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Decision 07-02-031 February 15, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

OPINION REGARDING TREATMENT OF VIRTUAL NXX CALLS WITH RESPECT TO SMALL LOCAL EXCHANGE CARRIERS

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OPINION REGARDING TREATMENT OF VIRTUAL NXX CALLS WITH RESPECT TO SMALL LOCAL EXCHANGE CARRIERS

1. Introduction

This decision resolves issues regarding intercarrier compensation for traffic transported over the networks of "Small" Local Exchange Carriers (LECs)[1] utilizing disparate rating and routing points. We use the term "virtual" NXX[2] (VNXX) traffic to describe this calling arrangement.[3] We address these issues pursuant to the directives in Decision (D.) 03-09-005.

While we acknowledge that the Small LECs are subject to different economic, technical, and regulatory constraints compared with the major Incumbent ILECs (ILECs), we conclude that the Small LECs have not demonstrated that such differences justify inconsistent intercarrier compensation treatment for VNXX traffic as previously applied to the major ILECs. We therefore conclude that intercarrier compensation for VNXX calls routed over

[1] The term "Small LEC" refers to carriers of last resort providing telecommunications service in outlying rural areas of California outside of the large and midsized ILEC service territories.

[2] "NXX" refers to the three-digit prefix used to identify blocks of telephone numbers assigned to a central office "rate center." A rate center is used to measure distances for purposes of rating calls as local or interexchange (subject to per-minute toll charges). The NXX determines how a call is rated based on the distance between the rate centers from which the originating and terminating phone numbers are assigned.

[3] "Virtual NXX" refers to codes that are assigned throughout a Local Access and Transport Area (LATA) without regard to the location of the end-use customer. As a result, a customer in one rate center may use a local call to call the end-use customer physically located in another rate center. This arrangement has been particularly popular with internet service providers (ISPs). In this way, the ISP gains local access throughout large geographic areas with all calls delivered to one (or a few) interconnection location(s) as if all calls are local.

facilities of the Small LECs should be consistent with the principles previously applied to the major ILECs, as outlined below.

Unlike the major ILECs, however, the Small LECs interconnect on an indirect basis with CLECs. As a result, VNXX traffic must transit from the Small LEC meet point to the ILEC tandem located outside of the local calling area. As discussed below, we conclude that the CLEC shall bear responsibility for any costs of transit between the meet point and the ILEC tandem.

Although provisions of federal and state statutes, as well as Commission decisions, address the issue of intercarrier compensation, the parties disagree as to how to interpret those provisions as applied to VNXX traffic transported over the facilities of the Small LECs.[4] Under traditional practices, a call is rated according to the routing points designated in the Local Exchange Routing Guide (LERG), and retail toll charges are incurred unless both the calling and receiving party reside within the same local exchange. The VNXX arrangement, however, enables a calling party to avoid per-minute toll charges even though the call is routed to a foreign exchange. The VNXX arrangement provides retail subscribers with a "virtual" presence in a local exchange without physically residing within it. Even though the NXX prefix is associated with a rate center in a designated local exchange, the retail subscriber's terminal equipment is physically located in a separate foreign exchange. Absent the VNXX arrangement, a long distance carrier would pay access charges to compensate

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[4] The FCC is addressing inter-carrier compensation issues in its own federal rulemaking with an aim of replacing the existing inter-carrier compensation regimes with a unified approach designed for a market characterized by increasing competition and new technologies. This order is not intended to prejudge the outcome of that proceeding.

both the originating and terminating carriers for the use of their networks to complete the customer's call.

Pac-West disagrees with the use of the term "VNXX" to describe the calling arrangements as addressed in this proceeding. Pac-West uses the term "disparately rated and routed locally dialed" to characterize the calls in question. Pac-West claims that VNXX arrangements are no different than traditional FX service offerings. Pac-West indicates that not all disparately rated and routed locally dialed calls are analogous to traditional foreign exchange calls, but that a material number of them are terminated in the same local calling area where originated. Pac-West believes that all Small LEC calls to Pac-West are likely to be disparately rated and routed because the ILEC tandem where Pac-West's point of interconnection is located is likely not to be located in the same local calling area as the Small LEC end office. Even if a disparately rated and routed call terminates in the same local calling area as it originates, the originating carrier will need to route the call to the Point of Interconnection of the terminating carrier.

The small LECs believe that VNXX is an appropriate designation, however, claiming that although the rating of VNXX calls may be similar to traditional FX arrangements, the routing is completely different.

We agree with the Small LECs that traditional FX arrangements are different from VNXX arrangements. Under the traditional FX arrangement, carriers rely on dedicated facilities to transport the FX traffic to the customer's location. The FX customer pays its service provider for the cost of transporting the traffic. By contrast, with the VNXX arrangement, the end user to whom traffic is routed does not pay for any dedicated facilities. Instead, the

responsibility for transporting the traffic is shifted to the carriers whose customer originates the call.

We shall generally use the term VNXX to designate the calls at issue in this order. As appropriate in the discussion below, however, we shall distinguish between VNXX calls that terminate outside of the originating calling area versus those that terminate in the same local calling area.

2. Procedural Background

Disputes over appropriate intercarrier compensation arrangements for calls involving disparate rating and routing points first arose in Case (C.) 96-10-018, a complaint case between Pac-West (complainant) and Evans and Volcano Telephone Companies (co-defendants). Pursuant to D.97-12-094 issued in that complaint,[5] the Commission directed that the Commission address on an industry-wide basis the appropriate intercarrier compensation principles applicable to calling arrangements utilizing disparate rating and routing points.

We adopted general principles concerning intercarrier compensation for calls involving disparate rating and routing points in D.99-09-029. We stated in D.99-09-029, that because parties had been unable to agree through arbitration on the treatment of disparate rating and routing of calls, however, issues governing such traffic would be addressed in a further phase of Rulemaking (R.) 95-04-043. Further consideration of these issues was subsequently transferred from R.95-04-043 to R. 00-02-005 which was initiated to establish rules for payment of reciprocal compensation for Internet Service Provider (ISP) traffic.

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[5] *See* Ordering Paragraph 2 of D.97-12-094 which directed that in R.95 04-043/I.95-04-044, the Commission was to consider the appropriate intercarrier compensation for foreign exchange arrangements utilizing disparate rating and routing points.

On April 27, 2001, the FCC released its "Order on Remand and Report and Order" in the matter of reciprocal compensation for ISP-bound traffic,[6] adopting prospective rules governing intercarrier compensation for delivery of ISP-bound traffic. The FCC's stated intention was to transition from reciprocal compensation to bill-and-keep compensation for delivery of all traffic over which the FCC has jurisdiction. The FCC Order abandoned the previous distinction between "local" and "nonlocal" calls for ISP-bound traffic, and asserted federal jurisdiction over ISP-bound traffic. Nonetheless, because the use of VNXX arrangements is not limited to ISP-bound traffic, compensation issues relating to VNXX traffic that is not ISP-bound were not resolved by the FCC Order.

In D.03-09-005, we closed R.00-02-005, noting that the issues previously designated in that rulemaking had either been resolved by federal order or were subject to resolution through other forums. We noted that the Commission had independently resolved issues as to compensation for VNXX calling arrangements on a case-by-case basis in arbitration of interconnection agreement disputes between the major Incumbent Local Exchange Carriers (ILECs) and Competitive Local Exchange Carriers (CLECs). In D.03-09-005, we concluded that in view of these arbitrated proceedings, no further forum was needed to address intercarrier compensation for VNXX arrangements between CLECs and the major ILECs.

Parties representing Small LECs argued, however, that while those arbitration proceedings addressed intercarrier compensation for specific carriers,

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[6] *In the matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic.* CC Docket 96-98; 99-68; Order on Remand and Report and Order, (FCC 01-131) (released April 27, 2001) (FCC Order).

those arbitrations involved specific interconnection agreements to which Small LECs were not a party and were excluded from active participation. The Small LECs argued, as a result, that they were completing disparately rated and routed calls at no charge to CLECs. They argued that the impact of the disparate rating and routing arrangements on Small LECs had been aggravated due to the elimination of the revenue and expense pooling process with Pacific that previously had served to ameliorate some of these impacts.

