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May 30, 1996

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Reply Comments of Jones Intercable, Inc., In The Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98

Dear Mr. Caton:

Pursuant to paragraph 289 of the Notice of Proposed Rulemaking in the above-referenced proceeding, enclosed for filing are an original and sixteen (16) copies of the Reply Comments of Jones Intercable, Inc.

Very truly yours,

Christopher W. Savage
COLE, RAYWID & BRAVERMAN, L.L.P.

Attorneys for
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	CC Docket No. 96-98

REPLY COMMENTS OF JONES INTERCABLE, INC.

JONES INTERCABLE, INC.

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	CC Docket No. 96-98

REPLY COMMENTS OF JONES INTERCABLE, INC.

Introduction and Summary

Jones Intercable, Inc. (Jones) is a large cable television multiple system operator, serving more than one million subscribers in cable systems across the nation. Jones has a vital interest in this proceeding due to its ongoing efforts to offer telephone service to its cable television subscribers (and others) in those areas where it is technically and economically feasible to do so. On May 16, 1996, Jones filed comments in this proceeding on pursuant to the Commission's ***Notice.***[1] Jones now respectfully submits these Reply Comments.

As with its initial comments, Jones has limited its Reply Comments to those issues that it believes to be most important, as a practical matter, to new entrants seeking to rapidly and effectively compete with incumbent local exchange carriers (LECs). Jones's failure to respond to a particular party's comments should not be construed in any way as an agreement with those comments.

Based on its review of other parties' comments, Jones's Reply Comments address the following four issues.

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[1] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, ***Notice of Proposed Rulemaking,*** CC Docket 96-98, FCC 96-182 (released April 19, 1996) (hereinafter "***Notice***").

Uniform National Rules. Some parties question the wisdom of adopting uniform national rules to implement Sections 251 and 252, others even question the Commission's authority to do so, particularly in the area of the pricing standards to be applied to unbundled network elements, mutual traffic termination rates, etc. In fact, Congress not only permitted, but required this Commission to take a leading role in setting such standards, including pricing standards. Sections 251 and 252 rely on negotiations as the primary method to resolve questions regarding the interconnection of competing carriers and the introduction of local exchange competition. Those negotiations can only be expected to bear fruit if all parties have reasonably specific guidance from this Commission about what substantive obligations Sections 251 and 252 actually impose on incumbent LECs and new entrants. The parties will always remain free to waive those obligations under Sections 252(a)(1) and 252(e)(2)(A); but without a common understanding of what the obligations are, meaningful negotiations will be problematic.

Claims That Incremental Cost-Based Prices Are "Confiscatory." Some Regional Bell Operating Companies ("RBOCs") and GTE argue that setting prices on the basis of an estimate of forward-looking incremental cost would constitute "confiscation" under the Fifth Amendment. GTE also argues that requirement on incumbent LECs for physical interconnection with others' networks removes these claims from the normal standards used to determine whether a rate is confiscatory, and requires a "takings" analysis under the rule of ***Loretto v. Teleprompter***, 458 U.S. 419 (1982). These arguments are wholly unjustified. GTE's "takings" claim is frivolous at best. And, under long-accepted Fifth Amendment standards applicable to regulated LECs, there is simply no constitutional bar to using an incremental cost standard to set rates for items provided under Sections 251 and 252.

Restrictions on Resale. Some RBOCs and GTE have asked this Commission to approve, or to explicitly give the states authority to approve, a wide range of exceptions to their broad obligation under Sections 251(b)(1) and 251(c)(4) to make their retail services available for resale. The Commission should reject all of these requests and instead declare that the only restriction on resale that will be tolerated is one that limits the resale of explicitly subsidized

offerings targeted to customers of limited means (i.e. lifeline offerings). ***All*** other services — including residence services, business services, measured services, flat-rate services, vertical services, and ancillary services — should be fully available for resale. If an incumbent LEC is prepared to offer a service in the marketplace under particular terms and conditions to end users, that same service must be available for resale and shared use arranged by third parties as well.

Mandate "Type 1" Interconnection At Rates That Comply With The Act. While the record in this proceeding reflects a certain amount of attention to interconnection architectures that are likely to be of use to firms like AT&T, MFS, and others similarly situated, Jones believes that the Commission's final order should also expressly focus on, and expressly require that incumbent LECs make available, interconnection on the "Cellular Type 1" model, at rates determined in accordance with the pricing standards of the Act. In Jones's experience, this otherwise simple and readily understood technical mode of interconnection can be rendered infeasible as a method for providing local exchange competition if it is subject to traditional cellular-type pricing standards, which essentially impose tariffed PBX trunk and usage rates on a network-to-network interconnection.

I. This Commission Can And Should Issue Nationally Binding Rules To Implement Sections 251 And 252.[2]

A number of parties challenge not only the wisdom of this Commission issuing nationally binding rules to interpret and implement Sections 251 and 252, but also the Commission's authority under the statute to do so.[3] Both of these challenges are misplaced

[2] This section of these Reply Comments addresses issues raised in Part II.A. of the ***Notice.***

[3] ***See, e.g.,*** Initial Comments of National Associations of Regulatory Utility Commissioners ("NARUC Comments"), ***passim;*** Comments of GTE Service Corp. ("GTE Comments") at 2-12; Comments of Bell Atlantic ("Bell Atlantic Comments") at 2-8; Comments of the United States Telephone Association ("USTA Comments") at 5-8.

