using current technology, plus a fair rate of return.[54] The burden should clearly be on the ILECs to demonstrate that they cannot make the adjustments necessary to operate profitably with rates calculated on this basis. Moreover, in many states ILECs have sought permission to set some of their rates at TSLRIC and never have suggested that to do so would represent a taking or harm their financial integrity. For example, under section IV (H)(4) of the New York Telephone Performance Regulation Plan, a negotiated agreement between NYNEX, the New York Public Service Commission Staff, and other parties, New York Telephone is allowed to set the rates for competitive services at long run incremental cost.

Instead of making such a showing, the ILECs suggest that any rate-setting methodology that bars them from recovering their full embedded costs is confiscatory in principle. That is simply an incorrect characterization of the governing case law. Regulators have any number of options available to them as they decide how to set rates. TSLRIC-based pricing is certainly one which closely mirrors competitive pressures.[55] What the ILECs are really saying is that they have a constitutional right to maintain their current levels of compensation and profitability in perpetuity. This is wishful thinking, perhaps, but it is not the law. Nothing in the Constitution protects regulated companies from short-term losses or guarantees investors that their investments will never decline in value.[56]

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[54] See Section II.B.

[55] Duquesne Light Co., 488 U.S. at 308.

[56] See Hope Natural Gas, 320 U.S. at 601 ("fact that the value [of the regulated property] is reduced does not mean that the regulation is invalid"); In re Permian Basin Area Rate Cases, 390 U.S. 747, 769 (1974) ("Regulation may, consistently with the Constitution,

US West attempts to up the constitutional ante by characterizing the Act's requirements regarding sale of network elements and collocation as "physical occupations of incumbent LEC property."[57] An ILEC's involuntary sale of the right to use a loop or a switch does not constitute a physical invasion of its property. Regulated monopolies are routinely subject to legal mandates to sell their services to all customers who want them, on terms set by the regulators. The statutory requirements do not depart from this principle.

In any event, even "physical invasions" of property are constitutional if the property owner receives "just compensation." US West has made no showing that TSLRIC-based pricing would fail to satisfy this constitutional standard. It argues that the standard requires "realization of the full market value of the property taken."[58] However, TSLRIC, not embedded cost, most closely reflects current market value.

G. Application of Section 251 to Access for Toll Services

MCI dealt in its initial comments[59] with the principal arguments advanced by ILECs that Sections 251(c)(2) and (c)(3) do not apply by interconnection and access for toll telephone services.[60] None of these commenters comes to grips with the explicit language of the statute --

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limit stringently the return recovered on investment, for investors' interests provide only one of the variables in the constitutional calculus of reasonableness.")

57/ US West Comments at 29.

58/ US West Comments at 32.

59/ MCI Comments at 77-83.

60/ There is general agreement that under Section 251(c)(2), "the unbundled network elements can be used by the requesting carrier to fill out its network to provide any

that ILECs must provide to "any" telecommunications carrier on an unbundled basis include any "feature, function, or capability" as well as "equipment or facility" like a loop.[61] Their arguments based on provisions in unenacted drafts of the Act excluding access from the local interconnection provisions (e.g., Pacific 80) are rebutted by their acknowledgment that "both the House and Senate bills included provisions mandated cost-based access rates" in another section.[62] The 1996 Act simply combined in one section -- Section 251 -- provisions applying the same principles for interconnection and access to all types of carriers, including toll carriers.

Interpreting Sections 251(c) and 252(d) to apply to toll access charges would indisputably further the purposes of the Act. A striking consensus emerges from the comments that the current access charge system cannot co-exist with the interconnection regime required by that Act and that its immediate reform is essential.[63] It only makes sense to interpret the Act to address all critical parts of an admittedly interrelated system.

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telecommunications service that it wants (both local and long-distance, intrastate and interstate)." NYNEX Comments at 6; USTA Comments at 59.

61/ MCI Comments at 78 and n. 54. The argument of some commenters that applying Section 251 to interstate access would give state commissions control over this interstate service (NYNEX Comments at 18) is rebutted by the ILECs' own insistence that Section 251(i) preserves the jurisdiction of the Commission. Ameritech Comments at 21; USTA Comments at 61; see Bell Atlantic Comments at 7.

62/ NYNEX Comments at 16 and n.27.

