**[Service Date July 16, 2008]**

**BEFORE THE WASHINGTON STATE**
**UTILITIES AND TRANSPORTATION COMMISSION**

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<tr><td>QWEST CORPORATION,<br><br>Complainant,<br><br>v.<br><br>LEVEL 3 COMMUNICATIONS, LLC, et al.,<br><br>Respondents.<br><br>. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . .</td><td>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)</td><td>DOCKET UT-063038<br><br>ORDER 10<br><br>FINAL ORDER UPHOLDING INITIAL ORDER; GRANTING IN PART AND DENYING IN PART PETITIONS FOR ADMINISTRATIVE REVIEW; MODIFYING INITIAL ORDER; APPROVING SETTLEMENT AGREEMENT</td></tr>
<tr><td>In the Matter of the Request of MCI METRO ACCESS TRANSMISSION SERVICES, LLC d/b/a VERIZON ACCESS TRANSMISSION SERVICES<br><br>and<br><br>QWEST CORPORATION<br><br>For Approval of Negotiated Agreement Under the Telecommunications Act of 1996<br>. . . . . . . . . . . . . . . . . . . . . . . . . . . . . . . .</td><td>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)<br>)</td><td>DOCKET UT-063055<br><br>ORDER 03<br><br>FINAL ORDER UPHOLDING INITIAL ORDER, DENYING WITA'S PETITION FOR REVIEW; APPROVING AMENDMENT</td></tr>
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1 ***SYNOPSIS.*** *The Commission upholds the Initial Order's decision that Virtual NXX or VNXX traffic does not originate and terminate within a local calling area, that its compensation should be based on a bill and keep regime, and that the terminating carrier should be responsible for the cost of transporting the call. We grant in part petitions for review filed by Level 3 Communications, LLC (Level 3), Broadwing Communications, LLC (Broadwing), Pac-West Telecomm, Inc. (Pac-West), Advanced Telecom, Inc. (ATI), Electric Lightwave, Inc. (ELI), and Washington Independent Telephone Association (WITA) concerning the following issues:*

- *WITA's claim that VNXX traffic is interexchange traffic;*
- *Level 3's and Broadwing's claims that the Initial Order did not fully support its decision that classification and compensation of traffic exchanged between carriers should be based on a geographic method;*
- *ATI's, ELI's and Level 3's requests that we clarify how the Initial Order's transport compensation requirement applies when CLECs have deployed or obtained their own transport facilities;*
- *Pac-West's and Level 3's claims that the decisions in the Initial Order and this final order do not resolve all of the issues pending on remand from the District Court for the Western District of Washington.*

2 *We deny the parties' petitions for review on the remaining issues. We clarify and amplify the Initial Order's rationale for denying Broadwing's counterclaims. We also modify the Initial Order as Staff requests to (1) reflect that the Initial Order did not dismiss Qwest's complaint, but granted partial relief; (2) clarify that VNXX traffic is interexchange traffic; and (3) explain fully the Commission's authority to classify and establish compensation for VNXX traffic. Finally, we deny Staff's requests to modify the Initial Order to remove statements regarding assumptions.*

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## I. INTRODUCTION

3 **NATURE OF PROCEEDINGS.** In Docket UT-063038, Qwest Corporation (Qwest) filed a complaint with the Washington Utilities and Transportation Commission (Commission) alleging nine competitive local exchange carriers (CLECs)[1] violate Qwest's access tariffs, prescribed exchange areas and state law, and act contrary to public policy, by using virtual NXX (VNXX)[2] numbering arrangements.[3] Qwest seeks appropriate relief.

4 In Docket UT-063055, Qwest and Verizon Access filed an amendment to their interconnection agreement that allows for the exchange of VNXX traffic under a bill and keep arrangement.[4] As a result of negotiating the amendment to the parties' interconnection agreement, Qwest and Verizon Access also filed a settlement agreement in Docket UT-063038 in which Qwest agrees to dismiss Verizon Access from the complaint.

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[1] The nine CLECs are Level 3 Communications, LLC (Level 3), Pac-West Telecomm, Inc. (Pac-West), Northwest Telephone, Inc. (Northwest), Focal Communications Corporation, now known as Broadwing Communications, LLC (Broadwing), Global Crossing Local Services, Inc. (Global Crossing), TCG Seattle (TCG), Electric Lightwave, Inc. (ELI), Advanced Telecom, Inc. (ATI), and MCI Metro Access Transmission Services, LLC d/b/a Verizon Access Transmission Services (Verizon Access). Level 3's parent company acquired Broadwing in January 2007. Broadwing and Level 3 remain separate companies operating under separate authority and separate interconnection agreements with Qwest. *See* Broadwing Petition for Review, ¶ 2.

[2] The Commission has previously defined VNXX traffic as "a carrier's acquisition of a telephone number for one local calling area that is used in another geographic area. The call appears local based on the telephone number." *Pac-West Telecomm, Inc. v. Qwest Corporation*, Docket UT-053036, Order 05, Final Order Affirming and Clarifying Recommended Decision, n.1 (Feb. 10, 2006) [*Pac-West Order*].

[3] A glossary of terms is attached as Appendix A to this Order.

[4] Bill and keep is "an arrangement in which neither of two interconnecting networks charges the other for terminating traffic that originates on the other network. Instead, each network recovers from its own end-users the costs of both originating traffic that it delivers to the other network and terminating traffic that it receives from the other network." *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic, Order on Remand and Report and Order,* 16 FCC Rcd. 9151, ¶ 2, n.6 *(rel. April 27, 2001) [ISP Remand Order] remanded, WorldCom v. FCC,* 288 F.3d 429 (D.C. Cir. 2002), *cert. denied,* 538 U.S. 1012 (2003).

*5* **APPEARANCES.** Lisa A. Anderl, Associate General Counsel, and Adam Sherr, Senior Counsel, Seattle, Washington, represent Qwest. Gregory J. Kopta, Davis Wright Tremaine, LLP, Seattle, Washington, represents Pac-West, Northwest, Broadwing, and Global Crossing. Tamar E. King, Edward W. Kirsch and Frank G. Lamancusa, Bingham McCutchen, LLP, Washington, D.C., represent Level 3, and Broadwing. Gregory L. Castle, Senior Counsel, AT&T Services, Inc., San Francisco, California, and David W. Wiley, Williams, Kastner & Gibbs, PLLC, Seattle, Washington, represent TCG. Charles L. Best, Vice President, Government Affairs, Portland, Oregon, and Dennis D. Ahlers, Associate General Counsel, Minneapolis, Minnesota, represent ELI and ATI. Gregory M. Romano, General Counsel - Northwest Region, Everett, Washington, represents Verizon Access. Richard A. Finnigan, attorney, Olympia, Washington, represents the Washington Independent Telephone Association (WITA). Calvin K. Simshaw, Associate General Counsel, Vancouver, Washington, represents CenturyTel. Jonathan Thompson, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff). [5]

*6* **PROCEDURAL HISTORY.** Qwest filed this complaint on May 23, 2006. On June 26, 2006, Broadwing and Global Crossing filed counterclaims against Qwest, seeking compensation for terminating Internet Service Provider (ISP)-bound traffic that originated from Qwest's customers. WITA and CenturyTel were granted intervenor status without objection during the initial prehearing conference on July 20, 2006.[6]

*7* On October 5, 2007, Administrative Law Judge Theodora M. Mace entered an Initial Order (Order 05) finding that VNXX traffic is not *per se* unlawful, but is lawful only if subject to appropriate compensation. The Initial Order determined that VNXX traffic should be subject to a bill and keep mechanism, and that CLECs should pay for transport of VNXX traffic when using Qwest's facilities. Level 3, Broadwing,

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[5] In formal proceedings such as this case, the Commission's regulatory staff functions as an independent party with the same rights, privileges, and responsibilities as other parties to the proceeding. There is an "*ex parte* wall" separating the Commissioners, the presiding Administrative Law Judge, and the Commissioners' policy and accounting advisors from all parties, including regulatory staff. *RCW 34.05.455.*
[6] *See* Transcript (TR.) 11:22 – 13:13.

WITA, ELI, ATI and Pac-West filed petitions for administrative review on October 25, 2007.

*8* On November 14, 2007, Qwest, Level 3, Verizon Access, TCG Seattle, Global Crossing and Pac-West, jointly, and Commission Staff filed answers to the petitions for review.

*9* On November 30, 2007, Level 3 and Broadwing petitioned to reply to Qwest's answer. Among other issues, they sought to respond to Qwest's statements that the Initial Order addressed issues the federal district court remanded to the Commission in two separate dockets.[7] The Commission allowed Level 3 and Broadwing to file a joint reply to Qwest's answer on this issue.

*10* After seeking comments from all parties concerning whether to consolidate this proceeding with the two proceedings on remand from the district court, the Commission entered Order 09, declining to consolidate the proceedings.[8]

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[7] In Dockets UT-053036 and UT-053039, Pac-West and Level 3, respectively, filed petitions to enforce terms of their interconnection agreements with Qwest concerning compensation for traffic to Internet Service Providers (ISPs), including VNXX traffic. In counterclaims, Qwest asserted the traffic in question was not subject to compensation as ISP-bound traffic and that the CLECs' use of VNXX traffic was illegal. The Commission resolved the two petitions on motions for summary judgment, interpreting the CLECs' interconnection agreements and the Federal Communication Commission's (FCC) *ISP Remand Order*. The Commission found as a matter of law that Qwest must compensate Level 3 and Pac-West for ISP-bound traffic, regardless of whether the traffic originated and terminated within the same local calling area. *See Pac-West Order*, ¶ 30; *Level 3 Communications LLC v. Qwest Corporation*, Docket UT-053039, Order 05, ¶ 25 (Feb. 10, 2006) [*Level 3 Order*]. Qwest sought review of the Commission's orders in federal district court. On April 19, 2007, just prior to hearings in the complaint proceeding, a magistrate for the District Court for the Western District of Washington entered a decision rejecting the Commission's orders and remanding them for additional consideration. *See Qwest Corporation v. Washington Utils. and Transp. Comm'n*, 484 F.Supp.2d 1160 (W.D.Wash. 2007) [*Qwest v. WUTC*].

[8] We declined consolidating the three cases finding that although the dockets contain closely related issues of law and fact concerning the classification of and proper compensation for VNXX traffic, consolidating the proceedings would unacceptably delay entering a final order in the complaint proceeding. *Order 09, ¶¶ 14-16.*

## II. MEMORANDUM

*11* The appropriate classification and compensation for VNXX traffic is a matter of first impression in this state. The issue comes to us through petitions for administrative review of the Initial Order in which the administrative law judge determined that VNXX traffic is interexchange in nature and that VNXX arrangements are lawful, so long as appropriate compensation is paid to those carriers that initiate transport and terminate VNXX traffic.[9] During this proceeding, the parties progressively focused their debate on the issue of the appropriate classification of VNXX traffic and what, if any, compensation regime should be applied to the exchange of such traffic between competing telecommunications carriers. Before addressing the various objections to the Initial Order, it is helpful to recount the tortured legal and regulatory history behind the dispute over VNXX traffic.

*12* The core of the dilemma is that the entire system of intercarrier compensation, including the rating and routing of calls, historically has been based upon assumptions about the physical location of the customer and the type of network. In this model, knowing someone's telephone number tells one something about the presumed physical location of that customer.

*13* This geographic model, however, is fast being eclipsed by technologies supporting the Internet, including optical fiber, packet switching, soft switches, and other emerging Internet Protocol (IP)-based equipment which are not based on geography in the same way as copper wires and circuit switches, and are not connected to the existing circuit-switched network in the same manner. For example, a person may make a telephone call using Voice over Internet Protocol technology (VoIP) from anywhere in the world using any telephone number, and that call may appear to be local for billing purposes.

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[9] This matter originated as a complaint by Qwest against specific CLECs alleging "unlawful" behavior by the CLECs in providing VNXX services to their end-user customers, predominantly dial-up ISPs, and seeking remedies.

*14* Despite ten years and several decisions, appeals and remands, the FCC has not yet resolved the issue of appropriate intercarrier compensation for ISP-bound and VNXX traffic.[10] Nor has the FCC provided clear guidance as to how to fit the square peg of new technology into the round hole of historical precepts. Meanwhile, as we discuss below, carriers appear to have taken advantage of regulatory arbitrage opportunities due to ambiguities under the current intercarrier compensation system.

*15* Interpreting the FCC's decisions in particular the *ISP Remand Order,* is akin to Alice's trip down the rabbit hole.[11] The result thus far is a diverse range of state commission decisions concerning the classification and compensation for ISP-bound and VNXX traffic, a number of which have been reviewed by federal appellate courts.[12] We now plunge into that body of law in search of a logical answer to the questions before us.

## A. Historical Legal and Regulatory Background

### 1. Historical Rating and Routing of Telephone Calls.

*16* Telephone numbers historically have been assigned on the basis of the geographic location of the customer's telephone and then used for routing and rating, or compensation, for calls to and from that number. The Ninth Circuit Court of Appeals

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[10] Evidently frustrated after six years of waiting for the FCC to respond, the Court of Appeals for the D.C. Circuit recently issued a *writ of mandamus* ordering the FCC to "explain the legal basis for its ISP-bound compensation rules" established in the *ISP Remand Order* by November 5, 2008, after which deadline the court will vacate the rules. *See In re Core Communications, Inc.,* ___ F.3d ___, 2008 WL 2659636 at 1 (C.C.D.C.). Like the legendary case of *Jarndyce v. Jarndyce*, this may yet prove to be a case where the litigation outlives all the litigants until the issue itself is mooted by the technological death of dial-up ISPs. *See* Dickens, Charles, Bleak House, Penguin Books, London, 2003, at 16-17.

[11] *See* Carroll, Lewis, Alice's Adventures in Wonderland, Barnes & Noble Classics, New York, 2004, at 15.

[12] *See Global NAPs v. Verizon New England*, 444 F.3d 59 (1st Cir. 2006) [*Global NAPs I*]; *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91 (2nd Cir. 2006) [*Global NAPs II*]; *Verizon California, Inc., v. Peevey*, 462 F.3d 1142 (9th Cir. 2006); *Qwest v. WUTC,*, 484 F.Supp.2d 1160 (W.D. Wash. 2007). Judicial decisions provide guidance in administrative proceedings. However, in interpreting applicable federal law under the Telecommunications Act of 1996, federal law is controlling. *See* Washington Administrative Law Practice Manual, § 9.01 at 9-9 (2007).

explained the historical importance of, and geographic basis for, the assignment of telephone numbers:

> Telephone numbers generally consist of ten digits in the form of NPA-NXX-XXXX. The first three digits indicate the Numbering Plan Area (or NPA), commonly known as the area code, and the next three digits refer to the exchange code. Under standard industry practice, area codes and exchange codes generally correspond to a particular geographic area served by an [local exchange carrier]. These codes serve two functions: the routing of calls to their intended destinations, and the rating of calls for purposes of charging consumers. Each NPA-NXX code is assigned to a rate center, and calls are rated as local or toll based on the rate center locations of the calling and called parties. When the NPA-NXX codes of each party are assigned to the same local calling area, the call is rated to the calling party as local; otherwise it is a toll call for which the calling party must normally pay a premium.[13]

*17* The NXX code identifies the central office and switch that an incumbent local exchange carrier (ILEC) will use to route a phone call. Switches historically have been programmed to recognize the NXX code and route the call according to whether the NXX number is within a local calling area or outside the local exchange, *i.e.,* interexchange.[14] Whether a call is within a local exchange or interexchange will generally determine how much the customer is charged, as well as the compensation allocated between carriers that handle the call.[15]

*18* In 1996, Congress passed the Telecommunications Act of 1996 (the Act) to encourage competition among providers of telephone services, modifying, in part, the existing classification and compensation scheme.[16] The Act preserved in section 251(g) the existing compensation scheme for interstate and intrastate interexchange and information access traffic, but under section 251(b)(5) required local exchange

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[13] *Peevey*, 462 F.3d at 1147-48.
[14] Initial Order, ¶ 11.
[15] Interexchange calls that cross local exchanges are generally subject to toll, or access charges. An access charge typically involves a long distance company collecting payment from the caller and then paying compensation to the originating and terminating LECs. The determination of intrastate access charges is within state regulatory jurisdiction, while interstate access charges are within the FCC's authority.
[16] 110 Stat. 56, Pub. L. 104-104 (Feb. 8, 1996).

carriers to apply a new form of compensation, known as reciprocal compensation, to the transport and termination of telecommunications traffic.[17] The FCC determined that reciprocal compensation obligations under section 251(b)(5) apply only to traffic that originates and terminates within a local calling area, such that the customer initiating the call pays the originating carrier, and the originating carrier must pay the terminating carrier for completing the call.[18]

*19* In a reciprocal compensation regime, carriers exchange local traffic at identical rates that, historically, were based on some measure of the incumbent LEC's costs. Advocates of reciprocal compensation predicted that payments from one carrier to

[17] 47 U.S.C. §§ 251(b)(5), 251(g); *See also* Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15499, ¶¶ 1033, 1035 (1996) [*Local Competition Order*]. Section 251(g) provides:

> On and after February 8, 1996, each local exchange carrier, to the extent that it provides wire line services, shall provide exchange access, information access, and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996, under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996. During the period beginning on February 8, 1996, and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

Section 251(b)(5) provides: "Each local exchange carrier has the following duties: … (5) Reciprocal compensation. The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."

[18] *See Local Competition Order*, ¶¶ 1034-35: "We conclude that section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area, as defined in the following paragraph. … [S]tate 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." While the FCC later disavowed the use of the term "local" in determining whether traffic is subject to reciprocal compensation, the FCC determined that intrastate interexchange traffic was also excluded under section 251(g) from reciprocal compensation under section 251(b)(5). *See ISP Remand Order*, n.66.

another largely would be offset by payments in the other direction, because traffic between carriers was expected to be approximately in balance.

*20* Unfortunately that did not prove to be the case because of the nature of dial-up Internet service. Virtually all ISP-bound traffic is one way – customers call their ISPs, but ISPs do not call their customers, and call length (minutes-of-use) is generally quite long. Certain carriers realized they could specifically target service to ISPs for the large volume one-way inbound traffic and collect reciprocal compensation payments from the originating carrier. Since there was virtually no traffic going the other way (from ISPs), this business model took the "reciprocal" out of reciprocal compensation. In essence, the reciprocal compensation system created an incentive for carriers to serve customers like ISPs simply to attain revenues from other carriers rather than from their own end users.

*21* VNXX traffic arrangements occur when the carrier assigns a telephone number from a rate center (NXX) in a local calling area different from the one where the customer is physically located. For example, a customer in Seattle is assigned a number for a local calling area in Olympia. The effect of this assignment is that a call to the VNXX number appears to terminate within the Olympia local calling area, but will actually terminate in the Seattle local calling area. Because intercarrier compensation depends on whether this call is classified as "local" (subject to reciprocal compensation) or interexchange (subject to access charges), the classification decision is central to determining who pays whom and how much.

*22* The great majority of VNXX calls are made to ISPs (ISP-bound traffic).[19] CLECs use VNXX arrangements primarily to serve their ISP customers. VNXX enables the ISP dial-up customers to connect with the Internet without incurring toll or access charges.[20] Given this nexus of VNXX and ISP-bound traffic, the legal and regulatory

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[19] *See* Brotherson, Exh. No. 1T, 11: 13-18; Williamson, Exh. No. 201T, 14:6-13; Williamson, Exh. No. 203T, 13:35 – 14:1; Blackmon, Exh. No. 401T, 12-22, generally; Robins, Exh. No. 421T, 6:4-6; Neinast, Exh. No. 541, 4:10-23; Price, Exh. No. 551T, 2:19 – 3:1; s*ee also* Vasington, TR. 934:13–19.
[20] Initial Order, ¶ 13.

history of classification and compensation for ISP-bound traffic is instructive in trying to resolve the disputes in this proceeding.

### 2. ISP-Bound Traffic.

*23* As an initial matter, we observe that over the past decade there has been an extensive and prolonged debate at the FCC, state commissions, and various state and federal courts regarding the jurisdiction, classification, and determination of what, if any, intercarrier compensation is appropriate or should be applied to ISP-bound traffic. The CLECs emphatically contend that all ISP-bound traffic is "local" or has enough characteristics of genuinely local traffic to be afforded treatment as "local-like" by state regulators. Accordingly, CLECs argue the traffic should be subject to the reciprocal compensation provisions of section 251(b)(5) of the Act. In contrast, ILECs such as Qwest strenuously argue that ISP-bound traffic is jurisdictionally interstate, requiring compensation through appropriate access charges, which are subject to FCC but not state commission jurisdiction.

*24* Underpinning the many CLEC-ILEC contests over compensation for ISP-bound traffic has been confusion stemming from the FCC's effort to rationalize its determination that ISP-bound traffic is jurisdictionally interstate, while deferring material aspects of the compensation dispute to state commissions for resolution, implying the traffic is local or intrastate and thus within state jurisdiction.

*25* Since 1999, the FCC has entered three decisions on this subject. Collectively, the rulings confound rather than clarify how to classify or compensate ISP-bound traffic.

*26* In its first major ruling on the subject – the *Declaratory Ruling,* the FCC found that ISP-bound traffic is jurisdictionally interstate traffic subject to the FCC's authority under section 201 of Act.[21] Although recognizing the interstate nature of ISP-bound traffic, the FCC focused only on ISP-bound traffic that terminates locally, *i.e.,*

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[21] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, 14 FCC Rcd. 3689 (1999) *[Declaratory Order].*

originates and terminates within a local area, as most ISP calls were at the time made to an ISP modem located within a local calling area.[22] Based largely on an end-to-end analysis for calls placed by ISP customers seeking to access the Internet, the FCC concluded that ISP-bound traffic is "jurisdictionally mixed" and "appears to be largely interstate," presumably because such calls sought access to websites and other Internet-based applications that are often hosted across state boundaries and around the world. After determining its interstate nature, the FCC found that the traffic may or may not be subject to reciprocal compensation under section 251(b)(5), because carriers may have agreed in their interconnection agreements to treat the traffic as local and subject to reciprocal compensation.[23]

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[22] *Id.*, ¶¶ 4, 7, 18.
[23] *See*, *Id.*, ¶¶ 23-25. "Although *we determine, above, that ISP-bound traffic is largely interstate, parties nonetheless may have agreed to treat the traffic as subject to reciprocal compensation*. The Commission's treatment of [Enhanced Service Provider] ESP traffic dates from 1983 when the Commission first adopted a different access regime for ESPs. [footnote omitted] Since then, the Commission has maintained the ESP exemption, pursuant to which it treats ESPs as end users under the access charge regime and permits them to purchase their links to the [Public Switched Telephone Network] PSTN through intrastate local business tariffs rather than through interstate access tariffs. As such, *the Commission discharged its interstate regulatory obligations through the application of local business tariffs*. Thus, although recognizing that it was interstate access, *the Commission has treated ISP-bound traffic as though it were local*. In addition, incumbent LECs have characterized expenses and revenues associated with ISP-bound traffic as intrastate for separations purposes." (Emphasis added).

> *"Against this backdrop, and in the absence of any contrary Commission rule, parties entering into interconnection agreements may reasonably have agreed, for the purposes of determining whether reciprocal compensation should apply to ISP-bound traffic, that such traffic should be treated in the same manner as local traffic.* When construing the parties' agreements to determine whether the parties so agreed, state commissions have the opportunity to consider all the relevant facts, including the *negotiation of the agreements in the context of this Commission's longstanding policy of treating this traffic as local*, and the conduct of the parties pursuant to those agreements. For example, it may be appropriate for state commissions to consider such factors as whether incumbent LECs serving ESPs (including ISPs) have done so out of intrastate or interstate tariffs; whether revenues associated with those services were counted as intrastate or interstate revenues; whether there is evidence that incumbent LECs or CLECs made any effort to meter this traffic or otherwise segregate it from local traffic, particularly for the purpose of billing one another for reciprocal compensation; whether, in jurisdictions where incumbent LECs bill their end users by message units, incumbent LECs have included calls to ISPs in local telephone charges; and whether, if ISP traffic is not treated as local and subject to reciprocal compensation, incumbent LECs and CLECs would be compensated for this traffic. These factors are illustrative only; state commissions, not this

*27* Noting the absence of any rules addressing intercarrier compensation for ISP-bound traffic, the FCC offered little guidance to state commissions other than that they were free to require payment using reciprocal compensation or "to adopt another compensation mechanism."[24]

*28* In sum, the *Declaratory Ruling* found ISP-bound traffic to be interstate, and thus subject to the FCC's jurisdiction for purposes of determining compensation, then declined to determine what that compensation should be, and finally punted the issue to the state commissions because the carriers' interconnection agreements might be found by the commissions to classify the traffic as "local" even though the FCC declared ISP-bound traffic to be "interstate." Thus, "interstate" is "local" and "local" is "interstate."[25]

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Commission, are the arbiters of what factors are relevant in ascertaining the parties' intentions. *Nothing in this Declaratory Ruling, therefore, necessarily should be construed to question any determination a state commission has made, or may make in the future, that parties have agreed to treat ISP-bound traffic as local traffic under existing interconnection agreements*.[footnote omitted] Finally, we note that issues regarding whether an entity is properly certified as a LEC if it serves only or predominantly ISPs are matters of state jurisdiction. [footnote omitted]" (Emphasis added).

*"Even where parties to interconnection agreements do not voluntarily agree on an inter-carrier compensation mechanism for ISP-bound traffic, state commissions nonetheless may determine in their arbitration proceedings at this point that reciprocal compensation should be paid for this traffic.* The passage of the 1996 Act raised the novel issue of the applicability of its local competition provisions [footnote omitted] to the issue of inter-carrier compensation for ISP-bound traffic. Section 252 imposes upon state commissions the statutory duty to approve voluntarily-negotiated interconnection agreements and to arbitrate interconnection disputes. As we observed in the *Local Competition Order*, state commission authority over interconnection agreements pursuant to section 252 "extends to both interstate and intrastate matters." [footnote omitted] *Thus the mere fact that ISP-bound traffic is largely interstate does not necessarily remove it from the section 251/252 negotiation and arbitration process.* [footnote omitted] *However, any such arbitration must be consistent with governing federal law.* [footnote omitted] *While to date the Commission has not adopted a specific rule governing the matter, we note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic."* (Emphasis added).

[24] *Id*., ¶¶ 26-27.

[25] This brings to mind Alice's conversation in the rabbit hole:

"When *I* use a word," Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean – neither more nor less."

*29* The Court of Appeals for the District of Columbia rejected the FCC's jurisdictional traffic analysis and remanded the *Declaratory Ruling* for further consideration because the FCC failed to explain adequately why its jurisdictional analysis mooted or was otherwise relevant to the applicability of section 251(b)(5) to ISP-bound traffic.[26] On remand, in 2001, the FCC released a second order, the *ISP Remand Order*, modifying its previous jurisdictional analysis.[27]

*30* Abandoning its end-to-end model for determining the jurisdiction of ISP-bound traffic, the *ISP Remand Order* relied instead on section 251(g) of the Act, which the FCC described as a carve-out provision of traffic otherwise subject to section 251(b)(5).

