For small LECs, their two main sources of revenue are local service revenues and toll access service revenues. Lacking toll revenues and a vast array of enhanced service revenues, these companies must be allowed to recover their common and overhead costs in the pricing of basic local exchange interconnection.

It is ridiculous to attempt to establish an arbitrary rule to limit common and overhead costs. Only the market can regulate these costs--regulation cannot. Unequal fixed allocation procedures, such as the "Ramsey Rule," cannot apply in the long term when competition will control and the market place will determine how common costs and overheads will be distributed among services. Unequal fixed allocation procedures are not appropriate in the short term since proportionate contribution from all services helps avoid arbitrage opportunities and is simple to administer. Unequal contributions further cause subsidies between carriers and/or services which are contrary to the move to a competitive market place.

In **paragraph 132**, the Commission seeks comment regarding a transitional pricing mechanism such as "short-run marginal costs." There is no need to engage in this type of micro-management. Short-term cost studies are

flawed because the determination of what is "short term" is arbitrary. The results would be based on a lot of assumptions, would be subject to manipulation, and would be specious.

In **paragraph 133**, the Commission seeks comment regarding whether interconnection and unbundled element rates should be set on a geographically and class-of-service-averaged basis for each incumbent LEC, or whether some form of disaggregation would be desirable. The Commission should permit disaggregation so that incumbent LECs can meet competition and the needs of their customers. The broadest possible de-averaging should be allowed, but there is no need for a mandatory scheme in this regard. These types of decisions are management decisions. Since there is always a risk of arbitrage in any classification, the risk of determining the appropriate classifications should be borne by the companies who have incurred the investment.

(b) Proxy-Based Outer Bonds For Reasonable Rates.

In **paragraphs 134 through 142**, the Commission seeks comment regarding proxy-based outer bounds for reasonable rates, such as rate ceilings.

There is no need for any rate ceilings and any use of averaged data should be voluntary.

Michigan has no rate ceilings and competition is flourishing. The Michigan Legislature did not impose a ceiling and MECA sees no benefit to such a device. Similarly, the use of generic or average cost data (as suggested in paragraph 137) will not provide a benefit. The use of nationally-averaged costs or generic cost studies have no relation in fact to small telephone company costs in Michigan. There is no empirical evidence suggesting that rural LECs in Michigan are "average" companies. However, if the Commission decides to use averaged data or such a study, the use of a study should be voluntary. This is the traditional approach that has been adopted by the FCC for average schedule settlements with NECA are voluntary and were adopted to allow small LECs to avoid the cost of doing their own studies. MECA uses similar voluntary schedules for intrastate access settlements. Because of the Commission's experience with the universal service fund, the Commission should recognize that there are wide variations in cost nationally. It would be inappropriate to set arbitrary ceilings that prevent recovery of legitimate high costs.

The only possible legitimate price ceiling concept is one that is company-specific or exchange-specific where the ceiling is the retail rate. The most commonly recommended price ceiling is one that is set at the bundled retail rate charged to the end user. The ceiling is then applied so that the sum of the unbundled components' TSLRIC cannot exceed the price ceiling. Unfortunately, a price ceiling based on the retail rate charged to end users is simply unworkable for most small LECs at this time. In most cases, small LEC basic local exchange retail rates are currently below TSLRIC. These are not just minor price discrepancies, but significant differences caused by the states' historical residual local service pricing methodologies. Until there is rate restructuring, the small LECs cannot be subjected to a price ceiling based on the bundled basic rate charged to end users.

In **paragraph 143**, the Commission requests comments regarding price floors to protect incumbent LECs from confiscatory regulatory action. There is no need for Commission action in this regard. It is already commonly accepted that TSLRIC is a cost floor and there is no need for the Commission to establish new rule in this regard.

(c) Other Issues.

In **paragraph 144**, the Commission seeks comments regarding the relevance of embedded or historical cost. Private enterprises have a constitutional right to an opportunity to earn a profit on their investment and they should be entitled to recover stranded investment. It should be up to the state commissions, however, to address these issues. If this Commission is to adopt any rule, that rule should state that the state commissions should consider the recovery of embedded costs.

