

residential services may not be purchased for resale to business customers.<sup>43</sup> To create the exception advocated by some ILECs -- particularly if the Commission accepts at face value the unproven assertion that residential services provided by the large exchange carriers are under water<sup>44</sup> -- would eliminate residential resale as a viable business or, for that matter, as a legally permitted business. The Act countenances no such result and the Commission is barred enacting such a regime through regulation.

In addition, the attempt to exclude a whole host of services from the Act's resale requirements must fail. Promotional offerings, for example, are retail services, as are new services. The Act does not exclude them from its resale mandate. Nor should it. If the Commission creates such exceptions, an incumbent LEC could eviscerate the Act's resale mandate by denominating virtually everything a "promotion" or a "new service." It would certainly deny to resellers the opportunity to compete on the basis of the ILECs' own retail offerings, directly contrary to the plain meaning of the Act.

The most dangerous suggestion of all is that ILECs should be permitted to withdraw retail services at will<sup>45</sup> -- presumably, without regard to the economic impact of

---

<sup>43</sup>47 U.S.C. § 251(c)(4)(B).

<sup>44</sup>As Frontier demonstrates in its comments (at 30 n.57), the claim that massive subsidization currently exists is likely incorrect. If proper economic costs -- not inflated rate bases and revenue requirements -- are examined, subsidized services are likely fairly limited in scope. While the existence of subsidies may justify some degree of rate rebalancing, this circumstance should not create a *carte blanche* to interpret the Act's resale mandate out of existence.

<sup>45</sup>E.g., USTA at 72.

such action on their resale customers. The Department of Justice succinctly analyzed this claim:

*The Department believes that, with one exception, ILECs should not be able to avoid the resale requirements by withdrawing any retail service offering at the time the 1996 Act was enacted. States should only have the authority to approve such withdrawal requests where the purpose is a legitimate phase-out of an obsolete service; ILECs should not be allowed to use the withdrawal tactic to eliminate offerings that appear to provide an economical means for new entrants to become established in the local exchange markets.*

It seems particularly clear that the Act by its terms would not permit an ILEC to refuse to permit the resale of a service that it has not completely withdrawn, but has merely "grandfathered" for its existing customers. In such cases the ILEC is certainly continuing to provide the service, even though it may not be willing to extend the services to new customers or to add additional capacity.<sup>46</sup>

US West's recent attempt<sup>47</sup> to withdraw Centrex from resale -- which, surprisingly, is still ongoing in most US West states<sup>48</sup> -- demonstrates the courses of action which

---

<sup>46</sup>DOJ at 55-56 (emphasis added).

<sup>47</sup>See Frontier at 28-29.

<sup>48</sup>Not only has US West appealed Washington's suspension of its tariff revisions to grandfather Centrex service, it has refiled tariff revisions in Minnesota to the same effect in the face of the Minnesota Commission's rejection of its prior tariff filing.

monopoly ILECs will pursue to avoid resale.<sup>49</sup> The Commission should not -- indeed, may not -- countenance this strategy.

In addition, the Commission should reject the arguments raised by certain ILECs that would render the Act's wholesale pricing provisions meaningless by negating the literal avoided cost standard. The Commission should fully enforce the Act's pricing requirements. An ILEC must offer at wholesale services it offers at retail at prices that are calculated:

on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to marketing, billing, collection and any other costs that will be avoided by the local exchange carrier.<sup>50</sup>

Thus, the Act prohibits an ILEC from imposing costs on its wholesale customers that are generated as a result of its retail operations. The wholesale rate is a straight-forward *reduction* of retail rates by the amount of the avoided costs enumerated in the Act. Thus, in the wholesale context, marketing, billing, collection and related retail costs *are* avoided and shall be subtracted from the retail rate to create the wholesale price.

---

<sup>49</sup>The current oratory about the so-called "evils of resale" are starkly reminiscent of the reaction of the old Bell System to the resale of long distance services -- a reaction that ultimately led to its dissolution. United States v. Western Elec. Co., 552 F. Supp. 133 (D.D.C. 1982), affd mem., 460 U.S. 1001 (1983). The Commission must learn from these lessons of history to avoid repeating them.

