

## BELL ATLANTIC TELEPHONE COS. V. FEDERAL COMMUNICATIONS COMMISSION

*By Ernest H. Chen*

Congress enacted the Telecommunications Act of 1996<sup>1</sup> (“the Act”) to promote entry and competition in telecommunications markets, with the ultimate goal of better services and lower prices for consumers.<sup>2</sup> Sections 251 and 252 of the Act specifically address the opening of local telephone markets,<sup>3</sup> which is particularly challenging due to the tremendous economic and default market advantages that the incumbents hold.<sup>4</sup>

To help level the playing field, the Act imposes a set of duties upon local exchange carriers (“LECs”), two of which are network interconnection and reciprocal compensation.<sup>5</sup> Network interconnection is required so that customers of different networks can call one another.<sup>6</sup> The related reciprocal compensation provision is a form of “inter-carrier compensation”<sup>7</sup>

---

© 2001 Regents of the University of California.

1. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.).

2. *Id.* (stating in the preamble that the purpose of the Act is “to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies”).

3. *See* 47 U.S.C. §§ 251-52 (Supp. IV 1998).

4. *See* In the Matter of 1998 Biennial Regulatory Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers; United States Telephone Association’s Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers, 15 F.C.C.R. 242, 265 (Dec. 30, 1999) (stating that “the incumbent LECs had a 97 percent share of the local exchange market in 1997”) [hereinafter 1998 Biennial Regulatory Review]; *see also* In the Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, 12 F.C.C.R. 19,985, ¶ 42 (Aug. 14, 1997) (discussing barriers to entry into the local telecommunications marketplace).

5. 47 U.S.C. §§ 251(b)(1), 251(b)(5), 252(d) (Supp. IV 1998).

6. *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000).

7. When two or more carriers collaborate to complete a call, one carrier compensates the other(s) for their role(s) in completing the call. This is termed “inter-carrier compensation.” *See* In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, 11 F.C.C.R. 15,499, ¶ 1034 (Aug. 8, 1996) [hereinafter Local Competition Order].

that allows an interconnecting LEC to be compensated for its costs in transporting and terminating inbound calls from another LEC's network.<sup>8</sup>

Currently, a debate centers on whether the Act's reciprocal compensation provisions require a LEC to compensate another LEC for completing inbound calls from the first LEC's customers to Internet Service Providers ("ISPs") located on the second LEC's network ("ISP-bound traffic").<sup>9</sup> Because many Competitive LECs ("CLECs") carry more ISP-bound traffic originating from Incumbent LECs' ("ILECs") customers than vice-versa,<sup>10</sup> the FCC's February 1999 decision<sup>11</sup> to exclude ISP-bound traffic from section 251's reciprocal compensation requirement<sup>12</sup> threatened to shift the advantage back to the ILECs and hurt the CLECs' ability to negotiate fair terms for interconnection and reciprocal compensation agreements. The D.C. Circuit vacated the ruling and remanded the case, correctly pointing out that the basis of the FCC decision was unsound,<sup>13</sup> and suggesting that the decision might be inconsistent with the FCC's own precedents.<sup>14</sup> Because the court's criticism of the FCC decision was valid and because inclusion of ISP-bound traffic in reciprocal compensation will further the Act's goals of increasing competition in the local market, lowering prices for consumers, and promoting the Internet, the FCC, on remand, should find section 251's reciprocal compensation requirement to apply to ISP-bound traffic.

---

8. See 47 U.S.C. § 252(d)(2) (Supp. IV 1998).

9. See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic, 14 F.C.C.R. 3689, ¶ 1 (Feb. 26, 1999), *vacated by* 206 F.3d 1 (D.C. Cir. 2000) [hereinafter RC Ruling].

This Note uses the term "ISP-bound traffic" to specifically designate calls by end-users of one LEC network to an Internet Service Provider ("ISP") located within the local calling area but on another LEC network. Note, however, that connections between an end-user and an ISP's server may be long-distance in instances where the ISP's server is located outside of the end-user's local calling area.

10. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000) (stating that CLECs "stand to receive reciprocal compensation on ISP-bound calls" and thus implying that on balance CLECs complete more ISP-bound calls from ILEC networks than vice versa).

11. RC Ruling, *supra* note 9.

12. See *id.* ¶¶ 7, 18, 19, 22; see also *Bell Atlantic*, 206 F.3d at 2-3 ("Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for 'reciprocal compensation' . . .").

13. *Bell Atlantic*, 206 F.3d at 3.

14. See *id.* at 7-8.

## I. BACKGROUND

To facilitate competition through the entry of new local telephone carriers, the Federal Telecommunications Act of 1996 requires all local exchange carriers to interconnect their networks so that customers of different carriers can call one another.<sup>15</sup> The Act further requires LECs to “establish reciprocal compensation arrangements for the transport and termination of telecommunications” in order to compensate interconnected LECs for the costs incurred in completing inbound calls from other networks.<sup>16</sup> Shortly after the passage of the Act, the FCC determined that reciprocal compensation only applies to “local telecommunications traffic.”<sup>17</sup> Thus, reciprocal compensation only comes into play when two LECs serve customers in a single state-defined local calling area.<sup>18</sup>

The Act encourages voluntary negotiations of reciprocal compensation terms,<sup>19</sup> but at the same time, it provides some important basic guidelines.<sup>20</sup> Namely, reciprocal compensation agreements must provide for “mutual and reciprocal recovery by each carrier of costs associated with the transport and termination” of incoming calls.<sup>21</sup> These guidelines are important because interconnection is much more valuable to new entrants (CLECs) than to ILECs,<sup>22</sup> since ILECs, by default, have most of the customers in the market.<sup>23</sup> Therefore, without section 252’s guidelines, ILECs could easily use the value of interconnection to exercise leverage and extract one-way termination fees or charge exorbitantly high termination fees from CLECs.<sup>24</sup>

---

15. *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000) (citing 47 U.S.C. § 251(a)(1) (Supp. IV 1998)).

16. 47 U.S.C. § 251(b)(5) (Supp. IV 1998); *see also* 141 CONG. REC. S5961, S5970 (daily ed. May 1, 1995).

