

whether rates are reasonable.<sup>1996</sup> Sprint argues that, unless the Commission imposes an imputation rule, incumbent LECs will have little incentive to pursue rate rebalancing activities vigorously before state commissions.<sup>1997</sup> Teleport urges the Commission not to assume that new entrants possess sufficient financial resources to survive a price squeeze and suggests that, if a carrier fails an imputation test, the Commission should find that the market is not sufficiently competitive to allow incumbent BOC entry into the in-region long distance market.<sup>1998</sup>

841. Among new entrants, Time Warner believes an imputation rule is unnecessary because unbundled element rates will not exceed retail rates in most cases.<sup>1999</sup> It asserts that the Commission should not adopt an imputation rule during the transition period prior to the enactment of universal service reform, and that it is unlikely that competing providers will ignore competitive forces and uniformly retain non-competitive margins in order to support residential rates below TSLRIC.<sup>2000</sup>

842. Several commenters express the view that imputation issues should be left for decision by the states.<sup>2001</sup> A number of state utility commissions that employ an imputation rule in their states endorse imputation as a way to prevent price squeezes, but either take no position on, or oppose, Commission adoption of imputation as a national standard.<sup>2002</sup> The Michigan Commission Staff believes that states should have flexibility to address imputation issues on their own, a process that has already begun in Michigan.<sup>2003</sup> The Washington Commission states that, although it has employed imputation as a method of ensuring that customers of monopoly

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<sup>1996</sup> See, e.g., Intermedia Comments at 14; Sprint Comments at 72-74.

<sup>1997</sup> Sprint reply at 44.

<sup>1998</sup> Teleport comments at 60-63.

<sup>1999</sup> Time Warner comments at 83.

<sup>2000</sup> *Id.* at 84-85

<sup>2001</sup> See, e.g., Alabama Commission comments at 28; Florida Commission comments at 38 (no need for federal imputation rule if each state may implement unbundled element pricing rules that cover costs); Wyoming Commission comments at 36.

<sup>2002</sup> See, e.g., Colorado Commission comments at 56-57 (opposing a national imputation rule); Washington Commission comments at 35 (questioning the need for preemption order that would require that local service rates exceed costs); Illinois Commission comments at 56-58 (urging the Commission not to prohibit states from adopting imputation rules, but taking no position on the need for a national imputation rule pending further study by the federal-state joint board).

<sup>2003</sup> Michigan Commission Staff comments at 16-17.

services do not subsidize other more competitive services, the "threat" posed by below-cost rates generally has been overstated.<sup>2004</sup>

843. The National Association of State Utility Consumer Advocates and the Competition Policy Institute argue that the Commission lacks power to act in this area because of the intrastate/interstate jurisdictional divide established by section 152(b) of the Communications Act of 1934.<sup>2005</sup>

844. Responding to the concern, expressed in the NPRM, about requiring imputation for below-cost services, the Texas Commission observes that Texas law will permit waiver of its imputation rule in certain cases.<sup>2006</sup> Frontier states that in the case of subsidized services a limited offset could be applied to reflect the subsidy, but only in the uncommon case in which the incumbent LEC can affirmatively prove that the affected class of service is priced below its forward-looking incremental cost.<sup>2007</sup>

845. Joint Consumer Advocates and the Ohio Commission suggest that adoption of an imputation rule is unnecessary because both the incumbent LEC and the new entrant will face the same burdens in providing below cost service, and each may recover their costs through other revenue sources, such as federal and state universal service funds.<sup>2008</sup> Joint Consumer Advocates and Ohio Consumers' Counsel take issue with the assumption that local service is subsidized, and argue imputation is unnecessary because retail rates are not significantly below cost.<sup>2009</sup> They assert that since other services, such as toll, also use the local loop, it is improper to load all of the costs of the local loop onto local service.<sup>2010</sup>

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<sup>2004</sup> Washington Commission comments at 36.

<sup>2005</sup> Competition Policy Institute comments at 13; Natl. Ass'n of State Util. Consumer Advocates comments at 5-8; Joint Consumer Advocates reply at 14.

<sup>2006</sup> Texas Commission comments at 29-30, Attachment II (Public Util. Regulatory Act of 1995, Tex. Rev. Civ. Stat. Ann., Art. 1446(c)) (Texas law requires the Texas Commission to adopt imputation rules by December 1, 1996).

<sup>2007</sup> Frontier comments at 29-30.

<sup>2008</sup> Joint Consumer Advocates reply at 15-16; Ohio Commission comments at 67.

<sup>2009</sup> Joint Consumer Advocates reply at 14-16; Ohio Consumers' Counsel comments at 38-40.

<sup>2010</sup> *Id.*

846. Several commenters voice concerns that an imputation rule would be difficult to implement in rural areas.<sup>2011</sup> The Minnesota Independent Coalition states that imputation could lead to increases in local rates for rural service, in contravention of the 1996 Act's universal service requirements of preserving rates in rural areas that are reasonably comparable to rates charged for similar services in urban areas, and the universal service policy requirements of 254(b).<sup>2012</sup>

847. Incumbent LECs also oppose imputation, claiming that it would create opportunities for arbitrage,<sup>2013</sup> fail to reflect the costs of unbundling incumbent LEC networks,<sup>2014</sup> put pressure on states to raise retail rates,<sup>2015</sup> create a de facto ceiling preventing incumbent LECs from recovering their costs,<sup>2016</sup> and constitute an unconstitutional taking of incumbent LEC revenues.<sup>2017</sup> NYNEX and BellSouth also assert that restrictions on cost recovery are inconsistent with the 1996 Act's requirement that unbundled element rates be based on costs.<sup>2018</sup> According to USTA and Ameritech, an imputation rule may cause incumbent LECs to subsidize new entrants, and lead to inefficient entry.<sup>2019</sup> BellSouth argues that intrastate retail prices are based on factors other than cost, such as the policies of the state commission that approved the charges, and that an imputation rule would interfere with the states' exclusive ratemaking authority over intrastate rates and charges. According to BellSouth, Congress did not establish any requirement or expectation that these pricing standards would yield charges that would bear any particular relationship to one another, and BellSouth asserts there is no reason to expect the sum of unbundled element prices to add up to the retail rate any more than one would expect that the

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<sup>2011</sup> See, e.g., TCA Comments at 8.

<sup>2012</sup> Minn. Ind. Coalition comments at 31, 33; see also Western Alliance comments at 3-4 (Commission should not adopt an imputation rule until other, explicit mechanisms are in place to ensure the statutory goal of reasonable parity of urban and rural rates).

<sup>2013</sup> E.g., USTA comments at 75.

<sup>2014</sup> See, e.g., Ameritech comments at 83-84 (rejecting a "sum-of-the-parts" test for unbundled element pricing, and arguing that an imputation rule must make allowance for costs of unbundling the network); GTE comments at 64-65.

<sup>2015</sup> E.g., USTA comments at 77.

<sup>2016</sup> E.g., NYNEX comments at 60 (asserting that such a price ceiling conflicts with the 1996 Act).

<sup>2017</sup> See, e.g., NYNEX comments at 60-61; USTA comments at 77, reply at 31.

<sup>2018</sup> BellSouth reply at 42; NYNEX comments at 61.

