constitute a "taking" are "wholly lacking in merit."[41] Bill and keep, in fact, has been approved by a number of states.[42]

The "Takings Clause" of the Fifth Amendment provides that the government is obliged to pay a property owner when private property is taken for public use. Permanent physical occupation by the government or a third party pursuant to government authorization is the most obvious form of taking. This action is in effect a "categorical" taking, which is compensable without regard to any fact-specific inquiry.[43] If the government regulation completely eliminates all economic value or use of the property, it is also a categorical taking. However, claims that bill and keep regulations deprive ILECs of *all* economic value are totally without merit.

In any event, the 1996 Act makes it clear that bill and keep *does* compensate carriers. The Act states that arrangements that "*afford* the mutual recovery of costs through the offsetting of reciprocal obligations" are permitted,

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[41]California Public Utilities Commission, *Order Instituting Rulemaking on Commission's Own Motion into Competition for Local Exchange Service; Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service*, Docket Nos. R. 95-04-043 and I. 95-04-044, Decision No. 95-07-054 (July 24, 1995) at 38.

[42]States that have approved bill and keep include California, Oregon, Washington, Texas, Connecticut, Arizona, Michigan, Pennsylvania, and Florida. *See* TCG at 69-71. Iowa also has recently approved bill and keep. Telecommunications Reports, May 27, 1996, at 38.

[43]*Loretto v. TelePrompter Manhattan CATV Co.*, 458 U.S. 419, 432, 441 (1982) (statute requiring landlords to allow cable television installation in rental buildings was permanent physical invasion and thus a taking).

which recognizes that carriers are "afforded" a recovery of costs through the barter transaction that is bill and keep.

Accordingly, the Commission's adoption of bill and keep as the "Preferred Outcome" for transport and termination, at least on an interim basis, will allow for the most expeditious competitive entry into the local market, is consistent with the language and goals of the 1996 Act, and does not represent an unlawful "taking."

IV. MID-SPAN MEET INTERCONNECTIONS ARE A NECESSARY OPTION FOR CLECs TO DEVELOP THE MOST EFFICIENT, COST-EFFECTIVE NETWORKS.

Virtually all parties, except the ILECs, agree that the Commission clearly possesses the authority to order mid-span meet interconnection arrangements,[44] as well as physical and virtual collocation arrangements. These parties recognize the benefits of having flexible, varied interconnection options available to them. Such requirements are clearly within the framework of the 1996 Act. As the Act states, ILECs are required to provide interconnection "at any technically feasible point within the carrier's network." ILECs also must offer interconnection that is "at least equal in quality to that provided by the [ILEC] to itself or to any

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[44]Mid-span meet interconnection arrangements refer to situations in which two carriers each construct transmission facilities and arrange to interconnect them at a predetermined location, the "meet point."

subsidiary, affiliate, or any other party" and the "rates, terms and conditions" must be "just reasonable and nondiscriminatory."[45]

As TCG stated in its comments, ILECs today provide interconnection to one another using mid-span meet type arrangements and, under the 1996 Act, are obligated to provide this form of interconnection to competitive carriers. Despite the clear language of the 1996 Act, many of the ILECs claim that nothing in the 1996 Act compels ILECs to expand capacity or deploy new technologies to enable interconnection. For example, GTE claims that such a rule would arbitrarily permit new entrants to dictate the ILEC's investment program.[46] SBC seeks to refuse to provide mid-span meets by arguing that the FCC cannot compel "physical collocation" anywhere "except within an ILEC central office or a facility comparable to a central office."[47] GTE thus seeks to limit its "interconnection" obligations under the 1996 Act by linking them to the Commission's explicit grant of the authority to order physical collocation -- overlooking the fact that the physical collocation language was intended to *broaden* the Commission's authority, not shrink it as SBC would have it.

Similarly, Pacific Telesis seeks to avoid any obligation to provide mid-span meets by claiming that Sections 251, 252 and 271 of the Act should not require

[45] 1996 Act, Sec. 252(c)(2).

[46] GTE at 20.

[47] SBC at 66.

ILECs to develop new network capabilities, introduce new retail services solely for resale, *or expand current facilities to facilitate interconnection with CLECs.* This last claim is particularly telling -- given that CLECs are hardly even established in the marketplace, Pacific Telesis is apparently seeking to limit the scope of their network interconnections to what is in place today, or to place all the interconnection burden on the new entrant. Pacific Telesis goes on to urge the Commission to make clear the ILECs do not have to build new facilities or obtain any necessary permits for new entrants.[48] Pacific Telesis' claim obviously and completely ignores the statutory obligation to interconnect at technically feasible points, and to do so in a non-discriminatory manner. Moreover, Pacific Telesis' attempt to make CLECs pay for all the costs of interconnection is, yet again, an effort to treat CLECs like customers rather than co-carriers. Pacific Telesis' obligation to interconnect with TCG is no less than TCG's obligation to interconnect with Pacific Telesis.

