WILMER, CUTLER & PICKERING

Washington • Baltimore • New York • London • Brussels • Berlin

April 3, 2000

TELECOMMUNICATIONS LAW UPDATES

D.C. CIRCUIT OVERTURNS FCC RECIPROCAL COMPENSATION ORDER

The D.C. Circuit recently vacated and remanded a Federal Communications Commission order asserting jurisdiction over dial-up Internet access and suggesting that local exchange carriers ("LECs") have no right to receive "reciprocal compensation" payments for such traffic. The March 24 decision in *Bell Atlantic Telephone Cos. v. FCC* ensures that the flow of state-ordered compensation will continue for the next few months while the FCC attempts to rewrite its rules.

Section 251(b)(5) of the Telecommunications Act orders LECs "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." The provision requires LECs to pay each other when the customers of one LEC make calls that terminate on the other LEC's network; the payment is for the work the second LEC performs in carrying the call to its final destination. The FCC has ruled that reciprocal compensation applies to *local* calls only, not where a long-distance call traverses two LECs' networks on the way to or from a long-distance carrier.

The D.C. Circuit case involves the situation where the subscriber of an Internet service provider ("ISP") dials a local telephone number to reach the ISP, which then connects the subscriber to the worldwide network of servers making up the Internet. State regulators have treated the first leg of these Internet dial-up calls as a separate local call that terminates at the ISP's premises. As a result, if the subscriber and the ISP use different LECs, the states have required the subscriber's LEC to pay the ISP's LEC reciprocal compensation for every minute the subscriber is connected. Competitive LECs have signed up numerous ISPs just to take advantage of these payments, which total hundreds of millions of dollars in the aggregate. Footing the bill are the incumbent LECs, who serve the overwhelming majority of ISP subscribers.

In the order under review, the FCC determined that ISP dial-up calls are *not* local because they do not terminate at the ISP's premises; rather, they continue on to whatever Internet servers the subscriber accesses. The FCC came to this conclusion by applying its traditional method for determining whether a given service falls within its jurisdiction, which looks at whether the service is part of a broader chain of communication that begins in one state and ends in another. The FCC also determined that ISP dial-up calls are a type of "exchange access" service beyond the scope of the existing reciprocal compensation rule. The FCC began new proceedings to consider what compensation rule, if any, should govern ISP dial-up traffic; however, it left the state decisions ordering compensation under the old rules in place while the new proceedings were underway.

The D.C. Circuit held that the FCC did not adequately explain why its end-to-end jurisdictional analysis should control the question of whether the dial-up portion of an Internet-bound call counts as "local" for purposes of reciprocal compensation. While the opinion nominally just remands the order to the FCC for a better explanation (and has been spun by the FCC as only a minor setback), the court cast doubt on almost every legal theory the FCC has used to justify treating dial-up Internet-bound traffic as a single communication between the end user and the destination website.

The court noted that dial-up calls appeared to terminate at the ISP's premises, as the FCC has previously defined "termination," not the destination web site. It also held that, unlike long-distance carriers, ISPs purchase rather than provide telecommunications, making ISPs "no different from many businesses" — including pizza delivery firms —"which use a variety of communications services to provide their goods or services." The court faulted the FCC for failing to explain "why an ISP is not, for purposes of reciprocal compensation, 'simply a communications-intensive business end user selling a product to other consumer and business end-users.'" Last, the court rejected the FCC's contention that ISP dial-up is a form of "exchange access" exempt from reciprocal compensation; the Act defines "exchange access" as something used to originate "telephone toll service," and ISPs provide *information* services, not telephone toll service.

The D.C. Circuit's decision does not change the incumbent LECs' present reciprocal compensation obligations, since the vacated FCC order did not disturb state compensation orders or preempt states from imposing new payment obligations while the FCC drafted a new federal compensation rule. And because the decision casts doubt on most of the theories by which state compensation obligations have been challenged, it is unlikely that those obligations will change any time soon.

Importantly, the D.C. Circuit did not invalidate the FCC's basic method for determining whether it has jurisdiction over a service; on the contrary, it simply ruled that the FCC could not use this jurisdictional analysis to decide whether the service is "local" for purposes of reciprocal compensation. The FCC thus still has the power to regulate (and prescribe compensation rules for) ISP dial-up traffic. On remand, the FCC could decide that, while LECs must pay reciprocal compensation for this traffic, they should pay a significantly lower rate of compensation, since the cost of delivering aggregated traffic to a single ISP's point of presence is significantly lower than the cost of delivering traffic over a widely distributed network of ordinary end users. For that reason, the FCC battles over reciprocal compensation for Internet-bound calls are far from over.

Scott Blackmer	**202-663-6167**	**SBlackmer@wilmer.com**
Lynn Charytan	**202-663-6455**	**LCharytan@wilmer.com**
John Harwood	**202-663-6333**	**JHarwood@wilmer.com**
William Lake	**202-663-6725**	**WLake@wilmer.com**
Daniel Phythyon	**202-663-6545**	**DPhythyon@wilmer.com**
William Richardson	**202-663-6038**	**WRichardson@wilmer.com**