A. Nationally Applicable Rules Are Necessary To Promote Local Exchange Competition And To Facilitate Meaningful Negotiations.

Broadly speaking, it is completely sensible for this Commission to impose national rules for local exchange competition. The entire premise behind enacting Sections 251 and 252 into ***federal*** law is that on the whole, local exchange markets throughout the nation are more similar than different, presenting essentially the same opportunities for incumbents to exploit their market power and essentially the same challenges for new entrants seeking to break into the market.

From this perspective, simply by acting in the form of specific federal legislation, Congress has chosen to prescribe federal-level principles and requirements that will work to promote the development of competition in all local exchange markets throughout the country. Subject to exemptions for smaller LECs in Section 251(f), ***all*** incumbent LECs must interconnect with new entrants using mutual compensation arrangements; ***all*** incumbent LECs must make their services available for resale; and ***all*** incumbent LECs must provide unbundled access to network elements. At this level, nationwide, binding rules already exist. Section 251(d)(1)'s direction to this Commission to establish the regulations needed to implement the requirements of the law simply involves filling in the details of an inherently national policy.

Even so, GTE and others caution against the Commission adopting a "one size fits all" approach.[4] Their stated concern is that real, practical differences in the operating characteristics of different LECs (or the same LEC in different areas) could result in situations where a seemingly sensible national rule will either be physically impossible to comply with, or, if technically possible, unreasonably expensive. For example, if network elements are defined with great particularity, it may be that only certain central office switches are capable of offering

[4] GTE Comments at 7-12; NARUC Comments, ***passim.***

some elements, so it would be a mistake to require all incumbent LECs to offer all of them in all areas.[5]

These are not really arguments against national rules. They are arguments against national rules that do not make reasonable accommodations to reflect the differences that, upon a fair survey of the local exchange industry, actually exist in different areas. To that extent, GTE is certainly correct: rules that ignore the actual diversity in operating arrangements within the industry can create needless problems. The solution to these problems, however, is not for the Commission to abandon the development of generally applicable rules, but instead to apply common sense in fashioning them. The rules should permit an incumbent LEC to show in a state commission arbitration or mediation proceeding that it cannot meet a particular requirement in a particular situation by reason, for example, of not having the type of switch that supports the capability that the interconnector seeks.

There is no evidence whatsoever that the kinds of technical variations addressed by GTE and others break down along state-specific jurisdictional lines. The individual companies most affected by national rules -- GTE and the RBOCs -- offer their services in many different states. Similarly, challenging geographic situations that might affect technical feasibility in some cases, such as hilly terrain, low population density, marshy ground, etc.,[6] exist in many different states. As a result, setting rules on a state-by-state basis simply would not address the problem of providing sensible exceptions to otherwise generally applicable rules.

The potential scope of the problem, moreover, can be greatly overstated. Indeed, Congress has anticipated and dealt with this problem in the case of the hundreds of smaller LECs

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[5] GTE notes that its network uses a type of switch not often found in non-GTE networks, and that even "the same" switch may have differing actual capabilities depending on the particular software release the switch is running. GTE Comments at 8-12, 18-20.

[6] ***See*** GTE Comments at 7-8.

that serve often highly rural areas with relatively few customers and are most likely to require special handling. Truly rural LECs are exempt from the requirements of Section 251(c) until they receive a bona fide request for compliance ***and*** the state commission has determined that compliance is not unduly burdensome and is technically feasible. ***See*** Section 251(f)(1). And relatively small LECs (those serving less than 2 percent of the nation's access lines) are entitled to exemptions from the requirements of ***both*** Section 251(b) and Section 251(c) if they can show that complying with those requirements would be technically infeasible, unduly burdensome for the LEC, or would create economic harm for customers. ***See*** Section 251(f)(2).[7]

What these provisions mean in practical terms is that the numerous smaller carriers that would reasonably need special exemptions under the Commission's regulations are plainly entitled to them under the law. As a result, the Commission's general regulations under Section 251 will not immediately apply with full force to these firms. Instead, those regulations will apply primarily to the eight corporations who together serve an overwhelming majority of access lines not covered by the Section 251(f) exemptions: GTE and the RBOCs. The Commission should be highly skeptical of claims by these highly sophisticated, multi-billion dollar entities that they will be technically incapable of meeting any reasonable regulatory requirements that might be imposed on them, or that they will have difficulty clearly and convincingly articulating, in the context of a waiver request or arbitration proceeding, why a particular generally applicable requirement cannot legitimately be applied in some specific situation.

The Commission need not be concerned that GTE and the RBOCs will somehow be haplessly forced into taking steps that make no technical or economic sense. Rather, the Commission should be concerned with these entities' ability to use their enormous market power,

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[7] In this regard, while most "rural" LECs would clearly qualify for both categories of exemptions, the 2 percent limitation in Section 251(f)(2) actually permits some very large firms to seek exemptions from the requirements of the law. A firm serving 2,000,000 access lines, for example, would probably have annual revenues measured in the hundreds of millions of dollars, but would fall below the 2 percent threshold.

financial resources, and technical sophistication to impose roadblocks to the development of competition. For this reason. while some kind of waiver process should certainly be included in the final rules, the Commission should be very cautious in allowing exemptions from the rules for GTE or the RBOCs (or the relatively few other firms that will not qualify under Section 251(f)). If one of these firms requests an exemption from competitively sensitive rules, such as those regarding interconnection arrangements or the degree of network unbundling required under Section 251(c)(3), it should bear a heavy burden of showing that real and substantial harm will occur if the exemption is not granted.