> We conclude that a reasonable reading of the statute is that Congress intended to exclude the traffic listed in subsection (g) from the reciprocal compensation requirements of subsection (b)(5). [footnote omitted] Thus, the statute does not mandate reciprocal compensation for "exchange access, information access, and exchange services for such access" provided to [Interexchange, or long distance, carriers] IXCs and information service providers. Because we interpret subsection (g) as a carve-out provision, the focus of our inquiry is on the universe of traffic that falls within subsection (g) and *not* the universe of traffic that falls within subsection (b)(5). *This analysis differs from our analysis in the Local Competition Order, in which we attempted to describe the universe of traffic that falls within subsection (b)(5) as all "local" traffic. We also refrain from generically describing traffic as "local" traffic because the term "local," not being a statutorily defined category, is particularly susceptible to varying meanings and, significantly, is not a term used in section 251(b)(5) or section 251(g).*

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"The questions is," said Alice, "whether you *can* make words mean so many different things."

"The question is," said Humpty Dumpty, "which is to be master – that's all."
Carroll, Lewis, Through the Looking Glass, Barnes & Noble Classics, New York, 2004, at 219.

[26] *Bell Atl. Tel. Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) *[Bell Atlantic]*.

[27] *ISP Remand Order*, *supra,* n.4.

> We agree with the court that the issue before us requires more than just a jurisdictional analysis. Indeed, as the court recognized, the 1996 Act changed the historic relationship between the states and the federal government with respect to pricing matters. [footnote omitted] Instead, we focus upon the statutory language of section 251(b) as limited by 251(g). We believe this approach is not only consistent with the statute, but that it resolves the concerns expressed by the court in reviewing our previous analysis. *Central to our modified analysis is the recognition that 251(g) is properly viewed as a limitation on the scope of section 251(b)(5) and that ISP-bound traffic falls under one or more of the categories set forth in section 251(g). For that reason, we conclude that ISP-bound traffic is not subject to the reciprocal compensation provisions of section 251(b)(5).* We reach that conclusion regardless of the compensation mechanism that may be in place for such traffic under the ESP exemption.[28]

*31* Unlike the *Declaratory Ruling,* where the FCC determined that ISP-bound traffic may or may not be subject to reciprocal compensation under section 251(b)(5) depending on the interconnecting parties' intentions or existing state commission decisions, the FCC decided in the *ISP Remand Order* that because ISP-bound traffic fits one or more of the categories of traffic covered by the section 251(g) carve-out provision, it is not subject to section 251(b)(5). Also unlike the *Declaratory Ruling,* the FCC decided to adopt an intercarrier compensation "interim recovery scheme" that it contended would eliminate arbitrage opportunities by lowering existing reciprocal compensation payments to CLECs predominantly serving ISPs, establish a capping mechanism on the rates interconnecting carriers may charge for ISP-bound traffic and, perhaps most importantly, initiate a 36-month transition toward a "bill and keep" regime for ISP-bound traffic.[29] The FCC also imposed a number of limitations on recovery of interim rates, including a growth cap, limiting the total annual ISP-bound minutes for which a LEC or CLEC may receive compensation, and initiating a new markets rule, requiring carriers to exchange traffic on a bill and keep basis in markets where carriers were not exchanging traffic prior to adoption of the *ISP Remand Order*.[30]

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[28] *Id.,* ¶¶ 34-35. (Emphasis added).
[29] *See, supra*, n.4.
[30] *ISP Remand Order*, ¶¶ 78, 81.

*32* Bill and keep requires carriers to recover most, if not all, of their own costs from their own end users, and eliminates reliance on or the incentive to exploit the arbitrage opportunity associated with a per-minute reciprocal compensation system. In contrast, under reciprocal compensation, carriers serving ISPs could generate large payments from originating carriers for the traffic imbalance created by the one-way calling patterns generated by their ISP customers.

*33* The so-called interim compensation system established in the *ISP Remand Order* reflected the FCC's intention to wean carriers, particularly CLECs, from reliance on reciprocal compensation payments and transition them towards a bill and keep compensation regime.[31] As discussed above, this was necessary because per-minute reciprocal compensation provided a strong incentive to CLECs to effectively "milk" the intercarrier compensation system by targeting customers with unusual calling patterns (*i.e.,* dial-up ISPs, and customers with exclusively inbound calling). The goal of the interim regime and transition was to curtail this arbitrage opportunity and to mitigate the unanticipated consequences of reciprocal compensation on the development of competition in local markets.

*34* The net effect of the *ISP Remand Order* was to reverse the portion of the *Declaratory Ruling* that allowed treatment of "interstate" ISP-bound traffic as "local" and thus subject to reciprocal compensation, while "carving out" "interstate" ISP-bound traffic and creating an interim compensation regime that operates remarkably similar to reciprocal compensation. Not surprisingly, questions quickly arose over how to interpret the *ISP Remand Order*.

*35* Further complicating matters, in a third decision adopted in 2004, the FCC acted on a petition for forbearance filed by Core Communications, Inc., and released its *Core*

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[31] The FCC envisioned a three-year transition for CLECs to change their intercarrier practices, but deferred an ultimate decision on bill and keep for all ISP-bound traffic to the Intercarrier Compensation docket addressing comprehensive reform. *See Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92, Notice of Proposed Rulemaking, FCC 01-132 (rel. Apr. 27, 2001).

*Forbearance Order*.[32] There, the FCC removed the growth caps and new markets rules it had established in the *ISP Remand Order* for ISP-bound traffic. These restrictions had been designed to correct market distortions resulting from a usage-based (per-minute) compensation system (*e.g.*, reciprocal compensation) increasingly being applied by state commissions to ISP-bound traffic. Citing market developments, the FCC eased the growth caps and new markets rule because consumers were shifting to higher speed broadband Internet connections and away from dial-up ISP services, thus reducing the arbitrage opportunities for CLECs serving ISPs. However, the FCC reiterated its intent to address compensation for ISP-bound calls through a comprehensive intercarrier compensation mechanism for all traffic, stating in a footnote:

> The Commission is considering comprehensive reform of intercarrier compensation mechanisms for all traffic, including ISP-bound traffic. [Cite omitted] We have been presented with four separate proposals from different industry groups. [Cite omitted] These proposals represent the product of unprecedented industry-wide negotiations regarding this extremely complex subject matter. We hope to move forward *expeditiously* in our consideration of these proposals.[33]

*36* We concede to being confused by the FCC's orders. For example, in the wake of the *ISP Remand Order*, this Commission arbitrated an agreement between Level 3 and CenturyTel in which the parties disputed whether the FCC's interim compensation for ISP-bound traffic applies where an ISP is located outside the local calling area. The Commission found the *ISP Remand Order* did not distinguish between ISP-bound calls made inside or outside a local calling area, and upheld the Arbitrator's decision to apply the FCC's interim compensation regime to traffic bound for an ISP outside of the local calling area.[34] We followed this same analysis in later disputes between Pac-West and Qwest and Level 3 and Qwest.[35]

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[32] *Petition of Core Communications, Inc. for Forbearance under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171, FCC 05-2451 (Rel. Oct. 18, 2004) [*Core Forbearance Order*].
[33] *Id*., n.49. (Emphasis added).
[34] *In the Matter of the Petition for Arbitration of an Interconnection Agreement Between Level 3 Communications, LLC, and CenturyTel of Washington, Inc., Pursuant to 47 U.S.C. Section 252*,

*37* As discussed more fully below, recent federal decisions have rejected this analysis.[36] We find particularly persuasive the reasoning of the Arizona federal district court in *Qwest v. Arizona*.[37] There the court pointed out that whatever the words used by the FCC to label ISP-bound traffic, the Act clearly distinguished between traffic subject to section 251(b)(5) reciprocal compensation and section 251(g) interexchange and information access compensation. The FCC was attempting to address the regulatory arbitrage arising from reliance on reciprocal compensation, which only arose in relation to ISP-bound calls within a local calling area. Interstate and intrastate ISP calls were not deemed subject to reciprocal compensation, and thus were not the source of the arbitrage concerns of the FCC. The "carve-out" analysis of the *ISP Remand Order* was only necessary for the FCC to assert jurisdiction over ISP-bound calls within a local calling area so that it could address the arbitrage by creating a new "interim" compensation scheme specifically for this type of traffic.[38] The "interim" scheme is itself a form of reciprocal compensation intended to mitigate and ultimately wean away the arbitrage opportunities for ISP-bound calls. If it were extended to all ISP-bound calls (i.e., interexchange, interstate and intrastate), the effect would be to *increase* arbitrage opportunities, the opposite of the FCC's policy objective. Thus, contrary to our previous decisions in this regard, an ISP-bound call can be local or interexchange depending upon the location of the calling parties or some other basis for classifying the call.

*38* This analysis brings us to the heart of the current case and related disputes: As previously discussed, VNXX is largely used by CLECs to serve ISP-bound traffic. It appears to be a local call to the originating caller, but is routed to terminate outside

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Docket UT-023043, Seventh Supplemental Order, Affirming Arbitrator's Report and Decision, (Feb. 28, 2003) ¶¶ 7-10 [*CenturyTel Level 3 Order*].

[35] *Pac West Order*, *supra*, n.1, ¶ 30; *Level 3 Order*, *supra*, n.7, ¶ 25. *See also, infra*, paragraph 39.

[36] *See Global NAPs I*, 444 F.3d at 73-75; *Qwest v. WUTC*, 484 F.Supp.2d at 1170-73; *Qwest Corporation v. Arizona Corporation Comm'n, et al.,* No. CV-06-2130-PHX-SRB, slip opinion at 11-20 (Dist. Arizona, Nov. 20, 2007) [*Qwest v. Arizona*], *appeal docketed*, No. 08-15887 (9th Cir., Apr. 4, 2008).

[37] *See Qwest v. Arizona, supra*, n.36.

[38] *Id.* at 12.

the local calling area (interexchange). Our classification will determine the intercarrier compensation for this traffic.

*39* In 2005, Pac-West and Level 3 initiated Dockets UT-053036 and UT-053039, respectively, to enforce their interconnection agreements with Qwest, asserting that following the *Core Forbearance Order*, Qwest owed the CLECs reciprocal compensation for ISP-bound traffic originating on Qwest's network. In turn, Qwest denied an obligation to pay reciprocal compensation asserting that the traffic was not exchanged within a local calling area as required by the *ISP Remand Order.* Qwest also filed counterclaims arguing that the traffic in question was illegal VNXX traffic. We entered orders in the two proceedings denying Qwest's counterclaims as outside the scope of the proceeding. Consistent with the *Century Tel/Level 3 Order* and based on statements in the FCC's *amicus curiae* brief in a case before the First Circuit,[39] we also concluded that the *ISP Remand Order's* interim compensation scheme for ISP-bound traffic applies to all traffic bound for an ISP, regardless of where the traffic originated or terminated.[40] Qwest appealed these decisions to federal court.[41]

### 3. VNXX Traffic.

*40* Recent federal court decisions have reconciled the historical underpinnings of intercarrier compensation with the Act and clarified the meaning of the FCC's orders on ISP-bound traffic. Most importantly, these decisions confirm that state commissions retain authority to classify and determine the intercarrier compensation for VNXX traffic, and provide guidance on appropriate compensation mechanisms.

*41* The First, Second, and Ninth Circuit Courts of Appeal have all addressed the question of state commission authority to classify and determine compensation for VNXX traffic. After finding that the states retained authority under the Act to determine

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[39] *See Global NAPs I*, 444 F.3d at 74.
[40] *Pac-West Order*, ¶¶ 42-43; *Level 3 Order*, ¶¶ 39-40.
[41] We do not resolve in this Order the issues pending on remand as they specifically relate to Pac-West and Level 3. As some of the issues in this proceeding and the remand proceeding are similar, we must address them here, and will return to them in the remand proceeding.

intrastate calling area or exchange boundaries and compensation for intrastate interexchange traffic, the courts have upheld state commission decisions to ban VNXX traffic, to apply intrastate access charges, or to develop another method of compensation for this traffic.[42] We discuss these cases in the sequence in which they were decided.

*42* A few months before Qwest filed its appeal in the Pac-West and Level 3 decisions, the First Circuit Court of Appeals entered its *Global NAPs I* decision, interpreting the *ISP Remand Order* and addressing whether states could establish a compensation scheme for ISP-bound and VNXX traffic.[43] This seminal case arose from the decision of the Massachusetts Department of Telecommunications and Energy (DTE) requiring a CLEC, Global NAPs, to pay an ILEC, Verizon New England, intrastate access charges for all non-local ISP-bound traffic it exchanged with Verizon, including VNXX traffic. Global NAPs asserted that state commissions were preempted under the *ISP Remand Order* from regulating compensation for all ISP-bound traffic. The First Circuit upheld the DTE's decision.

*43* After describing VNXX arrangements as allowing "a party to call what appears to be a 'local' number, although behind the scenes that call is actually routed to a different local calling area,"[44] the First Circuit relied on the FCC's *Local Competition* and *ISP Remand Orders* to find that "[t]he FCC has consistently maintained a distinction between local and 'interexchange' calling and the intercarrier compensation regimes that apply to them, and reaffirmed that states have authority over intrastate access charge regimes."[45] Supported by an *amicus* brief filed by the FCC, the First Circuit rejected Global NAPs' preemption argument, finding that the *ISP Remand Order* does not clearly preempt state regulation of interexchange ISP-bound traffic. The court concluded that the FCC's focus in the *ISP Remand Order* was compensation for "the delivery of calls from one LECs' end-user customer to an ISP *in the same local calling area* that is served by a competing LEC," and not for all ISP-bound calls.[46] It

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[42] *See Global NAPs I*, 444 F.3d at 62-63, 73; *Global NAPs II,* 454 F.3d at 97; *Peevey*, 462 F.3d at 1146.
[43] *Global NAPs I, see supra*, n.12.
[44] *Id*. at 64.
[45] *Id*. at 73; *see also* 62-63, citing *Local Competition Order*, ¶¶ 1033-35.
[46] *Id*. at 73-74, quoting *ISP Remand Order*, ¶ 13. (Emphasis added).

determined that the *ISP Remand Order* did not clearly address ISP-bound VNXX traffic or preempt state commission authority to impose intrastate access charges for such traffic.[47]

*44* Since the *Global NAPs I* decision, the Courts of Appeal for the Second and Ninth Circuits and district courts in Arizona, Oregon and Washington have all addressed similar issues and reached similar conclusions.

*45* The Second Circuit in *Global NAPs II* upheld the Vermont Public Service Board's decision that Board-determined local calling areas would continue to control whether a call is a toll call or a local call.[48] The Second Circuit found that, "despite the monumental changes Congress had made in telecommunications law, the FCC early indicated that it intended to leave authority over defining local calling areas where it always had been – squarely within the jurisdiction of the state commissions."[49] Finding support for its conclusion in the *ISP Remand Order*, the court noted that the FCC's Order "expressly states that access services remain subject to FCC jurisdiction or, to the extent they are intrastate services, they remain subject to the jurisdiction of state commissions."[50] Under this analysis, the court determined, consistent with the First Circuit's decision, that states are not preempted from applying access charges to interexchange ISP-bound traffic or from banning the use of VNXX arrangements.[51]

*46* The Ninth Circuit in *Verizon California, Inc. v. Peevey*, upheld the California Public Utilities Commission's (CPUC's) decision to classify and determine compensation for VNXX traffic, finding it within the agency's authority over interexchange intrastate traffic under the Act and the FCC's *Local Competition Order.*[52]

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[47] *Id*. at 75.
[48] *Global NAPs II,*, 454 F.3d at 94. The Court also upheld the Vermont's Public Service Board's decision to prohibit Global NAPS from offering VNXX service.
[49] *Id*. at 97, citing *Local Competition Order*, ¶ 1035.
[50] *Id*. at 100.
[51] *Id*. at 98-99, 100, 101. The court also determined that the FCC did not preempt the field relating to ISP-bound traffic, allowing the Board's decision to stand. *See also* 101-103.
[52] *Peevey*, 462 F.3d at 1146, quoting *Local Competition Order*, ¶ 1033: "[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." *See also Id*. at 1157-58.

*47* *Peevey* involves two decisions by the CPUC. In the first decision, a 1999 rulemaking proceeding involving a number of carriers, the CPUC determined that VNXX calls should be rated as local calls, and that all carriers are entitled to fair compensation for the use of their facilities and related functions used to deliver calls to their destination. Compensation was to be based on a number of factors, including the actual routing points of a call.[53] The second decision arose from an arbitration proceeding between Verizon and Pac-West, wherein the CPUC allowed reciprocal compensation provided under state law (not under the federal Act's section 251(b)(5)) for VNXX traffic, finding that "whether or not a call is 'local' depends solely on the NPA-NXXs of the calling and called parties."[54] Thus, the CPUC created a structure in which Pac-West was entitled to reciprocal compensation from Verizon and Verizon was entitled to collect call origination charges from Pac-West to compensate it for transporting VNXX calls.[55]

*48* Verizon and Pac-West both contested the decision. The court upheld the CPUC's decision based in part on the First Circuit's finding that the *ISP Remand Order* does not preempt state authority to classify VNXX traffic and determine its compensation. Furthermore, it found that FCC rules prohibiting origination charges do not apply to intrastate or interstate exchange access traffic.[56] The court found the CPUC's rulemaking consistent with its arbitration decision. As in the rulemaking, the CPUC found "that 'calls should be rated in reference to the rate center of the assigned NXX prefix of the called party,' regardless of the called party's physical location."[57]

*49* Following *Peevey*, the District Court for Western Washington reversed our decisions interpreting the *ISP Remand Order* to apply to all ISP-bound traffic,[58] and remanded the decisions to:

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[53] *Id*. at 1148.
[54] *Id*. at 1149.
[55] *Id*. at 1150.
[56] *Id*. at 1157-58, citing 47 C.F.R. § 703(b).
[57] *Id*. at 1155.
[58] *See*, *supra*, nn.2, 7.

> reinterpret the *ISP-Remand Order* as applied to the parties' interconnection agreements, and classify the instant VNXX calls, for compensation purposes, as within or outside a local calling area, to be determined by the assigned telephone numbers, the physical routing points of the calls, or any other chosen method within the WUTC's discretion.[59]

*50* While observing that the *ISP Remand Order* is not a model of clarity, the court relied on the First Circuit's decision, stating that "Congress … did not intend to disrupt the pre-[Act] access charge regime, under which 'LECs provided access services … in order to connect calls that travel to points – both interstate and intrastate – beyond the local exchange'."[60] The court also noted that every circuit court of appeals addressing the issue has found that the FCC's *ISP Remand Order* and interim compensation scheme referred only to ISP-bound traffic within a local calling area,[61] and did not address interexchange traffic such as VNXX. Finally, the court determined that the Commission has authority to classify VNXX traffic and, if appropriate, to establish a reasonable compensation scheme for such traffic. [62]

*51* The court found that the Act left state commissions with the authority to define local calling areas consistent with their historical practice, and "the authority to 'determine whether intrastate transport and termination of traffic between competing LECs, where a portion of their local service areas are not the same, should be governed by section 251(b)(5)'s reciprocal compensation obligations or whether intrastate access charges should apply'."[63] The court restated the FCC's finding that section 251(g) carved out from section 251(b)(5) all ISP-bound traffic because it is interexchange or information traffic, and therefore not subject to reciprocal compensation.[64] The *ISP Remand Order* addressed only the compensation of ISP-bound traffic within a local calling area.[65]

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[59] *Qwest v. WUTC*, 484 F.Supp.2d at 1177.
[60] *Id*. at 1169; *see also* 1170.
[61] *Id*. at 1173, citing to *Global NAPs I*, *Global NAPs II*, *WorldCom*, and *Peevey*.
[62] *Id*. at 1175-77.
[63] *Id*. at 1163, quoting *Global NAPs I*, 444 F.3d at 63.
[64] *Id*. at 1164-65.
[65] *Id*. at 1171.

*52* No party, including Level 3 and Pac-West, sought review of this decision, which is controlling on the analogous issues raised here.[66]

*53* Finally, as we previously discussed, a recent Arizona District Court decision resolved a dispute between Qwest and Pac-West and Level 3 similarly to the district court in Washington.[67] In the Arizona case, Pac-West and Level 3 brought enforcement actions against Qwest to recover reciprocal compensation for ISP-bound traffic exchanged under their interconnection agreements. The Arizona commission determined, as did we, that the *ISP Remand Order* required interim compensation for *all* ISP-bound traffic. The court reversed and remanded the decisions, finding that the *ISP Remand Order* addressed ISP-bound traffic only within a local calling area and did not address compensation for VNXX traffic.[68] Relying on *Global NAPs I* and *Peevey*, the court also found that state commissions have authority to classify and determine compensation for VNXX traffic.[69]

*54* With this context, we turn to the issues raised in the parties' petitions for review of the Initial Order.

## B. Procedural Issues

### 1. Oral Argument

*55* Level 3, Broadwing and Pac-West request oral argument because of the asserted complexity of the factual, legal and policy issues.[70]

*56* Parties may request oral argument under WAC 480-07-825(6) when seeking review of initial orders, but must state why oral argument is necessary and why written

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[66] *Qwest v. WUTC, passim.* Federal court decisions interpreting the Telecommunications Act of 1996 are binding on state commissions. *See, supra,* n.12. We note that while neither Level 3 nor Pac-West sought review of the decision by the District Court for Western Washington, Level 3 has sought review of the Arizona district court's decision. *See, supra*, n.35.
[67] *Qwest v. Arizona, supra*, n.35.
[68] *Id*. at 11-20. *See,* our discussion of the Arizona court's rationale, *supra,* paragraph 37.
[69] *Id*., at 12-13, 23.
[70] Level 3 Petition, ¶ 1; Broadwing Petition, ¶ 1, Pac-West Petition, ¶ 1.

presentations will be insufficient. The rule allows the Commission discretion in determining whether to hear oral argument.

*57* We deny the requests for oral argument. We agree that the issues in this proceeding are complex, but find the evidentiary record and extensive briefing following the hearing and on review sufficient to reach our decision.

### 2. Scope of the Complaint and Commission Authority.

*58* In its complaint, Qwest requested that "the Commission … order that [VNXX] … arrangements are prohibited in the state of Washington, and that Respondents must cease and desist such arrangements immediately, or pay appropriate access charges for the traffic being routed via VNXX."[71] Qwest also requested the Commission grant the following relief:

> (1) [Hold] that VNXX violates state law and Qwest's tariff and is otherwise contrary to the public interest,
> (2) [Prohibit] Respondents from using VNXX numbering by assigning NPA/NXXs in local calling areas other than the local calling area where the customer is physically located or has a physical presence,
> (3) [Require] that Respondents cease their misuse of such telephone numbering resources,
> (4) [Require] that Respondents properly assign telephone numbers based on the actual physical location of its [sic] customer, and
> (5) [Require] that Respondents comply with Qwest's access tariffs if they wish to enable toll-free long distance calling for their own customers and the customers of other local exchange companies.
> Qwest also requests that the Commission grant such other and further relief that the Commission deems appropriate.[72]

*59* The Initial Order determined that Qwest did not meet its burden to show that VNXX services were *per se* illegal,[73] and then considered Qwest's arguments that VNXX

[71] Complaint, ¶ 12.
[72] *Id.*, ¶¶ 41-47.

service violates industry number assignment guidelines, Qwest's tariffs, state statutes, Commission orders, and interconnection agreements between Qwest and the responding CLECs. The Order concluded that VNXX service is unreasonable and violates state statutes unless Qwest is properly compensated for the traffic.[74] Specifically, the Order concluded that "CLECs may not legally provide VNXX services unless intercarrier compensation arrangements for those services reflect the true nature of VNXX calls – that they have both local, and more importantly, long distance characteristics – and that they may create traffic imbalances that skew intercarrier compensation associated with them."[75] After evaluating the policy considerations associated with VNXX calling arrangements and the parties' proposals, the Order found that bill and keep was the appropriate compensation scheme for VNXX traffic between Qwest and CLECs, and that CLECs using Qwest's local interconnection service (LIS) trunks must compensate Qwest under the TELRIC trunking rate.[76]

*60* The Initial Order rejected arguments by certain parties that the Commission should dismiss the complaint and address in a separate generic proceeding the policy issues of whether and how VNXX traffic should be allowed.[77] The Order reasoned that the Commission had suggested previously that Qwest file a complaint to explore its concerns over VNXX traffic, and that Qwest had raised the issue of appropriate compensation in its claims that VNXX was illegal.

*61* Level 3, Pac-West, ATI, ELI, and Global Crossing claim that the Initial Order exceeded the scope of Qwest's complaint when it classified and established compensation for VNXX traffic. They assert that Qwest's complaint asked only that the Commission determine that VNXX services were unlawful, and did not allege

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[73] Initial Order, ¶ 55.
[74] *Id.*, ¶ 47.
[75] *Id.*, ¶ 55.
[76] *Id.*, ¶¶ 56-107, 148-150, 156, 161. TELRIC stands for Total Element Long Run Incremental Cost. The FCC adopted this costing methodology in implementing the Telecommunications Act of 1996. This Commission has established rates for unbundled network elements, including a TELRIC rate for use of Qwest's trunks used for local interconnection service.
[77] *Id.*, n.57.

intercarrier compensation issues.[78] ELI, ATI and Pac West also assert that the Initial Order exceeds the Commission's authority by undertaking a generic inquiry of VNXX services and establishing policy of general applicability that can only be determined or implemented in a rulemaking under the Administrative Procedure Act (APA).[79] The CLECs request that the Commission reject or refuse to adopt the Initial Order's findings and conclusions about classification and compensation of VNXX traffic.

*62* We deny the CLECs' petitions for review on this issue. We find, consistent with Staff's and Qwest's responses, that Qwest's complaint encompasses the question of appropriate compensation for VNXX traffic and that the statute governing complaints provides the Commission authority to grant a remedy different than the specific remedies Qwest requested.[80] Further, principles of waiver and judicial economy impel rejection of the CLECs' arguments.

*63* Qwest's complaint specifically requested the Commission order the respondent CLECs to cease providing VNXX service or to pay appropriate intrastate access charges. Qwest's complaint also requested the Commission grant "such other and further relief that the Commission finds appropriate."[81] The plain language of the complaint shows that classification and compensation of VNXX traffic were well within its scope. The alternative relief granted in the Initial Order responds to Qwest's request for other appropriate relief.

*64* Even if compensation for VNXX traffic were not within the scope of Qwest's complaint, the express language of RCW 80.04.110, under which Qwest brought its complaint, gives the Commission authority to establish uniform charges and practices through adjudication, as well as to grant a remedy different than that requested:[82] The statute provides:

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[78] *See* Level 3 Petition ¶¶ 2, 6, 15; Broadwing Petition, ¶ 2; Pac West Petition, ¶¶ 4-9, ATI/ELI Petition at 1; Global Crossing/Pac West Joint Answer, ¶ 5; Level 3 Answer, ¶ 4.
[79] ATI/ELI Petition at 2-6; Pac-West Petition, ¶¶ 4-9.
[80] Staff Answer, ¶¶ 17-19; Qwest Answer, ¶¶ 6-12.
[81] Complaint, ¶¶ 12, 41-47; *see also* Qwest Answer, ¶ 8; Staff Answer, ¶¶ 18-19.
[82] Staff Answer, ¶¶ 20-21.

