can sell or reuse that material as it sees fit. The requirement imposed on the ILEC by Sec. 251(c)(3) is that it provide other carriers with access to the unbundled network element for their use in providing telecommunications services to their carriers. In the case of a loop, in other words, the ILEC must allow the requesting carrier to transmit and receive signals over the loop facility.

The contention that providing access to a communications facility is the same as a physical occupation of that facility is absurd on its face. If U S West's property is "physically occupied" when another telecommunications carrier sends signals over an unbundled loop, then certainly it would be "physically occupied" to the same extent every time a residential or business subscriber picked up the telephone to place or answer a call, and every time an interexchange carrier used switched access service to originate or terminate a call. U S West is required to provide these services to all takers without unreasonable discrimination (although it has been somewhat delinquent lately in fulfilling this obligation), and therefore could claim that this so-called "occupation of its property" was compelled by law. Unless U S West is prepared to demonstrate that *all* forms of common carrier regulation constitute involuntary physical occupation of property, its argument must fail.

3. The Commission Should Not Allow Resellers to Order and Combine Unbundled Network Elements to Offer Services That Are the Same as the Incumbent LEC's Wholesale Services (¶ 85)

In para. 85, the Commission specifically asked whether Congress intended Sec. 251(c)(3) to "provide new entrants with an alternative way to 'resell' the services of incumbent LECs in addition to the specific resale provision in subsection (c)(4)." Surprisingly, very few parties even attempted to answer this question. Instead, the comments of LDDS WorldCom, AT&T and MCI coyly ignore the thrust of the Commission's questions. LDDS at 30-36; AT&T at 28-31; MCI at 28-

29. They do not even begin to address the substantive issue of statutory interpretation, and instead merely extol the virtues of unbundling. The comments of Sprint and the Department of Justice ("DOJ") at least purport to deal with the issues raised in para. 85, although they also lack any detailed analysis of the difficult issues raised by the Commission.

The benefits of access to unbundled network elements are not in dispute. As MFS made clear in its initial comments, the availability of unbundled network elements on a discrete, tariffed basis, and without restrictions as to use or users, must be a critical component of policies designed to promote market-driven pricing in the local exchange market. The issue raised in para. 85, however, which AT&T, MCI and WorldCom choose not to confront, is whether unbundled network elements can be used as a pure substitute for resale of wholesale services.

Analysis of the statute necessarily leads to the conclusion that unbundled network elements were not intended as an alternative to wholesale services for pure resellers. As MFS demonstrated in its initial comments, Congress took some pains to establish different pricing standards for these two arrangements, clearly indicating that they were not intended to be interchangeable. Facilities-based competition would be harmed if resellers were able to resell the incumbent LEC's network at the rates applicable to unbundled elements. Facilities-based carriers must make vast investments in their local networks and incur concomitant risks. If a reseller could purchase every element of the ILEC network on an unbundled basis, it would obtain all the benefits of being a facilities-based carrier without making any investment or incurring any significant economic risk. Congress created distinct pricing regimes for resellers and facilities-based carriers in order to foster both resale and facilities-based competition. If the Commission allowed carriers to resell the local network, priced according to § 252(d)(1), it would repeal § 252(d)(3) and foreclose the possibility that vibrant facilities-based competition can arise.

Sprint suggests that "the opportunities for arbitrage created by the availability of both the 'resale' and 'unbundled network elements' options provides a critically important procompetitive incentive to rationalize pricing for the various services provided by incumbent LECs." Sprint at 27-28. Essentially, Sprint does not think that Secs. 252(d)(1) and (d)(3) act as separate pricing schemes. Sprint would "rationalize" away Congress's preference for facilities-based competition and § 251(d)(1)'s more favorable pricing scheme for facilities-based carriers purchasing unbundled network elements. All prices, whether for wholesale services or for unbundled network elements, would be the same. Sprint's position provides the Commission with no guidance on how to prevent § 252(d)(3) from being swallowed by § 252(d)(1). By contrast, MFS submits that its proposal for market-driven pricing (MFS at 50-54, 57-59) would harmonize these two provisions. The MFS proposal would require that wholesale rates be no lower than the sum of tariffed rates for unbundled network elements used in providing the telecommunications services, thereby assuring a rational economic relationship between the two sets of prices.[28] Retail rates, in turn, would exceed wholesale rates by the amount of any avoided retailing costs.