17. 47 C.F.R. § 51.701(a) (1999); *see also* Local Competition Order, *supra* note 7, ¶ 1033 (stating that compensation for the transport and termination of long-distance telecommunications traffic is via access charges and is governed by sections 201 and 202 of the Act).

18. *See Bell Atlantic*, 206 F.3d at 4.

19. *See* 47 U.S.C. §§ 251(c)(1), 252(a)(1) (Supp. IV 1998).

20. *See id.* § 252(d)(2)(A).

21. *Id.*

22. *See* PETER W. HUBER ET AL., THE TELECOMMUNICATIONS ACT OF 1996 SPECIAL REPORT 21 (1996) (“[A]ccess to the incumbent’s ubiquitous network is far more valuable to the new entrant than vice versa.”).

23. *See* 1998 Biennial Regulatory Review, *supra* note 4, at 265 (stating that “the incumbent LECs had a 97 percent share of the local exchange market in 1997”).

24. *See* Local Competition Order, *supra* note 7, ¶ 55.

While the Act permits a wide scope of compensation arrangements (including voluntary “bill-and-keep” arrangements),<sup>25</sup> ILECs generally pushed for a reciprocal compensation scheme based on per-minute traffic<sup>26</sup> and negotiated for relatively high compensation rates (which many parties argued were above costs)<sup>27</sup> because they apparently expected to be net-terminators.<sup>28</sup> The allegedly high termination rates provided an incentive for CLECs to provide service exclusively to customers with high inbound call volume and low outbound call volume;<sup>29</sup> this way, the CLECs would sit on the collecting end of reciprocal compensation agreements.

Reciprocal compensation became a contentious issue between the ILECs and CLECs when the CLECs began winning the business of ISPs and demanding reciprocal compensation payments from ILECs.<sup>30</sup> CLECs with ISP customers received a high volume of inbound calls from ILEC customers dialing into the ISPs’ servers.<sup>31</sup> Since ISPs do not make many outbound calls, these CLECs began to terminate more minutes of inbound calls from ILEC networks than vice-versa. The ILECs thus faced paying out reciprocal compensation at the rates they had negotiated.

---

25. See 47 U.S.C. § 252(d)(2)(B)(i) (Supp. IV 1998).

“[B]ill and keep is a system of reciprocal exchange of traffic in which each company receives something of value and can recover the costs for termination from its own end users in flat monthly charges.” In the Matter of Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers; Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Service Providers, 11 F.C.C.R. 5020, ¶ 37.

26. Donna N. Lampert Associates, P.C., *Competition, Reciprocal Compensation, and Internet-Bound Traffic: Issues and Policy Responses* (Sept. 18, 2000), at <http://www.incongress.com/issues/article.cfm?ArticleID=1263>.

27. See *id.* at 3.

28. A “net-terminator” is a LEC that has more inbound traffic than outbound traffic. Considering that ILECs controlled 97% of the local market in 1997, the ILECs’ prediction that they would be net-terminators was a fair one. The 3% of telephone subscribers with CLECs would probably make more local phone calls to the 97% of subscribers in the ILECs’ domain than vice versa. See 1998 Biennial Regulatory Review, *supra* note 4, at 265; Donna N. Lampert Associates, *supra* note 26, at 3; Kasey A. Chappelle, *The End of the Beginning: Theories and Practical Aspects of Reciprocal Compensation for Internet Traffic*, 7 COMMLAW CONSPECTUS 393, 397-98 (1999).

29. See Chappelle, *supra* note 28, at 398.

30. See Donna N. Lampert Associates, *supra* note 26, at 4; Chappelle, *supra* note 28, at 398.

31. These calls to ISPs also tended to be of long duration. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000).

Many ILECs decided to refuse payment of reciprocal compensation on ISP-bound traffic,<sup>32</sup> arguing that ISP-bound traffic terminates at distant out-of-state websites and is therefore “interstate” traffic, which does not qualify for reciprocal compensation under section 251.<sup>33</sup> The CLECs maintained that ISP-bound traffic terminates locally at the ISPs’ facilities, and is therefore covered by section 251’s reciprocal compensation.<sup>34</sup>

Following some ILECs’ refusal of payment, the ILECs and CLECs took this fight into three arenas. The CLECs petitioned the FCC for a declaratory ruling that ISP-bound traffic is included within the reciprocal compensation provision of section 251 of the Act.<sup>35</sup> The CLECs and ILECs also asked state commissions to rule on reciprocal compensation agreements.<sup>36</sup> Finally, the ILECs sought relief from the 106th Congress in the form of a bill that would exempt ISP-bound traffic from section 251’s reciprocal compensation requirement.<sup>37</sup>

## II. CASE SUMMARY

### A. FCC’s Reciprocal Compensation Ruling

In its February 1999 reciprocal compensation ruling (“*RC Ruling*”), the FCC determined that “ISP-bound traffic is jurisdictionally mixed and appears to be largely interstate,” and therefore is not subject to section 251’s reciprocal compensation requirement, which applies only to “local

---

32. See Chappelle, *supra* note 28, at 398. See, e.g., *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000); *Southwestern Bell Tel. Co. v. Pub. Util. Comm’n of Texas*, 208 F.3d 475, 477 (5th Cir. 2000).

33. See *RC Ruling*, *supra* note 9, ¶¶ 7-8.

34. See *id.*

35. On behalf of its CLEC members, the Association for Local Telecommunications Services (“ALTS”) petitioned the FCC. *Id.* at 3690 n.1.

36. Under the Act, state commissions have the authority to interpret and enforce reciprocal compensation agreements. See 47 U.S.C. § 252 (Supp. IV 1998); *Southwestern Bell*, 208 F.3d at 479-80; see also *Association for Local Telecommunications Services, State and Court Decisions on Reciprocal Compensation* (June 30, 2000), at <http://www.alts.org/Filings/091800StateRecipCompDecisions.pdf> (summarizing state and court decisions on reciprocal compensation).

