

VNXX Pre-Workgroup:

Please see the attachment.

Talk America has not, as of this time, taken a position in the Michigan Virtual NXX debate. The attached issues and considerations are based on some research we have conducted since the initial MPSC Virtual NXX meeting on 12/5/05.

Regards,

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## **Virtual NXX Issues and Considerations**

**Submitted by Talk America, Inc.**

### **Introduction.**

Talk America has not, as of this time, taken a position in the Michigan Virtual NXX debate. The following issues and considerations are based on some research we have conducted since the initial MPSC Virtual NXX pre-workgroup meeting on 12/5/05. This document is arranged in question and answer format.

**Q:** Do all leading Michigan-based CLECs use Virtual NXX today?

**A:** No. For example, Talk America does not. Where Talk America (or its LDMI subsidiary) serves local Michigan customers, it does so via collocations in the respective wire centers, and with trunking connecting those wire centers to its switching centers. From those switching centers, it connects directly to the various ILEC local tandems for interchange of local traffic with the ILECs and CLECs.

**Q:** Does Virtual NXX go by other names?

**A:** Yes. It is also called VNXX, and Virtual FX (virtual foreign exchange)<sup>1</sup>.

**Q:** Is Virtual NXX used only for ISP-bound traffic?

**A:** No. In an interesting case decided last year, the Alabama Public Service Commission observed that there were two basic classifications: (1) ISP-Bound FX and VNXX Calls; and (2) Non ISP-Bound FX and VNXX traffic<sup>2</sup>.

**Q:** In very simple terms, how did the Alabama PSC rule in that case?

**A:** With respect to ISP-Bound FX and VNXX Calls, they ruled that “by virtue of the determinations reached by the FCC in its *ISP Remand Order*, ISP-bound FX and VNXX

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<sup>1</sup> See for example Paetec Communications, Inc. v. State of Connecticut Dept. of Public Utility, Civil Action No. 3:03cv1783 (SRU), Decision and Order, 3/28/05.

<sup>2</sup> Alabama Public Service Commission, Docket 28906, Declaratory Ruling Concerning the Usage of Local Interconnection Services for the Provision of Virtual NXX Service, 4/29/04. This was in response to a petition filed by CenturyTel of Alabama against MCImetro.

calls are predominantly considered jurisdictionally interstate and subject to the authority of the FCC. [The Alabama] Commission accordingly has no authority to render determinations regarding the ISP-Bound FX/VNXX traffic referenced in this proceeding.”

**Q:** And with respect to Non ISP-Bound FX and VNXX Traffic?

**A:** Alabama PSC said, “While it is undeniable that the FX service offered by the ILECs and the VNXX service offered by the CLECs are provisioned differently due to variations in the network architecture and the local calling scopes of the ILECs as opposed to the CLECs, we find that those provisioning differences are insufficient to justify a disparate classification of FX and VNXX services for intercarrier compensation purposes...In light of the undisputed fact that the ILECs such as BellSouth, CenturyTel and the Rural ILECs have been providing FX services for many years, we look to the manner in which the ILECs themselves have handled the intercarrier compensation for such traffic. Our review of the tariff provisions of BellSouth, CenturyTel and certain other representative Rural ILECs reveals that each of those ILECs generally define FX service as a classification of exchange service even though they apparently consider such service to be a toll alternative... it is abundantly clear that the ILECs have not traditionally paid or imposed access charges or reciprocal compensation for FX traffic... We conclude that the traditional ILEC practice of neither assessing nor paying access charges or reciprocal compensation for FX traffic should be adhered to with respect to the VNXX services provided by the CLECs. We find that this policy will be best perpetuated by the implementation of a bill and keep regime for FX and VNXX traffic.”<sup>3</sup>

**Q:** What had been alleged in the Alabama case?

**A:** To quote just one paragraph: “CenturyTel asserted that MCI was attempting... to implement a VNXX arrangement where toll calls could be dialed in a seven digit fashion without the incurrence of applicable access service charges. CenturyTel maintained that MCI had no known presence, infrastructure or personnel in Dothan or Daleville that would support its claim to be a legitimate CLEC in those areas. CenturyTel alleged that MCI was merely attempting to use the Interconnection Agreement in Dothan, not to compete locally as a legitimate competitor under Section 251 of the Act, but to obtain interexchange access at local interconnection rates when the traffic involved was not local in nature.” [The Alabama PSC, in essence, did not buy this argument.]

