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
Request for Approval of Amendment to the Interconnection Agreement between QWEST CORPORATION and MCIMETRO ACCESS TRANSMISSION SERVICES LLC.	DOCKET NO. UT-063055 (Consolidated)

OPENING BRIEF OF COMMISSION STAFF

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I. INTRODUCTION

1 The "public-switched telephone network" (PSTN) is made up of hub-and-spoke local "exchanges" in each community. The "hub" is the local central office switch and the "spokes" are the copper loops (pairs of wires) that extend out to customers' homes and businesses in the surrounding area. These exchanges, in turn, are connected by "interexchange" facilities that allow calls to be made between customers in different exchanges. This architecture has been in existence for many years and is one of the reasons that telephone service continues to be offered in the distinct categories of "local" (also called "telephone exchange service") and "long distance" (also known as "interexchange" or "telephone toll service").

2 There are two common forms of compensation that telecommunications carriers pay each another when connecting calls between each other's customers—access charges and reciprocal compensation. The form of compensation that applies depends on whether the call is local or interexchange. Access charges apply among carriers for the connection of interexchange calls. Access charges compensate local exchange carriers for the cost of completing calls and also serve as a means of subsidizing "universal service"—that is, to provide LECs with additional revenue that helps keep local service rates low, particularly in high-cost rural areas. *See* Section IV.B.

3 The public switched telephone network has long been used not only for voice communication, but also as a means for consumers to access information or computer data services at distant locations. The FCC afforded the providers of such services, "enhanced service providers," an exemption from access charges. (Examples of enhanced or information services include Lexis/Nexis, services for bank card-swipe machines, voice mail

service, and dial-up Internet access provided by Internet service providers (ISPs) like Earthlink and AOL.) The "ESP exemption" requires the ESP to purchase local business lines in each local calling area where it seeks to receive "local" calls and then to bear the cost of transporting the call over private lines to its distant computer facilities. *Id.*

4 The 1996 Federal Telecommunications Act preserved the preexisting categories of enhanced services (called "information services"), exchange service, interexchange service, access charges (which interexchange carriers pay local exchange carriers for "exchange access service"), and reciprocal compensation.[1] Prior to the Act, competition already existed in the market for interexchange (long distance) services. The object of the Act was to facilitate competition into the market for *local* exchange service.

5 In order to reduce the cost of entering the market for local telephone service in competition with incumbent local exchange carriers like Qwest, competitive local exchange carriers are allowed to use a single switch to serve an area (usually a "LATA") that includes many incumbent LEC exchanges (or local calling areas) and perhaps 50 ILEC switches. The trade-off for the much smaller investment in switch costs, is that the CLEC must bear additional costs for private line transport of local traffic over longer distances to and from the CLECs' customers in local calling areas many miles from their switch. Paying more for transport but saving money on switching still represents a less expensive way of entering the local exchange market than building a switch in each exchange. *See* Section IV.A.

6 One consequence of allowing CLECs to provide local service in many local calling areas using only a single switch is as follows. When a Qwest customer calls a CLEC customer, Qwest is obligated to transport that call across exchange boundaries within the

[1] 47 U.S.C. § 251(a)(5), (g); Local Competition Provisions in the Telecommunications Act of 1996, ¶¶ 1033-35, 11 F.C.C.R. 15499, 16012-14, 1996 WL 452885 (1996).

"LATA" (*e.g.*, the Western Washington LATA which comprises many exchanges or local calling areas) to a single point of interconnection with the CLEC. Because it is assumed that the CLEC actually provides local exchange service to customers located in the local calling area from which the ILEC is transporting the call (otherwise, the call would not be "local"), it is also assumed that the CLEC bears a symmetrical burden to transport the call from its switch back to its customer in the same local calling area over facilities it leases or owns. Similarly, when the CLEC's customer calls a Qwest customer, the CLEC must haul the call from its customer's location to the same single point of interconnection to hand the call off to Qwest for completion. *Id.*

7 Shortly after the Act, CLECs began to target dial-up ISPs as customers. Having ISPs as customers allowed CLECs to reap what the FCC deemed a "windfall" in reciprocal compensation payments (paid on a minute-of-use basis) from the ILECs. The reason for this was that the incumbent LECs continued to serve virtually all of the residential and small business customers who made lengthy calls to the ISP's modems (which, in turn, connected to the Internet), while the CLEC's ISP customer never originated calls from its modem to the ILEC's customers. The FCC eventually concluded that this was an undesirable form of regulatory arbitrage. *See* Section II.D.2(a).

8 In its *ISP Remand Order*, the FCC embarked on a plan to eliminate, over time, the reciprocal compensation that CLECs were receiving by serving ISPs, and the economic distortions that resulted. *Id.*

9 In its analysis of the ISP arbitrage problem, the FCC assumed that CLECs were locating modems within each caller's local calling area—consistent with the ESP access charge exemption. The FCC did not even consider that CLECs might be able to continue to

receive reciprocal compensation from ILECs without even having to incur the expense of locating modems or servers in each local calling area. *Id.*; Section II.D.3.

10 In this and other dockets, CLECs assert a right to do just that. The CLECs assert a right to serve ISP customers using a practice called "virtual NXX" or "VNXX" that disregards local calling area boundaries and the distinction between local and interexchange telecommunications service. The use of VNXX disguises calls that would otherwise be rated and routed as an interexchange calls and instead causes them to be treated as if they were local calls (on which no access charges are collected). CLECs achieve a significant cost savings through the use of VNXX because it allows them to locate a single server or modem at the same location as their single switch instead of in every local calling area throughout the LATA. Despite this savings, and the arguable violation of the ILEC's access tariffs and interconnection agreements, the CLECs nonetheless assert a right to continue to receive terminating reciprocal compensation from the ILEC (at the *ISP Remand Order's* $0.0007 per minute rate), as if the calls were really local. *See* Section IV.A.

11 The CLECs assert four main arguments as to why this practice should be allowed and why Qwest should pay them terminating compensation at the *ISP Remand Order's* $0.0007 per minute rate:

12 **1) The CLECs assert that the *ISP Remand Order* requires that all ISP-bound traffic be treated alike for intercarrier compensation purposes—in other words, that local and interexchange distinctions are irrelevant where ISP-bound traffic is concerned.**

13 The Commission previously agreed with this interpretation of the *ISP Remand Order* in an arbitration between Level 3 and Century Tel, and in the complaints brought against

Qwest by Level 3 and Pac-West in dockets UT-053036 and UT-053039. The interpretation was recently rejected, however, by the U.S. District Court for the Western District of Washington. The district court followed the finding of the Ninth Circuit in *Verizon California, Inc. v. Peevey*, 462 F.3d 1142, 1159 (9th Cir. June, 2006) that the *ISP Remand Order* "had no effect on" the collection of charges by ILECs for originating interexchange ISP-bound traffic . . .[a]s this issue was not before the FCC when it crafted the *ISP Remand Order*." No party appealed the district court's judgment. Consequently, the CLECs can no longer rely on this argument. *See* Section II.D.3.

14 **2) The CLECs assert that what constitutes "local" traffic depends only on the NPA/NXXs of the calling and called parties and not on their physical location with respect to a geographic local calling area. As support for this, the CLECs point to the "foreign exchange" service long offered by incumbents like Qwest.**

15 This argument, too, must fail. This Commission already rejected this argument in an arbitration between AT&T and Qwest, where AT&T sought to include just such definition of "local" in its interconnection agreement with Qwest but the Commission, as arbitrator, instead adopted Qwest's definition which defined "local" calls based on the location of the calling and called parties. *See* Section II.C.

16 Foreign exchange service is different, from an engineering and cost-recovery standpoint, from VNXX. In order to obtain local service in a distant local calling area, a foreign exchange service subscriber must pay for a private line from the serving "foreign" exchange to its location in another local calling area and must also pay for local service in the foreign exchange, or local calling area, where it wishes to receive service. That is not the case with a VNXX customer. When a CLEC serves a customer using a VNXX

arrangement, *Qwest* (rather than CLEC or its customer) is forced to provide the transport from the local exchange to the customer's distant location without compensation, *and* the VNXX customer does not have to pay for local service in the local exchange (or exchanges) in which it enjoys "local" calling. *See* Sections III.A and IV.A.

17 **3) The CLECs argue that it would be discriminatory for the commission to prohibit VNXX arrangements because VNXX is the only way for CLECs to compete with Qwest in the market for foreign exchange service.** The CLECs assert that they lack the ability to provide foreign exchange service the way Qwest does (by providing the customer a private line from the switch in the local exchange, or local calling area, where the customer wishes to make and receive local calls), because the CLECs lack broadly deployed switches in each local calling area. *Id.*

18 First, it is incorrect that VNXX is the only way for CLECs to provide a true foreign exchange service in the manner described in Qwest's tariffs. A CLEC that has invested in physical plant in the local calling areas to provide a true local service can then offer foreign exchange service at little additional cost. The CLECs would not have to build a full switch in each local calling area to provide foreign exchange service. As Staff witness Mr. Williamson pointed out, a CLEC could locate a channel bank or a subscriber carrier facility (through which it remotes a piece of its existing switch) in the local exchange (local calling area) from which it wishes to offer local service. The carrier could then provide foreign exchange service from that equipment (in essence a "remote" piece of their existing switch). *See* Section III.A.

19 Second, allowing VNXX for ordinary voice services would erode access charge revenues and undermine universal service policies. While it is possible to justify VNXX for

ISP-Bound traffic on the basis that dial-up Internet traffic did not exist at the time access charges were devised, that argument does not work for ordinary voice calls. For example, it appears that Global Crossing is offering LATA-wide "local calling" to business customer in the Seattle local calling area where its switch is located. Both originating and terminated access charges are avoided on such traffic (voice traffic, unlike ISP-bound traffic is two-way). Although Qwest may be willing to forgo access charges on such calls (as would be the case under its proposed settlement with Verizon Access), the companies who benefit from Washington's "Traditional Universal Service Fund" are not. *See* Section IV.B, D.

20 **4) Finally, in support of allowing VNXX for ISP-bound traffic, the CLECs assert that it is more efficient to place a single server or modem bank next to the CLEC's switch instead of in every local calling area.** And, they argue, because of Qwest's obligation to transport calls to the single point of interconnection, it does not impose any greater costs on Qwest if the CLEC simply locates a centralized server or modem bank next to the CLEC's switch than if it hauls the calls back to modems located in the appropriate local calling areas. *See* Section IV.