Because their concerns relevant to disparately rated and routed calls had not been addressed in arbitration proceedings, the Small LECs recommended a separate forum be designated to address this issue, either in R.00-02-005, or in the Local Competition Docket (R.95-04-043).

In D.03-09-005, therefore, we designated R.95-04-043 as a forum in which to address Small LECs' concerns on the issue of intercarrier compensation for VNXX calls.

An Administrative Law Judge (ALJ) ruling, issued on December 30, 2004, solicited comments on the scope of issues to be addressed pursuant to D.03-09-005. Opening and reply comments were filed on January 18 and 28, 2005, respectively by a group of Small LECs, as well as by wireless carriers, by Pac-West Telecomm, Inc, and by the California Association of Competitive Telecommunications Companies (CALTEL). Reply comments were also jointly filed by the Commission's Division of Ratepayer Advocates and The Utility Reform Network (TURN).

In response to parties' opening and reply comments filed, a subsequent ruling, issued on April 11, 2005, identified the scope of issues to be addressed through the submission of opening and reply comments. Although parties

disagreed on certain details as to the scope of issues to be addressed in this proceeding, there was general consensus on the scope of relevant issues.

Opening comments were filed on May 16, 2005, jointly by a group of Small LECs,[7] as well as by Verizon West Coast West Inc. (VWC), jointly by Pac-West Telecomm, Inc, MCI, Inc. Level 3 Communications LLC, and the California ISP Association (Joint CLEC Parties), and by Sprint PCS (Sprint). Reply comments were filed on June 3, 2005.[8]

Parties had the opportunity to conduct discovery and to request evidentiary hearings. As directed in the April 11, 2005, ALJ ruling, any party requesting evidentiary hearings was to do so within 10 days after reply comments by filing a motion identifying specific factual disputes for which hearings were purportedly required. No party filed a motion requesting evidentiary hearings. Accordingly, we shall rely upon parties' written comments. No evidentiary hearings are required.

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[7] The small LECs joining in the joint comments were Calaveras Telephone Company, CAL-ORE Telephone Company, Ducor Telephone Company, Foresthill Telephone Company, Global Valley Networks, Inc., Happy Valley Telephone Company, Honitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, The Ponderosa Telephone Company, Sierrra Telephone Company, Volcano Telephone Company, and Winterhaven Telephone Company.

[8] Pac-West *et al.* submitted an errata to their June 3, 2005 comments on June 5, 2005, substituting updated information regarding the rate of $.000640 adopted in D.05-05-031 for Setup per Completed Message.

3. Disposition of Issues

A. Obligations of Small LECs to Route VNXX Traffic

1. Parties' Positions

Pursuant to the ALJ ruling, parties addressed the Small LEC's obligation to route traffic to another carrier's designated VNXX code where the carrier has established only an "indirect" tandem interconnection providing the interconnecting carrier with access to all switches subtending the tandem, including Small LEC networks. Alternatively, parties addressed the Small LEC's obligation to route traffic to another carrier's designated VNXX code where the interconnecting carrier has established a direct connection to the Small LEC serving territory and assumes all costs of transporting traffic between the calling and called parties.

Typically, Small LECs have not entered into interconnection agreements providing for a direct point of interconnection with CLECs, and their respective networks do not interconnect. CLECs (such as Pac-West) and the Small LECs interconnect instead with one or both of the major ILECs.

As indicated by Pac-West, both the CLEC and the Small LECs interconnect with the major ILECs at the same tandem offices. Pac-West has established Points of Interconnection at all tandem locations of SBC and Verizon. The Small LECs subtend these same tandem offices. The Small LECs generally route VNXX traffic over Feature Group C trunks originally provisioned to accommodate intraLATA toll traffic provisioned by SBC.

Pac-West argues that the Small LECs are obligated to transport VNXX traffic to the point of interconnection and are financially responsible for doing so. The Small LECs disagree, arguing that such an obligation only applies

to "local" traffic subject to § 251, and that VNXX traffic is not "local." The Small LECs contend that VNXX traffic instead is "interexchange" in nature.

2. Discussion

Both state and federal law require all telecommunications carriers to interconnect, either directly or indirectly. The 1996 Telecommunications Act (Act) provides that all telecommunications carriers, including the Small LECs, establish reciprocal compensation arrangements with respect to the exchange of traffic. As discussed below, we conclude that VNXX traffic is properly subject to reciprocal compensation. We thus conclude that consistent with the Act, the Small LEC remains responsible for transiting VNXX calls originated by its customers that terminate at the end office served by a CLEC. In situations where the Small LEC originates a VNXX call intended for an end-user served by a CLEC with which the Small LEC is only indirectly connected, the Small LEC is still obligated to transport the call to its point of interconnection with the ILEC, as an intermediary. In this situation, the ILEC would provide the transit service for the small LEC, and the arrangement between the Small LEC and the ILEC would determine how the ILEC recovers costs for transiting such calls. The Small LEC still remains responsible for routing the call to the carrier of the called party.

B. Intercarrier Compensation of Transport and Termination Costs for VNXX traffic over Small LEC Facilities

1. Parties' Positions

Federal and state rules govern the payments that carriers make to LECs that originate and terminate calls. For interexchange calls, the originating

carrier pays access charges.[9] Such access charges are to compensate LECs for use of the local plant to begin or complete a long-distance call.

Reciprocal compensation provisions established under § 251(b)(5) of the 1996 Act generally govern the compensation between telecommunications carriers for termination of "local" calls.[10] Under standard reciprocal compensation provisions of interconnection contracts between the major ILECs and CLECs, the cost of transporting and terminating a customer's local call that *originates* from one local exchange carrier's network and *terminates* on another local exchange carrier's network is attributed to the carrier from which the call originated. (47 CFR §§ 51.701(e), 51.703 (1997).) Such "local" calls are distinct from calls which merely pass through interexchange switches and involve access charges rather than reciprocal compensation fees.

Parties disagree regarding the appropriate intercarrier compensation for transport and termination of VNXX traffic involving the Small LEC's facilities. Parties disagree based, in part, on different views as to whether the VNXX traffic is local or interexchange under applicable law. Parties disagree as to whether a Small LEC must pay reciprocal compensation on VNXX traffic that terminates at an end office outside of the Small LEC's local calling area. The Small LECs deny that they are obligated to pay reciprocal compensation for VNXX calls based on their view that such calls are not "local." The Small LECs argue that they should not be responsible for paying reciprocal compensation on

[9] *See generally,* Pub. Util. Code §§ 489, 490, 495.7, 709, and 728.7.

[10] 47 U.S.C. § 251(b)(5). Intrastate access charges, and intrastate calling generally, are governed by state public utility commissions. Different rules apply depending on whether the calling and the called parties are using wireline or wireless services.

calls which would otherwise qualify for access charges but for the fact that a VNXX arrangement is involved. The Small LECs contend that VNXX traffic constitutes standard interexchange traffic, and as such, is subject to access charges due from originating carriers to transport VNXX calls to destinations outside of the local calling area.

Focusing on the actual routing of the VNXX calls as the measurement, the Small LECs argues that the VNXX traffic originating on the Small LEC networks does not terminate within the local calling area, but is interexchange. As such, the Small LECs argue, they are entitled to access charges on such traffic. If, however, the Commission views the VNXX traffic as a form of foreign exchange service offering, then the Small LECs argue that they should be compensated as a provider of special access facilities subject to access charges. The Small LECs characterize their role in providing transport of VNXX traffic as creating a virtual presence around the state for ISP customers of the VNXX provider. The Small LECs do not currently pay other ILECs for the completion of VNXX calls.

Parties also addressed the issue of the Small LEC's responsibility for compensating third-party carriers through whom VNXX traffic is exchanged beyond the Small LEC service boundaries. The Small LECs contend that the carrier arranging for the VNXX service offering is responsible for transit charges assessed by third-party carriers. In D.03-05-031, the Commission determined that SBC California could properly assess transport charges on the carrier arranging for the VNXX route even though the call had originated on SBC California's network. The Small LECs argue that a similar principle should apply in their case. Thus, if a third-party transiting carrier wishes to assess

charges for VNXX traffic, such charges are appropriately assessed on the carrier that arranged for the VNXX route.