<sup>2019</sup> Ameritech comments at 84; USTA comments at 77.

individual parts of an automobile could be obtained for less than the price of an already-assembled car.<sup>2020</sup>

**c. Discussion**

848. Although we recognize, as several commenters observe, that an imputation rule could help detect and prevent price squeezes, we decline to impose an imputation requirement. Adoption of an imputation rule could force states to engage in a major rate rebalancing effort at this time, because it would impose substantial additional burdens on states at a time when they will need to devote significant resources to implementing the 1996 Act.

849. In addition to our practical concerns regarding implementation of an imputation rule, we find that an imputation rule may not be necessary to achieve the pro-competitive goals of the 1996 Act. As some commenters, including several state commissions, suggest, competing providers may be able to provide basic service, at less than the cost of facilities and associated management, just as incumbent LECs do currently, by selling customers higher profit vertical or intrastate toll services, or through receipt of access revenues and subsidies. Further, the Ohio Consumers' Counsel suggest that below-cost rates may not be sufficiently prevalent to justify a national imputation rule.<sup>2021</sup> The Joint Consumer Advocates and the Ohio Consumers' Counsel question whether local service is, in fact, underpriced.<sup>2022</sup>

850. We give special weight to the comments of several state commissions that currently employ imputation rules.<sup>2023</sup> These state commissions endorse imputation as a tool to prevent price squeezes, but urge us only to provide states with the flexibility to adopt imputation rules. We agree with those state commission commenters that argue that nothing in the 1996 Act prohibits individual states from adopting imputation rules. While an imputation rule may be pro-competitive, we will leave the implementation of such rules to individual states for the time being.

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<sup>2020</sup> BellSouth comments at 68; *see also* US Network Services comments at 5-6.

<sup>2021</sup> Ohio Consumers' Counsel comments at 39.

<sup>2022</sup> Joint Consumer Advocates reply at 16; Ohio Consumers' Counsel comments at 39.

<sup>2023</sup> *See, e.g.*, Colorado Commission comments at 56-57; Illinois Commission comments at 57-58; Michigan Commission Staff comments at 16-17; Washington Commission comments at 35.

### 3. Discrimination

#### a. Background

851. In the NPRM, we noted the different usages of the term "discrimination" in the 1996 Act and the 1934 Act.<sup>2024</sup> Sections 251 and 252 require that interconnection and unbundled element rates be "nondiscriminatory."<sup>2025</sup> Similarly, section 251(c)(4) requires that, in making resale available, carriers not impose "discriminatory conditions or limitations on resale."<sup>2026</sup> Finally, section 252(e) provides that states may reject a negotiated agreement or a portion of the agreement if it "discriminates" against a carrier not a party to the agreement and section 252(i) requires incumbent LECs to "make available any interconnection, service, or network element provided under an agreement . . . to which it is a party to any requesting telecommunications carrier upon the same terms and conditions."<sup>2027</sup> In contrast, section 202(a) of the 1934 Act provides that "(i)t shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges . . . for . . . like communication service."<sup>2028</sup>

852. We sought comment on "the meaning of the term 'nondiscriminatory' in the 1996 Act compared with the phrase 'unreasonable discrimination' in the 1934 Act." We asked specifically whether Congress intended to prohibit all price discrimination, including measures such as density zone pricing or volume and term discounts, by choosing the word "nondiscriminatory." We further asked whether sections 251 and 252 could be interpreted to prohibit only unjust or unreasonable discrimination. Finally, we sought comment on whether the 1996 Act prohibited carriers from charging different rates to parties that are not similarly situated.<sup>2029</sup>

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<sup>2024</sup> NPRM at para. 155.

<sup>2025</sup> 47 U.S.C. §§ 251(c)(2), (3), (6), and 252(d)(1).

<sup>2026</sup> 47 U.S.C. § 251(c)(4)(B). *See infra*, Section VIII.C..

<sup>2027</sup> 47 U.S.C. §§ 252(e), (i).

<sup>2028</sup> 47 U.S.C. § 202(a).

<sup>2029</sup> NPRM at para. 156.

**b. Comments**

853. Many state regulatory commissions, several incumbent LECs, and USTA maintain that the term "nondiscriminatory" used in the 1996 Act is synonymous with the prohibition of "unjust and unreasonable discrimination" used in the 1934 Act.<sup>2030</sup> Generally, these parties agree that pricing variations are only discriminatory when the affected parties are similarly situated. They argue that a blanket prohibition on all price differences, even when justified by costs, would be anti-competitive and would appear to defeat the process of negotiation. The Ohio Commission argues that smaller companies, not similarly situated to the larger telephone companies already in operation, need different treatment in order to compete.<sup>2031</sup> Finally, they contend that Congress did not intend to prohibit reasonably supported plans, such as volume and term discounts. The Pennsylvania Commission argues that, if Congress had intended to prohibit cost-based price differences, it would have included interconnection and unbundled elements in the prohibition against geographic price differences for toll rates, which is contained in Section 254(g).<sup>2032</sup> Pacific Telesis argues that different prices are permissible under the "nondiscriminatory" standard wherever incremental costs decline as output increases.<sup>2033</sup>

854. Other commenters, including MCI and MFS, assert that the term "nondiscriminatory" in the 1996 Act must be interpreted to have a more stringent meaning than the phrase "unjust and unreasonable discrimination" used in the 1934 Act.<sup>2034</sup> Several parties suggest that since the conferees considered and rejected a version of section 251 that applied an "unreasonably discriminatory" standard to the actions of incumbent LECs, the change in wording was purposeful.<sup>2035</sup> Generally, these parties argue that although the "nondiscriminatory" standard is more stringent, cost-based price differences are nonetheless permissible under the 1996 Act.<sup>2036</sup> The Independent Cable & Telecommunications Association contends that the only way to prevent

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<sup>2030</sup> See, e.g., Alabama Commission comments at 23; BellSouth comments at 58; California Commission comments at 31-33; Colorado Commission comments at 48; District of Columbia Commission comments at 25; Illinois Commission comments at 47; Indiana Commission comments at 25; MECA comments at 55-56; Ohio Commission comments at 51; PacTel comments at 76-77; USTA comments at 57-58.

<sup>2031</sup> Ohio Commission comments at 53.

<sup>2032</sup> Pennsylvania Commission comments at 32.

<sup>2033</sup> PacTel comments at 77; *but see* AT&T reply at 35.

<sup>2034</sup> See, e.g., MCI comments at 71; MFS comments at 63; ALTS reply at 40.

<sup>2035</sup> NCTA comments at 31 n.114 (*citing* S. 652, 104th Cong. 1st Sess. § 101 (deleting Section 251(c)(2)(C)) (Draft, Nov. 27, 1995)); *see also* MFS comments at 63.

