

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

QWEST CORPORATION

Complainant,

v.

LEVEL 3 COMMUNICATIONS, LLC,
PAC-WEST TELECOMM, INC.,
NORTHWEST TELEPHONE, INC., TCG
SEATTLE, ELECTRIC LIGHTWAVE,
INC., ADVANCED TELECOM, INC. d/b/a
ESCHELON TELECOM, INC., FOCAL
COMMUNICATIONS CORPORATION,
GLOBAL CROSSING LOCAL SERVICES,
INC., and MCI WORLDCOM
COMMUNICATIONS, INC.

Respondents.

DOCKET NO. UT-063038

RESPONSE OF COMMISSION
STAFF TO QWEST AND
VERIZON'S PROPOSED PARTIAL
SETTLEMENT

1 Commission staff hereby responds to the joint motion of Qwest and Verizon Access to approve those parties' settlement agreement in this matter and to dismiss Qwest's complaint as to Verizon Access.

I. SUMMARY

2 The settlement proposal provides for the eventual filing of an amendment to Qwest and Verizon Access's Washington interconnection agreement. If that amendment is approved by the commission, any other competitive LEC would be entitled by 47 U.S.C. § 252(i) to opt into, and obtain the benefits of, the amended interconnection agreement. It appears that any competitive LEC opting into the agreement would be allowed to provide virtual NXX numbers to its Internet service provider customers to enable the ISP's

customers to connect to the ISP's Internet gateway in a distant local calling area by placing a locally-rated call. However, the agreement does not limit the use of VNXX to ISP-bound traffic, but expressly authorizes the use of virtual NXX arrangements for *any* customer who might want the ability to receive calls from (and perhaps to place calls to) a physically distant local calling area without incurring toll charges. Intrastate access charges would not apply to such traffic, but neither would Qwest pay terminating "reciprocal" compensation to the CLEC terminating the VNXX call, either at the *ISP Remand Order's* \$.0007/minute rate cap, or at any other rate. Neither carrier would compensate the other for terminating or originating such traffic. In other words, the carriers would exchange VNXX traffic under a "bill-and-keep" arrangement in which carriers would have to recover all of their costs from the carriers' own end users.

3 Staff believes it is premature to decide whether the proposed settlement is consistent with the public interest. It appears that Qwest is willing to forego the access charge revenues that it, along with staff, has argued should apply to all inter-local-calling area calls, including VNXX calls. Even assuming that this is an acceptable outcome because it is voluntarily entered into by Qwest, it is unclear what impact the settlement might have on rural local exchange carriers whose revenues might also be impacted. It is also unclear how Qwest will be able to maintain the advocacy position set out in its pre-filed testimony—that VNXX should be prohibited—when it is now apparent that it would agree to VNXX under a bill-and-keep arrangement for any carrier who might elect to opt-in.

4 Rather than simply accepting the settlement and dismissing Verizon Access from the proceeding at this time, the commission should instead treat the proposed settlement as Qwest's revised litigation position and proceed to hearing and briefing on that basis. To do

otherwise raises the possibility of an outcome that is inconsistent with the proposed settlement. If, for example, the commission were to decide, consistent with Qwest's pre-filed direct testimony, that VNXX should be prohibited for all purposes, or that VNXX should be prohibited for any purpose other than ISP-bound traffic (as staff intends to argue in its rebuttal testimony), that outcome would be inconsistent with the proposed settlement. Whatever the commission decides regarding the appropriateness of VNXX should apply to all carriers in this proceeding. The commission therefore should decline, at least until a full hearing in this case, to accept the settlement and to dismiss Verizon Access.

II. ANALYSIS

5 The question before the commission in this complaint proceeding is whether the commission should prohibit carriers from assigning their customers telephone numbers (NPA/NXXs) that are associated with local calling areas other than the one in which the customers' premises are physically located—a practice known as “virtual NXX” or “VNXX.”¹

6 The basic effect of the proposed settlement is to allow for the exchange of VNXX traffic between Verizon Access and Qwest at a compensation rate of zero—that is, subject to bill and keep.² The agreement would allow the parties to use VNXX arrangements for any purpose—not just for ISP-bound traffic.³

7 The settlement provides for amendment of the existing interconnection agreement between Qwest and Verizon Access. The amended interconnection agreement will need to be filed with the commission for approval pursuant to 47 U.S.C. § 252(e)(1). At that time,

¹ Complaint of Qwest Corporation for an Order Prohibiting VNXX at para. 43.