This discussion highlights the danger of some features of the LECs' proposals to rely on a bona fide request procedure for determining which network elements and interconnection arrangements will be made available beyond the initial basic list the Commission prescribes in this proceeding.[8] It clearly makes sense to have some sort of orderly process by which new entrants can request that an incumbent LEC provide a seemingly feasible network element or interconnection arrangement that has not been anticipated in this Commission's rules. But the Commission should reject the LECs' proposed requirements that a new entrant making a bona fide request commit to purchase the item being requested or bear the cost of developing the offering.[9]

These proposed requirements are simply an invitation to abuse by the incumbent LECs. Section 251(c)(1) already requires both the incumbent LEC and the new entrant to negotiate in good faith regarding interconnection agreements. This means that new entrants may not properly demand that incumbent LECs expend hundreds of hours of engineering time to develop a new interconnection architecture based on nothing more than the new entrant's casual curiosity about whether the architecture might work But this also means that the incumbent LECs must be willing to expend a reasonable amount of time and effort, without charge to the

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[8] ***See*** Bell Atlantic Comments at 17-20.

[9] Bell Atlantic Comments at 18.

new entrant, seeking to resolve real technical issues surrounding serious proposals for interconnection or unbundling. In the highly technical field of telecommunications network engineering, expending reasonable efforts of this sort is simply what "negotiating in good faith" means.

Making due allowance for the posturing that will inevitably arise in the context of a regulatory scheme based on negotiations, the Commission can reasonably expect that in most cases the real issue in any dispute about whether a particular sort of interconnection arrangement or network element should be made available will not be its technical feasibility, but rather its cost. Many participants in the industry (long distance carriers and competitive access providers ("CAPs") most prominently) are already very familiar with the capabilities of existing types of central office switches, transmission facilities, and related equipment, while new entrants without such expertise will be hard-pressed to function effectively in the local exchange market without obtaining such expertise. This means that, again with a reasonable allowance for posturing in negotiations, new entrants are unlikely to insist that an incumbent LEC take steps that are not technically achievable. The more likely dispute will be an incumbent LEC claiming that meeting a particular requirement will cost more than the new entrant believes is reasonable or realistic.

This brings into sharp focus the practical need for clearly stated and nationally applicable standards for pricing unbundled network elements, interconnection arrangements, and other services the incumbents are required by the law to provide. If the new entrant's view of a fair price is based on a forward-looking incremental cost analysis using the most efficient available technology,[10] while the incumbent LEC's view of a fair price is based on fully-allocated embedded costs, an allowance for unrecovered depreciation reserve deficiencies, and a "reasonable profit" based on a Ramsey pricing approach,[11] there is little chance that negotiations will be productive. New entrants will naturally favor costing approaches that lead to lower

[10] ***E.g.***, Comments of AT&T Corporation ("AT&T Comments") at 46-54.

[11] ***E.g.***, GTE Comments at 59-72.

prices, while incumbent LECs will naturally favor costing approaches that lead to higher prices. Unfortunately, the concept of what constitutes an appropriate "cost" for setting prices in the telecommunications industry is sufficiently muddled that radically divergent views — leaving no logical middle ground for a negotiated solution — may be held by the respective parties in complete "good faith."[12] On the other hand, once the Commission articulates what constitutes a reasonable basis for determining prices in particular cases, the parties will have something sensible to negotiate about. In these circumstances, the Commission ***must*** adopt ***some*** pricing standards in order for the basic framework of the law — reliance on carrier-to-carrier negotiations to solve most problems — to work.

Indeed, unless the Commission adopts nationally applicable pricing standards, every negotiation will lead to a regulatory lottery before the affected state commission, which will be pressed to accept one or another wildly divergent costing/pricing philosophy on an ad hoc basis. It would be inevitable in these circumstances for different states to develop different pricing rules, making it systemically harder to compete in some states (those that adopt rules that permit higher charges to new entrants) than others (those that adopt rules that require lower charges). This balkanization of the nation into jurisdictions that are "competition-friendly" and jurisdictions that are "competition-averse" is precisely what Congress was trying to end by passing Sections 251 ***et seq.*** in the first place.

For all of these reasons, Jones urges the Commission to adopt nationally applicable rules governing the interconnection arrangements and unbundled network elements that incumbent LECs must offer new entrants, as well as nationally applicable pricing standards regarding those

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[12] Jones notes that the comments in this proceeding include the views of an impressive array of highly qualified economists that appear to support very different end results in the area of pricing. ***Compare, e.g.,*** AT&T Comments at 46-54 and associated attachments ***with*** GTE Comments at 59-72 and associated attachments. ***Cf. Permian Basin Area Rate Cases,*** 390 U.S. 747, 790 (1968) ("[N]either law nor economics has yet devised generally accepted standards for the evaluation of ratemaking orders").

items. Otherwise, it will be essentially impossible for the congressionally-mandated policy of local exchange competition based on carrier-to-carrier negotiations to work.