Pacific Telesis' rationale -- such as it is -- appears to be that the Commission cannot mandate mid-span meet interconnections because Section 252 of the Act states that interconnection must be at a technically feasible point and be "within" the LEC's network. Pacific Telesis seems to imply that constructing facilities to a meet point would constitute facilities that are not "within" the LEC network, and,

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[48]Pacific Telesis at 19. Pacific Telesis also seeks to claim that interconnection points are limited to those employed today in central offices and tandems, and that nothing further should be mandated. Pacific Telesis at 21-22.

therefore, is not required under the 1996 Act. Such an overly narrow construction of the language in the 1996 Act defies all logic -- indeed under that view no point of interconnection could be required since Pacific Telesis apparently considers any point of interconnection to be "outside" its network.

Notwithstanding the ILEC's arguments, mid-span meet interconnection is (1) technically feasible, (2) is provided to other carriers today, and (3) must be provided to other parties to avoid discrimination. Mid-span interconnection allows interconnectors the flexibility to construct efficient networks because it does not impose on the competitive carrier the necessity of matching the ILEC's network. It also encourages facilities-based competition because it promotes differing network constructions and affords the opportunity to build networks that meet end-user demand rather than imposing network construction requirements that mirror ILEC configurations. The fact that mid-span meet arrangements have been commonly and uncontestedly used for decades for the exchange of traffic between non-competing ILECs provides strong evidence that these arrangements are a competitively neutral model for the exchange of switched traffic between networks, and one that the 1996 Act requires be made available.

V. EXPLICIT PERFORMANCE STANDARDS WILL PREVENT ILEC ABUSES AND FACILITATE COMPETITIVE ENTRY.

There is a general consensus among the potential competitive carriers that CLECs need a self-policing, self-executing remedy for poor ILEC performance. As MFS states, it is in the area of performance standards that disputes are most likely to arise and be most contentious.[49] Therefore, MFS strongly recommends, as did TCG, that the Commission impose uniform, pro-competitive national rules, particularly addressing minimum service provisioning standards, service levels and pricing standards applicable to ILECs. MFS also supports TCG's view that a requesting party should have a swift and certain remedy for violations of service standards by an ILEC, such as compensatory damages for failure to install circuits or facilities.[50]

SBC opposes performance standards -- although its very opposition helps establish the foundation for why such standards are so critically necessary. SBC limits its discussion of performance standards to the installation, service and maintenance of local exchange lines. SBC states that "ILECs should simply be required to provide the same installation, service and maintenance intervals to competitors as they do to their own customers. Anything beyond that would not

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[49]MFS at 5.

[50]*Id.* at 16.

be economical, reasonable or practical."[51] What SBC fails to recognize, however, (and, indeed, what the ILECs continually fail to recognize in their Comments) is that competitive telecommunications carriers *are not end users, they are co-carriers.* Thus, the statutory standard that must be applied for installation, service and maintenance intervals to *competitors,* is, at a minimum, what an ILEC applies to itself.[52] The fact that ILECs continue to view their obligations toward competitors as if they are end users demonstrates the strong need for explicit, national performance standards that can be expeditiously implemented through appropriate financial incentives.

The comments filed by other parties also confirm that other entities have experienced ILECs' failures to implement efficient interconnection arrangements in a timely manner.[53] As MFS and AT&T explain in their comments, the ILECs have successfully frustrated the FCC's efforts to implement collocation arrangements, and years after the tariffs were filed the FCC has still not resolved many important issues that were set for investigation, leaving in place tariffs and operating arrangements that are grossly overpriced and anticompetitive.[54]

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[51]SBC at 37.

[52]*See* Sec. 251(c)(2)(c).

[53]*See* examples set forth in Section II of these Reply Comments.

[54]See MFS at 20-21; AT&T at 35-38.