In **paragraph 145**, the Commission seeks comment regarding the inclusion of universal service costs and the New York "Play or Pay Plan." The public interest requires that in small rural LEC service areas, new competitors should make their services available to all customers in the historic franchise area. This issue illustrates the need for separate rules for large and small LECs. Without such a rule, "cherry picking" could cause a small LEC to go out of business. Many small LECs rely on one or two large business customers for a significant amount of their revenues. If they lose one of these customers, there is a drastic impact on their revenues. If this happens, the lost cost recovery most likely will be passed on

to customers by way of higher basic service rates or increased demands on the national Universal Service Fund ("USF").

In **paragraphs 147 through 148**, the Commission tentatively concludes that the "efficient component pricing rule ("ECPR"), or equivalent methodologies to set prices, proposed by economist William Baumol, J. Gregory Sidak, and others would be inconsistent with the Section 252(d)(1) requirement that prices be based on "costs." The Commission proposes that states be precluded from using this methodology to set prices. MECA disagrees with the Commission's interpretation of the arguments in support of using the ECPR in the price setting process. MECA has used the ECPR in Michigan proceedings to support the concept that rates cannot be set exactly at TSLRIC because it will cause an inefficient allocation of resources. The ECPR points out that incumbent LECs will subsidize new entrants if the price of unbundled services are set at TSLRIC. MECA does not suggest that the Commission use ECPR to directly set prices because the measurement of opportunity costs is entirely too subjective. However, the ECPR does demonstrate that prices cannot be set exactly at the level of TSLRIC.

In addition to common sense and Constitutional protections, this rule provides further theoretical support for allowing incumbent LECs to recover their shared and common costs in any pricing scheme.

Baumol and Sidak make the common sense observation that telephone customers do not purchase a local loop; rather, they purchase telecommunications services, e.g., local, toll, and custom calling features. A local loop in reality is an input needed to produce the final services demanded by telephone customers.

There is a benefit to using TSLRIC as a price floor and allowing incumbent LECs to also recover their common and overhead costs in a pricing scheme. This eliminates the possibility of the facility-based incumbent LECs having to subsidize a new entrant. By pricing the loop above TSLRIC, three socially-unacceptable consequences are avoided. First, this pricing prevents a flow of subsidies to the competitive provider, which discourages the entry of competitors that are less efficient than the incumbent. Entry of less efficient providers is a waste of scarce resources. Second, without a flow of subsidies, competitors that are more efficient than the incumbent will construct and maintain their own network. Otherwise, a rate equal to TSLRIC, which is a subsidized rate, would be more attractive and thus discourage the building a new facilities. This too is a

waste of resources and consumers would not benefit from the introduction of new technology or the benefits of the network of networks. Finally, customers of the incumbent LEC may experience rate shock as they pay for the lost revenues that previously supported common costs or there would be greater demand on the USF.

If, however, the LEC sells use of its loops at a price above TSLRIC that allows it to recover its common and overhead costs, the incumbent is indifferent to whether it or the competitor provides service to the end user because the incumbent recovers its true cost. Furthermore, the pricing structure is designed to allow entry of only those competitors who are more efficient than or as equally efficient as the incumbent LEC. Finally, there is no rate shock to the consumers who are left on the incumbent network. Thus, the ECPR provides further theoretical support for pricing above TSLRIC. However, because of the subjective nature of opportunity costs, it is not a rule that should be readily used to set prices.

In **paragraph 148**, the Commission also requests comment regarding whether a pricing methodology could constitute a barrier to entry under Section 253 of the 1996 Act. MECA believes that no reasonable pricing mechanism can violate Section 253 of the Act. Section 253 provides that no state or local statute

or regulation, or other state or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service. The general thrust of Section 253(a) is to eliminate unduly harsh state licensing requirements for new competitive entrants. While states may still impose requirements necessary to preserve an advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services and safeguard the rights of consumers pursuant to Section 253(b), states cannot go beyond that in reviewing an application of a new provider for a license to provide service within the state. Thus, any minimally qualified entity can enter into the telecommunications business.

