and resold services with its own equipment or facilities to provide an exchange or exchange access service.[87]

As switch software is currently designed, it is technically infeasible for the switch to access the call processing databases of multiple service providers. The addressing schemes and routing techniques used in the signalling are limited to a small number of database destinations. There is also no current means to validate the messages returned to the switch to ensure correct sequencing of call processing steps or appropriate usage of the switch resources. Today's switch software does not provide the required level of security validation to support switch conversations with alternate IN-based service providers' call processing databases. Failures or improper use of the SS7 messages could result in impaired service, not only to the subscriber, but also the other end-users served by that switch.

The Commission also asks whether requiring unbundled access to signalling and database networks could potentially permit competing carriers to gain access to competitively sensitive data. It notes that Louisiana has prohibited incumbent providers from accessing the CPNI of an interconnecting carrier. (*Notice,* para. 115.) Within the LEC, access to other carriers' records is restricted to a relatively few individuals with a need for such access (for purposes such as service assurance, database maintenance, and restoration/recovery). Competing service providers' data falls are governed by guidelines that restrict access and impose safeguards against misuse. Moreover, 47 U.S.C. Section 222(b) protects the confidentiality of carrier information.

[87] Resold services are repriced versions of a retail service, offered by the LEC, which is resold by the reseller to end users as we describe below (§I.B.3).

d. Pricing Rules Cannot Bypass State Commissions or Ignore Fundamental Rules on the Rights of LECs to Recover Their Costs

(1)-(4) The Act Contemplates That State Commissions Will Play a Pivotal Role in Setting Prices. Commission Rules Should Facilitate Negotiations and State Review, Not Dictate Outcomes. Rate Levels Cannot Be Tied To Rigid Cost Rules That Prevent Recovery of All LEC Costs. "ECPR" Is Necessary To Accomplish the Act's Intent. Cost Proxies Should, Where Practical, Match Current Rates and Not Promote Arbitrage. The "BCM" Does Not Reflect Real Costs and Cannot Serve As a Proxy.

We agree with the Commission that "the same pricing rules that apply to interconnection and unbundled network elements should apply to collocation as required under section 251(c)(6)." (*Notice*, para. 122.) Under that section, collocation applies to equipment "necessary for interconnection or access to unbundled network elements." Thus, interconnection, network elements, and collocation are closely linked together. Accordingly, the cost plus reasonable profit standard of section 252(d)(1), which expressly applies to interconnection and network element charges, also should apply to collocation.

The Commission requests comment on its authority to "adopt pricing rules to ensure that rates for interconnection, unbundled network elements, and collocation are just, reasonable, and nondiscriminatory ... to define what are 'wholesale rates' for purposes of resale, and what is meant by 'reciprocal compensation arrangements' for transport and termination of telecommunications." (*Notice,* para. 117.) (emphasis added.)

We have already stated our view that the 1996 amendments gave the FCC no new legal authority to determine rates for intrastate services. In *NARUC v. FCC*, the D.C. Circuit declared that "the Commission may only preempt state regulation ... to the degree necessary to keep such regulation from negating the Commission's exercise of its lawful authority."[88] The 1996 Act did not change this test; Section 251(d)(3), preserving State authority over intrastate matters, only reaffirms it. The Commission's "national pricing principles" fail the test.

No valid public policy supports such "national pricing principles," either. The Commission speculates that nationally uniform rates "would be likely to improve opportunities for local competition by reducing or eliminating inconsistent state regulatory requirements, thereby easing recordkeeping and other administrative burdens," and intimates that "the lack of consistent rates, even in contiguous geographic areas, [might] create a barrier to entry." Finally, the Commission asks whether "an absence of Federal pricing principles [would] impede the Commission's ability to arbitrate or review an agreement in a timely fashion." (*Notice,* para. 119.)

These reasons do not justify a constructive preemption of State ratemaking. No economic principle that we know of says that inputs to any product must cost the same from one State to the next for competition to flourish. IXCs pay rates for intrastate access that vary dramatically from one State to another, but to our knowledge this lack of uniform national rates has never affected competition in the IXC market, nor prevented IXCs from deploying nationwide networks or charging nationally uniform rates. Having such uniform competitive intrastate rates might "[e]ase recordkeeping and other administrative burdens" indeed, but if Congress had wished to elevate this comparatively trivial concern over principles of Federalism and competition, it could have done so by explicitly preempting all State regulation of rates -- and all negotiated prices -- in the local exchange. Congress took

---

[88] *NARUC v. FCC*, 880 F.2d 422, 425 (D.C. Cir 1989).

exactly the opposite approach, preserving the States' existing authority in Section 251(d)(3), giving freely negotiating parties the first opportunity to set prices, and entrusting the States in Section 252 with powers that could otherwise have been conferred on the FCC. Finally, the absence of national pricing principles would not impede the FCC's ability to arbitrate or review agreements. Under 252(e)(5) the FCC is not just allowed but *required* to arbitrate or review agreements according to State laws and rules, not its own.

