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IN THE COURT OF APPEALS OF THE STATE OF UTAH

LEVEL 3 COMMUNICATIONS, LLC, Petitioner and Appellant, vs. UTAH PUBLIC SERVICE COMMISSION and QWEST CORPORATION, Respondents and Appellees.	Case No. 20060042 CA Agency Decision No. 05-2266-01 (ORAL ARGUMENT REQUESTED)

REPLY BRIEF OF THE APPELLANT

Petition for Review of the Ruling of the Utah Public Service Commission

---

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ARGUMENT

Level 3's Brief of the Appellant ("Brief in Support") explains why the Public Service Commission ("Commission") erred in applying Sections 251 and 252 of the Telecommunications Act of 1996, 47 U.S.C.A. § 251, *et seq.* (the "ACT" or the "FTA"), and the Commission's own Decision and Order in the Arbitration Docket[1] to "interpret" the interconnection agreement ("ICA") between Qwest Corporation ("Qwest") and Level 3 Communications, LLC ("Level 3") ("Old Agreement"). The Commission erroneously applied federal law when the Old Agreement should have been interpreted under the principles of state contract law.

Upon receiving Level 3's Notice of Appeal, Qwest removed this appeal to the United States District Court and argued that, in interpreting the Old Agreement, the Commission's Decision relied on a provision in the federal Act for its conclusion that rates for interconnection facilities must be "just and reasonable." Opp'n to Mot. to Remand at 3 (attached as Exhibit J of the Addendum to Level 3's Brief of the Appellant). Qwest contended that the issue on appeal raised questions of federal law. The District Court disagreed and remanded the appeal to the Utah Supreme Court, holding that "*the resolution of this dispute depends upon state contract law*." Order Remanding Action to Utah Supreme Court, Case No. 2:06cv132K (D. Utah, May 30, 2006) ("Federal Court's Remand Order") at 2 (emphasis added) (attached as Exhibit A in the Addendum herein).

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[1] In the Matter of Level 3 Communications, LLC for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 with Qwest Corporation Regarding Rates, Terms and Conditions for Interconnection, (Utah PSC, Docket No. 02-2266-02) (hereinafter "Arbitration Docket").

In Qwest's Brief of Appellee ("Qwest Brief"), Qwest does not defend the Commission's Order in this matter on the grounds upon which it was decided. Qwest does not argue that the Commission's Order was properly based on federal law, or that this Court should uphold the Commission's reasons for reaching its decision. Instead, Qwest proposes an entirely new theory of the case on appeal and contends that the Commission's Order can be upheld on grounds of state law. Qwest Brief at 21-22. Qwest argues that the Commission's decision somehow "interpreted" the Relative Use Factor ("RUF") clause of the Old Agreement consistent with state law. In doing so, Qwest attributes to the Commission a rationale that has no basis in the facts of the case or in the Commission's Order. Qwest's arguments should be rejected.

A. <u>The Court Should Vacate the Commission's Decision and Order.</u>

1. Qwest Does Not Contest that the Commission Incorrectly Applied Federal Law.

Level 3's Brief in Support argues that the Commission erred in applying a just and reasonable standard under the Act to interpret the Parties' Old Agreement. Brief in Support at 21-27. In support of its position, Level 3 explained that the Commission incorrectly applied the federal standards for arbitrating ICAs to the present case, which instead requires interpretation and enforcement of an ICA. Brief in Support at 27. Level 3 demonstrated that the interpretation and enforcement of the RUF clause in the Parties' Old Agreement required the application of state contract law, rather than federal law. Brief in Support at 1, 27-31. The Federal District Court agreed that the interpretation of the RUF clause is purely a matter of state contract law. Federal Court's Remand Order

at 2. Qwest has not attempted to respond to Level 3's argument that the Commission erred in applying federal law to resolve this dispute.

2. Qwest Does Not Contest that the Commission Incorrectly Relied on the *ISP Remand Order* and the Commission's 2004 Order.

In its Brief in Support, Level 3 raised the issue of whether the Utah Commission also erred in relying on the Federal Communications Commission's ("FCC") *ISP Remand Order* and its own order from the Arbitration Docket to interpret the RUF clause in the Old Agreement. Brief in Support at 2 (statement of third issue), 31-35 (argument). Level 3 explained that the Commission's reliance on the *ISP Remand Order* was error because the Parties agreed that it was not directly applicable, and because the *ISP Remand Order* itself states that it does not apply to contracts entered into before the effective date of the Order. Id. at 32-35. Level 3 also explained that the Commission erred in relying on its order in the Arbitration Docket for its rationale about what the parties' financial obligations should be. Instead, the Commission should have enforced the plain language of the Parties' contract using principles of state contract law. Id. at 35-39.

Qwest has not addressed Level 3's third issue. Instead, it attempts to introduce a new issue, which it contends "roughly correspond[s]" to Level 3's third issue, but which it claims is "more appropriately" stated as follows: "[w]hether the Commission's interpretation of the Old Agreement was erroneous under state law, and if so whether any error substantially prejudiced Level 3." Qwest Brief at 2. Qwest's issue does not even

"roughly" correspond either to the issue that Level 3 has raised with the Court, or to the Commission's Order.

Qwest's attempt to redefine the issue on appeal should not be allowed. Even though Qwest's Brief states that it "accepts Level 3's statement of the preservation" of Level 3's third issue, id., Qwest in fact, has raised an entirely different issue: whether the Commission's decision was erroneous under state law and the error substantially prejudiced Level 3. Id. Therefore, Qwest must show that its own issue was properly preserved for appeal. In fact, Qwest's issue, as stated, did not even arise because the Commission did not interpret the Agreement under state law. Rather, the Commission applied federal law, which was the error that prompted this appeal. Because the Commission did not interpret the Old Agreement under state law, the issue of whether it *correctly* or *erroneously* interpreted the Old Agreement under state law never arose. Qwest's issue was not preserved for appeal, and thus must be rejected. Gibson v. Bd. of Review of Indus. Comm'n of Utah, 707 P.2d 675, 677 (Utah 1985) ("Issues not raised before the administrative agency are waived on appeal.").

The Commission's Order should be vacated because it erroneously imposed standards developed under a complex federal statutory regime to a simple question of interpreting the plain language of the RUF clause under state contract law. The federal court has made it clear that there is no federal question to be resolved in this dispute. The decision of the federal court effectively resolves the entire matter by placing the focus of the issue on appeal squarely on the actual language of the RUF clause of the Parties' contract. Qwest has not offered any justification of the grounds on which the

Commission's reached its decision. Therefore, for the reasons stated in Level 3's Brief in Support, the Court should vacate the Commission's Order.

B. As Matter of Law, the Plain Language of the RUF Clause Does Not Exclude ISP-Bound Traffic from the Relative Use Calculation.

Although Level 3 disagrees with Qwest's statement of the issue, it agrees, to some extent, with Qwest's position that this Court can interpret the plain language at issue as a matter of law and resolve this case. "Questions of contract interpretation not requiring resort to extrinsic evidence are matters of law, and on such questions we accord the trial court's interpretation no presumption of correctness." Zions First Nat'l Bank, N.A. v. National Am. Title Ins. Co., 749 P.2d 651, 653 (Utah 1988). Thus, this Court may interpret the meaning of the plain language and rule as a matter of law.

The plain language of the provision at issue can be interpreted by simply reading the RUF clause, Section 5.1.2.4. It provides:

> If the Parties' elect to establish two-way direct trunks, the compensation for such jointly used 'shared' facilities shall be adjusted as follows. . . . The actual rate paid to the provider of the direct trunk facility shall be reduced to reflect the provider's use of that facility. The adjustment in the direct trunk transport rate shall be a percentage that reflect the provider's relative use (i.e. originating minutes of use) of the facility in the busy hour.

R. 28, at 4 ¶ 9; R. 58, at 3–4.[2] As demonstrated in Level 3's Brief in Support, the plain meaning of this language is that the relative use of facilities must reflect the originating

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[2] The Commission ruled: "This section contains the Old Agreement's only mention of a relative use factor ("RUF") respecting the rates to be paid for direct trunk transport." R. 58, at 4.

minutes of use on the direct trunk facilities ("direct trunk transport" or "DTT" facilities). See Brief in Support at 39–42. It is undisputed that Qwest end users originated all the traffic carried over the DTT facilities during the dispute period. R. 58, at 5, 10. Because "use" is defined in section 5.1.2.4 as "originating minutes of use," Qwest, as the sole user of the DTT facilities, therefore, bears all of the cost.

The plain language of the RUF clause is unambiguous. It does not include any exception for Internet Service Provider ("ISP") traffic, and cannot reasonably be read to impose one. Therefore, by relying on what has already been settled, that is, that this clause applies to the traffic exchanged between the Parties on the DTT facilities, this Court can resolve this issue and rule as a matter of law that the RUF clause does not exclude ISP-bound traffic from the relative use calculation.

C. Qwest's Proposed Interpretation of the "Plain Language" of the RUF Clause Should be Rejected.

The Court may "not consider on appeal issues which were not submitted to the trial court and concerning which the trial court did not have the opportunity to make any findings of fact or law." Zions, 749 P.2d at 657. Even when an issue raised for the first time on appeal is a matter of law, an appellate court should not consider it because "[a]lthough [the appellate court] may not defer to a trial court's conclusion on a legal question, [it] certainly may derive great benefit from the trial judge's views on the issue and may be persuaded by those views." Id. at 654.

Qwest's argument that the Court may interpret the plain language of the RUF is, in fact, not based on the plain language, but on a document that is not in the record,

numerous assertions of fact that were never put before the Commission, and on legal arguments made for the first time on appeal. Qwest Brief at 23–31. The Court should therefore disregard Qwest's argument that the Court may affirm the Commission's Decision by interpreting the "plain language" of the RUF.

1. In Interpreting the Plain Language of the RUF Clause, the Court Should Not Consider the Entire Old Agreement.

In its Brief, Qwest states: "The plain-language purpose and concept of section 5.1.2.4 of Attachment 1 to the Old Agreement is not difficult to discern." Qwest Brief at 23. Rather than analyzing the language of Section 5.1.2.4, however, Qwest proceeds to argue that the "broader scope," and other sections of the Old Agreement, mean that Section 5.1.2.4 should be interpreted as being limited to "local" traffic only. Qwest Brief at 23. It cites a number of provisions in the Old Agreement to argue its point, and adds its own view about the intent of the Old Agreement ("[T]he specific language in the Old Agreement providing for DTT facilities only contemplated transport for local calls"). Id. at 26. Qwest's assertion that the Court can interpret "the broader scope of the Old Agreement" is incorrect. The Old Agreement is not in the record and cannot be introduced on appeal.[3]

There have been no findings as to the intent of the Old Agreement or the meaning of "local" traffic. The Commission has had the opportunity to review only Attachment 1

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[3] Qwest scolded Level 3 for choosing only to submit "limited sections of the Old Agreement for the Commission's review." Qwest Brief at 34. Nevertheless, despite the fact that Qwest counterclaimed below asking the Commission to issue an order "pursuant to the Old Agreement" (R. 24, at 10 ¶ A), Qwest never placed the Old Agreement into the record.

of the Old Agreement, which is in the Record at 44. Its Order in this case makes it clear that it never considered any other language of the Old Agreement except the provision that was in controversy, the RUF clause. R. 58, at 3–4.

Level 3 disagrees with Qwest's characterization and interpretation of the Old Agreement, and specifically disputes that it can be used to establish that the ISP-bound DTT traffic is not subject to the RUF clause. Accordingly, as more fully explained in Level 3's Motion to Strike and supporting Memorandum (filed concurrently herewith), the Court should disregard the Old Agreement, all references to it, and argument based on it, other than those provisions contained in Attachment 1 (R. 44).

2. In Interpreting the Plain Language of the RUF Clause, the Court Should Not Consider Qwest's Argument that the RUF Clause Does Not Apply to the Traffic Exchanged Between the Parties on the DTT Facilities.

