Legal Department

MARY K. KEYER
General Attorney

BellSouth Telecommunications, Inc.
150 South Monroe Street
Room 400
Tallahassee, Florida 32301
(404) 335-0729

November 12, 1998

Mrs. Blanca S. Bayó
Director, Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 981008-TP (e.spire Complaint)

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of the Direct Testimony of Jerry Hendrix and of Albert Halprin, which we ask that you file in the captioned matter on behalf of BellSouth Telecommunications, Inc.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

Sincerely,

Mary K. Keyer (KR)

Mary K. Keyer

MKK/ds
Enclosures

cc: All parties of record
A. M. Lombardo
N. B. White
William J. Ellenberg (w/o enclosures)

Leg - 2
(me)
Mat - orig + 5
Sec - 1

CERTIFICATE OF SERVICE

Docket No. 981008-TP

I HEREBY CERTIFY that a true and correct copy of the foregoing was served via U.S. Mail this 12th day of November, 1998 to the following:

Beth Keating, Esq.
Legal Counsel
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850
Tel. No. (850) 413-6199
Fax No. (850) 413-6250

Norman H. Horton, Jr., Esq.
Messer, Caparello & Self, P.A.
215 South Monroe Street
Suite 701
Tallahassee, FL 32301

James C. Falvey, Esq.
e.spire Communications, Inc.
133 National Business Parkway
Suite 200
Annapolis Junction, MD 20701

Mary K. Keyer (MKK)
Mary K. Keyer

ORIGINAL

BELLSOUTH TELECOMMUNICATIONS, INC.

DIRECT TESTIMONY OF JERRY HENDRIX

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 981008-TP

November 12, 1998

Q. PLEASE STATE YOUR NAME AND COMPANY NAME AND ADDRESS.

A. My name is Jerry Hendrix. I am employed by BellSouth Telecommunications, Inc., ("BellSouth") as Director - Interconnection Services Pricing. My business address is 675 West Peachtree Street, Atlanta, Georgia 30375.

Q. PLEASE SUMMARIZE YOUR BACKGROUND AND EXPERIENCE.

A. I graduated from Morehouse College in Atlanta, Georgia, in 1975, with a Bachelor of Arts Degree. I began employment with Southern Bell in 1979, and have held various positions in the Network Distribution Department before joining the BellSouth Headquarters Regulatory organization in 1985. On January 1, 1996, my responsibilities moved to Interconnection Services Pricing in the Interconnection Customer Business Unit. In my position as Director, I oversee the negotiations of interconnection agreements between BellSouth and Alternative Local Exchange Companies (ALECs).

Q. HAVE YOU TESTIFIED PREVIOUSLY?

A. Yes. I have testified in proceedings before the Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, and South Carolina Public Service Commissions, the North Carolina Utilities Commission, and the Tennessee Regulatory Authority.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to discuss whether reciprocal compensation for internet service provider (ISP) non-voice type traffic is required under the interconnection agreements that have been negotiated between BellSouth and e.spire Communications, Inc. ("e.spire"). As I explain below, calls made by an end-user customer to access the internet or other services offered by an ISP do not constitute local traffic, but instead are in the nature of exchange access traffic that is jurisdictionally interstate. Therefore, these types of calls (ISP traffic) are not subject to the reciprocal compensation requirements in the Interconnection Agreement between BellSouth and e.spire (hereinafter "the Agreement").

Q. WHAT ARE THE RECIPROCAL COMPENSATION REQUIREMENTS IN THE INTERCONNECTION AGREEMENT NEGOTIATED BETWEEN BELLSOUTH AND e.spire?

A. First, the Agreement with e.spire at Section VI. A states:

> The Parties agree for the purpose of this Agreement only that local interconnection is defined as the delivery of local traffic to be terminated on each party's local network so that customers of either party have the ability to reach customers of the other party, without the use of any access code or delay in the processing of the call. The Parties further agree that the exchange of traffic on BellSouth's Extended Area Service (EAS) shall be considered local traffic and compensation for the termination of such traffic shall be pursuant to the terms of this section. (emphasis added.)

Attachment B of the Agreement states:

> "Local Traffic" means telephone calls that originate in one exchange and terminate in either the same exchange, or a corresponding Extended Area Service ("EAS") exchange. The terms Exchange, and EAS exchanges are defined and specified in Section A.3 of BellSouth's General Subscriber Service Tariff.

Clearly, at a minimum, this agreement requires the termination of traffic on either BellSouth's or e.spire's network for reciprocal compensation to apply. As I explain below in more detail, call termination does not occur when an ALEC, serving as a conduit, places itself between BellSouth and an ISP. Further, the definition of local traffic requires the origination and termination of telephone calls to be in the same exchange and EAS exchanges as defined and specified in Section A.3 of BellSouth's General Subscriber Service Tariff (GSST). Local traffic as defined in Section A.3 in no way implies ISP traffic. The Federal Communications Commission (FCC) has concluded that enhanced

service providers (ESPs), of which ISPs are a subset, use the local network to provide interstate services.

I am the person responsible for all negotiations with ALECs. I was specifically involved with the negotiation of this agreement. BellSouth has entered into hundreds of agreements with ALECs across its region and has included in those agreements language discussing payment of reciprocal compensation. Nowhere in those agreements has BellSouth acknowledged or agreed to define ISP traffic as local traffic subject to reciprocal compensation. Further, BellSouth has not knowingly paid reciprocal compensation to ALECs who have transported traffic to their ISP customers, nor has BellSouth knowingly billed ALECs for performing that same service.

Q. IS BELLSOUTH CURRENTLY OBLIGATED TO COMPENSATE e.spire FOR TERMINATING BELLSOUTH'S LOCAL TRAFFIC?

A. No. The agreement between e.spire and BellSouth does not currently obligate BellSouth to compensate e.spire for terminating BellSouth's local traffic. Rather, Section VI.B of the Agreement provides that:

> For purposes of this Agreement, the Parties agree that there will be no cash compensation exchanged by the parties during the term of this Agreement unless the difference in minutes of use for terminating local traffic exceeds 2 million minutes per state on a monthly basis.

BellSouth does not believe that the difference in minutes of use for terminating local traffic exceeds 2 million minutes on a monthly basis for the state of Florida. However, even if the 2- million- minute difference had been met, the Agreement further states in Section VI.B that:

> In such an event, the Parties will thereafter negotiate the specifics of a traffic exchange agreement which will apply on a going-forward basis. (emphases added)

Thus, the Agreement only obligates BellSouth to commence negotiations with e.spire that would lead to an agreement on the exchange of traffic, including a mutually agreed-upon reciprocal compensation rate, once the 2- million-minute threshold is met. If the parties are unable to reach a voluntary agreement, either party would have the right to petition this Commission to arbitrate that issue. e.spire has improperly attempted to circumvent this process by filing its "complaint."

Q. DO YOU AGREE THAT THE DIFFERENCE IN MINUTES OF USE FOR TERMINATING LOCAL TRAFFIC BETWEEN BELLSOUTH AND e.spire HAS EXCEEDED 2 MILLION MINUTES ON A MONTHLY BASIS?

A. No. BellSouth believes that e.spire is including ISP interstate minutes in its calculation of local minutes of use. By letter dated August 12, 1997, BellSouth advised the ALEC industry that pursuant to current FCC rules regarding ESPs, of which ISPs are a subset, that ISP traffic is jurisdictionally interstate, not

local. The letter stated that due to this fact, BellSouth will neither pay nor bill reciprocal compensation for this traffic. In the November 1997 meeting, e.spire indicated that it used combined trunks to record minutes of use. Thus, until such time as BellSouth is assured that e.spire's 2- million- minute threshold calculation includes only local minutes of use, and a mutually agreed-upon compensation rate has been negotiated, BellSouth is not obligated to compensate e.spire for terminating BellSouth's local traffic.

Q. DO YOU AGREE THAT e.spire IS ENTITLED TO THE RECIPROCAL COMPENSATION RATE OF $.009?

A. No. e.spire seems to believe that the most favorable provisions language in Section XXII.A allows e.spire to pick and choose rates from any existing agreement in a particular state. As such, e.spire insists that it should be entitled to the termination rate of $.009 per minute.

While the language contained in Section XXII.A of the Agreement tracks Section 252(i) of the Act concerning the availability of any interconnection, service, or network element provided under an agreement with a LEC and one carrier to another carrier, Section XXVII of the Agreement states that this agreement shall be governed by, construed and enforced in accordance with applicable federal law. As interpreted by the Eighth Circuit Court in Iowa Utilities Board et al. v. FCC, 120 F.3d 753, 800-801 (8th Cir. 1997), federal law does not permit e.spire to "pick and choose" individual provisions of a negotiated agreement. The Eighth Circuit has determined that new entrants,

under Section 252(i), may accept the terms and conditions of prior agreements, but only "in their entirety." Thus, when read in light of the Eighth Circuit's decision in Iowa Utilities Board, Section XXII.A does not permit e.spire to "pick and choose" the termination rate in an agreement without accepting all the terms and conditions in that agreement.

Furthermore, Section XXII.A of the Agreement allows e.spire to "add" new network elements or services or to "substitute" more favorable rates, terms, and conditions. Here, there is nothing to "add" because the existing Agreement covers the termination of local traffic, and nothing to "substitute" because the existing Agreement does not contain a termination rate. e.spire's position that it can obtain reciprocal compensation under Section XXII.A is neither correct nor is it contractually sound. e.spire and BellSouth did not insert specific language into Section VI.B concerning the 2- million- minute threshold to be rendered null and void by another Section of its own Agreement. Section XXII.A was never intended to circumvent the negotiation process as e.spire seeks to do.

Q. IF e.spire AND BELLSOUTH DID NOT MUTUALLY INTEND TO TREAT THIS TYPE OF TRAFFIC AS LOCAL TRAFFIC FOR PURPOSES OF RECIPROCAL COMPENSATION, CAN EITHER PARTY BE REQUIRED TO PAY RECIPROCAL COMPENSATION FOR THAT TRAFFIC?

A. No. If both of the parties did not mutually intend to treat this traffic as local for purposes of reciprocal compensation, then BellSouth is under no contractual obligation to pay reciprocal compensation for such traffic. Moreover, considering current FCC rules regarding ESPs' traffic, this traffic is clearly interstate, not local traffic, and as shown later, reciprocal compensation should not apply for ISP traffic. I can unequivocally state that it was not BellSouth's intent, nor was it discussed during negotiations, for ISP traffic to be subject to reciprocal compensation.

Q. DESCRIBE THE TYPE OF TRAFFIC IN DISPUTE.

The following describes how a call by an end user is routed to the internet. Internet service is a subset of the services that the FCC has classified as enhanced services. As I explain below in more detail, the FCC has exempted enhanced service providers from paying interstate access charges. Hence, ISPs are permitted to obtain and use local exchange services to collect and terminate their interstate traffic. End users gain access to the internet through an ISP. The ISP location, generally referred to as an ISP Point of Presence (POP), represents the edge of the internet and usually consists of a bank of modems. ISPs can use the public switched network to collect their subscribers' calls to the internet. In this case, ISP subscribers access the ISP by dialing a local telephone number via their computer modem to connect to the ISP. The ISP typically purchases business service lines from various local exchange company end offices and physically terminates those lines at an ISP premise,

which are usually modem banks that connect to the internet. The ISP converts the signal of the incoming call to a digital signal and routes the call, through its modems, over its own network to a backbone network provider, where it is ultimately routed to an internet-connected host computer. Internet backbone networks can be regional or national in nature. These networks not only interconnect ISP POPs but also interconnect ISPs with each other and with online information content.

