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**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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In the Matter of the Commission Investigation)
into the Treatment of Reciprocal Compensation)
for Internet Service Provider Traffic.)

Case No. 99-941-TP-ARB

**AMERITECH OHIO'S REPLY BRIEF ON THE D.C.
CIRCUIT'S BELL ATLANTIC DECISION AND THIS PROCEEDING**

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Ameritech Ohio, by its attorneys, respectfully submits this Reply to the Initial Briefs of AT&T, Buckeye Telesystem, Inc., CoreComm Newco, Focal Communications, ICG Telecom Group, Intermedia Communications, KMC Telecom III, Level III Communications, MCI Worldcom, Sprint, Telecommunications Resellers Association, and Time Warner Telecom ("CLEC parties.")

I. INTRODUCTION AND SUMMARY OF POSITION

After reviewing the Initial Briefs, the Commission may question whether the CLEC parties read the same *Bell Atlantic*¹ decision as the ILECs. Only one CLEC, Sprint Communications Company, L.P., acknowledged that *Bell Atlantic* should not deter the Commission from conducting "a thorough analysis of the issues set forth in the Entry" to reach "a sound basis for determining appropriate compensation arrangements for ISP traffic." Sprint Initial Brief at 3. All the other CLEC parties, to varying degrees, mischaracterize the effect of D.C. Circuit's decision on the current state of the law. As will be discussed further below, **contrary to the CLEC assertions:**

- **The D.C. Circuit did not "reverse" or "reject" the FCC's conclusion in the *ISP Declaratory Ruling*² that Internet-bound traffic is not local and therefore not subject to reciprocal compensation under Section 251(b)5 of the 1996 Act.³ The sole legal effect of the decision was to vacate the FCC Order and remand for further explanation. The court held only that the FCC had not satisfactorily explained its position on the record before the court and directed the agency to supply a better explanation. *See Bell Atlantic* at *26-27. The FCC already has indicated through its Common Carrier Bureau Chief Lawrence Strickling that it would provide the requested clarification and still**

¹ *Bell Atlantic Tel. Cos. v. FCC*, No. 99-1094, 2000 U.S. App. LEXIS 4685 (D.C. Cir. March 24, 2000) ("*Bell Atlantic*").

² *Inter-carrier compensation for ISP-bound traffic*, FCC 99-38, Declaratory Ruling in CC Docket 96-98 and Notice of Proposed Rulemaking in CC Docket 99-68 (February 26, 1999) ("*ISP Declaratory Ruling*").

³ The Telecommunications Act of 1996, Pub L. No. 104-104, 110 Stat. 56, 47 U.S.C. §§ 151, *et seq.* (the "Act").

reach the same conclusion that calls to ISPs are interstate in nature. *See*, TR Daily, March 24, 2000 (Exhibit 1 to Ameritech Ohio's Initial Brief.)

- **The D.C. Circuit did not hold that Internet-bound traffic is not "exchange access" traffic.** Rather, the court remanded to the FCC for an explanation of its conclusion in the *ISP Declaratory Ruling* that ISP traffic qualifies as exchange access. *See Bell Atlantic* at *25-26. Not only did the Court not make the finding asserted by the CLECs, it expressly held that it was without authority to supply "a judicial judgment" because the issue involved "a determination of policy or judgment which the agency alone is authorized to make and which it has not made....," and that when made, the FCC's decision would be entitled to judicial deference. *Id.*
- **The D.C. Circuit also did not reject the FCC's end-to-end analysis.** Nor did the Court change or overrule the established precedent on which the end-to-end analysis is based. Again, the court simply found that the FCC had not sufficiently explained why the analysis applied to ISP traffic for purposes of reciprocal compensation. *See Bell Atlantic* at *22.
- **The D.C. Circuit's *vacatur* and remand of the *ISP Declaratory Ruling* did not affect, in any way, the FCC's binding determination in the *Advanced Services Order* that Internet traffic is "exchange access" traffic.** Although the *ISP Declaratory Ruling* has been remanded for further explanation, the court expressly acknowledged that it did not consider the FCC's most recent December 23, 1999 holding in its *Advanced Services Remand Order*⁴ that Internet-bound traffic is "exchange access." The FCC's December 23rd ruling thus remains a valid part of the law unless and until disturbed on appeal. Under the Hobbs Act, this Order is not subject to collateral challenge in this proceeding. *See*, 28 U.S.C. § 2342; *US West Communications v. MFS Intelenet, Inc.*, 193 F. 3d 1112, 1123 (9th Cir. 1999).
- **Prior to the *ISP Declaratory Ruling*, this Commission did not hold that Internet-bound traffic is subject to reciprocal compensation under Section 251(b)(5) of the Act.** Ignoring the *Advance Services Remand Order*, many of the CLECs seize upon Ohio Commission decisions in several complaint cases and FCC holdings issued prior to the *ISP Declaratory Ruling*. This is mystifying. The Commission expressly held in those complaint cases that its decisions did not constitute a determination on the broader policy implications of compensating the delivery of ISP traffic. Moreover, the Commission expressly reserved the right to conduct a generic investigation of inter-carrier compensation for Internet-bound traffic, the very proceeding that

⁴*In the Matter of Deployment of Wire Line Services Offering Advanced Telecommunications Capability*, CC Dockets Nos. 98-147, et. al., ¶16 (December 23, 1999) ("*Advanced Services Remand Order*").

is underway here. And on the federal level, a long line of federal precedents dating to 1983 establish that Internet-bound traffic is not local traffic.

- ***Bell Atlantic* in no way precludes the Commission's investigation into compensation mechanisms for delivery ISP traffic other than reciprocal compensation for traditional voice traffic as set forth in its March 15, 2000, Issues List Entry.** As demonstrated above, the FCC's binding orders make clear that Internet traffic is not subject to reciprocal compensation under Section 251(b)(5). Moreover, Ameritech Ohio maintains that this Commission is without authority to impose any form of inter-carrier compensation, outside of Section 251(b)(5), on internet traffic. The D.C. Circuit expressly preserves our right to make such a challenge, saying that "our vacatur of the Commission's ruling leaves the incumbents free to seek relief from state-authorized compensation that they believe to be wrongfully imposed." *Bell Atlantic* at *26-27. But in the event that it is determined that this Commission has authority to impose inter-carrier compensation outside of Section 251(b)(5), nothing in the D.C. Circuit's opinion in any way suggests that this proceeding is not an appropriate vehicle for determining such compensation.
- **Even assuming arguendo this Commission has authority to award inter-carrier compensation on Internet traffic, the rate structure must acknowledge the particular characteristics of this type of traffic so as not to over-compensate CLECs for the costs of delivering such traffic.** Limiting CLECs to their costs of terminating ISP-bound traffic is required by the Act. Policy considerations also compel this result. Given the enormous and ever-increasing volume of ISP traffic that originates on Ameritech Ohio's network and that is delivered to ISP customers of the CLEC parties, a rate that is over-compensatory by even a fraction of a cent per minute would have an equally enormous and socially undesirable impact and conflict with the most important policies underlying the Act. It would, among other things, operate to suppress competition for customers who use dial-up Internet access, particularly residential customers, and to retard the development of advanced and efficient alternatives to dial-up Internet access.