21 This efficiency argument has some merit. From an engineering standpoint, it makes sense to aggregate ISP-bound calls at fewer locations. And it is true that Qwest's costs are the same whether the CLEC terminates the call at a server located next to its switch, or instead hauls the call back to a similar Internet gateway located in the local calling area where the call originated. However, this argument still does not address the fact that calls between local calling areas are, by definition, interexchange. VNXX is an expedient that disregards the way the ESP access charge exemption has worked for many years (i.e., the ISP purchases local service *in each local calling area*). Moreover, VNXX arrangements

require Qwest to bear transport costs that are justifiable when the CLEC is actually serving a customer located in the distant local calling area—but cannot be justified in the specific context of VNXX. The rationale for requiring Qwest to transport calls to a single point of interconnection is that the CLEC is assumed to be bearing a symmetrical burden of hauling the call back to the same local calling area. That assumption is not correct in the case of VNXX (arguably, a CLEC providing VNXX service isn't even providing *local* telecommunications service as envisioned by the Act). *See* Section IV.A.

22 Moreover, requiring Qwest to pay reciprocal compensation on ISP-bound VNXX calls perpetuates the arbitrage the FCC identified in its ISP Remand Order (but declined to eliminate through an immediate "flash cut" to bill-and-keep) despite the fact that the CLEC saves money by having only a single server or modem bank in the LATA. *See* Section II.D.2(a).

23 In short, while it may not make sense to require CLECs to locate servers or modem banks in every exchange, it is neither equitable nor good policy to allow CLECs to enjoy the efficiencies and cost savings of VNXX for ISP-bound traffic (which are only possible due to the ubiquity of Qwest's hub and spoke facilities and Qwest's obligation to carry calls to a single point of interconnection with the CLEC) *and* to allow the CLECs to continue to demand reciprocal compensation from Qwest. *See* Section IV.A.

24 As an interim solution pending the FCC's ongoing rulemaking on intercarrier compensation, Staff recommends that the Commission allow the respondent CLECs and Qwest to enter into bill-and-keep arrangements for the exchange of ISP-bound VNXX calls as Qwest has done with Verizon Access and AT&T. The proposed settlement agreement between Qwest and Verizon Access should therefore be approved, but only to the extent that

it allows the use of VNXX arrangement for ISP-bound traffic. The Commission should expressly prohibit VNXX for purposes other than terminating ISP-bound traffic. *See* Section V.

II. "VNXX" LEGAL ISSUES.

A. COCAG and Other Industry Guidelines.

1. Extent to which guidelines are binding on the Commission.

25 State commissions have authority to define local calling areas and to thereby define what constitutes a "local" call, to which reciprocal compensation applies, and a "toll" call, to which access charges apply. *Global NAPs, Inc. v. Verizon New England, Inc.*, 444 F.3d 59, 63 (1st Cir. 2006) ("*Global NAPs I*").

26 The switching centers (also called "exchanges"), and later local calling areas, were and continue to be geographic areas. The location of the calling and called party is what differentiates "free" local area calls from long distance calls. Williamson, Exh. No. 201T, 2:17-20. As the First Circuit recently explained, "[l]ocal traffic stays within the boundaries of a local calling area. Interexchange (or 'non-local') traffic crosses the boundaries of a local calling area and is generally subject to toll or long-distance charges paid by the calling party." *Global NAPs I.*, 444 F.3d at 62-63.

27 Whether the parties to the call are located in the same or different calling areas is also the basis for determining whether reciprocal compensation applies (between local exchange carriers handing of a local call) or whether access charges apply among the interexchange carrier and local exchange carriers cooperating to complete the call. *See* Sections II.B and IV.B.

28 The standard practice in the telephone industry (endorsed by state and federal regulators on public policy grounds) has been that customers are allowed to make local calls—calls within a local calling area—for a flat monthly rate with no limit on the number of calls. Long distance calls, on the other hand, are priced on a per-minute of use basis. Carriers that provide long distance service—interexchange carriers—pay access charges to local exchange carriers for the right to "access" the local networks (*i.e.*, to the local switching and loop facilities that are the most costly part of the local telephone network). Williamson, Exh. No. 201T, 3:1-8.

29 It is permissible under federal law for a state to define "local" calls based not on the geographic location of the calling and called party, but solely on the NPA/NXX (area code and prefix) assigned to the parties, and without regard to their actual physical location. *Verizon California, Inc. v. Peevey*, 462 F.3d 1142, 1156 (9th Cir. June, 2006). However, allowing carriers to assign their customers telephone numbers without regard to the customer's geographic location would represent a departure from industry practice—albeit a departure that is not precluded by federal law.

30 The "default" practice for the assignment of NXXs is reflected in the "Central Office Code [NXX] Assignment Guidelines" (COCAG) published by the Alliance for Telecommunications Industry Solutions. (Discussed in detail in the next section, II.A.2, below.) This commission, however, has not made that departure from the prevailing national practice.

31 The COCAG is relevant to the matters raised in Qwest's complaint because it describes the industry consensus and the regulatory status quo in the absence of any contrary policy announced by an appropriate regulatory authority. The portion of the COCAG that is

relevant to this proceeding is important not because it binds this Commission to any result, but because it defines the commonly understood practice and standard within the industry, within state and federal regulatory requirements.

2. Industry guidelines and geographic issues in connection with numbers and number assignments.

32 In order for calls to be properly rated and routed by phone company equipment, customers have long been assigned telephone numbers that include an NPA-NXX (area code and prefix) that is unique to the exchange or local calling in which they are served. Williamson, Exh. No. 201T, 2:12-14.

33 Wireline telephone numbers are generally assigned geographically, based on the physical location of the subscriber's premises. Telephone numbers have been assigned this way since the beginning of dialable telephony. *Id.*

34 Telephone numbering plans for public telephone networks worldwide conform to standards established by the International Telecommunications Union (ITU).[2] Under the ITU standards, the world is divided into nine geographic World Zones, numbered one through nine. World Zone 1 has been assigned country code "1", which is shared by 18 countries in North America. *Id.*, 3:15-19.

35 Within World Zone 1, national numbers are formatted according to the North American Numbering Plan. The format for all international numbers (including those in World Zone 1) is defined by the ITU in section E.164 of its standards (a 16-digit numbering scheme that provides a unique telephone number for every subscriber in the world). In 1995, the FCC created the North American Numbering Council (NANC), which makes

[2] The ITU is a U.N. agency. It is based in Geneva, Switzerland and is arguably the most important telecom standards setting-body in the world. The ITU's work includes telephony, IP voice, telematics, and more.

recommendations to the FCC on numbering issues and oversees the North American Numbering Plan Administrator.[3] The North American Numbering Plan Administrator, created at the same time, is an impartial entity responsible for administering telecommunications numbering resources in an efficient and non-discriminatory manner.[4] NeuStar, Inc. is currently the administrator for the North American Numbering Plan. *Id.*, 3:20-4:8.

36 The North American Numbering Plan (NANP) generally defines a geographic hierarchy. The area covered by the NANP is divided into distinct geographic areas, each of which is assigned a three-digit Numbering Plan Area (NPA)[5] code (commonly known as an "area code"). Each NPA is divided into numerous three-digit Central Office codes, or NXXs, with each NXX code serving as many as 10,000 subscriber numbers. Historically, wireline NXX codes have represented a geographic local calling area for call rating. *Id.*, 5:9-14.

37 Some NPAs in the format N00 and N11 are not geographic in nature but are used for special purposes. Those NPAs formatted N11 are used for common public purposes. Some of those NPAs are 911 (emergency services), 511 (Department of Transportation road conditions) and 411 (information). The most common example of an NPA formatted in N00 is the 800 NPA, used to provide a "free" call to all originators because the called party pays for all charges. *Id.*, 5:17-22.

38 The COCAG,[6] mentioned in the previous section, defines NXX codes (or Central Office codes/blocks) in a geographic manner in section 2.14:

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[3] *See* 47 CFR § 52.11.
[4] *See* 47 CFR § 52.12.
[5] The NPA is most commonly the first set of three digits in a 10 digit telephone number: NPA-NXX-XXXX.
6 http://www.atis.org/inc/Docs/finaldocs/COCAG-Final-Document-04-09-07.doc

> It is assumed from a wireline perspective that CO codes/blocks allocated to a wireline service provider are to be utilized to provide service to a customer's premise located in the same rate center that the CO codes/blocks are assigned. Exceptions exist, for example tariffed services such as foreign exchange service.

The COCAG defines a rate center as "the smallest geographic area used to distinguish rate boundaries."[7]

39 "Virtual NXX, or VNXX, refers to telephone numbers assigned to a customer in a local calling area different from the one where the customer is physically located in circumstances where the telephone company assigning the number is not using facilities of its own to transport the call from the calling area associated with the telephone number to the area where the customer is actually located."[8] The assignment of a VNXX number violates the COCAG provision set out above because the customer to whom the geographic telephone number is assigned is not "located in the same rate center that the CO codes/blocks are assigned." Although "foreign exchange service" is listed as an exception, VNXX it is not listed in the COCAG as an exception.

40 Although, as discussed above, it is within the authority of a state commission to recognize an exception to the COCAG's geographic number assignment principles, the COCAG is binding on the industry, or at least upon the North American Numbering Plan Administrator, until such a departure is announced. The FCC requires, at 47 C.F.R. § 52.13(b)(3), that the North American Numbering Plan Administrator to comply:

> with guidelines of the North American Industry Numbering Committee (INC) or its successor, related industry documentation, Commission regulations and

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[7] *Id.* pg. 47.
[8] *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91, fn. 3 (2006).

> orders, and the guidelines of other appropriate policy-making authorities, all of which may be modified by industry fora or other appropriate authority[.]