37. See H.R. 4445, 106th Cong. (2000); S. 2902 106th Cong. (2000). These bills, if passed, would have determined that dial-up calls to ISPs are interstate and not subject to reciprocal compensation. The problem with both of these measures was that while they would have eliminated the current confusion by clearly removing reciprocal compensation obligations for ISP-bound traffic, they did not address the real question of how LECs would be compensated for the real costs incurred in transporting and terminating ISP-bound traffic. Ultimately, the 106th Congress failed to pass either of these bills.

telecommunications services.”<sup>38</sup> But the FCC also added that a state commission may nevertheless “impose[] reciprocal compensation obligations for this traffic.”<sup>39</sup>

The FCC began its reasoning by reiterating a former ruling that section 251’s reciprocal compensation provision only applies to “the transport and termination of ‘local telecommunications traffic,’”<sup>40</sup> because the alternate category of service, long-distance telecommunications, is already covered by access charges.<sup>41</sup> The FCC then explained that it must “determine as a threshold matter whether [ISP-bound traffic] is interstate or intrastate.”<sup>42</sup> Next, the FCC stated that it would make a jurisdictional determination of the nature of ISP-bound traffic by applying an “end-to-end” analysis.<sup>43</sup> To justify using this analysis, the FCC cited two cases where the “end-to-end” analysis was applied: *Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corporation (“BellSouth”)*<sup>44</sup> and *Teleconnect Company v. Bell Telephone Company of Pennsylvania (“Teleconnect”)*.<sup>45</sup>

In *BellSouth*, the FCC considered the jurisdictional nature of traffic that consisted of an incoming interstate call to a voicemail subscriber’s phone and an intrastate forwarding of that call by BellSouth from the subscriber’s phone<sup>46</sup> to BellSouth’s local voicemail facilities.<sup>47</sup> Using an “end-to-end” analysis, the FCC “determined that the entire transmission constituted one interstate call, because there is a continuous path of communications across state lines between the caller and the voice mail service.”<sup>48</sup> Hence, despite the “local” appearance of BellSouth’s voicemail service (which only involved local forwarding), the FCC pronounced the service jurisdictionally mixed (partially interstate) and preempted the

---

38. RC Ruling, *supra* note 9, ¶¶ 1, 7, 18, 19, 22; *see also* Bell Atlantic Tel. Cos. v. FCC, 206 F.3d 1, 2-3 (D.C. Cir. 2000).

39. RC Ruling, *supra* note 9, ¶ 1.

40. *Id.* ¶ 7 (quoting 47 C.F.R. § 51.701 (1999)).

41. *See id.* ¶ 9; *see also* Local Competition Order, *supra* note 7, ¶¶ 1033-34.

42. RC Ruling, *supra* note 9, ¶ 7.

43. Under “end-to-end” analysis, the FCC focuses on the “end points of the communication and . . . reject[s] attempts to divide communications at any intermediate points of switching or exchanges between carriers.” *Id.* ¶ 10.

44. 7 F.C.C.R. 1619 (Feb. 14, 1992) [hereinafter *BellSouth*].

45. 10 F.C.C.R. 1626 (Feb. 14, 1995), *aff’d sub nom.* Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997) [hereinafter *Teleconnect*].

46. Technically, the call is forwarded from the switch serving the subscriber’s phone. *BellSouth*, *supra* note 44, ¶ 8. However, this technical detail is of no consequence here. The important point is that BellSouth’s voicemail service only forwarded the call locally.

47. *See* RC Ruling, *supra* note 9, ¶ 10.

48. *Id.* (internal quotations omitted).

Georgia Public Utility Commission's authority over BellSouth's voicemail service.<sup>49</sup>

In *Teleconnect*, while addressing an access charge<sup>50</sup> issue, the FCC applied the "end-to-end" analysis in finding Teleconnect's service to involve a single interstate communication "extend[ing] from the inception of a call to its completion, regardless of any intermediate facilities."<sup>51</sup> *Teleconnect* also involved an apparently bi-segmented call: the first segment was an 800 call by an end-user to a long-distance carrier's switch via a LEC's network; the end-user then dialed the phone number of the party she wished to reach; the long-distance carrier's switch then executed the second segment of the call by connecting the end-user from the switch to the desired party, again via a LEC's network.<sup>52</sup> The FCC rejected an argument that the "800 call used to connect to [the long-distance carrier's] switch was a separate and distinct call from the call that was placed from that switch."<sup>53</sup> Instead, the FCC ruled that calls on Teleconnect's service were single end-to-end calls.<sup>54</sup> This finding meant that the defendant LECs could only charge Teleconnect, the long-distance carrier, the lower of two access charge rates as inter-carrier compensation.<sup>55</sup>

Using *BellSouth* and *Teleconnect* as precedent, the FCC proceeded with an "end-to-end" analysis for ISP-bound traffic, and found that the traffic does not terminate at the ISP's facilities but rather at the ultimate destination website(s), which may be out-of-state.<sup>56</sup> From this analysis, the FCC determined that ISP-bound traffic is jurisdictionally mixed but largely interstate.<sup>57</sup> The FCC then concluded that because ISP-bound traffic is jurisdictionally interstate, it is not subject to the reciprocal compen-

---

49. *BellSouth*, *supra* note 44, ¶¶ 6, 12, 22.

50. Access charge, like reciprocal compensation, is a form of inter-carrier compensation. It is applicable for long-distance traffic, while reciprocal compensation is applicable for local telecommunications traffic. *See* Local Competition Order, *supra* note 7, ¶¶ 1033-34.

51. RC Ruling, *supra* note 9, ¶ 11 (quoting *Teleconnect*, *supra* note 45, ¶ 12).

52. This is similar to placing a phone call in the United States using a calling card.

53. RC Ruling, *supra* note 9, ¶ 11.

54. *See Teleconnect*, *supra* note 45, ¶¶ 8, 23.

55. Though a detailed discussion of the access charge regime is beyond the scope of this Note, it is helpful to understand that in *Teleconnect*, the access charge compensation which the long-distance carrier had to pay the defendant LECs for their roles in originating and transporting part of the call depended on whether this bi-segmented call was deemed a single call or two separate calls. A finding of "two separate calls" would have allowed the defendant LECs to charge the higher of two access charge rates. *See id.*, ¶¶ 2, 12.