The CLEC parties argue that the Commission's current intercarrier compensation rules are adequate, and that no changes are warranted that would treat Small LECs differently from other carriers. The CLECs argue that the Act and FCC rules prohibit Small LECs from imposing costs on other carriers associated with Small LECs' originating and transporting their traffic to the point of interconnection. Rule 51.703 (b) states that a LEC "may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network."

The CLEC parties argue that, consistent with Rule 51.703, VNXX traffic is not subject to access charges, since the rating points of the calling and called party are in the same local area, even though the point of interconnection may be outside the local exchange. As such, the CLEC parties argue that VNXX traffic is subject to reciprocal compensation.

The CLEC parties argue that pursuant to § 251(b)(5) of the Act, all carriers, including Small LECs, have an affirmative obligation to pay reciprocal compensation arrangements for VNXX traffic. In this regard, D.99-09-029 states that the carrier establishing a VNXX arrangement shall pay for transporting VNXX calls to their point of termination.

The Joint CLEC parties argue that in implementing this reciprocal compensation obligation, the FCC adopted a rule that expressly prohibits the Small LECs from requiring other telecommunications carriers to pay for transporting traffic that the small LECs originate and deliver to the relevant point of interconnection. The Joint CLEC parties argue that nothing about the

situation or status of the Small LECs permits or requires adoption of different rules applicable only to the Small LECs.

The interconnection agreements between Pac-West and each of the major ILECs provide an example of CLEC arrangements. These interconnection agreements establish "transit rates" payable by Pac-West when originating VNXX calls destined to a customer served by a Small LEC. These agreements require Pac-West to collect termination charges directly from any third-party carrier originating such traffic and delivering it to Pac-West via such a transit arrangement. The major ILEC does not pay reciprocal compensation for VNXX calls originated by either the small LECs or Pac-West.

2. Discussion

Based on our analysis as discussed below, we conclude that similar principles applied in interconnection arbitrations involving the major ILECs should also be applied here in reference to the Small LECs' arrangements. As a starting point for considering intercarrier compensation for VNXX traffic applicable to Small LECs, we review the intercarrier compensation principles we have applied with respect to the major ILECs in past arbitrations. We then consider whether the record here provides a basis to treat the Small LECs differently.

a. General Principles of Cost Responsibility

In D.99-09-029, we set forth broad industry-wide standards applicable to the use of disparately rated and routed calls of the sort at issue here. In D.99-09-029, we found that "a carrier may not avoid responsibility for negotiating reasonable intercarrier compensation for the routing of calls from the foreign exchange merely by redefining the rating designation from toll to local." (D.99-09-029, *mimeo.* at p. 32.) We have also determined that "[a] carrier should

not be allowed to benefit from the use of other carriers' networks for routing calls to ISPs while avoiding payments of reasonable compensation for the use of those facilities." (D.99-09-029, *mimeo.* at p. 32.) Consistent with D.99-09-029, all carriers are entitled to be fairly compensated for the use of their facilities and related functions to deliver VNXX calls to their destination, taking into account the actual characteristics of the traffic involved. As stated in D.99-09-029:

> We conclude that all carriers are entitled to be fairly compensated for the use of their facilities and related functions performed to deliver calls to their destination, irrespective of how a call is rated based on its NXX prefix. Thus it is the actual routing points of the call, the volume of traffic, the location of the point of interconnection, and the terms of interconnection agreement – not the rating point – of a call which properly forms a basis for considering what compensation between carriers may be due.[11]

In D.99-09-029, however, we did not have a sufficient record to adopt specific intercarrier compensation arrangements for transport and delivery of traffic involving disparate rating and routing points. We did determine that existing tariffed switched access rates, as charged by the ILEC to other carriers for transport of intraLATA traffic, did not necessarily provide a fair or economically efficient basis for intercarrier compensation. (D.99-09-029 at 32.)

b. Intercarrier Compensation Treatment in Major ILEC Arbitrations

We have applied the broad principles outlined in D.99-09-029 regarding intercarrier compensation for VNXX calls in arbitrating interconnection agreement disputes between the major ILECs and CLECs.

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[11] D.99-09-029, *mimeo.* at p. 36.

In those arbitrations, we have consistently applied the "principle of cost causation." (*e.g.*, D.03-05-031, *mimeo.* at p. 8.) In D.03-05-031, in the arbitration between Pacific Bell Telephone Company and Pac-West, we determined that where a carrier has uncompensated costs when carrying calls for VNXX customers, that carrier should be compensated for the use of its facilities.[12]

Applying the principle of cost causation does not violate FCC Rule 51.703(b) which provides: "A LEC [local exchange carrier] may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network." (47 C.F.R., § 51.703(b).) In D.02-06-076 (the Global GNAPs Decision), we determined that Rule 51.703(b) must be read in conjunction with FCC Rule 51.701. Rule 51.701(a) states: "The provisions of this subpart apply to reciprocal compensation for transport and termination of telecommunications traffic between LECs and other telecommunications providers." (47 C.F.R., § 51.701(a).) § 51.701(b) states: "For purposes of this subpart, telecommunications traffic means: (1) Telecommunications traffic exchanged between a LEC and a telecommunications carrier other than a CMRS [Commercial Mobile Radio Service] provider, except for telecommunications traffic that is interstate or intrastate exchange access, information access, or exchange services for such access." (47 C.F.R., § 51.701(b).)

In D.03-05-031, we stated that: "the Commission's local competition rules require the originating call carrier to compensate the CLEC for

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[12] *See LEVEL 3 COMMUNICATIONS, LLC, Petition for Arbitration Pursuant to Section 252(b) of the 1996 Act, for Rates, Terms, and Conditions with Pac. Bell Telephone Company, Order Denying Rehearing of D.00-10-032* ("*Second Level 3/SBC* Arbitration Decision"), D.01-02-045, 2001 Cal. PUC LEXIS 117 at pp. 3-6; *Verizon/SBC* Arbitration Decision, D.03-05-075, *mimeo.* at p. 7.

terminating the "local" traffic, including VNXX traffic that is disparately rated and routed, as in a foreign exchange (FX) service."[13] VNXX and Foreign Exchange traffic are distinct from traditional arrangements where the called and the calling parties both reside within the same local exchange area. This treatment of VNXX traffic is consistent with D.99-09-029 which stated that:

> the assigning of NXX prefixes of ISPs in the manner used by Pac-West constitutes a form of foreign exchange service from the perspective of the end user. As such, the Pac-West arrangement warrants rating of the calls from the rate center of the foreign exchange in similar fashion to more traditional forms of foreign exchange service. Accordingly, such calls would be rated as local calls if originated from a rate center within 12 miles of the rate center of the designated foreign exchange of the called party's NXX prefix. This principle is consistent with the underlying intent of the tariffs governing the rating of calls as toll or local, applied in the context of foreign exchange service.[14]

Accordingly, the ILEC must pay reciprocal compensation to the CLEC for terminating such VNXX calls. We also required, however, as a quid pro quo for receiving reciprocal compensation, the CLEC would bear the cost of additional transport required to get the VNXX call to where it would be considered "local" (*i.e.,* from the rate center where the calling party physically

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[13] *See* D.03-05-031, *mimeo.* at p. 4, n. 3, p. 6, and p. 10; *In the Matter of Application of Verizon California, Inc., Petition for Arbitration with Pac-West Telecomm, Inc. Pursuant to Section 252(b) of the Telecommunications Act of 1996, Decision Approving Arbitrated Agreement Pursuant to Section 252(e) of the Telecommunications Act of 1996, ("Verizon/SBC* Arbitration Decision"), D.03-05-075 at p. 4; *GNPs* Decision, D.02-06-076, 2002 Cal. PUC LEXIS 319 at pp. 38-42.