Relying on material outside the record, Qwest contends that the RUF, and the whole ICA, apply to "local" traffic only. It then attempts to argue that the DTT traffic at issue is not "local" traffic because the ISPs to which it is ultimately directed may not be "local." Relying again on its own assertions of fact and the purported Old Agreement, Qwest argues for the first time on appeal that the traffic carried over the DTTs is "long distance" traffic because it spans more than one local calling area. Qwest Brief at 26. "Long distance traffic," it claims, is not within the scope of the Old Agreement at all. It "is merely referenced in the Old Agreement as being covered under the applicable Qwest Switched Access Tariff." Id. at 26-27. Qwest concludes, therefore that the traffic carried on the DTT facilities "is not subject to the relative use offset in section 5.1.2.4." Id. The

Court should reject Qwest's argument because, as discussed above, it is based on portions of the purported Old Agreement attached to its Brief that are not contained in the record, and on a series of unfounded assertions, also raised for the first time on appeal, about what constitutes "local" traffic.[4]

Qwest's argument that ISP-bound traffic carried on the DTT facilities is not subject to the RUF clause should also be rejected because the parties have agreed to the contrary. In both in the Arbitration Docket involving the New Agreement and in the present case involving Section 5.1.2.4 of the Old Agreement, the Parties agreed that ISP-bound traffic would be exchanged pursuant to the New and Old interconnection agreements, including Section 5.1.2.4, which is the RUF pricing provision for the DTT facilities at issue in this case. The doctrine of collateral estoppel bars Qwest from re-litigating the issue of whether Section 5.1.2.4 applies to the traffic that the Parties exchanged over DTT facilities because that issue was decided in the Arbitration Docket.

Even if the issue had not been previously decided, the issue of whether the Old Agreement applies to ISP-bound traffic was not raised before the Commission or preserved for appeal in the present case, and therefore, Qwest cannot raise it for the first time on this appeal.

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[4] See Level 3's Motion to Strike and Memorandum in Support of Motion to Strike filed concurrently herewith. Qwest's Brief makes assertions of fact that the Commission never considered below, for example, "if the call terminates in the different LCA then the one where it originated, it is not a local call." Qwest Brief at 25; "in other words, long distance traffic is traffic that spans more than one LCA." Id. at 26; "Level 3's VNXX ISP traffic at issue in this case not only spans more than one LCA, it spans more than one state." Id. These are only a few of the un-cited assertions of fact that Qwest relies upon in its allegation that the DTT traffic was not "local."

a. Qwest Is Barred from Asserting that the RUF Clause Does Not Apply to the Traffic at Issue in this Case Because the Question was Finally Resolved in the Arbitration Docket.

Res judicata refers to the "binding effect of a previous adjudication on a current adjudication." Culbertson v. Bd. of County Comm'rs, 44 P.3d 642 (Utah 2001). "Res judicata has two branches: claim preclusion and issue preclusion." Murdock v. Springville Mun. Corp. (In re Gen. Determination of the Rights to the Use of All the Water), 982 P.2d 65 (Utah 1999). "[C]laim preclusion bars a party from prosecuting in a subsequent action a claim that has been fully litigated previously." Culbertson, 44. P.3d at 642. Issue preclusion, also referred to as collateral estoppel, bars "parties or their privies from re-litigating issues which were once adjudicated on the merits and have resulted in a final judgment." Murdock, 989 P.2d at 65. The Utah court has set out four requirements for demonstrating issue preclusion:

> [1] [T]he party against whom issue preclusion is asserted must have been a party to or in privity with a party to the prior adjudication; [2] the issue decided in the prior adjudication must be identical to the one presented in the instant action; [3] the issue in the first action must have been completely, fully, and fairly litigated; and [4] the first suit must have resulted in a final judgment on the merits.

Brigham Young Univ. v. Tremco Consultants, Inc., 110 P.3d 678, 686 (Utah 2005) (citing Murdock, 982 P.2d 65). All of those requirements have been met in the present case.

The issue of whether ISP-bound traffic is subject to the ICA generally and to the RUF clause in particular was part of the litigation before the Commission in the prior proceeding in which it arbitrated the RUF clause of the New Agreement. R. 6 (Report

and Order, Docket No. 02-2266-02 ("2004 Order" or "Arbitration Order")). In the Arbitration Docket, the parties brought Section 5.1.2.4 (the RUF clause) of the New Agreement before the Commission to determine whether it should include language excepting ISP-bound traffic from the RUF calculation. Id. at 1. Qwest contended that the RUF clause should include an express exclusion for ISP-bound traffic; Level 3 contended it should not. But, both Parties agreed that the traffic carried on the DTT facilities was subject to the RUF clause, hence the request for the Commission to arbitrate the proposed exclusion.

The Commission stated in the Arbitration Docket as follows:

> The *facts are undisputed.* ... The interconnection agreement provision at issue in this matter deals with the financial responsibility of each party for direct trunk transport facilities ("DTTs") and related entrance facilities used to transport and exchange traffic between the companies. *Level 3 and Qwest have agreed that when traffic reaches a certain level, DTTs will be used to carry the traffic. They have further agreed that the cost of those facilities will be based on the "relative use" of the facilities.* The parties disagree, however, on whether ISP-bound traffic should be excluded from the relative use calculations.

Id. (emphasis added). The Commission accepted the Parties' representations and its ruling was based in part on the "undisputed fact" that the RUF clause applied to determine the financial responsibility of each party for the use of the DTT facilities.

Similarly, in the Order in the present docket, the Commission, referring to the Arbitration Docket, observed that "the sole provision at issue in [the Arbitration Docket] was Section 5.1.2.4 of Attachment 1, the same provision" that the Commission was asked

to interpret in the present docket. The Commission further observed that, just as in the Arbitration Docket:

> *Level 3 and Qwest agreed that when traffic reached a certain level, DTTs would be used to carry the traffic. They further agreed that the cost of those facilities would be based on the "relative use" of the facilities*, with Level 3 being billed for all of the cost of the interconnection facilities at issue but Qwest issuing Level 3 a credit for its portion of the relative use of the facilities.

R. 58, at 4-5. Having thus found that the parties agreed that Section 5.1.2.4 applied to the traffic exchanged on the DTT facilities, the Commission stated the sole issue before it in the present case: "The parties disagreed, however, on whether ISP-bound traffic should be excluded from the relative use calculations." Id. at 5.

There can be no question that the issue that Qwest seeks to raise, i.e., whether the RUF clause applies to traffic carried on the DTT facilities, is identical in the present proceeding to that issue as it was determined in the Arbitration Docket. Likewise, there can be no question that, just as in the Arbitration Docket, an essential predicate for the Commission's decision, and even the reason for the existence of the ultimate issue, was the Commission's finding, as an undisputed fact, that the RUF clause applied to traffic carried over the DTT facilities. Arbitration Order at 1.

The parties in the Arbitration Docket were the same parties as in the present case. As set forth above, the issue of whether DTT traffic is subject to the RUF clause in the Arbitration Docket was the same as the issue Qwest seeks to re-litigate in the present case. The parties had the opportunity to fully, fairly and completely litigate the applicability of the RUF to the DTT facilities in the Arbitration Docket. The

applicability of the RUF to the DTT facilities was an agreed-upon, essential finding underlying the Commission's Arbitration Order. The Arbitration dispute went to final judgment on February 20, 2004. Neither party appealed the Arbitration Order. R. 6. The doctrine of collateral estoppel thus bars Qwest from re-litigating in the current case the issue of whether the RUF clause applies to the traffic in question.

b. The Issue of Whether the RUF Clause Applies to the Exchange of ISP-bound Traffic Was Not Preserved for the Present Appeal.

In addition to the bar imposed by the doctrine of collateral estoppel, Qwest should be foreclosed from arguing that the RUF does not apply to the DTT facilities because it failed to raise the issue before the Commission.

"[I]n order to preserve an issue for appeal the issue must be raised in such a way that the trial court has an opportunity to rule on that issue." Brookside Mobile Home Park, Ltd. v. Peebles, 43 P.3d 968, 972 (Utah 2002). Factors that may be considered in determining whether the trial court had such an opportunity include whether the issue was raised "in a timely fashion," whether it was "specifically raised," and whether the party introduced "supporting evidence or relevant legal authority." Id. at 972 (citing Badger v. Brooklyn Canal Co., 966 P.2d 844, 847 (Utah 1998)). The same principle governs matters brought before the State's administrative agencies. See Gibson v. Bd. of Review of Indus. Comm'n of Utah, 707 P.2d 675, 677 (Utah 1985) ("Issues not raised before the administrative agency are waived on appeal.").

Qwest's argument that the RUF does not apply to the traffic that was exchanged over the Parties' interconnection facilities was not timely or specifically raised with the

Commission. R. 42, at 9-10; R. 55, at p. 18-19; Qwest Brief at 23-27 (first raising the issue). Qwest argued (both in the Arbitration Docket and the present case), that the RUF clause *does* apply, but in a way that should exclude ISP-bound traffic from the calculation, despite the fact there is no contractual language to support that position. R. 42, at 4-5, 9-10. Now, Qwest goes to great lengths to assert "facts" for the first time that might support its theory that the DTT facilities carried "non-local" traffic and that the RUF clause therefore does not apply at all. Those alleged facts, however, and any facts that Level 3 might have presented to controvert them, are not in the record because Qwest only raised the issue on appeal. See Mem. in Support of Mot. to Strike. Accordingly, the Court should not consider Qwest's argument that the RUF clause does not apply to the DTT traffic.

3. The SPOP Amendment Does Not Affect the Plain Meaning of the RUF Clause.

Qwest contends that the SPOP amendment, R. 34-35, 45, when read together with the RUF clause and other "provisions of the Old Agreement, . . . support[s] the exclusion of non-local traffic from the relative use offset of Section 5.2.1.4." Qwest Brief at 27. It relies on Section 1.3.3 of the SPOP amendment which provides that "[a] separate trunk group to the Qwest access tandem is necessary for the exchange of non-local Exchange Access (intraLATA toll non-IXC) traffic and jointly Provided Switched Access (interLATA and intraLATA IXC)." Id. at 27 (citing R. 36 § 1.3.3). Qwest also cites a provision of the SPOP amendment that Qwest claims provides that "DTT trunks 'will

carry exchange service EAS/local traffic only.'" Id. at 27 (quoting Attachment 1 to SPOP Amendment, R. 36 § 1.3.2).

Qwest's argument asserting that the SPOP supports the notion that DTTs will carry "local" traffic only begs the question by assuming that the traffic carried on the DTT trunks is not "local" traffic as defined by Qwest. As discussed above, that issue is *res judicata*, has not been preserved for appeal, and is without support based on the evidence of record. The Court, therefore, should not consider Qwest's argument that the SPOP amendment affects the plain meaning of the RUF clause.

4. In Interpreting the Plain Language of the RUF Clause, the Decisions of Courts and Regulators Cited by Qwest are Not Applicable.

Qwest contends that its interpretation of the "plain meaning" of the RUF clause is consistent with courts and regulators that have "considered attempts by CLECs such as Level 3 to game the system through the use of VNXX traffic." Qwest Brief at 29. There is no mention of "VNXX" anywhere in the record in this case and thus no evidence to support a finding that the traffic exchanged by the parties can be considered "VNXX." The same is true for Qwest's references to "interexchange" or "long distance" calling, or "bootstrapping VNXX." Id. As explained above, the record demonstrates that Qwest and Level 3 agreed that these facilities were to be provided under the ICA and subject to the RUF. Qwest is barred, therefore, from asserting that the RUF does not apply to the DTT traffic originated by Qwest's end users. Whether it may be considered "local" traffic or "non-local" traffic has never been addressed by the Commission, and there are no findings in the record to support any of Qwest's assertions. For the same reason, the

cases decided by courts and regulators cited by Qwest are not applicable to the issue before the Commission and this Court. Therefore, this Court should disregard Qwest's arguments on this point when interpreting the plain language of the RUF clause.

5. The Court Should Reject Qwest's Interpretation of the Plain Language of the RUF Clause.

The interpretation of the "plain language" of the RUF that Qwest urges is based entirely on references outside the record, extrinsic evidence in support of Qwest's interpretation, new theories about federal law, and questions of fact, "which may not be determined on appeal." Zions, 749 P.2d at 654. Qwest has raised issues that were "not submitted to the [Commission] and concerning which the [Commission] did not have the opportunity to make any findings of fact or law." Id. For the Court to accept Qwest's concept of "interpreting the plain language" it would have to ignore the plain language of Section 5.1.2.4 itself. Qwest also asks the Court to disregard the Commission's uncontroverted findings that the RUF clause applied to the traffic exchanged by the Parties over the DTT facilities and Qwest's own position statements to that effect, while accepting as fact the assertions of counsel made for the first time in Qwest's Brief in order to affirm the Commission on factual and legal grounds that the Commission never considered.