56. RC Ruling, *supra* note 9, ¶ 12.

57. *Id.* ¶ 1.

sation requirement of the Act's section 251, which only applies to "local telecommunications."<sup>58</sup> Nevertheless, the FCC noted that while ISP-bound traffic is not subject to reciprocal compensation based on the Act, state commissions may still require reciprocal compensation for ISP-bound traffic in their interpretation of reciprocal compensation agreements.<sup>59</sup>

This ruling led to two unhappy camps—one consisting of ILECs led by Bell Atlantic and the other consisting of CLECs led by MCI WorldCom ("MCI").<sup>60</sup> The ILECs were quite content with the FCC's determination that ISP-bound traffic is beyond the scope of section 251's reciprocal compensation requirement, but did not like the additional verbiage giving state commissions the option to require reciprocal compensation for ISP-bound traffic.<sup>61</sup> The CLECs, on the other hand, maintained that the FCC erred in determining that ISP-bound traffic is not included in section 251's reciprocal compensation requirement.<sup>62</sup> Both sides sought judicial review of the FCC ruling by the D.C. Circuit.<sup>63</sup>

## B. The District of Columbia Circuit Decision

The D.C. Circuit bluntly criticized the FCC's reasoning in arriving at its conclusion, and vacated and remanded the case; however, the court was more reserved in its criticism of the conclusion itself. First, the court criticized the FCC's decision to apply the "end-to-end" analysis. It noted that the FCC had traditionally used this test to "determine whether a call is within its interstate *jurisdiction*"<sup>64</sup> but provided insufficient explanation for why the same test is applicable here for a quite different purpose—determining reciprocal compensation.<sup>65</sup> The court found the two cases the FCC relied on to justify its application of "end-to-end" analysis "not on point" as they involved long-distance telecommunications carriers rather than "information service providers" (e.g. ISPs).<sup>66</sup> The court elaborated on the difference between a long-distance call and a call to an information

---

58. *See id.* ¶¶ 7, 18, 19, 22; *see also* Bell Atlantic Tel. Cos. v. FCC, 206 F.3d at 2-3 (D.C. Cir. 2000) ("Having thus taken the calls to ISPs out of § 251(b)(5)'s provision for 'reciprocal compensation' . . .").

59. RC Ruling, *supra* note 9, ¶ 1.

60. *Bell Atlantic*, 206 F.3d at 3.

61. *Id.* The CLECs have largely won the battle at the Commission level in most states. *See* Association for Local Telecommunications Services, *supra* note 36.

62. *See Bell Atlantic*, 206 F.3d at 3.

63. *See id.* United States Courts of Appeals have exclusive statutory jurisdiction to review the FCC's final orders. *See* 28 U.S.C. § 2342(1) (1994).

64. *Bell Atlantic*, 206 F.3d at 3 (emphasis in original).

65. *See id.*

66. *Id.* at 6.

service provider and reiterated MCI's argument that ISPs appear to be "no different from many businesses, such as pizza delivery firms, travel reservation agencies, credit card verification firms, or taxicab companies, which use a variety of communication services to provide their goods or services to their customers."<sup>67</sup> In short, the court held that the FCC did "not satisfactorily explain why an ISP is not, for purposes of reciprocal compensation, simply a communications-intensive business end-user selling a product to other consumer and business end-users."<sup>68</sup> On this ground, the court vacated the FCC ruling and remanded the case "for want of reasoned decisionmaking."<sup>69</sup>

The court also remanded the case on the independent ground that the FCC had not properly explained whether ISP-bound traffic fits into "exchange access"<sup>70</sup> or "telephone exchange service."<sup>71</sup> The court noted the FCC's concession on appeal that in the statutory world of the 1996 Act, "telephone exchange service" and "exchange access" are the only two categories of telephone traffic recognized.<sup>72</sup> The court added that the Act defines a call as "'exchange access' if offered 'for the purpose of the origination or termination of telephone toll services.'"<sup>73</sup> Finally, the court noted MCI's argument that "ISPs connect to the local network 'for the purposes of' providing information services, not originating or terminating telephone toll services."<sup>74</sup> While stating that the "statute appears ambiguous as to whether calls to ISPs fit within 'exchange access' or 'telephone exchange service,'"<sup>75</sup> the court criticized the FCC for brushing aside MCI's statutory argument which strongly suggests that ISP-bound traffic must be categorized as "telephone exchange service" (local telecommunications service) since ISPs do not assess toll charges for their services.<sup>76</sup>

---

67. *Id.* at 7 (internal quotation marks and citations omitted).

68. *Id.* (internal quotation marks omitted).

69. *Id.* at 3.

70. "Exchange access" traffic is traffic offered "for the purpose of the origination or termination of telephone toll services." 47 U.S.C. § 153(16) (Supp. IV 1998). Long-distance telephone service is "telephone toll service," whereas local telephone service is not. *See id.* § 153(48).

71. *See Bell Atlantic*, 206 F.3d at 8-9. For purposes here, "telephone exchange service" is synonymous with "local telecommunications service." *See* 47 U.S.C. § 153(47) (Supp. IV 1998). The FCC has explained that "telephone exchange service" is local service. *See* Local Competition Order, *supra* note 7, ¶ 87 ("Because telephone exchange service is a local, intrastate service . . .").

72. *Bell Atlantic*, 206 F.3d at 8.

73. *Id.* at 9 (quoting 47 U.S.C. § 153(16)).

74. *See id.* at 4-5, 9.

75. *Id.* at 9.

76. *See id.* at 5.

While the court did not explicitly reverse the FCC ruling, it did point out several inconsistencies. The court noted that the FCC has historically treated traffic to Enhanced Service Providers ("ESPs"),<sup>77</sup> of which ISPs are a subclass, as "local" and exempted ESPs from the access charge system for long-distance calls.<sup>78</sup> The court added that the FCC has provided this exemption both for policy reasons as well as "on an acknowledgment of the real differences between long-distance calls and calls to information service providers."<sup>79</sup> The court, therefore, implied that the FCC's attempt to characterize ISP-bound traffic as nonlocal was inconsistent with the ESP exemption. The court further pointed out that the FCC ignored its own definition of "local telecommunications," as set forth in 47 C.F.R. § 51.701, and that "[c]alls to ISPs appear to fit" this definition of "local telecommunications."<sup>80</sup> Thus, the court provided several grounds on which the FCC can reverse its ruling on reciprocal compensation.