In their efforts to obscure each of these points, the CLECs hope to avoid any inquiry by this Commission that may jeopardize the huge windfall they are now reaping at the ILECs' expense. They plainly have no desire to let anyone know their costs, network configurations, and arrangements with ISPs in connection with routing of Internet traffic.

The CLECs naturally would prefer to collect reciprocal compensation on ISP traffic while awaiting the FCC's ruling on remand. However, quite apart from the law not supporting

their desired approach, as a practical matter it is unclear just when the FCC will issue its clarifying ruling. Pending the FCC's decision, the Commission will again and again face the issue in two party arbitrations governed by statutory decision deadlines. The Commission originally elected to proceed with this generic docket because it recognized that "[a]ll parties entering into interconnection agreements will thus benefit by the Commission rendering a generic position on inter-carrier compensation for this traffic." Entry (January 13, 2000) at p. 3. This remains the right approach compared to one on one arbitrations. Moreover, while the FCC considers a range of potential compensation mechanisms, Ohio's generic policy very well could contribute to or be adopted as part of the FCC's determination.

In short, the D.C. Circuit's decision obviously does not stand in the way of this Commission's development of a generic interim policy that accounts for the unique characteristics of ISP-bound traffic and prevents over-recovery of costs. Nonetheless, in the event the Commission chooses to undertake a point-by-point consideration of the briefing by the CLECs, Ameritech Ohio addresses their principal contentions in consolidated fashion below.⁵

⁵ Ameritech Ohio has attempted, in the time permitted for reply briefing, to address the CLECs' arguments in consolidated fashion as much as practical since so many of the arguments are common to more than one CLEC. Ameritech has not attempted to reply to each and every point specifically, however. Should the Commission perceive any omission on Ameritech's part to address a particular assertion, the CLEC point should not be construed as conceded because Ameritech believes that no CLEC has presented any credible rationale for altering the course set for this proceeding, based on *Bell Atlantic* or otherwise.

II. The CLEC Parties Blatantly Mischaracterize The Effect of the D.C. Circuit Court's *Vacatur* and Remand

The D.C. Circuit did find that the FCC had failed adequately to explain its conclusion that ISP-bound traffic is not local for purposes of reciprocal compensation under Section 251(b)(5). However, the court left the FCC free to reach the same conclusion on remand.

The CLECs have unleashed an avalanche of initial briefing that misrepresents the effect of *Bell Atlantic*, hoping to derail the Commission's investigation (and all ILEC discovery) relevant to the above-cost reciprocal compensation payments they like to collect and the serious policy implications of permitting this gargantuan over-recovery of costs to continue. The Commission easily can cut through all of the CLEC rhetoric by simply accepting *Bell Atlantic* for what it is—a remand of one Order for further explanation. Nothing in the court's decision should deter the Commission from completing this proceeding.⁶

A. The CLECs' Claim That ISP Traffic No Longer Can Be Held To Be "Exchange Access" Is Wrong.

The CLECs all claim that the D.C. Circuit in *Bell Atlantic* held that ISP traffic is subject to reciprocal compensation under Section 251(b)(5) because such traffic is "telephone exchange service" not "exchange access." This is preposterous. As noted above, the D.C. Circuit held

⁶ As noted in its Initial Brief, Ameritech reserves the argument that, because Internet-bound traffic is interstate and not subject to the Act's reciprocal compensation requirement, the Commission has no authority to regulate such traffic or impose any inter-carrier charges on it. As the FCC itself has recognized: "The origination or termination of interstate communication . . . is necessarily a part of an interstate communication"; the understanding of Congress at the time of the Communications Act was that "the states would not acquire jurisdiction to regulate rates for such interstate access even if this Commission were abolished." Third Report and Order, *MTS and WATS Market Structure*, 93 F.C.C. 2d 241, 261, ¶ 58 (1983), *aff'd in relevant part, remanded in part*, 737 F.2d 1095 (D.C. Cir. 1984). Because prior to the 1996 Act the States had no authority to regulate interstate communications, and because the 1996 Act does not give them the authority to impose reciprocal compensation fees on the non-local traffic at issue here, the Commission simply does not have the power to impose any inter-carrier compensation arrangements for such traffic in this proceeding.

only that , the FCC, in the Declaratory Ruling, did not sufficiently explain why Internet traffic is exchange access. *See Bell Atlantic at *23, 26, 27*⁷

More fundamentally, the D.C. Circuit did not challenge the FCC's determination in the Advanced Services Order that Internet traffic is exchange access. Nor did the D.C. Circuit challenge the FCC's reasoning in that Order. And under the Hobbs Act, no one is free to challenge the determination or reasoning here. In its *Advance Services Remand Order* at ¶16, the FCC analyzed the manner in which ISPs provide Internet access service to their subscribers and determined that such service "is ordinarily exchange access service because it enables the ISP to transport the communication initiated by the end-user subscriber located in one exchange to its ultimate destination in another exchange, using both the services of the local exchange carrier and in the typical case the telephone toll service of the telecommunications carrier responsible for interexchange transport." *Id.* at 35.

The FCC specifically rejected the argument that "the *only* service originated or terminated by the local exchange carrier, when it provides access to the ISP, is an information service." *Id.* ¶ 37. "[E]ven though the access provided to the ISP by the local exchange carrier facilitates the delivery of an information service because of the 'applications that ride on top' of the telecommunications service, that same access necessarily facilitates the origination of the underlying telephone toll service used to transport the ISP's Internet access service." *Id.* Indeed, the FCC went so far as to *overrule* the statement that confused the D.C. Circuit (and is now being

⁷ As Ameritech noted in its Initial Brief, p. 4, n. 5 because reciprocal compensation applies only to local telecommunications, the dispositive question is whether ISP traffic is local or not local. Simply put, reciprocal compensation does not apply to ISP traffic if ISP traffic is not local, whether or not it is exchange access.

relied upon by AT&T⁸) suggesting that ISPs do *not* obtain exchange access. Specifically, the FCC, after reaffirming that ISP traffic is exchange access, stated:

We recognize that we did hold, in the *Non-Accounting Safeguards Order*, that ISPs do not receive “exchange access services . . . because of their status as non-carriers.” However, that Order constitutes a departure from other Commission precedent on this matter. . . .

On a more complete record in this proceeding, we correct the inconsistency in our prior orders and overrule the determination we made in the *Non-Accounting Safeguards Order* that non-carriers may not use exchange access services. . . . We find that this conclusion is consistent with the Commission’s longstanding characterization of the service that LECs offer to enhanced services providers (which include ISPs) as exchange access. In *MTS and WATS Markets Structure Order*, the Commission held that “[a]mong the variety of users of access services are . . . enhanced service providers.” . . . Similarly, we noted in the *Amendment of Part 69 of the Commission’s Rules Relating to Enhanced Service Providers* that enhanced service providers use “exchange access service.”