<sup>50</sup>47 U.S.C. § 252(d)(3).

## Conclusion

The Act places the Commission squarely at the crossroads. It may be cautious and continue the *status quo*. Alternatively, it may embrace Frontier's six core principles and further the purposes of the Act. Faced with this alternative, the Commission's course of action is clear.

Respectfully submitted,



Michael J. Shortley, III

Attorney for Frontier Corporation

180 South Clinton Avenue  
Rochester, New York 14646  
(716) 777-1028

Roy L. Morris  
Director, Public Policy  
Frontier Communications Services Inc.  
1990 M Street, N.W., Suite 500  
Washington, D.C. 20036  
(202) 293-0593

May 30, 1996

TSLRIC and Modern Finance  
Affidavit of Roy L. Morris

1.This affidavit addresses the support that modern finance approaches give to the use of TSLRIC pricing for new services or products by a competitive firm.

2.Modern finance teaches that the threshold analysis for determining whether it makes sense to go forward with a project (e.g., offering a new product or service) is to analyze the net present value of all future cash flows for that project (i.e., its "NPV"),<sup>1</sup>

3.By assuring that a project's NPV is estimated to be zero (or greater), the firm can be reasonably confident that proceeding with the project will increase the firm's value for its investors.

4.Mathematically, the formula for the NPV of a project is as follows:

$$a.NPV = \sum_{t=0}^N \frac{(r_t - c_t)}{(1+i)^t}$$

b.where t is an integer reflecting each time period (e.g., year 0, 1, 2, 3, ...N) up to the final time period of the project (year N)

c.where the  $r_t$ 's are the future cash inflows from the project (e.g., the revenues collected for the total project) for each time period t.

d.where the  $c_t$ 's are the future cash outflows caused by the project (i.e., the incremental costs of the total project (accounted for on a cash basis)) in each time period t.

e.where the i is the risk adjusted discount rate for the cash flows of the project (i.e., the return that the capital markets would expect to receive given the "riskiness" of that project). Id. at 183-183.

5.The threshold test for the viability of a project is that the NPV of the project equal zero. Stated otherwise,

---

<sup>1</sup>See, e.g., Brealey and Myers, Principles of Corporate Finance Fourth Edition, McGraw Hill, 1991 at 12-23.

$$a. NPV = \sum_{t=0}^N \frac{(r_t - c_t)}{(1+i)^t} = \sum_{t=0}^N \frac{(r_t)}{(1+i)^t} - \sum_{t=0}^N \frac{(c_t)}{(1+i)^t} = R - C = 0$$

b. where R is the present value of all future total incremental revenues of the project in each time period.

c. where C is the present value of all future total incremental cash outflows of the project [i.e., the Total Service Long Run Incremental Costs (expressed on a cash basis)].

d. N is the (long run) horizon of the project as determined by the project's effects on all future cash inflows and outflows.

6. Modern finance, thus, tells the firm that it should go forward with a project if that project's R (i.e., present value of the total project revenues which are produced by the project's rates) are large enough such that the NPV of the project is zero. If the NPV is greater than zero, then the project's revenues are higher than they need to be because they are expected to produce excess returns to the firm that are greater than the capital markets expect given the riskiness of the project.

7. A trivial solution to this NPV=0 analysis would be for R=C. That is, the firm should go forward with the project if the present value of its total incremental revenues (i.e., all rates charged discounted at the risk adjusted cost of capital) merely equal the present value of total incremental cash flows of the project (i.e., the costs of the project discounted at the risk adjusted cost of capital).

8. In other words, the project need only produce revenues that exceed the TSLRIC in order for it to make sense for the project to go forward.