63/ E.g., Bell Atlantic Comments at 8; BellSouth Comments at 63; SBC Comments at 95; US West Comments v at 4, 5-6, 12, 61, 63; USTA Comments I at 3, 4 n.4, 52, 65-66; DOJ Comments at 57, 58. The most extreme application of this recognition is the argument of some commenters that the Commission implement the requirements of the section differently than it otherwise would solely to avoid disrupting the current access charge system. Bell Atlantic Comments at 11; Pacific Comments at 67, 78.

In any event, even if Section 251 does not apply to access for toll services (and it does), it would be arbitrary and capricious to maintain the existing access charge regime for providers of toll services in the context of the sweeping changes in the rules for pricing of access provided to providers of other services, especially when the same carriers provide a range of services. The accompanying affidavit of Franklin M. Fisher demonstrates that the provisions of the Act opening up local markets to competition and potentially allowing the BOCs to provide interexchange services require a fundamental rethinking of the current access charge system. The existing distortions of this system, long recognized by the Commission, will be compounded in the new environment created by the Act. Paradoxically, the only conceivable benefit from entry of these purported defenders of the "level playing field" would come if they charged their own long-distance customers less for access than the monopoly price that independent inter-exchange carriers pay. Such discrimination would skew competition in favor of less efficient BOC entrants and harm consumers.

Any further delay in reducing access to cost will only further harm the development of effective local competition. It will also preclude the Commission from granting any BOC application to provide in-region interexchange services because no BOC will fully implement the competitive checklist as required by Section 271(c)(2)(B)(i) and (ii) until it reduces access to cost, and because BOC entry while access charges remain inflated would harm both local and interexchange competition and therefore be contrary to the public interest. To facilitate local competition, and to permit BOC entry that is otherwise consistent with the requirements of Section 271, the Commission must act now to reform the current access charge system.

III. ILEC Proposals to Limit Interconnection and Unbundling to What Is in Place Today Is Anticompetitive and Inconsistent with the Act

In their comments, the ILECs argue that their interconnection and unbundling obligations should be limited to those interconnection points and unbundled elements they currently provide; any other interconnection points or unbundled elements should not be mandated by the Commission or state commissions, they should only be the result of private negotiations between a requesting carrier and the ILEC. Interestingly, very few of the ILECs claim that other interconnection points or unbundled elements are not technically feasible; most either state that other points or elements may not be technically feasible or admit that virtually anything is technically feasible.[64] Instead, the ILECs would reverse the Commission's tentative conclusion that the burden of proof falls on ILECs to demonstrate that a carrier's request is technically infeasible, placing the entire burden on the requesting carrier within the context of negotiations. As part of these negotiations, the ILECs would require requesting carriers to (1) demonstrate that a checklist of requirements -- several of which, such as the development of operational support systems, are entirely within the control of the ILEC -- have been met before a point or element is determined to be technically feasible;[65] and (2) follow a lengthy and onerous "bona fide request" process in which all the risk and implementation costs are borne by the requesting

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[64] For example, NYNEX states "NYNEX does not believe that it is productive to engage in arguments about the 'technical feasibility' of particular unbundled elements, interconnection points or access to network functionality. Presuming that no one will ask us to change the laws of physics, any conceivable element or interconnection point can be created given enough time and resources." NYNEX Comments at 65.

[65] See, e.g., SBC Comments at 27-28; Pacific Telesis Comments at 18-19.

carrier.[66]

The ILEC proposals are anticompetitive and inconsistent with the Act. None of the interconnections, collocations, and unbundled elements available today are the result of negotiations between requesting carriers and the ILECs; they are the result of regulatory or court decisions requiring the ILECs to do what they adamantly resisted.[67] To the extent ILECs have interconnected with competing carriers or made unbundled network elements available, they have done so in an attempt to meet statutory or regulatory checklists, not as voluntary actions they would continue to pursue once they received regulatory relief. In the absence of national rules that place the burden on the ILECs to demonstrate that carrier requests are technically infeasible and that provide time limits for ILEC implementation of interconnection and unbundling requests, negotiations will result in the same types of roadblocks, delays, and outright refusals that the ILECs engaged in for placement of customer premises equipment, and for network access to provide competitive exchange services, enhanced services, and competitive access services. Moreover, the technical feasibility requirements and the "bona fide request" process proposed by the ILECs would create new means for delay and refusal.

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[66] See, e.g., USTA Comments at 13-16, Ameritech Comments at 35, Bell Atlantic Comments at 17.

