

# Competition, Reciprocal Compensation, and Internet-Bound Traffic: Issues and Policy Responses

September 2000



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# Competition, Reciprocal Compensation, and Internet-Bound Traffic: Issues and Policy Responses

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## Introduction<sup>1</sup>

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Virtually since the Telecommunications Act of 1996 (the “1996 Act”) was passed, which added to the Communications Act the duty to establish reciprocal compensation “for the transport and termination of telecommunications,” questions have been raised about the treatment of traffic directed to the Internet and Internet Service Providers (ISPs). For instance, should traffic bound for ISPs be treated differently than other traffic? Should there be a different rate for compensating carriers that transport this traffic or any compensation at all? What about interconnection agreements that are silent as to the treatment of Internet-bound traffic—should carriers be able to collect or not? Similarly, there are questions as to whether traffic headed for the Internet and ISPs is local, under the aegis of state public utility commissions (PUCs), or interstate, subject to the jurisdiction of the Federal Communications Commission (FCC)?

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<sup>1</sup> Special acknowledgment and appreciation should be given to Simone V. Davis for her enormous efforts and assistance in preparing this White Paper.

These questions and a host of others are at the heart of the debate that is now swirling around the issue of reciprocal compensation for ISP-bound traffic. Regulators, lawmakers, and affected industry players have been staking out their positions through arbitrations, negotiations, court rulings, and regulatory proceedings at the state and federal levels. Congress is now actively considering legislation to address these issues. Certainly, the stakes are high. Not only are current and expected reciprocal compensation payments a bottom line financial issue for affected incumbent local exchange carriers (ILECs) and competitive local exchange carriers (CLECs), the resolution of the issue could potentially affect the pricing structure of all Internet traffic, including the rates that ISPs, and ultimately, their customers pay. Moreover, depending upon how the questions are answered, the relative role of the states and the federal government will be defined, potentially affecting rules, regulations, and policies far beyond the narrow issue of reciprocal compensation.

This White Paper examines recent state and federal rulings regarding the application of reciprocal compensation to traffic bound for the Internet and details the variety of responses that have been pursued. After a brief background and overview, the White Paper describes the actions of key players: the FCC, the states, the courts, and the Congress. We stress that while the resolution of the issue is uncertain, the White Paper is designed to provide readers with sufficient information to understand the parties, policies, and politics of the issue and allow a thoughtful debate that will look past simplistic rhetoric. Although the White Paper does not draw specific conclusions as to many of the questions that have been posed (for example, should traffic be considered to “terminate” if the end user visits only the ISP’s homepage versus a website in another state?), it does offer some observations on the state of the debate. First, concerns about scores of companies abusing the 1996 Act are largely overstated, with only isolated instances of bad actors and regulatory arbitrage. Second, the issue cannot be considered in a vacuum as it necessarily implicates the larger issue of compensation between carriers. And perhaps most significantly, even while the debate has grown, carriers and regulators have been moving forward, creating market-based solutions that allow all affected to pursue the overarching goals of the 1996 Act: robust telecommunications competition and a vibrant, flourishing Internet.

## **Background**

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### **The 1996 Act: Duty to Establish Reciprocal Compensation**

The landmark Telecommunications Act of 1996 was designed to create a new and comprehensive framework for a pro-competitive, deregulatory telecommunications landscape where consumers would reap the benefits of

lower prices, improved service quality, advanced service deployment, and innovation. No longer would one or at most two carriers offer telecommunications services; instead, a thousand flowers would bloom and competition would flourish, especially local and long-distance wireline services. To this end, Section 251 of the 1996 Act establishes certain basic obligations for telecommunications carriers and local exchange providers. These include the duty to interconnect, the duty to provide services at resale, local number portability, dialing parity, and access to rights of way.<sup>2</sup> Of particular relevance here, Section 251(b)(5) also requires local exchange carriers “to establish reciprocal compensation arrangements for the transport and termination of telecommunications.”<sup>3</sup>

### The FCC's Interpretation of Section 251(b)(5)

Generally, the 1996 Act and the FCC's interpretation of Section 251(b)(5) has required local exchange carriers (LECs) to pay a per-minute rate when traffic is terminated on another carrier's network. For instance, if a customer of Hello Telephone Company calls a customer of Goodbye Telephone Company, Hello will pay Goodbye a specified rate of compensation, say in the range of a half cent per-minute. Similarly, if a customer of Goodbye calls a customer of Hello, Goodbye will pay the per-minute compensation rate. In its August 1996 First Report and Order on Local Competition (*First Report and Order*), the FCC determined that this reciprocal compensation obligation of Section 251(b)(5) should only apply to local traffic.<sup>4</sup> The FCC, at that time unaware of the looming issue concerning traffic headed for ISPs, reasoned that because its access charge ruling dealt with the costs associated with transporting and terminating long-distance access service, reciprocal compensation logically only applied to the transport and termination of local traffic.<sup>5</sup>

Significantly, when the FCC sought public comment on how it should implement Section 251(b)(5), the ILECs largely supported the symmetric and per-minute form of reciprocal compensation that the FCC adopted, opposing generally the “bill and keep” method of reciprocal compensation, whereby each carrier would essentially bill its own cost and keep its own revenues.<sup>6</sup> The FCC essentially agreed. Indeed, the ILECs typically argued for

<sup>2</sup> 47 U.S.C. § 251(b). “Interconnection” refers to the linking of two networks for the mutual exchange of traffic (47 CFR § 51.5). “Local Number Parity” allows a residential customer to change telephone vendors yet maintain the same telephone number. “Dialing Parity” permits local “Bell” companies to offer long distance services once they satisfy certain conditions related to competition in areas they monopolize.

<sup>3</sup> See 47 U.S.C. § 251(b)(5).

<sup>4</sup> See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 and *Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185, *First Report and Order*, 11 FCC Rcd. 15499, ¶ 1033 (1996) (“*First Report and Order*”).

<sup>5</sup> See *id.* at ¶ 1034.

relatively high compensation rates—which many parties argued were above costs—apparently believing they would naturally terminate more traffic than their competitors and thus, would be the beneficiaries of these rates. In fact, in some contexts, such as for wireless traffic, ILECs were (and remain today) far more often the recipients rather than the payers of the per-minute reciprocal compensation fees. As it has evolved, however, it has become clear that the ILECs miscalculated and did not factor in their arguments the rapid growth of the Internet, the increase in traffic bound for ISPs, and the demand for alternative, competitive services by ISPs.

### **The Genesis of the Controversy: Interconnection Agreements**

As contemplated by the 1996 Act, ILECs and CLECs almost immediately began in earnest their efforts to negotiate and reach interconnection agreements concerning the manner in which they would interconnect, use their respective networks and compensate each other for their costs. That being said, while both ILECs and CLECs were generally aware of ISPs and the functions they performed, most of these early interconnection agreements did not differentiate between traffic that might be directed to ISPs, which had as a legal matter been treated as if it were “local” for many years, and other local traffic. Indeed, from the perspective of the network, both classes of traffic involved the use of local dialing patterns, most often a seven-digit telephone number. Only when CLECs began to demand payment for ISP-bound traffic did the issue become glaringly apparent. Complaints were raised in state arbitrations (pursuant to Section 252 of the 1996 Act), federal District Courts and at the FCC and the dispute began in earnest. ILECs argued that ISP-bound traffic was not “local” and did not terminate within the meaning of Section 251(b)(5) and CLECs argued that ISP traffic was just like local traffic and has been consistently treated as such, regulated by the states.