<sup>2036</sup> See, e.g., MCI comments at 71-72; MFS comments at 64; Michigan Commission comments at 18; Municipal Utilities comments at 14-15; Pennsylvania Commission comments at 32; Sprint comments at 64-65.

incumbent LECs from discriminating against smaller companies and new entrants is to prohibit all non-cost based price differences.<sup>2037</sup> LDDS argues that only cost-based price differentials should be permitted, and that any non-cost-based volume discount should be prohibited, even if arrived at through agreement of the parties.<sup>2038</sup>

855. A third group of commenters argue for a strict reading of the term "nondiscriminatory."<sup>2039</sup> They argue that the plain meaning of the term "nondiscriminatory" without qualification demonstrates that under section 251 even reasonable discrimination is impermissible.<sup>2040</sup> R. Koch contends that if there is *any* discrimination, small entrants will be at a disadvantage.<sup>2041</sup> Finally, they maintain that the higher standard reflects the distinction between the carrier-user relationship being regulated in section 202(a) and the intercarrier relationship addressed in section 251(c).<sup>2042</sup>

856. CMRS providers argue that some state regulations treat CMRS providers differently than wireline new entrants with respect to the rates for interconnection with incumbent LECs. AT&T Wireless contends that the New York and Connecticut Commissions require incumbent LECs to charge two distinct interconnection rates depending on whether the carrier is classified as a CMRS provider or competing provider of local exchange service.<sup>2043</sup> According to AT&T Wireless, in New York, the wireline competitive LEC rate for termination of traffic on the incumbent LEC network is less than one cent per minute and the CMRS provider rate is approximately 2.6 cents (\$0.026) per minute.<sup>2044</sup> AT&T Wireless further contends that, in order to obtain the lower rate, a CMRS provider in New York must comply with state regulations, such

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<sup>2037</sup> Ind. Cable & Telecomm. Ass'n reply at 11-12.

<sup>2038</sup> LDDS reply at 40-41.

<sup>2039</sup> See, e.g., AT&T comments at 68-69; NCTA comments at 31 (section 251(c) requires strict scrutiny of any discrimination, not solely unreasonable discrimination); WinStar comments at 7.

<sup>2040</sup> See, e.g., WinStar comments at 7.

<sup>2041</sup> See, e.g., R. Koch comments at 3.

<sup>2042</sup> NCTA comments at 31.

<sup>2043</sup> Letter from Cathleen A. Massey, AT&T Wireless Services, to William F. Caton, Acting Secretary, FCC, July 2, 1996, filed in CC Docket Nos. 95-185 and 96-98, at 1-3 (*AT&T July 2, 1996 Ex Parte*).

<sup>2044</sup> *Id.*

as universal service obligations associated with residential and Lifeline service.<sup>2045</sup> Bell Atlantic NYNEX Mobile submits that in Connecticut, the rate for wireline new entrants' termination of traffic on the incumbent LEC network is less than one cent (\$0.01) per minute and the CMRS provider rate is 4.14 cents (\$0.0414) per minute.<sup>2046</sup> AT&T Wireless states that California has ordered incumbent LECs to implement interim bill-and-keep compensation for interconnection for wireline entrants' interconnection but not for CMRS providers' interconnection,<sup>2047</sup> and Florida has ruled that no compensation shall be paid to mobile carriers by incumbent LECs for land-originated calls.<sup>2048</sup>

857. In addition to their assertion regarding rate discrimination, CMRS providers maintain that state commissions permit incumbent LECs to treat CMRS providers in a discriminatory manner with respect to the terms and conditions of interconnection.<sup>2049</sup> Bell Atlantic NYNEX Mobile states that in Connecticut, Maryland, New York and Texas, the rates paid by Bell Atlantic NYNEX Mobile to the connecting LEC to terminate calls originated on Bell Atlantic NYNEX Mobile's network are more than twice the rates paid by competing wireline LECs to incumbent LECs.<sup>2050</sup> Bell Atlantic NYNEX Mobile also states that "these disparities have no rational cost basis since an incumbent LEC's costs to complete a call received from Bell Atlantic NYNEX

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<sup>2045</sup> See *Order Instituting Framework for Directory Listings, Carrier Interconnection and Carrier Compensation*, New York Public Service Commission, CASE 94-C-0095 (New York Commission, September 27, 1996) at 15.

<sup>2046</sup> Bell Atlantic NYNEX Mobile comments in CC Docket No. 95-185, at Exhibit A.

<sup>2047</sup> *Competition For Local Exchange Service*, Decision 95-07-054, Appendix A, para. 7 (California Commission, July 24, 1995).

<sup>2048</sup> See *Investigation Into the Rates For Interconnection of Mobile Service Providers With Facilities of Local Exchange Companies*, Docket No. 940235-TL, slip op. at 24 (Florida Commission, Oct. 11, 1995).

<sup>2049</sup> AT&T comments in CC Docket No. 95-185, at 27; AirTouch Communications comments in CC Docket No. 95-185, at 33; Bell Atlantic NYNEX Mobile comments in CC Docket 95-185, at 5-6; Comcast Corporation comments in CC Docket No. 95-185, at 6-7; New Par comments in CC Docket No. 95-185, at 4-5.

<sup>2050</sup> Bell Atlantic NYNEX Mobile comments in CC Docket No. 95-185, at Exhibit A, p.5. Bell Atlantic NYNEX Mobile's Exhibit A shows that LEC charges to competitive providers on an average rate per minute are considerably less than those to CMRS carriers: In Connecticut, Bell Atlantic NYNEX Mobile pays 4.14 cents/min. (\$0.0414) to terminate local traffic on a LEC network while competitive providers pay 0.8 cents/min. (\$0.008); in Maryland, Bell Atlantic NYNEX Mobile pays 2.27 cents/min. (\$0.0227) to terminate local traffic on a LEC network, while competitive providers pay 0.5 cents/min. (\$0.005); in New York, Bell Atlantic NYNEX Mobile pays 2.59 cents/min. (\$0.0259) to terminate local traffic on a LEC network, while competitive providers pay only 0.98 cents/min.; and in Texas, Bell Atlantic NYNEX Mobile pays 1.7 cents/min. (\$0.017) to terminate local traffic on a LEC network, while competitive providers pay zero cents/min. (\$0.0). *Id.*

Mobile should be no higher than its costs to complete calls received from other carriers.<sup>2051</sup> Similarly, APC states that its interconnection agreements with Bell Atlantic, which are identical in Maryland, Virginia, West Virginia, and District of Columbia, artificially inflate its costs by at least 3.1 cents (\$0.031) per minute.<sup>2052</sup>

858. Western Wireless also provides examples of discriminatory interconnection rates by LECs.<sup>2053</sup> Western Wireless states that it has been unable to reach an agreement with any incumbent LECs in its wireless service area that is based on cost or that provides reciprocal compensation.<sup>2054</sup> AT&T Wireless contends that states regularly permit LECs to charge wireless carriers significantly higher rates than competing LECs for intrastate interconnection.<sup>2055</sup> CTIA cites LEC-LEC interconnection agreements in 18 states that provide for rates much below the approximate nationwide average incumbent LEC-CMRS interconnection rate of three cents (\$0.03) per minute.<sup>2056</sup>

### c. Discussion

859. We conclude that the term "nondiscriminatory" in the 1996 Act is not synonymous with "unjust and unreasonable discrimination" in section 202(a), but rather is a more stringent standard.<sup>2057</sup> Finding otherwise would fail to give meaning to Congress's decision to use different language. We agree, however, with those parties that argue that cost-based differences in rates are permissible under sections 251 and 252.

860. Section 252(d)(1), for example, requires carriers to base interconnection and network element charges on costs. Where costs differ, rate differences that accurately reflect those

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<sup>2051</sup> *Id.* at 5-6.

<sup>2052</sup> APC comments in CC Docket No. 95-185 at 5-6 (alleging it pays Bell Atlantic a monthly \$25 per trunk surcharge between its mobile switching center and Bell Atlantic's tandem, a usage-sensitive charge for transport and switching elements, and \$800 a month for termination for SS7 connectivity, while Bell Atlantic pays APC nothing in return).

<sup>2053</sup> Letter from Doane F. Kiechel, counsel to Western Wireless Corporation, to William F. Caton, Acting Secretary, FCC, July 5, 1996, in CC Docket No. 96-98.