As mentioned earlier, the Alliance for Telecommunications Industry Solutions (ATIS) publishes the COCAG as the guidelines for the assignment of NXXs or "Central Office Codes."[9]

41 The FCC acknowledged that state commissions have the authority to order the NANPA to reclaim NXX's from telecommunications carriers engaging in "virtual NXX" practices in violation of the COCAG. In its *Notice of Proposed Rulemaking, Developing a Unified Intercarrier Compensation Regime*, FCC 01-132, ¶ 115 (April 27, 2001):

> We seek comment on the use of virtual central office codes (NXXs), and their effect on the reciprocal compensation and transport obligations of interconnected LECs. Commenters in this proceeding have indicated that some LECs are inappropriately using virtual NXXs to collect reciprocal compensation for traffic that the ILEC is then forced to transport outside of the local calling area. We note that the Commission has delegated some of its authority to state public utility commissions in order that they may order the North American Numbering Plan Administrator (NANPA) to reclaim NXX codes that are not used in accordance with the Central Office Code Assignment Guidelines. The Maine Public Utility Commission recently addressed the issue of virtual NXXs when it directed the NANPA to reclaim the NXX codes that Brooks Fiber used to provide "unauthorized interexchange service" as opposed to "facilities-based local exchange service."

Staff is not recommending that this Commission direct the NANPA to reclaim telephone numbers that are being used for VNXX. This merely demonstrates the FCC's acknowledgement that states might treat the use of VNXX code as a violation of the COCAG.

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[9] http://www.atis.org/inc/Docs/finaldocs/COCAG-Final-Document-04-09-07.doc

3. Exceptions/Industry Practices.

42 Various CLECs have argued that VNXX number assignment is permissible under paragraph 2.14 of the COCAG either because it is foreign exchange service or because it is an exception contemplated by the "for example" phrase. Staff's response to the "foreign exchange" argument is set out in Section III.A., below. As for the second argument, Staff believes it would be inappropriate to interpret VNXX as being within the "exception exist, for example . . ." language of paragraph 2.14 of the COCAG. The COCAG "exceptions" must be interpreted to mean exceptions that have been considered, deliberated upon and affirmatively endorsed by the appropriate regulatory (or allowed to go into effect, in the case of a tariffed service), or industry forum. To accept the CLEC's argument would be to accept the absurd result that the "exceptions" mean whatever any member of the industry unilaterally decides they mean. The reason for the "for example" language is to acknowledge that exceptions may be created "by industry fora or other appropriate authority" as indicated in 47 C.F.R. § 52.13(b)(3), set out above, not by the unilateral acts of some members of the industry.

43 This Commission could announce VNXX as an exception to the COCAG's general principle of geographic number assignment, but it has not and it should not do so without circumscribing that exception to ensure that it does not worsen arbitrage opportunities and undermine the access charge regime.

B. Washington State Statutes, Rules, Orders, Tariffs.

44 Because VNXX arrangements cause calls between parties in distant local calling areas to be misclassified as "local," VNXX is inconsistent with Washington state telecommunications policy reflected in statutes, Commission rules, and company tariffs.

45 RCW 80.36.230 grants the Commission authority "to prescribe exchange area boundaries and/or territorial boundaries for telecommunications companies." This language enables 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* [emphasis added]." *In re Electric Lighwave, Inc.*, 123 Wash.2d 530, 537, 869 P.2d 1045 (1994). The geographic local calling areas that delineate between local and long distance calling are defined in exchange maps in the tariffs of the legacy local exchange companies. The Commission's rules provide a process for the expansion of exchanges (or more specifically "local calling areas") upon complaint by customers. WAC 480-120-265.[10] WAC 480-120-021 defines a local calling area as: "one or more rate centers within which a customer can place calls without incurring long distance (toll) charges." While the definition is silent about the assignment of telephone numbers, it speaks to the geographic location of the customer and whether the endpoints of the call are both within the local calling area's "one or more rate centers."

46 Qwest's "Exchange and Network Services Tariff" defines "local service" as "exchange access service furnished between customer's premises located within the same

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[10] (1) Customers must make requests for expanded local calling areas under RCW 80.04.110 (the commission's complaint statute).

(2) The commission will order expansion of local calling areas only for compelling reasons. The commission will generally rely on long distance competition, local competition, and optional calling plans that assess additional charges only to participating customers, to meet customer demand for alternate or expanded calling.

In evaluating requests for expanded local calling, the commission will consider whether the local calling area is adequate to allow customers to call and receive calls from community medical facilities, police and fire departments, city or town government, elementary and secondary schools, libraries, and a commercial center.

The commission will consider the overall community-of-interest of the entire exchange, and may consider other pertinent factors such as customer calling patterns, the availability and feasibility of optional calling plans, and the level of local and long distance competition.

local service area."[11] A "local service area" is defined as "the area within which exchange access service is provided under specific rates. The area may include one or more exchanges without the application of toll charges."[12] "Toll service" is defined as "Telephone service between exchanges or locations for which a toll rate is charged." *Id.*

47 A CLEC utilizing VNXX assigns its customer, who is in all likelihood located in the same local calling area as the CLEC's switch, a geographic telephone number that is associated with a distant local calling area. As a result, a call from a Qwest customer, who is located in that distant area, to the CLEC VNXX customer, in the other local calling area, is treated by Qwest's switching equipment not as an interexchange toll call, but instead as a local call that Qwest transports to the CLEC switch over local interconnection facilities. After receiving the call from Qwest, the CLEC never actually transports the call back to the local calling area associated with the "virtual" NXX code. As a result, the person calling the CLEC customer avoids a toll charge, and there is no interexchange carrier involved to pay originating access charges to Qwest on the call. Additionally, the CLEC asserts a right to reciprocal compensation from Qwest, as if the call were local. *See* Section IV.A., *infra.*

48 The Commission's efforts to address the propriety of VNXX arrangements on an industry-wide basis have so far failed to result in any guidance for the industry.

49 VNXX came to this Commission's attention with the Washington Independent Telephone Association's (WITA's) petition for a declaratory ruling on the propriety of VNXX arrangements in Docket UT-020667. In that docket, Level 3 asserted that it was a "necessary party" whose rights would substantially be prejudiced by the declaratory order

[11] WN40 Exchange and Network Services Washington, § 2.1.
[12] *Id.*

sought by WITA, and it indicated that it would not consent in writing to a determination by a declaratory order.[13]

50 After concluding that a declaratory ruling was not possible in UT-020667, the Commission subsequently took up VNXX again in an informal process to develop a policy and interpretive statement in UT-021569. After the completion of a VNXX workshop attended by Staff and members of industry, and after reviewing written and oral comments of interested persons, the Commission concluded that "the complex issues and diverse interests represented in this docket cannot appropriately be addressed through the issuance of an interpretive or policy statement. The Commission believes that these issues are more appropriately pursued in fact-specific disputes."[14] Thus, the Commission set aside any industry-wide decision on VNXX for a more formal fact-finding proceeding—such as the complaint in this docket.

C. Interconnection Agreements.

51 In their interconnection agreements with Qwest, Competitive Local Exchange Carriers have uniformly adopted the same local calling areas (LCAs) as Qwest, although there is no rule that specifies that they must. CLECs can make LCAs for calls between their own customers whatever size they choose. Williamson, Exh. No. 203T, 12:16 – 13:23. However, the picture changes when CLECs connect to existing incumbent LEC networks. In their negotiated interconnection agreements approved by this Commission, all of the CLECs have agreed to match the serving ILECs LCAs for the purpose of rating calls as "toll" or "local." Examples of language from those agreements are as follows:

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[13] Order Declining to Enter Declaratory Order, Docket No. UT-020667, pp. 4-5 (August 19, 2002).
[14] UT-021569, Notice of Docket Closure, July 21, 2003.

> "Exchange Service" or 'Extended Area Service (EAS)/Local Traffic' means traffic that originated and terminated within the local calling area determined by the Commission. (Excerpt from Level 3's interconnection agreement with Qwest, approved 04/06/2003.)
>
> "Extended Area Service (EAS)/Local Traffic)" (Exchange Service) means traffic that is originated by an end user of one Party and terminates to an end user of the other Party as defined in accordance with Qwest's then current EAS/local service areas, as determined by the Commission. (Excerpt from ELI's interconnection agreement with Qwest, approved 8/14/2002, Docket UT-023037.)
>
> "Traffic Type" is the characterization of intraLATA traffic as "local" (local includes EAS), 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. (Excerpt from Broadwing's interconnection agreement with Qwest, approved 3/10/1999, Docket UT-990313.)

Id. Eschelon, Global Crossing, MCI (Verizon), Northwest Telephone, and TCG have similar provisions in their Interconnection Agreements. *Id.* By adopting the same local calling areas as Qwest, the CLECs entitle themselves to receiving originating and terminating access from interexchange carriers when the CLECs' customers make or receive long distance calls. WAC 480-120-540(2).

52 As noted previously, the Commission has express statutory authority to determine local calling area boundaries are set out in the legacy local exchange carriers' tariffs. The Court in *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91, 99 (2006), observed that "[a]llowing the state-commission-determined local calling areas to govern intercarrier compensation . . . makes good practical sense."

> Carriers may prescribe markedly different local calling areas in accordance with marketing considerations. This diversity may promote consumer choice and ultimately be beneficial to consumers. But, if carriers were free to define local calling areas for the purposes of intercarrier compensation, the door would be open to overweening conduct by the CLECs. ILECs are currently fixed in state-commission-imposed regimes and, in that framework, provide the infrastructure for CLECs. Local calling areas defined by CLECs would permit such areas to be so broad as to eliminate all intercarrier compensation

> for ILECs. Permitting CLECs to define local service areas and thereby set the rules for the sharing of infrastructure would eventually require ILECs to absorb all the costs and allow CLECs to reap all the profits.