> [W]hen two or more public service corporations . . . are engaged in competition in any locality or localities in the state, either *may make complaint* against the other or others that the . . . practices of such other or others with or in respect to which the complainant is in competition, are unreasonable, . . . unfair or intending or tending to oppress the complainant, [or] to stifle competition, . . . and upon such complaint . . . the commission shall have power, after notice and hearing as in other cases, to, *by its order*, subject to appeal as in other cases, *correct the abuse complained of by establishing such uniform rates, charges, rules, regulations or practices in lieu of those complained of, to be observed by all of such competing public service corporations* in the locality or localities specified as shall be found reasonable, remunerative, nondiscriminatory, legal, and fair . . . or to encourage competition, and upon any such hearing it shall be proper for the commission to take into consideration the rates, charges, rules, regulations and practices of the public service corporation or corporations complained of in any other locality or localities in the state.[83]

*65* Under this authority, the Initial Order fashioned a remedy that "establishes charges or practices in lieu of" those complained of by Qwest, applicable to the affected CLECs. Even if there were a colorable argument that the remedy was beyond the scope of the complaint, the CLECs waived this argument through the course of the litigation by proceeding without objection.

*66* Appropriate compensation for VNXX was addressed extensively in the proceeding: A number of parties, including Qwest, Staff, TCG, Level 3 and Pac-West, discussed the issue of compensation in testimony.[84] No party moved to strike this testimony as beyond the scope of the complaint or proceeding. Under our rules, we "liberally construe pleadings and motions with a view to effect justice among the parties. The Commission, at every stage of any proceeding, will disregard errors or defects in pleadings, motions, or other documents that do not affect the substantial rights of the parties."[85] Thus, even if we considered Qwest's complaint somehow defective, we would disregard that alleged flaw because substantial rights of the opposing parties

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[83] RCW 80.04.110. (Emphasis added).
[84] Qwest Answer, ¶¶ 7, 10.
[85] WAC 480-07-395(4).

were not affected. By fully litigating the issue of compensation for VNXX, the CLECs have waived any right to object to defects in the complaint or to object to testimony in the proceeding.[86] In sum, the complaint sought to address issues of classification of and compensation for VNXX traffic in addition to its legality, and significant evidence has been provided in the record on these issues.

*67* Finally, at this stage of the proceeding and on this record, it is in the interest of judicial economy to resolve the classification and compensation of VNXX traffic.

*68* Contrary to the CLECs' claims, it is not necessary to initiate a separate proceeding or a rulemaking to address how to classify or compensate VNXX traffic.[87] Administrative agencies may develop regulatory policy through either rulemaking or adjudication.[88]

*69* Generally, "where an agency's order, directive or regulation of general applicability meets the definition of a rule, the agency must go through a rulemaking."[89] However, in a recent case, carriers contested the Commission's authority to set terminating access charge rates by rule instead of by adjudication. The state supreme court upheld the Commission's action, finding that the Commission had not established a rate, but a rate-setting methodology, by rule.[90] The court found that APA rulemaking requirements do not trump an agency's statutory authority.[91] In this proceeding, we followed our statutory authority under RCW 80.04.110 to establish rates and order

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[86] *See State v. Myer*s, 133 Wn.2d 26, 34, 941 P.2d 110 (1997) ("Evidence admitted without objection may be properly considered."). Further, the Qwest / Verizon Access settlement and amendment, which also addressed compensation issues, was consolidated with the complaint docket for decision at the Commission's April 27, 2007, open meeting without objection. Although ELI objected to portions of Qwest's and Staff's rebuttal testimony relating to the settlement agreement, ELI's objection was denied, and ELI made no objection to any other testimony related to compensation. *See* TR. 38:15 – 48:12; TR. 218: 24 – 222:23.
[87] Qwest Answer, ¶ 104.
[88] *See Securities & Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 67 S.Ct. 1575, 91 L.Ed. 1995 (1947); *Budget Rent A Car Corp. v. Washington State Dept. of Licensing*, 100 Wn. App. 381, 387, 997 P.2d 420 (2000); *Washington Indep. Tel. Ass'n v. WUTC*, 148 Wn.2d 887, 901 64 P.3d 606 (2003) [*WITA*]; *see also* Staff Answer, ¶¶ 7-9.
[89] *WITA*, 148 Wn.2d at 901.
[90] *Id.* at 898, 900.
[91] *Id.* at 901.

changes in company practices and services among competing companies through adjudication. We made a conscious decision, in both a declaratory ruling and in considering whether to adopt an interpretive or policy statement, to address VNXX issues in an adjudicative proceeding due to the fact-specific nature of the disputes.[92] Thus, we find that the discussion and conclusions in the Initial Order are well within the Commission's authority and do not violate APA rulemaking requirements.

*70* Finally, Pac-West also asserts that the Initial Order should be rejected as the Commission is prohibited from issuing a "generic ruling on the nature of, and appropriate level of intercarrier compensation for, exchanged traffic that is binding on all CLECs with interconnection agreements."[93] Pac-West relies on a Ninth Circuit Court of Appeals decision arising from a CPUC rulemaking affecting all interconnection agreements between telecommunications companies in California, in which the CPUC established that ISP-bound traffic would be subject to reciprocal compensation.[94] The court overturned the CPUC's rule, finding that state authority to arbitrate, approve, or enforce interconnection agreements is strictly limited under section 252 of the Act, and does not include "general rulemaking authority over interstate traffic."[95]

*71* The subject matter and procedural nature of this proceeding is distinguishable from *Pacific Bell v. Pac-West*. Here, the Initial Order addressed specific claims in an adjudication, not a generic rulemaking proceeding. Further, as discussed above, the subject matter is not interstate ISP-bound calls as defined by the FCC, but intrastate interexchange traffic subject to state authority. While the Initial Order decides the

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[92] *See* Staff Answer, ¶¶ 10-12.
[93] Pac-West Petition for Review, ¶ 16, citing *Pacific Bell v. Pac-West*, 325 F.3d 1114 (9th Cir. 2003). We note that Pac-West's claim implies the Commission would also be prohibited from addressing the issues governing classification or compensation for VNXX traffic in a rulemaking, resulting in the Commission being prohibited from acting to address these critical issues in any proceeding. An adjudicative proceeding such as this, addressing specific facts for specific carriers, is consistent with the ruling in *Pacific Bell*.
[94] *Pacific Bell*, 325 F.3d at 1127.
[95] *Id*. In this decision, which was entered prior to *Global NAPs I* and *Peevey*, the Ninth Circuit addressed ISP-bound traffic as interstate traffic, as discussed in the *ISP Remand Order,* not intrastate interexchange ISP-bound traffic, which is the subject of this proceeding. *See Id.* at 1125.

issue of the appropriate classification of and compensation for VNXX traffic, the application of this decision to specific carriers and their interconnection agreements with Qwest will be determined separately. The exception is Broadwing and Global Crossing, who brought counterclaims against Qwest in this proceeding concerning the interpretation of their interconnection agreements which can be resolved here.[96]

*72* In summary, we deny Level 3, Broadwing, Pac-West, ATI and ELI's petitions to reverse the Initial Order's decisions regarding classification and compensation of VNXX traffic as beyond the scope of the complaint or the Commission's authority.

### 3. WITA's Standing

*73* WITA petitioned to intervene in this proceeding in support of Qwest's complaint.[97] WITA's petition was granted after no party opposed it. While WITA did not offer any witnesses or sponsor any testimony, it did cross-examine a number of witnesses and offer cross-examination exhibits.

*74* WITA seeks review of the Initial Order's failure to find that VNXX traffic is *per se* illegal or used to bypass access charges, and that CLECs should pay intrastate access charges for exchanging VNXX traffic.[98] WITA asserts that evidence in the proceeding demonstrates that VNXX is used to bypass intrastate access charges, and further that VNXX service may explain one of the sources of "phantom" traffic.[99]

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[96] The issue of retroactive application of the Initial Order – and this Order – is addressed below in Section F.
[97] WITA, or the Washington Independent Telephone Association, is a member organization of incumbent local exchange companies operating in Washington state who are carriers of last resort and are not classified as competitive telecommunications carriers by the Commission. Qwest is not a member of WITA. WITA currently has 14 active members representing 18 local exchange carriers. *See*, www.wita-tel.org.
[98] WITA Petition, ¶¶ 6-10, 17-26, 39-44.
[99] *Id.*, ¶¶ 11-16. WITA defines "phantom traffic" as "telecommunications traffic that is delivered for termination to end users without sufficient information present to allow the terminating company to bill the responsible carrier the appropriate terminating charges for that traffic. It is a means by which some carriers can use the public switch telephone network (PSTN) without paying for the cost they impose." September 27, 2005, letter to Chairman Sidran and Commissioners Oshie and Jones from Richard A. Finnigan concerning WECA Docket 02-01 – Phantom Traffic, filed in Docket UT-051450.

WITA asserts that using VNXX services for ISP dial-up traffic has an effect on customers and small, local, and rural ISPs, and on its members' access revenues, based on the Commission's mechanism for determining access revenue.[100] WITA also disputes that VNXX is the functional equivalent of foreign exchange (FX) service.[101] Finally, WITA objects to allowing the use of VNXX arrangements for voice traffic, and asserts the Qwest/Verizon Access Settlement Agreement and Amendment should not be approved to the extent it allows VNXX services.[102]

*75* Global Crossing and Pac-West assert that WITA has no standing or independent basis upon which to seek review of the Initial Order, as Qwest is not a member of WITA, and Qwest has not sought administrative review of the Initial Order.[103] Alternatively, they request the Commission deny WITA's petition. They assert that none of the issues addressed in the Initial Order is specific to WITA or its members, and further that WITA introduced no evidence, and the record contains no evidence, that the responding CLECs provide VNXX service outside of the Qwest local exchange areas that might have an impact on WITA.[104]

*76* TCG asserts that WITA has no standing to raise arguments on behalf of smaller, rural ISPs rather than its rural LEC members.[105] TCG also questions WITA's role in the proceeding as a general intervenor now taking on the mantle of the complainant in objecting to the Initial Order, and raising issues not addressed in the complaint, specifically, the effect of VNXX on intrastate access revenues.[106] TCG argues that the Commission may limit the participation of an intervenor in adjudications, and

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[100] *Id.*, ¶¶ 27-38.
[101] *Id.*, ¶¶ 45-49. FX is a service provided by incumbent local exchange carriers whereby a customer is assigned a phone number that is not a local number for the customer but rather is assigned to a different or foreign local exchange. Under FX service, the customer must purchase local service in the foreign exchange and a retail line to transport any calls from the foreign exchange. FX service is discussed in paragraph 95 below.
[102] *Id.*, ¶¶ 50-53.
[103] Global Crossing/Pac-West Answer to WITA, ¶ 2.
[104] *Id.*, ¶ 1.
[105] TCG Answer, ¶ 14.
[106] *Id.*, ¶¶ 16-17.

requests the Commission deny WITA's petition and not allow WITA to impermissibly broaden the issues in the proceeding.[107]

*77* Under the Commission's rules, a presiding officer may grant intervention "[i]f the petition discloses a substantial interest in the subject matter of the hearing or if the petitioner's participation is in the public interest."[108] A presiding officer may limit an intervenor's participation in the proceeding given the scope of its interest, or standing, or may dismiss the intervenor at any time in the proceeding.[109]

*78* As an association whose members are incumbent local exchange companies, WITA has a substantial interest in the outcome of this proceeding, regardless of whether Qwest is no longer pursuing certain claims. WITA does not have standing to raise arguments on behalf of smaller, rural ISPs who are not members of its association, but WITA may respond to policy arguments addressed in the Initial Order by identifying the possible effects of the Order.

*79* As to issues specifically addressed by the Initial Order, it would not be appropriate to limit WITA's participation at this late stage in the proceeding. However, WITA had the opportunity at earlier stages to file cross-complaints or testimony to address independently the issues it raises now for the first time on review, but did not. To the extent WITA seeks to broaden the issues on review, we will deny WITA's petition.

*80* Therefore, we deny the petitions contesting WITA's general standing and status as an intervenor, and will address WITA's petition more specifically below.

### 4. Pac-West's Petition for Leave to Reply to Qwest's Answer

*81* Pac-West filed a petition for leave to reply to Qwest's Answer, attaching a reply that addresses two main points – that Qwest misrepresents federal law and that disposing of the issues in this case will not resolve all of the issues on remand in Pac-West's petition to enforce its interconnection agreement in Docket UT-053036. Level 3 and

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[107] *Id.*, ¶¶ 18-22.
[108] WAC 480-07-355(3).
[109] RCW 34.05.443(2), (3); WAC 480-07-355(3), (4).

Broadwing jointly filed a similar petition, but did not attach a reply. In Order 08, entered on December 28, 2007, the Commission granted the joint petition in part, limiting Level 3 and Broadwing's reply to whether the Initial Order addressed the issues posed in the district court's remand order.

*82* Parties have the right to reply to address new challenges to an initial order raised in answers to petitions for review.[110] Other than to address new challenges, parties are not entitled to reply to an answer, but may petition for leave to reply to address "new matters raised in the answer and state why those matters were not reasonably anticipated and why a reply is necessary."[111]

*83* In the order granting in part Level 3 and Broadwing's joint petition, we denied the petition to the extent the parties sought to respond to new *arguments* Qwest allegedly made, finding that parties may reply only to new *matters*. We specifically limited Level 3's reply to issues related to whether the Initial Order addressed the issues posed in the district court's remand order.

*84* Pac-West similarly asserts that Qwest has made new arguments. Pac-West asserts that Qwest did not address Pac-West's arguments about the relationship between sections 251(b)(5) and 251(g) of the Act until Qwest filed its answer to the petitions for review. Pac-West claims it could not have reasonably anticipated Qwest's arguments at this stage of the proceeding.[112] Second, Pac-West asserts that Qwest mischaracterizes Pac-West's arguments about the *ISP Remand Order*.[113] Third, Pac-West claims that Qwest misstates the Commission's authority to require Qwest to pay compensation for terminating interexchange ISP traffic.[114] Finally, Pac-West asserts that Qwest misrepresents the FCC's recent decision on a forbearance petition filed by Core Communications.[115]

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[110] WAC 480-07-825(5)(a).
[111] WAC 480-07-825(5)(b).
[112] Pac-West Petition for Leave to Reply, ¶¶ 18-20.
[113] *Id.*, ¶ 21.
[114] *Id.*, ¶ 22.
[115] *Id.*, ¶¶ 23-25.

85 Similar to Level 3's petition, Pac-West seeks to reply to new arguments Qwest has allegedly made, rather than new matters presented in answer to a petition for review. Simply because Qwest has made new arguments in its answer does not justify allowing Pac-West, Level 3 or any other party to reply to those new arguments. Qwest is entitled to answer those arguments raised by Pac-West and Level 3 in their petitions. Without rules limiting the rounds of argument in litigation, parties would continue to respond to the arguments made by other parties. Pac-West's arguments about Qwest misinterpreting federal law are simply additional argument and should not be allowed.

86 In addition to objecting to new arguments, Pac-West objects and seeks to reply to Qwest's contention that the Initial Order resolves the remaining issues in the district court's decision remanding our order in Pac-West's petition to enforce its interconnection agreement with Qwest. Pac-West asserts that its interconnection agreement was never at issue in this complaint proceeding and that any application of this decision to Pac-West is inappropriate. While the parties certainly have debated the interpretation of the *ISP Remand Order* following the district court's decision, the effect of the district court's remand order on the parties to this case is a new issue or matter that the parties could not have expected to address in this proceeding. Consistent with our Order 08 granting in part Level 3 and Broadwing's joint petition, we grant in part Pac-West's petition, limited only to the issue of whether the Initial Order addressed the issues posed in the district court's remand order.[116]

### 5. Staff's Requests to Modify the Initial Order

87 In its answer, Staff requests that we modify the Initial Order in several ways. First, it asks that we modify the first ordering clause to state that the Initial Order actually granted Qwest partial relief, rather than dismissing Qwest's complaint. [117] Second, it asks that we modify the Initial Order to clarify that VNXX traffic is interexchange in nature and further explain the basis for our authority to classify and establish

[116] We address the issue of the effect of this Order on Pac-West and Level 3 below in Section F.
[117] Staff Answer, ¶ 40.

compensation for VNXX traffic.[118] Finally, it asks that we modify the Order to remove statements regarding assumptions on cost data or other bases for decision.[119]

*88* We grant in part Staff's requests. We deny Staff's requests to modify or remove references to the assumptions or bases for the Initial Order's conclusions, for the reasons we discuss below in Section D concerning compensation for VNXX traffic.

*89* We concur with Staff that the Initial Order did not fully explore the Commission's authority to classify and establish compensation for VNXX traffic, and we have explained that authority in Section A.2. of this Order. We address Staff's request concerning the nature of VNXX traffic below in Section C.

*90* Finally, we grant Staff's request to modify the ordering clause to state that we do not dismiss Qwest's complaint, but grant partial relief, with conditions. Qwest requested in the complaint that we ban VNXX arrangements, require the CLECs to pay appropriate access charges, or "grant such other and further relief that the Commission deems appropriate." The Initial Order did so, in part, and thus the ordering paragraph should be modified to reflect the action taken on Qwest's complaint.

*91* ELI and ATI assert that Staff's request is an "attempt to justify the expansion of Qwest's complaint into a virtual rulemaking proceeding" arguing, that the Initial Order dismisses the complaint, as Qwest lost on both its legal theory and proposed alternative remedies. [120] For the reasons discussed above, Staff's request does not convert the complaint proceeding to a rulemaking, nor is it improper to address the issues of classification and compensation for VNXX traffic in this proceeding.

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[118] *Id.*, ¶¶ 23, 29-31.
[119] *Id.*, ¶¶ 26, 34, 44.
[120] ELI/ATI Reply to Staff, ¶ 2.

## C. Classification of VNXX Traffic

### 1. What is VNXX Service?

*92* The nationwide telephone numbering system was designed so that the first six digits of each ten digit telephone number enabled telephone companies to assign a physical location to a telephone customer's specific telephone number. Telephone companies continue to use this geographic indicator to identify and expressly separate calls into two principal categories – local or interexchange – for retail billing to end users or for assessing charges to another carrier. VNXX calls, however, cannot be readily identified as local or interexchange.

*93* The Initial Order described VNXX calls as:

> those where the NXX, or central office code, is assigned to a person or business outside the local calling area where the central office is located. In other words, a VNXX number appears to be a geographically local call but will not actually terminate in the local calling area where the calling party is physically located.[121]

The First Circuit similarly described VNXX service as arising when a telephone company assigns to a customer a telephone number with an exchange code specifically associated with a particular local calling area (LCA) that is different from the one where the customer is physically located.[122]

*94* The record in this proceeding demonstrates that both ILECs and CLECs use VNXX or VNXX-like arrangements to provide locally-dialed service to their customers, but the services vary due to the different configurations of their networks and compensation for the arrangements.[123] ILEC networks are designed with a focus on the geographic LCA, or exchange unit, commonly known as the central office, which

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[121] Initial Order, ¶ 30, *see also* ¶ 4 n.2, ¶¶ 11-13; *see, supra,* paragraph 59.
[122] *See Global NAPs 1*, 444 F.3d at 63-64.
[123] Initial Order, ¶ 12.

houses a switch.[124] CLEC networks usually have one centrally located switch that covers large geographic areas over multiple ILEC LCAs, and in some circumstances, an entire state.[125]

*95* ILECs offer a service under state-approved tariffs known as foreign exchange (FX) service, in which they provide a customer outside a local calling area a local telephone number so that persons may call the number without incurring a toll call.[126] The ILEC FX customer must purchase local exchange service in the foreign exchange and must also purchase a retail private line to transport the non-local calls to the FX customer's home or business.[127] For example, an FX customer in Seattle must purchase local exchange service in Olympia and a private line to transport calls from Olympia to Seattle.

*96* CLECs use VNXX arrangements primarily to serve ISPs, and to allow dial-up customers Internet access through an ISP without incurring a toll call.[128] Given its different network architecture, the CLEC may have one switch in a central location, and will assign NXX's from other local calling areas to its ISP customer. As an example, should a Qwest customer in Olympia call the CLEC's ISP customer in Seattle, the call generally will travel over Qwest's LIS trunks to the CLEC's point of interconnection in Seattle, and then on to the ISP over the CLEC's network. Because the ISP has an Olympia NXX, the call appears to stay within the LCA.[129] The respondent CLECs have sought to recover reciprocal compensation payments from Qwest for this traffic.

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[124] *Id.*
[125] *Id.*, ¶ 13.
[126] Historically, ILECs have offered FX services to extend local exchange services for a particular local calling area to a business or residential customer physically located in another local calling area.
[127] *Id.*, ¶ 12.
[128] *Id.*, ¶ 13.
[129] *Id.*, ¶¶ 13 and 35, n.37. CLECs such as ELI may own facilities between the Qwest customer's local calling area and their centrally-located switch, in which case Qwest does not transport the call over its network.

*97* The Initial Order found that while VNXX calls are the "functional" equivalent of FX calls due to their local dialing characteristics,[130] they also bear the "physical" characteristics of long distance or interexchange calls by originating and terminating outside of a local calling area.[131] The Order concluded that VNXX calls are properly classified as non-local or interexchange calls.[132]

*98* We uphold the Initial Order's *description* of VNXX services, which for the most part, no party disputes. A number of parties, however, object to the Initial Order's classification of VNXX traffic as non-local or interexchange.

*99* Specifically, Level 3 claims the Initial Order went too far by classifying VNXX traffic when the original complaint only sought to establish whether CLECs may offer VNXX or FX-like services under federal and Washington state law.[133] ELI and Pac-West support the Initial Order's conclusion that VNXX service is lawful, does no harm to competition, and is the functional equivalent of the ILEC's FX service offerings. However, they object to classification of the service as interexchange in nature.[134]

*100* WITA argues that the Initial Order correctly characterized VNXX services as calling arrangements that make calls appear to be local but are more properly classified as interexchange because of the physical routing of such calls across two or more LCAs. WITA claims the Initial Order did not go far enough in classifying VNXX as an interexchange service because it failed to apply intrastate access charges to VNXX traffic.[135]

*101* Staff requests that we reject the statements in the Initial Order that VNXX and FX traffic are functionally equivalent and that prohibiting VNXX would be an impermissible barrier to competition.[136]

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[130] CLECs often refer to their VNXX service as "FX-like," or locally-dialed traffic.
[131] Initial Order, ¶ 47.
[132] *Id.*, ¶¶ 55, 146, 156.
[133] Level 3 Petition, ¶¶ 2, 6.
[134] ELI Petition at 2; Pac-West Petition, ¶¶ 4-9.
[135] WITA Petition, ¶¶ 6-8; WITA Answer, ¶ 4.
[136] Staff Answer, ¶ 26.

*102* We find the Initial Order correctly concluded that FX and VNXX services are functional equivalents only when the CLEC bears the cost of transporting the traffic between LCAs, as we discuss below in Section D.[137]

*103* Purchasers use each service to establish "local-like" calling between two or more LCAs. While the customer may understand each to be a separate service, the two services share the same technological foundation and differ only in cost and conditions of service. Once a customer's call is initiated using either service, it must be transported by a dedicated line (FX) or a common trunk (VNXX) to the point of its termination. In effect, the services are indistinguishable at the points of initiation and termination, and differ only in the manner in which transport moves calls across local calling areas. We find no material attributes that distinguish VNXX service from FX service and conclude that they are functional equivalents when the CLEC bears the cost of transporting the traffic between LCAs.

### 2. Is VNXX unlawful or illegal?

*104* As we discuss above in paragraph 59, the Initial Order found that VNXX service is not *per se* illegal and is lawful if a CLEC fairly compensates Qwest for the use of its network.[138] Specifically, the Initial Order concluded that CLECs using VNXX arrangements risk violating state statutes governing reasonable rates, charges and practices of telecommunications companies without appropriate compensation for the traffic.[139] WITA asserts the Order erred in finding that VNXX service is not unlawful or illegal under state law and prior Commission decisions.[140]

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[137] The Second Circuit made a similar finding about FX and VNXX services: "The significance of virtual NXX and FX technologies is that they essentially convert, for billing purposes, the caller's long-distance calls into local calls. The difference between virtual NXX and FX, however, is that an FX customer bears the cost of a dedicated facility known as a private line to enable access to a remote local exchange." *Global NAPs II*, 454 F.3d at 96.

[138] Initial Order, ¶¶ 28-55, particularly ¶¶ 40, 41, 47.

[139] The statutes – RCW 80.36.080, RCW 80.36.140, RCW 80.36.160 and RCW 80.36.170 – provide as follows:

> RCW 80.36.080. All rates, tolls, contracts and charges, rules and regulations of telecommunications companies, for messages, conversations, services rendered equipment and facilities supplied, whether such message, conversation or service to be

*105* WITA contends that the use of VNXX numbering and routing arrangements violates state statutes when VNXX service is used to mimic local calling, resulting in unfair, unjust, and unreasonable rates and practices.[141] Staff responds that the statutes allow the Commission to determine whether practices such as VNXX should be prohibited or allowed with conditions, but do not require that we prohibit VNXX.[142]

*106* In addition, WITA argues that VNXX service should be prohibited as it has the same effect as, and is functionally no different than, toll bridging, a method or device that circumvents defined local calling areas approved by the Commission and makes what would otherwise be a toll call appear as a local call.[143] Citing the *MetroLink*[144] and

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performed be over one company or line or over two or more companies or lines, shall be *fair, just, reasonable and sufficient*. (Emphasis added.)

RCW 80.36.140. Whenever the commission shall find … regulations or practices of any telecommunications company are *unjust or unreasonable*, or that the equipment, facilities or service of any telecommunications company is inadequate, inefficient, improper or insufficient, the commission shall determine the just, reasonable, proper, adequate and efficient rules, regulations, practices, equipment, facilities and service to be thereafter installed. (Emphasis added.)

RCW 80.36.160. In order to provide toll telephone service where no such service is available, or to promote the most expeditious handling or most direct routing of toll messages and conversations, or *to prevent arbitrary or unreasonable practices which may result in the failure to utilize the toll facilities of all telecommunications companies equitably and effectively, the commission may* …1) require the construction and maintenance of suitable connections between telephone lines for the transfer of messages and conversations at a common point or points…2) prescribe the routing of toll messages and conversations over such connections and the practices and regulations to be followed with respect to routing; and/or 3) *establish reasonable joint rates or charges*. (Emphasis added.)

RCW 80.36.170. *No telecommunications company shall make or give any undue or unreasonable preference or advantage* to any person, corporation, or locality, or subject any particular person, corporation, or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. (Emphasis added.)

[140] WITA Petition, ¶¶ 6-49.
[141] *Id.,* ¶¶ 39-44.
[142] Staff Answer, ¶ 27.
[143] WITA Petition, ¶¶ 18-19.
[144] *In the Matter of Determining the Proper Classification of: U.S. MetroLink Corp.*, Second Supplemental Order, Docket U-88-2370-J (1989 Wash. UTC LEXIS 40) [*MetroLink*)].