The essence of internet service is the ease with which a user can access and transport information from any host connected to the internet. The internet enables information and internet resources to be widely distributed and eliminates the need for the user and the information to be physically located in the same area. ISPs typically provide, in addition to internet access, internet services such as e-mail, usenet news, and Web pages to their customers. ISPs that have multiple local telephone numbers (as is the case for many ISPs) would not have duplicate hosts for such services in each local dial location. Indeed, such duplication would defeat a primary advantage of the internet. Thus, when a user retrieves e-mail or accesses usenet messages, for example, it is highly unlikely that the user is communicating with a host that is located in the same local calling area as the user. To the contrary, the concentration of information is more likely to result in an interstate, or even international, communication.

In short, an ISP takes a call and, as part of the information service it offers to the public, transmits that call to and from the communications network of other

telecommunications carriers (e.g., internet backbone providers such as MCI or Sprint) whereupon it is ultimately delivered to internet host computers, almost all of which are not located in the local serving area of the ISP.

Thus, the call from an end user to the ISP only transits through the ISP's local point of presence; it does not terminate there. There is no interruption of the continuous transmission of signals between the end user and the host computers.

The fact that an ISP can now obtain local business service lines from an ALEC switch in no way alters the continuous transmission of signals between an incumbent local exchange company's (ILEC's) end user to a host computer. In other words, if an ALEC puts itself in between a BellSouth end user and the internet service provider, it is acting like an intermediate transport carrier or conduit, not a local exchange provider entitled to reciprocal compensation. The ALEC is adding no value to either the ISP service nor to the end user. The ALEC is merely providing a local telephone number which the end user dials to access the ISP. See Exhibit JH-1 attached to this testimony.

Q. WHAT IS THE JURISDICTIONAL NATURE OF SUCH TRAFFIC?

A. Internet traffic is not local traffic subject to reciprocal compensation obligations. The vast majority of this traffic is interstate in nature. The fact that a single internet call may simultaneously be interstate, international and intrastate makes it inseverable for jurisdictional purposes. This inability to

distinguish the jurisdictional nature of each communication that traverses an internet connection coupled with the predominant interstate nature of internet communications leads to the inescapable conclusion that all internet traffic must be considered jurisdictionally interstate.

One of the great values of the internet is that the hosts are not tied to a certain geographic location. An ISP may have multiple local telephone numbers; however, they would not typically have multiple locations for their hosts. Instead, they would more economically provide these services by centralizing at one location. This is a "best practice" engineering design. Even when the content on a host is specifically designed and intended for a specific geographic area, such content does not need to be, and rarely is, hosted in that area. An example is Lycos CityGuide Service. According to information made available by Lycos, its CityGuide service provides locally-related content to over 1,000 cities. However, all of these CityGuide services are hosted from servers located in Pittsburgh, Pennsylvania. Thus, even if I am at a computer in Miami downloading information about Miami, my computer is actually receiving that information from a server located in Pennsylvania. This dispersion of servers world-wide and the lack of duplication attest to the fact that use of the internet will invariably involve interstate communications.

Further illustration of the interstate nature of internet bound traffic is found in looking at the most visited websites. A list of the top 100 Web sites in terms of number of hits can be found at www.hot100.com. The following list includes the top five sites for the week of October 7, 1998, and their

geographic locations, based on discussions with the owners of such sites, information contained in the site or in their respective SEC filings, or other such sources: 1) Yahoo: Silicon Valley, CA, Washington, D.C., Phoenix, and New York City, 2) Netscape: Silicon Valley, CA, 3) Microsoft: Redmond, WA, 4) Infoseek: Sunnyvale, CA, and 5) Altavista: Silicon Valley, CA. As seen from this list, none of these sites are geographically located in Florida. Thus, a Miami user who accesses one of these top Websites invariably utilizes interstate exchange access facilities.

Q. WHAT IS THE FCC'S POSITION ON THE JURISDICTIONAL NATURE OF ISP TRAFFIC?

The FCC has long held that the jurisdiction of traffic is determined by the end-to-end nature of a call. The end-to-end nature of a call has been the subject of many workshops (e.g., Percent Interstate Usage Workshops) with the Florida Public Service Commission ("FPSC" or "Commission") as well. It is, therefore, irrelevant that the originating end user and the ISP's POP are in the same local calling area or that local interconnection trunks are used to transmit calls to ISPs, because the ISP's POP is not the terminating point of this ISP traffic. The FCC stated in Paragraph 12 in an order dated February 14, 1992, in FCC Order Number 92-18, that:

> Our jurisdiction does not end at the local switch, but continues to the ultimate termination of the call. The key to jurisdiction is the nature of the communication itself, rather than the physical location of the technology.

The FCC recently upheld this position in its Memorandum Opinion and Order for GTE's ADSL Service. Paragraph 17 of CC Docket No. 98-79 states:

> The Commission traditionally has determined the jurisdictional nature of communications by the end points of the communication and consistently has rejected attempts to divide communications at any intermediate points of switching or exchanges between carriers.

In Paragraph 19, the Commission concluded that the ISP internet communications at issue in that proceeding, do not terminate at the ISP's local server, but continue to the ultimate destination, which is very often a long distance internet website.

Thus, the FCC has consistently upheld that the ending point of a call to an ISP is not the ISP POP, but rather the computer database or information source to which the ISP provides access. As such, calls to an ISP constitute exchange access traffic, not local telephone exchange service subject to reciprocal compensation. Calls that merely transit an ALEC's network cannot be eligible for reciprocal compensation.

The FCC has always recognized that the true nature of ISP traffic is access traffic. For example, in the 1983 order in which it initially established the ISP access charge exemption, the FCC stated: "Among the variety of users of access service are ... enhanced service providers." Likewise, in its 1987 Notice of Proposed Rulemaking in CC Docket No. 87-215 in which it proposed to lift the ISP access charge exemption, the FCC stated:

> We are concerned that the charges currently paid by enhanced service providers do not contribute sufficiently to the costs of the exchange access facilities they use in offering their services to the public. As we have frequently emphasized in our various access charge orders, our ultimate objective is to establish a set of rules that provide for recovery of the costs of exchange access used in interstate service in a fair, reasonable, and efficient manner from all users of access service, regardless of their designation as carriers, enhanced service providers, or private customers. Enhanced service providers, like facilities-based interexchange carriers and resellers, use the local network to provide interstate services. To the extent that they are exempt from access charges, the other users of exchange access pay a disproportionate share of the costs of the local exchange that access charges are designed to cover. (emphases added)

In both of these dockets, the FCC decided not to impose access charges on ESPs, of which ISPs are a subset. In each case, however, the FCC – after referring to the interstate nature of the call – cited only policy reasons for its decision, in particular, its concern that imposing access charges at that time upon ESPs could jeopardize the viability of what was still a fledgling industry.

Notably absent from any of these decisions is a determination by the FCC, or even a question raised by it, that traffic to ISPs is local traffic, rather than access traffic. Instead, in each case, the FCC granted or perpetuated an exemption from the access charge regime, based solely on pragmatic (and

political) considerations regarding the impact of existing access charges on the ESP / ISP industry. Moreover, in each instance, the FCC specifically noted the possibility that access charges, either as currently structured or modified, might be applied at some point in the future to ISPs. If the FCC had concluded that traffic received by ISPs was local, there would have been no need for it to exempt that traffic from the access charge regime; access charges would not have been applied in the first place. In the October 30 GTE ruling, the FCC emphasized that its decision to treat ISPs as end users for access charge purposes in no way affects the FCC's ability to exercise jurisdiction over such traffic.

Moreover, the FCC could not have held out the possibility that it might, in the future, assess some sort of access charge on such traffic. It should be noted that this exchange access arrangement parallels the Feature Group A (FGA) arrangement, where access charges are applicable. On Feature Group A calls, as with ISP calls, end users dial local numbers to make interstate interLATA calls, and thus switched access charges apply to the FGA subscriber.

Therefore, under clear FCC precedent, calls bound for the internet through an ISP's bank of modems can only be characterized as interstate exchange access traffic because they do not "terminate" at the ISP's POP, but rather the call continues to the database or information source to which the ISP provides access. The FCC, for policy reasons, has exempted ISPs for almost sixteen years from paying switched access charges to the local exchange companies for originating computer-based non-voice enhanced service traffic to them. This

in no way alters the fact that the traffic they collect is interstate access traffic, not local traffic. It is important to note that BellSouth's compliance with the FCC access charge exemption (by not applying access charges for the origination of computer-based non-voice enhanced service traffic to ISPs) in no way implies that BellSouth must pay reciprocal compensation on such traffic.

Q. PLEASE ADDRESS TWO FCC DOCKETS FREQUENTLY CITED BY ALECS AS JUSTIFICATION FOR THE PROPOSITION THAT THE INFORMATION SERVICE PROVIDED BY THE ISP IS SEPARATE AND DISTINCT FROM THE LOCAL EXCHANGE TELECOMMUNICATIONS SERVICE PROVIDED WHEN DETERMINING THE JURISDICTION OF THE TRAFFIC.

A. The two FCC dockets are the Non-Accounting Safeguard Docket (CC Docket No. 96-149) and the Universal Service Docket (CC Docket No. 96-45). ALECs have taken the FCC's commentary in these dockets totally out of context. The purpose of the Non-Accounting Safeguard docket was to deal specifically with the issue of separate subsidiary requirements for interLATA information service. The FCC ruled that there are two components of an interLATA information service: 1) interLATA transport and 2) information service. If an entity other than the local exchange company provides end users with interLATA transport, the LEC would not be providing an interLATA information service, therefore, would not be subject to the separate subsidiary requirements. This docket did not set forth a two-call method for determining

the jurisdiction of a call, but rather defined components of a service. Furthermore, in the October 30, 1998 GTE Order, the FCC specifically rejected the two-call theory for internet-bound traffic.

The purpose of the Universal Service docket was to set forth plans to satisfy statutory requirements and to put into place a universal support system that will be sustainable in an increasingly competitive marketplace. The order defines telecommunications services and information services for the sole purpose of determining who should contribute to the universal service fund. The order states that only telecommunications carriers that provide interstate telecommunications services should contribute. Hence, by making a distinction between telecommunications services and the ISP's offering, a valid determination of required contributors can be made.

In neither of these dockets did the FCC contradict the long standing FCC position that enhanced service provider's or internet service provider's services are jurisdictionally interstate. The determination of jurisdiction must be based on the end-to-end nature of a call, not on one component or a few components of a service. This fact is clearly stated in Paragraph 12 of FCC Order Number 92-18:

> Jurisdiction over interstate communications does not end at the local switchboard, it continues to the transmission's ultimate destination . . . This Commission has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with origination and termination of interstate calls.