**Q:** Some ILECs assert that a fundamental difference is that traditional FX service is essentially local exchange service with a really long cord, where the customer pays for a

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<sup>3</sup> Talk America takes no position, at this time, as to whether this conclusion of the Alabama PSC is correct or not. We simply found, in our quick research, the Alabama decision to clearly enunciate the positions of the various parties, and its discussion of the issues may be useful to the MPSC staff in the Michigan Virtual NXX investigation.

physical circuit that connects the central office (wire center) where the FX dial tone is located, over to the central office where the customer is located.

**A:** But this is not always true. In areas such as Los Angeles and Detroit, unusual demographics of calling result in high proportions of total toll calling being short-haul (or IntraLATA) in nature. With very high long distance rates in years past, pressure from businesses forced the ILECs to offer FX service, and to deploy large quantities of FX lines to business customers in Los Angeles, Detroit, and other similar areas, beginning in the 1960s – as an alternative to toll charges. There were such large quantities of these FX lines, that the affected ILECs sought ways to combat the large quantity of inter-wire-center lines they had to deploy, in order to serve these hundreds of FX lines.

**Q:** And what did the ILECs do, to handle the huge influx of FX lines, and the circuits they had to construct between central offices?

**A:** On the routes with the highest densities, they simply took an NPA-NXX in a wire center, and assigned it the Rate Center name of the foreign exchange, in a process that SBC Michigan calls “FX-NXX”. An example of this is the SBC Michigan wire center (central office) known as Royal Oak Main, located at 421 S. Williams Street in downtown Royal Oak. It contains about 17 NPA-NXXs, such as (248) 542, all but one of which are in area code 248, and all of which are billed as rate center “Royal Oak”. But SBC Michigan’s Royal Oak Main wire center also contains one “unusual” NPA-NXX, (313) 564, which is billed as rate center “Detroit”. The (313) 564 NPA-NXX is located on the same switching machine in that same building, RYLOMIMNDS0, that provides the dial tone to the Royal Oak NPA-NXXs. (313) 564 is not really in Detroit – it just “appears” to be. This Virtual-NXX-like service arrangement was constructed decades ago, and remains active today.

**Q:** Can you give a specific example?

**A:** Yes. As an example, the Hallock Clock Company Inc., at 702 W. Eleven Mile Road, in Royal Oak. Their normal local phone number is (248) 542-8130, but in the Detroit phone book they are listed with “Detroit Tel No (313) 564-5824”. But the dial tone for their “Detroit Tel No” is not provided in Detroit – it is provided in Royal Oak. So if a CLEC has a customer in downtown Detroit and they call (313) 564-5824, the CLEC will do a look-up in the database, and find they have to route the call to Royal Oak Main, and will need to cover the expense of routing and trunking the call to Royal Oak. But the CLEC will only be able to bill the call as a local Detroit-to-Detroit call, because (313) 564 is billed, in both directions, as if it were in Detroit. The CLEC gains no benefit from this arrangement, and incurs the additional cost. But SBC Michigan is able to bill the Hallock Clock Company for the extra monthly costs of a Detroit FX line, even though the line is really not a Detroit FX line, but is simply a Royal Oak phone number billed as if it were Detroit.

**Q:** Can you give more specifics as to this “FX-NXX” arrangement?

**A:** Yes. For example, the “Traffic Termination Agreement Between SBC Michigan and Westphalia Telephone Company”, filed with the MPSC on 2/18/04. In section 1.27, it describes the traditional type of FX line, which it calls “Dedicated FX Traffic”, as contrasted with the Royal Oak type, which it calls “Foreign Exchange – NXX (FX-NXX) Traffic” or “FX-type Traffic”. The agreement notes that “FX-NXX Service differs from Dedicated FX Service... in that FX-NXX end users continue to draw dial tone or are otherwise served from a Central (or End) Office physically located within their mandatory local calling area, whereas Dedicated FX Service end users draw dial tone or are otherwise served from a Central (or End) Office located outside their mandatory calling area.” The agreement also notes that “FX-NXX Service also permits an end user physically located in one exchange to be assigned telephone numbers resident in the serving Central (or End) Office in another, ‘foreign’ exchange, thereby creating a local presence in the ‘foreign’ exchange”. Thus, this “Royal Oak” type of arrangement seems to have characteristics very similar to Virtual NXX.