<sup>2054</sup> *Id.* at 4.

<sup>2055</sup> *AT&T July 2, 1996 Ex Parte* at 3.

<sup>2056</sup> Letter from Randall S. Coleman, CTIA, to Michele Farquhar, Chief, Wireless Telecommunications Bureau, FCC, July 2, 1996, in CC Docket Nos. 95-185 and 96-98, at Attachments.

<sup>2057</sup> *See supra*, Section IV.G, discussing nondiscriminatory terms and conditions for interconnection, and *supra*, Section V.G., discussing nondiscriminatory terms and conditions for unbundled network elements.

differences are not discriminatory. This is consistent with the economic definition of price discrimination, which is "the practice of selling the same product at two or more prices where the price differences do not reflect cost differences . . . . An important feature of the economic definition of price discrimination is that it occurs not only when prices are different in the presence of similar costs but also *when the prices are the same and the costs of supplying customers are different.*"<sup>2058</sup> As one economist has recognized, differential pricing is "one of the most prevalent forms of marketing practices" of competitive enterprises.<sup>2059</sup> Strict application of the term "nondiscriminatory" as urged by those commenters who argue that prices must be uniform would itself be discriminatory according to the economic definition of price discrimination. If the 1996 Act is read to allow no price distinctions between companies that impose very different interconnection costs on LECs, competition for all competitors, including small companies, could be impaired. Thus, we find that price differences, such as volume and term discounts, when based upon legitimate variations in costs are permissible under the 1996 Act, if justified.

861. On the other hand, price differences based not on cost differences but on such considerations as competitive relationships, the technology used by the requesting carrier, the nature of the service the requesting carrier provides, or other factors not reflecting costs, the requirements of the Act, or applicable rules, would be discriminatory and not permissible under the new standard. Such examples include the imposition of different rates, terms and conditions based on the fact that the competing provider does or does not compete with the incumbent LEC, or offers service via wireless rather than wireline facilities. We find that it would be unlawfully discriminatory, in violation of sections 251 and 252, if an incumbent LEC were to charge one class of interconnecting carriers, such as CMRS providers, higher rates for interconnection than it charges other carriers, unless the different rates could be justified by differences in the costs incurred by the incumbent LEC.

862. State regulations permitting non-cost based discriminatory treatment are prohibited by the 1996 Act. This conclusion is consistent with both the letter and the spirit of the 1996 Act and our determination that the pricing for interconnection, unbundled elements, and transport and termination of traffic should not vary based on the identity or classification of the interconnector.<sup>2060</sup>

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<sup>2058</sup> David L. Kaserman & John W. Mayo, *Government & Business: The Economics of Antitrust & Regulation* at 273-74 (1995) (citing George J. Stigler, *The Theory of Price* (3d ed. 1966)) (emphasis added).

<sup>2059</sup> Hal R. Varian, "Price Discrimination," in *Handbook of Industrial Organization*, vol.1, p. 598 (R. Schmalensee and R.D. Willig eds., 1989).

<sup>2060</sup> See *infra*, Section XI.A., discussing transport and termination rates.

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**VIII. RESALE**

863. Section 251(c)(4) imposes a duty on incumbent LECs to offer certain services for resale at wholesale rates. Specifically, section 251(c)(4) requires an incumbent LEC:

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.<sup>2061</sup>

864. The requirement that incumbent LECs offer services at wholesale rates is described in section 252(d)(3), which sets forth the pricing standard that states must use in arbitrating agreements and reviewing rates under BOC statements of generally available terms and conditions:

[A] State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

Section VIII.A. of this Order discusses the scope of section 251(c)(4). Section VIII.B. addresses the determination of "wholesale rates." Section VIII.C. considers the issue of conditions or limitations on resale under this section, Section VIII.D. discusses the resale obligations under section 251(b)(1), and Section VIII.E. considers the application of access charges in the resale environment.

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<sup>2061</sup> 47 U.S.C. § 251(c)(4).

**A. Scope of Section 251(c)(4)****1. Background and Comments**

865. In the NPRM, we sought comment generally on the scope of section 251(c)(4).<sup>2062</sup>

AT&T and MCI request that the Commission adopt a minimum list of services that should be available for resale under section 251(c)(4).<sup>2063</sup> Cable & Wireless, the Telecommunications Resellers Association, and others argue for an expansive definition of "telecommunications services."<sup>2064</sup> For example, MCI argues that we should explicitly identify the following as telecommunications services that must be made available for resale: measured-rate business, flat-rate business, measured-rate residential, flat-rate residential; custom calling features (including all CLASS services); call blocking services; voice messaging; Integrated Services Digital Network (ISDN), Basic Rate Interface (BRI), and Primary Rate Interface (PRI); flat-rated and measured trunk services (including all types of PBX trunks); Automatic Number Identification (ANI) over T-1; data services; promotions, optional calling plans, special pricing plans; calling card, directory services, operator services; intraLATA toll; public access line service; semi-public coin telephone service; foreign exchange services; video dialtone; and Centrex and all feature packages.<sup>2065</sup>

866. Incumbent LECs on the other hand, argue for a much more limited set of services, primarily those generally thought of as basic telephone services.<sup>2066</sup> For example, SBC lists the following as examples of services that should be excluded: billing and collection; enhanced billing products; enhanced white page listings; inside wire; BDS/LAN; customer premises equipment; and information services.<sup>2067</sup>

867. Some commenters argue that parties seeking discounted telecommunications services for their own telephony needs should not be allowed to purchase services at wholesale prices. For example, Roseville Telephone argues that (1) requests for discounted resale services must come from carriers, not from end users; (2) a wholesale customer must resell 95 percent of the services it purchases at wholesale prices to unaffiliated companies; and

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<sup>2062</sup> NPRM at para. 173.

<sup>2063</sup> AT&T comments at 77 n.113; MCI comments at 84.

<sup>2064</sup> Cable & Wireless comments at 38-39; Telecommunications Resellers Ass'n comments at 18 n.47; AT&T comments at 76-78; MCI comments at 84.

<sup>2065</sup> MCI comments at 84.

<sup>2066</sup> See, e.g., MECA comments at 60; NYNEX comments at 76-7; SBC reply at 13.

<sup>2067</sup> SBC comments at 67-68.

(3) limits should be placed on how much of what wholesale service is sold to any one subscriber.<sup>2068</sup> Similarly, GTE argues that new entrants must resell service they purchase under section 251(c)(4) and not simply use such services for their own internal or administrative purposes.<sup>2069</sup> Cincinnati Bell requests that we explicitly state that resellers of incumbent LEC service must be telecommunications carriers.<sup>2070</sup> Conversely, AT&T opposes predicating the ability to purchase services at wholesale rates on the percentage of customers that purchase the resold service.<sup>2071</sup>

868. Some parties address the application of section 251(c)(4) to the services incumbent LECs sell to independent public payphone providers. The American Public Communications Council contends that independent public payphone providers are not "telecommunications carriers."<sup>2072</sup> The American Public Communications Council cites the definition in section 3(44) that excludes "aggregators," as defined in section 226<sup>2073</sup> and points out that we have previously found that independent public payphone providers are aggregators insofar as they exercise control over payphones.<sup>2074</sup> Thus, the American Public Communications Council argues, services sold to independent public payphone providers by incumbent LECs would be "telecommunications service[s] that [an incumbent LEC] provides at retail to subscribers who are not telecommunications carriers," thereby making such services subject to section 251(c)(4).<sup>2075</sup> The American Public Communications Council also argues that nothing in section 251 requires an entity purchasing services for resale to be a "telecommunications carrier."<sup>2076</sup> NYNEX argues that independent public payphone providers do not purchase these services for resale, but for their own use.<sup>2077</sup> Additionally, NYNEX

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<sup>2068</sup> Roseville Tel. comments at 3-5.