Moreover, the FCC stated in footnote 220 on page 52 of the April 10, 1998, Report to Congress in Docket No. 96-45:

> We make no determination here on the question of whether competitive LECs that serve Internet Service Providers (or Internet service providers that have voluntarily become competitive LECs) are entitled to reciprocal compensation for terminating Internet traffic. That issue, which is now before the Commission, does not turn on the status of the Internet service provider as a telecommunications carrier or information service provider. (Emphasis added.)

Q. ARE THERE ANY NEGATIVE CONSEQUENCES THAT WOULD RESULT IF ISP TRAFFIC WERE CLASSIFIED AS LOCAL?

A. Yes. Attached as Exhibit JH-2 to my testimony is an ex parte filing by Bell Atlantic that was filed with the FCC on July 1, 1998. This ex parte filing accurately presents the extremely negative results of classifying ISP traffic as local traffic. Further, it also addresses how several State Commissions have mistakenly interpreted prior orders of the FCC in concluding that calls bound for the Internet are local.

Q. WHEN BELLSOUTH NEGOTIATED THE INTERCONNECTION AGREEMENTS IN QUESTION, WAS IT AWARE OF FCC RULINGS ADDRESSING THE JURISIDICTIONAL NATURE OF ISP TRAFFIC?

A. Yes.

Q. DID BELLSOUTH CONSIDER ISP TRAFFIC AS LOCAL TRAFFIC SUBJECT TO RECIPROCAL COMPENSATION AT THE TIME IT NEGOTIATED THESE OR ANY OTHER INTERCONNECTION AGREEMENTS?

A. Absolutely not. Considering the FCC rules currently in effect, BellSouth would have had no reason to consider ISP traffic to be anything other than jurisidictionally interstate traffic when it negotiated these agreements. Further, had BellSouth understood that e.spire considered ISP traffic to be local traffic subject to reciprocal compensation, the issue would have been discussed at length. During the negotiations of the agreement with e.spire, as well as with any ALEC, no party questioned the local traffic definitions referenced in the GSST and utilized in the agreements or whether ISP traffic should be considered local traffic. Had any party raised the ISP traffic issue, BellSouth would not have agreed to either bill or pay for reciprocal compensation associated with such traffic, because that traffic cannot possibly be considered to be local traffic, as reflected by a review of the FCC Orders and rules discussed above.

Again, BellSouth's interconnection agreements intend for reciprocal compensation to apply only when local traffic is terminated on either party's network. This interpretation is consistent with the Telecommunications Act of 1996, which established a reciprocal compensation mechanism to encourage

local competition. The payment of reciprocal compensation for ISP traffic would impede local competition. The FCC, in its August 1996, Local Interconnection Order (CC Docket No. 96-98), Paragraph 1034, made it perfectly clear that reciprocal compensation rules did not apply to interstate or interLATA traffic such as interexchange traffic:

> We conclude that Section 251(b)(5), reciprocal compensation obligation, should apply only to traffic that originates and terminates within a local area assigned in the following paragraph . . We find that reciprocal compensation provisions of Section 251(b)(5) for transport and termination of traffic do not apply to the transport and termination of interstate or intrastate interexchange traffic.

In Paragraph 1035 of that same Order, the FCC stated:

> 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. Traffic originating or terminating outside of the applicable local area would be subject to interstate and intrastate access charges.

Q. WOULD IT HAVE MADE ECONOMIC SENSE FOR BELLSOUTH TO HAVE AGREED TO CLASSIFY ISP TRAFFIC AS LOCAL TRAFFIC UNDER THE INTERCONNECTION AGREEMENTS AT ISSUE?

A. Absolutely not, and this reality is further proof that BellSouth never intended for ISP traffic to be subject to reciprocal compensation. A simple example will illustrate that point. First, it should be realized that traffic collected by non-voice ISPs will always be one-way, not two-way, as intended by the Act. That is, the traffic will originate from an end user and transit through the ISP's modem to a host computer on the internet. Reciprocal compensation becomes one-way compensation to those ALECs specifically targeting large ISPs. Hence, if ISP traffic were subject to payment of reciprocal compensation, the originating carrier in most instances would be forced to pay the interconnecting carrier more than the originating carrier receives from an end user to provide local telephone service. BellSouth would have never agreed to such an absurd result.

For example, assume a BellSouth residential customer in Miami subscribes to an ISP and that ISP is served by an ALEC. That customer uses the internet two hours a day and 30 days a month, which is a reasonable assumption given the long holding times associated with internet usage. This usage would generate a reciprocal compensation payment by BellSouth to the ALEC of $32.40 per month assuming a .9 cent per minute reciprocal compensation rate [$.009 * 2 hours * 60 minutes/hr. * 30 days]. BellSouth serves residence customers in Miami at $10.65 per month. Therefore, in this example, BellSouth would be forced to pay the ALEC $21.75 per month more than it receives from the end user for local service. Further, a significant portion of additional residential lines are bought primarily to access the internet and would not require more than a simple flat-rate line with no additional features.

The originating carrier, BellSouth in this example, would not only be forced to turn over to the ALEC that serves the ISP every penny of local service revenue it receives from its end users, but it would also have to pay a significant amount more to the ALEC, per month, in reciprocal compensation alone. This situation makes no economic sense and would place an unfair burden on BellSouth and its customers. It is incomprehensible that BellSouth would have willingly agreed to pay e.spire, or any other ALEC, over $21 more per month per customer than it receives from those customers for providing local service.

Q. WHAT IS THE ESTIMATED FINANCIAL IMPACT TO BELLSOUTH AND OTHER INCUMBENT LOCAL EXCHANGE CARRIERS IF ISP TRAFFIC WERE TREATED AS LOCAL?

A. If ISP traffic were treated as local so as to trigger the payment of reciprocal compensation for such traffic, BellSouth conservatively estimates that the annual reciprocal compensation payments by incumbent local exchange carriers in the United States for ISP traffic could easily reach $2.6 billion by the year 2002. This estimate is based on 64 million Internet users in the United States, an average Internet usage of 6.5 hours per week, and a low reciprocal compensation rate of $.002/minute. This is a totally unreasonable and unacceptable financial liability on the local exchange companies choosing to serve residential and small business users which access ISPs that are customers of other LECs. ALECs targeting large ISPs for this one-way traffic will benefit at the expense of those carriers pursuing true residential and business local competition throughout the country.

Q. IT HAS BEEN SUGGESTED THAT ALECS WOULD SUFFER FINANCIAL HARDSHIP IF THE FCC WERE TO ASSERT ITS JURISDICTION OVER ISP TRAFFIC OR CLARIFY THAT SUCH TRAFFIC IS NOT SUBJECT TO THE PAYMENT OF RECIPROCAL COMPENSATION. DO YOU AGREE?

A. No. James Henry of Bear Stearns has authored a report addressing this issue, entitled "What Reciprocal Compensation Means to the CLECs." According to Mr. Henry, "... the exposure of the CLEC group as a whole is minimal" if reciprocal compensation were not paid for ISP traffic. A copy of Mr. Henry's report was part of an ex parte filing by SBC Telecommunications, Inc., that was filed with the FCC on August 14, 1998, a copy of which is attached to my testimony as Exhibit JH-3.

Q. IN FPSC DOCKET NUMBER 880423-TP, THE BELLSOUTH WITNESS TESTIFIED THAT CONNECTIONS TO THE LOCAL EXCHANGE NETWORK FOR THE PURPOSE OF PROVIDING AN INFORMATION SERVICE SHOULD BE TREATED LIKE ANY OTHER LOCAL EXCHANGE SERVICE. HOW DOES THAT STATEMENT RELATE TO YOUR CURRENT POSITION?

A. First, the statement of the BellSouth witness must be reviewed in the context of that entire docket and the regulatory rulings in effect at the time. It is inappropriate to consider the testimony from a previous FPSC hearing which

was held prior to the final FCC ruling on that issue. BellSouth ultimately lost the argument it had advanced to this Commission when the matter came before the FCC. Additionally, this Commission held that its finding was interim and that it would be revisited again. Although this Commission did not revisit its interim finding, the FCC has issued several rulings relating to ISP traffic. Thus, BellSouth has acted in accordance with the subsequent FCC rulings. Moreover, in its Order in that docket, the Florida Commission plainly recognized that local exchange facilities provided to the ISP are used to carry intrastate and interstate calls, not just local calls.

Q. IS THE FCC CURRENTLY CONSIDERING THE PRECISE ISSUE RAISED BY e.spire IN THIS PROCEEDING?

A. Yes. The FCC initiated a proceeding in response to a June 20, 1997, letter from the Association for Local Telecommunications Services (ALTS) in which ALTS seeks a ruling from the FCC that "nothing in the [FCC's] Local Competition Order...altered the [FCC's] long standing rule that calls to an [ISP] made from within a local calling area must be treated as local calls by any and all LECs involved in carrying those calls" (Docket No. CCB/CPD 97-30). The ALTS sent a letter, dated July 2, 1998, to withdraw its request for clarification on this matter. In a Public Notice, dated August 17, 1998, the FCC essentially rolled this issue into CC Docket No. 96-98 (FCC's "Local Competition Order").

the FCC sought comments on whether the current exemption from access charges should continue for ISPs.

Further, the FCC filed a Memorandum of the Federal Communications Commission as Amicus Curiae filed in Case No. MO-98-CA-43 before the United States District Court for the Western District of Texas to clarify the FCC's position on the issue of ISP traffic and reciprocal compensation. In its Memorandum Brief the FCC made it clear that "[t]he FCC has not yet determined whether competitive local exchange carriers . . .are entitled to reciprocal compensation for terminating Internet traffic. That issue is currently before the FCC in an administrative proceeding and remains unresolved." (See FCC's Memorandum Filed in U.S. Dist. Ct., W. Dist., Texas, Case No. MO-98-CA-43, dated June 29, 1998, at page 2).

Additionally, the FCC issued an order concerning GTE's tariffing of its DSL service in the interstate tariff on October 30, 1998. In that Order, the FCC rejected the theory that for jurisdictional purposes this type of traffic must be separated into two components. Most importantly, the FCC upheld that this traffic does not terminate at the ISPs local server, but continues to its ultimate destination(s).

Q. WHAT ACTION DOES BELLSOUTH RECOMMEND THIS COMMISSION TAKE IN THIS PROCEEDING?

A. The Comission should find that the Agreement between BellSouth and e.spire does not obligate BellSouth to pay e.spire reciprocal compensation for traffic terminating to Internet Service Providers. Should it be determined that e.spire has met the 2- million- minute threshold, the Commission should find that the parties should negotiate on a going forward basis, as stated in the Agreement.