The Commission also tentatively concludes that Section 252(d)(1) "precludes states from setting rates by *use* of traditional cost-of-service regulation." (*Notice,* para. 123 (emphasis added.)) It all depends on what the Commission means by "*use*." 252(d)(1) does not require that rates for interconnection and network element charges be set at forward-looking cost, as new entrants sometimes suggest. The Section explicitly allows "a reasonable profit" to be added to "the cost." For more than half a century, Federal courts have held that the determination of a "reasonable" profit should consider the effect on the carrier's whole enterprise. "It is axiomatic that the end result of Commission rate orders must be 'just and reasonable' to both consumers and investors, and that, in achieving this balance, the Commission must consider the impact of its rate orders on the financial integrity of the utility."[89] The end result of a rate order cannot be deemed reasonable "simply because each of the component decisions of that order, taken in isolation, was permissible; it must be the case 'that they do not *together* produce arbitrary or unreasonable *consequences*.'"[90] Thus,

[89] *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1172 (D.C. Cir. 1987).

[90] *Id.* at 1177 (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 800 (1968) ("*Permian Basin Rate Cases*") (emphasis in original).

the sum of the carrier's rates must enable it to recover its total costs.[91] Historical cost has been the accepted basis on which to determine a fair return ever since *Hope Natural Gas*.[92] Regulators attracted capital to the network by leading investors to expect that its historical costs would be recovered in prospective rates. To "fairly compensate investors for the risks they have assumed,"[93] the opportunity to recover historical costs is required, not just allowed.

These concerns are apropos because the total effect of the tentatively proposed national uniform pricing policies could be devastating. First, as we have already pointed out, if the Commission set terms and conditions for intrastate products without regard to the contribution they have made to universal service burdens, or their cross-elasticity of demand with other intrastate products, it would destroy a balance delicately achieved in fifty years of local ratemaking. In reality, the Commission lacks the tools and the expertise to rebalance intrastate rates as competition is introduced. The Commission is barely able to keep up with what the States have done, let alone do it for them. For example, it says incorrectly that California "has set prices for unbundled elements based on a forward-looking calculation of TSLRIC, which excludes shared and common costs." (*Notice*, para. 127.) Review of the TSLRIC studies will not be completed until June; no prices have been set with reference to them. The CPUC specifically has recognized that "[a]n enduring feature of the

---

[91] *See Duquesne Light Co. and Penn. Power Co. v. Barasch,* 488 U.S. 299 (1989) ("*Barasch*"); *Kaiser Aetna v. U.S.*, 444 U.S. 164, 175 (1979); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope Natural Gas*").

[92] *See Hope Natural Gas* at 605; *Barasch* at 309.

[93] *Permian Basin Rate Cases* at 792.

telecommunications landscape is the presence of dominant joint and common costs," and intends to consider them when it sets prices.[94]

Second, if it precluded recovery of any portion of actual costs (see *Notice,* para. 144), the Commission would raise serious Constitutional issues. To say that "prices in competitive markets are based on firms' forward-looking costs rather than historic (sunk) costs" (*id.*) does not dispose of these issues at all. It is incorrect as a matter of economics: firms do not enter markets, whether competitive or regulated, unless they intend to recover their costs of entry (*i.e.*, sunk costs) as well as their forward-looking costs. It also ignores the fact of past regulation. There is a word for denying investors a reasonable return on investments that were made to satisfy regulatory dictates, in a market in which regulators prohibited competition: the word is confiscation. The same takings issue would be raised if the Commission did not allow carriers to earn sufficient profits at the service level to recover their joint and common costs.

Third, it would be arbitrary and capricious for the Commission to implement local exchange competition in a way that would be inconsistent with and undermine its own rules and policies. One example would be for the Commission to let CLCs use local exchange products such as network elements to avoid more expensive interstate access services, which were consciously designed by the Commission to be a major source of contribution to total costs. In 1983 the Seventh Circuit held that it was unlawful for the Commission to introduce long distance competition, but regulate AT&T's prices according to

---

[94] *Investigation on the Commission's own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*. CPUC I.93-04-002, slip op. (April 13, 1993), pp. 63-64.

fully distributed cost. The court pointed out that this was arbitrary and inconsistent, and would make it impossible in the long run for AT&T to respond to competition and remain in business.[95] Designing competitive local exchange products to substitute for access, without taking account of their respective prices, would be just as irrational.