[14] D.99-09-029 at 25.

resides to the point of interconnection closest to the switch used for delivering calls to the rate center where the call terminates).[15] Alternatively, the CLEC could avoid such transport charges by extending its point of interconnection to the ILEC tandem switch serving the end office of the originating traffic. As observed in D.03-05-031, this "quid pro quo" promotes local competition and enables CLECs to utilize one point of interconnection to serve each of the rate centers within the LATA. CLECs thereby must balance the investment of adding a point of interconnection with the cost of purchased transport, leased or otherwise, from their switching facilities to the end user. (D.03-05-031 at 11.)

We elaborated on this arrangement in the arbitration between the major ILECs and Global NAPs, Inc. in D.02-06-076 (page 28):

> "…VNXX calls would be intraLATA calls, not local calls, if tied to the rate center that serves the customer. By allowing disparate rating and routing, we are allowing for those calls to become local calls, and as such, subject to reciprocal compensation. However, GNAPs is required to pay the additional transport required to get those calls where they will be 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. Because these calls would be intraLATA toll calls, if they were rated out of the rate center, which actually provides service to the customer, they are not subject to the provisions of Rule 703(b)."

We have previously interpreted the FCC's rules to mean that a carrier is responsible for compensating the ILEC for termination of intraLATA

[15] *See* D.01-02-045, page 6.

tolls calls which are interexchange in nature from that carrier's customers. A carrier is not responsible for compensating the ILEC for transporting local calls, however, which *are* subject to reciprocal compensation on the ILEC's side of the point of interconnection. (D.02-06-076 at p. 16.)

We next consider parties' claims concerning whether characteristics of the Small LECs provide a basis to apply to them the principles of intercarrier compensation differently in comparison to the treatment used for the major ILECs, as outlined above.

c. Distinctions Between Small LECs and Large ILECs

As an additional basis for opposing payment of reciprocal compensation for VNXX traffic, the Small LECs claim that such payment would constitute an unfair burden. Although the Commission has required the major ILECs to pay reciprocal compensation for VNXX traffic, as noted above, the Small LECs argue that such requirements should not apply to them since they face different constraints. As a basis to evaluate such claims, we solicited comments as to relevant differences between the Small LECs and the major ILECs. Specifically, we solicited information as follows:

1. Is the technical and/or economic situation facing Small LECs with respect to the effects of exchanging VNXX traffic materially different than for the large ILECs? Do such differences provide a basis to treat Small LECs differently from ILECs with respect to interconnection rights and obligations applicable to VNXX traffic?
2. What are the current terms of interconnection between the Small LECs and ILECs with respect to VNXX Calls that are originated (a) by Small LECs (b) by CLECs?

3. What end user revenues do Small LECs receive for VNXX calls?
4. What incremental costs do Small LECs experience for VNXX calls?
5. What external subsidies do Small LECs receive for various categories of VNXX calls?
6. What is the quantity of VNXX calls involving Small LECs? How significant is the magnitude relative to other categories of calls?
7. Should currently effective tariffs covering reciprocal compensation for VNXX be enforced in the absence of an applicable interconnection agreement?

In contrast to the large ILECs, the Small LECs characterize themselves as carriers of last resort within their service territories which consist of rural customers. The Small LECs characterize their networks as "islands" within a particular LATA, in contrast with the large ILECs that own facilities throughout each LATA. As a result, the large ILEC has more control over how it routes VNXX traffic as compared with the Small LEC that relies on other carriers to fulfill traffic obligations.

The Small LECs also claim they lack the financial resources to fund reciprocal compensation payments, and are limited in the retail rates that they may charge under "rate-of-return" regulation. By contrast, the Commission has recently issued D.06-08-030 (R.05-04-005), essentially lifting most of the remaining regulatory restrictions on the major ILECs' ability to adjust their retail rates.

The flat-rate monthly service fee that Small LEC retail customers pay for local calling does not cover incremental reciprocal compensation fees for VNXX calls. Given the nature of calling patterns to dial-up ISPs, the Small LECs

claim that VNXX calls generate huge volumes of holding time, requiring additional trunk capacity to transport the calls without generating any offsetting incremental revenues. The Small LECs claim they also incur additional switching costs for every VNXX call that is placed.

The Small LECs claim that if required to pay reciprocal compensation for VNXX arrangements, either their financial health would be jeopardized or else the cost burden would shift to their ratepayers, either through increased retail rates or through external support from a source such as the California High Cost Fund-A. The Small LECs argue that if the Commission were to shift VNXX-associated costs onto the Small LECs in this manner, such a result would burden all ratepayers with costs which benefit only VNXX-based ISPs and the CLECs serving them.

Joint CLEC Parties argue that the magnitude of VNXX traffic routed through Small LEC networks is not relevant in determining the appropriate intercarrier compensation because carriers' legal obligations do not change as a function of traffic levels. The Joint CLEC Parties acknowledge that most, if not all, traffic originated by a Small LEC and transported by a CLEC will be disparately rated and routed because the Point of Interconnection is likely to be outside of the local exchange associated with the calling party's telephone number.

The Joint CLEC parties further claim that the Small LECs do not and should not have incremental costs associated with transporting VNXX traffic to the Point of Interconnection. The Joint Parties argue that if Small LECs incur a shortfall between costs and revenues, however, they should demonstrate a need and seek relief from the Commission, instead of imposing such costs on competitors. The Joint CLEC parties argue that while the Small LECs may not

have accounted for reciprocal compensation in their rate case submissions, nothing precludes them from doing so. The Small LECs had general rate cases completed in 1997. Some Small LECs also elected to file general rate cases in 2001 due to Commission revisions to the rules governing the CHCF-A.

The Joint CLEC parties claim that the Small LECs will not necessarily need to withdraw increased amounts from the CHCF-A, but should be entitled to such a draw if indeed the rules call for it.

We acknowledge that the Small LECs may be subject to different economic, technical, and regulatory constraints compared with the major ILECs, with respect to VNXX traffic. We conclude, however, that the Small LECs have not demonstrated that such differences justify inconsistent intercarrier compensation treatment as previously applied to the major ILECs.

d. Adopted Intercarrier Compensation Arrangements for Small LECs

We therefore conclude that the Small LECs should be held responsible for payment of reciprocal compensation for VNXX calls consistent with the principles previously applied to the major ILECs, as outlined above. Reciprocal compensation obligations are paid by the calling party's carrier for the costs associated with the transport and termination from the carriers' interconnection point to the called party's end-office, and for the additional costs of terminating the call to the called party.

In previous arbitration decisions involving the major ILECs, we applied our own independent balancing test in determining as a matter of fair compensation policy that VNXX traffic is subject to reciprocal compensation. We did not, however, rely upon the FCC's rules for reciprocal compensation pursuant to § 251(b)(5). Consequently, while we found that the ILEC was

responsible for paying reciprocal compensation for termination of VNXX traffic, we did so independently from FCC Rule 51.703(b).

Likewise, consistent with past treatment of the major ILECs, we do not rely upon Rule 51.703(b) in delineating intercarrier compensation for VNXX transport on the originating carrier's side of the point of interconnection. Rule 51.703(b) states: "A LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network." This rule, however, applies to traffic subject to the reciprocal compensation provisions of § 251(b)(5) of the Act. Yet, we have previously determined that: "VNXX Traffic is interexchange traffic, by nature of its termination outside of the originating calling area, that is not subject to the FCC's reciprocal compensation rules, even though it is rated as a local call to the calling party." (D.03-12-020 at 7.)

Consequently, consistent with our previous determinations, we likewise conclude that § 251(b) (5) and FCC Rule 51.703(b) do not apply in the case of VNXX traffic originated by a Small LEC. Such VNXX traffic is interexchange traffic, and thus is *not* subject to the FCC's reciprocal compensation rules restricting the assessment of transport charges.[16] Accordingly, we are not bound by the restrictions of § 251(b)(5) and Rule 51.703(b) in resolving the issue of intercarrier compensation relating to originating transport for Small LECs' VNXX traffic.

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[16] *See, e.g.,* D.03-05-031 (in A.02-03-059) at 8; *see* also the rehearing order in D.03-12-020 at 7. Rule 51.701(b) expressly excludes intrastate exchange access from the definition of "telecommunications traffic" that is applicable to Rule 51.703(b).

As noted previously, in past Commission arbitration decisions involving the major ILECs, a CLEC terminating VNXX traffic bears cost responsibility to get the call to the local rate center where it originated.