53 Outside of the ISP-bound traffic context, this Commission has never, in arbitrating an interconnection agreement, authorized carriers to use VNXX number assignment as a means of allowing calls between local calling areas to be treated as local calls subject to terminating reciprocal compensation. In fact, in its Order No. 5 in Docket UT-033035—an arbitration between AT&T and Qwest—the Commission rejected AT&T's request to define local calls based on "the calling and called NPA/NXXs."[15] AT&T's proposal to focus on the calling and called parties' assigned NPA/NXXs, rather than the parties' location, would have opened the way for AT&T to use VNXX for any purpose, including voice services. According to the Order, the "focus of AT&T's Petition, and its oral argument, was the company's concern that it be able to offer a service that will compete with Qwest's foreign exchange ("FX") services."[16] Despite this argument, the Commission noted with approval the arbitrator's concern that AT&T's definition "is too sweeping in its potential effect and has potentially unacceptable consequences in terms of intercarrier compensation."[17] The Commission, therefore, adopted language for the parties' interconnection agreement that defines a local call based on the physical routing points of a call and whether the call originates and terminates within the same local calling area, but suggested that the parties could negotiate a mutually acceptable way for AT&T to provide an FX-like service.[18]

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[15] *In the Matter of the Petition for Arbitration of AT&T Communications Of The Pacific Northwest and TCG Seattle with Qwest Corporation*, Docket UT-033035, Order No. 05; Final Order Affirming Arbitrator's Report and Decision; Approving Interconnection Agreement, at page 6 (February 6, 2004).
[16] *Id.* at page 7.
[17] *Id.* at page 8.
[18] *Id.*

54 The Commission has, however, recognized an exception to the local/interexchange dichotomy where ISP-bound calls are concerned. As such, the Commission has, in effect, authorized VNXX for ISP-bound traffic. In the CenturyTel-Level 3 arbitration in docket UT-023043, the Commission interpreted the FCC's *ISP Remand Order* as establishing single compensation structure for *all* calls to Internet service providers, including those using VNXX arrangements.[19] It appears that, in the CenturyTel-Level 3 arbitration, the Commission did not believe it had the discretion under federal law to apply a different form of compensation to such calls than the FCC's compensation scheme for ISP-bound traffic.[20] Interestingly, at that time, the compensation rate between the two affected carriers was zero—*i.e.*, "bill-and-keep"—not the $.0007 per minute terminating rate that is at issue here.[21]

55 Most recently, the Commission considered the issues surrounding VNXX in the two complaint proceedings that lead to the present complaint by Qwest. While ruling on the compensation applicable to VNXX ISP-bound traffic in the complaint proceedings in dockets UT-053039 and UT-053036, this Commission left open the possibility of deciding, in a separate complaint proceeding, whether VNXX is inappropriate under state law and policy:

> It is not necessary for us to decide in this proceeding whether VNXX arrangements generally, are appropriate or within the law. . . .

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[19] *In the Matter of the Petition for Arbitration of an Interconnection Agreement Between Level 3 Communications, LLC, and CenturyTel of Washington, Inc.*, Docket UT-023043, Seventh Supp. Order: Affirming Arbitrator's Report and Decision, at page 4 (February 28, 2003).

[20] *Id.*

[21] *Id.* at page 2.

> Should Qwest wish to pursue the broader issue of VNXX generally, it may file its own complaint about specific carriers and their behavior regarding intercarrier compensation methods.[22]

56 Qwest filed that complaint, initiating this proceeding. Qwest also sought review in federal court of the Commission's finding that Qwest owed intercarrier compensation to Pac-West and Level 3 for dial-up ISP-bound VNXX traffic based on the parties' existing ICAs, to pay compensation on "ISP-bound traffic" as defined by the *ISP Remand Order*.

57 The U.S. District Court for the Western District of Washington, in Case No. C06-956-JPD, decided on April 9, 2007, that the Commission had erred in interpreting the *ISP Remand Order* as including ISP-bound VNXX calls terminating outside a local calling area within its $0.0007 per minute compensation scheme. The court remanded the matter to the commission, expressly leaving open the possibility that the Commission could reach the same result based on the Commission's state law authority to define "local calling." *See* Section II.D.3, *infra*.

58 The question now before the Commission is whether, as a matter of state policy, and on the facts developed in this case, VNXX arrangements should be allowed, and if so, what form of inter-carrier compensation should apply for the exchange of VNXX traffic. (On remand in dockets UT-053036 and UT-053039, the Commission will need to decide whether Qwest owes reciprocal compensation on VNXX calls to Pac-West and Level 3 on a different theory than the one reversed by the court. It may be that the resolution of the present case will determine the outcome of those cases.)

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[22] *Level 3 Communications, LLC v. Qwest Corportation,* Docket No. UT-053039, Order No. 05, para. 39, 40 (February 10, 2006); *Pac-West Telecomm, Inc. v. Qwest Corporation,* Docket No. UT-053036, Order No. 05, para. 42, 43 (February 10, 2006).

D. FCC/Federal Court/Other State Commission decisions.

1. Telecom Act.

59 The 1996 Telecom Act preserves preexisting access charge regimes.[23] It also states a goal of preserving universal service.[24]

60 Except to the extent that the FCC's rules on interconnection preempt the states,[25] the states still have regulatory authority over intrastate services, including intercarrier compensation for intrastate, interexchange calls.[26]

2. FCC Orders.

a. ISP Remand Order.

61 Shortly after the 1996 Act went into effect, CLECs began to target dial-up ISPs as customers. The reason was that having ISPs as customers allowed CLECs to reap a windfall in reciprocal compensation payments (paid on a minute-of-use basis) from the ILECs. The reason for this windfall was that the incumbent LECs continued to serve virtually all of the residential and small business customers who made lengthy calls to the ISP's modems (which in turn connected to the Internet), while the CLEC's ISP customer never originated calls from its modem to the ILEC's customers.[27] The FCC eventually concluded in its *ISP Remand Order* that this was an undesirable form of regulatory arbitrage.

62 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

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[23] *See* Local Competition Provisions in the Telecommunications Act of 1996, ¶¶ 1033-35, 11 F.C.C.R. 15499, 16012-14, 1996 WL 452885 (1996).
[24] 47 U.S.C. § 254(b).
[25] 47 U.S.C. § 251(d)(3).
[26] *Global NAPs I*, 444 F.3d at 62-63.
[27] *Order on Remand and Report and Order*, CC Dockets 96-98, 99-68, FCC 01-131, ¶¶ 3-7 (April 27, 2001) ("*ISP Remand Order*").

market and "created the opportunity to serve customers with large volumes of incoming traffic."[28] 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.[29] The FCC therefore found that because of this type of regulatory arbitrage, reciprocal compensation had "undermine[d] the operation of competitive markets."[30] 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.[31] 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."[32]

63 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 ISP server located in the same local calling area."[33] 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 a CLEC to centrally locate a single modem bank (or server) in the same location as its switch. While the FCC took action to gradually reduce to zero the reciprocal compensation that the CLECs were receiving for local ISP bound traffic, it did not have in

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[28] *ISP Remand Order* at para. 69.
[29] *Id.* at para. 70.
[30] *Id.* at para. 71.
[31] *ISP Remand Order* para. 74.
[32] *Id.* at para. 77.
[33] *Id.* at para. 10.

mind CLECs providing dial-up ISP access at the significantly lower costs that VNXX affords, while still receiving (capped) reciprocal compensation from the ILECs.

b. Core Forbearance Order.

64 Core Communications, Inc. asked the FCC to forbear from applying rules the FCC adopted in 2001 to govern reciprocal compensation for ISP-bound dial-up traffic. The FCC declined to forbear from applying the rate caps it adopted to decrease arbitrage opportunities for CLECs to serve ISPs, but granted Core's request that it forbear from applying its "growth caps" and "new markets rule," on the basis that dial-up usage was not growing, and therefore the growth caps and new markets rules adopted in the ISP Remand Order were no longer needed.[34]

c. Other FCC orders.

65 In its Notice of Proposed Rulemaking *In the Matter of Developing a Unified Intercarrier Compensation Regime*, the FCC has sought comment on whether there are any circumstances under which VNXX should be allowed, and, if so, how the compensation scheme and transport obligations should be effected.[35] The FCC noted that it had already delegated some of its authority to state public utility commissions to deal with the issue, and that state commissions may order the NANPA to reclaim NXX codes that are not being used in accordance with the Central Office Assignment Guidelines (COCAG).[36] *See* Section II.A.2, *supra.*

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[34] Order, Petition of Core Communications, Inc., WC Docket No. 03-171, FCC 04-241 (October 18, 2004).
[35] *In the Matter of Developing a Unified Intercarrier Compensation Regime,* Notice of Proposed Rule Making, CC docket 01-92, FCC 01-132,¶115 (2001).
[36] *Id.*

3. Federal Court Decisions.

66 As noted above, the federal district court in Qwest's recent appeal from this Commission's orders in the Level 3, and Pac-West complaint cases (dockets UT-053036 and UT-053039) concluded that the Commission had misinterpreted the *ISP Remand Order* as abolishing the distinction between local and interexchange calling with regard to ISP-bound traffic.[37] The court found that in the *ISP Remand Order*, the FCC only addressed the compensation to be paid with respect to calls placed to ISP modems/servers located in the caller's local calling area.[38] The court therefore reversed and remanded the Commission's order requiring Qwest to pay compensation on ISP-bound traffic that, because of the use of VNXX arrangements, terminates at an ISP location outside the caller's local calling area.[39]

67 In keeping with decisions of the First, Second and Ninth Circuit Courts of Appeal, the court found that this Commission could "reach the same result" (*i.e.*, requiring Qwest to pay the CLECs compensation on VNXX calls) by defining local calling areas based on NPA/NXX, as California has done (albeit subject to a different compensation scheme that includes carrier origination charges). In the *Peevey*,[40] *Global NAPs I*,[41] and *Global NAPs II*[42]decisions cited by the district court, the three circuit courts of appeal rejected arguments by competitive LECs that the *ISP Remand Order* preempted state commissions from either prohibiting or applying different compensation rules, under state law, to VNXX ISP-bound traffic.[43]

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[37] Order Reversing and Remanding the Final Decisions of the WUTC, *Qwest v. WUTC, et al.*, Case No. C06-956-JPD (April 9, 2007).
[38] *Id.* at 13-23.
[39] *Id.* at 26.
[40] *Verizon California, Inc. v. Peevey*, 462 F.3d 1142 (9th Cir. June, 2006).
[41] *Global NAPs, Inc. v. Verizon New England, Inc.*, 444 F.3d 59 (1st Cir. April, 2006).
[42] *Global NAPs, Inc. v. Verizon New England, Inc.*, 454 F.3d 91 (2nd Cir. July, 2006).
[43] *Global NAPs I*, 444 F.3d at 62 ("issue on appeal is whether . . . *ISP Remand Order* preempted state

4. VoIP Preemption/ESP Exemption.

68 Staff believes that VoIP traffic (*i.e.*, PSTN calls that are bound for, or terminated from the Internet for purposes of completing VoIP calls) presents its own set of legal issues and should be decided separately from VNXX. Staff understands that the arbitrator in the UT-063006 Qwest/Level 3 arbitration has proposed to make VoIP traffic subject to bill-and-keep.