Fourth, in conflict with the purposes of the 1996 amendments, some of the Commission's proposed national pricing principles are anticompetitive and would hinder the achievement of economically efficient outcomes. The Commission, for example, asks whether interconnection and unbundling prices should be set at short-run marginal cost. (*Notice,* para. 132.) But as Drs. William J. Baumol and J. Gregory Sidak write, "if a firm's production process is subject to economies of scale, then the requirement that prices be set equal to marginal costs is a recipe for bankruptcy."[96] The Commission's discussion of pricing principles shows a general susceptibility to what might be called "the fallacy of perfect competition." It is true that competition drives the price of every product *toward* incremental cost; but every multi-product firm must have some products priced far enough *above* incremental cost to recover its total costs and return a profit to investors. As Baumol and Sidak point out, "no regulator can be expected to follow the precept of marginal-cost pricing that is integral to the model of perfect competition, for to do so would either drive the regulated firm into bankruptcy or force government permanently to subsidize the resulting deficit.... More than that, the model of perfect competition turns regulation and antitrust toward attempts to populate the industry with a multiplicity of smaller enterprises.

---

[95] *See MCI v. AT&T*, 708 F.2d 1081, 1125 (7th Cir. 1983).

[96] William J. Baumol and J. Gregory Sidak, *Toward Competition in Local Telephony* (1994) ("Baumol and Sidak"), p. 34.

But where scale economies are present and substantial, such an effort cannot long succeed unless government virtually dictates all operations of the firms."[97]

Prof. Hausman, in his testimony filed with USTA's Comments in this docket, agrees. "[A] markup above LRIC is required to create the 'reasonable profit' which helps recover the fixed and common costs of the network which are not included in LRIC or TSLRIC ... without profit to pay the joint and common costs, LECs would go out of business because their total revenues would be below their total costs.... If the reasonable profit criterion is not interpreted to allow recovery of fixed and common costs, a perverse economic incentive will be created which will distort future LEC investment and decrease economic efficiency." Prof. Hausman notes that in particular, "[t]he use of a short run marginal cost standard would be equivalent to a forced monetary transfer from the LECs to their competitors."

The Commission's rejection of the efficient component pricing rule ("ECPR"), which has support from economists around the world as a way to overcome this dilemma,[98] is especially disturbing. The ECPR simply posits that an input sold to competitors should be priced at its economic cost. Economic cost consists of the direct cost of making the input, plus the opportunity cost of making it available to competitors -- the earnings foregone elsewhere by making the sale. As Drs. Baumol and Sidak write, "the latter represents the contribution ... either toward meeting a shortfall in the price of another

---

[97] *Id.* at pp. 34-35.

[98] The ECPR has been upheld by the highest appellate court in the British Commonwealth. See *Telecom Corp. of New Zealand v. Clear Communications*, Privy Council Appeal No. 21 of 1994, Oct. 19, 1994.

service and/or toward recovery of the common fixed costs of supplying some or all of the incumbent's services."[99] In fact, as Prof. Alfred Kahn points out in testimony filed in this proceeding, ECPR is equivalent to the net avoided-cost pricing standard for resold services.

Contrary to what the Commission says (*Notice,* para. 147), the ECPR does *not* necessarily recover "monopoly profits," but contribution toward costs that were incurred pursuant to regulatory dictates, reviewed by regulators and allowed to be reflected in prices, and which do not disappear when competition arrives. As the Supreme Court has said, a utility should be compensated "for all prudent investments at their actual cost when made (their "historical" cost) irrespective of whether individual investments are deemed necessary or beneficial in hindsight."[100] Rates set at TSLRIC would discourage efficient entry and useful investment, both by the incumbent LEC and its competitors. The Commission has it wrong when it says that ECPR "precludes the opportunity to obtain the advantages of a dynamically competitive marketplace." (*Notice,* para. 147.) As Drs. Baumol and Sidak write, the ECPR "*always* assigns the supplier's task to the firm that can do it most efficiently. A price lower than that set in accordance with the rule ... always constitutes an interfirm cross-subsidy and so invites the assumption of the supplier's role by a firm that is not the most efficient provider."[101]

CLCs will no doubt point out that in the real world, the ECPR results in prices for unbundled loops that are higher than the prices the LEC charges subscribers for basic

[99] Baumol and Sidak, p. 115.

[100] *Barasch* at 309.

[101] Baumol and Sidak, p. 116 (emphasis in original).

access services. It is equally true that in the real world, the CLC will, if it can, take all of the toll traffic originating with the subscriber; will take all of the vertical services; may avoid originating access charges; and may receive access charges from other carriers for interexchange calls terminated to the subscriber If it wishes, the CLC may use the contribution from these other services (or the costs avoided) to reduce the subscriber charge for the loop, just as incumbent LECs have long been required to do. Depending on the criteria, the CLC may also qualify for universal service subsidies.

