signed to the TSLRIC of a specific service or facility (or any other cost category).

It is important to recognize that joint costs would be categorized as incremental if each service were produced and offered by different firms. In such case, however, each firm would have to incur those costs leading to greater total costs of providing the services to customers and therefore higher prices. In the case of custom calling features, the providers of each of the services would have to purchase the software module necessary to offer their service. The fact that costs are designated as "joint" or "shared" in no way lessens the need of the network provider to recover these costs in its prices the same as incremental costs.

There are many types of joint costs found throughout the service or facility families offered by LECs. For example, custom calling features such as call waiting, call forwarding, and speed dialing are all created by a single software module. The right-to-use fee ("RTU") associated with this software module is not an incremental cost to any one of these services, yet without the software module none of the services could be offered. The RTU is thus a joint cost for the offering of custom calling features.

Similarly, the service center of Ameritech Information Industry Services ("AIIS"), located in Milwaukee, exists for the benefit of all services provided to competing LECs regardless of whether such carriers purchase unbundled loops, interconnection, or collocation. The service center thus represents a joint cost in the provision of services to these competing carriers but is incremental to none of those services.

c. Common (Or Overhead) Costs

Common costs, which are often referred to as overhead, are those costs (*i.e.*, costs of capital, labor, materials and other costs) that support the operations of the firm as a whole, but are neither incremental to any individual service nor are they the joint costs of any specific group or family of services The difference between joint and common costs is that joint costs would be avoided if a single family of services were eliminated, but common costs would be avoided only if the entire firm shut down.

Common costs are incurred for the overall operation of a multiproduct business. Examples of common costs include corporate, legal, financial, communication-related, and personnel expenses. Virtually all large corporations in the United States -- General Electric, General Motors, AT&T, and of course Ameritech -- have common costs. Such costs are not wasteful or unnecessary. The fact that large multiproduct corporations exist with significant common costs in a competitive economy indicates that common costs are consistent with, and part of, efficiently organizing the production of goods and services.

d. Residual Costs

Finally, residual costs[98] include, among other things, the costs of a service that are not included in TSLRIC and the costs associated with the legacy of regulatory decisions, such as prescription of uneconomic depreciation rates. TSLRIC is not an estimate of the actual incremental cost of providing a service, but rather the cost that would be incurred if the service were provided under the most efficient technology available today. In reality, however, a network is not rebuilt at each point in time to take advantage of improved technology. Instead, it is built bit by bit over time and encompasses multiple generations of technology. Although, each technology decision may have been efficient and foresighted when made, the resulting network will not be identical to the one that could be built today if it were reconstructed

[98] In general, residual costs would include, among other things, embedded or historical costs.

under the best technology available today. Also, in some states such as Illinois, spare capacity may be included as a residual cost. As a consequence, current service incremental costs associated with providing a particular service are likely to exceed TSLRIC.

In a competitive market, historical costs above TSLRIC are typically recovered in prices. No firm will have a network comprised entirely of the best technology available because technology changes rapidly. All networks of all competitors will be an amalgamation of new and old technology. Prices in these markets will be competed down to the underlying costs of the most efficient existing networks. Thus incremental costs incurred above TSLRIC are recovered in competitive markets and should be recoverable here as well.

Legacy costs occur because of investments made as part of the regulatory bargain between the LEC and its regulators. For example the LEC may have made investments to satisfy service obligations for which there are still unrecovered costs. Or the LEC may have recovered investments using uneconomically long depreciation schedules specified by regulators. Those costs still remain on the books.

Residual costs cannot be ignored. The question whether these residual costs should also be recovered in the pricing of services to competitors should be left to the state commissions. At least some of this equipment and investment may be used and useful and therefore customers benefitting from their use should pay for the costs associated with the resources used.