In a similar manner, the DOJ argues that allowing resellers to use either § 252(d)(3) or § 252(d)(1) "comports with Congress' desire to offer new entrants a variety of ways to enter local

[28] Wholesale rates could, and likely would, be higher than the sum of the unbundled parts, reflecting the additional investment and risk incurred by facilities-based carriers. (On the other hand, transaction costs such as ILEC service order charges could tend to increase the relative cost of buying unbundled elements, especially if many different elements were ordered at different times.) But, since facilities-based carriers could purchase the unbundled ILEC network elements and then offer their own wholesale services to resellers in competition with the ILEC, market forces would limit the size of this rate differential.

markets and does not eliminate the usefulness of the resale provisions of section 251(c)(4)." DOJ at 49. The DOJ contends that unbundling and resale are qualitatively different competitive strategies that will be used by new entrants to varying degrees. DOJ at 49-50. This argument is fine as far as it goes, but it never gets to the issue of legislative intent. Like the other commenters, the DOJ fails to explain how the Commission can permit carriers to resell the LEC network through both Secs. 252(d)(3) and 252(d)(1) without eviscerating the former.

MFS submits that parties have not *inadvertently* failed to address the likelihood that the resale pricing methodology would be subverted if carriers could purchase, and subsequently resell, the entire LEC network piece by piece. Because the *NPRM* posed the issue of separate pricing standards for resale and unbundling directly, the Commission may infer from the silence of parties that only weak counter arguments exist. The Commission may anticipate that the reply comments of these parties will duck the crucial issues in similar fashion. Logically, if carriers can purchase the entire incumbent LEC network at cost-based rates for purposes of resale, they will disregard the 1996 Act's avoided cost pricing standard for wholesale services.

C. Collocation

1. Rates That Recover the Incremental Costs of Collocation Will Satisfy Constitutional "Just Compensation" Concerns (¶ 66, 121-122)

Many ILECs quite predictably asserted claims that physical collocation of equipment in ILEC premises, as authorized by Sec. 251(c)(6), will constitute a "taking" of ILEC property and therefore give rise to claims for "just compensation" under the Fifth Amendment.[29] The Commission need not delve into issues of constitutional law to determine what constitutes a "taking," however, because even assuming *arguendo* that a taking is found in this instance, the Commission can assure the ILECs of "just compensation" by allowing them to set collocation prices that recover all incremental costs they incur in providing collocation.

As a general rule, compensation for the taking of property by government action is determined by the fair market value of the property (or interest in property) taken.[30] In the case of physical collocation, the interest in property that is arguably being taken is the right to place "equipment necessary for interconnection or access to unbundled network elements" on "the premises of the local exchange carrier," including some limited access into the premises for the purpose of installing and maintaining this equipment.[31] As a practical matter, there is no market for

[29] There should be no doubt that Congress has constitutional authority to compel a taking of property, so long as it does provide for just compensation. *See, e.g., Bell Atlantic Tel. Cos. v. FCC,* 24 F.3d 1441, 1445 (D.C. Cir. 1994) ("Of course the [Takings] Clause prohibits only uncompensated takings; so long as the Tucker Act provides a subsequent action for redress, generally no constitutional question arises . . . .") (footnote omitted). Furthermore, it is obvious that there could be neither a taking nor a claim for compensation if an ILEC provides physical collocation pursuant to a negotiated agreement, but only if it is compelled to do so by government action.

[30] *Kirby Forest Indus., Inc. v. United States,* 467 U.S. 1 (1984) (fair market value of the property on the date it is appropriated, which is what a willing buyer would pay in cash to a willing seller at the time of taking).

[31] Sec. 251(c)(6). "Equipment," as used in this provision, necessarily cannot be limited to electronics used for transmission, reception, concentration, routing, and other processing of signals (MFS at 24-25), but must also include the wires, cables, antennas, and other devices that actually carry the signals. Collocation therefore encompasses not only placement of equipment in the ILEC premises, but also access to risers, conduits, ducts, and other passageways as necessary to connect the collocated equipment to the rest of the requesting carrier's network.

rights of entry into ILEC premises for the placement of equipment, and therefore no way to measure directly the market value of such rights.[32]

In the case of physical collocation, the potential market value of access to ILEC premises is fundamentally dependent on the use of those premises in the provision of telecommunications services. Access to this property is permitted *only* for purposes of interconnection under Sec. 251(c)(2) or access to unbundled network elements under Sec. 251(c)(3). Therefore, the potential value of the ILEC premises for any other purpose is irrelevant.[33] And, when property is dedicated to use in providing a regulated service, it is well-established that the Fifth Amendment entitles the owner to a reasonable opportunity to recover its costs, including a reasonable return on the investment in the property.[34] If the ILEC was recovering its costs before offering physical collocation, then the reasonable value of the obligation to permit physical collocation is limited to the incremental costs imposed on the ILEC by that obligation.[35] The ILEC will continue to operate its own network and will thus be able to continue recovering its total pre-collocation costs from the

[32] *Cf. Olson v. United States*, 292 U.S. 246 (1934) (because no market existed for flowage easements over private land, value of such easement had to be estimated).