*U&I CAN*[145] decisions, WITA claims that the Commission has historically found toll bridging improper and in violation of state law.[146] WITA argues that the Commission's rules define a local calling area as "one or more rate centers within which a customer can place calls without incurring long distance 'toll' charges."[147] WITA also asserts that VNXX is similar to the arrangement we rejected in the *LocalDial* case, in which a carrier used a variation of VoIP service to avoid paying intrastate access charges.[148]

*107* Level 3, Global Crossing and Pac-West assert that VNXX is no more an access bypass mechanism than FX service offered by ILECs.[149] Level 3 contests WITA's claims, asserting that the *MetroLink* and *U&I Can* cases classified interexchange carriers as subject to the Commission's jurisdiction, but did not directly address the propriety of the service provided.[150] Level 3 asserts that the test in these cases is whether there is an improper use of ILEC networks, which WITA has not proven in this record.[151] Level 3 further asserts that VNXX services do not "bridge" different calling areas, but operate as a functional equivalent to ILEC FX service.[152] Level 3 asserts that its customers pay for transport, as CLECs purchase special access facilities for transport beyond their point of interconnection to LCAs, and that this is functionally equivalent to the Primary Rate Interface (PRI) trunks Qwest uses to support its FX service.[153] Finally, Level 3 asserts that Staff's testimony supports that VNXX and toll bridging services differ technically in how they achieve their goal of avoiding toll charges.[154]

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[145] *In the Matter of Determining the Proper Classification of United & Informed Citizen Advocate Network,* Fourth Supplemental Order, Commission Decision and Final Cease and Desist Order, Docket UT-971515 (Feb. 9, 1999) [*U & I CAN*].
[146] WITA Petition, ¶¶ 18, 20-23.
[147] *Id*., ¶ 17, citing WAC 480-120-021.
[148] *Id*., ¶¶ 24-26; WITA Answer, ¶¶ 13-15, citing *Washington Independent Telephone Association v. LocalDial*, Docket UT-031472, Final Order Granting Motions for Summary Determination, Order 09 (June 11, 2004) [*LocalDial*].
[149] Level 3 Answer, ¶ 41; Global Crossing/Pac-West Answer, ¶ 13.
[150] Level 3 Answer, ¶¶ 39-40.
[151] *Id*., ¶ 42.
[152] *Id*., ¶ 41.
[153] *Id*. A Primary Rate Interface is the equivalent of a T-1 circuit for a circuit switched digital network. *See* Newton's Telecom Dictionary, CMP Books, San Francisco, 19th Ed. at 633 (2003).
[154] Level 3 Answer, ¶ 44.

*108* Global Crossing and Pac-West assert that under VNXX and FX service, customers may choose to have a presence in a certain local calling area, while toll bridging permits a customer with a telephone number in one calling area to call a customer with a telephone number rated to a different local calling area to avoid toll charges.[155] They assert that WITA does not address a lawful Qwest service – Market Expansion Line (MEL) – that allows customers to bridge an extended service area without being subject to access charges.[156]

*109* Level 3 and Pac-West also dispute that VNXX services are like the "IP-in-the-middle" services at issue in the *LocalDial* case.[157] The CLECs distinguish the *LocalDial* case as addressing a different question – whether the use of the Internet exempted the calls from access charges, or whether the calls were "telecommunications" subject to access charges.[158]

*110* We uphold the Initial Order's decision that VNXX service is not *per se* illegal either under state statutes or as a toll avoidance mechanism and deny WITA's petition for review; VNXX traffic is unlawful under state statutes only without appropriate compensation.[159] As discussed above, the federal courts have recognized state authority to classify and determine compensation for intrastate interexchange, or toll, traffic. Under state statutes, we may determine what practices and rates are just and reasonable for the use of toll facilities, and are not limited by statute to the existing intrastate access charge regime. RCW 80.36.160 specifically empowers the Commission "to prevent arbitrary or unreasonable practices which may result in the failure to utilize the toll facilities of all telecommunications companies equitably and effectively" and allows us to "establish reasonable joint rates or charges." Treating VNXX similarly to FX traffic, another form of interexchange traffic, is just and

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[155] Global Crossing/Pac-West Answer, ¶ 14.
[156] *Id.*, ¶ 15.
[157] Level 3 Answer, ¶ 43; Global Crossing/Pac-West Answer, ¶¶ 16-18. "IP-in-the-middle" involves the use of a VoIP call that begins in time division multiplexing (TDM) format on the public switched network (PSTN), then is converted to an Internet protocol, or IP, format and then reconverted into a TDM format before being sent to its final destination.
[158] *Id.*
[159] Initial Order, ¶ 47.

reasonable. Banning VNXX traffic, while allowing FX traffic, would not be just and reasonable.

*111* Further, while toll bridging, IP-in-the-middle, VNXX, and FX service all have the same goal – to avoid intrastate access charges – the difference between VNXX and toll bridging is that we previously have permitted VNXX services when arbitrating interconnection agreements as functionally equivalent to FX services, and FX services are not subject to access charges.[160] Finally, VNXX is not like an IP-in-the-middle service, as it does not use the Internet to avoid payment of access charges. VNXX services are an attempt by CLECs to provide service equivalent to FX service without duplicating the ILEC network.

### 3. How should VNXX service be classified?

*112* The central decision of the Initial Order and the primary focus of the CLECs' petitions for review, are the findings that VNXX traffic is interexchange in nature, subject to a bill and keep regime, and requiring compensation for any costs related to its transport.[161] The Initial Order found that the district court in *Qwest v. WUTC* directed us to determine whether ISP-bound calls that cross local calling area boundaries are subject to the FCC's interim compensation regime, *i.e.,* to classify VNXX traffic.[162] The Initial Order also concluded that the complaint proceeding, which preceded the district court's decision, involved the classification of VNXX calls.[163]

*113* In classifying the traffic as interexchange, the Initial Order relied on the district court's decision to find that the *ISP Remand Order* did not eliminate the geographic distinction between local and long distance, or interexchange calls,[164] and that the *ISP*

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[160] *Id*., ¶ 50.
[161] *Id*., ¶ 55. In reaching this decision, the Initial Order discussed the public interest and policy considerations associated with VNXX arrangements, including whether VNXX has an adverse affect on cost allocation and recovery, relevant access charge regimes, universal service, competition, and consumers of dial-up internet services. *Id*., ¶¶ 56-83.
[162] *Id*., ¶ 25.
[163] *Id*.
[164] *Id*., ¶ 23, citing *Qwest v. WUTC*, 484 F.Supp.2d at 1170.

*Remand Order* did not address VNXX traffic, only the narrow issue of "whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP in the same local calling area that is served by a competing LEC."[165] The Initial Order determined that "[a] local call continues to be defined based on the ILECs' geographic local calling areas, not on the local calling areas that define the CLECs' networks."[166] The Initial Order also found that "a geographically-based local call requires different compensation than a long distance call."[167]

*114* The parties contest the Initial Order's classification of VNXX as interexchange traffic claiming the Initial Order erred in analyzing VNXX using the terms "local" and "long distance" rather than the provisions of section 251 of the Act, and erred in applying the district court's decision. The parties also dispute the Initial Order's use of a geographic test for classifying VNXX traffic.

### a. How should VNXX traffic be classified under Section 251?

*115* Global Crossing and Pac-West argue that the Act establishes two types of telecommunications traffic, section 251(g) traffic, which the CLECs describe as switched access provided to interexchange carriers, and section 251(b)(5) traffic, which includes all other forms of traffic and is subject to reciprocal compensation.[168] Pac-West asserts that the Initial Order does not include VNXX in either of these categories, and erred in not analyzing intercarrier compensation for VNXX under the provisions of section 251.[169]

*116* Like Global Crossing and Pac-West, Level 3 asserts the Initial Order should have referred to section 251(b)(5) or section 251(g) traffic, not to local or long distance traffic, claiming that the FCC repudiated the use of the term "local" in favor of section 251(b)(5) traffic in the *ISP Remand Order* and its rules.[170] Level 3 also asserts

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[165] *Id.*, ¶ 24, citing *Qwest v. WUTC,* 484 F.Supp.2d at 1172, quoting *ISP Remand Order*, ¶ 13.
[166] *Id.*, ¶ 41.
[167] *Id.*, ¶ 46.
[168] Pac-West Petition, ¶ 11; Global Crossing/Pac West Answer, ¶ 7.
[169] Pac-West Petition, ¶¶ 12, 18.
[170] Level 3 Petition, ¶¶ 32-37.

the Initial Order erred in stating that the Act "established a distinction between local" and other calls. [171]

*117* Level 3 claims that we must repudiate the "local" distinction for determining the scope of reciprocal compensation under section 251(b)(5) and find that section 251(g) does not provide an exclusion for services not available when the access charge regime was first established.[172]

*118* Level 3 asserts that the D.C. Circuit rejected in *WorldCom v. FCC* the FCC's section 251(g) analysis, finding that the section "authorized only 'continued enforcement' of pre-1996 Act requirements," and that there was no pre-Act requirement for ISP-bound calls.[173] Level 3 and Pac-West assert that the exemption under section 251(g) is limited to traffic that is information or exchange access and must also (1) have existed and been subject to regulation prior to passage of the Act; (2) have been exchanged with an interexchange carrier (IXC), not another LEC; and (3) was subject to equal access obligations resulting from an FCC decision or court order prior to the Act.[174] They assert that VNXX traffic does not meet any of these criteria and that VNXX traffic thus falls within the section 251(b)(5) default category requiring reciprocal compensation.

*119* Level 3 disputes that VNXX traffic is exchange access traffic under section 251(g), asserting that the NXX codes, not the geographic endpoints of a call, determine compensation for a call.[175] Level 3 asserts that VNXX traffic is not exchanged with an IXC, did not exist prior to the Act, and that no FCC or Commission rules existed prior to the Act to govern this type of traffic.[176] Level 3 further argues that FX and FX-like traffic has never been subject to access charges.[177] Level 3 claims that locally-dialed, or VNXX, traffic meets the definition of telecommunications under the Act, *i.e.*, "the transmission, between or among points specified by the user, of

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[171] *Id.*, ¶¶ 19, 24-37.
[172] *Id.*, ¶¶ 36-37; Level 3 Answer, ¶¶ 8-9, 13.
[173] Level 3 Petition, ¶¶ 27-28; *see WorldCom v. FCC, supra,* n.4.
[174] *Id.*, ¶¶ 27-28, 37; Level 3 Reply to Staff, ¶¶ 12-18; Pac-West Petition, ¶ 12.
[175] Level 3 Petition, ¶ 61; Level 3 Answer, ¶ 10.
[176] Level 3 Petition, ¶¶ 27-28; Level 3 Reply to Staff, ¶¶ 14-17.
[177] Level 3 Petition, ¶¶, Level 3 Reply to Staff, ¶ 16.

information of the user's choosing, without change in the form or content of the information as sent and received."[178]

*120* Level 3 also asserts that a recent FCC order reiterates the limited nature of the section 251(g) exemption.[179] In that proceeding, a CLEC petitioned the FCC to forbear from applying rate regulation preserved under section 251(g) and section 254(g). In addressing section 251(g), the FCC stated that "section 251(g) preserves pre-Act compensation obligations and restrictions for exchange access, information access, and exchange services for such access … until such restrictions and obligations are explicitly superseded by regulations prescribed the Commission."[180] The FCC determined that if it granted forbearance from rate regulation under section 251(g), there would be no rate regulation of the exchange of traffic currently subject to the access charge regime until the FCC adopted new rules.[181]

*121* Level 3 claims that access charges have never been applied to ISP-bound traffic or VNXX (or other FX-like traffic), and should be assessed only to long distance traffic exchanged with an IXC.[182] Under this theory, Level 3 requests that we find that VNXX is subject to section 251(b)(5) and apply the FCC's interim compensation rate for ISP-bound traffic (i.e., $ 0.0007 per minutes of use (MOU)).[183]

*122* Level 3 asserts that we should not deviate from our previous orders in which we determined that VNXX traffic is subject to section 251(b)(5) reciprocal compensation or the FCC's interim rate.[184] Level 3 also asserts that we have consistently held that

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[178] Level 3 Petition, ¶¶ 26, 28, citing 47 U.S.C. § 153 (43).
[179] Level 3 Reply to Staff, ¶¶ 19-21, citing to *In the Matter of Petition of Core Communications for Forbearance From Sections 251(g) and 254(g) of the Communications Act and Implementing Rules,* Memorandum Opinion and Order, 22 FCC Rcd. 14118 (July 26, 2007) [*Core Forbearance Order II*].
[180] *Core Forbearance Order II*, ¶ 14.
[181] Level 3 Reply to Staff, citing *Core Forbearance Order II*, ¶ 14.
[182] Level 3 Petition, ¶ 27; Level 3 Answer, ¶¶ 5-7.
[183] Level 3 Petition, ¶ 36. Despite Level 3's reliance on section 251(b)(5) as the source of intercarrier compensation for VNXX traffic, Level 3 agrees with the Ninth Circuit that state commissions have authority to determine intercarrier compensation for VNXX. *Id.*, ¶ 20. Level 3 interprets *Peevey* as applying section 251(b)(5) reciprocal compensation for VNXX traffic, and requests the Commission reach the same result. Level 3 Answer, ¶ 45.
[184] Level 3 Petition, ¶ 21; Level 3 Answer, ¶¶ 3, 45.

ISP-bound and FX-like traffic should be subject to the same reciprocal compensation regime as voice traffic, and should not be subject to access charges.[185]

*123* On the other side of the coin, WITA asserts the Initial Order errs by not finding that VNXX traffic is interexchange in nature and applying access charges to VNXX traffic.[186] WITA describes as "sophistry" Level 3 and Pac-West's arguments that access charges have never applied to "locally-dialed" or FX-like traffic between two LECs, asserting that the CLECs are acting like IXCs.[187] WITA argues that nothing in the Act refers to the use of numbering digits as the basis for distinguishing between access and local traffic.[188]

*124* In response, Staff argues that state law determines whether a call is local and subject to section 251(b)(5) or is interexchange, subject to the Commission's determination of fair compensation.[189] Staff refutes the CLECs' argument that VNXX is subject to section 251(b)(5) reciprocal compensation as a matter of law, asserting this contention runs contrary to the district court's decision, *Peevey* and other federal circuit court decisions.[190] Staff concurs with Pac-West that the Initial Order does not clearly characterize VNXX traffic as within or outside a local calling area,[191] and requests that we clarify that VNXX traffic is "fundamentally intrastate interexchange traffic subject to state regulation."[192] Staff also requests that we clarify that CLEC local calling areas are no different than Qwest's.[193]

*125* Qwest states that the Initial Order properly found that VNXX traffic terminates outside an LCA and should be classified as interexchange, which Qwest alleges is

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[185] Level 3 Answer, ¶ 38.
[186] WITA Petition, ¶¶ 6-10, 40, 45-49; WITA Answer, ¶¶ 4, 9.
[187] WITA Answer, ¶¶ 10, 11, 14. Level 3 argues that we should deny WITA's arguments about access charges, asserting that WITA presented no evidence to support its arguments that VNXX traffic should be subject to access charges, or the alleged deleterious effect on universal service if VNXX traffic is not subject to access charges. Level 3 Answer, ¶¶ 12-13.
[188] WITA Answer, ¶¶ 10, 11, 14.
[189] Staff Answer, ¶ 23, citing *Global NAPs I*.
[190] *Id*., ¶¶ 24-25, 30.
[191] *Id*., ¶ 31.
[192] *Id*., ¶ 29.
[193] *Id*., ¶ 32, citing Initial Order, ¶¶ 41, 54.

required by the district court's remand order.[194] Qwest disputes Pac-West and Level 3's arguments about the application of section 251(b)(5) as the default compensation mechanism, arguing as we note above, that the D.C. Circuit did not vacate any portion of the FCC's *ISP Remand Order*, and that the Order remains in force.[195] Qwest also asserts that Level 3 and Pac-West ignore the conclusions in *Peevey* that VNXX traffic "is *not* subject to the FCC's reciprocal compensation rules" and that VNXX is exchange access traffic, a category of traffic included in section 251(g).[196]

*126* Qwest argues that there was a preexisting regime for interexchange ISP traffic, the Enhanced Service Provider (ESP) exemption to avoid payment of access charges.[197] Finally, Qwest asserts that the FCC's rationale in its recent *Core Forbearance Order II* supports the continued validity of section 251(g) and that the default relationship on which the CLECs rely is not valid.[198]

*127* Qwest argues that under *Peevey*, section 251(g) remains a viable way to distinguish certain traffic from section 251(b)(5) traffic under the *ISP Remand Order*.[199] Qwest disputes the CLECs' claims that access charges have applied only to traffic exchanged with an IXC, asserting that at least two states, Massachusetts and Ohio, have applied access charges to VNXX traffic, where locally-dialed traffic was exchanged between two LECs.[200] Qwest also refutes Level 3's argument that the local/long distance distinction no longer exists for intercarrier compensation after the *ISP Remand Order.* It asserts that nothing in the FCC's decision suggests that the FCC has eliminated the difference between local and long distance calls, and points out that the two *Global NAPs* decisions, *Peevey* and the district court's decision

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[194] Qwest Answer, ¶¶ 18-20.
[195] *Id*., ¶¶ 21-31. Qwest comments that the D.C. Circuit noted that there are many grounds upon which the *ISP Remand Order* could be justified. *Id*., ¶ 27.
[196] *Id*., ¶ 26, quoting *Peevey*, 462 F.3d at 1158. (Emphasis in original).
[197] *Id*., ¶¶ 28, 31. An Enhanced Service Provider, or ESP, is "a vendor who adds value to a telephone line using software or hardware; also called an information provider." *See* Newton's Telecom Dictionary, CMP Books, San Francisco, 19th Ed. at 292 (2003). Since 1983, the FCC has treated ESPs as end users under the access charge regime and allows them to connect to the public switched telephone network through local business service tariffs rather than interstate access tariffs. *See Declaratory Order*, ¶ 23.
[198] Qwest Answer, ¶¶ 28-29.
[199] *Id*., ¶¶ 26, 29-30.
[200] *Id*., ¶¶ 28, 31.

continue to refer to the distinction in evaluating these issues, effectively putting the CLECs' arguments to rest.[201]

*128* Finally, Qwest argues that we lack authority under *Global NAPs I, II, Peevey* and the district court's order to find that VNXX ISP-bound traffic is subject to terminating compensation under the *ISP Remand Order*, either at the voice rate or the $.0007 rate for local ISP traffic.[202]

*129* Having considered the parties' arguments and supporting record, we deny the petitions filed by Level 3, Broadwing, Global Crossing, and Pac-West, and affirm the Initial Order's decision that VNXX services are interexchange in nature and not subject to section 251(b)(5).

*130* We concur with Staff that the Initial Order did not clearly characterize VNXX traffic as within or outside a local calling area, and modify the Initial Order to include our findings on this issue. The Initial Order describes VNXX traffic as a hybrid form of traffic with local and interexchange attributes. Given our discussion above, we clarify that VNXX traffic does not originate and terminate within the same LCA. If it did, the CLECs would have no business rationale to establish VNXX arrangements, the traffic would fall within the *ISP Remand Order* compensation scheme, and this proceeding would be unnecessary. The classification of VNXX traffic as intrastate interexchange is consistent with state and federal law, is within the options suggested by the district court, and is clearly justified under our authority.

*131* We begin our analysis by returning to our previous discussion of the Act and the relevant FCC and federal court decisions. The FCC and federal courts have interpreted the Act to distinguish between traffic subject to reciprocal compensation under section 251(b)(5) and traffic which is treated as a carve out of traffic otherwise subject to section 251(b)(5).[203] In a number of recent decisions interpreting this

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[201] *Id.*, ¶¶ 43-51.
[202] *Id.*, ¶ 27.
[203] Although the D.C. Circuit Court rejected the FCC's conclusion that section 251(g) operates as a carve-out from section 251(b)(5), the court did not vacate the decision. The First Circuit and the district court have found that the *ISP Remand Order* remains in force. *Global NAPs I,* 444 F.3d at 65; *Qwest v. WUTC*, 484 F.Supp.2d at 1166.

compensation scheme as it applies to VNXX traffic, the courts interpret section 251(g) as retaining the historical categories of interexchange traffic, specifically exchange access, information access and exchange services.[204] Since *WorldCom*, the federal courts have found that distinctions between traffic subject to section 251(b)(5) and that carved out under section 251(g) remain in force, that intrastate interexchange traffic is subject to carve out under section 251(g) and that states retain jurisdiction over intrastate interexchange traffic. Under this analysis, it is unquestionable that states retain authority under the Act and FCC orders to determine compensation for intrastate interexchange traffic.

*132* Similarly, the FCC and federal courts plainly interpret the Act as retaining and not altering state authority to define LCAs, to establish on a geographic basis what traffic is within an LCA, or local, and what is interexchange, and to determine whether federal or state access charges apply.[205] Although the FCC chose to remove references to "local' traffic from its rules, it is abundantly clear that it did not intend to eliminate state control over intrastate interexchange traffic or the historically geographic basis for classifying traffic. *Global NAPs I* and other recent decisions support this conclusion.

*133* As we discuss above, VNXX traffic appears to be a call within a local calling area, but it is actually intrastate interexchange traffic. Therefore, we grant WITA's petition for review and Staff's request to modify the Initial Order on this point.[206] We also deny the CLECs' claims that VNXX should be treated as locally-dialed traffic subject to reciprocal compensation under section 251(b)(5) or the FCC's interim compensation rate. No federal court has supported either proposition, including Washington's Western District Court, which rejected our prior decision applying the FCC's interim rate to all ISP-bound traffic, including VNXX.

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[204] Further, no federal court has adopted Level 3 and Pac-West's argument that the section 251(g) carve out is limited to interexchange traffic exchanged by IXCs.
[205] *See, supra*, paragraphs 40-53.
[206] None of the cases Level 3 cites supports its position that the Commission has consistently applied reciprocal compensation to ISP-bound traffic or the FCC rate to VNXX traffic. The section 271 proceeding order to which Level 3 cites is an initial order, and the Commission reversed the decision in its final order: The remaining three cases are arbitration decisions about compensation for ISP-bound VNXX traffic now subject to the district court's remand decision.

134 VNXX and FX calls are both interexchange traffic, and are potentially subject to intrastate access charges. However, this Commission historically has treated FX traffic as an exception to such charges. Given their similarity, we find VNXX traffic should also be treated as an exception. Accordingly, we uphold and further clarify the Initial Order's decision by finding that VNXX and FX traffic are both interexchange in nature and should be treated similarly as exceptions to access charge compensation for interexchange traffic. We deny WITA's petition seeking to impose access charges on VNXX traffic. [207]

**b. Did the Initial Order correctly apply the district court's decision?**

135 Pac-West and Level 3 assert that the Initial Order does not satisfy the district court's remand requirements and further, that we should not address those requirements here. If we do so, Pac-West asserts that we must prepare findings of fact and conclusions of law consistent with the court's directions and address the requirements of federal law, or find that VNXX traffic, like other FX and FX-like traffic, is within an LCA for compensation purposes. [208]

136 Pac-West and Level 3 object to the proposition that the Initial Order or our final order would resolve *all* issues pending in the remand of their petitions for enforcement in Dockets UT-053036 and UT-053039.[209] As support, they identify issues specific to Pac-West and Level 3 that remain to be resolved, including retroactive application of any compensation mechanism adopted in this docket, and the calculation of compensation and amount of VNXX traffic each has terminated.[210] Pac-West requests the Commission leave open issues specific to Pac-West for resolution in a separate remand proceeding. Level 3 asserts this proceeding should not be used to

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[207] Dissimilar treatment may give rise to a discrimination claim. *See In re AT&T Communications of the Pacific Northwest and TCG Seattle*, Docket UT-033035, Order 04, Arbitrator's Report, ¶ 33 (Dec. 1, 2003) [*AT&T Arbitration Order*].
[208] Pac-West Petition, ¶¶ 3, 46, 47-48.
[209] Pac-West Reply, ¶¶ 27-28; Level 3 Reply to Qwest, *passim*.
[210] Pac-West Reply, ¶ 28.

determine whether VNXX traffic is within or outside an LCA under the terms of the parties' interconnection agreements.[211]

*137* Level 3 asserts that the Initial Order fails to answer the question posed by the district court, as it assumes a geographically-based definition of an LCA rather than relying on calling and called numbers (NPA-NXX) to define compensation.[212] Level 3 further asserts that the Initial Order misinterprets the decision in holding that the *ISP Remand Order* applies only to ISP-bound traffic exchanged within an ILEC-defined local calling area.[213] It argues that the court made no such finding, but directed the Commission to clarify the nature of VNXX calls for purposes of interpreting the carriers' interconnection agreements, specifically to:

> reinterpret the *ISP-Remand Order* as applied to the parties' interconnection agreements, and classify the instant VNXX calls, for compensation purposes, as within or outside a local calling area, to be determined by the assigned telephone numbers, the physical routing points of the calls, or any other chosen method within the WUTC's discretion.[214]

*138* Qwest asserts that the Initial Order follows the court's directions on remand by identifying what calls are local and interexchange, and finding that VNXX calls terminate outside of a LCA.

*139* While this is not the remand proceeding, we address the district court's order here, because the court's decision is persuasive in addressing overlapping issues between this complaint and the remanded proceeding. We agree that we cannot resolve how our decision here ought to apply to Pac-West's and Level 3's existing interconnection agreements with Qwest. We discuss this further below in Section F.

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[211] Level 3 Reply, *passim*.
[212] Level 3 Petition, ¶¶ 5, 21, 31.
[213] *Id*., ¶ 30.
[214] *Id*., ¶ 30, quoting *Qwest v. WUTC,* 484 F.Supp.2d at 1177.

*140* We reject Level 3 and Pac-West's interpretations of the district court's decision, and uphold the Initial Order's findings on this issue, in particular the meaning of ISP-bound traffic under the *ISP Remand Order*.

*141* Contrary to Level 3's assertion, we find that the Initial Order correctly stated and applied the district court's interpretation of the *ISP Remand Order*. The district court directed the Commission to classify VNXX traffic, and determine whether VNXX calls, including ISP-bound traffic, stay within or cross local-exchange area boundaries. The court clearly stated:

> In the *ISP Remand Order*, the question presented to the FCC was decidedly narrow: "whether reciprocal compensation obligations apply to the delivery of calls from one LEC's end-user customer to an ISP *in the same local calling area* served by a competing LEC." *ISP Remand Order,* 16 F.C.C.R at 9159, ¶ 13 (emphasis added). The scope of the *ISP Remand Order's* conclusions must therefore be confined to the context of that question.[215]

*142* Level 3's arguments to the contrary are untenable. Neither party sought review of the district court's decision, although both Level 3 and Pac-West were parties.[216] Thus, Level 3 and Pac-West are barred from arguing here that the court's decision is incorrect.[217]

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[215] *Qwest v. WUTC*, 484 F.Supp.2d at 1172. Contrary to our previous conclusion, the First, Second, and Ninth Circuit Courts of Appeal and other federal courts, including the District Court for Western Washington, have interpreted the *ISP Remand Order* to apply only to ISP-bound traffic originating and terminating within a local calling area, as defined by a state commission.
[216] *See, supra*, paragraph 52.
[217] *Christiansen v. Grant County Hospital*, 152 Wn.2d 299, 306, 96 P.3d 957 (2004): "Collateral estoppel, or issue preclusion, bars relitigation of an issue in a subsequent proceeding involving the same parties." (*Id*., citing *Rains v. State*, 100 Wn.2d 660, 665, 674 P.2d 165 (1983) (quoting *Seattle-First Nat'l Bank v. Kawachi*, 91 Wn.2d 223, 225-26, 588 P.2d 725 (1978); "[C]ollateral estoppel is intended to prevent retrial of one or more of the crucial issues or determinative facts determined in previous litigation." (*Id*., citing *Luisi Truck Lines, Inc. v. Washington Utils. & Transp. Comm'n*, 72 Wn.2d 887, 894, 435 P.2d 654 (1967)).