² Confidential Settlement Agreement and Release, Exhibit B-1 (ICA Amendment), Attachment 1, sections 2 and 3.

³ *Id.* at section 1, definition of “Virtual NXX Traffic.”

the commission may reject the agreement if it finds that it is discriminatory against a carrier who is not a party, or if implementation of the agreement is not consistent with the public interest.⁴ The issue before the Commission at this time is whether it is in the public interest to accept the settlement in resolution Qwest's complaint.

8 As stated above, staff believes that the settlement should not be accepted by the commission at this time, but instead should be considered as Qwest's revised litigation position and weighed against opposing positions at hearing. To assist the commission in understanding staff's position regarding the settlement, staff submits the following summary:

9 (1) It would be consistent with the public interest to authorize VNXX for ISP-bound traffic, as provided in the settlement.

10 (2) It would be consistent with the public interest to provide for the exchange of such traffic under a "bill-and-keep" arrangement, as provided in the settlement.

11 (3) It would *not* be consistent with the public interest to allow VNXX for services other dial-up Internet access, unless there is some further assurance that doing so will not open up too great an opportunity for toll bypass that might lead to higher local service rates for Washington consumers.

12 Staff's position in this case is that VNXX is inconsistent with the use of geographic local calling areas, the purpose of which is to differentiate local calls from toll calls on the basis of the physical location of the calling and called parties. Staff's view is that carriers should have obtained prior commission approval before assigning VNXX numbers to Internet service providers (and to other types of customers).

⁴ 47 U.S.C. § 252 (e)(2)(A).

13 Staff understands some of the CLECs to argue that VNXX is nothing more than “foreign exchange” (“FX”) service provided in the only manner that is possible or practical for CLECs, because CLECs typically have only one switch per LATA and not within every local calling area, as Qwest does. Because calls to the ILEC’s FX service subscribers are rated as local traffic, the CLECs argue that calls to their VNXX customers should be rated as local as well, and that Qwest should pay CLECs reciprocal compensation when a CLEC terminates a VNXX call that is originated by a Qwest customer. Both Staff and Qwest have argued that VNXX is not the same as FX and that VNXX raises implications regarding erosion of access charges that FX service provided by Qwest does not.

14 A second CLEC argument in this case is that the FCC’s *ISP Remand Order*⁵ gave LECs that serve ISPs the right to be compensated for all ISP-bound traffic terminated to that LEC, regardless of the location of the ISP’s server or modem bank, at the *ISP Remand Order*’s \$.0007/minute rate.

15 Courts have found that the *ISP Remand Order* was not sufficiently clear on this point to preempt state actions that either prohibit VNXX (ISP-bound or other) or allow ISP-bound VNXX subject to a form of compensation that better addresses the arbitrage problems that the FCC identified regarding ISP-bound traffic.⁶ (In a case currently pending in federal district court, Qwest contends that it was wrong, as a matter of law, for this commission to interpret the *ISP Remand Order* as extending its compensation scheme to any traffic other than “local” ISP-bound traffic.)

⁵ *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 F.C.C.R. 9151 (2001).

⁶ *Verizon California, Inc. v. Peevey*, 462 F.3d 1142 (9th Cir. June, 2006); *Global NAPs, Inc. v. Verizon New England, Inc.*, 444 F.3d 59 (1st Cir. April, 2006); *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91 (2nd Cir. July, 2006).

16 **Why allow VNXX for ISP-Bound traffic?**

17 It appears that a large portion of dial-up Internet traffic is now provisioned through the use of VNXX, and that customers likely would not pay toll rates for Internet service. As such, prohibiting VNXX or requiring CLECs to pay Qwest originating access charges likely would have very serious consequences for the CLECs, their ISP customers, and the ISP's end user customers (that is, people who use AOL or other dial-up Internet access services).