[67] Not surprisingly, the ILECs argue that collocation should be limited to physical collocation of the same equipment at the same points as mandated in the Commission's earlier collocation docket (Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd 7369 (1992)), which addressed the narrow collocation requirements needed for competitive access providers, not the broader collocation requirements relevant to the broad pro-competitive objectives of the Act. Of course, during the earlier collocation docket and the subsequent appeal, the ILECs strongly opposed even those much narrower collocation requirements.

For example, SBC would require technical feasibility to be determined based upon consideration of at least 11 characteristics.[68] Two of these are "ability of support systems to administer, provision, maintain, and order without unique or special handling and/or billing" and "ability to provide and maintain quality of service." In the absence of mandatory time constraints or the ability of a commission to mandate additional interconnection points or elements, an ILEC will have no incentive to cooperate with the requesting carrier to meet these requirements at all, no less in a timely fashion. This view is echoed by many of the states.[69] Moreover, these operational support systems, although necessary for nondiscriminatory access to interconnection points or unbundled elements, are irrelevant to technical feasibility. Another SBC requirement is that "ILECs should not be required to alter their networks in order to create feasible unbundling interconnection points or capabilities." But, as NYNEX states, "The existing network, including the loop plant, was not designed to accommodate multiple network providers."[70] Thus, some alterations surely will be necessary. The ILECs will never have the incentive to make alterations that foster competition, and therefore, in the absence of mandated time constraints or the ability of commissions to mandate additional interconnection points and unbundling, the ILECs quite simply will not provide interconnection or unbundling beyond what

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[68] SBC Comments at 27-28. Similarly, Pacific Telesis Comments provide a list of 9 requirements at 18-19.

[69] See, e.g., People of the State of California and the Public Utilities Commission of the State of California Comments at 18-19; District of Columbia Public Utilities Commission Comments at 18; Illinois Commerce Commission Comments at 31; Commonwealth of Massachusetts Department of Public Utilities Comments at 7.

[70] NYNEX Comments at 67.

they are required to do today. In fact, it would be far more appropriate to apply SBC's proposal to the ILECs than to new entrants. That is, the ILECs should be required to meet the appropriate entries in the SBC checklist as part of an ILEC obligation to actually provide a requesting carrier nondiscriminatory access to an interconnection point or an unbundled element within six months of the conclusion of initial negotiations and arbitration.

Impediments to competition would be exacerbated by the bona fide request process designed by USTA and endorsed by most of the ILECs. Under USTA's proposal, a requesting carrier would initiate the process by identifying: (a) the specific point(s) of interconnection sought; (b) any desired interface and other technical specifications; (c) the date when interconnection is desired; (d) the projected quantity of interconnection points ordered with a demand forecast; and (e) any desired changes in ILEC operations or procedures. The requestor would be required to include a commitment either to order the item(s) requested in the quantity requested, or to pay the ILEC's costs of processing the request. In addition, arrangements offered by an ILEC to the requestor would be made reciprocal. The ILEC could request additional information from the requestor. The ILEC then would have 90 days to respond to the requestor, including its determination of whether the request is technically feasible. It is only after those 90 days that the ILEC would have to determine availability at the requested point, determine the applicable prices, and establish estimated installation intervals (with no time limit placed on making that determination).

Thus, the requestor is required to make specific requests without essential information about the ILEC's network. Moreover, all of the risk would be borne by the requestor, which

must commit up-front to interconnections of unknown price and with unknown intervals. How, for example, could a requestor project its demand for unbundled loop distribution if it did not know (1) the amount, and the location, of the ILEC's loop plant that is divided into loop distribution and loop feeder[71/] (and some projection for the time period in which the interconnection would take place), (2) the ordering/provisioning/maintenance/service quality/etc. parameters associated with the loop distribution, and (3) the price of the loop distribution? At the same time, the ILEC would have no incentive to find technical feasibility (if it claimed infeasibility, the burden would fall on the requestor to prove otherwise), to price at reasonable levels (the requestor would be largely dependent on ILEC cost data), or to establish reasonable installation intervals. In fact, the ILEC would have the incentive to claim infeasibility, set high prices and long installation intervals. These would at a minimum delay competition through the time period required for an arbitration process, or likely could totally forestall competition.