69 In its *Vonage* order,[44] the FCC ruled that states cannot regulate VoIP services provided by Vonage and other providers of similar "nomadic" IP voice services. The FCC reasoned (1) that it would be impractical for a provider of nomadic VoIP services to identify both endpoints of a given VoIP call, given that its own customer could be connected to the Internet from anywhere in the world; (2) that it is thus impractical to determine whether any given VoIP call is "interstate" or "intrastate"; and (3) that state regulation of VoIP services would frustrate the federal objective of keeping Internet-based services free from unnecessary regulation.[45]

70 Thus, it appear that the assignment of geographic telephone numbers to nomadic VoIP providers is an FCC-authorized exception to the COCAG and any contrary state regulation. Both CLECs and Qwest are providing telephone numbers to providers of IP voice service.

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commissions from regulating intercarrier compensation for all ISP-bound calls"); *Peevey*, 462 F.3d at 1158 ("Pac-West ... contends that the [carrier origination charge the California PUC required for VNXX traffic] is contrary to the *ISP Remand Order* which preempts state commissions from imposing any intercarrier compensation not provided for in the order"); *Global NAPs II*, 454 F.3d at 99 (question is "whether the Board had the authority to ban virtual NXX").

[44] *In the matter of Vonage Holdings Corporation*, Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, WC-03-021 (September 22, 2003).

[45] *Id.* at para. 46.

71 Note: The FCC's preemption of state regulation of nomadic VoIP services is based on the FCC's exclusive authority over interstate telecommunications services and not necessarily on the same theory as the so-called "ESP exemption" from access charges. As such, Staff addresses the ESP exemption under section IV.B., below.

5. Other State Commission Decisions.

72 It is difficult to generalize what other state commissions have decided with regard to VNXX because there are often important difference among States' (1) underlying interconnection policies, and (2) interpretations of federal law. The intercarrier compensation arrangements applied to VNXX traffic vary from state to state, and result from various state commission decisions and interpretations in arbitrations and other dockets.

73 For example, the Texas Public Utility Commission concluded that the *ISP Remand Order's* compensation rate cap of $0.0007 per minute applied to VNXX calls, but because Texas had previously set reciprocal compensation rates at zero, bill-and-keep applies to VNXX calls notwithstanding the $0.0007 rate cap.[46]

74 At least one other state, and a federal district court (prior to the contrary federal *appellate* court decisions discussed in section II.D.3) concluded as this Commission had, that the *ISP Remand Order* required compensation at the $0.0007 per minute rate for ISP-bound VNXX traffic.[47] That conclusion is now foreclosed to this Commission because of

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[46] PUCT Docket 24015, Order on Clarification (ISP Remand compensation applied, and when the state commission had previously required bill and keep, then bill and keep applied under ISP Remand Order cap).

[47] **Alabama:** Opinion, All Providers of Local and Interexchange Telecommunications Services in the State of Alabama Declaratory Ruling Concerning the Usage of Local Interconnection Services for the Provision of Virtual NXX Service. Docket No. 28906, Alabama Public Service Commission (2004 Ala. PUC Lexis 144) (holding that ISP VNXX calls are exclusively under the jurisdiction of the FCC, but that other VNXX and FX calls should be compensated on a bill-and-keep basis); **Connecticut:** *The Southern New England Telephone Company v. MCI Worldcom Communications, Inc. et al*, United States District Court, D. Connecticut, Case

the recent federal district court decision reversing and remanding this Commission's decision in the Pac-West and Level 3 complaint cases. *See* section II.D.3, *supra*.

75 Some states, including the FCC's Common Carrier Bureau acting in place of the Commonwealth of Virginia, have required ILECs to pay reciprocal compensation on VNXX traffic based either on an interpretation the relevant interconnection agreements, or on state precedent, but not based on federal law.[48]

76 The majority of states, however, appear to have concluded that VNXX arrangements violate the distinction between local and interexchange calling and that the incumbent LEC on whose network the VNXX calls originate should not be required to pay terminating reciprocal compensation on such calls.[49]

No. 3:02cv274 (SRU)(March 16, 2005) (decided prior to the Second Circuit's Global NAPs II case, which reaches a contrary result).

[48] **Michigan:** Opinion and Order, In the matter of the application of Telnet Worldwide, Inc., for arbitration of interconnection rates, terms, and conditions and related arrangements with Verizon North, Inc. and Contel of the South, Inc., d/b/a Verizon North Systems, Case No. U-13931 (2005 Mich. PSC Lexis 39), refusing to alter longstanding precedent in Michigan that treats VNXX as local; following this decision, the Michigan legislature enacted legislation partially limiting the use of VNXX, *see* 2005 PA 235; **Virginia:** *In the Matter of Starpower Communications, LLC v. Verizon South Inc.*, 18 FCCR 23,625 (2003) (FCC sitting in place of the Virginia Corporation Commission, required Verizon to pay reciprocal compensation on VNXX traffic, focusing on the fact that "the Tariff does not expressly address whether the 'location' of a customer station turns on physical presence or number assignment."

[49] **Connecticut:** *DPUC Investigation of the Payment of Mutual Compensation for Local Calls Carried Over Foreign Exchange Service Facilities*, Decision, Docket No. 01-01-29 (Conn. PUC Jan. 30, 2002) (VFX calls not eligible for mutual compensation); **Florida:** *In re: Investigation Into Appropriate Methods to Compensate Carriers for Exchange of Traffic Subject to Section 251 of the Telecommunications Act of 1996*, Order on Reciprocal Compensation, Docket No. 000075-TP, Order No. PSC-02-1248-FOF-TP (Fl. PSC Sept. 10, 2002) (intercarrier compensation for calls to VFX numbers to be based on end points of call and are not subject to reciprocal compensation); **Georgia:** PSC Docket No. 13542-U (Ga. PSC July 23, 2001) at 10-12 ("The Commission finds that reciprocal compensation is not due for Virtual FX traffic."); **Illinois:** *Illinois Verizon/GNAPs Arbitration Order* at 16 (finding that the final destination of virtual FX traffic is by its very nature, beyond the caller's local calling area "with virtual NXX being simply a device to relieve the caller of toll charges"); *Illinois GNAPs/Ameritech Arbitration Order* at 15; *Level 3 Communications, Inc. Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Illinois Bell Telephone Company d/b/a Ameritech Illinois*, Arbitration Decision, Docket No. 00-0332, 2000 Ill PUC LEXIS 676 at *7 (Ill. Commerce Comm'n Aug. 30, 2001) ("FX traffic does not originate and terminate in the same local rate center and therefore, as a matter of law, cannot be subject to reciprocal compensation"); **Iowa:** Final Decision and Order, In Re Sprint Communications Company, L.P.,

and Level 3 Communications, LLC, Docket Nos. SPU-02-11, SPU-02-13, 2003, Iowa PUC LEXIS 229, *10-*12 (Iowa Utils. Bd. June 6, 2003) (in petition to limit certain CLECs from depleting numbering resources for VNXX, the Board concluded that VNXX calls are interexchange in nature); **Kansas:** Arbitrator's Order 10, In the matter of arbitration between Level 3 Communications, LLC and SBC Communications, Inc., Pursuant to Section 252(b) of the Communications Act of 1934, as Amended by the Telecommunications Act of 1996 for Rates, Terms and Conditions of Interconnection, Docket No. 04-L3CT-1046-ARB, Kansas Corporation Commission (2005 Kan. PUC Lexis 166) (Commission stated that SBC's proposed language appropriately classified traffic and ordered that VNXX ISP-bound traffic is not subject to reciprocal compensation). **Maine:** Public Offices Investigation into Use of Central Office Codes (NXXs) by New England Fiber Communications, LLC d/b/a/ Brooks Fiber, Docket No. 98-758, Order Requiring Reclamation of NXX Codes and Special ISP Rates by ILECs, and Order Disapproving Proposed Service (Me. PUC June 30, 2000); **Missouri:** *Application of AT&T Communications of the Southwest, Inc., TCG St. Louis, Inc., and TCG Kansas City, Inc., for Compulsory Arbitration of Unresolved Issues With Southwestern Bell Telephone Company Pursuant to Section 252(b) of the Telecommunications Act of 1996*, Arbitration Order, Case No. TO-2001-455, at 31 (Mo. PSC June 7, 2001) (finding VFX traffic "not classified as a local call"); **Massachusetts:** Order, Petition of Global NAPS, Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996, for Arbitration to Establish an Interconnection Agreement with Verizon New England, Inc. d/b/a Verizon Massachusetts f/k/a New England Telephone & Telegraph Co. d/b/a Bell Atlantic-Massachusetts, D.T.E. 02-45, 2002 Mass PUC LEXIS 65 at *50, 51 (Mass Dep't of Tel & Energy Dec. 12, 2002) (Department found that "VNXX calls will be rated as local or toll based on the geographic end points of the call" and that the Verizon tariff in Massachusetts "defines local calling areas in terms of municipalities and geographic areas, not in terms on NXXs."); **Nebraska:** Arbitrator's Recommended Decision, In the Matter of the Petition of Qwest Corporation for Arbitration of Interconnection Rates, Terms, Conditions, and Related Arrangements with AT&T of the Midwest and TCG Omaha, Docket No. C-3095, at 18, 19 (Neb PSC May 4, 2004) (Commission adopted Qwest proposal that "local exchange traffic" be defined as "traffic that is originated and terminated in the same local calling area as determined for Qwest by the Commission" and rejected AT&T-proposed language that would have excepted VNXX traffic from this definition, stating the AT&T approach would have "far reaching implications and unintended consequences by reclassifying a large number of interexchange calls as local calls in violation of state statutes and Commission rules."); **Nevada:** *Re: Pac-West Telecomm, Inc.*, Docket Nos. 98-10015, 99-1007, Order Adopting Revised Arbitration Decision, Attach. 1, ¶ 64 (Nev. PUC Apr. 8, 1999) (finding that "a local call is based on the physical location of the originating and terminating parties . . . [t]o define a local call based on the rate center of the NXX codes as proposed by Pac-West and ATG would subvert industry custom and practice. It could allow them to avoid access charges for toll calls and interLATA calls as well"); **New Hampshire:** Order, Re New England Fiber Communications, LLC, Nos. DT 99-081 & DT 99-085, 2003 N.H. PUC LEXIS 128, at 32-33 (NH PUC Nov. 12, 2003) ("Under the interconnection agreement, reciprocal compensation applies only to local traffic, which is defined in the tariff as calls originating and terminating within a specified geographic area, established for purposes of defining the zone within which in-state toll charges will not apply. This leads ineluctably to a determination here that the parties did not intend reciprocal compensation to apply to calls that were terminated to an ISP physically located outside the originating callers local service area."); **Ohio:** Re Global NAPs, Inc., No. 02-879-TP-ARB, 2002 Ohio PUC Lexis 644, *22-*23 (Ohio PUC July 22, 2002) (The Commission concluded that "[a]ny end-user call originating and terminating within the boundary of such a local calling area, regardless of the LEC at the originating and terminating end shall be treated as a local call" and that Verizon's local calling areas, as revised for EAS purposes, would "determine whether a call is local for the purpose of intercarrier local traffic compensation"). **Pennsylvania:** *Application of MFS Intelenet of Pennsylvania, Inc.*, Docket No. A-310203F0002, *Application of TCG Pittsburgh*, Docket No. A-310213F0002, *Application of MCI Metro Access Transmission Services, Inc.*, Docket No. A-310236F0002, *Application of Eastern Telelogic Corp.*, Docket No. A-310258F0002, Opinion and Order at 19 (Pa. PUC July 18, 1996) (holding that CLECs must assign NXX codes to customers that conform to the same local calling area/rate centers where customers are actually located in order "to avoid customer confusion and to clearly and fairly prescribe the boundaries for the termination of a local call and the incurrence of a transport and termination charge, as opposed to termination of a toll call in which case an access charge would be assessed."). **Vermont:** Order, Re Adelphia Business Solutions, Inc., Docket No. 6566, 2003 Vt PUC LEXIS 181, *76 (Vt PSB July 16, 2003) ("Reciprocal Compensation does not apply to VNXX traffic that physically terminates outside the local calling area.").