### III. DISCUSSION

Although the D.C. Circuit did not explicitly reverse the FCC's *RC Ruling*, the major flaws and contradictions in the ruling that the court correctly highlighted are insurmountable. The FCC ruling had significant logical gaps, and its conclusion contradicted a number of FCC precedents, including the FCC's definition of local telecommunications traffic and the FCC's historic treatment of ESPs. Moreover, inclusion of ISP-bound traffic in section 251's reciprocal compensation requirement will promote competition, lower prices, and the Internet, which are goals of the 1996 Act. Therefore, on remand, the FCC should reverse its prior conclusion to find that ISP-bound traffic is "local telecommunications traffic" for purposes of inter-carrier compensation and include ISP-bound traffic in section 251's reciprocal compensation requirement.

---

77. Basic services involve standard voice transmission. See Chappelle, *supra* note 28, at 399. "Enhanced Service Providers" is a category which includes ISPs. The term "enhanced services" has been defined by the FCC as "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." 47 C.F.R. § 64.702(a) (1999). The distinction was maintained within the Act, where Congress differentiated between "information services" and "telecommunications services" along the same lines as the enhanced/basic distinction. See 47 U.S.C. § 153(20) (Supp. IV 1998).

78. See *Bell Atlantic*, 206 F.3d at 7-8.

79. *Id.* at 8.

80. *Id.* at 6.

### A. The *RC Ruling* Was Based on the Wrong Test

While the FCC correctly framed the threshold question (whether ISP-bound traffic belongs in the local or long-distance service-category),<sup>81</sup> it applied an improper test to answer this question. It incorrectly assumed that a jurisdictional-nature determination of ISP-bound traffic is equivalent to a service-category determination for inter-carrier compensation purposes. Because the FCC's ruling hinged directly on its inappropriate application of the jurisdictional "end-to-end" analysis, the D.C. Circuit correctly vacated and remanded the ruling to the FCC.

#### 1. *A Jurisdictionally Interstate Finding Is Not Dispositive of the Service-Category Question*

The Act provides two forms of inter-carrier compensation—reciprocal compensation and access charge—to address the problem of how a terminating carrier will be compensated for its transport and termination costs when it does not directly bill the caller.<sup>82</sup> Because long-distance telecommunications traffic is already covered by the access charge regime,<sup>83</sup> it was reasonable for the FCC to determine that section 251's reciprocal compensation requirement is only applicable to "local telecommunications traffic."<sup>84</sup>

In the *RC Ruling*, the FCC mistakenly blurred the issue of jurisdiction with that of service-category for determining the appropriate form of inter-carrier compensation. The former merely determines whether the FCC or a state commission has regulatory authority over particular calls. The latter answers the separate question of how LECs are to be compensated for their costs when terminating an incoming call from a different network. A simple example illustrates the difference. In the *BellSouth* case cited by the FCC, the FCC found BellSouth's voicemail service to be jurisdictionally interstate based on the "end-to-end" analysis. Recall that BellSouth's service involved forwarding calls from a subscriber's phone to BellSouth's local voicemail facilities.<sup>85</sup> It would be ridiculous to claim that because of the "jurisdictionally interstate" finding, the forwarding aspect of the service necessarily involves long-distance service instead of local telecommunication service. It would be even more ludicrous to suggest

---

81. See *RC Ruling*, *supra* note 9, ¶ 7.

82. See *id.* ¶ 9 ("Generally speaking, when a call is completed by two (or more) interconnecting carriers, the carriers are compensated for carrying that traffic through either reciprocal compensation or access charges.").

83. See *id.*

84. See 47 C.F.R. § 51.701 (1999).

85. See *supra* text accompanying notes 46-49.

that for billing purposes BellSouth or the voicemail subscriber should now have to pay long-distance charges on that portion of the call, even though the call was only forwarded within the local calling area. Hence, as this illustration reveals, a finding that a call is "jurisdictionally interstate" does not automatically make it a long-distance call.

2. *The FCC Inappropriately Applied the Jurisdictional "End-to-End" Analysis*

While the FCC attempted to justify its application of the "end-to-end" analysis to the reciprocal compensation question, the D.C. Circuit correctly pointed out that the two cases cited by the FCC to support its use of "end-to-end" analysis were not on point.<sup>86</sup> The two cited cases involved "switch[ing] by a long-distance communications carrier," whereas the instant case involves ISPs, which are not "telecommunications providers."<sup>87</sup> Though the court did not explain in detail why this distinction is important, it certainly hit the nail on its head when it wrote: "Even if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears relevant for purposes of reciprocal compensation."<sup>88</sup>

The first case, *BellSouth*,<sup>89</sup> is easily distinguishable from the instant case, because it strictly involved a jurisdictional question as opposed to an inter-carrier compensation question. Hence, the "end-to-end" analysis, which the FCC has traditionally applied for jurisdictional questions,<sup>90</sup> was appropriate in *BellSouth*, where the issue was whether the Georgia Public Utility Commission had authority to "freeze" BellSouth's offering of voicemail service in an antitrust suit.<sup>91</sup> *BellSouth* is unhelpful to the FCC's arguments here because the "end-to-end" analysis was applied to a strictly jurisdictional question, as opposed to an inter-carrier compensation question.

---

86. The FCC itself noted in a footnote that the cited cases were distinguishable from the instant case: "the cited cases involve interexchange carriers [i.e. long-distance carriers] rather than ISPs, and the Commission has observed that it is not clear that [information service providers] use the public switched network in a manner analogous to IXCs [long-distance carriers]. . . ." RC Ruling, *supra* note 9, at 3697 n.36 (internal citation omitted). But the FCC conclusorily dismissed this distinction as being irrelevant. *Id.*

87. *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 6 (D.C. Cir. 2000).

88. *Id.* at 6-7.

89. 7 F.C.C.R. 1619 (Feb. 14, 1992).

90. *See Bell Atlantic*, 206 F.3d at 3.

91. *See supra* text accompanying notes 46-49 for details of the case.