**Q:** The ILECs argue that CLECs should pay Access Charges for Virtual NXX traffic. In the Traffic Termination Agreement with Westphalia to which you referred, do the ILECs propose charging each other Access Charges for “FX-NXX” service?

**A:** No. The agreement indicates the traffic would be considered local, not toll – and thus, Access Charges would not apply – even though the connection between SBC and Westphalia appears to be inter-LATA (“Intrastate InterLATA Local Traffic”).<sup>4</sup> The two ILECs meet at a common demarcation point, and each party is financially responsible for the facilities on its side of the demarcation point. It appears that the FX-NXX traffic is subject to Bill and Keep.

**Q:** Some ILECs argue that Virtual NXX is improper, in that it is a scheme to enable customers to avoid what might otherwise be toll calls between the customer’s physical location and customers in the foreign exchange.

**A:** Interestingly, the SBC-Westphalia agreement, again in section 1.27, notes the following regarding their agreement on their FX services: “FX service enables particular end-user customers to avoid what might otherwise be toll calls between the FX customer’s physical location and customers in the foreign exchange.” What is good for the goose, ought to be good for the gander.

**Q:** Why might the smaller ILECs be arguing that CLECs should pay Access Charges for Virtual NXX traffic?

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<sup>4</sup> “9.1 The Parties agree that no Meet Point or Switched Access Traffic will be exchanged between them under this Agreement.”

**A:** For many of the smaller ILECs, Access Charges are a very lucrative enterprise. For example, Reciprocal compensation, ostensibly cost based, often is priced at \$.0007 per minute. As to Access Charges, in Michigan, LDMI pays SBC and Verizon about \$.0045 per minute, whereas it pays CenturyTel about \$.0346 per minute, and Westphalia Telephone Company about \$.0881 per minute (to cite just a couple of examples).

**Q:** But we hear arguments that the smaller ILECs are struggling financially, and the high Access Charges are required to keep them financially solvent.

**A:** In its 10-K annual report for the year ending 12/31/04, CenturyTel Inc. reports that it is the eighth largest local exchange telephone company in the U.S. Its after-tax profit margin was 14.0%, more than double that of the Fortune 500 (6.2%). From their 10-K reports for 2004 and data filed with the FCC, it appears that SBC (now AT&T) derived about 25% of their national revenues from Access Charges, Verizon derived about 18% of its revenues from Access Charges, but according to its own numbers, CenturyTel derived over 40% of its national revenues from Access Charges.

**Q:** Is there further demonstration that these Access Charges of companies like CenturyTel may be higher than costs alone would dictate?

**A:** In its 10-K annual report for the year ending 12/31/04, CenturyTel discloses, “The Telecommunications Act of 1996 allows local exchange carriers to file access tariffs on a streamlined basis and, if certain criteria are met, deems those tariffs lawful. Tariffs that have been ‘deemed lawful’ in effect nullify an interexchange carrier’s ability to seek refunds should the earnings from the tariffs ultimately result in earnings above the authorized rate of return prescribed by the FCC. Certain of the Company’s telephone subsidiaries file interstate tariffs directly with the FCC using this streamlined filing approach. As of December 31, 2004, the amount of the Company’s earnings in excess of the authorized rate of return reflected as a liability on the balance sheet for the combined 2001/2002 and 2003/2004 monitoring periods aggregated approximately \$63 million...”

**Q:** And what about intrastate Access Charges?

**A:** CenturyTel discloses, “The local service rates and intrastate access charges of substantially all of the Company’s telephone subsidiaries are regulated by state regulatory commissions... In recent years, state legislatures and regulatory commissions in most of the 22 states in which the Company operates have either reduced the regulation of LECs or have announced their intention to do so, and it is expected that this trend will continue.”

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