[33] Of course, the ILEC retains the right to discontinue using its premises as part of its telecommunications network. For example, it could sell or lease a central office building (and the land on which it stands) to a third party for some other use, or it could convert a premises from network use to some other use, such as office space. Third parties' right to physical collocation under Sec. 251(c)(6) would automatically terminate as soon as the building ceased to be the "premises" of an ILEC, or ceased to be used for network purposes, so the market value of the land and buildings are not diminished in any way by physical collocation.

[34] *See, e.g., In re Permian Basin Rate Cases*, 390 U.S. 747, 768-70 (1968); *FPC v. Hope Natural Gas*, 320 U.S. 591 (1944).

[35] "Incremental costs" would include a reasonable return on any incremental capital investment required for the provision of physical collocation, assuming of course that the investment was actually necessary.

provision of other services. The combination of these other revenues and compensation equal to the additional costs imposed by the provision of collocation will allow it a continued opportunity to recover its total operating costs.

2. The 1996 Act Requires Significant Changes in the Commission's Current *Expanded Interconnection* Policies (¶¶ 71-73)

One of the more incongruous aspects of the comments in this docket is the fact that the ILECs, who only a few years ago strenuously objected to the adoption of rules requiring them to provide expanded interconnection, are now the only parties urging that those rules be kept intact (at least as they apply to physical collocation). The current rules were, of course, adopted under a different statutory scheme, when the Commission could not have foreseen the broader scope of the physical collocation requirement that Congress would impose in Sec. 251(c)(6). It would have been remarkable, to say the least, if regulations adopted in 1992 and 1993 had anticipated every issue that might arise under the 1996 Act —but, as MFS and many other parties demonstrated in the initial Comments, that is not the case. The Commission's current policies on expanded interconnection contain many limitations and conditions that were *perhaps* appropriate at the time they were adopted, but can no longer be squared with the language of the statute.[36]

[36] The *Expanded Interconnection* rules also provide a cautionary example for the Commission of the risk that sweeping policy declarations may be undone by the details of implementation. Although MFS and other competitive carriers fought long and hard for the adoption of expanded interconnection rules, the rules that were finally adopted in many respects protect the interests of the ILECs and have enabled them artificially to restrict competition within their markets. Although ILECs can no longer prevent collocation, they have been able to use high prices, discriminatory rollover charges, oppressive terms and conditions, and other devices to make collocation less attractive to competitors and thereby raise the hurdle that competitors must jump over in order to achieve access to customers.

Although the Commission's rules currently require collocation only at ILEC central offices, tandem switches, and certain remote nodes, the 1996 Act requires that ILECs permit collocation at their "premises" generally. Also while the current rules only allow collocation for certain types of transmission equipment, the 1996 Act requires collocation of "equipment necessary for interconnection or access to unbundled network elements[.]" The ILECs generally seek to limit the scope of the Act to those situations where collocation has already been required. SBC even argues specifically that Congress deliberately adopted the Commission's existing definition of physical collocation with respect to locations and types of equipment. SBC at 60-62. If that is what Congress had intended, however, it either would have specifically referred to the Commission's definition, or used the same terminology in the statute, or at least just used the term "physical collocation" without any reference to locations or types of equipment. The fact that Congress *did* specifically refer both to locations and to types of equipment in the statute, using terms that differ from the Commission's past definition, is strong evidence that Congress was not satisfied with the existing definitions.

The ILECs seek to limit the "premises" at which they must provide physical collocation to the equipment space within their central offices, and to exclude administrative space, vaults, and other remote facilities.[37] This argument finds no support in the statute, except as it relates to a building or facility used *solely* for administrative or non-network purposes. Under the statute, collocation is required only for purposes of interconnection or access to unbundled network elements; it therefore follows that the "premises" referred to in the statute must be premises where these activities can be conducted. An office building, parking garage, or other ILEC facility that

[37] *See, e.g.,* Ameritech at 22-23; Bell Atlantic at 33; GTE at 23-24. *But see* NYNEX at 67 (suggesting willingness to negotiate concerning collocation at non-central office locations).

