to their ISP. Arbitrator's Decision at 24, 26. If toll or access charges apply to dial-up Internet access—whether directly or indirectly—consumers will not use the service. And Qwest admits that if Level 3 has to absorb toll or access charges—whether directly or indirectly—its services would not be competitive.[8] In economic terms, dial-up Internet access must be available as a local call, or it is not available at all.

Level 3 has responded to these economic and technical realities by using VNXX arrangements. VNXX is similar to, but not the same as, FX. The differences are significant, and reflect the real, technology-driven differences between ILEC and CLEC network architecture. ILECs networks evolved over many decades and have a large number of end office switches,

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[8] *See also* Tr. II at 36:18-37:8, 61:10-16 (Brotherson); ("Q [by ALJ Petrillo]: Well, [a Level 3 witness] testified that he didn't believe that end-user customers accessing the internet via dial-up service would be willing to pay toll charges for that service. Do you basically agree with that? A: The end user would not, I don't believe."); *see* Tr. II at 58:10-11 (Brotherson) (witness doubts "it would ever be financially viable" to place media gateways or equivalent devices in rural areas – which would be required to avoid VNXX or FX arrangements). *See also Level 3 Brief* at 2 & n.5, 7 & n.12 (estimating number of Oregonians dependent on dial-up).

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typically placed in areas relatively close to customers. By contrast, CLECs do not deploy very many switches. Instead, CLECs more efficiently serve customers over a wide geographic region using a small number of centrally-located switches. Indeed, it is precisely the "higher capacity and wider geographic reach capable from competitive switches" that persuaded the FCC to exempt ILECs such as Qwest from the obligation to provide local switching at TELRIC rates.[9] The FCC found that CLEC switches served an "average reach of over 40 miles," and that a single CLEC switch in Tennessee "was being used to provide service in six states in BellSouth's territory as well as four other out-of-region states."[10]

This leads to quite different ways of serving a customer located in one area that needs a number associated with another area. ILECs provide this functionality by means of FX service, which is essentially a dial tone line in one exchange (the "foreign" exchange where the customer wants the number) linked to a customer's physical location in another exchange—which would normally be served by another switch—by means of a private line or special access circuit.[11] CLECs, by contrast, will typically use a single switch (or device with similar functionality) to serve both the area in which the customer wants the number (the "foreign" exchange) and the area in which the customer is located. So all the CLEC does—entirely within its own network—is to assign the customer a number (which is already homed on its centralized switch, as a technical matter) that corresponds to an exchange other than where the customer is located. No

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[9] *In the Matter of Unbundled Access to Network Elements Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers),* WC Docket No. 04-313, CC Docket No. 01-338 Order On Remand, ¶¶ 207, 209 (Rel. Feb. 4, 2005).

[10] *Id.*

[11] As Qwest's Oregon Foreign Exchange tariff notes, with FX service the ILEC actually "furnishes" service "from" an exchange other than the one where the customer is located. Tariff PUC Oregon No. 29, Original Sheet 1, Section 105.1.4.A.1.

CLEC private line or special access connection between the two areas is needed because the CLEC does not have pre-existing switches in the two areas to connect, the way ILECs do.[12]

As Judge Petrillo observed, there is no Oregon law or regulation that bans VNXX arrangements. Arbitrator's Decision at 28. On the other hand, the Commission has banned traditional FX service for nearly 25 years.[13] While Judge Petrillo was troubled by the fact that Qwest is violating this Commission requirement, he chose not to plainly declare that Qwest was doing so. *See* Arbitrator's Decision at 22-24. In fact, however, the evidence is unequivocal—Qwest has admitted that its Wholesale Dial service—that is, its service that competes with Level 3's services to ISPs—is simply FX for ISPs. It is just a tariffed dial tone line (in this case, a PRI circuit) in a distant local calling area linked via a tariffed private line to get it back to the customer's location:

> "QCC pays for the local exchange service and the ability to receive calls in the local calling area. QCC does not ask for free transport. They pay tariff private line for the transport of that traffic." Tr. II at 18:21-25 (Brotherson)
>
> "[T]hree or four ISPs might share a private line to a community. That would be what, in essence, wholesale dial offers. So QCC would buy the tariff service, and then make it available for the ISPs to utilize." Tr. II at 33:12-16 (Brotherson)
>
> "I want to clarify a little bit. The PRS service, local PRS service is a local exchange service to get the traffic to another exchange, as you have described. Would also require purchasing private line in combination with the PRS service. ***So you need to buy two tariff products, one out of the local exchange tariffs, and one out of the access tariffs.***
>
> "I don't know in Oregon whether the private line is carried in the access tariffs or the local exchange tariffs. Some states, they are carried in both, but in others we have merged them and they are only carried in one." Tr. II at 36:18-37:5 (Brotherson)

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[12] As the 9th Circuit found in *Peevey,* VNXX arrangements recognize "the essential differences between [ILEC and CLEC] network architectures." *Peevey,* 462 F.3d at 1155.

[13] *See 1983 FX Order*.

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“***The customer of record is QCC of the tariff service.*** What they in turn do is offer that to – deliver that traffic to the ISPs. So several ISPs could receive calls on that single PRS and private line combined product, more than one.” Tr. II 37:21-25 (Brotherson).

“Q: So if I am an end-user internet customer, and I am using one of the ISPs that subscribes to QCC's service, then I am going to call a local number that has been made available to the ISP by QCC by virtue of paying for this PRI service. And that traffic that I originate over the internet is going to be transported by QCC over private line to QCC's network access server, which is as you indicate in Exhibit 39. ***And the mode and functionality is going to be performed at that point in much the same way that Mr. Greene testified yesterday that the modem functionality was performed by Level 3 at the media gateway. Is that essentially how that works?***

“A: I would say that that is a true statement.” Tr. II at 40:1-15 (Brotherson).

Clearly, Qwest is providing FX service to its out of state ISP customers in order to allow them to receive “local” calls from end users in Oregon. (TR II at 33:2-33:16 (Brotherson) “Q So QCC puts together connectivity and modem functionality that it markets to Earthlink, AOL and NetZero. A That's correct.”).

In fact, the evidence of Qwest’s violation of the Commission’s ban on FX service goes even further than that. In response to a Level 3 data request, Qwest described its service for ISPs as follows:

> With Primary Rate Service, a customer could create a FX-like PRS service and receive dial tone from a switch other than from the switch in the central office that serves the customer’s physical location by ordering PRS from a distant local calling area and then ordering a DS1 facility to the customer owned premise within that local calling area.

Response to Level 3 Data Request Set 1 (Exhibit A to these Exceptions), Question 26. Qwest obviously could not bring itself to flat-out admit that it is providing banned FX service, as opposed to “FX-like” service, but that is exactly what its language describes—a dial tone line (PRS service) in one exchange connected to a distant area by means of a private line (a “DS1 facility”). Its response to Question 27 of that same set of data requests confirms that the distant

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ISP customer can receive "local" calls from end users in the area where it buys dial tone, not the area where it is physically located. And as Qwest admits in response to Question 30 of that set, "the LCA where the Qwest PRS FX-like customer purchases a connection to the local network is the point for determining whether a call is local."

But it goes even further than that. Not only is Qwest violating the Commission's ban on FX service in order to serve its ISP customers, it is economically profiting from that arrangement by charging originating carriers reciprocal compensation when their end users dial the "local" number of the distantly located ISP: "CLEC and ILEC calls originating in the LCA where the Qwest PRS FX-like customer purchased a local connection are billed local reciprocal compensation." *Id.* This has been going on for the last 10 years. *Id.* Qwest is extracting "local reciprocal compensation" payments from originating carriers for calls those carriers' customers make to distant ISPs who obtain a "local" number by means of Qwest's banned FX service.

Qwest's specific language in response to this data request bears study, because it reflects what is actually an astonishing admission. Qwest says that "***ILEC*** calls" to these FX services "are billed local reciprocal compensation." Level 3 submits that this language indicates that Qwest is using the sleight-of-hand of its supposedly "separate" affiliate Qwest Communications Corporation ("QCC") to ship enormous amounts of money from its regulated local service operations to its unregulated QCC entity.

The only way that Qwest can rationalize its violation of the Commission's ban on FX service is to hide behind the fig leaf of the supposedly separate entity status of QCC as a simultaneous "customer" and "carrier." Note Qwest's careful wording, above. Qwest does not say that ***Qwest*** (the ILEC) bills reciprocal compensation to carriers calling these numbers. Instead, the response is carefully worded in the passive voice—"***ILEC calls*** ... ***<u>are billed</u>*** local

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reciprocal compensation." This means that QCC-the-CLEC is most likely sending reciprocal compensation bills to Qwest-the-ILEC for Qwest end users' calls to ISPs served by QCC.[14] Of course, Qwest (the combined entity) would have a strong incentive to do this. As its witness admitted on the stand, all of the revenues of all of the Qwest entities are combined for purposes of the overall company's profits. *See* Tr. II at 28 (testimony of Mr. Brotherson). So, imposing costs on Qwest-the-ILEC while shipping revenues to QCC-the-CLEC has no direct impact on Qwest's bottom line, but does allow it to avoid any regulatory limitations associated with Qwest-the-ILEC's earnings, while boosting the apparent earnings of QCC-the-CLEC.[15]

And, make no mistake about it, QCC-the-CLEC is not, in any but the most formalistic legal sense, an entity that is "separate" from Qwest-the-ILEC. To the contrary, there is an extremely close—indeed, overlapping—relationship between Qwest-the-ILEC and QCC-the-CLEC. Qwest's website reports that Qwest Corporation—Qwest-the-ILEC—is performing fundamental business activities for QCC. These functions include "providing general accounting and business advice for [QCC] business transactions ... [including] functional support for finance systems, generating reports, data analysis and cash management processes." In addition, Qwest-the-ILEC provides QCC with

[14] In this regard, in Oregon Qwest-the-ILEC and QCC-the-CLEC have signed an interconnection agreement based on Qwest's SGAT. That agreement – available on Qwest's website—clearly provides for the payment of reciprocal compensation for "local" traffic. Given Qwest's position that its FX service transforms calls from end users to distant ISPs into "local" calls, it follows that Qwest-the-ILEC has been paying QCC-the-CLEC compensation for dial-up calls to QCC's ISP customers.

[15] Among other things, this would explain the mystery of how QCC can supposedly afford to pay inflated private line rates for connections to various Qwest local calling areas and still maintain rates in the market for ISP business that are reasonably competitive with those offered by Level 3. QCC may well "pay" private line rates to Qwest (in the form of inter-company accounting transfers), but those are offset by the fact that Qwest "pays" QCC "local reciprocal compensation rates" for each minute of ISP-bound traffic that Qwest's end users send to QCC.

> Federal & State Regulatory Reporting—analysis & preparation of Federal and State regulatory reports; Universal Service Fund Support—providing disbursements to customers of the Universal Service Fund (USF), supervision of disbursements and USF consultation, methods and assistance to QCC as well as interfacing with the Information Technologies personnel to develop requirements for the USF database programs; Asset Accounting and Operations—providing the recording of capital assets, providing the physical inventory, calculating depreciation and meeting all fixed asset tax requirements; Capital Recovery—providing depreciation parameters, depreciation budgets and advice regarding depreciation issues; Finance Billing Support-Provide Finance support functions for QCC related to affiliate transactions. This could involve activities such as the calculation of the pricing of services that QCC will bill, tracking and calculating monthly QCC billing amounts, generating invoices on behalf of QCC or other support needed by QCC; Revenue Operations—providing support to the migration of QCC billing systems into the Revenue Journal System. Work includes providing methods and procedures, review of user requirements, functional design meetings, creation of test requirements, validate test output. Ongoing work activities would include initiate and validate table changes and the monitoring of daily production files. Finance Systems—BART Billing Support—providing billing support on behalf of QCC for services rendered by QCC to non affiliate customers. Actual postage costs are also billed as incurred.

See http://www.qwest.com/about/policy/docs/qcc/documents/WO-fs-Amd32_092906.pdf; *see also* http://www.qwest.com/about/policy/docs/qcc/documents/WO-fs-Amd31_060705.pdf.

In addition, Qwest-the-ILEC provides QCC-the-CLEC "with access to [Qwest-the-ILEC's] internal employee communications network. This service includes Help Desk Plus problem resolution[, including] Operations Services (Computer Attendant): [Qwest-the-ILEC] provides [QCC-the-CLEC] ongoing support of the server, including tape management, and maintenance." It also includes "Use of Server Equipment. Qwest Corporation provides use of servers to host unregulated software used by [QCC." Finally, it also includes "Use of software. [Qwest-the-ILEC] grants license to use QRules Engine Software." *See* http://www.qwest.com/about/policy/docs/qcc/documents/WO-its-Amd19_092906.pdf. Indeed, the close identification between Qwest Corporation and QCC is not limited to internal, "behind

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the scenes" operations. To the contrary, in order to reinforce the close relationship in the minds of customers, Qwest-the-ILEC will provide central office tours for customers of QCC.[16]

Furthermore, any residual separation between Qwest-the-ILEC and QCC-the-CLEC is likely to dissolve in the very near future, because the FCC just granted Qwest's petition to forbear from requiring that Qwest maintain its interLATA long distance operations—presently housed in QCC – as a separate corporate entity. Instead, Qwest is now permitted to provide both intraLATA and interLATA services—including interstate interLATA services—out of the same corporation.[17]

Qwest has been more than willing to attack Level 3 for supposedly violating the Commission's policy regarding FX services not only in this case, but in other proceedings as well—even while it has been violating the policy for the last 10 years. For example, Qwest filed a complaint against Level 3 (in 2005) complaining about Level 3's serving arrangements:

> 19. This dispute arises because Level 3 has engaged in a practice of ***providing a service to its ISP customers which enables the ISP's customers (who are also Qwest local telephone customers) who are located in a particular local calling area to dial a local number to reach the ISP.*** The ISP, however, is ***actually located in a different local calling area, or possibly even a different state.*** Level 3 does this by assigning telephone numbers to Level 3 ISP customers based on where the call originates, thus allowing the calls to terminate in a different local calling area. Level 3 then knowingly misuses Qwest's Local Interconnection Service ("LIS") so that Qwest will believe it is obliged to route and transport calls to Level 3 disguised as "local" calls (or, as Level 3 would try to define them, "ISP-bound" calls) when, in fact, the calls should be treated as toll calls. While Level 3 seeks this treatment of ISP-bound calls, other carriers seek the same treatment of intercity calls not bound for the Internet.

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[16] "Central Office Tours - provide QCC employees a QC central office tour as a service to facilitate positive customer relations. QC will provide a generic tour including review of a cable vault, distribution frame, switch, and transmission facilities. Information unique to QC infrastructure, customer information, and systems access will not be provided to QCC employees during the tour." http://www.qwest.com/about/policy/docs/qcc/documents/WO-csw-Amd34_020707.pdf.

[17] *See* Public Notice, FCC 07-12A1 (released February 21, 2007).

Qwest v. Level 3, Qwest Corporation's Complaint for Enforcement of Interconnection Agreement (filed June 6, 2005) at ¶ 19 (emphasis added). Focusing on the emphasized material, it is now clear that for the last decade Qwest has been engaging in exactly the conduct about which it complained to the Commission—"providing a service to its ISP customers which enables [Qwest end users] who are located in a particular calling area to dial a local number to reach the ISP [even though the ISP] is actually located in a different local calling area, or possibly even a different state."

In the face of all this, the Arbitrator's Decision relieves Qwest of the obligation to pay Level 3 terminating compensation for ISP-bound calls and suggests that Level 3 should have to pay Qwest access rates when Qwest brings the traffic from a local calling area to a Level 3 POI. In other words, in the ongoing competition between Level 3 and Qwest for the business of ISPs who need dial-up connectivity in Oregon, Level 3 loses existing revenue, and has to pay Qwest more money, while Qwest no longer has to pay Level 3 and will receive more money. Under the best of circumstances there would be no possible legal or policy justification for tipping the competitive playing field in this market segment away from Level 3 and towards Qwest in this way. But it is obviously unjust, unreasonable, and discriminatory to tilt the competitive playing field in this way ***when Qwest serves ISPs, and has done so for a decade, by violating the Commission's ban on FX.***

In these circumstances, Level 3 submits that, until and unless the Commission decides to enforce its longstanding ban on FX services against Qwest's FX-based service to ISPs, it is completely unreasonable to ***extend*** that ban to embrace Level 3's VNXX service and ***penalize*** Level 3, in relation to Qwest, in the market for ISPs' connectivity business. We do not believe that the Commission should, in fact, penalize either carrier in this market segment. But there is

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no possible justification for penalizing Level 3 on a piece-meal basis while Qwest continues to violate the Commission's rulings. At an absolute minimum, therefore, the Commission must modify the Arbitrator's Decision by permitting Level 3 to continue its VNXX arrangements, and continue to receive compensation at the FCC rate of $0.0007 for VNXX ISP-bound calls, until the Commission decides what it will do about Qwest's FX services for ISPs.[18]

2. The Commission Should Approve Level 3's Compromise Solution that Arizona, California, Nevada, And Washington State Commissions Have Found To Be Fair And Reasonable, and Recently Approved By The 9th Circuit In *Peevey*. .

As noted above, while the Commission is bound by its obligation of nondiscrimination to treat Level 3 and Qwest fairly, it should not penalize either Level 3 or Qwest in connection with either Level 3's VNXX service or Qwest's FX-based service. Instead, the Commission should recognize the trend among 9th Circuit states to handle ISP-bound traffic in essentially the way that the 9th Circuit just approved in *Peevey.*

It is not often that state regulators under the 1996 Act confront a regulatory issue that has just been squarely dealt with by the applicable federal circuit court of appeals. When that occurs, the most logical and prudent course is to follow that court's ruling closely.

i. California PUC Approved The Same Type of Compromise Level 3 Offered in Oregon

[18] Level 3 notes that the logic of the Arbitrator's Decision would necessarily have serious unintended consequences for arrangements other than its own VNXX services. For example, it would seem that the Commission would have to require Qwest (and other carriers) to discontinue the provision of "411" service, since essentially all directory assistance operators are centrally located – often in a distant state – rather than in the originating caller's local calling area. The same would even appear to be true for calls to "911," since the emergency response center for a particular area may well be outside the local calling area of the originating caller. Similarly, calls to "511" (statewide road and traffic conditions) and "711" (dual-party relay for hearing and speech-impaired customers) are handled on a centralized basis and so are of questionable legality under the logic of the Arbitrator's Decision.

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The Commission faces just such a situation with the 9th Circuit's decision in *Peevey.* In that case, the California Public Utilities Commission ("California PUC") was dealing with an interconnection arbitration between a CLEC serving ISPs by means of VNXX arrangements and an ILEC complaining that the calls were not "local;" that they should not be subject to compensation under the FCC's $0.0007/minute regime; and that it was unfair to make the ILEC pay to deliver the traffic outside the originating local calling area. The parallels with the case before this Commission are obvious and numerous.

To resolve this dispute, the California PUC carefully parsed out the somewhat contradictory nature of VNXX traffic. On the one hand, in ***economic*** terms, this traffic is "local" to the core. VNXX calls are dialed on a local basis, they are rated on a local basis, and end users are charged on a local basis. On the other hand, in geographic terms, this traffic is "interexchange" because it does not begin and end in the same local calling area.[19]

Reflecting this dual nature, the California PUC ruled that for purposes of ***terminating*** compensation, the normal rules for "local" traffic—including local traffic to ISPs—applied. The ILEC—in that case, Verizon California—had to pay $0.0007/minute to the CLEC for VNXX

[19] *See Verizon California Inc. (U-10021-C) Petition for Arbitration with Pac-West Telecomm, Inc. (U5266-C) Pursuant to Section 252(b) of the Telecommunications Act of 1996,* DECISION APPROVING ARBITRATED AGREEMENT PURSUANT TO SECTION 252, SUBSECTION (e), OF THE TELECOMMUNICATIONS ACT OF 1996 (ACT) (CPUC May 22, 2003) ("*Peevey CPUC Ruling*") at 3-4, 12; *Peevey,* 462 F.3d at 1157. (A copy of the *Peevey CPUC Ruling* is attached as Exhibit C to these Exceptions.) In this regard, the Arbitrator's Decision suggests that the federal district court in Oregon has already concluded that VNXX traffic is not "local." *See* Arbitrator's Decision at 21 & n.79 (citing *Qwest v. Universal,* Civil No. 04-6047 AA (D. Ore. 2004)). This is an incorrect reading of *Universal.* In that case the question was not whether VNXX calls to ISPs were or should be treated as local for compensation purposes either under federal law in general, or as a matter of state or federal policy; the question was whether the specific contract language in place between Universal and Qwest defining "local" traffic in that specific agreement did, or did not, embrace VNXX calls. The court's decision that VNXX calls were not "local" under that specific contract has no bearing on the legal and policy questions at issue in this proceeding.

calls to ISPs. But the California PUC also ruled that—as opposed to geographically local traffic—the ILEC should not be required to bear the cost of transporting this traffic beyond the local calling area. So, the CLEC had to pay the ILEC to get the traffic from the local calling area to the CLEC's POI. But the California regulators were not trying to create a windfall for anyone. So, they did not permit the ILEC to charge above-cost access rates for performing the transport function. Instead, the CLEC could only be charged TELRIC rates for the transport function.[20]

ii. **California Federal District Court Affirmed CA PUC's Finding that ISP-bound VNXX was Economically Local And Geographically Interstate**

As with any compromise, both sides were unhappy with this ruling. The ILEC was outraged that VNXX-routed ISP-bound traffic was subject to the FCC's $0.0007/minute rate. And the CLEC was baffled by the requirement that it could be charged transport fees to get the economically "local" traffic to its centralized POI. Both appealed to federal district court—which sustained the California PUC on all points.[21] While the court specifically rejected Verizon's claim that requiring payment for VNXX traffic violated federal law, it also rejected Pac-West's claim that the call origination charges—that is, the requirement that Pac-West pay

[20] *See Peevey CPUC Ruling,* at 5-6 (describing "quid pro quo" for purely geographically local traffic where the CLEC has a distant POI—the ILEC carries the call to the POI but the CLEC returns it to the calling area; with VNXX, it is fair to have the CLEC pay to get the traffic to a POI located outside the originating calling area, but only at TELRIC rates). As discussed *infra,* TELRIC rates, as a matter of law, are fully compensatory. Also, as indicated above, the California PUC's ruling regarding call origination charges in *Peevey* simply followed its earlier ruling in another case involving a CLEC known as Global NAPs. A copy of that earlier ruling (the "*CPUC GNAPs Ruling*") is attached as Exhibit D.

[21] *See Verizon California Inc. v. Peevey,* Order Resolving Cross-Motions for Summary Judgment, Civ. No. 03-3441 CW (N.D. Cal. 2004) ("*Peevey District Court Ruling*"). A copy of the district court's ruling upholding the *Peevey CPUC Ruling* is attached to these Exceptions as Exhibit E.

1 TELRIC rates to get VNXX calls from the originating local calling are to the central POI—were
2 unlawful.[22]

3

4 iii. **The 9th Circuit Affirmed CA PUC's Finding that CLECs Should be Compensated for Terminating Economically Local Traffic Even Where it is Geographically Interstate**

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6 Still unsatisfied, both parties took the matter to the 9th Circuit—which, like the district
7 court, affirmed the PUC on both counts.[23] Like the California PUC, the 9th Circuit appreciated
8 the dual nature of VNXX ISP-bound traffic—economically local, but geographically
9 interexchange. So, it found that the PUC had been both legally and economically justified in
10 fashioning a regime that carefully reflected both sides of the matter—$0.0007 compensation for
11 the CLEC, but TELRIC-based "call origination" transport charges for the ILEC.
12
13 In this regard, Verizon must have realized that it would be completely futile to try to
14 persuade the 9th Circuit that requiring compensation for VNXX-bound ISP traffic violated
15 federal law—the claim it had lost in the district court. Verizon did not even bother to bring that
16 claim to the 9th Circuit. Instead, it argued only that the California PUC had failed to adequately
17 explain why it was imposing the compensation requirement. In response to this argument, the 9th
18 Circuit approved California PUC findings that clearly show that the Arbitrator's Decision in ***this***
19 case should be revised. Specifically, the 9th Circuit affirmed the California PUC's conclusion
20

21

22 [22] *Peevey District Court Ruling* at 15-17 (upholding terminating compensation for VNXX traffic against Verizon claims of violation of federal law and arbitrary and capricious action); *id.* at 17-23 (upholding
23 call origination charges against Pac-West claims of violation of federal law and arbitrary and capricious action).

24 [23] In an issue not relevant to the dispute before ***this*** Commission, the California PUC had also approved a way of determining how much traffic was actually ISP-bound that excluded paging traffic from the count.
25 The District Court permitted that ruling to remain in place, but the 9th Circuit set it aside. *See Peevey,* 462 F.3d at 1153-55. Also not relevant here was a dispute over when the old interconnection agreement
26 between the parties in *Peevey* expired and when the new one took effect. *Peevey,* 462 F.3d at 1150-53.

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that VNXX traffic was properly treated as local for purposes of call rating and terminating compensation. The court found that determining "whether a call is local" is reasonably "based on the NPA-NXXs of the calling and called parties, not the routing of the call." 462 F.3d at 1155-56. This approach is "consistent with ... industry-wide practice" and recognizes "essential differences between the ...network architectures" of ILECs and CLECs. *Id.* And, of course, there is no suggestion that treating VNXX ISP-bound traffic as "local" for these purposes is in any way contrary to federal law.[24]

iv. **Level 3 Reqests that the Commission Approve**

It is hard to imagine a clearer blueprint than *Peevey* for resolving the case at hand. The 9th Circuit has, in effect, pre-approved a reasonable compromise of the dispute between the parties in ***this*** case. When Qwest delivers locally-dialed and locally-rated VNXX traffic to Level 3 bound for Level 3's ISP customers, Qwest should continue to pay the $0.0007 rate that it is paying today. But Qwest would not be called on to bear the cost of getting that traffic from the originating local calling area to Level 3's network. Instead, Level 3 would pay a reasonable TELRIC rate for that transport function.[25]

[24] The logic of the California PUC's analysis, as affirmed by the 9th Circuit, applies to all VNXX traffic. However, Level 3 does not here challenge Judge Petrillo's conclusion that, for now, VNXX should only be permitted for ISP-bound traffic. *See* Arbitrator's Decision at 27-28, 31. In this regard, although Judge Petrillo did not cite to it, regulators in New Hampshire several years ago reached essentially the same conclusion. *See Investigation as to Whether Certain Calls are Local*, Docket Nos. DT 00-223, 00-054, Order No. 24,080, Final Order, at 54-56, 88 NH PUC 749 (2002). While New Hampshire regulators, like this Commission, did not want to establish a general regime in which the status of traffic as "local" for rating purposes was based on dialed NXX codes rather than geography, that Commission recognized the importance of affordable state-wide dial-up Internet access, and so approved a form of VNXX specific to ISP-bound calling.

[25] As the Supreme Court found in *Verizon v. FCC,* 535 U.S. 467 (2002), there is nothing inappropriate—or in any way "confiscatory"—about TELRIC rates. It follows that rates higher than TELRIC rates, such as tariffed access rates—even if they might be "reasonable" under some standard—necessarily contain some element of subsidy not included in TELRIC rates. For this reason there is no basis to shy away

(note continued)...

Under this compromise, everyone comes out in a reasonable place. First and foremost, end users can still have affordable dial-up Internet access. Qwest doesn't bear the cost of carrying this locally-dialed and locally-rated traffic outside the local calling area—that cost falls to Level 3.[26] But with end users paying local rates for these calls, and Qwest bearing only "local" costs for them, it is only fair that Level 3 receive compensation for these calls as though they were geographically local as well.

Perhaps because of the basic fairness of the *Peevey* approach, this regime—or something very like it—has already become the norm for all major states within the 9th Circuit. California, of course, follows *Peevey;* it was a California regulatory decision that the 9th Circuit upheld in that case. But Arizona, Nevada and Washington also follow this outline for handling calls to ISPs, in light of the changes in the technology and economics of serving ISPs that Judge Petrillo correctly noted in his decision. In Arizona, in the recent Qwest-Level 3 arbitration, the Arizona

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...(note continued)
from using TELRIC rates to determine how much Level 3 can be asked to pay for transporting calls from the originating local calling area to its own network. Judge Petrillo's decision should be revised in this respect as well. *See* Arbitrator's Decision at 27-28 (call origination/transport charges should be based on Qwest's tariffs, not TELRIC). *See also CPUC GNAPs Ruling* at 34, Finding of Fact No. 13 ("TELRIC pricing adequately compensates the ILECs for use of their networks").

[26] *Cf. Global NAPs Inc. v. Verizon New England, Inc.,* 454 F.3d 91 (2nd Cir. 2006) (*ISP Remand Order* does not preempt states from imposing call-origination charges with respect to VNXX-routed ISP-bound traffic). That said, there is good reason to believe that federal law contemplates that there will be no "call origination" payments from a CLEC to an ILEC for VNXX calls to ISPs. Noting that some LECs have "targeted ... ISPs" as customers, the FCC also notes that, "[i]n such situations"—that is, where the CLEC has a single, LATA-wide POI—"the originating carrier bears ***the cost of interconnection to the single POI selected by the competitive LEC in addition to paying reciprocal compensation for the termination of traffic.*** Because ISP customers rarely, if ever, originate traffic, there is little traffic flow in the opposite direction, and ***the originating carrier bears the majority of the interconnection costs between the two carriers.***" *Developing a Unified Intercarrier Compensation Regime,* Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (2005) ("*Intercarrier Compensation Further Notice*") at ¶ 91 & n.299. The most logical way to understand these FCC statements is that under the FCC's current rules, originating carriers are responsible for the costs of delivering ISP-bound traffic to a single, centralized, LATA-wide point of interconnection.

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Corporation Commission ruled that Level 3 should receive $0.0007/minute for locally-dialed calls to distant ISPs, while absorbing a fair estimate of the costs of transporting those calls outside the originating local calling area—the essence of *Peevey*.[27] In Nevada, Level 3 and AT&T agreed to an arrangement—which the regulators there approved—under which the reciprocal compensation is offset by an allowance for AT&T's costs of out-of-calling-area transport. And in Washington, regulators have treated VNXX ISP-bound calls as economically local, requiring the $0.0007/minute terminating compensation with no offset for transport at all.[28]

In light of this overwhelming regional trend, this Commission should not remain an outlier—and risk reversal in federal court—simply to maintain an outdated and discriminatory regime that, in this context, benefits no one but Qwest—and that Qwest has been ignoring with impunity for the last ten years. Instead, this Commission should formally acknowledge that the policy concerns that have animated its objections to FX service do not apply to ISP-bound traffic, and fashion a regime for that traffic that will allow Oregon's hundreds of thousands of dial-up customers to continue to receive dial-up connectivity to their ISPs at reasonable rates.[29]

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[27] *See Petition of Level 3 Communications, LLC for Arbitration of an Interconnection Agreement with Qwest Corporation Pursuant to Section 252(b) of the Telecommunications Act of 1996,* Order, Decision No. 69176, Docket Nos. T-03654A-05-0350, T-01051B-05-350 (Ariz. Corp. Comm. Dec. 5 2006). The Arizona Corporation Commission specifically rejected Qwest's contention that Level 3 should be required to pay private line or other retail rates for out-of-calling-area transport. *See id.* at ¶ 22.

[28] *See Level 3 Communications, LLC v. Qwest Corporation,* Order Denying Petition for Reconsideration, Order 06, Docket UT-053039 (Wash. Util. & Transp. Comm. June 6, 2006).

[29] As Level 3 explained below, using the most recent available data (for 2005), *see* Level 3's Opening Brief (October 10, 2006) at 4 n.5, Oregon had 1.42 million households. U.S. Dept. of Commerce, Census Bureau, *2005 American Community Survey, Selected Social Characteristics: Oregon*, available on-line at: www.census.gov/acs/www/Area%20Sheets/Area%20Sheet%20OR.doc. About 94.7% of these Oregon households have telephone service. FCC, 2005 *Statistics of Common Carriers,* Table 5.9. As of year-end 2005, however, there were only about 587,000 residential broadband users. FCC, *High-Speed Services for Internet Access, Status as of December 31, 2005* at Table 3. This means that the vast majority of Oregon households – more than 750,000 of them – either have no Internet access at all, or use dial-up.

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In this regard, Level 3 appreciates the Commission's historical concern that FX service should not be permitted because it would tend to undercut the ability of ILECs—particularly small, independent ILECs—to receive access charges on toll calls.[30] The *1983 FX Order* reasoned that certain customers (in effect) "attracted" large volumes of toll calls from distant areas – and thereby indirectly led the ILECs whose customers made the toll calls to receive access charges. If those customers were forbidden from facilitating bypass by means of FX service, the toll calls would continue to occur and the affected ILECs would continue to receive access charges and (if the ILECs were also toll carriers) toll revenues as well. *Id.* This concern was grounded in a realistic assessment of the vulnerability of toll revenues to bypass in 1983 and shortly thereafter. But the record in ***this*** case is clear that customers do not now, and never have, connected to their ISPs by means of toll calls and, indeed, if access or toll charges applied to calls to ISPs, those calls simply would not occur. *See* Arbitrator's Decision at 24, 26. As a result, VNXX calls to ***ISPs*** do not implicate the Commission's policy concern. In the case of calls to ISPs, there are no access charges to be had. Consumers will not pay for dial-up ISP service that is priced high enough to recover such charges. As a policy matter, therefore, the issue with VNXX calls to ISPs is not trying to prevent a loss of access or toll revenues. For ISP-bound calls, those revenues have never existed, and will not exist. The only policy question is fairly allocating the costs of handling the traffic—which the *Peevey* regime does.[31]

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[30] *1983 FX Order*. The Commission grandfathered FX service for those customers already subscribed to FX service.

[31] It is not necessary, in following *Peevey,* for this Commission even to decide whether the FCC's *ISP Remand Order* requires compensation for VNXX-routed ISP-bound traffic, much less to rule that it does so. *See Intercarrier Compensation for ISP-Bound Traffic,* Order on Remand and Report and Order, 16 FCC Rcd 9151 (2001) ("*ISP Remand Order*"), *remanded, WorldCom v. FCC,* 288 F.3d 429 (D.C. Cir. 2002). The Commission plainly has the discretion, under *Peevey,* to require such compensation, whether

(note continued)...

1 Indeed, an important aspect of the *Peevey* regime is establishing a fair "call origination
2 charge" that the CLEC receiving the VNXX traffic pay the ILEC sending it. As explained in the
3 footnote just above, it is not really necessary for there to be any such charge at all and, indeed,
4 Washington does not impose one.[32] That said, if there ***is*** going to be a call origination charge, it
5 must be designed with care. The point of the *Peevey* regime is to recognize the economically
6 local nature of VNXX calls to ISPs and to (in effect) put both the ILEC and the CLEC into the
7 same position they would have been in, were the calls also purely geographically local as well.
8
9

10 ...(note continued)
as a matter of federal law or as a matter of its own discretion. *See also Global NAPs, Inc. v. Verizon New*
11 *England, Inc.*, 444 F.3d 59 (1st Cir. 2006) (FCC *amicus* brief states that *ISP Remand Order* can be read
either way). That said, Level 3 submits that the most logical way to read the *ISP Remand Order* is to
12 cover VNXX traffic. At the outset, as discussed *infra*, the FCC had been well advised of the existence of
VNXX architectures in the proceedings leading up to the *ISP Remand Order*. *See* text at nn. 45-46, *infra*.
13 But looking only at the *ISP Remand Order* itself, while it does make reference to geographically "local"
ISP-bound traffic, all of those references are in the "background" section of the order. *See ISP Remand*
14 *Order* at ¶¶ 10, 13-14. Once the FCC moves on to discussing the new analysis presented in that order, it
repudiates the notion of "locality" as relevant to intercarrier compensation, *see id.* at ¶¶ 26, 45-46, 54, 59.
15 *See also id.* at Appendix B (modifying FCC's reciprocal compensation rules to eliminate references to
"local" traffic). Moreover, in discussing the ISP-bound traffic to which the order applies, the FCC
16 repeatedly emphasized that the ISP "end" of such traffic does not really exist, since the relevant
communication was between the end user and, in effect, the entire Internet. *See id.* at ¶¶ 18, 58-60, 64.
17 And, the concept of "local" ISP-bound traffic is completely absent from those portions of the order that
actually establish the new compensation regime. *See id.* at ¶¶ 77-94. A copy of the *ISP Remand Order* is
18 attached to these Exceptions for the Commission's convenience as Exhibit F. Finally, in a 2005 ruling,
the FCC made clear that its compensation regime for ISP-bound calls was entirely separate from the
19 regime applicable to local, long distance, or wireless traffic. *Developing A Unified Intercarrier*
20 *Compensation Regime,* Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (2005) ("*Intercarrier*
Compensation Further Notice") at ¶ 3 & n.8. Given this, there is no need to engraft the restrictions
21 applicable to reciprocal compensation for local traffic onto the separate regime applicable to ISP-bound
traffic.

22 [32] *See Petition for Arbitration of an Interconnection Agreement Between Level 3 Communications, LLC,*
23 *and Qwest Corporation Pursuant to 47 U.S.C. Section 252,* Docket No. UT-023042 Fourth Supplemental
Order & Commission's Final Order (Wash. Util. & Transp. Comm., February 5, 2003) at 9-11 (ISP-
24 bound traffic treated as normal traffic for purposes of the calculation of the "relative use factor," making
Qwest, not Level 3, financially responsible for costs of originating ISP-bound calls); *Level 3*
25 *Communications, LLC v. Qwest Corporation,* Order Denying Petition for Reconsideration, Order 06,
Docket UT-053039 (Wash. Util. & Transp. Comm. June 6, 2006) (VNXX ISP-bound traffic subject to
26 same FCC compensation regime as so-called "local" ISP-bound traffic).

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On the terminating side, this means that the originating ILEC should pay the (low) $0.0007/minute call termination rate. On the originating side, this means that the ILEC should be compensated to the extent that it incurs costs beyond those it would incur if the traffic were geographically as well as economically local.

Because CLECs are entitled to have a single LATA-wide POI for the exchange even of traffic that is geographically local in the sense that the calling and called parties are in the same calling area, ILECs are normally obliged to haul even that type of traffic outside—sometimes far outside—the originating local calling area without any compensation for doing so.[33] But assuming that, as in *Peevey,* the Commission concludes that it is fair to have the CLEC cover some of those costs, it is important to focus on what costs are really at issue. As the California PUC found, the relevant costs are limited to the incremental costs that the ILEC incurs in carrying traffic outside the originating local calling area. To the extent that the ILEC carries this traffic ***within*** a local calling area, the ILEC would have had to do that, at its own expense, even in the case of purely geographically local traffic, so it is not at all fair to expect the CLEC to cover any intra-local-calling-area transport costs for VNXX traffic. In Level 3's case, we already have POIs (where we, at our expense, pick up traffic from Qwest) in Ashland, Astoria, Bend, Eugene, Portland, Roseburg and Salem. To the extent that VNXX traffic from Qwest originates in any of those local calling areas, it is simply punitive to make Level 3 pay Qwest for transporting the traffic from a particular end office within that calling area to the location within

[33] As the FCC has noted, in the normal course of applying its rules, this is what happens even with ISP-bound traffic. Specifically, the *Intercarrier Compensation Further Notice,* released in 2005, says that even when CLECs have targeted ISPs as customers, "***the originating carrier bears the cost of interconnection to the single POI selected by the competitive LEC.***" *Intercarrier Compensation Further Notice* ¶ 91 & n.299. In other words, even for ISP-bound traffic, the originating carrier is responsible for transport to the POI. *See also CPUC Peevey Ruling* at 5.

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the same calling area where Level 3 already has a POI. And to the extent that the traffic originates an another calling area, the only mileage to which transport charges should apply is the mileage from the edge of the originating local calling area to the point at which Qwest hands the traffic off to Level 3.[34]

Moreover, the point of call origination charges under *Peevey* is not to create profits for the ILEC; it is to cover the ILEC's incremental costs of hauling traffic outside the local calling area. For this reason, any call origination charges should be set using TELRIC transport rates, not any ILEC tariffed rate.

* * * * *

The discussion above shows that *Peevey*'s compensation regime for VNXX traffic is completely consistent with federal law, and Level 3 submits that this Commission should follow that ruling here. While Level 3 obviously cannot guarantee that Qwest would not seek federal court reversal of a decision by this Commission to apply the same regime that the 9th Circuit just approved in *Peevey,* it is clear that any such court challenge by Qwest would be futile. It is rare indeed that such assurance regarding regulatory matters is available.

3. The Arbitrator's Decision Discriminates in the treatment of VNXX Traffic As Well.

Aside from creating a discriminatory regime that favors Qwest, and aside from ignoring *Peevey* and the fact that all major states in the 9th Circuit—besides Oregon—now follow the *Peevey* regime or something very like it, the Arbitrator's Decision regarding VNXX traffic is flawed in two other important respects as well. First, it mistakenly implies that VNXX

[34] In this regard, Qwest has forthrightly admitted that its costs of delivering traffic are not affected at all by where Level 3's customer might be located but, instead, depend entirely on the distance between the originating local calling area and Level 3's point of interconnection. *See* Exhibit A, page 11.

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1 arrangements are somehow contrary to applicable federal and industry number assignment
2 guidelines, and then uses that as a basis to find that this Commission has the legal authority to
3 ban VNXX ISP-bound calling even though the traffic is interstate. Second, it mistakenly
4 suggests that VNXX arrangements are contrary to two conditions included in Level 3's CLEC
5 certificate. Both of these suggestions are wrong.
6
7 **a. Approving VNXX for ISP-Bound Traffic**
Does Not Violate Numbering Rules.
8
9 Judge Petrillo found that the Commission may ban VNXX because states administer
10 numbering resources. Arbitrator's Decision at 24-26. But VNXX does not conflict with
11 numbering rules or guidelines or industry norms, so the fact that the Commission is empowered
12 to enforce those rules, guidelines and norms does not create any authority to ban VNXX.
13 First, consider *Peevey*. The court described VNXX arrangements as simply a "wrinkle"
14 in the normal reciprocal compensation rules. 462 F.3d at 1147-48. As Judge Petrillo correctly
15 noted, the 9th Circuit did not suggest that numbering rules or guidelines ban VNXX. Arbitrator's
16 Decision at 28. To the contrary, the court notes essentially without comment that the California
17 PUC has approved the general use of VNXX by CLECs. 462 F.3d at 1148. It is nonsensical to
18 think that the California PUC has been aiding and abetting violations of numbering requirements
19 without anyone doing anything about it.
20
21 But, of course, it is not just California. Among the other states that have approved the
22 use of VNXX arrangements in one form or another are Alabama,[35] Illinois,[36] Kentucky,[37]
23
24
25 [35] *Declaratory Ruling Concerning the Usage of Local Interconnection Services for the Provision of Virtual NXX Service,* Docket 28906, Declaratory Order (AL PUC April 29, 2004).
26 [36] *Global NAPs Illinois, Inc. Petition for Arbitration pursuant to Section 252(b) of the Telecommunications Act of 1996 to establish an interconnection agreement with Verizon North, Inc., f/k/a*
(note continued)...

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Maryland,[38] Michigan,[39] New Hampshire,[40] Ohio,[41] Rhode Island,[42] and Wisconsin.[43] In addition, as the record in this case shows, Level 3 was able to reach region-wide settlements that include compensation for VNXX calls to ISPs with all the other major ILECs—Verizon, AT&T,

...(note continued)
GTE North Incorporated and Verizon South, Inc., f/k/a GTE South Incorporated, Docket No. 02-0253, Arbitration Decision, at 15 (Ill. C.C. Oct. 1, 2002); *AT&T Communications of Illinois, Inc., TCG Illinois and TCG Chicago Verified Petition for Arbitration of Interconnection Rates, Terms, and Conditions and Related Arrangements with Illinois Bell Telephone Co. pursuant to Section 252(b) of the [1996 Act],* Docket No. 03-0239, Arbitration Decision, at 124 (Ill. C.C. August, 26 2003).

[37] *Petition of Level 3 Communications, LLC for Arbitration with BellSouth Telecommunications, Inc. Pursuant to Section 252(b) of the Communications Act of 1934, as Amended by the Telecommunications Act of 1996,* Order, Case No. 2000-404 (Ky. P.S.C. Mar. 14, 2001).

[38] *Petition of AT&T Communications of Maryland, Inc. for Arbitration Pursuant to 47 U.S.C. § 252(b) Concerning Interconnection Rates, Terms, and Conditions,* Order No. 79250, Case No. 8882, at Issue 3 (Md. PSC July 7, 2004); *AT&T Communications of Maryland, Inc.,* Order No. 78724, Case No. 8882 (Md. PSC Oct. 17, 2003); *Arbitration of US LEC of Maryland, Inc. v. Verizon Maryland, Inc.,* Order No. 79813, Case No. 8922 (Md. PSC March 10, 2005).

[39] *Petition of Coast to Coast Telecommunications, Inc. for arbitration of interconnection rates, terms, conditions, and related arrangements with Michigan Bell Telephone Company d/b/a Ameritech Michigan,* Case No. U-12382, at 6 (Mich. PSC, Aug. 17, 2000); *Petition of Level 3 Communications LLC, for arbitration pursuant to Section 252 of the federal Telecommunications Act of 1996 to establish and interconnection agreement with Ameritech Michigan,* Case No. U-12460, Opinion and Order, at 8-9 (Mich. PSC, Oct. 24, 2000); *Application of Ameritech Michigan to revise its reciprocal compensation rates and rate structure and to exempt foreign exchange service from payment of reciprocal compensation,* Case No. U-12696 (Mich. PSC, Jan. 23, 2001); *Petition for arbitration to establish an interconnection agreement between TDS Metrocom, Inc., and Ameritech Michigan,* Case No. U-12952, Opinion and Order (Mich. PSC, Sept. 7, 2001).

[40] *Investigation as to Whether Certain Calls are Local,* Docket Nos. DT 00-223, 00-054, Order No. 24,080, Final Order, at 54-56, 88 NH PUC 749 (2002) (ISP-bound calls).

[41] *Allegiance Telecom of Ohio, Inc.'s Petition for Arbitration of Interconnection Rates, Terms, and Conditions, and Related Arrangements with Ameritech Ohio,* Case No. 01-724-TP-ARB, Arbitration Award, at 8-9 (PUCO, Oct. 4, 2001) (ISP-bound calls only).

[42] *Arbitration of the Interconnection Agreement Between Global NAPS and Verizon-Rhode Island,* 2002 R.I. PUC LEXIS 20, at 34 (Oct. 16, 2002).

[43] *Level 3 Communications, LLC Petition for Arbitration Pursuant to 47 U.S.C. Section 252 of Interconnection Rates, Terms and Conditions With CenturyTel of Wisconsin,* Docket 05-MA-130, Arbitration Award (Wisc. P.S.C., Dec. 2, 2002); *Level 3 Communications, LLC Petition for Arbitration Pursuant to 47 U.S.C. Section 252 of Interconnection Rates, Terms, and Conditions, With CenturyTel of Wisconsin, LLC,* Docket No. 05-MA-130, Order Approving an Interconnection Agreement, at 9 (Wisc. P.S.C., Feb. 13, 2003).

and BellSouth—in virtually every non-Qwest state in the country, and a number of Qwest states as well.[44] It is not reasonable to think that all of these states are tolerating and even actively approving a use of numbering resources that violates federal numbering rules or guidelines or industry norms.

This is only confirmed by considering the actual substantive FCC rules governing numbering resources. Those rules make crystal clear that numbering resources should be made broadly available in order to encourage market entry and new technology, without discrimination in favor of typical ILEC operations that might not use VNXX. The basic rule is 47 C.F.R. § 52.9(a), which states that decisions about numbering shall:

> (1) ***Facilitate entry into the telecommunications marketplace*** by making telecommunications numbering resources available on an efficient, timely basis to ***telecommunications carriers***;
>
> (2) Not unduly favor or disfavor any particular ***telecommunications industry segment*** or group of telecommunications consumers; and
>
> (3) Not unduly favor one ***telecommunications technology*** over another.

47 C.F.R. § 52.9(a) (emphasis added). Interpreting numbering guidelines to favor ILECs over CLECs, traditional network architectures over newer, more innovative architectures, and traditional FX service over VNXX cannot possibly be squared with this rule.

In this regard, the document that lays out numbering guidelines—the Central Office Code Assignment Guidelines ("COCAG")—does not ban VNXX. No one disputes that traditional landline telephone numbers have typically been assigned on a geographic basis, but there have always been exceptions, such as FX service, that allow a customer to have a number associated

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[44] *See* Tr. I at 72 (Mr. Greene) (noting that under agreements with other major ILECs, Level 3 gets paid for all traffic but accepts a rate less than $0.0007/minute as a trade-off—that is, the *Peevey* approach). These negotiated agreements were all, necessarily, approved by the relevant state commissions. *See* 47 U.S.C. § 252(e).

with another area. *See* COCAG at § 2.14. This document does not say that FX is the only exception to the normal geographic assignment of telephone numbers to customers based on NXX codes. Rather, it simply lists FX service as an ***example*** of such an exception.

Moreover, in § 4.2.2, COCAG outlines what a carrier should do to receive numbers in a rate center. It does not say that the carrier's end users must be present in an area; instead, it looks to evidence that the carrier intends to do business there—a very different thing. In this regard, the guidelines obtain regulatory significance only because the FCC refers to them in its rules. *See* 47 C.F.R. § 52.13(b). But while that rule refers to industry guidelines, it also requires numbering authorities to assign numbering resources "in an efficient, effective, fair, unbiased, and nondiscriminatory manner consistent with … Commission regulations." The "Commission regulation" quoted above—that is, 47 C.F.R. § 52.9(a)—shows what it means to be "fair" and "nondiscriminatory:" facilitating market entry, not favoring any existing industry segment, and not favoring any particular technology. Moreover, Rule 52.13 does not lock numbering into traditional uses; it acknowledges that nontraditional uses will arise. When that happens, numbering authorities are to explore how to make the resources available—including, specifically, central office codes (NXXs).

Furthermore, it is not just the states that have permitted or embraced VNXX arrangements; the FCC itself has done so. First, at the time of the *ISP Remand Order,* the FCC knew that CLECs were serving ISPs using VNXX. ILECs had complained that CLECs should not get full reciprocal compensation rates for ISP-bound calls because centralized VNXX arrangements lowered CLEC costs. For example, Qwest's expert, Dr. William Taylor, stated:

> Unlike CLECs, ILECs must be prepared to provide local service to any or all such customers, regardless of their usage or location. In contrast, the incremental cost of an ISP-bound call does ***not*** reflect such a composite. ***ISPs can place their***

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> ***equipment in high-density, central business locations and frequently can collocate equipment in the CLEC's switch.*** Transport costs for such calls will be lower than for an average of all traffic terminating within the local exchange.

See Letter from Melissa Newman, U S West, to Magalie Roman Salas, Secretary, FCC, Attachment at 8 (Dec. 2, 1999) (emphasis added).[45] This material was not somehow lost in the record before the agency; the FCC ***cited to this specific Qwest filing*** in the *ISP Remand Order,* at ¶ 92 n.189. This same footnote also notes the submission of Mr. Fred Goldstein, an expert filing on behalf of a CLEC, as describing "the CLEC reduction of loop costs through collocation" of ISP equipment with centralized CLEC switches. The FCC then refers to SBC comments that (among other things) respond to Mr. Goldstein. Those SBC comments contain the following statement:

> [I]t has become ***routine practice*** for CLECs to assign NXX codes to switches that are nowhere near the calling area with which that NXX is associated. The CLECs then market themselves to their ISP customers on this basis, boasting that ***the ISP's subscribers will be able to connect to the ISP through a local call.***

Comments of SBC Communications Inc., 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 (filed July 21, 2000) at 43 (emphasis added).[46]

The FCC's acceptance of non-geographic telephone numbers is confirmed by its encouragement of IP-enabled services. The FCC has noted that a beneficial feature of such services is their "nomadic" quality, *i.e.,* the ability to move a VoIP phone from place to place

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[45] These materials underlying the ISP Remand Order are easily accessible by means of the FCC's web site. See *http://gullfoss2.fcc.gov/prod/ecfs/comsrch_v2.cgi*.

[46] Again, these materials are available for review at the FCC's website. *See* note 43, *supra.*

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without changing the telephone number.[47] If the FCC had disapproved of this use of numbers, it had a perfect opportunity to say so in 2005, when it was confronted with problems with E911 in connection with nomadic VoIP services.[48] The E911 problems arose in part because callers could be located somewhere other than their assigned telephone number would suggest. But the FCC found nothing inappropriate from a ***numbering*** perspective about these nomadic services. Instead, it was concerned with how to overcome their E911-related limitations ***given that there was no correlation between a customer's telephone number and physical location.***[49] The record in that case showed consumers suffering injuries and death because their telephone numbers did not reflect their location, so it is inconceivable that the FCC viewed the numbering issue to be a problem, but then said nothing about it. In fact, it found that the solution was to ensure that consumers are informed of the limitations of their VoIP-based E911 services and to find a way to update 911 authorities of a VoIP customer's location, not prohibit the service or economically penalize the facilities-based networks that support it.[50]

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[47] *See, e.g., Vonage Holdings Corp. Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission*, Memorandum Opinion and Order, 19 FCC Rcd 6429 (2004) *at* ¶ 5 ("In marked contrast to traditional circuit-switched telephony, however, it is not relevant where that broadband connection is located or even whether it is the same broadband connection every time the subscriber accesses the service. Rather, Vonage's service is fully portable; customers may use the service anywhere in the world where they can find a broadband connection to the Internet").