2. <u>Reasonable Profit Means a Positive Economic Profit.</u>

Profit generally is the difference between the firm's total revenues and the firm's total costs, including the cost of capital.[99] A firm earns zero economic profit if it merely covers its TSLRIC, common, joint, and other recoverable costs in the prices for its services. Under standard economic theory, the least efficient carriers in the industry would earn zero economic profits in a long-run competitive equilibrium in a static market.

The opportunity to earn positive economic profits may be earned by efficient and innovative firms in a competitive market. In addition, positive economic profits may be earned by all carriers in the industry if costs unexpectedly fall or demand unexpectedly rises. Without the potential for positive economic profits, investors have no incentive to risk

[99] <u>See generally</u> testimony of Dr. Debra J. Aron before the Illinois Commerce Commission in ICC Docket No. 95-0296, attached to the letter from Ameritech to Regina Keeney, Chief, Common Carrier Bureau, of 3/12/96.

their capital in research and development activities, and the public interest would suffer because consumers would be deprived of the benefits of innovation.[100] Therefore, pricing rules should not be put in place which would prevent firms from earning a positive economic profit when circumstances so warrant.

3. The Price Formula For Interconnection, Collocation, And Network Elements Equals Recovery Of Cost And May Include A Reasonable Profit.

Section 252(d)(1) provides that charges for interconnection under section 251(c)(2) and network elements under section 251(c)(3) are to be determined based on costs and may include reasonable profit. The allowance for reasonable profit underscores that Congress intended incumbent LECs to recoup all costs, including the cost of money associated with providing interconnection and network elements, because an incumbent LEC cannot earn a reasonable profit until all of its costs are recovered.

[100] The Commission has previously recognized that the public interest would be served by providing LECs with an adequate incentive to innovate. See Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture: Policy and Rules Concerning Rates for Dominant Carriers, *Report and Order & Order on Further Reconsideration & Supplemental Notice of Proposed Rulemaking*, 6 FCC Rcd 6524, 6531 (1991).

Because TSLRIC does not include all of the costs incurred by a firm that has economies of scope, Ameritech strongly opposes a pricing formula for interconnection and network elements based solely on TSLRIC.[101] Such a pricing standard would be contrary to Congress's express language in section 252(d)(1) because it does not cover, in any respect, all the costs of providing interconnection, collocation, or access to unbundled network elements. Rates charged to competitors that do not reflect all of the costs would result in uneconomic entry and would ultimately lead to the incumbent LEC's remaining customers' subsidizing new entrants through higher prices that they pay. Moreover, rates that do not reflect all costs will impede the development of facilities-based competition because new entrants will have no incentive to build their own facilities if they can acquire the components of a network below actual cost. The Commission itself has even recognized in the directly analogous context of expanded interconnection:

> [I]t would not be reasonable to require LECs to base [expanded interconnection] charges on the direct costs of those services, with no loadings for overhead costs. . . . [T]he low charges for interconnection with LEC facilities resulting from [such] approach would give

[101] See *NPRM* para. 29.

interconnectors false economic signals that could stimulate uneconomic entry.[102]

There is ample authority in the states that a national pricing rule for interconnection, collocation, and network elements should not limit cost recovery to TSLRIC. For example, the ICC has concluded that pricing for unbundled network elements may include a contribution for joint and overhead costs above incremental cost.[103]

Michigan applies basically the same costing methodologies as Illinois. Both methodologies establish price floors based on TSLRIC that prevent the cross-subsidization of competitive services. The setting of price floors, however, should not be confused with the actual setting of prices. Specifically, price *floors* merely establish a benchmark below which rates may not be set in order to guard against cross-subsidization and predatory pricing. States, however, have

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102 Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd at 7429 n.291; see also Reed Hundt May 10 Speech at 5 ("setting prices for all services at longrun incremental cost will not pay for the entire network"); Interconnection and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, para. 48 (released Jan. 11, 1996) (recognizing that setting price based only on TSLRIC will not recover total cost).