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

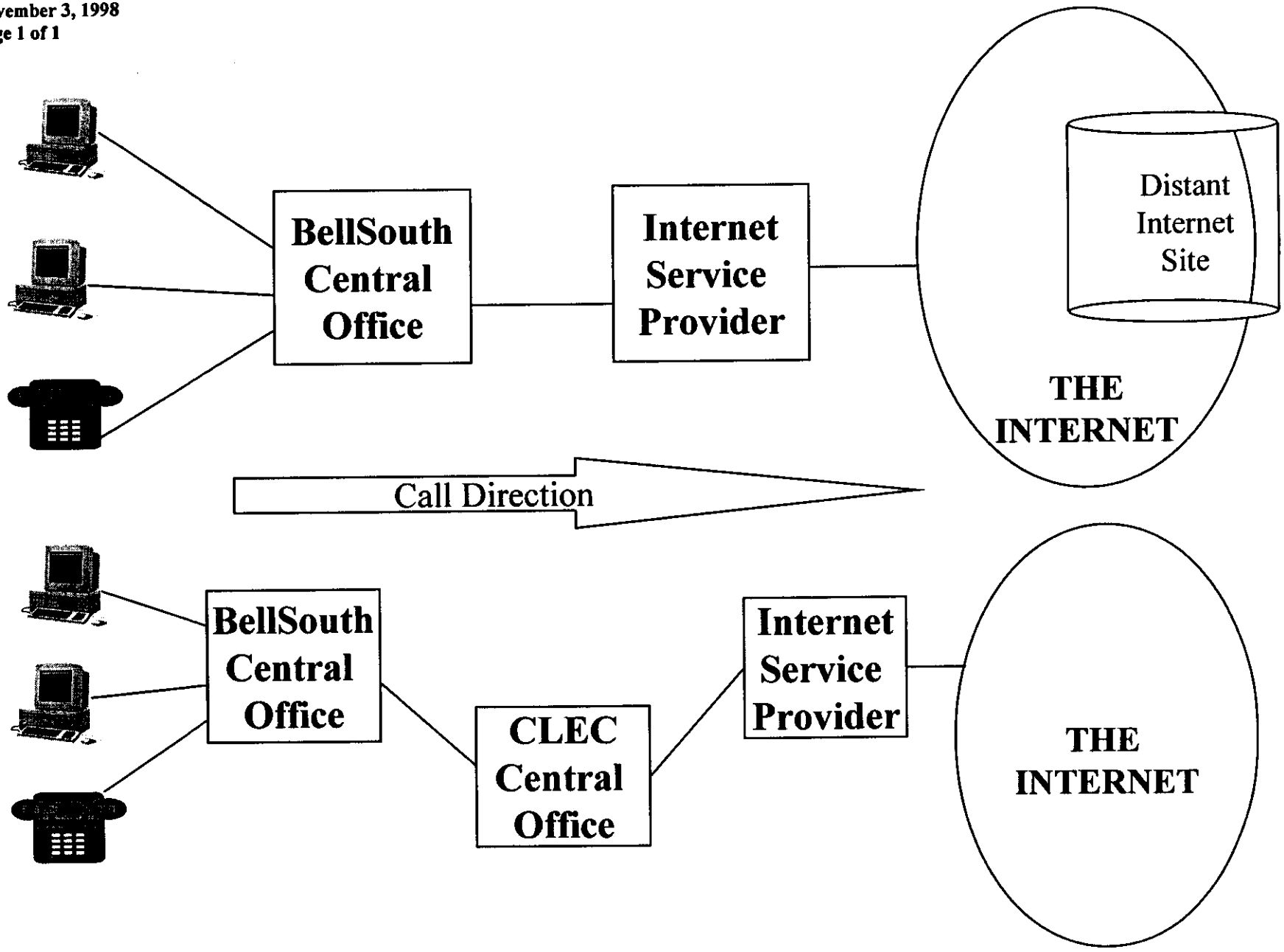
A. Yes. First, BellSouth has not mutually agreed with any ALEC, specifically e.spire, to treat the transport and termination of traffic to ISPs as local traffic for purposes of reciprocal compensation. Further, BellSouth has not acknowledged or agreed to define ISP traffic as local traffic. Hence, neither BellSouth nor e.spire can be required to pay reciprocal compensation for such traffic. Moreover, given that the traffic is clearly interstate traffic, such compensation should not apply. According to unbroken FCC and judicial precedent, the FCC's jurisdiction under the Communications Act extends from the inception of the communication to its completion, regardless of any intermediate facilities. This is the very jurisdictional underpinning that lies at the heart of the current enhanced service provider exemption to interstate access charges.

The Commission should find that the Agreement between BellSouth and e.spire does not obligate BellSouth to pay e.spire reciprocal compensation for traffic terminating to Internet Service Providers at this time. The Commission should

find that once the two-million- minute threshold is met, e.spire is required to negotiate with BellSouth to obtain a rate for reciprocal compensation.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.


BellSouth Central Office
Internet Service Provider
Distant Internet Site
THE INTERNET
Call Direction
BellSouth Central Office
CLEC Central Office
Internet Service Provider
THE INTERNET

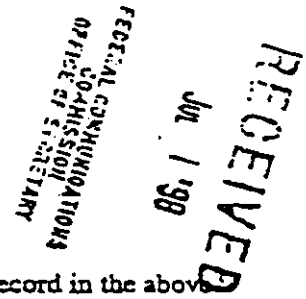
Bell Atlantic
1300 I Street NW, Suite 400W
Washington, DC 20005

Susanne Goyer
Executive Director,
Federal Regulatory Affairs

July 1, 1998

Ex Parte

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, DC 20554



Re: Docket CCB/CPD 97-30 Reciprocal Compensation

Dear Ms. Salas:

Please place the attached letter to Chairman William Kennard in the record in the above referenced proceeding.

In accordance with Section 1.1206(a)(1) of the Commission's rules, an original and one copy of this notice are being submitted to the Secretary.

Sincerely,

Susanne Goyer

Attachment

Bell Atlantic
1300 I Street, N.W.
Suite 400 West
Washington, D.C. 20005
(202) 336-7900

July 1, 1998

By Hand

The Honorable William E. Kennard
Chairman
Federal Communications Commission
1919 M Street, NW – Room 814
Washington, D.C. 20554

Re: Reciprocal Compensation for Internet Traffic

Dear Chairman Kennard:

The payment of reciprocal compensation for Internet-bound calls is distorting the market, undermining competition in residential telephony, and discouraging the deployment of high-speed networks.

Therefore, there is an urgent need for action by the Federal Communications Commission to confirm that Internet-bound calls are not local calls, and are not subject to the payment of reciprocal compensation.

Based on a mistaken interpretation of this Commission's prior orders, state commissions have classified calls bound for the Internet – and through it to other Internet users around the globe – as "local" calls. These decisions require telephone companies that provide local service to residential and other dial-up users of the Internet to pay "reciprocal" compensation when these calls are handed off to another carrier for delivery to an Internet service provider.

As one independent analyst puts it, this creates the "single greatest arbitrage opportunity and hence market distortion in the telecom sector today;" deters competition for residence and other dial-up users of the Internet because it has the "perverse effect of turning customers from assets into liabilities;" and discourages economically sound investment. (Attachment 1).

Reciprocal compensation pays carriers not to compete. Because it is available only when a customer's line is served by another carrier, Internet reciprocal compensation actually pays carriers not to invest in their own competing facilities and not to provide their own competing service to residence or small business customers.

The reason is simple: If competing carriers sign up residential or other dial-up Internet users for their own local services, they can kiss the risk-free cash from reciprocal compensation on those lines goodbye. Plus, they then have to pay reciprocal compensation when they hand off calls to another carrier for delivery to an Internet service provider.

The amount that carriers are being paid to not compete has ballooned along with the use of the Internet. Bell Atlantic alone will pay more than $150 million during 1998 and more than $300 million during 1999. The overwhelming majority of this money, roughly three-quarters in our case, currently goes to only two massive combines – Worldcom/MCI and AT&T/TCG.

Ironically, if a family or small business uses the Internet for as little as two hours a day, the reciprocal compensation typically totals more than the customer pays for the line. And if the customer leaves its computer connected to the Internet all the time, the reciprocal compensation can total $300 per month.

The ability to receive this kind of windfall deters competition, and at the same time creates an enormous drain on companies that have made the investment necessary to provide local service.

Reciprocal compensation pays people money for nothing. The ability to get reciprocal compensation without providing local dial tone service to even a single customer distorts behavior in other ways.

For example, Internet service providers have begun setting up shop as "carriers" for the sole purpose of getting paid reciprocal compensation for the Internet traffic that is delivered to them. One example is illustrative: During the first quarter of this year alone, just one of these "carriers" that provides no dial tone to anyone, sends essentially no traffic to us, and whose customer service representative says is not offering local telephone service, collected several million dollars in reciprocal compensation – all to provide the same Internet service it provided before it re-labeled itself a "carrier."

The payment of Internet reciprocal compensation has so distorted incentives that, region-wide, the number of minutes we hand off to competing carriers is approaching ten times the number of minutes they send to us. In some of our states, the ratio is more than fifty to one. These ratios are driven, of course, by the carriers' increasing focus on fronting for Internet service providers in order to get the easy cash from reciprocal compensation.

The lure of free cash also inspires conduct bordering on fraud. Because reciprocal compensation is available only for calls that begin and end in the same local calling area,

some carriers have assigned multiple blocks of numbers to Internet service providers – each attributable to a different local calling area – in order to make calls to those providers from distant calling areas appear "local." In fact, one Internet service provider cum carrier has locked up well over 100 NXXs – representing over a million numbers – *all without a single local telephone customer.*

These illicit activities only exacerbate the problem, deprive the originating carriers of toll revenues they are entitled to, and contribute to the rapid exhaustion of numbers to boot.

Reciprocal compensation deters investment. The payment of reciprocal compensation not only deters investment in local facilities by competitors, it also deters investment by all carriers in new technologies that could be used to handle this traffic more efficiently.

Although Internet-bound traffic could be handled more efficiently by moving it off the circuit-switched network, and onto more efficient packet-switched technologies, there is no incentive to deploy these technologies if they won't be used. But the fundamental problem is that, as long as Internet service providers (or their carrier affiliates) can get paid reciprocal compensation if they stay on the circuit-switched network, they have little incentive to move to new packet-switched technologies, no matter how reasonably priced. And so long as no one is willing to use these new technologies, there is little incentive for originating carriers to deploy them in the first place.

In light of these facts, the Commission must act now to correct the mistaken interpretation of its orders by the state commissions that have classified Internet calls as local.

As the attachment explains in further detail, while the Commission did exempt Internet and other enhanced service traffic from the payment of interstate access charges, it consistently has held that the traffic remains interexchange and interstate in nature – not local. (Attachment 2). Indeed, if this were not the case, there would be no need for an access charge "exemption," and the Commission would have had no jurisdiction to create one to begin with.

As a result, we urge you to quickly adopt an order in response to the petition filed by ALTS last summer declaring that, under the Commission's prior orders, Internet-bound traffic is not "local" and is not subject to reciprocal compensation.

We would appreciate the opportunity to meet with you to discuss this further.

Sincerely,

Edward D. Young, III
Senior Vice President &
Deputy General Counsel

Thomas J. Tauke
Senior Vice President
Government Relations

cc: Commissioner Furtchgott-Roth
Commissioner Ness
Commissioner Powell
Commissioner Tristiani
Kathy Brown

Attachment 1

LEGG MASON

The Precursor Group℠
Legg Mason Wood Walker, Inc.
1747 Pennsylvania Avenue, N.W., 6th Floor
Washington, DC 20006-4691
Phone (202) 778-1972; (800) 765-4411
Fax (202) 778-1975; Trading (800) 424-8570

LEGG MASON RESEARCH TECHNOLOGY TEAM
Precursor Research®
Scott C. Cleland
June 24, 1998

Reciprocal Comp For Internet Traffic--Gravy Train Running Out Of Track

(Part V of Internet Regulation Preview Series)

Summary: In a classic case of what you see is not necessarily what you get, investors should not expect the current reciprocal compensation arrangement for Internet traffic to continue much past the end of the year. Given that this issue is probably the single greatest opportunity for arbitrage in the whole sector, over 4,000 percent in some instances, TPG cautions investors that this extraordinary arbitrage "gravy train" will run out of track--probably this year. It is simply not sustainable long-term.