There is a great difference between prohibiting the ability of an entity to provide any intrastate service (which an entity can do by installing its own facilities, among other things) and simply setting a price for unbundled components and interconnection. The Commission has an interest under Section 253 in allowing new companies to enter into the telecommunications business. It is too broad an interpretation of this section, however, to read it as imposing limitations on pricing and other specific matters. This Commission cannot look at the economic circumstances of each competing provider and attempt to price so that

that competing provider will be ensured of making a profit. Congress did not intend for the FCC to have the role of ensuring that all new entrants become financially viable. Rather, Congress intended for the removal of any absolute outright barriers and intended for this Commission to set only certain minimum standards that are necessary to facilitate interconnection. The competitive marketplace and the states should be allowed to do the rest. The Commission can fulfill its Congressional mandates by focusing on states that have no local competition because they do not allow new competitors to be licensed or they do not have interconnection rules. In states that already have interconnection rules, pricing disputes can be left to arbitration and state complaint processes.

In **paragraphs 149 through 153**, the Commission seeks comment regarding rate structures. The Commission should not attempt to control the specific rate structures that will be used by the incumbent LECs. The incumbent LECs are private enterprises that should be allowed to use their managerial discretion to select appropriate price structures, subject to state review for non-discriminatory application. MECA does not understand why the Commission feels compelled to address rate structure issues.

In **paragraph 154**, the Commission seeks comment on whether under the 1996 Act the Commission should require or permit volume and term discounts for unbundled elements or services. MECA believes that the Commission should not preempt the states from allowing volume and term discounts. The Michigan Telecommunications Act of 1995 allows volume and term discounts. Volume and term discounts are accepted business practices in other service industries and they induce customer loyalty.

In **paragraphs 155 through 156**, the Commission seeks comments regarding "discrimination." The Commission seeks comment on whether the law can be interpreted to prohibit only unjust or unreasonable discrimination and asks whether carriers may charge different rates to parties that are not similarly situated.

A rate or action can only be considered to be "discriminatory" if the affected parties are similarly situated. If the affected customers or parties are not similarly situated, then there is no discrimination at all. If there are similarly situated parties, it may still be just and reasonable to discriminate among those parties. Volume and term discounts are allowable because those terms are not discriminatory in that any customer with sufficient business or who is willing to enter into a term arrangement can obtain the benefits of the volume and term

discounts. Any other approach to the discrimination issue would not provide enough flexibility and would not be desirable in a competitive market place.

In **paragraph 157**, the Commission seeks comments regarding the types of state policies that would or would not be consistent with the requirements of Section 251 and the purposes of Part II of Title II of the 1996 Act. MECA believes that several states have adopted entire regulatory schemes that are consistent with the 1996 Act. The Michigan Telecommunications Act of 1995 addresses competition in the local exchange market place and sets out an entire scheme that is consistent with the federal law. The FCC should defer to Michigan to allow it to use its own unique rules, which already comply with the Federal Act. MECA opposes a single national standard, but if the FCC chooses that route, then the Michigan plan is a good model for others to use.

e. Interexchange Services, Commercial Mobile Radio Services, And Non-Competing Neighboring LECs.

In **paragraph 158**, the Commission seeks comment regarding whether Section 251(c) applies to arrangements between incumbent LECs and IXCs, CMRS providers, and non-competing neighboring LECs. Section 251(c) should not be interpreted to apply to arrangements between incumbent LECs and IXCs. Nor

should it be interpreted to apply to arrangements between non-competing neighboring LECs. There are a number of co-extensive obligations imposed on LECs by Section 251 and, when read in conjunction, the thrust of those obligations is to allow providers to interconnect for purposes of competition in the local exchange market. There is no indication that Congress intended to disrupt existing toll access arrangements or arrangements between non-competing neighboring LECs for EAS or other services.