Advanced Services Remand Order, ¶¶ 42, 43 (footnotes omitted). The FCC thus underscored that ISP traffic is exchange access, *i.e.*, non-local traffic, and that its precedents, with the single exception of the one it overruled, had always so held.⁹

By their silence, it appears that the CLECs recognize that the FCC’s determination in the *Advance Services Remand Order* is not subject to collateral challenge in this proceeding. See *Hobbs Administrative Order Review Act*, 28 U.S.C. § 2342; *US WEST Communications v. MFS Intelenet, Inc.*, 193 F.3d 1112, 1123 (9th Cir. 1999). The only CLEC that even mentions it is ICG. Try as it does, however, to escape the holding in the *Advance Services Remand Order*, ICG comes up short. ICG argues that the *Advanced Services Remand Order* is not applicable to dial-up calls to ISPs. The assertion, however, is nonsense. The FCC itself rejected ICG’s

⁸ See AT&T Initial Brief at 7.

⁹ The D.C. Circuit was aware of this decision but declined to consider it because it was not included “in the ruling under review.” 2000 U.S. App. LEXIS, *24-25. However, the court acknowledged that the FCC’s interpretation “as to whether calls to ISPs fit within ‘exchange access’ or ‘telephone exchange service’ . . . would be subject to judicial deference.” *Id.* *25.

distinction in the *Advanced Services Order*. As the FCC explained (at para. 45), “[b]oth forms of access [switched dial-up access and dedicated special access] provide access to exchange facilities, which is the pertinent point under the statutory definition of “exchange access.” In light of the *Advanced Services Remand Order*, and prior FCC law, there is simply no room to argue that Internet-bound calls are subject to reciprocal compensation under the Act.¹⁰

The CLECs also overlook that the same reasoning under the Act compels the conclusion that ISP traffic is not local. Section 251(g) provides:

On and after the date of enactment of the Telecommunications Act of 1996, each local exchange carrier, to the extent that it provides wireline services, shall provide exchange access, information access and exchange services for such access to interexchange carriers and information service providers in accordance with the same equal access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding the date of enactment of the Telecommunications Act of 1996 . . . until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after such date of enactment.

Thus, there are two types of access service : access provided to interexchange carriers and access provided to information service providers, just as the FCC concluded in its *Advanced Services Remand Order*, *supra*, which was not in the record before the D.C. Circuit.

This answers the court’s question. Because ISP traffic is indeed exchange access and not local traffic, the reciprocal compensation provisions of the Act do not apply to ISP traffic, and this Commission cannot apply those provisions to ISP traffic consistent with the Act.

¹⁰ ICG, in its most recent 10-K report, directly contradicts its concluding assertion here that the D.C. Circuit decision compels a summary judgment ordering reciprocal compensation for ISP-bound traffic. In its March 30, 2000, SEC filing, ICG more candidly stated that, in light of *Bell Atlantic*, “. . . there can be no assurance that future FCC or state rulings will be favorable to the Company.” See attached excerpt of ICG’s 10-K, Exhibit 1 hereto.

B. The FCC's End-to-End Analysis Clearly Remains Viable To Support Its Conclusion That ISP Traffic Is Not Local

The D.C. Circuit was not satisfied with the FCC's explanation of why it relied upon its long-standing end-to-end jurisdictional analysis for ISP calls. Solely on the basis of questions the court raised about the FCC's explanation – which the FCC easily can answer – the CLEC parties absurdly claim that the FCC no longer can rely on the end-to-end analysis to support its conclusion that ISP traffic is interstate in nature and not eligible for reciprocal compensation under the Act. The CLECs' assertions are unsustainable for several reasons.

1. The D.C. Circuit Court neither reversed the FCC's conclusions nor considered the FCC's most recent determination.

As discussed above, the court issued no merit rulings and the FCC held that ISP traffic is not local in its *Advanced Services Remand Order*, *supra*. From the FCC's most recent ruling it follows inescapably that ISP traffic is not subject to section 251(b)(5) reciprocal compensation because the FCC has ruled that section 251(b)(5) applies only to local traffic. 47 C.F.R. § 51.701, *First Report and Order*¹¹ ¶ 1034.

2. FCC precedents pre-dating the *ISP Declaratory Ruling* remain valid and support the end-to-end analysis.

The FCC has repeatedly ruled — in two decades worth of decisions that antedate both the *ISP Declaratory Ruling* and the *Advanced Services Remand Order* — that Internet calls are interstate, exchange access calls. Starting in 1983, the FCC in *MTS and WATS Market Structure*, 97 F.C.C.2d 682, ¶ 78 (1983) explained that ISPs were indistinguishable from long-distance telephone companies (*Id.* ¶ 78):

¹¹ See First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16015 ¶1040, *modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part*, *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev'd in part, aff'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.* 119 S.Ct. 721 (1999) ("First Report and Order")

Among the variety of users of access service are facilities-based carriers, resellers (who use facilities provided by others), sharers, privately owned systems, enhanced service providers, and other private line and WATS customers, large and small, who 'leak' traffic into the exchange. In each case the user obtains local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location and, commonly, another location in the exchange area. (Emphasis added.)

As the FCC recognized in that passage, the “interstate calls” facilitated by enhanced service providers merely “transit” the provider’s location. In other words, Internet calls do not terminate at the ISP’s location. Driving the point home, the FCC further stated that the overwhelming majority of ISP traffic does not terminate at the ISP’s premises, noting that an enhanced service provider “*might terminate few calls at its own location and thus would make, relatively heavy interstate use of local exchange services and facilities.*” *Id.* ¶ 78.¹²

The FCC has repeatedly confirmed this holding over the past 15 years. See citations in Ameritech Ohio’s Initial Brief, pp. 2-3, n. 4. In the ruling closest in time before the *ISP Declaratory Ruling, In re GTE Telephone Operating Cos.*;¹³ the FCC stressed (at ¶ 19) that ISP calls “do not terminate at the ISP[] . . . but continue to the ultimate destination or destinations, very often at a distant Internet website accessed by the end user.” Thus, the Internet call that passes *through* the ISP is “a continuous transmission from the end user to a distant Internet site.” *Id.* ¶ 20.

If anything is certain — not only under the FCC’s precedents but also under the 1996 Act itself — it is that a telecommunication with the Internet is a unitary and indivisible transmission

¹² One would expect, as the FCC observed, that a few non-Internet calls — such as regular telephone calls by subscribers to an ISP’s business offices, or personal telephone calls to its employees — would terminate at an ISP’s location. Such non-Internet traffic is not at issue here.

¹³ *GTOC Tariff No. 1; GTOC Transmittal No. 1148*, CC Docket No. 98-79, ¶ 21 (F.C.C. Oct. 30, 1998) (“*GTE Tariff Order*”).

that runs from the end user, through the ISP's server, and on to the Internet. To be sure, the ISP does provide an *information service* that rides on the telecommunication, but the question here is who should compensate whom for the telecommunication, and the telecommunication (albeit switched at the ISP's server, just as it is switched at local exchange carriers' central offices) runs straight through from end to end.