Given the range of anticompetitive actions that ILECs can use to frustrate competition, clear performance standards are necessary to ensure fairness. These performance standards must include required installation intervals, mean time to repair, service availability standards, and similar performance criteria. Several parties agree with TCG that these performance standards will have no teeth without the imposition of financial penalties for failure to meet these standards, similar to the installation guarantees that ILECs already offer to their retail customers if they fail to timely make an appointment or install a service.[55] AT&T expresses this concern when it states: "ILECs must be required to perform ordering, provisioning, maintenance and billing service for ALECs at the same level of quality, and within the same intervals, as they do for their own end-user customers -- so as to ensure that customers do not perceive any differences in the quality in services provided by one carrier as opposed to the other."[56] AT&T also agrees with TCG and MFS that the important areas where such standards are

[55]TCG has been experiencing problems with service quality, ILEC resistance to the implementation of interconnection arrangements, and a host of other problems which it has brought to the attention of regulatory commissions but often with little effect. *Id.*

[56]AT&T at 35. AT&T's use of end-user installation standards is presumably driven by the fact that it is particularly interested in purchasing wholesale end user services, where the installation and other physical characteristics are essentially the same as an ordinary end user retail service. As a facilities based carrier, however, TCG must rely on the ILEC for transport and termination services (not needed for a wholesaler) and unbundled elements in order to compete with the ILEC's retail (and wholesale) services, so it must receive quality equal to that the ILEC experiences in its own network, as the statute requires.

needed include ordering, provisioning, maintenance, repair, billing, real time information exchange and the development of national standards for interfaces.[57]

VI. PRICING METHODOLOGY FOR INTERCONNECTION AND UNBUNDLED NETWORK ELEMENTS.

The consensus of most parties, including the Department of Justice, is that the proper cost standard for unbundled network elements is long run incremental cost ("LRIC") or Total Service Long Run Incremental Cost ("TSLRIC"). The Commission must dismiss proposals to recover shared and common costs via Ramsey pricing (e.g., GTE) or other forms of price discrimination (e.g., Pacific Telesis). Furthermore, contrary to the assertions made by some parties, common costs must not be included in the cost of unbundled elements, as they are not attributable to any element or subgroup of elements.[58] All carriers, including new entrants, incur common costs and they should not be required to pay for the ILEC's common costs as well as their own. Moreover, common costs may hide inefficiencies of a firm and competitors should not be required to subsidize the inefficiencies of the incumbent monopolists.

The reality underlying any discussion of cost studies, however, lies less in the title attached to the study than in the manner in which it is conducted. Simply labeling an embedded cost study as LRIC does not mean it will produce useful

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[57]AT&T at 35-38.

[58]*See, e.g.*, Harris and Yao, U S West Comments.

information. To avoid such problems, the Commission must ensure that any cost study claiming to be a LRIC analysis has the following characteristics:

1. It must use forward looking costs, i.e., the cost of deploying the element using the best available technology at today's prices. Historic, embedded, or book costs are not relevant to the decision to offer a service in the future and are therefore irrelevant.

2. It must account for only those costs directly attributable to a particular element and those costs that are shared among a subset of elements. Common costs, i.e., costs that are not directly associated with any element or any subset of elements, should not be included in the cost of the element.

3. It must not be tied to the existing architecture or deployment practices of the incumbent local exchange carrier. The existing network may not reflect the most efficient deployment of facilities or the latest technology and entrants should not have to pay for the inefficiencies of the incumbent local exchange carrier.

4. It must be available for public scrutiny and comment. To ensure that the studies are in indeed LRIC, all interested parties must have the opportunity to review the study and to suggest revisions to the Commission.

The adherence to these characteristics will ensure that the cost studies will not just be LRIC in name only.

A number of parties, however, recommend costing approaches that do not meet these objectives, and which will work against the efficient pricing of unbundled elements. Pacific Telesis, for example, suggests that universal service issues should be considered in the development of network element costs and prices, ignoring the fact that there is a separate statutory provision governing that issue and the costing standard for unbundled elements does not provide for universal service considerations to be taken into account.[59] Pacific Telesis also suggests that pricing at LRIC would lead it into bankruptcy, but its basis for that statement is flawed.[60] Pacific Telesis also attempts to resurrect the "efficient component pricing rule," but that effort should be soundly rejected by the Commission.[61] Pacific also argues against the use of Benchmark Cost Models ("BCMs"). TCG believes that BCMs represent a step forward in determining the costs of network elements independent of any particular carrier. It would be premature for the Commission to dismiss any particular cost model before interested parties have had an opportunity to review and comment, and thus rather

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[59]Pacific Telesis at 66. While Pacific Telesis claims that economists "around the world" support the ECPR, Pacific offers no support for its claim other than the unique situation in New Zealand, where affiliates of Ameritech and Bell Atlantic compete with an affiliate of MCI, and thus which hardly represents a new and innovative laboratory of local competition.