9. Relating this to the various criticisms of TSLRIC, it should be noted that:

a. a proper NPV analysis does not give any consideration to embedded costs or any other historical artifacts of the firm. The history of the firm is simply irrelevant to the analysis of what the firm must do in the future and how it should price its offerings. Thus, a proper financial analysis of a project undertaken by a competitive firm (e.g. the offering of unbundled elements/interconnection/transport/termination) properly ignores historical book values (and any other form of accrual accounting for past investments or operations of the firm), "margins" based on past accrual accounting entries, and even the capital costs of the total firm --

which are simply averages over the total firm's cash flows, as compared to the risk adjusted cost of capital for the particular project to be undertaken.

b. given that the objective of setting prices for unbundled elements, interconnection, and transport/termination is to produce prices at competitive levels (i.e., as if the firm offering these products were subject to vigorous competition in all markets), the proper competitive-threshold level for prices of a project are where  $R=C$  (i.e., when the present value of discounted revenues simply equals the present value of discounted costs (on a cash basis)).

c. When  $R=C$ , investors are given all of the competitive returns they are entitled to for the undertaking of this new project by the firm. No additional "economic profits" are required or otherwise demanded by the capital markets. That is,  $R$  does not have to exceed  $C$  for the project to be viable and beneficial to the firm's shareholders.

10. In sum, proper pricing for unbundling, interconnection, and transport/termination should reflect future costs that are incurred as a result of these new offerings.

I, Roy L. Morris, declare under penalty of perjury that the forgoing statement is true and correct to the best of my knowledge and belief.

  
\_\_\_\_\_  
Roy L. Morris

May 30, 1996

**EDUCATION**

Wharton School of Management, MBA, May 1995 (emphasis Finance)  
 George Washington University, JD, 1984  
 Massachusetts Institute of Technology, EE and SM, 1978

**WORK EXPERIENCE****Frontier Communications Services, Inc., Washington, D.C. (1988-Present)****Director, Public Policy and Regulatory Affairs (formerly also Regulatory Council Allnet)**

Manage Public Policy and Regulatory Affairs Department. Developed concept of Advanced Intelligent Network equal access; formulated proposal for Mexican government for telecommunications competition, based upon US model applied to Mexican demographics, and market conditions; conceived CIID industry solution for equal access to Bell Operating Company Calling Card numbering. Received Certificate of Commendation from Minnesota Governor Perpich, 1989 for intraLATA equal access development.

**MCI Telecommunications Corporation (1984-1987)****Senior Regulatory Attorney**

Primary regulatory subject matter expert for 800 database, access charge pricing, and dial-1 equal access.

**FCC, Office of Plans and Policy. (1980-1984)****Senior Staff Engineer.**

Advised FCC Commissioners and advocated pro-competitive policies within and outside agency using arguments founded in economics, law, and engineering.

**AT&T/Bell Telephone Laboratories (1978-1979)****Member of Technical Staff.**

Headed group that developed first customer T1 network interface.

**MIT. (1975-1978)****Research and Teaching Assistant, Electrical Engineering****PUBLICATIONS, PRESENTATIONS AND PAPERS INCLUDE**

Telecom Investment Strategies For the 1990's (unpublished)  
 The Added Value of Regulatory and Legislative Options (unpublished)  
 Time Warner: Multimedia Conglomerate or Elephant (Wharton)  
 Business Case for Genetically Altered Tomatoes and Methods (Wharton)  
 FCC Enforcement: Telecommunications Crisis for the 1990s (Allnet Policy Paper)  
 The Economics of Local Distribution, IEEE (FCC)  
 A Roadmap for Deregulation of AT&T, Airle (FCC)  
 Negotiating for Improved Interconnection, The Incentives to Bargain (FCC/OPP Working Paper)  
 Low Order Model of a Power Turbine, IEEE (MIT)

### **Certificate of Service**

I hereby certify that, on this 30th day of May, 1996, copies of the foregoing Reply Comments of Frontier Corporation were served by first-class mail, postage prepaid, upon the parties on the attached service list.