<sup>2069</sup> GTE comments at 47.

<sup>2070</sup> Cincinnati Bell comments at 31.

<sup>2071</sup> AT&T comments at 80 n.120.

<sup>2072</sup> American Public Communications Council comments at 2-3.

<sup>2073</sup> 47 U.S.C. § 153(44). Section 226(a)(2) defines "aggregator" as "any person that, in the ordinary course of its operations, makes telephones available to the public or to transient users of its premises, for interstate telephone calls using a provider of operator services. 47 U.S.C. § 226(a)(2).

<sup>2074</sup> American Public Communications Council comments at 2 (citing *Policies and Rules Concerning Operator Service Providers, Report and Order*, 6 FCC Rcd 2744 (1991), *recon.* 7 FCC Rcd 3882 (1992)).

<sup>2075</sup> American Public Communications Council at 3.

<sup>2076</sup> *Id.*

<sup>2077</sup> NYNEX reply at 39.

argues, independent payphone providers do not interpose themselves between incumbent LECs and their existing retail customers, and thus do not enable incumbent LECs to avoid some portion of costs they incur in dealing with those customers.<sup>2078</sup> MFS argues that no resale relationship exists between an incumbent LEC and an independent public payphone provider.<sup>2079</sup>

869. Parties dispute whether specially-priced bundles of services must be offered for resale. SNET argues that LECs are not required to resell bundled services, as long as the services are all offered separately. SNET contends that requiring wholesale offerings of bundled services would deter competitive offerings by incumbent LECs.<sup>2080</sup> SBC argues that bundled services are not single services and therefore not subject to the resale provisions of the 1996 Act.<sup>2081</sup> The Telecommunications Resellers Association, TCC, LDDS, and MCI take the opposite position,<sup>2082</sup> noting that bundled items are often sold at prices well below the sum of their stand-alone prices.

870. The Telecommunications Resellers Association and Cable & Wireless argue that, where the incumbent LEC offers services only on a bundled basis, these services should be unbundled and offered separately, at wholesale rates.<sup>2083</sup> AT&T specifically argues that it should be allowed to purchase local exchange service without operator services.<sup>2084</sup> Pacific Telesis, NYNEX, and NCTA argue that incumbent LECs should not be subject to this requirement so long as the services are not offered to retail customers on a stand-alone basis.<sup>2085</sup> Bell Atlantic opposes AT&T's claim that Bell Atlantic should be required to provide local service without operator services for resale.<sup>2086</sup>

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<sup>2078</sup> *Id.*

<sup>2079</sup> MFS reply at 32.

<sup>2080</sup> SNET comments at 34.

<sup>2081</sup> *Id.* at 72-73.

<sup>2082</sup> Telecommunications Resellers Ass'n comments at 18; TCC comments at 44; LDDS comments at 83; MCI comments at 89.

<sup>2083</sup> *See, e.g.*, Telecommunications Resellers Ass'n comments at 19 n.49; Cable & Wireless comments at 48.

<sup>2084</sup> AT&T comments at 81 n.123.

<sup>2085</sup> PacTel comments at 87; NYNEX comments at 73; NCTA comments at 57.

<sup>2086</sup> Bell Atlantic reply at 25.

## 2. Discussion

871. Section 251(c)(4)(A) imposes on all incumbent LECs the duty to offer for resale "any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."<sup>2087</sup> We conclude that an incumbent LEC must establish a wholesale rate for each retail service that: (1) meets the statutory definition of a "telecommunications service;" and (2) is provided at retail to subscribers who are not "telecommunications carriers."<sup>2088</sup> We thus find no statutory basis for limiting the resale duty to basic telephone services, as some suggest.

872. We need not prescribe a minimum list of services that are subject to the resale requirement. State commissions, incumbent LECs, and resellers can determine the services that an incumbent LEC must provide at wholesale rates by examining that LEC's retail tariffs. The 1996 Act does not require an incumbent LEC to make a wholesale offering of any service that the incumbent LEC does not offer to retail customers. State commissions, however, may have the power to require incumbent LECs to offer specific intrastate services.<sup>2089</sup>

873. Exchange access services are not subject to the resale requirements of section 251(c)(4). The vast majority of purchasers of interstate access services are telecommunications carriers, not end users. It is true that incumbent LEC interstate access tariffs do not contain any limitation that prevents end users from buying these services, and that end users do occasionally purchase some access services, including special access,<sup>2090</sup> Feature Group A,<sup>2091</sup> and certain Feature Group D elements for large private networks.<sup>2092</sup>

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<sup>2087</sup> 47 U.S.C. § 251(c)(4)(A).

<sup>2088</sup> "Telecommunications service" is defined in section 3(46) to mean "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46) "Telecommunications" is, in turn, defined in section 3(43) as "the transmission, between or among points specified by the user, of information of the user's choosing without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43). "Telecommunications carrier" is defined in section 3(44) to mean "any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in section 226)." 47 U.S.C. § 153(44).

<sup>2089</sup> See, e.g., Illinois Public Utilities Act, Section 13-505.5.

<sup>2090</sup> End users may purchase special access from incumbent LECs in order to use high volume services offered by IXC's, such as AT&T's Megacom service.

<sup>2091</sup> Feature Group A is similar to a local exchange service, but is used for interstate access. In such circumstances, the end user dials a seven-digit number to reach the LEC's "dial tone office" serving an IXC, where the LEC switches the call to the IXC's POP via a dedicated line-side connection. Feature Group A

Despite this fact, we conclude that the language and intent of section 251 clearly demonstrates that exchange access services should not be considered services an incumbent LEC "provides at retail to subscribers who are not telecommunications carriers" under section 251(c)(4). We note that virtually all commenters in this proceeding agree, or assume without stating, that exchange access services are not subject to the resale requirements of section 251(c)(4).<sup>2093</sup>

874. We find several compelling reasons to conclude that exchange access services should not be subject to resale requirements. First, these services are predominantly offered to, and taken by, IXCs, not end users. Part 69 of our rules defines these charges as "carrier's carrier charges,"<sup>2094</sup> and the specific part 69 rules that describe each interstate switched access element refer to charges assessed on "interexchange carriers" rather than end users.<sup>2095</sup> The mere fact that fundamentally non-retail services are offered pursuant to tariffs that do not restrict their availability, and that a small number of end users do purchase some of these services, does not alter the essential nature of the services. Moreover, because access services are designed for, and sold to, IXCs as an input component to the IXC's own retail services, LECs would not avoid any "retail" costs when offering these services at "wholesale" to those same IXCs. Congress clearly intended section 251(c)(4) to apply to services targeted to end user subscribers, because only those services would involve an appreciable level of avoided costs that could be used to generate a wholesale rate. Furthermore, as explained in the following paragraph, section 251(c)(4) does not entitle subscribers to obtain services at wholesale rates for their own use. Permitting IXCs to purchase access services at wholesale rates for their own use would be inconsistent with this requirement.