The ECPR is thus both economically rational and perfectly equitable. To ban States from using ECPR not only offends principles of Federalism that were at the heart of the 1996 amendments. To the extent the Commission re-characterizes as "monopoly profits" revenue streams that it previously approved to recover costs it also approved, it raises Constitutional concerns.

Finally, for the Commission to forbid use of the ECPR is unlawfully discriminatory under the Act. The 1996 Act is clear that rates for unbundled elements must be "just, reasonable, and nondiscriminatory."[102] For example, charges for subscriber loops should not be set at one price for MCI and a different one for everyone else.[103] Likewise, IXCs would protest that it would be discriminatory for a LEC to charge itself less for the use of a network element than what it charges IXCs.[104]

---

102 Act, Sections 251(c)(3), 252(d)(1).

103 This is not to say that volume discounts and other similar pricing conventions are prohibited for network elements. So long as carriers in like circumstances are treated alike (*e.g.*, the volume discount is available to anyone willing to meet the threshold requirements), no discrimination arises.

104 Interestingly, IXCs have essentially already done so by claiming LECs only charge themselves "direct economic costs" for the use of a network element. Their definition of

Yet strict pricing rules that mandate network element prices at short run marginal cost (*Notice*, para. 132), or TSLRIC with no recovery of shared and common costs (*Notice*, para. 129), will compel unlawful rate discrimination in today's competitive environment. The reason is that in most instances TSLRIC prices would be far below the level the LEC must charge itself (and its customers) to recover all of its costs. The affidavits that Professors Crandall, Hausman, and Kahn have filed in this proceeding make plain that TSLRIC prices for network elements will not allow recovery of the real and legitimate costs that LECs incur in making network elements available. A pricing rule that orders LECs to set prices for unbundled elements at TSLRIC also forces LECs to charge themselves (and their customers) a discriminatory and higher rate for using the same network elements, in order to recover all of their costs. For example, switch access is priced well above incremental cost in California, as in most jurisdictions. When it offers intraLATA toll service, Pacific is required to charge itself switched access, which in turn it is required to recover in toll rates charged to end users. In California, as in many other States, switched access already generates less cost coverage than intraLATA toll. A dramatic reduction in switched access charges to IXCs in the guise of TSLRIC prices for network elements would immediately cause rate discrimination, in that the LEC could recover its full costs only by charging itself (and its customers) significantly higher rates. The discrimination is no

---

"direct economic cost" is incorrectly stated, and it omits costs that LECs incur to provide any service or network element. But the point the IXCs raise is essentially one of discrimination, asserting that it is impermissible discrimination for LECs to charge themselves less for network elements than what they charge competitors. Not surprisingly, the IXCs have overlooked the real discrimination their proposal, if adopted, will cause, namely forcing LECs to charge themselves (and their customers) more for the use of network elements than the price to IXCs.

different in the case of below-cost services. It costs a LEC, on average, about $20 to $30 a month to provide a loop, a cost it must incur (and impose on customers) to recover its costs. TSLRIC rates below these levels would force a LEC to discriminate in the prices it charges for loops.

These instances of price discrimination are not just and reasonable. They do not promote competition; they would promote price umbrellas sheltering inefficient providers. They are not justified by differences in cost, since LECs would not avoid any joint or common costs by providing network elements to their competitors. They would be contrary to the 1996 Act, which prohibits such unjust and unreasonable discrimination,[105] and contrary to judicial and Commission decisions requiring like prices be charged for products that are equivalent in function and cost.[106]

Moreover, it is no answer to tell LECs the discrimination can be avoided if they simply lower their prices. To begin with, in nearly all States there remain substantial limits on the pricing flexibility of LECs, many of which were engineered by the LECs' competitors. In many cases, lowering prices is not a legal option for LECs. But more important, the Act was not intended to force LECs to set rates that will not allow costs to be recovered.

The Commission asks for comment on the alternative of setting "outer boundaries for reasonable rates" by proxy. (*Notice,* para. 134.) A proxy approach is certainly preferable to requirements that rates be set by measures, such as TSLRIC, that do

---

[105] *See* for example Act, Sections 251(c)(2)(D), 251(c)(3), 251(c)(4)(B).

[106] *See* for example *MCI v. FCC*, 842 F.2d 1296 (D.C.Cir. 1988).

not allow recovery of all joint and common costs. But if a proxy is used, it should not be a price ceiling, but a level below which rates are *presumed* reasonable.