  
Michael J. Shortley, III

Wayne V. Black  
C. Douglas Jarrett  
Susan M. Hafeli  
Brian Turner Ashby  
KELLER AND HECKMAN  
1001 G Street, NW  
Suite 500 West  
Washington, DC 20001

Rodney L. Joyce  
GINSBURG, FELDMAN & BRESS  
1250 Connecticut Avenue, NW  
Washington, DC 20036

Ellen G. Block  
James S. Blaszk  
Henry D. Levine  
LEVINE, BLASZAK, BLOCK & BOOTHBY  
1300 Connecticut Avenue, NW  
Suite 500  
Washington, DC 20036

Albert H. Kramer  
Robert F. Aldrich  
DICKSTEIN, SHAPIRO & MORIN, LLP  
2101 L Street, NW  
Washington, DC 20037-1526

Glenn S. Richards  
Stephen J. Berman  
FISHER WAYLAND COOPER  
LEADER & ZARAGOZA LLP  
2001 Pennsylvania Avenue, NW  
Suite 400  
Washington, DC 20006

Charles H. Helein  
HELEIN & ASSOCIATES, PC  
8180 Greensboro Drive  
Suite 700  
McLean, VA 22102

Gary L. Phillips  
AMERITECH  
1401 H Street, NW  
Suite 1020  
Washington, DC 20005

Bruce D. Jacobs  
Glenn S. Richards  
FISHER WAYLAND COOPER  
LEADER & ZARAGOZA LLP  
2001 Pennsylvania Avenue, NW  
Suite 400  
Washington, DC 20006

Lon C. Levin  
AMSC SUBSIDIARY CORPORATION  
10802 Park Ridge Boulevard  
Reston, VA 22091

Ms. Bettye Gardner  
THE ASSOCIATION FOR THE STUDY OF  
AFRO-AMERICAN LIFE AND HISTORY, INC.  
1407 Fourteenth Street, NW  
Washington, DC 20005-3704

Mark C. Rosenblum  
Roy E. Hoffinger  
Ava B. Kleinman  
AT&T CORP.  
Room 3244J1  
295 North Maple Avenue  
Basking Ridge, NJ 07920

Richard H. Rubin  
Clifford K. Williams  
Seth S. Gross  
AT&T CORP.  
Room 3244J1  
295 North Maple Avenue  
Basking Ridge, NJ 07920

David W. Carpenter  
AT&T CORP.  
One First National Plaza  
Chicago, IL 60603

Edward Shakin  
Edward D. Young, III  
Michael E. Glover  
BELL ATLANTIC TELEPHONE COMPANIES AND  
BELL ATLANTIC COMMUNICATIONS, INC.  
1320 North Court House Road  
Eighth Floor  
Arlington, VA 22201

Cheryl Lynn Schneider  
Joan M. Griffin  
BT NORTH AMERICA INC.  
601 Pennsylvania Avenue, NW  
North Building, Suite 725  
Washington, DC 20004

Mark P. Sievers  
William B. Wilhelm, Jr.  
SWIDLER & BERLIN, CHTD.  
3000 K Street, NW  
Suite 300  
Washington, DC 20007

Ann P. Morton  
CABLE & WIRELESS, INC.  
8219 Leesburg Pike  
Vienna, VA 22182

Danny E. Adams  
Edward A. Yorkgittis, Jr.  
KELLEY DRYE & WARREN  
1200 19th Street, NW  
Washington, DC 20036

Charlene Vanlier  
CAPITAL CITIES/ABC, INC.  
21 Dupont Circle  
6th Floor  
Washington, DC 20036

Howard Monderer  
NATIONAL BROADCASTING COMPANY, INC.  
11th Floor  
1299 Pennsylvania Avenue, NW  
Washington, DC 20004

Randolph J. May  
Timothy J. Cooney  
SUTHERLAND, ASBILL & BRENNAN  
1275 Pennsylvania Avenue, NW  
Washington, DC 20004-2404

Mark M. Johnson  
CBS INC.  
Suite 1200  
600 New Hampshire Avenue, NW  
Washington, DC 20037

Bertram W. Carp  
TURNER BROADCASTING, INC.  
Suite 956  
820 First Street, NE  
Washington, DC 20002

Winston R. Pittman  
CHRYSLER MINORITY DEALER ASSOCIATION  
27777 Franklin Road  
Southfield, MI 48034

Wayne Leighton, Ph.D.  
James Gattuso  
CITIZENS FOR A SOUND ECONOMY  
FOUNDATION  
1250 H Street, NW  
Suite 700  
Washington, DC 20005