For example, as noted in D.02-06-027, the Commission stated:

> "VNXX calls would be intraLATA calls, not local calls, if tied to the rate center that serves the customer. By allowing disparate rating and routing, we are allowing for those calls to become local calls, and as such, subject to reciprocal compensation. However, GNAPs is required to pay the additional transport required to get those calls where they will be considered local calls…"[17]

Similarly, as stated in D.03-05-075:

> "The Commission in deciding prior arbitration agreements concluded that CLECs would be absolved from paying the costs associated with transport from origination to their point of interconnection on the condition that the disparately rated and routed traffic was returned and terminated within the rate area where the local call originated."[18]

The rationale for this policy was explained in D.03-05-031 as follows:

> "this 'quid pro quo' policy promotes local competition and improves the opportunity for CLECs to utilize one point of interconnection to serve each of the rate centers within the LATA.

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[17] *See* D.02-06-076, p. 28, (In A.01-11-045 *et al.*, in the Matter of Global NAP's, Inc. Petition for Arbitration with Pacific Bell Telephone Company).

[18] *See* D.03-05-075, p. 6 in A.02-06-024, in the Matter of Verizon California, Inc. Petition for Arbitration with Pac-West Telecomm, Inc.

> Thus, the CLECs have to balance the investment cost of adding a point of interconnection with the cost of purchased transport, leased or otherwise, from their switching facilities to the end user."[19]

In the case of the major ILECs, Pac-West has satisfied the requirement to get the call to the local calling area by interconnecting at an ILEC tandem switch. An additional complicating factor in the case of the Small LECs' networks, however, is the fact that they do not interconnect directly with CLECs, but utilize third-party transit service to get VNXX calls delivered to the point of interconnection at the tandem.

When a Small LEC originates a VNXX call intended for an end-user served by a CLEC with which the Small LEC is indirectly interconnected, the Small LEC transports the call to its meet point with the ILEC which then transits the call to the point of interconnection with the CLEC. In the case of Small LECs, however, their meet point with the ILEC is typically located at a significant distance from the CLEC point of interconnection located at LEC tandem switch. For example, Volcano Telephone Company has for years sent traffic to Pac-West for termination via such tandem even though Volcano's meet point with the ILEC actually extends only 8 miles out of the 47 mile distance to the Stockton tandem. For the typical VNXX call originated by a Small LEC customer, therefore, the point of interconnection at the ILEC tandem is still outside of the Small LEC's local calling area. We therefore conclude that the CLEC should be responsible for costs of transit of VNXX traffic from the meet point to the common point of interconnection at the tandem switch. Such an

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[19] *See* D.03-05-031, p. 11 (In A.02-03-059 of Pacific Bell Telephone Company for Arbitration with Pac-West Telecomm, Inc.).

approach is consistent with existing policy requiring the CLEC to return the call to the local calling area where it originated.

As discussed above, Pac-West's reliance on FCC Rule 51.703(b) is misplaced as a basis to claim that the terminating carrier bears no cost responsibility for transit from the Small LEC meet point to the tandem. For example, in D.03-12-020, even though we required the ILEC to pay reciprocal compensation, we also required that Pac-West compensate the ILEC for the use of facilities when carrying calls destined for Pac-West. Such a requirement did not violate FCC Rule 51.703(b). Likewise here, FCC Rule 51.703(b) does not conflict with the requirement for the CLEC to bear cost responsibility for VNXX transport costs from the Small LEC meet point to the ILEC tandem. Because Small LEC VNXX traffic is interexchange traffic, it is not subject to the FCC's reciprocal compensation rules.

Pac-West argues that if the CLEC were required to pay for transit of VNXX traffic from the Small LEC meet point to the point of interconnection at the tandem switch, such payments would contravene currently effective ILEC/CLEC interconnection agreements that have been approved by this Commission. For example, the interconnection agreements between Pac-West and each of the ILECs contain explicit provisions for exchange of third-party transit traffic (including traffic originated by a Small LEC) at the tandem switch, and none of these agreements call for the terminating carrier to pay transiting traffic costs incurred on the originating carrier's side of the point of interconnection. Pac-West claims that the Ninth Circuit has previously concluded that the Commission's "general rule-making authority under California law to issue a generic order applicable to all interconnection

agreements between telecommunications companies in California is precluded by § 252."[20]

We disagree with Pac-West's claim that our rulemaking for intercarrier compensation as set forth herein conflicts with principles set forth in the Ninth Circuit opinion. In the same Ninth Circuit opinion cited by Pac-West, the Court also observed: "Arguably, there are other provisions in the Act that suggest that the Commission may engage in general rule-making as part of its authority over interconnection agreements or its authority under state law."[21] For example, the Ninth Circuit cites § 251(d)(3) which provides:

In prescribing and enforcing regulations to implement the requirements of this section the [FCC] shall not preclude the enforcement of any regulation, order, or policy of a State commission that –

(a) establishes access and interconnection obligations of local exchange carriers;

(b) is consistent with the requirements of this section; and

(c) does not substantially prevent implementation of the requirements of this section and purposes of this part.

We have repeatedly engaged in rulemaking in this proceeding, including adopting rules underlying the treatment of VNXX traffic. Contrary to Pac-West's claims, we find no basis under federal law precluding such rulemaking here with respect to VNXX traffic involving the Small LECs. The establishment of general rulemaking concerning intercarrier compensation for VNXX traffic as

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[20] *See* Pacific Bell v. Pac-West Telecomm, Inc., 325 F.3d 1114, 1127 (9th Cir. 2003).

[21] *Id*. 1127.

prescribed herein is consistent with the principles relating to § 251(d)(3) as discussed in the Ninth Circuit Opinion.

Pac-West also argues that if the terminating CLEC were to be responsible for transport up to the Small LEC/ILEC meet point, such a requirement would effectively be imposing a requirement for direct interconnection, in conflict with § 251(a) which expressly permits telecommunications carriers to interconnect indirectly at the tandem.

For indirect interconnection, the ILEC tandem is the default intermediary as the switch that typically serves as a routing point for all other switches serving NXXs assigned to the tandem service area. The significance of the tandem switch as the point of interconnection is explained in Sprint's comments as follows:

> "The LATA tandem switch information is particularly important because few carriers interconnect directly with each other; rather, they connect to the public switched telephone network (PSTN) at a LATA tandem switch. According to Sprint, when a call is placed, the originating carrier routes the call to an end-user via the LATA tandem switch, which is generally operated by a regional Bell operating company (RBOC)." [22]

We reject Pac-West's claim that our intercarrier compensation requirements violate federal law allowing for indirect interconnection. Requiring the CLEC to bear transport costs from the Small LEC meet point to the tandem is not equivalent to requiring the CLEC to interconnect directly at the

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[22] *See Comment Sought on Sprint Petition for Declaratory Ruling Regarding the Routing and Rating of Traffic by ILEC*s, 17 FCC Rcd 13859; 2002 FCC LEXIS 35267, DA 02-1740 (rel. July 18, 2002).

Small LEC meet point. The point at which cost responsibility is delineated between carriers is not necessarily the same as the point of physical interconnection where carriers' wires meet.

Interconnection is indirect whenever the attachment of two carriers' wires occurs only through intermediary facilities or equipment of one or more additional carriers. By addressing the allocation of cost responsibility for transport of VNXX traffic, however, we do not dictate how carriers physically interconnect, nor preclude use of third-party facilities to route VNXX traffic from a meet point to a tandem. We do, however, require that if a carrier interconnects on an indirect basis, it must bear responsibility for transport costs, if any, to get a VNXX call from the Small LEC local calling area to point of common interconnection, such as a tandem.