[48] *IP-Enabled Services, E911 Requirements for IP-Enabled Service Providers,* 20 FCC Rcd 10245 (2005) ("VoIP E911 Ruling").

[49] *See* 47 C.F.R. § 9.1 *et seq.* (new E911 rules).

[50] *See* 47 C.F.R. § 9.5(d) (rule requiring easy way for consumers to update their location information). One need not look to IP-enabled services to see that traditional linkages between telephone numbers and customer locations have completely broken down. Instead, one need only consider the wireless industry. As of year-end 2005 there were about 47 million ***more*** wireless phones in service than landline phones. FCC, *Trends In Telephone Service,* 2007 Edition, at Tables 7.2 (approximately 166 million landline switched access lines) & 11.1 (approximately 213 million wireless subscribers).

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All of these facts show that the Arbitrator's Decision is incorrect when it suggests that VNXX contravenes applicable numbering rules or industry guidelines. As a result, VNXX may not be banned based on any such considerations.

b. Approving VNXX Calling for ISP-Bound Traffic Does Not Violate Level 3's CLEC Certificate.

The Arbitrator's Decision suggests that Level 3's CLEC certificate prohibits Level 3 from employing the VNXX arrangements at issue in this docket. Arbitrator's Decision at 25. However, Level 3 has never understood those paragraphs to apply to or ban its VNXX architecture. The relevant provisions are as follows:

> 7. For purposes of distinguishing between local and toll calling, applicant shall adhere to local exchange boundaries and Extended Area Service (EAS) routes established by the Commission. Further, applicant shall not establish an EAS route from a given local exchange beyond the EAS area for that exchange.
>
> 8. When applicant is assigned one or more NXX codes, applicant shall limit each of its NXX codes to a single local exchange and shall establish a toll rate center in each exchange that is proximate to the toll rate center established by the telecommunications utility serving the exchange.

See Arbitrator's Decision at 25.

First, these paragraphs do not, in terms, say anything about VNXX, and in particular they say nothing about the types VNXX arrangements employed by Level 3 to route its ISP-bound and VoIP traffic. That makes sense, because these paragraphs have been included in certificates of authority granted to competitive carriers for over 10 years—long before VNXX was being used to route ISP-bound and VoIP traffic. On the contrary, to the extent that these paragraphs relate to this general issue, they were intended to extend the Commission's ban on traditional FX-traffic to the CLECs. Here, not only has there been no allegation that Level 3 is offering traditional FX-service, Qwest's witness Mr. Brotherson was at some pains to ***distinguish***

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Level 3's VNXX arrangements from the FX-type service that Qwest uses to provide centralized dial-up connectivity to ISPs:

> Q [by ALJ Petrillo]: So, in essence, when I think about [Qwest's] PRI service, similarities with FX service come to mind. ***Isn't it essentially an FX type substitute?***
>
> A: ***It is an FX type substitute*** in virtually all states.
>
> Q: And you are saying that ***that is what distinguishes it from the VNXX situation;*** is that correct?
>
> A: Yes.

Tr. II at 65:22-66:5 (Brotherson) (emphasis added).[51]

Moreover, Level 3's VNXX routing does not implicate the policy concerns that first gave rise to the Commission's ban on traditional FX. In its 1983 Order announcing its prohibition of traditional FX service, the Commission was unambiguous that its motive for banning traditional FX service was to preserve access charges necessary for the continued survival of the small ILEC after the breakup of AT&T.[52] As we have discussed above, the VNXX traffic at issue in this case does not displace access charges because it would not occur if access charges were applied to it. Therefore, from a purely policy perspective, there is no reason be believe paragraphs 7 and 8 were intended to prohibit Level 3's traffic routing arrangements.

In addition, the language of the paragraphs themselves does not support Judge Petrillo's interpretation of them as applying to VNXX. As noted above, neither says anything about VNXX. Level 3 submits that the Arbitrator should not have interpreted them as banning VNXX, when they do not mention that arrangement in any way. In this regard, although the Commission

[51] In this regard, as noted above, the 9th Circuit in *Peevey* noted that VNXX arrangements reflect the unique aspects of CLEC network architecture, as opposed to ILEC network architecture. *Peevey,* 462 F.3d at 1155-56.

[52] *Access Provisions and Charges of Telephone Utility Companies in Oregon, Public Utility Commission of Oregon,* UT 5, Order No. 83-869 (Or. PUC 1983), *supra.*

has expressly banned FX service, to which VNXX is in some ways analogous, these provisions do not mention the ban on FX either. There is, in short, nothing in these provisions that, at the time that they were imposed on Level 3, suggested to Level 3 that they meant that Level 3 cannot offer VNXX. Assuming for purposes of argument that the Commission actually has the authority to ban VNXX for interstate traffic such as ISP-bound calling, neither of these paragraphs, fairly read, constitutes an exercise of any such authority.

Furthermore, a careful reading of the specific language of the two provisions only supports this conclusion. First look at paragraph (7). The essence of a VNXX arrangement is the assignment of telephone numbers to customers in a way that is nontraditional but that makes sense in light of CLECs' network architectures. Paragraph (7), however, does not address the assignment of numbers at all. Instead, it relates to the local calling areas that a CLEC establishes for its own customers' outbound calling. Under that paragraph, a CLEC may not (for example) offer its customers LATA-wide local calling without Commission approval; instead, it must offer its customers local calling areas that reflect the Commission's existing areas (including EAS routes). VNXX, however, does not address the scope of local versus toll calling offered to the CLEC's customers. VNXX affects the rating of calls that other carriers' customers make to the CLEC's customers.

Similarly, paragraph (8) does not address the assignment of telephone numbers to end users. Instead, it requires the CLEC to associate each NXX code with a "single exchange" and that each NXX code is assigned to a "toll rate center" in each exchange that matches ("is proximate to") the ILEC's toll rate center. A "toll rate center," however, is a geographic point or

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1 region used for purposes of rating calls.[53] Paragraph (8) is addressing a matter known in the
2 industry as "rate center consolidation," which is a proposed number conservation measure that
3 would collapse a number of small toll rate centers into a single larger rate center. Without rate
4 center consolidation, a CLEC and an ILEC will associate their NXX codes with the same
5 geographic areas. Not only is this what Level 3 has done, this is what Level 3 ***has to do*** for a
6 VNXX arrangement to be established at all. Again, as with paragraph (7), paragraph (8) simply
7 does not address the assignment of telephone numbers to customers; it relates to the assignment
8 of geographic locations—"toll rate centers" to NXX codes.
9
10 Level 3 recognizes that the Commission has had reservations about FX services, and,
11 apparently, VNXX arrangements as well.[54] Our close parsing of the language in our CLEC
12 certificate cited by Judge Petrillo is not intended to denigrate those concerns, but merely to note
13 that the cited provisions do not, fairly read as legal documents setting out Level 3's rights and
14 obligations as a CLEC, ban or forbid VNXX. Those provisions address other matters that are, to
15 a greater or lesser degree, related to the same general topic as VNXX, but, again, they do not
16 actually address VNXX at all. It is therefore unreasonable to conclude that Level 3's VNXX
17
18
19
20 [53] *See* Interconnection Agreement, Section 4 (language not in dispute):

21 > "Rate Center" identifies 1) the specific geographic point identified by specific vertical and horizontal (V&H) coordinates, which are used to measure distance sensitive End User Customer traffic to/from the particular NPA-NXX designations with the specific Rate Center, and 2) the corresponding geographic area which is associated with one or more particular NPA-NNX codes which have been assigned to a LEC or its provision of Telephone Exchange Service.
22
23
24 When paragraph (8) speaks of establishing a "toll rate center" it is clear that the reference is to the first identified usage noted above.
25
26 [54] *Investigation Into the Use of Virtual NPA/NXX Calling Patterns,* Docket UM-1058, Order 03-329 (Ore. PUC May 27, 2003) at 7.

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arrangements violate the terms of Level 3's CLEC certificate.[55]

B. The Arbitrator's Decision Imposes Restrictions on Level 3's Ability To Provide Competing Tandem Access Service That Do Not Exist For Qwest.

In addition to creating a regime regarding VNXX that unfairly discriminates against Level 3, Judge Petrillo also (we believe, without intending to) created an illogical regime regarding Level 3 using LIS trunks to terminate long distance traffic to Qwest end offices. This situation arose because Qwest's contract language—that Judge Petrillo approved—permits Level 3 to use LIS trunks for exactly this purpose, as long as the inbound long distance traffic comes from unaffiliated IXCs. When Level 3 switches inbound long distance traffic to the destination Qwest end office, Level 3 is providing terminating tandem switched access service, and that traffic meets the agreement's definition of "jointly provided switched access." Qwest's language expressly permits the use of LIS trunks to carry jointly provided switched access traffic in general; the ***only*** exclusion is where Level 3 is the originating IXC.

First, consider the definition of "jointly provided switched access:"

[55] In this regard, in Order 04-704, the Commission expressly ruled that it had not reached any determination with regard to whether the two certificate provisions at issue here did, or did not, have the effect of banning VNXX service. The Commission stated: "When a complaint or request for arbitration is filed, the Commission or Arbitrator shall receive the allegations and the facts *de novo* and make factual findings and legal conclusions in the ordinary course of proceedings. The parties shall be free to present and argue the totality of the case and the factual and legal burdens shall not be altered by the subject matter of the proceeding." *Investigation Into the Use of Virtual NPA/NXX Calling Patterns,* Docket UM-1058, Order 04-704 (Ore. PUC Dec. 8, 2004) at 3. We respectfully request that the Commission view Level 3's careful parsing of the language of these certificate provisions as part of its "argu[ment of] the totality of the case," as contemplated by Order 04-704. Indeed, for this reason, Judge Petrillo should not have relied on the results of ARB 671, involving a different CLEC with a different network architecture, to conclude that ***Level 3*** is or could be in violation of Level 3's certificate provisions. *See* Arbitrator's Decision at 24-26. Level 3 does not take any position on whether ARB 671 was correctly decided on the facts in that case; but the facts in ***this*** case are clearly sufficiently different (and much more robustly developed) that it is not reasonable to rely on that other proceeding to Level 3's detriment in this one.

> "Meet-Point Billing" or "MPB" or "Jointly Provided Switched Access" refers to an arrangement whereby two (2) LECs (including a LEC and CLEC) jointly provide Switched Access Service to an Interexchange Carrier, with each LEC (or CLEC) receiving an appropriate share of the revenues from the IXC as defined by their effective access Tariffs.

See Qwest's Response to Arbitration Petition, Attachment (Qwest version of contract showing agreed-to and disputed language) at 24 (definition of meet point billing). This definition is neutrally phrased and does not require or suggest that only Qwest may provide tandem functionality. Indeed, any such limitation would have been blatantly discriminatory by excluding Level 3 from competing with Qwest for the business of IXCs purchasing terminating access services in Oregon. So when Level 3 provides tandem functionality to IXCs, that fits within this definition.[56]

Qwest's language also says that LIS trunks may be used to carry jointly provided switched access. Qwest's Section 7.1.1 states that LIS trunks are "provided for the purpose of connecting ... End Office Switches to Access Tandem Switches for the exchange of ***Jointly***

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[56] Qwest has admitted, in litigation in neighboring Washington, that its contract language permits this. *See* Qwest Corporation's Reply Brief, Washington Util. & Transp. Comm'n Case No. UT-063006 (January 22, 2007) at 7 ("The issue that *is not* before the Commission is whether Level 3 can deliver jointly provided switched access ("JPSA") traffic to Qwest over LIS trunks. The undisputed language of the ICA permits this but only so long as Level 3 is functioning as a LEC for the traffic in question and all of the requirements applicable to the provision of JPSA are met."). Also, in Washington, Qwest's witness Mr. Linse admitted this on the stand. *See* Washington Util. & Transp. Comm'n Case No. UT-063006, Transcript of Proceedings at 610:20-611:16 (Qwest's Mr. Easton) (emphasis added) ("Q: But, in fact, if a CLEC had a switch that had multiple capabilities, and wanted to compete with the ILEC in the provision of tandem functionality, nothing that you are aware of would prevent the CLEC from soliciting business from IXCs, saying, connect to me, and I will get your traffic out to the end offices cheaper and more efficiently than the ILEC can. That's perfectly legal? ***A: Nothing I am aware of would prohibit that.*** Q: And if that were to occur, that would be a form of jointly provided switched access? A: Let's go through the example again. So it would be an ILEC going through a CLEC's tandem? Q: And it would be incoming, an IXC with a call coming in from Los Angeles, goes to the CLEC switch which is functioning as a tandem, recognizes that call as bound for a particular Qwest customer. The CLEC would then route that to the appropriate Qwest end office? ***A: That would be an example of jointly provided switched access.***") A copy of these two transcript pages is attached at Exhibit G to these Exceptions.

Provided Switched Access traffic." Disputed Points List at 8. (Qwest's language, emphasis added). And its version of Section 7.2.2.9.3.1 states that:

> Exchange Service (EAS/Local), ISP-Bound Traffic, Exchange Access (IntraLATA Toll carried solely by Local Exchange Carriers), VoIP traffic and ***Jointly Provided Switched Access (InterLATA and IntraLATA Toll involving a third party IXC) may be combined in a single LIS trunk group or transmitted on separate LIS trunk groups.***

Id. at 43-44 (Qwest's language, emphasis added). In other words, incoming long distance traffic may be transmitted by Level 3 over LIS trunks because the definition of "jointly provided switched access" includes Level 3 providing tandem switching functionality.

So, under the Arbitrator's Decision, Level 3 may send an unlimited amount of Feature Group D traffic to Qwest over LIS trunks. As a result, all of the problems that Qwest argued would exist if Level 3's language were adopted, exist under Qwest's language as well. For example, Qwest argued that because its end offices are not configured to record call details on incoming traffic on LIS trunks, those trunks should not be used for incoming long distance traffic. But its language ***permits*** an unlimited amount of such traffic on LIS trunks. So, under its own language Qwest must either configure those trunks to record call details or rely on Level 3 to provide call detail recordings ("CDRs") for this traffic.[57] For this reason, concern about whether Qwest will be able to provide its wholesale customers (that is, "QPP" customers) with

[57] This is standard industry practice—the provider of tandem switching is responsible for recording traffic so that the provider of end office switching can bill appropriately. For this reason, the Arbitrator's Decision is wrong to suggest that the contract does not oblige Level 3 to provide CDRs when it delivers terminating long distance traffic to Qwest end offices. *See* Arbitrator's Decision at 36. Section 7.2.2.4 and Section 7.5 of the agreement—provisions that are not in dispute—oblige the parties to use industry-standard MECOD/MECAB arrangements in the provision of jointly provided switched access. Those arrangements entail the tandem service provider supplying CDRs as needed to the carrier supplying end office functionality, so the contract—albeit by referring to those other documents—does oblige Level 3 to provide CDRs when needed.

the CDRs they need to bill long distance carriers—a matter that apparently helped convince Judge Petrillo on this score—is, in fact, a complete red herring. Because Qwest's language expressly permits Level 3 to use LIS trunks to send Qwest terminating long distance traffic from 3rd-party IXCs, if Qwest is going to supply CDRs to its QPP customers, it must either establish its own recording capabilities or rely on Level 3 for CDRs.

Again, the actual language Qwest proposed and that Judge Petrillo approved ***does not exclude Feature Group D traffic from LIS trunks.*** All it does is exclude such traffic in those cases where Level 3 itself is the IXC. This exclusion does not avoid Qwest's alleged problems regarding lack of recording capability; all it does is make things inefficient for Level 3—which has indisputably been the result of over three year's worth of negotiations and arbitrations with Qwest.

The fact that Qwest's language already allows Level 3 to send terminating access traffic over LIS trunks fundamentally undercuts Judge Petrillo's reliance on the supposed limitation of LIS trunks to traffic contemplated by Section 251(c)(2) of the Act. *See* Arbitrator's Decision at 38; see also Exhibit Level 3 / 316 at page 30 (Qwest admits that the Oregon SGAT permits Level 3 to terminate IXC traffic tandem switched by other carriers). The *Local Competition Order* indicates that, while pure IXCs may not use interconnection under Section 251(c)(2) "solely" to terminate their own long distance traffic, they may do so as long as the traffic they send ***includes*** Section 251(c)(2) traffic—specifically, access traffic where another IXC is involved. *Local Competition Order* at ¶¶ 184, 191. Section 251(c)(2) plainly contemplates that a carrier may compete with an ILEC to provide terminating access services to 3rd-party IXCs, and also contemplates that a carrier may ***combine*** its own terminating long distance traffic with traffic from 3rd parties. The supposed Section 252(c)(2) limitation makes no sense when Level 3 is

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already permitted to send unlimited amounts of terminating Feature Group D traffic from 3rd parties over the LIS trunks it obtains from Qwest. To the contrary, as the FCC explained, allowing both access traffic and an IXC's own long distance traffic on a Section 251(c)(2) interconnection enables carriers who might be engaged, in part, in the long distance business to compete against ILECs in the provision of access services. *Id.* at ¶ 184. This is just what Level 3 wants to do.

In short, the arrangement established by Qwest's language is irrational and discriminatory. Level 3 is permitted under the agreement to perform terminating tandem switching for IXCs, so LIS trunks can and will be used by Level 3 to deliver Feature Group D traffic. Allowing Qwest to discriminate against ***Level 3's*** terminating long distance traffic by requiring that traffic alone to be routed on separately established Feature Group D trunks fundamentally makes no sense. The Commission, therefore, should revise the Arbitrator's Decision on this topic to allow ***all*** inbound long distance traffic that Level 3 tandem-switches to be routed to Qwest by means of LIS trunks to appropriate Qwest end offices.

III. CONCLUSION

First, to ensure there is no discrimination in favor of Qwest, the Commission must not adopt the Arbitrator's treatment of VNXX calls to ISPs. Level 3 has provided a reasonable, legal alternative that places the Parties in a similar position. As noted above, on this topic the Commission is in the rate position of having a recent federal circuit court decision that affirmatively approves a particular arrangement that fully addresses the concerns of both parties to this arbitration. There is no reason for the Commission to shy away from following that federal court guidance.

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However, should the Commission approve the recommended decision it will be ordering that an interconnection agreement be established which by its terms is manifestly discriminatory against Level 3. The Arbitrators recommendation demonstrates this anti-competitive discrimination; the Judge in his recommended decision reflects this discrimination; and Qwest has as much admitted this. The Commission, when approving an interconnection agreement, has the affirmative duty to determine that the terms and conditions of the resulting agreement are just, reasonable and nondiscriminatory.[58] With the facts before this Commission, this obligation can not be met by approving the recommended decision as it relates to VNXX traffic. An approval of the Recommended Decision in this regard would, in effect, be tantamount to deciding that the treatment of Level 3 in the face of Qwest's operations and treatment in Oregon—memorialized in the resulting interconnection agreement, was nondiscriminatory. As Judge Petrillo stated, Qwest position is inconsistent; it warrants further Commission inquiry; and the arbitration docket is not the proper forum to conduct that inquiry.[59] How then can the Commission, decide that an interconnection agreement which is to include the terms and conditions Qwest's seeks when the very inquiry that would determine whether Qwest's conduct was discriminatory—and that the Judge says is merited—has not been conducted? It is a logical impossibility.

Accordingly, if the Commission is as yet unwilling to adopt Level 3's proposal, the Commission needs to suspend this aspect of the decision, pending a full inquiry into Qwest's practices and whether or not they constitute discrimination as regards their proposed

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[58] 47 U.S.C § 252(e)(2)(B); 47 USC §251(c)(2)(D).

[59] *See* Arbitrator's Decision at p. 24.

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interconnection agreement. During the pendency of this proceeding, Qwest should be obligated to reserve the amounts that Qwest would be obligated to pay should the inquiry determine that Qwest's practices are truly discriminatory. Second, the Commission should modify the Arbitrator's Decision adopting Qwest's language regarding the use of LIS trunks to terminate long distance calls. It is evident that Judge Petrillo did not realize that the Qwest language he approved ***already permits Level 3 to do this,*** with the sole exception of traffic where Level 3 is the originating IXC. This completely undermines the logic of his ruling.

Finally, while we do not address our other positions in detail here, we urge the Commission to adopt Level 3's proposals on all other disputed issues, based on the briefing and evidence below.

Respectfully submitted this 23rd day of February, 2007.

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Before the
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Washington, D.C. 20554

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

ORDER ON REMAND AND REPORT AND ORDER

Adopted: April 18, 2001 **Released:** April 27, 2001

By the Commission: Chairman Powell issuing a statement; Commissioner Furchtgott-Roth dissenting and issuing a statement.

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I. INTRODUCTION

1. In this Order, we reconsider the proper treatment for purposes of intercarrier compensation of telecommunications traffic delivered to Internet service providers (ISPs). We previously found in the *Declaratory Ruling*[1] that such traffic is interstate traffic subject to the jurisdiction of the Commission under section 201 of the Act[2] and is not, therefore, subject to the reciprocal compensation provisions of section 251(b)(5).[3] The Court of Appeals for the District of Columbia Circuit held on appeal, however, that the *Declaratory Ruling* failed adequately to explain why our jurisdictional conclusion was relevant to the applicability of section 251(b)(5) and remanded the issue for further consideration.[4] As explained in more detail below, we modify the analysis that led to our

[1] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd 3689 (1999) (*Declaratory Ruling* or *Intercarrier Compensation NPRM*).

[2] *See* 47 U.S.C. § 201, Communications Act of 1934 (the Act), as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). Hereinafter, all citations to the Act and to the 1996 Act will be to the relevant section of the United States Code unless otherwise noted.

[3] 47 U.S.C. § 251(b)(5).

[4] *See Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic*).

determination that ISP-bound traffic falls outside the scope of section 251(b)(5) and conclude that Congress excluded from the "telecommunications" traffic subject to reciprocal compensation the traffic identified in section 251(g), including traffic destined for ISPs. Having found, although for different reasons than before, that the provisions of section 251(b)(5) do not extend to ISP-bound traffic, we reaffirm our previous conclusion that traffic delivered to an ISP is predominantly interstate access traffic subject to section 201 of the Act, and we establish an appropriate cost recovery mechanism for the exchange of such traffic.

2. We recognize that the existing intercarrier compensation mechanism for the delivery of this traffic, in which the originating carrier pays the carrier that serves the ISP, has created opportunities for regulatory arbitrage and distorted the economic incentives related to competitive entry into the local exchange and exchange access markets. As we discuss in the *Unified Intercarrier Compensation NPRM,*[5] released in tandem with this Order, such market distortions relate not only to ISP-bound traffic, but may result from any intercarrier compensation regime that allows a service provider to recover some of its costs from other carriers rather than from its end-users. Thus, the *NPRM* initiates a proceeding to consider, among other things, whether the Commission should replace existing intercarrier compensation schemes with some form of what has come to be known as "bill and keep."[6] The *NPRM* also considers modifications to existing payment regimes, in which the calling party's network pays the terminating network, that might limit the potential for market distortion. The regulatory arbitrage opportunities associated with intercarrier payments are particularly apparent with respect to ISP-bound traffic, however, because ISPs typically generate large volumes of traffic that is virtually all one-way -- that is, delivered to the ISP. Indeed, there is convincing evidence in the record that at least some carriers have targeted ISPs as customers merely to take advantage of these intercarrier payments. Accordingly, in this Order we also take interim steps to limit the regulatory arbitrage opportunity presented by ISP-bound traffic while we consider the broader issues of intercarrier compensation in the *NPRM* proceeding.

II. EXECUTIVE SUMMARY

3. As presaged above, we must wrestle with two difficult issues in this Order: first, whether intercarrier compensation for ISP-bound traffic is governed by section 251 or section 201; and, if the latter, what sort of compensation mechanism should apply. The first question is difficult because we do not believe it is resolved by the plain language of section 251(b)(5) but, instead, requires us to consider the relationship of that section to other provisions of the statute. Moreover, we recognize

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[5] Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (rel. April 27, 2001) ("*Unified Intercarrier Compensation NPRM*" or "*NPRM*").

[6] "Bill and keep" refers to an arrangement in which neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers from its own end-users the cost of both originating traffic that it delivers to the other network and terminating traffic that it receives from the other network. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 16045 (1996) (*Local Competition Order*), *aff'd in part and vacated in part sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) (*CompTel*), *aff'd in part and vacated in part sub nom. Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (*Iowa Utils. Bd.*), *aff'd in part and rev'd in part sub nom., AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); Order on Reconsideration, 11 FCC Rcd 13042 (1996); Second Order on Reconsideration, 11 FCC Rcd 19738 (1996); Third Order on Reconsideration and Further Notice of Proposed Rulemaking, 12 FCC Rcd 12460 (1997); *further recon. pending*. Bill and keep does not, however, preclude intercarrier charges for transport of traffic between carriers' networks. *Id.*

the legitimate questions raised by the court with respect to the rationales underlying our regulatory treatment of ISPs and ISP traffic. We seek to respond to those questions in this Order. Ultimately, however, we conclude that Congress, through section 251(g),[7] expressly limited the reach of section 251(b)(5) to exclude ISP-bound traffic. Accordingly, we affirm our conclusion in the *Declaratory Ruling* that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5).

4. Because we determine that intercarrier compensation for ISP-bound traffic is within the jurisdiction of this Commission under section 201 of the Act, it is incumbent upon us to establish an appropriate cost recovery mechanism for delivery of this traffic. Based upon the record before us, it appears that the most efficient recovery mechanism for ISP-bound traffic may be bill and keep, whereby each carrier recovers costs from its own end-users. As we recognize in the *NPRM*, intercarrier compensation regimes that require carrier-to-carrier payments are likely to distort the development of competitive markets by divorcing cost recovery from the ultimate consumer of services. In a monopoly environment, permitting carriers to recover some of their costs from interconnecting carriers might serve certain public policy goals. In order to promote universal service, for example, this Commission historically has capped end-user common line charges and required local exchange carriers to recover any shortfall through per-minute charges assessed on interexchange carriers.[8] These sorts of implicit subsidies cannot be sustained, however, in the competitive markets for telecommunications services envisioned by the 1996 Act. In the *NPRM*, we suggest that, given the opportunity, carriers always will prefer to recover their costs from other carriers rather than their own end-users in order to gain competitive advantage. Thus carriers have every incentive to compete, not on basis of quality and efficiency, but on the basis of their ability to shift costs to other carriers, a troubling distortion that prevents market forces from distributing limited investment resources to their most efficient uses.

5. We believe that this situation is particularly acute in the case of carriers delivering traffic to ISPs because these customers generate extremely high traffic volumes that are entirely one-directional. Indeed, the weight of the evidence in the current record indicates that precisely the types of market distortions identified above are taking place with respect to this traffic. For example, comments in the record indicate that competitive local exchange carriers (CLECs), on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic.[9] Moreover, the traffic imbalances for some competitive carriers are in fact much greater, with several carriers

[7] 47 U.S.C. § 251(g).

[8] Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 15998-99 (1997) (*Access Charge Reform Order*), *aff'd, Southwestern Bell Telephone Co. v. FCC,* 153 F.3d 523 (8th Cir. 1998).

[9] *See, e.g.,* Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet-bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001)(ILECs owed $1.98 billion in reciprocal compensation to CLECs in 2000). On June 23, 2000, the Commission released a Public Notice seeking comment on the issues raised by the court's remand. *See* Comment Sought on Remand of the Commission's Reciprocal Compensation Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit, CC Docket Nos. 96-98, 99-68, Public Notice, 15 FCC Rcd 11311 (2000) (*Public Notice*). Comments and reply comments filed in response to the *Public Notice* are identified herein as "Remand Comments" and "Remand Reply Comments," respectively. Comments and replies filed in response the 1999 *Intercarrier Compensation NPRM* are identified as "Comments" and "Reply Comments," respectively.

terminating more than forty times more traffic than they originate.[10] There is nothing inherently wrong with carriers having substantial traffic imbalances arising from a business decision to target specific types of customers. In this case, however, we believe that such decisions are driven by regulatory opportunities that disconnect costs from end-user market decisions. Thus, under the current carrier-to-carrier recovery mechanism, it is conceivable that a carrier could serve an ISP free of charge and recover all of its costs from originating carriers. This result distorts competition by subsidizing one type of service at the expense of others.

6. Although we believe this arbitrage opportunity is particularly manifest with respect to ISP-bound traffic, we suggest in the *NPRM* that any compensation regime based on carrier-to-carrier payments may create similar market distortions. Accordingly, we initiate an inquiry as to whether bill and keep is a more economically efficient compensation scheme than the existing carrier-to-carrier payment mechanisms. Alternatively, the record developed in that proceeding may suggest modifications to carrier-to-carrier cost recovery mechanisms that address the competitive concerns identified above. Based upon the current record, however, bill and keep appears the preferable cost recovery mechanism for ISP-bound traffic because it eliminates a substantial opportunity for regulatory arbitrage. We do not fully adopt a bill and keep regime in this Order, however, because there are specific questions regarding bill and keep that require further inquiry, and we believe that a more complete record on these issues is desirable before requiring carriers to recover most of their costs from end-users. Because these questions are equally relevant to our evaluation of a bill and keep approach for other types of traffic, we will consider them in the context of the *NPRM*. Moreover, we believe that there are significant advantages to a global evaluation of the intercarrier compensation mechanisms applicable to different types of traffic to ensure a more systematic, symmetrical treatment of these issues.

7. Because the record indicates a need for immediate action with respect to ISP-bound traffic, however, in this Order we will implement an interim recovery scheme that: (i) moves aggressively to eliminate arbitrage opportunities presented by the existing recovery mechanism for ISP-bound by lowering payments and capping growth; and (ii) initiates a 36-month transition towards a complete bill and keep recovery mechanism while retaining the ability to adopt an alternative mechanism based upon a more extensive evaluation in the *NPRM* proceeding. Specifically, we adopt a gradually declining cap on the amount that carriers may recover from other carriers for delivering ISP-bound traffic. We also cap the amount of traffic for which any such compensation is owed, in order to eliminate incentives to pursue new arbitrage opportunities. In sum, our goal in this Order is decreased reliance by carriers upon carrier-to-carrier payments and an increased reliance upon recovery of costs from end-users, consistent with the tentative conclusion in the *NPRM* that bill and keep is the appropriate intercarrier compensation mechanism for ISP-bound traffic. In this regard, we emphasize that the rate caps we impose are not intended to reflect the costs incurred by each carrier that delivers ISP traffic. Some carriers' costs may be higher; some are probably lower. Rather, we conclude, based upon all of the evidence in this record, that these rates are appropriate limits on the amounts recovered from other carriers and provide a reasonable transition from rates that have (at least until recently) typically been much higher. Carriers whose costs exceed these rates are (and will continue to be) able to collect additional amounts from their ISP customers. As we note above, and explain in more detail below, we believe that such end-user recovery likely is the most efficient mechanism.

8. The basic structure of this transition is as follows:

[10] *See, e.g.,* Verizon Remand Comments at 11, 21.

* Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. Any additional costs incurred must be recovered from end-users. These rates reflect the downward trend in intercarrier compensation rates contained in recently negotiated interconnection agreements, suggesting that they are sufficient to provide a reasonable transition from dependence on intercarrier payments while ensuring cost recovery.

* We also impose a cap on total ISP-bound minutes for which a local exchange carrier (LEC) may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation for ISP-bound minutes up to a ceiling equal to the 2002 ceiling. These caps are consistent with projections of the growth of dial-up Internet access for the first two years of the transition and are necessary to ensure that such growth does not undermine our goal of limiting intercarrier compensation and beginning a transition toward bill and keep. Growth above these caps should be based on a carrier's ability to provide efficient service, not on any incentive to collect intercarrier payments.

* Because the transitional rates are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic). The rate caps are designed to provide a transition toward bill and keep, and no transition is necessary for carriers already exchanging traffic at rates below the caps.

* In order to limit disputes and costly measures to identify ISP-bound traffic, we adopt a rebuttable presumption that traffic exchanged between LECs that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic subject to the compensation mechanism set forth in this Order. This ratio is consistent with those adopted by state commissions to identify ISP or other convergent traffic that is subject to lower intercarrier compensation rates. Carriers that seek to rebut this presumption, by showing that traffic above the ratio is not ISP-bound traffic or, conversely, that traffic below the ratio is ISP-bound traffic, may seek appropriate relief from their state commissions pursuant to section 252 of the Act.

* Finally, the rate caps for ISP-bound traffic (or such lower rates as have been imposed by states commissions for the exchange of ISP-bound traffic) apply only if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. An incumbent LEC that does not offer to exchange section 251(b)(5) traffic at these rates must exchange ISP-bound traffic at the state-approved or state-negotiated reciprocal compensation rates reflected in their contracts. The record fails to demonstrate that there are inherent differences between the costs of delivering a voice call to a local end-user and a data call to an ISP, thus the "mirroring" rule we adopt here requires that incumbent LECs pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

III. BACKGROUND

9. In the *Declaratory Ruling* released on February 26, 1999, we addressed the regulatory treatment of ISP-bound traffic. In that order, we reached several conclusions regarding the jurisdictional nature of this traffic, and we proposed several approaches to intercarrier compensation for ISP-bound traffic in an accompanying *Intercarrier Compensation NPRM*. The order, however, was vacated and remanded on appeal.[11] This Order, therefore, again focuses on the regulatory treatment of ISP-bound traffic and the appropriate intercarrier compensation regime for carriers that collaborate to deliver traffic to ISPs.

10. As we noted in the *Declaratory Ruling*, an ISP's end-user customers typically access the Internet through an ISP server located in the same local calling area.[12] Customers generally pay their LEC a flat monthly fee for use of the local exchange network, including connections to their local ISP.[13] They also generally pay their ISP a flat monthly fee for access to the Internet.[14] ISPs then combine "computer processing, information storage, protocol conversion, and routing with transmission to enable users to access Internet content and services."[15]

11. ISPs, one class of enhanced service providers (ESPs),[16] also may utilize LEC services to provide their customers with access to the Internet. In the *MTS/WATS Market Structure Order*, the Commission acknowledged that ESPs were among a variety of users of LEC interstate access services.[17] Since 1983, however, the Commission has exempted ESPs from the payment of certain interstate access charges.[18] Consequently ESPs, including ISPs, are treated as end-users for the

[11] *See Bell Atlantic*, 206 F.3d 1.

[12] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[13] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[14] *Declaratory Ruling*, 14 FCC Rcd at 3691.

[15] *Declaratory Ruling*, 14 FCC Rcd at 3691 (citing Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11531 (1998) (*Universal Service Report to Congress*)).

[16] The Commission defines "enhanced services" as "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." 47 C.F.R. § 64.702(a). The 1996 Act describes these services as "information services." *See* 47 U.S.C. § 153(20) ("information service" refers to the "offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications."). *See also Universal Service Report to Congress*, 13 FCC Rcd at 11516 (the "1996 Act's definitions of telecommunications service and information service essentially correspond to the pre-existing categories of basic and enhanced services").

[17] MTS and WATS Market Structure, CC Docket No. 78-72, Memorandum Opinion and Order, 97 FCC 2d 682, 711 (1983)(*MTS/WATS Market Structure Order)* (ESPs are "[a]mong the variety of users of access service" and "obtain[] local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit [their] location and, commonly, another location.").

[18] This policy is known as the "ESP exemption." *See MTS/WATS Market Structure Order*, 97 FCC 2d at 715 (ESPs have been paying local business service rates for their interstate access and would experience rate shock that could affect their viability if full access charges were instead applied); *see also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket 87-215, Order, 3 FCC Rcd 2631, 2633 (1988) (*ESP Exemption*
(continued….)

purpose of applying access charges and are, therefore, entitled to pay local business rates for their connections to LEC central offices and the public switched telephone network (PSTN).[19] Thus, despite the Commission's understanding that ISPs use *interstate* access services, pursuant to the ESP exemption, the Commission has permitted ISPs to take service under *local* tariffs.

12. The 1996 Act set standards for the introduction of competition into the market for local telephone service, including requirements for interconnection of competing telecommunications carriers.[20] As a result of interconnection and growing local competition, more than one LEC may be involved in the delivery of telecommunications within a local service area. Section 251(b)(5) of the Act addresses the need for LECs to agree to terms for the mutual exchange of traffic over their interconnecting networks. It specifically provides that LECs have the duty to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[21] The Commission determined, in the *Local Competition Order,* that section 251(b)(5) reciprocal compensation obligations "apply only to traffic that originates and terminates within a local area," as defined by state commissions.[22]

13. As a result of this determination, the question arose whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP in the same local calling area that is served by a competing LEC.[23] The Commission determined at that time that resolution of this question turned on whether ISP-bound traffic "originates and terminates within a local area," as set forth in our rule.[24] Many competitive LECs argued that ISP-bound traffic is local traffic

(Continued from previous page)
Order) ("the imposition of access charges at this time is not appropriate and could cause such disruption in this industry segment that provision of enhanced services to the public might be impaired"); *Access Charge Reform Order*, 12 FCC Rcd at 16133 ("[m]aintaining the existing pricing structure … avoids disrupting the still-evolving information services industry").

[19] *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. *See also Access Charge Reform Order*, 12 FCC Rcd at 16133-35.

[20] 47 U.S.C. §§ 251-252.

[21] 47 U.S.C. § 251(b)(5).

[22] *See Local Competition Order*, 11 FCC Rcd at 16013 ("With the exception of traffic to or from a CMRS network, state commissions have the authority to determine what geographic areas should be considered 'local areas' for the purpose of applying reciprocal compensation obligations under section 251(b)(5), consistent with the state commissions' historical practice of defining local service areas for wireline LECs."); *see also* 47 C.F.R. § 51.701(b)(1-2). For CMRS traffic, the Commission determined that reciprocal compensation applies to traffic that originates and terminates within the same Major Trading Area (MTA). *See* 47 C.F.R. § 51.701(b)(2).

[23] *See, e.g.,* Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53922 (1996); Petition for Partial Reconsideration and Clarification of MFS Communications Co., Inc. at 28; Letter from Richard J. Metzger, ALTS, to Regina M. Keeney, Chief, Common Carrier Bureau, FCC (June 20, 1997); Pleading Cycle Established for Comments on Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CCB/CPD 97-30, DA 97-1399 (rel. July 2, 1997); Letter from Edward D. Young and Thomas J. Tauke, Bell Atlantic, to William E. Kennard, Chairman, FCC (July 1, 1998). The Commission later directed parties wishing to make *ex parte* presentations regarding the applicability of reciprocal compensation to ISP-bound traffic to make such filings in CC Docket No. 96-98, the local competition proceeding. *See Ex Parte* Procedures Regarding Requests for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic, CC Docket No. 96-98, Public Notice, 13 FCC Rcd. 15568 (1998).

[24] *Declaratory Ruling*, 14 FCC Rcd at 3693-94.

that terminates at the ISP's local server, where a second, packet-switched "call" then begins.[25] Thus, they argued, the reciprocal compensation obligations of section 251(b)(5) apply to this traffic. Incumbent LECs, on the other hand, argued that no reciprocal compensation is due because ISP-bound traffic is interstate telecommunications traffic that continues through the ISP server and terminates at the remote Internet sites accessed by ISP customers.[26]

14. The Commission concluded in the *Declaratory Ruling* that the jurisdictional nature of ISP-bound traffic should be determined, consistent with Commission precedent, by the end points of the communication.[27] Applying this "end-to-end" analysis, the Commission determined that Internet communications originate with the ISP's end-user customer and continue beyond the local ISP server to websites or other servers and routers that are often located outside of the state.[28] The Commission found, therefore, that ISP-bound traffic is not local because it does not "originate[] and terminate[] within a local area."[29] Instead, it is jurisdictionally mixed and largely interstate, and, for that reason, the Commission found that the reciprocal compensation obligations of section 251(b)(5) do not apply to this traffic.[30]

15. Despite finding that ISP-bound traffic is largely interstate, the Commission concluded that it had not yet established a federal rule to govern intercarrier compensation for this traffic.[31] The Commission found that, in the absence of conflicting federal law, parties could voluntarily include ISP-bound traffic in their interconnection agreements under sections 251 and 252 of the Act.[32] It also found that, even though section 251(b)(5) does not *require* reciprocal compensation for ISP-bound traffic, nothing in the statute or our rules prohibits state commissions from determining in their arbitrations that reciprocal compensation for this traffic is appropriate, so long as there is no conflict with governing federal law.[33] Pending adoption of a federal rule, therefore, state commissions exercising their authority under section 252 to arbitrate, interpret, and enforce interconnection agreements would determine whether and how interconnecting carriers should be compensated for carrying ISP-bound traffic.[34] In

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[25] *Declaratory Ruling,* 14 FCC Rcd at 3694.

[26] *Declaratory Ruling,* 14 FCC Rcd at 3695.

[27] *Declaratory Ruling,* 14 FCC Rcd at 3695-3701; *see also* Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation, Memorandum Opinion and Order, 7 FCC Rcd 1619 (1992) (*BellSouth MemoryCall*), *aff'd, Georgia Pub. Serv. Comm'n v. FCC*, 5 F.3d 1499 (11th Cir. 1993)(table); Teleconnect Co. v. Bell Telephone Co. of Penn., E-88-83, 10 FCC Rcd 1626 (1995) (*Teleconnect*), *aff'd sub nom. Southwestern Bell Tel. Co. v. FCC*, 116 F.3d 593 (D.C. Cir. 1997).

[28] *Declaratory Ruling,* 14 FCC Rcd at 3695-97.

[29] *Declaratory Ruling*, 14 FCC Rcd at 3697.

[30] *Declaratory Ruling,* 14 FCC Rcd at 3690, 3695-3703.

[31] *Declaratory Ruling,* 14 FCC Rcd at 3703.

[32] *Declaratory Ruling,* 14 FCC Rcd at 3703.

[33] *Declaratory Ruling,* 14 FCC Rcd at 3706.

[34] *Declaratory Ruling,* 14 FCC Rcd at 3703-06. The Commission did recognize, however, that its conclusion that ISP-bound traffic is largely interstate might cause some state commissions to re-examine their conclusions that reciprocal compensation is due to the extent that those conclusions were based on a finding that this traffic terminates at the ISP's server. *Id*. at 3706.

the *Intercarrier Compensation NPRM* accompanying the *Declaratory Ruling*, the Commission requested comment on the most appropriate intercarrier compensation mechanism for ISP-bound traffic.[35]

16. On March 24, 2000, prior to release of a decision addressing these issues, the court of appeals vacated certain provisions of the *Declaratory Ruling* and remanded the matter to the Commission.[36] The court observed that, although "[t]here is no dispute that the Commission has historically been justified in relying on this [end-to-end] method when determining whether a particular communication is jurisdictionally interstate,"[37] the Commission had not adequately explained why the jurisdictional analysis was dispositive of, or indeed relevant to, the question whether a call to an ISP is subject to the reciprocal compensation requirements of section 251(b)(5).[38] The court noted that the Commission had not applied its definition of "termination" to its analysis of the scope of section 251(b)(5),[39] and the court distinguished cases upon which the Commission relied in its end-to-end analysis because they involve continuous communications switched by interexchange carriers (IXCs), as opposed to ISPs, the latter of which are not telecommunications providers.[40] As an "independent reason" to vacate, the court also held that the Commission had failed to address how its conclusions "fit . . . within the governing statute."[41] In particular, the court found that the Commission had failed to explain why ISP-bound traffic was not "telephone exchange service," as defined in the Act.[42]

17. In a public notice released June 23, 2000, the Commission sought comment on the issues raised by the court's remand.[43] The *Public Notice* specifically requested that parties comment on the jurisdictional nature of ISP-bound traffic, the scope of the reciprocal compensation requirement of section 251(b)(5), and the relevance of the concepts of "termination," "telephone exchange service," "exchange access service," and "information access."[44] It invited parties to update the record by responding to any *ex parte* presentations filed after the close of the reply period on April 27, 1999. It also sought comment on any new or innovative intercarrier compensation arrangements for ISP-bound traffic that parties may have considered or entered into during the pendency of the proceeding.

[35] *Declaratory Ruling,* 14 FCC Rcd at 3707-09.

[36] *See Bell Atlantic*, 206 F.3d 1.

[37] *Bell Atlantic*, 206 F.3d at 5.

[38] *Bell Atlantic*, 206 F.3d at 5*; see also id*. at 8 (the Commission had not "supplied a real explanation for its decision to treat end-to-end analysis as controlling" with respect to the application of section 251(b)(5)).

[39] *See Bell Atlantic*, 206 F.3d at 6-7.

[40] *See Bell Atlantic*, 206 F.3d at 6-7.

[41] *Bell Atlantic*, 206 F.3d at 8.

[42] *Bell Atlantic*, 206 F.3d at 8-9; 47 U.S.C. § 153(47) (defining "telephone exchange service").

[43] *Public Notice*, 15 FCC Rcd 11311.

[44] *Id.; see also* 47 U.S.C. § 251(g); 47 U.S.C. § 153(20).

IV. DISCUSSION

A. Background

18. The nature and character of communications change over time. Over the last decade communications services have been radically altered by the advent of the Internet and the nature of Internet communications. Indeed, the Internet has given rise to new forms of communications such as e-mail, instant messaging, and other forms of digital, IP-based services. Many of these new services and formats have been layered over and integrated with the existing public telephone systems. Most notably, Internet service providers have come into existence in order to facilitate mass market access to the Internet. A consumer with access to a standard phone line is able to communicate with the Internet, because an ISP converts the analog signal to digital and converts the communication to the IP protocol. This allows the user to access the global Internet infrastructure and communicate with users and websites throughout the world. In a narrowband context, the ISP facilitates access to this global network.

19. The Commission has struggled with how to treat Internet traffic for regulatory purposes, given the bevy of its rules premised on the architecture and characteristics of the mature public switched telephone network. For example, Internet consumers may stay on the network much longer than the design expectations of a network engineered primarily for voice communications. Additionally, the "bursty" nature of packet-switched communications skews the traditional assumptions of per minute pricing to which we are all accustomed. The regulatory challenges have become more acute as Internet usage has exploded.[45]

20. The issue of intercarrier compensation for Internet-bound traffic with which we are presently wrestling is a manifestation of this growing challenge. Traditionally, telephone carriers would interconnect with each other to deliver calls to each other's customers. It was generally assumed that traffic back and forth on these interconnected networks would be relatively balanced. Consequently, to compensate interconnecting carriers, mechanisms like reciprocal compensation were employed, whereby the carrier whose customer initiated the call would pay the other carrier the costs of using its network.

21. Internet usage has distorted the traditional assumptions because traffic to an ISP flows exclusively in one direction, creating an opportunity for regulatory arbitrage and leading to uneconomical results. Because traffic to ISPs flows one way, so does money in a reciprocal compensation regime. It was not long before some LECs saw the opportunity to sign up ISPs as customers and collect, rather than pay, compensation because ISP modems do not generally call anyone in the exchange. In some instances, this led to classic regulatory arbitrage that had two troubling effects: (1) it created incentives for inefficient entry of LECs intent on serving ISPs exclusively and not offering viable local telephone competition, as Congress had intended to facilitate with the 1996 Act; (2) the large one-way flows of cash made it possible for LECs serving ISPs to afford to pay their own customers to use their services, potentially driving ISP rates to consumers to uneconomical levels. These effects prompted the Commission to consider the nature of ISP-bound traffic and to examine whether there was any flexibility under the statute to modify and address the pricing mechanisms for this traffic, given that there is a

[45] *See* Digital Economy 2000, U.S. Department of Commerce (June 2000) ("Three hundred million people now use the Internet, compared to three million in 1994.")

federal statutory provision authorizing reciprocal compensation.[46] In the *Declaratory Ruling,* the Commission concluded that Internet-bound traffic was jurisdictionally interstate and, thus, not subject to section 251(b)(5).

22. In *Bell Atlantic*, the court of appeals vacated the *Declaratory Ruling* and remanded the case to the Commission to determine whether ISP-bound traffic is subject to statutory reciprocal compensation requirements. The court held that the Commission failed to explain adequately why LECs did not have a duty to pay reciprocal compensation under section 251(b)(5) of the Act and remanded the case to the Commission.

B. Statutory Analysis

23. In this section, we reexamine our findings in the *Declaratory Ruling* and conclude that ISP-bound traffic is not subject to the reciprocal compensation requirement in section 251(b) because of the carve-out provision in section 251(g), which excludes several enumerated categories of traffic from the universe of "telecommunications" referred to in section 251(b)(5). We explain our rationale and the interrelationship between these two statutory provisions in more detail below. We further conclude that section 251(i) affirms the Commission's role in continuing to develop appropriate pricing and compensation mechanisms for traffic -- such as Internet-bound traffic -- that travels over convergent, mixed, and new types of network architectures.

1. Introduction

24. In the *Local Competition Order*, the Commission determined that the reciprocal compensation provisions of section 251(b)(5) applied only to what it termed "local" traffic rather than to the transport and termination of interexchange traffic.[47] In the subsequent *Declaratory Ruling,* the Commission focused its discussion on whether ISP-bound traffic terminated within a local calling area such as to be properly considered "local" traffic. To resolve that issue, the Commission focused predominantly on an end-to-end jurisdictional analysis.

25. On review, the court accepted (without necessarily endorsing) the Commission's view that traffic was either "local" or "long distance" but faulted the Commission for failing to explain adequately why ISP-bound traffic was more properly categorized as long distance, rather than local. The Commission had attempted to do so by employing an end-to-end jurisdictional analysis of ISP traffic, rather than by evaluating the traffic under the statutory definitions of "telephone exchange service" and "exchange access." After acknowledging that the Commission "has historically been justified in relying on" end-to-end analysis for determining whether a communication is jurisdictionally interstate, the court stated: "But [the Commission] has yet to provide an explanation of 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."[48] After reviewing the manner in which the Commission analyzed the parameters of section

[46] 47 U.S.C. § 251(b)(5).

[47] *Local Competition Order*, 11 FCC Rcd at 16012.

[48] *Bell Atlantic*, 206 F.3d at 5.

251(b)(5) traffic in the *Declaratory Ruling*, the court found that the central issue was "whether a call to an ISP is local or long distance."[49] The court noted further that "[n]either category fits clearly."[50]

26. Upon further review, we find that the Commission erred in focusing on the nature of the service (*i.e.*, local or long distance) and in stating that there were only two forms of telecommunications services -- telephone exchange service and exchange access -- for purposes of interpreting the relevant scope of section 251(b)(5).[51] Those services are the only two expressly defined by the statute. The court found fault in the Commission's failure to analyze communications delivered by a LEC to an ISP in terms of these definitions.[52] Moreover, it cited the Commission's own confusing treatment of ISP-bound traffic as local under the ESP exemption and interstate for jurisdictional purposes.[53]

27. Part of the ambiguity identified by the court appears to arise from the ESP exemption, a long-standing Commission policy that affords one class of entities using interstate access -- information service providers -- *the option* of purchasing interstate access services on a flat-rated basis from intrastate local business tariffs, rather than from interstate access tariffs used by IXCs. Typically, information service providers have used this exemption to their advantage by choosing to pay local business rates, rather than the tariffed interstate access charges that other users of interstate access are required to pay.[54] In fending off challenges from those who argued that information service providers must be subject to access charges because they provide interexchange service, the Commission has often tried to walk the subtle line of arguing that the service provided by the LEC to the information service provider is an access service, but can justifiably be treated as akin to local telephone exchange service for purposes of the rates the LEC may charge. This balancing act reflected the historical view that there were only two kinds of intercarrier compensation: one for local telephone exchange service, and a second (access charges) for long distance services. Attempting to describe a hybrid service (the nature being an access service, but subject to a compensation mechanism historically limited to local service) was always a bit of mental gymnastics.

28. The court opinion underscores a tension between the jurisdictional nature of ISP-bound traffic, which the Commission has long held to be interstate, and the alternative compensation mechanism that the ESP exemption has permitted for this traffic. The court seems to recognize that, if an end-to-end analysis were properly applied to this traffic, this traffic would be predominantly interstate, and consequently "long distance." Yet it also questions whether this traffic should be considered "local" for purposes of section 251(b)(5) in light of the ESP exemption, by which the Commission has allowed information service providers at their option to be treated for compensation purposes (but *not* for jurisdictional purposes) as end-users.

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[49] *Id.*

[50] *Id*.

[51] *Id.* at 8.

[52] *Id.* at 8-9.

[53] *Id.*

[54] Significantly, however, the compensation mechanism effected for this predominantly interstate access traffic is the result of a federal mandate, which requires states to treat ISP-bound traffic for compensation purposes in a manner similar to local traffic if ISPs so request. *See infra* note 105.