### c. Did the Initial Order err in applying a geographic test to classify VNXX calls?

*143* Level 3 and Broadwing assert the Initial Order erred in concluding that local calls should be defined based on incumbent geographic local calling areas. They argue that the Initial Order does not analyze whether the assigned telephone numbers and physical end points of the calls matter in determining the classification or compensation of VNXX traffic, or whether another option is appropriate, as the district court identified in its remand order.[218]

*144* Staff refutes Level 3 and Broadwing's arguments asserting that Washington law distinguishes local and interexchange traffic on the basis of the geographic endpoints of the call,[219] relying on RCW 80.36.230 and case law.[220] Staff also relies on *Global NAPs I* and *Peevey* for the rule that state commissions have the authority to define local calling areas and thus define what constitutes a local call to which reciprocal compensation applies.[221]

*145* Qwest asserts that the Initial Order's conclusion that call classification in Washington is based on the geographical location of the parties to a call is supported by statute, rules, Qwest and CLEC tariffs, language in interconnection agreements and prior Commission decisions.[222] Qwest notes that the CLECs do not argue that this conclusion is incorrect, but that the Initial Order failed to properly analyze the issue.[223]

*146* We grant in part Level 3 and Broadwing's petitions for review finding that the Initial Order did not fully support its conclusion that telecommunications traffic in Washington should be defined based on the ILECs' geographic local calling areas,

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[218] Level 3 Petition, ¶ 72.
[219] Staff Answer, ¶ 32, citing Staff Opening Brief, ¶¶ 44-46.
[220] Staff Opening Brief, ¶ 45, citing *In re Electric Lightwave, Inc*., 123 Wn. 2d 530, 537, 869 P.2d 1045 (1994).
[221] Staff Answer, ¶ 32, citing to Staff Opening Brief, ¶¶ 25-30.
[222] Qwest Answer, ¶¶ 33-40.
[223] *Id*., ¶ 33.

but we uphold the Initial Order's conclusion that a geographic basis for intercarrier compensation in Washington is sound and correct as a matter of law.

*147* The Initial Order did not expressly identify or discuss the Commission's authority under statute, rule, case law and tariff to establish local calling areas based upon geography. However, the record of the proceeding, in particular Staff's and Qwest's post-hearing briefs,[224] and federal case law, provide a sufficient basis to decide the issue.

*148* We are authorized by statute to "to prescribe exchange area boundaries and/or territorial boundaries for telecommunications companies."[225] The state supreme court has determined that this language enables us "to define the geographical limits of a company's obligation to provide service on demand, and to delineate boundaries between local and long distance calling."[226] Our rules define a local calling area as "one or more rate centers within which a customer can place calls without incurring long distance (toll) charges."[227] In addition, the geographic areas that distinguish between local and long distance calling are defined in exchange maps in the Commission-approved tariffs of local exchange companies such as Qwest.[228] Finally, both Qwest and Staff point out that in interconnection agreements with Qwest, CLECs have adopted the same LCAs as Qwest.[229]

*149* The federal courts have long recognized state authority to establish local calling areas on a geographic basis as the continuing basis for classifying and compensating calls.[230] The *Global NAPs II* court found that "despite the monumental changes Congress had made in telecommunications law, the FCC early indicated that it intended to leave authority over defining local calling areas where it always had been

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[224] Staff Initial Brief, ¶¶ 23-30, 32-33, 44-58; Qwest Initial Brief, ¶¶ 22, 27-28, 37-48.
[225] RCW 80.36.230.
[226] *In re Electric Lightwave*, 123 Wn.2d at 537.
[227] *See* WAC 480-120-021.
[228] *See* Staff Initial Brief, ¶ 45; Qwest Initial Brief, ¶¶ 28, 37-38.
[229] *See* Staff Initial Brief, ¶ 51; Qwest Initial Brief, ¶ 47. We reject the implication in the Initial Order that CLEC local calling areas are different than or larger than ILEC local calling areas, as carriers that interconnect with Qwest must use the same local calling areas. Staff Answer, ¶ 32.
[230] *See, supra,* paragraphs 40-53.

– squarely within the jurisdiction of the state commissions."[231] The district court recently stated that "[a]lthough the FCC did reevaluate its use of the term 'local' in the *ISP Remand Order*, it did not eliminate the distinction between 'local' and 'interexchange' traffic and the compensation regimes that apply to each – namely reciprocal compensation and access charges."[232]

*150* We recognize that the *Peevey* court upheld the California Commission's decision to classify VNXX calls as local based on the originating and terminating NPA-NXX of the call. The California Commission chose to rate VNXX calls as local because carrier tariffs based call rating on the telephone number prefix (NXX), not the physical location of the calling or called parties.[233] Washington tariffs, supported by state law and rule, apply call rating based on the physical location of the calling and called parties, not on the respective NPA-NXX codes. Thus, while the California model is one acceptable way to classify VNXX traffic, it is not appropriate for Washington. We reject Level 3 and Broadwing's claims that the distinction between local and long distance traffic no longer exists, that geography is not an appropriate basis for classifying traffic, and that local calls should not be defined based on ILEC local calling areas.

### D. Compensation for VNXX Traffic

*151* Having determined that VNXX traffic should be classified as intrastate interexchange, we now turn to how it should be compensated.

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[231] *Global NAPs II*, 454 F.3d at 97; *see also Global NAPs I*, 444 F.3d at 62-63; *Peevey*, 462 F.3d at 1158-59.
[232] *WUTC v. Qwest*, 484 F.Supp.2d at 1170.
[233] *In re Competition for Local Exchange Service Rulemaking Proceeding,* 95-04-043, Interim Order 95-04-044, Decision 99-09-029, California Public Utilities Commission (Sept. 2, 1999), cited as 1999 WL 1127635 (Cal. P.U.C.) at 12-13.

### 1. Bill and Keep Compensation for VNXX traffic.

#### a. Should the Commission change the "status quo" regarding compensation for "local" traffic including VNXX traffic?

152 The Initial Order adopted bill and keep as the appropriate intercarrier compensation for the exchange of VNXX traffic.[234] In its petition for review, Level 3 characterizes this decision as a reversal of the status quo, and argues it would impose uncompensated termination costs on CLECs for VNXX traffic that originates on Qwest's network.[235] Pac-West makes similar arguments, contending that the decision is inconsistent with both past Commission decisions and FCC orders, and undermines the Order's own conclusions regarding intercarrier compensation as it recognizes that CLECs incur some costs to terminate VNXX calls.[236] Finally, ELI and ATI argue that the Commission should not apply bill and keep because "the FCC has ruled numerous times regarding the compensability of ISP-bound traffic and that analysis supports the continued application of the ISP rate to VNXX-provisioned ISP traffic."[237]

153 Staff responds that state law determines whether a call is "local," subject to section 251(b)(5), or is intrastate "interexchange" and subject to state statutes and policies relating to fair compensation. Staff specifically refutes Level 3's argument that federal law requires the Commission to define VNXX as "local" traffic subject to section 251(b)(5), noting that this argument is contrary to the district court's decision to which Level 3 and Pac-West were parties.[238]

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[234] Initial Order, ¶ 97; *see, supra*, paragraph 59.
[235] Level 3 Petition, ¶ 65. Level 3 makes a similar argument with respect to the Initial Order's decision on sharing of transport costs which is addressed separately in subsection D.2.
[236] Pac-West Petition, ¶ 37.
[237] ELI/ATI Petition at 19. ELI and ATI note later in the same section of their petition that the district court's recent ruling on our previous decisions on the *ISP Remand Order* only applies to ISP-bound traffic that falls within a local calling area. More importantly, they fully acknowledge that the court's recent ruling allows the Commission to interpret the *ISP Remand Order* as it applies to VNXX traffic pursuant to "any other chosen method within the WUTC's discretion."
[238] Staff Answer, ¶ 23.

*154* As previously discussed, a litany of federal cases decided since our previous orders regarding compensation for ISP-bound traffic compels a reexamination of the "status quo". Federal authority being consistent, persuasive and to a degree controlling, it was entirely appropriate for the Initial Order to reassess our prior orders in this regard.

*155* Having concluded that VNXX traffic is clearly interexchange in nature, it does not follow that the intrastate access charge compensation regime must apply. Our authority and responsibility is to determine rates for exchange of VNXX traffic that are "uniform …, reasonable, remunerative, nondiscriminatory, legal, and fair. …"[239]

**b. Should ISP-bound traffic provisioned by VNXX be subject to the FCC's rate of $.0007 per minute of use**?

*156* Level 3 continues to insist that the interim compensation rate established by the FCC in the *ISP Remand Order* for ISP-bound traffic ($.0007 per minute of use (MOU)) applies to all ISP-bound traffic, including all VNXX ISP-bound traffic in this proceeding.[240] ELI and ATI agree that we should continue to apply the interim rate to VNXX ISP-bound traffic,[241] but unlike Level 3, they acknowledge that the federal courts have determined that the *ISP Remand Order* applies only to ISP-bound traffic within an LCA. Nevertheless, they assert that we have the authority to interpret interconnection agreements to apply the interim rate to VNXX traffic.[242] They further claim that, because they use their own local network to service customers, VNXX ISP-bound traffic on their network is no different than local traffic.[243]

*157* Pac-West takes a slightly different tack, asserting that VNXX traffic, like other FX and FX-like traffic, should be classified as originating and terminating within an LCA for compensation purposes, and that we should apply section 251(b)(5) reciprocal compensation to VNXX traffic, including where applicable, ISP-bound traffic.[244]

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[239] RCW 80.04.110. *See, supra*, paragraphs 64-65.
[240] Level 3 Petition, ¶¶ 17, 36-37.
[241] ELI/ATI Petition at 19-20.
[242] *Id*. at 19.
[243] *Id*. at 19-20.
[244] Pac-West Petition, ¶¶ 18, 45, 48.

*158* Staff and Qwest both assert that the Initial Order correctly followed the district court's legal conclusions about the application of the interim rate.[245] Staff goes on to assert that the FCC intended the interim rate called for in the *ISP Remand Order* to apply only to ISP-bound traffic within local calling areas, and did not intend this new compensation scheme to override the intrastate access charge regime that may apply to ISP-bound calls between local calling areas.[246]

*159* As noted above, Qwest contests as deeply flawed Pac-West and Level 3's arguments that section 251(b)(5) compensation is the default and that the FCC's interim rate applies, asserting the arguments are not consistent with *WorldCom* or every subsequent federal decision that has addressed the *ISP Remand Order*.[247]

*160* Consistent with our analysis above, we reject the CLECs' petitions for review on this issue. As VNXX traffic originates and terminates outside of a single local calling area, it is clearly intrastate interexchange traffic subject to state, not federal, jurisdiction. The Act, FCC orders, and the *Global NAPs*, *Peevey,* and *Qwest* decisions all recognize state commission authority to establish local calling areas and compensation for intrastate traffic that originates and terminates outside of those local calling areas. The FCC's interim compensation rate is not intended for traffic, such as VNXX, that does not originate and terminate within the same local calling area.

*161* The recent federal cases also make it abundantly clear that the FCC's interim rate of $.0007 per MOU applies *only* to ISP-bound traffic within a local calling area.[248]

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[245] Qwest Answer, ¶ 32, n.56.
[246] Staff Answer, ¶ 35.
[247] Qwest Answer, ¶¶ 21-31.
[248] All circuit courts addressing the issue have made consistent findings. *See Qwest v. WUTC*, 484 F.Supp.2d at 1173.

### c. Does bill and keep or VNXX traffic violate Washington statutes or misconstrue prior decisions?

*162* Pac-West asserts that the Initial Order's proposal violates state law, *i.e.*, RCW 80.36.080, RCW 80.36.140, and RCW 80.36.160, by not applying similar terms to Qwest's FX and FX-like services.[249] Pac-West argues that VNXX traffic does not use any portion of Qwest's toll network and uses the same portion of Qwest's local exchange network as any other Qwest local call.[250]

*163* In response, Qwest argues that the Initial Order does not violate state law, asserting that there is no state law prohibiting a bill and keep regime, and that the Commission does not need specific statutory authority to impose one.[251] Qwest further notes that prior decisions on compensation for ISP-bound and VNXX traffic were all entered prior to *Peevey* and the district court's decision.[252] Qwest asserts that the Commission has always maintained the local/long-distance distinction in arbitrating interconnection agreements, and that to the extent these decisions referred to the category of ISP-bound traffic, it was only to local ISP-bound traffic.[253]

*164* Contrary to Pac-West's concerns, Qwest maintains that the Initial Order found that its FX and FX-like services do not violate state law, as Qwest's customers pay appropriate compensation for these services.[254]

*165* We uphold the Initial Order's adoption of bill and keep as consistent with Washington statutes and recent federal court decisions.

*166* The Initial Order carefully considered the requirements of state and federal law, weighed pertinent policy interests including regulatory arbitrage and the effect on consumers, and found bill and keep to be an appropriate compensation

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[249] Pac-West Petition, ¶¶ 29-31; *see also* discussion of compensation for FX traffic, *infra,* paragraphs 234-237.
[250] *Id.*, ¶ 31.
[251] Qwest Answer, ¶ 63.
[252] *Id.*, ¶¶ 76-77.
[253] *Id.*, ¶¶ 76-81.
[254] *Id.*, ¶¶ 95-101.

methodology.[255] Specifically, the Order found that bill and keep "offers a fair, just, and reasonably balanced resolution to the traffic imbalance problems and skewed intercarrier compensation … that result from VNXX service," considering the very statutes the CLECs claim have been violated.[256] These statutes require carriers to engage in fair practices and charge just and reasonable rates for the services they provide, and allow the Commission to establish different rates after finding a service does not meet the statutory standard. The Initial Order correctly concluded that requiring Qwest to pay for services that are arguably toll traffic and for which Qwest would be entitled to compensation is an unfair and anticompetitive practice that this Commission must remedy.

*167* We find the Initial Order strikes a careful and appropriate balance between the competing interests of ILECs, who wish to curtail or eliminate the financial effects of CLEC provisioning of VNXX services to ISPs, and CLECs, who identified a niche opportunity to exploit grey areas of industry numbering guidelines to offer expanded local area calling capabilities to their ISP customers, largely at the expense of the ILECs. While the Initial Order denies Qwest the right to access charges for VNXX traffic that Qwest (and WITA) contend is interexchange traffic, it also denies section 251(b)(5) reciprocal compensation payments to CLECs for VNXX traffic.

*168* We find bill and keep a reasonable position between reciprocal compensation on the one hand and intrastate access charges on the other. We note that the *ISP Remand Order* itself envisioned a transition to bill and keep as a reasonable compensation methodology for ISP-bound traffic subject to section 251(b)(5).[257] Although we determine that VNXX traffic is not subject to section 251(b)(5), there is no persuasive reason why bill and keep is not an equally suitable methodology for VNXX traffic that is intrastate interexchange.

*169* In sum, we find that section 251(b)(5) reciprocal compensation only applies to "local" traffic, *i.e.,* traffic originating and terminating in a local calling area, that the FCC's interim rate applies only to ISP-bound traffic originating and terminating within a

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[255] Initial Order, ¶ 96.
[256] *Id.*, ¶¶ 96-97.
[257] *ISP Remand Order,* ¶¶ 2, 4, 6, 7.

local calling area, and that VNXX traffic does not originate and terminate within a local calling area. We uphold the Initial Order's decision to apply bill and keep to VNXX traffic.

#### d. Does the Initial Order misinterpret decisions by other state commissions on compensation for VNXX traffic?

*170* The Initial Order identified how other states have decided the issue of compensation for VNXX traffic, as well as some of the policy considerations that influenced those decisions.[258] Pac-West asserts the Initial Order misconstrues or misinterprets the state decisions it relied on for support, arguing each decision reflects state policies on ISP-bound and FX traffic.[259] Pac-West and Level 3 both recommend the Commission adopt the compensation approach adopted by the California commission because it has been approved by the Ninth Circuit and is arguably "simpler" than bill and keep.[260]

*171* Staff and Qwest dispute the simplicity of California's approach. Qwest points out that California relies upon numbering assignment (NPA-NXX) to determine whether a call is local or interexchange, not the geographic calling area method used in Washington.[261]

*172* We deny Pac-West's petition for review on this issue. It is clear that states have approached compensation for VNXX traffic differently.[262] Some have banned it altogether, while others have adopted various compensation mechanisms, including: (1) intrastate access charges; (2) state-determined compensation for locally dialed traffic (not section 251(b)(5) reciprocal compensation); and (3) bill and keep.

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[258] Initial Order, ¶¶ 83, 91, 95-96, 101-105. A table summarizing other state decisions is attached as Appendix B to this Order.
[259] Pac-West Petition, ¶ 38.
[260] *Id.*, ¶ 45; Level 3 Petition, ¶ 20, citing *Peevey*, 462 F.3d 1142 (9th Cir. 2006); ¶ 70; Level 3 Answer, ¶ 45.
[261] Qwest Answer, ¶ 41.
[262] As seen in Appendix B, attached to this Order, some states have banned the use of VNXX arrangements, while other states have allowed VNXX traffic and applied different methods for compensation for the traffic.

*173* What other states have done is interesting, but hardly dispositive in Washington. For example, we find as Staff and Qwest note, that the California scheme is based on a different model for rating traffic. Based on historical language in ILEC tariffs, California rates traffic based on the NPA-NXX of the calling and called parties. Because the statutes, tariffs, and rules in Washington apply a geographic model for rating traffic, the California model relying exclusively on NPA-NXX would not work here.

*174* We conclude that the Initial Order did not misconstrue other state decisions. It carefully weighed the policy concerns different states have considered and reached a decision supported by an analysis consistent with Washington law. We find no fault in its determination that a bill and keep approach with a requirement that CLECs pay transport costs is the best compensation policy for VNXX traffic in Washington.

**e. Is the Initial Order's decision supported by sufficient evidence?**

*175* The Initial Order adopted Staff's bill and keep compensation proposal primarily based on policy considerations about regulatory arbitrage and traffic imbalances resulting from VNXX traffic.[263] Having examined the parties' evidence as to whether VNXX service has an adverse effect on cost recovery, the Initial Order found the evidence insufficient to reach a reasoned opinion, concluding that "the parties provided little hard evidence about the actual costs attributable to carrying VNXX ISP-bound calls."[264] Considering such evidence helpful, but not necessary to a decision on the merits, the Initial Order found that "the Commission can make some reasoned assumptions about costs," including that "Qwest incurs some additional costs for transporting VNXX calls to the CLEC point of interconnection" and that "CLECs may incur some costs related to terminating VNXX calls."[265] Supported by this assessment of costs to transport and terminate VNXX calls, the Initial Order weighed

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[263] Initial Order, ¶¶ 96-97. The Initial Order also relied on evidence in the record of significant traffic imbalances. *See, Id.*, at ¶ 58, n.59.
[264] *Id.*, ¶ 64. Qwest relied on a theory of cost causation rather than presenting evidence of lost revenues, and Level 3 presented no evidence of the actual costs of terminating VNXX calls. *Id.*
[265] *Id.*, ¶ 65.

the policy questions presented and found Staff's compensation proposal to be reasonable.[266]

*176* ATI, ELI and Pac-West request that we reverse the Initial Order's compensation decision as arbitrary and capricious, alleging it is based on assumptions, not on substantial factual or evidentiary support.[267] They object to the Initial Order making policy determinations, even while recognizing that the record contains very little evidence about costs, cross-subsidization, or amount of VNXX voice calling.[268]

*177* ATI and ELI claim the Initial Order seeks to solve a problem that does not clearly exist,[269] and that there is no evidence to support finding that VNXX deprives Qwest of revenue, or that connecting to the Internet by a dial-up ISP is in stasis or declining. Moreover, they argue that deriving intrastate access revenues from VNXX traffic is not crucial to Qwest's business plan, which demonstrates there may not be a problem requiring the Initial Order's remedy.[270]

*178* ATI and ELI also assert that the Initial Order misconstrues the evidence by (1) stating that the CLECs did not seriously dispute Qwest's evidence of traffic imbalances, and (2) implying that CLECs have implemented different local calling areas than Qwest.[271] The CLECs identify examples in the record of their response to Qwest's claim and state that CLEC and Qwest local calling areas match exactly under their interconnection agreements.[272]

*179* Level 3 contends that the Initial Order ignores relevant law and makes incorrect or unsupported assumptions about costs relating to VNXX call termination and transport. Level 3 argues that there is little, if any, factual information on the record regarding CLEC or Qwest's costs of transporting and terminating VNXX traffic.

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[266] The Initial Order considered such policy considerations as traffic imbalances, skewed intercarrier compensation, regulatory arbitrage, parity—all issues the FCC addressed in its *ISP Remand Order*.
[267] ATI/ELI Petition at 6; Pac-West Petition, ¶ 9.
[268] ATI/ELI Petition at 6.
[269] *Id*. at 7-8.
[270] *Id*. at 7.
[271] *Id*.
[272] *Id*.

Consequently, Level 3 finds fault with the Initial Order for making assumptions about carriers' costs in finding that VNXX services may be permitted only if bill and keep is used for VNXX traffic termination and CLECs compensate Qwest for VNXX transport at TELRIC-based rates.[273] It argues that the FCC recognized that CLECs incur costs in terminating ISP-bound traffic and that some form of terminating compensation is due. Level 3 asserts that the Initial Order's proposal will create a windfall for Qwest, and will not address the issues of traffic imbalance.[274]

*180* Pac-West makes a similar argument about the paucity of cost evidence in the record, asserting that we must make our compensation decision based on evidence and not assumptions. Pac-West claims there is insufficient evidence to support the Initial Order's decision to impose a bill and keep mechanism on VNXX traffic and to require CLECs to pay for transport of VNXX traffic.[275] It argues that the Initial Order's reliance on scant evidence of traffic imbalances, skewed intercarrier compensation, and the desire for parity with Qwest's FX service do not justify the conclusion that bill and keep is the appropriate compensation for VNXX traffic.[276] Pac-West also asserts that we lack authority to establish intercarrier compensation methods that are not based on cost,[277] and since there is very little cost evidence in the record, the Order relies on mere assumptions.[278]

*181* Like Level 3, Pac-West contends that the FCC in its *ISP Remand Order* has found that CLECs do incur costs to terminate VNXX traffic and are entitled to some form of compensation for doing so; albeit at rates lower than the switching rates the Commission established for local switching in previous Commission proceedings.[279] Noting that the FCC has not imposed or rejected bill and keep to address concerns over traffic imbalances or regulatory arbitrage, Pac-West and Level 3 assert that

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[273] Level 3 Petition, ¶¶ 42-47.
[274] *Id*., ¶¶ 51-54.
[275] Pac-West Petition, ¶¶ 24-28, 35-37.
[276] *Id*., ¶ 24.
[277] *Id*., ¶ 25
[278] *Id*., ¶¶ 35-37.
[279] *Id*.

traffic imbalance and arbitrage opportunities are illusory concerns unsupported by record evidence.[280]

*182* Further, Pac-West asserts the Initial Order erred by failing to make a conclusion of law about costs.[281] Pac-West asserts that establishing a bill and keep compensation scheme violates the pricing standards of section 252(d)(2) of the Act, which requires state commissions to establish reciprocal compensation rates that "provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[282]

*183* Pac-West also asserts that the Commission has entered into a generic proceeding, in violation of federal law, concerning the nature and appropriate level of intercarrier compensation for exchange traffic for all CLECs with interconnection agreements.[283] Pac-West asserts that we must reserve these issues for an appropriate cost docket or interconnection agreement arbitration.[284]

*184* Finally, Pac-West claims the record does not support the Initial Order's determination that CLECs must pay for transport of VNXX calls, as it mistakenly compares retail FX service with wholesale interconnection service, not retail FX and retail VNXX service.[285]

*185* WITA argues that the Initial Order will have a deleterious effect on intrastate access charges revenues, because as minutes of use go down, revenues are lost.[286] Global Crossing and Pac-West assert that WITA has demonstrated no basis for its claims that access revenue is lost through ISP dial-up traffic, or that WITA members place any calls to CLEC customers.[287]

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[280] *Id.*, ¶¶ 25-26; Level 3 Petition, ¶¶ 56-57, citing *Core Forbearance Order*, ¶¶ 20-21.
[281] Pac-West Petition, ¶¶ 13-15.
[282] *Id.*, ¶ 13, citing 47 U.S.C. § 252(d)(2)(B)(i).
[283] *Id.*, ¶ 16.
[284] *Id.*, ¶ 18.
[285] *Id.*, ¶¶ 26-28.
[286] WITA Petition, ¶ 33.
[287] Global Crossing/Pac-West Answer, ¶ 20.

*186* Staff and Qwest assert that the CLECs' argument about evidentiary support is irrelevant, as the issue in this proceeding is not the cost of VNXX traffic but which intercarrier compensation regime should apply to VNXX traffic.[288] In fact, Staff requests the Commission strike from the Initial Order any reference to the lack of cost evidence to support its conclusions.[289] Staff asserts that the basis for the Initial Order's decision is not assumptions about the costs carriers incur in exchanging VNXX calls, but the policy rationale the FCC articulated in the *ISP Remand Order, i.e.*, that ISP-bound traffic creates arbitrage opportunities and traffic imbalances.[290] Staff and Qwest argue that the policy concerns of traffic imbalance and regulatory arbitrage remain a valid reason to impose a bill and keep compensation regime, and that the FCC has not repudiated the use of bill and keep for ISP-bound traffic.[291]

*187* Staff also claims that, by applying a bill and keep mechanism, the Initial Order does not set a rate that requires an evaluation of costs, but directs CLECs to recover their costs from their customers rather than from Qwest.[292] Staff and Qwest assert that the bill and keep approach adopted in the Initial Order is not based on reciprocal compensation for section 251(b)(5) traffic, but is a compensation approach for certain interexchange traffic, to which the provisions of section 252(d)(2) do not apply.[293]

*188* Qwest contends that when providing VNXX services, CLECs are actually operating as long distance carriers in enabling end users to make interexchange calls disguised as "local" calls. Qwest concludes that the economic principle of cost causation requires the cost causer – the dial-up customer of the ISP served by the CLEC – to bear the cost of originating and transporting VNXX calls in its retail rates, rather than Qwest's end users bearing Qwest's costs of reciprocal compensation payments and transporting VNXX calls to CLECs for what CLECs contend is local traffic termination.[294]

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[288] Staff Answer, ¶ 33-35; Qwest Answer, ¶ 62.
[289] Staff Answer, ¶ 34.
[290] *Id.*, ¶ 33.
[291] *Id.*, ¶ 35; Qwest Answer, ¶ 52.
[292] Staff Answer, ¶ 34.
[293] Qwest Answer, ¶ 55; Staff Answer, ¶¶ 28-30.
[294] Qwest Answer, ¶¶ 73-75.

*189* This proceeding originated as a complaint filed by Qwest against nine CLECs, which Qwest initially contended were operating illegally in Washington by offering VNXX services. The CLECs responded by pointing to the similarities between their VNXX service offerings and the historical FX and FX-like service offerings of the ILECs. The proceeding quickly changed into a rigorous and detailed debate about the appropriate terms and conditions under which VNXX services may be allowed, rather than if they should be allowed.

*190* We reject the CLECs' argument that there is no issue or problem requiring resolution. The number of complaint, enforcement, and arbitration proceedings before the Commission over the last few years concerning compensation for VNXX traffic clearly demonstrate the need for resolution.[295] Simply stated, this proceeding is a direct consequence of these individual proceedings and represents a timely and efficient opportunity to resolve a number of VNXX compensation issues because it involves most, if not all, of the principal parties to these ongoing matters.

*191* We have already determined that ISP-bound VNXX traffic is appropriately classified as intrastate interexchange traffic, for which we have authority to determine compensation.[296] It is not subject to section 251(b)(5) or the costing requirements of section 252(d)(2). Bill and keep applies equally to interconnecting carriers, imposing no intercarrier payments and requiring the carriers to recover their costs equally from their own customers. In this model, extensive and detailed cost analysis is irrelevant because no costs are being recovered from another carrier.