875. We conclude that section 251(c)(4) does not require incumbent LECs to make services available for resale at wholesale rates to parties who are not "telecommunications carriers" or who are purchasing service for their own use. The wholesale pricing requirement is intended to facilitate competition on a resale basis. Further, the negotiation process established by Congress for the implementation of section 251 requires incumbent LECs to negotiate agreements, including resale agreements, with "requesting telecommunications

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represents approximately one percent of incumbent LEC transport revenues.

<sup>2092</sup> Feature Group D is the set of elements through which IXCs today almost universally purchase switched access services from incumbent LECs.

<sup>2093</sup> See, e.g., Cincinnati Bell comments at 34; Citizens Utilities comments at 25; NYNEX comments at 35 n.70; Rural Tel. Coalition comments at 20; J. Staurulakis comments at 6; SBC reply at 13; USTA reply at 31; Wisconsin Commission comments at Attachment, pp. 7-8.

<sup>2094</sup> 47 U.S.C. § 69.5(b).

<sup>2095</sup> The one exception, as discussed below, is the SLC, which is assessed on end users regardless of who purchases the access services from the incumbent LEC.

carrier or carriers,"<sup>2096</sup> not with end users or other entities. We further discuss the definition of "telecommunications carrier" in Section IX. of the Order.

876. With regard to independent public payphone providers, however, we agree with the American Public Communication Council's argument that such carriers are not "telecommunications carriers" under section 3(44). We therefore also agree with the American Public Communications Council's contention that the services independent public payphone providers obtain from incumbent LECs are telecommunications services that incumbent LECs provide "at retail to subscribers who are not telecommunications carriers" and that such services should be available at wholesale rates to telecommunications carriers. Because we conclude that independent public payphone providers are not "telecommunications carriers," however, we conclude that incumbent LECs need not make available service to independent public payphone providers at wholesale rates. This is consistent with our finding that wholesale offerings must be purchased for the purpose of resale by "telecommunications carriers."

877. We conclude that the plain language of the 1996 Act requires that the incumbent LEC make available at wholesale rates retail services that are actually composed of other retail services, *i.e.*, bundled service offerings. Section 251(c)(4) states that the incumbent LEC must offer for resale "any telecommunications service" provided at retail to subscribers who are not telecommunications carriers. The resale provision of the 1996 Act does not contain any language exempting services if those services can be duplicated or approximated by combining other services. On the other hand, section 251(c)(4) does not impose on incumbent LECs the obligation to disaggregate a retail service into more discrete retail services. The 1996 Act merely requires that any retail services offered to customers be made available for resale.

## **B. Wholesale Pricing**

### **1. Background**

878. As discussed above, section 251(c)(4) requires incumbent LECs to offer at "wholesale rates" any telecommunications services that the carrier provides at retail to subscribers who are not telecommunications carriers. Section 252(d)(3) establishes the standard that states must use in determining wholesale rates in arbitrations or in reviewing wholesale rates under BOC statements of generally available terms and conditions. Specifically, section 252(d)(3) provides that wholesale rates shall be set "on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the

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<sup>2096</sup> 47 U.S.C. § 252(a)(1).

portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier."<sup>2097</sup>

879. In the NPRM, we generally sought comment on the meaning of the term "wholesale rates" in section 251(c)(4).<sup>2098</sup> We asked if we could and should establish principles for the states to apply in order to determine wholesale prices in an expeditious and consistent manner. We also sought comment on whether we should issue rules for states to apply in determining avoided costs. We stated that we could, for example, determine that states are permitted under the 1996 Act to direct incumbent LECs to quantify their costs for any marketing, billing, collection, and similar activities that are associated with offering retail, but not wholesale, services.<sup>2099</sup> We also sought comment on whether avoided costs should include a share of common costs and general overhead or "markup" assigned to such costs. LECs would then reduce retail rates by this amount, offset by any portion of expenses that they incur in the provision of wholesale rates.<sup>2100</sup> We noted that this approach appeared to be consistent with the 1996 Act, but would create certain administrative difficulties because all of the information regarding costs is under the control of the incumbent LECs.<sup>2101</sup> We also asked for comment on several alternative approaches. For example, we asked whether we could establish a uniform set of presumptions regarding avoided costs that states could adopt and that would apply in the absence of a quantification of such costs by incumbent LECs.<sup>2102</sup> Additionally, we asked whether we should identify specific accounts or portions of accounts in the Commission's Uniform System of Accounts ("USOA")<sup>2103</sup> that the states should include as avoided costs.<sup>2104</sup> We also requested comment on whether we should establish rules that allocate avoided costs across services.<sup>2105</sup> We asked whether incumbent LECs should be allowed, or required, to vary the percentage wholesale discounts across different services

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<sup>2097</sup> 47 U.S.C. § 252(d)(3).

<sup>2098</sup> NPRM at para. 179.

<sup>2099</sup> *Id.* at para. 180.

<sup>2100</sup> *Id.*

<sup>2101</sup> *Id.*

<sup>2102</sup> *Id.* at para. 181.

<sup>2103</sup> 47 C.F.R. § 32.

<sup>2104</sup> NPRM at para. 181.

<sup>2105</sup> *Id.* at para. 182.

based on the degree the avoided costs relate to those services.<sup>2106</sup> Finally, we asked whether we should adopt a uniform percentage discount off of the retail rate of each service.<sup>2107</sup>

## 2. Comments

880. Most commenters other than incumbent LECs and some states advocate establishment of national pricing rules regarding arbitrated rates for competitors' acquisition of services for resale under section 251(c)(4).<sup>2108</sup> Incumbent LECs and state commissions argue that we do not have the authority to establish such rules and, even assuming such authority exists, we should not exercise it.<sup>2109</sup> Bay Springs, *et al.*, GVNW, and the Rural Telephone Coalition argue that establishing national wholesale pricing rules would insufficiently recognize differences in LECs' operations, resulting in inadequate compensation for small incumbent LECs.<sup>2110</sup>

881. Many commenters preface their arguments concerning wholesale discounts calculation with a general discussion of the role of resale in creating a competitive local exchange market. IXC's and resellers argue that resale is the quickest method of developing ubiquitous competition and therefore encourage the Commission to adopt of national rules that would result in substantial wholesale discounts.<sup>2111</sup> AT&T argues that a discount that does not permit viable competition should be presumed unreasonable.<sup>2112</sup> Cable & Wireless and the Telecommunications Resellers Ass'n point out that resale will be a particularly important

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<sup>2106</sup> *Id.*

<sup>2107</sup> *Id.*

<sup>2108</sup> See, e.g., AT&T comments at 82; Cable & Wireless comments at 37; CompTel comments at 96; MFS comments at 72; LCI comments at 31; Telecommunications Resellers Ass'n comments at 24; Teleport comments at 55-56; TCC comments at 45.

<sup>2109</sup> See, e.g., BellSouth comments at 67; SBC comments at 74; District of Columbia Commission comments at 32; Pennsylvania Commission comments at 37.

<sup>2110</sup> Bay Springs, *et al.*, comments at 17; GVNW comments at 40; Rural Tel. Coalition comments at 21. For example, the Rural Telephone Coalition points out that setting a national wholesale discount based on certain assumed levels of marketing expenses overstates avoided costs for small and rural incumbent LECs because such carriers face less competition and therefore have fewer marketing expenses. Rural Telephone Coalition comments at 21. Similarly, Bay Springs, *et al.*, GVNW, and the Rural Telephone Coalition argue that smaller incumbent LECs will not be able to avoid as many shared costs because their smaller staffing and operational functions are less responsive to the overall size of the carriers' operations. Bay Springs, *et al.*, comments at 17; GVNW comments at 40; Rural Tel. Coalition comments at 21.