77 California takes a thoughtful approach to VNXX. On the one hand, the California Commission has treated VNXX traffic like local traffic by subjecting it to reciprocal compensation charges to be paid by the originating ILEC to the terminating CLEC. On the other hand, California authorized the ILEC to charge the CLEC an offsetting "carrier origination charge" to compensate the ILEC for the cost of transporting the call beyond the originating local exchange.[50] The Ninth Circuit Court of Appeals upheld this approach in the *Peevey* case.[51] These offsetting forms of compensation would seem to have the effect of driving the net compensation between the carriers to zero, albeit with a great deal of administrative complexity. Staff believes the California analysis of intercarrier compensation for VNXX is sound, but that the compensation scheme it adopts is unnecessarily complex. *See* Section V, *infra.*

III. VNXX RELATIONSHIP TO OTHER SERVICES.

A. Foreign Exchange Service.

78 Some of the CLECs 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. *See, e.g.,* Greene, Exh. No. 451T, 21:1-22:16; Robins, Exh. No. 451T, 21:1 – 22:16.

79 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

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[50] *In the Matter of Verizon California Inc. (U-10021-C) Petition for Arbitration with Pac-West Telecomm, Inc. (U5266-C) Pursuant to Section 252(b) of the Telecommunications Act of 1996,* Decision 03-05-075 (May 22, 2003).
[51] Verizon California, Inc. v. Peevey, 426 F.3d 1142 (June 2006).

originated by a Qwest customer. Although FX and VNXX may be similar from a functional standpoint, it would not be good policy to allow CLECs unlimited use of VNXX as a purported substitute for FX service.

80 Foreign exchange service is different from an engineering and cost-recovery standpoint from VNXX. The telephone company provides FX service by connecting the FX customer's physical location to the location of the company's central office in the distant ("foreign") local calling area. Williamson, Exh. No. 201T, 6:5-16. The FX customer pays the regular rate for the local service in the local calling area where it wishes to receive "local" calls, and also pays an extra charge for the facility that connects their physical location to the distant telephone company switch, like a very long loop. The FX customer pays a monthly facility fee, which varies by distance, to pay the cost of being physically connected to the local calling area of their choice. *Id.* Thus, the customer makes payments that contribute to the cost of the local exchange network and pays the cost to transport the call to the foreign exchange. Brotherson, Exh. No. 24T, 4:8-5:12.

81 By contrast, when a CLEC customer is served using a VNXX arrangement, the result is that *Qwest* (rather than CLEC or its customer) carries the call over its local interconnection trunks from the local exchange to the CLEC's point of interconnection—effectively providing the transport for which the Qwest FX customer must pay retail private line rates. *Id.* at 9:10 – 10:24. With VNXX, the customer makes no contribution to the cost of the local exchange and the ILEC, rather than the customer, is responsible for the cost of transporting the call to the "foreign" exchange. *Id.* at 9:10 – 10:24; 5:4-12.

> [A]lthough virtual NXX and FX share some similarities, there is one fundamental difference: retail customers using FX service purchase a foreign exchange line, paying the costs both of installation of the line and of transportation of bulk traffic between the two points of communication.

> Virtual NXX customers, on the other hand, do not purchase any lines or pay transportation costs, but rely on the terminating carrier to provide the service without cost. [Prohibiting] virtual NXX does not necessarily prevent users from obtaining nongeographically correlated numbers; the ban simply requires that someone pay Verizon for use of its infrastructure.

Global NAPs, Inc. v. Verizon New England, Inc., 454 F.3d 91, 101 (2006).

82 Foreign exchange service has traditionally been used by businesses that provide service on a regional basis and who want to receive calls without the calling customer incurring toll charges. As a voice service, FX is a narrow exception to the general rule that numbers are to be assigned based on the physical location of the customer. Because of the way FX service is provisioned by the ILECs, FX service is expensive for subscribers and often proves less cost-effective than functionally equivalent 800- service. Williamson, Exh. No. 203T, 10:1-12. The expense of the service for customers has prevented it from ever amounting to a significant "loophole" (if viewed as such) in the access charge system; there has never been any concern that traditional FX would result in any significant erosion of access charges and Universal Service. If this Commission were to accept the notion that a LEC may assign NPA/NXXs in any way it wishes, or without the understanding that the customer must pay for the cost of extending a private line from the serving switch to each foreign exchange in which the customer wants to be able to make and receive "local calls," the result would likely be a much larger hole in the access charge regime. *Id.*

83 It is incorrect, as some CLEC and Qwest witnesses assert, that VNXX is the only way for CLECs to provide a true foreign exchange service in the manner described in Qwest's tariffs. A CLEC that has invested in physical plant in the local calling areas to provide a true local service can then offer foreign exchange service at little additional cost. (As an aside, it is intuitively nonsensical to allow a CLEC to offer "foreign exchange"

service—which is a form of local service—out of a local calling area in which it hasn't invested in or leased any plant to serve a customer actually located in that exchange. This is why the New Hampshire Commission has required CLECs to offer service to at least one customer in a local calling area as a precondition to being allowed to provide VNXX "local" calling from that local calling area.[52]) The CLECs would not have to build a full switch in each local calling area to provide foreign exchange service. As Staff witness Mr. Williamson pointed out, a CLEC could locate a channel bank or a subscriber carrier facility (through which it remotes a piece of its existing switch) in the local exchange (local calling area) from which it wishes to offer local service. Tr. 433:13 – 436:10. The carrier could then provide foreign exchange service from that equipment (in essence a "remote" piece of their existing switch). *Id.*

84 As discussed in Section IV.A, below, using VNXX as a substitute for Qwest's foreign exchange is unfair to Qwest from a cost recovery standpoint because the CLEC forces Qwest to provide the equivalent of the private line transport element of a foreign exchange service without adequate compensation.

85 As discussed in Section IV.B, below, allowing VNXX for ordinary voice services would erode access charge revenues and undermine universal service policies.

B. 800 Service.

86 There are numbers in the North American Numbering Plan that are specifically set aside to be used in a non-geographic manner. The most common are "800" toll free numbers that allow the terminating customer to pay all charges so that the "calling" party makes the call toll free. Non-geographic numbers are listed in the COCAG in section 4 (as

[52] Investigation as to Whether Certain Calls and Local, DT-00-054, Independent Telephone Companies and Competitive Local Exchange Carriers – Local Calling Areas, DT 00-054, p. 56 (October 28, 2002).

well as in the "Numbering and Dialing Plan Within the United States," ATIS-0300076, para. 4.8.2), and they include, along with 800 toll free service, 500, 700 and 900 numbers as well as numerous N11 codes (911, 811, 411, etc.). Since they are non-geographic in nature, they are not assigned in a geographic manner and do not have to match LCAs. Williamson, Exh. No. 203T, 11:14-23. VNXX uses "geographic numbers" to achieve the functionality of "non-geographic" 800 numbers, but in a way that not only avoids the payment of access charges, but also forces the incumbent to pay reciprocal compensation to the terminating CLEC on the call. *Id.*

C. Market Expansion Line/Remote Call Forwarding Services.

87 Qwest's Market Expansion Line ("MEL") is simply a remote call forwarding "feature" for business customers that allows the customer to call forward their service to a different location without the need for a physical location in that area. It does not avoid access charges, and it is not an exception to geographic number assignment. Brotherson, Exh. No. 24T, 46:5-21; See TR at 307 (Brotherson); see also Ex. 220 (Staff Response to Pac-West DR # 17). Calls to a MEL service are forwarded automatically from the central office to another telephone number of the customer's choice, either within the LCA or to another LCA. If the number to which MEL is forwarded to is outside the LCA of the central office serving the MEL line, full retail toll charges apply to the MEL customer (and access charges are applied to such calls). When a MEL customer forwards its service to another local calling area, it is the MEL customer that incurs the toll charges for that portion of the call and the MEL customer's interexchange carrier would pay all applicable access charges. *Id.*

D. One Flex Service.

88 One Flex is a VoIP service provided by a Qwest affiliate. As described in section II.D.4, above, both CLECs and Qwest are providing telephone numbers to unregulated providers of IP voice service.