### **Where We Stand**

Since that time, a majority of the state PUCs have addressed the issue, as have the FCC and numerous federal courts. As it stands, the debate over reciprocal compensation focuses on a few key issues:

1. Is ISP-bound traffic jurisdictionally local or interstate?;
2. Do current reciprocal compensation rates reflect the true costs of terminating traffic directed to ISPs?; and

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<sup>6</sup> See *Reciprocal Compensation Adjustment Act: Hearing on H.R. 4445 Before the Subcomm. on Telecomm., Trade, and Consumer Protection of the House Comm. On Commerce*, 106<sup>th</sup> Cong. (2000) (statement of Robert Taylor, Chairman, Association for Local Telecommunications Carriers (“ALTS”) and CEO, Focal Communications).

3. Should ISP traffic be treated differently than other traffic that may have similar or identical characteristics? As discussed below, the FCC, state regulators, and Congress have all attempted to answer these inquiries, but to date no resolution has been reached.

## Federal Responses

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Currently, while there is no FCC rule governing inter-carrier compensation for ISP-bound traffic (the term “inter-carrier compensation” is preferred by the FCC rather than “reciprocal compensation”), the FCC has addressed the issue on several occasions, both directly and indirectly. Not only has the FCC issued a Declaratory Ruling on the issue of whether ISP-bound traffic is subject to the provisions of Section 251(b)(5), it is engaged in an ongoing rule-making that has generated hundreds of pages of public comments. Moreover, the FCC is now weighing as well the opinion of the United States Court of Appeals for the District of Columbia Circuit, who remanded the issue back to the agency.

### Federal Communications Commission: Actions and Further Actions

#### *Early Response*

When the initial disputes arose, the FCC was not generally the forum where parties argued their respective positions. Indeed, although the FCC was provided with anecdotal information regarding interconnection disputes over ISP-bound traffic and reciprocal compensation payments, as well as a Petition for a Declaratory Ruling,<sup>7</sup> it generally allowed states and the relevant courts reviewing state decisions to determine the interpretation of the particular disputed interconnection agreements.

Indeed, even where the FCC had occasion to opine about the jurisdictional nature of traffic destined for ISPs and the Internet, it carefully avoided addressing the issue as it implicated reciprocal compensation. Thus, in October 1998, the FCC held that GTE’s ADSL Internet Access Service, designed to offer high-speed connections to the Internet through a dedicated connection, was interstate and should be tariffed and regulated at the federal level.<sup>8</sup> There, the FCC referenced its previous decisions regarding dedicated “spe-

<sup>7</sup> Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53,922 (1996); 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).

<sup>8</sup> See *In the Matter of GTE Tel. Op. Co.s, Memorandum Opinion and Order*, 13 FCC Rcd 22466, ¶ 1 (1998).

cial access” lines stating that access lines carrying more than ten percent interstate traffic are tariffed at the federal level while those carrying less than ten percent are tariffed at the state level.<sup>9</sup> The FCC was careful, however, to emphasize that this decision did not determine the nature of ISP-bound traffic when it travels over traditional circuit-switched telephone lines (i.e., via the typical dial-up connections offered by ISPs) and clearly stated that this “interstate” classification could not be used in the context of a reciprocal compensation discussion.<sup>10</sup>

### *February 1999 Declaratory Ruling and Notice of Proposed Rulemaking*

Four months later, the FCC issued a **Declaratory Ruling** (Declaratory Ruling or Ruling) and a **Notice of Proposed Rulemaking (NPRM)** in response to growing pressure from ILECs, CLECs, state regulators and others.<sup>11</sup> Thus, in February 1999, the FCC issued its first ruling on the issue, holding that ISP-bound calls are not local calls subject to reciprocal compensation under Section 251(b)(5) of the Communications Act. Instead, the FCC held that:

- ▶ ISP-bound traffic should be characterized as “a continuous transmission from the end user to a distant Internet site.” Applying an end-to-end analysis, the FCC concluded that end-user “calls” do not terminate at the ISP’s local server, but rather end at servers holding websites which often are located in other states.<sup>12</sup>
- ▶ Although ISP-bound traffic is largely interstate, ISPs are still considered end users and are not subject to interexchange carrier access charges.<sup>13</sup>
- ▶ Until a permanent rule is adopted, state utility commissions are directed to enforce reciprocal compensation provisions in current interconnection agreements.<sup>14</sup>

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<sup>9</sup> See *id.* at ¶ 25.

<sup>10</sup> See *id.*

<sup>11</sup> See *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Inter-Carrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98 and 99-68, **Declaratory Ruling and Notice of Proposed Rulemaking**, 14 FCC Rcd 3689 (1999) (**Declaratory Ruling**).

<sup>12</sup> See *id.*

<sup>13</sup> See *id.* at ¶ 17.

<sup>14</sup> See *id.* at ¶ 24. The FCC recommended several factors for state commissions to consider in determining whether reciprocal compensation applies: whether ILECs serve ISPs out of interstate or intrastate tariffs; whether ILECs treat revenues as interstate or intrastate; whether ILECs make efforts to meter or segregate ISP-bound traffic; whether ILECs who bill message units have included ISP-bound traffic in the bills; whether ILECs have included calls to ISPs in local telephone charges; and whether ILECs and CLECs would be compensated if the traffic were not treated as local subject to reciprocal compensation.

In a companion Notice of Proposed Rulemaking, the FCC sought comment and proposals on federal rules for inter-carrier compensation of ISP-bound traffic so that the appropriate mechanism for fairly compensating carriers could be determined. In the NPRM, the FCC:

- ▶ Noted its preference for commercial negotiations and further suggested that market-driven negotiation processes would likely produce more efficient results than would regulation.<sup>15</sup> As an alternative, the FCC proposed to adopt federal rules to govern the parties as they negotiate inter-carrier compensation for ISP-bound reciprocal. In this regard, the FCC asked how disputes would be resolved, such as an FCC arbitration-like process, and asked for comment on an appropriate costing methodology.
- ▶ In addition, the FCC sought comment on the impact of the “most favored nation” (MFN) provisions whereby some state regulators have permitted CLECs to avail themselves of previously negotiated interconnection agreements, such that the ability to renegotiate might be affected.<sup>16</sup>
- ▶ Finally, the FCC asked how intrastate ISP-bound traffic should be treated, including whether it was too difficult to separate interstate from intrastate ISP-bound traffic and sought comment on the implications of its decision for jurisdictional separations purposes.

As noted below, as a result of the Declaratory Ruling, state PUCs that had previously addressed the issue were often called upon to examine their earlier decisions. As expected, the FCC’s decision was the subject of an immediate appeal.

