RED HERRING THE BUSINESS OF TECHNOLOGY

Will new phone charges signal the great e-depression?

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The low cost of Internet access via home phone lines has drawn millions of new users online. But the price of access for the average Web surfer could double if the former AT&T regional bells are successful in pushing through a key piece of federal legislation when Congress reconvenes next January.

What, exactly, such a price hike would do to Internet traffic is hard to say. But at a time when venture capital is drying up, and Net companies need users more than ever, any significant drop in traffic could prove disastrous for the dot-com economy.

The clouds are forming around a dispute between the regional bells, also known as incumbent local exchange carriers, or ILECs, and their competitors, the competitive local exchange carriers, or CLECs. Back in the mid-1990s, the ILECs decided they didn't want to bother dealing with Internet service providers, so they signed agreements to pay what's called "reciprocal compensation" to CLECs to connect consumers' calls to ISPs. It seemed like a good idea at the time: to the ILECs, ISPs looked like more trouble than they were worth; to the CLECs -- upstarts like US LEC (Nasdaq : CLEC), ITC/Deltacom (Nasdaq : ITCD), and Teligent (Nasdaq : TGNT) that must lease access to the ILECs' networks -- ISPs looked like much-needed new customers.

A $60 MILLION BORE

If at this point you're starting to think that reciprocal compensation is just another boring billing issue, that's because it is. In fact, it's so bland that for years even the ILECs ignored it. They can no longer afford to do so. Five years and millions of new Internet users since they signed their original deals later, the ILECs now find themselves shelling out around $60 million a month in reciprocal compensation fees -- and to their competitors, no less.

"This has been a major problem for local telephone companies," said Tom Tauke, executive vice president of external affairs for Bell Atlantic and chairman of the U.S. Telecom Association, in testimony last June before the House Commerce Committee's Subcommittee on Telecommunications, Trade, and Consumer Protection. Tauke estimated that "payments for Internet-bound calls will exceed $2 billion this year."

To fix the situation, the ILECs are pursuing a number of avenues. They're lobbying Congress to pass House Bill 4445 and its Senate counterpart, SB-2902, which would eliminate reciprocal compensation for dial-up Internet calls. Neither bill succeeded this past term, but both will be reintroduced when Congress returns to Washington.

On the Federal Communications Commission front, ILECs are pushing the agency to change the definition of an ISP dial-up from a local call to a long-distance call. Because reciprocal compensation only applies to local calls, such a change would absolve the ILECs of their fees. It would also make ISP dial-ups subject to federal taxes and to the ILECs' own long-distance access fees. Faced with those new fees -- and the loss of their billions of dollars in reciprocal compensation -- CLECs would have little choice but to charge higher rates to ISPs; the ISPs, in turn, would have to pass on their higher costs to consumers. Many people's monthly ISP bills could double overnight, and eventually climb into the threefigure range.

TALKING 'BOUT A RESOLUTION

The most desirable scenario is a compromise. The most likely is a showdown. ILECs have been swinging for the fences in the last few months. A legislative showdown is surprising given that legislators' natural instinct is to make deals, but ILECs may be betting that, with everyone focused on the White House, no one will be paying attention to a topic as dull as reciprocal compensation.

The CLECs do realize that the current arrangement can't continue. With reciprocal compensation rates dropping -- from an initial rate of 1 cent per minute per call to about 0.3 cents per minute today -- they know that overreliance on such compensation for their operating revenue makes it difficult to attract venture capital.

The real question is: how low reciprocal compensation rates will go -- and, in turn, how high consumers' ISP-access rates will rise. If people have to pay by the minute, they will undoubtedly spend less time online. This economy was founded on a build-it-and-they-will-come approach. But will they still come no matter how expensive it is to get in?

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