Pac-West further claims that making the VNXX carrier responsible for ILEC transport charges contradicts the holding in *Atlas Telephone Co. v. Oklahoma Corp. COM's,* 400 F.3d (10th Cir. 2005)(*Atlas*). We disagree. In *Atlas,* the Tenth Circuit interpreted the FCC's reciprocal compensation rules as they applied to wireless carriers and rural, incumbent local exchange carriers. The court applied the FCC's reciprocal compensation rules to the exchange of wireless intraMTA traffic. Because the VNXX decision does not pertain to wireless carriers or the exchange of intraMTA traffic, *Atlas* does not apply to the circumstances at issue here.

e. Alternative Options to the Small LECs

We do not believe that the Small LECs have adequately explored all of the alternative options potentially available to address perceived adverse effects resulting from paying reciprocal compensation. For example, a Small LEC could seek to enter into a traffic exchange agreement with any

telecommunications carrier to which it sends or from which it receives significant amounts of local traffic. By entering into such an agreement, the Small LEC might avoid paying transit charges which could be higher than applicable local termination charges. Pac-West provides, for example, traffic volumes and related intercarrier charges invoiced to Volcano Telephone Company. The charges applicable to such traffic are set forth below:

	Traffic Volumes	**Pac-West Invoice to Volcano**	**ISP Traffic Rate**	**SBC Transit Traffic Rate**
Total Messages	96,661			
Total Minutes of use	2,634,935			
Per Message Rate		$0.0020		$0.00064
Minutes of Use Rate		$0.0010	$0.0007	$0.002963
Total		**$2,828.26**	**$1,844.45**	**$7,869.18**

As depicted, Pac-West invoiced Volcano $2,828.26 for terminating traffic on a per-minute basis. If, however, Volcano had elected to opt into the FCC's ISP traffic rate plan, Pac-West claims Volcano could have reduced its obligations to only $1,844.45.[23] Because Volcano declined these options, it presumably paid the SBC tandem transit rate on this traffic, amounting to $7,869.18, pursuant to the interconnection agreement between Pac-West and SBC. Volcano has not negotiated to exchange traffic directly with Pac-West at the

[23] Both of the major ILECs have adopted the rate plan set forth in the FCC's ISP Remand Order (FCC 01-131, released April 27, 2001) , and the provisions of the ISP Order are reflected in each of Pac-West's currently effective interconnection agreements with the major ILECs. By contrast, the Small LECs, which utilize the transit provisions of Pac-West's interconnection agreements with the major ILECs to indirectly deliver traffic to Pac-West, have not adopted the FCC's rate plan applicable to ISP-bound traffic. As a result, the Small LECs remain free to enter into voluntary intercarrier agreements setting for the terms and conditions that will apply to traffic utilizing disparate rating and routing points, including ISP-bound traffic.

SBC tandem which, according to Pac-West, would result in Volcano paying either of the two smaller amounts noted above. Thus, the Small LECs' apparent decision not to pursue negotiations with CLECs seems to run counter to their concerns over increased costs.

As another option, a Small LEC might seek to negotiate direct interconnections with CLECs, and file a request for dispute resolution before the Commission with respect to any billing issues. Moreover, the Commission previously established a streamlined dispute resolution process in D.95-12-056 (as summarized in the Appendix to this order) through which carriers may seek expedited resolution of disputes concerning the terms of interconnection. The Small LECs could avail themselves of this process as one possible way to address disputes over the terms of interconnection with CLECs.

The Small LEC also might seek authority to adjust retail subscriber rates, or to draw upon the California High Cost Fund-A. The Small LECs have not provided sufficient detail to quantify specifically how retail rates might be affected, or to what the California High Cost Fund-A may be implicated if adjusted to account for reciprocal compensation payments. The Small LECs provide an anecdotal example of an invoice sent to Volcano from O1 Communications, Inc. for $261,941, representing two years of VNXX traffic. The Small LECs claim such an amount would "wreak havoc" on Volcano's balance sheet if required to be paid out of shareholder funds.

Volcano estimates that it originates approximately 4 million minutes per month of VNXX traffic. Assuming a reciprocal compensation rate of one cent per minute, Volcano would owe approximately $40,000 per month for VNXX traffic. Spread over its 11,300 customers, Volcano estimates it would pay approximately $3.54 per customer per month if required to pay reciprocal

compensation for VNXX traffic. During 2004, the VNXX traffic volume originated by Volcano customers was more than double the volume state access minutes and more than all other switched access minutes combined.

No data is provided, however, quantifying specific impacts on the Small LECs' respective returns on equity, bond ratings, or other relevant financial measures as a result of reciprocal compensation payments for VNXX traffic. The Small LECs likewise do not account for offsetting receipts of transport charges that may be collected from CLECs pursuant to the quid pro quo policy referenced above. Correspondingly, we cannot make definitive findings based on the existing record concerning whether or to what extent reciprocal compensation payments might warrant adjustments to one or more of the Small LECs' retail rates and/or to draws from the High Cost Fund A. In the absence of a detailed showing in this regard, the Small LECs have not justified nonpayment of reciprocal compensation based on claimed adverse shareholder and/or customer impacts. In any event, we find insufficient basis to conclude that the Small LECs have explored all reasonable alternatives to address the funding of reciprocal compensation payments for VNXX traffic.

f. Effects of Intercarrier Compensation Arrangements on Competition

The Small LECs argue that the primary beneficiaries of VNXX arrangements are ISPs that do not wish to invest in facilities in rural areas. Such ISPs compete with other ISPs that have invested in rural areas. The Small LECs argue that CLECs offering VNXX arrangements typically focus on a narrow set of potential subscribers, specifically business entities that generate substantial volumes of one-way inbound calls. If a VNXX-based ISP wishes to procure a rural presence hundreds of miles away from its servers, the Small LECs argue

that such ISP should pay for the network facilities required to create the virtual presence.

Pac-West argues, however, that it is the Small LECs' proposal that would give an unfair competitive advantage to Small LECs and their ISP affiliates. Pac-West observes, for example, that Volcano Telephone Company serves in approximately the same territory as that of its affiliate, Volcano Internet Provider. Pac-West claims that the Small LECs are attempting to drive up the cost to independent ISPs of providing service through a CLEC, as compared with the cost to an ISP affiliated with the Small LEC. Pac-West argues that the Small LEC proposal, if adopted, would cause the withdrawal of CLECs serving exchanges adjacent to the Small LEC territory due to cost increases, thereby decreasing ISP competition and consumer choice in the affected areas.

We conclude that by requiring the Small LECs to pay reciprocal compensation for VNXX calls on the same basis as required for the major ILECs, a competitive environment is promoted for the provision of service by ISPs in the rural areas served by the Small LECs. Likewise, by requiring the CLEC to be responsible for the cost of transport on a quid pro quo basis, as outlined above, the Small LECs are not competitively disadvantaged.

C. Use of Tariffs Covering Reciprocal Compensation Should Govern in the Absence of an Interconnection Agreement

1. Parties' Position

Another issue in dispute is whether a carrier's tariff should govern reciprocal compensation obligations for VNXX Traffic in the absence of an interconnection agreement between the parties.

The CLEC parties argue that tariffs should govern in the absence of parties entering into an interconnection agreement because tariffs are an efficient

method for implementing uniform terms and conditions governing a service offered to a class of customers. The CLEC parties argue that tariffs are efficient to the extent that parties are not required to spend significant administrative and legal resources negotiating contract terms that simply reflect Commission approved rates. Tariffs also provide that all customers are treated in a non-discriminatory manner. While carriers have the option to, and may wish to, negotiate an individual agreement, the tariff provides another option for example, if parties exchange only small volumes of traffic.

Pac-West argues that if the CLEC tariff is not applied as a default rate, Small LECs could avoid paying reciprocal compensation simply by refusing to negotiate a rate, thereby forcing the terminating carrier to continue providing transport and termination of the originating carrier's traffic without compensation. Pac-West also argues that requiring the payment of tariffed rates as a default provides a "bright-line" rule that will motivate carriers to resolve factual disputes as to volume, jurisdiction, and the appropriate rate for exchange of § 251(b)(5) traffic. Pac-West further argues that carriers that do not exchange a significant amount of traffic may not wish to spend the resources negotiating a rate that is different than the tariff rate, and that use the CLEC's tariff as a default rate would provide a vehicle to bill such carriers without the expense of negotiations.

