

## VNXX Workgroup Proposed Comments

### **What is Virtual NXX**

NeuStar, as NANPA (North American Numbering Plan Administration) administrator assigns NXX blocks of local telephone numbers, typically in groups of a thousand or ten thousand numbers, to telecommunications carriers. When a carrier requests local number resources, they specifically request NeuStar to assign an NXX block within a specific local exchange service geographic area.

Virtual NXX (“VNXX”) is the assignment of one or more local telephone numbers to customers outside the specific local exchange service geographic area. Since the telephone numbers are part of a block assigned to a specific geographic local exchange calling area, callers in that local area (a calling party) can dial these numbers as local calls. However, the call cannot be terminated within that geographic local calling area associated with the VNXX because the called carrier (and the called customer) is actually located beyond the local calling area. Therefore, for the call to be completed, the calling party has to use interexchange facilities to reach the called party.

VNXX calls do not normally generate reciprocal exchange of local telecommunications traffic. VNXX calling generally produces a one-way traffic flow that originates in an ILEC’s local calling area but is terminated in an exchange beyond the originating ILEC’s local calling area, usually to an Internet Service Provider (“ISP”). Interexchange facilities are used to reach the VNXX called party. Therefore, there is no possibility for actual *reciprocal* compensation between the originating ILEC and the terminating CLEC. Since the overwhelming majority of VNXX calls are ISP-bound traffic and due to the long holding times associated with dial-up internet calls, this

quickly overburdens the interoffice trunks to the tandem switch. This causes the ILEC to add additional trunks without the ability to recover these costs while the cost-causer contributes nothing to the cost recovery.

### **Current VNXX Compensation Model**

The issue of compensation for VNXX calls first came before the Michigan Public Service Commission (“Commission”) in 1998. The Commission was asked to resolve a complaint brought by a customer of CenturyTel of Michigan (“CenturyTel”) who was billed a toll rate for calls she made to an ISP within an NPA-NXX in CenturyTel’s local area, but the calls were transported to Flint to connect to the Internet. *Bierman v. CenturyTel of Michigan, Inc.*, Case No. U-11821, (April 12, 1999).<sup>1</sup>

In *Bierman*, the Commission resolved the issue of whether the calls were local or toll by looking at the language in CenturyTel’s tariff. The Commission concluded that CenturyTel’s tariff language for providing basic local exchange service dictated that the calls were classified as local rather than toll. The Michigan Court of Appeals, in *In re Complaint Against CenturyTel of Michigan, Inc.*, affirmed the Commission’s decision that the tariff language prevails. *In re Complaint Against CenturyTel of Michigan, Inc.*, 245 Mich. App. 351. **This case only addressed the rates to be paid by the end user. Intercarrier compensation was not addressed in this case.**

The Commission has consistently used its decision in *Bierman* and *Bierman*’s progeny as the fundamental foundation that the tariff language controls whether a call should be rated a local call or toll call. In some circumstances when a telephone carrier’s

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<sup>1</sup> The Commission’s decision in *Bierman* only addressed what costs the end user paid, not whether reciprocal compensation was required to be paid by one LEC to another LEC for the termination of the call.

tariff indicates that VNXX calls are local exchange calls, some CLECs have made claims for reciprocal compensation. However, the Commission has only addressed reciprocal compensation for such calls in a limited number of arbitration cases and these were all reached prior to the 2005 amendment of the MTA.

Although problems relating to the compensation for VNXX calls existed in Michigan due to EAS, these problems grew in magnitude when the state legislature enacted legislation expanding local calling areas. In the Michigan Telecommunication Act of 2000, Incumbent Local Exchange Carriers (“ILECs”) like SBC (now AT&T Michigan) and Verizon were required to implement expanded local calling to adjacent exchanges. However, the state legislature realized that smaller rural ILECs may suffer economic hardship if they were arbitrarily required to implement expanded local calling at that time. The rural ILECs were expressly exempted from this requirement. However the demand from the rural ILECs’ customers for expanded local calling plans similar to SBC and Verizon caused most rural ILECs to voluntarily implement expanded local calling. When the rural ILECs implemented these voluntary expanded local calling plans, the ILECs’ customers began to make “local” calls to VNXX codes in the newly expanded areas.

The use of VNXX to route ISP-bound calls to CLECs physically located outside the local calling area of the originating caller has put a strain on the intercarrier compensation scheme. Although VNXXs allow end users to avoid payment of toll charges to reach their ISPs-of-choice, the originating telephone carrier receives no compensation for originating and transporting a true interexchange call while incurring costs for use of interexchange facilities to transport the VNXX call beyond its own

exchange to the called party. While the CLEC utilizing the VNXX bypasses interexchange carriers and exchange access charges, the CLEC still seeks compensation for the termination of the VNXX calls from the originating carrier under the intercarrier local reciprocal compensation regime. Moreover, the originating carrier is not being sufficiently compensated by its local rates because local rates do not (and cannot) include interexchange costs. When rural ILECs filed their expanded local calling plans they could not include interexchange transport costs in their basic local rates.