Clearly, the ILEC proposals for technical feasibility, interconnection, and unbundling would stifle any interconnection and unbundling beyond the limited dimensions available today. Negotiations could not succeed in the absence of effective national rules. The Commission should implement the following simple rules that would allow there to be meaningful

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71/ Several of the ILECs attacked requesting carriers' proposals for the unbundling of the loop subelements on the false grounds that requestors would demand unbundled loop distribution in urban areas where the ILECs only utilize loop feeder, and no loop distribution facilities. Requestors seek access to unbundled subelements only where the ILECs have such subelements. To avoid the costs to both requestors and ILECs associated with requests for nonexistent subelements, the ILECs must be required to make publicly available an up-to-date inventory and mapping of their facilities.

negotiations:

- The burden of proof is on the ILEC to demonstrate that a telecommunications carrier's request to interconnect at a point on its network or obtain an unbundled element is technically infeasible.

- If an ILEC claims that it is not technically feasible to interconnect at a point on its network, or to provide a particular element, requested by a telecommunications carrier, a regulatory determination of the validity of the claim must be made within 30 days of either party seeking arbitration.

- Each ILEC must make publicly available an up-to-date itemized inventory of its facilities by location, providing all information needed by requesting carriers to determine where interconnection or unbundling is most likely to be technically feasible.

- Each ILEC must fully implement the minimum requirements for nondiscriminatory access to unbundled elements and points of interconnection within six months of the conclusion of initial negotiations and arbitration, with explicit penalties for failure to implement.

The 30-day timetable for determining technical feasibility is necessary because interconnection and unbundling are essential for competition to develop, but ILECs will have no incentive to facilitate either; in the absence of the timetable, a feasible interconnection or unbundling could be delayed an additional half a year. An ILEC would not be placed at any disadvantage by the shortened timetable because, under the Act, it would have received the interconnection or unbundling request at least 135 days before arbitration began, more than enough time to make any valid demonstration of infeasiblity.

The six-month timetable for full implementation would have many beneficial effects. First, it would put the ILECs on notice that they are responsible for implementing nondiscriminatory interconnection and unbundling, not merely for negotiating agreements that then are never fully implemented. Second, much of the development needed for technical

standards and operations support services occurs in Alliance for Telecommunications Industry Solution (ATIS) sponsored industry committees and fora that are dominated by the RBOCs, and whose agendas and timetables therefore are determined by the RBOCs. While new entrants have the incentive to prod these committees and fora to move forward quickly, the RBOCs have encouraged a more leisurely pace. If ILECs are responsible for implementing processes and standards within explicit time frames -- and especially if such implementation is a prerequisite for RBOC entry into the long distance market -- then they will have the incentive to speed up the pace in these committees and fora. ILECs will claim that full implementation cannot be accomplished within six months of the end of the negotiation and arbitration periods, but their only basis for the allegation is the slow pace at which they developed pro-competitive processes in the past.

IV. The Unbundled Elements the ILECs Propose to Offer Are Insufficient for Requesting Carriers to Provide A Full Array of Telecommunications Services

The ILECs propose limiting the unbundled elements they will make available to requesting carriers to those that they currently offer. This is insufficient in three significant ways:

- their refusal to unbundle the local loop into its subelements where such subelements exist forces requesting carriers to purchase loop subelements that they can provide themselves.
- their refusal to offer an unbundled local switching element that can be used to provide all local exchange services, but rather insisting on offering only a switch port that has limited functional capability (and more closely resembles a portion of basic exchange service than a network element), denies requesting carriers access to all the features, functions, and capabilities residing in the switch facilities and equipment. As a result, requesting

parties are excluded from the switched access market and artificially forced to provide vertical features as resold services.

- their refusal to unbundle their databases and signaling systems keeps other providers from offering advanced services to their customers.

The ILECs would have the Commission believe that their networks are filled with relatively new technologies that are not amenable to unbundling. For example, at p. 8 of his affidavit attached to the Bell Atlantic Comments, Ray Albers refers to "a relatively new technology called Integrated Digital Loop Carrier" (IDLC) that he alleges is technically infeasible to unbundle. IDLC may be new relative to the invention of the telephone, but it has been available for more than ten years; Bell Atlantic's Williamsburg, Virginia central office deployed IDLC systems in the very early 1980s. IDLC systems do not foreclose the provision of unbundled loops and loop subelements. Some potential solutions to the alleged infeasibility of unbundling where IDLC systems are in place include the use of a mechanism known as "hair pinning," that can take circuits off of the IDLC before they are switched. Also, circuits can be groomed onto a particular T1 from the IDLC and connected to another service providers switch. And finally, there is a feature call multi-hosting for IDLC that could overcome the "technically unfeasible" characteristics of IDLC. This is jut one example of many ILEC statements designed to instill doubt by highlighting possible problems while ignoring feasible solutions.