does not contain network equipment obviously would not be a location at which physical collocation can occur. But this does not imply that ILECs should be able arbitrarily to reclassify space within their central office buildings or other network premises as "administrative" in order to limit the amount of space available for collocation. If space within an ILEC premises is in reasonable proximity to network equipment and is not being used by the ILEC, then it should be available for physical collocation.[38]

ILECs argue that vaults, remote distribution nodes, and other facilities should be exempt from physical collocation based on previous Commission decisions (Bell Atlantic at 33) and based on concerns over technical feasibility (GTE at 23-24) or contractual and legal restrictions on third-party access to these facilities (Ameritech at 22-23). In Section 251(c) generally, Congress expressed a clear intention to allow access to ILEC networks at "any technically feasible point." This phrase appears both in subsection (c)(2) with respect to interconnection, and in subsection (c)(3) with respect to unbundled network elements, which are the two purposes for which physical collocation is authorized. Therefore, only technical feasibility is even potentially a reasonable basis on which to refuse collocation at premises other than central offices.[39] However, the comments of the ILECs do not offer any basis for the Commission to adopt a general rule that collocation at locations other than central offices is technically infeasible. Technical feasibility necessarily

[38] If the space is actually vacant and has not previously been conditioned for telecommunications equipment use, then the ILEC may be entitled to charge collocators for the incremental cost of reasonable and necessary conditioning (*e.g.*, installing ventilation, power lines, cable support structures, and so on).

[39] Contrary to Ameritech's argument, any requirement of State or local law that imposes or permits restrictions on third-party access to ILEC facilities at any location would be potentially subject to pre-emption under Sec. 253.

depends on both the characteristics of the premises where collocation is sought, and the characteristics of the equipment that the requesting carrier seeks to place there. A remote node may be too small to accommodate some types of equipment, but could be suitable for collocation of other, more compact, devices. The Commission should not automatically foreclose collocation at these premises (which would amount to foreclosing future technological innovation that will inevitably produce new ways of achieving interconnection), but instead should allow resolution of disputes over technical feasibility at particular premises through negotiation and (if necessary) arbitration.

Similar considerations should lead the Commission to reject ILEC efforts to limit the types of equipment that may be collocated at their premises. The only restriction permitted by the Act is to limit collocation to "equipment necessary for interconnection or access to unbundled elements[.]" It would be imprudent to prescribe regulations that categorically exclude certain types of equipment as being unnecessary for these purposes, not only because the Commission cannot hope to foresee future developments in technology, but also because it cannot determine what types of equipment are necessary for access to unbundled elements without knowing all the types of unbundled elements to which carriers may seek access.[40] The Commission should reject the suggestion that a requesting carrier must affirmatively demonstrate that particular equipment is "necessary" for interconnection or access.[41] The overall scheme of Sec. 251(c) is that requesting carriers are entitled to access ILEC networks at any place and in any manner that is technically feasible. Therefore, if the requesting carrier demonstrates in good faith that the equipment it proposes to collocate will in fact be used for

[40] *See, e.g.*, ALTS at 21; AT&T at 40; ICI at 7-9.

[41] *See, e.g.*, SBC at 62-64; Sprint at 20-21.

interconnection or access to unbundled elements, the burden of proof should then shift to the ILEC to demonstrate either lack of space or sufficient technical reasons for refusing collocation.

The Commission should also reject the arguments of many ILECs that the Act does not permit their competitors a choice among physical collocation and other forms of interconnection (including virtual collocation).[42] Sec. 251(c)(2) and (3) plainly allow a telecommunications carrier to request interconnection or access to unbundled network elements at *any* technically feasible point, not just those points preferred by the ILEC. Although Sec. 251(c)(6) expressly requires that ILECs provide physical collocation as one form of interconnection or access, this paragraph does not preclude a carrier from requesting a different form of interconnection or access under the other provisions of subsection (c). The Commission's rules implementing the physical collocation requirement, therefore, should not exempt ILECs from responding to requests for any other technically feasible form of interconnection or access.

IV. RESALE

A. The Commission Should Reject ILEC Efforts to Preserve Sweeping Restrictions on Resale (¶¶ 175-177, 196-197)

Many ILECs urge the Commission not to prescribe any regulations implementing Secs. 251(b)(1) and (c)(4)(B), but instead to defer to the States to determine what may constitute a "reasonable" condition or limitation on resale. Some even suggest that the Commission lacks authority to prescribe such regulations. *See* GTE at 47 n.72; USTA at 71. It is, of course, true that Sec. 251(c)(4)(B) specifically authorizes States to impose one particular type of resale limitation, but it also requires that the States exercise that authority "consistent with regulations prescribed by

[42] *See, e.g.,* Ameritech at 24.

the Commission[.]" It is a long stretch indeed to infer from that clause that the Commission may not identify any other type of limitation or condition as being unreasonable. The ILECs cannot point to any other provision of the statute that limits the Commission's authority in this regard. To the contrary, Sec. 251(d)(1) affirmatively requires the Commission to adopt rules to implement "this section," without any exception for the provisions relating to resale. The Commission should therefore reject these ILEC arguments.