29. The court also expresses consternation over what it perceives as an inconsistency in the Commission's reasoning. On the one hand, the court observes, the Commission has argued that calls to ISPs are predominantly interstate for jurisdictional purposes because they terminate at the ultimate destination of the traffic in a distant website or e-mail server (*i.e.,* the "one call theory"). On the other hand, the court notes, the Commission has defended the ESP exemption by analogizing an ISP to a high-volume business user, such as a pizza parlor or travel agent, that has different usage patterns and longer call holding times than the average customer.[55] The court questioned whether any such differences should not, as some commenters argued, lend support to treating this traffic as "local" for purposes of section 251(b)(5). As discussed in further detail below, while we continue to believe that retaining the ESP exemption is important in order to facilitate growth of Internet services, we conclude in section IV.C.1, *infra*, that reciprocal compensation for ISP-bound traffic distorts the development of competitive markets.

30. We respond to the court's concerns, and seek to resolve these tensions, by reexamining the grounds for our conclusion that ISP-bound traffic falls outside the scope of section 251(b)(5). A more comprehensive review of the statute reveals that Congress intended to exempt certain enumerated categories of service from section 251(b)(5) when the service was provided to interexchange carriers or information service providers. The exemption focuses not only on the nature of the service, but on to whom the service is provided. For services that qualify, compensation is based on rules, regulations, and policies that preceded the 1996 Act and not on section 251(b)(5), which was minted by the Act. As we explain more fully below, the service provided by LECs to deliver traffic to an ISP constitutes, at a minimum, "information access" under section 251(g) and, thus, compensation for this service is not governed by section 251(b)(5), but instead by the Commission's policies for this traffic and the rules adopted under its section 201 authority.[56]

2. Section 251(g) Excludes Certain Categories of Traffic from the Scope of "Telecommunications" Subject to Section 251(b)(5)

a. Background

31. Section 251(b)(5) imposes a duty on all local exchange carriers to "establish reciprocal compensation arrangements for the transport and termination of telecommunications."[57] On its face, local exchange carriers are required to establish reciprocal compensation arrangements for the transport and termination of *all* "telecommunications" they exchange with another telecommunications carrier,

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[55] *Access Charge Reform Order*, 12 FCC Rcd at 16134 ("Internet access does generate different usage patterns and longer call holding times than average voice usage.").

[56] Some critics of the Commission's order may contend that we rely here on the same reasoning that the court rejected in *Bell Atlantic*. We acknowledge that there is a superficial resemblance between the Commission's previous order and this one: Here, as before, the Commission finds that ISP-bound traffic falls outside the scope of section 251(b)(5)'s reciprocal compensation requirement and within the Commission's access charge jurisdiction under section 201(b). The rationale underlying the two orders, however, differs substantially. Here the Commission bases its conclusion that ISP-bound traffic falls outside section 251(b)(5) on its construction of sections 251(g) and (i) -- not, as in the previous order, on the theory that section 251(b)(5) applies only to "local" telecommunications traffic and that ISP-bound traffic is interstate. Furthermore, to the extent the Commission continues to characterize ISP-bound traffic as interstate for purposes of its section 201 authority, it has sought in this Order to address in detail the *Bell Atlantic* court's concerns.

[57] 47 U.S.C. § 251(b)(5).

without exception. The Act separately defines "telecommunications" as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[58]

32. Unless subject to further limitation, section 251(b)(5) would require reciprocal compensation for transport and termination of *all* telecommunications traffic, -- *i.e.*, whenever a local exchange carrier exchanges telecommunications traffic with another carrier. Farther down in section 251, however, Congress explicitly exempts certain telecommunications services from the reciprocal compensation obligations. Section 251(g) provides:

> On or after the date of enactment of the Telecommunications Act of 1996, each local exchange carrier . . . shall provide exchange access, *information access*, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 under any court order, consent decree, or regulation, order, or policy of the [Federal Communications] Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment.[59]

33. The meaning of section 251(g) is admittedly not transparent. Indeed, section 251(g) clouds any plain reading of section 251(b)(5). Nevertheless, the Commission believes the two provisions can be read together consistently and in a manner faithful to Congress's intent.[60]

b. Discussion

34. We conclude that a reasonable reading of the statute is that Congress intended to exclude the traffic listed in subsection (g) from the reciprocal compensation requirements of subsection (b)(5).[61] Thus, the statute does not mandate reciprocal compensation for "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers. Because we interpret subsection (g) as a carve-out provision, the focus of our inquiry is on the universe of traffic that falls within subsection (g) and *not* the universe of traffic that falls within subsection (b)(5). This analysis differs from our analysis in the *Local Competition Order*, in which we attempted to

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[58] 47 U.S.C. § 153(43).

[59] 47 U.S.C. § 251(g) (emphasis added).

[60] *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999)("It would be a gross understatement to say that the Telecommunications Act of 1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction. . . . But Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency. . . . We can only enforce the clear limits that the 1996 Act contains.").

[61] In the *Declaratory Ruling*, the Commission did not explain the relevance of section 251(g) nor discuss the categories of traffic exempted from reciprocal compensation by that provision, at least until the Commission should act otherwise. Reflecting this omission in the underlying order, the *Bell Atlantic* court does not mention the relationship of sections 251(g) and 251(b)(5), nor the enumerated categories of services referenced by subsection (g). Rather, the court focuses its review on the possible categorization of ISP-bound traffic as "local," terminology we now find inappropriate in light of the more express statutory language set forth in section 251(g).

describe the universe of traffic that falls within subsection (b)(5) as all "local" traffic. We also refrain from generically describing traffic as "local" traffic because the term "local," not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g).

35. We agree with the court that the issue before us requires more than just a jurisdictional analysis. Indeed, as the court recognized, the 1996 Act changed the historic relationship between the states and the federal government with respect to pricing matters.[62] Instead, we focus upon the statutory language of section 251(b) as limited by 251(g). We believe this approach is not only consistent with the statute, but that it resolves the concerns expressed by the court in reviewing our previous analysis. Central to our modified analysis is the recognition that 251(g) is properly viewed as a limitation on the scope of section 251(b)(5) and that ISP-bound traffic falls under one or more of the categories set forth in section 251(g). For that reason, we conclude that ISP-bound traffic is not subject to the reciprocal compensation provisions of section 251(b)(5). We reach that conclusion regardless of the compensation mechanism that may be in place for such traffic under the ESP exemption.

36. We believe that the specific provisions of section 251(g) demonstrate that Congress did not intend to interfere with the Commission's pre-Act authority over "nondiscriminatory interconnection . . . obligations (including receipt of compensation)"[63] with respect to "exchange access, information access, and exchange services for such access" provided to IXCs or information service providers. We conclude that Congress specifically exempted the services enumerated under section 251(g) from the newly imposed reciprocal compensation requirement in order to ensure that section 251(b)(5) is not interpreted to override either existing or future regulations prescribed by the Commission.[64] We also find that ISP-bound traffic falls within at least one of the three enumerated categories in subsection (g).

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[62] *Bell Atlantic*, 206 F.3d at 6; *see also AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. at 377-87.

[63] Authority over rates (or "receipt of compensation") is a core feature of "equal access and nondiscriminatory interconnection" obligations. Indeed, one of the Commission's primary goals when designing an access charge regime was to ensure that access users were treated in a nondiscriminatory manner when interconnecting with LEC networks in order to transport interstate communications. *See National Ass'n of Regulatory Util. Comm'nrs v. FCC*, 737 F.2d 1095, 1101-1108, 1130-34 (D.C. Cir. 1984), *cert. denied,* 469 U.S. 1227 (1985)(*NARUC v. FCC*).

[64] This view is consistent with previous Commission orders construing section 251(g). The Commission recognized in the *Advanced Services Remand Order*, for example, that section 251(g) preserves the requirements of the AT&T Consent Decree (*see United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982)(hereinafter AT&T Consent Decree or Modification of Final Judgment ("MFJ"), but that order does not conclude that section 251(g) preserves *only* MFJ requirements. Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147 et al., Order on Remand, 15 FCC Rcd 385, 407 (1999)(*Advanced Services Remand Order*). Indeed, the ultimate issue addressed in that part of the order was *not* the status or scope of section 251(g) as a carve-out provision at all, but rather the question -- irrelevant for our purposes here -- whether "information access" is a category of service that is mutually exclusive of "exchange access," as the latter term is defined in section 3(16) of the Act. *See id.* at 407-08; *see also infra* para. 42 & note 76. By contrast, when the Commission first addressed the scope of the reciprocal compensation obligations of section 251(b)(5) in the *Local Competition Order*, it expressly cited section 251(g) in support of the decision to exempt from those obligations the tariffed interstate access services provided by all LECs (not just Bell companies subject to the MFJ) to interexchange carriers. 11 FCC Rcd at 16013. The *Bell Atlantic* court did not take issue with the Commission's earlier conclusion that section 251(b)(5) is so limited. 206 F.3d at 4. The interpretation we adopt here -- that section 251(g) exempts from section 251(b)(5) information access services provided to information service providers, as well as access provided to IXCs – thus is fully consistent with the Commission's initial construction of section 251(g), in the *Local Competition Order,* as extending beyond the MFJ to *our own* access rules and policies.

37. This limitation in section 251(g) makes sense when viewed in the overall context of the statute. All of the services specified in section 251(g) have one thing in common: they are all access services or services associated with access.[65] Before Congress enacted the 1996 Act, LECs provided access services to IXCs and to information service providers in order to connect calls that travel to points – both interstate and intrastate – beyond the local exchange. In turn, both the Commission and the states had in place access regimes applicable to this traffic, which they have continued to modify over time. It makes sense that Congress did not intend to disrupt these pre-existing relationships.[66] Accordingly, Congress excluded all such access traffic from the purview of section 251(b)(5).

38. At least one court has already affirmed the principle that the standards and obligations set forth in section 251 are not intended automatically to supersede the Commission's authority over the services enumerated under section 251(g). This question arose in the Eighth Circuit Court of Appeals with respect to the access that LECs provide to IXCs to originate and terminate interstate long-distance calls. Citing section 251(g), the court concluded that the Act contemplates that "LECs will continue to provide exchange access to IXCs for long-distance service, and continue to receive payment, under the *pre-Act* regulations and rates."[67] In *CompTel,* the IXCs had argued that the interstate access services that LECs provide properly fell within the scope of "interconnection" under section 251(c)(2), and that, notwithstanding the carve-out of section 251(g), access charges therefore should be governed by the cost-based standard of section 252(d)(1), rather than determined under the Commission's section 201 authority. The Eighth Circuit rejected that argument, holding that access service does not fall within the scope of section 251(c)(2), and observing that "it is clear from the Act that Congress did *not* intend all access charges to move to cost-based pricing, at least not immediately."[68] Neither the court nor the parties in *CompTel* distinguished between the situation in which *one LEC* provides access service (directly linking the end-user to the IXC) and the situation here in which *two LECs* collaborate to provide access to either an information service provider or IXC. In both circumstances, by its

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[65] The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ. Rather, the term "exchange service" is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purpose of originating or terminating interexchange telecommunications." *United States v. AT&T*, 552 F. Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. Consistent with that, in section 251(g), the term is used as part of the longer phrase "exchange services for such [exchange] access to interexchange carriers and information service providers." The phrasing in section 251(g) thus parallels the MFJ. All of this indicates that the term "exchange service" is closely related to the provision of exchange access and information access.

[66] Although section 251(g) does not itself compel this outcome with respect to *intrastate* access regimes (because it expressly preserves only *the Commission's* traditional policies and authority over *interstate* access services), it nevertheless highlights an ambiguity in the scope of "telecommunications" subject to section 251(b)(5) -- demonstrating that the term must be construed in light of other provisions in the statute. In this regard, we again conclude that it is reasonable to interpret section 251(b)(5) to exclude traffic subject to parallel intrastate access regulations, because "it would be incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms." *Local Competition Order*, 11 FCC Rcd at 15869.

[67] *CompTel*, 117 F.3d at 1073 (emphasis added). The court continued that the Commission would be free under section 201 to alter its traditional regulatory treatment of interstate access service in the future, but that the standards set out in sections 251 and 252 would *not* be controlling. *Id.*

[68] *CompTel*, 117 F.3d at 1072 (emphasis added).

underlying rationale, *CompTel* serves as precedent for establishing that pre-existing regulatory treatment of the services enumerated under section 251(g) are carved out from the purview of section 251(b).

39. Accordingly, unless 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). These services thus remain subject to Commission jurisdiction under section 201 (or, to the extent they are *intra*state services, they remain subject to the jurisdiction of state commissions), whether those obligations implicate pricing policies as in *CompTel* or reciprocal compensation. [69] This analysis properly applies to the access services that incumbent LECs provide (either individually or jointly with other local carriers) to connect subscribers with ISPs for Internet-bound traffic. Section 251(g) expressly preserves the Commission's rules and policies governing "access . . . to information service providers" in the same manner as rules and policies governing access to IXCs.[70] As we discuss in more detail below, ISP-bound traffic falls under the rubric of "information access," a legacy term carried over from the MFJ.[71]

40. By its express terms, of course, section 251(g) permits the Commission to supersede pre-Act requirements for interstate access services. Therefore the Commission may make an affirmative determination to adopt rules that subject such traffic to obligations different than those that existed pre-Act. For example, consistent with that authority, the Commission has previously made the affirmative determination that certain categories of interstate access traffic should be subject to section 251(c)(4).[72] Similarly, in implementing section 251(c)(3), the Commission has required incumbent

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[69] For further discussion of the jurisdictionally interstate nature of ISP-bound traffic, *see infra* paras. 55-64. *See also NARUC v. FCC*, 737 F.2d at 1136 (determining that traffic to ESPs may properly constitute interstate access traffic); Access Billing Requirements for Joint Service Provision, CC Docket 87-579, Memorandum Opinion and Order, 4 FCC Rcd 7183 (1989).

[70] The Commission has historically dictated the pricing policies applicable to services provided by LECs to information service providers, although those policies differ from those applicable to LEC provision of access services to IXCs. Prior to the 1996 Act, it was the Commission that determined that ESPs either may purchase their interstate access services from interstate tariffs or (at their discretion) pay a combination of local business line rates, the *federal* subscriber line charges associated with those business lines, and, where appropriate, the *federal* special access surcharge. *See* note 105, *infra*. We conclude that section 251(g) preserves our ability to continue to dictate the pricing policies applicable to this category of traffic. We do not believe, moreover, that section 251(g) extends only to those specific carriers providing service on February 7, 1996. At the very least, subsection (g) is ambiguous on this point. On the one hand, the first sentence of this provision states that its terms apply to "each local exchange carrier, to the extent that it provides wireline services," without regard to whether it may be a BOC or a competitive LEC. 47 U.S.C. § 251(g). On the other hand, that same sentence refers to restrictions and obligations applicable to "such carrier" prior to February 8, 1996. *Id.* We believe that the most reasonable interpretation of that sentence, in this context, is that subsection (g) was intended to preserve pre-existing regulatory treatment for the enumerated *categories* of carriers, rather than requiring disparate treatment depending upon whether the LEC involved came into existence before or after February 1996.

[71] *See United States v. AT&T,* 552 F. Supp. at 229; *Advanced Services Remand Order*, 15 FCC Rcd at 406-08.

[72] *See* Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, Second Report and Order, 14 FCC Rcd 19237 (1997), *petition for review pending*, *Ass'n of Communications Enterprises v. FCC*, D.C. Circuit No. 00-1144. In effect, we have provided for concurrent authority under that provision and section 201 by permitting a party to purchase the same service under filed tariffs or to proceed under interconnection arrangements to secure resale services.

LECs to unbundle certain network elements used in the provision of xDSL-based services.[73] In this instance, however, for the reasons set forth below,[74] we decline to modify the restraints imposed by section 251(g) and instead continue to regulate ISP-bound traffic under section 201.

41. Some may argue that, although the Commission did not analyze subsection (g) in the *Declaratory Ruling,* a passing reference to section 251(g) in one paragraph of the Commission's brief filed with the court in that proceeding suggests that the argument we make here has been specifically rejected by the court. We disagree. Because our analysis of subsection (g) was not raised in the order, the court, under established precedent, probably did not consider the argument when rendering its decision.[75] Indeed, subsection (g) is not mentioned in the court's opinion.

3. ISP-Bound Traffic Falls within the Categories Enumerated in Section 251(g)

42. Having determined that section 251(g) serves as a limitation on the scope of "telecommunications" embraced by section 251(b)(5), the next step in our inquiry is to determine whether ISP-bound traffic falls within one or more of the categories specified in section 251(g): exchange access, information access, and exchange services for such access provided to IXCs and information service providers. Regardless of whether this traffic falls under the category of "exchange access" -- an issue pending before the D.C. Circuit in a separate proceeding[76] - - we conclude that this traffic, at a minimum, falls under the rubric of "information access," a legacy term imported into the 1996 Act from the MFJ, but not expressly defined in the Communications Act.

a. Background

43. Section 251(g) by its terms indicates that, in the provision of exchange access, information access, and exchange services for such access to IXCs and information service providers, various pre-existing requirements and obligations "including receipt of compensation" are preserved, whether these obligations stem from "any court order, *consent decree*, or regulation, order or policy of the Commission." (Emphasis added.) Similarly, in discussing this provision, the Joint Explanatory

[73] *See* Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3775 (1999). *See also Advanced Services Remand Order,* 15 FCC Rcd at 385, 386. We emphasize that these two examples are illustrative and may not be the only instances where the Commission chooses to supersede pre-Act requirements for interstate access services.

[74] *See infra* paras. 67-71.

[75] *See, e.g., SEC v. Chenery Corp*., 318 U.S. 80, 88 (1943).

[76] *See Worldcom, Inc. v. FCC*, No. 00-1022 et al. (D.C. Cir.). In that proceeding, the Commission has argued that the category previously labeled "information access" under the MFJ is a subset of those services now falling under the category "exchange access" as set forth in section 3(16) of the Act, 47 U.S.C. 153(16), while incumbent LECs and others have argued that the two categories are mutually exclusive. We need not reargue here whether "information access" is a subset of "exchange access" or whether instead they are mutually exclusive categories. The only issue relevant to our section 251(g) inquiry in this case is whether ISP-bound traffic falls, at a minimum, within the legacy category of "information access." Both the Commission and incumbent LECs have agreed that the access provided to ISPs satisfies the definition of information access.

Statement of the Committee of Conference explicitly refers to preserving the obligations under the "AT&T Consent Decree."[77]

b. Discussion

44. We conclude that Congress's reference to "information access" in section 251(g) was intended to incorporate the meaning of the phrase "information access" as used in the AT&T Consent Decree.[78] The ISP-bound traffic at issue here falls within that category because it is traffic destined for an information service provider.[79] Under the consent decree, "information access" was purchased by "information service providers" and was defined as "the provision of specialized exchange telecommunications services . . . in connection with the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services."[80] We conclude that this definition of "information access" was meant to include all access traffic that was routed by a LEC "to or from" providers of information services, of which ISPs are a subset.[81] The record in this proceeding also supports our interpretation.[82] When Congress passed the 1996 Act, it adopted new terminology. The term "information access" is not, therefore, part of the new statutory framework. Because the legacy term "information access" in section 251(g) encompasses

[77] *Joint Explanatory Statement of the Committee of Conference*, S. Conf. Rep. No. 230, 104th Cong., 2d Session at 123 (February 1, 1996).

[78] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[79] *See* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000)(stating that section 251(g) applies by its very terms to "information access").

[80] *United States v. AT&T*, 552 F. Supp. at 196, 229.

[81] This finding is consistent with our past statements on the issue. In the *Non-Accounting Safeguards Order*, we found that the access that LECs provide to enhanced service providers, including ISPs, constitutes "information access" as the MFJ defines that term. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 22024 & n.621 (1996). Although we subsequently overruled our statement in that order that ISPs do not also purchase "exchange access" under section 3(16), we have not altered our finding that the access provided to enhanced service providers (including ISPs) is "information access." *Advanced Services Remand Order*, 15 FCC Rcd at 404-05.

[82] *See, e.g.,* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 9 (Dec. 14, 2000). Some have argued that "information access" includes only certain specialized functions unique to the needs of enhanced service providers and does not include basic telecommunications links used to provide enhanced service providers with access to the LEC network. *See, e.g.,* Brief of WorldCom, Inc., D.C. Circuit No. 00-1002, *et al.*, filed Oct. 3, 2000, at 16 n.12. The MFJ definition of information access, however, includes the telecommunications links used for the "origination, termination, [and] transmission" of information services, *and* "*where necessary*, the provision of network signalling" and other functions. *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Others have argued that the "information access" definition engrafts a geographic limitation that renders this service category a subset of telephone exchange service. *See* Letter from Richard Rindler, Swindler, Berlin, to Magalie Roman Salas, Secretary, FCC, at 3 (Apr. 12, 2001). We reject that strained interpretation. Although it is true that "information access" is necessarily initiated "in an exchange area," the MFJ definition states that the service is provided "*in connection with* the origination, termination, transmission, switching, forwarding or routing of telecommunications traffic to or from the facilities of a provider of information services" *United States v. AT&T*, 552 F. Supp. at 229 (emphasis added). Significantly, the definition does not further require that the transmission, once handed over to the information service provider, terminate within the same exchange area in which the information service provider first received the access traffic.

ISP-bound traffic, however, this traffic is excepted from the scope of the "telecommunications" subject to reciprocal compensation under section 251(b)(5).

45. We recognize, as noted earlier, that based on the rationale of the *Declaratory Ruling*, the court indicated that the question whether this traffic was "local or interstate" was critical to a determination of whether ISP-bound traffic should be subject to reciprocal compensation.[83] We believe that the court's assessment was a result of our statement in paragraph nine of the *Declaratory Ruling* that "when two carriers collaborate to complete a *local call*, the originating carrier is compensated by its end user and the terminating carrier is entitled to reciprocal compensation pursuant to section 251(b)(5) of the Act."[84] We were mistaken to have characterized the issue in that manner, rather than properly (and more naturally) interpreting the scope of "telecommunications" within section 251(b)(5) as being limited by section 251(g). By indicating that all "local calls," however defined, would be subject to reciprocal compensation obligations under the Act, we overlooked the interplay between these two inter-related provisions of section 251 -- subsections (b) and (g). Further, we 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. In the context of ISP-bound traffic, as the court observed, our use of the term "local" created a tension that undermined the prior order because the ESP exemption permitted ISPs to purchase access through local business tariffs,[85] yet the jurisdictional nature of this traffic has long been recognized as interstate.

46. For similar reasons, we modify our analysis and conclusion in the *Local Competition Order*.[86] There we held that "[t]ransport and termination of *local* traffic for purposes of reciprocal compensation are governed by sections 251(b)(5) and 251(d)(2)." We now hold that the telecommunications subject to those provisions are all such telecommunications not excluded by section 251(g). 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.

47. We note that the exchange of traffic between LECs and commercial mobile radio service (CMRS) providers is subject to a slightly different analysis. In the *Local Competition Order,* the Commission noted its jurisdiction to regulate LEC-CMRS interconnection under section 332 of the Act[87] but decided, at its option, to apply sections 251 and 252 to LEC-CMRS interconnection.[88] At that time, the Commission declined to delineate the precise contours of or the relationship between its jurisdiction over LEC-CMRS interconnection under sections 251 and 332,[89] but it made clear that it

[83] *Bell Atlantic*, 206 F.3d at 5.

[84] *Declaratory Ruling*, 14 FCC Rcd at 3695 (emphasis added).

[85] This is the compensation mechanism chosen by the ISPs. *See* note 105, *infra*.

[86] *Local Competition Order*, 11 FCC Rcd at 1033-34.

[87] 47 U.S.C. § 332; *Local Competition Order*, 11 FCC Rcd at 16005-06.

[88] *Local Competition Order*, 11 FCC Rcd at 16005-06; *see also Iowa Utils. Bd. v. FCC*, 120 F.3d at 800 n. 21 (finding that the Commission had jurisdiction under section 332 to issue rules regarding LEC-CMRS interconnection, including reciprocal compensation rules).

[89] We seek comment on these issues in the *NPRM*.

was not rejecting section 332 as an independent basis for jurisdiction.[90] The Commission went on to conclude that section 251(b)(5) obligations extend to traffic transmitted between LECs and CMRS providers, because the latter are telecommunications carriers.[91] The Commission also held that reciprocal compensation, rather than interstate or intrastate access charges, applies to LEC-CMRS traffic that originates and terminates within the same Major Trading Area (MTA).[92] In so holding, the Commission expressly relied on its "authority under section 251(g) to preserve the current interstate access charge regime" to ensure that interstate access charges would be assessed only for traffic "currently subject to interstate access charges,"[93] although the Commission's section 332 jurisdiction could serve as an alternative basis to reach this result. Thus the analysis we adopt in this Order, that section 251(g) limits the scope of section 251(b)(5), does not affect either the application of the latter section to LEC-CMRS interconnection or our jurisdiction over LEC-CMRS interconnection under section 332.

4. Section 251(i) Preserves the Commission's Authority to Regulate Interstate Access Services

48. Congress also included a "savings provision" – subpart (i) – in section 251, which provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[94] Under section 201, the Commission has the authority to regulate the *interstate* access services that LECs provide to connect end-users with IXCs or information service providers to originate and terminate calls that travel across state lines.

49. We conclude that subpart (i) provides additional support for our finding that Congress has granted us the authority on a going-forward basis to establish a compensation regime for ISP-bound traffic.[95] 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.

50. When viewed in the overall context of section 251, subsections (g) and (i) serve compatible, but different, purposes. Subsection (g) preserves rules and regulations that existed at the time Congress passed the 1996 Act, and thus functions primarily as a "backward-looking" provision (although it does grant the Commission the authority to supersede existing regulations). In contrast, we interpret section 251(i) to be a "forward-looking" provision. 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

[90] *Local Competition Order*, 11 FCC Rcd at 16005.

[91] *Id*. at 16016.

[92] *Id.* at 16016-17.

[93] *Id.* at 16017.

[94] 47 U.S.C. § 251(i).

[95] *See also* Letter from Gary L. Phillips, SBC, to Jon Nuechterlein, Deputy General Counsel, FCC, at 8 (Dec. 14, 2000).

that falls within the purview of section 201. This reading of section 251 is consistent with the notion that section 251 generally broadens the Commission's duties, particularly in the pricing context.[96]

51. We expect that, as new network architectures emerge, the nature of telecommunications traffic will continue to evolve. As we have already observed, since Congress passed the 1996 Act, customer usage patterns have changed dramatically; carriers are sending traffic over networks in new and different formats; and manufacturers are adding creative features and developing innovative network architectures. Although we cannot anticipate the direction that new technology will take us, we do expect the dramatic pace of change to continue. Congress clearly did not expect the dynamic, digital broadband driven telecommunications marketplace to be hindered by rules premised on legacy networks and technological assumptions that are no longer valid. Section 251(i), together with section 201, equips the Commission with the tools to ensure that the regulatory environment keeps pace with innovation.

5. ISP-Bound Traffic Falls Within the Purview of the Commission's Section 201 Authority

52. Having found that ISP-bound traffic is excluded from section 251(b)(5) by section 251(g), we find that the Commission has the authority pursuant to section 201 to establish rules governing intercarrier compensation for such traffic. Under section 201, the Commission has long exercised its *jurisdictional* authority to regulate the interstate access services that LECs provide to connect callers with IXCs or ISPs to originate or terminate calls that travel across state lines. Access services to ISPs for Internet-bound traffic are no exception. The Commission has held, and the Eighth Circuit has recently concurred, that traffic bound for information service providers (including Internet access traffic) often has an interstate component.[97] Indeed, that court observed that, although some traffic destined for information service providers (including ISPs) may be intrastate, the interstate and intrastate components cannot be reliably separated.[98] Thus, ISP traffic is properly classified as interstate,[99] and it falls under the Commission's section 201 jurisdiction.[100]

53. In its opinion remanding this proceeding, the court appeared to acknowledge that the end-to-end analysis was appropriate for determining the scope of the Commission's jurisdiction under section 201, stating that "[t]here is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[101] The court nevertheless found that we had not supplied a logical nexus between the jurisdictional end-to-end analysis (which delineates the contours of our section 201 authority) and our

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[96] For example, section 251 has expanded upon our historic functions by providing us with the authority to set the framework for pricing rules applicable to unbundled network elements, purchased under interconnection agreements.

[97] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 543 (8th Cir. 1998) (affirming the jurisdictionally mixed nature of ISP-bound traffic).

[98] *Id*.

[99] *See, e.g., Louisiana PSC v. FCC*, 476 U.S. 355, 375 n.4.

[100] *See* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC (Dec. 8, 2000)(attaching *A Legal Roadmap for Implementing a Bill and Keep Rule for All Wireline Traffic*, at 10-11)(*Qwest Roadmap)*.

[101] *Bell Atlantic*, 206 F.3d at 5; *see Qwest Roadmap* at 4.

interpretation of the scope of section 251(b)(5). In that regard, the court appeared not to question the Commission's longstanding assertion of jurisdiction over ESP traffic, of which Internet-bound traffic is a subset.[102] It did, however, unambiguously question whether, for purposes of interpreting section 251(b)(5), the jurisdictional end-to-end analysis was dispositive. Accordingly, the court explained its basis for remand as follows: "Because the Commission has not supplied a real explanation for its decision to treat end-to-end analysis as controlling [in interpreting the scope of section 251(b)(5)] . . . we must vacate the ruling and remand the case."[103]

54. As explained above, we no longer construe section 251(b)(5) using the dichotomy set forth in the *Declaratory Ruling* between "local" traffic and interstate traffic. Rather, we have clarified that the proper analysis hinges on section 251(g), which limits the reach of the reciprocal compensation regime mandated in section 251(b). Thus our discussion no longer centers on the jurisdictional inquiry set forth in the underlying order. Nonetheless, we take this opportunity to respond to questions raised by the court regarding the differences between ISP-bound traffic (which we have always held to be predominantly interstate for jurisdictional purposes) and intrastate calls to "communications-intensive business end user[s],"[104] such as travel agencies and pizza parlors.

55. Contrary to the arguments made by some IXCs, the Commission has been consistent in its jurisdictional treatment of ISP-bound traffic. For compensation purposes, in order to create a regulatory environment that will allow new and innovative services to flourish, the Commission has exempted enhanced service providers (including ISPs) from paying for interstate access service at the usage-based rates charged to IXCs.[105] The ESP exemption was and remains an affirmative *exercise* of federal regulatory authority over interstate access service under section 201, and, in affirming pricing under that exemption, the D.C. Circuit expressly recognized that ESPs use *interstate* access service.[106] Moreover, notwithstanding the ESP exemption, the Commission has always *permitted* enhanced service providers, including ISPs, to purchase their interstate access out of interstate tariffs -- thus

[102] The D.C. Circuit itself has long recognized that ESPs use interstate access. *See, e.g., NARUC v. FCC*, 737 F.2d at 1136.

[103] *Bell Atlantic*, 206 F.3d. at 8.

[104] *Bell Atlantic,* 206 F.3d at 7.

[105] As noted, the Commission has permitted ESPs to pay local business line rates from intrastate tariffs for ILEC-provided access service, in lieu of interstate carrier access charges. *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 715; *ESP Exemption Order*, 3 FCC Rcd at 2635 n.8, 2637 n.53. ESPs also pay the *federal* subscriber lines charges associated with those business lines and, where appropriate, the *federal* special access surcharge. The subscriber line charge (SLC) recovers a portion of the cost of a subscriber's line that is allocated, pursuant to jurisdictional separations, to the interstate jurisdiction. *See* 47 C.F.R. § 69.152 (defining SLC); 47 C.F.R. Part 36 (jurisdictional separations). The special access surcharge recovers for use of the local exchange when private line/PBX owners "circumvent the conventional long-distance network and yet achieve interstate connections beyond those envisioned by the private line service." *NARUC v. FCC,* 737 F.2d at 1138. *See* 47 C.F.R. § 69.115.

[106] With judicial approval, the Commission initially adopted this access service pricing policy in order to avoid rate shock to a fledgling enhanced services industry. *NARUC v. FCC*, 737 F.2d at 1136-37. In the decision affirming this pricing policy, the court expressly recognized that ESPs use interstate access service. *Id.* at 1136 (enhanced service providers "may, at times, heavily use exchange access"). The Commission recently decided to retain this policy, largely because it found that it made little sense to mandate, for the first time, the application of existing non-cost-based interstate access rates to enhanced services just as the Commission was reforming the access charge regime to eliminate implicit subsidies and to move such charges toward competitive levels. *Access Charge Reform Order*, 12 FCC Rcd at 16133, *aff'd*, *Southwestern Bell Telephone Co*., 153 F.3d at 541-42.

underscoring the Commission's consistent view that the link LECs provide to connect subscribers with ESPs is an interstate access service.[107]

56. We do not believe that the court's decision to remand the *Declaratory Ruling* reflects a finding that such traffic constitutes two calls, rather than a single end-to-end call, for jurisdictional purposes. The court expressly acknowledged that "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."[108] The court also said that "[t]here is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate."[109] And the court appeared to suggest, at least for the sake of argument, that the Commission had not misapplied that analysis *as a jurisdictional matter* in finding that ISP-bound traffic was interstate.[110] We do recognize, however, that the court was concerned by how one would categorize this traffic under our *prior* interpretation of section 251(b)(5), which focused on whether or not ISP-bound calls were "local." That inquiry arguably implicated the compensation mechanism for the traffic (which included a local component), as well as the meaning of the term "termination" in the specific context of section 251(b); but neither of these issues is germane to our assertion of jurisdiction here under our section 201 authority.

57. For jurisdictional purposes, the Commission views LEC-provided access to enhanced services providers, including ISPs, on the basis of the end points of the communication, rather than intermediate points of switching or exchanges between carriers (or other providers).[111] Thus, in the *ONA Plans Order*, the Commission emphasized that "when an enhanced service is interstate (that is, when it involves communications or transmissions between points in different states on an end-to-end basis), the underlying basic services are subject to [our jurisdiction]."[112] Consistent with that view, when end-to-end communications involving enhanced service providers cross state lines, the Commission has categorized the link that the LEC provides to connect the end-user with an enhanced service provider as interstate access service.[113] Internet service providers are a class of ESPs.

[107] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711-12, 722; Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Memorandum Opinion and Order, 4 FCC Rd 1, 141 (1988), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993) (*ONA Plans Order*); GTE Telephone Operating Cos., CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466 (1998).

[108] *Bell Atlantic*, 206 F.3d at 3.

[109] *Id. at 5.*

[110] *See, e.g., id.* at 6, 7 (accepting, *arguendo*, that ISP-bound traffic is like IXC-bound traffic for jurisdictional purposes).

[111] *See, e.g., BellSouth MemoryCall*, 7 FCC Rcd at 1620 (voicemail is interstate because "there is a continuous path of communications across state line between the caller and the voice mail service"); *ONA Plans Order,* 4 FCC Rcd at 141 (an enhanced service is subject to FCC authority if it is interstate, "that is, when it involves communications or transmissions between points in different states on an end-to-end basis").

[112] *ONA Plans Order*, 4 FCC Rcd at 141; *see also id.,* Memorandum Opinion and Order on Reconsideration, 5 FCC Rcd 3084, 3088-89 (1990), *aff'd, California v. FCC*, 4 F.3d 1505 (9th Cir. 1993)(rejecting claim that basic service elements, consisting of features and functions provided by telephone company's local switch for benefit of enhanced service providers and others, are separate *intra*state offerings even when used in connection with end-to-end transmissions).

[113] *See, e.g., MTS/WATS Market Structure Order*, 97 FCC 2d at 711 ("[a]mong the variety of users of access service are … enhanced service providers"); Amendment of Part 69 of the Commission's Rules Relating to Enhanced Service (continued….)

Accordingly, the LEC-provided link between an end-user and an ISP is properly characterized as *interstate* access.[114]

58. Most Internet-bound traffic traveling between a LEC's subscriber and an ISP is indisputably interstate in nature when viewed on an end-to-end basis. Users on the Internet are interacting with a global network of connected computers. The consumer contracts with an ISP to provide access to the Internet. Typically, when the customer wishes to interact with a person, content, or computer, the customer's computer calls a number provided by the ISP that is assigned to an ISP modem bank. The ISP modem answers the call (the familiar squelch of computers handshaking). The user initiates a communication over the Internet by transmitting a command. In the case of the web, the user requests a webpage. This request may be sent to the computer that hosts the webpage. In real time, the web host may request that different pieces of that webpage, which can be stored on different servers across the Internet, be sent, also in real time, to the user. For example, on a sports page, only the format of the webpage may be stored at the host computer in Chicago. The advertisement may come from a computer in California (and it may be a different advertisement each time the page is requested), the sports scores may come from a computer in New York City, and a part of the webpage that measures Internet traffic and records the user's visit may involve a computer in Virginia. If the user decides to buy something from this webpage, say a sports jersey, the user clicks on the purchase page and may be transferred to a secure web server in Maryland for the transaction. A single web address frequently results in the return of information from multiple computers in various locations globally. These different pieces of the webpage will be sent to the user over different network paths and assembled on the user's display.[115]

59. The "communication" taking place is between the dial-up customer and the global computer network of web content, e-mail authors, game room participants, databases, or bulletin board contributors. Consumers would be perplexed to learn regulators believe they are communicating with ISP modems, rather than the buddies on their e-mail lists. The proper focus for identifying a communication needs to be the user interacting with a desired webpage, friend, game, or chat room, not on the increasingly mystifying technical and mechanical activity in the middle that makes the communication possible.[116] ISPs, in most cases, provide services that permit the dial-up Internet user to communicate directly with some distant site or party (other than the ISP) that the caller has specified.

60. ISP service is analogous, though not identical, to long distance calling service. An AT&T long distance customer contracts with AT&T to facilitate communications to out-of-state locations. The customer uses the local network to reach AT&T's facilities (its point of presence). By dialing "1" and an area code, the customer is in essence addressing his call to an out of state party and is instructing his LEC to deliver the call to his long distance carrier, and instructing the long distance carrier

(Continued from previous page)
Providers, CC Docket No. 87-215, Notice of Proposed Rulemaking, 2 FCC Rcd 4305, 4305, 4306 (1987) (noting that enhanced service providers use "exchange access service"); *ESP Exemption Order*, 3 FCC Rcd at 2631 (referring to "certain classes of exchange access users, including enhanced service providers").

[114] *See, e.g., Access Charge Reform Order*, 12 FCC Rcd at 16131-32; GTE Telephone Operating Cos.,13 FCC Rcd at 22478. *Cf. Bell Atlantic,* 206 F.3d at 4, 6-7.

[115] Of course, the Internet provides applications other than the World Wide Web, such as e-mail, games, chat sites, or streaming media, which have different technical characteristics but all of which involve computers in multiple locations, often across state and national boundaries.

[116] *See Qwest Roadmap* at 4-5, 9-10.

to pick up and carry that call to his intended destination. The caller on the other end will pick up the phone and respond to the caller. The communication will be between these two end-users. This analogy is not meant to prove that ISP service is identical to long distance service, but is used merely to bolster, by analogy, the reasonableness of not characterizing an ISP as the destination of a call, but as a facilitator of communication.

61. Moreover, as the local exchange carriers have correctly observed, the technical configurations for establishing dial-up Internet connections are quite similar to certain network configurations employed to initiate more traditional long-distance calls.[117] In most cases, an ISP's customer first dials a seven-digit number to connect to the ISP server before connecting to a website. Long-distance service in some network configurations is initiated in a substantially similar manner. In particular, under "Feature Group A" access, the caller first dials a seven-digit number to reach the IXC, and then dials a password and the called party's area code and number to complete the call. Notwithstanding this dialing sequence, the service the LEC provides is considered *interstate* access service, not a separate local call.[118] Internet calls operate in a similar manner: after reaching the ISP's server by dialing a seven-digit number, the caller selects a website (which is identified by a 12-digit Internet address, but which often is, in effect, "speed dialed" by clicking an icon) and the ISP connects the caller to the selected website. Such calling should yield the same jurisdictional result as the analogous calls to IXCs using "Feature Group A" access.

62. Commission precedent also rejects the two-call theory in the context of calls involving enhanced services. In *BellSouth MemoryCall*, the Commission preempted a state commission order that had prohibited BellSouth from expanding its voice mail service -- an enhanced service -- beyond its existing customers.[119] In doing so, it rejected claims by the state that the Commission lacked jurisdiction to preempt because, allegedly, out-of-state calls to the voice mail service really constituted two calls: an *inter*state call from the out-of-state caller to the telephone company switch that routes the call to the intended recipient's location, and a separate *intra*state call that forwards the communication from the switch to the voice mail apparatus in the event that the called party did not answer.[120] The Commission explained that, whether a basic telecommunications service is at issue, or whether an enhanced service rides on the telephone company's telecommunications service, the Commission's jurisdiction does not end at the local switchboard, but continues to the ultimate destination of the call.[121]

63. The Internet communication is not analogous to traditional telephone exchange services. Local calls set up communication between two parties that reside in the same local calling area. Prior to the introduction of local competition, that call would never leave the network of the incumbent LEC. As other carriers were permitted to enter the local market, a call might cross two or more carriers' networks simply because the two parties to the communication subscribed to two different local carriers. The two parties intending to communicate, however, remained squarely in the same local

[117] *See, e.g.,* Verizon Remand Reply at 9 (Internet traffic is indistinguishable from Feature Group A access service).

[118] *See Local Competition Order*, 11 FCC Rcd at 15935 n. 2091 (describing "Feature Group A" access service); *see also MCI Telecomm. Corp. v. FCC*, 566 F.2d 365, 367 n.3 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978).

[119] *BellSouth MemoryCall*, 7 FCC Rcd at 1619.

[120] *Id.* at 1620.

[121] *Id.* at 1621.

calling area. An Internet communication is not simply a local call from a consumer to a machine that is lopsided, that is, a local call where one party does most of the calling, or most of the talking. ISPs are service providers that technically modify and translate communication, so that their customers will be able to interact with computers across the global Internet.[122]

64. The court in *Bell Atlantic* noted that FCC litigation counsel had differentiated ISP-bound traffic from ordinary long-distance calls by stating that the former "is really like a call to a local business" -- such as a pizza delivery firm, a travel reservation agency, a credit card verification firm, or a taxicab company -- "that then uses the telephone to order wares to meet the need."[123] We find, however, that this citation to a former litigation position does not require us to alter our analysis. First, the Commission itself has never analogized ISP-bound traffic in the manner cited in the agency's brief in *Southwestern Bell*. Indeed, in the particular order that the Commission was defending in *Southwestern Bell*, the Commission distinguished ISP-bound traffic from other access traffic on *other* grounds -- *e.g.*, call direction and call holding times[124] -- which have no arguable bearing on whether the traffic is one interstate call (as the Commission has always held) or two separate calls (one of which allegedly is intrastate) as some parties have contended. Second, the cited portion of the Commission's brief was not addressing jurisdiction at all. Rather, the brief was responding to a claim that the ESP exemption *discriminated* against IXCs and in favor of ISPs.[125] Finally, in the very case in which litigation counsel made the cited analogy, the Eighth Circuit affirmed the Commission's consistent view that ISP-bound traffic is, as a *jurisdictional* matter, predominantly interstate.[126] In any event, to the extent that our prior briefs could be read to conceptualize the nature of ISP service as local, akin to intense users of local service, we now embrace a different conceptualization that we believe more accurately reflects the nature of ISP service.

65. For the foregoing reasons, consistent with our longstanding precedent, we find that we continue to have jurisdiction under section 201, as preserved by section 251(i), to provide a compensation mechanism for ISP-bound traffic.

C. Efficient Intercarrier Compensation Rates and Rate Structures

66. Carriers currently recover the costs of call transport and termination through some combination of carrier access charges, reciprocal compensation, and end-user charges, depending upon the applicable regulatory regime. Having concluded that ISP-bound traffic is not subject to the reciprocal compensation obligations of section 251(b)(5), we must now determine, pursuant to our section 201 authority, what compensation mechanism is appropriate when carriers collaborate to deliver calls to ISPs. In the companion *NPRM*, we consider the desirability of adopting a uniform intercarrier compensation mechanism, applicable to all traffic exchanged among telecommunications carriers, and, in

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[122] It is important to note that a dial-up call to an ISP will not even be required when broadband services arrive. Those connections will be always on and there will be no phone call in any traditional sense. Indeed, the only initiating event will be the end-user interacting with other Internet content or users. Thus, increasingly, notions of two calls become meaningless.

[123] *Bell Atlantic*, 206 F.3d at 8 (citing FCC Brief at 76, *Southwestern Bell v. FCC*, 153 F.3d 523).

[124] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34.

[125] *See* FCC Brief at 75-76, *Southwestern Bell v. FCC*, 153 F.3d 523.

[126] *Southwestern Bell v. FCC*, 153 F.3d at 534.

that context, we intend to examine the merits of a bill and keep regime for all types of traffic, including ISP-bound traffic. In the meantime, however, we must adopt an interim intercarrier compensation rule to govern the exchange of ISP-bound traffic, pending the outcome of the *NPRM*. In particular, we must decide whether to impose (i) a "calling-party's-network-pays" (CPNP) regime, like reciprocal compensation, in which the calling party's network pays the network serving the ISP; (ii) a bill and keep regime in which all networks recover costs from their end-user customers and are obligated to deliver calls that originate on the networks of interconnecting carriers; or (iii) some other cost recovery mechanism. As set forth more fully below, our immediate goal in adopting an interim compensation mechanism is to address the market distortions created by the prevailing intercarrier compensation regime, even as we evaluate in a parallel proceeding what longer-term intercarrier compensation mechanisms are appropriate for this and other types of traffic.

1. CPNP Regimes Have Distorted the Development of Competitive Markets

67. For the reasons detailed below, we believe that a bill and keep approach to recovering the costs of delivering ISP-bound traffic is likely to be more economically efficient than recovering these costs from originating carriers. In particular, requiring carriers to recover the costs of delivering traffic to ISP customers directly from those customers is likely to send appropriate market signals and substantially eliminate existing opportunities for regulatory arbitrage. As noted above, we consider issues related to the broader application of bill and keep as an intercarrier compensation regime in conjunction with the *NPRM* that we are adopting concurrently with this Order. In this Order, however, we adopt an interim compensation mechanism for the delivery of ISP-bound traffic that addresses the regulatory arbitrage opportunities present in the existing carrier-to-carrier payments by limiting carriers' opportunity to recover costs from other carriers and requiring them to recover a greater share of their costs from their ISP customers.

68. In most states, reciprocal compensation governs the exchange of ISP-bound traffic between local carriers.[127] Reciprocal compensation is a CPNP regime in which the originating carrier pays an interconnecting carrier for "transport and termination," *i.e.,* for transport from the networks' point of interconnection and for any tandem and end-office switching.[128] The central problem with any CPNP regime is that carriers recover their costs not only from their end-user customers, but also from *other carriers*.[129] Because intercarrier compensation rates do not reflect the degree to which the carrier can recover costs from its end-users, payments from other carriers may enable a carrier to offer service to its customers at rates that bear little relationship to its actual costs, thereby gaining an advantage over its competitors. Carriers thus have the incentive to seek out customers, including but not limited to ISPs, with high volumes of incoming traffic that will generate high reciprocal compensation

[127] In the *Declaratory Ruling*, we stated that, pending adoption of a federal rule governing intercarrier compensation for ISP-bound traffic, state commissions would determine whether reciprocal compensation was due for such traffic. *Declaratory Ruling*, 14 FCC Rcd at 3706. Since that time, most, though not all, states have ordered the payment of reciprocal compensation for ISP-bound traffic.

[128] 47 C.F.R. § 51.703(a).

[129] Recovery from other carriers is premised on the economic assumption that the carrier whose customer originates the call has "caused" the transport and termination costs associated with that call, and the originating carrier should, therefore, reimburse the interconnecting carrier for "transport and termination." The companion *NPRM* evaluates the validity of that assumption and tentatively concludes that it is an incorrect premise.

payments.[130] To the extent that carriers offer these customers below cost retail rates subsidized by intercarrier compensation, these customers do not receive accurate price signals. Moreover, because the originating LEC typically charges its customers averaged rates, the originating end-user receives inaccurate price signals as the costs associated with the intercarrier payments are recovered through rates averaged across all of the originating carrier's end-users. Thus no subscriber faces a price that fully reflects the intercarrier payments. An ISP subscriber with extensive Internet usage may, for example, cause her LEC to incur substantial reciprocal compensation obligations to the LEC that serves her ISP, but that subscriber receives no price signals reflecting those costs because they are spread over all of her LEC's customers.

69. The resulting market distortions are most apparent in the case of ISP-bound traffic due primarily to the one-way nature of this traffic, and to the tremendous growth in dial-up Internet access since passage of the 1996 Act. Competitive carriers, regardless of the nature of their customer base, exchange traffic with the incumbent LECs at rates based on the incumbents' costs.[131] To the extent the traffic exchange is roughly balanced, as is typically the case when LECs exchange voice traffic, it matters little if rates reflect costs because payments in one direction are largely offset by payments in the other direction. The rapid growth in dial-up Internet use, however, created the opportunity to serve customers with large volumes of exclusively *incoming* traffic. And, for the reasons discussed above, the reciprocal compensation regime created an incentive to target those customers with little regard to the costs of serving them – because a carrier would be able to collect some or all of those costs from *other* carriers that would themselves be unable to flow these costs through to their own customers in a cost-causative manner.

70. The record is replete with evidence that reciprocal compensation provides enormous incentive for CLECs to target ISP customers. The four largest ILECs indicate that CLECs, on average, terminate eighteen times more traffic than they originate, resulting in annual CLEC reciprocal compensation billings of approximately two billion dollars, ninety percent of which is for ISP-bound traffic.[132] Verizon states that it sends CLECs, on average, twenty-one times more traffic than it receives, and some CLECs receive more than forty times more traffic than they originate.[133] Although there may be sound business reasons for a CLEC's decision to serve a particular niche market, the record strongly suggests that CLECs target ISPs in large part because of the availability of reciprocal compensation

[130] *Cf. Local Competition Order*, 11 FCC Rcd at 16043 (symmetrical termination payments to paging providers based on ILECs' costs "might create uneconomic incentives for paging providers to generate traffic simply in order to receive termination compensation").

[131] 47 C.F.R. § 51.705 (an incumbent LEC's rates for transport and termination shall be established on the basis of the forward-looking economic costs of such offerings); 47 C.F.R. § 51.711 (subject to certain exceptions, rates for transport and termination shall be symmetrical and equal to those that the incumbent LEC assesses upon other carriers for the same services).

[132] Letter from Robert T. Blau, BellSouth, to Magalie Roman Salas, Secretary, FCC (November 6, 2000); *see also* Verizon Remand Comments at 2 (Verizon will be billed more than one billion dollars in 2000 for Internet-bound calls); Letter from Richard J. Metzger, Focal, to Deena Shetler, Legal Advisor to Commissioner Gloria Tristani, FCC (Jan. 11, 2001)(ILECs owed $1.98 billion in reciprocal compensation to CLECs in 2000).

[133] Verizon Remand Comments at 11, 21. Verizon also cites extreme cases of CLECs that terminate in excess of *eight thousand* times more traffic than they originate. *Id.* at 21. *See also* Letter from Robert T. Blau, BellSouth; Melissa Newman, Qwest; Priscilla Hill-Ardoin, SBC; and Susanne Guyer, Verizon, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Nov. 9, 2000).

payments.[134] Indeed, some ISPs even seek to become CLECs in order to share in the reciprocal compensation windfall, and, for a small number of entities, this revenue stream provided an inducement to fraudulent schemes to generate dial-up minutes.[135]

71. For these reasons, we believe that the application of a CPNP regime, such as reciprocal compensation, to ISP-bound traffic undermines the operation of competitive markets.[136] ISPs do not receive accurate price signals from carriers that compete, not on the basis of the quality and efficiency of the services they provide, but on the basis of their ability to shift costs to other carriers. Efficient prices result when carriers offer the lowest possible rates based on the costs of the service they provide to ISPs, not when they can price their services without regard to cost. We are concerned that viable, long-term competition among efficient providers of local exchange and exchange access services cannot be sustained where the intercarrier compensation regime does not reward efficiency and may produce retail rates that do not reflect the costs of the services provided. As we explain in greater detail in the companion *NPRM*, we believe that a compensation regime, such as bill and keep, that requires carriers to recover more of their costs from end-users may avoid these problems.

72. We acknowledge that we did not always hold this view. In the *Local Competition Order*, the Commission concluded that state commissions may impose bill and keep arrangements for traffic subject to section 251(b)(5) *only* when the flow of traffic between interconnected carriers is roughly balanced and is expected to remain so.[137] The Commission reasoned 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."[138] The concerns about the opportunity for cost recovery and economic efficiency are not present, however, to the extent that traffic between carriers is balanced and payments from one carrier will be offset by payments from the other carrier. In these circumstances, the Commission found that bill and keep arrangements may minimize administrative burdens and transaction costs.[139]

73. Since that time, we have observed the development of competition in the local exchange market, and we now believe that the Commission's concerns about economic inefficiencies associated with bill and keep missed the mark, particularly as applied to ISP-bound traffic. The Commission appears to have assumed, at least implicitly, that the calling party was the sole cost causer of the call, and it may have overstated any incentives that a bill and keep regime creates to target customers that primarily originate traffic. A carrier must provide originating switching functions and must recover the costs of those functions from the originating end-user, not from other carriers. Originating traffic thus

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[134] *See, e.g.,* Verizon Remand Comments at 15 (citing case of CLEC offer of free long distance service to dial-up Internet customers, an offer it did not extend to its customers that accessed the Internet via cable modem or DSL service); SBC Remand Comments at 45 (citing examples of CLEC offering free service to ISPs that collocated in its switching centers and CLECs offering to share reciprocal compensation revenues with ISPs).