On the pretext of technical infeasiblity, the ILECs refuse to unbundle their databases and signaling systems that can be used by telecommunications carriers to offer advanced services comparable to those offered by the ILECs. The Commission should not be misled by the ILECs' claim that SS7 signaling is fully unbundled, and their gross exaggerations of infeasibility and

reliability issues associated with AIN. A number of states concur that signalling capabilities and databases should be included in the "minimum" list of unbundled elements.[72] The Commission should not limit signaling and database access to the present SS7 capabilities, as the ILECs advise the Commission to do.[73] Today, SS7 signaling can be used to deliver LEC switch AIN triggers to non-LEC Service Control Points (SCPs), and non-LEC Service Switching Point (SSP) trigger control at the ILEC switch, as was requested by AT&T, Comptel, and MCI.[74] These access points have been specified by the Information Industry Liaison Committee (IILC) in industry agreement Issue #026, and access to these interconnection points can be made available now via SS7. In addition, MCI would support a study by an established industry forum to examine implementation of other access points in the ILEC network, as well as to explore the need for a competitively neutral mediation capabilities. This study, however, should be accomplished within established fora, and not as part of the LEC Intelligent Network (IN) project, as suggested by several of the ILECs in their comments. The LEC IN project proposal is

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[72] See, e.g., District of Columbia Public Utilities Commission Comments at 23; Florida Public Utilities Commission Comments at 17; Commonwealth of Massachusetts Department of Public Utilities Comments at 7; New York Public Utilities Commission Comments at 26; Oregon Public Utility Commission Comments at 24; as well as local switching elements New York at 25-30, District of Columbia Public Utilities Commission Comments at 23; Commonwealth of Massachusetts Department of Public Utilities Comments at 7; New York Public Utilities Commission Comments at 26; Oregon Public Utility Commission Comments at 24. Moreover, each state indicated that it should have the option to require further unbundling when appropriate.

[73] See, e.g., Bell Atlantic at 27-28.

[74] See the *ex parte* comments in Docket 91-346 of AT&T (August 21, 1995), Comptel (March 29, 1996), and MCI (April 19, 1996).

an attempt to move unbundling issues, which have been addressed for several years in the IILC, into a new venue that will further slow the process of unbundling by performing yet another study while giving the appearance that progress is being made.

One common theme running through the ILEC comments is that they had no responsibility for designing their networks in a fashion that makes interconnection and unbundling difficult; rather, the vendors designed the network facilities. This is a specious argument. Bellcore wrote the specifications that the vendors had to build to -- and the RBOCs own and direct Bellcore. Another common theme in the ILEC comments is that networks differ so much across networks that a single national policy could not be supported. Again, every network is designed, engineered, and deployed according to Bellcore specifications. The variation across networks is minor.

V. National Rules Are Needed to Provide Guidance in the Negotiations over Reciprocal Compensation Arrangements

The ILECs' comments demonstrate conclusively that national rules for reciprocal compensation are needed for successful negotiations. In each case, the ILEC assumes that both the point of interconnection and the compensation terms must conform to the ILEC's network architecture, and not take into account the interconnecting carrier's architecture. The ILECs would limit interconnection to access tandems and end offices, and set a rate structure based on the ILEC network configuration of switching and transport charges. These proposals force the new entrant to mirror the ILEC network, impose additional charges on the entrant, and keep the

entrant from recovering its network costs that do not conform to the ILEC network and price structure.

The ILECs argue that new entrants have fewer facilities and lower costs. As blanket statements, these are not correct. A new entrant and an ILEC each has the same responsibility to transport and terminate traffic destined to its customers that originate on the other carrier's network; they simply will meet their responsibility using different network architectures. Referring to Diagram 2 in MCI's Comments (appended to these Reply Comments as Attachment 2), each carrier will have customers distributed throughout local calling areas 1 and 2. The ILEC will reach its customers using a network with many access tandems and end office switches, interoffice trunks, and relatively short loops. The new entrant using the sonet ring architecture shown in Attachment 2 will reach its customers with a lesser investment in switches, a greater investment in fiber rings, and a greater investment in loops or trunks that carry traffic between the ring and its customers. But each will provide the same transport and termination functions for the other. Requiring the interconnection to occur only at (access tandem or end office) switches, and imposing the traditional ILEC rate structure that only reflects the transport and termination cost structures of the traditional ILEC network architecture, will artificially favor the ILEC. The new entrant will have to pass through to its customers the higher costs associated with the longer loops required for its architecture, but that should be balanced in the market by also passing through to its customers the lower switching and transport costs required. If the reciprocal compensation arrangements do not take into account this fundamental difference in underlying costs -- and instead impose the ILEC's higher switching and transport costs on the

new entrant and the new entrant's customers -- the entrant's viability is threatened.