The ISP "combines '[computer and information processing functions] with transmission to enable users to access Internet content and services.'" *GTE Tariff Order, supra*, ¶ 6. For the ISP traffic at issue here, in other words, the ILEC and CLEC provide pure transmission service, while the ISP offers something *in addition to* (not instead of) transmission. Specifically, the ISP combines telecommunications with enhancements, such as data processing and other functions. As the FCC has explained, ISPs "lease lines, and otherwise acquire telecommunications, from telecommunications providers — interexchange carriers, incumbent local exchange carriers, competitive local exchange carriers, and others. In offering services to end users, they . . . conjoin . . . transport with data processing, information provision, and other computer-mediated offerings, thereby creating an information service." *Universal Service Report*¹⁴ ¶ 81. And as Congress put it in the 1996 Act, "The term 'information service' means the offering of a capability for generating, acquiring, [etc.] information *via telecommunications*." 47 U.S.C. § 41.

Once one understands that ISPs provide transmission plus enhancements, one also understands that telecommunication with the Internet (*i.e.*, the transmission) runs end-to-end, from ISP subscriber to the Internet. As the FCC explained in the *GTE Tariff Order*, the FCC "has never found that 'telecommunications' ends where 'enhanced' information service begins. . . . Under the definition of information service [in] the 1996 Act, an information service,

¹⁴ *In Re Federal-State Joint Board on Universal Service*, F.C.C. 98-67, Report to Congress, CC Docket No. 96-45, ¶146 (April 10, 1998) ("Universal Service Report").

while not a telecommunications service itself, is provided *via telecommunications*.” Thus, ISP traffic is “a continuous transmission from the end user to a distant Internet site.” *GTE Tariff Order* at ¶20.

Although the D.C. Circuit found that the FCC had not adequately explained why its prior jurisdictional treatment of Internet-bound traffic *compelled* the conclusion that such traffic is non-local, the FCC will surely be able to show on remand that those precedents help to show why those jurisdictional decisions help to *support* the FCC's interpretation of its existing regulations. And it is firmly established that the key to whether a communication is local or interstate is the nature of the communication, rather than the physical location of the facilities that carry it. Indeed, “every court that has considered the matter has emphasized the nature of the communications is determinative, rather than the physical location of the facilities used.” *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 746 F.2d 1492, 1498 (D.C. Cir. 1984). *See also, e.g., New York Tel. Co. v. FCC*, 631 F.2d 1059 (2d Cir. 1980).

3. The D.C. Circuit's questions can and will be easily answered by the FCC.

The FCC's Common Carrier Chief already has indicated that the FCC will provide the requested clarification and still reach the same conclusions. In the meantime, the CLECs hope to ignore the obvious legal and economic answers to the question the D.C. Circuit posed about *why* ISP traffic should not be subject to reciprocal compensation. The court put it as follows:

The issue at the heart of this case is whether a call to an ISP is local or long-distance. Neither category fits clearly. The [FCC] has described local calls, on the one hand, as those in which LECs collaborate to complete a call and are compensated for their respective roles in completing the call, and long-distance calls, on the other, as those in which the LECs collaborate with a long-distance carrier, which itself charges the end-user and pays out compensation to the LECs. [Citation omitted.]

Calls to ISPs are not quite local, because there is some communication taking place between the ISP and out-of-state websites. But they are not quite long-distance, because the subsequent communication is not really a continuation, in the conventional sense, of the initial call to the ISP. The Commission's ruling rests squarely on its decision to employ an end-to-end analysis for purposes of determining whether ISP-traffic is local. . . . But [the FCC] has yet to provide an explanation why this inquiry is relevant to discerning whether a call to an ISP should fit within the local call model of two collaborating LECs or the long-distance model of a long-distance carrier collaborating with two LECs.

Bell Atlantic at *13-14.

What the court is saying is this: We understand that there are two models of inter-carrier compensation. In one – the model that applies to local calls – two LECs collaborate to complete the call, and the originating LEC compensates the terminating LEC. In the other – the model that applies to long-distance calls – two LECs collaborate with a long-distance carrier to complete the call, and the long-distance carrier compensates the two LECs. Tell us why ISP traffic fits into the long-distance model rather than the local model.

The *legal* answer to that question is that the originating LEC provides local exchange service for the local call, but provides exchange access for the long-distance call and, likewise, for the ISP call. And the reason this matters — for purposes of compensation as opposed to “just” regulatory jurisdiction — is, as the FCC has repeatedly held, that the ISP is subject to the imposition of access charges, just like the long-distance carrier. Putting it in the terms the *Bell Atlantic* decision used when it posed the question, the call to the ISP fits within the compensation model of a long-distance carrier collaborating with two LECs because the ISP, like the IXC, is subject to the imposition of access charges. The FCC has exempted the ISP from the charges, but it has not changed the model.

The answer based on a comparison of the economic relations among the parties to the three types of calls is equally straightforward:

- In the case of a local call, the originating end user is making use of his ongoing contractual relationship with his local exchange carrier. The end user pays his LEC to complete local calls that the end user originates. When the LEC requires a contribution from a second LEC (*i.e.*, call termination) in order to render that service, the first LEC compensates the second LEC for its contribution. This is what the D.C. Circuit called the local call model of two collaborating LECs.
- In the case of a long-distance call, the originating end user is making use of his ongoing contractual relationship with his interexchange carrier. The end user pays his IXC to complete long-distance calls that the end user originates. When (as is generally the case for long-distance calls) the IXC requires a contribution from local exchange carriers (*i.e.*, local network access) in order to render that service, the IXC compensates the LECs for their contribution. This is what the D.C. Circuit called the long-distance model of a long-distance carrier collaborating with two LECs.
- In the case of an ISP call, the originating end user is making use of his ongoing contractual relationship with his ISP. The end user pays his ISP to provide him with access to the Internet. When (as is generally the case with dial-up ISP calls) the ISP requires a contribution from local exchange carriers (*i.e.*, local network access) in order to render that service, the ISP *should* compensate the LECs for their contribution.

The call to the ISP fits within the long-distance model of a long-distance carrier collaborating with two LECs rather than the local call model of two collaborating LECs because

the ISP's role in the transaction is exactly the same, as far as the participants' economic functions are concerned, as the IXC's.

Finally, contrary to all of the CLEC parties' contentions, the D.C. Circuit's statement that "ISP calls are not quite local" actually leads to the conclusion that section 251(b)(5) does not *require* reciprocal compensation on ISP calls. *Bell Atlantic* at *13. Given that section 251(b)(5) applies only to local calls, the view that "ISP calls are not quite local," assuming the Commission shares it, forecloses any argument by the CLECs that section 251(b)(5) compels summary judgment in their favor as to their claimed entitlement to reciprocal compensation. *Id.*

On the other hand, the D.C. Circuit's suggestion that Internet-bound calls "are not quite long-distance, because the subsequent communication is not really a continuation . . . of the initial call to the ISP" reveals a misunderstanding of what is happening on the network when an ISP's subscriber is in communication with the Internet. *Bell Atlantic* at *13. The FCC's regulations define "termination" as the "switching" of traffic and "delivery of such traffic to the called party's premises." *Id.* § 51.701(e). As anyone who uses the Internet knows, in the case of Internet-bound traffic the ISP is *not* the "called party." No one calls the Internet to connect to a modem bank, but instead to access content or communicate directly with other people over the packet-switched Internet network. The ISP is accordingly merely an intermediate point in a continuous transmission that ends only when it reaches a website.