The Court should reject Qwest's interpretation of the plain language of the RUF clause.

D. <u>The Court Should Not Consider or Resolve Any Ambiguity Even if One Were to Exist.</u>

Qwest argues that "even if the Court determines there is an ambiguity [in the RUF clause], the Commission still reached the correct result in this case." Qwest Brief at 31. Qwest claims that "if the Court finds ambiguity, it may look to broader considerations in assessing party intent." Id. at 33. If this Court were to determine that the language of Section 5.1.2.4 is ambiguous, Level 3 agrees, the trier of fact can then look to extrinsic evidence to make a determination as to the intent of the parties. Qwest Brief at 32. But, because the case would then turn on extrinsic evidence, it must be remanded to the Commission. This Court is not the trier of fact. Zions, 749 P.2d at 654. (questions of fact "may not be determined on appeal").

1. The Commission's Decision Cannot be Affirmed on the Basis that it Correctly Interpreted the RUF Clause According to Utah Law.

Qwest's Brief offers argument and extrinsic evidence in support of its contention that the RUF clause, if ambiguous, should be interpreted in its favor. Qwest Brief at 31-43. The Court should not consider any of the argument contained at pages 31-43 in Qwest's Brief because it is offered to *resolve* ambiguity in the RUF, assuming *arguendo* there is one. Nevertheless, because that portion of Qwest's Brief contains some argument in rebuttal to Level 3's Brief in Support, Level 3 responds as follows to those points.

a. <u>Qwest Does Not Have a Right to Just and Reasonable Compensation for Its Own Use of DTT Facilities.</u>

Qwest argues that the Commission did not err in interpreting the RUF to require just and reasonable compensation for Qwest because, it claims, Qwest did not negotiate

away its "right to just and reasonable compensation under Section 251 (c) of the Act." Qwest Brief at 35.

The record shows that Qwest stated to the Commission that the RUF was negotiated. R. 71, at 13.[5] Even if the facts were as Qwest now urges, that the clause was arbitrated rather than negotiated, which Level 3 denies and contends is not supported by the record, that would only affect the standard by which the Old Agreement would have been *approved*. This does not change the fact that *interpretation and enforcement* of the RUF clause is governed by state contract law, not by federal law of any kind. See Level 3's Brief in Support at 27-31; Federal Court's Remand Order at 2. Qwest, like the Commission, has confused the standard applicable to approving ICAs with the law applicable to interpreting and enforcing them. Thus, Qwest's suggestion that the law at the time the Parties entered into the agreement required the RUF to be just and reasonable is simply wrong. Qwest never had a right to have the RUF clause interpreted in a way that required just and reasonable compensation for Qwest.[6]

---

[5] Qwest's argument to the contrary is based, in part, on the "testimony" of counsel about how AT&T and Qwest arrived at the language in the clause. Qwest Brief at 34-35. Level 3 has moved to strike that alleged "fact" and others upon which Qwest's argument is based. See Mot. to Strike and supporting Memorandum filed concurrently herewith. There is no testimony that the RUF was the product of arbitration, or that the language was "ordered" by the Commission. The discussion about what the bold typeface means is not helpful to know whether the parties negotiated the crucial words or what it means to say that such language "corresponds to language included to comply with Commission's Orders." Qwest Brief at 35. Furthermore, no witnesses were presented by Qwest to testify about the origin of the RUF.

[6] Qwest argues later in its Brief that the Commission's Utah statutes impose a "just and reasonable" requirement. That argument is also incorrect as discussed below.

b. Even Though Qwest's Alleged "Other Surrounding Circumstances" Actually Favor Level 3's Interpretation, Any Ambiguity Should Not Be Decided by this Court.

Qwest argues that the Commission could have drawn no implication in favor of Level 3's interpretation from other surrounding circumstances, including the fact that the parties did not renegotiate the RUF in response to the *ISP Remand Order*. Qwest Brief at 36. Qwest points out, correctly, that the *ISP Remand Order* was inapplicable to the RUF clause. Id. At the same time, it claims the *ISP Remand Order* clarifies federal policy by preventing "arbitrage." Id. at 37. Thus, Qwest contends, the fact that the Parties did not negotiate the RUF does not mean that the state of the law prior to the issuance of the *ISP Remand Order* supported Level 3's argument that internet traffic was included in the RUF." Id.

The only established facts that need be considered in this case are that the DTT traffic was subject to the RUF clause, and that the RUF clause was never amended by Qwest during the term of the contract.[7] Speculating about Qwest's intent or actions that were not reduced to writing in the Parties' contract is not appropriate or necessary.

Further, Qwest is overly selective in its reliance on the *ISP Remand Order*. The Order itself states that parties with contracts requiring reciprocal compensation for ISP-bound traffic were to amend them, or abide by them until they expired. *ISP Remand Order* at ¶ 82. Thus, if the *ISP Remand Order* is invoked to clarify federal policy, it must

[7] The term of the Old Agreement included the release of the FCC's *ISP Remand Order* and the Parties' adoption of an amendment to the contract based upon that Order. Id. at 37-38.

be concluded that at the time the parties contracted, ISP-bound traffic was to be included in the RUF, and was to remain in the calculation until the contract was amended or expired. Qwest's slurs about arbitrage and gaming the system ignore the fact that the regulatory system for the exchange of ISP-bound traffic depended on the parties to make, maintain, and stand by their own contracts, including the reciprocal compensation terms and relative use clauses.

c. The Law in Effect at the Time the RUF Was Agreed Upon Requires Enforcement of the Contract as Written.

Qwest contends that "when approving the Old Agreement in the first instance (in the AT&T arbitration) the Commission was required to ensure that the agreement be just and reasonable, in the public interest, and non-discriminatory." Qwest Brief at 39 (citing 47 U.S.C. §§ 252(c), (d)). Hence, Qwest contends, there "is no basis" for Level 3 to claim that the Commission should interpret it inconsistent with the requirements by which it was approved. Qwest Brief at 39.

As Level 3 explained in its Brief in Support, the standard for approving interconnection agreements is different from the standard for interpreting and enforcing them. Brief in Support at 27. Federal law applied to approve the RUF (47 U.S.C. § 252(e)(1)), but state law applies to interpret it. Federal Court's Remand Order at 2. Any other circumstances surrounding the RUF clause are relevant only if the clause is ambiguous and cannot be interpreted from its plain language. In that case, such circumstances should be considered by the Commission, not the Court.

E. The Enforcement of the Contract as Written is in the Public Interest.

The FTA was enacted to create "a new regime designed to foster competition in local telephone markets," in response to the naturally monopolistic system that had developed as a consequence of state-granted exclusive franchises. Verizon Maryland v. Pub. Serv. Comm'n, 535 U.S. 635, 638 (2002); AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371 (1999). It was designed to "foster rapid development of telecommunications competition in local markets" served by the incumbent monopoly providers. GTE Nw., Inc. v. Nelson, 969 F. Supp. 654, 656 (W.D. Wash. 1997). To facilitate and promote competition between incumbent telephone carriers and new entrants into the market, the Act allows carriers to arrive at "detailed technological and monetary provisions" through voluntary negotiation of competitive terms of their contracts. TCG Milwaukee, Inc. v. Pub. Serv. Comm'n, 980 F. Supp. 992, 995 (W.D. Wis. 1997). The Act allows parties to agree to competitive terms free of the regulations that traditionally required rates to be just and reasonable. 47 U.S.C. § 252(a)(1); see also Alenco Commc'ns, Inc. v. FCC, 201 F.3d 608, 620 (5th Cir. 2000) (Act intended to introduce competition; it "does *not* guarantee all local telephone service providers a sufficient return on investment"); Brief in Support at 22-25.

While the *ISP Remand Order* is not directly applicable to the RUF clause, it does reflect the FCC's policy regarding ISP-bound traffic. The *ISP Remand Order* ultimately adjusted reciprocal compensation requirements to address the "market distortions under the current intercarrier compensation regimes for ISP bound traffic." *ISP Remand Order* at ¶ 77. The FCC stated, however, "At the same time, 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." Id. The FCC thus established an "interim regime," to apply "as carriers renegotiate expired or expiring interconnection agreements." Id. at 82. Thus, the public interest in preventing market distortions does not extend to abrogating existing contracts. A number of courts have recently held that carriers who did not exclude or specify unique reciprocal compensation rates for ISP-bound traffic in their previous ICAs or in subsequent amendments, are required to pay the reciprocal compensation as agreed upon in their contracts, despite the current policy. *ISP Remand Order* at ¶ 77-83, 82; see also Verizon Del., Inc. v. AT&T Commc'ns of Del., LLC, 326 F. Supp. 2d 574, 587-88 (D. Del. 2004) (despite FCC policy against treating ISP-bound traffic as local for purpose of reciprocal compensation, ILEC required to pay reciprocal compensation for ISP-bound traffic where ICA did not specifically except ISP-bound calls); S. New England Tele. Co. v. Conn. Dept. of Pub. Util., 285 F. Supp. 2d 252, 260 (D. Conn. 2003) (ICA that included reciprocal compensation for ISP-bound traffic was enforceable and did not violate FTA). The "market distortion" that Qwest complains about was a consequence of the Act's primary goal to give competition a foothold in the telecommunications industry. While the FCC eventually addressed the problem as it related to reciprocal compensation, nevertheless, the public interest requires that contracts remain enforceable until amended or expired in accordance with established contract law.

Finally, Qwest also contends that under state law, the Commission has a duty to ensure that charges demanded or received by public utilities must be "just and

reasonable." Qwest Brief at 44 (citing Utah Code Ann. § 54-3-1; 54-8b-16). It further contends that "in all of its actions" the Commission must consider and act consistently with the public interest. Qwest Brief at 45. Thus, Qwest reasons, the Commission should interpret the RUF clause in a way that would allow Qwest to avoid paying for its use of the DTT facilities. Id. at 45-46.

Qwest's argument is based upon the application of Utah's public utility statutes. Utah Code, Title 54. Qwest suggests that the Court and the Commission should disregard Utah contract law, and instead apply the Utah public utility statutes in a way that would defeat the policy objectives of the Act. The Act contemplated that the absence of federal regulation for competitive contract terms would stimulate a competitive environment. The application of Utah regulation to protect Qwest from the consequences of the RUF clause would defeat the competitive purposes of the Act by artificially guaranteeing the monopolist's profits while undermining a fundamental principle of contract law in the process. Qwest's argument, rather than expressing the real public interest, urges, contrary to the Act and the *ISP Remand Order*, that it is more important that Qwest be spared from paying the cost of the DTT facilities, than it is for competition to develop across the industry. The public interest is best served by enforcing the RUF in the Old Agreement by applying Utah contract law as the federal court ordered, rather than interpreting the public utility statutes to protect Qwest from the competitive terms of its own contract. Federal Court's Remand Order at 2; *ISP Remand Order* at ¶ 77-83, 82; Verizon Del., 326 F. Supp. 2d at 588.

CONCLUSION

Level 3 filed its Petition with the Commission, seeking enforcement of the plain language of the RUF clause in the Old Agreement to prevent Qwest from billing and collecting improper charges for DTT facilities during the Dispute Period. The Petition required only that the Commission review and enforce the plain language of the RUF clause, which does not provide any exception for ISP-bound traffic.

The Commission erred in interpreting the Old Agreement by applying the FTA, and in relying on its Arbitration Order to produce "just and reasonable compensation for Qwest." R. 58, at 10. Section 252(d)(1) of the Act, relied on by the Commission as support for its proposition that it must help Qwest achieve a "just and reasonable" result, is not applicable. Likewise, because the Arbitration Order arose under the portion of the Act governing arbitration, it was inapplicable to the interpretation of the RUF. As the federal court concluded, this case must be decided under Utah contract law. For that reason the Court should vacate the Commission's Order.

Even though this Court may not engage in fact finding, it can interpret the RUF clause, as a matter of law, by giving it its plain meaning. While this would result in Qwest bearing the cost of the DTT facilities rather than Level 3, Utah contract law does not allow the reformation of the RUF clause, and the public interest does not compel a different result.

