Moreover, in support of a capacity-based compensation method, NYNEX recently informed the FCC that a significant portion of its local switching costs are actually not traffic sensitive. As part of its petition for a waiver of certain access charge rules, NYNEX, relying on an internal cost study, sought permission to recover local switching charges through a flat rate per line charge as opposed to a per minute charge. NYNEX argued that only 27 percent of switched access costs actually vary with usage, and 73 percent of switched access costs were non-traffic sensitive. NYNEX also claimed that the usage-based charges exposed the company to greater risk.[24]

Lastly, the Attorney General's interim compensation proposal would discourage CLECs from engineering their network designs inefficiently, and will motivate ILECs to accelerate the process of developing a cost-based compensation rate. Most importantly, the Attorney General's interim and long-term compensation arrangements will stimulate meaningful local competition, which will result in higher quality services at lower prices to ratepayers sooner rather than later.

C. Advantages And Disadvantages Associated With The Mutual Traffic Exchange Or The Bill And Keep Compensation Method. Comments on ¶¶ 150-154 and 226-244 of the NPRM.

In a proceeding before the Massachusetts Department of Public Utilities ("Department"), MCI recommended "Mutual Traffic Exchange", also commonly know as

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[24] *See, Prefiled Rebuttal Testimony of Mr. Paul Kouroupas*, Regional Director, Regulatory Affairs, Eastern Region, Teleport Communication-Boston, Massachusetts Department Of Public Utilities, docket 94-185, pp. 14-17 (Aug. 22, 1995); *NYNEX Telephone Companies, Transition Plan to Preserve Universal Service in a Competitive Environment, Memorandum and Opinion Order*, FCC 95-185 (rel. May 4, 1995); and *NYNEX's Petition for Waiver, Exhibit 4-NYNEX New York Specific Cost Study*, p. 4.

"bill and keep", as the most efficient means of compensating for the termination of local exchange traffic.[25] Under the bill and keep compensation method, no money passes hands, each carrier simply bills its own customers for call origination, and completes each other's traffic without charge. The advantages associated with the bill and keep compensation method areas follows: (1) each carrier has the incentive to minimize the cost of terminations; (2) bill and keep does not impose the cost of establishing a billing system, and the cost of auditing and verifying bills and, therefore, is the method most likely to help drive local exchange rates down as low as possible; (3) bill and keep offers ILECs the least ability to use a compensation mechanism to try to impose both unnecessary and anti-competitive costs upon other CLECs; (4) bill and keep is neutral in terms of both the technology and architecture that CLECs may choose to adopt and, therefore, it is the method most likely to enhance dynamic efficiency in telecommunications; (5) if the bill and keep arrangement is interim only, no rational CLEC will engineer its network in other than the design that will produce the most efficiencies over the long-term; and (6) if the bill and keep arrangement is interim only, it will provide an incentive for ILECs to accelerate the process of developing cost-based rates and will enable economic local competition now.[26]

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[25] *See, Prefiled Testimony of Dr. Nina W. Cornell*, on behalf of MCI, before the Department of Public Utilities, docket DPU 94-185, (May 19, 1995).

[26] The Iowa Utilities Board, the California Public Utilities Commission, and a Pennsylvania Public Utility Commission Administrative Law Judge have recently ordered bill and keep compensation on an interim basis. In addition, the Michigan Public Utilities Commission adopted the bill and keep method of compensation as long as traffic is within five percent of being in balance, reasoning that such an approach will

The disadvantages associated with the bill and keep compensation method are: (1) if traffic flows are not equal between two carriers, bill and keep will not accurately reflect the differences in traffic volummes or differences in the use of the other CLEC's network (e.g., the amount of service that two CLECs provide to each other may be in imbalance, either in terms of number of calls, amount of transport provided, or amount of switching used), and therefore the issue of confiscation may be raised; (2) bill and keep makes interconnection an essentially free service, and therefore does not provide an incentive to develop the most efficient or technically advanced trunking arrangements; (3) each provider would focus only on minimizing its own cost of delivering traffic to the other provider's network, rather than acting to minimize the total of both their own traffic delivery costs and the other provider's terminating access costs; and (4) bill and keep does not accommodate ILECs compensation for lost contribution with the provision of interconnection or wholesale network functions.

Bill and keep is an appropriate method to use on an interim basis, however, it is an inappropriate permanent compensation method. Bill and keep may have been acceptable in a situation where extended area service traffic was exchanged between monopoly local service providers, however, it is an unacceptable pricing mechanism for

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reduce net billing costs when traffic volummes are essentially balanced. *In Re Mcleod Telemanagement, Inc.*, Docket No. TCU-94-4 (Iowa Dept. Comm., March 31, 1995); *Order Instituting Rulemaking On The Commission's Own Motion Into Competition for Local Exchange Service*, R.95-04-043, p. 39, (CPUC, July 24, 1995), *Order Denying Rehearing*, Decision 95-09-121, R.95-04-043, I.95-04-044, (September 27, 1995); *In The Matter Of The Application Of City Signal, Inc., For An Order Establishing And Approving Interconnection Arrangements With Ameritech Michigan.* Case No. U-10647, p. 29 (MPUC, February 23, 1995).

local service traffic exchange between competing local exchange utilities. Cost-based pricing of the services provided is essential in the competitive market. "Permanent bill and keep methodology would be looking backward to the monopoly regulation of the past, rather than forward to the regulation of the competitive utilities in the future." *In Re Mcleod Telemanagement Inc.*, 161 PUR 4th 605 (Iowa U.B., Docket No. TCU-94-4, 1995). Consequently, the Attorney General recommends that the Commission only adopt bill and keep on a interim basis until TSLRICplus cost studies are approved, or traffic balances between an ILEC and a CLEC are in balance or do not exceed 5 percent.