Moreover, as indicated by MECA with regard to paragraph 84, it makes no sense to allow an IXC to acquire an unbundled loop when that carrier is not also providing basic local exchange service. If the incumbent LEC retains the loop to provide basic local exchange service, then an IXC obviously cannot acquire the loop and pay local interconnection rates to circumvent toll access charges.

In addition, in determining what network elements should be made available for purposes of subsection (c)(3), such as determining whether loops should be made available for purposes of providing toll service, the Commission must consider whether "the failure to provide access to these network elements would impair the ability of the telecommunications carrier seeking access to provide the services that it seeks to offer." See Section 251(d)(2)(B). Clearly the

ability of toll carriers to continue to provide toll service would not be impaired by denying them unbundled local network elements because they can continue to use the existing access charge arrangement.

Further, Section 251(g) states that LECs shall continue to provide exchange access service for toll access to interexchange carriers until current regulations are superseded by regulations prescribed by the Commission. Access charge revisions should be addressed in a separate docket so that implicit universal service support issues can be addressed, as well as other rate rebalancing issues. This docket does not address all the important issues necessary for a review of the toll access rate structure. Thus, MECA encourages the Commission to commence the process of access charge reform as soon as possible.

Further support for continuing the current toll access arrangements can be found in Section 251(i), which states that nothing in Section 251 shall be construed to limit or otherwise affect the Commission's authority under Section 201. Section 201 provides the jurisdictional basis under which long distance carriers have historically been allowed to interconnection for originating and

terminating interstate toll traffic. Section 261 further confirms that the Commission and the states are not prohibited from enforcing regulations that were applicable prior to the date of enactment of the 1996 Act.

In **paragraph 166,** the Commission seeks comment on whether arrangements between incumbent LECs and CMRS providers fall within the scope of Section 251(c)(2). MECA notes that it filed comments in CC Docket No. 95-185 and relies generally on those comments. The existing arrangements between LECs and CMRS providers in Michigan are access arrangements that have been in place since 1990 and nothing should be done in this docket to disrupt this state solution that has worked successfully.

3. Resale Obligations Of Incumbent LECs.

a. Statutory Language.

b. Resale Services And Conditions.

In **paragraph 175**, the Commission seeks comment on what limitations incumbent LECs should be allowed to impose with respect to services offered for resale and whether and how the resale obligation extends to an incumbent LEC's discounted and promotional offerings. MECA believes that the parties can negotiate appropriate terms and conditions for resale or that the states can resolve

any disputes between the parties. With regard to discounted and promotional offerings, these are not separate services offerings. They are merely pricing arrangements for services already being offered and should not be subject to distinct wholesale rates. Competing providers can purchase a given service for resale and, if entitled, purchase at a wholesale rate, but should be required to come up with their own promotional and discount offerings regarding those services.

Further, a number of resale limitations should be permissible, such as: (1) a provider is not required to offer for resale any service where, for social policy reasons, the current retail price is below cost, such as residential service, (2) resale should be limited to end user customers, (3) a company should be able to limit the resale of any service packages or promotional offerings, (4) LECS should not be required to make proprietary services available for resale, (5) LECs should not be required to make non-network based services available for resale, and (6) LECs should not be required to extend or build facilities to provide services to a reseller.

The Commission also seeks comment regarding whether a LEC can avoid making the service available at wholesale rates by withdrawing the service from its retail offerings. MECA believes that it would be imprudent to adopt a regulation that necessitates inquiry into the motives of a LEC for withdrawing a

service. There are many reason why a LEC may withdraw a service and LECs should not be forced to provide unprofitable services or prove their motives. The choice of whether offer or withdraw service is a management decision that can be made subject to state constraints regarding withdrawal of service, as is the case in the Michigan law.