### *U.S. Court of Appeals (D.C. Circuit) Remand*

On March 24, 2000, the D.C. Circuit vacated portions of the Declaratory Ruling, and remanded the matter for further FCC consideration.<sup>17</sup> The court held that the FCC had not adequately explained why ISP-bound traffic does not “terminate” at the ISP’s local office, nor why, within the definitions of the 1996 Act, such traffic is considered “exchange access” rather than “telephone exchange service.”

- ▶ According to the Court, the FCC did not explain why its end-to-end analysis was employed to establish the “termination” point of ISP-bound traffic. The Court stated that traditionally, the FCC has reserved this test for establishing whether traffic was jurisdictionally interstate. In this case, stated the Court, the FCC applied it to the question of whether dial-up calls to ISPs are “local” for reciprocal compensation purposes.

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<sup>15</sup> See *id.* at ¶¶ 28–29.

<sup>16</sup> See *id.* at ¶ 35.

<sup>17</sup> See generally, *Bell Atl. Tel. Companies v. FCC*, 206 F.3d 1 (D.C. Cir. 2000).

- ▶ Further, the Court determined that the FCC had not explained how its characterization of ISP-bound traffic as non-local traffic answered the question of whether such traffic is either “exchange access” or “telephone exchange service.”<sup>18</sup> The classification is important not only because if traffic is “telephone exchange service” then it is “local” and subject to reciprocal compensation, but because other rights and obligations attach.
- ▶ Finally, the Court noted that the FCC treats ISPs as end users rather than as long-distance carriers, and stated that therefore, the FCC cannot now proclaim that ISP traffic is analogous to long distance traffic without providing an explanation.<sup>19</sup>

### *Current Status*

On June 23, 2000, the FCC issued a **Public Notice** seeking comment on the D.C. Circuit’s Remand order. In particular, the FCC sought comment on: (1) the jurisdictional nature of ISP-bound traffic, including the scope of the reciprocal compensation requirement of section 251(b)(5) of the 1996 Act; (2) the relevance of the concepts of “termination,” “telephone exchange service,” “exchange access service,” and “information access”; (3) any ex parte presentations in the pending rulemaking proceeding filed after the April 27, 1999 reply period; and (4) any new or innovative inter-carrier compensation arrangements for ISP-bound traffic that parties may be considering or may have entered into during the pendency of the proceeding.<sup>20</sup>

Comments essentially reiterated previously argued positions:

- ▶ **State PUCs** generally argued that ISP-bound traffic is “local” and subject to reciprocal compensation.<sup>21</sup> Some states, such as New York and Texas, further suggested that the Commission adopt a threshold ratio scheme whereby only traffic terminated below a certain ratio would be compensated.<sup>22</sup>
- ▶ The **incumbent LECs**, on the other hand, maintained that Internet connections are jurisdictionally interstate because a connection to the Internet does not occur until the customer accesses a website which is often located out-of-state.<sup>23</sup> In addition, some ILECs claimed that since the costs of serving ISPs are significantly lower than the costs associated with voice traffic, CLECs are receiving an unjust and imbalanced advantage.<sup>24</sup> In-

<sup>18</sup> See 47 U.S.C. §§ 153(16) and (47). “Exchange access” is defined as the transport of interexchange communications (e.g., long-distance), whereas “telephone exchange service” refers to the transport of traffic within the same exchange area.

<sup>19</sup> See *Bell Atlantic*, 206 F.3d at 7.

<sup>20</sup> See *Public Notice: Comment Sought on Remand of the Commission’s Reciprocal Compensation Declaratory Ruling by the U.S. Court of Appeals for the D.C. Circuit*, FCC 00-227, at 2 (rel. June 23, 2000).

<sup>21</sup> See e.g., comments filed by the California Public Utilities Commission 4-5.

<sup>22</sup> See comments filed by New York (2) and Texas (5-6).

<sup>23</sup> See generally comments filed by SBC, Verizon, and Qwest.



stead, they urged the FCC to implement the “bill and keep” scheme in which no payments would be made for terminating traffic.

- ▶ **Competitive LECs**, such as Sprint, Worldcom, and Time Warner Telecom continued to assert that ISP-bound traffic is local and is “telephone exchange” service.<sup>25</sup> Some CLECs, however, did agree that the ratio mechanism proposed by the New York and Texas PUCs may be the most equitable solution.<sup>26</sup>
- ▶ Finally, some **consumer and public interest groups** argued that as a matter of public policy, reciprocal compensation is stifling the expansion of residential services and is inconsistent with the goals of the 1996 Act to increase local competition.<sup>27</sup> They urged the FCC to eradicate reciprocal compensation with respect to ISP-bound traffic.

In the absence of a definitive FCC rule, states have continuing jurisdiction under the Declaratory Ruling in resolving reciprocal compensation disputes.

### Congressional Activity

While the FCC struggled to establish the limits of inter-carrier compensation and its relationship to traffic bound for ISPs and the Internet, Congress began to formulate its own response to growing complaints, largely from ILECs who urge that they are unfairly paying large sums of money to competitors. In the spring of 2000, H.R. 4445, the Reciprocal Compensation Adjustment Act of 2000 was introduced in the House Commerce Committee’s Subcommittee on Telecommunications, Trade, and Consumer Protection. Similarly, S. 2902, the Broadband Internet Regulatory Relief Act of 2000 was recently revised by the Senate Committee on Commerce, Science, and Transportation to include a provision that seeks to eliminate inter-carrier compensation for calls directed to ISPs. Indeed, numerous members of Congress have weighed in on the issue, with letters and statements directed at the FCC.

### *Reciprocal Compensation Adjustment Act of 2000*<sup>28</sup>

On May 15, 2000 Rep. Billy Tauzin (R-La.) along with co-sponsors Reps. Tom Bliley (R-Va.), Rick Boucher (D-Va.), and John Dingell (D-Mich.) introduced H.R. 4445, a measure that would amend section 251(b)(5) to prohibit reciprocal compensation payments for “the transport and termination of telecommunications to the Internet or any provider of Internet

<sup>24</sup> See e.g., comments filed by BellSouth (12-15).

<sup>25</sup> See generally, comments filed by Sprint, WorldCom, and Time Warner Telecom.

<sup>26</sup> See e.g., comments filed by Focal and Cablevision Lightpath.

<sup>27</sup> See generally, comments filed by the National Consumers League and the Alliance for Public Television.

<sup>28</sup> H.R. 4445, 106<sup>th</sup> Cong. (2000).

access service.” The bill determines that dial-up calls to ISPs are interstate and not subject to reciprocal compensation; however, the legislation would not affect current interconnection agreements. A subcommittee hearing was held on June 22, 2000, which elicited testimony from incumbent LECs, competitive LECs, state public utility commissions, Internet service providers and others.<sup>29</sup>

Not surprisingly, most **incumbent LECs** support H.R. 4445 and the eradication of reciprocal compensation payments for ISP-bound traffic. They charge that reciprocal compensation disproportionately costs them billions of dollars each year. ILECs warn that if the FCC or Congress does not fix the problem, they will be forced to pass the compensation costs onto their customers who use the Internet or force all customers to subsidize the costs.<sup>30</sup> ILECs also contend that reciprocal compensation for the termination of ISP-bound traffic is anti-competitive. Because CLECs are gaining significant revenue through the ISP loophole, they urge that many no longer solicit residential customers. Consequently, maintain the ILECs, there is no competition in the residential market and thus no incentive for ILECs to deploy new and improved services.