Moreover, investors should not be lulled into a false sense of security that 19 consecutive state public utility commissions have ruled (in addition to a recent Federal Court in Texas) that Internet service provider (ISP) traffic passed through a competitive local exchange carrier (CLEC) is classified as a local call. In the coming months, TPG expects the FCC to trump these state decisions by clarifying that Internet traffic is indeed interstate, effectively reasserting its federal jurisdiction over data or Internet transport. *(Reciprocal compensation is a regulatory arrangement where local telecom providers pay each other for "the cost" of terminating the calls they originate. In most cases, reciprocal compensation traffic is two-way and thus largely offsetting. However, since Internet/data traffic is one-way, there is little "reciprocal" about this arrangement. It is just a regulatory compensation windfall for CLECs/ISPs.)*

A Big Deal for Investors: This reciprocal compensation arbitrage is a significant part of the existing "data growth engine" of many CLEC and ISP business models. Consequently, investors need to be aware that in some instances, short-term projected results may be artificially "juiced up," potentially providing an illusion of faster-than-real long-term growth. The flip side of this problem is that reciprocal compensation is a significant and growing liability, primarily for the Baby Bells. It is growing at such a rapid rate that it could be a significant threat to earnings roughly in 1999, if not fixed by the FCC by then.

Why the FCC Will Fix It: First, reciprocal compensation for one-way Internet traffic is arguably the single greatest arbitrage opportunity and hence market distortion in the telecom sector today. TPG flagged this important issue in our April 6 *"Internet Regulation Preview"* bulletin as akin to a broken bank ATM machine that only allows withdrawals and takes no deposits. No other place in the sector can companies reap as much as a 4,000 percent arbitrage for minimal, value-added service. No competitive market, legal or illicit, can generate such gargantuan arbitrage. Only regulatory distortions can generate this size arbitrage over an extended period of time.

Second, this arbitrage opportunity is greatly contributing to an artificial misalignment of the market structure of this newly emerging competitive voice/data niche. Reciprocal compensation is driving many alliances, mergers and acquisitions for purely regulatory and not economic or competitive reasons. Thus, in some instances, an ISP is currently an asset to a CLEC, but could become a serious liability without the arbitrage of reciprocal compensation. Third, it discourages economically sound facilities-based local investment and inhibits the development of an efficient competitive market. It has the perverse effect of turning customers from assets into liabilities. Why would any competitor want to win a customer if that customer would cost them more in reciprocal compensation terminating minutes than they could earn in revenue from that customer?

What to Expect From the FCC: Investors need to appreciate that it is not that hard for the FCC to fix this in the coming months. ALTS, the association representing the CLECs, has an active petition (dated June 20, 1997) requesting that the FCC issue a clarification that the traffic in question is local and not interstate. ALTS argues in its petition that "this clarification is clearly in the Commission's (FCC) exclusive jurisdiction." For FCC legal authority, ALTS cites a 1980 Computer II FCC decision which was subsequently upheld in the DC Court of Appeals in 1982 and again in 1984. Now that the states have ruled the CLECs' way, the association likely regrets having requested this clarification from the FCC.

Why would the FCC believe such Internet calls are not local, but interstate? The FCC has exempted this traffic from interstate access charges for over a decade. Why would an exemption from interstate access charges be needed if the FCC thought it was a local call? Moreover, in the FCC's April 10 report to Congress, (paragraph 106) the FCC said that ISPs "are not entitled to reciprocal compensation for terminating local telecommunications traffic." However, the FCC explicitly did not comment on whether CLECs that serve ISPs are entitled to reciprocal compensation for terminating Internet traffic. They said that issue was now before the FCC. • • • • •

Attachment 2

Internet Traffic Is Not Subject to Reciprocal Compensation

As the Commission's own prior decisions make clear, calls bound for the Internet are interexchange and predominantly interstate, rather than local, and are not subject to the payment of reciprocal compensation.

1. Internet calls are not local. When a person sitting at a keyboard at home in Washington, D.C. dials in to the Internet, he or she is able to communicate with, and receive information from, other Internet users around the world. During any given call, he or she may read the day's news in the electronic version of the New York Times stored in New York City, check on breaking stories in the computers of CNN in Atlanta, and/or tap into historical archives stored half the world away in New Zealand.

Despite this fact, a number of state commissions have concluded that calls bound for the Internet should be treated as "local" calls, and should be subject to the payment of reciprocal compensation.

They have done so, in large part, based on a mistaken reading of this Commission's orders creating the so-called "ESP exemption." But those orders merely exempt Internet and other enhanced service providers from paying the interstate access charges that otherwise would apply. They do not classify the traffic as "local." On the contrary, the only reason for an exemption in the first place is that the Commission recognized that this is not local traffic – it is interexchange. If it wasn't, no exemption would be needed.

Indeed, the Commission consistently has classified this traffic as interexchange, and predominantly interstate, since its first order creating the ESP exemption and continuing through the present – reiterating the conclusion most recently in its report to Congress on universal service. See, e.g., MTS and WATS Market Structure, 97 FCC 2d 682, ¶ 78 (1983) (ESPs use "local exchange services or facilities . . . for the purpose of completing interstate calls"); id. at ¶ 83 (ESPs use "exchange service for jurisdictionally interstate communications"); Amendments of Part 69 of the Commission's Rules, 2 FCC Rcd 4305, 4306 (1987) (ESPs "like facilities-based interexchange carriers and resellers, use the local network to provide interstate services"); In re Access Charge Reform, 11 FCC Rcd 21354, ¶ 284 (ESPs use "incumbent LEC facilities to originate and terminate interstate calls"); Universal Service Report, ¶ 146 (ESPs use "local exchange networks to originate and terminate interstate services").

2. Internet calls are not two calls. Despite this unbroken chain of decisions extending over 15 years, some parties now assert that Internet calls should be treated as two separate calls, and that the first "call" to the Internet service provider should be

classified as "local." But the short answer to this claim is that it too is foreclosed by a long and consistent line of prior decisions by this Commission.

As the Commission itself has explained, when a customer calls his or her Internet service provider, the call does not stop at that point, but is instead connected to the Internet, and through it, to the caller's chosen destinations around the world. As the Commission puts it: "An end-user may obtain access to the Internet from an Internet service provider, by using dial-up or dedicated access to connect to the Internet service provider's processor. The Internet service provider, in turn, connects the end user to an Internet backbone provider that carries traffic to and from other Internet host sites." Non-Accounting Safeguards Order, 11 FCC Rcd 21905, ¶ 127, n. 291 (1996).

Under identical circumstances, the Commission consistently has held that the "nature of a call is determined by its ultimate origination and termination, and not . . . its intermediate routing." See Southwestern Bell Tel. Co., 3 FCC Rcd 2339, ¶ 26 (1988). For example, in the context of calling cards and other services where a customer first dials an 800 number and receives a second dial tone before connecting to his or her ultimate destination, the Commission repeatedly has rejected arguments that there are two calls involved. Id. at ¶ 28; see also Long Distance/USA, Inc., 10 FCC Rcd 1634, ¶ 13 (1995) ("[B]oth court and Commission decisions have considered the end-to-end nature of the communications more significant than the facilities used to complete such communications;" "[A] single interstate communication does not become two communications because it passes through intermediate switching facilities."); Teleconnect Company v. Bell Tel. of Pa., 10 FCC Rcd 1626, ¶ 12 (1995) (same), aff'd sub nom. 116 F.3d 593 (D.C. Cir. 1997).

This conclusion does not change merely because the customer has the option of dialing a local, rather than 800, number prior to being connected to his or her ultimate destination. This is no different than a call made to a Feature Group A access line to place a long distance call. Even though the caller's line and the Feature Group A line are in the same local calling area, and the customer dials a local number, the Commission always has looked to the ultimate destination to determine that calls made using these arrangements are interexchange and interstate. See, e.g., Determination of Interstate and Intrastate Usage of Feature Group A, 4 FCC Rcd 8448 (1989).

Nor does the conclusion change merely because some portion of the end to end communication may be stored locally before being retrieved by the customer. Again, the Commission has decided this very issue in the context of voice mail services, where it rejected a claim that the delivery of a voice message involves two separate, jurisdictionally distinct calls. According to the Commission, "the key to jurisdiction is the nature of the communication itself rather than the physical location of the technology," and the local storage and local delivery of a message left by an out of state caller does not change the interstate nature of the end to end communication. BellSouth Emergency Petition, 7 FCC Rcd 1619, ¶ 12 (1992), quoting New York Tel. Co. V. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980). On the contrary, "an out-of-state call to [a] voice

mail service is a jurisdictionally interstate communication, just as is any other out-of-state call to a person or service." Id.

Finally, the Commission's recent report to Congress on universal service does nothing to change all this. The parties who argue otherwise base their claim on the fact that the Commission said an Internet call has two distinct components, one of which is a telecommunications service and one of which is an information service. But the simple fact is that this has nothing to do with the end-to-end nature of the communication. The Commission itself expressly said as much: "We make no determination here on the question of whether competitive LECs that serve Internet service providers (or Internet service providers that have voluntarily become competitive LECs) are entitled to reciprocal compensation for terminating Internet traffic. That issue, which is now before the Commission, does not turn on the status of the Internet service provider as a telecommunications carrier or information service provider." Report to Congress, CC Dkt 96-45, at n. 220 (rel. Apr. 10, 1998) (emphasis added).

3. Internet calls are not subject to reciprocal compensation. The significance of all of this is straightforward: Because Internet traffic is not "local," it is not subject to the payment of reciprocal compensation when it is handed off to another carrier for delivery to an Internet service provider.

The Commission has firmly established that, as a matter of law, interconnecting carriers are entitled to receive reciprocal compensation only for the transport and termination of local calls. As the Commission has explained, "[t]he Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long-distance traffic." Local Interconnection Order, 11 FCC Rcd 15499, ¶¶ 1033 (1996). For this reason, the reciprocal compensation obligations imposed by the Act "apply only to traffic that originates and terminates within a local calling area, as defined [by a state commission];" they "do not apply to the transport and termination of interstate or intrastate interexchange traffic." Id., ¶¶ 1034-35. This distinction between local and interexchange traffic, moreover, was upheld on appeal and is now final. Comptel v. FCC, 117 F.3d 1068 (8th Cir. 1997).

In sum, Internet-bound traffic is not local, and is not subject to the payment of reciprocal compensation.