The facts of the second case, *Teleconnect*,<sup>92</sup> are closer to the instant case since both address inter-carrier compensation issues, but *Teleconnect* is nonetheless distinguishable because, as the court pointed out, it involved a long-distance carrier rather than ISPs. *Teleconnect* addressed the question of whether LECs can recoup a higher or lower access charge from a long-distance carrier as compensation for the LECs' assistant role in originating and transporting calls. Regardless of the outcome, the LECs would have been adequately compensated for originating and transporting the calls.<sup>93</sup>

In contrast, in the instant case, because ISPs are exempt from paying access charges, the issue is whether a LEC will be compensated *at all* for transporting and terminating ISP-bound traffic. This distinction has legal significance because an interconnection duty without an associated inter-carrier compensation requirement could lead to inadequate or no compensation for costs which a LEC is legally required to incur. Here, an arbitrary application of jurisdictional "end-to-end" analysis to the inter-carrier compensation question could force a LEC into an involuntary "bill-and-keep" situation for ISP-bound traffic. This result may be constitutionally problematic in light of the Takings Clause.<sup>94</sup> Because of this distinction, the application of "end-to-end" analysis in *Teleconnect* does not justify the FCC's application of the same analysis in the instant case.

As the court aptly criticized, the cases cited by the FCC fail to justify its application of "end-to-end" analysis in the instant case.<sup>95</sup> Because the FCC's finding that ISP-bound traffic is not covered by section 251's reciprocal compensation requirement hinged directly on its incorrect decision

---

92. 10 F.C.C.R. 1626 (Feb. 14, 1995), *aff'd sub nom.* Southwestern Bell Tel. Co. v. FCC, 116 F.3d 593 (D.C. Cir. 1997). See *supra* text accompanying notes 50-55 for a brief discussion of the case.

93. There was no argument nor evidence that compensation at the lower rate would have been insufficient to cover the defendant LECs' costs.

94. U.S. CONST. amend. V ("... nor shall private property be taken for public use without just compensation.").

On behalf of Bell Atlantic, Professor Richard A. Epstein considered whether bill-and-keep arrangements between LECs and Commercial Mobile Radio Service ("CMRS") providers ran afoul of the Takings Clause. Epstein concluded that "[o]wing to the imbalance in call origination, a bill and keep system works a major redistribution in wealth away from the LECs to the CMRS providers in a manner that is inconsistent with the takings clause of the Constitution." Letter from Richard Epstein to William Kennard, General Counsel, FCC, at 3, In the Matter of Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers (No. 95-185) (letter dated May 15, 1996), at [http://gulfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=1615930001](http://gulfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=1615930001).

95. See *Bell Atlantic*, 206 F.3d at 3.

to apply “end-to-end” analysis to the threshold question of whether the traffic is local or long-distance,<sup>96</sup> the court properly vacated and remanded the case to the FCC.

### B. ISP-Bound Traffic as “Local Telecommunications”

One simple approach to determining the service-category of ISP-bound traffic is to look at the FCC’s own definitions. In the same regulation where the FCC established that reciprocal compensation applies only for local telecommunications traffic,<sup>97</sup> the FCC defined local telecommunications traffic to mean: “[t]elecommunications traffic between a LEC and a telecommunications carrier . . . that originates and terminates within a local service area established by the state commission.”<sup>98</sup> The FCC further defined “termination” as “the switching of local telecommunications traffic at the terminating carrier’s end office switch, or equivalent facility, and delivery of such traffic to the called party’s premises.”<sup>99</sup>

ISP-bound traffic fits this definition of “local telecommunications traffic.” There is no real debate over whether a terminating LEC is a telecommunications carrier or whether ISP-bound traffic originates within the terminating LEC’s local calling area. The main issue is whether the ISP-bound traffic actually “terminates” within the same local calling area. Upon receipt of the ISP-bound traffic by a LEC, “[t]he traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP. . . .”<sup>100</sup> Since the caller (or the caller’s computer modem) dialed the ISP’s access number, it seems reasonable to deem the ISP the “called party,” thereby completing the definition. Hence, the D.C. Circuit correctly pointed out that “[c]alls to ISPs appear to fit [the above] definition.”<sup>101</sup>

The *RC Ruling* simply ignored the FCC’s own definitions and instead applied the “end-to-end analysis.” But as discussed above, this choice was improper.<sup>102</sup> It seems much more straightforward to use the definitions provided in the same regulation<sup>103</sup> in which the FCC established that section 251’s reciprocal compensation only applies to “local telecommunications traffic” to answer this inter-carrier compensation question.

---

96. *See id.* at 5.

97. 47 C.F.R. § 51.701(a) (1999).

98. *Id.* § 51.701(b)(1).

99. *Id.* § 51.701(d); *see also* Local Competition Order, *supra* note 7, ¶ 1040.

100. *Bell Atlantic*, 206 F.3d at 6.

101. *Id.*

102. *See supra* Part III.A.2.

103. *See* 47 C.F.R. § 51.701 (1999).

An alternative approach is to examine how ISP-bound traffic fits into statutorily defined categories of telecommunications traffic. In the Act, only two types of telecommunications traffic are described: “exchange access” and “telephone exchange service.”<sup>104</sup> The FCC has explained that “telephone exchange service” is local service.<sup>105</sup> Furthermore, on appeal, the FCC conceded that these two types of statutorily defined traffic occupy the field.<sup>106</sup> According to the Act, telephone traffic is “exchange access” traffic if offered “for the purpose of the origination or termination of *telephone toll services*.”<sup>107</sup> MCI argued that “ISPs connect to the local network ‘for the purpose of’ providing information services, not originating or terminating telephone toll services.”<sup>108</sup> MCI’s argument is supported by the FCC’s designation of ISPs as “information service providers” rather than “telecommunications providers” under the Act.<sup>109</sup> Because ISPs do not provide telephone toll service, ISP-bound traffic cannot qualify as “exchange access” traffic. This leaves only “telephone exchange service,” which, the FCC has declared, is equivalent to “local” service. Indeed, the FCC failed to adequately address this argument,<sup>110</sup> and thus the court properly remanded the case to the FCC on this independent ground.<sup>111</sup>

On remand, it will be difficult for the FCC to counter the argument that because ISPs do not offer telephone toll service, ISP-bound traffic does not qualify as “exchange access” traffic. Unless it is able to successfully demonstrate that ISP-bound traffic is “exchange access” traffic and not “telephone exchange service” traffic, the FCC must reverse its *RC Ruling*.