The primary argument of **competitive LECs** is that the Reciprocal Compensation Adjustment Act unfairly prohibits *all* compensation for the termination of calls to ISPs.<sup>31</sup> They argue that there are real costs incurred in terminating traffic and if ILECs are unwilling to finance the expense, they will be forced to pass it along to ISP customers who will in turn pass it onto their customers. Significantly, despite their position, some CLECs have stated that they recognize lower payments may more accurately reflect costs. Indeed, as the first generation of interconnection agreements expire, newly negotiated contracts have produced significantly lower per minute rates. Focal Communications, for example, noted that rates for transmission between them and Bell Atlantic have dropped more than 10%.<sup>32</sup>

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<sup>29</sup> Among those testifying: Lawrence Strickling, Chief of the FCC’s Common Carrier Bureau; Thomas Tauke, Executive Vice President of External Affairs and Corporate Communications for Bell Atlantic, and Chairman for the United States Telecom Association; Joan Smith, Oregon Public Utility Commissioner, and Chair of NARUC Telecommunications Committee; Jay Blossman, Louisiana Public Service Commissioner; Eric Stuminger, Managing Director of Research for Paine Webber; Chad Kissinger, On Ramp Access, Inc. President; and Bob Taylor, Chairman of the Association for Local Telecommunications Services, and CEO of Focal Communications.

<sup>30</sup> See *Reciprocal Compensation Adjustment Act: Hearing on H.R. 4445 Before the Subcomm. on Telecomm., Trade, and Consumer Protection of the House Comm. On Commerce*, 106<sup>th</sup> Cong. (2000) (statement of Thomas Tauke, Executive Vice President of External Affairs and Corporate Communications, Bell Atlantic) (testifying that Bell Atlantic spends approximately \$60 million per month in reciprocal compensation, without comparable payments from CLECs).

<sup>31</sup> See *Reciprocal Compensation Adjustment Act: Hearing on H.R. 4445 Before the Subcomm. on Telecomm., Trade, and Consumer Protection of the House Comm. On Commerce*, 106<sup>th</sup> Cong. (2000) (statement of Robert Taylor, Chairman, ALTS and CEO, Focal Communications).

<sup>32</sup> See *id.*

Many **state regulators** also oppose the bill because it would undermine their ability to arbitrate disputes as provided by the 1996 Act. Currently, thirty-eight states have commenced proceedings on reciprocal compensation, and most state commissions better understand local competition in their jurisdiction to establish fair compensation schemes than a federally mandated system.<sup>33</sup> NARUC, the National Association of Regulatory Utility Commissioners, also disavows H.R. 4445, primarily for policy reasons, and urges that the regulatory classification of Internet traffic as interstate is not consistent with their legal conclusion. States also sometimes argue that a failure to compensate for the termination of traffic will constitute the unconstitutional “taking” of a property right and lead to increased litigation at both the state and federal levels.<sup>34</sup>

While ISPs have not been as vocal as the other interests, the lone **ISP** representative to testify on H.R. 4445 argued that ILECs are profiting generously from the growth of the Internet because many homes and businesses purchase second and third telephone lines from ILECs to accommodate their Internet use and that arguments about “unfairness” are not grounded in reality.<sup>35</sup> For example, based on the 1999 SBC report, it is asserted that customer requests for additional telephone lines increased by 39% resulting in \$480 million in new revenue.<sup>36</sup> ISPs also note that they do not necessarily favor competitive LECs over incumbent LECs, but rather in the search for the best service plan, CLECs have consistently offered better service plans.<sup>37</sup>

### ***Broadband Internet Regulatory Relief Act of 2000***<sup>38</sup>

On July 20, 2000, Senator Sam Brownback (R-KS) introduced a revised version of his broadband bill that also addressed the issue. The bill, which had originally addressed issues regarding advanced services, now included an amendment to section 251(b) of the Act that did not require LECs to “make any payments for the transport, delivery, or termination of telecommunications to, or telecommunications that connects to, the Internet or any Internet service provider.”

At the July 26, 2000 hearing on the legislation, ILEC and CLEC representatives reiterated their on-going positions,<sup>39</sup> with CLECs arguing that elimination of reciprocal compensation could result in increased Internet access

<sup>33</sup> See *Reciprocal Compensation Adjustment Act: Hearing on H.R. 4445 Before the Subcomm. on Telecomm., Trade, and Consumer Protection of the House Comm. On Commerce*, 106<sup>th</sup> Cong. (2000) (statement of Joan Smith, Chairman, National Association of Regulatory Utility Commissioners (“NARUC”).

<sup>34</sup> See *id.*

<sup>35</sup> See *Reciprocal Compensation Adjustment Act: Hearing on H.R. 4445 Before the Subcomm. on Telecomm., Trade, and Consumer Protection of the House Comm. On Commerce*, 106<sup>th</sup> Cong. (2000) (statement of Chad Kissinger, President, Onramp Access, Inc.).

<sup>36</sup> See *id.*

<sup>37</sup> See *id.*

<sup>38</sup> S. 2902, 106th Cong. (2000).

fees and/or the dramatic exit of many CLECs from the market.<sup>40</sup> It was further argued that Congress should defer the reciprocal compensation debate to the states, the FCC, and the marketplace, since each has unmatched experience in determining interconnection rate structures.<sup>41</sup> ILECs countered by contending that S. 2902 justifiably eliminates an unfair regulatory loophole and without the measure, investment in the telecommunications industry will remain risky.<sup>42</sup> Yet, as with testimony given during the H.R. 4445 hearing, ILECs proclaimed that they were amenable to the CLECs' suggestion that the market forces be the final arbiter of reciprocal compensation rates.<sup>43</sup>

### *Congressional Opinion*

Regardless of the fate of these pieces of legislation, there is no doubt that reciprocal compensation has become a hot Congressional topic. Just prior to the introduction of H.R. 4445, Commerce Committee Chairman Tom Bliley and 48 Committee members urged the FCC to resolve the reciprocal compensation "problem" by September 30, 2000. In response, the FCC promised to attend to the issue with "due diligence" and stated that it would continue to welcome Congressional input as they examined the matter.<sup>44</sup> On June 29, 2000 a similar letter was sent to the Commission by Senators Trent Lott (R-Miss.) and John Breaux (D-La.).<sup>45</sup>

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<sup>39</sup> Among those testifying: John Shelby Bryan, Chairman and CEO, ICG Communications, Inc.; James Ellis, Senior Executive Vice President and General Counsel, SBC Telecommunications, Inc.; Arne Hayes, President, The Ranier Group; Robert Taylor, President and CEO, Focal Communications; Sue Ashdown, Co-owner, Xmission; Tom Duesterberg, President and CEO, Manufacturers Alliance; James Glassman, Resident Fellow, American Enterprise Institute, and Host, TechCentralStation.com; Peter Pitsch, Communications Policy Director, Information Technology Industry Council; and Eric Strumingher, Managing Director, Paine Webber.

