Telecommunications Law UPDATES

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NEW SUITS FILED AGAINST FCC'S RULES FOR INTERNET-BOUND TRAFFIC

For several years the FCC has struggled with the question of how local exchange carriers ("LECs") should compensate each other when a LEC's subscriber connects to an Internet Service Provider ("ISP") served by another LEC. The FCC's attempt to resolve this question, its April 27 Reciprocal Compensation Order ("Order"), should result in significantly reduced payments to competitive LECs ("CLECs") by incumbent LECs ("ILECs") for call termination. The Order sets a schedule for reducing reciprocal compensation and capping compensation growth. Beneficiaries of the payments, however, have recently filed suit in federal court against the Order in the hope of preserving the previous arrangements.

Section 251(b)(5) of the Communications Act ("Act") orders LECs "to establish reciprocal compensation arrangements for the transport and *termination* of telecommunications" (emphasis added). The provision has been construed to require LECs in a variety of circumstances to pay one another 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. When the Act was passed, carriers expected that these traffic flows would, in most cases, prove largely proportional between firms. Many CLECs, however, sought to serve ISPs – which are characterized by unidirectional traffic flows, because subscribers call ISPs, but ISPs do not make significant outgoing calls over the public switched network. These relationships resulted in significant traffic imbalances between CLECs and the ILECs that serve subscribers. A number of state public utility commissions determined that, even though ISPs connect their subscribers to web sites located across the globe, the ISPs' CLECs should be considered as "terminating" the local call between the subscriber and the ISP for compensation purposes. These rulings brought these unidirectional flows within the section 251(b)(5) reciprocal compensation system – and resulted in a payment stream approaching $2 billion flowing from ILECs to CLECs. These payments typically far exceeded the CLECs' true costs of transporting and terminating the calls at issue.

The Order represents the FCC's second attempt to address intercarrier compensation for ISP-bound traffic. In a Declaratory Ruling ("Ruling") released on February 26, 1999, the FCC found that an ISP call often connects a subscriber in one state through the ISP to websites in other states or countries. That finding ultimately led the FCC to conclude that the calls fall outside the scope of the mandatory reciprocal compensation scheme of section 251(b)(5) but within the scope of the Commission's plenary authority, under section 201 of the Communications Act, to regulate interstate telecommunications traffic. That finding was significant because section 201 has been construed to impose fewer substantive limits on the Commission's ability to choose among different approaches to intercarrier compensation. The Commission began a proceeding to determine how best to exercise its section 201 authority in this context, and in the interim it left individual states with considerable discretion to determine compensation arrangements.

Before the FCC could formulate a federal rule, however, the D.C. Circuit vacated and remanded the earlier Ruling, finding that the FCC had not adequately defended and explained the legal basis for its determination. On remand, in the current Order, the Commission reaffirmed its earlier conclusion that this traffic falls outside the scope of section 251(b)(5) and within the scope of its plenary regulatory authority under section 201. And, in exercising that authority, the FCC has now sought to reduce the flow of payments from ILECs to CLECs. In particular, while reciprocal compensation rates had previously risen to levels as high as $.0050 per minute, the Order reduces those payments, in the first six months following its effective date, to $.0015 per minute. For the following eighteen months, the rate is reduced to $.0010 per minute. Thereafter the rate will fall to $.0007. The FCC established a rebuttable presumption that all traffic imbalances of greater than a 3-to-1 ratio are caused by ISP-bound traffic and are therefore subject to this compensation scheme. Moreover, the agency placed a cap on the total amount of ISP-bound traffic for which any firm may seek compensation. For 2001 the cap equals the annualized total of the company's first-quarter 2001 traffic, plus ten percent. For 2002 and thereafter, the cap is set at ten percent more than the 2001 figure. These rules should greatly reduce the payment flow from ILECs to CLECs, while continuing to provide CLECs some compensation for handling this traffic.

This accommodation of the ILECs comes at a price, however. In order to qualify for this new compensation regime, an ILEC must agree to charge these same reduced rates for all traffic subject to section 251(b)(5) – including certain mobile wireless traffic. According to the FCC, "[t]he record fails to demonstrate . . . inherent differences between the costs of delivering a voice call . . . and a data call" that would allow for different pricing regimes. Given that mobile traffic (and therefore intercarrier compensation) travels disproportionately from the mobile user to the wireline ILEC, this aspect of the FCC's ruling will likely reduce ILEC compensation.

Though generally considered a positive step by the industry, the Order does face some hurdles. Some analysts, following the dissenting opinion of Commissioner Furchtgott-Roth, take issue with the Commission's legal justification for placing this traffic outside the scope of section 251(b)(5). Direct threats to the Order have arisen from WorldCom, Sprint and Level 3 Communications, which have filed petitions to review the Order in the D.C. Circuit, and from Core Communications, Inc. ("CoreTel"), a CLEC in the mid-Atlantic region. CoreTel had asked the FCC and the D.C. Circuit to stay the Order while an appeal is pending, but was denied. It has also asked the panel that vacated and remanded the prior Ruling to "enforce its mandate," claiming that the FCC's current Order violates the panel's remand instructions. The D.C. Circuit has set a briefing schedule, and will review the Order this fall. The ultimate fate of the Order – and the FCC's broader attempts to rationalize the system of intercarrier compensation rules – turns on the outcomes of these challenges.

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