---

104. See *Bell Atlantic*, 206 F.3d at 8.

105. Local Competition Order, *supra* note 7, ¶ 87 (“Because telephone exchange service is a local, intrastate service . . .”).

106. *Bell Atlantic*, 206 F.3d at 8.

107. 47 U.S.C. 153(16) (Supp. IV 1998) (emphasis added).

108. *Bell Atlantic*, 206 F.3d at 9.

109. See *id.* at 6 (“ISPs, in contrast, are ‘information service providers,’ Universal Service Report, 13 F.C.C.R. at 11,532-33 (¶66), which upon receiving a call originate further communications to deliver and retrieve information to and from distant web-sites.”).

110. See *id.* at 8.

111. *Id.*

### C. Inclusion of ISP-Bound Traffic in Section 251's Reciprocal Compensation Requirement Furthers the Goals of the Act

The common carrier provisions of the Act seek to open local telephone markets to competition<sup>112</sup> by removing regulatory barriers for new market entrants<sup>113</sup> and by counteracting market barriers to entry created by competitive advantages of ILECs. The ILECs' competitive advantages were limited by imposing statutory obligations on ILECs and granting the FCC the power to implement these provisions.<sup>114</sup> Of course, the ultimate goal is to benefit U.S. telecommunication consumers in the form of higher quality services, lower prices, and rapid development of new telecommunication technologies.<sup>115</sup>

#### 1. *Inclusion of ISP-bound Traffic in Reciprocal Compensation Promotes Competition and the Goal of Lower Prices for Consumers*

Including ISP-bound traffic in section 251's reciprocal compensation obligation will give CLECs more bargaining power in interconnection and reciprocal compensation negotiations with ILECs, and limit the ILECs' leverage and ability to demand high termination rates that do not represent actual termination costs. This outcome is consistent with the Act's goals of increasing competition in the local telephone market and lowering prices for consumers.

When Congress drafted the Act, it recognized that

[e]ffective interconnection arrangements are among the most critical issues for . . . competitors. . . . For example, arrangements must be made for networks to compensate each other for terminating calls that originate in another network. *Unless properly structured, the reciprocal compensation arrangements can raise significant barriers to entry by potential local competitors.*<sup>116</sup>

---

112. See H.R. CONF. REP. NO. 104-458, at 113 (1996); see also H.R. CONF. REP. NO. 104-882 (1997) ("One of the primary goals of the new telecommunications law is the promotion of competition in the local telephone market.").

113. See Local Competition Order, *supra* note 7, ¶ 12.

114. See Thomas J. Hall, *The FCC and the Telecom Act of 1996: Necessary Steps to Achieve Substantial Deregulation*, 11 HARV. J. L. & TECH. 797, 801 nn.14-15 (1998).

115. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 56 (pre-ample).

116. 141 CONG. REC. S5961, 5970 (daily ed. May 1, 1995) (statement of Sen. Byrd) (emphasis added).

Congress had the foresight to see the importance of including a reciprocal compensation provision for facilitating entry into and increasing competition in the local telephone market.

Similarly, the FCC has recognized that ILEC-CLEC interconnection negotiations are not typical commercial negotiations because "ILECs have virtually no incentive to cooperate in establishing reasonable terms and conditions for interconnection with CLECs."<sup>117</sup> Further, "ILECs have much greater bargaining power than CLECs,"<sup>118</sup> partly because interconnection is much more valuable to CLECs than to ILECs.<sup>119</sup> Accordingly, the FCC concluded that rules should be construed in favor of new entrants: "The inequality of bargaining power between incumbents and new entrants militates in favor of rules that have the effect of equalizing bargaining power in part . . . ."<sup>120</sup>

Ruling that ISP-bound traffic is included in section 251's reciprocal compensation obligation would follow this principle by favoring new entrants and bolstering the CLECs' bargaining power. Including ISP-bound traffic makes many CLECs with ISP customers net-terminators of traffic (relative to the ILECs), thus requiring ILECs to pay those CLECs transport and termination fees based on negotiated reciprocal compensation agreements. Since ILECs will have to pay this fee, ILECs will be more likely to propose termination rates for future reciprocal compensation agreements that more closely reflect actual costs of termination. Lower reciprocal compensation rates should ultimately translate to lower prices for consumers and encourage entry of new competitors into the local telephone market by lowering provisioning costs. At the same time, because ILECs will receive lower reciprocal compensation for delivering traffic, ILECs will be encouraged to invest in newer, more efficient technologies for transporting and terminating calls.

2. *ILECs Wrongly Identify Inclusion of ISP-bound Traffic in Reciprocal Compensation as the Cause of CLECs' Limited Competitive Incentives*

ILECs argue that inclusion of ISP-bound traffic in reciprocal compensation is inconsistent with the Act's goal of increasing competition because CLECs will only have incentive to serve a limited market (i.e. ISP

---

117. Hall, *supra* note 114, at 801; *see also* Local Competition Order, *supra* note 7, ¶ 55.

118. Local Competition Order, *supra* note 7, ¶ 55.

119. *See* HUBER ET AL., *supra* note 22, at 21; *see also* Local Competition Order, *supra* note 7, ¶ 55. *See supra* text accompanying notes 22-24.

120. Local Competition Order, *supra* note 7, ¶ 55.

customers and other end-users with a high volume of inbound calls) in order to collect reciprocal compensation fees.<sup>121</sup> CLECs will have no incentive to enter or compete in other segments of the market, such as local residential user markets.<sup>122</sup>

This argument, however, is flawed because the inclusion of ISP-bound traffic in reciprocal compensation obligations is not the cause of the stated problem. Rather, the problem is due to high reciprocal compensation rates, which are significantly above actual transport and termination costs.<sup>123</sup> These high rates exist because ILECs generally pushed for high rates during the negotiations of first generation reciprocal compensation agreements and because single-tiered reciprocal compensation rates fail to take into account the difference in costs of transporting and terminating voice versus data traffic.<sup>124</sup>

Given the current single-tiered reciprocal compensation agreements, ILECs have a legitimate complaint that CLECs serving ISPs are receiving an imbalanced advantage, because the cost of transporting and terminating data traffic is generally less than that for voice traffic.<sup>125</sup> However, the fair solution to this problem is not to eliminate reciprocal compensation for ISP-bound traffic or data traffic altogether—after all, there are real costs, however low, incurred during the transport and termination of that traffic.<sup>126</sup> A reasonable solution is to restructure reciprocal compensation rates into two tiers: one for data traffic, another for voice traffic. This restructuring can be accomplished during negotiations of future reciprocal compensation agreements, since a two-tiered plan is not precluded by the Act.