<sup>40</sup> See *Broadband Internet Regulatory Relief Act: Hearing on S. 2902 Before the Comm. on Commerce, Science, and Transportation*, 106<sup>th</sup> Cong. (2000) (testimony of John Shelby Bryan, Chairman and CEO, ICG Communications, Inc.).

<sup>41</sup> See *id.*

<sup>42</sup> See *Broadband Internet Regulatory Relief Act: Hearing on S. 2902 Before the Comm. on Commerce, Science, and Transportation*, 106<sup>th</sup> Cong. (2000) (testimony of Arne Haynes, President, The Ranier Group).

<sup>43</sup> See *id.*

<sup>44</sup> Letter from William Kennard, Chairman, FCC to Rep. Tom Bliley, Chairman, House Commerce Committee (June 7, 2000).

<sup>45</sup> Letter from Sens. Trent Lott and John Breaux to William Kennard, Chairman, FCC (June 29, 2000).

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## State Efforts

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### Pre-FCC Declaratory Ruling

Prior to the Declaratory Ruling, at least 26 state public utility commissions (“PUCs”) had addressed the issue and ruled that reciprocal compensation should be paid for ISP-bound traffic terminated by a CLEC.<sup>46</sup> These PUCs based their rulings on their own interpretation of the interconnection agreements between CLECs and ILECs. In particular, they focused on the parties’ previous treatment of ISP-bound traffic as local or interstate in nature. States that reached this conclusion also relied in some instances on the FCC’s decision in the access charge context that required ISPs to be treated the same as local telecommunications end users. Additionally, some state regulators noted that a call to the Internet could be separated into two distinct components, sometimes referred to as the “two-call” theory: a local voice grade connection to the public switched telephone network (“PSTN”) and the connection from the ISP server to the Internet.

### Post-FCC Declaratory Ruling

Following the Declaratory Ruling, state commissions again examined the issue. Significantly, some states followed the FCC’s lead and ruled that ISP-bound traffic is primarily interstate for reciprocal compensation purposes.<sup>47</sup> The majority, however, continued to hold that such traffic is local and subject to reciprocal compensation.<sup>48</sup> Moreover, other states noted the unique characteristics of dial-up calls to ISPs, and developed compensation schemes that take into account the volume or ratio of traffic originating from a local exchange carrier versus the amount of traffic that it terminates. When the volume exceeds a specified ratio, reciprocal compensation rates are either decreased or eliminated. Some have argued that these “ratio” or “traffic threshold” mechanisms provide the most equitable compromise for both incumbent and competitive LECs.<sup>49</sup> In addition, several states, such as California and Wisconsin, have initiated “generic” dockets to examine proper pricing mechanisms for traffic transmitted to ISPs.<sup>50</sup>

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<sup>46</sup> See Robert Cannon, *FCC Releases Reciprocal Compensation Order; Declares ISP-Bound Telephone Calls Interstate*, Boardwatch Magazine (May 1999).

<sup>47</sup> As a result of the **Declaratory Ruling**, both Massachusetts and Colorado vacated earlier decisions characterizing ISP-bound traffic as “local” traffic. Louisiana, New Jersey, and South Carolina also adopted the “interstate” theory in the wake of the **Declaratory Ruling**.

<sup>48</sup> To date, 33 states have concluded that ISP-bound traffic is local in nature while 6 have found that it is interstate. Only 11 states and the District of Columbia have not addressed reciprocal compensation for ISP-bound traffic.

<sup>49</sup> See Comments filed by Verizon at 10.

<sup>50</sup> See *Telephone Traffic/Internet Service*, Proceeding R0002005 (Cal. PUC, filed Feb. 3, 2000) and *Investigation of the Compensation Arrangements for the Exchange of Traffic Directed to Internet Service Providers*, Docket No. 05-TI-283 (Wis. PUC, Dec. 14, 2000).

### “Local” Traffic Theories

For many states, the determination that ISP-bound traffic is local is governed by the language and intent of negotiated interconnection agreements.<sup>51</sup> Similar to their decisions prior to the Declaratory Ruling, these state commissions rely upon the contractual treatment of ISP-bound traffic under the terms of the given interconnection agreement in lieu of formulating a substantive regulatory position on the issue. In some instances, the FCC’s definition of “local traffic” is also considered.<sup>52</sup>

For example, in January 2000, Wisconsin’s<sup>53</sup> Public Service Commission determined that the MCImetro/Ameritech Wisconsin interconnection agreement intended to apply reciprocal compensation provisions to calls directed at ISPs within the local calling area.<sup>54</sup> Wisconsin based its decision on several factors including the fact that the agreement did not include Internet traffic on a list of switched exchange access services excluded from the agreement, that dial-up calls to ISPs are rated and billed as local calls under Ameritech’s Local Exchange Services Tariff,<sup>55</sup> and that revenue earned from

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<sup>51</sup> At least one federal appellate court recently held, however, that federal courts have jurisdiction to review a state PUC’s treatment of ISP-bound traffic when it interprets an interconnection agreement. On September 12, 2000, the U.S. Court of Appeals for the Eighth Circuit held that the Arkansas Public Service Commission’s decision to interpret ISP-bound traffic as “local” under the terms of an ILEC-CLEC interconnection agreement was an issue of federal law that is subject to review by the federal district courts. *Southwestern Bell Tel. Co. v. Connect Communications Corp.*, Case No. 99-3952 (8<sup>th</sup> Cir. Sept. 13, 2000).

<sup>52</sup> See e.g., *In the Matter of the Petition of US WEST Communications, Inc. for a Determination That ISP-bound traffic is Not Subject to Reciprocal Compensation Payments Under the MFS/US WEST Interconnection Agreement*, Docket No. P-421.M-99-529 (Minn. PUC Aug. 17, 1999).