The Commission should also uphold its tentative conclusion that limitations and conditions on resale are presumptively anticompetitive, and that any LEC advocating such restrictions should have the burden of demonstrating that they are reasonable. Various ILECs invite the Commission to certify in advance numerous categories of resale conditions or restrictions as "reasonable," but the Commission should decline. USTA (at 72) even goes so far as to suggest that restrictions on resale can be "pro-competitive," which is a truly Orwellian statement. A restriction on resale is *by definition* a restriction on participation in a market, and when the party restricting resale of its services also exercises market power, such a restriction is anti-competitive.

First, some of the supposed "conditions or limitations" that ILECs propose are really "prohibitions" of resale, which the statute simply does not permit. *See, e.g.,* Michigan Exchange Carriers Ass'n at 60 (no resale of residential service if priced below cost); GTE at 51 (no resale of "proprietary" services); USTA at 72 (no resale of "grandfathered" services).[43] Second, even those proposals that would not prohibit resale still appear clearly designed to give the ILECs a competitive advantage, and are rife with the potential for abuse. Most of these proposals revolve around promotional, discount, contract, and trial services. If the Commission were to authorize restrictions on resale of these offerings, it would be creating an exception that would inevitably swallow the rule.[44] If the ILECs are not required to disclose the terms of *all* service offerings and make them available for resale on a nondiscriminatory basis, they will easily be able to engage in cross-subsidization and predatory pricing, simply by designating the services they target to their favored customers as "trial" or "promotional" or "contract" offerings.

The Commission should, accordingly, prescribe rules that require any LEC proposing a limitation or condition on resale to demonstrate affirmatively that its proposal is reasonable and nondiscriminatory; and clarify that a prohibition on resale of any service cannot be approved under any circumstances.

B. The Commission Should Require That Wholesale Prices Be Based on a Forward-Looking Avoided Cost Analysis (¶¶ 178-183)

As on so many issues, a number of ILECs argue that the Commission should (or, in some versions, must) refrain from prescribing any rules to implement the wholesale pricing provision of

[43] NYNEX also presents a relatively lengthy argument concerning resale of coin service, which MFS finds puzzling at best. NYNEX at 78-79. A customer purchases coin service by placing a coin in the slot and dialing a telephone number. The only way that the customer could resell this service would be to hand the phone to someone else after inserting the coin, and accepting payment from the third party in exchange. It is quite unclear why anyone would care to engage in a transaction of this nature, but equally unclear, if the parties chose to do it, how (or why) the ILEC would prevent it from occurring.

[44] *See, e.g.*, LDDS Worldcom at 82; NEXTLINK at 31; AT&T at 83.

Sec. 251(c)(4)(A), and instead should defer to the State commissions to determine wholesale rates.[45] For the same reasons as discussed in preceding sections, the Commission should reject these arguments and should adopt nationwide rules to establish minimum standards for the States to apply in making wholesale price determinations.[46]

In establishing such rules, the Commission should require the States to adhere to the "avoided cost" standard of the Act, and prohibit the use of shortcuts, surrogates, and substitutes as urged by some parties. As MFS discussed in its initial Comments, the statutory pricing standard requires a forward-looking analysis of actual net avoided cost on a service-by-service basis; that is, **avoided cost is the total cost of providing the service at retail minus the total cost of providing the same service at wholesale**. *See* MFS at 74. This is not only the standard specified by Congress, but it is also the *only* standard that will allow the efficient operation of market forces in the retail market. In a competitive, unregulated market, a producer would follow precisely this avoided cost standard in setting its wholesale prices. If it costs $2.00 more to sell a pair of socks at retail than to sell the same product wholesale, then the manufacturer would rationally set its retail price $2.00 higher than its wholesale price. It would have no incentive to sell the socks at wholesale for, say, $3.00 off the retail price, because it would lose more in revenue than it would save in costs.

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[45] *See, e.g.*, Bell Atlantic at 66-67; GTE at 52; U S West at 68.