The Small LECs argue, however, that any CLEC tariffs purportedly applying to VNXX traffic should not be enforced because the Commission has generally never reviewed such tariffs for reasonableness. To the extent that the CLEC tariffs purport to establish a reciprocal compensation charge, the Small LECs argue that those tariffs are preempted by the negotiation obligations imposed on CLECs that wish to take advantage of the reciprocal compensation

opportunity presented by § 251(b)(5). Instead of tariffs for reciprocal compensation, CLECs are required to negotiate intercarrier compensation. On the other hand, while agreeing that access charges should apply to VNXX traffic, the Small LECs argue that they are not the proper carrier upon which to assess tariffed access charges. The Small LECs thus argue any reliance on CLEC tariffs purportedly addressing intercarrier compensation obligations should be given little weight given the perfunctory review CLEC tariff filings received when filed with the Commission.

2. Discussion

As discussed above, we have concluded that Small LECs are required to pay reciprocal compensation for VNXX traffic that is rated as a local call. The question remains as to what reciprocal compensation rates should apply, and the applicability of reciprocal compensation for any traffic exchanged prior to the point in time that an intercarrier agreement is finalized with the CLEC. We do not adopt specific figures in this decision for purposes of establishing reciprocal compensation rates to be paid by a Small LEC to a CLEC.

As prescribed in Sec. 251(c), each Small LEC has the duty to negotiate in good faith the terms of intercarrier compensation arrangements in accordance with Sec. 252, subject to any applicable exemption as a "rural telephone company."[24] We recognize that a qualifying "rural telephone company" is exempt under Sec. 251(f)(1) from the statutory duty to negotiate as prescribed in Sec. 251(c). Accordingly, for any Small LEC that does not voluntarily agree to negotiate terms and conditions of intercarrier compensation

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[24] The definition of a "rural telecommunications company" is found in the 1996 Telecommunications Act, Title I, Sec. 3 [47 U.S.C. 153] Definitions (37).

for VNXX arrangements on the basis of a "rural telephone company" exemption, we shall require that the CLEC tariff apply as the default. In such cases only, the CLEC tariff shall apply for establishing rates applicable to reciprocal compensation for VNXX traffic consistent with the provisions of this decision. Otherwise, we direct that the determination of the reciprocal compensation rates for termination of VNXX traffic be established through mutual agreement as negotiated between the relevant carriers.

Where the carriers exchange only limited amounts of traffic, they are free to consider the suitability of expedited measures to minimize the time and costs of negotiations. Such measures should be subject to mutual agreement, however, rather than unilateral imposition of a default rate or terms.

Pac-West cites D.06-06-055 in which the Commission concluded that it was appropriate to apply a CLEC's intrastate tariff for termination services afforded to another CLEC where no interconnection agreement was in effect between the two CLECs. Although the Commission concluded in D.06-06-055 that it was appropriate to apply a CLEC tariff for termination services afforded to another CLEC where no interconnection agreement was in effect, the applicability of a CLEC tariff in that proceeding is not applicable to the circumstances here. In D.06-06-055, because there was no incumbent local exchange carrier involved in the dispute, the provisions of Sec. 252 did not apply. By contrast, the dispute at issue here is between CLECs and Small LECs. Under provisions of Sec. 252 of the Act, VNXX carriers such as Pac-West have authority to demand negotiations with a Small LEC with whom traffic is exchanged through indirect interconnection (unless a "rural telephone company" exemption applies, as noted above).

Likewise, we do not resolve here the disagreement concerning the extent to which a CLEC can collect reciprocal compensation payments for VNXX traffic exchanged prior to the point in time that a mutual agreement is executed. In this decision, we establish the applicable principles underlying intercarrier compensation for VNXX traffic. The question of the specific rates to apply and the extent to which such rates may be billed and collected for prior-period VNXX traffic, however, is a matter for intercarrier negotiations. To the extent that the parties refuse to proceed with good faith negotiations, or are unable to reach a mutually agreeable compensation arrangement, either party to the negotiations would have the option to initiate a filing with the Commission for dispute resolution pursuant to the process outlined in D.95-12-056 (as summarized in the Appendix hereto).

D. Intercarrier Compensation for VNXX Traffic in Extended Area Service Arrangements

1. Parties' Positions

Parties disagree as to whether traffic rated and routed to an exchange subject to an extended area service (EAS) arrangement is subject to reciprocal compensation.

The Small LECs indicate that most, if not all, VNXX minutes originating on Small LEC networks are rated as if traveling to an exchange with which the Small LECs have an EAS arrangement. The Small LECs argue that EAS traffic should not be treated as § 251(b)(5) traffic subject to reciprocal compensation on the grounds that EAS calls are merely toll calls, re-rated based on a flat fee basis. Verizon WC and Pac-West disagree, arguing that as long as the call terminates in the exchange subject to an EAS arrangement, reciprocal compensation applies.

2. Discussion

Typically, when the Commission in the past adopted an EAS route and extended the local calling area, we would apply the "Salinas formula" resulting in rate increments to enable the Small LEC to recover lost toll revenues. Thus, we conclude that such calls are subject to reciprocal compensation.

In D.96-02-072, we stated, with respect to SBC and Verizon, that all local calls, including EAS calls, between a CLEC network and an ILEC end office were subject to "bill-and-keep" provisions, even if the call is routed through an access tandem. (D.96-02-072, Appendix E, Rule 7(c).) Reciprocal compensation is an alternative to "bill and-keep" provisions. Therefore, we conclude that Small LECs should be required to pay reciprocal compensation for VNXX traffic applicable to such EAS routes.

4. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Thomas R. Pulsifer is the assigned Administrative Law Judge in these proceedings.

5. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with § 311 of the Pub. Util. Code and Rule 14.2(a) of the Commission's Rules of Practice and Procedure. Comments were filed on October 30, 2006, and reply comments were filed on November 6, 2006. An additional third round of concurrent comments were filed on November 27, 2006. We have taken the comments into account, as appropriate, in finalizing this order.

Findings of Fact

1. The Commission has developed a record in previous arbitration proceedings on intercarrier compensation pursuant to interconnection agreements for calls between the major incumbent local exchange carriers and

other carriers involving calls utilizing disparate rating and routing points (*e.g.*, D.02-06-076 and D.03-05-031).

2. In D.03-09-005, the Commission directed that issues regarding small LECs' compensation for disparately rated and routed calls (*i.e.*, "virtual" NXX calls) be transferred to the Local Competition proceeding for resolution.

3. A "virtual" NXX arrangement provides retail subscribers with a presence in a local exchange without physically residing there. Although the NXX prefix is associated with a rate center in a designated local exchange, the subscriber's terminal equipment and/or point of interconnection can be physically located in a separate foreign exchange.

4. D.99-09-029 determined that a carrier may not avoid responsibility for negotiating reasonable intercarrier compensation for the routing of calls from a foreign exchange merely by redefining the rating designation from toll to local.

5. Pursuant to D.99-09-029, the carrier establishing a VNXX arrangement is required to pay for transporting VNXX calls to their point of termination.

6. In past arbitrations, the Commission has found that the ILEC must pay reciprocal compensation to the CLEC for terminating VNXX calls.

7. When a Small LEC originates a call intended for an end-user served by a CLEC with which the Small LEC is only indirectly interconnected, the Small LEC is responsible for payment of reciprocal compensation to the CLEC.

8. As a quid pro quo for receiving reciprocal compensation, the Commission has found in past arbitrations that the CLEC would bear the cost of additional transport required to get the VNXX call to where it would be considered "local".

9. In the case of Small LECs, however, their meet point with the ILEC is a significant distance from the ILEC tandem. Accordingly, additional transport is

required for VNXX traffic from the Small LEC-ILEC meet point to the ILEC tandem.

10. Both state and federal law require all telecommunications carriers to interconnect, either directly or indirectly, and to establish reciprocal compensation arrangements with respect to the exchange of traffic.

11. Small LECs typically have not entered into interconnection agreements providing for a direct point of interconnection with CLECs, and their respective networks do not interconnect. CLECs and Small LECs each interconnect instead with one or both of the major ILECs.

12. The Small LECs' networks are configured as "islands" within a particular LATA, in contrast with the large ILECs that own facilities throughout each LATA. As a result, the large ILEC controls how it routes VNXX traffic more completely as compared with the Small LEC that relies on other carriers to fulfill traffic obligations.