<sup>53</sup> See *Complaint of MCImetro Access Transmission Services, Inc., to Compel Payment of Reciprocal Compensation from Wisconsin Bell, Inc. d/b/a Ameritech Wisconsin, for Traffic Terminated to Internet Service Providers*, Docket 15-TD-100/6720-TD-102, (Wis. PSC Jan. 19, 2000). Other states that also examined the negotiated agreements of interested parties include **Alabama** (see *BellSouth Telecommunications v. ITC DeltaCom Communications, Inc.*, Civ. A 99-D-287-N/Civ.A. 99-D-747-N (M.D.Ala., Nov. 12, 1999); **Arkansas** (see *Connect Communications Corporation v. Southwestern Bell Telephone Company*, Docket. No. 98-167-C (Ark. PUC Dec. 31, 1998); **Delaware** (see *In the Matter of the Application of Global Naps South, Inc., for the Arbitration of Unresolved Issues for the Interconnection Negotiations with Bell Atlantic-Delaware, Inc.*, Docket No. 98-540 (Del. PSC May 11, 1999); **Florida** (see *In re Request for Arbitration Concerning Complaint of American Communication Services of Jacksonville, Inc., d/b/a/ e.spire Communications, Inc. and ACSI Local Switched Services, Inc. d/b/a e.spire Communications Against BellSouth, Telecommunications, Inc. Regarding Reciprocal Compensation for Traffic Terminated to Internet Service Providers*, Docket No. 981008-TP/Order No. PSC-99-0658-FOF-TP (Fla. PSC Apr. 6, 1999); **Hawaii** (see *In the Matter of the Petition of GTE Hawaiian Telephone Company Incorporated For a Declaratory Order that Traffic to Internet Service Providers is Interstate and Not Subject to Transport and termination Compensation*, Docket No. 99-067(HI PUC May 6, 1999); **Maryland** (see *In the Matter of the Complaint of MFS Intelnet of Maryland, Inc. Against Bell Atlantic-Maryland, Inc. for breach of interconnection Terms and Request for Immediate Relief*, Order No. 75820 (Md. PSC June 11, 1999); **North Carolina** (see *In the Matter of BellSouth Telecommunications, Inc. v. US LEC of North Carolina Inc.*, Docket. No. P-561, Sub 10 (NC Util. Comm’n Mar. 31, 2000); and **Utah** (see *In the Matter of a Complaint Against U.S. West Communications, Inc. by NextLink, Inc. Requesting the Utah Public Service Commission Enforce an Interconnection Agreement Between NextLink and U.S. West Communications, Inc.*, Docket No. 99-049-44 (Utah PSC Oct. 28 1999).



Internet traffic was recorded as local by Ameritech for separations purposes.<sup>56</sup>

In holding that ISP-bound traffic is subject to reciprocal compensation, other states have simply treated ISPs as local exchange customers. In **Connecticut**, the PUC held that ISPs are business local exchange customers that purchase service and use the network in a manner similar to other end users.<sup>57</sup> Similarly in **Tennessee**, the Commission relied on the definition of “local service,” “completed call,” “off hook,” and “answer supervision” provided in BellSouth’s General Service Subscriber Tariff (GSST) to conclude that a call originating from a BellSouth end user to the ISP is “answered” and the “answer supervision” returned by the ISP within the local exchange area.<sup>58</sup> In **Illinois**, the terms of the interconnection agreement between MCI/WorldCom and Ameritech defined “local traffic” as a call transmitted within 15 miles or less as calculated by their respective vertical and horizontal coordinates.<sup>59</sup>

Equity provides yet another theory by which states have defended the imposition of reciprocal compensation on ISP-bound traffic. Thus, the **Washington** PUC determined that traffic carried by two carriers not otherwise subject to access charges should be subject to reciprocal compensation.<sup>60</sup> The PUC noted that Section 251(g) of the Act requires an alternative system of compensation for the transport and termination of telecommunications carried by three or more carriers where access charges do not apply. The PUC reconciled Section 251(g) with the requirements of Section 251(b) by interpreting the reciprocal compensation provision as intended to apply for the transport and termination of local traffic carried by two carriers. Thus, under that theory, traffic for which compensation is not already provided by access charges is subject to reciprocal compensation.<sup>61</sup>

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<sup>54</sup> See *Complaint of MCI Metro Access Transmission Services, Inc., to Compel Payment of Reciprocal Compensation from Wisconsin Bell, Inc., d/b/a Ameritech Wisconsin for Traffic Terminated to Internet Service Providers*, Docket No. 15-TD-100/6720-TD-102 (Wis. PSC Jan. 19, 2000).

<sup>55</sup> See *id.* at 8 (describing Ameritech’s tariff which defined the local calling area as the exchange area within which customers could place local messages at Residence or Business Local Messages or Extended Community Calling (ECC) Local Message charges).

<sup>56</sup> See *id.* at 16–22.

<sup>57</sup> See *Petition of the Southern New England Telephone Company For a Declaratory Ruling Concerning Internet Service Provider Traffic*, Docket No. 97-05-22 at 10 (Conn. DPUC Sept. 10, 1997).

<sup>58</sup> See *Complaint of AVR of Tennessee, L.P. d/b/a/ Hyperion of Tennessee, L.P. against BellSouth Telecommunications, Inc. to Enforce Reciprocal Compensation and “Most Favored Nation” Provision of the Parties’ Interconnection Agreement*, No. 98-00530 (Tenn. Regulatory Auth. Mar. 14, 2000).

<sup>59</sup> See *Teleport Communications Group, Inc. v. Illinois Bell Telephone Company, Ameritech Illinois, et al., Illinois Commerce Comm’n* Docket Nos. 97-0404, 97-0519, 97-0525 at 4 (consolidated) (Ill. Commerce Comm’n Mar. 11, 1998). This decision was upheld by the Seventh Circuit in *Illinois Bell Telephone Co. v. WorldCom Technologies, Inc.*, 179 F.3d 566 (7th Cir. (Ill.) (June 18, 1999)).

<sup>60</sup> See *WorldCom Inc., f/k/a MFS Intelnet of Washington, Inc. v. GTE Northwest Incorporated*, Docket No. UT-980338 (Wash. Util. and Transp. Comm’n May 1999).

<sup>61</sup> See *id.*

### *“Interstate” Traffic Theories*

Other states have taken a different position, agreeing with the FCC’s position that ISP-bound traffic is “interstate.” Depending on the state, this position may be out of deference to the FCC, agreement with the argument that traffic headed for the Internet does not terminate at the ISP’s modem, a public policy position that CLECs should not be able to reap the benefits of an imbalanced payment mechanism which was initially designed for voice, not data, traffic, or some combination of these arguments.

Thus, in May 2000, the **Colorado** Public Utilities Commission concluded that ISPs play a role similar to that of an interexchange carrier (IXC) who must compensate LECs that originate and terminate calls from the IXC’s customers.<sup>62</sup> The PUC noted that in the transmission of a call to the Internet, both the ILEC and the CLEC provide access-like functions similar to when they provide access to an IXC to transmit an interstate call.<sup>63</sup> Using this analogy, stated the PUC, leads to the conclusion that ISPs should pay the access charges associated with a dial-up call to the Internet; however, the FCC’s access charge exemption for ISPs prohibits this. Thus, the Colorado regulators stated that if ISPs were not able to pay compensation costs, the costs would simply remain unrecovered.<sup>64</sup> In the PUC’s view, the determining factor in the decision was the negative impact of per-minute reciprocal compensation payments on the market. Consequently, the PUC determined that the “bill and keep” scheme, whereby Internet-bound traffic flows between LECs without compensation for the cost of originating and terminating such traffic, should be adopted.<sup>65</sup>

For other states, the FCC’s **Declaratory Ruling**, which held that ISP-bound traffic is primarily interstate, was a sufficient legal basis to conclude the same. For example, in May 1999 the **Massachusetts** Department of Telecommunications and Energy was the first state to rule that ISP-bound traffic is interstate and not subject to reciprocal compensation, thereby overturning its prior ruling to the contrary.<sup>66</sup> In July 1999, the **New Jersey** Board of Public Utilities similarly held that ISP-bound traffic is interstate in nature and not subject to reciprocal compensation. Both state commissions relied heavily on the FCC’s Declaratory Ruling.<sup>67</sup> In addition, in October 1999, both the

<sup>62</sup> See *In the Matter of the Petition of Sprint Communications Company, L.P. for Arbitration Pursuant to U.S. Code § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with US West Communications, Inc.* Docket No. 00B-011/Decision No. C00-470 at 14 (Colo. PUC May 3, 2000).