AT&T's recent investment in Net2Phone aptly illustrates the reality of Internet communications. AT&T plans to provide voice-over-Internet service – voice calls routed over the packet switched Internet – in the hopes of avoiding interstate access charges.¹⁵ This

¹⁵ AT&T Hopes to Save 'Billions' by Routing Calls Over the Web, Wall Street Journal, Apr. 10, 2000, Exhibit 2 hereto.

dramatically illustrates the fact that while Internet calls may be routed to ISPs, such calls certainly do not “terminate” at the ISP’s premises.¹⁶

C. The CLECs Mischaracterize The Commission’s Orders In Several Complaint Cases

Several CLEC parties mischaracterize the Commission’s decisions in the three complaint cases against Ameritech Ohio as holding that ISP traffic is local. Completely ignored is the narrow ground on which these cases were decided. *See e.g.* ICG Opinion and Order at 8.¹⁷ Moreover, the Commission specifically reserved judgment on the policy issues that are presented in this proceeding. *Id.* Therefore, these cases actually support the Commission’s continuation of this proceeding, consistent with its past commitment.

A number of the CLECs similarly rely mistakenly on contract interpretation cases outside of Ohio that involve different contracts and parties. None of those cases addressed the legal and policy issues in this proceeding, namely, whether any, and if so what, compensation scheme should apply to Internet traffic. Indeed, we are baffled by the CLECs’ arguments.

For example, the recent Fifth Circuit decision in *Southwestern Bell Tel. Co. v. Public Utility Comm’n of Texas*¹⁸ provides no support for the argument that the reciprocal compensation provisions of the Act apply to Internet-bound traffic; to the contrary, the court did not call into question the point that, under the Act, Internet traffic is not subject to reciprocal compensation. Rather, the court simply held that under existing interconnection agreements, Southwestern Bell

¹⁶ The FCC has not yet determined how such calls should be treated for access charge purposes. But whatever proposal this Commission adopts for Internet-bound calls obviously would not apply to long distance voice-over-Internet calls to the extent a different federal rule applies – now or in the future.

¹⁷ *In the Matter of the Complaint of ICG Telecom Group, Inc. v. Ameritech Ohio*, No. 97-1557-TP-CSS, (Opinion and Order August 27, 1998). The Commission rendered nearly identical decisions in the complaint cases brought against Ameritech Ohio by MCI and Time Warner, Case Nos. 97-1723-TP-CSS and 98-308-TP-CSS.

¹⁸ *See Southwestern Bell Tel. Co. v. Public Utility Comm’n of Texas*, No. 98-50787, 2000 U.S. App. LEXIS 5642 (5th Cir. Mar. 30, 2000).

had voluntarily agreed to pay compensation on Internet traffic, the requirements of federal law notwithstanding. *Id.* at *38.

The CoreComm Newco parties' joint brief cites to *U.S. West Communications, Inc. v. MFS Intelenet, Inc.*, 193 F. 3d 1112 (9th Cir. 1999), *Southwestern Bell Tel. Co. v. Brooks Fiber Communications*, No. 98-CV-468-K(J), Order (N.D. Okla. Oct. 1, 1999), and *U.S. West Communications, Inc. v. WorldCom Technologies, Inc., et al.*, 31 F.Supp. 2d 819 (D. Or. Dec. 10, 1998). All three cases involve state commission interpretations of interconnection agreements and are not relevant here.

Buckeye Telesystem in its brief exclaims that the "Florida Public Service Commission held that calls to ISPs should be treated as local exchange calls over 11 years ago." *Bell South Telecommunications, Inc. v. ITC Deltacom Communications, Inc.*, 62 F. Supp. 2d 1302 (M.D. Ala. 1999).¹⁹ The district court, however, held only that the record supported a finding that when the parties entered into their respective interconnection agreements, they intended that calls which connected customers to an ISP, and which originated and terminated in same local calling area, would qualify as "local traffic" subject to reciprocal compensation under the interconnection agreement. Consequently, the decision in *Bell South* is a mere contract interpretation case as opposed to support for the bold proposition Buckeye is asserting.

In its section on the "merits," Buckeye cites a number of cases to support the proposition that "dozens of other states have already required reciprocal compensation for ISP calls." Again, these cases concern reviews of a state public service commission's interpretation of an interconnection agreement.

¹⁹ Buckeye Telesystem oddly ignores the central reason for this briefing. The Commission should strike its brief altogether for failing to even discuss *Bell Atlantic*.

Simply stated, these decisions say nothing about the proper way to treat Internet-bound traffic going forward.

III. The Issues Identified For This Proceeding In The Commission's March 15, 2000 Entry Remain Relevant After *Bell Atlantic*

The Commission identified the issues it expects the parties to address in paragraphs 4a through 4e of its March 15, 2000 Entry. Each is repeated below. For the reasons stated above and here, there is no cause to narrow the scope of this proceeding.

- Issue 4a. Discuss the extent of the Commission's jurisdiction to establish the terms and conditions of service regarding compensation for dial-up internet service provider (ISP) traffic? Examine the Commission's jurisdiction to investigate compensation for dial-up ISP traffic in light of pending proceedings at the Federal Communications Commission (FCC) on similar issues? Discuss whether any compensation mechanism developed through this proceeding should terminate at the time the FCC issues an order in its pending proceeding? If so, should the compensation mechanism developed in this docket terminate at the time the FCC renders its decision or await the issuance of a final (non) appealable decision on the issue?

These are the jurisdictional issues reserved for post-hearing briefing. *Bell Atlantic* did not decide those issues; indeed, it expressly freed ILECs to seek relief from state-imposed compensation that they believe to be wrongfully imposed. *See Bell Atlantic* at *26-27. For all the reasons previously stated, the *vacatur* of the FCC's Order does not mean reciprocal compensation is now owing. The *ISP Declaratory Ruling* was but one of the many federal precedents holding ISP traffic as non-local.

The CLECs also ignore that the Commission did not conceive of this generic investigation on the basis of the *ISP Declaratory Ruling*. The Commission originally decided the need for this generic proceeding *before* the FCC issued its *ISP Declaratory Ruling*. In its August 27, 1998 decision holding that Ameritech Ohio and ICG had agreed in their interconnection

agreement to voluntarily treat ISP traffic as local traffic for purposes of reciprocal compensation, the Commission – at a time when there was no FCC Declaratory Ruling – emphasized that:

[I]n making this determination, we specifically note that we are deciding this case solely on our interpretation of what the parties understood at the time the agreement was negotiated. This decision should not be viewed by anyone as an opinion on the broader policy implications involved, many of which Ameritech makes in support of its position in this matter. We specifically reserve our rights to consider these policy implications in a future proceeding.

In the Matter of the Complaint of ICG Telecom Group, Inc. v. Ameritech Ohio, No. 97-1557-TP-CSS, (Opinion and Order August 27, 1998) at p. 8. Commissioner Mason, though dissenting from the majority's interpretation of the agreement, also advocated the need for a future generic proceeding in the form of "[e]ither a Commission ordered investigation or the creation of a collaborative" and "encourage[d] the Commission to be aggressive in establishing a *customized* approach to dealing with Internet traffic reciprocal compensation issues within state jurisdiction on a long-term basis." Dissenting op. at 2 (Emphasis added.)