*192* Once we properly classify VNXX traffic, the issue of compensation becomes a question of policy. Both Qwest and the CLECs introduced extensive evidence and argument into the record concerning FCC decisions, court interpretations, state commission decisions and other written materials in support of their views on the

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[295] *See, e.g.*, the complaint in this proceeding, Pac-West petition for enforcement in Docket UT-053036, Level 3 petition for enforcement in Docket UT-053039, and Qwest's counterclaims in those proceedings; *see also* Level 3's petition for arbitration with Qwest in Docket UT-063006, Level 3's petition for arbitration with CenturyTel in Docket UT-023043, and AT&T's petition for arbitration with TCG Seattle in Docket UT-033035.

[296] *See, supra*, paragraphs 40-53, 129-134.

appropriate treatment and compensation for VNXX traffic. While the CLECs are correct that this proceeding contains limited evidence regarding the parties' actual costs for transporting or terminating VNXX traffic, this lack of cost evidence is of little moment unless it bears on the policy decision about the appropriate compensation regime.

*193* In fact, the FCC did not rely on detailed cost support in finding bill and keep to be an appropriate compensation regime for ISP-bound traffic.[297] The FCC instead relied on its policy concerns about regulatory arbitrage and market distortion:

> As the current controversy about ISP-bound traffic demonstrates, reciprocal compensation encourages carriers to overuse competing carriers' origination facilities by seeking customers that receive high volumes of traffic.
>
> We believe that a bill and keep regime for ISP-bound traffic may eliminate these incentives and concomitant opportunity for regulatory arbitrage by forcing carriers to look only to their ISP customers, rather than to other carriers for cost recovery.[298]
>
> We are convinced … that intercarrier payments for ISP-bound traffic have created severe market distortions. Although it would be premature to institute a full bill and keep regime before resolving the questions presented in the NPRM, in seeking to remedy an exigent market problem, we cannot ignore the evidence we have accumulated to date that suggest that a bill and keep regime has very fundamental advantages over a [calling party network pays] CPNP regime for ISP-bound traffic. Contrary to the view espoused by the CLECs, *we are concerned that the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to "get the rate right*."[299]

*194* It is clear that the FCC grounded its decision on well reasoned policy considerations and established an interim compensation scheme for ISP-bound traffic that declined

[297] *ISP Remand Order*, ¶ 84.
[298] *Id.*, ¶¶ 73-74.
[299] *Id.*, ¶ 76. (Emphasis added).

over a three-year period to $0.007 per MOU, based on its best analysis of costs in interconnection agreements at the time. More importantly, the FCC stated its policy preference ultimately for a bill and keep arrangement, but advocated taking such action in a separate rulemaking to consider comprehensive intercarrier compensation reform. While the FCC has yet to conclude its rulemaking, we are not so constrained. We find the analysis and reasoning in support of bill and keep sufficient to adopt it as the appropriate compensation for VNXX traffic in Washington.

*195* We reject the CLECs' claims that the Initial Order is not supported by sufficient evidence pertaining to the cost of transporting and terminating VNXX calls and find that the Initial Order's policy rationale for establishing a bill and keep compensation regime, with compensation for transport, is sufficient without detailed evidentiary or cost support.

*196* Our adoption of bill and keep should come as no surprise to CLECs. The FCC published its *ISP Remand Order* in April 2001, established a three-year transition, and called for "prompt" action on a unified intercarrier compensation system.[300] Although the FCC did not immediately apply bill and keep for ISP-bound traffic out of concern for disrupting the market through a "flash-cut" process, the FCC noted that "CLECs have been on notice since the 1999 *Declaratory Ruling* that it might be unwise to rely on the continued receipt of reciprocal compensation for ISP-bound traffic."[301] Further, contrary to the CLECs' claims, the FCC has not rejected or repudiated these policy concerns; rather the FCC in the *Core Forbearance Order* chose not to forbear from enforcing the rate caps and mirroring rules of the *ISP Remand Order*, finding that they "remain necessary to prevent regulatory arbitrage and promote efficient investment in telecommunications services and facilities."[302] The Initial Order appropriately considered these same policy issues.

*197* Finally, for the same reasons, we deny Staff's request to modify the Initial Order to remove language that the decision is not based on cost evidence. The Initial Order acknowledges the paucity of costing evidence introduced in the proceeding, basing its

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[300] *Id.*, ¶¶ 2, 7.
[301] *Id.*, ¶¶ 77, 84.
[302] *Core Forbearance Order*, ¶ 19; *see also* ¶¶ 18, 23, 25.

decision instead on policy rationale. It was not error for the Initial Order to state the basis for its decision. This policy judgment is fully within the bounds of our authority in regulating intrastate telecommunications services.[303]

### 2. Compensation for transporting VNXX traffic.

#### a. Does the Initial Order's conclusion that CLECs should pay Qwest for transport of VNXX calls on the CLECs' side of the point of interconnection (POI) violate federal law and Washington precedent?

*198* Level 3 contends that the Initial Order violates FCC rules and Commission precedent by allowing Qwest to charge CLECs for transporting ISP-bound calls to a point of interconnection (POI) – including, presumably, VNXX calls – originated by Qwest's customers. Specifically, Level 3 claims two FCC rules prohibit imposing transport costs on terminating carriers (*i.e.,* CLECs) for "telecommunications traffic."[304] Level 3 also refers to a previous Commission decision involving an arbitration between itself and Qwest, and contends the Commission found that "[t]he originating carrier

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[303] As discussed above, the Initial Order properly finds that a bill and keep compensation regime for VNXX traffic falls within the Commission's jurisdiction to establish appropriate compensation for such traffic. Further, the Initial Order determined that it was unreasonable to require Qwest to bear the cost of transporting a VNXX call beyond the local calling area where it originates. Consequently, the Initial Order requires CLECs to reimburse Qwest for transport where its facilities are used for such transport.

[304] Level 3 Petition, ¶¶ 39-40. 47 C.F.R. § 703(b) provides:

> A LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network.

47 C.F.R. § 709(b) provides:

> The rate of a carrier providing transmission facilities dedicated to the transmission of traffic between two carriers' networks shall recover only the costs of the proportion of that trunk capacity used by an interconnecting carrier to send traffic that will terminate on the providing carrier's network. Such proportions may be measured during peak periods.

… is obligated to carry the call to the POI between the carriers' networks."[305] Level 3 further contends that where carriers are sharing a transport facility, the carrier providing transport may only charge the other for the costs of the portion ("relative use") of the facilities used by the interconnecting carrier to send traffic that will terminate on the providing carrier's network. Level 3 implies that, in the arbitration, the Commission determined that in calculating the relative use of a transport facility, all originating traffic, including ISP-bound traffic, is to be included as part of an originating carrier's usage, and that it does not matter whether the traffic was "local" or "interstate."[306]

*199* Qwest responds that Level 3 is simply trying to extend rules that apply to local traffic to interexchange traffic. Further, Qwest intimates that Level 3 is really attempting to make Qwest responsible for absorbing the cost of transporting traffic to a POI for all traffic types, not just traffic subject to the FCC rules relating to reciprocal compensation and the transport and termination of local calls.[307] Finally Qwest states:

> Under the current version of these rules, the prohibition upon charges for delivering traffic to the POI with the other carrier is limited to "telecommunications traffic." Rule 51.701(a) provides that "the provisions of this subpart apply to reciprocal compensation for transport and termination of *telecommunications traffic*." (Emphasis added). Rule 51.701(b)(1) defines "telecommunications traffic" for the purposes of subpart H (the FCC's Reciprocal Compensation rules) to exclude "interstate or intrastate *exchange access*, *information access*, or exchange services for such access." (Emphasis added). Rule 51.703(b) states: "A LEC may not assess charges on any other telecommunications carrier for *telecommunications traffic* that originates on the LEC's network." (Emphasis added). Therefore, the prohibition contained in Rules 51.703(b) and 51.709(b) do not apply to either ISP traffic, which is "information access," or to VNXX traffic, which is "exchange access."[308]

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[305] Level 3 Petition, ¶ 41, citing *Arbitration of an Interconnection Agreement Between Level 3 Communications, LLC and Qwest Corp*., Docket UT-023042, Final Order at 9 (Feb. 5, 2003).
[306] *Id*.
[307] Qwest Answer, ¶¶ 64-65.
[308] *Id*., ¶ 66. In the *Local Competition Order*, the FCC determined that interexchange traffic was not subject to reciprocal compensation, a ruling that remains the law today. *Local Competition Order,* ¶ 1034; *see also Peevey*, 462 F.3d at 1157-59.

*200* Staff asserts that if we reject the Initial Order's requirement that CLECs pay for their proportional use of local interconnection facilities that carry VNXX traffic, CLECs will gain an unfair competitive advantage in the provisioning of FX-like services. Staff notes that when a customer orders FX service from Qwest, the customer is specifically required to purchase a dedicated private line (*e.g*., transport facility) to transport calls from the foreign exchange where the customer wishes to receive local service to the customer's premises.[309]

*201* Staff points out that for VNXX services, CLECs knowingly obtain comparable transport by assigning the VNXX customer a number in the foreign exchange, thereby forcing Qwest to route the call to the CLEC over local interconnection facilities. Under FCC rules applicable to the exchange of local traffic, Qwest would have to bear the cost of that local interconnection facility in proportion to the amount the facility is used to terminate calls to the CLEC. However, Staff argues that where ISP-bound VNXX calls are concerned, calls from Qwest customers to the CLEC's ISP customer are largely one-directional, which means that Qwest bears the cost of the transport facility to the extent that it is used to transport FX-like calls on behalf of the CLEC and ISP customers. Staff argues that it is simply unfair to allow CLECs to continue to use VNXX arrangements on the theory that CLECs need VNXX to be able to compete with Qwest's FX service, but then to require Qwest to absorb the full cost of transport to the POI.[310]

*202* We uphold the Initial Order's decision that CLECs should bear the cost of transporting VNXX calls. We agree with Staff that requiring CLECs to compensate Qwest for the transport costs it incurs in handling VNXX calls is equivalent to the historical practice of requiring FX customers to pay separately for a private line (transport) between two LCAs.

*203* We also agree with Qwest that Level 3 misconstrues federal law and our previous decision in the Level 3 / Qwest arbitration regarding cost responsibility for transport of VNXX services. FCC rules regarding transport facility costs do not apply to interexchange traffic. The term "telecommunications traffic" under the Act excludes

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[309] Staff Answer, ¶¶ 36-37.
[310] *Id*., ¶¶ 36-39.

interstate or intrastate exchange access, information access, or exchange services for such access. As we discuss above, VNXX traffic is intrastate interexchange traffic subject to state law, and therefore, Level 3's reliance on 47 C.F.R. §§ 51.703(b) and 51.709(b) is misplaced. [311]

*204* Level 3 is also incorrect in claiming that the Commission's arbitration order found Qwest responsible for the cost of transporting VNXX calls. Referring to the arbitration order, Level 3 states "[t]he Commission emphasized that when calculating the relative use of the facility, *all originating traffic, including ISP-bound traffic, is to be included as part of an originating carrier's usage, [footnote omitted] and that it mattered not whether the traffic was "local" or "interstate."*[312] Although the Commission did determine that Qwest was responsible for transporting to a POI calls originated by Qwest's end users, that finding did not extend to or address directly the issue of who should bear the transport costs associated with VNXX traffic (whether ISP-bound or voice). As we make clear, these costs will be borne by the terminating carrier.

**b. Does the Initial Order's compensation proposal for VNXX traffic create an unworkable system for identifying VNXX calls and for determining each party's transport obligation?**

*205* Level 3 argues that the Initial Order's requirement to implement bill and keep compensation for VNXX traffic makes it impractical for carriers to distinguish VNXX calls from normal "local" calls, both for ISP-bound and voice traffic. Level 3 goes on to assert that, given the varying configuration of switches, trunks and interconnection points that exist between telecommunications carriers, the Initial Order's requirement of bill and keep for VNXX traffic results in a bifurcated compensation regime that is impractical to apply, presumably because local calls and VNXX calls are routed over common network connections pursuant to a common dialing pattern. Because there is no viable means to determine the actual physical location of each calling and called party, Level 3 suggests it is impossible to apply a differentiated compensation structure to traffic terminated using common facilities.[313]

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[311] *See also, Peevey*, 462 F.3d at 1157.
[312] Level 3 Petition, ¶ 41. (Emphasis added).
[313] *Id.*, ¶¶ 59-62.

*206* ELI and ATI agree with Level 3, claiming that the Initial Order fails to provide a clear understanding of how to identify specifically VNXX calls in order to avoid applying reciprocal compensation rates. ELI and ATI discuss several call routing examples between Olympia and Seattle in support of their position that applying bill and keep to VNXX calls will likely lead to constant billing disputes between CLECs and Qwest over determining billable traffic (*i.e.*, applying reciprocal compensation rates only to traffic that is truly "local").[314]

*207* In addition to the arguments advanced by Level 3, ELI and ATI, Pac-West contends that the Initial Order improperly assumes that carriers actually know where their customers are physically located, which they argue is not supported in the record. Referring specifically to CLEC ISP customers, Pac-West points out that increasingly the modems used to support ISP operations have been replaced by IP portals or media gateways which act generally as centralized hubs for providing Internet access and which are not designed to be physically located within each local calling area. According to Pac-West, this network configuration shows the complexity of actually identifying or determining a customers' physical location.[315]

*208* Qwest responds that CLEC claims about the difficulty of distinguishing VNXX traffic from local traffic are not credible because modern telecommunications equipment, with proper software programming, can distinguish such traffic if CLECs properly identify and classify traffic placed to or from telephone numbers associated with VNXX routing. Qwest goes on to suggest that if CLECs are unable or unwilling to make the effort to identify and track usage for VNXX numbers they should be required to discontinue providing VNXX services.[316]

*209* Staff acknowledges that the Initial Order's approach would require carriers to use traffic studies to distinguish VNXX from local traffic and that such studies may be contentious. Nevertheless, Staff suggests that this is not a sufficient basis to reject or

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[314] ELI/ATI Petition at 16-19.
[315] Pac-West Petition, ¶¶ 41-45.
[316] Qwest Answer, ¶¶ 82-88.

overturn the Initial Order's compensation regime.[317] Staff argues that the telecommunications industry has used traffic studies for decades for a variety of purposes. In this proceeding, Qwest used traffic information or data in its possession to identify those CLECs operating in Washington that were most likely providing VNXX services. As Staff notes, Qwest and Verizon Access also used traffic studies to determine the hybrid compensation rate to be applied to VNXX and local traffic passing over common local interconnection trunks between the companies pursuant to the amendment to their interconnection agreement.

*210* The CLECs provide no facts to disprove Qwest's contention that modern telephone switches are essentially large computers which, if programmed correctly, can capture VNXX information sufficiently to support the differentiated compensation structure contemplated in the Initial Order. We believe it is reasonable to presume that Qwest and CLECs can devote sufficient technical resources to enable the parties to segment VNXX traffic from local traffic. We are persuaded by Qwest's argument that with additional effort by each carrier using VNXX arrangements, telephone numbers associated with VNXX calling can be identified and traffic to such numbers may be captured separately. Furthermore, any potential methodological or billing disputes associated with this requirement may be brought to the Commission for resolution in a future proceeding, if necessary.

*211* Accordingly, we deny the CLECs' petitions for review on this issue. Contrary to the CLECs' concerns, the Initial Order's application of the bill and keep mechanism to VNXX traffic is not unworkable. While it may require the use of traffic studies or switch programming to track, record, and classify traffic correctly, the fact remains that bill and keep has been required and implemented effectively in other states for VNXX traffic and remains a distinct possibility for adoption by the FCC in its reform of intercarrier compensation. The fact that application of bill and keep compensation to VNXX traffic may create some additional recordkeeping requirements and complexities for carriers does not override the prevailing public policy interest in imposing a fair and competitively neutral compensation regime, in the absence of which the lawfulness of VNXX would be in question.

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[317] Staff Answer, ¶¶ 40-45.

### c. Should CLECs pay rural LECs transport under the Initial Order's compensation scheme?

*212* As we discuss above, WITA contends that CLEC use of local interconnection trunks to send and receive VNXX calls constitutes a form of switched access charge bypass. Contending that VNXX traffic is being originated as local/exchange area service (EAS) traffic, WITA argues that no switched access records are being generated and transmitted to WITA's rural members so they may assess intrastate switched access charges.[318]

*213* Regarding compensation for VNXX transport, WITA presumes that the Initial Order's requirement for CLECs to compensate Qwest for VNXX transport extends to its members.[319] In footnote 88, the Initial Order discussed a motion WITA filed on August 20, 2007, requesting permission to respond to Staff's response to Bench Request No. 2. In its motion, WITA proposed that a CLEC offering VNXX services should be treated as having a point of interconnection (POI) with rural LECs and that CLECs should be fully responsible for the cost of transporting VNXX calls from a rural LEC switch to the POI, using a relative use calculation of the percent of VNXX traffic that traverses common local/EAS interconnection trunks that exist between a rural LEC and Qwest.[320] The Initial Order denied WITA's motion, finding no support in the record for WITA's recommendation. WITA touches again on its proposal in its Petition for Review, when it briefly mentions its assumption that the Initial Order's requirement that CLECs compensate Qwest for VNXX transport extends to rural LECs as well.[321]

*214* Level 3 challenges WITA's contention and responds that the Initial Order's transport ruling applies only to Qwest, and not to rural LECs. Level 3 points to language in the Initial Order rejecting WITA's proposal due to lack of evidence to support WITA's

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[318] WITA Petition, ¶ 14.
[319] *Id.*, ¶ 6.
[320] WITA Motion to Allow Response to Staff Response to Bench Request No. 2, ¶ 9 (Aug. 20, 2007).
[321] WITA Petition, ¶ 6.

transport recommendation, and argues that its proposal would require reopening the record. Additionally, it argues the Initial Order specifically found that WITA's transport issues fall outside the scope of the proceeding.[322]

*215* We reject WITA's attempt to resuscitate its rural LEC transport compensation proposal. The Initial Order clearly rejected WITA's efforts to broaden the scope of the proceeding by introducing a transport proposal for rural LECs through a motion filed well after the hearing in the proceeding had been completed. Even if one could argue the issue was somehow within the scope of Qwest's complaint, WITA did not submit prefiled testimony, sponsor witnesses, or otherwise introduce any evidence to address rural LEC compensation issues. Rather, WITA limited its participation to cross-examining other parties' witnesses and submitting post-hearing briefs. We see no reason to reverse the Initial Order on this issue, as it properly decided WITA's attempt to insert its compensation issues into a complaint proceeding between Qwest and certain CLECs. Moreover, WITA may, at any time, avail itself of its right to address its concerns in a complaint proceeding.

**d. Is the Initial Order's transport compensation requirement unfair?**

*216* The Initial Order acknowledged the Commission's prior finding in the *AT&T Arbitration Order* that CLECs typically deploy different switch and transport network architectures from those ILECs have employed historically and that this difference should not be used as a basis to prevent CLECs from offering VNXX services that are functionally equivalent to the ILECs' FX services.[323] However, while recognizing CLECs use different network designs, the Initial Order required CLECs to compensate Qwest when their service offerings actually use Qwest's transport facilities for VNXX calls entering or exiting local calling areas where CLECs do not have a physical network presence.[324]

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[322] Level 3 Answer, ¶¶ 18–20.
[323] Initial Order, ¶ 38.
[324] *Id.*, ¶¶ 97-98.

*217* The Initial Order further clarified that the requirement to compensate Qwest for transport applies only where VNXX calls actually traverse Qwest's transport facilities outside or beyond a local calling area. It made clear that to the extent a CLEC uses its own transport facilities or those provided by a third party, no transport compensation obligation to Qwest arises. Finally, the Initial Order determined that the appropriate rates for the use of Qwest's transport facilities to provide VNXX services must be cost-based using TELRIC principles.[325]

*218* ELI and ATI argue that the Initial Order fails to distinguish properly the difference among various CLEC network architectures. ELI and ATI note that some CLECs such as ELI and ATI have invested substantially in their own transport facilities, a condition which they contend creates a "physical presence" in each local calling area it serves. As an example, ELI and ATI state that, in the Seattle area, they have established eight fiber-based collocations with Qwest and purchased interconnection trunking to another 31 Qwest end offices. ELI and ATI argue that their transport network configuration throughout the Seattle metropolitan area effectively replicates the Qwest network in terms of its geographic scope and coverage.

*219* The CLECs assert that the Initial Order's transport compensation requirement ignores or excludes similar recovery for CLECs, and creates an unfair circumstance for those CLECs, like ELI and ATI, that have invested heavily in their own networks.[326]

*220* Staff asserts that most of the respondent CLECs have similar networks and offer VNXX by directing VNXX traffic over local exchange interconnection facilities. Staff notes ELI and ATI's position and factual presentation that their transport networks are unlike those of most CLECs, and responds by pointing out that the Initial Order limited its transport compensation remedy to those CLECs who actually rely on Qwest's local interconnection facilities for transporting VNXX traffic to a non-local exchange.[327]

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[325] *Id.*
[326] ELI/ATI Petition at 9.
[327] Staff Answer, ¶¶ 36-39.

*221* Level 3 opposes the Initial Order's transport compensation requirement, but concedes that if we accept the Initial Order's decision we should clarify that:

(1) Special access facilities purchased by the CLEC to connect its POI to local calling areas where the call originated are the functional equivalent of the ILEC PRI or private line that is provisioned in a traditional ILEC FX service;

(2) A CLEC that establishes such facilities to the local calling area will not be required to pay any of Qwest's purported originating transport costs; and

(3) A CLEC that establishes such facilities to the local calling area is entitled to terminating intercarrier compensation.[328]

*222* Level 3 contends that the Act does not encourage or require a competitor to replicate an ILEC's network to provide competing telecommunications services, including services that compete directly with ILEC FX or FX-like service offerings.[329]

*223* We find that the Initial Order recognizes and addresses the differences between CLEC and ILEC network architectures in recommending compensation for CLEC use of Qwest facilities for transporting VNXX calls. ELI and ATI correctly note that the Initial Order focuses primarily on compensation owed to Qwest for transport of VNXX calls, but is not clear about when or how the compensation obligation for transport applies – particularly where CLECs have deployed or otherwise obtained their own transport facilities. Certain CLECs have established extensive transport networks and in doing so have effectively established a "physical presence" in a number of local calling areas.

*224* For the reasons we discuss above, we uphold the Initial Order's findings regarding transport compensation for VNXX traffic. We conclude the Order intended that CLECs compensate Qwest only when they actually use Qwest's transport facilities for VNXX purposes; that is, where a CLEC is simply using local-dialing arrangements to compel Qwest to route the traffic over Qwest-provided local

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[328] Level 3 Answer, ¶ 26.
[329] *Id.*, ¶ 27.

interconnection facilities running between the location of the CLEC's switch and the local exchange to which a VNXX telephone number is assigned. We clarify that a CLEC is not obligated to pay for transport if a CLEC has built its own transport facilities, has procured alternative facilities from a third party, or uses special access services for transporting VNXX calls to and from a local calling area where the CLEC does not have switching facilities.

*225* Accordingly, we agree with Level 3, in part, ELI and ATI on these issues and grant clarification as follows: The Initial Order's transport compensation requirement should not apply when a CLEC establishes a "physical presence" in a local calling area through its own facilities, a collocation arrangement with Qwest, or through lease or purchase of transport facilities, such as special access facilities from Qwest or a third party.

*226* Finally, we reject Level 3's suggestion that terminating compensation is appropriate if a CLEC establishes a "local presence" by procuring third party transport facilities, including special access. This fact would not change our previous analysis regarding the classification of VNXX traffic and the appropriateness of bill and keep as its compensation regime.

### 3. Should VNXX arrangements be allowed for voice services as well as ISP-bound traffic?

*227* The Initial Order determined that carriers may use VNXX services for voice traffic in addition to ISP-bound traffic, concluding that doing so would allow CLEC VNXX service offerings to be fully competitive with ILEC FX services and would provide benefits to consumers through more service options and potential lower prices.[330] It recognized that allowing VNXX voice traffic may result in some reduction in access charge revenues, but that there was little evidence in the record about the effect of voice VNXX traffic on intrastate access charges, or that there will be significant VNXX voice traffic in the near term.[331] Specifically, the Initial Order concluded that, given the "little if any hard evidence of cost of service on this record," it was

[330] Initial Order, ¶¶ 35-38, 104-107.
[331] *Id.*, ¶¶ 105-106.

impossible to determine if imposing access charges on VNXX traffic would result in an over or under recovery of charges.[332]

*228* Acknowledging that the Commission might authorize VNXX services for ISP-bound traffic, WITA objects to and seeks review of the Initial Order's decision to allow VNXX services to be used to provide voice service.[333] WITA asserts that prior Commission orders establishing the access charge regime in Washington cannot be overturned without a factual record supporting the change. WITA further claims that the Initial Order speculates that allowing VNXX services for voice traffic would have no effect on intrastate access charges, and argues that there are no facts in the record in the proceeding that justify or support this conclusion.[334]

*229* Global Crossing and Pac-West dismiss WITA's arguments, asserting that Qwest, as the complainant in this proceeding, bore the burden of proving that VNXX services would affect the access charge system more than Qwest's own FX or FX-like service offerings. Without such evidence, Global Crossing and Pac-West argue that Qwest failed to "carry the burden."[335] These CLECs and TCG also point out that WITA provided no witnesses or other evidence of its own to support its contentions regarding potential access charge losses.[336]

*230* Staff did not include voice VNXX traffic in its compensation proposal. Staff notes that cost studies are only necessary to identify voice traffic under the Initial Order's proposal. If the voice VNXX traffic were not permitted, no traffic studies would be necessary.[337]

*231* The Initial Order's decision to allow telecommunications companies to offer VNXX-based services that include a voice component is reasonable and should not be reversed. Although the preponderance of the record in this proceeding focused on CLEC VNXX service offerings that support dial-up ISP services, there was also

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[332] *Id.*, ¶ 70.
[333] WITA Petition, ¶ 51.
[334] *Id.*, ¶¶ 50-52.
[335] Global Crossing/Pac-West Answer, ¶¶ 27-29.
[336] *Id.*, ¶ 29; TCG Answer, ¶¶ 10-12.
[337] Staff Answer, ¶ 44.

evidence that some CLECs use VNXX arrangements to offer voice services that compete with the traditional FX or FX-like service offerings of ILECs.[338] The ILEC offerings predate considerably the advent of ISP traffic and were used primarily to extend local telephone services to "foreign" exchanges outside of the calling party's LCA for voice traffic.

*232* Although there may be some impact on existing intrastate access charges as WITA alleges, on this record we believe it would be more appropriate to allow legitimate CLEC service offerings that compete with similar ILEC offerings than to prohibit or ban such offerings. Without evidence to support its position, WITA must rely on the "possible" to persuade, and it does not. Any "potential" adverse effect on the intrastate access charge system – the specter WITA raises – is simply not a sufficient basis for reversing the Initial Order's appropriate focus on the probable discriminatory effect of banning the CLEC's voice-based VNXX service offerings. WITA, of course, is free to bring its own complaint in this regard and prove the harm it alleges here outweighs the probable discriminatory and anticompetitive effects of banning CLEC VNXX voice services while allowing ILEC FX voice services.