[60]Pacific Telesis appears to base this argument on a conditional statement by Baumol and Sidak regarding scale economies: "... 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." However, many firms in competitive industries take advantage of scale economies, and the presence of scale economics has not precluded pricing at incremental cost in those industries. While there is no question that ILECs are monopolies or that unbundled elements are unavailable from any other source, ILEC monopoly status is more the result of legal constraints on competition than of any alleged natural monopoly characteristics. All the more reason, therefore, to ensure that the monopoly's prices recover only the LRIC plus some reasonable portion of shared costs, rather than the higher amounts posited by Pacific Telesis.

[61]Pacific Telesis at 69-71. While Pacific Telesis claims that economists "around the world" support the ECPR, Pacific offers no support for its claim other than the unique situation in the New Zealand, where affiliates of Ameritech and Bell Atlantic compete with an affiliate of MCI, and thus hardly represents a new and innovative laboratory of local competition.

than discarding BCMs, the Commission should invite the submission of those and other cost models.

Finally, both Pacific and GTE recommend various forms of price discrimination (*e.g.*, Ramsey pricing) as means of recovering the costs of unbundled network elements.[62] While price discrimination may in theory be economically efficient for a monopoly or a monopolistic firm, it is not competitively neutral nor does it maximize consumer welfare. The fact that ILECs would publicly state a clear desire to discriminate against these competitors in the prices of bottleneck network elements serves as yet another evidence of the need for the Commission to establish a firm set of Preferred Outcomes in order to protect CLECs from predatory or discriminatory pricing of essential network elements by ILECs.

VII. THE COMMISSION MUST ADOPT ARBITRATION RULES THAT WILL EXPEDITE THE ARBITRATION PROCESS THUS PROMOTING COMPETITION.

In its initial comments, TCG recommended that the Commission adopt arbitration rules that will expedite the arbitration process and remove any unnecessary delay in bringing competitive local telecommunications services to the public while recognizing the individual needs of different carriers. Toward this end TCG recommended *inter alia* that the Commission (1) limit the arbitration proceedings only to the parties that will sign the agreement; (2) require that the

[62]Pacific Telesis at 73-77; GTE at 63-64.

arbitrator choose a "best and final" proposal; and (3) adopt rules which permit a party to use commercial arbitrators.[63]

Limiting the arbitration proceedings only to the negotiating parties will allow for a more timely resolution of any unresolved issues and acknowledges that each interconnector have unique interconnection requirements that reflect its individual product line, customer base and network configuration. In addition, mandating that the arbitrators choose from one of the alternatives offered by each of the parties places pressure on the parties to submit recommendations that are reasonable and more likely to be selected by the arbitrator. Use of commercial arbitrators allows parties to seek the assistance of trained, impartial and experienced arbitrators, rather than Commission staff (or Commissioners) who may have no training in the arbitration process.

While SBC agrees with TCG's position that the Commission should adopt national guidelines for "final offer" arbitration, and that arbitrations should be limited to the parties,[64] SBC also makes the extraordinary assertion that under the 1996 Act, arbitration decisions are non-binding. According to SBC, "Congress did not intend for parties to 'be bound' by arbitration decisions under the Act in the sense that they are legally obligated to enter into an agreement after receipt of the

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[63]The specific arbitrations rules which TCG proposed are listed in Appendix A attached to its original comments.

[64]SBC at 103. *See also* MFS at 89 (generally supporting TCG's position on arbitration).

arbitrator's decision. Clearly, if they decide to enter into an agreement, then they must incorporate the arbitrator's decision (unless of course they decide to re-negotiate the entire agreement) . . . ."[65]

Contrary to SBC's fanciful interpretation of the 1996 Act, it explicitly requires that the state commission (or the FCC if the state commission fails to act) approve any negotiated or arbitrated agreement submitted to it. The only narrow exceptions under which the state commission or the FCC may reject certain portions of an interconnection agreement are set forth in Section 252(e)(2)(B).[66] Clearly, if Congress intended that arbitrated agreements would not be binding, it would not have designed a separate, distinct section of the Act explicitly requiring that negotiated agreements be approved except in certain limited circumstances. While SBC's position is baseless, the fact that it would even assert such a claim makes clear the significance of having explicit, national guidelines for the arbitration process.

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[65]SBC Comments at 103. SBC further states that "[T]he law is clear that in the case of compulsory arbitration, as in the act, unless the parties agree in advance to be legally bound by the result, they cannot be found, and are entitled to a de novo court determination of the issues."

[66]Sec. 252(e)(2)(B) states that:

> an agreement (or any portion thereof) adopted by arbitration under subsection (b) if it finds that the agreement does not meet the requirements of Section 251, including the regulations prescribed by the Commission pursuant to section 251, or the standards set forth in subsection (d) of this section.