[46] However, the need for the Commission to set uniform national *standards* for this and other provisions of the 1996 Act does not mean that it should (or could) attempt to set nationally uniform *rate levels* or discount percentages. *See* MFS at 49. The mere fact that the size of wholesale discounts varies from State to State, as argued by Time Warner at 75, is not sufficient reason for the Commission to take action in this docket. Rather, Commission guidance is required if those results have been reached by applying inconsistent pricing standards (which is the case in many States).

The Commission should also recognize that it would be far more harmful to competition to *overestimate* the avoided costs than to underestimate them. To use the example of socks again, if a regulator mandated a \$3.00 wholesale discount, then a reseller that is as efficient as the manufacturer could sell the socks at retail for the wholesale price plus the \$2.00 incremental retailing cost, and undercut the manufacturer's price by a dollar. The manufacturer would be priced out of the retail market and would have to sell its products exclusively at a depressed wholesale price. If, however, the regulator set the wholesale discount at \$1.50, the manufacturer would still have an economic incentive to increase that discount to \$2.00 based on its avoided cost. At the \$1.50 discount, few wholesalers would buy the product and the manufacturer would have to incur the full \$2.00 of retailing costs in order to sell its socks. By increasing the discount, the manufacturer could induce more wholesalers to buy socks and thereby eliminate the retailing costs. Thus, market forces can readily correct a regulator-imposed discount that is too small, but not one that is too large.

Despite the clear direction of the statute, a number of parties insist upon "avoided cost" methodologies that do not really measure avoided cost and would result in inflated, inefficient discount levels. MCI provides the most detailed proposal in this regard, and the Commission should specifically and unequivocally reject the MCI approach.[47] MCI's method is inconsistent with the Act in numerous respects, as follows:[48]

- MCI defines avoided cost as "those costs that will not be incurred by the ILEC in providing a telecommunications service for resale, *as well as* those costs that should not be paid by

[47] MCI's model appears to be extremely similar to the methodology proposed recently by AT&T in several State commission proceedings.

[48] All citations below are to the pages of MCI's Attachment 2.

a reseller because they do not relate to resale products." (p. 1.) Only the first part of MCI's definition is consistent with the statute.

- MCI defines marketing, billing and collection costs as "100% avoided" because these categories are specifically mentioned in the statute. (p. 1.) In fact, however, Sec. 252(d)(3) does not categorically exclude all marketing, billing, and collection costs from wholesale rates, but only "the portion thereof attributable to any . . . costs that will be avoided by the local exchange carrier."

- MCI includes an allocation of common costs (general overhead and support) to so-called "avoided cost activities" (p. 1). Such an allocation is improper in the absence of any evidence that any of these overhead costs are actually avoided when providing the service on a wholesale basis.

- MCI bases its calculations on ARMIS data (¶. 1-2). Although the use of publicly available data is desirable, ARMIS data does not purport to report forward-looking or incremental costs; it is a retrospective, embedded-cost reporting system, which is simply not a sound basis for determining avoided costs. Further, as MCI acknowledges (p. 3), the ARMIS data does not permit service-specific cost analyses; however, the statute plainly requires that wholesale prices be based on the retail price and avoided costs "for the telecommunications service requested[.]"

- MCI treats as "avoided" several categories of costs that appear to have nothing to do with retailing functions, including (1) aircraft expense, (2) large PBX expense, (3) public telephone terminal equipment expense, (4) property held for future use (and depreciation thereof), (5) provisioning expenses relating to office supplies and the like, and (6) amortization of intangibles. At least some of these costs do not appear to be appropriate to recover through charges for *either* retail or wholesale local exchange service (for example, public telephone expenses should be recovered solely from users of public telephones), and others appear to be overhead expenses (such as office supply provisioning). If these costs are not being properly incurred, then they should be excluded from *both* wholesale and retail rates, but they are not properly accounted for as avoided costs. If these costs are being properly incurred as overhead expense, then they cannot be treated as "avoided" unless there is evidence that they will actually be avoided when service is provided on a wholesale basis.

- After subtracting the purported avoided costs from the ILEC's revenues, the MCI model makes a further downward adjustment so that the ILEC's "margin" from wholesale services will be equal to its retail "margin" on a proportionate basis. (¶. 3-4.) Again, this is simply not the standard mandated by the statute. Sec. 252(d)(3) requires that wholesale prices be equal to retail price minus avoided cost, not retail price minus avoided cost minus a proportionate share of any mark-up above costs.