*233* Accordingly, we uphold the Initial Order's decision to allow use of VNXX arrangements for voice services, finding the Order's reasoning to be balanced, competitively neutral, and in the public interest.

### 4. Is the Initial Order's compensation proposal discriminatory?

#### a. Is the Initial Order's finding that CLEC VNXX services are "functionally equivalent" to ILEC FX services, while allowing different compensation regimes, anticompetitive or discriminatory?

*234* Pac-West argues that the Initial Order is anticompetitive and discriminatory because the compensation scheme appears to apply to CLEC VNXX service offerings and not to FX or FX-like services offered by Qwest. Pac-West contends the Initial Order's effect would require it to terminate calls from Qwest customers to its VNXX

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[338] *See* Initial Order, citing Staff Opening Brief at 46; Brotherson, Exh. No. 24T at 48.

customers without compensation. In contrast, Pac-West claims CLECs would have to compensate Qwest for calls their customers make to customers of Qwest's FX or FX-like services. Pac-West specifically cites Qwest's market expansion line (MEL) service and a Qwest affiliate's VOIP service as two examples of FX-like or VNXX-like service offerings to which this discriminatory condition would apply. Pac-West asserts that a requirement that it continue to compensate Qwest for calls Pac-West's customers make to customers of Qwest's MEL or VOIP service is discriminatory and anticompetitive in violation of federal and state law.[339]

*235* Staff responds that the record is not clear regarding the extent to which Qwest uses or offers FX-type services, but agrees that there is some evidence that Qwest and its affiliate do offer such services. Staff suggests that Pac-West could file its own complaint against Qwest if it believes that payment of reciprocal compensation to Qwest for FX-like traffic is inappropriate.

*236* As we have stated above, this proceeding is a complaint filed by Qwest against nine CLECs over the legality of VNXX services, or the appropriate terms and conditions for intercarrier compensation if such services are deemed lawful. It does not address the appropriate treatment of Qwest's VNXX-like or FX offerings.

*237* We agree with Pac-West that Qwest offers several services which, from a telephone number assignment and traffic routing perspective, are similar in nature to the VNXX services offered by CLECs. As we discuss above, VNXX and FX services are both interexchange in nature, but differ in that FX customers pay for the transport of traffic while VNXX customers do not.[340] While it may be appropriate to also apply the bill and keep and transport facility compensation regime to Qwest's VNXX-like services, that is beyond the scope of this proceeding. We thus uphold the Initial Order's conclusions, but recognize that the VNXX compensation regime we adopt for the CLECs may also equitably apply to Qwest's FX and VNXX-like services.

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[339] Pac-West Petition, ¶¶ 19-23.
[340] The bill and keep regime we adopt in this Order will allow CLECs to recover their costs from their customers, as Qwest recovers costs from its customers for FX service.

**b. Is it discriminatory to adopt the Initial Order's compensation regime for the CLECs named in Qwest's complaint, but not for all CLECs in Washington?**

*238* Level 3 claims that the Initial Order's decision to establish a compensation regime for VNXX traffic does not name all CLECs that provide FX-like services in Washington. This result, Level 3 contends, is discriminatory because the adopted compensation regime does not apply to any CLECs that provide FX-like services that are not parties to this proceeding.[341]

*239* In response, Qwest states that it filed its complaint against CLECs that, based on information available to the company, appeared to be providing VNXX services in Washington. Qwest states that it did not bring a complaint against any CLEC where the evidence suggested the carrier did not provide VNXX service. Qwest notes that if some other unnamed CLEC is later determined to be using VNXX arrangements, Qwest will be bound by the Commission's decision in this proceeding. Should that circumstance arise, and if the unnamed CLEC and Qwest could not agree on how to handle VNXX traffic, Qwest would be able to bring a separate complaint before the Commission. Staff agrees with Qwest, noting that if there are other CLECs that attempt to provide VNXX services in a manner inconsistent with terms of the Initial Order, they risk facing a similar complaint from Qwest.[342]

*240* From a procedural perspective, Qwest notes that nothing in this proceeding prevented Level 3 or any other party from moving to join additional parties to this docket if they believed that another CLEC was using VNXX arrangements. Qwest argues that the fact that there may be some unknown or unnamed CLEC using VNXX now or in the future is not a valid basis to allow CLECs who are using VNXX to be freed from compliance with federal and state law.[343]

*241* We deny Level 3's petition for review on this issue and reject its contention that upholding the decisions in the Initial Order against the named complainants would

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[341] Level 3 Petition, ¶ 8.
[342] Staff Answer, ¶ 48.
[343] Qwest Response, ¶ 103.

somehow produce a discriminatory result. Qwest named nine CLECs that, based on information in its possession, were the entities most likely to be providing VNXX services in Washington. Qwest introduced direct evidence in the proceeding that showed specific traffic patterns that indicated a preponderance of one-sided flow of traffic over local interconnection facilities between itself and the CLECs named in the complaint. None of the named CLECs refuted Qwest's contention that it was actually providing VNXX services, nor alleged there were other CLECs offering such services that should be joined.

*242* Level 3's discrimination argument is a thinly veiled variant of its argument that VNXX classification and compensation should be addressed in a rulemaking of general applicability rather than in this complaint proceeding. Its discrimination argument meets the same fate as its rulemaking argument, and largely for the same reasons.[344]

## E. Qwest / Verizon Access Settlement Agreement and ICA Amendment

*243* Prior to the evidentiary hearing, Qwest and Verizon Access (Verizon) filed a settlement agreement under which Qwest would support dismissing Verizon from the complaint in return for Verizon agreeing to an amendment to the parties' existing interconnection agreement which, among other provisions, allows for the exchange of VNXX traffic under a bill and keep arrangement.[345] As the Initial Order describes, the proposed Qwest/Verizon Access ICA Amendment (ICA Amendment) allows for the exchange of VNXX voice and ISP-bound traffic between the two parties throughout Qwest's fourteen-state region. The ICA Amendment is only available for the entire fourteen-state region and not on a state-by-state basis because it contains a

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[344] *See, supra*, paragraphs 68-71.

[345] Request for approval of Third Amendment to Interconnection Agreement between Qwest Corporation and MCIMetro Access Transmissions Services for approval of fully negotiated interconnection agreement and First Amendment, filed in Docket UT-063055 on February 28, 2007. On March 7, 2007, Verizon Access and Qwest filed in Docket UT-063038, the complaint docket, a settlement agreement between the parties and motion to approve the agreement and dismiss Verizon Access from the complaint.

"unitary rate" applicable to the combined exchange of all local voice and local ISP-bound traffic across Qwest's fourteen-state region.[346]

*244* The Initial Order finds that the unitary rate was established for local voice and local ISP-bound traffic[347] using the applicable state-approved TELRIC end office and tandem rates for local voice traffic and the FCC's interim rate of $0.0007 for local ISP-bound traffic.[348] Because its terms state that the unitary rate does not apply to VNXX traffic and there are no other provisions for intercarrier compensation for VNXX, the settlement agreement effectively defaults to bill and keep for all VNXX traffic (both ISP-bound and voice).[349] For local and VNXX traffic traversing common local interconnection trunks (LIS trunks), the ICA amendment uses a Percent Compensable Minute Factor (PCMF) that effectively determines which traffic exchanged by the parties is subject to the unitary rate. The PCMF is calculated as the ratio of the quantity of local voice traffic and local ISP-bound traffic to the quantity of VNXX traffic plus local voice traffic and local ISP-bound traffic. The ICA Amendment allows for a review of the initial unitary rate and the PCMF after one year to address any material changes in the mix of local voice, ISP-bound, and VNXX traffic exchanged or for changes in the state-approved voice rate or FCC interim rate. Finally, the ICA Amendment contains a relative use factor (RUF) that allocates cost responsibility for any two-way LIS trunks carrying traffic between the carriers.

*245* Over Level 3's and WITA's objections, the Initial Order approved the settlement agreement and ICA Amendment, stating they are non-discriminatory and meet the Commission's standards when considering settlement agreements or reviewing negotiated interconnection agreements or amendments. [350] It noted, "The Commission may approve settlement agreements when doing so is lawful, the settlement terms are supported by an appropriate record, and when the result is

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[346] Initial Order, ¶ 108. Development of the unitary rate excluded consideration of traffic exchanged by the parties in the states of Colorado and Iowa because those states had already established a bill and keep compensation regime for all local and VNXX traffic.
[347] Local ISP-bound traffic means traffic exchanged within the same geographic local calling area.
[348] Initial Order, n.106.
[349] *Id.*, n.107.
[350] *Id.*, ¶ 115.

consistent with the public interest."[351] The Commission may reject an ICA amendment if it discriminates against a telecommunications carrier not a party to the agreement, or if it is not consistent with the public interest, convenience and necessity.[352]

*246* Both Level 3 and WITA seek review of the Initial Order's decision, albeit for different reasons.

*247* Although it is not entirely clear from its petition for review, Level 3 appears to claim that the unitary rate under the ICA Amendment is discriminatory because the mix of traffic that Verizon exchanges with Qwest in Washington has a much higher level of "compensable" usage than that Verizon exchanges with Qwest in other states.[353] Level 3 claims the terms of the amendment are discriminatory, noting that Verizon's network architecture is different than that of most CLECs and that the company has a relatively low percentage of VNXX traffic. Level 3 contends the end result is that under the amendment Verizon would be entitled to a relatively high percentage of compensatory traffic while other CLECs would not be able to obtain a similar result.[354] Accordingly, Level 3 objects to the conclusions of law in the Initial Order concerning the settlement and amendment.[355] Level 3 also objects in its statements of error to the following finding of fact of the Initial Order:[356]

> The terms of the settlement agreement and interconnection agreement amendment between Qwest and Verizon Access allow for the use of VNXX arrangements under a bill and keep compensation system and require Verizon Access to pay Qwest for transport of VNXX calls.[357]

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[351] *Id.*, ¶ 109, citing WAC 480-07-750(1).
[352] *Id*.
[353] Level 3 Petition, ¶ 68.
[354] *Id*.
[355] *Id.*, ¶ 15 (Contentions 8 and 9).
[356] *Id*.
[357] Initial Order, ¶ 151.

*248* Level 3 claims the finding "is based on assumptions that are unsupported by record evidence and should be struck from the *Initial Order*."[358] Level 3 does not discuss this asserted error further in its petition.

*249* Verizon requests we deny Level 3's petition. It asserts, consistent with the Initial Order, that applying the same formula for calculating a unitary compensation rate for each carrier is not discriminatory simply because the formula would yield different results for different carriers.[359] Similarly, Verizon argues that the fact that it has a different network architecture than other CLECs is not relevant, as competitive entry should encourage firms to invest in new systems and technology to meet differing customer needs.[360]

*250* Qwest also requests we reject Level 3's objections, asserting that Level 3 provides no substantive support for them.[361] Qwest points out that Level 3 cannot cite to evidence in the record that supports its arguments.[362] Qwest also asserts that all the other thirteen state commissions have approved the amendment, including Minnesota and Colorado where Level 3 also objected to the amendment.[363]

*251* WITA objects to the ICA Amendment simply because it reflects Qwest's concession to allow Verizon to exchange VNXX traffic contractually and thereby offer VNXX services. WITA contends that we should not approve the proposed amendment to the extent it allows the use of VNXX services for both ISP-bound and voice traffic.[364] WITA asserts that the validity of the amendment depends on how we resolve the issue of VNXX services in general.[365]

*252* Verizon argues that WITA does not provide a basis for rejecting the amendment under the applicable legal standard, because it does not demonstrate that the

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[358] Level 3 Petition, ¶ 15 (Contention 6).
[359] Verizon Access Answer at 2-3.
[360] *Id*. at 2.
[361] Qwest Answer, ¶ 13.
[362] *Id*.
[363] *Id*., ¶ 14.
[364] WITA Petition, ¶ 53.
[365] *Id*.

provisions allowing the exchange of voice traffic would discriminate against another carrier or otherwise be inconsistent with the public interest, convenience or necessity.[366]

*253* We uphold the Initial Order and find the settlement agreement and the ICA Amendment to be lawful. They do not violate legal standards for approval of negotiated agreements or state law, and are supported by evidence in the record.[367]

*254* Level 3 provides no substantive basis for the claim that the Initial Order's Finding of Fact No. 9 regarding bill and keep and compensation for transport is "unsupported by record evidence."[368] A party may not claim error without establishing a substantive basis for the objection. Level 3 has failed to do so on this issue, and its claim of error concerning this finding of fact is denied.

*255* The Initial Order correctly found the settlement in the public interest by reasonably resolving a dispute between two parties, an outcome supported and encouraged as an effective means to informally resolve disputes.[369] Further, we must approve negotiated interconnection agreements and amendments that are nondiscriminatory and in the public interest.[370]

*256* We conclude that the settlement reasonably resolves the dispute between Qwest and Verizon Access by offering a fair and practical treatment of VNXX traffic, as described in the Initial Order, and is consistent with our findings above concerning VNXX services.

*257* We also uphold the Initial Order's finding that the ICA Amendment's unitary rate formula is not discriminatory, even though it may result in a different actual rate for each CLEC. Specifically, Qwest and Verizon's use of a unitary rate formula, which includes a bill and keep component for VNXX traffic, does not preclude in any way

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[366] Verizon Access Answer at 3-4.
[367] *See* WAC 480-07-750(1). The record evidence includes the settlement agreement, narrative, amendment and testimony about the agreement.
[368] Citing Initial Order, ¶ 151; Level 3 Petition, ¶ 15 (Contention 6).
[369] *See* RCW 34.05.060; *see also* WAC 480-07-700.
[370] 47 U.S.C. §252 (e)(2).

calculation of a different unitary rate for another CLEC with different traffic patterns, or, simply, the use of bill and keep for VNXX purposes without a unitary rate. In other words, no discrimination occurs so long as the result of the calculation of a unitary rate for each carrier means that VNXX traffic is effectively rated on a bill and keep basis, local voice traffic is rated at state-approved rates, and "local" ISP-bound traffic is rated at the FCC interim ISP rate.

*258* Whether or not WITA believes that voice traffic should be exchanged through VNXX arrangements, WITA has not provided a compelling basis to reject the proposed amendment. As we found above, VNXX services are a form of intrastate interexchange service authorized under state law which compete directly with similar ILEC offerings including FX and MEL services. Effectively banning VNXX services by rejecting the ICA Amendment, as WITA requests, would clearly produce a discriminatory result.

*259* In sum, we find the ICA Amendment meets the standards for approval under the Act and we deny Level 3's and WITA's petitions for review on this issue.

### F. Broadwing's Counterclaims

*260* After Qwest filed its complaint, two of the named CLECs – Broadwing and Global Crossing – filed counterclaims alleging that Qwest had failed to compensate them for traffic exchanged under their interconnection agreements, and demanding that Qwest pay them reciprocal compensation, access charges, universal service and interest.[371] Qwest denies the claims, asserting that the CLECs seek compensation for VNXX ISP-bound traffic, and that such traffic is not compensable under the parties' agreements.

*261* Broadwing claims that Qwest owes it a total of $1,235,368.54 for exchanged traffic: $986,724 for locally-dialed or FX-like traffic (VNXX traffic), $318,000 for minutes that Qwest claims exceeded the growth cap established in the *ISP Remand Order*, and

[371] When Broadwing acquired Focal Communications, Broadwing adopted the interconnection agreement between Focal and Qwest, and all amendments to the agreement, including the amendment at issue in this proceeding. *See* Exh. No. 243.

$225,304.60 for intrastate access charges.[372] Global Crossing simply claims that Qwest owes it reciprocal compensation for traffic exchanged under their interconnection agreement.[373]

*262* The Initial Order determined that Broadwing and Global Crossing bore the burden of proof and failed to meet it for their claims of reciprocal compensation and compensation for growth cap minutes, finding that the CLECs did not show the traffic was truly local as defined by Qwest's geographic local calling areas.[374] The Order interpreted the *ISP Remand Order* to apply only to "geographically local ISP-bound calls in establishing the interim compensation regime and growth caps."[375] The Order further found that Broadwing's interconnection agreement with Qwest defined local calls "in terms of Qwest's geographic local calling areas, not in terms of Broadwing's local calling area."[376] The Order determined that geographically non-local calls should be subject to bill and keep, not reciprocal compensation, denying Broadwing's claims for reciprocal compensation and compensation for minutes that Qwest claims exceed the growth cap. The Initial Order also determined that Broadwing met its burden of proof on the issue of underpayment of access charges and directed Qwest to pay those amounts.[377]

*263* Broadwing and Level 3 seek review of the Initial Order's findings and conclusions in rejecting two of Broadwing's counterclaims. They claim the Initial Order failed to properly evaluate the terms of the parties' interconnection agreement and improperly applied a new rule retroactively. Global Crossing did not seek review.

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[372] Broadwing Initial Brief, ¶ 38.
[373] Peters, Exh. No. 441T at 3; Exh. No. 442C.
[374] Initial Order, ¶¶ 125, 128-29, 138.
[375] *Id.*, ¶¶ 125, 128.
[376] *Id.*, ¶ 129.
[377] *Id.*, ¶ 133.

**1. Should the Commission reverse the Initial Order's interpretation of the interconnection amendment negotiated between Broadwing and Qwest?**

*264* The Initial Order determined that "Broadwing has not shown that any of the local VNXX calls for which it is billing Qwest are local in the geographical sense of the word. Without such evidence, Broadwing's counterclaims are unsupported and must be denied."[378] In addition, the Order found that "Broadwing provided no evidence to distinguish between geographically local ISP-bound calls and VNXX calls."[379]

*265* Broadwing claims the Initial Order erred in addressing whether the traffic in question was "local," asserting that its agreement with Qwest does not use the term "local" or refer to the exchange of ISP-bound traffic as distinguishing between local or non-local traffic.[380] Broadwing asserts that an amendment to the parties' agreement negotiated after the *ISP Remand Order* allows the exchange of *all* ISP-bound traffic at the FCC's interim rate and does not limit compensation to traffic exchanged within a local calling area. Broadwing argues that the specific language of the amendment does not support the Initial Order's finding and requests that we reverse the Initial Order on this point and order Qwest to pay the contract rate for terminating ISP-bound traffic.[381]

*266* Broadwing claims the Initial Order erred in finding that it had failed to meet its burden of proof to show that the traffic in question was "local."[382] The company argues that such a conclusion is "nonsensical" under the parties' amendment, which governs what traffic is ISP-bound, including a presumption that traffic exceeding the 3:1 ratio is ISP-bound traffic.[383] It argues that Qwest did not submit any evidence to

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[378] *Id*., ¶ 128.
[379] *Id*., ¶ 125.
[380] Broadwing Petition, ¶¶ 14-27.
[381] *Id*., ¶ 13.
[382] Level 3 also claims the Initial Order erred in its conclusion that Broadwing and Global Crossing failed to meet their burden of proof. Level 3 Petition, ¶ 15 (Contention 10). Level 3 provides no support or argument for this contention.
[383] *Id*., ¶¶ 3-4, 11 (Contentions 1, 2, and 4), 23, 25.

counter this presumption.[384] Finally, Broadwing asserts that it was error to deny its claim for failing to provide information that was not previously required under the parties' agreement or Commission precedent.[385]

*267* Qwest responds that the parties negotiated the amendment to their agreement to implement the change of law provision by applying the terms of the *ISP Remand Order*, and that the "whereas" clauses at the beginning of the amendment establish this fact.[386] Qwest asserts that the meaning of ISP-bound traffic under the amendment has always been consistent with the definition in the *ISP Remand Order*, *i.e.,* ISP-bound traffic exchanged within a local calling area.[387] Qwest asserts that the Initial Order correctly interpreted the terms of the amendment in denying Broadwing's claims.[388]

*268* We uphold the Initial Order's decision to deny Broadwing's claim, but clarify and amplify the Order's rationale that Broadwing failed to meet its burden of proof to show that the traffic in question was local.

*269* The parties' interconnection agreement and amendment is a contract between the parties and the appropriate analysis derives from principles of contract law. The intent of the parties governs our review of the contract, and we must determine that intent from reading the contract as a whole, while not reading ambiguity into the contract.[389] While we must give words and provisions in contracts their ordinary meaning, they will be considered ambiguous if they are uncertain or capable of more than one meaning.[390] In determining the parties' intent, we must consider "the contract as a whole, its subject matter and objective, the circumstances of its making,

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[384] *Id*.
[385] *Id*., ¶ 44.
[386] Qwest Answer, ¶¶ 111, 114-15.
[387] *Id*., ¶ 114.
[388] *Id*., ¶¶ 106-24.
[389] *Davis v. State Dep't of Transportation,* 138 Wn. App; 811, 818, 159 P.3d 427 (2007) citing *Dice v. City of Montesano*, 131 Wn.App. 675, 683-84, 129 P.3d 1253, *review denied*, 158 Wn.2d 1017, 149 P.3d 377 (2006); *Mayer v. Pierce County Med. Bureau*, 80 Wn.App. 416, 420, 909 P.2d 1323 (1995).
[390] *Davis*, 138 Wn. App. at 818, citing *Corbray v. Stevenson*, 98 Wn.2d 410, 415, 656 P.2d 473 (1982).

the subsequent acts and conduct of the parties, and the reasonableness of the parties' intentions."[391]

*270* The negotiated amendment was entered as an exhibit and provides in relevant part:[392]

> WHEREAS, unless it is vacated or reversed on appeal the ISP Order constitutes a change of law that affects material terms of the Interconnection Agreement; and
>
> WHEREAS, Qwest has elected to adopt the *federal intercarrier compensation regime for ISP-Bound traffic*, and has offered to terminate *all Section 251(b)(5) and ISP-Bound traffic* in Washington with all carriers in Washington at the rates for ISP-Bound traffic described in the ISP Order; and
>
> WHEREAS, the Parties desire to amend the Interconnection Agreement to reflect the interim rates and structure *for ISP-Bound traffic described in the ISP Order*.
>
> …
>
> "ISP-Bound traffic" is all traffic transported by a carrier to the Receiving Party and then Delivered by the Receiving Party to an Internet service provider. …
>
> "Reciprocal Compensation" is the arrangement for recovering, in accordance with Section 251(b)(5) of the Act, the ISP Order and other applicable FCC orders and FCC Regulations costs incurred for the transportation and termination of telecommunications traffic originating on one Party's network and terminating on the other Party's network.
>
> "Switched Exchange Access Service" means the offering of switched access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services, as defined by law.
>
> The word "termination" as used in this Amendment includes delivery of Information Services Access Traffic to an Information Service Provider, including an Internet service provider.
>
> **2. Identification of ISP-bound traffic.** All traffic transported by a carrier to the Receiving Party and then delivered to customers of the

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[391] *Davis*, 138 Wn. App. at 818-19, citing *Berg v. Hudesman*, 115 Wn.2d 657, 667, 801 P.2d 222 (1990).

[392] Exh. No. 243 at 2-4. (Emphasis added).

> Receiving Party that exceeds a 3:1 ratio of terminating minutes to originating minutes is presumed to be ISP-bound traffic. …
>
> **5.2 (b)** Switched Exchange Access Service and InterLATA Toll Service shall continue to be governed by the terms and conditions of the applicable Tariffs ……
>
> **6. Subsequent Change of Law.** Pursuant to the change of law provisions of the Agreement, upon issuance of any FCC Order on Remand from the May 3, 2002 decision of the District of Columbia Circuit Court of Appeals, or other change in law, the parties shall utilize reasonable best efforts to effect any true up that may be required. …

*271* Consistent with its findings about how VNXX traffic should be classified and compensated, the Initial Order determined that Broadwing had not shown that the calls for which it seeks compensation were "local in the geographic sense of the word."[393] While the Initial Order is correct that the underlying interconnection agreement distinguishes between "local" and "toll" traffic,[394] we must also look to the language of the amendment, which governs ISP-bound traffic.

*272* Broadwing argues that the definition of ISP-bound traffic in the amendment applies to "*all* traffic transported by a carrier to the Receiving Party and then Delivered by the Receiving Party to an Internet service provider."[395] While it is true that the definition of "ISP-bound traffic" in the amendment does not use the words "as defined by the *ISP Remand Order,*" Qwest argues that "[i]n context, it is clear that the definition of ISP-Bound Traffic is limited to ISP traffic as defined by the *ISP Remand Order*, and not all traffic destined for an ISP."[396]

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[393] Initial Order, ¶ 125.
[394] *See* Exh. No. 242 at 7: " 'Traffic Type' is the characterization of intraLATA traffic as 'local' (local includes EAS [exchange access service]), or 'toll' which shall be the same as the characterization established by the effective tariffs of the incumbent local exchange carrier as of the date of this agreement."
[395] Broadwing Petition, ¶ 4, quoting Exh. No. 243 at 2. (Emphasis added).
[396] Qwest Answer, ¶ 116.

*273* In looking at the contract as a whole, we agree with Qwest and find that the parties' intent was to reflect the meaning of ISP-bound traffic under the *ISP Remand Order* and the interim rates that apply to such traffic.

*274* The "whereas" clauses of the amendment are not ambiguous about its purpose and intent. The purpose is to change the interconnection agreement to reflect the "change of law" brought about by the FCC's *ISP Remand Order,* which the amendment refers to as the "ISP Order." Qwest's intent is "to adopt the federal intercarrier compensation regime for ISP-Bound traffic … at the rates for ISP-bound traffic described in the ISP Order." The parties' shared intent is "to reflect the interim rates and structure for ISP-Bound traffic described in the ISP Order." While the definition of "ISP-bound traffic" in the amendment may be ambiguous by referring to "all" traffic, in context it is clear that the traffic in question is that subject to the *ISP Remand Order*.

*275* This interpretation of the amendment is confirmed by Broadwing's own witness, Mr. Meldazis, who during cross examination agreed with the statement that "there is, between the parties, an amendment that incorporates into the interconnection agreement the definition of ISP-bound traffic as contained in the ISP Remand Order …."[397]

*276* Having found that the parties intended to incorporate the *ISP Remand Order's* meaning of "ISP-bound traffic" in their amendment, we now come full circle to our previous discussion of the meaning of that term in the *ISP Remand Order*.[398] The ISP-bound traffic compensable under the amendment is geographically local traffic, not all ISP-bound traffic. As the Initial Order correctly found, Broadwing has failed to prove that the traffic for which it seeks compensation is in fact "local" and not VNXX (intrastate interexchange) or other traffic not falling within the *ISP Remand Order's* interim compensation regime.

*277* Thus, we uphold the Initial Order's denial of Broadwing's claim for compensation under the amendment for ISP-bound traffic, and deny Broadwing's petition for

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[397] *See* Meldazis, TR. 724:14-18.
[398] *See, supra*, paragraphs 37, 43, 50-51.

review. Our decision is without prejudice to a potential future claim for compensation by Broadwing should it be able to prove the traffic falls within compensable ISP-bound traffic as interpreted by this Order.

### 2. Did the Initial Order err by failing to consider the expiration of the growth cap restraints imposed in the *ISP Remand Order*?

*278* Broadwing argues that the Initial Order erred in addressing its claim that Qwest failed to pay amounts due for ISP-bound traffic that Qwest claims exceed the growth caps established in the *ISP Remand Order*.[399] Specifically, Broadwing states the Initial Order decided the claim incorrectly by relying on its decision on compensation for VNXX traffic and finding that Broadwing provided no evidence that distinguished between geographically local ISP-bound calls and VNXX calls.[400] Similar to its claim above for compensation for ISP-bound traffic, Broadwing argues that the amendment to the interconnection agreement governs the relationship between the two carriers, not the Initial Order's analysis of compensation for ISP-bound and VNXX traffic.