VIII. THERE IS NO BASIS FOR IMPOSING ILEC REQUIREMENTS ON CLECs.

Some parties assert that the obligations set forth in the 1996 Act which specifically apply to ILECs should be required of all competitive telecommunications carriers.[67] For example, Pacific Telesis states that the Commission should impose the same duties on all similarly situated carriers. If a CLEC has substantially replaced an ILEC, then the Commission should impose Sec. 251(c) duties on the new entrant. Pacific Telesis believes that Commission should define "substantially replaced" flexibly. For example, it states a new entrant will have "substantially replaced an ILEC if its revenues in the area exceed the ILEC's, even if the ILEC has a greater number of subscribers."[68]

Pacific Telesis fails to recognize that the underlying rationale behind assigning additional obligations to ILECs does not apply to CLECs. ILECs own and control ubiquitous bottleneck facilities -- facilities that largely or absolutely cannot be obtained through another means by ILEC competitors or customers. The owners of such facilities, therefore, must be regulated until such time as a true facilities-based, alternative network is in place. Clearly, the 1996 Act recognizes this distinction, as Section 251(c) lists requirements that have been separated out

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[67]*See, e.g.*, Comments of Pacific Telesis Group, Public Utilities of Ohio and Pennsylvania Public Utilities Commission.

[68]Pacific Telesis at 16. The "revenues" test suggested by Pacific Telesis is fundamentally flawed. It ignores the fact that a CLEC may be operating largely as a reseller or wholesaler of the ILEC's services, and therefore most of its revenues would be "passed through" to the ILEC. The CLEC might, therefore, have large revenues but still be functionally and practically dependent on the ILEC.

from the general LEC requirements and set aside as explicit "additional obligations of incumbent local exchange carriers." If the intent of the Act had been to include these obligations for all LECs, there would be no need for a separate section ascribing obligations to ILECs only.

The Department of Justice addresses this claim and promptly -- and insightfully -- dismisses it: "The Department opposes any proposal to impose mandatory duties to deal, beyond those duties deemed necessary by Congress, on parties that lack significant market power."[69] The Department goes on to explain that imposing "such reciprocal obligations on new entrants would be anti-competitive, and thus inconsistent with the pro-competitive deregulatory thrust of the Act." The Department caps off its discussion of this issue with rising eloquence: making obligations reciprocal "purchases speed of negotiation with the coin of forsaken competition. Such a bargain finds no support in either the language or policy of the 1996 Act."[70]

Other parties, like TCG, agree with Justice. As MFS states, a statute must be construed so as "to give effect, if possible to every clause and work . . ., rather than to emasculate an entire section. Therefore, the 1996 Act must be interpreted as prohibiting the imposition of Sec. 251(c) duties on any carriers other than those

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[69]Department of Justice at 22.

[70]*Id.* at 23.

LECs defined by statute, or designated by this Commission as incumbents."[71] This is manifestly the correct answer, and the efforts by Pacific and others to expand the statute beyond its words must not be accepted.

IX. CONCLUSION

In order to achieve Congress' vision of facilities-based competition through negotiated agreements, the Commission must adopt clear national standards -- "Preferred Outcomes." These standards will give CLECs some bargaining ability in their negotiations with the ILECs.

CLECs are today, and will remain for the near future, overwhelmingly dependent on the ILECs. Effective competition cannot begin until that dependence wanes. Today, the CLECs face an overwhelming dependence on the ILEC -- virtually 100% of their local switched calls must be completed on the ILEC's network. The CLECs are, to a large extent, in the position of "customers" of the ILEC, rather than competitors -- their dependence is so extensive and the proportion of their revenues is paid to the ILECs is so large, that they do not represent a true competitive counterbalance. As time goes on and more end users are brought directly on the CLEC networks, the degree of dependence will lessen, but at first competition will be more an illusion than a reality. It is not until the

[71]MFS at 10. *See also* TCI at 13.

CLECs substantially lessen their relative dependence on the ILEC that true facilities-based competition can begin.

The Commission's challenge in this proceeding is to take CLECs from their current state -- a near total dependence on the ILEC and a customer-type status -- through the transition to the beginnings of real competition. In its initial comments, TCG spelled out how the use of a "Preferred Outcomes" approach will permit this evolution to occur, by providing the CLECs with some bargaining leverage to take into their negotiations and arbitrations. A key element of those preferred outcomes is to select "bill and keep" as the transport and termination method of choice, until ILECs can demonstrate that there are carrier-specific "additional costs."

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