* * * * *

Dale (Zeke) Robertson
Senior Vice President

SBC Telecommunications, Inc.
1401 I Street, N.W.
Suite 1100
Washington, D.C. 20005
Phone 202 326-8856
Fax 202 289-3699

August 14, 1998

The Honorable William E. Kennard
Chairman, Federal Communications Commission
1919 M Street, NW, Room 814
Washington, D.C. 20554

Re: Jurisdictional Nature of Calls to Internet Service Providers: CCB/CPD 97-30

Dear Chairman Kennard:

In a July 23, 1998 ex parte submission, WorldCom, Inc. ("WorldCom"), urged the Commission to neither assert its jurisdiction over Internet traffic nor to clarify that such traffic is not subject to reciprocal compensation agreements for local traffic.[1] The Commission should not take WorldCom's advice. Instead, now is the time for the Commission to descend from its perch on the fence and resolve this long-running debate by asserting its jurisdiction over Internet traffic. The attached materials demonstrate such action would:

- not cause material financial harm to CLECs, including those terminating Internet traffic to ISPs,
- be consistent with many state decisions that acknowledge Commission action may necessitate a revisiting of their determinations, and
- be consistent with long precedent.

NO MATERIAL HARM TO CLECS

The financial community has been observing and analyzing this regulatory anomaly. The report "What Reciprocal Compensation Means to the CLECs" by James Henry of Bear Stearns is included as Attachment I. The report finds that:

- "... the exposure of the CLEC group as a whole is minimal" and
- "It seems that nearly 80% of the reciprocal compensation payments are going to other large carriers like MCI and WorldCom. As such, for the majority of the CLECs, we believe that investors should not lose any sleep over this issue."

[1] Letter from Catherine R. Sloan, Vice President, Federal Affairs, WorldCom, Inc., to the Honorable William E. Kennard, Chairman, FCC, dated July 21, 1998 ("WorldCom Letter").

Reports such as this one and Scott Cleland's "Reciprocal Comp For Internet Traffic – Gravy Train Running Out Of Track" (Attachment II) indicate that the financial marketplace has already factored in anticipated changes to existing reciprocal compensation claims for Internet traffic into their evaluations of CLEC investments.

IMPACT ON STATE ORDERS

State commissions have been forced to effect interim practices in the absence of a definitive conclusion by this Commission. As demonstrated by the Attachment III, many states which have addressed this issue have recognized that this matter is before the Commission and indicated that their decisions may require revisiting once the FCC issues a ruling. In essence, such states have essentially deferred to this Commission's authority in this matter. Consequently, the actions of the states should not be construed to indicate definitively that Internet traffic is local, as argued by WorldCom and others.

PRECEDENT

Consistently, throughout the past one and one-half decades, this Commission has held that Internet traffic is interstate which, except for the Enhance Service Provider ("ESP") exemption, would be subject to interstate access charges.[2] As part of the ESP exemption, the FCC concluded that local service charges would apply to such traffic. However, in no way did the FCC find that Internet traffic is local and therefore under the jurisdiction of the various State commissions and ripe for reciprocal compensation under Rule 51.701. *Indeed, if Internet traffic is, or ever was, local telecommunications service an exemption from interstate access charge would be unnecessary.*

The actions of the LECs since the inception of the ESP exemption cannot now be used by WorldCom and others to demonstrate that Internet traffic is local telecommunications service. The LECs billed local access charges in compliance with the mandate of the Commission, not as an admission of jurisdictionality. In fact, LECs have continually sought to reverse the ESP exemption in order to correctly bill Internet service providers ("ISPs") for their interstate access services. Moreover, the negotiations between LECs and CLECs, as alluded to in the WorldCom letter, were conducted in an environment in which the LECs presumed that this Commission would preserve its long-held position that Internet traffic is indeed subject to Federal jurisdiction.

IN CONCLUSION

In order to bring this matter to a rational resolution, the Commission must act expediently to rule in CCB/CPD 97-30[3] with a definitive conclusion regarding the inapplicability of

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[2] For a detailed chronology, see SBC's May 8, 1998 ex parte filing at Tab 1.

[3] It should be noted that WorldCom has incorrectly indicated that "no pending proceeding on this issue" exists. Although ALTS has filed to withdraw its request for clarification, the proceeding continues to exist, even to the extent that WorldCom filed the instant ex parte within that proceeding. Further, the

reciprocal compensation payments for Internet traffic. Absent any action by this Commission or in the event this Commission would find that Internet traffic is local in nature, the industry would realize a significant shift in the demand for interstate access services. It can reasonably be expected that consumers would shift their demand for interstate services to the intrastate jurisdiction relying on the void created by this Commission's inaction or incorrect action. To finally conclude the ongoing debates that serve only to slow development of competition, the Commission should include in its Order the following language: "Because Internet traffic is subject to Interstate jurisdiction, imposition of payments for local reciprocal compensation for such traffic without the express and unambiguous agreement of the parties to such a provision or interpretation is inconsistent with the Telecommunications Act of 1996."

The marketplace needs this Commission's clear declaration that Internet traffic should not be subject to local reciprocal compensation, and it needs it now.

Sincerely,

Dale Robertson (JJB)

Attachments

cc: Commissioner Furchtgott-Roth
Commissioner Ness
Commissioner Powell
Commissioner Tristani
Kathryn Brown, CCB Chief
Jim Schlichting, CCB Deputy Chief

Commission has indicated this matter is currently under its consideration and remains unresolved. (See June 29, 1998 Memorandum of the Federal Communications Commission as Amicus Curiae in Case No. MO-98-CA-43, U.S. Dist. Ct., W.D., Texas)

What Reciprocal Compensation Means To The CLECs

What Is Reciprocal Compensation? Under the Telecommunications Act of 1996 and the FCC's Interconnection Order, it was established that local carriers (CLECs and ILECs) need to have a mechanism in place in order to compensate each other for the exchange of local traffic. Reciprocal Compensation, one of these mechanisms, dictates that a carrier will pay another carrier approximately 0.7 cents per minute for terminating a call on its network. As such, if a customer of Bell Atlantic places a local call to a customer of Teleport, Bell Atlantic will have to pay 0.7 cents per minute to Teleport. The same is true in reverse if a customer of Teleport calls a customer of Bell Atlantic.

Sounds Logical, So What's The Issue? Reciprocal Compensation is a very equitable arrangement in many cases since the average local customer has about as much incoming traffic as outgoing traffic. However, CLECs have very intelligently targeted high-volume customers like Internet Service Providers (ISPs) that have lots of inbound traffic from the ILECs. If I dial into America OnLine's (AOL's) local access number from my home in New York over my Bell Atlantic phone line, Bell Atlantic will carry that call from my home to its central switching office (CO) and then hand off that call to whichever carrier (typically a CLEC) is providing AOL with that local line. As such, Bell Atlantic will be paying out roughly 0.7 cents per minute for the duration of that call. These payments can get large with ISP customers that stay on line for hours instead of minutes, so the ILECs are crying bloody murder about this issue.

What Has Happened Thus Far? Despite the fact that ILECs have contractual obligations to pay the CLECs for reciprocal compensation on calls to ISPs, they have largely refused to make payments and are disputing this issue to the highest possible authority. This process has not gone particularly well for the ILECs since they have lost 21 out of 21 state rulings and court cases which ruled on the issue in favor of the CLECs. In these cases, the courts largely ruled with respect to the ILEC's contractual obligation under the negotiated interconnection deals and typically did not make judgements as to whether calls to ISPs were local or long distance calls and therefore whether they were subject to reciprocal compensation payments. Consequently, the ILECs are now seeking a "clarification" from the FCC as to whether calls to ISPs are local or long distance. If the FCC says that they are long distance calls then the ILECs will claim in court that only local calls are subject to reciprocal compensation.

What Is Likely To Happen? Consensus beliefs are that ISP-related reciprocal compensation is likely to be greatly diminished in profitability or disappear entirely by year 2000 time frame when the initial round of interconnection agreements comes up for renegotiation. The question is whether something happens before that as a result of the recent CLEC and ILEC initiatives. Based on feedback from a broad variety of industry sources, we would not be surprised if the FCC opted to make some decision or clarification on this issue at some point after Labor Day. While we would not venture to guess exactly when a decision will be made and what the specific outcome will be, we do believe that investors need to be aware of each CLEC's exposure to the reciprocal compensation issue so that they can make informed investment decisions when the time comes. While some are inclined to say that any decision will be a one-sided victory for either the ILECs or the CLECs, investors should recall that the FCC has typically been very evenhanded in its rulings in the past. As such, we would expect any action on reciprocal compensation to include a transition mechanism that would ease the impact of any reduction of payments.

BEAR STEARNS

James H. Henry
(212) 272-2741
jhenry@bear.com

What Are The Implications For The CLECs. By and large, our research reveals that the CLECs have relatively minimal exposure to reciprocal compensation. We were pleasantly surprised by this discovery given the statements by the ILECs that they expect to pay out $600 million in reciprocal compensation in revenue in 1998 and up to $1.5 billion in 1999. With exception of US LEC, which generated 60% of its 2Q98 revenue from ISP-related reciprocal compensation revenue, only one of the CLECs had more than 15% of 2Q98 revenue related to reciprocal compensation. In fact eight had less than 10% of revenue from this segment and another eight had no exposure at all. It seems that nearly 80% of the reciprocal compensation payments are going to other larger carriers like MCI and WorldCom. As such, for the majority of the CLECs, we believe that investors should not lose any sleep over this issue.

What About The Impact On CLEC EBITDA? Even though the percentage of revenue is minimal for most of the CLECs, the percentage of EBITDA is clearly more significant given the 80%-plus margin that reciprocal compensation revenue carries. That said, we still believe that this issue should not be a significant concern given the high growth rates that the CLECs are posting and the powerful operating leverage that they are demonstrating in their core businesses. ICG Communications posted a sequential EBITDA improvement of $7.2 million in 2Q98 as its gross margins expanded by 590 basis points. This feat was accomplished in spite of the fact that its reciprocal compensation revenue declined to $6.6 million from $8.5 million in 1Q98. Moreover, we believe that CLEC EBITDA estimates for 1999E are conservative enough to create a cushion if reciprocal compensation dries up sooner than expected.

Net-Net. Our intent in this piece is to alert investors to an issue that we expect will come to a head during the next quarter. While only time will tell how this issue will be resolved, we wanted to put forth data that will enable investors to make objective decisions about which companies have relevant exposure to reciprocal compensation and which companies do not. Our conclusion is that the exposure of the CLEC group as a whole is minimal. The following table lists each of the stocks in our CLEC universe along with details about their exposure to reciprocal compensation.