In addition to rejecting the MCI proposal, the Commission should also reject other efforts to change the wholesale pricing standard adopted by Congress. For example, AT&T's suggestion that an ILEC could be compelled to grant discounts that exceed its avoided costs, either to penalize an ILEC for allegedly inferior service interfaces or simply in order to "further competition," AT&T at 84-85, is both bad policy and contrary to the law. The statute prescribes that wholesale discounts shall be based solely on avoided cost, and the Commission's regulations should affirm this requirement. The Commission should also specify that avoided cost calculations may not be based on historical or embedded cost methods, and may not include arbitrary allocations of overhead, common costs, or returns; rather, calculations must be based on a forward-looking incremental cost methodology designed to identify the actual difference in cost between wholesale and retail provision of a particular service.

V. RECIPROCAL COMPENSATION

A. The Commission Should Mandate Mutual and Reciprocal Compensation That Is Equal in Amount and Uniform in Structure (¶¶ 230-238)

The Act specifically requires that ILECs must not only exchange local traffic with competing carriers, but must enter into compensation arrangements that provide "mutual and reciprocal" recovery of incremental costs. Secs. 251(b)(5), 252(d)(2). In spite of this clear statutory language, many ILECs devoted their initial comments on this issue to arguing for compensation standards that are not mutual and reciprocal. The Commission should reject these specious arguments and adopt regulations that specifically implement the "mutual and reciprocal" compensation standard required by the Act.

As discussed in MFS' initial Comments, MFS at 82 & n.87, the phrase "mutual and reciprocal" in Sec. 252(d)(2)(A)(i) means not only that each carrier in a traffic exchange arrangement must compensate each other, but also that each party must be placed in the same relationship to the other. Further, Sec. 252(d)(2)(A)(ii) (coupled with subsection (d)(2)(B)(ii)) expressly prohibits any detailed scrutiny into any carrier's costs, but instead requires that compensation be based on a "reasonable approximation" of costs. Read together, these provisions clearly forbid any policy, such as those urged by many ILECs, that requires either different rate structures or different rate levels for new entrants as opposed to ILECs based upon the supposed cost characteristics of their respective networks.

Some ILECs argue for compensation systems that allow additional charges for termination at an ILEC tandem, based upon the added costs that ILECs allegedly incur to switch calls through their tandems.[49] Others argue for systems that permit the ILEC to recover its higher embedded costs, while limiting new entrants to recovery of efficient costs based on current technology.[50] Only NYNEX and, to some extent, Sprint appear to recognize that the "reasonable approximation" standard requires that new entrants have the opportunity to recover costs at the same level as the incumbent.[51]

In their efforts to achieve unequal and undeserved compensation schemes, the ILECs tear the phrase "recovery by each carrier of costs" out of its context in Sec. 252(d)(2), and fail to harmonize it with the other requirements of that paragraph. The requirement of "mutual and reciprocal recovery" plainly is not satisfied by considering the tandem switching costs incurred by ILECs while ignoring other types of costs incurred by their rivals. Further, this problem cannot be cured by conducting a study of the specific cost structure of each carrier and tailoring a separate compensation method for each carrier, because subparagraph (d)(2)(B)(ii) expressly prohibits imposition of any cost study requirement.

The consideration of embedded or historical costs, as urged by BellSouth most notably, is even less compatible with the statutory provisions. Subparagraph (d)(2)(A)(ii) specifically requires that compensation be based upon "a reasonable approximation of the *additional costs* of terminating

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[49] *See, e.g.*, Bell Atlantic at 43-44. Of course, the cost data used to justify these assertions in rate proceedings often ignore the additional costs that the ILEC would incur for direct trunked transport if the tandem did not exist. Although there are costs associated with tandem switching, it seems likely that the ILECs would not deploy these switches unless they allowed the ILECs to avoid other costs that would be even greater in amount.

[50] BellSouth at 73; *see also, e.g.*, Alltel at 15; Michigan Exchange Carriers Assoc. at 67; TDS Telecom. at 23.

[51] NYNEX at 88; Sprint at 83.

. . . calls." (Emphasis added.) This language compels the use of a forward-looking, incremental cost methodology. Historical and embedded costs simply cannot be considered in determining the "additional costs" of terminating calls originated by other carriers.