<sup>2111</sup> See, e.g., AT&T reply at Appendix E (Avoided Cost Model); Cable & Wireless comments at 38.

<sup>2112</sup> AT&T comments at 85.

market entry strategy for small businesses that cannot afford the investments necessary to construct their own facilities or purchase unbundled elements.<sup>2113</sup>

882. Incumbent LECs, cable companies, CAPs, and Sprint generally argue for low wholesale discounts.<sup>2114</sup> Facility-based competitors and potential competitors, such as MFS and cable operators, argue that we should focus our efforts on encouraging facilities-based competition. Such parties, including incumbent LECs, claim that large resale discounts will discourage the development of facilities by making it unnecessary for a new entrant to construct its own facilities in order to compete effectively on the basis of price.<sup>2115</sup> MFS and GTE state that wholesale pricing should only be applied in the absence of facilities-based competition and that once such competition exists, we should forbear from imposing wholesale pricing on incumbent LEC services offered for resale.<sup>2116</sup> Incumbent LECs, cable operators, and Sprint oppose AT&T's proposal that discounts that do not permit viable competition should be presumed unreasonable.<sup>2117</sup>

883. Parties favoring national rules regarding resale differ as to the form such rules should take. Some propose that we establish a methodology for calculating avoided costs. For example, certain parties advocate a rule requiring the use of long-run incremental cost.<sup>2118</sup> Others advocate some form of proxies or presumptions to determine avoided costs. NEXTLINK argues that the Commission should establish a uniform set of presumptions regarding the types of costs that are to be avoided and require that calculations of avoided costs be based on publicly available sources.<sup>2119</sup> NEXTLINK contends that these requirements

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<sup>2113</sup> Cable & Wireless at 35; Telecommunications Resellers Ass'n at 15. The Competition Policy Institute similarly argues that resale will bring both large and small (resale) carriers into the market. Competition Policy Institute comments at 24.

<sup>2114</sup> See, e.g., GTE reply at 25-26; NYNEX comments at 40-41; NCTA comments at 23; TCI comments at 8; MFS reply at 34-36; Sprint reply at 41.

<sup>2115</sup> See, e.g., NCTA comments at 29-30; Comcast comments at 21; Cox comments at 32; Time Warner comments at 70; MFS comments at 72; U S West comments, Exhibit A (Federal Implementation of the Telecommunications Act of 1996) at 26; BellSouth comments at Attachment (Interconnection and Economic Efficiency), p. 19; Bell Atlantic comments at Attachment (Declaration of Robert W. Crandall), pp. 4-5.

<sup>2116</sup> This forbearance would be pursuant to 47 U.S.C. § 160. MFS comments at 72 n.80; GTE reply at 26 n.44.

<sup>2117</sup> See, e.g., Bell Atlantic reply at 24; Time Warner reply at 22; Sprint reply at 40.

<sup>2118</sup> See, e.g., GSA/DoD comments at 11.

<sup>2119</sup> NEXTLINK comments at 33.

would allow rapid identification of avoided costs and should lead to the development of presumptive percentage discounts that will apply to retail rates.<sup>2120</sup>

884. Incumbent LECs and MFS also argue that "avoided" costs are those that are actually avoided by such carriers instead of costs that are theoretically "avoidable."<sup>2121</sup> GTE argues that an "avoidable" standard improperly measures avoided costs in the long run versus actually avoided costs.<sup>2122</sup> IXC's and resellers argue that the standard should be "avoidable" costs; otherwise, incumbent LECs will be able to game their accounting systems and business practices to minimize actually "avoided" expense.<sup>2123</sup>

885. A number of parties propose that this Commission specify various USOA accounts as avoided costs.<sup>2124</sup> Several parties introduced models or studies that use accounting data to calculate wholesale discounts. These proposals are summarized in detail in the next section.

886. Some parties recommend that we adopt a specific percentage discount from the retail rate. For example, the Massachusetts Attorney General recommends an interim discount of 25 percent until carrier-specific cost studies can be performed.<sup>2125</sup> ACTA suggests that we adopt a 25 percent discount as a national standard.<sup>2126</sup> Several cable interests recommend ten

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<sup>2120</sup> *Id.* Also, the Telecommunications Resellers Ass'n advocates establishing a minimal discount, to which states may add, but not delete, unless they petition the FCC for express exemption. Telecommunications Resellers Ass'n comments at 24-25.

<sup>2121</sup> *See, e.g.*, GTE reply at 25-26; NYNEX comments at 81; SBC reply at 15 n.35; USTA reply at 30; MFS comments at 72.

<sup>2122</sup> *See* Rebuttal Testimony of Douglas E. Wellemeyer, *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a Framework for Network Architecture Development of Dominant Carrier Networks*, R. 93-04-003 and I. 93-04-002 (California Commission July 10, 1996), submitted as attachment to Letter from Whitney Hatch, Assistant Vice President--Regulatory Affairs, GTE, to John Nakahata, Senior Legal Advisor, Chairman Reed E. Hundt, FCC, July 18, 1996.

<sup>2123</sup> *See, e.g.*, AT&T comments at 84 n.129; Cable & Wireless reply at 29.

<sup>2124</sup> *See* AT&T comments at 83-84 n.130-131; GCI comment at 15; MCI comments at Attachment 2 (Pricing of Wholesale Services); TCC comments at 45-46; Telecommunications Resellers Ass'n comments at 25-26; Sprint comments at Appendix C. While not providing specific USOA accounts, several parties encourage the Commission to identify these accounts. *See, e.g.*, ACSI comments at 61.

<sup>2125</sup> Mass. Attorney General comments at 24.

<sup>2126</sup> ACTA comments at 31-32.

percent maximum discounts, at least until avoided cost studies can be performed.<sup>2127</sup> The Telecommunications Resellers Association suggests that discounts in the range of 30 to 50 percent off the retail rate are necessary to allow resellers to provide competition.<sup>2128</sup> AT&T argues that, whatever discount is selected, states should be allowed to increase it to promote competition.<sup>2129</sup> Furthermore, AT&T argues that states should be allowed to impose penalties in the form of increased discounts for failure to provide service of equivalent quality offered to incumbent LEC customers or to provide electronic interfaces to the incumbent LEC network.<sup>2130</sup> Incumbent LECs and MFS argue that the 1996 Act does not authorize the service quality penalties or competition-enhancing increased discounts suggested by AT&T.<sup>2131</sup>

887. MFS, Teleport, Time Warner, the Massachusetts Commission, and a number of incumbent LECs argue that joint, common, and overhead costs should not be included in the calculation of avoided costs.<sup>2132</sup> They argue that these costs are not avoided because they will continue to be incurred in providing wholesale service. AT&T, MCI, and others favor inclusion of a portion of joint, common, and overhead costs in avoided costs because these costs will decrease as the overall level of operations of an incumbent LEC decrease (as a result of downscaling their retail operations).<sup>2133</sup>

888. There is significant disagreement about whether wholesale rates should take into account any additional costs incumbent LECs incur in providing wholesale service, such as those relating to wholesale marketing and billing operations. Incumbent LECs, facilities-based competitors, Sprint, and others argue that wholesale rates must include such costs to

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<sup>2127</sup> See, e.g., Comcast comments at 21; NCTA comments at 41.