The only neutral way to allow different network architectures to co-exist is to allow each carrier to designate one point of interconnection (POI) on the other carrier's network (in each local calling area) at which it will hand off traffic. This allows each carrier to take into account the cost structure of its own network. At pp. 9-10 of his affidavit attached to the Bell Atlantic comments, Dr. Hausman states that "The CLEC provider will choose the least cost alternative to itself, but this alternative may create large costs for the interconnecting LEC and for society." This is only partly correct, and it is misleading. First of all, the ILEC also will seek to interconnect at the point that is lowest cost to itself, and that too may impose large costs on the entrant and on society. By setting a national rule that each carrier must designate one POI on the other carrier's network -- and leaving any alternative outcome to the mutual agreement of the parties -- there is a neutral basis for negotiations between the carriers. With the designated POIs identified, each carrier will be able to determine how the other's choice of POI affects its costs, and each will have the incentive to reach agreement on interconnection points that reduce its total costs. By contrast, using the existing interconnection points and rate structure simply imposes the ILEC architecture upon the new entrant, and eliminates the efficiencies associated with the entrant's architecture.

U S West's proposal[75/] to distinguish between transport and termination and to limit reciprocal compensation to termination is especially insidious because it is the ultimate

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[75/] US West at 70 and Harris-Yao Aff. at 16-17.

arrangement for imposing the ILEC network architecture on its competitors. Each carrier would be responsible for getting its traffic to the other carrier's switch that is closest to the customer receiving the call. For a competitor using a fiber ring architecture with a single switch, the ILEC would only have to get its traffic to that one switch. But the competitor would have to bear the costs of getting the traffic originating on its network to every single end office on the ILEC network (all five end offices in Attachment 2). The competitor would be forced to have multiple points of interconnection in each local calling area. To the extent that past rate of return regulation motivated the ILEC to build more than the optimal number of switches, the new entrants would be forced to replicate the expensive network architecture. Again, the only way to get reasonable negotiations is to start with the national rule that each carrier designates a single interconnection point on the other carrier's network in each local calling area.

Since each carrier's network will be different, any reciprocal compensation arrangement based on the ILEC network architecture will be biased against the entrant. Bill and keep, which explicitly recognizes the reciprocal functions performed but does not attempt to squeeze those functions into the traditional "switching" and "transport" rate elements that do not properly reflect the underlying costs of fiber ring architectures, is the compensation mechanism least likely to introduce competitive bias.[76] By contrast, requiring the new entrant to pay the costs of

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[76] The ILECs' attack on bill and keep reaches its ludicrous height in the Rohlfs, Haring, Monson, and Shooshan paper at 9 attached to the Bell South comments, where the authors attempt to discredit bill and keep because in-kind compensation (which should recover all relevant network costs) does not match up exactly to the traditional switching and transport charges that reflect the ILEC's -- but not the new entrant's -- network. Theirs is the ultimate exercise in living in the past and denying the existence of new

the ILEC network will provide the wrong market signals -- penalizing the entrant if it is more efficient than the ILEC and rewarding the entrant if it is less efficient. Moreover, requiring each carrier to perform cost studies makes no sense -- (1) it impedes competition by imposing substantial costs on new entrants to perform these studies, and (2) commissions unfamiliar with new network architectures will have difficulty determining the costs associated with terminating calls on those networks. As a result, monetary charges for transport and termination can never be certain to cover the costs of each of the carriers. Thus, given all the advantages of bill and keep, it is surely the best alternative for reciprocal compensation arrangements, and just as consistent with Section 252(d)(2)(A)(i) as payment in cash.[77]

VI. Other Issues

Section 152(b). Some commenters argue that section 2(b) of the 1934 Act categorically deprives the Commission of any jurisdiction to adopt national rules to implement section 251, except perhaps in narrowly limited circumstances.[78] No serious dispute exists that Section 251 does "apply" to charges or practices related to intrastate services notwithstanding the general rule

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networks with new architectures.