[135] *See, e.g.,* Verizon Remand Comments at 17-18.

[136] The *NPRM* that we adopt in conjunction with this Order seeks comment on the degree to which a modified CPNP regime might address these concerns.

[137] *Local Competition Order*, 11 FCC Rcd at 16054-55; *see also* 47 C.F.R. § 51.713(b).

[138] *Local Competition Order*, 11 FCC Rcd at 16055 (emphases added).

[139] *Id.* at 16055.

lacks the same opportunity for cost-shifting that reciprocal compensation provides with respect to serving customers with disproportionately incoming traffic. Indeed, it has become apparent that the obligation to pay reciprocal compensation to interconnecting carriers may give rise to uneconomic incentives. As the current controversy about ISP-bound traffic demonstrates, reciprocal compensation encourages carriers to overuse competing carriers' *origination* facilities by seeking customers that *receive* high volumes of traffic.

74. We believe that a bill and keep regime for ISP-bound traffic may eliminate these incentives and concomitant opportunity for regulatory arbitrage by forcing carriers to look only to their ISP customers, rather than to other carriers, for cost recovery. As a result, the rates paid by ISPs and, consequently, their customers should better reflect the costs of services to which they subscribe. Potential subscribers should receive more accurate price signals, and the market should reward efficient providers.[140] Although we do not reach any firm conclusions about bill and keep as a permanent mechanism for this or any other traffic, our evaluation of the record evidence to date strongly suggests that bill and keep is likely to provide a viable solution to the market distortions caused by the application of reciprocal compensation to ISP-bound traffic. We take that observation into account, below, as we fashion an interim compensation mechanism for this traffic.

75. Bill and keep also may address the problem regulators face in setting intercarrier compensation rates that correlate to the costs carriers incur to carry traffic that originates on other networks. The record suggests that market distortions appear to have been exacerbated by the prevalence of excessively high reciprocal compensation rates. Many CLECs argue that the current traffic imbalances between CLECs and ILECs are the product of greediness on the part of ILECs that insisted on above-cost reciprocal compensation rates in the course of negotiating or arbitrating initial interconnection agreements.[141] CLECs argue that, because these rates were artificially high, they naturally responded by seeking customers with large volumes of incoming traffic. If the parties or regulatory bodies merely set cost-based rates and rate structures, they argue, arbitrage opportunities and the resulting windfalls would disappear.[142] They note that reciprocal compensation rates have fallen dramatically as initial agreements expire and the parties negotiate new agreements.[143]

76. We do not believe that the solution to the current problem is as simple as the CLECs suggest.[144] We seek comment in the accompanying *NPRM* on the potential for a modified CPNP regime, such as the CLECs advocate, to solve some of the problems we identify here. We are convinced, however, that intercarrier payments for ISP-bound traffic have created severe market distortions. Although it would be premature to institute a full bill and keep regime before resolving the

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[140] We also note that bill and keep arrangements are common among entities providing Internet backbone services, where the larger carriers engage in so-called "peering" arrangements.

[141] Time Warner Remand Comments at 15-16.

[142] Time Warner Remand Comments at 16. Some parties suggest that a bifurcated rate structure (a call set-up charge and a minute of use charge) would ensure appropriate cost recovery. *See* Sprint Remand Comments at 2-4. We seek comment on this approach in the *NPRM*.

[143] *See infra* note 158.

[144] We note that many CLECs expressed the same view following adoption of the *Declaratory Ruling* in 1999, yet the problems persist. *See, e.g.,* Cox Reply Comments at 6 (If termination "rates are too high, this is entirely at the ILEC's behest, and should be remedied in the next round of negotiations.").

questions presented in the *NPRM*,[145] in seeking to remedy an exigent market problem, we cannot ignore the evidence we have accumulated to date that suggests that a bill and keep regime has very fundamental advantages over a CPNP regime for ISP-bound traffic. Contrary to the view espoused by CLECs, we are concerned that the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to "get the rate right." A few examples may illustrate the vexing problems regulators face. Reciprocal compensation rates have been determined on the basis of the ILEC's average costs of transport and termination. These rates do not, therefore, reflect the costs incurred by any particular carrier for providing service to a particular customer. This encourages carriers to target customers that are, on average, less costly to serve, and reap a reciprocal compensation windfall. Conversely, new entrants lack incentive to serve customers that are, on average, more costly to serve, even if the new entrant is the most efficient provider. It is not evident that this problem can be remedied by setting reciprocal compensation rates on the basis of the costs of carrier serving the called party (or, in the case of ISP-bound traffic, the CLEC that serves the ISP).[146] Apart from our reluctance to require new entrants to perform cost studies, it is entirely impracticable, if not impossible, for regulators to set different intercarrier compensation rates for each individual carrier, and those rates still might fail to reflect a carrier's costs as, for example, the nature of its customer base evolves. Furthermore, most states have adopted per minute reciprocal compensation rate structures. It is unlikely that any minute-of-use rate that is based on average costs and depends upon demand projections will reflect the costs of any given carrier to serve any particular customer. To the extent that transport and termination costs are capacity-driven, moreover, virtually any minute-of-use rate will overestimate the cost of handling an additional call whenever a carrier is operating below peak capacity.[147] Regulators and carriers have long struggled with problems associated with peak-load pricing.[148] Finally, and most important, the fundamental problem with application of reciprocal compensation to ISP-bound traffic is that the intercarrier payments fail altogether to account for a carrier's opportunity to recover costs from its ISP customers. Modifications to intercarrier rate levels or rate structures suggested by CLECs do not address carriers' ability to shift costs from their own customers onto other carriers and their customers.

2. Intercarrier Compensation for ISP-bound Traffic

77. We believe that a hybrid mechanism that establishes relatively low per minute rates, with a cap on the total volume of traffic entitled to such compensation, is the most appropriate interim approach over the near term to resolve the problems associated with the current intercarrier compensation regime for ISP-bound traffic. Our primary goal at this time is to address the market distortions under the current intercarrier compensation regimes for ISP-bound traffic. At the same time,

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[145] A number of questions must be resolved before we are prepared to implement fully a bill and keep regime where most costs are recovered from end-users. (We say most, not all, costs are recovered from end-users because a bill and keep regime may include intercarrier charges for transport between networks.) These questions include, for example, the allocation of transport costs between interconnecting carriers and the effect on retail prices of adopting a bill and keep regime that is not limited to ISP-bound traffic. We seek comment on these and other issues in the accompanying intercarrier *NPRM*.

[146] *Cf.* Verizon Remand Reply Comments at 14-15.

[147] The problem of putting a per minute price tag, in the form of intercarrier payments, where no per minute cost exists is exacerbated in the case of local exchange carriers that, in most cases, recover costs from their end-users on a flat-rated basis.

[148] *See, e.g., Local Competition Order*, 11 FCC Rcd at 16028-29.

we believe it prudent to avoid a "flash cut" to a new compensation regime that would upset the legitimate business expectations of carriers and their customers. Subsequent to the Commission's *Declaratory Ruling*, many states have required the payment of reciprocal compensation for ISP-bound traffic, and CLECs may have entered into contracts with vendors or with their ISP customers that reflect the expectation that the CLECs would continue to receive reciprocal compensation revenue. We believe it appropriate, in tailoring an interim compensation mechanism, to take those expectations into account while simultaneously establishing rates that will produce more accurate price signals and substantially reduce current market distortions. Therefore, pending our consideration of broader intercarrier compensation issues in the *NPRM*, we impose an interim intercarrier compensation regime for ISP-bound traffic that serves to limit, if not end, the opportunity for regulatory arbitrage, while avoiding a market-disruptive "flash cut" to a pure bill and keep regime. The interim regime we establish here will govern intercarrier compensation for ISP-bound traffic until we have resolved the issues raised in the intercarrier compensation *NPRM*.

78. Beginning on the effective date of this Order, and continuing for six months, intercarrier compensation for ISP-bound traffic will be capped at a rate of $.0015/minute-of-use (mou). Starting in the seventh month, and continuing for eighteen months, the rate will be capped at $.0010/mou. Starting in the twenty-fifth month, and continuing through the thirty-sixth month or until further Commission action (whichever is later), the rate will be capped at $.0007/mou. In addition to the rate caps, we will impose a cap on total ISP-bound minutes for which a LEC may receive this compensation. For the year 2001, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to compensation under that agreement during the first quarter of 2001, plus a ten percent growth factor. For 2002, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the minutes for which it was entitled to compensation under that agreement in 2001, plus another ten percent growth factor. In 2003, a LEC may receive compensation, pursuant to a particular interconnection agreement, for ISP-bound minutes up to a ceiling equal to the 2002 ceiling applicable to that agreement.[149]

79. We understand that some carriers are unable to identify ISP-bound traffic. In order to limit disputes and avoid costly efforts to identify this traffic, we adopt a rebuttable presumption that traffic delivered to a carrier, pursuant to a particular contract, that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic that is subject to the compensation mechanism set forth in this Order. Using a rebuttable presumption in this context is consistent with the approach that numerous states have adopted to identify ISP-bound traffic or "convergent" traffic (including ISP traffic) that is subject to a lower reciprocal compensation rate.[150] A carrier may rebut the presumption, for example,

[149] This interim regime affects only the intercarrier *compensation* (*i.e.,* the rates) applicable to the delivery of ISP-bound traffic. It does not alter carriers' other obligations under our Part 51 rules, 47 C.F.R. Part 51, or existing interconnection agreements, such as obligations to transport traffic to points of interconnection.

[150] *See* Texas Public Utility Commission, Docket No. 21982, Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of 1996, at 36 (July 12, 2000)(applying a blended tandem switching rate to traffic up to a 3:1 (terminating to originating) ratio; traffic above that ratio is presumed to be convergent traffic and is compensated at the end office rate unless the terminating carrier can prove tandem functionality); New York Public Service Commission, Op. No. 99-10, Proceeding on Motion of the Commission to Reexamine Reciprocal compensation, Opinion and Order, at 59-60 (Aug. 26, 1999) (traffic above a 3:1 ratio is presumed to be convergent traffic and is compensated at the end office rate unless the terminating carrier can demonstrate "that [the terminating] network and service are such as to warrant tandem-rate compensation"); Massachusetts Dept. of Telecommunications and Energy, D.T.E. 97-116-C, at 28-29 n.31 (May 19, 1999) (requiring reciprocal compensation for (continued….)

by demonstrating to the appropriate state commission that traffic above the 3:1 ratio is in fact local traffic delivered to non-ISP customers. In that case, the state commission will order payment of the state-approved or state-arbitrated reciprocal compensation rates for that traffic. Conversely, if a carrier can demonstrate to the state commission that traffic it delivers to another carrier is ISP-bound traffic, even though it does not exceed the 3:1 ratio, the state commission will relieve the originating carrier of reciprocal compensation payments for that traffic, which is subject instead to the compensation regime set forth in this Order. During the pendency of any such proceedings, LECs remain obligated to pay the presumptive rates (reciprocal compensation rates for traffic below a 3:1 ratio, the rates set forth in this Order for traffic above the ratio), subject to true-up upon the conclusion of state commission proceedings.

80. We acknowledge that carriers incur costs in delivering traffic to ISPs, and it may be that in some instances those costs exceed the rate caps we adopt here. To the extent a LEC's costs of transporting and terminating this traffic exceed the applicable rate caps, however, it may recover those amounts from its own end-users.[151] We also clarify that, because the rates set forth above are *caps* on intercarrier compensation, they have no effect to the extent that states have ordered LECs to exchange ISP-bound traffic either at rates below the caps we adopt here or on a bill and keep basis (or otherwise have not required payment of compensation for this traffic).[152] The rate caps are designed to provide a transition toward bill and keep or such other cost recovery mechanism that the Commission may adopt to minimize uneconomic incentives, and no such transition is necessary for carriers already exchanging traffic at rates below the caps. Moreover, those state commissions have concluded that, at least in their states, LECs receive adequate compensation from their own end-users for the transport and termination of ISP-bound traffic and need not rely on intercarrier compensation.

81. Finally, a different rule applies in the case where carriers are not exchanging traffic pursuant to interconnection agreements prior to adoption of this Order (where, for example, a new carrier enters the market or an existing carrier expands into a market it previously had not served). In such a case, as of the effective date of this Order, carriers shall exchange ISP-bound traffic on a bill-and-keep basis during this interim period. We adopt this rule for several reasons. First, our goal here is to address and curtail a pressing problem that has created opportunities for regulatory arbitrage and distorted the operation of competitive markets. In so doing, we seek to confine these market problems

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traffic that does not exceed a 2:1 (terminating to originating) ratio as a proxy to distinguish ISP-bound traffic from voice traffic; carriers may rebut that presumption).

[151] We note that CLEC end-user recovery is generally not regulated. As non-dominant carriers, CLECs can charge their end-users what the market will bear. Access Charge Reform, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962, 13005 (2000) (*CALLS Order*)("Competitive LECs are not regulated by the Commission and are not restricted in the same manner as price caps LECs in how they recover their costs."). Accordingly, we permit CLECs to recover any additional costs of serving ISPs from their ISP customers. ILEC end-user charges, however, are generally regulated by the Commission, in the case of interstate charges, or by state commissions, for intrastate charges. Pursuant to the ESP exemption, ILECs will continue to serve their ISP customers out of intrastate business tariffs that are subject to state regulation. As the Commission said in 1997, if ILECs feel that these rates are so low as to preclude cost recovery, they should seek relief from their state commissions. *Access Charge Reform Order*, 12 FCC Rcd at 16134 ("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." (emphasis added)).

[152] Thus, if a state has ordered all LECs to exchange ISP-bound traffic on a bill and keep basis, or if a state has ordered bill and keep for ISP-bound traffic in a particular arbitration, those LECs subject to the state order would continue to exchange ISP-bound traffic on a bill and keep basis.

to the maximum extent while seeking an appropriate long-term resolution in the proceeding initiated by the companion *NPRM*. Allowing carriers in the interim to expand into new markets using the very intercarrier compensation mechanisms that have led to the existing problems would exacerbate the market problems we seek to ameliorate. For this reason, we believe that a standstill on any expansion of the old compensation regime into new markets is the more appropriate interim answer.[153] Second, unlike those carriers that are presently serving ISP customers under existing interconnection agreements, carriers entering new markets to serve ISPs have not acted in reliance on reciprocal compensation revenues and thus have no need of a transition during which to make adjustments to their prior business plans.

82. The interim compensation regime we establish here applies as carriers re-negotiate expired or expiring interconnection agreements. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions. This Order does not preempt any state commission decision regarding compensation for ISP-bound traffic for the period prior to the effective date of the interim regime we adopt here. Because we now exercise our authority under section 201 to determine the appropriate intercarrier compensation for ISP-bound traffic, however, state commissions will no longer have authority to address this issue. For this same reason, as of the date this Order is published in the Federal Register, carriers may no longer invoke section 252(i) to opt into an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic.[154] Section 252(i) applies only to agreements arbitrated or approved by state commissions pursuant to section 252; it has no application in the context of an intercarrier compensation regime set by this Commission pursuant to section 201.[155]

83. This interim regime satisfies the twin goals of compensating LECs for the costs of delivering ISP-bound traffic while limiting regulatory arbitrage. The interim compensation regime, as a whole, begins a transition toward what we have tentatively concluded, in the companion *NPRM*, to be a more rational cost recovery mechanism under which LECs recover more of their costs from their own customers. This compensation mechanism is fully consistent with the manner in which the Commission has directed incumbent LECs to recover the costs of serving ESPs, including ISPs.[156] The three-year

[153] *See American Public Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000)("Where existing methodology or research in a new area of regulation is deficient, the agency necessarily enjoys broad discretion to attempt to formulate a solution to the best of its ability on the basis of available information.").

[154] 47 U.S.C. § 252(i) (requiring LECs to "make available any interconnection, service, or network element provided under an agreement approved under this section" to "any other requesting telecommunications carrier"). This Order will become effective 30 days after publication in the Federal Register. We find there is good cause under 5 U.S.C. § 553(d)(3), however, to prohibit carriers from invoking section 252(i) with respect to rates paid for the exchange of ISP-bound traffic upon publication of this Order in the Federal Register, in order to prevent carriers from exercising opt in rights during the thirty days after Federal Register publication. To permit a carrier to opt into a reciprocal compensation rate higher than the caps we impose here during that window would seriously undermine our effort to curtail regulatory arbitrage and to begin a transition from dependence on intercarrier compensation and toward greater reliance on end-user recovery.

[155] In any event, our rule implementing section 252(i) requires incumbent LECs to make available "[i]ndividual interconnection, service, or network element arrangements" to requesting telecommunications carriers only "for a reasonable period of time." 47 C.F.R. § 51.809(c). We conclude that any "reasonable period of time" for making available rates applicable to the exchange of ISP-bound traffic expires upon the Commission's adoption in this Order of an intercarrier compensation mechanism for ISP-bound traffic.

[156] *Access Charge Reform Order*, 12 FCC Rcd at 16133-34.

transition we adopt here ensures that carriers have sufficient time to re-order their business plans and customer relationships, should they so choose, in light of our tentative conclusions in the companion *NPRM* that bill and keep is the appropriate long-term intercarrier compensation regime. It also affords the Commission adequate time to consider comprehensive reform of all intercarrier compensation regimes in the *NPRM* and any resulting rulemaking proceedings. Both the rate caps and the volume limitations reflect our view that LECs should begin to formulate business plans that reflect decreased reliance on revenues from intercarrier compensation, given the trend toward substantially lower rates and the strong possibility that the *NPRM* may result in the adoption of a full bill and keep regime for ISP-bound traffic.

84. We acknowledge that there is no exact science to setting rate caps to limit carriers' ability to draw revenue from other carriers, rather than from their own end-users. Our adoption of the caps here is based on a number of considerations. First, rates that produce meaningful reductions in intercarrier payments for ISP-bound traffic must be at least as low as rates in existing interconnection agreements. Second, although we make no finding here regarding the actual costs incurred in the delivery of ISP-bound traffic, there is evidence in the record to suggest that technological developments are reducing the costs incurred by carriers in handling all sorts of traffic, including ISP-bound traffic.[157] Third, although the process has proceeded too slowly to address the market distortions discussed above, we note that negotiated reciprocal compensation rates continue to decline as ILECs and CLECs negotiate new interconnection agreements. Finally, CLECs have been on notice since the 1999 *Declaratory Ruling* that it might be unwise to rely on the continued receipt of reciprocal compensation for ISP-bound traffic, thus many have begun the process of weaning themselves from these revenues.

85. The rate caps adopted herein reflect all these considerations. The caps we have selected approximate the downward trend in intercarrier compensation rates reflected in recently negotiated interconnection agreements. In these agreements, carriers have agreed to rates, like those we adopt here, that decline each year of a three-year contract term, and at least one agreement reflects different rates for balanced and unbalanced traffic.[158] For example, the initial rate cap of $.0015/mou

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[157] *See, e.g.,* Letter from David J. Hostetter, SBC, to Magalie Roman Salas, Secretary, FCC (Feb. 14, 2001), Attachment (citing September 2000 Morgan Stanley Dean Witter report that discusses utilization of lower cost switch technology); Donny Jackson, "One Giant Leap for Telecom Kind?," *Telephony,* Feb. 12, 2001, at 38 (discussing cost savings associated with replacing circuit switches with packet switches); Letter from Gary L. Phillips, SBC, to Magalie Roman Salas, Secretary, FCC (Feb. 16, 2001) (attaching press release from Focal Communications announcing planned deployment of next-generation switching technology "at a fraction of the cost of traditional equipment"); *see also infra* para. 93**.**

[158] The Commission takes notice of the following interconnection agreements: (1) Level 3 Communications and SBC Communications (effective through May 2003): This 13-state agreement has two sets of rates. For balanced traffic, the rate is $.0032/mou. For traffic that is out of balance by a ratio exceeding 3:1, the rate starts at $.0018/mou, declining to a weighted average rate of $.0007/mou by June 1, 2002. S*ee* PR Newswire, WL PRWIRE 07:00:00 (Jan. 17, 2001); Letter from John T. Nakahata, Harris, Wiltshire & Grannis, to Magalie Roman Salas, Secretary, FCC, Attachment (Jan. 19, 2001). (2) ICG Communications and BellSouth (retroactively effective to Jan. 1, 2000): This agreement provides for rates to decline over three years, from $0.002/mou to $0.00175/mou to $0.0015/mou. S*ee* Communications Daily, 2000 WL 4694709 (Mar. 15, 2000). (3) KMC Telecom and BellSouth: This agreement provides for a rate of $0.002/mou in 2000, $0.00175/mou in 2001, $0.0015/mou in 2002. *See* Business Wire, WL 5/18/00 BWIRE 12:50:000 (May 18, 2000). (4) Level 3 Communications and Verizon (formerly Bell Atlantic) (effective Oct. 14, 1999): This agreement governs all of the former Bell Atlantic/NYNEX states. The applicable rate declines over the term of the agreement from $.003/mou in 1999 to rates in 2001 of $.0015/mou for balanced traffic and $.0012/mou where the traffic imbalance exceeds a 10:1 ratio. *See* Letter from Joseph J. Mulieri, Bell Atlantic, to Magalie Roman Salas, Secretary, FCC (Nov. 22, 1999)(attaching agreement); *see also* Letter from John T. Nakahata, Harris, Wiltshire &

(continued….)

approximates the rates applicable this year in agreements Level 3 has negotiated with Verizon and SBC.[159] The $.0010/mou rate that applies during most of the three-year interim period reflects a proposal by ALTS, the trade association representing CLECs, for a transition plan pursuant to which intercarrier compensation payments for ISP-bound traffic would decline to $.0010/mou.[160] Similarly, the $.0007/mou rate reflects the average rate applicable in 2002 under Level 3's agreement with SBC.[161] We conclude, therefore, that the rate caps constitute a reasonable transition toward the recovery of costs from end-users.

86. We impose an overall cap on ISP-bound minutes for which compensation is due in order to ensure that growth in dial-up Internet access does not undermine our efforts to limit intercarrier compensation for this traffic and to begin, subject to the conclusion of the *NPRM* proceedings, a smooth transition toward a bill and keep regime. A ten percent growth cap, for the first two years, seems reasonable in light of CLEC projections that the growth of dial-up Internet minutes will fall in the range of seven to ten percent per year.[162] We are unpersuaded by the ILECs' projections that dial-up minutes will grow in the range of forty percent per year,[163] but adoption of a cap on growth largely moots this debate. If CLECs have projected growth in the range of ten percent, then limiting intercarrier compensation at that level should not disrupt their customer relationships or their business planning. Nothing in this Order prevents any carrier from serving or indeed expanding service to ISPs, so long as they recover the costs of additional minutes from their ISP customers. The caps merely ensure that growth in minutes above the caps is based on a given carrier's ability to provide efficient and quality service to ISPs, rather than on a carrier's desire to reap an intercarrier compensation windfall.

87. We are not persuaded by arguments proffered by CLECs that requiring them to recover more of their costs from their ISP customers will render it impossible for CLECs profitably to serve ISPs or will lead to higher rates for Internet access.[164] First, as noted above, this compensation mechanism is fully consistent with the manner in which this Commission has directed ILECs to recover

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Grannis, to Magalie Roman Salas, Secretary, FCC, at 2 (Jan. 4, 2001)(reciprocal compensation rate in most recent Level 3 – Verizon agreement is now $.0012/mou in all states except New York, where the rate is $.0015/mou).

[159] In the Level 3 – SBC agreement, the applicable rate is $.0018/mou for traffic that exceeds a 3:1 ratio; in the Level 3 – Verizon agreement, the applicable rate is $.0015/mou for balanced traffic and $.0012/mou for traffic that exceeds a 10:1 ratio. *See supra* note 158.

[160] *See* Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC, at 3 (Dec. 19, 2000).

[161] *See supra* note 158.

[162] *See, e.g.,* Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC (Dec. 18, 2000) (offering evidence that dial-up traffic per household will grow only 7%/year from 1998 to 2003 and that dial-up household penetration will decline between 2000 and 2003); Letter from Jonathan Askin, ALTS, to Magalie Roman Salas, Secretary, FCC (Jan. 9, 2001)(citing, *inter alia*, Merrill Lynch estimate of 7% annual increased Internet usage per user between 1999 and 2003, and PricewaterhouseCoopers' study suggesting that Internet usage per user declined from 1999 to 2000).

[163] *See, e.g.,* Letter from Robert T. Blau, BellSouth, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Dec. 22, 2000) (forecasting 42% annual growth in total Internet access minutes between 2000 and 2003); *but see* Dan Beyers, "Internet Use Slipped Late Last Year," Washingtonpost.com, Feb. 22, 2001, at E10 (noting decline in average time spent online in 2000).

[164] *See, e.g.,* Time Warner Remand Comments at 4-5; Centennial Remand Comments at 2, 6-7.

the costs of serving ISPs.[165] Moreover, the evidence in the record does not demonstrate that CLECs cannot compete for ISP customers in the growing number of states that have adopted bill and keep for ISP-bound traffic or that the cost of Internet access has increased in those states. Second, next-generation switching and other technological developments appear to be contributing to a decline in the costs of serving ISPs (and other customers).[166] Third, if reciprocal compensation merely enabled CLECs to recover the costs of serving ISPs, CLECs should be indifferent between serving ISPs and other customers. Instead, CLECs have not contradicted ILEC assertions that more than ninety percent of CLEC reciprocal compensation billings are for ISP-bound traffic,[167] suggesting that there may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination.[168] Finally, there is reason to believe that our failure to act, rather than the actions we take here, would lead to higher rates for Internet access, as ILECs seek to recover their reciprocal compensation liability, which they incur on a minute-of-use basis, from their customers who call ISPs.[169] Alternatively, ILECs might recover these costs from all of their local customers, including those who do not call ISPs.[170] There is no public policy rationale to support a subsidy running from all users of basic telephone service to those end-users who employ dial-up Internet access.[171]

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.[172] The CLECs argue that the incumbents' local rates are set to recover the costs of originating and terminating calls and that the ILECs avoid termination costs when their end-users call ISP customers served by CLECs. The record does not establish that ILECs necessarily avoid costs when they deliver calls to CLECs,[173] and 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. The ILECs point out that, in response to their complaints about the costs associated with delivering traffic to ISPs, the Commission has directed them to seek

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[165] *Access Charge Reform Order*, 12 FCC Rcd at 16134; *MTS/WATS Market Structure Order*, 97 FCC 2d at 720-721.

[166] *See infra* para. 93.

[167] *See* Letter from Robert T. Blau, BellSouth, *et al.*, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 4 (Nov. 3, 2000); SBC Remand Comments at 42, 51, 57.

[168] We do not suggest that it costs CLECs less to serve ISPs than other types of customers. New switching technologies make it less costly to serve *all* customers. If, however, costs are lower than prevailing reciprocal compensation rates, then CLECs are likely to target customers, such as ISPs, with predominantly incoming traffic, in order to maximize the resulting profit.

[169] *See, e.g.,* Verizon Remand Comments at 16.

[170] *Id.*

[171] Most CLECs assert that they compete with ILECs on service, not price, and that the rates they charge to ISPs are comparable to the ILEC rates for the same services. *See, e.g.,* Time Warner Remand Comments at 5. We acknowledge, however, that any CLECs that use reciprocal compensation payments to offer below cost service to ISPs may be unable to continue that practice under the compensation regime we adopt here. We reiterate that we see no public policy reason to maintain a subsidy running from ILEC end-users to ISPs and their customers.

[172] *See, e.g.,* Letter from Robert W. McCausland, Allegiance Telecom; Kelsi Reeves, Time Warner Telecom; Richard J. Metzger, Focal, R. Gerard Salemme, XO Communications; and Heather B. Gold, Intermedia; to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 6 (Oct. 20, 2000).

[173] *See, e.g.,* SBC Remand Reply Comments at 31-32 (explaining how an ILEC may incur additional switching and transport costs when its end-user customer calls an ISP served by a CLEC).

permission from state regulators to raise the rates they charge *the ISPs*, an implicit acknowledgement that ILECs may not recover all of their costs from the originating end-user.[174]

3. Relationship to Section 251(b)(5)

89. It 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,[175] while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher than the caps we adopt here, when the traffic imbalance is reversed.[176] Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to "pick and choose" intercarrier compensation regimes, depending on the nature of the traffic exchanged with another carrier. The rate caps for ISP-bound traffic that we adopt here apply, therefore, *only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5)[177] at the same rate. Thus, if the applicable rate cap is $.0010/mou, the ILEC must offer to exchange section 251(b)(5) traffic at that same rate. Similarly, if an ILEC wishes to continue to exchange ISP-bound traffic on a bill and keep basis in a state that has ordered bill and keep, it must offer to exchange all section 251(b)(5) traffic on a bill and keep basis.[178] For those incumbent LECs that choose *not* to offer to exchange section 251(b)(5) traffic subject to the same rate caps we adopt for ISP-bound traffic, we order them to exchange ISP-bound traffic at the state-approved or state-arbitrated reciprocal compensation rates reflected in their contracts.[179] This "mirroring" rule ensures that incumbent LECs will pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic.

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[174] *See Access Charge Reform Order*, 12 FCC Rcd at 16134; *see also MTS/WATS Market Structure Order*, 97 FCC 2d at 721 (the local business line rate paid by ISPs subsumes switching costs). Moreover, most states have adopted price cap regulation of local rates, in which case rates do not necessarily correlate to cost in the manner the CLECs suggest. *See* "Price Caps Standard Form of Telco Regulation in 70% of States," Communications Daily, 1999 WL 7580319 (Sept. 8, 1999).

[175] The four largest incumbent LECs – SBC, BellSouth, Verizon, and Qwest – estimate that they owed over $2 billion in reciprocal compensation for ISP-bound traffic in 2000. *See, e.g.,* Letter from Robert T. Blau, BellSouth, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Jan. 16, 2001).

[176] More calls are made from wireless phones to wireline phones than vice-versa. The ILECs, therefore, are net recipients of reciprocal compensation from wireless carriers.

[177] Pursuant to the analysis we adopt above, section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier other than a CMRS provider that is not interstate or intrastate access traffic delivered to an IXC or an information service provider, and to telecommunications traffic between a LEC and a CMRS provider that originates and terminates within the same MTA. *See supra* § IV.B.

[178] If, however, a state has ordered bill and keep for ISP-bound traffic only with respect to a particular interconnection agreement, as opposed to state-wide, we do not require the incumbent LEC to offer to exchange all section 251(b)(5) traffic on a bill and keep basis. This limitation is necessary so that an incumbent is not required to deliver all section 251(b)(5) in a state on a bill and keep basis even though it continues to pay compensation for most ISP-bound traffic in that state. *See, e.g.,* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC (April 2, 2001)(citing, for example, Washington state, where 16% of ISP-bound traffic is subject to bill and keep). In those states, the rate caps we adopt here will apply to ISP-bound traffic that is not subject to bill and keep under the particular interconnection agreement if the incumbent LEC offers to exchange all section 251(b)(5) traffic subject to those rate caps.

[179] ILECs may make this election on a state-by-state basis.

90. This is the correct policy result because we see no reason to impose different rates for ISP-bound and voice traffic. The record developed in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP.[180] Assuming the two calls have otherwise identical characteristics (*e.g.*, duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP.[181] We therefore are unwilling to take any action that results in the establishment of separate intercarrier compensation rates, terms, and conditions for local voice and ISP-bound traffic.[182] To the extent that the record indicates that per minute reciprocal compensation rate levels and rate structures produce inefficient results, we conclude that the problems lie with this recovery mechanism in general and are not limited to any particular type of traffic.

91. We are not persuaded by commenters' claims that the rates for delivery of ISP-bound traffic and local voice traffic should differ because delivering a data call to an ISP is inherently less costly than delivering a voice call to a local end-user. In an attached declaration to Verizon's comments, William Taylor argues that reciprocal compensation rates may reflect switching costs associated with both originating and terminating functions, despite the fact that ISP traffic generally flows in only one direction.[183] If correct, however, this observation suggests a need to develop rates or rate structures for the transport and termination of *all* traffic that exclude costs associated solely with originating switching.[184] Mr. Taylor similarly argues that ISP-bound calls generally are longer in duration than voice calls, and that a per-minute rate structure applied to calls of longer duration will spread the fixed costs of these calls over more minutes, resulting in lower per-minute costs, and possible over recovery of the fixed costs incurred.[185] Any possibility of over recovery associated with calls (to ISPs or otherwise) of

[180] Many commenters argue that there is, in fact, no difference between the cost and network functions involved in terminating ISP-bound calls and the cost and functions involved in terminating other calls to users of the public switched telephone network. *See, e.g.,* AOL Comments at 10-12 ("there is absolutely no technical distinction, and therefore no cost differences, between the way an incumbent LEC network handles ISP-destined traffic and the way it handles other traffic within the reciprocal compensation framework."); AT&T Comments at 10-11 ("[T]here is no economic justification for subjecting voice and data traffic to different compensation rules." "ILECs have not demonstrated, and cannot demonstrate, that the costs of transporting and terminating data traffic differ categorically from the costs of transporting and terminating ordinary voice traffic."); Choice One Comments at 8 ("[C]osts do not vary significantly based on whether data or voice traffic is being transmitted."); Corecomm Reply at 2 (network functions are identical whether a carrier is providing service to an ISP or any other end-user); Cox Comments at 7 & Exhibit 2, Statement of Gerald W. Brock at 2 ("None of the distinctions between ISP calls and average calls relate to a cost difference for handling the calls."); MediaOne Comments at 4 (LECs incur the same costs for terminating calls to an ISP as they do for terminating any other local calls); Time Warner Comments at 9 ("[A]ll LECs perform the same functions when transporting and delivering calls to ISP end-users as they do when transporting and delivering calls to other end-users. When LECs perform the same functions, they incur the same costs."); Letter from Donald F. Shepheard, Time Warner Telecom, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC (Feb. 28, 2001)(disputing claim that CLEC switching costs are as low as the ILECs argue).

[181] *See, e.g.,* Cox Comments at Exhibit 2, Statement of Gerald W. Brock at 2.

[182] *See, e.g.,* Intermedia Comments at 3-4 (arguing that the rates for transport and termination of ISP-bound traffic must be identical to the rates established for the transport and termination of local traffic).

[183] *See* Verizon Remand Comments, Declaration of William E. Taylor at 14, 17.

[184] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 14. *See also* Letter from John W. Kure, Qwest, to Magalie Roman Salas, Secretary, FCC, Attachment at 7-8 (Oct. 26, 2000).

[185] *See* Verizon Remand Comments, Declaration of William E. Taylor at 14-15.

longer than average duration can be eliminated through adoption of rate structures that provide for recovery of per-call costs on a per-call basis, and minute-of-use costs on a minute-of-use basis.[186] We also are not convinced that ISP-bound calls have a lower load distribution (*i.e.,* number and duration of calls in the busy hour as a percent of total traffic), and that these calls therefore impose lower additional costs on a network.[187] It is not clear from the record that there is any "basis to speculate that the busy hour for calls to ISPs will be different than the CLEC switch busy hour,"[188] especially when the busy hour is determined by the flow of both voice and data traffic.

92. Nor does the record demonstrate that CLECs and ILECs incur different costs in delivering traffic that would justify disparate treatment of ISP-bound traffic and local voice traffic under section 251(b)(5). Ameritech maintains that it costs CLECs less to deliver ISP-bound traffic than it costs incumbent LECs to deliver local traffic because CLECs can reduce transmission costs by locating their switches close to ISPs.[189] The proximity of the ISP or other end-user to the delivering carrier's switch, however, is irrelevant to reciprocal compensation rates.[190] The Commission concluded in the *Local Competition Order* that the non-traffic sensitive cost of the local loop is not an "additional" cost of terminating traffic that a LEC is entitled to recover through reciprocal compensation.[191]

93. SBC argues that CLECs should not be entitled to symmetrical reciprocal compensation rates for the delivery of ISP-bound traffic, because CLECs do not provide end office switching functionality to their ISP customers and therefore do not incur the same costs that ILECs incur when delivering local voice traffic. Specifically, SBC claims that the switching functionality that CLECs provide to ISPs is more like a trunk-to-trunk connection than the switching functionality normally provided at end offices.[192] SBC also claims that CLECs are able to reduce the costs of delivering ISP-bound traffic by using new, less expensive switches that do not perform the functions necessary for both the origination and delivery of two-way voice traffic.[193] Similarly, GTE asserts that new technologies and system architectures make it possible for some CLECs to reduce costs by entirely avoiding circuit-switching on calls "to selected telephone numbers."[194] CLECs respond, however, that they are in fact

[186] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 10-11. Time Warner also disputes that the "average duration of calls to ISPs has been accurately measured to date." *Id*. at 11.

[187] *See* Verizon Remand Comments, Declaration of William E. Taylor at 17-18.

[188] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 14-15.

[189] *See* Letter from Gary L. Phillips, Ameritech, to Magalie Roman Salas, Secretary, FCC, Attachment at 5 (Sept. 14, 1999). *See also* SBC Remand Comments at 32-33 (referring to Global NAPS Comments, Exhibit 1, Statement of Fred Goldstein at 6, which describes CLEC reduction of loop costs through collocation); Letter from Melissa Newman, U S West, to Magalie Roman Salas, Secretary, FCC, Attachment at 8 (Dec. 2, 1999).

[190] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 25.

[191] *See Local Competition Order*, 11 FCC Rcd at 16025.

[192] SBC Remand Comments at 33.

[193] SBC Remand Comments at 33-34 (referring, *inter alia*, to "managed modem" switches).

[194] GTE Comments at 7-8 (noting the existence of SS7 bypass devices that can avoid circuit switching and arguing that competitive LEC networks are far less complex and utilize fewer switches than incumbent LEC networks); GTE Reply Comments at 16 (compensating competitive LECs based on an incumbent LEC's costs inflates the revenue that competitive LECs receive); Letter from W. Scott Randolph, GTE, to Magalie Roman Salas, Secretary, FCC, (continued….)

using the same circuit switching technology used by ILECs to terminate the vast portion of Internet traffic.[195] In any event, it is not evident from any of the comments in the record that the apparent efficiencies associated with new system architectures apply exclusively to data traffic, and not to voice traffic as well. ILECs and CLECs alike are free to deploy new technologies that provide more efficient solutions to the delivery of certain types of traffic,[196] and these more efficient technologies will, over time, be reflected in cost-based reciprocal compensation rates. The overall record in this proceeding does not lead us to conclude that any system architectures or technologies widely used by LECs result in material differences between the cost of delivering ISP-bound traffic and the cost of delivering local voice traffic, and we see no reason, therefore, to distinguish between voice and ISP traffic with respect to intercarrier compensation.

94. Some CLECs take this argument one step further. Whatever the merits of bill and keep or other reforms to intercarrier compensation, they say, any such reform should be undertaken only in the context of a comprehensive review of *all* intercarrier compensation regimes, including the interstate access charge regime.[197] First, we reject the notion that it is inappropriate to remedy some troubling aspects of intercarrier compensation until we are ready to solve all such problems. In the most recent of our access charge reform orders, we recognized that it is "preferable and more reasonable to take several steps in the right direction, even if incomplete, than to remain frozen" pending "a perfect, ultimate solution."[198] Moreover, it may make sense to begin reform by rationalizing intercarrier compensation between competing providers of telecommunications services, to encourage efficient entry and the development of robust competition, rather than waiting to complete reform of the interstate access charge regime that applies to incumbent LECs, which was created in a monopoly environment for quite different purposes. Second, the interim compensation scheme we adopt here is fully consistent with the course the Commission has pursued with respect to access charge reform. A primary feature of the

(Continued from previous page)
Attachment (Dec. 8, 1999 (new generation traffic architectures may use SS7 Gateways instead of more expensive circuit-switched technology).

[195] *See, e.g.,* Letter from John D. Windhausen, Jr., ALTS, and H. Russell Frisby, Jr., CompTel, to Kyle Dixon, Legal Advisor, Chairman Michael Powell, FCC, at 4-5 (March 16, 2001)(Focal is testing two softswitches, but as of now all ISP-bound traffic terminated by Focal uses traditional circuit switches; Allegiance Telecom has a single softswitch in its network; Advanced Telecom Group, Inc. is in the testing phase of softswitch deployment; Pac-West Telecomm, Inc., does not have any softswitches in its network; e.spire uses only circuit switches to terminate ISP-bound traffic);Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 27 (Time Warner is "deploying fully functional end office switches"); Letter from Donald F. Shepheard, Time Warner, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 3 (February 28, 2001)(Time Warner "does not provide managed modem services." Like the ILECs, Time Warner "has an extensive network of circuit switched technology" and has only just begun to deploy softswitches); Letter from Teresa Marrero, AT&T, to Magalie Roman Salas, Secretary, FCC, at 1 (April 11, 2001)("Virtually all of AT&T's ISP-bound traffic is today terminated using full circuit switches.").

[196] *See* Time Warner Remand Reply Comments, Exhibit 1, Declaration of Don J. Wood at 28; *see also* Letter from Donald F. Shepheard, Time Warner, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 3 (Feb. 28, 2001)("if softswitch technology will lower carriers' costs, then all carriers, including the ILECs[,] will have incentive to deploy them"); Letter from John D. Windhausen, Jr., ALTS, and H. Russell Frisby, Jr., CompTel, to Dorothy Attwood, Chief, Common Carrier Bureau, FCC, at 4 (February 16, 2001)(same).

[197] *See, e.g.,* Letter from Karen L. Gulick, Harris, Wiltshire & Grannis, to Magalie Roman Salas, Secretary, FCC, at 1 (Dec. 22, 2000).

[198] *See CALLS Order*, 15 FCC Rcd at 12974.

CALLS Order is the phased elimination of the PICC and CCL, [199] two intercarrier payments we found to be inefficient, in favor of greater recovery from end-users through an increased SLC, an end-user charge.[200] Finally, like the *CALLS Order*, the interim regime we adopt here "provides relative certainty in the marketplace" pending further Commission action, thereby allowing carriers to develop business plans, attract capital, and make intelligent investments.[201]

D. Conclusion

95. In this Order, we strive to balance the need to rationalize an intercarrier compensation scheme that has hindered the development of efficient competition in the local exchange and exchange access markets with the need to provide a fair and reasonable transition for CLECs that have come to depend on intercarrier compensation revenues. We believe that the interim compensation regime we adopt herein responds to both concerns. The regime should reduce carriers' reliance on carrier-to-carrier payments as they recover more of their costs from end-users, while avoiding a "flash cut" to bill and keep which might upset legitimate business expectations. The interim regime also provides certainty to the industry during the time that the Commission considers broader reform of intercarrier compensation mechanisms in the *NPRM* proceeding. Finally, we hope this Order brings an end to the legal confusion resulting from the Commission's historical treatment of ISP-bound traffic, for purposes of jurisdiction and compensation, and the statutory obligations and classifications adopted by Congress in 1996 to promote the development of competition for all telecommunications services. We believe the analysis set forth above amply responds to the court's mandate that we explain how our conclusions regarding ISP-bound traffic fit within the governing statute.[202]

V. PROCEDURAL MATTERS

A. Final Regulatory Flexibility Analysis

96. As required by the Regulatory Flexibility Act (RFA),[203] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *Declaratory Ruling and NPRM*.[204] The Commission sought and received written comments on the IRFA. The Final Regulatory Flexibility Analysis (FRFA) in this Order on Remand and Report and Order conforms to the RFA, as amended.[205] To the extent that any

[199] The PICC, or presubscribed interexchange carrier charge, and the CCLC, carrier common line charge, are charges levied by incumbent LECs upon IXCs to recover portions of the interstate-allocated cost of subscriber loops. *See* 47 C.F.R. §§ 69.153, 69.154.

[200] *CALLS Order,* 15 FCC Rcd at 12975 (permitting a greater proportion of the local loop costs of primary residential and single-line business customers to be recovered through the SLC).

[201] *CALLS Order*, 15 FCC Rcd at 12977 (The CALLS proposal is aimed to " bring lower rates and less confusion to consumers; and create a more rational interstate rate structure. This, in turn, will support more efficient competition, more certainty for the industry, and permit more rational investment decisions.").

[202] *Bell Atlantic*, 206 F.3d at 8.

[203] *See* 5 U.S.C. § 603.

[204] *Declaratory Ruling*, 14 FCC Rcd at 3710-13.

[205] *See* 5 U.S.C. § 604. The Regulatory Flexibility Act, 5 U.S.C. § 601 *et. seq*., was amended by the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA), which was enacted as Title II of the Contract With America Advancement Act of 1996, Pub.L. No. 104-121, 110 Stat. 847 (1996) (CWAAA).

statement contained in this FRFA is perceived as creating ambiguity with respect to our rules, or statements made in preceding sections of this Order on Remand and Report and Order, the rules and statements set forth in those preceding sections shall be controlling.

1. Need for, and Objectives of, this Order on Remand and Report and Order

97. In the *Declaratory Ruling*, we found that we did not have an adequate record upon which to adopt a rule regarding intercarrier compensation for ISP-bound traffic, but we indicated that adoption of a rule would serve the public interest.[206] We sought comment on two alternative proposals, and stated that we might issue new rules or alter existing rules in light of the comments received.[207] Prior to the release of a decision, the Court of Appeals for the District of Columbia Circuit vacated certain provisions of the *Declaratory Ruling* and remanded the matter to the Commission.[208]

98. This Order on Remand and Report and Order addresses the concerns of various parties to this proceeding and responds to the court's remand. The Commission exercises jurisdiction over ISP-bound traffic pursuant to section 201, and establishes a three-year interim intercarrier compensation mechanism for the exchange of ISP-bound traffic that applies if incumbent LECs offer to exchange section 251(b)(5) traffic at the same rates. During this interim period, intercarrier compensation for ISP-bound traffic is subject to a rate cap that declines over the three-year period, from $.0015/mou to $.0007/mou. The Commission also imposes a cap on the total ISP-bound minutes for which a LEC may receive this compensation under a particular interconnection agreement equal to, on an annualized basis, the number of ISP-bound minutes for which that LEC was entitled to receive compensation during the first quarter of 2001, increased by ten percent in each of the first two years of the transition. If an incumbent LEC does not offer to exchange all section 251(b)(5) traffic subject to the rate caps set forth herein, the exchange of ISP-bound traffic will be governed by the reciprocal compensation rates approved or arbitrated by state commissions.

2. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

99. The Office of Advocacy, U.S. Small Business Administration (Office of Advocacy) submitted two filings in response to the IRFA.[209] In these filings, the Office of Advocacy raises significant issues regarding our description, in the IRFA, of small entities to which our rules will apply, and the discussion of significant alternatives considered and rejected. Specifically, the Office of Advocacy argues that the Commission has failed accurately to identify all small entities affected by the rulemaking by refusing to characterize small incumbent local exchange carriers (LECs), and failing to identify small ISPs, as small entities.[210] We note that, in the IRFA, we stated that we excluded small

[206] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3707.

[207] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[208] *See Bell Atlantic*, 206 F.3d 1.

[209] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999.

[210] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999, at 1-3; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 2-3.

incumbent LECs from the definitions of "small entity" and "small business concern" because such companies are either dominant in their field of operations or are not independently owned and operated.[211] We also stated, however, that we would nonetheless, out of an abundance of caution, include small incumbent LECs in the IRFA, and did so.[212] Small incumbent LECs and other relevant small entities are included in our present analysis as described below.

100. The Office of Advocacy also states that Internet service providers (ISPs) are directly affected by our actions, and therefore should be included in our regulatory flexibility analysis. We find, however, that rates charged to ISPs are only indirectly affected by our actions. We have, nonetheless, briefly discussed the effect on ISPs in the primary text of this Order.[213]

101. Last, the Office of Advocacy also argues that the Commission has failed to adequately address significant alternatives that accomplish our stated objective and minimize any significant economic impact on small entities.[214] We note that, in the IRFA, we described the nature and effect of our proposed actions, and encouraged small entities to comment (including giving comment on possible alternatives). We also specifically sought comment on the two alternative proposals for implementing intercarrier compensation – one that resolved intercarrier compensation pursuant to the negotiation and arbitration process set forth in Section 252, and another that would have had us adopt a set of federal rules to govern such intercarrier compensation.[215] We believe, therefore, that small entities had a sufficient opportunity to comment on alternative proposals.

102. NTCA also filed comments, not directly in response to the IRFA, urging the Commission to fulfill its obligation to consider small telephone companies.[216] Some commenters also raised the issue of small entity concerns over increasing Internet traffic and the use of Extended Area Service (EAS) arrangements.[217] We are especially sensitive to the needs of rural and small LECs that handle ISP-bound traffic, but we find that the costs that LECs incur in *originating* this traffic extends beyond the scope of the present proceeding and should not dictate the appropriate approach to compensation for *delivery* of ISP-bound traffic.

3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply

103. The rules we are adopting apply to local exchange carriers. To estimate the number of small entities that would be affected by this economic impact, we first consider the statutory definition of "small entity" under the RFA. The RFA generally defines "small entity" as having the same meaning as

[211] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[212] *Declaratory Ruling and Intercarrier Compensation NPRM*, 14 FCC Rcd at 3711.

[213] *See supra* paras. 87-88.

[214] Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 3.

[215] *Declaratory Ruling [IRFA]*, 14 FCC Rcd at 3711 (para. 39); *see also Declaratory Ruling*, 14 FCC Rcd at 3707-08 (paras. 30-31).

[216] NTCA Comments at vi, 15.

[217] *See, e.g.*, ICORE Comments at 1-7; IURC Comments at 7; Richmond Telephone Company Comments at 1-8.

the term "small business," "small organization," and "small governmental jurisdiction."[218] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act, unless the Commission has developed one or more definitions that are appropriate to its activities.[219] Under the Small Business Act, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.[220] The SBA has defined a small business for Standard Industrial Classification (SIC) categories 4812 (Radiotelephone Communications) and 4813 (Telephone Communications, Except Radiotelephone) to be small entities when they have no more than 1,500 employees.[221]

104. The most reliable source of information regarding the total numbers of certain common carrier and related providers nationwide, as well as the numbers of commercial wireless entities, appears to be data the Commission publishes annually in its Carrier Locator report, derived from filings made in connection with the Telecommunications Relay Service (TRS).[222] According to data in the most recent report, there are 4,144 interstate carriers.[223] These carriers include, *inter alia*, incumbent local exchange carriers, competitive local exchange carriers, competitive access providers, interexchange carriers, other wireline carriers and service providers (including shared-tenant service providers and private carriers), operator service providers, pay telephone operators, providers of telephone toll service, wireless carriers and services providers, and resellers.

105. We have included small incumbent local exchange carriers (LECs) in this regulatory flexibility analysis. As noted above, a "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g.*, a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."[224] The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent LECs are not dominant in their field of operation because any such dominance is not "national" in scope.[225] We have therefore included small incumbent LECs in this regulatory flexibility analysis, although we emphasize that this action has no effect on the Commission's analyses and determinations in other, non-RFA contexts.

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[218] 5 U.S.C. § 601(6).

[219] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 5 U.S.C. § 632).

[220] 15 U.S.C. § 632.

[221] 13 C.F.R. § 121.201.

[222] FCC, Carrier Locator: Interstate Service Providers, Figure 1 (Jan. 2000) (*Carrier Locator*).

[223] *Carrier Locator* at Fig. 1.

[224] 5 U.S.C. § 601(3).

[225] Office of Advocacy, U.S. Small Business Administration *ex parte*, May 27, 1999, at 1-3; Office of Advocacy, U.S. Small Business Administration *ex parte*, June 14, 1999, at 2-3. The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." *See* 15 U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b). Since 1996, out of an abundance of caution, the Commission has included small incumbent LECs in its regulatory flexibility analyses. *See, e.g.*, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket, 96-98, First Report and Order, 11 FCC Rcd 15499, 16144-45 (1996).

106. Total Number of Telephone Companies Affected. The United States Bureau of the Census (the Census Bureau) reports that, at the end of 1992, there were 3,497 firms engaged in providing telephone services, as defined therein, for at least one year.[226] This number contains a variety of different categories of carriers, including local exchange carriers, interexchange carriers, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, PCS providers, covered SMR providers, and resellers. It seems certain that some of those 3,497 telephone service firms may not qualify as small entities or small incumbent LECs because they are not "independently owned and operated."[227] For example, a PCS provider that is affiliated with an interexchange carrier having more than 1,500 employees would not meet the definition of a small business. It seems reasonable to conclude, therefore, that fewer than 3,497 telephone service firms are small entity telephone service firms or small incumbent LECs that may be affected by the decisions and rule changes adopted in this proceeding.