89 Qwest's affiliate, QCC, under the ESP exemption, typically buys local service (PRI or its equivalent) in the LCA where it obtains local phone numbers (the numbers are included with the local exchange service purchased by QCC) instead of buying interconnection services as a CLEC under an Interconnection Agreement. According to Qwest, QC adheres to the numbering guidelines and properly assigns telephone numbers within the LCA. Brotherson, Exh. No. 24T, 45:13-24. Local numbers are assigned to each dedicated local PRI circuit that is provisioned from each LCA to the customer, QCC. QC knows that its PRI customer is located in the LCA, or has a physical presence in that calling area by virtue of purchasing the tariffed local service and combining it with a tariffed or catalogued private line transport service (an FX arrangement). A QCC customer must purchase local service to obtain a local number. If such customers have no local dial-up number, then a dial-up end user would have to dial a "1+" call or an 8XX number to connect to QCC. *Id.*

E. Other Services.

90 N/A.

IV. VNXX POLICY CONSIDERATIONS.

A. Cost Issues.

91 From Staff's perspective, there are two main cost issues raised in this case: (1) whether VNXX deprives Qwest (and rural LECs) of access charge revenues that cover the

cost of the local exchange, and (2) whether VNXX results in Qwest providing CLECs with transport for what amounts to a "foreign exchange-like" service, without compensation.

92 Staff addresses the access charge issue in section IV.B, below. In this section, Staff addresses the transport cost issue.

93 In order to reduce the cost of entering the market in competition with incumbent local exchange carriers like Qwest, competitive local exchange carriers have been allowed to use a single switch to serve an area (usually a "LATA") that includes many incumbent LEC exchanges (or local calling areas). Williamson, Exh. No. 201T, 14:15 – 15:16. The trade-off is that the competitive LECs have to bear additional costs for transporting calls over longer distances to and from their less widely distributed switches, but this still represents a less expensive way of entering the local exchange market than to build a switch in each exchange. *Id.*

94 One consequence of allowing CLECs to provide local service over a large area using only a single switch is that, when a Qwest customer calls a CLEC customer, Qwest is obligated to transport that call across exchange boundaries within the "LATA" (e.g., the Western Washington LATA which comprises many exchanges or local calling areas) to a single point of interconnection with the CLEC. Brotherson, Exh. No. 24T, 6:1 – 7:11.

95 When the CLEC actually provides local exchange service to customers located in the local calling area from which the ILEC is transporting the call, the CLEC bears a symmetrical burden to transport the call from its switch back to its customer in the same local calling area over facilities it leases or owns. Similarly, when the CLEC's customer calls a Qwest customer, the CLEC must haul the call from its customer's location to the same single point of interconnection to hand the call off to Qwest for completion. *Id.* This

parity, and the reason for requiring Qwest to transport calls to a single CLEC point-of-presence, breaks down where VNXX calls are concerned.

96 CLECs achieve a significant cost savings through VNXX because it allows them to have a single server or modem bank located next to their single switch, instead of within every local calling area throughout the LATA. Williamson, Exh. No. 201T, 15:19 – 17:14. Dial-up ISP customers in each LCA are able to make calls to their ISP's modem (or more commonly to the CLEC's server or modem) by dialing a number associated with the caller's local calling area. The reason this is possible is because the CLEC has assigned numbers to the ISP (or to itself, acting as a wholesale ISP) that are associated with a local calling area other than the LCA where the ISP equipment is located. Because VNXX calls are indistinguishable to Qwest's switching equipment from calls to a CLEC customer who is actually located in the same local calling area, Qwest transports these calls from various local calling areas in the LATA over its local interconnection service trunks, across exchange boundaries, to the CLEC's point of presence, near the CLEC's switch. *Id.* But rather than hauling these calls back to a customer located in the same local calling area as caller, as would be the expectation with a locally rated and routed call, the CLEC simply directs the call from its switch to a server or modem bank located next to its switch.

97 Qwest's affiliate, QCC, provides a *functionally* similar wholesale dial-up Internet access service. However, it does so by purchasing what amounts to foreign exchange service from Qwest (the local exchange carrier). QCC buys local service from Qwest in each local calling area where it seeks to obtain "local" service, and it purchases a private line at retail rates from each LCA to the location of its Internet access equipment. Linse, Tr. at 136:24 – 138:14.

98 By using VNXX arrangements, the CLEC's ISP customer (or the CLEC itself, acting as a provider of wholesale ISP services) obtains the equivalent of private line transport from the LCA to its server/modem from Qwest under the pretense that the call is local (i.e., between customers in the same local calling area). Neither the CLEC nor its ISP customer compensates Qwest for this transport. Brotherson, Exh. No. 24T, 6:1 – 7:11. Despite the obvious cost savings associate with this arrangement, and the arguable violation of the ILEC's access tariffs and interconnection agreements (which require interexchange calls to be handled as such), the CLECs nonetheless assert a right to continue receiving terminating reciprocal compensation from the ILEC (at the *ISP Remand Order's* $0.0007 per minute rate), as if the calls were really local.

99 The CLECs assert that it is more efficient to place a single server or modem bank next to the CLEC's switch instead of in every local calling area. And, they argue, because of Qwest's obligation to transport calls to the single point of interconnection, it does not impose any greater costs on Qwest if the CLEC simply locates a centralized server or modem bank next to the CLEC's switch than if it hauls the calls back to modems located in the appropriate local calling areas.

100 This efficiency argument has some merit. Williamson, Exh. No. 203T, 17:9 – 18:15. From an engineering standpoint, it makes sense to aggregate ISP-bound calls at fewer locations. And it is true that Qwest's costs are the same whether the CLEC terminates the call at a server located next to its switch, or instead hauls the call back to a similar Internet gateway located in the local calling area where the call originated. *Id.*

101 However, VNXX arrangements require Qwest to bear transport costs that are only justifiable when the CLEC is actually serving a customer located in the distant local calling

area. As noted above, the rationale for requiring Qwest to transport calls to a single point of interconnection is that the CLEC is assumed to be bearing a symmetrical burden of hauling the call back to the same local calling area. That assumption is not correct in the case of VNXX (arguably, a CLEC providing VNXX service isn't even providing *local* telecommunications service as envisioned by the Act, *see* Section II.B, *supra*).

102 This is why the California Public Utilities Commission, while allowing VNXX and requiring the incumbent to pay reciprocal compensation on VNXX traffic, the CLEC is required to pay the ILEC a call origination charge to compensate the ILEC for the transport that a foreign exchange customer would have to pay.

> By allowing disparate rating and routing [i.e., VNXX], we are allowing for those calls to become local calls, and as such, subject to reciprocal compensation. However, [the CLEC] is required to pay the additional transport required to get those calls where they are considered local calls. . . . This is similar to the concept of the ILEC's tariffed FX service, in which the customer pays for the privilege of receiving dialtone from a different exchange.

In the Matter of Verizon California, Inc. (U-10021-C) Petition for Arbitration with Pac-West Telecomm, Inc. (U5266-C) Pursuant to Section 252(b) of the Telecommunications Act of 1996, Decision 03-05-075, page 5 (May 22, 2003).

103 Moreover, requiring Qwest to pay reciprocal compensation on ISP-bound VNXX calls perpetuates the arbitrage the FCC identified in its ISP Remand Order (but declined to eliminate through an immediate "flash cut" to bill-and-keep) despite the fact that the CLEC saves money by having only a single server or modem bank in the LATA. *See* Section II.D.2(a), *supra.*

104 In short, while it may not make sense to require CLECs to locate servers or modem banks in every exchange, it is neither equitable nor good policy to allow CLECs to enjoy the

efficiencies and cost savings of VNXX for ISP-bound traffic (which are only possible due to the ubiquity of Qwest's hub and spoke facilities and Qwest's obligation to carry calls to a single point of interconnection with the CLEC) *and* to allow the CLECs to continue to demand reciprocal compensation from Qwest.

105 Staff's proposal, discussed in section V below, is that pending the FCC's ongoing rulemaking on intercarrier compensation, the Commission allow the respondent CLECs and Qwest to enter into bill-and-keep arrangements for the exchange of ISP-bound VNXX calls as Qwest has done with Verizon Access and AT&T. For reasons related to erosion of access charge revenues discussed in section IV.B, below, the Commission should expressly prohibit VNXX for purposes other than terminating ISP-bound traffic.

B. Impact on Access Regime/Impact on Competition.

106 Carriers that provide long distance service—interexchange carriers—pay access charges to local exchange carriers for the right to "access" the local networks (*i.e.*, to the local switching and loop facilities that are the most costly part of the local telephone network). Williamson, Exh. No. 201T, 3:5-11.

107 The FCC regulates what local exchange carriers charge interexchange carriers for originating and terminating calls between customers in different states (*i.e.*, interstate access charges). The states regulate what local exchange carriers charge interexchange carriers for calls between customers located within the same state (*i.e.*, intrastate access charges).

108 When long distance competition began in the 1970s, regulators had to devise a mechanism for allocating two categories of the costs of a long distance call: long distance transport and the cost of "accessing" the local network.[53] The mechanism adopted was

[53] The cost of long distance transport consists mainly of the cost of the large "pipes" or facilities that connect

called access charges. Williamson, Exh. No. 201T, 7:18 – 8:10. There are two distinct types of access charges: switched access and special access. Only switched access charges are at issue in this case. A long distance carrier pays originating switched access charges to the local carrier whose customer originates the call and also pays terminating switched access charges to the local carrier whose customer is terminating the call. The long distance company passes those charges on to its customers, on a per-minute basis for all "switched access" calls, *i.e.*, calls that pass to/from the long distance network through the local carrier's switches. *Id.* Access charges are used in the recovery of a local telephone company's total costs. Access charges have historically been used to keep down the price of local service and provide funds for certain Universal Service programs. *Id.*

109 This Commission has authorized local exchange companies to recover costs for support of universal access to basic telecommunications service through additional, explicit universal service rate elements applied to terminating access service. *WAC 480-120-540(3).* Ever since the divestiture of the Bell System and the advent of traditional long distance (or toll) service competition, access charges have been used as a way to make sure that local rates in Washington remain affordable and that rates in rural Washington remain comparable to those in urban Washington despite higher per-customer costs in those areas.[54] Williamson, Exh. No. 201T, 3:5-11.