For the foregoing reasons, Level 3 respectfully requests that the Court vacate the Order of the Commission and either rule on the plain language of Section 5.1.2.4 that the

RUF calculation does not exclude ISP-bound traffic, or remand this case to the Commission for reconsideration.

DATED this 10th day of October, 2006.

WILLIAM J. EVANS (5276)
VICKI M. BALDWIN (8532)
PARSONS BEHLE & LATIMER

Attorneys for Petitioner & Appellant

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October, 2006, I caused to be hand-delivered, a true and correct copy of the foregoing **REPLY BRIEF OF THE APPELLANT**, to:

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ADDENDUM INDEX

Exhibit

Order Remanding Action to Utah Supreme Court, Case No. 2:06CV132K (May 30, 2006) .... A

Attachment 1 and Section 5.1.2.4 ("RUF Clause") of Old Agreement .... B

Single Point of Presence (SPOP) Amendment C

Utah Public Service Commission Report & Order, Docket No. 02-2266-02 (Feb. 20, 2004) ("Arbitration Order") .... D

Utah Public Service Commission Report & Order, Docket No. 05-2266-01 (Aug. 18, 2005) .... E

In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 16 F.C.C.R. 9151, *ISP Remand Order* (April 27, 2001) .... F

Tab A

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

LEVEL 3 COMMUNICATIONS, LLC **Plaintiff,** vs. **PUBLIC SERVICE COMMISSION OF UTAH and QWEST CORPORATION** **Defendants.**	**ORDER REMANDING ACTION TO UTAH SUPREME COURT** **Case No. 2:06CV132K**

This matter is before the court on Level 3 Communications, LLC's ("Level 3") Motion to Remand A hearing on the motion was held on May 17, 2006 At the hearing, Level 3 was represented by Gregory L Rogers and William J Evans Defendant Qwest Corporation ("Qwest") was represented by David L Elmont Before the hearing, the court considered carefully the memoranda and other materials submitted by the parties Since taking the motion under advisement, the court has further considered the law and facts relating to this motion Now being fully advised, the court renders the following Order

Level 3 has requested that this court remand this case back to the Utah Supreme Court Level 3 had previously appealed to the Utah Supreme Court the Public Service Commission's decision regarding an agreement Level 3 had with Qwest Qwest removed that appeal to this court Level 3 argues that this court does not have subject matter jurisdiction over this appeal from the Commission's Report and Order because Level 3's Petition before the Commission did not raise a question of federal law, its causes of action were not created by federal law, and there

is no issue in this case that turns on a substantial question of federal law. Instead, Level 3 argues, the resolution of this matter requires only the application of state law principles of contract interpretation. Qwest, on the other hand, claims that this court has jurisdiction because the appeal involves the interpretation of federal law.

District courts have "original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." 28 U.S.C. § 1331. "A case arises under federal law if its well-pleaded complaint establishes either that federal law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal law. *Nicodemus v. Union Pacific Corp.*, 440 F.3d 1227, 1232 (10th Cir. 2006) (internal quotations and citations omitted). Thus, "even though a plaintiff asserts only claims under state law, federal-question jurisdiction may be appropriate if the state-law claims implicate significant federal issues." *Id.*

The court finds that there is no federal question on the face of Level 3's Petition, its claims were not created by federal law, and also that Level 3's right to relief does not depend on resolution of a substantial question of federal law. Rather, the resolution of this dispute depends upon state contract law. For the reasons stated in Level 3's memorandum in support and in its reply memorandum, the court agrees that it does not have subject matter jurisdiction over this action.

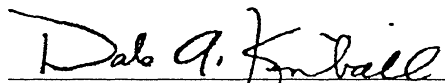
CONCLUSION

For the foregoing reasons, and good cause appearing, IT IS HEREBY ORDERED that Level 3's Motions to Remand [Docket No. 4] is GRANTED. The Clerk of the Court is directed

to remand this action back to the Utah Supreme Court.

DATED this 26th day of May, 2006.

BY THE COURT:



DALE A. KIMBALL
United States District Judge

Moschini, Gail

From: Fax Center
Sent: Tuesday, May 30, 2006 9:28 AM
To: Baldwin, Vicki; Evans, William
Cc: Moschini, Gail; Nelson, Joy
Subject: FW: Activity in Case 2:06-cv-00132-DAK Level 3 Communications v. Public Service Commission of Utah et al "Order on Motion to Remand"
Attachments: PBL01-860798.PDF.DRF

DL

From: utd_enotice@utd.uscourts.gov [mailto:utd_enotice@utd.uscourts.gov]
Sent: Tuesday, May 30, 2006 9:26 AM
To: ecf_notice@utd.uscourts.gov
Subject: Activity in Case 2:06-cv-00132-DAK Level 3 Communications v. Public Service Commission of Utah et al "Order on Motion to Remand"

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The following transaction was received from blk, entered on 5/30/2006 at 9:25 AM MDT and filed on 5/30/2006

Case Name: Level 3 Communications v. Public Service Commission of Utah et al
Case Number: 2:06-cv-132
Filer:
Document Number: 12

Docket Text:
ORDER granting [4] Motion to Remand to the Utah Supreme Court. Signed by Judge Dale A. Kimball on 5/26/06. (blk,)

The following document(s) are associated with this transaction:

Document description: Main Document
Original filename:n/a
Electronic document Stamp:
[STAMP dcecfStamp_ID=1060034973 [Date=5/30/2006] [FileNumber=602660-0]
[78a867466f941c768c6b3ebb36b546c641515a644f6b646014f3a1be88084c47279e
d1a523167a8cd8f0fabca87942c6d97b85b300f43d5f0682f668fc897ba8]]

2:06-cv-132 Notice will be electronically mailed to:

Vicki M. Baldwin (E-Filer) ecf@parsonsbehle.com

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2:06-cv-132 Notice will be delivered by other means to:

Gregory L. Rogers
LEVEL 3 COMMUNICATIONS
1025 ELDORADO BLVD
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Tab B

RATES and CHARGES

1. General Principles

1.1 All rates provided under this Agreement shall remain in effect for the term of this Agreement unless they are not in accordance with all applicable provisions of the Act, the rules and regulations of the FCC, or the Commission's rules and regulations.

1.2 Except as otherwise specified in this Agreement, as approved or ordered by the Commission, or as agreed to by the Parties through good faith negotiations, nothing in this Agreement shall prevent a Party through the dispute resolution process described in this Agreement from seeking to recover the costs and expenses, if any, it may incur in (a) complying with and implementing its obligations under this Agreement, the Act, and the rules, regulations and orders of the FCC and the Commission, and (b) the development, modification, technical installation and maintenance of any systems or other infrastructure which it requires to comply with and to continue complying with its responsibilities and obligations under this Agreement.

2. Resale Rates and Charges

U S WEST shall make its retail Telecommunications Services available to CO-PROVIDER for resale at the interim wholesale rates specified in Appendix A to this Attachment 1.[1]

2.2 [Intentionally left blank for numbering consistency]

2.3 If the resold services are purchased pursuant to tariffs and the tariff rates change, charges billed to CO-PROVIDER for such services will be based upon the new tariff rates less the applicable wholesale discount as agreed to herein. The new rate will be effective upon the tariff effective date.

2.4 A Subscriber Line Charge (SLC) will continue to be paid by CO-PROVIDER without discount for each local exchange line resold under this Agreement. All federal and state rules and regulations associated with SLC or as found in the applicable tariffs also apply.

2.5 CO-PROVIDER will pay to U S WEST the PIC change charge without discount associated with CO-PROVIDER end user changes of inter-exchange or intraLATA carriers.

2.6 CO-PROVIDER agrees to pay U S WEST at the wholesale discount rate when its end user activates any services or features that are billed on a per use or per activation basis (e.g., continuous redial, last call return, call back calling, call trace, etc.). U S WEST shall provide CO-PROVIDER with detailed billing information per applicable OBF standards unless otherwise agreed to by the Parties as necessary to permit CO-PROVIDER to bill its end users such charges.

2.7 [Intentionally left blank for numbering consistency]

2.8 Nonrecurring charges will be billed as approved by the Commission.

2.9 [Intentionally left blank for numbering consistency]

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[1] At&t Order, pg. 2, "Resale Restrictions" paragraph 1

2.10 [Intentionally left blank for numbering consistency]

2.11 Resale prices shall be wholesale rates determined on the basis of retail rates charged to subscribers for the Telecommunications Service requested, excluding the portion thereof attributable to any marketing, billing, collection and other costs that will be avoided by U S WEST, as specified in the Act, by the FCC and/or the Commission. **U S WEST shall be obligated to offer its volume and term discount service plans to CO-PROVIDER provided that CO-PROVIDER complies with the volume and term requirements contained therein. If selected by CO-PROVIDER, an appropriate wholesale discount shall also be applied to such plans. With the exception of the preceding, CO-PROVIDER shall not be required to agree to volume or term commitments as a condition for obtaining Local Service.**[2]

2.12 U S WEST shall bill CO-PROVIDER and CO-PROVIDER is responsible for all applicable charges for Resale Services. CO-PROVIDER shall be responsible for all charges associated with services that CO-PROVIDER resells to an end user.

3. Construction and Implementation Costs

3.1 **U S WEST shall perform construction for CO-PROVIDER for the services provided hereunder pursuant to and in accordance with the terms of U S WEST's retail and wholesale construction charge tariffs, as appropriate for the type of service provided. Such construction charge tariffs shall be imposed only if U S WEST assesses its own end users such charges for similar construction and also demonstrates to the Commission that it is customary industry practice to charge end users for similar costs. If another CLEC or U S WEST receives a benefit from the construction or other activity for which CO-PROVIDER is charged, CO-PROVIDER is entitled to recover contribution from the CLEC, or, if applicable, U S WEST as a beneficiary, for a share of the costs.**[3]

3.2 [Intentionally left blank for numbering consistency]

3.3 [Intentionally left blank for numbering consistency]

3.4 A quote for the CO-PROVIDER portion of a specific job will be provided to CO-PROVIDER. The quote will be in writing and will be binding for ninety (90) days after the issue date. When accepted, CO-PROVIDER will be billed the quoted price and construction will commence after receipt of payment. If CO-PROVIDER chooses not to have U S WEST construct the facilities, U S WEST reserves the right to bill CO-PROVIDER for the expense incurred for producing the engineered job design.

3.5 CO-PROVIDER shall make payment of fifty percent (50%) of the nonrecurring charges and fees upon acceptance of the quotation with the remainder due upon completion of the construction. In the event that CO-PROVIDER disputes the amount of U S WEST's proposed construction costs, CO-PROVIDER shall deposit fifty percent (50%) of the quoted construction costs into an interest bearing escrow account prior to the commencement of construction. The remainder of the quoted construction costs shall be deposited into the escrow account upon completion of the construction. Upon resolution of the dispute, the escrow agent shall distribute amounts in the account in accordance

[2] Final Arbitration Order at pg. 30
[3] Final Arbitration Order at pg 34

with the resolution of such dispute, and any interest that has accrued with respect to amounts in the account shall be distributed proportionately to the Parties The pendency of any such dispute shall not affect the obligation of U S WEST to complete the requested construction

4. Unbundled Loops - Conditioning Charge

4 1 To the extent CO-PROVIDER requires an Unbundled Loop to provide ISDN, HDSL, ADSL or D-S1 service, such requirements will be identified on the order for Unbundled Loop Service. Conditioning charges to condition such loops to ensure the necessary transmission standard will be accrued at actual cost by US WEST for each such loop. U S WEST's actual out-of-pocket costs [illegible]dition loops of varying lengths will be examined in Docket No. 94-999-01 (Phase III).