107. *Wireline Carriers and Service Providers*. The SBA has developed a definition of small entities for telephone communications companies other than radiotelephone companies. The Census Bureau reports that there were 2,321 such telephone companies in operation for at least one year at the end of 1992.[228] According to the SBA's definition, a small business telephone company other than a radiotelephone company is one employing no more than 1,500 persons.[229] All but 26 of the 2,321 non-radiotelephone companies listed by the Census Bureau were reported to have fewer than 1,000 employees. Thus, even if all 26 of those companies had more than 1,500 employees, there would still be 2,295 non-radiotelephone companies that might qualify as small entities or small incumbent LECs. Although it seems certain that some of these carriers are not independently owned and operated, we are unable at this time to estimate with greater precision the number of wireline carriers and service providers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are fewer than 2,295 small entity telephone communications companies other than radiotelephone companies that may be affected by the decisions and rule changes adopted in this proceeding.

108. *Local Exchange Carriers, Interexchange Carriers, Competitive Access Providers, Operator Service Providers, and Resellers*. Neither the Commission nor the SBA has developed a definition particular to small LECs, interexchange carriers (IXCs), competitive access providers (CAPs), operator service providers (OSPs), or resellers. The closest applicable definition for these carrier-types under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[230] According to our most recent TRS data, there are 1,348 incumbent LECs and 212 CAPs and competitive LECs.[231] Although it seems certain that some of these carriers are not independently owned and operated, or have more than 1,500 employees, we are unable at this time to estimate with greater precision the number of these carriers that would qualify as small business

[226] United States Department of Commerce, Bureau of the Census, 1992 Census of Transportation, Communications, and Utilities: Establishment and Firm Size, at Firm Size 1-123 (1995) (*1992 Census*).

[227] 15 U.S.C. § 632(a)(1).

[228] *1992 Census* at Firm Size 1-123.

[229] 13 C.F.R. § 121.201, Standard Industrial Classification (SIC) Code 4813.

[230] 13 C.F.R. § 121.201, SIC Code 4813.

[231] *Carrier Locator* at Fig. 1.

concerns under the SBA's definition. Consequently, we estimate that there are fewer than 1,348 incumbent LECs and fewer than 212 CAPs and competitive LECs that may be affected by the decisions and rule changes adopted in this proceeding.

4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements

109. The rule we are adopting imposes direct compliance requirements on interconnected incumbent and competitive LECs, including small LECs. In order to comply with this rule, these entities will be required to exchange their ISP-bound traffic subject to the rules we are adopting above.

5. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

110. In the *Declaratory Ruling and Intercarrier Compensation NPRM* the Commission proposed various approaches to intercarrier compensation for ISP-bound traffic.[232] During the course of this proceeding the Commission considered and rejected several alternatives.[233] None of the significant alternatives considered would appear to succeed as much as our present rule in balancing our desire to minimize any significant economic impact on relevant small entities, with our desire to deal with the undesirable incentives created under the current reciprocal compensation regime that governs the exchange of ISP-bound traffic in most instances. We also find that for small ILECs and CLECs the administrative burdens and transaction costs of intercarrier compensation will be minimized to the extent that LECs begin a transition toward recovery of costs from end-users, rather than other carriers.

111. Although a longer transition period was considered by the Commission, it was rejected because a three-year period was considered sufficient to accomplish our policy objectives with respect to all LECs.[234] Differing compliance requirements for small LECs or exemption from all or part of this rule is inconsistent with our policy goal of addressing the market distortions attributable to the prevailing intercarrier compensation mechanism for ISP-bound traffic and beginning a smooth transition to bill-and-keep.

Report to Congress: The Commission will send a copy of this Order on Remand and Report and Order, including this FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act.[235] In addition, the Commission will send a copy of this Order on Remand and Report and Order, including the FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this Order on Remand and Report and Order and FRFA (or summaries thereof) will also be published in the Federal Register.[236]

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[232] *Declaratory Ruling*, 14 FCC Rcd at 3707-10.

[233] *See supra* paras. 67-76 (rejecting application of a reciprocal compensation mechanism to ISP-bound traffic).

[234] We note, however, that the interim regime we adopt here governs for 36 months or until further action by the Commission, *whichever is longer*.

[235] 5 U.S.C. § 801(a)(1)(A).

[236] *See* 5 U.S.C. § 604(b).

VI. ORDERING CLAUSES

112. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i) and (j), 201-209, 251, 252, 332, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-209, 251, 252, 332, and 403, and Section 553 of Title 5, United States Code, 5 U.S.C. § 553, that this Order on Remand and Report and Order and revisions to Part 51 of the Commission's rules, 47 C.F.R. Part 51, ARE ADOPTED. This Order on Remand and Report and Order and the rule revisions adopted herein will be effective 30 days after publication in the Federal Register except that, for good cause shown, as set forth in paragraph 82 of this Order, the provision of this Order prohibiting carriers from invoking section 252(i) of the Act to opt into an existing interconnection agreement as it applies to rates paid for the exchange of ISP-bound traffic will be effective immediately upon publication of this Order in the Federal Register.

113. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Order on Remand and Report and Order, including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

Appendix A
List of Commenters in CC Docket Nos. 96-98, 99-68

Comments Filed in Response to the June 23, 2000 Public Notice

Advanced TelCom Group, Inc.; e.spire Communications, Inc.; Intermedia Communications, Inc.; KMC Telecom, Inc.; Nextlink Communications, Inc.; The Competitive Telecommunications Association
Alliance for Public Technology
Association of Communications Enterprises
Association for Local Telecommunications Services
AT&T Corp. (AT&T)
BellSouth Corporation
Cablevision Lightpath, Inc.
California State and California Public Utilities Commission
Centennial Communications Corp. (Centennial)
Florida Public Service Commission
Focal Communications Corporation, Allegiance Telecom, Inc., and Adelphia Business Solutions, Inc.
General Services Administration
Global NAPs, Inc.
ICG Telecom Group, Inc.
Keep America Connected; National Association of the Deaf; National Association of Development Organizations; National Black Chamber of Commerce; New York Institute of Technology; Ocean of Know; Telecommunications for the Deaf, Inc.; United States Hispanic Chamber of Commerce
Massachusetts Department of Telecommunications & Energy
Missouri Public Service Commission
National Consumers League
National Exchange Carrier Association, Inc.
New York Department of Public Service
Pac-West Telecomm, Inc.
Pennsylvania Office of Consumer Advocate
Prism Communications Services, Inc.
Qwest Corporation
RCN Telecom Services, Inc. and Connect Communications Corporation
RNK, Inc.
Rural Independent Competitive Alliance
SBC Communications, Inc. (SBC)
Sprint Corporation (Sprint)
Texas Public Utility Commission
Time Warner Telecom Inc. (Time Warner)
United States Telecom Association
Verizon Communications (Verizon)
Western Telephone Integrated Communications, Inc.
WorldCom, Inc.

Reply Comments Filed in Response to the June 23, 2000 Public Notice

Adelphia Business Solutions, Inc.; Allegiance TeleCom, Inc., Focal Communications Corporation, and RCN Telcom Services, Inc.
AT&T Corp.
BellSouth Corporation
Cablevision Lightpath, Inc.
Cincinnati Bell Telephone Company
Commercial Internet Exchange Association
Converscent Communications, LLC
Covad Communication Company
Duckenfield, Pace
e.spire Communications, Inc., Intermedia Communications Inc., KMC Telecom, Inc., NEXTLINK Communications, Inc., The Association for Local Telecommunications Services, and The Competitive Telecommunications Association
General Services Administration
Global NAPs, Inc.
ICG Telecom Group, Inc.
Keep America Connected; National Association of Development Organizations; National Black Chamber of Commerce; New York Institute of Technology; United States Hispanic Chamber of Commerce
Pac-West Telecomm, Inc.
Prism Communications Services, Inc.
Qwest Corporation
Riter, Josephine
SBC Communications, Inc. (SBC)
Sprint Corporation
Time Warner Telecom Inc. (Time Warner)
US Internet Industry Association
United States Telecom Association
Verizon Communications (Verizon)
Western Telephone Integrated Communications, Inc.
WorldCom, Inc.

Comments Filed in Response to the February 26, 1999 Notice of Proposed Rulemaking

Airtouch Paging
America Online, Inc. (AOL)
Ameritech
Association for Local Telecommunications Services
AT&T Corp. (AT&T)
Baldwin, Jesse
Bardsley, June
Bell Atlantic Corporation
BellSouth Corporation
Cablevision Lightpath, Inc.
California Public Utilities Commission
Choice One Communications (Choice One)
Cincinnati Bell Telephone Company
Commercial Internet eXchange Association
Competitive Telecommunications Association)
Corecomm Limited
Cox Communications, Inc. (Cox)
CT Cube, Inc. & Leaco Rural Telephone Cooperative, Inc.
CTSI, Inc.
Florida Public Service Commission
Focal Communications Corporation
Frontier Corporation
General Communication, Inc.
General Services Administration
Global NAPs Inc.
GST Telecom, Inc.
GTE Services Corporation (GTE)
GVNW Consulting, Inc.
Hamilton, Dwight
ICG Communications
ICORE, Inc.
Indiana Utility Regulatory Commission
Information Technology Association of America
Intermedia Communications Inc. (Intermedia)
Keep America Connected; Federation of Hispanic Organizations of the Baltimore Metropolitan Area, Inc; Latin American Women and Supporters; League of United Latin American Citizens; Massachusetts Assistive Technology Partnership; National Association of Commissions for Women; National Association of Development Organizations; National Hispanic Council on Aging; New York Institute of Technology; Resources for Independent Living; Telecommunications Advocacy Project; The Child Health Foundation; The National Trust for the Development of African American Men; United Homeowners Association; United Seniors Health Cooperative
KMC Telecom Inc.
Lewis, Shawn
Lloyd, Kimberly, D.
MCI WorldCom, Inc.
MediaOne Group (Media One)

Miner, George
Missouri Public Service Commission
National Telephone Cooperative Association
New York State Department of Public Service
Pennsylvania Public Utility Commission
Personal Communications Industry Assoc.
Public Utility Commission of Texas
Prism Communications Services, Inc.
RCN Telecom Services, Inc.
Reinking, Jerome C.
Richmond Telephone Company
RNK Inc.
SBC Communications
Schaefer, Karl W.
Sefton, Tim
Shook, Ofelia E.
Sprint Corporation
John Staurulakis, Inc.
Telecommunications Resellers Association
Telephone Association of New England
Thomas, William J.
Time Warner Telecom Inc. (Time Warner)
United States Telephone Association
Verio Inc.
Vermont Public Service Board
Virgin Islands Telephone Corporation
Wisconsin State Telecommunications Association

Reply Comments Filed in Response to the February 26, 1999 Notice of Proposed Rulemaking

Airtouch Paging
Ameritech
Association for Local Telecommunications Services
AT&T Corp.
Bell Atlantic Corporation
BellSouth Corporation and BellSouth Telecommunications, Inc.
Competitive Telecommunications Association
Corecomm Limited (CoreComm)
Cox Communications, Inc. (Cox)
Focal Communications Corporation
General Services Administration
Global NAPs Inc.
GST Telecom Inc.
GTE Services Corporation (GTE)
GVNW Consulting, Inc.
ICG Communications, Inc
Illinois Commerce Commission
Intermedia Communications Inc.

KMC Telecom Inc.
MCI WorldCom, Inc.
National Exchange Carrier Association, Inc.
National Telephone Cooperative Association
Network Plus, Inc.
New York State Department of Public Services
Pac-West Telecomm., Inc.
Pennsylvania Public Utility Commission
Personal Communications Industry Association
Prism Communications Services, Inc.
Public Service Commission of Wisconsin
RCN Telecom Services
RNK Telecom
SBC Communications, Inc.
Sprint Corporation
Supra Telecommunications & Information Systems, Inc.
TDS Telecommunications Corporation
Time Warner Telecom
United States Telephone Association
US West Communications, Inc.
Verio Inc.
Virgin Islands Telephone Corporation
Wyoming Public Service Commission

Appendix B – Final Rules

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

Part 51, Subpart H, of Title 47 of the Code of Federal Regulations (C.F.R.) is amended as follows:

1. The title of part 51, Subpart H, is revised to read as follows:

Subpart H--Reciprocal Compensation for Transport and Termination of Telecommunications Traffic

2. Section 51.701(b) is revised to read as follows:

(a) **§ 51.701 Scope of transport and termination pricing rules.**

*****

(b) *Telecommunications traffic*. For purposes of this subpart, telecommunications traffic means:

(1) Telecommunications traffic exchanged between a LEC and a telecommunications carrier other than a CMRS provider, except for telecommunications traffic that is interstate or intrastate exchange access, information access, or exchange services for such access (*see* FCC 01-131, paras. 34, 36, 39, 42-43); or

(2) Telecommunications traffic exchanged between a LEC and a CMRS provider that, at the beginning of the call, originates and terminates within the same Major Trading Area, as defined in § 24.202(a) of this chapter.

3. Sections 51.701(a), 51.701(c) through (e), 51.703, 51.705, 51.707, 51.709, 51.711, 51.713, 51.715, and 51.717 are each amended by striking "local" before "telecommunications traffic" each place such word appears.

SEPARATE STATEMENT OF CHAIRMAN MICHAEL K. POWELL

Re: 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)

In this *Order,* we re-affirm our prior conclusion that telecommunications traffic delivered to Internet service providers (ISPs) is subject to our jurisdiction under section 201 of the Act. Thus, we reject arguments that section 251(b)(5) applies to this traffic. I firmly believe that this *Order* is supported by reasonable interpretations of statutory provisions that read together are ambiguous and, absent a reconciling interpretation, conflicting.

I also support the fact that this *Order,* for the first time, establishes a transition mechanism that will gradually wean competitive carriers from heavy reliance on the excessive reciprocal compensation charges that incumbents have been forced to pay these competitors for carrying traffic from the incumbent to the ISP. This transition mechanism was carefully crafted to balance the competing interests of incumbent and competitive telephone companies and other parties, so as not to undermine the Act's goal of promoting efficient local telephone competition.

I write separately only to emphasize a few points:

As an initial matter, I respectfully disagree with the objections to our conclusion that section 251(g) "carves out" certain categories of services that, in the absence of that provision, would likely be subject to the requirements of section 251(b)(5).[1] Section 251(b)(5)'s language first appears to be far-reaching, in that it would seem to apply, by its express terms, to all "telecommunications."[2] There is apparently no dispute, however, that at least one category of the LEC-provided telecommunications services enumerated in section 251(g) (namely, "exchange access") is not subject to section 251(b)(5), despite the broad language of this provision. Indeed, the *Bell Atlantic* Court appears to have endorsed that conclusion.[3] The question then arises whether the other categories of traffic that are enumerated in section 251(g) (including, "information access") should also be exempted from the application of section 251(b)(5). We answer this question in the affirmative, and no justification (compelling or otherwise) has been offered for why only one service – exchange access – should be afforded disparate treatment in the construction of section 251(g). I would note, moreover, that on the only other occasion in which the Commission directly addressed the question whether section 251(g) serves as such a "carve-out," the

1 To be more precise, section 251(g) refers to certain categories of service *provided by LECs* to *ISPs and interexchange carriers.* 47 U.S.C. § 251(g). In this statement, I use a short-hand reference to the "categories of services" enumerated in section 251(g).

2 47 U.S.C. § 251(b)(5).

3 *See cf. Bell Atl. Tel. Cos. v. FCC,* 206 F.3d 1, 4 (D.C. Cir. 2000) ("Although [section] 251(b)(5) purports to extend reciprocal compensation to all 'telecommunications,' the Commission has construed the reciprocal compensation requirement as limited to local traffic."). The Court then went on to conclude that the Commission had not provided an adequate explanation of why LECs that carry traffic to ISPs are providing "'exchange access,' rather than 'telephone exchange service.'" *Id.* at 9. The Court does not appear to have questioned anywhere in its opinion the notion that the scope of the reciprocal compensation requirement does not extend to certain categories of LEC-provided services, including "exchange access."

Commission concluded, as we do here, that it does perform that function.[4]

Nor do I find the position we adopt here irreconcilable with our decision in the *Advanced Services Remand Order*.[5] In discussing the term "information access" in that *Order,* we were not addressing the question whether section 251(g) exempts certain categories of traffic provided by LECs to ISPs and interexchange carriers from the other requirements of section 251. Rather, we addressed only the relationship between "information access" and the categories of "exchange access" and "telephone exchange service." Specifically, we "decline[d] to find that information access services are a separate category of services, distinct from, and mutually exclusive with, telephone exchange and exchange access services."[6] But under the reading of section 251(g) put forth in this *Order,* the question whether information access is distinct from these other services is irrelevant. Because information access is specifically enumerated in section 251(g), it is not subject to the requirements of section 251(b)(5), whether or not that category of service overlaps with, or is distinct from, telephone exchange service or exchange access.

Similarly, I reject the suggestion that section 251(g) *only* preserves the MFJ requirements. The language of section 251(g) specifically refers to "each local exchange carrier," not just to the Bell Operating Companies.[7] Section 251(g) also expressly refers to any "regulation, order, or policy of the Commission."[8] Such clauses support the reading of section 251(g) that we adopt today.[9]

Finally, I disagree that section 251(g) cannot be construed to exempt certain categories of traffic from the requirements of section 251(b)(5), simply because the former provision does not include the words "exclude" or "reciprocal compensation" or "telecommunications."[10] As I have said, our reading that the categories of LEC-provided services enumerated in subsection (g) are exempted from reciprocal compensation arises from our duty to give effect to both section 251(g) and section 251(b)(5). I also would point out that section 251(g) does include a specific reference to "receipt of compensation," just as the services enumerated in that section (e.g., exchange access, information

4 *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers,* CC Dkt. Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499 (1996), ¶ 1034.

5 *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Dkt. Nos. 98-147 et al., Order on Remand, 15 FCC Rcd 385 (1999) (*Advanced Services Remand Order*); *see also WorldCom, Inc. v. FCC,* No. 00-1002 (D.C. Cir. filed Apr. 20, 2001) (affirming *Advanced Services Remand Order* on one of the alternative grounds proffered by the Commission).

6 *Advanced Services Remand Order,* 15 FCC Rcd at 406, ¶ 46.

7 47 U.S.C. § 251(g).

8 *Id.*

9 Had the language of section 251(g) been limited to the Bell Companies or to court orders and consent decrees, for example, perhaps one could construct an argument that Congress meant to limit the scope of section 251(g) to the MFJ requirements.

10 Section 251(b)(5) states that all LECs must "establish *reciprocal compensation* arrangements for the transport and termination of *telecommunications.*" 47 U.S.C. § 251(g) (emphasis added).

access) undeniably involve telecommunications.[11]

In closing, I would only reiterate that the statutory provisions at issue here are ambiguous and, absent a reconciling interpretation, conflicting. Thus, the Commission has struggled long and hard in an effort to give as full a meaning as possible to each of the provisions in a manner we conclude is consistent with the statutory purpose. It would not be overstating matters to acknowledge that these issues are highly complex, disputed and elusive, and that what we decide here will have enormous impact on the development of new technologies and the economy more broadly. It is for their relentless efforts to wrestle with (and now resolve) these issues that I am deeply grateful to my colleagues and our able staff.

[11] As the *Order* suggests, Section 251(g) enumerates "exchange access," "information access" and "exchange services for such access." 47 U.S.C. § 251(g). For purposes of subsection (g), all of these services are provided by LECs to "interexchange carriers and information service providers." These three categories undeniably involve telecommunications. "Information access" was defined in the MFJ as "the provision of specialized exchange *telecommunications* services" to information service providers. *United States v. AT&T,* 552 F. Supp. 131, 196, 229 (D.D.C. 1982). The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ. Rather, the term "exchange service" is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purposes of originating or terminating interexchange *telecommunications.*" *United States v. AT&T,* F. Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. Consistent with that, in section 251(g), the term is used as part of the longer phrase "exchange services for such [exchange] access to interexchange carriers and information service providers." All of this indicates that the term "exchange service" is closely related to the provision of exchange access and information access, and that all three involve telecommunications.

DISSENTING STATEMENT OF
COMMISSIONER HAROLD FURCHTGOTT-ROTH

Re: *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, CC Docket Nos. 96-98, 99-68.

To some observers, the Telecommunications Act of 1996 ("1996 Act"), in general, and sections 251 and 252 (47 U.S.C. §§ 251 and 252), in particular, have become unnecessary inconveniences. The poster child for those who proclaim the 1996 Act's failure is reciprocal compensation. It has led to large billings – some paid, some unpaid – among telecommunications carriers. These billings have not shrunk, in large part because the Commission's interpretation of the pick-and-choose provision of the Act (47 U.S.C. § 252(i)) has led to unstable contracts, with perverse incentives for renegotiation.

Reciprocal compensation is an obscure and tedious topic. It is not, however, a topic that Congress overlooked. To the contrary, in describing reciprocal compensation arrangements in sections 251 and 252, Congress went into greater detail than it did for almost any other commercial relationship between carriers covered in the 1996 Act. Among other things, Congress mandated that reciprocal compensation arrangements would be:
(1) made by contract; (2) under State supervision; (3) at rates to be negotiated or arbitrated; and (4) would utilize a bill-and-keep plan only on a case-by-case basis under specific statutory conditions. *See* 47 U.S.C. §§ 251(b)(5), 252(a), 252(b), 252(d)(2).

Faced with these statutory mandates, how should the large billings for reciprocal compensation be addressed? Renegotiating contracts would be the simple market solution, only made precarious by our pick-and-choose rules. Another solution would be to seek review of reciprocal compensation agreements by State commissions. Other solutions would be for this Commission to change its pick-and-choose rules or to issue guidelines for State commission decisions (*see AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 385 (1999)).

Each of these solutions, of course, would reflect at least a modicum of respect for States, their lawmakers, their regulators, federal law, and the Congress that enacted the 1996 Act. Each would also be consistent with, and respectful of, the prior ruling on reciprocal compensation by the Court of Appeals for the D.C. Circuit. *See Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

There is, however, one solution that is not respectful of other governmental institutions. It is a solution that places under exclusive federal jurisdiction broad expanses of telecommunications. It is a solution that does not directly solve the problem at hand. It is a solution that can be reached only through a twisted interpretation of the law and a vitiation of economic reasoning and general common sense. That solution is nationwide price regulation. That is the regrettable solution the Commission has adopted.

The Commission's decision has broad consequences for the future of telecommunications regulation. In holding that essentially all packetized communications fall within federal jurisdiction, the Commission has dramatically diminished the States' role going forward, as such communications are fast becoming the dominant mode. Whatever the merits of this reallocation of authority, it is a reallocation that properly should be made only by Congress. It certainly should not be made, as here, by a self-

serving federal agency acting unilaterally.

There is doubtlessly underway a publicity campaign by the proponents of today's action. It will spin nationwide mandatory price regulation as "deregulation." It will spin the abandonment of States and contracts as "good government."

The media might be spun by this campaign. The public might be spun. But it will be far more difficult to convince the courts that the current action is lawful.

A Flawed Order From Flawed Decisionmaking

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.

In March 2000, the Court of Appeals for the D.C. Circuit vacated the Commission's conclusion that section 251(b)(5) does not apply to calls made to Internet service providers ("ISPs"). *See Bell Atlantic*, 206 F.3d at 9. The court ruled that, among other things, the Commission had not provided a "satisfactory explanation why LECs that terminate calls to ISPs are not properly seen as 'terminating . . . local telecommunications traffic,' and why such traffic is 'exchange access' rather than 'telephone exchange service.'" *Id.*

The Commission has taken more than a year to respond to the court's remand decision. My colleagues some time ago decided on their general objective – asserting section 201(b) jurisdiction over ISP-bound traffic and permitting incumbent carriers to ramp down the payments that they make to competitive ones. The delay in producing an order is attributable to the difficulty the Commission has had in putting together a legal analysis to support this result, which is at odds with the agency's own precedent as well as the plain language of the statute.

Today, the Commission rules, once again, that section 251(b)(5) does not apply to ISP-bound traffic. In a set of convoluted arguments that sidestep the court's objections to its previous order, the Commission now says that ISP-bound traffic is "information access," which, the Commission asserts, is excluded "from the universe of 'telecommunications' referred to in section 251(b)(5)" (Order ¶¶ 23, 30) – despite the Commission's recent conclusion in another context that "information access" is not a separate category of service exempt from the requirements of section 251. *See Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Order on Remand, 15 FCC Rcd 385, ¶¶ 46-49 (1999) ("*Advanced Services Remand Order*").

The result will be another round of litigation, and, in all likelihood, this issue will be back at the agency in another couple of years. In the meantime, the uncertainty that has clouded the issue of compensation for ISP-bound traffic for the last five years will continue. The Commission would act far more responsibly if it simply recognized that ISP-bound traffic comes within section 251(b)(5). To be sure, this conclusion would mean that the Commission could not impose on these communications any rule that it makes up, as the agency believes it is permitted to do under section 201(b). Rather, the Commission would be forced to work within the confines of sections 251(b)(5) and 252(d)(2), which, among other things, grant authority to State commissions to decide on "just and reasonable" rates for

reciprocal compensation. 47 U.S.C. § 252(d)(2). But the Commission surely could issue "rules to guide the state-commission judgments" regarding reciprocal compensation (*Iowa Utilities Bd.*, 525 U.S. at 385) and perhaps could even put in place the same compensation scheme it orders here. At the same time, the confusion that this order will add to the agency's already bewildering precedent on Internet-related issues would be avoided.

The Commission's Previous Order and the Court's Remand Decision

To see how far the Commission has come in its attempt to assert section 201(b) jurisdiction over ISP-bound traffic, let us briefly review the court's decision on the Commission's previous order, which receives little attention in the order released today. In its previous order, issued in February 1999, the Commission focused on the jurisdictional nature of ISP-bound traffic. *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic*, Declaratory Ruling, 14 FCC Rcd 3689 (1999) ("*Reciprocal Compensation Declaratory Ruling*"). Applying an "end-to-end" analysis, the agency concluded that calls to ISPs do not terminate at the ISP's local server, but instead continue to the "ultimate destination or destinations, specifically at a[n] Internet website that is often located in another state." *Id.* ¶ 12. Based on this jurisdictional analysis, the Commission ruled that a substantial portion of calls to ISPs are jurisdictionally interstate, and it described ISP-bound traffic as interstate "access service." *Id.* ¶¶ 17, 18. The Commission reasoned that, since reciprocal compensation is required only for the transport and termination of *local* traffic, section 251(b)(5)'s obligations did not apply to ISP-bound calls. *See id.* ¶¶ 7, 26.

1. The Court Asked the Commission Why ISPs Are Not Like Other Local Businesses

The court vacated the Commission's decision. It held that, regardless of the jurisdictional issue, the Commission had not persuasively distinguished ISPs from other businesses that use communications services to provide goods or services to their customers. *See Bell Atlantic*, 206 F.3d at 7. In the court's view, the Commission had failed to explain why "an ISP is not, for purposes of reciprocal compensation, 'simply a communications-intensive business end user selling a product to other consumer and business end-users.'" *Id.* (citation omitted).

2. The Court Asked the Commission Why Calls Do Not Terminate at ISPs

The court also questioned the Commission's conclusion that a call to an ISP did not "terminate" at the ISP. "[T]he mere fact that the ISP originates further telecommunications does not imply that the original telecommunication does not 'terminate' at the ISP." *Id.* The court concluded that, "[h]owever sound the end-to-end analysis may be for jurisdictional purposes," the Commission had failed to explain why treating these "linked telecommunications as continuous works for purposes of reciprocal compensation." *Id.*

3. The Court Asked the Commission How Its Treatment of ISP-Bound Traffic Is Consistent with Its Treatment of Enhanced Service Providers

The court also wondered whether the Commission's treatment of ISP-bound traffic was consistent with the approach it applies to enhanced service providers ("ESPs"), which include ISPs.

See id. at 7-8. The Commission has long exempted ESPs from the access charge system, effectively treating them as end-users of local service rather than long-distance carriers. The court observed that this agency, in the Eighth Circuit access charge litigation, had taken the position "that a call to an information service provider is really like a call to a local business that then uses the telephone to order wares to meet the need." *Id.* at 8. The court rejected as "not very compelling" the Commission's argument that the ESP exemption is consistent with the understanding that ESPs use interstate access services. *Id.*

4. The Court Asked the Commission Whether ISP-Bound Traffic is "Exchange Access" or "Telephone Exchange Service"

Finally, the court rejected the Commission's suggestion that ISPs are "users of access service." *Id*. The court noted that the statute creates two statutory categories – "telephone exchange service" and "exchange access" – and observed that on appeal, the Commission had conceded that these categories occupied the field. *Id.* If the Commission had meant to say that ISPs are users of "exchange access," wrote the court, it had "not provided a satisfactory explanation why this is the case." *Id.*

The Commission's Latest Order

Today, the Commission fails to answer any of the court's questions. Recognizing that it could not reach the desired result within the framework it used previously, the Commission offers up a completely new analysis, under which it is irrelevant whether ISP-bound traffic is "local" rather than "long-distance" or "telephone exchange service" rather than "exchange access."

In today's order, the Commission concludes that section 251(b)(5) is not limited to local traffic as it had previously maintained, but instead applies to all "telecommunications" traffic except the categories specifically enumerated in section 251(g). *See* Order ¶¶ 32, 34. The Commission concludes that ISP-bound traffic falls within one of these categories – "information access" – and is therefore exempt from section 251(b)(5). *See id.* ¶ 42. The agency wraps up with a determination that ISP-bound traffic is interstate, and it thus has jurisdiction under section 201(b) to regulate compensation for the exchange of ISP-bound traffic. *See id.* ¶¶ 52-65.

The Commission's latest attempt to solve the reciprocal compensation puzzle is no more successful than were its earlier efforts. As discussed below, its determination that ISP-bound traffic is "information access" and, hence, exempt from section 251(b)(5) is inconsistent with still-warm Commission precedent. Moreover, its interpretation of section 251(g) cannot be reconciled with the statute's plain language.

1. Today's decision is a complete reversal of the Commission's recent decision in the *Advanced Services Remand Order*. In that order, the Commission rejected an argument that xDSL traffic is exempt from the unbundling obligations of section 251(c)(3) as "information access." Among other things, the Commission found meritless the argument that section 251(g) exempts "information access" traffic from other requirements of section 251. *Id.* ¶ 47. Rather, the Commission explained, "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." *Id.* According to the Commission, section 251(g) "is a transitional enforcement mechanism that obligates the incumbent LECs to continue to abide by equal access and nondiscriminatory interconnection requirements of the MFJ." *Id.* The Commission thus concluded that section 251(g) was not intended to exempt xDSL traffic from

section 251's other provisions. *See id.* ¶¶ 47-49.

In addition, the Commission rejected the contention that "information access" is a statutory category distinct from "telephone exchange service" and "exchange access." *See id.* ¶ 46.[1] It pointed out that "'information access' is not a defined term under the Act, and is cross-referenced in only two transitional provisions." *Id.* ¶ 47. It ultimately concluded that nothing in the Act suggests that "information access" is a category of services mutually exclusive with exchange access or telephone exchange service. *See id.* ¶ 48.

The Commission further determined that ISP-bound traffic is properly classified as "exchange access." *See id.* ¶ 35. It noted that exchange access refers to "access to telephone exchange services or facilities for the purpose of originating or terminating communications that travel outside an exchange." *Id.* ¶ 15. Applying this definition, and citing the *Reciprocal Compensation Declaratory Ruling*, the Commission reasoned that the service provided by the local exchange carrier to an ISP is ordinarily exchange access service, "because it enables the ISP to transport the communication initiated by the end-user subscriber located in one exchange to its ultimate destination in another exchange, using both the services of the local exchange carrier and in the typical case the telephone toll service of the telecommunications carrier responsible for the interexchange transport." *Id.* ¶ 35.

The *Advanced Services Remand Order* was appealed to the D.C. Circuit. *See WorldCom*, 2001 WL 395344. The Commission argued to the court in February that the term "information access" is merely "a holdover term from the MFJ, which the 1996 Act supersedes." *WorldCom, Inc. v. FCC*, Brief for Respondents at 50 (D.C. Cir. No. 00-1002). Its brief also emphasized that section 251(g) was "designed simply to establish a transition from the MFJ's equal access and nondiscrimination provisions . . . to the new obligations set out in the statute." *Id.*

Today, just two months after it made those arguments to the D.C. Circuit, the Commission reverses itself. It now says that section 251(g) exempts certain categories of traffic, including "information access," entirely from the requirements of section 251(b)(5) and that ISP-bound traffic is "information access." *See* Order ¶¶ 32, 34, 42. The Commission provides nary a word to explain this reversal.

Of course, the Commission's conclusions in the *Advanced Services Remand Order* that ISP-bound traffic is "exchange access" and that the term "information access" has no relevance under the 1996 Act were themselves reversals of earlier Commission positions. In the *Non-Accounting Safeguards Order*,[2] the Commission concluded, relying in part on a purported distinction between "exchange access" and "information access," that ISPs "do not use exchange access as it is defined by the Act." *Id.* ¶ 248. In that order, the Commission was faced with determining the scope of section 272(e)(2), which states that a Bell operating company ["BOC"] "shall not provide any facilities, services, or information regarding its provision of exchange access to [a BOC affiliate] unless such

[1] This aspect of the *Advanced Services Remand Order* was remanded to the Commission by the D.C. Circuit because of its reliance on the vacated *Reciprocal Compensation Declaratory Ruling*. *See WorldCom, Inc. v. FCC*, No. 00-1062, 2001 WL 395344, *5-*6 (D.C. Cir. Apr 20, 2001).

[2] *Implementation of the Non-Accounting Safeguards Of Sections 271 and 272 of the Communications Act of 1934, as Amended*, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) ("*Non-Accounting Safeguards Order*").

facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions." 47 U.S.C. § 272(e)(2). The Commission rejected the argument that BOCs are required to provide exchange access to ISPs, reasoning that ISPs do not use exchange access. *See Non-Accounting Safeguards Order* ¶ 248. In making that decision, the Commission relied on the language of the statute as well as the MFJ's use of the term "information access." *See id.* ¶ 248 & n. 621. As the Commission explained, its "conclusion that ISPs do not use exchange access is consistent with the MFJ, which recognized a difference between 'exchange access' and 'information access.'" *Id.* ¶ 248 n.621.

Thus, in reversing itself yet again, the Commission here follows a time-honored tradition. When it is expedient to say that ISPs use "exchange access" and that there is no such thing as "information access," that is what the Commission says. *See Advanced Service Remand Order* ¶¶ 46-48. When it is convenient to say that ISPs use the local network like local businesses, then the Commission adopts that approach. *See Access Charge Reform*, First Report and Order, 12 FCC Rcd 15982, ¶ 345 (1997). And, today, when it helps to write that ISPs use "information access," then that is what the Commission writes. The only conclusion that one can soundly draw from these decisions is that the Commission is willing to make up whatever law it can dream up to suit the situation at hand.

Nevertheless, there is one legal proposition that the Commission has, until now, consistently followed – a fact that is particularly noteworthy given the churn in the Commission's other legal principles. The Commission has consistently held that section 251(g) serves only to "preserve[] the LECs' existing equal access obligations, originally imposed by the MFJ." *Operator Communications, Inc., D/B/A Oncor Communications*, Memorandum Opinion and Order, 14 FCC Rcd 12506, ¶ 2 n.5 (1999).[3] Today's order ignores this precedent and transforms section 251(g) into a categorical exemption for certain traffic from section 251(b)(5). It is this transformation – much more than the shell game played with "information access" and "exchange access" – that is most offensive in today's decision.

2. The Commission's claim that section 251(g) "excludes several enumerated categories of traffic from the universe of 'telecommunications' referred to in section 251(b)(5)" (Order ¶ 23) stretches the meaning of section 251(g) past the breaking point. Among other things, that provision does not even mention "exclud[ing]," "telecommunications," "section 251(b)(5)," or "reciprocal compensation."

Section 251(g), which is entitled, "Continued enforcement of exchange access and interconnection requirements," states in relevant part:

On and after February 8, 1996, each local exchange carrier, to the extent that it

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[3] *See also*, *e.g.*, *Application for Review and Petition for Reconsideration or Clarification of Declaratory Ruling Regarding U S West Petitions To Consolidate Latas in Minnesota and Arizona*, Memorandum Opinion and Order, 14 FCC Rcd 14392, ¶ 17 (1999) ("In section 251(g), Congress delegated to the Commission sole authority to administer the 'equal access and nondiscriminatory interconnection restrictions and obligations' that applied under the AT&T Consent Decree."); *AT&T Corporation, et al., Complainants*, Memorandum Opinion and Order, 13 FCC Rcd 21438, ¶ 5 (1998) ("Separately, section 251(g) requires the BOCs, both pre- and post-entry, to treat all interexchange carriers in accordance with their preexisting equal access and nondiscrimination obligations, and thereby neutralize the potential anticompetitive impact they could have on the long distance market until such time as the Commission finds it reasonable to revise or eliminate those obligations.").

> provides wireline services, shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996 under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996.

47 U.S.C. § 251(g).

As an initial matter, it is plain from reading this language that section 251(g) has absolutely no application to the vast majority of local exchange carriers, including those most affected by today's order. The provision states that "each local exchange carrier . . . shall provide [the enumerated services] . . . in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations . . . *that apply to such carrier on the date immediately preceding February 8, 1996*." *Id.* (emphasis added). If a carrier was not providing service on February 7, 1996, no restrictions or obligations applied to "such carrier" on that date, and section 251(g) would appear to have no impact on that carrier. The Commission has thus repeatedly stated that section 251(g) applies to "Bell Operating Companies" and is intended to incorporate aspects of the MFJ. *Applications For Consent To The Transfer Of Control Of Licenses And Section 214 Authorizations From Tele-Communications, Inc., Transferor To AT&T Corp., Transferee.*, Memorandum Opinion and Order, 14 FCC Rcd 3160, ¶ 53 (1999); *see also* cases cited *supra* note 3. Accordingly, by its express terms, section 251(g) says nothing about the obligations of most CLECs serving ISPs, which are the primary focus of the Commission's order.

Moreover, it is inconceivable that section 251(g)'s preservation of pre-1996 Act "equal access and nondiscriminatory interconnection restrictions and obligations" is intended to displace section 251(b)(5)'s explicit compensation scheme for local carriers transporting and terminating each other's traffic. Prior to passage of the 1996 Act, there were no rules governing compensation for such services, whether or not an ISP was involved. It seems unlikely, at best, that Congress intended the absence of a compensation scheme to preempt a provision explicitly providing for such compensation.[4] At the very least, one would think Congress would use language more explicit than that seized upon by the Commission in section 251(g).

Finally, if, as the Commission maintains, section 251(g) "excludes several enumerated categories of traffic from the universe of 'telecommunications' referred to in section 251(b)(5)" (Order ¶ 23), why does section 251(g) not also exclude this traffic from the "universe of 'telecommunications'" referred to in the rest of section 251, or, indeed, in the entire 1996 Act? As noted, section 251(g) nowhere

[4] The case of IXC traffic is thus completely different. There was a compensation scheme in effect for such traffic prior to enactment of the 1996 Act – the access charge regime. Because reciprocal compensation and the access charge regime could not both apply to the same traffic, the Commission could reasonably conclude that the access charge regime should trump the reciprocal compensation provision of section 251(b)(5). *See Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068, 1072-73 (8th Cir. 1997). Here, there is no pre-1996 Act compensation scheme to conflict with reciprocal compensation. As the Commission has stated, "the Commission has never applied either the ESP exemption or its rules regarding the joint provision of access to the situation where two carriers collaborate to deliver traffic to an ISP." *Reciprocal Compensation Declaratory Ruling* ¶ 26.

mentions "reciprocal compensation" or even "section 251." In fact, there appears to be no limiting principle. It would thus seem that, under the Commission's interpretation, the traffic referred to in section 251(g) is exempt from far more than reciprocal compensation – a consequence the Commission is sure to regret. *See*, *e.g.*, *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 15499, ¶ 356 (1996) (concluding that "exchange access" provided to IXCs is subject to the unbundling requirements of section 251(c)(3)).

* * *

The end result of today's decision is clear. There will be continued litigation over the status of ISP-bound traffic, prolonging the uncertainty that has plagued this issue for years. At the same time, the Commission will be forced to reverse itself yet again, as soon as it dislikes the implication of treating ISP-bound traffic as "information access" or reading section 251(g) as a categorical exemption from other requirements of the 1996 Act. The Commission could, and should, have avoided these consequences by applying its original analysis in the manner sought by the court.

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-026IS1

REQUEST:

Please state whether Qwest offers any FX-like service, other than service specifically described as Foreign Exchange. If the answer is anything other than an unqualified "no," please state the name of each such FX-like service and provide service descriptions (including, but not limited to, tariff pages) for each such FX-like service.

RESPONSE:

Qwest objects to this request to the extent that it seeks information concerning Qwest's product offerings in states other than the state of Oregon.

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving the prior objections to this request, Qwest responds:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an ‘NXX’ that is not associated with the rate center where the customer is located."

Qwest’s Market Expansion Line ("MEL") has, in the past, been erroneously characterized as an FX-like service. It does not, however, meet the definition set forth above because MEL is simply a remote call forwarding "feature" for business customers that allows the customer to call forward their service to a different location without the need for a physical location in that area. Calls to a MEL service are forwarded automatically from the central office to another telephone number of the customer’s choice, either within the LCA or to another LCA, but if the number to which it is forwarded is outside the LCA of the central office serving the MEL line, full retail toll charges apply to the MEL customer. MEL service is no different than any other customer that subscribes to "call forwarding" forwarding their line to another location.

Primary Rate Service (PRS-Integrated Services Digital Network) is a high-capacity local service (DS1 and higher) that allows business customers to receive and terminate calls within a LCA. With Primary Rate Service, a customer could create a FX-like PRS service and receive dial tone from a switch other than from the switch in the central office that serves the customer’s physical location by ordering PRS from a distant local calling area and then ordering a DS1 facility to the customer owned premise within that local calling area.

Respondent: Larry Brotherson
Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-027IS1

REQUEST:

Unless your answer to Question #23 above was an unqualified "no," please identify:

a. The number of customers in this state who subscribe to or purchase each of the FX-like services identified in response to the preceding questions;

b. The number of lines in this state over which Qwest provides each of the FX-like services identified in response to the preceding questions;

c. How long each FX-like services has been available from Qwest; and

d. The number of ISPs who purchase each of the FX-like services identified in response to the preceding questions.

RESPONSE:

Qwest objects to this request and its subparts in so far as it seeks information about the number of customers and lines it is serving, on the basis that such information constitutes a trade or business secret and is confidential and proprietary to Qwest. Qwest further objects on the basis that it does not retain information about the business purposes of its customers and that such information may be proprietary to Qwest's customers.

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving the prior objections to this request, Qwest responds:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an 'NXX' that is not associated with the rate center where the customer is located."

a. Qwest does not maintain the information necessary to identify the number of "customers."

b. Qwest does not uniquely identify MEL provided from a foreign exchange or PRS ordered in conjunction with a DS1 facility and therefore cannot quantify the specific number of such services.

c. MEL has been available since at least 1982 and Qwest began offering PRS when ordered in conjunction with a DS1 facility to create a FX-like PRS, as early as 1990 in most states within Qwest's territory.

d. Qwest does not track FX-like service by the type of customer (including whether the customer is an ISP) that purchases the service. Therefore, Qwest does not have the information necessary to respond to this question.

Respondent: Larry Brotherson
Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-028IS2

REQUEST:

With respect to Qwest's FX and FX-like services:

a. Please explain the circumstances under which calls *from* a subscriber to a Qwest FX or FX-like service are rated as local versus toll, and provide all documentation supporting your answer.

b. Please explain the circumstances under which calls *to* a subscriber from a Qwest FX or FX-like service are rated as local versus toll, and provide all documentation supporting your answer.

RESPONSE:

Qwest objects to this request and its subparts on the basis that the terms "toll" and "local" are not defined and may be ambiguous in this context. Qwest further objects on the basis that the request is overly broad and therefore not reasonably calculated to lead to the discovery of admissible evidence.

SUPPLEMENTAL RESPONSE DATED 7/08/05:

Without waiving the foregoing objections, Qwest states:

The Commission discontinued FX service in Oregon with certain existing customers grandfathered in 1983. (See Order No. 83-839).

Respondent: Larry Brotherson

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving the prior objections, Qwest states:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an 'NXX' that is not associated with the rate center where the customer is located."

a. and b. With regard to MEL, all calls from the MEL customer to other customers are rated based on the location of the LCA where the MEL customer obtains local service. Thus, if the call is to a customer in the same LCA, it is local. If the call is to a customer located in a different LCA, the call is toll. With regard to MEL, if the calling party is located in the same local calling area (LCA) in which the MEL customer obtains local service, the call is local. If the calling party is located in a different LCA than the LCA in which the MEL customer obtains its local service, the call is a toll call. In other words, whether the calling party incurs a toll charge is dependent solely on that customer's location in relation to the LCA in which the MEL customer obtains local service. If the MEL customer forwards its service to another LCA, it is the MEL customer that incurs the toll charges for that portion of the call.

a. and b. PRS when ordered in conjunction with a DS1 facility to create a FX-like PRS is a combination of rate elements from the Local Exchange tariffs and Private Line Transport tariffs and/or catalogs. All calls to and from other subscribers located in the same LCA where the PRS FX-like subscriber purchased a connection are treated as local. All calls to and from

subscribers outside the LCA where the PRS FX-like subscriber connection was purchased are treated as toll calls. The additional transport for carrying calls beyond the LCA where the connection was purchased are private line tariffed services (DS1 or higher) and the PRS FX-like customer is financially responsible for payment of these charges. Documentation for charges are identified in the Exchange and Network Services tariff for each service.

Respondent: Larry Brotherson
Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-029IS2

REQUEST:

Please state whether Qwest has ever billed or demanded payment of access charges from an incumbent LEC for calls originated by Qwest's end user to an incumbent LEC's FX or FX-like customer.

RESPONSE:

Qwest objects to this request on the basis that it is not limited to the state of Oregon and is otherwise overly broad, unreasonably burdensome, and does not appear reasonably calculated to lead to the discovery of admissible evidence.

SUPPLEMENTAL RESPONSE DATED 7/08/05:

Without waiving the foregoing objections, Qwest states:

The Commission discontinued FX service in Oregon with certain existing customers grandfathered in 1983. (See Order No. 83-839).

Respondent: Larry Brotherson

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving the prior objections, Qwest states:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an 'NXX' that is not associated with the rate center where the customer is located."

No.

For purposes of this response, Qwest assumes that another LEC provides MEL and PRS FX-like service to its own customers. Qwest also assumes that those services operate the same way Qwest's services by those same names operate.

With regard to MEL, if the call from a calling party (Qwest's customer) to a MEL customer of another LEC originates in a different LCA than the LCA in which the MEL customer obtains local service, the caller would need to dial 1+ and the call would be a toll call; the calling party's IXC will pay the appropriate access charges. If the calling party is located in the same LCA as the LCA in which the MEL customer obtains local service, the call will be local and no access charges would apply. If the MEL customer forwards its service to another LCA, it is the MEL customer that incurs the toll charges for that portion of the call and the MEL customer's IXC would pay all applicable access charges.

With regard to PRS FX-like, if the call is placed by a Qwest customer to another LEC's subscriber who had purchased a PRS FX-like connection in the same LCA as the calling party, the call would be treated as a local call. If the call was made by a Qwest subscriber from a location outside the LCA of the PRS FX-like service, access charges would be paid by the IXC of the calling party. The purchaser of the PRS FX-like service bears the financial responsibility to transport the traffic from the LCA where service is received to the distant LCA.

Respondent: Larry Brotherson

Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-030IS2

REQUEST:

Please state whether Qwest has ever billed or received reciprocal compensation or other terminating compensation for calls received from an incumbent LEC or any CLECs for termination to Qwest's FX or FX-like customers? Please explain your answer, including but not limited to:

a. The dates upon which you first began billing incumbent LECs or CLECs for such compensation;

b. The amount of compensation received from incumbent LECs and CLECs; and

c. Description of any changes you may have made to your billing policies with respect to calls terminating to your FX or FX-like customers.

RESPONSE:

Qwest objects to this request on the basis that it is not limited to the state of Oregon and is otherwise overly broad, unreasonably burdensome, and does not appear reasonably calculated to lead to the discovery of admissible evidence.

SUPPLEMENTAL RESPONSE DATED 7/08/05:

Without waiving the foregoing objections, Qwest states:

The Commission discontinued FX service in Oregon with certain existing customers grandfathered in 1983. (See Order No. 83-839).

Respondent: Larry Brotherson

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving the prior objections, Qwest states:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an 'NXX' that is not associated with the rate center where the customer is located."
Yes.

With regard to MEL, the only situation in which Qwest has billed for and would be entitled to receive reciprocal compensation for traffic directed to a MEL customer would be where a CLEC or another ILEC is providing local exchange service to end users in the same LCA as the LCA in which the MEL customer obtains local service. In that case, a call from the CLEC end user to the Qwest MEL customer would be a local call for which reciprocal compensation would be billed.

With regard to PRS FX-like, the LCA where the Qwest PRS FX-like customer purchases a connection to the local network is the point for determining whether a call is local. A call from a customer of other carrier to a Qwest PRS FX-like customer who purchases a connection in the same LCA from which the call originated are local and would be subject to reciprocal compensation. CLEC and ILEC calls originating in the LCA where the Qwest PRS FX-like customer purchased a local connection are billed local reciprocal

compensation.

a. It is impossible for Qwest to determine when such billings of reciprocal compensation for local calls began in Oregon; Qwest assumes it was shortly after the first interconnection agreements were effective following the 1996 Act, most probably sometime in 1997.

b. It would be impossible to determine the amount of reciprocal compensation that Qwest may have been received under the circumstances described above. To even attempt to do so would be highly burdensome and would not lead the discovery of admissible evidence.

c. Qwest is unaware of any changes made to its billing systems. In the circumstances described above, there would have been no need to make such changes.

Respondent: Larry Brotherson
Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-031IS2

REQUEST:

Are there any circumstances in which Qwest has paid access charges to the originating carrier for a call originated by another carrier and terminated to a Qwest FX or FX-like customer? If your answer is anything other than an unequivocal "no," please describe all circumstances under which Qwest has made such payments.

RESPONSE:

Qwest objects to this request on the basis that it is not limited to the state of Oregon and is otherwise overly broad, unreasonably burdensome, and does not appear reasonably calculated to lead to the discovery of admissible evidence.

SUPPLEMENTAL RESPONSE DATED 7/08/05:

Without waiving the foregoing objections, Qwest states:

The Commission discontinued FX service in Oregon with certain existing customers grandfathered in 1983. (See Order No. 83-839).

Respondent: Larry Brotherson

SUPPLEMENTAL RESPONSE DATED 8/24/05:

Without waiving prior objections, Qwest states:

If the call originated outside the local calling area, the toll carrier pays access charges. When Qwest is the toll carrier, and the call originates in a non-Qwest exchange, Qwest pays originating access.

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an ‘NXX’ that is not associated with the rate center where the customer is located."

Respondent: Larry Brotherson
Legal

QWEST CORPORATION
DOCKET: ARB 665
INTERVENOR: Level 3 Communications, Inc.
REQUEST NO: L3CI 01-032IS2

REQUEST:

Please state whether Qwest knows, or has reason to believe, that any independent LECs with whom Qwest has EAS arrangements provide FX or FX-like services that permits customers physically located in another rate center to be assigned a number that is local to the rate center included in Qwest's EAS area.

RESPONSE:

Qwest objects to this request on the basis that it is not limited to the state of Oregon and is otherwise overly broad and unreasonably burdensome. Qwest further objects that the service offerings of independent LECs in Oregon are available from said LECs and are as readily available to Level 3 as to Qwest.

SUPPLEMENTAL RESPONSE DATED 7/08/05:

Without waiving the foregoing objections, Qwest states:

Without waiving this objection, Qwest states:

Qwest is not aware if any Independents in Oregon offer FX or FX-like services to their end-users. If they do, they are likely to be described in their tariffs on file with the Oregon Public Utility Commission.

Respondent: Larry Brotherson

SUPPLEMENTAL RESPONSE DATED 08/24/05:

Without waiving prior objections, Qwest states:

Pursuant to agreement of the parties, the definition of "FX-like service" shall mean "any product or service under which a customer is assigned a telephone number with an 'NXX' that is not associated with the rate center where the customer is located."

Qwest is unaware whether independent companies in Oregon provide either MEL or PRS FX-like. Their tariffs are publicly filed and may be reviewed by Level 3.

Respondent: Larry Brotherson

Oregon
ARB 665
L3CI 01-023I

INTERVENOR: Level 3 Communications, Inc.

REQUEST NO: 023I

Does Qwest contend that the costs it incurs in originating a call to a Level 3 customer differ in any respect whatsoever based upon the physical location of the Level 3 customer? If Qwest responds to the above question with anything other than an unequivocal "no," please provide a detailed explanation of how the location of Level 3's customer on Level 3's side of the POI could affect Qwest's costs. Include in that explanation all cost studies and any other documentation in your possession that you believe provide support for your position.

RESPONSE:

No. The costs Qwest incurs do not vary based upon the physical location of the Level 3 customer. Qwest's overall costs incurred to complete a call, however, vary depending on the originating voice caller's location and the location of the Level 3 POI.