While nationally-averaged costs are acceptable, the Commission should not use either the Benchmark Cost Model ("BCM") submitted by MCI, US West and others in the record of CC Docket No. 80-286 (see *Notice*, para. 137), or the HBCM (the Hatfield version of BCM). The BCM and the HBCM have been the subject of considerable testimony and cross-examination at the CPUC. Among the chief flaws of the BCM (which also apply to the HBCM) are:

(i) It estimates incremental expenses by applying embedded cost factors (current period ARMIS expenses divided by ARMIS booked investments) to incremental investments. Since in the BCM incremental investments typically are lower than booked investments, the model systematically understates operating expenses.

(ii) The BCM's allocation of maintenance and other costs, such as customer service expense, based on investment factors tends to overstate costs in rural areas.

(iii) The BCM understates loop investments because it omits necessary costs. For example, the BCM omits costs for drops, terminals, cross-connects, splicing, engineering, and the service area interface between feeder and distribution cable.

(iv) The BCM estimates the cost of cable material only, then multiplies that cost by a cable multiplier to estimate the total costs of the loop. Since cable material accounts for only about 20% of the total costs, this methodology is unreliable. Small changes in cable material costs cause major changes in total loop costs. For example, the BCM allows the user to put in a percentage discount for cable material, but that discount will also lower the cost of structures and labor through the cable multiplier. The cable multiplier also omits significant costs including terminals, manholes, and engineering costs.

(v) We have compared BCM estimates to actual rural construction experience and found the BCM cable multiplier to understate loop investment significantly. We have attempted to work with the model's authors to understand the cable multiplier. However, since we have not been given access to the underlying data, we have been unable to validate or offer suggestions for improvement to the cable multiplier.

(vi) The BCM lumps buried cable and underground cable together. Underground cable requires conduit, manholes, and higher costs for splicing and placing than buried cable. The methodology in the BCM to account for this difference is poorly documented and appears to rely on undocumented factors.

(vii) The BCM assumes all customers within a census block group are served by four equally sized distribution cables, each with a length of 0.75 times the square root of the census block area. However, real customers tend to be located along streets and roads, and cable must travel along all those roads to reach the customers. Four equally sized cables of a fixed length are simply not enough to serve customers in many census block groups. Fundamentally, the BCM does not correctly model how distribution cable is provided and sized.

(viii) Finally, the BCM associates census block groups (CBGs) with the nearest wire center. Some CBGs will inevitably be assigned to the "wrong" carrier (one that does not serve most of the CBG, but whose wire center is nearest to it). For large LECs the resulting distortion of cost may be insignificant. For hundreds of small LECs that serve only a few census block groups, the distortion may be very significant indeed.

Many of the flaws in BCM have been admitted by its authors. We are working with them to correct these problems. However, until they are corrected, the Commission should not rely on the BCM. We have developed a superior alternative to the BCM known as the "Cost Proxy Model" or CPM. A more complete description of the CPM was filed with our Comments in CC Docket No. 96-45. The CPM is more flexible than BCM; can be based on non-proprietary information; can be independently audited; can estimate the cost of providing local telephone service down to a 1/4 square mile grid, or up to any larger geographic area; and reflects the actual location of subscribers within a census block (thus computes accurate loop lengths).

The Commission also discusses using interstate access charges as a proxy for cost-based rate ceilings for interconnection or unbundled elements. (See *Notice,* para. 139.) Provided that the proxy is not a ceiling, but merely the basis for a presumption, this may be acceptable, but it is second-best to letting States and private parties determine the rates.

(5) Whether a Practice or Outcome Is "Discriminatory" Should Be Evaluated Under Existing Standards.

The Commission seeks comment on the meaning of the term "nondiscriminatory" in the Act, compared with the phrase "unreasonable discrimination." It asks whether Congress intended to prohibit all price discrimination. (*Notice,* para. 156.) The answer, beyond all doubt, is no. In Section 252(d)(3), Congress provided explicitly for the resale of retail services at wholesale rates, which is a form of explicit price discrimination. As Congress thereby recognized, charging different rates for the same product or service to different customers is economically justified if the cost of the product or service provided is different. Based on such cost differences, the Commission has also found discriminatory pricing for products as various as private line service and long distance toll discounts and promotions to be just and reasonable.[107] Competitive necessity has also been considered a legitimate ground for discrimination.[108] Mainstream economic literature also holds that price discrimination is efficient when the marginal cost per unit of the product or service declines as output rises. "It is easy to show that such differential prices, suitably selected, can benefit even the party that pays the higher relative price."[109] Given these well-known public benefits, and provisions in the Act that explicitly require discriminatory pricing, Congress obviously adopted the same shorthand as the Commission, which has often used "nondiscriminatory" to mean "not unjustly or unreasonably discriminatory."[110] The Act was intended to be "pro-competitive."[111] As economist Hal Varian has recognized, differential pricing is "one of the most prevalent forms of marketing practices" of competitive enterprises.[112]

---

[107] *See Private Line Rate Structure and Volume Discount Practices*, 97 F.C.C.2d 923 (1984); *Rules Concerning Rates for Dominant Carriers*, 10 FCC Rcd 7854 (1995).