The Commission subsequently remained on course toward holding a generic proceeding after and notwithstanding the FCC's *ISP Declaratory Ruling* that ISP traffic is interstate and not subject to 251(b)(5) reciprocal compensation. The Commission concluded that the *ISP Declaratory Ruling* "did not resolve the question of whether reciprocal compensation is owed for this [ISP] traffic" and "[u]ntil there is a federal rule in place, this Commission had, and continues to have, an obligation to resolve this issue." *Entry on Rehearing* (May 5, 1999) at 10-11. Consistent with its decisions before and after the FCC issued its now vacated *ISP Declaratory Ruling*, the Commission most recently on January 11, 2000 elected to commence this proceeding on state and federal law jurisdictional grounds *other than* the *ISP Declaratory Ruling* "to develop

a generic position on inter-carrier compensation for ISP-bound traffic, and perhaps other principally one-way traffic with characteristics similar to ISP-bound traffic....” *Entry* at pp. 3-4.

Thus, just as the FCC’s *ISP Declaratory Ruling* did not persuade the Commission to convene this generic investigation, the Commission naturally should view the temporary loss of that ruling through the D.C. Circuit’s *vacatur* as equally inconsequential. The significant policy implications remain, and there is still no FCC rule prescribing a customized compensation mechanism for ISP traffic.

Issue 4b. Is it possible to separate dial-up ISP traffic from other types of traffic? If so, explain how. If not, are there reasonable alternatives to actual identification of dial-up ISP traffic? Should the Commission also consider separating other types of traffic that have similar call characteristics as dial-up ISP calls and treat this one subset of calls differently from other locally dialed traffic? Is such a distinction between traffic legally permitted?

MCI contends that this Commission may not address the issues in 4b because, according to MCI, the D.C. Circuit held that “calls to ISPs are no different than other local calls” for purposes of reciprocal compensation under Section 251(b)(5). Again, MCI blatantly misrepresents the D.C. Circuit’s holding. As we demonstrated above, Bell Atlantic did no such thing. The D.C. Circuit simply asked the FCC to better explain its conclusion that ISP traffic is different from local traffic.

MCI also would be wrong even if ISP calls are someday held to be “local.” Section 252(d)(2)(A) of the Act establishes that “the terms and conditions for reciprocal compensation” shall not satisfy the requirements of the Act unless they “provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier’s network facilities of calls that originate on the network facilities of the other carrier” and such costs are determined “on the basis of a reasonable approximation of the additional costs of

terminating such calls.” 47 U.S.C. § 252(d)(2)(A). In Ohio, the overwhelming majority of the calls handed off from Ameritech to CLECs are Internet-bound. Therefore, under the explicit terms of the Act, the inter-carrier compensation rate must reflect the costs of “terminating” that traffic — that is, largely Internet-bound traffic — on an efficiently designed CLEC network — this means, networks optimized for the delivery of high concentrations of Internet-bound traffic.

Assuming this proceeding resumes with discovery and an evidentiary hearing, the Commission will be presented with ample evidence that shows that the CLECs’ costs of transporting and “terminating” the traffic originated on Ameritech’s network are far lower than the end-office reciprocal compensation rate. Accordingly, the reciprocal compensation rate applicable to traditional voice traffic is not “a reasonable approximation of the additional costs” of delivering traffic to CLEC end-users. 47 U.S.C. § 252(d)(2)(A).

As discussed in Ameritech Ohio’s Initial Brief, the FCC’s treatment of reciprocal compensation payments to paging carriers illustrates this principle. *See* Ameritech Initial Brief at p. 7. The FCC recognized that “incumbent LECs’ forward-looking costs may not be reasonable proxies for the costs of paging providers” because “[p]aging is typically a significantly different service than wireline or wireless voice service and uses different types and amount of equipment and facilities.”²⁰ Accordingly, the FCC required paging providers to prove to state commissions the costs associated with terminating local calls on their networks. *Id.* at 16044, ¶ 1093. The same principle here requires that the FCC ensure that the inter-carrier compensation applicable to Internet-bound traffic be no greater than the costs of delivering such traffic.

²⁰ *See* First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16043, ¶1092, *modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *rev’d in part, aff’d in part sub nom. AT&T Corp. v. Iowa Utils. Bd.* 119 S.Ct. 721 (1999).

Thus, the FCC held that Rule 51.711(a) does not apply even to a class of *local* traffic when (i) the characteristics of that traffic call into question the presumption that the ILEC's costs are a good proxy for the CLEC's costs, and (ii) there is a "lack of information in the record concerning [the CLEC's] costs."

This does not mean though— as some have argued — that an ISP is no different from any other business user — a pizza parlor, for example. An ISP provides information services "via telecommunications." A pizza parlor provides — pizzas. An ISP provides its Internet-access services only to its clients: its number is provided not for the purpose of communicating with all subscribers to the PSTN, but only with those who have paid for such access. A pizza parlor's number is available to all. Consequently, there is no anomaly in recognizing that the costs of Internet-access should not be spread among all subscribers to the PSTN — including those with no ability to use the service — but only among an ISP's subscribers.

The issue here is not the proper treatment of ordinary local voice calls, but the proper treatment of information service calls, where the seven-digit number is dialed *not* to complete a local telephone call but instead to access the Internet — a call that the FCC has definitively ruled is an exchange access call, not a local call.

Consequently, regardless of whether interstate as Ameritech asserts or local as the CLEC's argue, there is good reason for the Commission to proceed with its focused investigation of ISP traffic due to its special characteristics.

- Issue 4c. Identify the cost elements that contribute to the overall cost of a dial-up ISP call. Do those cost elements vary in any manner from other locally dialed traffic? Does the cost a dial-up internet call vary upon the network configuration of the carrier originating/terminating the call? Explain.

Plainly, *Bell Atlantic* had nothing to say about these issues. And it is outrageous that MCI, AT&T, ICG, and other CLECs want to keep the Commission from seeing the cost information it needs to make a reasoned judgment in this proceeding. Not surprisingly, all CLECs riding the reciprocal compensation gravy train abhor the thought of disclosing any information about their costs to deliver ISP traffic. Yet, this disclosure is central to the Commission's investigation into the legal and policy implications of the present system. The CLECs like to claim that their costs to deliver ISP calls mirror those of ILECs in routing local traffic. Recent developments continue to demonstrate otherwise. For example, as previously noted, AT&T is now offering interstate Internet voice calls for less than a penny a minute (and can still afford to pay the terminating access charges.) *See* Exhibit 2 hereto.

In short, the characteristics of ISP traffic do not just call into question the presumption that the ILEC's termination costs are a good proxy for the CLEC's costs of delivering ISP traffic; they positively rebut that presumption. What Ameritech opposes, and what federal law forbids, is applying the rates for termination of traditional voice traffic to a service with demonstrably different cost characteristics – delivery of Internet-bound data traffic. It is important for the Commission investigation to address these issues.

- Issue 4d. What compensation methodology or mechanism do local exchange carriers utilize today to compensate each other for the exchange of local, non-ISP traffic? Does the originating local exchange carrier compensate the terminating local exchange carrier for completing local, non-ISP calls today? Explain whether or not identical compensation arrangements should be utilized to compensate local exchange carriers for completing a local dial-up non-ISP call and local dial-up call? What is the appropriate compensation mechanism (i.e., reciprocal compensation, bill and keep, or some other compensation mechanism?) Explain the workings of the selected methodology. Should the Commission develop a true-up mechanism that reconciles any compensation mechanism this Commission develops with any compensation mechanism developed by the FCC?