5. Transport and Termination - Interim Prices and Methodology[5]

5.1 Rate Structure

5.1.1 Local Traffic

5.1.1.1 Call Termination

5.1.1.1.1 **The Parties agree that call termination rates as described in Appendix A to this Attachment 1 will apply reciprocally for the termination of EAS/Local traffic per minute of use. If the exchange of EAS/Local traffic between the Parties is within +/- 5% of balance (as measured monthly), the Parties agree that their respective call termination charges will offset one another, and no compensation will be paid. The Parties agree to perform monthly joint traffic audits, based upon mutually agreeable measurement criteria and auditing standards. In the event that the exchange of traffic is not in balance as described above, the call termination charges in Appendix A will apply.**

5 1 1 1 2 **For traffic terminated at an U S WEST or CO-PROVIDER end office, the end office call termination rate in Appendix A shall apply.**

5 1 1 1 3 **For traffic terminated at a U S WEST or CO-PROVIDER tandem switch, the tandem switched rate and the tandem transport rate in Appendix A shall apply in addition to the end office call termination rate described above.**

[4] Final Arbitration Order at pg 35

[5] Final Arbitration Order at pg 40

5.1.1.4 Switching shall be purchased on a per line basis with all functionality and features of such switch including, but not limited to call routing.

5.1.1.5 All other unbundled network elements may be purchased separately or in combination on the basis outlined in Appendix A.

5.1.2 Transport

5.1.2.1 If the Parties elect to each provision their own one-way trunks to the other Party's end office for the termination of local traffic, each Party will be responsible for its own expenses associated with the trunks and no transport charges will apply.

5.1.2.2 If one Party desires to purchase direct trunk transport from the other Party, the following rate elements will apply. Transport rate elements include the direct trunk transport facilities between the POI and the terminating party's tandem or end office switches. The applicable rates are described in Appendix A.

5.1.2.3 Direct-trunked transport facilities are provided as dedicated DS3 or DS1 facilities without the tandem switching functions, for the use of either Party between the Point of Interconnection and the terminating end office or tandem switch.

5.1.2.4 If the Parties elect to establish two-way direct trunks, the compensation for such jointly used 'shared' facilities shall be adjusted as follows. The nominal compensation shall be pursuant to the rates for direct trunk transport in Appendix A. The actual rate paid to the provider of the direct trunk facility shall be reduced to reflect the provider's use of that facility. The adjustment in the direct trunk transport rate shall be a percentage that reflects the provider's relative use (i.e., originating minutes of use) of the facility in the busy hour.

5.1.2.5 Multiplexing options are available at rates described in Appendix A.

5.1.3 Toll Traffic.

Applicable Switched Access Tariff rates, terms, and conditions apply to toll traffic routed to an access tandem, or directly to an end office.

5.1.4 Transit Traffic.

Applicable switched access, Type 2 or LIS transport rates apply for the use of U S WEST's network to transport transit traffic. For transiting local traffic, the applicable local transit rate applies to the originating Party per

Appendix A. For transiting toll traffic, the Parties will charge the applicable Switched Access rates to the responsible carrier. For terminating transiting wireless traffic, the Parties will charge their applicable rates to the wireless provider. For transiting wireless traffic, the Parties will charge each other the applicable local transit rate.

6. Number Portability

6.1 CO-PROVIDER may request U S WEST to provide CO-PROVIDER call detail records identifying each IXC which are sufficient to allow CO-PROVIDER to render bills to IXCs for calls IXCs place to ported numbers in the U S WEST network which U S WEST forwards to CO-PROVIDER for termination. To the extent U S WEST is unable to provide billing detail information within a reasonable time frame, the Parties may agree on an interim method to share access revenues pursuant to a mutually agreed upon surrogate approach.

7. Rate Structure

The prices set forth in Appendix A to this Attachment 1 which are designated as interim in nature are subject to true-up upon establishment of permanent rates by the Commission in Docket 94-999-01. The prices set forth in Appendices A and B to this Attachment 1 which are designated as final in nature are subject to change if the Commission so orders in its pricing dockets.

Tab C

Single Point of Presence (SPOP) Amendment
To the Interconnection Agreement
Between
Level 3 Communications, LLC
And Qwest Corporation
For the State of Utah

This Amendment ("Amendment") is made and entered into by and between Level 3 Communications, LLC ("CLEC") and Qwest Corporation ("Qwest").

WHEREAS, CLEC and Qwest entered into an Interconnection Agreement ("the Agreement") for service in the state of Utah that was approved by the Public Service Commission of Utah ("Commission") on January 10, 2001; and

WHEREAS, CLEC and Qwest desire to amend the Agreement by adding the terms and conditions contained herein.

AGREEMENT

NOW THEREFORE, in consideration of the mutual terms, covenants and conditions contained in this Amendment and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Parties agree as follows:

1. **Amendment Terms.**

This Amendment is made in order to add terms, and conditions for Single Point of Presence ("SPOP") in the LATA as set forth in Attachment 1 and Exhibit A attached hereto and incorporated herein.

Neither Party shall lose any of its rights from the original contract by entering into this Amendment for SPOP.

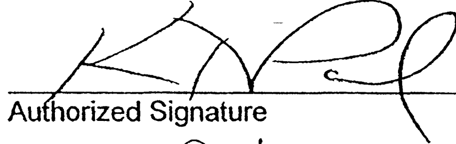
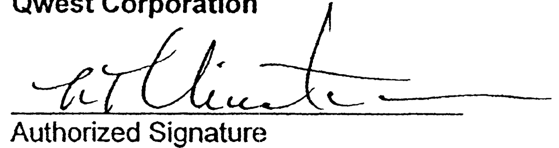
2. **Effective Date.**

This Amendment shall be deemed effective upon approval by the Commission; however, the Parties may agree to implement the provisions of this Amendment upon execution. To accommodate this need, CLEC must generate, if necessary, an updated Customer Questionnaire. In addition to the Questionnaire, all system updates will need to be completed by Qwest. CLEC will be notified when all system changes have been made. Actual order processing may begin once these requirements have been met.

3. **Further Amendments.**

Except as modified herein, the provisions of the Agreement shall remain in full force and effect. Neither the Agreement nor this Amendment may be further amended or altered except by written instrument executed by an authorized representative of both Parties. This Amendment shall constitute the entire agreement between the Parties, and supersedes all previous agreements and amendments entered into between the Parties with respect to the subject matter of this Amendment.

The Parties intending to be legally bound have executed this Amendment as of the dates set forth below, in multiple counterparts, each of which is deemed an original, but all of which shall constitute one and the same instrument.

Level 3 Communications, LLC	Qwest Corporation
	
Authorized Signature	Authorized Signature
Kevin Paul	L. T. Christensen
Name Printed/Typed	Name Printed/Typed
VP- Softswitch Deployment	Director – Business Policy
Title	Title
June 26, 2002	6/28/02
Date	Date

Attachment 1

Single Point of Presence (SPOP) in the LATA is a Local Interconnection Service (LIS) Interconnection trunking option that allows CLEC to establish one physical point of presence in the LATA in Qwest's territory. Qwest and CLEC may then exchange traffic at the SPOP utilizing trunking as described following.

1.1 By utilizing SPOP in the LATA, CLEC can deliver both Exchange Access (IntraLATA Toll Non-IXC) and Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic and Exchange Service EAS/Local traffic at Qwest's Access Tandem Switches. CLEC can also utilize Qwest's behind the tandem infrastructure to terminate traffic to specific end offices. The SPOP is defined as the CLEC's physical point of presence.

1.2 SPOP in the LATA includes an Entrance Facility (EF), Expanded Interconnect Channel Termination (EICT), or Mid Span Meet POI and Direct Trunked Transport (DTT) options available at both a DS1 and DS3 capacity.

1.3 Where there is a Qwest local tandem serving an end office that CLEC intends to terminate traffic, the following conditions apply:

1.3.1 The Parties shall terminate Exchange Access Service (EAS/Local) traffic on tandem or end office switches. When there is a DS1 level of traffic (512 BHCCS) between CLEC's switch and a Qwest End Office Switch, Qwest may request CLEC to order a direct trunk group to the Qwest End Office Switch. CLEC shall comply with that request unless it can demonstrate that such compliance will impose upon it a material adverse economic or operations impact. Furthermore, Qwest may propose to provide Interconnection facilities to the local tandems or end offices served by the access tandem at the same cost to CLEC as Interconnection at the access tandem. If CLEC provides a written statement of its objections to a Qwest cost-equivalency proposal, Qwest may require it only: (a) upon demonstrating that a failure to do so will have a material adverse affect on the operation of its network and (b) upon a finding that doing so will have no material adverse impact on the operation of CLEC, as compared with Interconnection at such access tandem.

1.3.1.1 When CLEC has an NXX that subtends a local tandem, but the anticipated traffic to and from the NXX is less than 1 DS1s (512 CCS) worth of traffic, CLEC may choose to use the access tandem for local traffic in the circumstances described above in 1.3.1. CLEC will be required to submit an electronic letter on CLEC letterhead to Qwest stating at which local tandems they will not interconnect. This letter should include, the local tandem CLLI(s) and the CLEC specific NPA-NXXs for the local tandems. In addition, CLEC will provide a revised electronic letter to Qwest of any changes in the network configuration or addition/deletions of NPA-NXXs of the aforementioned local tandems.

1.3.2 Connections to a Qwest local tandem may be two-way or one-way trunks. These trunks will carry Exchange Service EAS/Local traffic only.

1.3.3 A separate trunk group to the Qwest access tandem is necessary for the exchange of non-local Exchange Access (IntraLATA Toll Non-IXC) traffic and

jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic.

1.4 Where there is no Qwest local tandem serving a Qwest end office, CLEC may choose from one of the following options:

1.4.1 A two-way CLEC LIS trunk group to the Qwest access tandem for CLEC traffic terminating to, originating from, or passing through the Qwest network that combines Exchange Service EAS/ Local, Exchange Access (IntraLATA Toll Non-IXC) and Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic.

1.4.2 A two-way CLEC LIS trunk group to the Qwest access tandem for CLEC Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic terminating to and originating from the IXC Feature Group (FG) A/B/D network through the Qwest network and an additional two-way trunk group to the Qwest access tandem for the combined Exchange Service EAS/ Local and Exchange Access (IntraLATA Toll Non-IXC) traffic terminating to, originating from, and transiting the Qwest network.

1.4.2.1 If CLEC uses two way trunking, Qwest will send all Exchange Service EAS/Local, Exchange Access (IntraLATA Toll Non-IXC) and Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic delivered to the Qwest access tandem on the same combined trunk.

1.4.3 A one-way terminating CLEC LIS trunk group to the Qwest access tandem for CLEC traffic destined to or through the Qwest network that combines Exchange Service EAS/Local, Exchange Access (Intra LATA Toll Non-IXC) and Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic.

1.4.4 CLEC may utilize a one-way LIS trunk group to the Qwest access tandem for Jointly Provided Switched Access (InterLATA and IntraLATA IXC) traffic terminating to the IXC FG A/B/D network through the Qwest network, and an additional one-way trunk group to the Qwest access tandem for the combined Exchange Service EAS/ Local, Exchange Access (IntraLATA Toll Non-IXC) traffic terminating to, originating from, and transiting the Qwest network.

1.4.4.1 If CLEC orders either of the above one-way trunk options, Qwest will return the traffic via one combined Exchange Service EAS/ Local, and Exchange Access (IntraLATA Toll Non-IXC) trunk group.

1.4.5 To the extent Qwest combines Exchange Service (EAS/Local), Exchange Access (IntraLATA Toll carried solely by Local Exchange Carriers), and Jointly Provided Switched Access (InterLATA and IntraLATA calls exchanged with a third-party IXC) traffic on a single LIS trunk group, Qwest, at CLEC's request, will declare a percent local use factor (PLU). Such PLU(s) will be verifiable with either call summary records utilizing Calling Party Number information for jurisdictionalization or call detail samples. CLEC should apportion per minute of use (MOU) charges appropriately.

1.5 CLEC must have SS7 functionality to use SPOP in the LATA.

1.6 Qwest assumes CLEC will be originating traffic destined for end users served by each Qwest access tandem in the LATA, therefore, CLEC must order LIS trunking to each Qwest access tandem in the LATA to accommodate routing of this traffic. Additionally, when there is more than one Qwest access tandem within the LATA boundary, the CLEC must order LIS trunking to each Qwest access tandem that serves its end-user customers' traffic to avoid call blocking. Alternatively, should the CLEC accept the conditions as outlined in the SPOP Waiver (Exhibit A), trunking will not be required to each Qwest access tandem in a multi-access tandem LATA. Should CLEC not be utilizing the option of interconnecting at the access tandem for local, due to low volume of local traffic under the circumstances described in 1.3.1, CLEC needs trunking only to each local tandem where they have a customer base. The 512 CCS rule and other direct trunking requirements will apply for direct trunking to Qwest end offices.