B. There Are No Legal Obstacles To The Creation Of Nationally Applicable Rules.

Numerous state regulators, as well as a number of incumbent LECs, argue that the Commission lacks the legal authority to adopt rules — notably, but not limited to, pricing rules — to implement Section 251 that are binding on the states in proceedings under Section 252.[13] These commenters claim both that Section 251(d)(1) does not contemplate the issuance of rules binding on the states, and that, Section 251(d)(1) notwithstanding, the rule of ***Louisiana PSC v. FCC,*** 476 U.S. 355 (1986), Section 2(b) of the Communications Act, and/or Section 601(c)(3) of the 1996 Telecommunications Act indicate that Congress did not want the Commission to issue such rules. None of these claims has merit.

First, it is absolutely clear that Congress intended this Commission's rules implementing Section 251 to be fully binding on the states. Other than reviewing negotiated agreements under the lenient standard of Section 252(e)(2)(A) — which permits parties to agree to disregard the requirements of Section 251 altogether if they choose — ***every*** provision of Section 252 that provides a rule of decision for state commissions specifically requires those commissions to follow this Commission's regulations:

- **Resolution of Specific Issues Presented for Arbitration:** "In resolving by arbitration under subsection (b) any open issues and imposing conditions

[13] ***See, e.g.,*** NARUC Comments, ***passim;*** GTE Comments at 2-12; Bell Atlantic Comments at 2-8; Initial Comments of the Virginia State Corporation Commission at 1-3; Comments of the South Carolina Public Service Commission at 2. Section 251(d)(1) itself clearly directs this Commission to issue any and all necessary regulations to implement Section 251. While some have suggested that few regulations are "necessary," on the ground that the statute speaks for itself, ***e.g.,*** NARUC Comments at 6, the profound disagreements about what Section 251 really requires shown in the comments demonstrate that regulations are, indeed, necessary.

upon the parties to the agreement, a State commission shall—(1) ensure that such resolution and conditions meet the requirements of section 251, ***including the regulations prescribed by the Commission pursuant to section 251.***"

- **Approval of Agreements Following Arbitration:** "The State commission may only reject ... (B) 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*** "

- **Approval of a BOC's "Statement of Generally Available Terms":** "A State Commission may not approve such statement unless such statement complies with ... section 251 ***and the regulations thereunder.***"

This means that the Commission may determine, for example, what network elements and interconnection arrangements incumbent LECs must offer, what conditions may (or may not) be placed on the resale of incumbent LEC services, what constitutes "technical feasibility," and so on, and that state commissions ***must*** abide by those regulations in any contested proceedings under Section 252.

The only question, then, is whether the Commission's regulations under Section 251(d)(1) may lawfully encompass pricing standards. If so, then under the provisions quoted above, those standards are binding on state commissions under Section 252 as part of the "regulations prescribed by the Commission pursuant to Section 251" with which state commissions must comply.

Those who claim that the Commission may ***not*** promulgate pricing standards rely on the fact that Congress placed the statutory provisions regarding pricing not in Section 251, but in Section 252(d), and the fact that in each of the provisions quoted above, accompanying the injunction to state commissions to act in accordance with this Commission's regulations is

a separate injunction to act in accordance with Section 252(d).[14] While these observations are both correct, neither supports the conclusion that Congress has placed pricing standards beyond the purview of this Commission's regulations under Section 251.

The reason is that Section 251 itself — as to which the Commission is ***required*** by Section 251(d)(1) to promulgate all necessary regulations — contains pricing standards of its own. Under Section 251(b)(5), arrangements for mutual traffic exchange must be based on "reciprocal compensation." Under Section 251(c)(4), incumbent LECs' retail telecommunications services must be made available to new entrants for resale "at wholesale rates." And under Sections 251(c)(2) and 251(c)(3), interconnection arrangements and network elements, respectively, must be priced at levels that are "just, reasonable and nondiscriminatory." Since the Commission's authority to issue regulations under Section 251 plainly extends to these statutory provisions, the Commission is empowered to adopt regulations to clarify and define what constitutes a suitable "reciprocal compensation" arrangement, a sufficiently low "wholesale rate" when compared to retail, or a "just and reasonable" interconnection or network element price. And, as noted above, these regulations are fully binding on state commissions under the express terms of Section 252.

This raises the theoretical prospect of a conflict between the Commission's regulations establishing pricing standards, adopted under Section 251, and the specific pricing standards of Section 252(d), which state commissions are separately enjoined to follow. But the conflict is theoretical only, because this Commission has already recognized that its "Section 251" regulations regarding pricing standards must comport with Section 252(d).[15] Indeed, it would be nonsensical for this Commission to try to develop pricing standards to implement Section 251 on the basis of a contrived ignorance of what Congress said about pricing in Section 252(d). If there were any doubt on this score, Sections 251(c)(2) and 251(c)(3) both expressly require that

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[14] ***See, e.g.,*** NARUC Comments at 17-20.