103 See Customers First Order at 60-61. The Illinois LRSIC methodology is used to establish price floors, not to "derive rates" as suggested by the Commission. See *NPRM* para. 127.

acknowledged that it is not appropriate to order that prices be set as low as TSLRIC.[104]

Illinois and Michigan have recognized the need and appropriateness of recovering joint and common costs when pricing services, although both have made it clear that common overhead costs should not be included in the incremental cost studies themselves.[105] Specifically, the Michigan Public Service Commission ("MPSC") has issued an Opinion and Order in which it adopted a Staff Report identifying nine costing

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[104] Although Michigan has temporarily set rates for interconnection at TSLRIC until January 1, 1997, thereafter rates for interconnection are to be just and reasonable as determined by the Michigan Public Utilities Commission. See Mich. Comp. Laws § 484.2352 (Michigan Telecommunications Act § 352).

[105] See Customers First Order at 61-62; Proceedings To Refine the Definition of, and Develop a Methodology To Determine, Long Run Incremental Cost for Application Under 1991 PA 179, *Opinion and Order*, Case No. U-10620, app. A at 5 (Mich. Pub. Serv. Comm'n Sept. 8, 1994). Similarly in Ohio, the Public Utilities Commission ("PUCO") has initiated a docket to investigate issues involving the establishment of local exchange competition. The PUCO Staff's recommendation concluded that "[carrier-to-carrier] prices should be set at a level which enables the carrier to recover its Long Run Service Incremental Cost (LRSIC) [or TSLRIC] for provision of network functionality, facility, or service, plus a reasonable contribution to joint and common overhead costs." According to the Staff, setting prices (in contrast to establishing a price floor) at incremental cost would threaten the viability of the carrier and encourage entry of inefficient carriers. Commission Investigation Relative to the Establishment of Local Exchange Competition and Other Competitive Issues, Case No. 95-845-TP-COI, 164 P.U.R.4th 214, app. A (Ohio Pub. Utils. Comm'n Sept. 27, 1995).

principles related to refining the definition of "long run incremental cost."[106] Principle No. 5 of the Staff Report addresses the treatment of joint (or shared) costs and common (or overhead) costs. Specifically, Principle No. 5 provides: "Common overheads are not part of a long run incremental cost study. Recovery of those costs is a pricing issue."[107] The Staff Report thus distinguishes between joint (or shared) costs that must be included in required cost studies and common (or overhead) costs that, although not included in required cost analysis, nevertheless are "costs" and thus should be recovered as statutorily mandated in section 252(d)(1).

Even IXCs and CAPs, such as AT&T, Sprint, Teleport, and MFS Intelenet, have acknowledged that pricing for

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[106] See Proceedings To Refine the Definition of, and Develop a Methodology To Determine, Long Run Incremental Cost for Application Under 1991 PA 179, *Opinion and Order*, Case No. U-10620, at 1-2 (Mich. Pub. Serv. Comm'n Sept. 8, 1994). This methodology is currently under review by the MPSC staff to ensure that it is in compliance with the revised Michigan Telecommunications Act enacted in 1995. Ameritech does not expect any significant changes to be recommended by staff.

[107] Id. app. A at 5 Staff Report on Refining the Definition of and Developing a Methodology To Determine Long Run Incremental Cost for Application Under 1991 PA 179. California has recognized similar cost methodology principles. See Rulemaking on the Commission's Own Motion To Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks, Decision No. 95-12-016, Rulemaking No. 93-04-003, Investigation No. 93-04-002 (Cal. Pub. Utils. Comm'n Dec. 6, 1995).

unbundled network elements should permit a reasonable recovery of joint and common costs over incremental cost.[108] In a brief filed before the Illinois Commerce Commission ("ICC") regarding Illinois Bell Telephone Company's First Proposed Alternative Regulation Plan, MCI stated:

> For MCI, making a profit does not mean merely meeting only its long run incremental costs, but rather it must recover all costs. MCI has to recover its common overhead costs; to do any less invites bankruptcy.[109]

Similarly, AT&T told the Ninth Circuit Court of Appeals in 1995 that:

> The reality is that because fixed costs of telecommunications facilities are high and the marginal costs are very low, prices for telecommunications must exceed marginal costs (and make a contribution to fixed costs) for carriers to remain financially viable.[110]

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108 See, e.g., Testimony of Cathleen M. Conway for AT&T Communications of Michigan, Inc. at 23, MPSC Case No. U-10860, at 23 (July 24, 1995); Testimony of Susan Delflorio for MFS Intelenet of Michigan, Inc. at 22, MPSC Case No. U-10860, at 22 (July 24, 1995); Testimony of Elizabeth Howland for Teleport Communications Group, Inc. at 3, MPSC Case No. U-10860 (July 24, 1995).

109 Reply Brief of MCI Telecommunications Corporation, Docket No. 89-0033, at 3 (Ill. Commerce Comm'n 1991).

110 Joint Brief of Petitioner AT&T Corp. and the Competitive Telecommunications Assoc. in California v. FCC, Nos. 94-70197, 95-70470, 95-70519, 95-70571, at 28. (Aug. 17, 1995). See also Testimony of Mr. Fonteix in AT&T Communications of Ill., Inc. v. LDDS Communications, Inc., Docket No. 95-0458, at 114 (Mar. 18, 1996) (acknowledging, as an expert witness (continued...)

Thus, because section 252(d)(1) mandates the recovery of all costs, and because an incumbent LEC cannot earn a reasonable profit until all of its costs are recovered, a national standard for pricing interconnection, collocation, and network elements at least must allow recovery of TSLRIC joint, common and residual costs. Furthermore, because state social policies such as underdepreciated assets and otherwise unrecovered incremental costs (as described above) have constrained the ability of LECs to recover those costs, states should have the flexibility to provide for the recovery of such costs. Indeed, public policy demands recovery of such residual costs at least until the issue of subsidies is resolved during the course of the ongoing universal service docket.[111] In the meantime, recovery of residual costs will not result in over recovery because these are actual costs incurred in the provision of service.

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[110](...continued) on behalf of AT&T, that "AT&T's objective is . . . to recover all of its costs, and any firm's objective to do so is reasonable").

[111] See generally Federal-State Joint Board on Universal Service, *Notice of Proposed Rulemaking*, CC Docket No. 96-45 (released Mar. 8 1996).

4. Rates For Reciprocal Compensation Must Afford <u>The Recovery Of Costs By Each Carrier.</u>

Section 252(d)(2) provides that the terms and conditions for reciprocal compensation are not just and reasonable unless such terms and conditions allow for the recovery by each carrier of the costs associated with terminating traffic that originates on the other carrier's network. Such charges should allow the carrier to recover all costs, including joint, common, and residual costs that the parties have negotiated, if the state finds such charges just and reasonable.

Section 252(d)(2)(B)(i) also provides that arrangements affording the mutual and reciprocal recovery of costs do not "preclude . . . arrangements that waive mutual recovery (such as bill-and-keep arrangements)."[112] The Commission has thus requested comment regarding whether this provision authorizes either states or the Commission to impose bill-and-keep arrangements.[113] Insofar as a waiver is a *voluntary* relinquishment of rights, section 252(d)(2)(B) in no way authorizes either states or the Commission to mandate an arrangement, such as bill-and-keep, in contravention of the right of each

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[112] 47 U.S.C. § 252(d)(2)(B)(i).

[113] <u>See</u> *NPRM* para 243.

carrier to recover its costs. Moreover, bill-and-keep may create significant economic distortions as well.[114]

The reference to "additional costs" in section 252(d)(2)(A)(ii) guarantees that carriers, at a minimum, recover TSLRIC. If a state were to force parties into bill-and-keep arrangements, it could result in one or more carriers being required to provide a service without adequate compensation, which is the equivalent of requiring one carrier to subsidize the services provided by another carrier -- a result clearly not permitted by the statute.[115]

5. Costs Incurred By An Incumbent LEC In Making A Service Available On A Wholesale Basis Are Not Avoided And Thus Should Be Recovered In Wholesale Rates.