1.7 If Direct Trunked Transport is greater than 50 miles in length, and existing facilities are not available in either Party's network, and the Parties cannot agree as to which Party will provide the facility, the Parties will construct facilities to a mid-point of the span.

1.8 CLEC will provide notification to all Co-Providers in the local calling areas of CLEC's change in routing when the CLEC chooses to route its traffic in accordance with Qwest's SPOP interconnection trunking.

1.9 Ordering

1.9.1 SPOP in a LATA will be ordered based upon the standard ordering process for the type of facility chosen. See the Qwest Interconnection and Resale Resource Guide for further ordering information.

1.9.2 CLEC will issue ASRs to disconnect/new connect existing access tandem trunk groups to convert them to SPOP trunk groups.

1.9.3 In addition, the ASR ordering SPOP trunks will include SPOP Remarks "Single POP in LATA " and the SPEC Field must carry "SPOLATA ."

EXHIBIT A

SINGLE POINT OF PRESENCE WAIVER

Qwest will waive the requirement for CLEC to connect to each Qwest Access Tandem in the LATA with this waiver amendment.

CLEC certifies that it will not originate any traffic destined for subtending offices of Qwest's Access Tandems for which CLEC seeks a waiver. Or, if CLEC does originate such traffic, that CLEC will route such traffic to a Non-Qwest network. In addition, CLEC certifies that it has no end users in the serving area of the Qwest Access Tandem for which CLEC seeks a waiver.

CLEC will send an electronic letter to Qwest indicating the Qwest access tandems subject to this waiver at the time of ordering trunks required to implement SPOP in the LATA. In addition, CLEC will provide a revised electronic letter to Qwest advising of any changes in the network configuration of the aforementioned access tandems. Should CLEC desire to begin serving end users in the serving area of a Qwest access tandem currently under this waiver, CLEC must first establish trunking to the Qwest access tandem. Additionally, should CLEC desire to originate traffic destined to a Qwest end office subtending a Qwest access tandem currently under this waiver, CLEC must first establish trunking to the Qwest access tandem.

Under this waiver any CLEC originated traffic destined for an end office subtending a Qwest tandem under this waiver will be billed separately, by Qwest to CLEC, via a manual bill.

Misrouted usage under this waiver will be billed, a penalty of $.21 per MOU.

Additionally, a manual handling fee of $100 or 10% of total billing, whichever is greater, will be charged for each such manual bill rendered.

Late Payment charges will apply as outlined in the existing Interconnection Agreement currently in effect between the Parties.

Should this traffic occur, the Parties agree to meet within forty-five (45) days of Qwest's identification of such misrouted traffic to discuss methods for avoiding future misrouting on that trunk group or groups. CLEC will then have thirty (30) days from the date of meeting to correct such misrouting on that trunk group or groups. If further misrouting occurs or continues after that date on the same trunk group or groups as the original misrouting identified, the Parties agree to meet again within thirty (30) days of Qwest's identification of such misrouted traffic to discuss methods for avoiding future misrouting on that trunk group or groups. CLEC will then have thirty (30) days from the date of meeting to correct such misrouting. If further misrouting occurs or continues after that date on the same trunk group or groups, Qwest will consider this waiver null and void and all requirements in Attachment 1 or in the existing Interconnection Agreement currently in effect between the Parties will be reinstated. If the parties disagree about whether the traffic identified by Qwest was actually misrouted, the Parties agree to avail themselves of the dispute resolution provision of their interconnection agreement. Nothing in this provision affects or alters in any way CLEC's obligation to pay the rates, the manual handling fee, and the late payment charges specified above for misrouted traffic.

Tab D

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of Level 3 Communications, LLC for Arbitration Pursuant to Section 252 (b) of the Telecommunications Act of 1996 with Qwest Corporation Regarding Rates, Terms, and Conditions for Interconnection	)))))	DOCKET NO. 02-2266-02 REPORT AND ORDER

ISSUED: February 20, 2004

By The Commission:

BACKGROUND

This matter was commenced by a petition of Level 3 Communications, LLC ("Level 3") for arbitration under §251(b)(1) of the Telecommunications Act of 1996, 47 U.S.C. §151 *et seq.* (the "Act"). This petition presents one major issue for decision that the parties could not reach agreement on with respect to an interconnection agreement between Level 3 and Qwest Corporation ("Qwest"). The parties represented, and we find, that they have made good faith efforts to reach agreement on the terms of interconnection. Hearings were held, and both parties fully briefed the issue. In addition, subsequent to the hearing both parties have submitted numerous motions for leave to file additional authority, with decisions from other jurisdictions attached.

The facts are undisputed. Level 3 is a Competitive Local Exchange Carrier that provides service exclusively, at this time, to Internet Service Providers. Qwest is an incumbent local exchange carrier. The interconnection agreement provision at issue in this matter deals with the financial responsibility of each party for direct trunk transport facilities ("DTTs") and related entrance facilities used to transport and exchange traffic between the companies. Level 3 and Qwest have agreed that when traffic reaches a certain level, DTTs will be used to carry the traffic. They have further agreed that the cost of those facilities will be based on the "relative use" of the facilities. The parties disagree, however, on whether ISP-bound traffic should be excluded from the relative use calculations.

As stated, Level 3's current business in Utah consists exclusively of servicing ISPs. Level 3 has a single point of interconnection ("POI") with Qwest servicing the entire state. The interconnection facilities in question are all on Qwest's side of the POI. Level 3 provides its ISP customers with local telephone numbers in various parts of the state. For example, a Qwest customer in Cedar City may call a local Cedar City number to reach an ISP serviced by Level 3. That call is then transported to the point of interconnection in Salt Lake and there delivered to Level 3. Unlike if this were a voice call to a Level 3 customer, there is no return traffic to Cedar City, in this example. The call is terminated at the ISP's facilities in Salt Lake or elsewhere and no return traffic to Cedar City will occur.

Since at the current time all traffic to Level 3 is ISP traffic, a decision on the issue of how relative use of the facilities should be calculated will determine who pays all of the costs of the interconnection facilities. If ISP traffic is included in the calculation of relative use, Qwest will pay 100% of the costs because its customers originate all of the traffic to the ISP's served by Level 3. If ISP traffic is not

included in relative use, Level 3 will pay all of the costs of these interconnection facilities.[(1)] Accordingly, Qwest proposes language that excludes ISP traffic from the calculation, and Level 3's proposes language including ISP traffic.

PARTY POSITIONS

Qwest argues that its language and position should be adopted for five reasons:

1. Adopting Level 3's position would result in Level 3 obtaining interconnection trunks for free. Such a result would violate requirements of the Telecommunications Act that Qwest receive just and reasonable compensation for providing interconnection to CLECs.

2. The *ISP Remand Order*[(2)] determined that ISP traffic is interstate and not subject to reciprocal compensation under section 251(b)(5) of the Act. Level 3's argument that it should obtain interconnection trunks without cost rests on reciprocal compensation rules. Qwest argues that for the same reason Internet traffic is excluded from reciprocal compensation, it should be excluded from relative use calculations for interconnection facilities.

3. The *ISP Remand Order* determined that since Internet traffic is interstate, treatment of Internet traffic is exclusively within the jurisdiction of section 201 of the Act. Qwest therefore argues that this Commission is without authority to order the parties to include Internet traffic in relative use calculations.

4. Qwest argues that including Internet traffic in relative use calculations would violate the same policy considerations that caused the FCC to reject payment of reciprocal compensation for Internet traffic. Qwest argues that including Internet traffic would (a) lead to improper subsidies and uneconomic pricing signals; (b) give Level 3 and other CLECs distorted incentives to serve ISP customers to the exclusion of other customers, and (c) improperly ignore the ability of Level 3 and other CLECs to collect the interconnection costs from their ISP customers.

5. Qwest argues that this issue has already been addressed in the Statement of Generally Available Terms and Conditions, or SGAT, proceeding in which its proposed language was adopted, nothing has changed since that time, and the language should therefore be adopted here.

In favor of the adoption of its language Level 3 argues:

1. The ISP Remand Order did not address the issue in dispute here.

2. FCC "rules of the road" permit Level 3 to interconnect with Qwest at a single point per LATA and require Qwest to deliver its traffic to that interconnection point. Qwest is therefore obligated to deliver all traffic, voice and Internet, to the POI at no cost to Level 3. Terminating compensation issues are separate, and Qwest's position attempts to confuse the issues of interconnection rights and obligations with terminating compensation issues. Qwest also ignores the plain language of FCC rules.

3. Qwest's argument that the adoption in the SGAT proceeding of the language Qwest proposes in this action should be rejected. Level 3 argues that no party challenged Qwest's SGAT language, and therefore this is the first opportunity for the Commission to address this issue.

DISCUSSION

This issue has been addressed in many other states, with conflicting results. Both parties have submitted decisions from various jurisdictions supporting their positions. The best that can be said is that this is not a settled issue. There is no definite FCC pronouncement on this issue at this time. We are left to determine which arguments are more persuasive and which outcome better promotes the public interest in Utah.

SGAT language: Qwest argues at some length that in the SGAT proceeding this Commission has already accepted the language proposed by Qwest in this docket. Qwest argues that nothing has changed since approval of the SGAT language, and therefore the Commission should adopt the same language here.

Level 3 states that this argument is meritless. Level 3 argues that the negotiation and arbitration process is distinguishable from the SGAT process, and that this Commission has the jurisdiction to arbitrate interconnection disputes. Level 3 argues that the SGAT is like a tariff that it or other carriers may adopt, but that it is still entitled to negotiate and arbitrate its own interconnection agreement based on its individual situation and priorites. Level 3 also argues that the Commission has not considered the lawfulness of Qwest's proposed language because in the SGAT proceeding no CLEC advocated that the language be changed.

We agree that the presence of Qwest's proposed language in its SGAT is not determinative. As Level 3 states, such a result "would make the negotiation and arbitration provisions superfluous." The issue is properly before the Commission for resolution at this time and based on the record in this proceeding, and that is how it will be decided.

FCC Jurisdiction: Qwest argues that in the *ISP Remand Order* the FCC ruled Internet traffic is within its exclusive jurisdiction. As a result, Qwest argues, state commissions are without authority to include Internet traffic in relative use calculations, including in this matter.

Level 3 makes a related, but more involved argument. Level 3 argues that there are two different obligations under the Telecommunications Act: the obligation to interconnect under Section 251(c)(2), and the obligation to pay terminating compensation under Section 251(b)(5). Level 3 argues that Qwest's interconnection obligation is to route and deliver traffic from Qwest customers to the POI, and absorb all costs in doing so. Level 3 further argues that the *ISP Remand Order* only modified compensation obligations, and not "other obligation[s]" such as interconnection. Level 3 therefore argues that unless the Commission decides that the costs at issue are an "interconnection" obligation not changed by the *ISP Remand Order* then this Commission lacks jurisdiction to resolve this dispute. In other words, Level 3 states that if this Commission does not agree with Level 3's position, it does not have jurisdiction to render any other decision.

The issue presented in this arbitration is the calculation of "relative use" for transportation facilities. We do not read the FCC's pronouncements about its jurisdiction over Internet traffic as barring this Commission from addressing that issue. The issue here is the calculation of charges for transportation facilities based on relative use, an issue that has not been addressed by the FCC. We will proceed to address that issue.

Obligations under the Telecommunications Act: Having dealt with the parties' jurisdictional and precedential arguments, we now turn to the merits. Section 251(d)(1) of the Act requires that rates for interconnection facilities be "just and reasonable" and based on the cost of providing the interconnection. An incumbent LEC is to recoup the interconnection costs from the competing carriers making the request. *Iowa Utilities Board v. FCC*, 120 F.3d 753, 810 (8th Cir. 1997), *aff'd in part, rev'd*

in part, remanded AT&T Corp. V. Iowa Utils Bd., 525 U.S. 366 (1999).

Level 3's proposed language would result in Qwest bearing all of the costs of the interconnection facilities. We agree with Qwest's assertion that such a result would violate the requirements under the Act; that ILECs receive just and reasonable compensation for interconnection. Level 3 paying nothing toward the interconnection facilities is not a just and reasonable rate.