[108] *See AT&T v. FCC*, 449 F.2d 439, 448 (2d Cir. 1971).

[109] Baumol and Sidak, p. 73.

[110] *See*, for example, *Expanded Interconnection with Local Telephone Company Facilities*, 9 FCC Rcd 2718 (1994), para. 35; *New Jersey Bell Telephone Company*, 9 FCC Rcd 3677 (1994), para. 17; *Craig O. McCaw and AT&T*, 9 FCC Rcd 5836 (1994), para. 133.

[111] Conference Report, p. 1.

[112] Hal R. Varian, "Price Discrimination," in *Handbook of Industrial Organization*, vol. 1, p. 598 (R. Schmalensee and R.D. Willig eds., 1989).

e. <u>Interexchange Services, CMRS, and Noncompeting Neighboring LECs</u>

(1) The Act Does Not Repeal Part 69. Access Charges Cannot Be Evaded Through the Purchase of Unbundled Elements or Resold Services.

The Commission concludes that "a telecommunications carrier may request cost-based interconnection under section 251(c)(2) for the purpose of *offering* access services in competition with the incumbent LEC. We seek comment, however, on whether a carrier may request cost-based interconnection under section 251(c)(2) *solely* for this purpose." (*Notice,* para. 162.)

The answer is no. As the Commission must surely realize, an IXC or other carrier who interconnected with us for the sole purpose of offering competing access services would do nothing to stimulate local exchange competition, but would merely undermine the Commission's access charges and policies. For reasons we discuss below, this was clearly not the intention of Congress when it enacted Sections 251-52.

This clear statutory dictate will not constrain local competition. Obviously, CLCs will provide *both* local exchange service and long distance access to their subscribers. This statutory limitation also will not constrain competitive access providers from providing both access and local exchange service. All of the major CAPs in our region have executed, or requested interconnection agreements. It will *only* constrain price arbitrage between interconnection and access services that would be uneconomic, contrary to the statute, and contrary to the Commission's access charge policies.

This statutory dictate also is consistent with collocation pursuant to section 251(c)(6). CAPs and other interconnectors will collocate not only "for the purpose of offering access services in competition with the incumbent LEC" (*Notice*, para. 162), as they do today under the *Expanded Interconnection* rules, but also to compete for local service. Thus, rules implementing section 251(c)(6) will supersede the Expanded Interconnection rules.

The Commission also tentatively concludes that "carriers may request unbundled elements for purposes of originating and terminating interexchange toll traffic, in addition to whatever other services the carrier wishes to provide over those facilities." (*Notice,* para. 163.) We disagree with this tentative conclusion, which is directly inconsistent with the Commission's holding on interconnection. There, just two paragraphs earlier, the Commission reasons that because "exchange access" is defined in the Act as "the *offering* of access," and because an IXC that "requests interconnection to originate or terminate an interexchange toll call would not appear to be 'offering' access services, but rather to be 'receiving' access services," then the "obligation to provide interconnection ... does not apply to telecommunications carriers requesting such interconnection for the purpose of originating or terminating interexchange traffic." (*Notice,* para. 161.) But Section 251(c)(3) (unbundling) contains an identical limitation. Carriers may request access to unbundled network elements "for the provision of a telecommunications service." Section 3(46) defines "Telecommunications service" as "the *offering* of telecommunications for a fee directly to the public" (emphasis added) -- *not* the *receiving* of access services. The Commission's tentative conclusions with respect to interconnection and unbundled network elements are thus directly at war with one another The Commission's tentative conclusion in paragraph 161 with respect to interconnection should also apply to network elements.

The Commission acknowledges that "allowing interexchange carriers to circumvent Part 69 access charges" through purchasing unbundled network elements may be inconsistent with other provisions in Section 251. (*Notice,* paras. 163-65.) We agree that it would be inconsistent. Section 251(c)(3) was not designed to override the Commission's current access charge regime. Section 251(g) requires that LECs provide access to IXCs subject to the same equal access and nondiscriminatory interconnection restrictions and obligations, "including receipt of compensation," that currently apply until the Commission prescribes new governing regulations. Furthermore, in describing Section 251 of S.652 on which Section 251(c) of the Act is based, the Conference Report states:

> The obligations and procedures prescribed in this section do not apply to interconnection arrangements between local exchange carriers and telecommunications carriers under section 201 of the Communications Act for the purpose of providing interexchange service, and nothing in this section is intended to affect the Commission access charge rules.[113]

The Senate Committee on Commerce, Science, and Transportation Report on S.652 stated, "nothing in Section 251 is intended to change or modify the FCC's rules at 47 CFR 69 et seq. regarding the charges that an interexchange carrier pays to local exchange carriers for access to the local exchange carrier's network."[114]

[113] Conference Report, p. 117.