In response to the Commission's general request for comment on the meaning of "wholesale rates,"[116] Ameritech maintains that a wholesale price is properly calculated by compar-

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114 See Statement of Dr. Kenneth Gordon attached to Ameritech Comments, CC Docket No. 94-54 (filed Mar. 4, 1996).

115 It should be clarified (see *NPRM* para. 240) that Michigan does not simply *allow*, but rather *mandates*, the waiver of mutual recovery through the use of bill and keep when traffic from one network is not more than 5% greater than the traffic flowing in the other direction. *Order*, Case No. U-10647 (Mich. Pub. Serv. Comm'n Feb. 23, 1995). Because the Michigan arrangement is narrowly tailored (*e.g.*, within 5% of traffic), Ameritech has no objection to this arrangement on an interim basis.

116 See *NPRM* para. 179.

ing the costs of the incumbent LEC operating as a retail enterprise with the costs of such incumbent LEC operating as a wholesale enterprise. The difference is the avoided cost that should be deducted from the retail price to determine the wholesale price. In other words, costs that are incurred as a result of making services available on a wholesale basis are not avoided and cannot be excluded in the calculation of just and reasonable wholesale prices.

In addition, since general overhead costs (*e.g.*, cost of corporate headquarters) are not avoided merely because services are made available on a wholesale basis, as opposed to retail, avoided costs should not include a share of general overhead costs. From an economic perspective, common or overhead costs are not "attributable" to the marketing, billing, collection, and other costs referenced by section 252(d)(3). Indeed, to exclude recovery of any costs incurred in the course of wholesale offerings would encourage inefficient entry and again impede the development of facilities-based competition. As a policy matter, incumbent LECs must be able to recover costs, including a reasonable allocation of joint and common costs, in their wholesale rates. As the emergence of CAPS demonstrated, competing LECs initially will choose to provide service in the more profitable urban areas and business centers. And thus, unless incumbent LECs are able to recover unavoided joint and common costs in their wholesale rates, incumbent LECs will be forced to recover a greater proportion of these costs from their remaining customers -- primarily residential customers. As a result, these customers in residential markets will end up paying higher rates.

Further, incumbent LECs should be allowed to vary the percentage of wholesale discounts across various services based on the degree that costs are avoided.[117] Such an approach more closely simulates cost-based pricing and thus encourages efficient entry. Claims of administrative complexity are unfounded. Ameritech Illinois, for example, has developed avoided cost data by each major service category and has filed wholesale tariffs that vary the wholesale discount accordingly. Ameritech Illinois did not find that this cost-based ratemaking approach created significant, additional administrative complexities.

6. States Which Have Already Developed And Adopted Cost Methodologies Should Not Be Required To Delay Or Revisit Their Procompetitive Policies.

In the Ameritech region, Illinois and Michigan both implemented local exchange competition policies prior to the passage of the 1996 Act. In both states, entry has taken

117 See *NPRM* para. 132.

place and competitors are offering competitive local exchange and exchange access services in competition with Ameritech. The ICC and the Michigan Public Service Commission gathered evidence and conducted extensive hearings in which all interested parties were allowed to participate. Pricing for unbundled network elements, interconnection and terminating access was set. In Illinois, those rates have been tariffed. In Michigan, the rates were set on an interim basis to allow for a competitor, U.S. Signal, to begin operations, and those rates are available to other similarly situated competitive local exchange carriers.[118] Ohio has conducted a local competition proceeding, has released proposed rules, and issued interim interconnection rules to allow one competitor, Time Warner, to begin providing service. Just this week, Wisconsin reached final decision on a number of local competition issues, including the appropriate costing standard. It would be unwise for the Commission to develop and implement national rules of such detail that these commissions would be forced to undertake significant re-work of their own rules.