Respondent: Larry Brotherson

Signal unavailable
As of: Dec 13, 2006

VERIZON CALIFORNIA, INC., Plaintiff-Appellant, v. MICHAEL R. PEEVEY; LORETTA M. LYNCH; CARL W. WOOD; GEOFFREY F. BROWN; SUSAN P. KENNEDY, in thier official capacities as Commissioners of the Public Utilities Commission of the State of California, and not as individuals; PAC-WEST TELECOMM, INC., Defendants-Appellees. PAC-WEST TELECOMM, INC., Counter-claimant-Appellant, v. VERIZON CALIFORNIA, INC., Counter-defendant- Appellee, v. PAC-WEST TELECOMM, INC., Cross-claimant-Appellant, v. MICHAEL R. PEEVEY; LORETTA M. LYNCH; CARL W. WOOD; GEOFFREY F. BROWN; SUSAN P. KENNEDY, in their official capacities as Commissioners of the Public Utilities Commission of the State of California, and not as individuals, Cross-defendants-Appellees.

No. 04-16382, No. 04-16394

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

462 F.3d 1142; 2006 U.S. App. LEXIS 22742

June 12, 2006, Submitted, San Francisco, California
September 7, 2006, Filed

PRIOR HISTORY: [1]** Appeals from the United States District Court for the Northern District of California Claudia Wilken, District Judge, Presiding. D.C. No. CV-03-03441-CW, D.C. No. CV-03-03441-CW.

DISPOSITION: AFFIRMED IN PART; REVERSED AND REMANDED, IN PART.

COUNSEL: Burton A. Gross, Munger, Tolles & Olson, San Francisco, California, for the plaintiff-appellant/cross-appellee.

D. Anthony Rodriguez, Morrison & Foerster, San Francisco, California, for defendant-appellee/cross-appellant; Pac-West Telecomm, Inc.

Lindsay M. Brown,California Public Utilities Commission, San Francisco, California, for defendants-appellees/cross-appellees Commissioners of the Public Utilities Commission.

JUDGES: Before: Pamela Ann Rymer, Thomas G. Nelson, and William A. Fletcher, Circuit Judges. Opinion by Judge Rymer.

OPINION BY: RYMER

OPINION: **[*1145]** RYMER, Circuit Judge:

These appeals arise out of a dispute between local exchange carriers over the identification of internet-bound traffic, and compensation for delivery of telephone calls to internet service providers and for calls that appear to the customer to be made within a local area code but in fact are not. One of the carriers, Verizon California, Inc., had an exclusive franchise within **[**2]** California before passage of the Telecommunications Act of 1996, *47 U.S.C. § 151 et seq.* However, the Act established a competitive system whereby "incumbent" local exchange carriers such as Verizon must share their networks with "competitive" carriers such as Pac-West Tele-comm, Inc. It also provides that disagreements are to be referred for arbitration to the state public utility commission, in this case, the California Public Utilities Commission (CPUC). Verizon and Pac-West entered into an interconnection agreement in 1996, but when they reached an impasse in negotiating a new agreement in 2001 and referred the dispute to the CPUC, the commission ruled in Pac-West's favor that (1) during the interim period before a new agreement was in place, the parties' 1996 agreement continued in force such that Verizon must continue to pay reciprocal compensation for delivery of internet-bound calls at pre-existing rates rather than at the lower capped rates set by the Federal Communications Commission (FCC) that apply to new contractual obligations; (2) Pac-West could exclude calls to paging services before applying an FCC presumption that when terminated calls are **[**3]** more than three times the number of originated calls, the excess calls are bound for internet service providers; and (3) Pac-West is entitled to reciprocal compensation for traffic that appears to originate and terminate within a single exchange by virtue of Pac-West's assignment of a number that appears to be "local," but in fact is not-so-called "Virtual Local" or "VNXX" traffic. The CPUC ruled in Verizon's favor that Verizon is entitled to collect call origination charges for its cost of transporting Virtual Local traffic to a distant point of interconnection. The district court found that the commission's decision was not arbitrary or capricious. Both parties appeal. We agree with the district court, and therefore affirm all rulings except for the commission's determination that Pac-West may **[*1146]** disregard paging traffic for purposes of computing the presumptive volume of traffic bound for an internet service provider (ISP). As to that issue, federal law is to the contrary. Accordingly, we reverse and remand the ruling on calls to paging customers.

I

A.

Until passage of the Telecommunications Act, local telephone service was provided primarily by a single company within each local **[**4]** area that had an exclusive franchise to serve an authorized territory within the state. The Act replaced this system with a competitive regime under which incumbent local exchange carriers, or ILECs, such as Verizon, are obliged to permit competitive local exchange carriers, or CLECs, such as Pac-West, to interconnect "at any technically feasible point within the [ILEC's] network." *47 U.S.C. § 251(c)(2)(B).* Interconnection allows customers of one LEC to call the customers of another, with the calling party's LEC (the "originating" carrier) transporting the call to the connection point, where the called party's LEC (the "terminating" carrier) takes over and transports the call to its end point. To ensure that each LEC is fairly compensated for such calls, the Act requires interconnected LECs to "establish reciprocal compensation arrangements" with one another "for the transport and termination of telecommunications." *47 U.S.C. § 251(b)(5).*

Under a reciprocal compensation arrangement, the originating LEC must compensate the terminating LEC for delivering its customer's call to the end point. The FCC has determined that this reciprocal compensation **[**5]** requirement applies only "to traffic that originates and terminates within a local area." *In re Implementation of the Local Competition Provisions in the Telecomms. Act of 1996, 11 F.C.C. Rcd. 15499, 16013, P1034 (Aug. 8, 1996)* (subsequent history omitted) (the *Local Competition Order*). Thus, "[t]he Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic." *Id. at 16013, P1033*.

Under the Act, ILECs and CLECs have a duty to negotiate in good faith the terms of their network sharing, including rates of reciprocal compensation. *47 U.S.C. § 251(c)(1)*. A voluntary agreement reached by the parties need not conform to all of the requirements of *§ 251*, *47 U.S.C. § 252(a)(1)*, and the state public utility commission reviews voluntary agreements only for limited purposes, *47 U.S.C. § 252(e)(2)(A)*. However, if the state public utility commission is asked to resolve open issues by means of compulsory arbitration, *47 U.S.C. § 252(b)(1)*, the Act requires that it **[**6]** "ensure that such resolution and conditions meet the requirements of *section 251* [of the Act], including the regulations prescribed by the [FCC] pursuant to *section 251* . . . ." *47 U.S.C. § 252(c)(1)*; *see also 47 U.S.C. § 252(e)(2)(B)*.

Two wrinkles in the reciprocal compensation regime of *§ 251* are at the crux of this appeal. First, there was confusion from day one about whether the reciprocal compensation requirement should apply to local calls made via modem to an ISP. Following a tortured history that we do not detail, the issue was resolved (for now) when the FCC concluded in 2001 that ISP-bound calls are not subject to reciprocal compensation. *In re Implementation of the Local Competition Provisions in the Telecomms. Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, 16 F.C.C. Rcd. 9151, 9189, P82 (Apr. 27, 2001)* (the *ISP Remand* **[*1147]** *Order*). n1 In the *ISP Remand Order*, the FCC held that *§ 251(g)* carves out a category of telecommunications traffic not subject to the reciprocal compensation requirement of *§ 251(b)(5)*, *id. at 9165-66, PP31-32*, and that ISP-bound traffic is within **[**7]** this category, *id. at 9166-67, P34*. The FCC prohibited reciprocal compensation for termination of calls to an ISP for carriers that did not exchange traffic prior to the order. *Id. at 9188-89, P81*. For carriers that were already exchanging traffic prior to the order, the FCC established an interim regime according to which reciprocal compensation rates for ISP-bound calls were capped, with the rate cap declining over time toward zero. *Id. at 9155-57, PP7-8, 9186-87, PP77-78*. This was done to eliminate the regulatory arbitrage opportunity available to CLECs. Also, "[i]n order to limit disputes and costly measures to identify ISP-bound traffic, "the FCC adopted

> a rebuttable presumption that traffic exchanged between LECs that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic subject to the compensation mechanism set forth in this Order. . . . Carriers that seek to rebut this presumption, by showing that traffic above the ratio is not ISP-bound traffic or, conversely, that traffic below the ratio is ISP-bound traffic, may seek appropriate relief from their state commissions pursuant to *section 252* **[**8]** of the Act.

Id. at 9157, P8. Finally, the FCC stated that "[t]he interim compensation regime we establish here applies as carriers renegotiate expired

or expiring interconnection agreements. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions." *Id. at 9189, P82*. With the promulgation of these rate caps, "state commissions will no longer have authority to address this issue" after June 14, 2001. n2 *Id.*

n1 In *In re Implementation of the Local Competition Provisions in the Telecomms. Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, 14 F.C.C. Rcd. 3689 (Feb. 26, 1999)* (*ISP Order*), the FCC applied an "end to end" analysis of ISP traffic, treating the user's call to the ISP in conjunction with the ISP's connection to the internet, to conclude that ISP-bound "local" calls were in fact interstate calls and thus not subject to reciprocal compensation under federal law. State commissions were free to come out differently. CPUC issued two generic rulemaking decisions in 1999 under which all existing interconnection agreements providing reciprocal compensation for local calls were interpreted to include ISP-bound calls. *Order Instituting Rulemaking and Investigation on the Commission's Own Motion into Competition for Local Exchange Service, CPUC Decision No. 98-10-057, 82 C.P.U.C. 2d 492, 1998 WL 1109251 (Oct. 22, 1998)*, *modified on rehearing by* CPUC Decision No. 99-07-047, 1999 WL 703040 (July 22, 1999) (the *Generic Internet Orders*). However, we invalidated the *Generic Internet Orders* on the ground that the commission "lacks authority under the Act to promulgate general 'generic' regulations over ISP traffic." *Pac. Bell v. Pac-West Telecomm., Inc., 325 F.3d 1114, 1125 (9th Cir. 2003)*. Meanwhile, the D.C. Circuit reversed and remanded the *ISP Order* for "want of reasoned decision-making." *Bell Atl. Tel. Cos. v. FCC, 340 U.S. App. D.C. 328, 206 F.3d 1, 3 (D.C. Cir. 2000)*. On remand the FCC again concluded that ISP-bound calls are not subject to reciprocal compensation. *ISP Remand Order, 16 F.C.C. Rec. at 9189, P82*. Although the D.C. Circuit reversed once more, *WorldCom, Inc. v. FCC, 351 U.S. App. D.C. 176, 288 F.3d 429, 433-34 (D.C. Cir. 2002)*, it left the rules set out in the *ISP Remand Order* in place. Accordingly, the *ISP Remand Order* remains binding.

[9]**

n2 The *ISP Remand Order* provided that its rulings would go into effect "30 days after publication in the Federal Register." *Id. at 9204, P112*.

The second wrinkle in the reciprocal compensation regime concerns VNXX traffic. Telephone numbers generally consist often digits in the form of NPA-NXX-XXXX. **[*1148]** The first three digits indicate the Numbering Plan Area (or NPA), commonly known as the area code, and the next three digits refer to the exchange code. Under standard industry practice, area codes and exchange codes generally correspond to a particular geographic area served by an LEC. These codes serve two functions: the routing of calls to their intended destinations, and the rating of calls for purposes of charging consumers. Each NPA-NXX code is assigned to a rate center, and calls are rated as local or toll based on the rate center locations of the calling and called parties. When the NPA-NXX codes of each party are assigned to the same local calling area, the call is rated to the calling party as local; otherwise it is a toll call, for which the calling party must normally pay a premium. **[**10]**

VNXX, or "Virtual Local" codes are NPA-NXX codes that correspond to a particular rate

center, but which are actually assigned to a customer located in a different rate center. Thus a call to a VNXX number that appears to the calling party to be a local call is in fact routed to a different calling area. The CPUC has determined that VNXX traffic should be rated to consumers as a local call, meaning that the originating LEC cannot charge the calling customer a toll despite the long-distance nature of the call's physical routing. *In re Competition for Local Exchange Service*, CPUC Decision No. 99-09-029, 1999 WL 1127635, *11 (Sept. 2, 1999) (the *VNXX Decision*). In the course of its decision, the CPUC also stated:

> We conclude that all carriers are entitled to be fairly compensated for the use of their facilities and related functions performed to deliver calls to their destination, irrespective of how a call is rated based on its NXX prefix. Thus, it is the actual routing points of the call, the volume of traffic, the location of the point of interconnection, and the terms of the interconnection agreement--not the rating point--of a call which properly forms **[**11]** a basis for considering what compensation between carriers may be due.

Id. at *19. VNXX numbers are often assigned to ISP customers by CLECs, thus allowing the ISP to serve internet users outside the ISP's local calling area without subjecting such users to toll charges.

B

Within a few months of the effective date of the 1996 Tele-communications Act, Verizon (then GTE California) and Pac-West entered into a negotiated interconnection agreement under which Verizon paid Pac-West reciprocal compensation for ISP-bound local calls terminated by Pac-West (the 1996 contract). Paragraph 9.02 of the 1996 contract established an initial term of one year, stated that it could be terminated by either party upon 60 day's notice, and provided that

> the other party at any time during such 60 day period, may request negotiation of a new interconnection agreement, in which case interconnection shall continue between the Parties in full accordance with all of the terms of this Agreement pending execution of a replacement interconnection agreement within 125 days from the date the agreement terminates. If parties are unable to come to agreement within 125 days, both parties agree **[**12]** to seek resolution from the CPUC.

Neither party exercised the option until 2001. However, shortly after the *ISP Remand Order* was issued, Verizon took the position that reciprocal compensation payments for internet-bound traffic were no longer required. Pac-West objected to **[*1149]** Verizon's unilateral imposition of the FCC's new, capped rate structure, and requested resolution by the CPUC. An ALJ ruled in favor of Pac-West on September 27, 2001, and the CPUC affirmed that ruling in January 2002. *Order Denying the Complaint of Verizon California Inc. Against Pac-West Telecomm., Inc.*, CPUC Decision No. 02-01-062 (Jan. 24, 2002). The CPUC held that the 1996 agreement's change-of-law provision did not cover the *ISP Remand Order*, and so compensation for ISP-bound traffic was not subject to the FCC's new rate caps. n3 *Id.*

n3 This ruling has not been challenged.

On October 10, 2001, Verizon exercised its right to terminate the 1996 agreement, effective December 9, 2001. On December 3, Pac-West, in turn, **[**13]** requested negotiation of a new agreement, thereby invoking the 125-day contract renegotiation period in Paragraph 9.02. Several issues remained outstanding as April 13, 2002 -- the end of the 125-day period -- approached. Accordingly, on April 3, 2002, Verizon filed an emergency motion with the CPUC, invoking Paragraph 9.02 to request an expedited order establishing a temporary agreement with Pac-West pending adoption of a new interconnection agreement. In particular, Verizon requested that the reciprocal compensation rates applicable to ISP-bound local traffic be set in the interim agreement in conformance with the lower rates specified in the *ISP Remand Order*. On April 12, 2002, one day before the end of the 125-day negotiation period, CPUC Commissioner Michael R. Peevey imposed an interim agreement. He noted that the parties had failed to negotiate a provision in their existing agreement as to what terms would govern in the event of contract termination without a successor agreement, and found the only defensible alternative was to continue the status quo agreement for the interim period. With regard to reciprocal compensation for ISP-bound calls in particular, Commissioner **[**14]** Peevey ruled that the 1996 agreement's payment schedule would continue to apply instead of the FCC's capped rates, but that compensation exchanged during the interim period would be subject to later adjustment by the CPUC. On April 26, 2002, the CPUC adopted Commissioner Peevey's order in its entirety.

No progress having been made, on June 13, 2002 Verizon petitioned the CPUC for arbitration of a new agreement pursuant to *§ 252(b)*. The arbitrator issued a final report (the *Final Arbitrator's Report*) on February 10, 2003 that adopted Verizon's position with regard to reciprocal compensation rates for ISP-bound traffic in the interim period, ruling that an interconnection agreement "becomes an 'expiring' one when the ILEC gives notice to that effect, and the new intercarrier compensation arrangement [mandated by the *ISP Remand Order*] should thus become effective at the inception of negotiations." The arbitrator also determined that "[l]ocal traffic to customers reasonably identifiable as paging carriers will not be considered ISPs in the [interconnection agreement] when the [*ISP Remand Order*] is implemented, unless the order clearly and finally establishes otherwise. **[**15]** " Finally, as to VNXX traffic, the arbitrator ruled that "[w]hether or not a call is 'local' depends solely upon the NPA-NXXs of the calling and called parties . . . and does not depend upon the routing of the call, even if it is outside the local calling area." An arbitrated interconnection agreement, consistent with the arbitrator's report, was filed by the parties on February 18, 2003.

On May 22, 2003, the CPUC modified and adopted the *Final Arbitrator's Report (Arbitration Decision)*. The commission **[*1150]** overturned the arbitrator's ruling on reciprocal compensation for ISP-bound traffic under the interim agreement, holding that the FCC's rate caps could not be applied retroactively from the effective date of the new (2003) agreement. It noted that the FCC had stated in the *ISP Remand Order* that the order "does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions." One commissioner dissented on the footing that the 1996 agreement expired on April 14, 2002, and that "with the expiration of the interconnection agreement, the rates contained in the FCC's *ISP Remand Order* became effective." **[**16]** The CPUC adopted the arbitrator's position on paging traffic and reciprocal compensation for VNXX calls. With respect to VNXX calls, however, the CPUC further ruled that Verizon was entitled to collect call origination charges, or COCs, from Pac-West, so as to compensate

Verizon for the transport of VNXX calls over long distances.

Verizon challenged these rulings in district court. Both parties, and the CPUC, filed cross-motions for summary judgment. The district court granted the CPUC's cross-motion regarding call origination charges on VNXX traffic, and the CPUC's and Pac-West's cross-motions regarding interim reciprocal compensation, paging traffic, and VNXX reciprocol compensation. Verizon appeals the adverse rulings with respect to interim reciprocal compensation, paging traffic, and VNXX reciprocal compensation. Pac-West cross-appeals judgment for Verizon on VNXX call origination charges. CPUC defends its rulings in all respects.

II

"We review de novo the district court's grant[s] of summary judgment." *U.S.W. Commc'ns, Inc. v. Wash. Utils. & Transp. Comm'n, 255 F.3d 990, 994 (9th Cir. 2001).* We also "review de novo whether the arbitrated agreements are in **[**17]** compliance with the Act and the implementing regulations," and "review all other issues under an arbitrary and capricious standard." *Id.* A state commission's decision is arbitrary and capricious if the decision "was not supported by substantial evidence," or the commission made a "clear error of judgment." *Pac. Bell, 325 F.3d at 1131* (internal quotation marks omitted).

III

The central issue on appeal is whether the *ISP Remand Order* should govern compensation for ISP-bound traffic exchanged between the parties during the period from December 3, 2001 (when Pac-West requested renegotiation), or from April 13, 2001 (when the 125-day contractual period for renegotiation expired), until CPUC handed down its arbitration decision approving a new, arbitrated interconnection agreement. Verizon advances a number of reasons why the decision is arbitrary. It argues that extending its obligation to pay intercarrier compensation at rates above the FCC's caps violates Paragraph 82 of the *ISP Remand Order* which, as of June 14, 2001, stripped all state commissions of authority to impose any rate structure other than that set forth in the order. While Verizon recognizes **[**18]** that the *ISP Remand Order* excepts enforcement of an "existing contractual obligation," it maintains that the exception is inapplicable here because, at least after April 13, 2002, there was no contractual agreement between the parties requiring payment of reciprocol compensation for internet-bound traffic at rates higher than the FCC's caps. In effect, Verizon contends, the CPUC's decision simply perpetuates through the back door the generic rulemaking that this court invalidated in **[*1151]** *Pacific Bell*. Verizon submits that the *Arbitration Decision* also violates the *ISP Remand Order* because the order directs that the FCC's capped rates go into effect "*as*" carriers renegotiate "expired or expiring" interconnection agreements. In its view, the 1996 agreement began "expiring" as of December 3, 2001 when Pac-West requested renegotiation and was "expired," at the latest, as of April 13, 2001 when the renegotiation period ended. Thus, Verizon posits, the interim interconnection agreement imposed by CPUC was itself a *new* agreement subject to the FCC's rate cap.

We hold that the CPUC did not act in derogation of federal law by extending the status quo, that is, in continuing **[**19]** the reciprocal compensation terms of the 1996 agreement after Pac West requested renegotiation and until the new (2003) interconnection agreement was in place. There is no question that the FCC caps apply to the 2003 agreement. However, when the parties couldn't agree within the contractual time frame, it fell to the CPUC, pursuant to the 1996 agreement, to decide how interconnection would be governed in the meantime. Neither the Act nor the *ISP Remand Order* requires reversal of the CPUC's interim directive. This is so for two independent reasons.

First, it does not appear that federal law applies to the *Interim Order*. Parties who enter into a voluntary interconnection agreement need not conform to the requirements of the Act, *47 U.S.C. § 252(a)(1)*, and a state commission need not review such agreements for compliance with *§ 251*, *47 U.S.C. § 252(e)(2)*. Accordingly, if Verizon and Pac-West had reached a new private agreement imposing reciprocal compensation on ISP-bound traffic above the FCC's mandated rate caps for the duration of the interim negotiation period, that agreement would be binding on the parties regardless of the **[**20]** *ISP Remand Order*. If Verizon and Pac-West had reached such an agreement with the assistance of a private arbitrator, the conclusion would be no different. Only if the parties sought mandatory arbitration from the commission under *§ 252(b)(1)* would the restrictions of the Act, and thus the *ISP Remand Order*'s interpretation of *§ 251(b)(5)*, apply to the interconnection agreement. *47 U.S.C. § 252(c)*.

Verizon did not invoke *§ 252(b)(1)* in requesting an emergency interim agreement. Rather, it cited Paragraph 9.02 of the 1996 agreement. Indeed, it does not appear that Verizon *could* have requested compulsory arbitration under the Act. While Paragraph 9.02 of the 1996 agreement provides that parties may seek resolution by the CPUC "within 125 days" of Pac-West's request to negotiate a new agreement, *§ 252(b)(1)* of the Act may be invoked only "[d]uring the period from the 135th to the 160th day (inclusive) after the date on which an incumbent local exchange carrier receives a request for negotiation under this section. . . ." The parties were not yet within this period when Verizon made its emergency plea to the CPUC.

The fact that Verizon invoked a **[**21]** contractual provision, and could not invoke the Act, in requesting the commission's assistance, suggests that the CPUC in imposing an interim agreement acted as an ordinary private arbitrator not subject to the restrictions of the Act. Such a role for the commission is contemplated by the Act. *Section 252(a)(2)* provides that "[a]ny party negotiating an agreement under this section may, at any point in the negotiation, ask a State commission to participate in the negotiation and to mediate any differences arising in the course of the negotiation." A commission acting in this capacity is not required by the Act to implement the provisions of *§ 251*. *See 47 U.S.C. § 252(c)* (requiring only commissions **[*1152]** acting in their compulsory arbitration capacity pursuant to *§ 252(b)* to implement *§ 251*). We therefore believe that Paragraph 9.02 of the 1996 agreement gave the CPUC freedom to impose any terms it believed necessary on a temporary basis to resolve the parties' disagreement.

Alternatively, even if the commission were required to comply with the *ISP Remand Order*, we are persuaded that it did. Paragraph 82 of the *ISP Remand Order* controls the application **[**22]** of the FCC's new rate caps. This paragraph provides in relevant part that "[t]he interim compensation regime we establish here applies as carriers renegotiate expired or expiring interconnection agreements. It does not alter existing contractual obligations . . . ." *16 F.C.C. Rec. at 9189, P82*. This means that for the new FCC rate caps to apply, the parties must be renegotiating an "expiring or expired" agreement *and* application of the new rates would not "alter existing contractual obligations."

Verizon relies on both prongs but for different time periods -- the period after April 13, 2002 and before approval of the 2003 agreement, and the period between December 4, 2001 and April 13, 2002. While not perfectly clear, the *Arbitration Decision* reflects the commission's determination that the interim agreement represents an extension of Verizon's existing contractual obligations in the 1996 agreement, rather than an entirely new agreement. Substantial evidence supports this deter-

mination, given that the *Interim Order* characterized the interim agreement as "the temporary extension of the old interconnection agreement." As the district court observed, this is **[**23]** not an issue of federal law answered by the *ISP Remand Order*, but rather is an issue governed by state contract law and principles. *See Pac. Bell, 325 F.3d at 1128* (citing *S.W. Bell v. Pub. Util. Comm'n, 208 F.3d 475, 485 (5th Cir. 2000))*. In light of Paragraph 9.02 of the 1996 agreement, which Verizon invoked in requesting an interim agreement and which grants the commission unqualified authority to arbitrate the parties' disputes, the CPUC's interpretation of the nature of the interim agreement resolves its status. Because the 1996 agreement remained in effect after April 13, 2002, it was not, as Verizon insists, "expired." It follows that the CPUC's ruling in the *Arbitration Decision* that the FCC rate caps did not apply during this period was not arbitrary and capricious, but was in fact dictated by its earlier intent to continue the 1996 agreement in force in the interim.

Nor was the 1996 agreement "expiring" once Pac-West demanded renegotiation such that application of the FCC rate caps thereafter was required. Whether or not this agreement was "expiring" at that time -- a process which, we suppose, begins to happen whenever a notice **[**24]** of termination is given -- the FCC rate caps would alter the existing 1996 contractual obligations which were alive as of December 3, 2001 when renegotiation was requested. In any event, we have no difficulty concluding that Verizon places too much weight on the language in Paragraph 82 of the *ISP Remand Order* that rate caps apply "*as* carriers renegotiate." It seems clear in context that when the FCC said that the rate caps were to apply" as carriers renegotiate" their interconnection agreements, it meant for the caps to apply *to the renegotiation*, not to transactions that take place *during* the renegotiation. Put differently, compliance with the *ISP Remand Order* requires LECs to incorporate the FCC's rate caps prospectively into the new interconnection agreement produced through renegotiation. This construction is not only grammatically plausible, it allows LECs to continue to abide by **[*1153]** the terms of existing agreements, as they must, without changing those terms retroactively, even as they negotiate a new agreement that incorporates the FCC rate caps. In sum, to impose the new rate caps during the renegotiation period of an expiring contract would be to alter an **[**25]** "existing" contractual obligation, an outcome forbidden by the *ISP Remand Order* itself.

Verizon's related argument, that the CPUC ran afoul of Paragraph 82's proscription against a state commission's determining appropriate compensation for ISP-bound traffic, fares no better. Once the CPUC determined pursuant to its authority under Paragraph 9.02 of the 1996 agreement that the terms of that agreement temporarily continue in effect, the FCC rate caps do not apply in the first place. Therefore, the CPUC made no "determination" about appropriate reciprocal compensation to which Paragraph 82's bar could pertain. Although Verizon correctly notes that an extension theory (by contrast to its own take that the interim agreement was a new agreement) delays ultimate implementation of the new rate caps, nothing in the *ISP Remand Order* expressly precludes a state commission from making a decision of the sort the CPUC made here.

Verizon suggests that there was no longer any basis for it to pay reciprocal compensation for ISP-bound traffic once the CPUC's *Generic Internet Rulings* were overturned by *Pacific Bell* in 2003. We disagree. The commission had issued two generic rulemaking **[**26]** orders that concluded that ISP traffic was intrastate for jurisdictional purposes and local for purposes of interconnection agreements. However, as the FCC had defined ISP traffic as "interstate" for jurisdictional purposes in the *ISP Remand Order*, we held that the CPUC lacked authority under the Act to promulgate general "generic"

regulations over ISP traffic. We noted that the commission's only authority over interstate traffic is the authority under *§ 252* to approve new arbitrated interconnection agreements and to interpret existing ones. In other words, *Pacific Bell* simply voided generic orders that purported to affect existing interconnection agreements without reference to any single, specific agreement; it had nothing to do with commission arbitrations of particular agreements such as occurred here. Thus, Verizon's obligation to pay reciprocal compensation for ISP-bound traffic arises from its own agreement and the *Arbitration Decision*'s interpretation of the 1996 agreement, not from the *Generic Internet Rulings*. While the 1996 agreement does not explicitly mention ISP-bound traffic, it does require Verizon to compensate Pac-West for the termination of all "local" **[**27]** calls. The CPUC's determination that calls destined for a local ISP are "local" within the meaning of the 1996 agreement is reasonable. Even the FCC has abandoned the notion, adopted in the original *ISP Order* but rejected by the D.C. Circuit, that ISP-bound calls are not local. Accordingly, during the December 3, 2001 to April 13, 2002 period, the 1996 agreement remained an "existing contractual obligation" with regard to reciprocal compensation for ISP-bound traffic, thereby rendering the FCC rate caps inapplicable.

IV

Verizon argues that the CPUC violated federal law governing the measurement of internet-bound traffic subject to the FCC's capped rates by allowing Pac-West to remove paging traffic from the total pool of terminated calls in computing the presumptive volume of ISP-bound traffic under the *ISP Remand Order*. Rather than identifying and separately measuring internet-bound calls, Pac-West opted to rely on the FCC's 3-to-1 ratio separating **[*1154]** ISP-bound calls from non-ISP-bound calls not subject to the FCC's capped rates. However, the CPUC, and the district court, allowed Pac-West to subtract out from the pool subject to the 3:1 ratio the calls Pac-West terminates to **[**28]** paging carriers. We agree with Verizon that this traffic, that is, calls to paging companies that are not ISP-bound, is already accounted for by the FCC's presumptive ratio, which provides that for every one minute of traffic Pac-West originates, three minutes of traffic Pac-West terminates will be deemed to be non-ISP traffic.

This issue turns entirely on the interpretation of paragraphs 8 and 79 of the *ISP Remand Order*. For the sake of efficiency, the order adopts a presumption that traffic exceeding a 3:1 ratio of terminating calls to originating calls is ISP-bound and thus, subject to compensation on a capped basis. This relieves both CLECs and ILECs of the burden of actually establishing how many calls are ISP-bound and how many are not. Thus, if Pac-West were hypothetically to originate 100 calls and terminate 1,000 calls, 300 of the terminated calls are presumptively non-ISP-bound calls and 700 are presumptively ISP-bound calls. However, the presumption is rebuttable; a CLEC that wants to rebut the numbers produced by applying the 3:1 ratio may show that traffic above the ratio is not ISP-bound, or an ILEC may show that traffic below it is ISP-bound. The order thus allows **[**29]** a CLEC to show that the *actual* number of non-ISP-bound calls exceeds the *presumptive* number. What the commission's determination does, by contrast, is to allow Pac-West to *add* the number of calls identifiable as actually non-ISP-bound to the presumptive number. Returning to the hypothetical, if Pac-West were able to identify 50 paging calls that are not ISP-bound, under the commission's ruling it could exclude those 50 calls yet still rely on the presumption that 300 of its terminated calls are non-ISP-bound. In our view this is arbitrary, because the 50 non-ISP-bound calls are subsumed in the numerator, that is, *all* non-ISP-bound calls are already included in the presumptive 3 to 1 ratio *unless* the CLEC shows that the ratio isn't an accurate enough reflection

of reality. The only thing that Pac-West shows by identifying 50 paging calls is that *50* of its terminated calls are in fact not ISP-bound; it does not thereby show that *350* of its terminated calls are not ISP-bound. Put differently, to permit Pac-West to pull paging traffic out of the pool of terminated calls before the presumptive ratio is applied allows it to receive reciprocal compensation for **[**30]** all identifiable non-ISP-bound calls *plus* three times the number of originated calls -- without any showing that it is not fairly compensated according to the 3:1 ratio.

We are not persuaded by the district court's observation that the end result is the same whether paging calls are excluded from the pool of terminated traffic before or after the presumptive ratio is applied. In its view, either approach is equally correct; in ours, each is equally incorrect. Under the construct of the *ISP Remand Order*, paging calls as a category of non-ISP-bound traffic should not be excluded *at all* because the whole universe of non-ISP-bound traffic (of which paging calls are part) is *included* in the pool both before *and* after the presumptive ratio is applied.

Applying the 3:1 ratio to the total pool of all terminated calls is an imminently reasonable approach. If there were no presumption as to the normal ratio between terminated and originated calls, parties would be forced to go to great lengths to distinguish ISP-bound from non-ISP-bound traffic. The presumption helps to avoid unnecessary work as it should accord with **[*1155]** industry experience in the main. Assuming the ratio is **[**31]** a mostly accurate reflection of reality, both parties should be satisfied with how the ratio plays out in practice and neither ILECs nor CLECs should have an undue incentive to employ costly measures to rebut it. Although Pac-West protests that rebutting the 3:1 presumptive relationship between terminated and originated calls is harder under Verizon's reading than under CPUC's, it is hard precisely because the ratio closely tracks reality. It is no answer that it would be easier for Pac-West to chip away at the pool before applying the 3:1 ratio, for to do so would defeat the whole point of presuming a relationship of all terminated to all originated calls.

The CPUC argues that paging traffic is excludable as a matter of state law because paging carriers are not telephone corporations, but this argument is flawed for similar reasons. Just as the FCC's presumption does not apply only to traffic terminated to non-paging carriers, it is also not limited only to traffic terminated to telephone corporations.

We conclude that the CPUC erred in its *Arbitration Order* by allowing Pac-West to remove all paging traffic from the pool of total terminated traffic in calculating ISP-bound calls **[**32]** for purposes of applying the FCC's 3:1 ratio.

V

Finally on its appeal, Verizon contends that the decision to impose reciprocal compensation on Virtual NXX traffic was arbitrary and capricious as the CPUC provided no meaningful explanation for it and, in any event, the decision contradicts the commission's own rule, established in the *VNXX Decision*, that intercarrier compensation determinations for such traffic are properly based on the routing points -- not the rating points -- of a call. *See VNXX Decision*, 1999 WL 1127635, at *19.

We disagree that CPUC failed to explain its decision. The CPUC adopted the *Final Arbitrator's Report*, which explains the VNXX reciprocal compensation ruling as follows:

> Whether or not a call is "local" depends solely upon the NPA-NXXs of the calling and called parties as established by Verizon's traditional local calling areas, and does not depend upon the routing of the call, even if it is outside the local

> calling area. This is consistent with the Commission's consistent manner of rating calls, is an industry wide practice, and recognizes the essential difference in the parties' respective network architectures . . . **[**33]** . Intercarrier compensation obligations between these two carriers must be consistent with this precept unless the underlying rule is changed.

Thus, the ruling is not without rationale; in the CPUC's view, reciprocal compensation turns on whether a call is local, and determining whether a call is local based on the NPA-NXXs of the calling and called parties, not the routing of the call, is consistent with CPUC's traditional call rating regime, industry-wide practice, and recognition of essential differences between the parties' network architectures.

Neither does the VNXX reciprocal compensation ruling represent an arbitrary departure from CPUC's earlier *VNXX Decision*. The *VNXX Decision* addressed two issues: the appropriate *rating to customers* of VNXX calls and the appropriate *intercarrier compensation* for such calls. As to rating, the CPUC ordered that "[c]alls shall be rated in reference to the rate center of the assigned NXX prefix of the called party," regardless of the called party's physical location. *VNXX Decision*, 1999 WL 1127635, at *19. That ruling did not, however, affect intercarrier compensation **[*1156]** for VNXX calls. As to this issue, **[**34]** the CPUC ordered that

> [t]he compensation exchanged between carriers related to the origination, switching, and routing of calls shall consider the actual routing points of the call, the volume of traffic, the location of the point of interconnection, and the terms of the interconnection agreement in situations where different rating and routing points are used.

Id. Verizon relies on the requirement that compensation arrangements should "consider the actual routing points of the call," as opposed to the (local) rating point, to show that the *VNXX Decision* and the *Arbitration Decision* are irreconcilable. However, we do not believe that the *VNXX Decision* must be read as Verizon suggests.

First, it is not evident from the *VNXX Decision* that the CPUC had *reciprocal* compensation in mind when it suggested that actual routing points should be considered in determining intercarrier compensation. Rather, the commission's main concern appears to be compensation *to* the originating LEC, paid *by* the terminating LEC. Reciprocal compensation, by contrast, is paid *by* the originating LEC *to* the terminating LEC. The language upon which Verizon **[**35]** relies is expressly limited to "[t]he compensation exchanged between carriers related to the *origination, switching*, and *routing* of calls"; there is no reference to the *termination* of calls, the source of reciprocal compensation obligations. The CPUC's discussion further supports this interpretation, because it focuses on the compensation due to ILECs in exchange for their transporting VNXX calls out of the local calling area, but makes no mention of compensation due to CLECs for terminating those calls. *See, e.g., id*. at *17 ("We conclude that, whatever method is used to provide a local presence in a foreign exchange, a carrier may not avoid responsibility for negotiating reasonable intercarrier compensation for the routing of calls from the foreign exchange merely by redefining the rating designation from toll to local."); *id*. ("Incumbents are entitled to fair compensation for the use of their facilities in the transport and termination of foreign exchange traffic."); *id*. at *19 ("We conclude that all carriers are entitled to be fairly compensated

for the use of their facilities and related functions performed to deliver calls to their destination, irrespective **[**36]** of how a call is rated based on its NXX prefix."). Accordingly, the *VNXX Decision* does not apply on its face to reciprocal compensation arrangements.

Regardless, the *VNXX Decision* does not establish a clear rule as to whether such compensation is ever appropriate. The effect of the decision is to require parties to "consider" physical routing in negotiating a compensation agreement; physical routing is but one of several considerations, and it does not dictate compensation. Therefore, a reciprocal compensation arrangement for VNXX calls does not necessarily violate its command. Balancing the considerations identified by the CPUC is fact-intensive, and the CPUC was careful to note that "the record at this point does not provide a sufficient basis to adopt appropriate preferred outcomes for intercarrier compensation arrangements for the transport and delivery of traffic involving different rating and routing points." *Id*. In short, the commission declined to issue any broad rule relative to intercarrier compensation for VNXX traffic. This being the case, we cannot say that its *Arbitration Decision* is plainly inconsistent with the *VNXX Decision*, or such a radical change **[**37]** of course from it that the *Arbitration Decision* may only stand with more expansive reasoning.

[*1157] VI

Pac-West's cross-appeal also involves VNXX traffic, both non-ISP bound and ISP bound. While Pac-West supports the CPUC's decision to allow reciprocal compensation for Virtual NXX traffic, it challenges the decision to allow call origination charges for the same traffic. In a nutshell, its position is that once CPUC (correctly, in its view) decided that non-ISP VNXX traffic is rated and billed as "local traffic" for purposes of reciprocal compensation, it cannot then decide that VNXX traffic is also interexchange traffic such that ILECs can collect call origination charges. n4 In doing this, Pac-West maintains, the CPUC created a "hybrid" version of traffic that it lacks authority to do. The primary reason is that, as Pac-West sees it, *47 C.F.R. § 51.703(b)* precludes collection of origination charges for any calls subject to reciprocal compensation.

> n4 As the First Circuit recently explained, "[l]ocal traffic stays within the boundaries of a local calling area. Interexchange (or 'non-local') traffic crosses the boundaries of a local calling area and is generally subject to toll or long-distance charges paid by the calling party." *Global NAPs, Inc. v. Verizon New England, Inc., 444 F.3d 59, 62-63 (1st Cir. 2006).* Such traffic may be a "local toll" call which crosses the boundaries of local calling areas but stays within a local access and transport area, or a "long distance" call that crosses the boundaries of local calling areas. *Id. at 63 n.1.*

[38]**

The CPUC, on the other hand, submits that it is inappropriate to rely on *§ 703(b)* because Virtual Local traffic is similar to Extended Area Service and Foreign Exchange Service. It points out that if the centers for two exchanges are within twelve miles of one another, the calls between those exchanges are generally rated as local calls whereas, if the rate centers are more than twelve miles apart, the calls between the two are rated as toll calls. Accordingly, as it explained in the *Arbitration Decision*, for rating purposes, Virtual Local traffic is a local call but for routing purposes, it is an interexchange call because it terminates outside of the originating calling area. Separating the two, the commission says, is not unusual for, as an example, the FCC has done the same thing with high-speed service. The CPUC sees no inconsistency with federal law and disclaims having created a hybrid category, asserting that instead it balanced the benefits that a carrier is receiving for its use

of another carrier's network with its obligation to compensate the other carrier for transporting Virtual Local calls. Verizon, in turn, emphasizes that otherwise, it incurs an uncompensated **[**39]** cost to "long haul" VNXX traffic to a distant point of interconnection between the carriers that distorts marketplace investments by CLECs like Pac-West and forces ILECs such as Verizon to provide an unwarranted subsidy. The problem, from its perspective, lies in the CPUC's decision establishing intercarrier compensation for this traffic, not in its ruling that Pac-West must pay Verizon for the cost of transporting the traffic to a distant point of interconnection.

We agree that *§ 703(b)*, read in isolation, appears to bar a VNXX transport charge, but we conclude that it does not have such an effect in this case. *Section 703(b)* provides that "[an] LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network." However, as the CPUC and the district court recognized, the FCC has expressly excluded interexchange traffic from the reach of *§ 703(b)*. As *§ 701(b)(1)* provides, *§ 703(b)* does not apply to "telecommunications traffic that is interstate or intrastate exchange access, information access, or exchange services for such access." *47 C.F.R. § 51.701(a)-(b)*. Here, **[*1158]** the CPUC applied **[**40]** its *own* balancing test in determining as a matter of fair compensation policy that VNXX traffic is subject to reciprocal compensation as "local" traffic; it did not make that determination under the *Telecommunications Act* or the *FCC*'s rules for reciprocal compensation. Rather, the CPUC determined that VNXX traffic is interexchange traffic that is *not* subject to the FCC's reciprocal compensation rules. *Arbitration Decision* at 4 n.3; *Rehearing Decision* at 7. This comports with the CPUC's prior determination that *§ 703(b)* must be read in conjunction with *§ 701*, and that any call rated as a toll call within a local access and transport area is exchange access traffic. *In re Global NAPs, Inc.*, CPUC Decision No. 02-06-076, 2002 WL 31521502 at *5, *12-14 (June 27, 2002).

This case is therefore not controlled by the *Virginia Arbitration Order*, where the FCC Wireline Competition Bureau considered whether to adopt Verizon's proposal to be compensated for transport of local calls to financial interconnection points outside the local calling area. *In re Petition of WorldCom, Inc., 17 F.C.C. Rcd. 27039, 2002 WL 1576912 (July 17, 2002)* **[**41]** (*Virginia Arbitration Order*). The Bureau concluded that *§ 703(b)* precludes originating carriers from charging transport for "local" traffic subject to federal reciprocal compensation. While similar in many respects, the *Virginia Arbitration Order* is critically different in that it was concerned with traffic that originates on the LEC's network and is subject to reciprocal compensation under federal law, whereas the CPUC found that VNXX calls are interexchange traffic that is not subject to the FCC's reciprocal compensation rules. That the CPUC did not deem VNXX traffic local for purposes of federal law also distinguishes this case from others relied upon by Pac-West, *Mountain Commc'ns, Inc. v. FCC, 359 U.S. App. D.C. 349, 355 F.3d 644 (D.C. Cir. 2004)*; *MCImetro Access Transmission Servs, Inc. v. BellSouth Telecomms., Inc., 352 F.3d 872 (4th Cir. 2003)*; and *S.W. Bell Tel. Co. v. Pub. Utils Comm'n of Tex., 348 F.3d 482 (5th Cir. 2003)*. In each, the court overturned rulings that allowed collection of charges by an ILEC for traffic that originated and terminated in the same calling area and was deemed local for purposes of federal law. None required **[**42]** consideration of *§ 701* and its exceptions to *§ 703*.

Pac-West further contends that the COC ruling is contrary to the *ISP Remand Order* which preempts state commissions from imposing any intercarrier compensation not provided for in the order. We disagree, as the *ISP Remand Order* was exclusively concerned with the operation of *§ 251(b)(5)* of the Act and the

imposition of reciprocal compensation charges on ISP-bound traffic. The order holds that ISP-bound traffic does not fall within *§ 251(b)(5)*, and so is not subject to the reciprocal compensation requirement. As the district court also noted, it addressed charges that may properly be imposed by the receiving carrier for receipt and handling of traffic, but does not govern charges imposed by the originating carrier for the delivery of VNXX traffic. Accordingly, this ruling has no effect on the determination of whether collection of call origination charges for ISP-bound VNXX traffic is appropriate. *See Global NAPs, Inc., 444 F.3d at 72* (holding that "the *ISP Remand Order* does not clearly preempt state authority to impose access charges for interexchange VNXX ISP-bound traffic").

For the same reason, **[**43]** the FCC's imposition of rate caps on ISP-bound traffic, and simultaneous preemption of state authority to address compensation for ISP-bound traffic, are not relevant. Those rate **[*1159]** caps are intended to substitute for the reciprocal compensation that would otherwise be due to CLECs for terminating local ISP-bound traffic. They do not affect the collection of charges by ILECs for originating interexchange ISP-bound traffic. As this issue was not before the FCC when it crafted the *ISP Remand Order*, the order does not preclude the CPUC's ruling.

Finally, Pac-West submits that the decision to allow call origination charges was not supported by substantial evidence, and was arbitrary and capricious, as the CPUC failed to cite any record evidence in support of its conclusion that Pac-West could distinguish VNXX from non-VNXX traffic for purposes of complying with the ruling. Pac-West posits that this conclusion is not only contrary to testimony in the record, but that it rests on the presumption that Pac-West *could* establish a means for separating VNXX from non-VNXX traffic in the future, thus implicitly conceding that no such means currently exist.

The CPUC's conclusion that Pac-West **[**44]** is able to distinguish VNXX traffic from local traffic that is first transported long-distance to a Pac-Wests witch and then back to the original calling area rests on statements by Pac-West witnesses that "Pac-West knows where its network ends" and the call is picked up by the customer. Since that is the end of Pac-West's responsibility for the call, it should also be the relevant end point of the call for purposes of determining whether the call is local or VNXX. The record indicates that traffic studies are common in the industry and that Pac-West could conduct such studies to separate the calls that are not subject to reciprocal compensation but are subject to access charges. Other state commissions have reached similar conclusions, n5 so we cannot say that the CPUC's determination is without support.

n5 *See, e.g., AT&T Commc'ns of Ill., Inc. et al. Verified Petition for Arbitration, 2003 Ill. PUC LEXIS 715, *288-89, *303-04 (Aug. 26, 2003)*; *In re Arbitration of the Interconnection Agreement Between Global NAPs and Verizon-Rhode Island, 2002 R.I. PUC LEXIS 20, *49 (Oct. 16, 2002)*; *Petition of Global NAPs, Inc., Pursuant to Section 252(b) of the Telecomms. Act of 1996 for Arbitration to Establish an Interconnection Agreement with Verizon New Engl., Inc., 2002 Mass. PUC LEXIS 65, *49-54 (Dec. 12, 2002).*

[45]**

VII

We conclude that the CPUC's *Arbitration Decision* was not arbitrary and capricious in determining that during the interim period between a request to renegotiate an interconnection agreement or after the contractual period for renegotiation has run and adoption of a "new" agreement, the "old" agreement contin-

ued in effect such that Verizon must pay reciprocal compensation for delivery of internet-bound calls at pre-existing rates rather than at the lower capped rates set by the FCC that apply to new contractual obligations; that Pac-West is entitled to reciprocal compensation for Virtual NXX traffic; and that Verizon is entitled to collect call origination charges for virtual traffic. We therefore affirm the district court's judgment as to these issues. However, we also conclude that the commission's determination that Pac-West could disregard paging traffic for purposes of computing the presumptive volume of ISP-bound traffic is incorrect. As to that issue, we reverse and remand.

Each party shall bear its own costs.

AFFIRMED IN PART; REVERSED AND REMANDED, IN PART.

COM/GFB/RW1/vfw

MAILED 5/27/03

Decision 03-05-075 May 22, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Verizon California Inc. (U-10021-C) Petition for Arbitration with Pac-West Telecomm, Inc. (U5266-C) Pursuant to Section 252(b) of the Telecommunications Act of 1996.	Application 02-06-024 (Filed June 12, 2002)

DECISION APPROVING ARBITRATED AGREEMENT PURSUANT TO SECTION 252, SUBSECTION (e), OF THE TELECOMMUNICATIONS ACT OF 1996 (ACT)

Summary

In this decision we modify and approve the arbitrated interconnection agreement (ICA) filed by on February 18, 2003, Verizon California Inc. (Verizon) and Pac-West Telecomm, Inc. (Pac-West), under Rule 4.2 of our Revised Rules Governing Filings made Pursuant to the Telecommunications Act of 1996 (Rules), pursuant to Subsection 252(e) of the Act. We find that the ICA does not violate the requirements of Section 251 of that Act, the Federal Communications Commission's (FCC) implementing regulations therefore, or the pricing standards set forth in Subsection 252(d) of the Act. However, we do find that the Final Arbitrator's Report finding on Issue 3 of the agreement is inconsistent with Commission policy established in prior interconnection agreement (ICA) cases and therefore Issue 3 of the ICA shall be modified to comport with this decision.

Application (A.) 02-06-024 is closed.

Background and Procedural History

As required by Subsection 252(e)(1) of the Act, in this decision we approve in its entirety the proposed ICA between Verizon and Pac-West, following arbitration of certain issues the parties could not resolve through negotiation. Pac-West's previous ICA with Verizon expired on April 13, 2002.

The history of the dispute, and a complete discussion of the parties and disputed issues, are set forth in detail in the Final Arbitrator's Report (FAR), which was filed on February 10, 2003. Rule 4.2.1 required the parties to file the entire agreement conforming to the FAR, and respective statements concerning approval or rejection of the proposed ICA, within seven days after issuance of the FAR. Both parties timely filed these documents, thus placing before us the task of approving or rejecting the ICA in its current form.[1]

Rule 4.2.1 specifies that each party's statement must indicate:

a. the tests the Commission must use to measure an agreement for approval or rejection,
b. whether the party believes the agreement passes or fails each test, and
c. whether or not the agreement should be approved or rejected by the Commission.

An arbitrated ICA may be rejected by this Commission only if it does not meet the requirements of Section 251, implementing regulations prescribed by the FCC, or the pricing standards set forth in Section 252(d). This test is mirrored by our Rule 4.2.3.

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[1] No comments were filed by any member of the public within ten days after the filing of the agreement, as permitted under Rule 4.2.1.

Verizon's statement urges us to take a piecemeal approach in adopting the ICA, specifically by rejecting the Arbitrator's resolution of Issues 1, 3, 4, and 7; modifying his resolution of Issues 5, 6, 8 and 18; and drafting replacement contract provisions reflecting his resolution of Issues 19 and 20, because the parties have been unable to do so themselves. Essentially, Verizon's statement reargues its position with respect to all of these issues in an effort to have the Commission overturn the arbitrated outcome on each. This is inappropriate to the task before us, which is to determine whether the ICA as a whole satisfies Section 251 and its implementing regulations, and Section 252(d) of the Act. On the issues cited by Verizon, either party's position appears lawful on its face and satisfies this standard, and we will not be placed in the position of overturning or reworking the Arbitrator's resolution of an issue, or undertaking the parties' job of translating those results into contract language.

Discussion Issue 3

We find that consistent with the outcome in a previous Commission Decision (D.) 99-09-029, and three Commission arbitration decisions based upon that rulemaking, Verizon should receive transport charges from Pac-West for Virtual NXX (VNXX) traffic pending FCC resolution of the issue in the *Intercarrier Compensation NPRM.*[2]

Issue number 3, as cast by the parties, asks whether Verizon should be allowed to collect transport charges on calls destined to Pac-West customers with disparate rating and routing points. At issue is whether Verizon should, or should not be compensated for the costs to deliver VNXX traffic to Pac-West.

[2] This ICA is approved concurrent with the Commission approval of the ICA between Pac-West and SBC-California. The VNXX issue is the same in both ICAs, although the discussion in the Pac-West and SBC-California case is more detailed.

VNXX is a form of Foreign Exchange service where the purchaser of the VNXX is not physically located in the originating callers local calling area, yet the originating call to the VNXX is considered local from the caller's perspective. VNXX traffic is interexchange traffic because it terminates outside of the originating calling area (exchange), although it is rated as a local call to the calling party. VNXX and Foreign Exchange differ from traditional local calling where the called NXX and callers NXX resides within the same local calling area.

The nature of the Pac-West's network design requires Verizon to long-haul virtually all calls to Pac-West in order for Pac-West's switch to route the call over its system to its customer. The Commission in deciding prior arbitration agreements concluded that CLECs would be absolved from paying the costs associated with transport from origination to their point of interconnection on the condition that the disparately rated and routed traffic was returned and terminated within the rate area where the local call originated. [3] For foreign exchange type of service, where the traffic does not return to the originating rate center, the Commission determined that such traffic would be subject to transport charges.[4] These policies are clearly elucidated by the Commission in D. 02-06-076;

> The calling areas adopted by the Commission govern whether a call is local or an intraLATA toll call. Any call rated as an intraLATA

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[3] FCC Rule 51.703(b) forbids the ILECs from assessing any charges to transport "local" traffic, which is subject to reciprocal compensation provisions. However, Interexchange traffic is not subject to the Telecommunications Act's reciprocal compensation requirements. The California Commission determined that disparately routed, local calls and VNXX calls are subject to reciprocal compensation, not the FCC.