18 Given this fact, and the confusion surrounding the FCC's intent in its *ISP Remand Order*, staff believes it would be consistent with public interest for the commission to allow the use of virtual NPA/NXXs for the limited purpose of dial-up ISP-bound traffic at a reciprocal compensation rate of zero (i.e., bill-and-keep) until the FCC addresses the matter in its inter-carrier compensation proceeding.⁷

19 In his pre-filed testimony in this case, Dr. Blackmon argues (on behalf of Level 3) that allowing VNXX for ISP-bound traffic is not a threat to the intrastate access charge system.⁸ (Dr. Blackmon explains that under the access charge regime, LECs have historically charged "substantially more than the economic cost of originating and terminating long distance calls, thereby allowing local rates to be lower than they otherwise would be at any given level of overall telephone company revenue.") According to Dr.

Blackmon:

That regime was developed before there was any Internet-bound traffic or indeed any Internet. The fact that the Commission historically supported a policy of charging more for interexchange voice calls than for local voice calls says little or nothing about what the appropriate charge is for data calls to the Internet. Incumbent local exchange companies have not relied on large

⁷ See *Developing A Unified Intercarrier Compensation Regime*, Further Notice of Proposed Rulemaking, 20 FCC Rcd 4685 (2005).

⁸ Direct Testimony of Glenn Blackmon, Ph.D., Exhibit ____ (GB-1T), Docket No. UT-063038 (filed Feb. 2, 2007).

access revenue streams for Internet-bound calls to keep local service affordable, because Internet-bound calls did not exist until recently.⁹

Dr. Blackmon's analysis may be another reason for allowing VNXX arrangements for the limited purpose of ISP-bound calls.

20 **Why apply "bill-and-keep" to ISP-bound VNXX calls?**

21 In the ISP Remand Order, the FCC was particularly concerned with problems that had arisen due to reciprocal compensation payments ordered by state utility commissions under the *ISP Declaratory Ruling*. The FCC found that ISP dial-up access distorted the market and "created the opportunity to serve customers with large volumes of *incoming* traffic."¹⁰ The record before the FCC at that time showed that CLECs terminated 18 times more calls than they originated, leading to the receipt of net reciprocal compensation payments amounting to nearly \$2 billion annually at the time of the Order.¹¹ The FCC therefore found that because of this type of regulatory arbitrage, reciprocal compensation had "undermine[d] the operation of competitive markets."¹² The FCC believed that a "bill-and-keep" regime under which each carrier collected its own costs from its own customers and not another carrier, would be a viable compensation approach to dial-up ISP-bound traffic.¹³ The FCC decided not to employ a "flash cut" (that is, an immediate transition) to bill-and-keep however. Instead it adopted a transition period to avoid rate shock and upsetting "the legitimate business expectations of carriers and their customers."¹⁴

22 It is important to recognize that, at the time of the ISP Remand Order, the FCC's understanding was that "ISP end-user customers typically access the Internet through an

⁹ *Id.* at p. 16.

¹⁰ *ISP Remand Order* at para. 69 (emphasis in original).

¹¹ *Id.* at para. 70.

¹² *Id.* at para. 71.

¹³ *ISP Remand Order* para. 74.

¹⁴ *Id.* at para. 77.

ISP server located in the same local calling area.”¹⁵ Prior to the ISP Remand order, CLECs put modem banks in each local calling area to enable dial-up data users to place local (toll free) calls to their ISPs. One of the CLEC’s arguments is that the FCC’s decision in the *ISP Remand Order* eliminated the need to locate modems in each local calling area, thereby allowing CLECs to centrally locate a single modem bank (or server) in the same location as their switch. The CLECs assert that, as a result of the *Order*, they were allowed to transport ISP-bound calls of over local trunks while still receiving compensation from the ILECs at the FCC’s new rate caps, even when such calls would previously have been toll calls.

23 Thus, the CLEC’s theory appears to be that while the FCC took action to gradually reduce to zero the reciprocal compensation that the CLECs were receiving for local ISP bound traffic, the FCC simultaneously opened a new way for CLECs to provide dial-up ISP access at significantly lower costs while still receiving reciprocal compensation. If that theory is correct, then there is no reason why the bill-and-keep regime, which the FCC said it preferred, should not immediately apply to this new, less costly means of providing dial-up ISP service.