[114] S.Rpt. No. 104-23, 104th Congress, 1st Sess. (1995) at 22.

(2) __CMRS Providers Are "Requesting Telecommunication Carriers," and Their__ __Interconnection Agreements With LECs Are Governed By Section 251__.

The Commission seeks comment on the effect of Section 251(c)(2) on interconnection arrangements between LECs and commercial mobile radio service ("CMRS") providers.[115] The Commission opines that such arrangements fall within the scope of Section 251(c)(2) because CMRS providers are "requesting telecommunications carriers."[116] The Commission also seeks comment on the interplay between Section 251(c)(2) and Section 332(c), a provision that predates the 1996 Act, and on the overall regulatory scheme governing CMRS providers.

CMRS providers providing services which are equivalent to wireline local exchange services -- i.e., fixed wireless local loop services[117] -- should be regulated the same as CLCs, rather than under a separate CMRS regulatory structure. Telecommunications technologies are developing very quickly, and wireless technology can be used to provide an increasingly broad array of services traditionally provided by LECs. In California, competition has been introduced in the local exchange market, and LECs are subject to requirements imposed by the CPUC with respect to their provision of local exchange service. If a competitor

---

115 *Notice,* paras. 166-169, 195.

116 *Id.* at para. 168.

117 *See Notice,* para. 195. Fixed wireless local loop service is any CMRS service in which the customer's dedicated radio transmit/receive unit is intended to be permanently installed on a stationary structure. The CPE that runs behind this transmit unit consists of wired telephones or commercial cordless products. When the CPE moves outside of the range of the customer's fixed transmit/receive unit, there is no hand-off to another unit.

can offer local exchange service using fixed wireless technology but be subject to reduced regulatory requirements as compared to LECs, competition will not develop fairly.[118]

The rates set in LEC-CMRS interconnection arrangements should be governed primarily by State law. The 1996 Act, as well as Section 332(c), supports this proposition. The 1996 Act delegates to the States authority over specific terms and conditions contained in interconnection agreements.[119] The rates between LECs and CMRS providers for interconnection are also subject to State regulation: Section 332(c) applies only to rates charged *by* CMRS providers to end users, not rates charged *to* them by LECs.[120] The Commission has already held that Section 332(c) does not preempt state regulation of interconnection rates.[121] and given the growth of the CMRS marketplace since Section 332(c) was enacted, the Commission should reaffirm its ruling. Clearly, there have been no barriers to CMRS entry.

Since CMRS providers are "requesting telecommunications carriers" under Section 251(c)(2),[122] "LEC-CMRS interconnection arrangements . . . fall within the scope of

---

[118] For example, LECs must comply with the number portability, dialing parity and resale requirements of the 1996 Act. If fixed wireless local loop providers furnish competitive local exchange service without bearing these obligations. the wireline carriers will be disadvantaged.

[119] Act, Section 252(a)-(c), (d)(1) & (e).

[120] *See* 47 U.S.C. § 332(c)(3).

[121] *Petition on Behalf of the Louisiana Public Service Commission For Authority To Retain Existing Jurisdiction Over Commercial Mobile Radio Services Offered Within the State of Louisiana*, 10 FCC Rcd 7898, 7908 (1995); *Implementation of Sections 3(n) and 332 of the Communications Act. Regulatory Treatment of Mobile Services*, 9 FCC Rcd 1411, para. 231 (1994).

[122] *Notice*, para. 168.

section 251(c)(2),"[123] and the States retain primary jurisdiction over such agreements. As we have already explained, under Section 251, together with 252, States play the primary role in overseeing the negotiation, arbitration and approval of interconnection agreements. Unless the parties agree otherwise, transport and termination in these agreements must be based on reciprocal compensation.[124]

(3) Agreements Between Non-competing Neighboring LECs Need Not Be Filed or Made Available to Others.

The Commission requests comment on whether Section 252 requires interconnection arrangements between incumbent LECs and non-competing neighboring LECs to be filed and made available to other carriers, or alternatively, whether this would be inconsistent with the purpose of section 251(c)(2), which could apply only to arrangements between competing carriers. (*Notice*, para. 171.)