[4] See GNAPs Arbitration Decision 02-06-076, pp. 25-30.

> toll call under the Commission's established calling areas would constitute exchange access traffic, not local traffic. (p.20)
>
> "(W)e have no intention of making a decision in an arbitration proceeding that would have the net result of abolishing intraLATA calling. For calls that are intaLATA in nature, e.g., those beyond 16 miles, traditional access charges will apply." (p.24)

Additionally, the Commission's local compensation rules require the originating call carrier to compensate the CLEC for terminating the "local" traffic, including VNXX traffic that is disparately rated and routed, as in a foreign exchange (FX) service.

Decision 02-06-076, page 28, states;

> "…VNXX calls would be intraLATA calls, not local calls, if tied to the rate center that serves the customer. By allowing disparate rating and routing, we are allowing for those calls to become local calls, and as such, subject to reciprocal compensation. However, GNAPs is required to pay the additional transport required to get those calls where they will be considered local calls. …This is similar to the concept of the ILEC's tariffed FX service, in which the customer pays for the privilege of receiving dialtone from a different exchange. Because these calls would be intraLATA toll calls, if they were rated out of the rate center, which actually provides service to the customer, they are not subject to the provisions of Rule 703(b)."

The rationale supporting the premise of the ILEC not having to pay for transport for disparately rated and routed "local calls" was based on a quid pro quo that the CLEC bears the cost of returning the traffic from its point of interconnection to the local calling rate center. This "quid pro quo" policy promotes local competition and improves the opportunity for CLECs to utilize one point of interconnection to serve each of the rate centers within the LATA. Thus, CLECs have to balance the investment cost of adding a point of

interconnection with the cost of purchased transport, leased or otherwise, from their switching facilities to the end user.

Verizon cannot differentiate the traffic it hands off to Pac-West that is destined for the originating rate center (local NXX) from interexchange traffic destined 16 miles away from the originating rate center (VNXX). However, Pac-West knows to where it terminates the traffic it receives from Verizon. It is irrelevant whether the traffic Pac-West terminates to its customer is a voice call, or is handed off to the Internet or a private network. The rate area associated with where Pac-West delivers traffic to its customer is the relevant " termination point" for transport rating purposes. Since Pac-West knows to where it terminates traffic for its customers, Pac-West is capable of identifying the amount of traffic that is returned to the originating rate center (local NXX), and the amount of traffic it terminates which is interexchange - more than 16 miles away from the originating rate center (VNXX).[5]

We do not agree with the Arbitrator that customer location is *inmaterial* because Verizon must hand off all traffic to a Pac-West POI. Clearly, uncompensated costs are borne by the originating network provider and Pac-West's claim that a cost differential between VNXX and local NXX calls must be found is a red herring. Regardless of whether the traffic's eventual destination is the originating local NXX calling area or a VNXX destination, or an interLATA toll destination, the transport cost between Verizon and Pac-West are the same. Yet, the FAR would only allow Verizon compensation for interexchange toll calls, but not interexchange VNXX calls. We overturn the result reached by the

[5] The ICA includes non-disclosure agreements necessary to protect confidential/proprietary information.

Arbitrator on this issue, because contrary to the FAR, there is no need for Verizon to explain whether its cost of transporting traffic to Pac-West will differ based on where Pac-West delivers it. The Commission in a prior arbitration decision already addressed this issue. Decision 01-02-045, states;

> "D.99-09-029 granted Level 3 the right to assign routing and rating points and provide Virtual NXX service, so long as Pacific is fairly compensated. Pacific showed that it has uncompensated costs when carrying calls for Level 3's Virtual NXX customers. Therefore, Level 3 must compensate Pacific for the use of Pacific's facilities regardless of whether or not Pacific incurs additional costs when transporting Level 3's Virtual NXX traffic.

The prior arbitration decisions reflect a consistent Commission application of the principle of cost causation. The principle would be violated if the Commission allowed competitors to avoid paying for transport over another carrier's network in order to long haul interexchange traffic terminated in disparate rate centers. To allow such long-haul transport without transport compensation would be unfair for the ILEC, which bears the cost of its transport network. Further, such a policy in regards to VNXX, once widely adopted by the CLEC industry would potentially result in a shift in the cost of such transport to local exchange subscribers rather than to the subscribers of VNXX service which is the beneficiary of the foreign exchange like service.[6]

Pac-West has developed its VNXX product largely to serve its ISP customers, a substantial part of its business. VNXX is a valuable service that

[6] Pac-West argues that transport charges are paid by the originating call, telephone subscriber. This may be true to a very limited extent that local exchange costs include interexchange costs within the local calling area. However, transport costs outside the local calling area are excluded. Potentially, ILECs could assign these unrecovered transport costs to local calling in any proceeding addressing local exchange costs.

subscribers are willing to pay a premium for. Such service rates should bear the costs associated with provisioning the service. Verizon offers a similar product as foreign exchange service. The FAR would have Verizon provide transport services for non-local VNXX traffic without charge to its competitors while bearing the full cost of transport for provisioning its own foreign exchange service. CLECs are free to compete utilizing wholesale services of the ILEC, other CLEC transport providers, or to provision transport services themselves.

The policies of this Commission and the Telecom Act precisely intends for carriers to invest in facilities based on the innovation incentives inherent in an openly competitive market. We refrain from creating an incentive that distorts marketplace investments by requiring incumbents to either subsidize its competitors' or shift costs to local exchange customers for inter-exchange traffic that is destined beyond the origination rate center. Such policy would encourage CLECs to become providers of termination facilities, to collect reciprocal compensation and thereby avoid investment in multiple points of interconnection, switching, and transport, and result in less network redundancy than facilities based competition economics would otherwise dictate. The competitive challenge is both on the CLECs and ILECs to invest wisely in origination and termination facilities.

Discussion Issues 2 and 17(a)

Pac-West's statement indicates its belief that the conformed ICA satisfies the rejection standard, with the exception of provisions reflecting two issues, 2 and 17(a), that were decided by the Arbitrator in the FAR. Regarding Issue 2, Pac-West is concerned that Verizon might construe the FAR to impose the FCC's reduced rate caps on presumptively ISP-bound traffic retroactively from the effective date of the new ICS. We agree with Pac-West that Paragraph 82 of the

FCC's *ISP Remand Order*[7] expressly proscribes such a result,[8] and may not be reflected in the ICA.

Regarding Issue 17(a), we also agree with Pac-West that a requirement for Pac-West to pay any allocated portion of costs on Verizon's side of the carriers' point of interconnection does not satisfy the interconnection requirements of Section 251 of the Act, and therefore must not be included in the ICA.

We have examined the conformed agreement filed by the parties, and have determined that approval should be granted, subject to the foregoing discussion. The pricing provisions comply with the standards for interconnection and network element charges, as well as the charges for transport and termination of traffic, under Section 252(d). The ICA does not discriminate against nonparties, and is consistent with the public interest, convenience and necessity, and thus comports with Section 252 (e)(2)(A). It also satisfies the requirements of Section 251 and the FCC's implementing rules, and thereby satisfies Section 252(e)(2)(B). Lastly, the agreement satisfies our own regulatory requirements.

Rule 4.2.4 requires a decision approving or rejecting an arbitrated ICA to contain written findings.[9] Consistent with this rule, we include findings in support of our order.

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[7] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic* CC Docket Nos. 96-98 and 99-68, *Order on Remand and Report and Order*, 17 FCC Rcd 9151 (2001).

[8] "The interim compensation regime we establish here applies as carriers renegotiate expired or expiring interconnection agreements. *It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions."* (*Italics* supplied.) D.02-01-062 determined that the change-of-law provision in the existing ICA excludes FCC orders, and any change to the terms of the existing ICA requires a written amendment by both parties.

Comment on Draft Decision

Comments were received on April 1, 2003 from Pac-West Telecomm, Inc., Verizon California, Inc., and California ISP Association, Inc. Reply Comments were received on April 7, 2003 from Pac-West Telecomm, Inc., and Verizon California, Inc. In its comments Pac-West states that Verizon Call Origination Charges permitted by the Alternate would impose approximately $11 million of new charges on Pac-West for the same interconnections that are currently in place at current traffic volumes, and that Verizon's proposal did not include a network reconfiguration option that would avoid the imposition of Call Origination Charges.[10] The Commission recently determined in the arbitration between Pac-West and SBC-California, that the applicable TELRIC-based UNE rates should become effective January 1, 2004, and that Pac-West could avoid all such charges by reconfiguring its network with POIs located at network tandems.[11] Similarly in this case, Pac-West should have a choice to either reconfigure its network by establishing POIs at network tandems or to pay transport rates for VNXX calls. To provide Pac-West sufficient time to reconfigure its network, for purposes of this interconnection agreement, the applicable transport rates shall be effective upon January 1, 2004, on a going forward basis. We recognize the FCC could change this VNXX transport charge policy. When the FCC acts on its Intercarrier Compensation NPRM regarding

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[9] Section 252(e)(1) of the Act only requires us to include written findings as to any deficiencies in the ICA.

[10] See Comments of Pac-West Telecom, Inc., p.12.

[11] See Decision 03-05-031, p.11.

the VNXX issue, such outcome shall be reflected in this ICA via its Change in Law provision.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Victor D. Ryerson is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Pac-West can identify to Verizon the amount of disparately rated and routed traffic that Pac-West terminates within 16 miles of the originating rate center in order to avoid inappropriate assessment of interexchange transport charges.

2. The Interconnection Agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Verizon California Inc. and Pac-West Telecomm, Inc. (ICA), filed by the parties on February 18, 2003, pursuant to Rule 4.2.1, conforms to the Final Arbitrator's Report in this proceeding, except for the modification required to reflect the resolution of Issue 17(a).

3. The pricing provisions of the ICA comply with the standards for interconnection and network element charges, and the charges for transport and termination of traffic, under Section 252(d) of the Act.

4. The ICA does not discriminate against nonparties, and is consistent with the public interest, convenience and necessity, and thus comports with Section 252 (e)(2)(A) of the Act.

5. The ICA, with the indicated modification of the outcome under Issue 17(a), satisfies the requirements of Section 251 of the Act and the FCC's implementing rules, and thereby satisfies Section 252(e)(2)(B).

6. The ICA satisfies the Commission's regulatory requirements, as reflected in its rules, decisions, and orders.

Conclusion of Law

1. Verizon is entitled to receive compensation at UNE prices for facilities used per D.99-09-029 at 32, Decision 00-08-011 at 18, and Decision 02-06-076, at 28. The UNE transport rates applicable in this order should become effective January 1, 2004.

2. It is appropriate that VNXX traffic be subject to reciprocal compensation.

3. The Commission should approve the modified ICA.

O R D E R

IT IS ORDERED that:

1. The Interconnection Agreement under Sections 251 and 252 of the Telecommunications Act of 1996 by and between Verizon California Inc. and Pac-West Telecomm, Inc., filed by the parties on February 18, 2003, is approved, subject to the modifications indicated in the body of our decision.

2. To avoid paying the costs associated with transport from origination to their point of interconnection, Pac-West shall disclose to Verizon the percentage of disparately rated and routed traffic that was returned and terminated within the rate area where the local call originated.

3. The UNE transport rates applicable in this order shall be effective upon January 1, 2004, and on a going forward basis.

4. Parties shall modify the agreement in conformance with this order and shall file it in this docket within 7 days. A copy shall be provided to the Director of the Telecommunications Division. The signed ICAs shall become effective on the date filed.

5. Application 02-06-024 is closed.

This order is effective today.

Dated May 22, 2003, at San Francisco, California.

CARL W. WOOD
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I dissent.

/s/ MICHAEL R. PEEVEY
President

I dissent.

/s/ LORETTA M. LYNCH
Commissioner

I will file a concurrence in part and a dissent in part.

/s/ SUSAN F. KENNEDY
Commissioner

Commissioner Kennedy, concurring in part and dissenting in part,

Today's order by this Commission offers a good approach to resolving the issues before us. In particular, this order offers a reasonable resolution of the vexing problem of ensuring that virtual NXX-calls bear a fair share of the costs that they impose on the telecommunications network and on other consumers. In addition, the order provides firms that relied on previous Commission orders the time to reconfigure their networks so as to reduce the costs of transporting calls and to protect their customers from any unnecessary costs. It applies these rates for transporting virtual NXX calls prospectively, which is consistent with the FCC's delegation of authority to resolve this issue to the states. Finally, this order requires Verizon and PacWest to incorporate into their interconnection contract the reciprocal compensation prices adopted in the FCC's *ISP Remand Order.*[12] I concur in these actions.

Concerning the issue of the appropriate date for the applicability of those particular rates adopted in the FCC's *ISP Remand Order* (Issue 2 in this proceeding), this order, which sets the mailing date of today's order as the effective date, does not conform with the FCC's order. In particular, although our order cites Paragraph 82 of the FCC's *ISP Remand Order* as requiring the adoption the FCC's reciprocal compensation rates on a going-forward basis, it errs in its interpretation of this very paragraph.

An examination of Paragraph 82 shows that it does not support an extension of existing pricing terms that contravene the FCC-adopted prices and does not permit states to apply the FCC-adopted prices on a forward-going basis. Paragraph 82 states:

> 82. The interim compensation regime we establish here **applies as carriers re-negotiate expired or expiring interconnection agreements**. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-law provisions. This Order does not preempt any state

[12] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic* CC Docket Nos. 96-98 and 99-68, *Order on Remand and Report and Order*, 17 FCC Rcd 9151 (2001).

> commission decision regarding compensation for ISP-bound traffic for the period prior to the effective date of the interim regime we adopt here. Because we now exercise our authority under section 201 to determine the appropriate intercarrier compensation for ISP-bound traffic, however, state commissions will no longer have authority to address this issue. (emphasis added)[13]

As paragraph 82 clearly states, the rates adopted in the FCC's *ISP Remand Order* apply "**as**" the interconnection contract is "expiring or expired."

Although today's order rightly notes that the interconnection agreement between Verizon and Pac-West expired on April 13, 2002, it ignores the relevance of this fact to the issues at hand and fails to apply the relevant FCC regulation. First, beginning April 14, 2002 there was no contractual relationship between Verizon and Pac-West – the contract had expired. Second, since the FCC's *ISP Remand Order* and its reciprocal compensation rates became effective June 2001, there was no legal basis for this Commission to extend the reciprocal compensation rates in the "expired" interconnection agreement beyond April 14, 2002. Thus, with the expiration of the interconnection agreement, the rates contained in the FCC's *ISP Remand Order* became effective. Moreover, this Commission's extension of the reciprocal compensation prices in the expired contract is an unlawful action that both violates the pricing terms of the remand order and creates a new agreement concerning these pricing terms where none rightfully exists.[14]

For these reasons, I respectfully dissent in this order's failure to implement the pricing terms of the FCC's *IDP Remand Order* effective April 14, 2002.

/s/ SUSAN P. KENNEDY

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[13] *Ibid.,* paragraph 82.

[14] Note: As before, we distinguish the ability of states to resolve the pricing issues concerning the transport of virtual NXX calls from the issue of reciprocal compensation. On the pricing of virtual NXX calls, the FCC has not exercised its jurisdiction and the states are free to apply pricing terms prospectively.

Susan P. Kennedy
May 22, 2003

 Mailed 7/5/2002

Decision 02-06-076 June 27, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Global NAPs, Inc. (U-6449-C) Petition for Arbitration of an Interconnection Agreement with Pacific Bell Telephone Company Pursuant to Section 252(b) of the Telecommunications Act of 1996.	Application 01-11-045 (Filed November 30, 2001)
In the Matter of Global NAPs, Inc. (U-6449-C) Petition for Arbitration of an Interconnection Agreement with Verizon California Inc. f/k/a GTE California Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996.	Application 01-12-026 (Filed December 20, 2001)

Cole, Raywid & Braverman, L.L.P, by John C. Dodge, Attorney at Law, for Global NAPs, Inc., applicant.
John W. Bogy, Attorney at Law, for Pacific Bell Telephone Company and Hunton & Williams, by Kelly L. Faglioni, Attorney at Law, for Verizon California Inc., respondents.

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OPINION ADOPTING FINAL ARBITRATOR'S REPORT WITH MODIFICATION

1. Summary

We affirm the results adopted in the Final Arbitrator's Report (FAR), with modification, and approve the resulting arbitrated Interconnection Agreements (ICA) between Global NAPs, Inc. (GNAPs) and Pacific Bell Telephone Company (Pacific) and between GNAPs and Verizon California Inc. (Verizon), as modified by this order. Within 30 days of the date of this order, parties shall jointly file and serve signed, complete Interconnection Agreements that conform to the decisions herein. This proceeding is closed.

2. Background

On November 30, 2001, GNAPs filed an application for arbitration of an interconnection agreement with Pacific pursuant to Section 252(b) of the Telecommunications Act of 1996 (Act or TA96). Formal negotiations between the parties commenced on January 19, 2001. As negotiations progressed, Pacific agreed to extend the closing date of the parties' arbitration window, making November 30, 2001 the date the arbitration window closed. Therefore, GNAPs' Petition was timely filed.

GNAPs agreed to negotiate the terms of an ICA based on Pacific's proposed "13-state" ICA. While there was no dispute over the vast majority of terms in the ICA, the parties reached an impasse on 13 key issues. In its petition, GNAPs indicated that it discusses all key unresolved issues in detail, but stated the petition did not identify all of the disputed language in the ICA. GNAPs requested that the Commission resolve the disputed issues on a policy level and affirmatively order the parties to implement contract language embodying this policy decision.

On December 26, 2001, Pacific filed its Response to GNAPs' application. In its Response, Pacific summarized its position on the 13 issues previously raised by GNAPs. Pacific also indicated that GNAPs' proposal that the Commission resolve disputed issues at a policy level is both impractical and contrary to law. Resolution ALJ-181 requires parties to identify the issues for which they request arbitration and propose contractual language to match. In its Response, Pacific presented Pacific's proposed resolution of the 13 issues that were described in the Petition, with Pacific's proposed contractual language.

Similarly, on December 20, 2001, GNAPs filed an application for arbitration of an ICA with Verizon California Inc. f/k/a GTE California Inc. (Verizon) pursuant to Section 252(b) of the Act. GNAPs listed 11 unresolved issues.

Verizon filed a response to GNAPs' petition on January 14, 2002. Verizon responded to the 11 issues GNAPs raised, and added 3 others, for a total of 14 issues. Verizon pointed out, as did Pacific, that GNAPs articulated very narrow issues for arbitration, but proposed significant changes to the ICA, which were not mentioned in the Petition nor supported by testimony.

Conference calls were held on January 7 and January 15, 2002, to discuss the schedule for the case and to address various procedural issues. During the January 7, 2002 conference call, the arbitrator assigned to the proceedings raised the issue of consolidating the two arbitration proceedings since many of the issues to be addressed were common to both. During the January 15, 2002 conference call with GNAPs, Pacific, and Verizon, the arbitrator indicated her intent to consolidate the two arbitration proceedings and revise the hearing schedule.

GNAPs was ordered to make a Supplemental Filing on January 22, 2002. The filing included GNAPs' position on all areas where there was disputed language that was not addressed specifically in GNAPs' initial petitions. GNAPs' Supplemental Filing was not filed with the Commission until January 23, 2002, and it was accompanied by a motion for acceptance of late filed comments. Pacific and Verizon filed their Supplemental Responses on February 1, 2002. An ALJ Ruling was issued on January 22, 2002 formally consolidating the two proceedings and affirming the procedural schedule discussed during the January 15, 2002 conference call.

An arbitration hearing was held on February 11, 2002. Concurrent briefs were filed and served on March 8, 2002. On March 28, 2002, Verizon filed a motion to strike portions of the post-hearing brief of GNAPs relating to Issues 6 (dark fiber) and 9 (performance measures). In its motion, Verizon indicated that parties had settled Issues 6 and 9 prior to the arbitration hearing. At the start of the hearing, the parties informed the arbitrator of their settlement of those issues. The Draft Arbitrator's Report (DAR) was filed on April 8, 2002, disposing of the contested issues as set forth below. Comments on the DAR were filed on April 24, 2002, and the FAR was filed and served on May 15, 2002.

Parties continued their negotiations up until the time of the hearing and resolved some issues in dispute. During the hearing, Pacific reported that only Issues 1-4 were still in dispute. Verizon reported that 12 issues, 1-5, 7-8, and 10-14 were still in dispute. Issues 1-4 are common to both Pacific and Verizon, while issues 5, 7-8, and 10-14 apply only to Verizon.

The most significant issues presented in this arbitration are:

1) Should either party be required to install more than one point of interconnection (POI) per Local Access and Transport Area (LATA)?

2) Should each party be responsible for the costs associated with transporting telecommunications traffic to the single POI?

3) Should the ILECs' local calling area boundaries be imposed on GNAPs or may GNAPs broadly define its own local calling area?

4) Can GNAPs assign to its customers NXX codes that are "homed" in a central office switch outside of the local calling area in which the customer resides?

The GNAPs/Pacific conformed agreement was filed with the Commission on May 22, 2002, and the GNAPs/Verizon conformed agreement, on May 29, 2002. On May 22, 2002 Pacific filed a statement concerning the outcomes in the FAR. GNAPs served its statement on May 24, 2002. Verizon and GNAPs filed statements on May 29, 2002, regarding whether the Commission should adopt or reject the conformed agreement.

On June 13, 2002, GNAPs filed a Supplemental Statement regarding Commission approval or rejection of the ICA conformed to the FAR. GNAPs' Supplemental Statement was accompanied by a motion to accept the Supplemental Statement. GNAPs asks that its statement be accepted in the interest of fairness and due process, since Pacific and Verizon filed substantial, similar statements.

Both Pacific and Verizon filed in opposition to GNAPs' motion on June 20, 2002. Pacific points out that GNAPs had not just an opportunity, but an obligation to file a timely statement regarding the lawfulness of the ICA, but did not comply. The FAR itself directs parties to file such a statement.

Also, Pacific states that GNAPs' Supplemental Statement is a point-by point reply to Pacific's and Verizon's statements. Pacific asserts that GNAPs was given due process and simply did not accept it.

Verizon states that the Supplemental Statement should not be accepted because GNAPs chose to forego its opportunity to comment. According to Verizon, this is hardly unfair or a denial of due process. In fact, Verizon asserts it would be unfair to Verizon and Pacific to allow GNAPs to "respond to Pacific and Verizon's legal memoranda." Verizon views GNAPs' filing as untimely and states that the Commission rules and procedural order never contemplated the opportunity to "respond" to parties' comments as GNAPs now suggests. Rather, the parties were supposed to file concurrent comments. Verizon also adds that GNAPs had the opportunity to file 10-page comments on the DD.

Ordering Paragraph (OP) 1 in the FAR provides clear language on what the parties should file concurrently with the conformed agreement. The parties are ordered to file on the schedule specified in the order:

An entire Interconnection Agreement, for Commission approval, that conforms with the decisions of this Final Arbitrator's Report. A statement which (a) identifies the criteria in the Act and the Commission's Rules (e.g., Rule 4.3.1, Rule 2.18, and 4.2.3 of Resolution ALJ-181), by which the negotiated and arbitrated portions pass or fail those tests; (b) states whether the negotiated and arbitrated portions pass or fail those tests; and (c) states whether or not the Agreement should be approved or rejected by the Commission.

GNAPs failed to provide substantive comments on the conformed ICA in a timely fashion, as required by our rules and should not now be rewarded by allowing it to make what is in essence a rebuttal to the timely filings made by Pacific and Verizon. We will deny GNAPs' motion to accept its Supplemental Comments. GNAPs had the same opportunity as Pacific and Verizon to file comments on this draft decision, so GNAPs' due process rights have not been violated.

3. Negotiated Portions of Agreement

Section 252(e) of the Act provides that we may only reject an agreement (or portions thereof) adopted by negotiation if we find that the agreement (or portions thereof) discriminates against a telecommunications carrier not a party to the agreement, or implementation of such agreement (or portion thereof) is not consistent with the public interest, convenience and necessity. No party or member of the public alleges that any negotiated portion of the agreement should be rejected. We find nothing in any negotiated portion of the agreement which results in discrimination against a telecommunications carrier not a party to the agreement, nor which is inconsistent with the public interest, convenience and necessity.

4. Arbitrated Portions of Agreement

Section 252(e) of the Act, and our Rule 4.2.3, provide that we may only reject an agreement (or any portion thereof) adopted by arbitration if we find that the agreement does not meet the requirements of § 251 of the Act, including the regulations prescribed by the Federal Communications Commission (FCC) pursuant to § 251, or the standards set forth in § 252(d) of the Act.[1]

In statements filed with each conformed agreement, GNAPs states that the conformed agreements should be adopted. However, both Pacific and Verizon dispute various outcomes in the FAR. According to Pacific, the FAR violated or misapplied §§ 251(c)(2), 252(b)(4) and 252(d) of the Act. Verizon asserts that the Commission should reject the interconnection agreement conformed to the FAR, in three areas. These three areas which Verizon claims are contrary to the Act

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[1] Section 251 describes the interconnection standards. Section 252(d) identifies pricing standards.

include (i) the requirements of § 251 of the Act, including the FCC's regulations; (ii) the pricing standards set forth in § 252(d) of the Act; and (iii) the Commission rules, regulations and orders. The Incumbent Local Exchange Carriers (ILECs') concerns relate to Issues 1-4.

The FAR addressed issues 1 and 2 together. Those issues are as follows:

1) Should either party be required to install more than one POI per LATA?

2) Should each party be responsible for the costs associated with transporting telecommunications traffic to the single POI?

Parties do not dispute that GNAPs has the right to install a single POI per LATA. However, in their statements on the conformed agreement, both Pacific and Verizon dispute the FAR's determination on Issue 2.

In making the determination under Issue 2 that GNAPs was not required to pay for any transport on the ILEC's side of the POI, the arbitrator relied on FCC Rule 51.703(b) which states: "[a[LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network." However, in its statement on the conformed agreement, Pacific points out that § 703(b) was applied out of context. The FAR does not take Rule 701, which defines the "scope of transport and termination pricing rules" into consideration. According to Pacific, the rules must be read together.
Section 701(a) says:

> The provisions of this subpart apply to reciprocal compensation for transport and termination of telecommunications traffic between LECs and other telecommunications providers.

Section 701(b) reads as follows:

> "Telecommunications traffic" is "Telecommunications traffic exchanged between a LEC and a telecommunications carrier other

> than a CMRS [Commercial Mobile Radio Service] provider, *except for telecommunications traffic that is interstate or intrastate exchange access, information access, or exchange services for such access.*
> (Emphasis added.)

Pacific asserts that this definition from § 701 means that § 703(b) does not apply in this case for two independent reasons. First, "exchange access" is excepted from the definition of "telecommunications traffic" that is subject to reciprocal compensation, and transport from one of Pacific's calling areas to a different local calling area constitutes exchange access. Second, transport and tandem switching between Pacific's end office and GNAPs' POI is not "from the parties' interconnection point to the terminating carrier's end office switch." On the contrary, it is transport from the originating carrier's switch to the POI. Pacific has agreed to pay reciprocal compensation when GNAPs terminates Pacific-originated calls. However, Pacific is proposing that GNAPs bear a portion of the incremental costs to get to GNAPs' POI. Pacific clarifies that its proposal would not require GNAPs to pay for all transport between the Pacific end office and the POI. GNAPs would pay only when the caller and the POI are situated in different tandem sector areas, and the transport mileage would be discounted by the mileage for a local call in California. (Appendix Network Interconnection Methods, § 2C.)

We concur with Pacific's statement that the arbitrator erred in relying on Rule 51.703(b) without taking Rule 51.701 into account. To understand the full picture regarding reciprocal compensation requirements, Rule 51.703 cannot be viewed in a vacuum; it must be read in conjunction with Rule 51.701. Part of the confusion relating to these provisions centers around the fact that the FCC has changed its definition from its Local Competition Order, which used the term "local" to distinguish the types of calls subject to reciprocal compensation. However, in its ISP Remand Order, the FCC concluded that a reasonable reading of the Act is that Congress intended to exclude the traffic listed in subsection 251(g) from the reciprocal compensation requirements of subsection

251(b)(5).[2] The FCC states that the statute does not mandate reciprocal compensation for "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers. The FCC acknowledges that it refrains from generically describing traffic as "local" traffic because the term "local" is not a statutorily-defined category, is susceptible to varying meanings, and is not a term used in § 251(b)(5) or § 251(g). (ISP Remand Order, ¶ 34.)

In footnote 65, the FCC provides further guidance on the meaning of the phrase in 251(g), "exchange access, information access, and exchange services for such access." Footnote 65 states:

> The term "exchange service" as used in section 251(g) is not defined in the Act or in the MFJ [Modified Final Judgment]. Rather, the term "exchange service is used in the MFJ as part of the definition of the term "exchange access," which the MFJ defines as "the provision of exchange services for the purpose of originating or terminating

[2] Order on Remand and Report and Order, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Intercarrier Compensation for ISP-Bound Traffic, CC Docket No 99-68, FCC 01-131 (rel. April 27, 2001) "ISP Remand Order." We note that the ISP Remand Order was again remanded to the FCC by the United States Court of Appeals, D.C. Circuit, in WorldCom Inc v FCC, 288 F.3d 429, Case No. 01-1218, May 3, 2002. Because § 251(g) was worded simply as a transitional device, preserving various local exchange carrier duties that antedated the 1996 Act until such time as the FCC adopted new rules pursuant to the Act, the court found the commission's reliance on § 251(g) was precluded. However, the court acknowledged that there could be other legal bases for adopting the rules chosen by the commission, and did not vacate the commission's order but remanded the case for further proceedings. In its struggles to distinguish the type of traffic covered by the reciprocal compensation provisions of § 251(b)(5), the FCC has made it clear that that provision applies to local traffic, which is the way we have applied the FCC's rules in this arbitration. Therefore, the court's decision does not impact on the determinations we make in this order. However, we recognize that the FCC's order on remand will be covered by the change in law provisions of these ICAs.

> interexchange telecommunications." *United States v. AT&T*, 552 F.Supp. at 228. Thus, the term "exchange service" appears to mean, in context, the provision of services in connection with *interexchange* communications. (ISP Remand Order, footnote 65.)

In terms of this arbitration, this clarification the FCC provided assists us in determining which telecommunications traffic is subject to the reciprocal compensation provisions of § 251(b)(5). While the FCC has moved away from its initial use of the term "local" to differentiate the traffic that is subject to reciprocal compensation, use of the terms "local" and "interexchange" helps us to clarify which traffic is subject to reciprocal compensation.

The FAR relies on the language in FCC Rule 51.703(b) as justification that GNAPs should not have to pay transport and tandem switching for any traffic that GNAPs receives from the ILECs at the single POI it plans to establish for a given LATA. The FAR erroneously relied on Rule 51.703(b) and failed to look at that rule in conjunction with Rule 51.701. Based on the FCC's interpretation of the Act's meaning in § 251(g), we find that interexchange traffic is not subject to the Act's reciprocal compensation requirements. At the same time, § 703(b) forbids the ILEC from assessing any charges to transport "local" traffic which is subject to reciprocal compensation

We interpret the FCC's rules to mean that GNAPs is responsible for compensating the ILECs for terminating intraLATA toll calls (which are interexchange in nature) from GNAPs' customers. At the same time, GNAPs is not responsible for compensating the ILECs for transporting local calls (which are subject to reciprocal compensation) on the ILEC's side of the POI.

The FCC has provided language in various orders that supports the interpretation of its rules that we have made here. The FCC reiterated its position in its Kansas/Oklahoma 271 order as follows:

> In our *SWBT [Southwestern Bell Telephone] Texas Order*, we cited to SWBT's interconnection agreement with MCI-WorldCom to support the proposition that SWBT provided carriers the option of a single point of interconnection. We did not, however, consider the issue of how that choice of interconnection would affect inter-carrier compensation arrangements. Nor did our decision change an incumbent LEC's reciprocal compensation obligations under our current rules. For example, these rules preclude an incumbent LEC from charging carriers for *local traffic* that originates on the incumbent LEC's network.[3]

And in its Intercarrier Compensation NPRM, the FCC states:

> Our current reciprocal compensation rules preclude an ILEC from charging carriers for local traffic that originates on the ILEC's network. These rules also require that an ILEC compensate the other carrier for transport and termination for local traffic that originates on the network facilities of such other carrier.[4]

The FCC's language cited above makes it clear that Rule 51.703(b) applies to *local* traffic.

In its Comments on the Draft Decision (DD), GNAPs reiterates its argument that toll traffic is only "exchange access" traffic when a separate toll charge is imposed on the customer. According to GNAPs, since it proposes a LATA-wide local calling area, calls between exchanges within the LATA would

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[3] Memorandum Opinion and Order, In the Matter of Joint Application by SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29 (Rel. January 22, 2001), ¶235 (footnotes omitted, emphasis added), "Kansas/Oklahoma 271 Order."

[4] Notice of Proposed Rulemaking, In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, FCC 01-032 (Rel. April 27, 2001), ¶ 112.

be not subject to toll charges. As a consequence, GNAPs believes that traffic is not exchange access traffic.

As we stated above, the calling areas adopted by the Commission govern whether a call is local or an intraLATA toll call. There is a difference between the retail service offering that GNAPs provides to its customers, e.g., LATA-wide local calling, and the wholesale obligations between carriers. In this instance, we are using the Commission-adopted calling area paradigm to determine whether calls are rated as local or intraLATA toll. Since that is the case, GNAPs' argument that this would not be "exchange access" traffic does not have merit. Any call rated as an intraLATA toll call under the Commission's established calling areas would constitute exchange access traffic, not local traffic.

Once we distill this issue down to this easily understandable difference in traffic, we need to evaluate the parties' positions to see whether the ICA language is consistent with our determination. In the following section, we provide broad policy guidance on the issues discussed. The specific contract language we adopt, to the extent that it differs from that adopted in the FAR, is addressed in Appendix A.

First, we examine Pacific's proposed language in Appendix NIM [Network Interconnection Methods], § 2-A, 2-B and 2-C. In § 2-A, Pacific states: "For calls that originate and terminate to end users physically located in the local exchange where the POI is located, both Carrier and Company shall only be financially responsible for the facilities, trunking and equipment on its side of the POI." That language does not conform to the FCC's rule that carriers are responsible for transport on their side of the POI of <u>all</u> calls that would be classified as "local." For example, there could be two neighbors within the LATA, but distant from the POI. If one is a customer of the ILEC, and the other is a customer of

GNAPs, and they call each other, those calls would be classified as local, regardless of the fact that the call itself had to be transported from Caller A, to the POI, and then back out to Caller B. Pacific's language in 2-C would allow the company to charge transport for that call, just because the POI is located outside of the local exchange where the call originates and terminates. That outcome violates the FCC's rules, and will not be allowed. The call would be classified as local, and GNAPs may not be assessed transport charges on the ILEC's side of the POI.

Next we examine Verizon's use of the Interconnection Point or IP for determining where financial responsibility is passed from one carrier to another. As cited in the Draft Arbitrator's Report, Verizon's witnesses Kathryn Allison and Don Albert provide a succinct definition of the difference between the POI and the IP in Verizon's proposal:

> A POI is where the ILEC and CLEC physically interconnect their respective networks. This is the place where the carriers' wires physically meet. An IP is the place in the network at which one local exchange carrier hands over financial responsibility for traffic to another local exchange carrier. A POI and an IP may be at the same place but do not have to be. Pursuant to Verizon's proposal, Verizon is financially responsible for delivering its traffic to GNAPs' IP. Once Verizon delivers traffic originating on its network to GNAPs' IP, then GNAPs is financially responsible for transporting the traffic to its customer.[5]

We find Verizon's IP concept to be problematic. There is no indication that there is any relationship between the IPs, and the local calling area. The IPs

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[5] Exhibit 5, Direct Testimony of Kathryn Allison and Don Albert on Behalf of Verizon at 6.

represent points at which financial responsibility for the traffic passes from one carrier to the other. Therefore, the IPs could be locations that would require GNAPs to pay transport charges for calls that would be rated as local calls. That violates the FCC's § 703(b) that states that the ILEC may not assess charges for such traffic.

Verizon cites the FCC's Pennsylvania 271 Order to demonstrate that its proposal to allocate financial responsibility for transporting traffic to GNAPs' distant POI complies with federal requirements. According to Verizon, the FCC rejected the claim that Verizon's proposal to allocate financial responsibility for interconnection on Verizon's side of the POI violates federal requirements:

> Although several commenters assert that Verizon does not permit interconnection at a single point per LATA, we conclude that Verizon's policies do not represent a violation of our existing rules. Verizon states that it does not restrict the ability of competitors to choose a single point of interconnection per LATA because it permits carriers to physically interconnect at a single point of interconnection (POI). Verizon acknowledges that its policies distinguish between the physical POI and the point at which Verizon and an interconnecting competitive LEC are responsible for the cost of interconnection facilities. The issue of allocation of financial responsibility for interconnection facilities is an open issue in our *Intercarrier Compensation NPRM.* We find, therefore, that Verizon complies with the clear requirement of our rules, i.e., that incumbent LECs provide for a single physical point of interconnection per LATA. Because the issue is open in our *Intercarrier Compensation NPRM,* we cannot find that Verizon's policies in regard to the financial responsibility for interconnection facilities fail to comply with its obligations under the Act.[6]

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[6] Memorandum Opinion and Order, In the Matter of Application of Verizon Pennsylvania, Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon

Footnote continued on next page

The FCC stresses that Verizon complies with its "clear requirement" that ILECs provide for a single POI per LATA. However, it is not at all clear from the FCC's language that it is endorsing Verizon's IPs, since that specific issue is included in its Intercarrier Compensation NPRM. We are reminded that this decision is in a 271 proceeding, not in a rulemaking, and peripheral issues are not addressed in the same way as they would be in a rulemaking. The FCC does not state that Verizon's IP proposal is in compliance with the Act. It simply says that it cannot find that Verizon's policies for financial responsibility fail to comply with its obligations under the Act.

The FCC has indicated in the past that its 271 proceedings are limited in scope. In its statement on the conformed agreement, Pacific cites a portion of the FCC's Louisiana/Georgia 271 Order, as follows:

> [As] the Commission stated in prior section 271 orders, while the Commission will consider, in a section 271 proceeding, whether a BOC [Bell Operating Company] permits a requesting LEC to physically interconnect at a single Point of Interconnection (POI), it will not attempt to settle new and unresolved disputes about the precise content of an incumbent LEC's obligations to its competitors – disputes that do not involve per se violations of self-executing requirements of the Act.[7]

Global Networks, and Verizon Select Services for Authorization to Provide in-Region Services in Pennsylvania, CC Docket No. 01-138, FCC No. 01-269 (re. Sep. 19, 2001) ¶ 100 (footnotes omitted) "Pennsylvania 271 Order."

[7] Memorandum Opinion and Order, In the Matter of Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region Services in Georgia and Louisiana, CC Docket No. 02-35, FCC 02-147 (released May 15, 2002, "Louisiana/Georgia 271 Order," ¶208 and 816.

We believe that the issue of Verizon's IPs is more in the nature of "new and unresolved disputes" that the FCC does not address specifically in its 271 Orders.

However, regardless of the FCC's intent in its Pennsylvania 271 Order, it is of limited value in our arbitration proceeding in California. There could well be factual differences between the Pennsylvania 271 proceeding and our arbitration proceeding. For instance, the local calling areas in Pennsylvania may be different from those in California, so the relationship between local calling areas and IPs may differ between the two states. In other words, we do not place the same reliance that Verizon does on what the FCC concluded in its Pennsylvania 271 Order. We make our determination on the FCC's Rule 703(b) which is currently in effect, and will govern the outcome in this arbitration. We note that the issue of whether the ILECs should be compensated for *local* traffic on the ILEC's side of the POI is currently before the FCC in the Intercarrier Compensation NPRM. The outcome of the FCC's decision in that docket will be incorporated into the ICAs under the applicable change in law provisions.

In its Statement, Pacific asserts that the FCC has *never* said *anywhere* that its rules mean an ILEC must pay for the transport necessary to reach a Competitive Local Exchange Carrier (CLEC) point of interconnection in a distant local calling area. Pacific cites the Pennsylvania 271 Order as proof that the FCC specifically does not mean that.

However, we dispute Pacific's conclusion. We respond that the FCC has never said anywhere that its rules mean an ILEC does not have to pay for transport necessary to reach a CLEC POI in a distant local calling area. The FCC's Kansas/Oklahoma 271 Order Paragraph 235 supports our position:

> Finally, we caution SWBT [Southwestern Bell Telephone] from taking what appears to be an expansive and out of context interpretation of findings we made in our *SWBT Texas Order* concerning its obligation to deliver traffic to a competitive LEC's point of interconnection. In our *SWBT Texas Order*, we cited to SWBT's interconnection agreement with MCI-WorldCom to support the proposition that SWBT provided carriers the option of a single point of interconnection. *We did not, however, consider the issue of how that choice of interconnection would affect inter-carrier compensation arrangements. Nor did our decision to allow a single point of interconnection change an incumbent LEC's reciprocal compensation obligations under our current rules. For example, these rules preclude an incumbent LEC from charging carriers for local traffic that originates on the incumbent LEC's network.* These rules also require that an incumbent LEC compensate the other carrier for transport and termination for local traffic that originates on the network facilities of such other carrier.[8]

The FCC does not provide any sort of exclusion for local traffic that must travel across the ILEC's network. The key element is that the traffic is local in nature, and in that case Rule 51.703(b) applies. Pacific turns the FCC's rule on its head when it states that the rule has to specifically include local traffic that is transported across the ILEC's network to the single POI. We disagree. Since the FCC does not exclude any type of local traffic from its Rule 51.703(b), there are no exclusions. We acknowledge that the FCC is looking at this specific issue in its Intercarrier Compensation NPRM, but until the FCC completes its

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[8] Memorandum Opinion and Order, In the Matter of Joint Application by SBC Communications Inc., Southwest Bell Telephone "Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwest Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29 (rel. January 22, 2001), ¶ 235, "Kansas/Oklahoma 271 Order." (Footnotes omitted, emphasis added.)

rulemaking, the current rule applies. It is clear from the FCC's language in the Kansas/Oklahoma 271 order that the FCC is well aware that the single POI raises issues relating to inter-carrier compensation arrangements.

Pacific cites 113 from the Intercarrier Compensation NPRM, in support of its view that there is currently no Federal regulation concerning which carrier should bear the cost of transport to the POI, and under what circumstances an interconnecting carrier should be able to recover from the other carrier the costs of transport from the POI to the switch serving its end user. Pacific asserts that the FCC would not have had to ask the questions that it did if its current rules on this issue were clear. We disagree with Pacific's interpretation. A more logical interpretation is that the FCC is examining the issue, in light of new information, to determine the necessity of amending its current rule to provide compensation to the ILECs for transporting traffic to the POI. The current rule was adopted, without taking the concept of a single POI into account, and in its Intercarrier Compensation NPRM, the FCC is taking the opportunity to revisit its rule, in light of some CLECs' intention to establish a single POI per LATA.

In its Comments, Pac-West states that the DD requires terminating carriers to pay access charges to the originating carrier when a terminating carrier's single POI in a LATA is in a different local calling area than the originating calling area, irrespective of the eventual termination point of the call. That misstates the outcome of our order. The physical route a call takes between its origination and termination points has no bearing on whether the call is local or toll. In order to determine if a particular call is local or toll, the rating points of the calling and called numbers are compared to determine if the call is deemed for billing purposes to be originating and terminating in the same local calling area (a local call) or in different local calling areas with rating points more than

16 miles apart (a toll call). Even though the call is passed from one carrier to the other at the POI, we do not count the POI as the termination point for the call. Rather, the rating point of the called party determines the eventual termination point of the call.

Pac-West and O1 point out that the terminating carrier would always charge the originating carrier switched access. Pac-West states that this makes sense because the originating carrier collects all of the revenue paid by the customer for the toll call, and therefore compensates the terminating carrier via the access charge process for its termination of the call. We clarify that it is our intention to require that the originating carrier pay access charges in the form of transport and tandem switching, if applicable, to the terminating carrier for carrying intraLATA traffic across the terminating carrier's network to the called party.

The Draft Arbitrator's Report required GNAPs to pay the ILECs for transporting and terminating traffic from GNAPs' customers, but at Total Element Long Run Incremental Costs (TELRIC) rates. We do not believe that TELRIC rates are appropriate in this case where we are clearly dealing with what are defined as intraLATA toll calls. Carriers traditionally pay access charges to other carriers who complete their customers' intraLATA calls, and there is no reason that GNAPs should be treated any differently for the intraLATA phone calls its customers make.

Pacific made its proposal for the use of TELRIC pricing for transport and tandem switching on its side of the POI, based on the intention of applying that to certain types of <u>local</u> traffic. We have determined that it is not appropriate for Pacific to charge GNAPs for transport of local traffic on Pacific's side of the POI. Pacific did not, however, intend to apply TELRIC pricing to intraLATA traffic.

In their Statements, both Pacific and Verizon indicate that when a CLEC designates a single POI in a LATA, the ILECs are entitled under this Commission's decisions to receive compensation at TELRIC rates for transporting traffic to a single POI outside of the local calling area. The ILECs traced this requirement to Decision (D.) 99-09-029, in which the Commission determined that all carriers should be "reasonably compensated for use of their networks."[9] We remind the ILECs that D.99-09-029 addressed the VNXX issue, not the single POI issue, so they have taken the statement out of context. As we state below, we are relying on D.99-09-029 to resolve the VNXX issue.

Both Verizon and Pacific dispute the outcome in the FAR on Issue 2 on policy grounds as well. Verizon asserts that there is no valid legal or policy basis to support the ICA's abolition of intraLATA access charges for GNAPs. According to Verizon, either by precedent or through adoption under § 252(i), it will result in the end of intraLATA access charges for all CLECs. If the ICA is approved by the Commission, there is effectively no longer a category of intraLATA access traffic for CLECs in California. Verizon claims that not only is this illegal, it is bad policy.

Verizon states that it does not dispute the provision in the ICA that allows GNAPs to select the geographic calling area it will offer to its retail end-users for a flat, monthly rate. The ICA, however, also allows GNAPs to use this self-selected geographic area to determine whether GNAPs should pay Verizon reciprocal compensation or access charges to terminate its traffic. This should not be permitted because it would abolish access charges.

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[9] Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service, Decision (D.)99-09-029 (rel. Sept. 2, 1999) "D.99-09-029."

Verizon asserts that the ICA contravenes Commission precedent establishing statewide uniform calling zones. The FCC looks to the states to determine what geographic areas should be considered a "local area" for purposes of applying reciprocal compensation obligations under § 251(b)(5) of the Act. This Commission's historical practice is to define all calls routed over 16 miles as toll calls.[10] In order to be consistent with its practice of defining local service areas, Verizon states the Commission must adhere to its uniform, statewide design for local calling areas for intercarrier compensation purposes. Federal law allows the Commission to change how it defines local calling zones, but the Commission has not done so. Verizon asserts that to be consistent with state and federal law, Verizon's calling areas must be used as the basis for the parties' intercarrier compensation obligations.

Pacific echoes the same concerns expressed by Verizon, stating that when the LATA boundaries fall, GNAPs looks forward to designating just one POI in every state in which SBC can lawfully provide interLATA service. Pacific claims that eventually GNAPs intends to have just one POI per region. If GNAPs' proposal is adopted, instead of competing with low monthly rates for exchange access, GNAPs will have a perverse incentive to offer a bundle of local and long distance calling at a high fixed rate, not because it truly reflects the costs incurred but because GNAPs can avoid paying for any transport or any access charges that way. Pacific criticizes the FAR for not challenging any of the economic reasons for requiring GNAPs to pay the additional costs it causes.

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[10] Verizon cites D.90-06-011 and D.90-11-058, addressing the expansion of the local calling scope and creation of Zone Usage Measurement (ZUM).

We support the ILECs' policy arguments relating to Issue 2. It is not our intent in this arbitration to disrupt the local and intraLATA calling paradigm adopted by this Commission. And we have no intention of making a decision in an arbitration proceeding that would have the net result of abolishing intraLATA calling. For calls that are intraLATA in nature, e.g., those beyond 16 miles, traditional access charges will apply.

The second area that Pacific and Verizon dispute relates to Issues 3 and 4. The FAR addressed issues 3 and 4 together. Those issues are as follows:

3) Should the ILECs' local calling area boundaries be imposed on GNAPs, or may GNAPs broadly define its own local calling areas?

4) Can GNAPs assign to its customers NXX codes that are "homed" in a central office switch outside of the local calling area in which the customer resides?

In resolving Issue 3, the FAR determined that GNAPs can define the local calling area boundaries for its own customers, and we concur with that determination. Issue 4 includes three major sub-parts:

- May GNAPs establish disparate rating and routing points for its customers?

- Is that VNXX[11] traffic subject to reciprocal compensation provisions?

- Should GNAPs pay access charges or TELRIC-based transport charges for transporting such traffic across the ILEC's network?

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[11] VNXX (Virtual NXX) traffic is traffic where the NXX (central office codes) are used to provide locally-rated calling to customers who physically reside beyond the local calling area of the designated NXX code.

The FAR found that GNAPs may establish disparate rating and routing points for its customers. However, the FAR includes the caveat that GNAPs must ensure that NXX codes are associated with a particular rate center to identify the jurisdictional nature of the traffic for intercarrier compensation purposes, and we concur with that outcome. This is consistent with our determination in D.99-09-029, in which we addressed the issue of VNXX codes and determined that a carrier may set disparate rating and routing points. The FCC has not addressed this particular issue in its rules, although the issue is to be addressed in the FCC's Intercarrier Compensation NPRM. This outcome allows the CLEC to make more effective use of its unique network topology, while ensuring that calls are rated properly.

The FAR also determined that VNXX traffic is subject to reciprocal compensation obligations. This is consistent with our finding in D.99-09-029 that such traffic should be treated as local calls:

> We conclude that the assigning of NXX prefixes of ISPs in the manner used by Pac-West constitutes a form of foreign exchange service from the perspective of the end user. As such, the Pac-West arrangement warrants rating of the calls from the rate center of the foreign exchange in similar fashion to more traditional forms of foreign exchange service. Accordingly, such calls would be rated as local calls if originated from a rate center within 12 miles of the rate center of the designated foreign exchange of the called party's NXX prefix. This principle is consistent with the underlying intent of the tariffs governing the rating of calls as toll or local, applied in the context of foreign exchange service.[12]

[12] D.99-09-029 at 25.

Since these calls are rated as local calls, they should be subject to reciprocal compensation requirements. This is consistent with our treatment of the ILECs' tariffed FX service.

The FAR also determined that GNAPs is not required to compensate Pacific and Verizon for use of the ILECs' transport and tandem switching networks to carry the FX-type traffic. The FAR found that GNAPs could not be assessed intrastate access charges or transport and tandem switching at TELRIC prices under the dictates of FCC Rule 703(b), which does not allow the ILEC to charge for transport on its side of the POI. The FAR relied on § 703(b), and the 115 in the FCC's Intercarrier Compensation NPRM, in support of that conclusion.

We do not agree with the FAR's outcome on this issue. First, the FCC has said very little about VNXX traffic, although the issue is up for comment in the Intercarrier Compensation NPRM. It is not appropriate to rely on Rule 51.703(b) to say that GNAPs should not be required to pay for transporting traffic across the ILECs' networks to turn the resulting calls into local calls. We view this more in the nature of traditional tariffed FX service, where the customer obtains a local presence in a different community, but the customer pays to transport those calls from the central office which actually serves the customer to the central office where the customer wants to establish a calling presence. FX customers do not get the service at no charge, and we believe that the ILECs should be compensated for routing the traffic to a different rate center.

This finding is consistent with D.99-09-029, in which we made the following determination on the specific issue of intercarrier compensation in cases of disparate rating and routing:

> We conclude that all carriers are entitled to be fairly compensated for the use of their facilities and related functions performed to deliver calls to their destination, irrespective of how a call is rated

> based on its NXX prefix. Thus, it is the actual routing points of the call, the volume of traffic, the location of the point of interconnection, and the terms of the interconnection agreement—not the rating point—of a call which properly forms a basis for considering what compensation between carriers may be due.[13]

In that decision, we also concluded that we did not have sufficient record to adopt specific intercarrier compensation arrangements for the transport and delivery of traffic involving different rating and routing points. We did determine, however, that existing tariffed switched access rates, such as those charged by the ILEC to other carriers for the transport of intraLATA toll traffic, did not necessarily provide a fair or economically efficient basis for intercarrier compensation under this type of FX arrangement. (D.99-09-029 at 32.) Until such time that the Commission had an opportunity to revisit the issue, carriers were told that they should resolve the issue through interconnection agreements negotiated in conformance with the Act. This issue is before us in this arbitration proceeding because parties to this arbitration were unable to agree on the proper treatment of these FX-type calls.

In its Comments, O1 claims that VNXX traffic is not included in the "carve-out" provisions of § 251(g), so it must be subject to FCC Rule 51.703(b). GNAPs makes a similar argument stating that because the decision declares that VNXX traffic is local traffic, and Rule 703(b) forbids the ILECs from assessing any charges to transport "local" traffic, GNAPs cannot be required to pay the ILECs to transport that VNXX traffic.