In **paragraph 176**, the Commission seeks comment regarding the "category of subscriber" language in Section 251(c)(4)(B). The Michigan Public Service Commission Staff has taken the position that the resale of residential service is a moot issue because a reseller by its very nature is a business customer and, therefore, is only eligible to purchase business services from the incumbent. MECA agrees with the position that customer classifications need to be transferred in tact if a local service were resold. It would be improper, for example, to allow flat rated residential service to be resold to a business customer since residential rates in Michigan are lower than business rates and business usage is measured. Otherwise, the re-seller would obtain an unreasonable pricing advantage. Unfortunately, if <u>all</u> local exchange services are allowed to be resold, there is no practical way of preventing such arbitrage and abuse. Therefore, only the resale of business services should be allowed. This would eliminate the need for resale

restrictions on residential service which cannot be enforced without excessive administrative expense.

With regard to the Lifeline program, Lifeline is not a service. Rather, Lifeline is a discounted rate that applies to basic local exchange service. Thus, "Lifeline" cannot be resold, though the reseller should be obligated to provide similar discounts.

c. Pricing Of Wholesale Services.

In **paragraphs 179 through 183**, the Commission seeks comment regarding wholesale pricing principles for states to apply. The Commission should not establish any regulations in this regard since the states themselves are capable of determining avoided costs. The states have made avoided cost determinations in the electric utility industry for years. As long as the states are not impeding competition, there is no need for this Commission to adopt additional cost rules.

In **paragraph 184**, the Commission seeks comments regarding the relationship between rates for unbundled elements and rates for wholesale or retail offerings. The Commission is considering price ceilings and imputation rules. First, a price ceiling based on retail rates is unworkable for most small LECs at this time since, in most cases, small LEC basic local exchange rates are currently below

TSLRIC. These are not just minor price discrepancies, but significant differences caused by the FCC's Part 69 Rules and states' residual pricing methodologies. Thus, until there is rate restructuring bringing basic local rates up to at least TSLRIC, the small LECs cannot be subjected to a price ceiling based on the unbundled basic rate charged to end users.

C. Obligations Imposed On "Local Exchange Carriers" By Section 251(b) (¶¶ 195-244).

1. Resale.

In **paragraph 197**, the Commission seeks comment regarding the types of restrictions on resale that would be "unreasonable." These types of determinations should be left to the states.

2. Number Portability.

In **paragraph 199**, the Commission indicates that in an effort to adopt number portability rules expeditiously, the Commission will address number portability issues raised by the 1996 Act in the ongoing proceeding on number portability, CC Docket No. 95-116. MECA agrees with that conclusion. Contrary to most issues raised by this NPRM, MECA believes that the Commission is the proper body to set standards regarding number portability. MECA supports the

Commission because true number portability requires a national data base similar to 800 service. A national solution is therefore required. In order to have compatibility of systems along with a practical funding solution, a nationally coordinated effort is required. Though equipment manufacturers are progressing towards a consensus with some long distance carriers accepting their proposal, none of the various "call model architectures" are compatible or fully tested. Moreover, various states are proceeding in different directions. If states were to develop their own parallel long-term solutions, there is no guarantee that their selected protocols can interface with each other. Therefore, this Commission should address long-term alternatives for number portability to the exclusion of the states.

Furthermore, this Commission should address all types of number portability, i.e. provider portability, geographical portability, and service portability. All three types of number portability should be addressed before selecting a specific protocol. The public interest will not likely be served by adopting regional or state solutions that have not addressed either service or geographic portability.

Long-term solutions for number portability will require that there be switch conversions and network reconfigurations. Thus, the Commission will also

have to determine who will pay for these switch conversions and network reconfigurations. These are significant costs that will need to be recovered and the most equitable means is sharing them on a national basis among all carriers.

3. Dialing Parity.

In **paragraphs 203 through 213**, the Commission seeks comment regarding various aspects of dialing parity. MECA encourages the Commission to defer to the states regarding dialing parity. In Michigan, all incumbent LECs and major IXCs have participated in at least two lengthy proceedings before the Michigan Public Service Commission and have participated on a Dialing Parity Task Force. In addition to the time and effort spent by the LECs and IXCs, the State Legislature and Governor enacted a law requiring dialing parity in Michigan. MECA willingly accepts that regulatory framework instead of incurring the significant amount of costs that would be necessary to re-address this issue one more time. This is another perfect example of an issue that should not be addressed by the FCC and that should be deferred to those states who have already concluded proceedings that conform to the Federal Act.