In the *ISP Remand Order* decision, Internet-bound traffic was determined to be interstate access. As a result, the FCC has excluded Internet traffic from the reciprocal compensation requirements of section 251(b)(5). Level 3's argument relies on Rule 51.703(b), adopted pursuant to section 251(b)(5) and dealing with reciprocal compensation, and the *TSR Wireless*[(3)] decision applying that rule. That reliance is misplaced. The FCC has clearly stated on numerous occasions that the reciprocal compensation obligations of section 251(b)(5) do not apply to Internet traffic. The *TSR Wireless* decision, likewise, is not applicable. That decision dealt with local calls to one-way paging providers and the costs of facilities to carry those calls. The claims of *TSR Wireless* only dealt with local calls. The decision is not applicable to Internet-bound traffic. We agree with the reasoning of the U.S. District court in *Level 3 Communications, LLC vs. Public Utilities Commission of Colorado,* Civil Action No. 01-N-2455 (CBS), Colorado District, U.S. District Court, December 11, 2003, that 47 C.F.R. § 51.703(b) does not apply.

Many of the same policy considerations used in the reciprocal compensation are applicable to the issue presented here. In the *ISP Remand Order* the FCC found that the payment of reciprocal compensation for Internet traffic caused uneconomic subsidies and improperly created incentives for CLECs to specialize in serving ISPs to the exclusion of other customers.[(4)] The FCC noted that these improper incentives and market distortions are most apparent in Internet traffic because of the one-way nature of the traffic. The same considerations apply to the issue at hand. If Internet-bound traffic is not excluded from the relative use calculations, Level 3 would be allowed to shift all of the costs of the interconnection trunks to Qwest. Level 3 would then have strong incentive to continue to focus on serving ISPs to the exclusion of other customers. Just as these considerations caused the FCC to declare that Internet traffic is not subject to reciprocal compensation payments, they strongly favor the exclusion of ISP traffic from the relative use calculations at issue in this matter.

We will order the use of the language proposed by Qwest for the calculation of the relative use of the interconnection facilities.

Sub-issues: There are two related sub-issues raised by Level 3 in this arbitration. The first is the relative use factor to be used for the initial quarterly billing period. The contract provides for a relative use factor of 50% to be used until a new factor is agreed upon by the parties. Qwest proposes that when a new factor is established that bills should be retroactively adjusted for the initial billing quarter. Level 3 argues that any new relative use factor should be used prospectively only. We will adopt Level 3's position and order that the contract language be modified so that no true up will be made and new relative use factors will apply prospectively only.

The second sub-issue is whether the relative use factor should be used to apportion the nonrecurring installation charges for the transportation and interconnection facilities at issue. Qwest's proposal would cause Level 3 to pay all of the installation charges. Level 3 proposes that the charges be apportioned according to relative use. Qwest did not address this issue in its brief. As a matter of policy, however, the just and reasonable approach to these costs would be to apportion them using the relative use factor. We will therefore require that the contract language be modified accordingly.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED, that

1. All motions for leave to file additional authority are granted.

2. Qwest's proposed language regarding the calculation of relative use is adopted. The contract language regarding the two sub-issues shall be modified as set forth above.

3. The interconnection agreement, as modified herein, between Qwest Corporation and Level 3 Communications, LLC, is approved.

4. The parties shall submit an interconnection agreement reflecting the determinations in this order within 30 days.

Dated at Salt Lake City, Utah, this 20th day of February, 2004.

/s/ Doug Tingey
Administrative Law Judge

Approved and Confirmed this 20th day of February, 2004, as the Report and Order of the Public Service Commission of Utah.

/s/ Ric Campbell, Chairman

/s/ Constance B. White, Commissioner

/s/ Ted Boyer, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary

G#37166

1. The contract terms call for Level 3 to be billed for all of the cost of the interconnection facilities at issue, and for Qwest to issue Level 3 a credit for its portion of the relative use of the facilities. Therefore, if Internet-bound traffic is excluded from the calculation of relative use, Level 3 will receive no credit and will be responsible for the full cost of the facilities.

2. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, CC Dkt. Nos. 96-98 & 99-68, FCC 01-131, 2001 FCC LEXIS 2340 (rel. Apr. 27, 2001), *remanded, WorldCom, Inc. V. FCC*, 288 F.3d 429 ID.C. Cir. 2002).

3. *TSR Wireless , L.L.C., v. US West Communications, Inc.*, 15 FCC Rcd 11166, ¶ 3.

4. *ISP Remand Order*, ¶¶ 67-76.

Tab E

DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Petition of Level 3 Communications, LLC for Enforcement of the Interconnection Agreement Between Qwest and Level 3	))))	DOCKET NO. 05-2266-01 REPORT AND ORDER

ISSUED: August 18, 2005

SYNOPSIS

The Commission concludes the method of calculation of the relative use factor for direct trunk transport facilities under the parties' previous interconnection agreement for the period in dispute properly excludes Internet Service Provider-bound traffic. The Commission denies the Petition of Level 3 Communications, LLC, and grants Qwest Corporation's counterclaim while making no finding regarding the amount owed by Level 3 to Qwest.

By The Commission:

PROCEDURAL HISTORY

On June 23, 2005, Level 3 Communications, LLC ("Level 3"), filed a Petition for Enforcement of the Interconnection Agreement Between Qwest and Level 3 and Motion for Expedited Relief seeking Commission order finding that Level 3 is current in all payments owed to Qwest Corporation ("Qwest") for the period July 2002 through February 2004 (the "Dispute Period") and enjoining Qwest from taking various actions concerning Level 3's accounts. This petition was generated by Level 3's receipt of a letter from Qwest dated June 13, 2005, in which Qwest claimed Level 3 was in default of $563,616.79 in payments on its account and demanded payment on or before June 27, 2005. If payment was not received by this date, Qwest would take certain action with respect to Level 3's accounts, without further notice, including but not limited

to the suspension of all service order activity and eventual disconnection of services.

On June 24, 2004, pursuant to *Utah Code Annotated* ' 54-8b-17, the Commission issued a Notice of Prehearing Conference setting said conference for June 30, 2005. However, by agreement of the parties, the Commission canceled this conference by Notice issued on June 29, 2005, and issued a Scheduling Order on June 30, 2005, setting a hearing date of July 26, 2005.

On July 6, 2005, Qwest filed its Response to Level 3's Petition for Enforcement of Interconnection Agreement and Motion for Expedited Relief and Counterclaim Against Level 3 for Enforcement of Interconnection Agreement. By its Counterclaim, Qwest seeks Commission order declaring that, pursuant to the terms of the previous interconnection agreement between the parties, Level 3 owes Qwest the sum of $563,616.79, plus interest, for the provision of direct trunk transport ("DTT") facilities during the Dispute Period.

On July 14, 2005, Level 3 filed its Reply to Qwest Corporation's Counterclaim in which Level 3 denied Qwest's claim that the principal amount Level 3 might owe to Qwest for the use of DTT facilities during the Dispute Period is $563,616.99.

On July 15, 2005, Level 3 and Qwest submitted Position Statements in support of their competing claims. In its Position Statement, Qwest indicated that Level 3's Reply of July 14, 2005, was the first time that Level 3 had challenged the rate in Qwest's DTT facility billings as improper.

This matter was heard by the Administrative Law Judge on July 26, 2005. At hearing, Level 3 was represented by Gregory L. Rogers and William J. Evans. Qwest was

represented by Ted Smith and Robert Brown. Due to the nature of the parties' dispute, hearing was limited to oral argument, no evidence or testimony being offered by either party.

BACKGROUND

Level 3 is a certificated competitive local exchange carrier providing service primarily to Internet Service Providers ("ISPs") in Utah. Qwest is an incumbent local exchange carrier. On September 7, 2000, Level 3 and Qwest, pursuant to the Telecommunications Act of 1996 (the "Act"), entered into an interconnection agreement ("Old Agreement") which was approved by the Commission in Docket No. 00-049-88 on January 10, 2001. The record in that docket indicates the parties entered into this Old Agreement by virtue of Level 3 opting into an interconnection agreement between Qwest predecessor U.S. West Communications, Inc., and AT&T Communications of the Mountain States, Inc., approved by the Commission in Docket No. 96-087-03 on March 25, 1997.

To provide its services, Level 3 established a single Point of Interconnection ("POI") with Qwest in Salt Lake City, obtained local telephone numbers throughout the State of Utah through the North American Numbering Plan Administrator, and provided these numbers to its ISP customers. The ISP customers then provided these numbers to their dial-up customers (who were also Qwest local exchange service customers) so those customers could access the Internet. These locally dialed calls were then routed over Qwest's DTT facilities to Level 3's POI for delivery to Level 3's ISP customers.

Section 5.1.2.4 of Attachment 1 to the Old Agreement states:

> If the Parties' elect to establish two-way direct trunks, the compensation for such jointly used 'shared' facilities shall be

> adjusted as follows. The nominal compensation shall be pursuant to the rates for direct trunk transport in Appendix A. The actual rate paid to the provider of the direct trunk facility shall be reduced to reflect the provider's use of that facility. The adjustment in the direct trunk transport rate shall be a percentage that reflects the provider's relative use (i.e. originating minutes of use) of the facility in the busy hour.

This section contains the Old Agreement's only mention of a relative use factor ("RUF") respecting the rates to be paid for direct trunk transport. The term of the Old Agreement was as follows:

> This Agreement shall be effective upon Commission approval and shall remain in effect until June 26, 2001 and thereafter shall continue in force and effect unless and until a new agreement addressing all of the terms of this Agreement, becomes effective between the Parties. Either Party may request resolution of open issues in accordance with the provisions of Section 27 of this Part A of this Agreement, Dispute Resolution, beginning nine (9) months prior to the expiration of this Agreement. Any disputes regarding the terms and conditions of the new interconnection agreement shall be resolved in accordance with said Section 27 and the resulting agreement shall be submitted to the Commission. This Agreement shall remain in effect until a new interconnection agreement approved by the Commission has become effective.

When the Old Agreement expired on June 26, 2001, Level 3 and Qwest had not yet finalized negotiations on a new agreement ("New Agreement") so the parties' relationship continued to be governed by the terms of the Old Agreement. On August 7, 2002, in Docket No. 02-2266-02, Level 3 petitioned the Commission for arbitration of the New Agreement.

The sole provision at issue in that arbitration was Section 5.1.2.4 of Attachment 1, the same provision in the Old Agreement referred to *supra*. Level 3 and Qwest agreed that when traffic reached a certain level, DTTs would be used to carry the traffic. They further agreed that

the cost of those facilities would be based on the "relative use" of the facilities, with Level 3 being billed for all of the cost of the interconnection facilities at issue but Qwest issuing Level 3 a credit for its portion of the relative use of the facilities. The parties disagreed, however, on whether ISP-bound traffic should be excluded from the relative use calculations. In its Order in Docket No. 02-2266-02 ("2004 Order"), the Commission noted:

> Level 3's current business in Utah consists exclusively of servicing ISPs. Level 3 has a single point of interconnection ("POI") with Qwest servicing the entire state. The interconnection facilities in question are all on Qwest's side of the POI. Level 3 provides its ISP customers with local telephone numbers in various parts of the state. For example, a Qwest customer in Cedar City may call a local Cedar City number to reach an ISP serviced by Level 3. That call is then transported to the point of interconnection in Salt Lake and there delivered to Level 3. Unlike if this were a voice call to a Level 3 customer, there is no return traffic to Cedar City, in this example. The call is terminated at the ISP's facilities in Salt Lake or elsewhere and no return traffic to Cedar City will occur.
>
> Since at the current time all traffic to Level 3 is ISP traffic, a decision on the issue of how relative use of the facilities should be calculated will determine who pays all of the costs of the interconnection facilities. If ISP traffic is included in the calculation of relative use, Qwest will pay 100% of the costs because its customers originate all of the traffic to the ISP's served by Level 3. If ISP traffic is not included in relative use, Level 3 will pay all of the costs of these interconnection facilities. Accordingly, Qwest proposes language that excludes ISP traffic from the calculation, and Level 3's [sic] proposes language including ISP traffic.[1]

The Commission ultimately resolved this issue in Qwest's favor, noting:

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[1] 2004 Order at 2-3 (footnote omitted).