*279* Broadwing claims that the amendment set limits on the number of minutes of ISP-bound traffic for which a party may be compensated which expired December 31, 2003.[401] Thereafter, Broadwing claims that Qwest must compensate it for terminating ISP-bound traffic at the $.0007 per MOU rate under the amendment, as Qwest continued to send ISP-bound traffic to Broadwing.[402]

*280* Qwest argues that the growth caps in the amendment remain in place and continue to apply.[403] Qwest argues that the parties' amendment is consistent with the *ISP Remand Order*, which established the growth caps in question. Qwest argues that Broadwing provided no evidence to support its argument that the growth caps expired on December 31, 2003, noting that the *ISP Remand Order* and the amendment are

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[399] Broadwing Petition, ¶¶ 28, 32.
[400] *Id*.
[401] *Id*., ¶¶ 29-31, citing Exh. No. 243 at 3.
[402] *Id*., ¶ 31.
[403] Qwest Answer, ¶ 119, citing Qwest Initial Brief, ¶¶ 139, 142-43.

both silent as to how the growth cap provision applies after 2003.[404] Qwest further asserts that Broadwing's argument is contrary to the interpretation of the industry, and the effect of the FCC's October 8, 2004, *Core Forbearance Order,* in which the FCC chose not to enforce the growth cap provisions of the *ISP Remand Order*.[405] Specifically, if the growth caps expired on December 31, 2003, there would have been no reason for Core to have sought forbearance, and no need in October 2004 for the FCC to forbear from enforcing the growth cap provision of the *ISP Remand Order*.[406] Qwest also argues that the issue is moot because of the Initial Order's holding on compensation for VNXX traffic.[407]

*281* As with Broadwing's claim for compensation for ISP-bound traffic, the Initial Order denied Broadwing's claim for compensation based on expiration of the growth caps on the basis that the company did not meet its burden of proof to show that the traffic in question was geographically local. Our disposition of this issue is guided by our analysis of Broadwing's claim for compensation for ISP-bound traffic in general, and this claim meets the same fate.

*282* First, we agree with Qwest that given our rejection of any compensation for ISP-bound traffic absent proof that it is geographically local, a cap on such compensation is currently moot. Second, even if we were to entertain Broadwing's argument, it would fail because it is not consistent with the intent of the parties.

*283* As previously discussed, the interpretation of the interconnection agreement and its amendment is a question of contract law and the intent of the parties. As Qwest notes, the amendment is silent about how the growth caps apply after December 31, 2003. Section 4 of the amendment, which sets forth the growth cap requirements, provides:

> **4. Growth Ceiling.** A Party may be compensated for ISP-Bound traffic only up to the cap in minutes of use determined as follows:

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[404] Qwest Initial Brief, ¶ 142.
[405] *Id.*, ¶¶ 143-47.
[406] *Id.*, ¶ 146.
[407] Qwest Answer, ¶ 119.

A. For the year 2001:
(1) determine the number of terminating minutes in excess of three times the number of originating minutes exchanged between the Parties between January 1, 2001 and March 31, 2001 in Washington.
(2) multiply the result from (1) above by 4;
(3) multiply the result from (2) by 1.10.

B. For the period from January 1, 2002 through and including December 31, 2002, an amount equal to the ISP-Bound minutes for which the Party was entitled to compensation under that Agreement in 2001, multiplied by 1.10.

C. For the period from January 1, 2003 through and including December 31, 2003, and amount equal to the ceiling for 2002, set forth in B above.[408]

*284* There is no discussion in the amendment about how the growth caps are to apply after December 31, 2003. We cannot imply, as Broadwing does, that silence under the amendment means that no growth cap applied after that date and that the company is entitled to recover compensation for all ISP-bound traffic at the $.0007 MOU rate beginning on January 1, 2004. We again find that the parties intended to incorporate the applicable provisions of the *ISP Remand Order* to govern their agreement, including growth caps. Further, we find that growth caps did not end under the *ISP Remand Order* until the FCC reached its decision in the *Core Forbearance Order* that growth caps would no longer apply after October 8, 2004.

*285* We uphold the Initial Order's conclusion on this issue, albeit on different grounds. Broadwing's petition for review of this claim is denied.

### 3. Is altering the "negotiated" compensation regime for ISP-bound traffic in an interconnection agreement a retroactive application of a rule or law?

*286* The Initial Order concluded that bill and keep is the appropriate compensation system for VNXX traffic under the Broadwing / Qwest amendment.[409] Broadwing claims the

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[408] Exh. No. 243 at § 4.

Initial Order improperly applied a new compensation regime retroactively to the parties' amendment.[410] Broadwing claims that even if the Commission adopts the Initial Order's compensation proposal for VNXX traffic, the Commission should apply the compensation scheme prospectively, not retroactively.[411]

*287* Broadwing asserts that applying the new bill and keep requirement retroactively "violates principles of equity and fairness that prohibit retroactive application of a new standard through adjudication."[412] Broadwing claims that the parties have operated under this amended agreement since the Commission approved it in July 2002.[413] Broadwing asserts that the Initial Order reached conclusions fundamentally different than and contrary to the terms of the parties' amended agreement.[414] It asserts that the Initial Order's conclusions should not be applied retroactively, relying on a five-part test established by the federal circuit courts to determine if retroactive application of an adjudicative decision is appropriate.[415]

*288* Level 3 argues that the district court's directives on remand of Dockets UT-053036 and UT-053039 should not control this proceeding. Level 3 argues that this proceeding is forward-looking and the remand proceeding is retrospective.[416] Specifically, Level 3 asserts that the district court remand proceeding is backward-looking at the meaning of the parties' existing interconnection agreements.[417] It argues that the interpretation of its interconnection agreement is not at issue here, and

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[409] Initial Order, ¶¶ 125, 129.
[410] Broadwing Petition, ¶ 5.
[411] *Id*., ¶¶ 35, 43.
[412] *Id*., ¶¶ 33, 35.
[413] *Id*., ¶ 36.
[414] *Id*., ¶ 37.
[415] *Id*., ¶¶ 38-42, citing *Retail, Wholesale and Department Store Union v. NLRB*, 446 F.2d 380, 390 (D.C. Dir. 1972) [*Retail Union*] and *Montgomery Ward & Co. v. FTC*, 691 F.2d 1322, 1327, 1333 (9th Cir. 1982). The test requires a court to examine:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

[416] Level 3 Reply to Qwest, ¶ 2; *see also* ¶¶ 5-14.
[417] *Id*., ¶ 18.

that retroactively reinterpreting state law at the time the agreement was executed would violate principles of contract interpretation and administrative law.[418] Level 3 and Pac-West object to the Commission using this proceeding to resolve the issues resulting from the district court's remand decision.[419] Level 3 further argues that we should make no findings concerning Level 3's interconnection agreement in this Order that might have an effect on the retroactivity analysis in the remand proceeding.[420] Finally, Level 3 contests Staff's statement in its answer that the Initial Order "addresses the retrospective compensation question."[421] Rather, it argues that the Initial Order "sprung" the issue of retroactive application on all parties without justification and that we cannot apply the Initial Order's compensation plan retroactively to eliminate Broadwing's claims under its interconnection agreement with Qwest.[422]

*289* Qwest asserts there is no retroactivity issue because the Initial Order simply adjudicates the parties' rights under state law and the amended interconnection agreement; the decision is consistent with what the *ISP Remand Order* always meant, and is not a new retroactive interpretation.[423] Qwest argues that applying the decision prospectively would allow Broadwing to collect on invoices that Qwest has no legal obligation to pay and would be inconsistent with federal law.[424] Qwest asserts that even if Broadwing is correct that there is an issue of retroactivity, applying the five-part test would not support the result Broadwing requests.[425]

*290* First, with respect to Level 3's and Pac-West's argument that the remand proceeding is separate from this complaint proceeding and that our decision here should not resolve issues related to their interconnection agreements with Qwest, we agree to a point. There are common issues of law in the two proceedings and common parties. To that extent, we can assume that similar issues would be decided similarly, even if,

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[418] *Id*. at ¶¶ 18-19.
[419] *Id*., ¶¶ 22-29; Pac-West Reply, ¶¶ 27-29.
[420] Level 3 Reply to Qwest, ¶¶ 30-33.
[421] Level 3 Reply to Staff, ¶ 23, citing Staff Answer, ¶ 14.
[422] *Id*., ¶¶ 23- 25.
[423] Qwest Answer, ¶ 108.
[424] *Id*., ¶¶ 108, 120-22.
[425] *Id*., ¶¶ 123-24.

*arguendo,* the doctrine of collateral estoppel were found not to apply. Nonetheless, interconnection agreements are contracts, the interpretation of which depend on their terms and perhaps facts and circumstances if necessary to determine the parties' intent. Thus, we do not purport to determine here the applicability to Level 3 or Pac-West of our decision regarding Broadwing's interconnection agreement. That issue is reserved for the remand proceeding.

*291* Next, we agree with Qwest that the doctrine of retroactivity applicable to a new rule or judicial decision does not apply here. As discussed above, we are interpreting a contract that incorporates by reference the FCC's *ISP Remand Order*, which, to put it mildly, is itself subject to interpretation. This is quite different from retroactive application of a new rule. The five-part retroactivity test that Broadwing describes arose in cases where the National Labor Relations Board brought actions against companies to enforce its rules, modified the rules, and applied the revised rules retroactively in its enforcement decisions. The courts established the five-part rule to determine when it is appropriate to apply new or revised rules retroactively.

*292* In contrast, here Broadwing and Qwest specifically included a "change of law" provision in their contract and provided a process for "any true up that may be required."[426] Thus, the parties anticipated and provided for the circumstance we have here – a "subsequent change of law," such as our interpretation of the *ISP Remand Order* and its application to VNXX traffic, might require a "true up" of their intercarrier compensation.

*293* Our decision, informed by federal courts interpreting the *ISP Remand Order* and by terms of the parties' interconnection agreement as amended, may be a "change in law." It is certainly not retroactive, because the parties clearly anticipated just such a possibility and provided a means to address it in their contract.

*294* Further, and as previously noted, we do not decide here what, if any, compensation is due as between Qwest and Broadwing, but establish the classification and

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[426] *See* Exh. No. 243, § 6.

compensation methodology by which such a claim may be made. This is precisely the "true up" possibility anticipated by the interconnection agreement amendment.

*295* We deny Broadwing's petition for review on the issues of retroactivity.

## III. FINDINGS OF FACT

*296* Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary findings of fact, incorporating by reference pertinent portions of the preceding detailed findings:

*297* (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including telecommunications companies.

*298* (2) Qwest is engaged in the business of furnishing telecommunications services including, but not limited to, providing basic local exchange service to the public for compensation within the state of Washington.

*299* (3) The respondent competitive local exchange carriers, or CLECs – Level 3, Pac-West, Northwest, Broadwing, Global Crossing, TCG Seattle, ELI, ATI and Verizon Access – are local exchange carriers within the definition of 47 U.S.C. § 153(26), providing local exchange telecommunications service to the public for compensation within the state of Washington, or are classified as competitive telecommunications companies under RCW 80.36.310-.330.

*300* (4) The Washington Independent Telephone Association, or WITA, is a member organization of incumbent local exchange companies operating in Washington state who are carriers of last resort and are not classified as competitive telecommunications carriers by the Commission.

*301* (5) Qwest and Verizon Access filed a negotiated amendment to their interconnection agreement on February 28, 2007, in Docket UT-063055, in which they agreed, among other terms, to allow for the exchange of VNXX traffic under a bill and keep arrangement.

*302* (6) The nationwide telephone numbering system was designed so that the first six digits of each ten-digit telephone number enabled telephone companies to assign a physical location to a telephone customer's specific telephone number, and telephone companies continue to use this geographic indicator to identify and separate calls into local or interexchange calls for retail billing to end users or assessing charges to another carriers.

*303* (7) The NXX code identifies the central office and switch that an incumbent local exchange carrier will use to route a telephone call.

*304* (8) In Washington, call rating, *i.e.,* whether a call is local or long distance, and subject to toll charges, is based on Commission-established geographic areas or exchanges.

*305* (9) The geographic areas that distinguish between local and long distance calling in Qwest's service territory are defined in exchange maps in Qwest's Commission-approved tariffs.

*306* (10) CLECs and ILECs typically deploy different switch and transport network architectures.

*307* (11) The respondent CLECs have adopted Qwest's local calling areas in their interconnection agreements with Qwest.

*308* (12) VNXX traffic arrangements occur when a carrier assigns a telephone number from a rate center in a local calling area different from the one where the customer is physically located.

*309* (13) VNXX calls do not originate and terminate in the same local calling area.

*310* (14) Qwest, like many ILECs, offers foreign exchange, or FX, service under its tariff, in which it provides a customer outside of a local calling area a local telephone number so that person may call the number without incurring a toll call. The FX customer must purchase local exchange service in the foreign exchange and purchase a retail private line to transport the non-local calls to the FX customer's home or business.

*311* (15) The great majority of VNXX traffic is ISP-bound traffic, although some CLECs use VNXX arrangements for voice traffic in competition with ILEC FX or FX-like service offerings.

*312* (16) Qwest and CLECs use VNXX or FX arrangements to provide locally-dialed service to their customers, and although the services vary due to network configuration and compensation for the arrangements, VNXX and FX services have the same goal – to avoid access or toll charges.

*313* (17) Under a bill and keep compensation arrangement, neither of two interconnection carriers charges the other for terminating traffic that originates on the other network, but they may charge their end-users for the cost of the network and terminating traffic from the other carrier.

*314* (18) Bill and keep for VNXX traffic is a workable compensation methodology and it is reasonably possible to distinguish between VNXX traffic and truly local traffic.

*315* (19) Qwest and Broadwing's predecessor, Focal Communications, entered into an amendment to their interconnection agreement to incorporate into their agreement the intercarrier compensation provisions of the FCC's *ISP Remand Order*.

316 (20) There is a substantial imbalance in the exchange of traffic between the CLECs and Qwest that is attributable to VNXX ISP-bound traffic.

317 (21) ISP-bound traffic imbalance is due to many more calls terminating at the ISP than originating from the ISP and by the longer duration of ISP-bound calls than typical voice calls.

## IV. CONCLUSIONS OF LAW

318 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law incorporating by reference pertinent portions of the preceding detailed conclusions:

319 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, this proceeding. *RCW Title 80.*

320 (2) Qwest's complaint encompasses the appropriate classification and compensation for VNXX traffic and requests such other relief as the Commission finds appropriate.

321 (3) The Commission, at every stage of any proceeding, will disregard errors or defects in pleadings that do not affect the substantial rights of the parties. *WAC 480-07-395(4).*

322 (4) By fully litigating the issue of compensation for VNXX without objecting to the scope of the complaint, the CLECs rights were not substantially affected by any alleged defects in the complaint and any right to object to such alleged defects has been waived.

323 (5) The complaint statute, RCW 80.04.110, authorizes the Commission to establish uniform charges and order changes to company practices and services through adjudication, and to grant a remedy different than that requested in a complaint.

*324* (6) The classification and compensation of VNXX traffic may be established in an adjudicatory proceeding. *RCW 80.04.110.*

*325* (7) Parties are not entitled to reply to an answer to a petition for review of an initial order, but may petition for leave to reply to address new matters raised in the answer. *See WAC 480-07-825(5)(b).* The effect on this proceeding of the federal district court remand in Docket UT-053036 and UT-053039 is a new matter which the parties may address. New arguments in an answer to a petition for review are not necessarily new matters.

*326* (8) WITA does not have standing to raise arguments on behalf of rural ISPs. WITA may respond to policy arguments identified in the Initial Order, but may not raise issues for the first time on review.

*327* (9) VNXX traffic is lawful under applicable state law if appropriate compensation is paid for the exchange of such traffic between carriers. RCW 80.36.080, .140, .160, .170.

*328* (10) The *ISP Remand Order* addressed only ISP-bound calls from one LEC's end user customer to an ISP within the same local calling area that is served by a competing LEC, not all ISP-bound calls or VNXX traffic. See *Global NAPs I*, *Global NAPs II*, *Peevey*, *Qwest*.

*329* (11) Neither Pac-West nor Level 3 sought review of the district court's decision in *Qwest v. WUTC* and are collaterally estopped from re-litigating here issues that the court resolved concerning the *ISP Remand Order*.

*330* (12) State commissions have authority under federal law to define local calling areas and determine appropriate compensation for intrastate interexchange traffic. *See Global NAPs I*, 444 F.3d at 62-63, 73; *Global NAPs II,* 454 F.3d at 97; *Peevey*, 462 F.3d at 1146; *Qwest v. WUTC*, 484 F.Supp.2d at 1163, 1175-77.

*331* (13) The Commission is authorized "to prescribe exchange area boundaries and /or territorial boundaries for telecommunications companies," (RCW 80.36.230)

allowing the Commission to "define the geographical limits of a company's obligation to provide service on demand, and to delineate boundaries between local and long distance calling." *In re Electric Lightwave*, 123 Wn.2d at 537.

*332* (14) In Washington, telephone calls are classified as local or interexchange based on geographic calling areas, not on the basis of assigned telephone numbers. VNXX traffic does not originate and terminate within the same local calling area and is thus intrastate interexchange traffic subject to Commission determined compensation and not subject to section 251(b)(5) of the Act.

*333* (15) VNXX and FX traffic are both interexchange in nature, are functional equivalents, and should be treated similarly as exceptions to access charge compensation for interexchange traffic.

*334* (16) To allow FX traffic and prohibit VNXX traffic would be unlawfully discriminatory, anticompetitive, and unfair.

*335* (17) The FCC has identified regulatory arbitrage and traffic imbalances caused by CLEC reliance on ISP-bound traffic, which it has sought to address through interim compensation measures. The FCC has put CLECs on notice that bill and keep may ultimately be adopted for such traffic. *ISP Remand Order*, ¶¶ 77, 84.

*336* (18) Regulatory arbitrage is associated with VNXX ISP-bound traffic in Washington.

*337* (19) Bill and keep is a reasonable methodology to address intercarrier compensation for the exchange of VNXX traffic at fair, just and reasonable rates, provided that the CLEC bears the cost of transporting VNXX calls, except where it has built its own transport facilities, has procured alternative facilities from a third party, or uses special access services for transporting VNXX calls to and from a local calling area where it does not have switching services.

*338* (20) In a bill and keep compensation methodology the cost of exchanging traffic is not relevant because each carrier is responsible for recovering its own costs from its customers.

*339* (21) "Telecommunications traffic" under the Act excludes information access, and rules governing reciprocal compensation exclude interstate or intrastate exchange access, information access or exchange services for such access. *See* 47 U.S.C. § 3 (43); *see also* 47 C.F.R. §§ 51.701(b)(1).

*340* (22) FCC rules that prohibit applying charges for transport or termination of telecommunications traffic do not apply to VNXX traffic because it is intrastate interexchange traffic.

*341* (23) WITA's motion to require CLECs to pay for the costs of transporting VNXX calls from a rural LEC switch to the CLEC's point of interconnection is beyond the scope of Qwest's complaint and unsupported by evidence in the record.

*342* (24) Absent proof of harm to the public interest, CLEC voice VNXX service offerings that compete with similar ILEC FX offerings should be allowed in order to avoid the anticompetitive effects of discrimination between FX and VNXX services.

*343* (25) Compensation for FX services is not within the scope of this proceeding, and any different intercarrier compensation treatment between VNXX and FX services may be addressed in a separate proceeding.

*344* (26) Applying the Initial Order's compensation decision only to the respondent CLECs and not to all CLECs in Washington is not discriminatory, as the Commission may address disputes over other telecommunications carriers using VNXX services in a subsequent proceeding.

*345* (27) Under the Act, state commissions must approve negotiated interconnection agreements and amendments to those agreements if they do not discriminate

against a telecommunications carrier not a party to the agreement, and if the agreement is consistent with the public interest. *See* 47 U.S.C. § 252 (e)(2).

*346* (28) The Commission supports and encourages informal resolution of disputes through settlement agreements, and approves agreements if they are lawful, supported by evidence in the record, and in the public interest. *See* RCW 234.05.060, WAC 480-07-700, -750(1).

*347* (29) The settlement agreement between Qwest and Verizon Access is lawful, is supported by the evidence, does not discriminate against other telecommunications carriers, even though the unitary rate in the agreement may result in a different actual rate for another carrier, and is in the public interest by fairly resolving a dispute between the parties.

*348* (30) An interconnection agreement is a contract. The meaning of an interconnection agreement is governed by the intent of the parties as determined from reading the contract as a whole, the subject matter and objective of the contract, the circumstances of making the contract, the subsequent acts and conduct of the parties, and the reasonableness of the parties' intentions.

*349* (31) In the amendment to the interconnection agreement between Broadwing and Qwest, the parties intended to apply the terms of the *ISP Remand Order*, including the meaning of ISP-bound traffic, the interim rates that apply to such traffic, and the growth caps.

*350* (32) The compensation regime for VNXX traffic adopted in this Order applies prospectively to all respondent CLECs.

*351* (33) The retroactive effect of the compensation regime for VNXX traffic adopted in this Order depends on the terms of interconnections agreements. The interconnection agreements between Qwest and Level 3 and between Qwest and Pac-West are not part of this proceeding and the effect of this Order on those agreements remains to be determined.

352 (34) The compensation regime for VNXX traffic adopted in this Order applies to Broadwing, because its interconnection agreement includes a change of law provision and a provision to true up compensation. These provisions effectively provide for the retroactive application of regulatory and judicial decisions affecting compensation.

353 (35) The *Retail Union* retroactivity analysis applies to changes in rules and laws. It does not apply where a contract specifically provides for the application of a change in law to the terms of the contract.

## V. ORDER

**THE COMMISSION ORDERS:**

354 (1) Pac-West Telecomm, Inc.'s (Pac-West's) Motion for Leave to File a Reply to Qwest's Answer is granted in part, limiting the company's reply to the issue of the effect of the district court's remand order on this case.

355 (2) Level 3 Communications, LLC's (Level 3's), and Pac-West's requests for oral argument are denied.

356 (3) Level 3's, Pac-West's, Advanced Telecom, Inc.'s (ATI's), Electric Lightwave, Inc.'s (ELI's), and Global Crossing Local Services, Inc.'s (Global Crossing's) claims that the Initial Order exceeded the scope of Qwest's complaint and the Commission's authority by classifying and establishing compensation for VNXX traffic, are denied.

357 (4) Pac-West's and Global Crossing's claims that the Washington Independent Telephone Association (WITA) has no standing to seek review on its own behalf are denied. TCG Seattle's (TCG) claim that WITA has no standing to seek review on behalf of rural Internet Service Providers is granted.

358 (5) Commission Staff's requests to modify or clarify of the Initial Order are granted in part. The Initial Order is modified to reflect that Qwest's complaint

is granted in part, rather than dismissed; that VNXX traffic does not originate or terminate within a local calling area; and that VNXX traffic is interexchange in nature. Staff's request that this Order further establish the basis of the Commission's authority to classify and establish compensation for VNXX traffic is also granted.

*359* (6) Commission Staff's requests that the Initial Order be modified to remove statements regarding assumptions about cost data or the lack of evidence are denied.

*360* (7) WITA's claim that VNXX traffic is interexchange traffic is granted. WITA's claims that the Initial Order erred in finding that VNXX service is not *per se* unlawful, and in not requiring that VNXX traffic be subject to access charges, are denied.

*361* (8) Level 3's, Broadwing Communications, LLC's (Broadwing's), Pac-West's, and Global Crossing's claims that the Initial Order erred by not classifying VNXX traffic as traffic subject to section 251(b)(5) of the federal Telecommunications Act of 1996 are denied.

*362* (9) Level 3's and Pac-West's claims that the Initial Order incorrectly applied the district court's remand decision are denied. Their claims that this proceeding should not address how the district court's decision applies to their interconnection agreements are granted, in part.

*363* (10) Level 3's and Broadwing's claims that the Initial Order did not expressly identify or discuss the Commission's authority to establish local calling areas on a geographical basis are granted. Their claims that the Initial Order erred in defining local calls based on incumbent geographic local calling areas are denied.

*364* (11) Level 3's, Pac-West's, ATI's and ELI's claims that the Initial Order's decision concerning compensation for VNXX traffic is inconsistent with prior Commission decisions and FCC orders are denied.

*365* (12) Level 3's, Pac-West's, ATI's and ELI's claims that the Initial Order erred in not applying the FCC's interim rate of $.0007 per minute of use to VNXX ISP-bound traffic are denied.

*366* (13) Pac-West's claims that the Initial Order's compensation decision violates RCW 80.346.080, RCW 80.36.140, and RCW 80.36.160, and misinterprets other state decisions concerning VNXX traffic, are denied.

*367* (14) Pac-West's, Level 3's, ATI's, and ELI's claims that the Initial Order erred by not supporting its decision on substantial evidence are denied.

*368* (15) Level 3's claim that the Initial Order's transport compensation decision, *i.e.,* that CLECs should pay Qwest to transport VNXX ISP-bound calls to the CLECs' points of interconnection, violates FCC rules and Commission precedent, is denied.

*369* (16) Level 3's, Pac-West's, ELI's and ATI's claims that Initial Order's bill and keep and transport compensation decisions are unworkable are denied.

*370* (17) WITA's claim that the Initial Order's transport compensation decision should also apply to rural local exchange carriers is denied.

*371* (18) ATI's, ELI's and Level 3's requests to clarify the Initial Order's transport compensation requirement are granted, as follows: The Initial Order's transport compensation requirement does not apply when a CLEC establishes a "physical presence" in a local calling area through its own facilities, a collocation arrangement with Qwest, or through lease or purchase of transport facilities, such as special access facilities from Qwest or a third party.

*372* (19) Level 3's request to modify the Initial Order's compensation decision to allow terminating compensation if a CLEC establishes a "local presence" by procuring third-party transport facilities is denied.

*373* (20) WITA's claim that the Initial Order erred in allowing carriers to use VNXX services to provide voice service is denied.

*374* (21) Pac-West's claim that the Initial Order is discriminatory and anticompetitive by applying its compensation decision only to VNXX traffic, and not FX traffic, is denied.

*375* (22) Level 3's claim that the Initial Order is discriminatory as it does not apply to CLECs that provide FX services and that are not parties to the proceeding is denied.

*376* (23) Level 3's and WITA's claims that the Initial Order erred in adopting the Third Amendment to the Interconnection Agreement between Qwest Corporation (Qwest) and MCI Metro Access Transmission Services, LLC. d/b/a Verizon Access Transmission Services (Verizon Access) concerning a unitary rate for all traffic exchanged between the parties, and approving the Settlement Agreement between Qwest and Verizon Access, are denied.

*377* (24) The Third Amendment to the Interconnection Agreement between Qwest and Verizon Access filed in Docket UT-063055 on February 28, 2007, is approved.

*378* (25) The Settlement Agreement between Qwest and Verizon Access filed in Docket UT-063038 on March 6, 2007, is approved.

*379* (26) Broadwing's and Level 3's claims that the Initial Order erred in denying Broadwing's claims for compensation under its interconnection agreement are denied.

*380* (27) Broadwing's and Level 3's claims that the Initial Order erred by applying the decision retroactively to its interconnection agreement are denied.

381 (28) The Commission retains jurisdiction over the subject matter and parties to this proceeding to effectuate the provisions of this Order.

Dated at Olympia, Washington, and effective July ___, 2008.

WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

**NOTICE TO PARTIES:** This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.