D. Weaknesses Of The Per-Minute-Of-Use Compensation Method. Comments on ¶¶ 150-154 of the NPRM.

In Massachusetts, AT&T proposed that the Department adopt NYNEX's per-minute-of-use compensation method proposed in the New York Collaborative. NYNEX's New York proposal bases compensation on TSLRIC for direct trunking and tandem switching for terminating local calls.[27] The NYNEX-New York proposed rates are:

Type of Trunking	Day	Evening	Night/Weekend
Direct End Office To End Office Total	$.0074	$.0034	$.0027
Tandem Switching Total	$.0098	$.0073	$.0029

Id, p. 12.

AT&T asserts that since the same types of switching and transport facilities would

[27] *Prefiled Testimony of Mr. William D. Salvatore, District Manager - Regulatory Affairs for AT&T*, before the Massachusetts Department of Public Utilities, docket DPU 94-185, p. 11 (May 19, 1995).

be used by NYNEX in Massachusetts and New York to terminate local calls, the TSLRIC to provide both services should be the same. However, because there may be variations (e.g., time of day distributions) which will cause the costs to vary somewhat between states, AT&T recommended that NYNEX should be required to demonstrate Massachusetts specific costs to terminate local calls Until that time, AT&T recommended that the Department adopt the proposed NYNEX-New York Compensation rates for Massachusetts.

AT&T's proposal has two glaring problems. First, AT&T's proposal excludes a markup for economic overhead costs and a reasonable profit in its TSLRIC cost calculations. The proposal would base NYNEX's compensation for terminating local traffic at incremental cost. Therefore, CLECs would be paying termination prices which do not include contribution toward economic shared and common costs. Hence, some CLECs, which are less efficient than NYNEX, may be allowed to enter the Massachusetts local exchange market at a cost to NYNEX. Second, AT&T's proposal is a per-minute-of-use compensation method. As discussed in the Attorney General's compensation rate recommendation, in a highly competitive market where services and prices would be continuously changing, a per-minute-of-use method fails to promote economic efficiency and sends incorrect investment signals.

E. The Massachusetts Attorney General's Proposed Flat-Rate Capacity-Based Compensation Proposal Meets The Requirements Of Section 252(d)(2)(A) and (B) of the Act. Comments on ¶¶ 150-154 and 226-244 of the NPRM.

The MassAG's flat-rate capacity-based compensation proposal is inherently based on the TSLRICplus per-minute-of-use cost associated with the transport and termination

on each ILEC's network facilities for calls that originate on the network facilities of another ILEC or CLEC. Therefore, the MassAG proposal results in a very reasonable approximation of the additional costs of transport and termination of local exchange traffic for an ILEC or a CLEC, and satisfies the requirements of Sections 252(d)(2)(A) and (B) of the Act. The MassAG urges the Commission to use its authority under section 252(d)(2)(B)(ii) to adopt as a national standard the Attorney General's reciprocal compensation plan and order State commissions to engage in rate regulation proceedings to determine the TSLRICplus amounts for the additional cost to ILECs to transport and terminate calls between ILEC and CLEC networks.

V. The FCC Has The Authority To Require ILECs To Sell Their Retail Subscriber Services At Wholesale Rates To CLECs. Comments on ¶¶ 172-183 of the NPRM.

A. Introduction.

The ability of one IXC to acquire and resell the services of another provider is an integral feature of the post-divestiture, competitive interLATA market. In this market resellers purchase large bulk quantities of minutes of use ("MOUs") at a discount from IXCs, then resell those MOUs to end users who do not have sufficient usage to take advantage of such discounts. End users are willing to buy from resellers because they believe the reseller's price or other value-added services are superior to those available from other IXCs. There is no reason why end users should not have the same choice regarding retail services, such as unlimited local calling services in local exchange markets. Resale of services has played a critical role in bringing competition to all segments of the long distance market, and there is no reason why resale of services

should not play that same critical role in bringing competition to all segments of local exchange markets.