<sup>63</sup> See *id.*

<sup>64</sup> See *id.* at 16.

<sup>65</sup> See *id.* at 17.

<sup>66</sup> *Complaint of MCI WorldCom, Inc. Against New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts for Breach of Interconnection Terms Entered Into under Section 251 and 252 of the Telecommunications Act of 1996*, Docket No. D.T.E. 97-116-C at 16-18 (May 11, 1999)

<sup>67</sup> See *In the Matter of the Petition of Global NAPs Inc. For Arbitration of Interconnection Rates, Terms, Conditions and Related Arrangements with Bell Atlantic-New Jersey, Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996*, Docket No. TO98070426 (N.J.B.P.U. July 12, 1999).

Louisiana and South Carolina Public Service Commissions held that the CLECs were unable to prove that ISP-bound traffic terminates within a local exchange area.<sup>68</sup> Relying heavily on the FCC's Declaratory Ruling, both commissions agreed that ISP-bound traffic often "terminates" at Internet websites located in other states and that without further evidence that the parties intended to subject such traffic to reciprocal compensation, the traffic was deemed interstate and not subject to reciprocal compensation.<sup>69</sup>

### *Other Theories and Models*

Significantly, some states have addressed the reciprocal compensation issue in other ways that avoid the "all-or-nothing" approach of treating ISP-bound traffic as either "local" or "interstate." The ratio-based model, for example, recognizes a middle ground for carriers to recover the costs associated with terminating traffic and attempts to prevent carriers from unfairly gaming the system with no corresponding benefits.

#### **Ratio-Based Model**

► In New York, the Public Service Commission (NYPSC) established a rate structure designed to address generally imbalances in revenue between interconnected carriers. Thus, in New York, when a carrier's incoming to outgoing traffic ratio exceeds 3:1, the NYPSC has held that there is a strong presumption that the traffic is convergent and is less expensive to terminate than non-convergent traffic.<sup>70</sup> Under New York's model, carriers will be compensated at end office rates when their incoming to outgoing traffic ratio exceeds 3:1 for the most recent three-month period.<sup>71</sup> If the traffic falls below the ratio, compensation will accrue at tandem rates.<sup>72</sup> The presumption may be rebutted, however, if a carrier demonstrates that its network and services are functionally equivalent to a tandem switch.<sup>73</sup> If successful, the tandem rate compensation would continue to apply.<sup>74</sup> In January 2000, Cablevision Lightpath, Inc., a CLEC based in New York,

<sup>68</sup> See *In re Petition of KMC Telecom, Inc. Against BST to Enforce Reciprocal Compensation Provisions of the Parties Interconnection Agreement*, Docket. No. U-23839 at 15-16 (La. PSC Oct. 13, 1999) and *In Regard to petition of ITC/DeltaCom Communications, Inc. for Arbitration With BellSouth Telecommunications Inc. Pursuant to the Telecommunications Act of 1996*, Docket. No. 1999-259-C/Order No. 1999-690 at 63 (SC PUC Oct. 4, 1999).

<sup>69</sup> See *id.* at 18-19 and 63, respectively.

<sup>70</sup> See *Proceeding on Motion of the Commission to Reexamine Reciprocal Compensation*, Opinion No. 99-10 at 56 (NY PSC Aug. 26, 1999).

<sup>71</sup> See *id.* at 60.

<sup>72</sup> See *id.*

<sup>73</sup> The NYPSC suggested several factors which may indicate that a network has tandem-like functionality including: the number and capacity of central office switches; the number of points of interconnection offered to other LECs; the number of collocation cages; the presence of SONET rings and other types of transport facilities; the presence of local distribution facilities such as coaxial cable and/or unbundled loops (See *id.* at 60).

<sup>74</sup> See *id.* at 38.

successfully rebutted the presumption and raised the ratio to 5.5:1 with an end office rate of \$.0059/min when traffic falls below that ratio and \$.0015/min when it exceeds it.<sup>75</sup>

- ▶ **Texas** adopts a similar model whereby dial-up calls to ISPs are treated as local calls subject to amended reciprocal compensation payments. As with New York, traffic ratios exceeding a 3:1 ratio are compensated at rates lower than traffic falling below the ratio for traffic terminated through a switch capable of performing both end office and tandem office functions, a blended compensation rate will apply until a 3:1 ratio (terminating to originating calls) is reached.<sup>76</sup> The blended rate consists of an end office rate and a tandem/inter-carrier compensation rate. The end office rate is bifurcated to reflect: (1) a charge for setting up a call (\$.0010887) and (2) a charge based on duration (\$.0010423/min). The tandem/inter-carrier transport rate consists of a single flat rate (\$.002858/min).<sup>77</sup> Once the 3:1 ratio is eclipsed, only the end office rate applies unless the terminating carrier can prove tandem functionality.<sup>78</sup>
- ▶ Similarly, regulators in **West Virginia** applied a variation of the ratio scheme in that local exchange carriers are first directed to negotiate an equitable compensation rate; however, if no agreement can be reached, then a 3:1 ratio compensation scheme is employed.<sup>79</sup>

#### Aggregation Service For ISP-Bound Traffic

- ▶ **Maine** has undertaken a unique approach to reciprocal compensation, finding that no reciprocal compensation is due for ISP-bound traffic and yet also requiring the ILEC to offer an allegedly cost-based service for statewide aggregation of ISP-bound traffic. In June 1999, the Maine PUC had ruled that CLEC Brooks Fiber's service to ISPs was not "local" (and thus not entitled to reciprocal compensation), but rather was "inter-exchange" traffic because it originated in another exchange area within the state of Maine.<sup>80</sup> In effect, Brooks' offering created "FX-like" (foreign exchange) services for an ISP to connect to its end user through a "local" telephone call, even though neither Brooks nor the ISP had any terminat-

<sup>75</sup> See *Petition of Cablevision Lightpath, Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Interconnection Agreement with New York Telephone Company d/b/a/Bell Atlantic-New York*, Case No. 97-C-0961 at 1-2 (NY Dept. of Pub. Svc. Jan. 27, 2000).

<sup>76</sup> See *id.* at 36.

<sup>77</sup> See *id.* at 42, 49.

<sup>78</sup> See *id.* at 49.

<sup>79</sup> See *Bell Atlantic-West Virginia, Inc. Petition for Declaratory Ruling that Internet-bound Telecommunications Traffic is not Subject to Reciprocal Compensation Under Existing Interconnection Agreements*, Case No. 99-0426-T-P at 6-7 (W. Va. PSC Oct. 19, 2000).