---

121. See Letter from Edward D. Young, III, Senior Vice President & Deputy General Counsel for Bell Atlantic, & Thomas J. Tauke, Senior Vice President of Government Relations for Bell Atlantic, to Hon. William E. Kennard, Chairman, FCC (July 1, 1998), at [http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native\\_or\\_pdf=pdf&id\\_document=2101290001](http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=2101290001) (last visited February 4, 2001).

122. *Id.*

123. Ironically, while responding to charges that ILECs would set reciprocal compensation fees above actual costs, Bell Atlantic itself wrote prophetically: "If these rates are set too high, the result will be that new entrants, who are in a much better position to selectively market their services, will sign up customers whose calls are predominantly inbound, such as credit card authorization centers and internet access providers." Reply Comments of Bell Atlantic to the Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Internet Service Provider Traffic, Dkt. No. CCB/CPD 97-30, at 21 (May 30, 1996). The fact that CLECs have signed up customers whose calls are predominantly inbound strongly suggests that the reciprocal compensation rates are too high.

124. See Donna N. Lampert Associates, *supra* note 26, at 7.

125. *Id.*

126. See RC Ruling, *supra* note 9, ¶ 29.

This way, the rate for each tier can more accurately reflect the costs of terminating either voice or data traffic. This should lead to more balanced market incentives for CLECs.

### 3. *Inclusion of ISP-bound Traffic in Reciprocal Compensation Promotes the Internet*

Inclusion of ISP-bound traffic in section 251's reciprocal compensation requirement is also consistent with the FCC's policy justifications for exempting ISPs from access charges and the Act's general goal of promoting the Internet.<sup>127</sup>

The FCC has acknowledged that "no matter what the payment arrangement, LECs incur a cost when delivering traffic to an ISP that originates on another LEC's network."<sup>128</sup> Statutorily, the LEC may seek compensation for termination costs via access charges or reciprocal compensation.<sup>129</sup> However, recovery of costs through access charges is not possible due to the FCC's exemption of ISPs from that form of inter-carrier compensation.<sup>130</sup> ESPs, of which ISPs are a subclass, have been exempted from paying access charges since the FCC established the access charge regime for long-distance calls in 1983.<sup>131</sup> The FCC effectively treats ESPs "like end-users rather than long-distance carriers."<sup>132</sup> In 1997, it again preserved the status quo and "justified the exemption in terms of the goals of the 1996 Act, saying that its purpose was to 'preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services.'"<sup>133</sup>

Providing this exemption strongly suggests that the FCC, consistent with the goals of the Act, does not want to impose extra costs on ISPs that could stifle the relatively new Internet industry. In effect, the FCC has implicitly decided, as a matter of policy, to have the general public (or at least the general telephone-service-consuming public) "subsidize" the costs of Internet access, rather than requiring Internet users themselves to pay a higher fee for access.

---

127. See 47 U.S.C. § 230(b)(2) (Supp. IV 1998).

128. RC Ruling, *supra* note 9, ¶ 29.

129. See Local Competition Order, *supra* note 7, ¶ 1034.

130. See In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End User Common Line Charges, 12 F.C.C.R. 15,982, 16,133 ¶ 344 (May 16, 1997) [hereinafter Access Charge Reform].

131. See *Bell Atlantic Tel. Co. v. FCC*, 206 F.3d 1, 7 (D.C. Cir. 2000).

132. *Id.*

133. *Id.* (citing Access Charge Reform, *supra* note 130, ¶ 344, and quoting 47 U.S.C. § 230(b)(2)).

Recovery of costs of terminating ISP-bound traffic through reciprocal compensation depends partly on the FCC's decision on remand.<sup>134</sup> If ISP-bound traffic is not included in reciprocal compensation obligations, CLECs may not be able to recoup those transport and termination costs from the originating ILEC. But economics dictates that companies cannot continue operating without recovery of their cost basis, which means that CLECs will have to either exit the market (or at least exit the market serving ISP customers) or pass the transport and termination costs directly onto the ISP by charging higher monthly business end-user fees.

The first option would lead to diminished competition in the local telephone market, which is contrary to the goals of the Act. The second option would lead to higher prices for Internet access, since the ISP would likely pass the increased costs onto its customers. This would run counter to the implicit FCC policy of subsidizing Internet access. Therefore, to avoid these two possibilities, and to promote the goals of the Act, the FCC should rule that ISP-bound traffic is included in section 251's reciprocal compensation requirement.

#### IV. CONCLUSION

The D.C. Circuit correctly pointed out the flaws in the FCC's *RC Ruling*. Because the inconsistencies in the FCC's ruling are insurmountable, the FCC must reverse its ruling to find that ISP-bound traffic is "local" for inter-carrier compensation purposes and include ISP-bound traffic in section 251's reciprocal compensation obligation. In so doing, the FCC will foster competition in the local telephone market, help bolster the bargaining power of the CLECs (against the ILECs), and further the goals of the Act.

With the help of appropriate interconnection requirements coupled with properly structured reciprocal compensation agreements, the players in the local telephone market will be able to shape an industry with lower prices, higher quality service, and more advanced technologies for the benefit of consumers.

---

134. The FCC has stated that even if ISP-bound traffic is not included in section 251's reciprocal compensation requirement, parties may nonetheless include it in their interconnection/reciprocal compensation agreements. However, this places tremendous strain on the CLECs who then have to repeatedly argue for its inclusion during negotiations and before state commissions. See *RC Ruling*, *supra* note 9, ¶ 1.

**BERKELEY TECHNOLOGY LAW JOURNAL  
ANNUAL REVIEW OF LAW AND TECHNOLOGY**

**BUSINESS LAW**