[77] If the Commission were to determine that reciprocal compensation should be in cash rather than in kind, it should take the form of a flat, per-minute charge, equal to the average TSLRIC costs incurred by the ILEC in providing the network functions necessary to terminate the local calls originating on the networks of its competitors. This would recover the ILEC's costs, recover the costs of an equally efficient new entrant, and avoid a rate structure that mirrors the ILEC network architecture.

[78] E.g., NARUC Comments ii, 10; Pacific Comments 12-14.

in section 2(d) that the Act does not "apply" to intrastate matters. Because the scope of the Section and the Commission's jurisdiction are coextensive, the Commission is not categorically precluded by Section 2(b) from adopting national rules that provide a reasonably specific framework for state commissions. The real question is whether the Commission should exercise its discretion under Section 251 to adopt reasonably specific national rules, or instead the vague, non-binding guidelines advocated by certain state commissions and the ILECs. For the reasons explained in MCI's initial comments, reasonably specific rules are essential for the prompt development of effective competition throughout the nation.

Resale. The ILECs uniformly request the Commission to refrain from establishing a wholesale rate for residential service, on the grounds that the retail rate for this service is priced below the ILEC's long run incremental cost. There is no legal support for not determining a wholesale rate for the resale of residential service. Section 251(c)(4) requires wholesale rates to be set for all ILEC retail telecommunications services. ILECs are not disadvantaged in this instance because the subsidized wholesale rate plus any universal service subsidy they will receive recovers their cost of providing the service. Moreover, as the Hatfield Model demonstrates, only a small percentage of local exchange rates are subsidized, based on an analysis of the direct economic costs of providing service. Thus, in resale as with unbundled network elements, presumptive price ceilings should be established.

VII. Conclusion

For the reasons described above, MCI respectfully requests that the Commission adopt the tentative conclusions proposed in the Notice and endorsed by MCI, and adopt the additional requirements MCI requests in its Comments and Reply Comments.

Respectfully submitted,
MCI TELECOMMUNICATIONS CORPORATION

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Filed: May 30, 1996

Attachment 1

An Analysis of Switched Access Pricing and the Telecommunications Act of 1996

By

Franklin M. Fisher

AN ANALYSIS OF SWITCHED ACCESS PRICING AND THE TELECOMMUNICATIONS ACT OF 1996

By

FRANKLIN M. FISHER[1]

1. I have been asked by MCI Telecommunications Corporation to analyze the economic effects of setting the interstate switched access charges paid by interexchange carriers ("IXCs") substantially above economic cost in the new telecommunications environment created by the Telecommunications Act of 1996. I will address how the 1996 Act will change the market environment and the resulting impact of above-cost pricing of switched access.

2. The primary conclusions of my analysis are:

- Provisions of the Telecommunications Act of 1996 opening the way for local competition are unlikely soon to result in completely competitive markets that drive switched access prices to cost.
- If incumbent local exchange carriers ("ILECs") are allowed to set switched access prices far above economic cost, incentives for entry and investment in local markets will be distorted. High switched access prices also will increase the incentives of ILECs to block or limit competition from new local carriers.
- High switched access prices will give the Regional Bell Operating Companies ("RBOCs") an artificial advantage in competing for interexchange business in their regions. This advantage will distort interexchange competition, inducing consumers to choose RBOC service when that otherwise would not be the most efficient choice, and allowing the RBOCs to capture a larger market share than they otherwise would. RBOC stockholders need share only a limited portion of their advantage with consumers of interexchange service because the continued burden of high switched access prices will limit other IXCs' ability to compete.

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[1] Professor of Economics, MIT.

- Separate subsidiary and related imputation rules in the 1996 Act cannot be expected to make RBOCs act as if switched access prices were a real cost for their interexchange services.
- A general lowering of switched access prices would provide considerable benefits, encouraging efficient, while discouraging inefficient, investment by competitive LECs ("CLECs") and by RBOCs in interexchange services, and allowing all consumers to benefit from lower costs of switched access for all interexchange carriers.

EFFECTS OF HIGH SWITCHED ACCESS PRICES BEFORE THE 1996 ACT

3. The substantial difference between the price paid by IXCs for switched access and the economic cost to ILECs of supplying access can be thought of as a tax levied on users of switched access, albeit one paid to ILECs rather than to the government. The claimed intent of this tax has been to provide support for universal service and other social objectives. Nonetheless, as the Commission has understood, like almost all taxes, this tax changes the market behavior of producers and consumers and imposes losses in economic efficiency and welfare.