<sup>80</sup> See *Public Utilities Commission Investigation into Use of Central Office Codes (NXXs) by New England Fiber Communications LLC d/b/a Brooks Fiber Communications*, Order Adopting Factual and Legal Conclusions, Docket No. 98-758 (Me. PUC June 22, 1999).

ing facilities in the end user's local exchange area.<sup>81</sup> To avoid dislocation of ISPs serving rural areas, however, the Maine PUC also ordered ILECs to tariff a statewide aggregation service for purchase by an ISP at cost-based rates, and designed to ensure that the ISP's customers can dial a toll-free number to connect to the ISP.<sup>82</sup>

- ▶ In this same proceeding, the **Maine** PUC also found that Brooks Fiber was improperly allocated NXX telephone number blocks (approximately 540,000 telephone numbers), and using those numbers to serve ISPs with the FX like service when, in fact, Brooks had no facilities in those exchanges.<sup>83</sup> Maine ordered the numbering administrator to reclaim Brooks' NXX codes. Thus, Maine's reciprocal compensation inquiry into ISP-bound traffic led it to another vexing telecommunications issue, numbering resources exhaust.

#### “Wait-and-See” Approach

- ▶ Some states have concluded that the lack of direction from the FCC prevents them from adjudicating reciprocal compensation proceedings. For example, the **Virginia** State Corporations Commission (Virginia Commission), for example, held that the lack of FCC guidance and the possibility that a state-authored decision could conflict with a later FCC order, made it impossible for it to rule on the issue. The Virginia Commission instead urged the parties to seek resolution directly from the FCC.<sup>84</sup> In light of the Virginia Commission's refusal to act, the FCC preempted Virginia's jurisdiction and will adjudicate the reciprocal compensation dispute

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<sup>81</sup> Brooks Fiber did have facilities in the Portland, ME exchange area. In other exchanges throughout Maine, Brooks would assign one or more local dial-up numbers for its ISPs' customers' traffic using numbers assigned from Brooks' NXX blocks for use in those exchanges. The ISP-bound traffic was then transported by Bell Atlantic from the foreign exchange to the Brooks' facilities in Portland.

<sup>82</sup> The service, Single Number Service/Hubbed Primary Rate ISDN (SNS/PRI), would be toll-free to the end user and would function by assigning a 7-digit number with a “500” NPA to ISPs. The proposed rate of Bell Atlantic's service is \$500-600 per month and ISP subscribers would have to acquire at least two SNS/PRI facilities, one in each of Maine's “sector hubs” (Portland and Bangor). In addition, an ISP would be offered special flat rate access prices in order to obtain Local Distribution Channels that would allow it to connect an ISP's location to a single interconnection point on Bell Atlantic's network. See *Investigation into the Use of Central Office Codes (NXXs) by New England Fiber Communications, LLC d/b/a/ Brooks Fiber*, Order Requiring Reclamation of NXX Codes and Special ISP Rates by ILECs, Docket No. 98-758 (Me. PUC June 30, 2000).

<sup>83</sup> See *Investigation into the Use of Central Office Codes (NXXs) by New England Fiber Communications, LLC d/b/a/ Brooks Fiber*, Examiner's Report, Docket No. 98-758 (Me. PUC February 23, 2000).

<sup>84</sup> This decision arose when Cox Virginia Telecom, Inc. (Cox) and Starpower Communications, LLC (Starpower) filed a petition against GTE South Incorporated (GTE) seeking reciprocal compensation payments in accordance with provisions of an incorporation agreement. See *Petition of Starpower Communications, LLC For Declaratory Judgment Interpreting Interconnection Agreement with GTE South, Inc.*, Case No. PUC99023 and *See Petition of Cox Virginia Telecom, Inc. v. GTE South Incorporated For Enforcement of Interconnection Agreement for Reciprocal Compensation for the Termination of Local Calls to Internet Service Providers*, Case No. PUC990046 (Va. SCC Jan. 24, 2000). See also *Petition of Starpower Communications, LLC For Declaratory Judgment and Enforcement of Interconnection Agreement with Bell Atlantic-Virginia, Inc.*, Case No. PUC9901156 at 4, Order Dismissing Petition (VSCC Feb. 9, 2000).

itself, citing the state's failure to act within a "reasonable time" in accordance with Section 252(b)(4)(C) of the Act.<sup>85</sup>

As indicated, while there is certainly a range of state responses, then, to the issue of payments for ISP-bound traffic as between carriers, there is no evidence that this variety has caused or will cause any undue hardship or interferes with the true business of telecommunications—robust and competitive service provision. Notably, it is this very variety that some assert best serves the various interests as it fosters tailored responses to particular situations rather than mandating a "one size fits all" response that may be divorced from circumstances.

## **Conclusion: What's in Store for the Future?**

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Significantly, as the debate over reciprocal compensation for ISP-directed traffic has grown, the market has adjusted to allow carriers to move past their differences on these issues. As interconnection agreements expire and are renegotiated, both ILECs and CLECs have increasingly moved to lower rates and alternative structures that account for Internet-bound traffic. For example, in October 1999 Bell Atlantic and Level 3 Communications reached an agreement to settle an ongoing dispute regarding reciprocal compensation rates, incorporating both a rate reduction and a ratio threshold for measuring and compensating traffic.<sup>86</sup> BellSouth and ICG and others have also moved forward with new interconnection agreements that incorporate lower rates. Certainly, unlike the past, all parties are keenly aware of this issue as they negotiate interconnection agreements.

Moreover, as indicated, the state PUCs, who regularly entertain issues regarding interconnection agreements and their interpretation, are devising a range of responses that arguably, are best-suited to meet the specific needs of the parties and that may arguably best reflect the nature and scope of costs that are incurred. Indeed, in the FCC's ongoing rulemaking, one option that appeared to gain significant traction was to defer to state PUC determinations, regardless of the ultimate jurisdictional classification of ISP-bound traffic.

Finally, regulators and lawmakers that are considering the issue must understand that sweeping statements about the nature of Internet-bound traffic can have consequences far beyond the narrow issue of whether per-

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<sup>85</sup> See *In the Matter of Starpower Communications, LLC Petition of Jurisdiction of the Virginia State Corporation Commission Pursuant to Section 252(e) of the Telecommunications Act of 1996*, Memorandum Opinion and Order, FCC 00-216, ¶¶ 5, 8 (rel. June 14, 2000).

<sup>86</sup> See also *BellSouth and ICG Resolve Payment Issues Around Internet Traffic: Agreement Settles Reciprocal Compensation Matter* (visited Aug. 7, 2000) <<http://www.bellsouth.com/proactive/documents/ren-der/32002.vtml>> (discussing the March 2000 settlement agreement reached between BellSouth and ICG regarding reciprocal compensation).

minute compensation is owed to carriers that complete calls to ISPs. For example, a critical factor often overlooked is the jurisdictional separations process, whereby all telecommunications costs and revenues are allocated according to whether the traffic is interstate or intrastate. A change in the classification of ISP-bound traffic (that is treated as “local” for separations purposes) could unintentionally impact this structure. Certainly, the full ramifications of what appears to be a simple “fix” should be explored thoroughly before a rush to action. While the growth of Internet traffic was not anticipated, regulators and lawmakers should seek to ensure their actions do not create unintended results.