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local calling areas via tandem switches to one another. These cable or fiber facilities and switches are used exclusively for interexchange calls. The cost of accessing the local network, on the other hand, consists mainly of the cost of the switching facilities and loops that extend to each customer's premises. These local facilities are used not only for local calling (i.e., calls between customers in the same local calling area), but also for originating and terminating calls between exchanges (i.e., interexchange or "toll" calls).

[54] The Commission, in Cause U-85-23, et al., established access charges and the traditional universal service fund (or USF) through a series of adjudicative orders, which recognized the importance of maintaining and protecting universal service in the State of Washington. In Docket UT-970325 the Commission updated and memorialized this policy in a rule by adopting WAC 480-120-540 (specifically subsection (3), in order to make this amount explicit and to accommodate the new competition resulting from the Telecommunications Act of 1996 (while still continuing to protect universal service to the extent authorized. The Commission's November

110 The public switched telephone network has long been used not only for voice communication, but also as a way for people to access information services or data from computers at distant locations. The FCC has afforded the "enhanced service providers" that provide such information or computer processing services an exemption from access charges. (Examples of enhanced or information services include Lexis/Nexis, services for bank card-swipe machines, voice mail service, and dial-up Internet access provided by Internet service providers (ISPs) like Earthlink and AOL.) The "ESP exemption" requires the ESP to purchase local business lines in each local calling area where it seeks to receive "local" calls and then to bear the cost of transporting the call over private lines to its distant computer facilities.[55]

111 While it might have been possible for an enhanced service provider with computers at various central locations throughout the U.S. to require its customers to make a long distance calls to its locations, ESPs instead found it economical to obtain private lines from their facilities to each local calling area from which they wished to enable their end users to reach them. Then, just like a local service customer, ESP's purchased local business lines in each local calling area as a means for its customers to place a local call to it, and then to be connected to the distant computer over the ESP's long private line. While the FCC recognized that this was essentially the same as a long distance call from the end user to the distant computer, it nonetheless exempted the ESP from having to pay originating interstate access charges to the LEC on whose local facilities the calls originated (like an IXC would have to do) and permitted the ESP to purchase its connections in local exchanges as if it

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1998 Report to the Legislature, which was derived from information gathered in Docket UT-980311, discusses the importance of access charges in maintaining universal service in Washington.

[55] *See* Huber, Kellog, Thorne, *Federal Telecommunications Law,* 2d Ed., Sec. 12.6.2 (1999); MTS and WATS Market Structure, 48 FR 42984, para. 78 (1983); *ISP Remand Order* at para. 27; Access Charge Reform, First Report and Order 12 F.C.C.R. 15982, 16133 (1997).

were an end user of local services, rather than an interexchange carrier.[56] This was called the "ESP exemption" from interstate access charges. It is important to note that, in order to take advantage of the ESP exemption, the ESP had to purchase local exchange service in each LCA where it sought to receive local calls, and it had to obtain a means of transporting calls from that LCA to its computer facility.[57]

112 VNXX allows an ISP, or a CLEC acting as a wholesale ISP, to avoid the purchase of local service in each local calling area where it wants to receive "local" calls. As such, VNXX is inconsistent with the way the ESP access charge exemption has worked for many years.

113 As discussed in Section IV.A, *supra*, there is a persuasive efficiency argument for allowing VNXX for purposes of intraLATA ISP-bound traffic. Additionally, as Dr. Blackmon argues, allowing VNXX for ISP-bound traffic does not erode access charges because dial-up ISP "data" calls are a use of the public switched telephone network that did not exist at the time the access charge system came about. 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. Exh. No. 401T. (Dr. Blackmon explains that under the access charge regime, LECs have historically charged "substantially more than the economic cost of originating and terminating interexchange ('long distance' or 'toll') calls, thereby allowing local rates to be lower than they otherwise would be at any given level of overall telephone company revenue.") *Id.* at 15:25-27. According to Dr. Blackmon:

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[56] *Id.*
[57] *See* 48 FR 42984 at para. 78.

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

Id. at 16:3-9. Dr. Blackmon's analysis supports allowing VNXX arrangements for the limited purpose of ISP-bound calls.

114 The use of VNXX for voice service, however, is impossible to meaningfully distinguish from the kinds of toll bypass schemes that the Commission has acted to prevent in the past. In dockets U-88-2370-J (U. S. Metrolink Corp., First Supplemental Order) and UT-971515 (United & Informed Citizen Advocates v. Pacific Northwest Bell Telephone Company), the Commission addressed services that provided toll bridging where calls are passed between overlapping extended area service regions thereby bypassing intrastate access charges. The Commission's decision in those two dockets was that bypassing intra-LATA toll charges by bridging between extended area service regions was unlawful.

115 In Docket No. UT-031472 (WITA v. LocalDial), the Commission's decision was that it was unlawful for LocalDial to bypass intrastate access charges by transporting a portion of the call over an IP link (a type of VoIP service known as IP-in-the-middle or phone-to-phone VoIP).

116 Toll bridging and "IP-in-the-middle VoIP" services are identical, at least in their effect, to "virtual local" number assignment. Although all three services differ in how they technically achieve their goal, they are the same in that they allow end users to call from one local calling area to another without incurring toll charges. Williamson, Exh. No. 201T, 24:3-7.

C. Consumer Impact.

117 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). Williamson, Exh. No. 203T, 20:3-6.

118 On the other hand, due to the deployment of broadband services, such as DSL and Cable Modems, dial-up internet service has been steadily declining. "Once the outside plant in rural America can be upgraded to support broadband service, which will take time, market demand will diminish the need for dial-up internet service." Neinast, Exh. No. 541T, 5:8-11.

119 Both of these considerations counsel in favor of allowing VNXX for ISP-bound traffic. While banning VNXX could have a dire affect on the dial-up Internet access industry, with consequences for consumers' ability to obtain dial-up services, the problems associated with VNXX are unlikely to worsen as a consequence of growth in dial-up access. By contrast, it appears that few have come to rely on VNXX for voice services, but there is a potential for great abuse of local calling areas and the access charge system in VNXX is allowed for voice services.

D. Impact on Independent ILECs.

120 The potential impact of voice VNXX service on independent LECs is perhaps best illustrated by the fact that Global Crossing is offering LATA-wide "local calling" to business customer in the Seattle local calling area where its switch is located. Brotherson,

Exh. No. 24T, 48:4-14. Both originating and terminated access charges are avoided on such traffic (voice traffic, unlike ISP-bound traffic is two-way). Although Qwest may be willing to forgo access charges on such calls (as would be the case under its proposed settlement with Verizon Access), the companies who benefit from Washington's "Traditional Universal Service Fund" are not. *See* BR-2 (regarding all LEC's obligation to collect the WECA rate element on access minutes and remit it to WECA). Staff expects WECA to address this problem in its brief.

E. Other Public Policy Considerations.

121 N/A.

V. STAFF PROPOSAL.

122 As noted above, a large portion of dial-up Internet traffic is now provisioned through the use of VNXX, and 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).

123 Given this fact, and the efficiency of allowing carriers to continuing to aggregate ISP-bound traffic at fewer servers or modem banks (*i.e.*, one per LATA, rather than one per local calling area), 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.[58]

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

124 Staff's recommendation is an interim approach only and is meant to address the inequity of existing compensation charges for dial-up ISP-bound VNXX traffic by replacing them with bill-and-keep. Staff would recommend that the Commission strongly encourage industry members to take the VNXX standards issues addressed in this case to the appropriate standards bodies, there to be opened as active items and when resolved to update the appropriate industry standards.

125 In its *ISP Remand Order*, the FCC embarked on a plan to eliminate, over time, what it deemed a reciprocal compensation "windfall" that CLECs were receiving by serving ISPs, and the economic distortions that resulted. 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.[59] 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."[60]

126 In its analysis of the ISP arbitrage problem, the FCC assumed that CLECs were locating modems within each caller's local calling area—consistent with the ESP access charge exemption. The FCC did not even consider that CLECs might be able to continue receiving reciprocal compensation without even having to incur the expense of locating modems or servers in each local calling area. As such, there is no reason why the bill-and-keep regime, which the FCC said it preferred, should not immediately apply to this less costly means of providing dial-up ISP service.

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[59] *ISP Remand Order* para. 74.
[60] *Id.* at para. 77.

127 In Staff's view, if VNXX is allowed for ISP-bound traffic, it should not be allowed for other types of traffic. The commission recognized the perils of doing so in the Qwest/AT&T Arbitration in Docket UT-033035 when it agreed with the arbitrator's conclusion that "AT&T's alternative [defining "local" solely on the basis of assigned NPA-NXX] 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.[61]

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

VI. QWEST/MCI VERIZON ACCESS SETTLEMENT.

A. Standards for Approval of Negotiated ICA.

128 Staff's objective with regard to the proposed settlement agreement between Qwest and Verizon is that the definition of the permitted uses of VNXX arrangements be narrowed to ISP dial-up service, and restricted against the use of VNXX for other uses, including voice. (VoIP would have to be addressed separately depending on the outcome of other proceedings.) If the Commission takes Staff's recommendation to prohibit VNXX for non-ISP-bound traffic, the respondent CLECs, including Verizon Access, should be required to modify any contrary provisions in the ICAs.

B. Terms and Conditions.

129 N/A.

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[61] Order No. 05, paragraph 15, Docket UT-033035.

VII. CARRIER-SPECIFIC ISSUES.

A. Level 3/Broadwing Counterclaim.

130 N/A.

B. Global Crossing Counterclaim.

131 N/A.

C. Other Carriers (Listed Individually).

132 N/A.

VIII. CONCLUSION/RECOMMENDATIONS

133 For the foregoing reasons, Staff recommends that the Commission allow the respondent CLECs and Qwest to enter into bill-and-keep arrangements for the exchange of ISP-bound VNXX calls as Qwest has done with Verizon Access and AT&T. The proposed settlement agreement between Qwest and Verizon Access should therefore be approved, but only to the extent that it allows the use of VNXX arrangements for ISP-bound traffic. The Commission should expressly prohibit VNXX for purposes other than terminating ISP-bound traffic.

DATED this 1st day of June, 2007.

Respectfully submitted,

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