### **Post-December 31, 2007 Compensation Model**

On November 22, 2005, the MTA was amended with regard to VNXX calls. The Legislature, recognizing the strain being placed on the local reciprocal compensation regime and the problems in Michigan caused by the growing volume of uncompensated traffic on interexchange facilities, included language in section 304(9) that allows local telephone companies to declare in their tariffs whether VNXX calls should be considered local or non-local: “Effective December 31, 2007, a call made to a called party who is not located in the geographical area of the caller’s local calling area or an adjacent local calling area as defined by the Commission’s Orders in Case Numbers U-12515 and U-12528, dated February 5, 2001, is not a local call if the tariff of the provider originating the call does not classify the call as local.”

The Legislature’s clear intent is to allow telephone companies the ability to include language in their tariff that identifies whether VNXX calls are to be treated as local calls or toll calls. When section 304(9) of the MTA takes effect after December 31, 2007, the language in the originating provider’s tariff will control whether a VNXX call

is treated as a local call or a toll call—thus fully comporting to the decision in *Bierman, supra*, which is the foundation that this Commission has relied upon in determining how VNXX calls are to be rated.

After December 31, 2007, no doubt some ILECs in Michigan will include language in their tariffs that VNXX calls are to be treated as interexchange calls. However, it is unfounded to say that all ILECs will treat VNXX calls as interexchange calls. Some ILECs may choose to classify VNXX calls as local, and offer instead a variety of options for end users to reach their ISPs-of-choice.

For end users in local calling areas where VNXX calls are considered as interexchange, they may purchase optional toll calling plans from their toll carrier, or in the alternative, the ISP may offer 800 numbers so its customers can reach it. In either case, the compensation model will require that either the originating end user or the ISP pay toll to its designated interexchange carrier for transporting the call; whereas, the interexchange carrier will compensate the originating carrier for originating exchange access and the terminating carrier for terminating exchange access.

For those ILECs that choose to keep VNXXs as local calls, they will now have the opportunity to provide optional local calling plans that include VNXXs. However, unlike the current regime, the ILEC will also have an opportunity to recover its cost to complete the call. The state legislature made this option possible to ILECs when it enacted section 301(a) of the MTA, which requires all telecommunications providers to offer Primary Basic Local Exchange Service (“PBLES”) to their residential customers.

PBLES is the provision of one primary access line to a residential customer for voice communication, and PBLES must include (i) Not fewer than 100 outgoing calls per

month; (ii) Not less than 12,000 outgoing minutes per month; (iii) Unlimited incoming calls.<sup>2</sup> Since telephone providers are only required to include voice communications in their PBLES, data communications for connection to ISPs may be excluded in an ILEC's PBLES. This allows the ILEC to offer optional calling plans to end users who would like to add data communications to their service and/or a specific VNXX at a reasonable rate.

### **Federal Communication Commission's Jurisdiction**

The FCC has explained that it “has not had an occasion to determine whether incumbent LECs have a duty to pay reciprocal compensation for virtual FX traffic under section 252(d)(2)” and has found “no clear Commission precedent or rules declaring such a duty.”<sup>3</sup> Further, the FCC declined to address the issue of VNXX traffic *In The Matter of Starpower Communications, LLC v Verizon South Inc.* In *Starpower*, the FCC merely addressed the parties' obligations under their current interconnection agreement because that was the only issue before the FCC and indicated that its decision in *Starpower* only applied in that case.

The FCC's *ISP Remand Order* determined that ISP-bound calls that originate and terminate in the same local calling area are exempted from reciprocal compensation obligations pursuant to section 251(b)(5) based on section 251(g) of the Federal Telecommunications Act (“FTA”). However, the FCC introduced an interim compensation for ISP-bound calls that originate and terminate in the same local calling area and took exclusive jurisdiction over compensation for ISP-bound calls. Nonetheless,

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<sup>2</sup> Section 101 (2) (Y) of the Michigan Telecommunications Act, as amended on November 22, 2005.

<sup>3</sup> *Application by Verizon Maryland, Inc. et al., for Authorization to Provide In-Region, InterLATA Services in Maryland, Washington, D.C., and West Virginia*, 18 FCC Red 5212 (2003).

the FCC has not yet determined that VNXX ISP-bound calls are subject to the interim rate set forth in the *ISP Remand Order*.

The majority of VNXX calls are ISP-bound traffic, and compensation for the termination of ISP calls that originate and terminate in the same local calling area is not based on section 251(b)(5) of the FTA. Instead, the FCC's *ISP Remand Order*, issued on April 27, 2001, implemented an interim compensation regime for ISP-bound traffic. This interim compensation regime included the following:

- A. Rate Caps – Compensation for ISP-bound traffic was to begin at .0015 per minute-of-use and declining, over a three year period, to .0007 per minute-of use.<sup>4</sup>
- B. Growth Caps - Compensation for ISP-bound traffic was based on the total minutes, plus a 10% growth factor.
- C. Mirroring Rule – A LEC that offered reciprocal compensation consistent with the Rate Caps must offer all 251(b)(5) reciprocal compensation at the same rate. A LEC that did not offer to exchange 251(b)(5) reciprocal compensation pursuant to the *ISP Remand Order* was required to exchange reciprocal compensation at state-approved rates.
- D. New Market Rule – Carriers that were not exchanging traffic pursuant to an interconnection agreement prior to the *ISP Remand Order* must exchange traffic on a bill-and-keep basis.