4. First, setting the price of switched access substantially above cost has resulted in IXC prices for interstate toll services using switched access that exceed the true cost of the end-to-end service. The resulting decline in consumption of interstate interexchange service reduces consumer surplus as consumers are deterred from making calls they would value more than the overall cost of supplying those calls. Up to now, however, high switched access prices have had a limited effect on consumers' choices among competing IXCs because all IXCs paid the same tariffed rates for switched access service.

5. Second, high switched access rates distort IXCs' choices of access arrangements. IXCs have an alternative to switched access for customers with higher traffic volumes: both ILECs and competitive access providers offer direct connections between the customer and the IXCs' point of presence ("POP") at prices substantially closer to cost than switched access. Within a range of traffic volumes, the high price of switched access sends an inaccurate signal that causes IXCs to

substitute a higher-cost (albeit lower-priced) dedicated connection. This is inefficient bypass. The input substitution limits the prices charged consumers (and thus the loss of consumer surplus), but creates an inefficiency: use of the more costly input increases the true cost of producing the service.

EFFECTS ON LOCAL SERVICE AFTER THE 1996 ACT

6. Allowing ILECs to charge high switched access prices will have a strong effect on the development of competition in local service – a central purpose of the 1996 Act. Allowing ILECs to set high switched access prices would have little effect on the development of local competition if market pressure from competing suppliers of local services, including switched access services, would quickly force ILEC switched access prices to cost, but I do not believe this will occur.

7. CLECs will supply both local service and switched access services to their subscribers, and CLEC switched access will therefore add a third alternative to the two choices IXCs now have for access arrangements – ILEC switched access and dedicated access.[2] CLECs will have to commit investments in some facilities to become competing suppliers of switched access and local service; simply reselling ILEC local service will not be sufficient. A CLEC will not sink investments unless it expects to earn sufficient net revenues. Those expected returns will depend on the demand the CLEC anticipates for its services, which in turn will depend on the price of ILEC switched access with which it will have to compete. The ILEC price that matters for the CLEC's expected returns is not today's price, but rather the switched access price the ILEC is expected to charge in response to actual or potential entry.

8. An ILEC that prices its switched access above cost could respond to CLEC entry in one or

[2] Customers must subscribe to CLEC local service before IXCs can use CLEC-supplied switched access. By subscribing, however, a customer effectively chooses a supplier of switched access as well as of local service. If a CLEC charges less in total for these two services, there will be ways to insure that this is reflected in prices customers pay and therefore that customers take it into account when choosing their local carrier.

more of three ways: (1) by uniformly lowering prices for switched access service, (2) by targeting lower prices for customers most likely to switch to other carriers, or (3) by adjusting the pricing and supply of other inputs used by competing local carriers. I examine each response in turn.

9. *Uniform Price Reductions.* An ILEC allowed to set high switched access prices will not find it profitable to institute a major, uniform reduction of those prices if it can retain a substantial portion of its switched access revenues without doing so because, for example, many customers have either no or limited competitive alternatives, or are reluctant to shift to a new local carriers.

10. The resulting high prices the ILEC would continue to charge will distort the choice between ILEC and CLEC switched access service in essentially the same way that high switched access prices have distorted the choice between switched and dedicated access. IXCs (and customers) will choose CLEC-supplied switched access in cases where it is more costly to supply, but it appears less costly because the price of ILEC-supplied access is so far above cost. CLECs will be given incentives to invest in supplying service less efficient than ILEC service that they would not have if ILEC switched access prices were set at cost. This incentive for "inefficient bypass" created by high ILEC switched access prices could become a driving force in determining investment in competing local services. Customers might enjoy somewhat lower prices as a result of the additional investment and entry induced by high ILEC access prices, but at the welfare cost of less efficient, higher cost production.

11. *Targeted Price Reductions.* Aggressively lowering switched access prices in response to entry is much more likely to be profitable if the ILEC can target the reductions at those customers most likely to switch local carriers. To the extent the ILEC can target lower prices, the CLEC will expect to compete with lower prices and to earn lower returns on its investments. That in turn will deter some CLEC investment.

12. Targeted reductions in downstream prices are likely to be easy for the ILEC to implement if the ILEC offers interexchange service and can offer lower interexchange service prices to relatively high volume users who continue to subscribe to ILEC local service. Customers that use