13. While Small LECs are subject to different regulatory constraints compared with the major ILECs, they have not adequately supported their claims of adverse economic impacts to justify inconsistent intercarrier compensation treatment as compared with the major ILECs.

14. By requiring the Small LECs to pay reciprocal compensation for VNXX calls on the same basis as required for the major ILECs, a competitive environment is promoted for provision of service by ISPs in the rural areas served by the Small LECs.

15. For recognizing extended Area Service calls are appropriately subject to reciprocal compensation that the Small LECs have been reasonably compensated for lost toll revenue associated with provisioning such calls.

16. When a Small LEC originates a VNXX call destined for termination by a CLEC with which the Small LEC is indirectly interconnected, the Small LEC transports the call to its meet point with the ILEC which then transits the call to its tandem where the CLEC is interconnected.

17. The Small LEC/ILEC meet point is typically a significant distance from the ILEC tandem switch.

18. Even though Small LECs may not typically own facilities from the meet point to the tandem, they have worked out arrangements for the transport of their originating traffic to the tandem as necessary to complete VNXX calls terminated by a CLEC.

19. A requirement for the CLEC to pay for transit of VNXX traffic from the Small LEC meet point to the point of interconnection at the tandem would be within the scope of state rule-making authority under § 251(d)(3).

20. Requiring the CLEC to be responsible for transit costs of VNXX traffic from the Small LEC meet point to the point of interconnection at the tandem would not constitute a requirement for direct interconnection.

21. Interconnection agreements between Pac-West and each of the ILECs contain explicit provisions for exchange of third-party transit traffic (including that originated by a Small LEC) at the tandem switch, none of which call for the terminating carrier to pay transiting traffic costs incurred on the originating carrier's side of the point of interconnection.

22. For indirect interconnection, the ILEC tandem is the default that typically serves as a routing point for all other switches serving NXXs assigned to the tandem service area.

23. Although the Commission decided in D.06-06-055 to apply a CLEC tariff for termination services afforded to another CLEC where no interconnection

agreement was in effect, the applicability of a CLEC tariff in that proceeding is not applicable to the circumstances here.

24. In D.06-06-055, because there was no incumbent local exchange carrier involved in the dispute, the provisions of Sec. 252 did not apply. By contrast, the dispute at issue here is between CLECs and Small LECs. Under Sec. 252 of the Act, therefore, VNXX carriers such as Pac-West have authority to demand negotiations with a Small LEC with whom traffic is exchanged through indirect interconnection.

Conclusions of Law

1. In situations where the Small LEC originates a VNXX call intended for an end-user served by a CLEC with which the Small LEC is only indirectly connected, the Small LEC is obligated to transport the call to its point of interconnection with the ILEC, as an intermediary.

2. Although reciprocal compensation provisions are prescribed under § 251(b)(5) of the 1996 Act, this Commission did not rely on those provisions, but applied its own balancing test in addressing the compensation between telecommunications carriers for termination of VNXX.

3. Compensation for originating carriers charges generally apply in the case of interexchange traffic.

4. The VNXX reciprocal compensation principles applied in interconnection arbitrations involving the major ILECs should apply similarly with reference to the Small LECs' arrangements.

5. Small LECs have an affirmative obligation to pay reciprocal compensation for the termination of traffic, which utilizes a VNXX arrangement.

6. Absent an alternate arrangement between a Small LEC and a CLEC, the Small LEC must deliver its VNXX traffic to its meet-point with the intermediary

ILEC, as applicable, who will then transit such traffic to the ILEC-CLEC point of interconnection. The CLEC shall be financially responsible for indirectly exchanged VNXX traffic from the Small LEC-ILEC meet point to the ILEC-CLEC point of interconnection.

7. In the event that the CLEC has not established a point of interconnection at the Small LEC meet point under the applicable ILEC-CLEC interconnection agreement, the CLEC will be responsible for any transport costs required to get the VNXX call from the meet point to the ILEC-CLEC point of interconnection.

8. The appropriate vehicle through which to establish applicable intercarrier compensation rates, terms, and conditions for VNXX traffic is through the process of negotiating intercarrier agreement (subject to the applicability of the "rural telephone company" exemption).

9. For any Small LEC that does not voluntarily agree to negotiate reciprocal compensation rates based on a claim that it comes under the "rural telephone company" exemption, the CLEC tariff should apply as a default.

10. Under provisions of Sec. 252 of the Act, VNXX carriers such as Pac-West have authority to demand negotiations with a Small LEC with whom traffic is exchanged through indirect interconnection (assuming no "rural telephone company" exemption applies). To the extent that the parties cannot reach a mutually agreeable rate or other terms and conditions applicable to reciprocal compensation, either party has recourse to invoke the dispute resolution process outlined in D.95-12-056 (as outlined in the Appendix of this order).

O R D E R

IT IS ORDERED that:

1. Small Local Exchange Carriers (LECs) and Competitive Local Exchange Carriers (CLECs) are each directed to interconnect, transport and terminate traffic, and to pay intercarrier compensation in a manner consistent with the principles set forth in the Findings of Fact and Conclusions of Law set forth above.

2. For any Small LEC that does not voluntarily agree to negotiate terms and conditions of intercarrier compensation for VNXX arrangements on the basis of a "rural telephone company" exemption, the CLEC tariff shall apply as the default for setting reciprocal compensation rates for VNXX traffic consistent with the provisions of this decision.

3. For any Small LEC not subject to the "rural telephone company" exemption, the determination of the specific reciprocal compensation rates, terms, and conditions for termination of VNXX traffic shall be established through mutual agreement as negotiated between the relevant carriers.

4. Carriers that are impacted by the intercarrier compensation provisions of this decision are hereby authorized to enter into negotiations pursuant to Sec. 252 of the Act to reach agreement on the rates, terms, and conditions applicable to intercarrier compensation, including that associated with VNXX traffic, both prospectively and as applicable, for previously exchanged traffic (subject to the "rural telephone company" exemption as applicable).

5. To the extent that the parties are unable to reach mutually agreeable intercarrier compensation rate levels, either party to the dispute may initiate a filing for dispute resolution pursuant to the process outlined in Decision 95-12-056 (as summarized in the Appendix of this Order).

This order is effective today.

Dated February 15, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners

APPENDIX
Procedures for Dispute Resolution
Adopted in D.95-12-056

Section III(D) of D.95-12-056 provides for an expedited dispute resolution process that addresses interconnection agreement disputes over breach of contract or interpretation of parties' rights and obligations. This process includes the following procedure for mediation by an ALJ:

> " If parties are unable to informally resolve their interconnection dispute, one or more of the parties may file a motion to have the dispute mediated by an ALJ who in turn may be assisted by [Telecommunications Division] staff. We will establish an expedited Dispute Resolute Procedure (DRP), within this docket, in which parties can file motions seeking mediation and an ALJ ruling on the merits of their case. All local carriers, including small and mid-sized LECs, will be parties to the DRP, and any local carrier with a valid CPCN may file a motion asking for an ALJ ruling to establish the time and place for mediation to occur.
>
> As a condition of having an ALJ assigned to mediate, the parties must show that they have first attempted to resolve the dispute within their own companies through escalation to the executive level within each company.

Section III(D) also provides the following general guidelines for conducting the expedited dispute resolution process:

> "We will leave it to the discretion of the ALJ presiding over the DRP to schedule and conduct the dispute resolution process, to establish new service lists, and to determine the need for any written submittals in the proceeding. The motion requesting mediation need only be served on parties to the dispute, the ALJ assigned to the DRP, and the Director of [Telecommunications Division]. The motion should also be served on the Docket Office which will publish a notice of the motion in the Daily Calendar."

Section III(D) of D.95-12-056 specifies the following procedure for an ALJ ruling:

> "If mediation fails, the ALJ will direct parties to submit short pleadings and issue a written ruling to resolve the dispute. The ALJ shall use our adopted preferred outcomes as guidelines under which disputes will be reviewed and resolved. If a party objects to the ALJ's ruling, it may then file a formal complaint under the Commission's expedited process described below."

(END OF APPENDIX)