Consistent with the approach throughout its brief, MCI baldly asserts that *Bell Atlantic* also dictates the Commission's resolution of these issues such that "the Commission no longer may consider a compensation mechanism for ISP-bound traffic that differs from the reciprocal compensation mechanism required by federal law and the Local Service Guidelines." See MCI Brief at 12. Again, this is false. For the reasons stated earlier, MCI and the other CLECs have no credible support for their position.

Issue 4e. Explain the policy implications and the competitive incentives that exist with each proposed compensation arrangement for providing dial-up ISP traffic.

Before the FCC issued its now vacated *ISP Declaratory Ruling*, the Commission expressly recognized from Ameritech's position in the ICG complaint case that there are "broad policy implications" that had to be addressed in a future proceeding concerning compensation for delivery of Internet-bound traffic. See *ICG Complaint Case, supra*, at 8. Ameritech was eager to discuss these policy implications then and remains committed now to demonstrating that any scheme of inter-carrier compensation that over-compensates CLECs disserves every pertinent goal of the Telecommunications Act of 1996. As the FCC has observed, any scheme of inter-carrier compensation for ISP traffic should aim to produce "efficient outcomes" – *i.e.*, to "ensur[e] the broadest possible entry of efficient new competitors, eliminat[e] incentives for inefficient entry and irrational pricing schemes, and provid[e] to consumers as rapidly as possible the benefits of competition and emerging technologies." *ISP Declaratory Ruling, supra*, at ¶¶ 29, 33. A skewed system of inter-carrier compensation for ISP traffic, however, ensures the opposite: It reduces competition among LECs; fosters inefficient entry; institutionalizes irrational pricing of local exchange and Internet services; and denies consumers the benefits of emerging

technologies. *Bell Atlantic* says nothing to preclude the Commission's investigation of these serious policy implications which it committed to do in 1998.

IV. Discovery Issues

AT&T and ICG argue directly that the Commission should not permit discovery in this proceeding. Although it is not surprising that the CLECs oppose divulging information about their costs, network configurations, and arrangements with ISP customers, this is critically important information without which the Commission cannot properly address both the significant legal and policy issues at stake here. Moreover, the Attorney Examiner stated at the April 3rd pre-hearing conference that discovery issues would *not* be a subject for this briefing and, therefore, Ameritech will not belabor what should be obvious: the importance of discovery here. Once the issues for hearing are confirmed, normal discovery procedures will apply and any discovery controversies thereafter can then be resolved.

V. Conclusion

In the event the Commission determines, over our objection, that it indeed has the power to impose inter-carrier compensation arrangements on Internet traffic, there are many good reasons to proceed with this generic investigation. This is an important proceeding at a pivotal time to the Commission's efforts to promote competition, particularly in the residential market. Where regulation provides opportunities for guaranteed high returns — opportunities for “regulatory arbitrage” — such opportunities will attract a disproportionate share of investment. Such investment provides no benefit to society as a whole: because the resulting profits reflect a regulatory loophole rather than any genuine efficiency, the effect of such investment is simply to arbitrarily shift wealth from one set of subscribers and shareholders to another. The

Massachusetts DTE recognized this very point when it held that reciprocal compensation would no longer be paid on Internet-bound traffic:

The unqualified payment of reciprocal compensation for ISP-bound traffic . . . does not promote real competition in telecommunications. Rather, it enriches competitive local exchange carriers, Internet service providers, and Internet users at the expense of telephone customers or shareholders. This is done under the guise of what purports to be competition, but is really just an unintended arbitrage opportunity derived from regulations that were designed to promote real competition. A loophole, in a word.²¹

The payment of above-cost reciprocal compensation on Internet-bound traffic has been just such a loophole in Ohio. This proceeding offers the opportunity to finally address it.

For all of the foregoing reasons, the Commission should deny the CLECs' motion for summary judgment and set a pre-hearing conference to discuss a new procedural schedule to address those issues identified in the Commission's Entry dated March 15, 2000.

Dated: April 24, 2000

Respectfully submitted,

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²¹ Order, Complaint of MCI WorldCom, Inc. against New England Tel. Co. d/b/a Bell Atlantic-Massachusetts (Mass. DTE May 19, 1999).

CERTIFICATE OF SERVICE

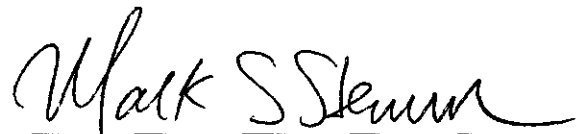
I hereby certify that a copy of the foregoing Ameritech Ohio's Reply Brief was via regular U.S. Mail, postage prepaid and also via mail delivery on this 24th day of April, 2000, on the following counsel of record:

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March 30, 2000

ICG COMMUNICATIONS INC /DE/ (ICGX)

Annual Report (SEC form 10-K)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND - RESULTS OF OPERATIONS

The following discussion includes certain forward-looking statements which are affected by important factors including, but not limited to, the ability of the Company to obtain adequate financing to fund expansion, the dependence on increased traffic on the Company's facilities, the successful implementation of the Company's strategy of offering an integrated telecommunications package of local, long distance, data and enhanced telephony and network services, the continued development of the Company's network infrastructure and actions of competitors and regulatory authorities that could cause actual results to differ materially from the forward-looking statements. The results for the years ended December 31, 1997, 1998 and 1999 have been derived from the Company's audited consolidated financial statements included elsewhere herein. The Company's consolidated financial statements reflect the operations of Zycom, NETCOM, Network Services and Satellite Services as discontinued for all periods presented. All dollar amounts are in U.S. dollars.

Company Overview

ICG Communications, Inc. (ICG or the Company) is a facilities-based communications provider and, based on revenue and customer lines in service, one of the largest competitive communications companies in the United States. The Company primarily offers voice and data services directly to small- to medium- sized business customers and offers network facilities and data management to

such calls are not local traffic as defined by the various agreements and not subject to payment of transport and termination charges under state and federal laws and public policies. However, the Company has resolved certain of these disputes with some of the ILECs.