[15] ***See Notice*** at ¶ 177

prices be set "in accordance with ... the requirements of this section [Section 251] ***and*** section 252." The only logical conclusion in these circumstances, therefore, is ***not*** that the Commission may not promulgate pricing rules. It is that the Commission may do so, but the rules it promulgates must not contravene Section 252(d).[16]

Perhaps recognizing that any logical reading of Sections 251 and 252 in isolation plainly empowers the Commission to adopt binding regulations regarding all aspects of local exchange competition (including pricing standards), some commenters also assert that extraneous legal principles — the ***Louisiana*** case, Section 2(b) of the Act, or Section 601(c)(3) of the 1996 amendments — prevent such rules from being adopted.[17] These assertions are baseless.

In ***Louisiana***, the Court applied standard principles of preemption to this Commission's attempt to prescribe depreciation rates for intrastate assets. In light of Section 2(b)'s express statement that intrastate ratemaking matters fell under the purview of state law, the Court held that this Commission was not empowered to preempt state law in ratemaking matters regarding intrastate services. ***Louisiana*** provides a good statement of general preemption principles. But the fact that the Court in 1988 decided that a particular exercise of this Commission's authority to prescribe depreciation rates under Section 220 of the Communications

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[16] In this regard, if a party to this proceeding is convinced that the pricing rules this Commission ultimately adopts ***do*** contravene Section 252(d), that party may seek judicial review of those rules under normal procedures. On the other hand, if a state commission adjudicating a dispute under Section 252 is convinced that this Commission's regulations (which it is bound to follow) conflict with Section 252(d) (which it is also bound to follow), then its obligation is to try to harmonize whatever conflict it perceives to the best of its ability. Any party aggrieved in ***that*** proceeding can take its complaint to federal District court under the terms of Section 252(e)(6), which will review the matter under the terms of ***both*** Section 251 and 252. Clearly, however, neither of these strained and hypothetical potential "conflicts" between this Commission's pricing-related regulations and Section 252(d) remotely suggests that Congress did not intend this Commission to issue such regulations in the first place.

[17] NARUC Comments at 13-14 (§ 601 issue), ***passim;*** Bell Atlantic Comments at 5 n.2 (§ 601 issue), 2-8; GTE Comments at 2-7.

Act was not sufficient, under those principles, to preempt state law obviously says nothing about the impact of ***Sections 251 and 252*** (and the rest of new Part II of Title II) on state law.

As noted in ***Louisiana,*** the key question in any preemption analysis is whether Congress intended to preempt state law. 476 U.S. at 369. Undoubtedly, that is exactly what Congress intended to do in enacting Sections 251 and 252. Prior to the passage of the 1996 Act, essentially all questions relating to local exchange competition were questions of state law. The reason was that Section 2(b) of the Act expressly divested this Commission of jurisdiction over intrastate telecommunications, and (with the exception of interstate access services), essentially all local exchange services and activities were intrastate in nature. Yet in Sections 251 and 252, Congress has plainly and directly legislated regarding all aspects of local exchange competition. Issues such as the provision of access to operator services, directory assistance, and white pages directory listings; restrictions on the resale of local exchange services; obligations to interconnect for the mutual termination of local exchange traffic; and the availability of network elements for the provision of local exchange service are all plainly "intrastate" issues under the terms of Section 2(b). These matters, however, are now all subject to federal standards, including this Commission's regulations; and, under Section 252, state commissions are bound to follow both the statutory standards and the regulations. Finally, any doubt about whether local exchange competition is now a federal matter should be finally resolved by Section 252(e)(4), which states that "[n]o state court shall have jurisdiction to review the action of a State commission in approving or rejecting an agreement under this section," and Section 252(e)(6), which specifically directs "any party aggrieved by" a state commission's decisions to "an appropriate federal District court."

What all this means is that the normal inquiry under Section 2(b) — "Does the matter in question relate to interstate or intrastate activities or services?" — simply does not apply to matters that fall within the purview of Section 251 and Section 252. These are now federal questions, pure and simple, to be decided under federal statutory and regulatory standards and resolved, if need by, by federal courts. Consequently, neither ***Louisiana*** nor Section 2(b) acts

in any way to bar this Commission from issuing regulations under Section 251 that are binding on the states. The issuance of such regulations is exactly what Congress had in mind.[18]

These considerations also answer any argument under Section 601(c)(3) of the 1996 Act, which, according to NARUC, bars "implied" preemption of state law.[19] As the Court stated in ***Louisiana,*** "the best way of determining whether Congress intended the regulations of an administrative agency to displace state law is to examine the nature and scope of the authority granted by Congress to the agency." 476 U.S. at 373 In Section 252, Congress said plainly and directly that state commissions must apply federal law, including this Commission's regulations. One could conceivably argue that Congress could have made matters even more plain by saying that state commissions must follow federal law "even if there is a conflict with some state law." But under any fair reading, Congress's direct command to state regulators to follow federal law is hardly an "implied" preemption of the sort addressed by Section 601(c)(3).

[18] The fact that Congress did not amend Section 2(b) to exclude Sections 251 ***et seq.***, as it did with Section 332, ***see*** NARUC Comments at 10; GTE Comments at 4-5, is irrelevant. For Section 332, an amendment to Section 2(b) was needed because without one, end user rates for some wireless services, as well as the basic authority of some firms to provide wireless services within a state, would logically have been subject to Section 2(b)'s traditional interstate/intrastate division of responsibility. As described in the text, Section 251 and 252 do not contemplate parceling out regulatory responsibilities between state and federal jurisdictions. To the contrary, those sections embody a direct federal ***assertion*** of jurisdiction over matters that were previously classified, ***under Section 2(b) itself,*** as matters of state law. This means that Section 2(b) inherently cannot apply to Sections 251 and 252. Amending Section 2(b) to exclude them, therefore, would have been totally unnecessary.