In **paragraphs 214 through 218**, the Commission seeks comments regarding non-discriminatory access to telephone numbers, operator services,

directory assistance, and other related matters. These issues have all been addressed in Michigan in a generic interconnection case and the Michigan Commission is preparing an order to address them. Furthermore, any failure to comply can be addressed by the complaint and review process.

In **paragraph 219**, the Commission seeks comment regarding cost recovery regarding dialing parity. The Michigan Commission has adopted an equal access recovery charge that allows LECs to recover specifically designated intraLATA dialing parity conversion costs. There is no just reason for the FCC to preempt these rules.

4. Access To Rights-Of-Way.

No comment.

5. Reciprocal Compensation For Transport And Termination Of Traffic.

In **paragraphs 226 through 244**, the Commission seeks comment regarding reciprocal compensation, including use of negotiation, bill and keep arrangements, symmetry, and other matters. MECA asserts that the reciprocal compensation pricing structure for small incumbent LECs should be different than that for the large LECs for the reasons already mentioned.

Competing LECs should be required to compensate each other for terminating each other's traffic. Compensation rates for terminating traffic should be cost-based for each carrier. Therefore, compensation rates must not be uniform because each carrier has its own unique cost structure.

When competing LECs terminate traffic on each other's networks, the actual use of the network components will vary on the terminating side for each carrier. Compensation between competing carriers should be based on the actual use of the various components (dedicated trunking, common tandem trunking, tandem switching, end office switching, virtual collocation, etc.) of the terminating carrier's network, with usage-based rates where appropriate based on cost causation principles. It is absolutely essential that compensation arrangements between competitors be consistent with cost causation principles, including the recovery of a reasonable contribution towards shared and common costs, in order to avoid subsidization of economically inefficient competitive entry and the resulting reduction (or even the complete elimination) of any public welfare gain that is expected to flow from the introduction of competition into the local exchange marketplace.

The term "bill and keep" as used in the local competition and interconnection debate means that the originating carrier bills his own end user and pays the terminating carrier nothing for the use of that carrier's network. Competitive LECs argue that this is analogous to compensation arrangements between LECs in an EAS situation. They point out that in an EAS arrangement LECs do not flow cash compensation between each other for terminating each other's traffic. They claim that between two carriers terminating traffic volumes and terminating access costs are roughly equal and, therefore, no compensation is required. To the contrary, however, their claims are unsound and EAS is not a comparable model.

The bill and keep proposal as defined in this docket is not an appropriate model for mutual compensation for several reasons. One flaw with a bill and keep proposal is the assumption that terminating traffic would be equal in both directions for competing LECs. This assumption is faulty because new entrants will engage in niche marketing in order to get a toehold in a new service area. Therefore, the size of the customer base of each carrier will be different and the total number of originating minutes will be different. Moreover, because the business and residential subscriber mix between the carriers is different, the

number of minutes generated will most likely be different. Third, the community of interest will be different between the customer bases served by the carriers. These three variables all demonstrate that terminating traffic will not likely be equal between two competing carriers.

Costs are also different between carriers. Costs vary due to differing economies of sale, differing in network configurations, demographics of their customer bases and levels of deployed technology. Therefore, the costs to terminate traffic will be different between carriers. Therefore, a bill and keep compensation arrangement is not appropriate.

The bill and keep proposal cannot be supported by arguing that local competition is analogous to existing EAS arrangements. Compensation arrangements should not be patterned after the EAS interconnections between LECs since EAS was not designed for the competitive environment.

Although there are some similarities between EAS and LECs competing in the same geographic area in that (1) terminating costs vary between adjacent carriers and (2) traffic flows are unequal, EAS was implemented as a time when LECs had exclusive franchise service areas and monopoly protection. This allowed the incumbent LECs to cross-subsidize the interexchange service known as