The resolution of these disputes have been, and will continue to be, based on rulings by state public utility commissions and/or by the Federal Communications Commission (FCC), or

through negotiations between the parties. To date, there have been favorable final rulings from 31 state public utility commissions that ISP traffic is subject to the payment of reciprocal compensation under current interconnection agreements. Many of these state commission decisions have been appealed by the ILECs. To date, five federal court decisions, including two federal circuit court of appeals decisions have been issued upholding state commission decisions ordering the payment of reciprocal compensation for ISP traffic. On February 25, 1999, the FCC issued a decision that ISP-bound traffic is largely jurisdictionally interstate traffic. The decision relies on the long-standing federal policy that ISP traffic, although jurisdictionally interstate, is treated as though it is local traffic for pricing purposes. The decision also emphasizes that because there currently are no federal rules governing intercarrier compensation for ISP traffic, the determination as to whether such traffic is subject to reciprocal compensation under the terms of interconnection agreements is properly made by the state commissions and that carriers are bound by their interconnection agreements and state commission decisions regarding the payment of reciprocal compensation for ISP traffic. The FCC has initiated a rulemaking proceeding regarding the adoption of prospective federal rules for intercarrier compensation for ISP traffic. In its notice of rulemaking, the FCC expresses its preference that compensation rates for this traffic continue to be set by negotiations between carriers, with disputes resolved by arbitrations conducted by state commissions, pursuant to the Telecommunications Act. Since the issuance of the FCC's decision on February 25, 1999, 19 state utility commissions, have either ruled or reaffirmed that ISP traffic is subject to reciprocal compensation under current interconnection agreements, and two state commissions have declined to apply reciprocal compensation for ISP traffic under current interconnection agreements. Additionally, 11 state commissions have awarded reciprocal compensation for ISP traffic in arbitration proceedings involving new agreements. One state has declined to order reciprocal compensation in an arbitration proceeding, and two states have declined to decide the issue in the arbitration until after the FCC and/or the state commission reaches a decision in pending proceedings on prospective compensation.

On March 24, 2000, the United States Court of Appeals for the District of Columbia Circuit vacated and remanded the FCC's February 25, 1999 decision. The Company does not believe that the Circuit Court's decision will adversely affect the state decisions noted above with respect to reciprocal compensation. The decision does, however, create some uncertainty and there can be no assurance that future FCC or state rulings will be favorable to the Company.

The Company has aggressively participated in a number of regulatory proceedings that address the obligation of the ILECs to pay the Company reciprocal compensation for ISP-bound traffic under the Company's interconnection agreements. These proceedings include complaint proceedings brought by the Company against individual ILECs for failure to pay reciprocal compensation under the terms of a current interconnection agreement; generic state commission proceedings concerning the obligations of ILECs to pay reciprocal compensation to CLECs, and arbitration proceedings before state commissions addressing the payment of reciprocal compensation on a prospective basis under the new interconnection agreements.

In 1999, the state utility commissions in Colorado issued a final decisions granting a complaint filed

AT&T Hopes to Save 'Billions' by Routing Calls Over the Web

By James M. McManus

LOS ANGELES—AT&T Corp. can save billions of dollars each year by using Net2Phone Inc.'s Internet-based phone technology, said Kathleen Earley, president of AT&T's Data & Internet Services unit.

In a keynote speech at the Internet World conference here Friday, Ms. Earley said AT&T can avoid paying access fees to local phone service providers by using Net2Phone's technology. Last week, a consortium led by AT&T acquired a controlling stake in Net2Phone from IDT Corp.

"We don't like paying the bad guys for settlement costs," Ms. Earley said. "We don't like that; we'd rather keep that \$10 billion a year." She also expects the emergence of Internet phone service to present new revenue opportunities.

Still, AT&T is a few years away from deploying Web-based phone service, known as voice-over-IP, on the public Internet, she said. The quality of that service is too shaky for such widespread deployment. But AT&T is already using voice-over-IP for its internal communications system, Earley said.

The investment in Net2Phone is only one way that AT&T is tapping into the Internet, Earley said. On Thursday, the Basking Ridge, N.J., concern and British Telecommunications PLC said they will invest \$3 billion in linking 41 Internet data centers in 16 countries.

EXHIBIT



News Release

FOR RELEASE MONDAY, APRIL 10, 2000

AT&T WorldNet® Service Offers Members Special Net2Phone (sm) Promotion

Up to 1,000 Free Minutes of Domestic PC-to-Phone Calling

BASKING RIDGE, N.J. -- AT&T WorldNet® Service today announced a promotional offer for its members in conjunction with Net2Phone(sm). The offer, available through October 10, 2000, is good for up to 1,000 free minutes of domestic long distance calling -- from personal computer to phone -- using Net2Phone's web-based communications technologies.

"We're thrilled to be able to follow-through on our recent announcement with Net2Phone and offer this new generation of voice-enhanced, web-based communications to our members," said Ed Chatlos, AT&T WorldNet vice president and general manager. "We're always looking for value-added services for our customers and this new technology is at the leading edge of communications technology."

"Inclusion in AT&T WorldNet's site is certainly very important to us," said Howie Balter, CEO of Net2Phone. "We expect AT&T WorldNet members to enjoy the convenience, great rates and added value that Net2Phone brings. We hope this relationship flourishes and look forward to working with AT&T."

WorldNet members who enroll for the Net2Phone offer get their first 1,000 minutes of domestic PC phone calls at no charge, and can then take advantage of a great rate of a penny a minute to anywhere in the 50 states for additional calls. Members may also use this offer to place the equivalent value of international calls with rates as low as 3.9 cents a minute. Additional pricing information for international calls is available during the Net2Phone registration process.

To enroll for the new offer, or for more information, WorldNet members can visit the AT&T WorldNet homepage. Consumers interested in signing up for AT&T's award-winning WorldNet Service can go online to <http://www.att.net/>.

As an added incentive, members who enroll with Net2Phone before October 10, 2000, will receive a professional telephone headset -- a \$39.95 value -- free of charge (shipping and handling charges also will be waived if members enroll by April 17).

Upon free download and registration, WorldNet users can conveniently place telephone calls from their computers to any telephone around the world. Once installed, the Net2Phone software opens a pop-up window that resembles a traditional telephone, and users can dial telephone numbers on their keyboard just as they would on a regular telephone. Calls are routed over WorldNet's Internet backbone to Net2Phone gateways around the world and then converted to the public switched telephone network, where they are sent to the caller's destination.

Also included in the offer is the complete Net2Phone Communications Package:

- PC Phone Calls -- Call anywhere in the world from your PC.
- Free VoiceMail -- Allows members to record an audio message and send it out via e-mail -- at no charge.
- Free PC to PC -- Call any PC and talk at no charge.
- Net2Fax -- Fax from your PC to anywhere in the world at excellent rates.

About Net2Phone:

Net2Phone (NASDAQ: NTOP) is a leading provider of voice-enhanced Internet communications services to individuals and businesses worldwide. Net2Phone enables people to place low-cost high quality calls from their computer, telephone, or fax machine to any telephone or fax machine in the world. Net2Phone develops and markets technology and services for IP voice and e-commerce solutions for the web and other IP networks. For more information about Net2Phone's products and services, please visit www.net2phone.com.

About AT&T WorldNet Service:

AT&T WorldNet® Service (<http://www.att.net>) is one of the leading Internet Service Providers in the U.S., serving more than 1.5 million customers. It provides reliable, easy Internet access across the nation, 6 e-mail addresses with 10-megabytes of free Web space per e-mail ID, chat, anti-spam service, instant messaging, online communities and access to discounted games. AT&T WorldNet Service was named "Best Buy" in PC World Magazine (March 1999), won PC Magazine's "Editor's Choice" award (April 1999) and was praised as the top ISP in SmartMoney (April 1999).

AT&T WorldNet Service consumer software for Windows 95/98/NT and Macintosh is available by download free-of-charge from the public AT&T WorldNet Web site (<http://www.att.net/>). For more information on other AT&T products and services go online to <http://www.att.com/>.

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