In addition, proxies are of little benefit in such progressive states The best data for setting prices are the actual costs of providing the services and facilities demand-

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118 See supra n.104.

ed. Setting up proxies in those states that have already examined cost issues and adopted specific costing methodologies is largely a waste of effort and resources. If the Commission chooses to provide guidance on the choice of proxies, it should make clear the use of proxies is unnecessary in those states that have implemented cost methodologies that are consistent with the 1996 Act.

One specific comment on proxies, however, is necessary. During the Illinois Customers First proceeding, the ICC adopted a staff recommendation, with certain restrictions, that required the sum of the prices for an unbundled loop and an unbundled port to be no greater than the price of the bundled service employing those two components. The staff was concerned about the potential for a price squeeze for competitors using one or both of those components to provide a competitive local exchange service. The *NPRM* seeks comment on the desirability of implementing such a rule.[119]

The "sum-of-the-parts rule," as it has come to be known, has significant drawbacks that could lead to inefficient entry and competition. The basic rule does not recognize that there may be costs of unbundling network elements that would cause the sum of the loop and port costs to exceed

[119] *NPRM* at 143, 184-185.

the costs of offering them as a single service. Moreover, the problem for which it was designed -- a price squeeze -- can be dealt with using other regulatory tools such as an imputation test which, in Illinois, is codified in the state statute governing telecommunications.

Unbundling of network elements can create costs which would not exist otherwise in the provision of the bundled services.[120] If the rule was adopted without modification, network element prices could be set below cost, creating a subsidy for new entrants, encouraging the development of inefficient competition and ultimately leading to higher rates to consumers as the additional costs of unbundling would need to be recovered from other services and customers.

Realizing this possibility, the ICC modified the rule to allow exceptions for the case when there were costs to offering network elements on an unbundled basis. This is an important restriction on the rule, especially if additional unbundling beyond loops and switching is considered. In the case of subloop unbundling, for example, significant modifications would need to be made to LEC outside plant including, among other things re-engineering of outside plant, creating new record-keeping and maintenance systems, and developing

[120] Bellcore Statement at 4.

standard interfaces for interconnection purposes, which have substantial upfront development and operational costs that would need to be recovered in the pricing of loop sub-elements.

Considering the costs and problems associated with the sum-of-the-parts rule, and the fact that there are other tools that can be used in its place, the Commission should not consider its recommendation or implementation on a national basis.

C. Pricing Principles Must Promote Efficient Competitive Entry And Maintain Incentives For Incumbent LECs To Invest And Provide Quality Services.

The principle of efficient competition requires that entrants and incumbents alike recognize and pay for the costs of resources they use in the construction and operation of their businesses. If prices for facilities and services supplied by the incumbent LEC are too low, it will encourage inefficient entrants to enter downstream (*i.e.*, retail) markets. Artificially low prices will also discourage entry by carriers into the upstream input markets. In contrast, setting prices too high will discourage entry by efficient providers of retail services while encouraging the entry of inefficient providers of interconnection and network elements.

Clearly there is a fine line here, deviation from which will lead to the violation of the efficient competition principle.

The 1996 Act is intended to promote the development of facilities-based competition. Entry by a facilities-based competitor can only take place if, when faced with a "build or buy" decision, the competitor decides to build. The competitor will only build facilities, however, if the price at which LEC facilities and services may be provided is higher than the entrant's cost of building them. Thus the prices for interconnection, network elements, collocation, reciprocal compensation, and resold services are critical factors in the entrant's decision to install its own network facilities, as opposed to buying them from the incumbent LEC.

It is also important that entrants make economically efficient purchasing decisions among services offered by the LEC. For example, if prices for network elements are too low relative to prices for wholesale bundled services, competition through resale will be effectively discouraged. If pricing of unbundled network elements and wholesale bundled services are not harmonized, the possibility exists that one or the other will become competitively nonviable.