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James H. Henry
(212) 272-2741
jhenry@bear.com

Table 1. CLEC Exposure To Reciprocal Compensation

Company Name	2Q98 Reciprocal Comp. Revenue	% Of Total 2Q98 Revenue	Comments On Company Exposure To Reciprocal Compensation
Advanced Radio Telecom Corp. (ARTT-$4 13/16)	$0.0	0.0%	As an early stage company with only $0.2 million in 2Q98 revenue and no switched services revenue, ARTT has ***no exposure*** to the reciprocal compensation issue. Estimates for 1999 do not reflect any revenue from this source.
COLT Telecom Group PLC (COLTY-$167 1/8)	£0.0	0.0%	As an international CLEC, COLTY has ***no exposure*** to the reciprocal compensation issue by virtue of the fact that local lines in most of its markets are billed on a usage sensitive basis so the incumbent PTT collects a per minute rate that offsets the fees that it pays out to COLTY for the termination of local traffic.
Concentric Network Corp. (CNCX-$20 3/8)	$0.0	0.0%	As an Internet and data services provider CNCX has ***no exposure*** to reciprocal compensation. Although it has filed for CLEC status in a number of states, that was largely to reduce its interconnection and line costs as opposed to taking advantage of reciprocal compensation.
e.spire Communications, Inc. (ESPI-$18 ½)	$3.5	9.8%	ESPI has ***little exposure*** to the reciprocal compensation issue since it generates less than 10% of its revenue from this source. While this percentage of revenue may seem high relative to some of its peers, bear in mind that ESPI is posting growth rates in its core telecom service business that far exceeds most of its peers. As such, the percentage of 1999E revenue should be significantly less. Moreover, ESPI is not targeted to hit EBITDA breakeven until 2Q99, leaving it plenty of time to refocus on other initiatives in the event that the FCC rules against the CLECs on reciprocal compensation.
GST Telecommunications, Inc. (GSTX-$12 3/8)	$0.0	0.0%	GSTX has a healthy business providing PRI lines to Internet Service Providers (ISPs) but has not been reporting any of its reciprocal compensation revenue thus far. As such, it has ***no exposure*** to this issue and could actually see upward revisions to estimates if the issue is resolved in favor of the CLECs. 1999 estimates do not reflect any reciprocal compensation revenue.

BEAR STEARNS

James H. Henry
(212) 272-2741
jhenry@bear.com

Hyperion Telecommunications, Inc. (HYPT-$13 7/8)	$1.3	17.1%	HYPT has *some exposure* to the reciprocal compensation issue as it has more than 10% of total revenue related to this line of business. That said, the company's growth rate is so high that we would expect the percentage of 1999E revenue to be well less than 10%. In addition, the company is not expected to hit EBITDA breakeven until some time in 1999, leaving it plenty of time to refocus its business initiatives on other areas.
ICG Communications, Inc. (ICGX-$25 ¾)	$6.6	4.8%	ICGX has *little exposure* to the reciprocal compensation issue as it has less than 10% of total revenue related to this line of business. We believe that our 1999 revenue and EBITDA estimates of $700 million and $100 million, respectively, reflect little impact from reciprocal compensation. 1999E EBITDA could be approximately $85 million if reciprocal compensation disappears all together in 1999. ICGX recently reached an agreement with Pacific Bell in California for the RBOC to pay 0.3 cents per minute for reciprocal compensation but has not yet started collecting cash.
Intermedia Communications Inc. (ICIX-$35 13/16)	$8.0	4.2%	ICIX has *little exposure* to the reciprocal compensation issue as it has less than 10% of total revenue related to this line of business. Moreover, we estimate that only $6.4 million of the $190.2 million in total 2Q98 revenue originates from ISPs and is therefore subject to risk. We believe that our 1999 revenue and EBITDA estimates of $1.1 billion and $175 million, respectively, reflect little if any impact from reciprocal compensation. We would also point out that 1999 estimates reflect little if any revenue or EBITDA contribution from ICIX's agreements with US West and Ameritech, providing additional cushion in the event that reciprocal compensation goes away.
ITC^DeltaCom, Inc. (ITCD-$44 ¾)	$0.2	0.4%	ITCD has very *little exposure* to the reciprocal compensation issue as it has well less then 10% of reported revenue related to that line of business. The company has elected to report only the revenue that it actually collects from the ILECs, which is approximately 10% of the revenue owed. The company has elected to pursue ISP traffic aggressively based on a business case justified solely by PRI rates, not on any reciprocal compensation payments. ITCD could see upward revisions to estimates if the issue is resolved in favorably.

James H. Henry
(212) 272-2741
jhenry@bear.com

McLeodUSA Incorporated (MCLD-$34 ¾)	$0.0	0.0%	MCLD has virtually *no exposure* to the reciprocal compensation issue since it booked only $30,000 of reciprocal compensation revenue in 2Q98. This line of business is not included in any material way in our 1999 estimates.
MetroNet Communications Corp. (METNF-$27 ¾)	C$0.0	0.0%	METNF has *no exposure* to the reciprocal compensation issue by virtue of the fact that the regulatory regime in Canada is based on "bill and keep" interconnection for the time being. The majority of the international players have no risk from this issue.
MGC Communications, Inc. (MGCX-$12)	$0.0	0.0%	MGCX has *no exposure* to the reciprocal compensation issue since it made a conscious decision to sit on the sidelines until the FCC and the courts made a final decision on the subject. The company's strong positive EBITDA and EBIT in its initial Las Vegas market after only 6 quarters are great evidence that the growth and profitability of the CLEC model, particularly the switch-based model, is by no means dependent on any reciprocal compensation revenue stream.
NEXTLINK Communications, Inc. (NXLK-$35 ½)	$0.3	1.0%	NXLK has virtually *no exposure* to the reciprocal compensation issue since it has primarily focused on providing local dialtone services to business customers. The company's guidance has been that it has "less than $1 million" in revenue from that line of business, with likely less than that coming from ISP circuits.
RCN Corp. (RCNC-$20 15/16)	$0.1	0.2%	RCNC has virtually *no exposure* to the reciprocal compensation issue since it has almost no revenue coming from this line of business. The company has stated that ISP reciprocal compensation is not a focus of its business and that it is primarily focused on installing local lines for its retail residential customers.
Teleport Communications Group, Inc. (T-$57 5/8)	$4.5	1.5%	TCGI had virtually *no exposure* to the reciprocal compensation issue since less than 10% of its 2Q98 revenue originated from this source. We were surprised by the relatively small size of the this number, but apparently the company has many "bill and keep" interconnection agreements. An annualized reciprocal compensation figure of $20 million is far less than a rounding error on the income statement of TCGI's new parent AT&T, so investors should not be concerned about this issue.

James H. Henry
(212) 272-2741
jhenry@bear.com

Teligent Corp. (TGNT-$26 1/8)	$0.0	0.0%	As an early stage startup, Teligent has *no exposure* to the reciprocal compensation because it has virtually no revenue at this point in time. The company is expected to launch a full-scale deployment of its broadband wireless services during 2H98, focusing on business customers. We see no risk to its 1999 revenue or EBITDA estimates related to this issue.
US LEC Corp. (CLEC-$19 5/8)	$12.2 million	66.7%	CLEC has *significant exposure* to the reciprocal compensation by virtue of the fact that the majority of its revenue mix comes from this source. In our May 19, 1998 initiation of coverage, we referenced the company's exposure to this revenue stream and the expectation that this reciprocal compensation revenue opportunity would eventually disappear. As such our enthusiasm of the company was and is based on the skill of its management team and its strong prospects for market share gains in its business customer focused initiatives. The company has an annualized revenue run rate of $24.5 million after only 6 quarters of operations from businesses other than reciprocal compensation. 60% of our 1999 revenue estimate of $155 million comes from sources other than reciprocal compensation. While we would clearly expect the stock to get hit in the event of a negative FCC ruling on reciprocal compensation, we believe that the company is creating enduring value for its investors within its core business.
WinStar Communications, Inc. (WCII-$30)	$0.1	0.5%	WCII has virtually *no exposure* to reciprocal compensation and said on its 2Q98 conference call that it has no intention of pursuing a business line that it expects to disappear within 24 months.

All Stocks priced August 5, 1998

BEAR STEARNS

James H. Henry
(212) 272-2741
jhenry@bear.com

MASON [illegible]
[illegible] Washington, DC [illegible]
Phone [illegible] Fax [illegible]

[illegible] TECHNOLOGY TEAM
Precursor Research
Scott C. Cleland
June 24, 1998

Reciprocal Comp For Internet Traffic--Gravy Train Running Out Of Track

(Part V of Internet Regulation Preview Series)

Summary: In a classic case of what you see is not necessarily what you get, investors should not expect the current reciprocal compensation arrangement for Internet traffic to continue much past the end of the year. Given that this issue is probably the single greatest opportunity for arbitrage in the whole sector, over 4,000 percent in some instances, TPG cautions investors that this extraordinary arbitrage "gravy train" will run out of track–probably this year. It is simply not sustainable long-term.

Moreover, investors should not be lulled into a false sense of security that 19 consecutive state public utility commissions have ruled (in addition to a recent Federal Court in Texas) that Internet service provider (ISP) traffic passed through a competitive local exchange carrier (CLEC) is classified as a local call. In the coming months, TPG expects the FCC to trump these state decisions by clarifying that Internet traffic is indeed interstate, effectively reasserting its federal jurisdiction over data or Internet transport. *(Reciprocal compensation is a regulatory arrangement where local telecom providers pay each other for "the cost" of terminating the calls they originate. In most cases, reciprocal compensation traffic is two-way and thus largely offsetting. However, since Internet/data traffic is one-way, there is little "reciprocal" about this arrangement. It is just a regulatory compensation windfall for CLECs/ISPs.)*

A Big Deal for Investors: This reciprocal compensation arbitrage is a significant part of the existing "data growth engine" of many CLEC and ISP business models. Consequently, investors need to be aware that in some instances, short-term projected results may be artificially "juiced up," potentially providing an illusion of faster-than-real long-term growth. The flip side of this problem is that reciprocal compensation is a significant and growing liability, primarily for the Baby Bells. It is growing at such a rapid rate that it could be a significant threat to earnings roughly in 1999, if not fixed by the FCC by then.

Why the FCC Will Fix It: First, reciprocal compensation for one-way Internet traffic is arguably the single greatest arbitrage opportunity and hence market distortion in the telecom sector today. TPG flagged this important issue in our April 5 "*Internet Regulation Preview*" bulletin as akin to a broken bank ATM machine that only allows withdrawals and takes no deposits. No other place in the sector can companies reap as much as a 4,000 percent arbitrage for minimal, value-added service. No competitive market, legal or illicit, can generate such gargantuan arbitrage. Only regulatory distortions can generate this size arbitrage over an extended period of time.

Second, this arbitrage opportunity is greatly contributing to an artificial misalignment of the market structure of this newly emerging competitive voice/data niche. Reciprocal compensation is driving many alliances, mergers and acquisitions for purely regulatory and not economic or competitive reasons. Thus, in some instances, an ISP is currently an asset to a CLEC, but could become a serious liability without the arbitrage of reciprocal compensation. Third, it discourages economically sound facilities-based local investment and inhibits the development of an efficient competitive market. It has the perverse effect of turning customers from assets into liabilities. Why would any competitor want to win a customer if that customer would cost them more in reciprocal compensation terminating minutes than they could earn in revenue from that customer?

What to Expect From the FCC: Investors need to appreciate that it is not that hard for the FCC to fix this in the coming months. ALTS, the association representing the CLECs, has an active petition (dated June 20, 1997) requesting that the FCC issue a clarification that the traffic in question is local and not interstate. ALTS argues in its petition that "this clarification is clearly in the Commission's (FCC) exclusive jurisdiction." For FCC legal authority, ALTS cites a 1980 Computer II FCC decision which was subsequently upheld in the DC Court of Appeals in 1982 and again in 1984. Now that the states have ruled the CLECs' way, the association likely regrets having requested this clarification from the FCC.