The *ISP Remand Order* was appealed to the D.C. Circuit Court of Appeals in *WorldCom v. FCC*, 288 F. 3d 429 (2002). The D.C. Circuit Court remanded the matter to the FCC because it did not accept the FCC's reasoning for why ISP-bound traffic was excluded from section 251(b)(5) reciprocal compensation. However, the D.C. Circuit Court did not vacate the *ISP Remand Order* and the rules it set forth remain in effect. The

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<sup>4</sup> The ISP regime rate cap of .0007 only applies to ILECs that opt to exchange all 251 (b)(5) traffic at the same rate.

FCC later granted forbearance from the Growth Factor and New Market Rule to all telecommunications carriers effective October 8, 2004.<sup>5</sup>

During this VNXX Committee's discussions, it was suggested that ILECs need to compensate CLECs for the termination of ISP-bound traffic using only the *ISP Remand Order* rate of \$0.0007 per minute. This rate may be acceptable to large ILECs like AT&T Michigan and Verizon because their local interconnection rates are lower than the *ISP Remand Order* rate. Whereas, if the rural ILECs were to opt into using the *ISP Remand Order* rate, they would be required to use the *ISP Remand Order* rate for all reciprocal compensation. The *ISP Remand Order* rate is, however, significantly lower than the rural ILECs' approved TSLRIC-based local reciprocal compensation rates.

### **Types of Services Affected By VNXX**

If ILECs declare in their tariffs that VNXX calls, post-December 31, 2007, will be interexchange calls, it will not preclude the further use of VNXX codes. End users and CLECs will still have access to VNXX codes. However, those end users that make calls to VNXXs and the businesses that benefit from the use of VNXX calls, will no longer be subsidized by the ILECs or other end users who do not make VNXX calls. Instead, the end users making VNXX calls or the businesses that benefit from the use VNXX calls will pay the cost of service. Businesses that desire a local presence in an area where they are not physically located will still be able to use VNXX codes. End users will still be able to use VNXX calls to dial up to the Internet. The true affect of treating VNXX calls as interexchange calls will be the shift of the cost recovery of using VNXX calls to those

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<sup>5</sup> *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160(c) from Application of the ISP Remand Order*, WC Docket No. 03-171 (October 8, 2004).

end users that make VNXX calls and the businesses that benefit from VNXX calls, i.e. the cost causers.

### **Conclusion**

The MTA as amended in 2005, has resolved all major issues surrounding VNXX. Because of this, there is no need for future legislation.

The MTA as amended in 2005, is a reasonable step towards a competitive telecommunications market. Section 304(9) of the MTA addresses serious arbitrage problems by allowing local exchange carriers to determine whether VNXX calls are to be considered local. The Legislature's creation of PBLES and the elimination of local rate regulation of non-PBLES local services allows LECs to restructure their local calling plans to provide for premium services such as accessing VNXX codes bound for ISPs. When the VNXX provisions of section 304(9) are looked at together with the creation and regulation of PBLES in section 101(2)(y), 301a and 304, it is apparent that the Legislature had a comprehensive approach that ensured the availability of a basic local service via landline but without access to the Internet and the high usage associated with that access. It then gave the local exchange carriers the option of providing local access to VNXXs for those consumers wishing access to distant ISPs-of-choice while freeing them of the burden of cross-subsidizing foreign CLECs. Furthermore, the Legislature decided that CLECs and others using VNXX as an intercarrier compensation loophole should be required to compensate the facility-based carrier for the use of its network.

The workgroup has thoroughly examined the legal, operational and financial aspects of VNXX. There seems to be general agreement among all participants that the

underlying issue—intercarrier compensation—is currently receiving attention by NARUC, the FCC and the industry in Washington, D.C. As several parties have concluded, expending more time on this issue on the state level would be redundant and could lead in a different direction than the more global talks taking place on the national level, which would not be productive.

On the issue of whether the MTA comports to the FTA and FCC rules, there is not agreement among the workgroup participants on what the litany of past FCC orders actually mean relative to VNXX. However, two points are evident. First, the FCC acknowledges that the current intercarrier compensation regime is temporary and in need of modifications and is actively addressing it. Second, the MTA amendment to section 304(9) provides nearly two years to work out the contractual and network arrangements between those companies impacted in the event the FCC does not act in the coming months.

Finally, the MTA is clear on its face and does not ask the VNXX workgroup to determine whether the Legislature erred in passing section 304(9).

Based on the workgroup's discussions, MECA concludes there is no need for additional state legislation at this time regarding VNXXs.