Jeffrey A. Campbell  
COMPAQ COMPUTER CORPORATION  
1300 "I" Street, NW  
Suite 490E  
Washington, DC 20005

Robert A. Mazer  
Albert Shuldiner  
VINSON & ELKINS  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1008

Natalie Marine-Street  
TELECO COMMUNICATIONS GROUP, INC.  
Long Distance Wholesale Club  
4219 Lafayette Center Drive  
Chantilly, VA 22021

Michael G. Hoffman, Esq.  
VARTEC TELECOM, INC.  
3200 W. Pleasant Run Road  
Lancaster, TX 75146

Genevieve Morelli  
COMPETITIVE TELECOMMUNICATIONS  
ASSOCIATION  
1140 Connecticut Avenue, NW  
Suite 220  
Washington, DC 20036

Robert J. Aamoth  
Jonathan E. Canis  
REED SMITH SHAW & McCLAY  
1301 K Street, NW  
Suite 1100 - East Tower  
Washington, DC 20005

Bradley Stillman  
Gene Kimmelman  
CONSUMER FEDERATION OF AMERICA and  
CONSUMERS UNION  
1424 16th Street, NW  
Suite 804  
Washington, DC 20036

John W. Pettit  
Sue W. Bladek  
Richard J. Arsenault  
DRINKER BIDDLE & REATH  
901 Fifteenth Street, NW  
Washington, DC 20005

Dr. Robert Self  
d/b/a MARKET DYNAMICS  
4641 Montgomery Avenue - #515  
Bethesda, MD 20814-3488

Stuart Zimmerman  
FONE SAVER, LLC  
733 Summer Street  
Suite 306  
Stamford, CT 06901-1019

Kathy L. Shobert  
GENERAL COMMUNICATION, INC.  
901 15th Street, NW  
Suite 900  
Washington, DC 20005

Emily C. Hewitt  
Vincent L. Crivella  
Michael J. Etnier  
GENERAL SERVICES ADMINISTRATION  
18th & F Streets, NW  
Room 4002  
Washington, DC 20405

Gail L. Polvy  
GTE  
1850 M Street, NW  
Suite 1200  
Washington, DC 20036

Herbert E. Marks  
Jonathan Jacob Nadler  
Thomas E. Skilton  
Adam D. Krinsky  
SQUIRE, SANDERS & DEMPSEY  
1201 Pennsylvania Avenue, NW  
PO Box 407  
Washington, DC 20044

Joseph P. Markoski  
Marc Berejka  
SQUIRE, SANDERS & DEMPSEY  
1201 Pennsylvania Avenue, NW  
PO Box 407  
Washington, DC 20044

Lee M. Weiner  
Douglas W. Kinkoph  
LCI INTERNATIONAL TELECOM CORP.  
8180 Greensboro Drive  
Suite 800  
McLean, VA 22102

Catherine R. Sloan  
Richard L. Fruchterman  
Richard S. Whitt  
WORLD.COM, INC. d/b/a LDDS Worldcom  
1120 Connecticut Avenue, NW  
Suite 400  
Washington, DC 20036

Donald J. Elardo  
Frank W. Krogh  
Larry A. Blosser  
Mary J. Sisak  
MCI TELECOMMUNICATIONS CORPORATION  
1801 Pennsylvania Avenue, NW  
Washington, DC 20006

Andrew D. Lipman  
Erin M. Reilly  
SWIDLER & BERLIN, CHARTERED  
3000 K Street, NW  
Suite 300  
Washington, DC 20007

Robert L. Boxer  
MOSCOM CORPORATION  
3750 Monroe Avenue  
Plattsford, NY 14534

Earl Pace  
NATIONAL BLACK DATA PROCESSORS  
ASSOCIATION  
1250 Connecticut Avenue, NW  
Suite 600  
Washington, DC 20036

John Crump  
NATIONAL BAR ASSOCIATION  
1225 11th Street, NW  
Washington, DC 20001-4217

Aliceann Wohlbruck  
NATIONAL ASSOCIATION OF DEVELOPMENT  
ORGANIZATIONS  
444 North Capitol Street  
Suite 630  
Washington, DC 20001