Why would the FCC believe such Internet calls are not local but interstate? The FCC has exempted this traffic from interstate access charges for over a decade. Why would an exemption from interstate access charges be needed if the FCC thought it was a local call? Moreover, in the FCC's April 10 report to Congress, (paragraph 106) the FCC said that ISPs "are not entitled to reciprocal compensation for terminating local telecommunications traffic." However, the FCC explicitly did not comment on whether CLECs that serve ISPs are entitled to reciprocal compensation for terminating Internet traffic. They said that issue was now before the FCC. * * * * *

Internet Traffic Terminating Compensation Issue

SEVERAL STATES ACTED PENDING FCC REVIEW OF THIS ISSUE OR RECOGNIZING THAT THEIR ORDERS MAY NEED TO BE LATER MODIFIED BASED ON A FCC RULING.

State	Docket Reference	Quote
Arizona	**Petition of MFS for Arbitration of Interconnection Rates, Terms and Conditions with US West Communications, Inc., Docket Nos. U-2752-96-362, et. al., Opinion and Order dated October 23, 1996.**	**"The Commission will adopt the exemption permitted by the FCC. However, the Agreement should indicate that if and when the FCC modifies the access charge exemption, the Agreement will also be modified." (p. 7)**
Delaware	**Petition of MCI for the Arbitration of Unresolved Interconnection Issues with Bell Atlantic, Docket No. 97-323, Arbitration Award dated December 16, 1997.**	**"The FCC may someday reach a clearly contradictory conclusion. However, there is no reason to assume in advance that it will. Moreover, a deferral of authority here appears to leave a substantial gap in the event that there is no such FCC determination. In contrast, exercising authority here to adopt the position urged by BA-DEL presents no substantial problem should the FCC decide in the future that it will use federal authority to negate the action taken here. Thus, there are also substantial practical grounds to favor reaching a decision on this issue in this arbitration, rather than deferring one indefinitely, as BA-Del proposes." (pp. 14-15)**
Illinois	**Teleport Communications Group Inc. vs. Illinois Bell; Complaint as to Dispute over a Contract Definition, Docket Nos. 97-0404, et al., Order dated March 11, 1998.**	**"There is no dispute that the FCC is currently considering various issues regarding Internet communications. However, the initiation of that proceeding provides an insufficient basis for deferring a decision here. It is possible that the FCC may reverse itself and institute some type of access charge or other compensation regime which would be applicable to carriers, or ISPs or other telecommunications end-users. It is also quite plausible that the FCC may conclude that the current situation so recently determined by the FCC, should remain undisturbed. The ultimate conclusion, as well as its timing can only be the subject of speculation. This Commission anticipates that if the FCC institutes a change in policy which impacts the interconnection agreements or any other aspect of state policy, the parties will bring that matter to the Commission's attention in an appropriate fashion." (p. 13)**

Internet Traffic Terminating Compensation Issue

SEVERAL STATES ACTED PENDING FCC REVIEW OF THIS ISSUE OR RECOGNIZING THAT THEIR ORDERS MAY NEED TO BE LATER MODIFIED BASED ON A FCC RULING.

State	*Docket Reference*	*Quote*
Maryland	**Complaint against Bell Atlantic-Maryland, Inc. for Breach of Interconnection Terms, and Request for Immediate Relief by MFS Intelenet, Letter to David E. Hall and Andrew D. Lipman by MD P.S.C, dated September 11, 1997.**	**"Moreover, we note that this matter is currently being considered by the FCC and may ultimately be resolved by it ... In the event that the FCC issues a decision that requires revisions to the directives announced herein, the Commission expects that the parties will so advise it."**
Michigan	**Application for Approval of an Interconnection Agreement between Brooks Fiber and Ameritech, Case Nos. U-11178, et al., Opinion and Order dated January 28, 1998.**	**"The Commission concludes that it need not withhold a ruling at this time ... When the FCC rules in the pending docket, the Commission can determine what action, if any, is required." (pp. 14-15)**
Missouri	**Petition of Birch Telecom for Arbitration of the Rates, Terms, Conditions and Related Arrangements for Interconnection With Southwestern Bell Telephone Company, Case No. TO-98-278, Order dated April 23, 1998.**	**"The record presented by the parties is not sufficiently persuasive to make a final decision on the reciprocal compensation issue in light of the FCC's pending proceeding on the same issue." (p. 7)** **"...the Commission finds that it would not be appropriate to *determine whether the traffic to ISPs constitutes local traffic* until the issue of compensation is resolved by the FCC. The Commission will direct the parties to file a notice with the Commission within ten days after the FCC makes its determination on the reciprocal compensation issue." (p. 7)**
West Virginia	**Petition for Arbitration of Unresolved Issues for the Interconnection Negotiations between MCI and Bell Atlantic, Case No. 97-1210-T-PC, Order dated January 13, 1998.**	**"If the FCC should change its position, then the Commission expects interconnection agreements to be applied in accordance with the FCC's new policy." (p. 30)** **"The Internet-bound traffic issue is currently pending before the FCC." (p. 39)** **"The Parties shall bring the FCC's final determination regarding this issue to the Commission's attention as soon as possible to allow the Commission to consider whether any further action is appropriate." (p. 40).**

Internet Traffic Terminating Compensation Issue

SEVERAL STATES ACTED PENDING FCC REVIEW OF THIS ISSUE OR RECOGNIZING THAT THEIR ORDERS MAY NEED TO BE LATER MODIFIED BASED ON A FCC RULING.

State	*Docket Reference*	*Quote*
Wisconsin	**Contractual Dispute About the Terms of Interconnection Agreement Between Ameritech and TCG, Docket Nos. 5837-TD-100, et. al., Letter to Ms. Rhonda Johnson and Mr. Mike Paulson by WI P.S.C. Staff dated March 31, 1998.**	**"Although the FCC may some day reach a different conclusion than the Commission, we have no reason to presume in advance that such will be the case. The parties can always bring any FCC decision to the attention of the Commission, so it can consider whether further action is appropriate." (p. 4)** **"The Commission also decided that postponing a decision to await a Federal Communications Commission decision is not in the parties' interest or in the public interest."**

Internet Traffic Terminating Compensation Issue

STATE ORDERS BASED ON THE NOTION THAT THERE WAS NOTHING IN PREVIOUS FCC RULINGS TO PRECLUDE STATE ACTION AND THAT STATE DECISIONS WERE CONSISTENT WITH PREVIOUS FCC ACCESS REFORM AND/OR UNIVERSAL SERVICE DECISIONS.

State	Docket Reference	Quote
Colorado	**Petition of MFS for Arbitration with US West Docket No. 96A-287T, Decision No. C96-1185 dated November 8, 1996.**	**"We have searched the Act and FCC Interconnection Order and find no reference to this issue." (p. 30)**
Connecticut	**Petition of the Southern New England Telephone Company for a Declaratory Ruling, Docket No. 97-05-22, Decision dated September 17, 1997.**	**"The Department considers call originating and terminating between these customers (ISPs and other SNET customers) within the same local calling area to be local, and, therefore, should be subject to the mutual compensation arrangements adopted in the Plan. This is consistent with the FCC's position that ISPs may pay business rates and the appropriate subscriber line chanrge, rather than interstate access rates, even for calls that appear to traverse state boundaries. Access Charge Order ¶342."**
Florida	**Complaint of Worldcom Against BellSouth for Breach of Terms of Interconnection Agreement, Docket No. 971478-TP, Memorandum dated February 26, 1998. Commission decision pending.**	**"Staff believes a finding on the part of the Commission that ISP traffic should be treated as local for purposes of the subject interconnection agreement would be consistent with the FCC's treatment of ISP traffic, all jurisdictional issues aside." (p. 11)**
North Carolina	**Interconnection Agreement Between BellSouth and US LEC, Docket No. P-55, SUB 1027, Order dated February 26, 1998.**	**"The FCC has not squarely addressed this issue, although it may do so in the future. While both sides presented extensive exegeses on the obscurities of FCC rulings bearing on ISPs, there is nothing positive in the FCC rulings thus far." (p. 7)**
Oklahoma	**Application of Brooks Fiber for an Order concerning Internet Traffic, Cause No. PUD 970000548, Order No. 423626 dated June 3, 1998.**	**"The Commission finds it noteworthy that to date the FCC has not attempted to block those decisions on the grounds that the calls are inherently interexchange and interstate in nature, as alleged by SWBT." (p. 10)** **"No support has been offered to show that the FCC has acted in any manner to limit or dictate the type of compensation local exchange carriers can assess each other under an interconnection agreement for termination of traffic destined to ISPs." (p. 11)**

Internet Traffic Terminating Compensation Issue

STATE ORDERS BASED ON THE NOTION THAT THERE WAS NOTHING IN PREVIOUS FCC RULINGS TO PRECLUDE STATE ACTION AND THAT STATE DECISIONS WERE CONSISTENT WITH PREVIOUS FCC ACCESS REFORM AND/OR UNIVERSAL SERVICE DECISIONS.

State	Docket Reference	Quote
Oregon	**Petition of MFS for Arbitration, ARB 1, Arbitration Decision dated November 8, 1996.**	**"There is no reason to depart from existing law or speculating what the FCC might ultimately conclude in a future proceeding." (p. 13)**
Texas	**Complaint and Request for Expedited Ruling of Time Warner, Docket No. 18082, Order dated March 2, 1998.**	**"The Commission agrees with the FCC's view that the provision of Internet service via the traditional telecommunications network involves multiple components." (p. 4)**
Washington	**(a) Petition for Arbitration Between MFS and US West, Docket UT-960323, Arbitrator's Report and Decision dated November 8, 1996.** **(b) US West Communications, Inc. v. MFS Intelenet, Inc., et. al., No. C97-222WD, Order on Motions for Summary judgment dated January 7, 1998.**	**" It is premature to change the treatment of ESPs at this time." (p. 26)** **"The WUTC did not act arbitrarily or capriciously in deciding *not to change the current treatment* of ESP call termination from reciprocal compensation to special access fees. The decision was properly based on FCC regulations which exempt ESP providers from paying access charges. See 47 C.F.R. pt. 69." (p. 8)**

BellSouth Telecommunications, Inc.
FPSC Docket No. 981008-TP
Exhibit JH-3
November 3, 1998
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Internet Traffic Terminating Compensation Issue

STATES THAT DID NOT REFERENCE FCC'S ORDERS OR PENDING FCC ACTION IN THEIR DECISIONS.

State	Docket Reference	Quote
Minnesota	**Consolidated Petitions of AT&T, MCImetro, and MFS, for Arbitration with US West, Docket Nos. P-442, et al., Order dated December 2, 1996.** **No reference to the FCC orders or pending action regarding this issue.**	
New York	**Proceeding on Motion of the Commission to Investigate Reciprocal Compensation Related to Internet Traffic, Case No. 97-C-1275, Order Closing Proceeding dated March 19, 1998.** **The only mention of pending FCC action is in the NY Commission's summary of the parties' positions.**	
Virginia	**Petition of Cox for Enforcement of Interconnection Agreement with Bell Atlantic and Arbitration Award, Case No. PUC970069, Final Order dated October 27, 1997.** **No reference to the FCC.**	