<sup>2128</sup> Telecommunications Resellers Ass'n comments at 24.

<sup>2129</sup> AT&T comments at 84.

<sup>2130</sup> *Id.* at 84-85.

<sup>2131</sup> See, e.g., MFS reply at 36; Bell Atlantic reply at 24; Sprint reply at 42.

<sup>2132</sup> See, e.g., MFS comments at 74; Teleport comments at 56-57; Time Warner comments at 77; Mass. Commission comments at 14-15; Ameritech comments at 80; BellSouth comments at 67; Cincinnati Bell comments at 35; GTE comments at 51; Lincoln Tel. reply at 8; U S West comments at 68-69; PacTel comments at 90; Rural Tel. Coalition reply at 15; USTA comments at Attachment (Affidavit of Jerry A. Hausman), p. 11.

<sup>2133</sup> See, e.g., TCC comments at 45-46; AT&T reply at Appendix E (Avoided Cost Model); MCI comments at Attachment 2 (Pricing of Wholesale Services), p. 9; Texas Public Utility Counsel comments at 45-46.

ensure recovery from the cost-causing parties -- resellers.<sup>2134</sup> Some incumbent LECs note that these additional costs could also be recovered through a separate charge.<sup>2135</sup> IXCs and resellers argue that the plain language of the section 252(d)(3) does not provide for the recognition of these costs.<sup>2136</sup> They also add that allowing incumbent LECs to recover these costs from resellers discourages efficiency in their wholesale operations.<sup>2137</sup>

889. A number of incumbent LECs oppose application of a single percentage discount rate for all services, arguing that avoided costs will vary among different services.<sup>2138</sup> Some state commissions also recommend against adoption of a uniform rate.<sup>2139</sup> MFS argues that, because section 252(d)(3) refers to retail rates charged to subscribers "for the telecommunications service requested," a uniform wholesale discount rate would frustrate Congressional intent.<sup>2140</sup> Advocates of a uniform discount, however, contend that incumbent LECs will be able to game any system involving a nonuniform allocation of avoided cost, because the information regarding such costs is under their control.<sup>2141</sup> Advocates of a uniform discount also argue that apportioning avoided costs over specific services can be difficult, while a uniform rate is simple to apply. Ameritech argues that the wholesale rate structure of an incumbent LEC should not mirror its retail rate structure. Rather, it should be based on a weighted average of all retail rates provided by the incumbent LEC, less avoided cost.<sup>2142</sup>

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<sup>2134</sup> See, e.g., Ameritech comments at 80; Bell Atlantic comments at 44-45; BellSouth comments at Attachment (Interconnection and Economic Efficiency), p. 20; Citizens Utilities comments at 25; USTA comments at Attachment (Affidavit of Jerry A. Hausman), p.12, reply at 29; MFS comments at 73-74; Teleport comments at 57; Time Warner comments at 78; Ohio Commission comments at 59-60, 66; Sprint comments at 72; J. Staurulakis comments at 10.

<sup>2135</sup> See, e.g., BellSouth comments at 67; NYNEX comments at 83.

<sup>2136</sup> See, e.g., AT&T reply at 10; LDDS reply at 45; TCC comments at 47; Cable & Wireless reply at 28-29; Telecommunications Resellers Ass'n reply at 18.

<sup>2137</sup> LDDS reply at 45. LDDS argues that such costs should be recovered in a competitively-neutral manner. *Id.*

<sup>2138</sup> See, e.g., Bell Atlantic comments at 46; USTA comments at 74-75; MFS comments at 73.

<sup>2139</sup> See, e.g., California Commission comments at 37-38.

<sup>2140</sup> MFS comments at 73.

<sup>2141</sup> See, e.g., Cable & Wireless comments at 47; TCC comments at 47, Telecommunications Resellers Ass'n reply at 18-19; NEXTLINK comments at 33.

<sup>2142</sup> Ameritech comments at 58. For example, this would average various time-of-day plans and usage plans.

### 3. The Models and Study

890. MCI and AT&T introduced models, and Sprint submitted a study for calculating wholesale rates. This section describes each of these proposals and summarizes the criticisms directed against them. AT&T and MCI offer models which, they contend, can be used to generate discount rates for each incumbent LEC's retail offerings. As an example of the avoided cost approach Sprint advocates, Sprint submits a study based on its United Telephone subsidiary operations in Tennessee.<sup>2143</sup>

891. MCI's model uses publicly available USOA data.<sup>2144</sup> MCI analyzes three categories of avoided cost: (1) marketing, billing, and collection costs; (2) "other costs"; and (3) common costs allocated to avoided cost activities. MCI identifies the following USOA accounts as avoided marketing, billing, and collection costs:

- Account 6611 (product management)
- Account 6612 (sales)
- Account 6613 (product advertising)
- Account 6621 (call completion services)
- Account 6622 (number services)
- Account 6623 (customer services)
- Account 6722 (external relations)
- Account 6727 (research and development)

MCI treats as "other" avoided costs all of the expenses recorded in the following accounts:

- Account 6113 (aircraft expense)
- Account 6341 (large PBX expense)
- Account 6351 (public telephone terminal equipment expense)
- Account 6511 (property held for future telecommunications use)
- Account 6512 (provisioning expense)
- Account 6562 (depreciation expense--property held for future telecommunications use)
- Account 6564 (amortization expense--intangible)

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<sup>2143</sup> Sprint comments at Appendix C (Avoided Cost Study: Tennessee United Telephone--S.E., Inc.).

<sup>2144</sup> MCI comments at Attachment 2 (Pricing of Wholesale Services).

MCI's model also allocates to avoided cost activities a portion of the general overhead and general support expenses recorded in the following accounts:

*general overhead*

Account 6711 (executive)  
 Account 6712 (planning)  
 Account 6721 (accounting and finance)  
 Account 6723 (human resources)  
 Account 6724 (information management)  
 Account 6725 (legal)  
 Account 6726 (procurement)  
 Account 6728 (other general and administrative)  
 Account 6790 (provision for uncollectible notes receivable)

*general support*

Account 6121 (land and building expense)  
 Account 6122 (furniture and artworks expense)  
 Account 6123 (office equipment expense)  
 Account 6124 (general purpose computers expense)

MCI uses an iterative process to determine separate avoided cost percentages for general overhead costs and for general support costs.<sup>2145</sup> The resulting percentages are based on the relative ratios of avoided costs to total operating expense.<sup>2146</sup> MCI's model assumes that incumbent LECs incur no additional expenses in providing wholesale services.

892. After total avoided costs are determined, MCI subtracts the total avoided costs from total operating expenses to derive total wholesale expenses. MCI then calculates wholesale service revenue using a formula that allows the incumbent LEC the same

<sup>2145</sup> The formulae used by MCI in calculating certain overhead and general support costs are dependent on variables affected by the result of the calculation of such costs. Iteration is a means of solving for variables in such circumstances.

<sup>2146</sup> Total Avoided Expense = [Not Avoided Expenses \* 0%] + [Totally Avoided Expenses \* 100%] + [Partially Avoided Expenses \* a%] + [Partially Avoided Expenses \* b%]

Where:

$$a = \% \text{ Corporate Operations Avoidable} = \frac{\text{Total Avoided Expenses}}{\text{Total Expenses} - \text{Depreciation \& Amortization Expense}}$$

$$b = \% \text{ General Support Avoidable} = \frac{\text{Total Avoided Expenses}}{\text{Total Expenses} - \text{General Support}}$$