The only agreements required to be filed with the State commission under Section 252(a)(1) are those reached "upon receiving a request for interconnection, services, or network elements pursuant to section 251." Section 251(c)(2) makes clear that such agreements must be, among other things, for "the transmission and routing of telephone exchange service and exchange access ... at any technically feasible point within the carrier's network," *i.e.*, to compete with the incumbent LEC within its exchange. Agreements between non-competing LECs do not fit this description. They are agreements for the

[123] *Id.*

[124] Act, Sections 251(b)(5) and 252(d)(2).

exchange of traffic not "within the carrier's network" but between different, non-overlapping networks.

3. <u>State Commissions Should Take the Leading Role in EstablishingReasonable Resale Rates and Terms</u>.

a, b. <u>Resale Rates Should Reflect "Net" Avoided Costs, and Should Not Include Reductions for Shared and Common Costs Which Are Not Avoided</u>. <u>The Unbundling Requirements for Network Elements Do Not Apply To Resold Services</u>.

The Commission seeks comment on Section 251(c)(4), including: whether all LECs, or only incumbent LECs, must provide retail services at wholesale rates to requesting telecommunications carriers; what limitations, if any, incumbent LECs should be allowed to impose on services offered for resale; whether the resale obligation extends to discounted and promotional offerings; whether a LEC can withdraw a retail service, and thereby avoid making it available at wholesale rates, or whether access to unbundled elements addresses this concern. (*Notice*, paras. 175-176.)

The CPUC has authorized the competitive resale of many local exchange services, both wholesale and retail. Such services as residential and business dialtone, local usage, vertical features, customer-owned pay telephone (COPT) lines and features, Centrex, ISDN, intraLATA toll, special access and private lines are now available for resale.[125]

---

[125] CPUC Resale Decision. Initially, the CPUC has calculated average discounts for some of these services from resale prices based on average avoided retail costs. In its pending OANAD proceeding, expected to be completed by the end of this year, the CPUC will determine total service long run incremental costs (TSLRIC) for network elements and services and determine the discount for resale services. The CPUC is proceeding on the explicit understanding that its actions must satisfy Sections 251 and Section 252 of the Act. *See* CPUC Resale Decision at p. 4, n.4.

The Act leaves the States with considerable discretion to regulate the terms and conditions of exchange services, including their resale. Section 251(d)(3), for example, prevents the Commission from preempting a State rule even if it is inconsistent with this Commission's rules, so long as the State's action is consistent with the requirements of Section 251 and does not "substantially prevent" its implementation.[126] Section 251(c)(4) reserves to States the ability to prescribe reasonable and nondiscriminatory conditions on resale, and expressly allows States to "prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers."[127]

By leaving so much to the States, Congress recognized that, as a matter of practicality, only the States can fairly resolve issues surrounding the diversity of retail rates and rate structures that they have constructed. For decades, State regulators have set the retail prices of intrastate services to reflect societal goals that are as different as the States themselves are different, as well as to reflect complex differences in costs, service requirements, and network capabilities. Local exchange services are commonly priced at geographically averaged rates and sometimes have been priced below geographically averaged costs.[128] For LECs to meet the competition unleashed by the Act, local exchange

---

[126] Any party who believes that a State's actions are inconsistent with Section 251 may, of course, seek review in Federal district court. *See* Act, Section 252(e)(6).

[127] *Id.* at Section 251(c)(4)(B).

[128] *See* CPUC Resale Decision, p. 33. The CPUC will determine incremental costs for services such as residential service later this year.

rates will have to be deaveraged. This would be fully consistent with the Act, which contemplates cost-based pricing and the elimination of subsidies.[129]

The Commission should therefore not encumber State PUCs with dictates of what prices, terms, and conditions should apply to resold exchange services. It is in no position to determine the cost of local exchange services or the correct deaveraged prices and price structures in fifty States -- even if doing so did not raise serious jurisdictional issues. We suggest the Commission substantially defer such issues to State policies and expertise by adopting a list of major local exchange services to be resold, which, so long as the LEC also has in place a process to respond to bona fide requests for the resale of additional retail services, would be sufficient to satisfy the Act.

To provide guidance to Section 271 applicants, the Commission should, however, indicate that States will be within their authority when they take certain actions. For example, what other local exchange services are "retail," and what retail costs are avoided by reselling them, are issues best determined by the States. Local exchange services in different States are not necessarily comparable, even if they are called the same thing. For example, customer-owned pay telephone (COPT) services in California have all of the characteristics of wholesale services,[130] while in other States, they may have additional functionalities or be offered on terms that make them true retail offerings. States may reasonably interpret "avoided costs" to be the net costs of resale (taking into account such expenses as changes to billing and operations systems). For services offered under discount

---

[129] *See*, for example, Act, Section 252(d)(1)(A)(i).

[130] *See* CPUC Resale Decision, p. 25