> Level 3's proposed language would result in Qwest bearing all of the costs of the interconnection facilities. We agree with Qwest's assertion that such a result would violate the requirements under the [Telecommunications Act of 1996, 47 U.S.C. '151 *et seq.*] that ILECs receive just and reasonable compensation for interconnection. Level 3 paying nothing toward the interconnection facilities is not a just and reasonable rate.[2]

Thus, while the Old Agreement was silent on the issue of whether ISP-bound traffic was included in the calculation of the relative use factor for DTT billing, the New Agreement specifically excludes such traffic from this calculation. Qwest, citing the 2004 Order, now seeks to exclude ISP-bound traffic from relative use calculations during the Dispute Period.[3]

DISCUSSION

A. Level 3's Position

Level 3 argues that the Commission's decision in Docket No. 02-2266-02 may not be applied retroactively to modify the relative use calculations provided for under the Old

---

[2] *Id* at 7. A sub-issue in Docket No. 02-2266-02 which Level 3 cites in support of its current position concerned which RUF should be used for the initial quarterly billing period under the New Agreement. Qwest proposed that when a new factor was established bills should be retroactively adjusted for the initial billing quarter. Level 3 argued that any new RUF should be used prospectively only. The Commission adopted Level 3's position, ordering language prohibiting true up and mandating that new relative use factors apply prospectively only.

[3] In October 2002, the parties reached a global settlement of a number of past billing issues for all amounts in dispute between the parties through June 30, 2002. Hence, the Dispute Period begins on July 1, 2002, and continues through February 2004 to the effective date of the New Agreement.

Agreement. In support of this position, Level 3 notes the Commission determined in Docket No. 02-2266-02 that the new RUF calculated following the first quarter of activity under the New Agreement would not be applied retroactively to that quarter. Level 3 reads this decision as a determination that the method of calculating the RUF adopted in the New Agreement should only be applied prospectively.

Level 3 also argues that the Old Agreement is a contract, that the plain language of Section 5.1.2.4 of Attachment 1 to that contract makes no mention of excluding ISP-bound traffic from RUF calculations, and that it would now be improper for the Commission to add such exclusionary terms to this provision. In Level 3's view, the plain meaning of this section is that the calculation of relative use under the Old Agreement was to reflect all of the originating minutes of use on the trunks without exception. Because Qwest end-users originated all of the traffic in question and because the Old Agreement provided for no exclusion of ISP-bound traffic, Qwest has no basis under the Old Agreement to charge Level 3 for DTT facilities.

B. Qwest's Position

Qwest, on the other hand, relies on the Commission's conclusion in Docket No. 02-2266-02 that including ISP-bound traffic in RUF calculations would violate the requirements of the Act by precluding Qwest from receiving just and reasonable compensation for interconnection. Qwest argues the Commission must apply this same reasoning to the provision of DTT facilities during the Dispute Period; that to do otherwise would contradict the Commission's own conclusions in Docket No. 02-2266-02 and violate the Act by requiring Qwest to provide DTT facilities to Level 3 at its own expense.

In the alternative, Qwest attempts to redefine the traffic it carries on its DTT facilities for Level 3 by arguing that Qwest customers who place local calls on Qwest's network in order to connect to their ISP are not placing those calls as Qwest customers but as ISP customers and, by extension, Level 3 customers. Viewed in this light, the traffic on the DTT facility is attributable to Level 3 for purposes of relative use factor calculation, resulting in the payments Qwest seeks in its counterclaim.

Finally, Qwest notes the parties amended the Old Agreement several times, including the Single Point of Presence ("SPOP") Amendment approved August 21, 2002, which allowed Level 3 to connect to Qwest as a single POI in Salt Lake City, and the Internet Service Provider Amendment approved January 8, 2003, which was intended to deal with reciprocal compensation for ISP traffic after the FCC issued its *ISP Remand Order*[4] on that issue. Paragraph 1.3.1 of the SPOP Amendment required Level 3 to order one or more direct trunk groups from Qwest when traffic volume reached a certain level. Level 3, having placed such orders, Qwest began billing Level 3 on a monthly basis for the cost of these DTT facilities, resulting in the disputed bills at issue in this docket.

FINDINGS AND CONCLUSIONS OF LAW

We do not agree with Level 3's characterization that it would be improper for this Commission to "add language" to the Old Agreement by excluding ISP-bound traffic from the RUF calculation. This Commission is routinely asked to interpret disputed terms between parties

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[4]Order on Remand, *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, 16 FCCR 9151 (2001)

in order to produce a just and reasonable result in accordance with applicable law and regulation. This case is no different.

In Docket No. 02-2266-02, we recognized the applicability to the issue of relative use of the FCC's reasoning in its *ISP Remand Order* regarding reciprocal compensation:

> Many of the same policy considerations used in the reciprocal compensation [sic] are applicable to the issue presented here. In the *ISP Remand Order* the FCC found that the payment of reciprocal compensation for Internet traffic caused uneconomic subsidies and improperly created incentives for CLECs to specialize in serving ISPs to the exclusion of other customers. The FCC noted that these improper incentives and market distortions are most apparent in Internet traffic because of the one-way nature of the traffic. The same considerations apply to the issue at hand. If Internet-bound traffic is not excluded from the relative use calculations, Level 3 would be allowed to shift all of the costs of the interconnection trunks to Qwest. Level 3 would then have strong incentive to continue to focus on serving ISPs to the exclusion of other customers. Just as these considerations caused the FCC to declare that Internet traffic is not subject to reciprocal compensation payments, they strongly favor the exclusion of ISP traffic from the relative use calculations at issue in this matter.[5]

We do not look to Docket No. 02-2266-02 as controlling precedent in deciding the matter now before us, but we do recognize that the rationale behind our 2004 Order is equally applicable to the parties' current dispute both because the issue now before us is identical to the issue in Docket No. 02-2266-02 and because the release of the *ISP Remand Order* predates the start of the Dispute Period by more than a year. We view the *ISP Remand Order* as illuminating the

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[5] 2004 Order at p. 8 (citing *ISP Remand Order*, && 67-76)

proper meaning of Section 5.1.2.4 of Attachment 1 to the Old Agreement. It would therefore be unreasonable for this Commission to ignore such guidance in rendering a decision.

As we recognized in Docket No. 02-2266-02, any interpretation of Section 5.1.2.4 of Attachment 1, whether in the New Agreement or in the Old Agreement, must accord with the Section 251(d)(1) requirement of the Act that rates for interconnection of facilities be just and reasonable. No one disputes that including ISP-bound traffic in the RUF calculation under the Old Agreement would result in Qwest bearing all of the cost of the DTT facilities. We cannot conclude that such a result would equate to just and reasonable compensation for Qwest. We therefore conclude that the only proper reading of Section 5.1.2.4 of Attachment 1 to the Old Agreement excludes ISP-bound traffic from the RUF calculation in determining the parties' respective payment obligations for DTT facilities provided during the Dispute Period.

We note, however, that the issue of how much Level 3 might owe Qwest if ISP-bound traffic is excluded from relative use calculations was raised relatively late in these proceedings. Qwest appears to stand by the figure of $563,616.99 contained in its Counterclaim. Level 3 disputes this amount but offered no evidence concerning what it believes the correct amount to be. The Commission therefore makes no finding on this issue.

Therefore, based upon the foregoing information, and for good cause appearing, the Administrative Law Judge enters the following proposed:

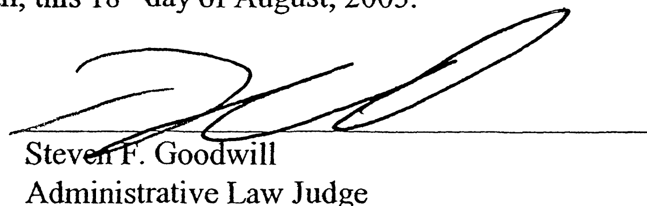
ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. The Petition of LEVEL 3 COMMUNICATIONS, LLC, is denied. QWEST CORPORATION'S Counterclaim is granted in part to the extent that the Commission concludes ISP-bound traffic is properly excluded from calculation of the relative use factor for direct trunk transport facilities during the Dispute Period. The Commission enters no order respecting the amount owed to Qwest by Level 3 for direct trunk transport facilities provided by Qwest during the Dispute Period.

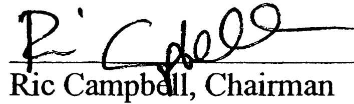
2. Pursuant to *Utah Code Annotated* " 63-46b-12 and 54-7-15, agency review or rehearing of this order may be obtained by filing a request for review or rehearing with the Commission within 30 days after the issuance of the order. Responses to a request for agency review or rehearing must be filed within 15 days of the filing of the request for review or rehearing. If the Commission fails to grant a request for review or rehearing within 20 days after the filing of a request for review or rehearing, it is deemed denied. Judicial review of the Commission's final agency action may be obtained by filing a Petition for Review with the Utah Supreme Court within 30 days after final agency action. Any Petition for Review must comply with the requirements of *Utah Code Annotated* " 63-46b-14, 63-46b-16 and the Utah Rules of Appellate Procedure.

Dated at Salt Lake City, Utah, this 18th day of August, 2005.



Steven F. Goodwill
Administrative Law Judge

Approved and Confirmed this 18th day of August, 2005, as the Report and Order of the Public Service Commission of Utah.

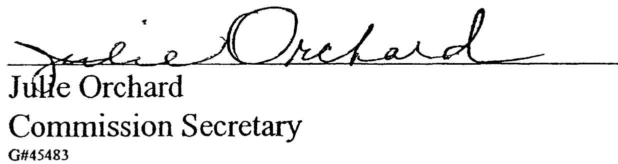


Ric Campbell, Chairman

Ted Boyer, Commissioner

Ron Allen, Commissioner

Attest:



Julie Orchard
Commission Secretary
G#45483

Tab F

Before the
Federal Communications Commission
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

[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).

remanded the issue for further consideration.[4] As explained in more detail below, we modify the analysis that led to our 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.

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

[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.*

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 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

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[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).

for ISP-bound traffic.[9] Moreover, the traffic imbalances for some competitive carriers are in fact much greater, with several carriers 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

[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.

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

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:

* 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

[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.

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 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

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[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 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.

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 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

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[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.

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

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

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 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

[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.

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

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.

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

[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).

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 federal statutory provision authorizing reciprocal compensation.[46] In the *Declaratory Ruling,* the Commission

[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.")

[46] 47 U.S.C. § 251(b)(5).

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 251(b)(5) traffic in the *Declaratory Ruling*, the

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

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

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

[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.

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.

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]

[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.

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, 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]

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[57] 47 U.S.C. § 251(b)(5).

[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.").

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 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

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[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).

[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*).

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).

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).

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[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.

[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 (continued....)

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 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

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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).

[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 (continued....)

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 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

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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.

[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.

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 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

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[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.

[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.

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 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

[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.

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

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 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

[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*.

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

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

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[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)

compensation mechanisms for traffic 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

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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*).

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 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

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

[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.

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 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]

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[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.

[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 (continued....)

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. 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

(Continued from previous page)
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 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.

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 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

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[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.

[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).

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 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

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

[120] *Id.* at 1620.

[121] *Id.* at 1621.

[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).

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 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.

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[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.

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 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

[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.

[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").

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 payments.[134] Indeed, some ISPs even seek to become CLECs in order to share in the reciprocal compensation windfall, and, for a small

[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).

[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).

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 lacks the same opportunity for cost-shifting that reciprocal compensation provides with respect to serving customers with

[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.

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

[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.").

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 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.

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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.

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, 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

[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.

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, 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

[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 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)).

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 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)

[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.

[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 (continued....)

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 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

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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.

[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 (continued....)

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 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

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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. *See* 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. *See* 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 & 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.

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 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

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[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.

[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.

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 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]

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[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).

[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).

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.

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]

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[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.

[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 (continued....)

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 longer than average duration can be eliminated through adoption of rate structures that provide

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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.

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

[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).

telephone numbers."[194] CLECs respond, however, that they are in fact 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

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[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, 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.

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 *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]

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[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.

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 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

[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).

[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.

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 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

[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.

[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.

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 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]

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[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.

[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*).

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.

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.

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[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).

[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).

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 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.

[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.

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]

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

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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).

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.**

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(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

[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."

which the Commission directly addressed the question whether section 251(g) serves as such a "carve-out," the 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)

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).

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 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

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[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).

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 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

[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*").

[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.").

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 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 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.

[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.