[19] NARUC Comments at 13-14; Bell Atlantic Comments at 5 n.2.

II. There Is No Constitutional Bar To Setting Prices For Interconnection Arrangements, Network Elements, And Other Services Required To Be Provided Under The Law On The Basis Of Incremental Costs.[20]

GTE and others claim that it would violate the Constitution for this Commission to set interconnection rates based on forward-looking incremental cost.[21] This is so, they claim, because for a firm with high joint and common costs, setting rates at incremental cost will necessarily result in substantial under-recovery of costs. As a result, they claim, the only proper basis for setting interconnection and network element rates is some measure of fully allocated, embedded cost.[22]

This argument suffers from two fatal flaws. First, it confuses two fundamentally different ratemaking concepts: revenue requirement and rate design. A regulated entity is entitled to rates that ***in the aggregate*** are not "confiscatory" in a constitutional sense. But there is no constitutional entitlement to have any one rate, or any particular set of rates, set at non-confiscatory levels when considered in isolation.[23]

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[20] This section of these Reply Comments addresses Part II.B.2.d. of the ***Notice.***

[21] ***See, e.g.,*** GTE Comments at 65-71; Bell Atlantic Comments at 37-38.

[22] GTE Comments at 61-63, 65-67.

[23] ***See, e.g., Colorado Interstate Gas Co. v. FPC,*** 324 U.S. 581, 593-94 (1944) (whether regulatory action is confiscatory may properly be assessed on the basis of its impact on the entirety of the firm's regulated activities). GTE claims that the new conditions established by the Act somehow require the rates for "Section 251" services to be assessed separately, for constitutional purposes, from all other regulated services an incumbent LEC providers., but its only case support for this novel proposition simply restates the general rule that non-regulated revenues cannot justify a confiscatory rate for regulated services. GTE Comments at 69-71.

This principle derives from the fact that what is protected from confiscation by the Fifth Amendment is confiscation of the investor's overall investment in the regulated business.[24] As long as the total revenues from the regulated business are sufficient to cover operating expenses, pay lenders for borrowed money, and provide earnings sufficient to attract capital, the regulated firm has no constitutional basis for complaint. Indeed, it is precisely to avoid inquiries into the specific details of regulatory methodology -- including regulatory arcana such as costing standards and the rates set for a few services out of dozens or hundreds offered by a regulated firm — that led the Supreme Court to adopt the "end result" test in ***Hope Natural Gas v. FPC.***[25] As long as the "end result" of a rate order is not unjustly confiscatory, the constitutional inquiry is at an end.[26]

GTE argues that this normal rule does not apply because the services that the Commission proposes to price at incremental cost entail mandatory physical interconnection of incumbent LECs' networks to the networks of new entrants. In GTE's view, this converts a garden-variety utility rate analysis into a separate species of constitutional "taking," to be

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[24] "The thing devoted by the [regulated company] investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise. Upon ***the capital so invested***, the Federal Constitution guarantees to the [regulated company] an opportunity to earn a fair return." ***Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n,*** 262 U.S. 277, 290 (1922) (Brandeis, J., concurring) (emphasis added). In this regard, courts have noted that Justice Brandeis's "central idea that the investor's legally protected interest resides in the ***capital he invests*** in the [regulated firm] rather than the items of property which the capital purchases for provision of [regulated] service" has prevailed. ***Democratic Central Committee v. Washington Metro Area Transit Commission,***, 485 F.2d 786, 801 (D.C. Cir. 1973) (emphasis added). ***See also Duquesne Light v. Barasch,*** 488 U.S. 299, 309 (1989).

[25] 320 U.S. 591 (1944).

[26] "[I]t is not the theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important." ***Duquesne Light, supra,*** 488 U.S. at 210, ***quoting Hope Natural Gas Co.,*** 320 U.S. at 602. The Court characterized this as an "end result" test in the ***Permian Basin Area Rate Cases,*** 390 U.S. 747, 791 (1968). ***See also Illinois Bell v. FCC,*** 988 F. 2d 1254, 1260 (D.C. Cir. 1993).

evaluated under the doctrine of ***Loretto v. Teleprompter.***[27] This claim is utterly without merit. It is impossible for any LEC to provide service without physically connecting its facilities to facilities owned by others. With end user customers, this physical connection occurs at the rate demarcation point on the customer's premises. ***See*** 47 C.F.R. § 68.3. With long distance customers, this physical connection occurs at the long distance carrier's point of presence. With CAPs, this physical connection takes place in a manhole outside a central office (virtual collocation) or by means of cross-connections inside the central office (physical collocation). With co-carriers in existence prior to the 1996 Act (***e.g.***, independent telephone company-to-BOC), this physical connection typically takes place at a "mid-span meet" at the border of the two companies' territories.[28]