John Abernathy  
NETWORK ANALYSIS CENTER, INC.  
45 Executive Drive  
Suite GL 3  
Plainview, NY 11803

Campbell L. Ayling  
Donald C. Rowe  
NYNEX TELEPHONE COMPANIES  
1111 Westchester Avenue  
White Plains, NY 10504

Robert S. Tongren  
David C. Bergmann  
THE OFFICE OF THE OHIO CONSUMERS'  
COUNSEL  
77 South High Street  
15th Floor  
Columbus, OH 43266-0550

Marlin D. Ard  
John W. Bogy  
PACIFIC TELESIS GROUP  
140 New Montgomery Street  
Room 1530 A  
San Francisco, CA 94105

Margaret E. Garber  
PACIFIC TELESIS GROUP  
1275 Pennsylvania Avenue, NW  
Washington, DC 20004

Alan Kohler  
Veronica A. Smith  
John F. Poviliatis  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
PO Box 3285  
Harrisburg, PA 17105-3265

James D. Ellis  
Robert M. Lynch  
David F. Brown  
SBC COMMUNICATIONS INC.  
175 E. Houston  
Room 1254  
San Antonio, TX 78205

Paul R. Schwedler  
Carl Wayne Smith  
DEFENSE INFORMATION SYSTEMS AGENCY  
701 S. Courthouse Road  
Arlington, VA 22204

Leon M. Kestenbaum  
Jay C. Keithley  
Michael B. Fingerhut  
SPRINT CORPORATION  
1850 M Street, NW  
11th Floor  
Washington, DC 20036

Robert M. Halperin  
CROWELL & MORING  
1001 Pennsylvania Avenue, NW  
Washington, DC 20004

John W. Katz, Esq.  
OFFICE OF THE STATE OF ALASKA  
Suite 336  
444 North Capitol Street, NW  
Washington, DC 20001

Samuel A. Simon  
TELECOMMUNICATIONS RESEARCH and  
ACTION CENTER  
901 15th Street, NW  
Suite 230  
Washington, DC 20005

Charles C. Hunter  
HUNTER & MOW, PC  
1820 "I" Street, NW  
Suite 701  
Washington, DC 20006

**William B. Goddard**  
**TELECOMMUNICATIONS INFORMATION**  
**SERVICES**  
4613 West Chester Pike  
Newtown Square, PA 19073

**Cheryl A. Tritt**  
**Joan E. Neal**  
**MORRISON & FOERSTER LLP**  
2000 Pennsylvania Avenue, NW  
Suite 5500  
Washington, DC 20006

**Mary McDermott**  
**Linda Kent**  
**Charles D. Cosson**  
**UNITED STATES TELEPHONE ASSOCIATION**  
1401 H Street, NW  
Suite 600  
Washington, DC 20005

**Helen E. Disenhaus**  
**Kathy L. Cooper**  
**SWIDLER & BERLIN, CHARTERED**  
3000 K Street, NW  
Suite 300  
Washington, DC 20007

**Jeffrey L. Sheldon**  
**Sean A. Stokes**  
**UTC**  
1140 Connecticut Avenue, NW  
Suite 1140  
Washington, DC 20036

**Dana Frix**  
**Morton J. Posner**  
**SWIDLER & BERLIN, CHARTERED**  
3000 K Street, NW  
Suite 300  
Washington, DC 20007

**Timothy R. Graham**  
**Robert G. Berger**  
**Joseph M. Sandri, Jr.**  
**WINSTAR COMMUNICATIONS, INC.**  
1146 19th Street, NW  
Washington, DC 20036

**William H. Welling**  
**XIOX CORPORATION**  
577 Airport Boulevard  
Suite 700  
Burlingame, CA 94010

**John F. Beasley**  
**William B. Barfield**  
**Jim O. Llewellyn**  
**BELLSOUTH CORPORATION**  
1155 Peachtree Street, NE  
Suite 1800  
Atlanta, GA 30309-2641

**Charles P. Featherstun**  
**David G. Richards**  
**BELLSOUTH CORPORATION**  
1133 21st Street, NW  
Washington, DC 20036