Congress was not only concerned with the development of facilities-based competition. It also expressed concern that all carriers have an incentive to invest in their networks to provide its customers innovative new services and lower prices while maintaining or improving existing quality levels. For incumbent and competitive LECs to have the correct incentives to invest, they must be able to recover the capital they invest, the operations cost they incur, and an opportunity to earn returns sufficient to justify their investments.

If incumbent LECs are not allowed to recover all costs, they may be precluded from recovering invested capital and necessary returns and be forced as a result to curtail investment in the network. As the backbone for the network of networks, at least for the near future, incumbent LECs must continue to have the opportunity and incentive to make needed investments in network technology and architecture. Otherwise, incumbent LECs will not be able to afford to maintain their network and invest in new technology. As a result, service quality will decline.

D. Pricing Standards Should Be Consistent With The Social Policy Of Maintaining Available And Affordable Rates.

The 1996 Act recognizes that the industry has a price structure and other regulatory obligations that are not compatible with open, unrestricted competition.[121] Although the 1996 Act establishes the conditions necessary for local competition to develop, such competition must develop in a way that coexists, and does not thwart, the social policies of maintaining available services and affordable rates to consumers.

Pricing policies to be adopted in this proceeding should begin by taking the world as they find it, rather than apply rules that would be appropriate for a world where prices already reflect costs. Incumbent LECs must be able to recover all costs, including joint and common costs. As competing LECs initially enter the local exchange marketplace, most likely they will choose to provide service in the more profitable urban areas and business centers. And thus, unless incumbent LECs are able to recover joint and common costs in their prices for interconnection, network elements, collocation, and resold services, these joint and common costs will have to be recovered from the incumbent LEC's remaining customers -- who, most likely, will be residential customers. As a result, these residential customers will end up paying higher prices for local exchange service. This result clearly

121 Examples of policy mandates that are not sustainable in the face of open competition include, for example, the universal service provision requiring geographic averaging of toll rates. See 47 U.S.C. § 254(b)(1).

violates the social policy of maintaining available and affordable rates.

E. The Section 252(d) Pricing Principles Should Not Be Interpreted In A Manner That Would Lead To The Wholly Impracticable And Untenable Consequence Of Price Arbitrage.

As discussed above, the 1996 Act adopts completely different language for price standards for resold services and network elements.[122] The former is based on retail price; the latter, on cost plus a reasonable profit. And thus, just as sections 251(c)(2), (c)(3), and (c)(4) must be read together, the three separate pricing standards of section 252(d) likewise should be interpreted together as a whole. To allow requesting carriers to use section 251(c)(3) as a vehicle for obtaining what is functionally indistinguishable from pure resale would establish a classic arbitrage situation and discourage the development of facilities-based competition and technological innovation. Given that many LEC services are priced at rates that reflect specific public policies (with some rates being below cost and some above), this result would be untenable and inconsistent with congressional intent.

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122 Compare 47 U.S.C. § 252(d)(3)(calculating wholesale rates based on retail rates) with 47 U.S.C. § 252(d)(1)(establishing charges for network elements based on cost and reasonable profit).

Congress's intent in establishing the different pricing standards is obvious. Resale prices are based on retail rates because there are retail rates for existing telecommunications services. Unbundled network elements, in contrast, necessarily must be priced from the bottom up based on cost because such elements are not telecommunications services heretofore provided at retail and thus have no corresponding retail price. In other words, Congress has logically determined that, if a retail rate exists, that rate should be the starting point for which a service is to be made available to a new entrant. If a retail price does not exist, a price must be established -- a price based on cost and a reasonable profit.[123]

Indeed, this intent is confirmed by the legislative history. As explained in the Joint Conference Report, the pricing standards of the 1996 Act are a combination of the pricing standards contained in the Senate and House bills.[124] Specifically, in reconciling the two bills, the Joint Conference combined the wholesale price formula from the House bill with the unbundled network element pricing standard of the

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123 See infra Part II.B. (discussion of relationship between (c)(2) and (c)(3)).

124 *Conference Report* at 125.