Particularly bizarre in this regard is GTE's apparent view that carrying messages to its customers that may have originated on another carrier's network constitutes a "physical occupation" of its facilities by a third party.[29] First, if this analysis were correct, then providing terminating access service to IXCs, or similar services to cellular carriers, entails a "taking" subject to compensation in the ***Loretto*** sense, as compared to the provision of a regulated common carrier service provided subject to the right to receive non-confiscatory rates in the ***Hope Natural Gas/Duquesne Light*** sense. Essentially, this would mean that the entire line of utility ratemaking cases is inapplicable to telecommunications -- a wholly frivolous claim after nearly a century of state and federal regulatory activity treating telecommunications common carriers like other regulated utilities. Second, GTE's claim ignores the fact that in carrying these calls, it is actually performing a service for its own customers, who want to receive calls intended for

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[27] 458 U.S. 419 (1982). ***See*** GTE Comments at 66-68. GTE also relies on two more recent "takings" cases: ***Dolan v. Tigard,*** 114 S. Ct. 2309 (1994) and ***Lucas v. South Carolina Coastal Council,*** 505 U.S. 1003 (1992).

[28] Probably the only type of telecommunications service that does not involve a physical contact in the ***Loretto*** sense is the connection between a CMRS customer and a cell site handling a wireless call.

[29] ***See*** GTE Comments at 57-58, 66-68.

them just as surely as they want to make calls. In this regard, in the ongoing universal service proceeding, the Commission has proposed to include the ability to ***receive*** calls as a part of the "universal service" that carriers are expected to provide to ***their own customers.***[30] Incoming calls, therefore, no more constitute a foreign invasion of GTE's network subject to a separate "takings" analysis than do calls that its customers originate.[31] Third, GTE's analysis is wrong in physical terms as well. Carrying "other parties'" telecommunications on GTE's system does not entail any physical invasion of that system. In carrying telecommunications, the intangible ***patterns*** in electromagnetic wave forms and/or optical laser pulses embodied in equipment within GTE's network change. These changed patterns contain the intangible ***information*** that comprise the messages that GTE is carrying. Requiring GTE to change these patterns in order to convey messages cannot reasonably be analogized to ***Loretto,*** where building owners were being required to attach a physical, tangible wire to a piece of real estate.

The fact that GTE (and, presumably other incumbent LECs) will only be providing the connections to new entrants under regulatory and/or statutory duress has no impact on the applicable constitutional standard. Part of the obligation of being a regulated telecommunications common carrier is to provide services deemed to be necessary by regulators whether the regulated

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[30] ***See*** In the Matter of Federal-State Joint Board on Universal Service, ***Notice of Proposed Rulemaking and Order Establishing Joint Board,*** CC Docket No. 96-45, FCC 96-93 (released March 8, 1996) at ¶ 16. In this regard, Bell Atlantic raises an analogous "takings" claim in the context of bill-and-keep compensation arrangements, relying on ***Nollan v. California Coastal Commission,*** 483 U.S. 825 (1987). Bell Atlantic Comments at 41-42. Bell Atlantic claims that bill-and-keep forces carriers to incur traffic termination costs, but "precludes them from recovering these costs." As Jones explained in its Initial Comments, however, this is simply untrue. Bill-and-keep allows a carrier to fully recover the cost recovery of terminating calls to its end users. It simply requires those end users, not the end users of the other carrier, to bear those costs.

[31] The fact that GTE's own customers desire to receive the incoming calls as to which GTE now apparently takes such umbrage eviscerates GTE's claim (GTE Comments at 68-69) that requiring GTE or other incumbent LECs to terminate such calls places any "disproportionate burdens or costs" on incumbent LECs under the doctrine of ***Dolan, supra,*** or ***Yee v. Escondido,*** 503 U.S. 519 (1992).

common carrier "wants" to provide them or not.[32] Indeed, in most jurisdictions, not only can regulators establish minimum service obligations that regulated carriers must meet, the regulated carrier cannot even withdraw a service from the market without specific prior approval of the regulators.[33]

These obligations — inherently including the obligation to physically interconnect with customers and other carriers of various stripes -- do not magically transfer the constitutional analysis from the standard ***Hope/Permian Basin/Duquesne Light*** line of "confiscation" cases to the ***Loretto/Nollan/Lucas/Dolan*** line of "takings" cases. To the contrary, it is only by virtue of the existence of these obligations that GTE and the RBOCs are entitled to ***any*** constitutional protection of their investments at all, and it has been settled for more than fifty years, at least since ***Hope,*** that the regulated firm has no constitutionally cognizable problem if, at the end of the day, the total amount of money received by the firm is enough to make ends meet. Until the incumbent LECs can make a credible showing that the rates imposed by regulators, in the aggregate and for all of their regulated services, produce revenues so meager as to be confiscatory in a constitutional sense, this Commission is free to use any reasonable method to set particular rates that its expertise and judgment commend to it.[34]

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[32] ***See, e.g., Duquesne Light, supra,*** 488 U.S. at 307

[33] ***See*** 47 U.S.C. § 214(a); ***Southwestern Bell v. FCC***, 19 F.3d 1475 (1994).