The "mutual and reciprocal" requirement of the statute is further confirmation of Congress' focus on forward-looking costs. Although any two carriers' costs are unlikely to be identical at any particular moment, both carriers have the same economic incentives to adopt technology that will allow them to operate in the most efficient manner. Over time, therefore, all carriers' costs should trend toward an optimal level, as each carrier invests in improvements or modifications to its network that will allow it to operate more efficiently. If a carrier can operate most efficiently by maintaining a hierarchy of tandem and end office switches, then the optimal level of costs will include the costs of the tandem switching function. But, if another form of network architecture proves to be more efficient, then the optimal level of costs will not support the costs of tandem switches. Tailoring compensation to the individual network architecture and cost structure of each carrier (even assuming this could be done without requiring the determination of actual costs "with particularity") would negate the economic incentive to optimize each network, since any reductions in cost due to technological improvements would in principle be offset by an equal reduction in traffic exchange revenues.[52]

The only approach to reciprocal compensation that is consistent with all the requirements of the statute, instead of considering isolated provisions out of context, is to require that States establish

[52] Of course, the "optimal" level of costs itself will change over time as new technologies are introduced and new advances in network design and operation are unveiled. Periodic re-examination of the optimal cost level would not stifle innovation or incentives for efficiency, however, because carriers would always have the incentive to reduce their costs by moving closer to the new optimum.

a single, uniform, compensation rate based upon a reasonable estimate of the incremental cost of transport and termination using optimal technology. No carrier should be rewarded for its relative inefficiency by receiving a higher, unequal compensation rate. No particular network design should be rewarded through a rate structure that favors some architectures over others. And, most clearly, reciprocal compensation should not be used as a vehicle for compensating ILECs for historical or embedded costs that have nothing to do with the forward-looking, incremental costs of terminating additional traffic.

B. The Commission's Rules May Neither Mandate Nor Preclude "Bill-and-Keep" Arrangements (¶¶ 239-243)

Quite a few parties argued that the Commission should require States to approve bill-and-keep arrangements for reciprocal compensation purposes, although some parties suggested this requirement should apply for only an interim period.[53] The ILECs, on the other hand, generally argued that the Act prohibits bill-and-keep arrangements except by voluntary agreement. Both of these views are wrong. For the reasons explained in its initial Comments, MFS at 85-86, MFS does not believe that bill-and-keep arrangements are economically sound or reasonable in most circumstances. Nonetheless, the Act does not authorize the Commission either to compel or to prohibit approval of bill-and-keep arrangements by the States in their role as arbitrators.

First, Sec. 252(d)(2)(A) bars the Commission from mandating bill-and-keep terms. This provision directs that "a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless— (i) such terms and conditions provide for the mutual

[53] *See, e.g.,* American Communications Services, Inc. at 25; AT&T at 69; Massachusetts Atty. General at 14; NCTA at 54-55; Sprint at 85-87; Sprint Spectrum and American Personal Communications at 10-11.

and reciprocal recovery by each carrier of costs associated with . . . transport and termination . . . ." The Commission therefore cannot adopt rules requiring a State to approve a reciprocal compensation arrangement that the State does not find satisfies the "mutual and reciprocal recovery of costs" standard. If a bill-and-keep arrangement does not provide for such recovery of costs (and, as MFS showed in its initial Comments, this will generally be the case), then the State cannot be required to approve it.

Second, Sec. 252(d)(2)(B)(i) expressly provides that the statute "shall not be construed to preclude" bill-and-keep arrangements. The ILEC arguments seek to twist this language around to mean the opposite of what it says, but these efforts do not even merit serious consideration. *See* MFS at 85 n.90. Even though MFS does not support bill-and-keep as a matter of policy, neither can it support deliberate flouting of the statutory language. The Commission must recognize that any regulations that purport to preclude the States from considering bill-and-keep arrangements in arbitration would violate the express directive of the statute.

VI. CONCLUSION

The record in this docket strongly supports the Commission's tentative decision to prescribe specific, detailed national standards for implementation of Sec. 251. The ILECs appear anxious to dilute the pro-competitive intent of the new Act and to retain as many of the benefits of monopoly as they can manage. The Commission should take decisive action to nip this campaign in the bud. The Commission should promulgate rules that establish minimum standards for compliance with the Act, while respecting the authority of the States to prescribe specific rates, terms, and conditions within the limits set by those standards. Wherever possible, those rules should be guided by competitive market principles, and should be designed to allow market forces to set prices. Above all, the Commission should be faithful both to the letter and to the spirit of the 1996 Act, and should emphasize that the Act means what it says. Therefore, interconnection and collocation should be available at "any technically feasible point," not just those preferred by the ILECs; wholesale pricing should be based only on "avoided cost," and not on other standards that would produce results more to the liking of prospective resale entrants; and reciprocal compensation should be established on the "mutual and reciprocal" basis of a single, uniform, rate per minute that recovers the efficient long-run incremental cost of transport and termination.

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CERTIFICATE OF SERVICE

I hereby certify that on this 30th day of May 1996 copies of Reply Comments of MFS Communications Company were served on the attached list by first class mail, postage prepaid.

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