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[13] D.99-09-029, September 2, 1999, at 35.

We disagree with this viewpoint. VNXX calls would be intraLATA toll calls if GNAPs did not specify a different rate center for the calls than the rate center where the customer is physically located. These VNXX calls would be intraLATA calls, not local calls, if tied to the rate center that serves the customer. By allowing disparate rating and routing, we are allowing for those calls to become local calls, and as such, subject to reciprocal compensation. However, GNAPs is required to pay the additional transport required to get those calls to where they will be considered local calls. As stated above, this is similar to the concept of the ILECs' tariffed FX service, in which the customer pays for the privilege of receiving dialtone from a different exchange. Because these calls would be intraLATA toll calls, if they were rated out of the rate center which actually provides service to the customer, they are not subject to the provisions of Rule 703(b).

On an interim basis, until further action by this Commission or by the FCC in its Intercarrier Compensation NPRM, we will require GNAPs to pay the ILECs for use of their networks at TELRIC prices. We adopt TELRIC pricing in lieu of switched access charges because we believe that TELRIC prices provide adequate compensation to the ILECs for use of their network. Switched access rates are higher than Unbundled Network Element prices based on the TELRIC methodology and, as such, will help to encourage competitors to make use of VNXX traffic and make creative service offerings to their customers.

In its comments on the DD, Verizon indicates that GNAPs should not be permitted to use Verizon's network to provide toll-free interexchange calling to Verizon customers and then charge Verizon reciprocal compensation for that privilege. This should be especially true when GNAPs use of virtual NXX codes relieves Verizon's end-users from paying toll. We remind Verizon that they are

receiving compensation for those VNXX calls. The ILECs are being compensated at TELRIC prices for transporting those VNXX calls for GNAPs.

It appears that the ILECs both support the use of TELRIC pricing for transport of GNAPs' VNXX traffic. In its Statement, Verizon states:

> …the DAR [Draft Arbitrator's Report] correctly recognized that 'ILECs are entitled to fair compensation for the use of their facilities in the transport of FX traffic.' The DAR required GNAPs to compensate Verizon at TELRIC rates for use of Verizon's network to carry the virtual NXX traffic to GNAPs' POI. This result was consistent with the result ordered in the AT&T/Pacific Bell arbitration.[14]

In its Statement, Pacific includes the following:

> D.99-09-029 is clear that 'reasonable compensation' must be paid. What D.99-09-029 did not decide is what the '*proper* compensation arrangement' should be – access charges, TELRIC, or some other 'reasonable' amount. See Conclusions of Law 10 and 11 of that decision. Pac-West's implicit suggestion that what D.99-09-029 meant by 'reasonable compensation' is *zero* compensation is absurd. The Commission was within its rights to order for the time being, that 'reasonable compensation' could be based on TELRIC. Other State commissions faced with the same question have ordered compensation at access rates.[15]

Pac-West explains that the routing point of a given telephone number in the Local Exchange Routing Guide (LERG) tells all carriers where to deliver calls

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[14] Statement of Verizon California Inc. Regarding Commission Approval or Rejection of the Interconnection Agreement Conformed to the Final Arbitrator's Report, May 29, 2002, at 13-14.

[15] Statement of Pacific Bell Telephone Company Regarding Whether the Interconnection Agreement Resulting from this Proceeding Should be Approved or Rejected by the Commission, May 22, 2002, fn. 3.

to or from that number. All ILECs and CLECs specify routing points for their telephone numbers. To the extent the routing point is associated with a specific place on a carrier's network, it will have different V&H coordinates than the rating point of the telephone numbers associated with the rating and routing point. Therefore, Pac-West concludes there will be disparate rating and routing points for almost all (if not all) telephone numbers, even those served by ILECs.

Regardless of how a call is routed to a particular customer, that customer is associated with a particular rating point, generally based on the central office that provides dialtone to that customer. Under a system of disparate rating and routing, that customer would be rated as though it were served out of a different central office.

In its Comments on the DD, GNAPs states that in the ISP Remand Order, the FCC determined that intercarrier compensation for ISP-bound traffic is solely within the jurisdiction of the FCC and that on a going-forward basis, state commissions have been preempted from addressing the issue. GNAPs states that intercarrier compensation for ISP-bound traffic is not an appropriate subject for ICAs. GNAPs neglects to mention that the parties—Pacific, Verizon and GNAPs—all addressed the issue of ISP-bound traffic in their ICAs. In fact, the parties agreed to the language relating to ISP traffic, and that particular issue is not before us in this arbitration. In the Pacific/GNAPs' ICA, Appendix Reciprocal Compensation, § 5.1 includes language that was agreed to by both Pacific and GNAPs that states local traffic to ISPs will be compensated the same as other local traffic:

> Until and unless ILEC chooses to invoke the FCC's pricing plan as ordered in FCC 01-131, the compensation set forth below will also apply to all Local and Local ISP Calls as defined in section 3.2 of this Appendix….

Further, the parties also recognized and agreed that ISP and Internet-bound traffic could also be traded outside of the applicable local calling area. IntraLATA Interexchange Traffic was one example of this type of traffic. Further, § 6.2 contains the following language negotiated by the parties: "To the extent such "nonLocal" ISP calls are placed, the Parties agree that section 5 above does not apply, and that the Agreement's rates, terms and conditions for IntraLATA and/or InterLATA calling shall apply…." In other words, the parties themselves have negotiated the language relating to compensation for ISP-bound traffic.

The issue is handled differently in the Verizon ICA. Verizon has adopted the FCC's pricing plan outlined in the ISP Remand Order, and the ICA includes the following language, which was negotiated by the parties:

> 7.3.2 Reciprocal Compensation shall not apply to Internet Traffic
>
> 7.3.2 The determination of whether traffic is Reciprocal Compensation Traffic or Internet Traffic shall be performed in accordance with the FCC Internet Order and then current Applicable Law.

To summarize, in both ICAs, the parties have negotiated and agreed to language relating to compensation for ISP-traffic. The Commission is not being asked to resolve issues relating to ISP-bound traffic. We note that our decision refers to calls as "local" or "intraLATA," and does not refer to ISP-bound calls so we are not in violation of the ISP Remand Order.

We recognize that both the FCC and this Commission have open dockets which deal with the issue of how to treat VNXX traffic. Any decisions issued by this Commission or the FCC will be covered by the change in law provisions of the ICAs we are adopting here.

In its comments on the conformed interconnection agreement, Verizon encouraged us to reject the ICA because it was not compliant with the Act. With the changes we have made to the FAR, and to the conformed interconnection agreements, in this decision, we believe that the arbitrated portions of the ICAs are in compliance with the Act and the FCC's rules and should be adopted.

5. Preservation of Authority

Section 252(e)(3) of the Act provides that nothing shall prohibit a state Commission from establishing or enforcing other requirements of state law in its review of an agreement, including compliance with intrastate telecommunications service quality standards. Our Rules 4.2.3 and 4.3.1 provide that we may also reject agreements or portions thereof, which violate other requirements of the Commission, including but not limited to, quality of service standards. Other than the matters addressed and disposed of above, no party or member of the public identifies any clause in the ICA that potentially conflicts with any state law, or requirement of the Commission, including service quality standards, and we are aware of none.

6. Filing the Conformed ICA

Within 30 days of the date of this decision, parties shall file and serve entire ICAs which conform with the decisions herein. Parties should also serve a copy on the Director of the Telecommunications Division. Parties should sign the conformed ICAs before they are filed so that they may become effective without additional delay. The signed ICAs should become effective on the date filed.

7. Waiver of Period for Public Review and Comment

The Public Utilities Code and our Rules of Practice and Procedure generally require that draft decisions be circulated to the public for review and

comment 30 days prior to the Commission's vote.[16] On the other hand, the Act requires that the Commission reach its decisions to approve or reject an arbitrated agreement within 30 days after submission by the parties.[17] This establishes a conflict.

However, Rule 77.7(f)(5) provides that we may reduce or waive the period for public review and comment "for a decision under the state arbitration provisions of the Telecommunications Act of 1996." We consider and adopt this decision today under the state arbitration provisions of the Act.

Under Rule 77.7(f)(5), we are not required to provide this Draft Decision for public review and comment. However, since we made some changes from the FAR, we chose to send the Draft Decision to the parties so that parties could be given an opportunity to comment on the changes from the FAR. The Draft Decision was mailed and e-mailed to parties on June 13, 2002, and comments were filed on June 20, 2002. Comments were filed by GNAPs, Verizon, Pacific, Pac-West Telecomm, Inc. (Pac-West), and O1 Communications, Inc. (O1). We have taken the comments into account, as appropriate, in finalizing this order.

Findings of Fact

1. No party or member of the public alleges that any negotiated portion of the ICA must be rejected.

2. No negotiated portion of the ICA results in discrimination against a telecommunications carrier not a party to the ICA; is inconsistent with the public

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[16] See Pub. Util. Code § 311(g)(1), and Rule 77.7 of the Commission's Rules of Practice and Procedure.

[17] 47 U.S.C. Section 252(e)(4).

interest, convenience and necessity; or does not meet other Commission rules, regulations, and orders, including service quality standards.

3. No arbitrated portion of the ICA, as modified by this decision, fails to meet the requirements of § 251 of the Act, including FCC regulations pursuant to § 251, or the standards of § 252(d) of the Act.

4. Interexchange traffic is not subject to the Act's reciprocal compensation requirements.

5. Rule 51.703(b) forbids the ILECs from assessing any charges to transport "local" traffic which is subject to reciprocal compensation provisions.

6. GNAPs is responsible for compensating the ILECs for terminating intraLATA toll calls from GNAPs' customers.

7. GNAPs is not responsible for compensating the ILECs for transporting local calls on the ILECs' side of the POI.

8. The calling areas adopted by the Commission govern whether a call is local or an intraLata toll call.

9. The physical route a call takes between its origination and termination points has no bearing on whether the call is local or toll.

10. The rating points of the calling and called numbers are compared to determine whether the call is local or toll.

11. VNXX traffic is local traffic and is subject to reciprocal compensation requirements.

12. A carrier may set disparate rating and routing points.

13. TELRIC pricing adequately compensates the ILECs for use of their networks.

14. No provision of the ICA conflicts with State law, including compliance with telecommunications service quality standards, or requirements of the Commission.

15. The Act requires that the Commission approve or reject an arbitrated ICA within 30 days after the agreement is filed (47 U.S.C. § 252(e)(4)), which in this case is within 30 days of the date statements in compliance with the FAR were filed.

16. A draft decision must be subjected to 30 days' public review and comment prior to the Commission's vote; however Rule 77.7(f)(5) provides that the Commission may reduce or waive the period for public review and comment under Pub. Util. Code § 311(g)(1) for a decision under the state arbitration provisions of the Act.

17. This is a proceeding under the state arbitration provisions of the Act.

Conclusions of Law

1. The FAR and the ICAs between GNAPs and Pacific and between GNAPs and Verizon, which conform to the decisions in the FAR, as modified by this order, should be approved.

2. 47 C.F.R. § 51.703(b) must be read in conjunction with § 51.701.

3. The ILECs should receive compensation for costs associated with the use of their networks for the transmission of traffic with disparate rating and routing points.

4. GNAPs/Pacific and GNAPs/Verizon should jointly file and serve within 30 days of the date of this order signed ICAs which conform with the decisions herein.

5. The conformed, signed ICAs should be effective when filed.

6. The 30-day public review and comment period should be reduced pursuant to Pub. Util. Code § 311(g)(3) and Rule 77.7(f)(5).

7. This order should be effective today because it is in the public interest to implement national telecommunications policy as accomplished through the ICAs which result from the decisions in the FAR and this order as soon as possible.

O R D E R

IT IS ORDERED that:

1. We affirm the results reached in the May 15, 2002, Final Arbitrator's Report (FAR), as modified by this order and, pursuant to the Telecommunications Act of 1996, and Resolution ALJ-181, we approve the Interconnection Agreements (ICA) between Global NAPs, Inc (GNAPs) and Pacific Bell Telephone Company and between GNAPs and Verizon California Inc. (Verizon), as modified by this order, that result therefrom.

2. Within 30 days of the date of this order, parties shall sign and jointly file and serve entire ICAs that conform with the decisions in the FAR, as modified by this order. The signed ICAs shall become effective on the date filed.

3. GNAPs' January 23, 2002, motion for acceptance of its late-filed Supplemental Information is granted.

4. Verizon's March 28, 2002, motion to strike portions of the post-hearing brief of GNAPs is granted.

5. GNAPs' June 13, 2002, motion for acceptance of its Supplemental Statement is denied.

6. This proceeding is closed.

This order is effective today.

Dated June 27, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

Appendix A

The following section disposes of all disputed contract language in the ICA between GNAPs and Pacific, which must be changed to conform to the outcomes in this decision:

- T&C § 1.1.3: Pacific's definition of "Access Compensation" shall be included in the ICA. It states that parties pay access compensation for originating or terminating intraLATA calls.
- T&C § 1.1.40: Pacific's proposed language is adopted. An "Exchange Area" is established and defined by the Commission.
- T&C § 1.1.56: GNAPs' proposed definition of "Foreign Exchange" is adopted, with modification. Pacific's definition would limit Foreign Exchange (FX) to the FX service purchased from a carrier's tariff. On the other hand, GNAPs' definition includes FX-like services, such as VNXX calls. VNXX calls are FX-like, and those within a particular LATA are to be treated as local calls for reciprocal compensation purposes. However, the interLATA FX service GNAPs lists as part of its definition would not be considered local in nature, and those calls are interLATA toll calls and would not be subject to reciprocal compensation provisions.
- T&C § 1.1.68: Pacific's proposed definition of "IntraLATA Toll Traffic" is adopted. Any traffic between the parties which is outside the "normal" local calling areas adopted by the Commission is considered intraLATA toll traffic, and that traffic is subject to access charges.
- T&C § 1.1.76: Pacific's definition of "Local Calls" is adopted, with modification. Local calls do not have to originate and terminate to customers physically located within the same local calling area. We have already determined that VNXX calls would be included within the definition of a local call, and in that case, the customers will not be physically located within the same local calling area.
- T&C § 1.1.83: Pacific's definition of "Meet Point Billing" is adopted. It describes the process to follow in a multi-bill environment.
- T&C § 1.2.8: Pacific's proposed language is adopted. Pacific allows for disparate routing and rating points within the same LATA, but makes it clear that the routing point is used to calculate mileage measurements for the distance-sensitive transport element. This is consistent with the Commission's determination in D.99-09-029. GNAPs' language would

allow the routing point to be anywhere in SBC's territory and goes beyond a simple definition of the term "routing point."

- Reciprocal Compensation § 6.2: Pacific's proposed language is adopted. It reflects the fact that when an end-user customer places a "non-local" call to an ISP, the call will be rated according to the terminating carrier's Exchange Access tariffs.
- NIM §§ 2-A, 2-B, 2-C: Sections 2-A, 2-B, and 2-C govern financial responsibility for calls transported within the same calling area as the POI and between different calling areas within the LATA. Pacific's proposed language is rejected. It is inconsistent with the determination that GNAPs cannot be required to pay for transport of local traffic on Pacific's side of the POI.

The following section disposes of all disputed contract language in the ICA between GNAPs and Verizon submitted to the Commission on May 29, 2002, which must be changed to conform to the outcomes in this decision:

- T&C Glossary § 2.56: Verizon's proposed definition for "Measured Internet Traffic" is adopted. Verizon's definition includes a reference to its local calling area.
- T&C Glossary § 2.75: Verizon's proposed language is adopted, with modification. The designation of traffic between the parties will be based on Verizon's local calling areas, which have been adopted by the Commission. Reciprocal compensation does apply to Foreign Exchange (FX)-type traffic that does not originate and terminate within the same Verizon local calling area. An FX-type call is rated as a local call, and reciprocal compensation should apply. Section 2.75 shall include GNAPs' language relating to changes in applicable law.
- T&C Glossary § 2.91: Verizon's proposed definition of "Toll Traffic" is adopted. It is more precise, and eliminates GNAPs' requirement that toll traffic relate to whether or not the carrier imposes a toll charge.
- Interconnection § 2.1.1: GNAPs' proposed language is adopted with modification. GNAPs is entitled to have only one POI per LATA. However, GNAPs' final sentence is problematic because it states that each party is responsible for transporting "telecommunications traffic" originating on its network to the POI at its own cost. The two parties dispute the meaning of the term "telecommunications traffic," and the term is not defined in the ICA. Therefore, the parties shall add a sentence to clarify that "telecommunications

traffic" includes local traffic subject to reciprocal compensation provisions, but does not include "intraLATA traffic."

- Interconnection § 2.1.2: GNAPs' proposed language, which describes the relationship between the POI and Verizon's IPs, is adopted. GNAPs indicates that the IP will be located at the POI. This is appropriate since financial responsibility for reciprocal compensation traffic (which would be local traffic) passes from one carrier to the other at the POI.
- Interconnection § 6.2: Verizon's proposed language is adopted. It explains the use of Traffic Factors and deletes GNAPs' language related to its defined calling areas. The reference to applicable tariffs is appropriate. That tariff section explains the measurement of billing minutes for toll traffic.
- Interconnection § 7.2: GNAPs' proposed language is adopted. GNAPs will not be subject to additional charges for Verizon's transport of those calls which are subject to reciprocal compensation to the POI.
- Interconnection § 9.2.1: In its comments on the DD, Verizon indicates that Verizon's language is necessary to ensure proper routing – not rating—of traffic exchanged between GNAPs and interexchange carriers interconnected at a Verizon tandem. Verizon's language is adopted.

(End of Appendix A)

United States District Court
For the Northern District of California

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

VERIZON CALIFORNIA, INC.,

Plaintiff,

v.

MICHAEL R. PEEVEY, et al.,

Defendants.

No. 03-3441 CW

ORDER RESOLVING CROSS-MOTIONS FOR SUMMARY JUDGMENT

____

PAC-WEST TELECOMM, INC.

Counterclaimant,

v.

VERIZON CALIFORNIA,

Counterdefendant.

______________________________________/

Plaintiff Verizon California, Inc. (Verizon) moves for summary judgment pursuant to Federal Rule of Civil Procedure 56.

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Defendant Commissioners of the California Public Utilities Commission Michael R. Peevey, Loretta M. Lynch, Carl W. Wood, Geoffery F. Brown, and Susan P. Kennedy (collectively, CPUC) oppose this motion and cross-move for summary judgment. Defendant and Counterclaimant Pac-West Telecomm, Inc. (Pac-West) also opposes Verizon's motion and cross-moves for summary judgment. The matter was heard on March 12, 2004. The Court DENIES Verizon's motion for summary judgment and GRANTS the CPUC and Pac-West's cross-motions regarding interim reciprocal compensation; DENIES Verizon's motion and GRANTS the CPUC's cross-motion regarding paging traffic; DENIES Verizon's motion and GRANTS the CPUC's cross-motion regarding VNXX reciprocal compensation; and DENIES Pac-West's motion and GRANTS the CPUC's cross-motion regarding call origination charges on VNXX traffic.

BACKGROUND

I. Telecommunications Act of 1996

Verizon is an "incumbent" local exchange carrier (ILEC). An ILEC is a dominant local exchange carrier, as defined by 47 U.S.C. § 251(h)(1), that was providing telephone service when the Telecommunications Act of 1996 (Act) became law. 47 U.S.C. § 151 et seq. An ILEC previously held a State-sanctioned monopoly on local telephone service in a particular service area. The Act provides that States may no longer enforce laws that impede competition, and ILECs are subject to a host of duties intended to facilitate market entry. Foremost among these duties is the ILEC's obligation to share its network with competitors. Pac-West is a "competitive" local exchange carrier

(CLEC).

An ILEC must enter into an interconnection agreement (ICA) with CLECs which sets out the terms of network sharing. ICAs include "reciprocal compensation arrangements." Id. § 251(b)(5). Reciprocal compensation is a mechanism by which telecommunications carriers compensate one another for the costs associated with the transport and termination of calls that originate on one LEC's network and terminate on another LEC's network. For example, when a Verizon customer makes a local call to a Pac-West customer, Verizon, the "originating" carrier, switches the call over to Pac-West, the "terminating" carrier. Pac-West then transports the call to its customer. Verizon must compensate Pac-West for the costs it incurs to complete the Verizon customer's call. Traffic destined for an Internet Service Provider (ISP-bound traffic) functions in exactly the same way, except that the called party is an ISP instead of an individual.

The FCC has determined that reciprocal compensation is only required for local calls. Local Competition Order, 11 FCCR 15499 at 16013 (1996). Whether a call is billed as a local call is determined by comparing the first six digits of the calling and called parties' ten-digit phone number. Every telephone number is linked to a specific rate center based on the number's area code and central office code. Telephone numbers consist of ten digits in the form of NPA-NXX-XXXX. "NPA" is the area code. "NXX" is the central office code. When the NPA-NXXs of the calling and called parties are assigned to the same local

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calling area, the call is rated as a local call. When they are not, it is rated as a toll or inter-exchange call.

Generally, an NXX code corresponds to a rate center or particular geographic area served by an LEC. Virtual NXX (VNXX) codes are central office codes that correspond to a particular rate center, but are actually assigned to a customer located in a different rate center. VNXX numbers are often assigned to ISP customers by CLECs like Pac-West.

II. FCC and CPUC Decisions

In 1999, the FCC issued a Declaratory Ruling, 14 FCCR 3689 (1999), in which it determined that ISP-bound traffic was substantially interstate traffic that was not subject to reciprocal compensation. Declaratory Ruling, at ¶ 13. The FCC reached this conclusion by applying an "end-to-end" analysis, finding that ISP traffic does not terminate at the ISP's modem. Id. at ¶ 18. However, so long as there was no federal rule regarding the appropriate inter-carrier compensation for ISP-bound traffic, the FCC did not preclude State commissions from requiring LECs to pay reciprocal compensation for this traffic. Id. at ¶ 22. Relying on the FCC's Declaratory Ruling, many States required the payment of reciprocal compensation for ISP-bound traffic, and carriers entered into contracts reflecting the expectation that they would continue under the reciprocal compensation system.

Finding end-to-end analysis unpersuasive, the District of Columbia Court of Appeals vacated and remanded the Declaratory Ruling to the FCC for "want of reasoned decisionmaking." Bell

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Atlantic Tel. Cos. v. FCC, 206 F.3d 1, 3 (D.C. Cir. 2000). In response to Bell Atlantic, the FCC issued ISP Remand Order, 16 FCCR 9151 (2001). In ISP Remand Order, the FCC reached the same conclusion it had reached in Declaratory Ruling, but based on different reasoning: that ISP traffic falls into one of the enumerated exceptions in section 251(g), information access, and is therefore exempt from § 251(b)(5)'s reciprocal compensation requirements. ISP Remand Order, at ¶ 3, 31-34.

ISP Remand Order established a "bill and keep" cost recovery system for ISP-bound traffic, whereby carriers would recover costs from their end-users. Id. at ¶ 4. This system posed a significant transition for carriers in States that had previously required reciprocal compensation for ISP-bound traffic. In order "to avoid a 'flash cut' to a new compensation regime that would upset the legitimate business expectations" of these carriers, id. at ¶ 77, ISP Remand Order set out a regime of decreasing reciprocal compensation for ISP-bound traffic, consisting of a graduated series of rate caps. For the first six months after the ISP Remand Order, reciprocal compensation for ISP-bound traffic was to be capped at a rate of $.0015/minute-of-use (mou). For the next year and a half the cap was to decrease to $.0010/mou. For the subsequent year and a half the cap would decrease to $.0007/mou. Id. at ¶ 78. The FCC stated,

> The interim compensation regime we establish here applies as carriers renegotiate expired or expiring interconnection agreements. It does not alter existing contractual obligations, except to the extent that parties are entitled to invoke contractual change-of-

> law provisions. . . . State commissions will no longer have authority to address this issue.

Id. at ¶ 82.

Concerned with the superior bargaining power of the ILECs, the ISP Remand Order also imposed a mirror offer requirement. Any ILEC that wanted to invoke the rate caps must first offer the capped reciprocal compensation rates to all of its competitors. Id. at ¶ 89. Verizon offers some evidence that it sent a letter to all California carriers offering mirror rates, and posted a mirror offer letter on its website. Direct Testimony of William Munsell at 6 (Admin. Rec. at 389).

The ISP Remand Order addressed the problem of identifying ISP-bound traffic by adopting "a rebuttable presumption that traffic delivered to a carrier . . . that exceeds a 3:1 ratio of terminating to originating traffic is ISP-bound traffic . . . " ISP Remand Order, ¶ 79. A carrier may rebut the presumption by demonstrating that traffic above the 3:1 ratio is in fact local traffic delivered to non-ISP customers or that traffic below the 3:1 ratio is actually ISP-bound traffic subject to the FCC's rate caps. Id.

The ISP Remand Order was the subject of a second decision by the District of Columbia Court of Appeals, WorldCom, Inc. v. FCC, 288 F.3d 429 (D.C. Cir. 2002), which addressed reciprocal compensation for ISP-bound traffic and rejected the FCC's reliance on § 251(g). Although the District of Columbia Circuit remanded the ISP Remand Order, it did not vacate it because of

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its belief that "there may well be other legal bases for adopting the rules chosen by the [FCC] for compensation between the originating and the terminating LECs in calls to ISPs." Id. at 430.

III. The 1996 ICA

To reach an ICA, ILECs such as Verizon must negotiate with CLECs like Pac-West to interconnect their facilities. 47 U.S.C. § 252(a). If the parties are unable to reach an agreement, they may request arbitration before the State regulatory agency. Id. § 252(b). The final agreement between the ILEC and the CLEC must be approved by the State commission. Id. § 252(e)(1).

In 1996, Verizon (then GTE California) and Pac-West entered into an ICA. Paragraph 9.02 of the 1996 ICA set out its terms of duration and termination. The ICA was to remain in effect for one year, after which either party could terminate it after providing sixty days notice. During this sixty day period, the other party could request renegotiation of a new ICA. If a party invoked the renegotiation provision, the 1996 ICA would stay in effect for 125 days. If, after 125 days, the parties could not agree on a new ICA, they would seek resolution from the CPUC. 1996 ICA § 9.02 (Admin. Rec. at 18).

IV. The Verizon/Pac-West Arbitration

Until 2001, the 1996 ICA between Verizon and Pac-West continued in effect because neither party exercised its contractual right to terminate. On October 10, 2001, Verizon gave Pac-West sixty days notice of its intent to terminate the 1996 ICA. On December 3, 2001, Pac-West requested renegotiation

toward a new ICA. This triggered the 125-day contract extension period, which began on December 9, 2001 and ended on April 13, 2002. During the 125-day extension period, Pac-West and Verizon attempted to negotiate a replacement ICA. Unable to reach an agreement, Verizon and Pac-West turned to the CPUC for help. The CPUC issued its Order Requiring Interim Continuation of Interconnection Agreement, D. 02-06-007 (Admin. Rec. 2288) (Interim Continuation Order) ordering that the 1996 ICA remain in effect pending negotiation or arbitration of a successor agreement.

Verizon and Pac-West engaged in extensive arbitration. In addition to the issues of reciprocal compensation for ISP-bound traffic, the parties disagreed on whether Verizon could impose call origination charges or transport charges on Pac-West for transporting VNXX traffic outside of the originating calling area. The parties submitted briefing, written testimony and exhibits and conducted a three-day hearing before an arbitrator. The arbitrator issued a Draft Arbitrator's Report and then a Final Arbitrator's Report (FAR).

Arbitration concluded on May 27, 2003, when the CPUC issued its Decision Approving Arbitrated Agreement, D.03-05-075 (Arbitration Decision) approving a new ICA that will remain in effect until at least 2006. Four aspects of the Arbitration Decision are at issue here. First, the CPUC determined that the terms of the 1996 ICA remained in effect during the negotiation and arbitration of the new ICA. Therefore, the Arbitration Decision continued reciprocal compensation for ISP-bound traffic

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at rates higher than the caps set out in ¶ 78 of the ISP Remand Order. The negotiation and arbitration process began on December 3, 2001 and lasted until May 27, 2003. Thus, these reciprocal compensation rates remained in effect for eighteen months.

Second, the Arbitration Decision allowed Pac-West to exclude from the FCC's 3:1 ratio "local traffic to customers reasonably identifiable as paging carriers." Admin. Rec. at 2238 Third, it determined that VNXX traffic is local, and therefore is subject to reciprocal compensation. The CPUC adopted the arbitrator's finding that: "Whether or not a call is 'local' depends solely on the NPA-NXX's of the calling and called parties as established by Verizon's traditional calling areas, and does not depend on the routing of the call, even if it is outside the local calling area." Admin. Rec. at 2237. Fourth, the CPUC's new ICA required Pac-West to pay call origination charges to Verizon for the long-haul expense associated with VNXX traffic, rejecting the recommendation of the FAR on this point. Admin Rec. at 2759-61.

Verizon filed this suit under § 252(e)(6) against the CPUC and Pac-West seeking review of the Arbitration Decision. Pac-West counterclaimed against Verizon and cross-claimed against the CPUC. Section 252(e)(6) grants the Court jurisdiction to review a State commission determination only to "determine whether the agreement or statement meets the requirements of section 251 of this title and this section." 47 U.S.C. § 252(e)(6). The Court considers de novo "whether the CPUC's

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1 decisions are in compliance with the act and the FCC's
2 implementing regulations." AT&T Communs. of Calif. v. Pacific
3 Bell Tel. Co., 228 F.Supp. 2d 1086, 1099 (N.D. Cal. 2002). The
4 Court reviews the CPUC's factual determinations and all other
5 issues under an "arbitrary and capricious" standard. U.S. West
6 Communs., Inc. v. MFS Intelenet, Inc., 193 F.3d 1112, 1117, 1124
7 (9th Cir. 1999). Section 252(e)(6) does not confer authority on
8 federal courts to review the actions of State commissions for
9 compliance with State law. US West Communs., Inc. v. AT&T
10 Communs., Inc., 31 F. Supp. 2d 839, 843-444 (D. Or. 1998).

11 LEGAL STANDARD

12 Summary judgment is properly granted when no genuine and
13 disputed issues of material fact remain, and when, viewing the
14 evidence most favorably to the non-moving party, the movant is
15 clearly entitled to prevail as a matter of law. Fed. R. Civ. P.
16 56; Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986);
17 Eisenberg v. Ins. Co. of N. Am., 815 F.2d 1285, 1288-89 (9th
18 Cir. 1987). Here, all parties agree that the issues should be
19 decided on the record before the CPUC, as a matter of law, on
20 cross-motions for summary judgment.

21 DISCUSSION

22 I. Interim Reciprocal Compensation

23 Verizon moves for summary judgment that the CPUC's
24 Arbitration Decision violates federal law by continuing
25 reciprocal compensation on ISP-bound traffic, at rates above the
26 FCC-mandated caps, for the eighteen months between December 3,
27 2001, when Pac-West requested renegotiation of the 1996 ICA, and
28

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May 27, 2003, when the CPUC approved the new ICA. The CPUC and Pac-West cross-move against Verizon on this issue. The FCC rate caps apply "as carriers renegotiate expired or expiring interconnection agreements." ISP Remand Order, ¶ 82. The ISP Remand Order did not alter "existing contractual obligations." Id. Thus, the issue is whether the 1996 ICA was "expired or expiring" in 2001, such that the rate caps went into effect, or whether Verizon and Pac-West had existing contractual obligations under the 1996 ICA until May 27, 2003, such that the rate caps did not apply.

A. Mirror Offer Requirement

As a threshold matter, Pac-West argues that the rate caps were unavailable to Verizon regardless of whether or not the 1996 ICA was "expired or expiring," because Verizon failed to comply with the mirror offer requirement. However, Verizon offers evidence that it complied by sending a letter to all California carriers offering mirror rates.

Pac-West argues that the offer letter Verizon sent is insufficient according to the CPUC's Opinion on Pac-West Motion on Implementation of FCC Order on Internet Traffic, D.01-11-067, (Implementation Opinion), which, according to Pac-West, required Verizon to verify in an "advice letter" to the CPUC that it had complied with the mirror offer requirement. It is telling that it is Pac-West, and not the CPUC, that advances this argument. Pac-West mischaracterizes the CPUC's holding. The Implementation Opinion requires an ILEC to submit an advice letter verifying compliance with the mirror offer if the ILEC

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1 seeks an amendment to a current ICA but establishes no such
2 requirement here, where parties are renegotiating an ICA. In
3 fact, the Implementation Opinion explicitly rejects such
4 "additional layers of generic state filing requirements and
5 preapprovals" as Pac-West insists upon. Implementation Opinion
6 at 10 (Admin. Rec. at 2869). Thus, Verizon complied with the
7 mirror offer rule, and the Court DENIES Pac-West's motion for
8 summary judgment on this ground.
9 B. "Expired or Expiring"
10 Verizon moves for summary judgment that the 1996 ICA was
11 "expired or expiring." The CPUC and Pac-West cross-move,
12 arguing that it was not. Verizon asserts that the 1996 ICA
13 became "expiring" as of October 10, 2001, the day that Verizon
14 served its termination notice. Accordingly, it argues that the
15 rate caps became effective on December 3, 2001, the day that
16 Pac-West invoked the renegotiation provision of the 1996 ICA.
17 The CPUC contends that because the ISP Remand Order does
18 not explicitly define "expired or expiring," the CPUC has the
19 authority to determine as a matter of contract interpretation
20 under State law whether the ICA was expiring. The CPUC argues
21 that, because the 1996 ICA remained in effect until the new ICA
22 was approved, the parties' 1996 ICA was not "expired or
23 expiring." Pac-West argues that the 1996 ICA never expired
24 because the CPUC extended its terms pursuant to the parties'
25 agreement that the CPUC would resolve any post-impasse disputes.
26
27 In interpreting an ICA, a State commission must apply
28

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1 principles of State contract law. Pacific Bell v. Pac-West
2 Telecomm, Inc., 325 F.3d 1114, 1127-28 (9th Cir. 2002). Here, the
3 CPUC enforced § 9.02 of the 1996 ICA as the parties had
4 contracted. In § 9.02, the parties agreed that the CPUC would
5 resolve any dispute which remained after the 125-day
6 renegotiation period, which ended on April 13, 2002. Thus, §
7 9.02 authorized the CPUC to decide the terms of the parties'
8 interconnection agreement from April 14, 2002 until the
9 effective date of the 2003 agreement. In exercising that
10 authority, the CPUC interpreted and enforced the parties'
11 agreement, so the 1996 ICA was not "expired or expiring" as
12 defined in the ISP Remand Order.

13 Verizon argues that even though the parties had authorized
14 the CPUC to determine the terms of interconnection after the
15 125-day period, federal law requires the CPUC to impose the rate
16 caps established in the ISP Remand Order. Verizon relies on ¶
17 82 of the ISP Remand Order, in which the FCC stated that "State
18 commissions will no longer have authority to address [the] issue
19 [of interim reciprocal compensation.]" However, ¶ 82 also
20 states that the ISP Remand Order did not alter "existing
21 contractual obligations." Id. at ¶ 82. Here, § 9.02 of the
22 1996 ICA created an existing contractual obligation for Verizon
23 and Pac-West to allow the CPUC to resolve disputes after the
24 125-day period. Thus, the CPUC did not act contrary to federal
25 law.

26 In sum, the 1996 ICA gave the CPUC the authority to resolve
27 disputes after April 14, 2002. Thus, the 1996 ICA was not
28

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"expired or expiring" and the rate caps did not go into effect. Therefore, by continuing reciprocal compensation at rates higher than the FCC-mandated caps after December 3, 2001, the Arbitration Decision was not arbitrary or capricious, and did not violate the Telecommunications Act of 1996 or the FCC's ISP Remand Order. The Court DENIES Verizon's motion for summary judgment on this issue and GRANTS the CPUC and Pac-West's cross-motions.

II. Paging Traffic

The CPUC moves for summary judgment that the Arbitration Decision complies with the FCC's rules for differentiating between ISP-bound traffic that is subject to its caps and other traffic that is not subject to the caps. Verizon cross-moves. Pac-West does not move for summary judgment on this issue. The Arbitration Decision allows Pac-West to exclude local traffic to paging carriers from the FCC's 3:1 ratio. The issue is whether the exclusion of paging traffic complies with federal law.

Verizon argues that the exclusion of paging traffic gives Pac-West a windfall by skimming paging traffic off the top of the total amount of traffic subject to lower reciprocal compensation rates. Verizon asserts that the FCC has established two mutually exclusive options: either apply the 3:1 presumption, or rebut the presumption by determining whether the amount of ISP-bound traffic is actually greater or less than the presumptive amount.

Verizon's argument is not well-taken. The CPUC's exclusion of paging traffic from the 3:1 presumption has no effect on the

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final calculation of ISP-bound traffic. Because the CPUC provides the parties with the opportunity to compare the actual amount of ISP-bound traffic to the presumptive amount, it does not benefit Pac-West to determine that paging traffic is not ISP-bound before the ratio applies rather than after the ratio applies. The CPUC's ruling is consistent with the FCC's stated objective in the ISP Remand Order of sparing carriers and commissions from litigating and adjudicating "disputes and . . . costly efforts to identify [ISP-bound] traffic." ISP Remand Order, ¶ 79. Paging traffic is not ISP-bound. It is efficient to exclude traffic reasonably identifiable as paging traffic from the universe of traffic to which the ratio applies. Thus, the CPUC's exclusion of paging traffic is not contrary to the ISP Remand Order. The Court DENIES Verizon's motion for summary judgment and GRANTS the CPUC's cross-motion on this issue.

III. VNXX Reciprocal Compensation

The Arbitration Decision determined that VNXX calls are local and therefore subject to reciprocal compensation. Verizon moves for summary judgment that this determination violates federal law. The CPUC cross-moves. Pac-West does not move for summary judgment on this issue. The Court must determine: (1) whether there is conclusive federal law regarding reciprocal compensation for VNXX calls and, if so, whether the Arbitration Decision violates it, and (2) whether the Arbitration Decision provides justification for its VNXX determination.

Verizon relies on the FCC's previous holding that the physical beginning and end points of a telephone call determine

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1 whether reciprocal compensation should be paid. Local
2 Competition Order at ¶ 1034. However, this end-to-end analysis
3 was explicitly rejected by the District of Columbia Court of
4 Appeals in Atlantic Bell.
5 Verizon also points out that there is no federal
6 requirement that VNXX traffic is subject to reciprocal
7 compensation. It is true that, since the remand of the FCC's
8 ISP Remand Order, the FCC has not supplied a rule addressing
9 whether VNXX traffic is subject to reciprocal compensation.
10 However, the lack of a federal requirement for reciprocal
11 compensation for VNXX traffic is not the same as a federal
12 prohibition of such compensation. "That the Act does not
13 require reciprocal compensation for calls to ISPs is not to say
14 it prohibits it." Ill. Bell Tel. Co. v. WorldCom Tech., Inc.,
15 179 F.3d 566, 573 (7th Cir. 1999) (emphasis in original).
16 Indeed, the FCC has recently sought comment on this very issue
17 in pending matters. In re Developing an Unified Intercarrier
18 Compensation Ruling 16 FCCR 9610, ¶ 115 (2001); In the Matter of
19 Petition of WorldCom, Inc., 17 FCCR 27039, ¶ 54 (2002).
20 Moreover, the FCC has supported State commissions' conclusions
21 that VNXX calls are subject to reciprocal compensation.
22 Starpower Communs., LLC v. Verizon S., Inc., 18 FCCR 23625 ¶¶
23 15-17 (2003); In the Matter of Petition of WorldCom, Inc., 17
24 FCCR 27039, ¶ 301 (2002). And, no federal court has prohibited
25 reciprocal compensation for VNXX traffic. See, e.g., Pacific
26 Bell, 325 F.3d at 1130-31; Southwestern Bell Tel. Co. v. Public
27 Util. Comm'n of Tex., 208 F.3d 475, 485-88 (5th Cir. 2000).
28

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1 Verizon next contends that the CPUC's decision is arbitrary
2 and capricious because it is not justified with an explanation.
3 It asserts that the Arbitration Decision departs from the CPUC's
4 own authority in previous decisions. Verizon relies on the
5 CPUC's VNXX Decision, which purportedly decided that
6 intercarrier compensation must turn on the physical routing, not
7 the retail routing, of VNXX traffic. VNXX Decision at 2834.
8 However, Verizon misstates the holding of VNXX Decision,
9 which actually determined that VNXX traffic is subject to
10 reciprocal compensation and that the classification of a call as
11 local or toll should be based on NXX numbers regardless of
12 physical location. Id. at 2834, 2838. Furthermore, the CPUC
13 explained that its VNXX determination prevails "until the
14 governing law conclusively provides otherwise." FAR at 2239.
15 As explained above, the governing law is inconclusive. Id. at
16 2765.
17 The CPUC's VNXX determination is justified, and consistent
18 with federal law and FCC guidance. The Court DENIES Verizon's
19 motion for summary judgment and GRANTS the CPUC's cross-motion
20 on this issue.
21 IV. VNXX Call Origination Charges
22 Pac-West moves for summary judgment that the CPUC's VNXX
23 call origination charges ruling is unlawful because it is (1)
24 beyond the CPUC's authority, (2) contrary to federal law, (3)
25 arbitrary and capricious and (4) preempted. The CPUC cross-
26 moves. Verizon does not move for summary judgment on this
27 issue.
28

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A. Scope of CPUC Authority

First, Pac-West contends that the call origination charges ruling is beyond the scope of the CPUC's authority. According to Pac-West, § 252(e)(2) sets out three grounds upon which the CPUC may reject an arbitrated agreement, none of which apply. Pac-West argues that, by modifying the agreement, the CPUC acted outside the bounds of its authority. The primary flaw in this argument is that the Act grants authority to the CPUC as a whole, not to any individual arbitrator. 47 U.S.C. § 252(b)(1). In addition, pursuant to § 252(e)(3), the CPUC has the authority to reject portions of agreements that violate State law or CPUC policy. The CPUC offers evidence that it has an established policy of requiring "fair compensation" when a CLEC uses an ILEC network to complete its calls. Call origination charges fall within the CPUC's authority to enforce its fair compensation policy. Verizon must pay Pac-West reciprocal compensation on VNXX calls. However, VNXX traffic is routed through Pac-West's switches located outside of the local calling area. Thus, for each VNXX call originated by its customers, Verizon incurs a "long haul" expense for which it deserves fair compensation. It is within the CPUC's authority to enforce fair compensation for long haul expenses by imposing call origination charges.

Next, Pac-West argues that the CPUC is implementing a general policy of imposing call origination charges and has no authority to do so. Relying on Pacific Bell, 325 F.3d at 1126-27, it argues that the CPUC has authority to arbitrate disputes only on a case-by-case basis. However, Pacific Bell is not

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applicable because there ILECs and CLECs were disputing generic orders by the CPUC, id. at 1125, not an arbitration decision arising out of a specific dispute, as is the case here. The general policy rejected by the Pacific Bell court was embodied in generic orders issued by the CPUC in a rulemaking proceeding. The Ninth Circuit did not take issue with the CPUC's imposition of reciprocal compensation for ISP-bound traffic after an individual arbitrated proceeding.

Pac-West also asserts that the CPUC violated its due process rights because Pac-West was not a party to any of the arbitrations in which the CPUC constructed the policy that it applied to Pac-West in its Arbitration Decision. Florida Gas Transmission Co. v. FERC, 876 F.2d 42, 44 (5th Cir. 1989). However, Pac-West was a party to D.99-09-029, in which the CPUC developed the policy that it applied in the Arbitration Decision. Moreover, Pac-West had the opportunity to file comments in other CPUC arbitrations that applied the D.99-09-029 policy. Thus, the CPUC did not violate Pac-West's right to due process.

In sum, the call origination charges ruling was within the CPUC's authority. Pac-West's summary judgment motion on this ground fails. The CPUC's cross-motion on this point is granted.

B. Contrary to Federal Law.

Pac-West argues that the CPUC treats VNXX traffic as a "hybrid" of local and interexchange traffic, in that it is treated as "interexchange" for purposes of call origination

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charges but "local" for purposes of reciprocal compensation. This is true. As discussed above, the CPUC classifies VNXX traffic as local and therefore subject to reciprocal compensation. However, for purposes of call origination charges, the CPUC classifies VNXX traffic as interexchange in order to impose those charges. The CPUC denies that it has created a hybrid category of traffic. Rather, the CPUC argues that it merely balances the benefits that Pac-West enjoys from its use of Verizon's network with Pac-West's obligations fully to compensate Verizon for the use of its facilities. D.029 at 2830.

Pac-West cites no authority that this treatment is contrary to federal law. Relying on WorldCom and Bell Atlantic, Pac-West argues that the District of Columbia Court of Appeals has twice reversed FCC attempts to create hybrid types of traffic. Contrary to Pac-West's argument, these two cases did not discuss hybridization. Rather, they rejected the FCC's rationale for concluding that ISP-bound traffic is not local. Thus, Pac-West's argument that the call origination charges ruling is contrary to established federal law against hybridization fails.

Next, Pac-West asserts that the call origination charges ruling violates 43 C.F.R. § 51.703(b) (§ 703(b)). Section 703(b) provides, "A LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network." However, when read in context,

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1 § 703(b) does not prevent call origination charges because it
2 only applies to "telecommunications traffic," a term that the
3 FCC has defined as excluding interexchange, or toll traffic. 43
4 C.F.R.
5 §§ 51.701(a),(b). VNXX traffic is interexchange traffic.
6 Pac-West also argues that, as one-way charges, call
7 origination charges violate the Act's requirement that
8 reciprocal compensation be "nondiscriminatory", or "mutual and
9 reciprocal." 47 U.S.C. § 252(d)(1)(A)(ii). Although the call
10 origination charges are not reciprocal in practice, this is a
11 result of the nature of Pac-West and Verizon's relationship; it
12 is not inherent in the call origination charges themselves.
13 Verizon is allowed to assess call origination charges against
14 Pac-West because Verizon incurs long haul charges from the high
15 volume of Pac-West VNXX traffic. Pac-West could charge Verizon
16 such charges if Verizon began to do the same. The charges are
17 not impermissibly "discriminatory" within the meaning of §
18 252(d) simply because Verizon does not assign its customers VNXX
19 codes and use Pac-West's network for transport. Verizon could
20 do so, and if it did, Pac-West could impose call origination
21 charges in a "mutual and reciprocal" manner.
22 C. Arbitrary and Capricious
23 Next, Pac-West argues that, contrary to the CPUC's finding,
24 Pac-West is not able to identify which traffic is VNXX traffic
25 and which is real local traffic, which means that the
26 <u>Arbitration Decision</u> is arbitrary and capricious.
27 Pac-West offers evidence that it does not know where some
28

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of its customers are physically located, so therefore it does not know where it terminates traffic. Sumpter Testimony (Admin Rec. 1864-65). However, the CPUC argues that the Arbitration Decision relied on evidence in the record that Pac-West had the "functioning capability" to differentiate VNXX from non-VNXX. Moreover, Verizon offers evidence that Pac-West does know the physical location of its customers. Hawn Testimony (Admin. Rec. at 1795-96), Sumpter Testimony (Admin. Rec. at 1840-43). The CPUC's finding that Pac-West knows the end points of the wires it uses to deliver calls to its customers is not arbitrary and capricious. Thus, the Court denies Pac-West's motion on this point. The CPUC's cross-motion on this point is granted.

D. Preemption

Lastly, Pac-West argues that the ISP Remand Order preempts the CPUC's authority to impose call origination charges on ISP-bound VNXX traffic. The FCC's rate cap regime clearly removes the CPUC's authority to determine reciprocal compensation for ISP-bound traffic. ISP Remand Order, ¶ 82. Pac-West argues that the FCC therefore expressly declared the regulation of compensation for ISP-bound traffic to be wholly off-limits to State commissions. However, the ISP Remand Order does not have such a broad scope. While the ISP Remand Order does explicitly remove State commissions' authority to impose reciprocal compensation on ISP-bound traffic, it does not address the CPUC's authority to impose call origination charges on this traffic. A call origination charge is not reciprocal compensation. Therefore, there is no preemption.

In sum, the CPUC's call origination charge ruling in the Arbitration Decision was not outside the CPUC's authority, contrary to federal law, arbitrary and capricious or preempted. Pac-West's motion for summary judgment on this issue is DENIED. The CPUC's motion for summary judgment on this issue is GRANTED.

CONCLUSION

For the foregoing reasons, the Court DENIES Verizon's motion for summary judgment and GRANTS the CPUC and Pac-West's cross-motions upholding the CPUC's decision on interim reciprocal compensation; DENIES Verizon's motion and GRANTS the CPUC's cross-motion upholding the CPUC's decision on paging traffic; DENIES Verizon's motion and GRANTS the CPUC's cross-motion upholding the CPUC's decision on VNXX reciprocal compensation; and DENIES Pac-West's motion and GRANTS the CPUC's cross-motion upholding the CPUC's decision allowing origination charges on VNXX traffic.

Judgment shall enter accordingly.

IT IS SO ORDERED.

Dated: 6/17/04

/s/ CLAUDIA WILKEN

CLAUDIA WILKEN
United States District Judge

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1 Q And the way it works, basically, in that
2 scenario, the CLEC charges the IXC for what it
3 does, which is basically originating end office
4 functions, and the ILEC charges the IXC for what it
5 does, which is basically tandem switching functions
6 and then they split the transport?
7 A Both parties have provided a portion of the
8 access, which is why they call it jointly provided
9 switched access, yes.
10 Q So now it also works in the other direction,
11 so if a call comes in from Minneapolis to Seattle,
12 the long distance carrier, if it doesn't have a
13 direct connection to the CLEC, will end it to the
14 ILEC tandem. The ILEC will recognize the number as
15 belonging to the CLEC, send it to the CLEC, down to
16 the customer. And at the end of the day the ILEC
17 charges for tandem switching and some transport,
18 and the CLEC charges the end office functions, and
19 then whatever transport it may have provided?
20 A That's correct.
21 Q Is there anything that you see in the
22 definition of meet point billing that contemplates
23 or requires that it is the ILEC that provides the
24 tandem function for incoming access?
25 A Would you repeat that, please.

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1 Q Is there anything in the definition that you
2 can see that either contemplates or requires that
3 for incoming jointly provided switch access, it is
4 the ILEC that will provide the tandem function?
5 A No, it doesn't specify that. The definition
6 makes pretty clear that there are going to be two
7 carriers involved. And the exchange access, it
8 doesn't specify who is going to have the tandem and
9 who is responsible for the end office.
10 Q So to the extent that a CLEC has a switch
11 surveying a broad area, and that switch has direct
12 connectivity to a wide variety of end offices, an
13 ILEC could choose to direct its traffic to the CLEC
14 and have the CLEC then directed on to the
15 appropriate end office; isn't that correct?
16 A They could. I am not aware of situations
17 where that happens. In fact, it's the ILECs who
18 tend to have the ubiquitous network, and would have
19 the tandem switches.
20 Q But, in fact, if a CLEC had a switch that
21 had multiple capabilities, and wanted to compete
22 with the ILEC in the provision of tandem
23 functionality, nothing that you are aware of would
24 prevent the CLEC from soliciting business from
25 IXCs, saying, connect to me, and I will get your

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1 traffic out to the end offices cheaper and more
2 efficiently than the ILEC can. That's perfectly
3 legal?
4 A Nothing I am aware of would prohibit that.
5 Q And if that were to occur, that would be a
6 form of jointly provided switched access?
7 A Let's go through the example again. So it
8 would be an ILEC going through a CLEC's tandem?
9 Q And it would be incoming, an IXC with a call
10 coming in from Los Angeles, goes to the CLEC switch
11 which is functioning as a tandem, recognizes that
12 call as bound for a particular Qwest customer. The
13 CLEC would then route that to the appropriate Qwest
14 end office?
15 A That would be an example of jointly provided
16 switched access.
17 Q So as far as you understand it, it is
18 perfectly okay for Level 3 to do that, and send
19 that traffic over LIS trunks?
20 MR. DETHLEFS: Are you asking about under
21 this agreement?
22 MR. SAVAGE: Under this agreement, as with
23 his restrictions on LIS trunks, with this
24 definition.
25 Q BY MR. SAVAGE: Wouldn't that be perfectly

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1 fine?
2 A That would be perfectly fine if, in fact,
3 that was what Level 3's network was configured to
4 do, and what Level 3 was intending to do. That is
5 not what I understand Level 3 to be proposing in
6 this proceeding.
7 Q Well, suppose an IXC were to come to Level 3
8 and were to say, I think Qwest tandem rates are too
9 expensive. Frankly, I think Qwest transport rates
10 are too expensive. I would like you to take my
11 traffic bound for Qwest customers, switch it as
12 necessary at your devices in Seattle, whatever they
13 are, and point it out to the right end offices.
14 I think we have established that would be
15 jointly provided switched access. I am wondering
16 how you think that differs from what Level 3's
17 proposal is.
18 A We will let Mr. Linse get into the
19 definition of what is and is not an appropriate
20 tandem switch. I would suggest to you that my
21 understanding of what Level 3 is proposing, and
22 this is based on what I have heard Mr. Greene say
23 in a number of states, is that Level 3 is proposing
24 to aggregate IXC traffic, and then terminate it
25 using LIS trunks.