[34] Just as the incumbent LECs are not entitled to a rate for each individual regulated service that is non-confiscatory when viewed in light of the properly defined costs of that service, ***see Colorado Interstate Gas Co., supra,*** the incumbent LECs are also not entitled even to an overall revenue stream that is non-confiscatory in any particular ***year.*** Instead, regulators have considerable discretion to assess the reasonableness of earnings over a multi-year period. ***See, e.g., Virgin Islands Telephone Company v. FCC,*** 989 F.2d 1231, 1238 (D.C. Cir. 1993) (noting this Commission's two-year "monitoring period" for rate of return regulated LECs, and indicating that rate of return regulation inherently calls for a "temporal mooring"); ***City of Ottawa, Illinois v. Sammons Communications,*** 836 F. Supp. 555 (N.D. Ill. 1993) (noting that the reasonableness of a firm's return on long-lived assets should be assessed over the life-cycle of those assets). In fact, this Commission inherently assesses the reasonableness of LEC returns over a multi-year period when it establishes depreciation lives for LEC assets under Section 220. In any particular year, both the LEC's rate base (gross plant less

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The second fatal flaw in the LECs' constitutional argument is that, in rapidly changing technological and market conditions such as those that confront the telecommunications industry today, it is far from clear that the LECs would necessarily be entitled to rates sufficient to recover their embedded costs in any event. There are several reasons for this conclusion. First, there is no constitutional entitlement to the use of an embedded cost rate base in setting rates. While regulators may not arbitrarily jump from one ratemaking methodology to another in order to harm the regulated firm, neither are regulators forever bound to one particular method of determining rate base if changed conditions reasonably warrant a change in regulatory approach.[35]

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[34](...continued)
accumulated depreciation) and expense levels (depreciation expense), and, therefore, its regulatory "earnings" are affected by the depreciation rates applied to various classes of assets. Accounting "losses" can almost always be generated by accelerating depreciation of assets to a sufficient degree. (The extreme case is writing them off in one year; ***see*** AT&T Comments at 71-72 & n. 105.) So even if GTE's dire predictions of massive under-recovery of embedded costs (calculated in the traditional manner) were to eventually come true in one particular year, and even if that under-recovery were directly attributable to this Commission's decision to set certain LEC rates under the 1996 Act on the basis of incremental cost, that ***still*** would not necessarily entail "confiscation" in the constitutional sense if this Commission were to reasonably determine that the appropriate period for assessing earnings were longer than one year and losses were not incurred over that longer period viewed as a whole. ***Cf.*** AT&T Comments at 71 & n. 104 (noting substantial LEC over-earnings, over several years, under price cap regulation).

[35] ***See Duquesne, supra,*** 488 U.S. at 315-16. While the Court did indeed caution against the possibility of a state "arbitrarily switch[ing] back and forth between methodologies," 488 U.S. at 315, the Court also noted that "[t]he adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since ***Hope Natural Gas, supra.*** As demonstrated in Wisconsin v. FPC, [373 U.S. 294 (1963),] circumstances may favor the use of one ratemaking procedure over another." 488 U.S. at 316. In ***Wisconsin,*** the Court observed that "[i]t has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates." 373 U.S. at 309.

In this regard, as noted above, several LECs have taken large "write-offs" against earnings reported for financial reporting purposes to reflect diminished asset values caused by the possibility, or actuality, of competition. ***See*** AT&T Comments at 71-72 & n. 105. Any inquiry into whether revenues from regulated services are unconstitutionally low — in the sense of providing an inadequate return to investors — would logically never acknowledge the existence of an investment base larger
(continued...)

Second, whatever method is used to set the rate base (against which the existence of a "reasonable return" is measured), it has long been settled that regulation does not guarantee the regulated firm a profit,[36] and certainly not an uninterrupted profit year after year, seemingly in perpetuity, such as GTE and the RBOCs have enjoyed during most of their corporate existence. For example, during the era in which street railway companies were being supplanted by buses and cars, it was not unheard of for the regulated firms to lose money due to lost traffic, request and be granted a rate increase to try to make up the losses from remaining customers, only to have so many additional customers leave that losses were incurred again.[37] The constitutional ban on confiscation requires only that the regulated firm be ***permitted*** to charge rates high enough to cover costs. It does not require the marketplace to cooperate by producing customers willing to pay those rates so that costs are actually covered. As long as the losses are attributable to changing market and technological forces, not to regulation itself, no Fifth Amendment "taking" has occurred. If, over time, the forces of competition and technological change make it difficult or impossible for incumbent LECs to earn a profit, that will certainly present a business problem for them, but it will not present a constitutional problem for this Commission or the courts as long as the losses cannot fairly be laid at the door of the regulatory system.[38]

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[35](...continued)
than that which the LECs have actually reported to those investors, ***i.e.***, a "rate base" reflecting these massive write-offs. ***See Market Street Railway v. California***, 324 U.S. 548 (1945).

[36] ***Hope Natural Gas, supra***, 320 U.S. at 603. ***See also Jersey Central Power & Light Co. v. FERC***, 810 F.2d 1168, 1175 (D.C. Cir. 1987).

[37] ***See, e.g., Market Street Railway, supra***, 324 U.S. at 562-68.

[38] ***Market Street Railway, supra***, 324 U.S. at 562-68. ***Cf. Illinois Bell v. FCC, supra***, 988 F.2d at 1262 ("The Supreme Court has made clear that the FCC has no obligation to maintaining the current market value of investors' property") (citations omitted).