24 **Why should the commission prohibit VNXX for purposes other than dial-up
ISP service?**

25 In staff’s view, if VNXX is allowed for ISP-bound traffic, it should not be allowed for other types of traffic. Although the traffic in this case appears to largely be ISP-bound, there also appear to be many questionable uses for VNXX numbers. The commission acknowledged this in the Qwest/AT&T Arbitration in Docket UT-033035. In that arbitration, AT&T proposed to define “Exchange Service” or “Extended Area Service (EAS)/Local Traffic” as “traffic that is originated and terminated within the same local

¹⁵ Id. at para. 10.

calling area as determined by the calling and called NPA/NXXs.” Qwest then advocated, as it has in this proceeding, that the physical location of the originating and terminating callers must be in the same local calling area for the call to be Exchange Service or EAS/Local Traffic. In other words, AT&T argued for a definition of local traffic that would include VNXX, while Qwest argued for a definition that would preclude VNXX. The arbitrator decided in favor of Qwest’s definition and the commission affirmed. The commission stated that it agreed with the arbitrator’s conclusion that “AT&T’s alternative simply goes too far—is too sweeping in its implications—to be adopted on the record in this proceeding.” The commission quoted, with favor, the arbitrator’s analysis that AT&T’s proposed definition

implicates not only the specific services about which AT&T professes to be concerned [i.e., services functionally equivalent to Qwest’s FX service and local-number-presence service for ISP bound traffic], it also implicates other potential services that it would be better to consider on a case-by-case basis as one carrier or another seeks to implement new services.¹⁶

Staff believes that the broad definition of VNXX in the proposed settlement raises the same problems the commission identified in the AT&T arbitration.

26 For example, in Dr. Blackmon’s testimony he mentions “international callback” and destination numbers for fax-to-e-mail (eFax) as two examples of services that that may be using VNXX. Such services are not covered by any FCC ruling such as the *ISP Remand Order*.

27 The New Hampshire PUC has been studying VNXX issues since October of 2000. It has made a number of rulings in the matter and in its latest investigation¹⁷ its staff found areas of concern:

¹⁶ Order No. 05, paragraph 15, Docket UT-033035.

¹⁷ State of New Hampshire, Inter-Department Communication, Investigation Into Whether Certain Calls Are

Some CLECs are assigning out-of-state customers telephone numbers associated with a New Hampshire exchange in which neither the CLEC nor its customers have a physical presence. Calls to the number are delivered to the CLEC's point of interconnection, in an exchange in which the customer again has no physical presence.

Some CLECs are providing out-of-state companies with telephone numbers which the company assigns to end users, very similar to the eFax situation. In Order No. 23,454 the Commission denied future numbering requests for the purpose of providing eFax and other email delivery services.

Some CLECs are assigning toll provider customers with telephone numbers that allow end users to make prepaid toll calls. Neither the toll provider nor the CLEC have a physical presence in most exchanges associated with the telephone numbers. The end user is directed to call one of the numbers locally, enter an identification code, and then is able to make long distance calls over the network of the toll provider. Staff believes this is prohibited by the FCC and by previous orders of the Commission.

Beyond the use of VNXX for ISP access, the New Hampshire staff discovered that at least one CLEC is using VNXX numbers for toll bypass, both through prepaid calling cards that it issues and for interexchange carriers. The staff also found that, out of a total of 66 customers that one CLEC reported having in the state of New Hampshire, 26 were actually located in other states, primarily California and Florida. None were New Hampshire-based companies.

28 The New Hampshire report continues: "Staff is also concerned about the use of numbers as a substitute for 800- service. 800- service allows a carrier to pay for the cost of carrying a call, so the end user does not have to pay toll charges. ... it appears that at least some of Level 3's customers are using VNXX as an interstate CLEC FX service, which the Commission did not consider as an acceptable use of VNXX."

29 There is no reason to believe that that the situation in Washington is different than New Hampshire. Given the wide range and the questionable nature of some of the uses of telephone numbers in other states such as New Hampshire, staff believes that VNXX should

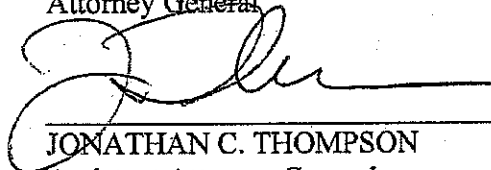
Local, Staff Investigation into Number Usage, DT-00-223, November 9, 2006.

be limited to dial-up ISP-bound traffic, at least until carriers obtain carrier's obtain approval for proposed services utilizing VNXX on a case-by-case basis.

DATED this 19th day of March, 2006.

Respectfully submitted,

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