Today, ILECs' own and control the local exchange network facilities in the local exchange markets. If consumers must wait for CLECs to construct and fully develop their own local exchange networks in these markets, the majority of local service end users will not realize the benefits of competitive local services for many years to come. Therefore, ILECs must be required to resell their unlimited services now so that CLECs can enter the market more rapidly and provide telephony users with more competitive service offerings now rather than later. The availability of ILECs to resell service offerings at economically efficient prices will mark the beginning of a more fully competitive local exchange markets. During the development of competitive local exchange markets, resellers, as well as facilities-based competitors, can vigorously compete with one another for both residence and business end users. Consequently, the resale of ILEC services, particularly unlimited services, will result in innovative retail service packages, lower prices and more specific and efficient responses to specialized customer needs.

B. The Commission Should Order ILECs To Provide Like-For-Like Resale Of All Services At A 25 Percent Discount Off Retail Prices Until TSLRICplus Avoidable Cost Studies Are Completed And Approved. Comments on ¶¶ 172-183 of the NPRM.

The Attorney General recommends that the Commission order ILECs to provide

like-for-like[27] resale of all services at a 25 percent discount off retail prices.[28] This 25 percent discount should remain in effect until State Commissions have approved TSLRICplus cost studies, which quantify an ILEC's avoidable costs associated with offering retail services on a wholesale basis.

In Massachusetts, AT&T demonstrated, using RBOC ARMIS data, that NYNEX would avoid 25 percent of it costs by offering local unlimited services for resale on a wholesale basis.[29] AT&T also demonstrated that, during the early years of (1983-1986) resale, its interstate toll minutes increased by 60 percent.[30] Based on this information,

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[27] Like-for-like resale involves the purchase of an ILEC's unlimited residential or business services by a CLEC and resale as the same type of service to a Massachusetts end user. For example, an individual unlimited residential service would be sold at wholesale to a CLEC and then resold to a single unlimited residential customer. The Attorney General's like-for-like recommendation satisfies the ILEC concern that the resale of unlimited services would create uneconomic incentives for resellers to tariff shop.

[28] In addition, the Attorney General recommends that the Commission should prohibit like-for-unlike and traffic aggregation resale of unlimited services. Like-for-unlike resale involves the purchase of a service, which is resold by a CLEC as a different type of service. For example, an unlimited residential service is resold by a CLEC as measured residence or business service. Aggregated resale involves the aggregation of traffic or multiple end users, in which the reseller gathers the traffic from multiple customers at its switch, and resells the service to multiple end users.

[29] *Prefiled Rebuttal Testimony of Mr. William D. Salvatore, District Manager, Regulatory Affairs for AT&T*, before the Massachusetts Department of Public Utilities, docket 94-185, p. 10 (Aug 23, 1995); *Prefiled Rebuttal Testimony of Mr. Roger L. Riggert, Consultant for AT&T*, before the Massachusetts Department of Public Utilities, docket 94-185, pp. 6-7 (Aug. 23, 1995); and *Exhibits AG-96* and *AG-301*, in docket 94-185.

[30] *Prefiled Rebuttal Testimony of Mr. William D. Salvatore, District Manager, Regulatory Affairs for AT&T*, before the Massachusetts Department of Public Utilities, docket 94-185, p. 12 (Aug 23, 1995).

AT&T recommended that an additional 20 percent revenue stimulation discount[31] should be added to its 25 percent avoided cost discount for a total resale discount of 45 percent. *Id.* In comparison, New England Cable Television Association ("NECTA") demonstrated that AT&T's effective discount offered to toll resellers in the interLATA toll market is approximately 35 percent.[32]

Section 252(d)(3) of the Act provides that wholesale rates shall be set "on the basis of the retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the ILEC. AT&T's avoidable cost analysis is based on ILEC data and is a reasonable wholesale discount until the TSLRICplus avoidable cost studies are complete. For a long-term national standard, the Attorney General recommends that TSLRICplus avoidable cost studies for determining wholesale rates based on the avoidable costs of retail rates sold to subscribers, which includes a share of general economic overhead costs or "markup" assigned to such costs, should be adopted. Under the Attorney General's proposal, ILECs would then reduce their retail rates by this TSLRIC avoidable cost amount, offset by any portion of those expenses that ILECs incur in the provision of their wholesale services. The Attorney General's proposal is consistent with section 252(d)(3), because it specifically focuses on marketing,

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[31] Section 252(D)(3) of the Act does not provide for a revenue stimulation discount in wholesale resale prices.

[32] *See*, Dr. Lee L. Selwyn's response to the Attorney General's 21st record request, docket 94-185, before the Massachusetts Department of Public Utilities.

billing, collection, and other costs that ILECs will avoid when selling retail services on a wholesale basis to CLECs. In addition, the MassAG's proposal is based on TSLRICplus, and therefore, eliminates the possibility of CLECs being charged monopoly rents in the wholesale prices ILECs charge for the resale of their services. Lastly, TSLRICplus, assures that the cost ILECs incur in the provision of wholesale services to CLECs is included in the prices for these services. Consequently, ILEC wholesale prices for retail services based on TSLRICplus will be just, reasonable, nondiscriminatory, and in compliance with the Act.

VI. CONCLUSION.

To ensure the meaningful development of a truly competitive local exchange markets, the Commission should adopt the Attorney General's recommendations as national pricing principles in accordance with the Act.

Respectfully submitted,

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